

Bank of Ireland



WESTERN INVESTMENT CLUB

Bank of Ireland (IRE.N)

Sell Presentation

*Financial Institutions Group
October 10, 2012*

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BACKGROUND

- Established in 1783 by Royal Charter
- Historically the premier bank of the Big 4 Irish banks
- Unique relationship – served some central banking functions but was NEVER a central bank

Recent History:

- **2008**: Moody downgrades outlook from stable to negative due to poor asset quality and challenging economic environment
- **2009**: Irish government provides €7.0Bn bailout package to Bank of Ireland and Allied Irish Banks plc
- **2010**: Ireland implements dire austerity measures; European Commission mandates the disposal of certain non-core business lines
- **2011-2012**: Substantial divestitures continue

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BACKGROUND

Irish Austerity

- In 2010, the Irish government underwent significant cutbacks in government spending
- In effect, the minimum wage was slashed and social welfare was drastically reduced
- Protestors took to the streets to contest these “drastic” austerity measures → the first of many EU riots to follow

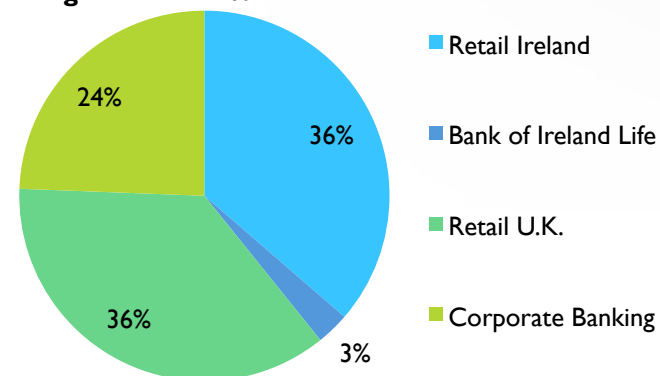


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BUSINESS MODEL

- Operates in five major segments:
 - Retail Services in Ireland and UK
 - Life Insurance,
 - Corporate Banking and Group Centre

Segments as a % of revenue



- Provides financial services to both individual and commercial clients in Ireland and the UK, and corporate banking services to commercial clients in the US
- Similar to comparable financial institutions, IRE derives profit from a *net interest margin* (Interest Earned from Assets – Interest Incurred from Liabilities)

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ORIGINAL INVESTMENT THESIS

- The Irish banking system, in the midst of structural reform, seems to be near the bottom of the trough in the business cycle
- Limited downside risk
 - At time of original investment, shares were trading in the pennies
 - Worse Case Scenario: nationalization of the bank
- Significant upside potential
 - Structural reform will improve quality asset base
 - Liquidity would come for Irish government bail-out

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ORIGINAL INVESTMENT THESIS

What Has Happened Since?

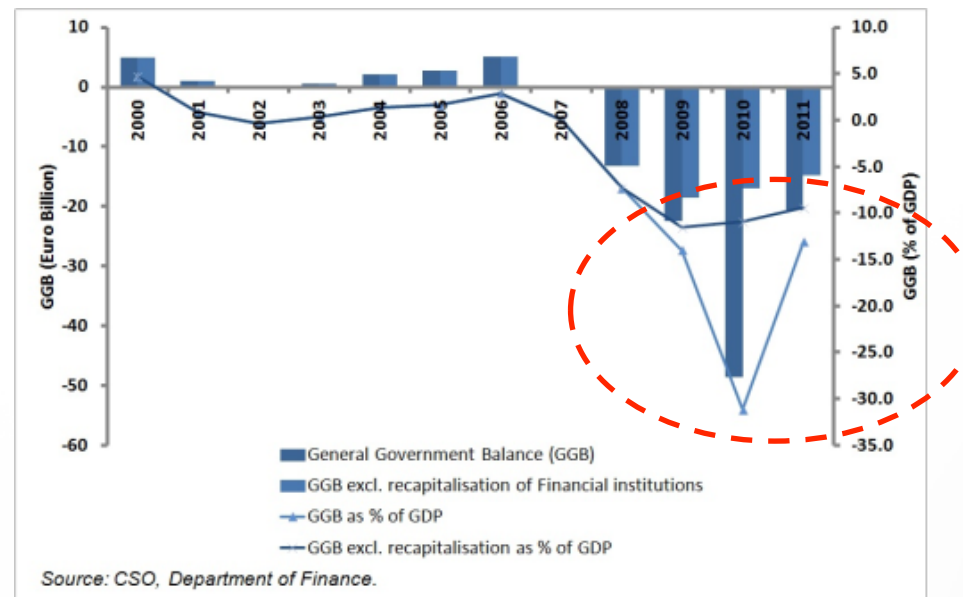
- Investors are still extremely cautious of quality of asset base
- Government bail-out has not provided adequate liquidity to fund operations, hence recent string of divestitures
- Company issued 10:1 reverse stock split to increase price, which increased downside risk



