

## SUMMARY AND CONCLUSIONS

### Investment Banking since March 2004

Since Straumur was licensed as an investment bank at the end of March last year, its activities have been very successful and exceeded expectations. Lending has increased from ISK 1 billion (bn) to ISK 26 bn, the Bank's market share of equities brokering amounted to 8% last year and its share of HFF bond brokering 4%. This must be regarded as a very creditable performance in only three quarters.

We expect the relative importance of investment banking activities to increase substantially in the coming years, with net interest income and commissions increasing many times over. This will result both from increasing market turnover and a growing market share.

### Equity Market Developments Decisive

Despite its positive progress in investment banking, Straumur's performance is still determined by developments on equity markets. Last year its pre-tax profit amounted to ISK 7.7 bn, of which trading rate gains were ISK 7.3 bn. Straumur's Q4 results were considerably below our expectations, both with regard to trading rate gains and the outcome of investment banking activities.

Straumur's largest individual domestic equity holdings are in Íslandsbanki, TM Insurance, Icelandic Group, Burðarás, Kögun and Actavis Group. After receiving its investment banking license, Straumur need not disclose its equity holdings in as much detail as previously, which makes it impossible to determine the Bank's equity position precisely.

### Tripartite Valuation

Our valuation of Straumur Investment Bank is divided into three parts: Firstly, we revalue Straumur's equity as if it were purely an investment fund. Secondly, we calculate the surplus value of this equity, assuming that Straumur's profitability will exceed the discount rate we apply to the company's own equity. Finally, we evaluate its investment banking activities.

### Outcome of the Valuation

The outcome of our valuation is a company value of ISK 45.5 bn for Straumur. The estimated value of equity is ISK 32.8 bn, the surplus value of the asset portfolio is assessed at ISK 4.3 bn and investment banking activities as ISK 8.4 bn. Outstanding share capital is ISK 5,375 m nominal value, giving a valuation share price of 8.5. Since Straumur's closing price today was 9.9, we recommend that investors sell their shares in the company, but market weight them in a well-diversified portfolio.

Valuation	ISK 45.5 bn
Valuation share price	8.5
Closing price 2 March	9.9

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Landsbanki has a holding of 17.4% in the investment company Fjárfestingarfélagið Grettir, which owns 16.3% of Straumur.

Analyst:  
Markús H. Árnason + 354 410 7388  
markus.h.arnason@landsbanki.is

Head of Research:  
Edda Rós Karlsdóttir +354 410 7381  
eddaros@landsbanki.is

English text:  
Keneva Kunz  
keneva.kunz@landsbanki.is

## A very different Straumur

*Straumur's 2004 profit was ISK 6.4 bn, making it by far the most successful year ever for the company*

Straumur's 2004 profit was ISK 6.4 bn, making it by far the most successful year ever for the company. The company was licensed to operate as an investment bank early in the year, transforming it from a pure investment fund. This implies that Straumur can now grant loans, provide guarantees and collateral, trade on its own account in the principal financial instruments, bid in auctions, serve as advisor in corporate projects and hold securities in custody. This has strengthened Straumur's position in stiff competition for corporate projects, as was clearly demonstrated when it was involved in financing the takeover of the Danish department store retailer *Magasin du Nord* last November. The company's balance sheet grew by 298% in 2004, to ISK 90 bn, partly as the result of an increase in share capital in September amounting to ISK 11 bn at market value.

## The Financial Supervisory Authority (FME) approves Straumur's acquisition of a qualifying holding in Íslandsbanki

*Straumur may not hold qualifying interests in both TM Insurance and Íslandsbanki for an extended period*

Straumur's two largest assets are holdings in Íslandsbanki and TM Insurance. Shortly after Straumur's annual results were published on the Iceland Stock Exchange (ICEX), FME announced that Straumur's application to own a qualifying holding in Íslandsbanki had been approved. Due to the danger of conflicts of interests on the insurance market, however, FME set the condition that Straumur may not hold qualifying interests in both TM Insurance and Íslandsbanki for an extended period. At a presentation following its annual results, Straumur indicated that the company was financially capable of owning both holdings for the near term and it is thus not expected to sell either immediately. In its annual financial statements, Straumur has entered its holding in Íslandsbanki with investment equities, while the holding in TM Insurance is entered with trading book securities. It could be concluded from this that Straumur intends to sell its holding in TM Insurance within one year.

