

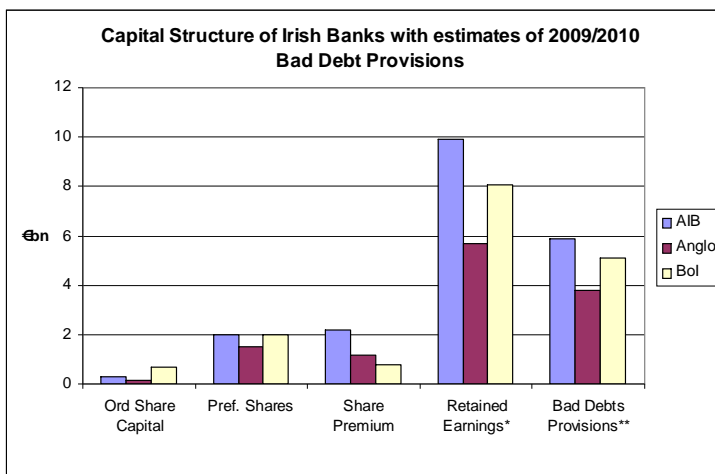


Irish Bank Recapitalisation

- On Sunday the Irish government announced details of the recapitalisation of Allied Irish Bank (AIB), Bank of Ireland (BoI) and Anglo Irish Bank (Anglo). Under the terms of the deal the Government will initially inject €5.5bn into the three banks. The Government also indicated that it has a substantial pool of additional capital available to underwrite and otherwise support the issuance of core tier 1 capital by the relevant institutions. In relation to further capital raisings, the Government has indicated that it need not be the principal source of this additional capital and is encouraging each institution to access private sources of capital. The Government said that it is prepared to underwrite further issuance of core tier 1 capital. Both AIB and BoI have indicated an interest in an underwritten issuance of up to €1bn each. Irish Life & Permanent was not mentioned in the deal. However, the group issued a statement yesterday indicating that their capital position remains strong. Press reports have suggested that they may take €500m in additional capital. Details of the deal are laid out as follows:
- Allied Irish Bank & Bank of Ireland**
The Government has agreed with AIB and BoI that both banks will each issue €2bn of perpetual preference shares to the state with a fixed annual dividend of 8%. These shares will have voting rights in respect of change of control and any changes in the capital structure. The shares will also include 25% of the voting rights in respect of appointments of directors and 25% of the directors on the board, currently including any directors to be appointed in connection with the Government's guarantee scheme. The capital injection is expected to take place for AIB and BoI by the end of the first quarter of 2009.
- Anglo Irish Bank**
Anglo is to receive an initial investment of €1.5bn of core tier 1 capital. The investment will be in the form of €1.5bn of perpetual preference shares with a fixed annual dividend of 10%. The Government also indicated that it will make further capital available to the bank if required. The capital injection for Anglo is due to take place following an EGM in mid-January. The preference shares carry 75% of the voting rights of Anglo and are non-transferable.
- Under the terms of the deal, all of the institutions may redeem the preference shares within 5-years at the issue price or after 5-years at 125% of the issue price. The preference shares are non-convertible and will be treated as core tier 1 capital by the financial regulator and are replaceable only with other core/equity tier 1 capital.

Preference Shares & Capital explained

- Preference shares are a type of equity that gives priority to holders over ordinary shares. This priority usually relates to the payment of dividends which must be paid before ordinary share dividends. In the event of liquidation of a company, preference shares will rank above ordinary shares in terms of losses, but in the shares the Irish Government are purchasing from Anglo, AIB and BOI this liquidation condition has been waived. They will rank the same as ordinary shares except in the case of dividends where the Government's preference share coupon will rank higher than ordinary share dividends.
- The injection of this form of preference capital into three Irish banks needs to be examined in how it will work in a period of excess bad debts.
- Banks hold capital to provide a buffer in the event of excessive bad debts. Regulators force banks to put aside a certain amount of capital for each loan, and banks historically held capital levels well above the regulatory minimum.
- If the level of bad debts a bank experiences is greater than its profits in a given year, the retained earnings of the bank will be lowered by the amount of the actual loss or expected loss on the loan. Once retained earnings are fully eroded, the share premium account is next in line. The share premium account is the amount of cash raised above the nominal value of each share when issued. If the nominal value of each share is €1 and the bank issues a new share at €2, the share premium account will have a balance of €1.
- After the share premium account has been eroded all that is left is ordinary share capital and the Government's preference share. Before the ordinary share capital and Government preference shares are lowered by actual losses or expected loan losses, extra capital raising would be required by the market to ensure the bank as a business remains viable.