## Valuation Method

Our valuation of Straumur is divided into three parts: Firstly, we revalue Straumur's equity as if it were purely an investment fund. Secondly, we calculate the surplus value of this equity, assuming that Straumur's profitability will exceed the discount rate we apply to the company's own equity. Finally, we evaluate its investment banking activities. This route was chosen because for some time yet Straumur's performance will be determined primarily by equity market price developments. Its equity position is therefore by far the largest component of the company's value; investors are thus primarily acquiring a holding in a "mutual fund".

## Revaluation of Own Funds

*In revaluing Straumur's own equity, we have assessed all assets included in the Bank's balance sheet at year-end 2004 with the exception of its lending*

In revaluing Straumur's own equity, we have assessed all assets included in the Bank's balance sheet at year-end 2004 with the exception of its lending. Loans granted amounted to ISK 25.9 bn at year-end and are included in the valuation of the investment bank portion. This is offset by a reduction of liabilities on the balance sheet by ISK 22 bn and equity by ISK 3.9 bn. These amounts are also part of the valuation of investment banking activities. The

Valuation of Straumur, MISK	
Assets:	Value
Equities	57,547
Bonds	4,682
Holdings in affiliates	41
Holdings in connected companies	0
Amt. due from credit institutions	2,771
Other assets	1,319
<b>Total assets</b>	<b>66,360</b>
Liabilities	33,601
<b>Net value of portfolio</b>	<b>32,758</b>

amounts are determined with reference to Straumur's objective of a minimum of 15% equity, representing reserve requirements of ISK 3.9 bn for the loan portfolio based on a risk co-efficient of 1 for its loans.

*We estimate Straumur's holding in Íslandsbanki at 18%; according to the company's latest flagging its holding was 16.5%*

In re-evaluating equity, we have taken into consideration increases in Straumur's equity portfolio since its annual financial statements. Its value has increased considerably since the beginning of this year, primarily due to the increase in Íslandsbanki's share price. According to the shareholders' register, Straumur owned 24% of Íslandsbanki at year-end 2004 (ISK 30.1 bn at market value), but since forward contracts entered into on behalf of clients could reduce this amount, it is difficult to get a clear picture of the Bank's real position and exposure. Based on the equity calculation in Straumur's year-end balance sheet (Note no. 40), however, the Bank's position would appear to be substantially less than indicated by the shareholders' register. Going on this, we estimate Straumur's holding in Íslandsbanki to be around 18%; according to its most recent flagging, on 21 October 2004, its holding was then 16.5%. Straumur has profited on the 4% rise in Íslandsbanki's share price since the beginning of this year, while at the same time we assume that the Bank has availed itself of its pre-emptive rights to purchase shares in the January offering, at a share price of 10.65. According to the above, unrealised trading rate gains on Íslandsbanki's shares amount to ISK 1.2 bn, in addition to which Straumur should receive a dividend of ISK 0.8 bn on 15 March. While the value of Straumur's holdings in Burðarás and Icelandic Group has increased slightly, that of its holding in TM Insurance had decreased. Taken all together, we estimate that the value of the equity portfolio, including the dividend from Íslandsbanki, will have boosted the value of the Bank's assets by ISK 2.7 bn since the beginning of this year.

*Revalued equity ISK 32.8 bn*

Straumur's revalued equity amounts to ISK 32.8 bn, assuming that deferred income tax is treated as an interest-free loan which will not be repaid for the moment. It should be pointed out that if Straumur does decide to sell its 35% share of TM Insurance soon, the sale price will naturally make a substantial difference to the company's equity. TM Insurance's market selling price is currently 21.2, which would make the holding worth ISK 6.9 bn. However, this far exceeds our market valuation of TM.

## Surplus value of asset portfolio ISK 4.3 bn

In order to assess the present value of Straumur's asset portfolio, we have attempted to estimate the future value of its portfolio in excess of its revalued equity. In order to assess the surplus value of the asset portfolio, we assume that Straumur will achieve an average 15% ROE, in accordance with the assumptions used in our analysis of Burðarás and Atorka. According to Straumur's own financial objectives, however, it aims at an average minimum ROE of 16%. At the same time, we apply a discount rate of 13.3% to the portfolio, which makes the excess yield 1.7%. The discount rate is comprised of a risk-free interest rate of 7.44%, with the Icelandic nominal rate given a weighting of 100% since Straumur's equity portfolio is comprised almost exclusively of domestic equities. The market premium is 4.8%, beta 1.1 and small cap premium 0.5%.

*Surplus value of the asset portfolio is estimated at ISK 4.3 bn*

Based on the above assumptions, the surplus value of the asset portfolio is estimated at ISK 4.3 bn. Attention should be drawn to the fact that the surplus value

Value of Straumur's future operations, MISK	
Revalued equity	32,758
ROE	15.0%
Discount rate on equity	13.3%
<b>Surplus value of future operations</b>	<b>4,276</b>

is highly sensitive to the excess yield on the asset portfolio, e.g. if this were 1.2%, then the future value would be ISK 2.9 bn, while if excess yield proved to be 2.2% then the estimated future value would be ISK 5.7 bn.

## Relative importance of investment banking will increase

*Net interest income and commissions will increase many times over in the coming years*

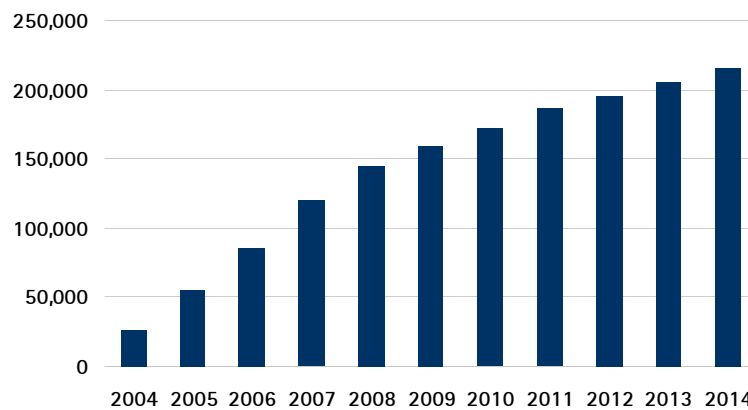
Since Straumur was licensed as an investment bank early last year, its activities have been very successful and exceeded expectations. Its lending growth has been high and market trading very successful. At the end of last year, total loans outstanding were ISK 26 bn, up from ISK 1 bn at the beginning of the year. This rapid lending growth can be attributed to Straumur's participation in several corporate projects, as well as its participation in syndicated loans. As far as market trading is concerned, Straumur's share in trading of equities listed on ICEX last year was 8.8% and its share of HFF bond trading 4%. This year has also begun well, with the Bank's share of equity turnover in January 11.9% and its share of HFF bond turnover 3.3%. Despite the major success of its investment banking activities, Straumur's performance is still determined primarily by equity market price developments; of its ISK 7.7 bn pre-tax profit in 2004 trading rate gains accounted for ISK 7.3 bn. We can expect the relative importance of investment banking to increase in the coming years, and our assumptions include an increase many times over in net income and commissions.

## Loan portfolio will continue to grow rapidly

*We expect the loan portfolio to expand by an average of ISK 30 bn or 57% annually over the next four years*

We expect continuing rapid growth in lending in the next few years, and an average increase in Straumur's loan portfolio of ISK 30 bn or 57% annually over the next four years. According to the company's presentation of its results, emphasis this year will be on increasing participation in syndicated loans, as well as co-ordinating financing of individual projects.

### Assumptions on lending development



Since the interest spread on syndicated loans is generally higher than on other loans, we expect the company to enjoy a high net interest spread. Although its net interest margin (net interest revenues expressed as a percentage of average interest-earning assets) last year was 3.2%, in the longer term we estimate its net interest margin to be 3% annually. However, since experience of Straumur's lending activities is very limited, this assumption is subject to considerable uncertainty. Since we anticipate a high interest spread on lending, we also expect provisions for credit losses to be high, due to the high lending risk level. Provisions for credit losses last year were 1.2% of average loans outstanding but we estimate this will be 1.5% annually over the longer term.