- While the Irish Government's preference shares rank the same as ordinary equity in liquidation, the preference shares loss absorption ability is significantly weaker compared to ordinary share capital. The reason for this can be seen in the table to the left as ordinary share capital is a small part of a bank's capital structure with retained earnings having the greatest loss absorption ability followed by share premium.

*estimated figures, before impairment provisions over the next two years

**estimated impairments over the next two years

Impact on key Stakeholders

| Tax-Payers | |
|--|---|
| Advantages | Disadvantages |
| Banks will pay coupons of 8-10% for the capital The capital injections increases the security of the banking system | No incentive to renew lending May be a disincentive to private investors forcing the Government to invest further funds, in turn reducing Government spending and increased taxes in the future. |

| Government | |
|---|---|
| Advantages | Disadvantages |
| The capital injection increases the security of the banking system Banks will pay coupons of 8-10% for the capital The Government gains voting rights, along with its investment The perpetuities issued to BOI & AIB are transferable The perpetuities occupy a senior position in the capital structure The perpetuities simply reduce the existing potential Government liability | The Pension Reserve will be severely reduced due to this investment The Government will receive a debt investment return from an equity injection The Government gains only limited voting rights in BOI & AIB The ability of the Government to force lending is uncertain There is no way to accurately ascertain future losses on loan books The Government may have to follow with further capital on the assumption that the Government is the only investor |

| Banks | |
|--|---|
| Advantages | Disadvantages |
| Ordinary shareholders will not be unduly diluted, by the perpetuities AIB and BOI surrender just 25% of voting rights on certain issues None of the banks are required to make management changes The investments are closer to debt, than equity | The market may not view the investments as equity The investments may lead to future government interference The coupons on the perpetuities are not tax deductible The ability of the banks to pay ordinary dividends will be limited The attractiveness to private equity investors has decreased |

Dolmen view of Recapitalisation

- The recapitalisation of BOI and AIB does benefit shareholders due to the reduced dilution. Indeed surprisingly on a conference call today, BOI has stated that the extra €1Bn of capital raising, which is to be underwritten by the Irish Government, may be done through additional preference shares, avoiding dilution.
- The future of Anglo Irish Bank is still uncertain with the Government now controlling the bank and a restructuring plan to be presented by the bank in 6-months time. It is unlikely that any such strategy will result in an independent bank.
- Irish taxpayers have given a loan to the three Irish banks and will not benefit from any upside from recovery in the share prices of these banks.
- In return for these “loans”, guarantees have been given by the banks to lend to the SME sector and to the mortgage market. No detail has been given as to how this will be achieved, and in the UK and US the ability of the relevant Governments to force the banks to lend even with large shareholdings has been limited.
- The repayment terms of the preference shares actually provide an incentive to the three banks to limit lending and conserve capital to redeem the shares by year five. This will avoid repaying the face value of the shares plus a 25% premium.
- Despite the Government injecting €5.5bn into the three banks, a large level of uncertainty still exists on the level of bad debts they will face over the next 2-years, and what, if any, profits they will generate over that period. This recapitalisation plan is the start of solving the problems with the Irish banks, but further capital will in our view be needed before the problems are resolved. The problems are not just capital availability, but equally strategic focus and necessary management change, which in our view have yet to be addressed. In regards of capital availability however we would have to regard the current partial solution as a potential impediment to future provision of capital by investment institutions. The lack of strategic solution and absence of commercial return does not bode well for the Irish Taxpayer and would concern investment institutions of a less than clear government agenda. The proposed solution will, ceteris paribus, ultimately widen Irish government spreads which makes likely funding of both the banks and government deficit more expensive. Relief rallies may turn to concerns of postponing some or all of the inevitable.
- As we anticipated, Irish Life & Permanent are not participating in this scheme, and stated this morning that they have adequate capital levels for the anticipated bad debt levels on their loan book. As the Irish Life & Permanent loan book is primarily residential mortgages, it is a lower risk book compared to the other three listed Irish banks.
- This supports our choice of Irish Life & Permanent as our preferred pick in the Irish banking sector and we remain cautious on the other banks.