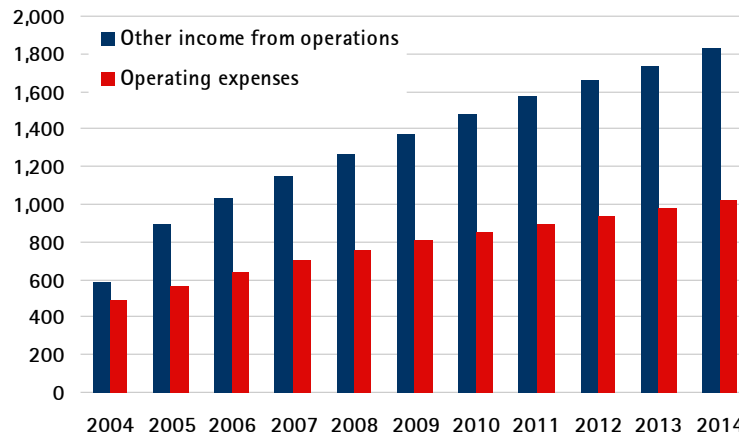
## Capital markets income will increase substantially

*Straumur's share of turnover on ICEX last year came as a surprise*

The first year of operation for Straumur's Capital Markets division was very successful and the size of its share of trading on ICEX came as a surprise. Turnover on ICEX has grown enormously in the past few years and we expect this trend to continue in the coming

years, although growth will likely be less dramatic. We also expect Straumur's share of trading to increase slightly as compared to the previous year, since the Bank only received its brokering license in May last year. We thus expect income from market trading to amount to ISK 670 million (m) this year, a YoY increase of 60%. In the longer term, we expect income from market trading to grow in line with the increase in turnover on ICEX.

#### Forecast for growth of income and expenses



*Commissions earned by Corporate Finance division this year estimated at ISK 225 m*

Straumur has been involved in several corporate projects since the company received its investment bank license, including Kögún's takeover of Opin Kerfi, the delisting of Síldarvinnslan and providing advisory and financing services when Icelandic investors acquired the Danish department store chain *Magasin du Nord*. According to Straumur's CEO, the company's deal flow is good and it plans to strengthen its Corporate Finance division with additional employees. We anticipate that commissions from Corporate Finance will grow substantially this year, or by 40%, and amount to ISK 225 m. The company's Corporate Finance division only began operations in Q2 of 2004. In the longer term, we anticipate considerable growth, in line with high lending growth, since part of this major lending growth can be expected to be connected with advisory projects.

*Operating expenses will grow considerably in the coming years in parallel to major expansion of investment banking activities*

Straumur's operating expenses will rise considerably in the coming years in parallel to its expanding activities. Straumur's CEO has stated, for instance, that the company intends to hire several additional employees this year. The increase in operating expenses will be greatest in the next four years, while the Bank is growing most rapidly, averaging 11% annually during this period. Once the period of greatest expansion has passed, we expect growth in expenses to slow.

#### Discount rate

In determining the discount rate, Research and Analysis bases its calculations on the capital asset pricing method (CAPM), plus an additional two items, a company premium (FRT) and small cap premium (SC), as shown in the equation below:

$$E(R) = R_f + \beta * (E[R_m] - R_f) + FRT + SC$$

Abbreviations used:

E(R) = Discount rate (expected return)

R<sub>f</sub> = Risk-free interest

β = risk co-efficient intended to represent the deviation of the company's share price development from the average price development on the market in question

(E[R<sub>m</sub>] - R<sub>f</sub>): risk premium due to uncertainty on the equity market

E[R<sub>m</sub>]: Expected equity market return

FRT: premium due to additional risk of the company in question as compared to the sector on average. The premium is comprised of three factors: currency risk, special operating risk and political risk.

SC: Small cap premium

*The discount rate for investment banking activities is 11.8%*

Risk-free interest rates (Rf) are based on yields on 10-year, non-indexed government bonds in the currencies which form the company's net cash flow. Using this methodology gives a risk-free interest rate of 4.9%, with nominal interest rates in Iceland (40%) and the Eurozone (28%) dominating. The beta used is 1.1, based on the beta used for European investment banks. The market premium E[Rm] is calculated based on the historical return of US shares in excess of government bond returns. Landsbanki Research revises the market premium regularly; it is currently 4.8%. Furthermore, we have decided to add an additional 1% company premium, due to the fact that Straumur's portfolio is still very small and the risk level of its loans rather high. This makes it very sensitive to credit losses which justifies, in our estimation, adding an extra 1% to the discount rate. Finally, a 0.5% small cap premium is added to Straumur's shares, which is used for companies with a market value of over ISK 50 bn.

The outcome is a discount rate on equity of 11.8% for investment banking activities.

## Investment banking activities valued at ISK 8.4 bn

*Investment banking activities are valued at ISK 8.4 bn. Profit is considerably higher, but part of this profit must be tied up in reserve funds if Straumur is to achieve an CAD ratio of 15%*

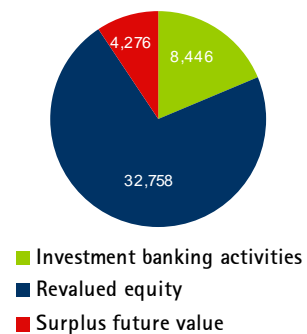
Based on the above assumptions, our valuation of investment banking activities is ISK 8.4 bn. While the profit on investment banking activities is considerably greater, Straumur has set itself the objective of maintaining a minimum CAD ratio of 15% in the long term. As a result, the company must tie up part of each year's profit in operations in order to achieve this objective and pave the way for further growth.

## Conclusions of the Valuation

The outcome of our valuation is a company value of ISK 45.5 bn for Straumur. The estimated value of equity is ISK 32.8 bn, the surplus value of the asset portfolio is assessed at ISK 4.3 bn and investment banking activities as ISK 8.4 bn. Outstanding share capital is ISK 5,375 m nominal value, giving a valuation share price of 8.5. Since Straumur's closing price today was 9.9, we recommend that investors sell their shares in the company, but market weight them in a well-diversified portfolio.

*We recommend selling Straumur's shares and that investors market weight them in a well-diversified portfolio*

Valuation breakdown





2 March 2005

## Straumur Fjárfestingarbanki

## SELL

Share price	Stock turnover	Major shareholders *																																														
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Annual Statements of Straumur	Board of Directors											
ISK millions	2003	2004	1Q 03	2Q 03	3Q 03	4Q 03	1Q 04	2Q 04	3Q 04	4Q 04		
<b>Income Statement</b>											<b>Chairman of the board</b>	
Net interest income	-444	426	-64	-65	-117	-197	26	122	161	117	Kristinn Björnsson	
Other operating income	4,730	7,888	560	322	1,961	1,886	2,514	1,335	3,811	227	<b>Other board members:</b>	
thereof trading gains	4,538	7,308	560	103	1,892	1,983	2,509	1,230	3,542	28	Ingimundur Sigurpálsson	
thereof net commissions	10	581	0	-3	-1	13	9	107	272	194	Magnús Kristinnsson, vice chairman	
Other operating expenses	317	494	28	75	74	140	95	123	141	135	Þorsteinn Már Baldvinsson	
Provisions for losses	0	76	0	0	0	0	0	-11	-19	-46	Þór Kristjánsson	
Net income before taxes	3,969	7,745	468	182	1,770	1,549	2,445	1,324	3,812	163		
Income tax	155	1,369	-60	277	-299	-72	-431	-220	-672	-46		
After-tax Profits	3,815	6,404	408	459	1,471	1,477	2,014	1,122	3,141	127		
<b>Balance sheet</b>											<b>Valuation breakdown</b>	
Equities	20,573	54,141	11,450	11,873	12,823	20,573	15,093	18,984	46,941	54,141		
Bonds	534	4,682	218	256	251	534	4,464	2,793	4,778	4,682		
Loans	840	25,946	0	0	0	840	1,614	4,784	12,238	25,946		
Total assets	22,530	89,649	11,825	13,067	19,770	22,530	23,393	37,622	68,385	89,649		
Amounts owes to credit institutions	5,709	21,569	0	0	0	5,709	3,836	14,020	24,954	21,569		
Borrowings	168	32,108	2,343	2,686	4,354	168	175	4,214	7,688	32,108		
Share capital	4,083	5,400	2,791	3,152	4,129	4,083	4,149	4,149	5,400	5,400		
Equity	16,094	32,475	8,509	10,108	14,805	16,094	17,079	18,194	32,348	32,475		
<b>Key ratios</b>												
Earnings per share	1.17	1.44	0.16	0.15	0.42	0.44	0.49	0.27	0.75	0.02		
CAD ratio	-	15.5%	-	-	-	-	61.6%	45.8%	28.9%	15.5%		
ROE after taxes	39.0%	34.5%	19.2%	18.2%	39.7%	36.7%	47.2%	24.7%	38.8%	1.6%		
P/E ratio (trailing)	5.4	8.1	21.7	12.0	7.0	5.4	4.8	4.7	5.4	8.1		
P/B ratio	1.3	1.6	1.0	1.1	1.2	1.3	1.5	1.6	1.3	1.6		