Disclosures

This report has been prepared by Dolmen Stockbrokers ('Dolmen') for information purposes only to assist investors to make their own investment decisions and is not intended to and does not constitute personal recommendations nor provide the sole basis for any evaluation of the securities discussed. Specifically the information contained in this report should not be taken as an offer or solicitation of investment advice or, encourage the purchase or sale of any particular security, option, future or other derivative investment. Not all recommendations are necessarily suitable for all investors and Dolmen recommend that specific advice should always be sought prior to investment, based on the particular circumstances of the investor.

Although the information in this report has been obtained from sources, which Dolmen believes to be reliable and all reasonable efforts are made to present accurate information Dolmen give no warranty or guarantee as to, and do not accept responsibility for, the correctness, completeness, timeliness or accuracy of the information provided or its transmission. Nor shall Dolmen, or any of its employees, directors or agents, be liable to for any losses, damages, costs, claims, demands or expenses of any kind whatsoever, whether direct or indirect, suffered or incurred in consequence of any use of, or reliance upon, the information. Any person acting on the information contained in this report does so entirely at his or her own risk.

All estimates, views and opinions included in this report constitute Dolmen's judgment as of the date of the report but may be subject to change without notice. Changes to assumptions may have a material impact on any recommendations made herein.

Unless specifically indicated to the contrary this report has not been disclosed to the covered issuers(s) in advance of publication.

Past performance is not necessarily a guide to future returns. The value of investments and the income from them can fall as well as rise. Investments denominated in foreign currencies are subject to fluctuations in exchange rates, which may have an adverse affect on the value of the investments, sale proceeds, and on dividend or interest income. Investors may not necessarily recoup the full value of their original investment. Investors should be aware that forwarding looking statements and forecasts may not be realised.

This report may not be reproduced (in whole or in part) altered, transmitted or made available to any other person without the prior written permission of Dolmen.

Dolmen Securities Limited is regulated by the Financial Regulator. Dolmen Securities Limited is a member firm of the London Stock Exchange. Dolmen Stockbrokers is regulated by the Financial Regulator. Dolmen Stockbrokers Limited is a member firm of the Irish Stock Exchange and the London Stock Exchange.

Conflicts of Interest & Share Ownership Policy

Dolmen, its employees, directors or related companies, may have a shareholding in the securities (or related investments/ derivatives) of certain companies covered in this report, or may provide/ solicit investment banking or other services to/ from them.

It is noted that research analysts' compensation is impacted upon by overall firm profitability and accordingly may be affected to some extent by revenues arising other Dolmen business units including Corporate Finance, Fund Management and Stockbroking. Revenues in these business units may derive in part from the recommendations or views in this report. Notwithstanding, Dolmen is satisfied that the objectivity of views and recommendations contained in this report has not been compromised.

Dolmen permits research analysts to own shares and/ or derivative positions in issuers they publish research, views and recommendations on and accordingly analysts involved in the production of this report may own stocks in a company covered in it. Any own account staff trading is undertaken in strict compliance with Dolmen's own account internal rules and therefore Dolmen is satisfied that the impartiality of research, views and recommendations remains assured.

Analyst Certification

Each research analyst responsible for the content of this report, in whole or in part, certifies that: (1) all of the views expressed accurately reflect his or her personal views about those securities or issuers; and (2) no part of his or her compensation was, is, or will be, directly or indirectly, related to the specific recommendations or views expressed by that research analyst in the research report. Oliver Gilvarry, David Dunk, Stephen Taylor and Edward Keeling are responsible for the production of this report. Oliver Gilvarry is Head of Research and David Dunk, Stephen Taylor & Edward Keeling are equity analysts.

For US Persons Only

This report is only provided in the US to major institutional investors as defined by s. 15 a-6 of the Securities Exchange Act, 1934 as amended. A US recipient of this report shall not distribute or provide this report or any part thereof to any other person.