Forecasts - Investment banking	Principal equity assets *												
ISK thousands	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	ISK bn	Holding	
Average total loans	40,473	70,000	102,500	132,500	152,250	165,880	179,150	190,692	200,226	210,238	Íslandsbanki hf. **	33.2	21.6%
annual change .....	202%	73.0%	46.4%	29.3%	14.9%	9.0%	8.0%	6.4%	5.0%	5.0%	Tryggingamiðstöðin	7.1	35.9%
Net interest income	1,214	2,100	3,075	3,975	4,568	4,976	5,375	5,721	6,007	6,307	SH	2.3	16.6%
annual change .....	185%	73.0%	46.4%	29.3%	14.9%	9.0%	8.0%	6.4%	5.0%	5.0%	Burðarás hf.	2.2	3.1%
as a ratio of average total loans .....	3.0%	3.0%	3.0%	3.0%	3.0%	3.0%	3.0%	3.0%	3.0%	3.0%	Kögun ***	1.6	16.5%
Net operating revenues	2,111	3,132	4,223	5,237	5,937	6,456	6,951	7,376	7,744	8,132	Actavis Group	0.9	0.8%
annual change .....	110%	48.3%	34.8%	24.0%	13.4%	8.7%	7.7%	6.1%	5.0%	5.0%			
Other operating expenses	568	636	698	753	804	849	897	937	979	1,023	* acc. to Shareholders' Register		
annual change .....	15.0%	12.0%	9.7%	7.9%	6.8%	5.6%	5.6%	4.5%	4.5%	4.5%	24/02/2005		
Loan-loss provisions	506	1,050	1,538	1,988	2,284	2,488	2,687	2,860	3,003	3,154	** includes forward contracts on		
annual change .....	567%	107.5%	46.4%	29.3%	14.9%	9.0%	8.0%	6.4%	5.0%	5.0%	behalf of customers		
as a ratio of average total loans .....	1.3%	1.5%	1.5%	1.5%	1.5%	1.5%	1.5%	1.5%	1.5%	1.5%	*** holding according to Kögun's		
Net profit	851	1,185	1,629	2,047	2,337	2,557	2,761	2,934	3,085	3,243	prospectus, issued in December 2004		
annual change .....		39.3%	37.5%	25.7%	14.1%	9.4%	8.0%	6.3%	5.1%	5.1%			

Sensitivity of the valuation for changes in the discount rate and future growth

Future growth	Discount rate					
	10.8%	11.3%	11.8%	12.3%	12.8%	
4.0%	8.7	8.4	8.2	8.0	7.8	
4.5%	8.8	8.6	8.3	8.1	7.9	
5.0%	9.0	8.7	8.5	8.2	8.0	
5.5%	9.3	8.9	8.6	8.4	8.2	
6.0%	9.6	9.2	8.8	8.5	8.3	

Sensitivity of the valuation for changes in the discount rate and interest rate margin

Interest rate margin	Discount rate					
	10.8%	11.3%	11.8%	12.3%	12.8%	
2.50%	7.4	7.2	7.0	6.9	6.8	
2.75%	8.2	8.0	7.8	7.6	7.4	
3.00%	9.0	8.7	8.5	8.2	8.0	
3.25%	9.9	9.5	9.2	8.9	8.6	
3.50%	10.7	10.3	9.9	9.5	9.3	

Sensitivity of the valuation for changes in the discount rate and credit loss provisions

Credit loss provisions	Discount rate					
	10.8%	11.3%	11.8%	12.3%	12.8%	
1.00%	10.7	10.3	9.9	9.5	9.3	
1.25%	9.9	9.5	9.2	8.9	8.6	
1.50%	9.0	8.7	8.5	8.2	8.0	
1.75%	8.2	8.0	7.7	7.6	7.4	
2.00%	7.4	7.2	7.0	6.9	6.8	

Sensitivity of the valuation for changes in the discount rate and income growth

Income growth	Discount rate					
	10.8%	11.3%	11.8%	12.3%	12.8%	
-2.0%	8.7	8.4	8.1	7.9	7.8	
-1.0%	8.9	8.6	8.3	8.1	7.9	
0.0%	9.0	8.7	8.5	8.2	8.0	
1.0%	9.3	8.9	8.6	8.4	8.2	
2.0%	9.5	9.1	8.7	8.6	8.3	

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Tel: +354 410-4000 Landsbanki Research, Hafnarstræti 5, 101 Reykjavík

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greining@landsbanki.is [www.landsbanki.is](http://www.landsbanki.is)