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THE IRISH ECONOMY

- Ultimately IRE's fate is linked to the medium and long-term performance of the Irish economy
- Economic recovery is reliant on the IMF/ECB support for the foreseeable future
- Further austerity cuts aim to bring deficit down to 3% by 2015
- Export – dependent economy



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EU BANK OUTLOOK WORSENS

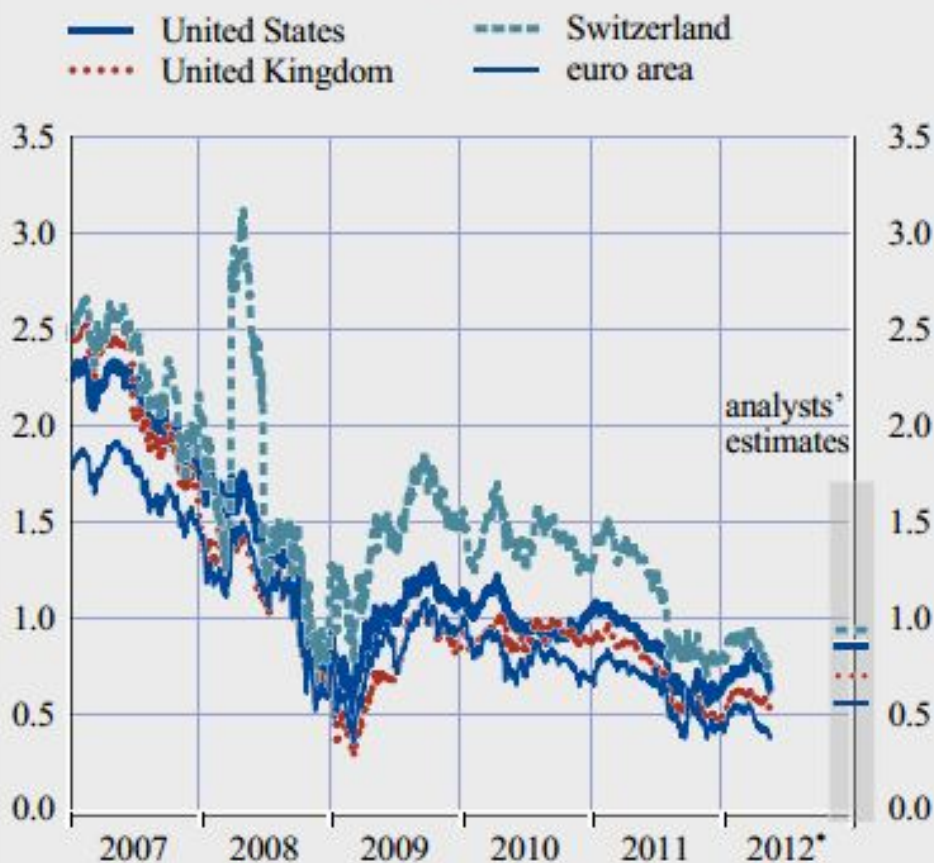
- Facing general asset-price volatility, declining property prices and further mark-downs of loan portfolios
- Cumulative medium-term reduction in leverage within the EU banking sector could exceed €1 trillion
- Major restructuring plans across most EU financial institutions
- Vulnerabilities in the EU non-financial sector could have adverse effect on credit risks
- Historic reliance on unstable wholesale funding sources
- High costs associated with restructuring and conforming to Basel III regulation
- Low yields of highly rated government bonds constrain insurance profitability

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LOWER OVERALL VALUATIONS

Price/Book Value

(Jan. 2007 – May 2012; averages)



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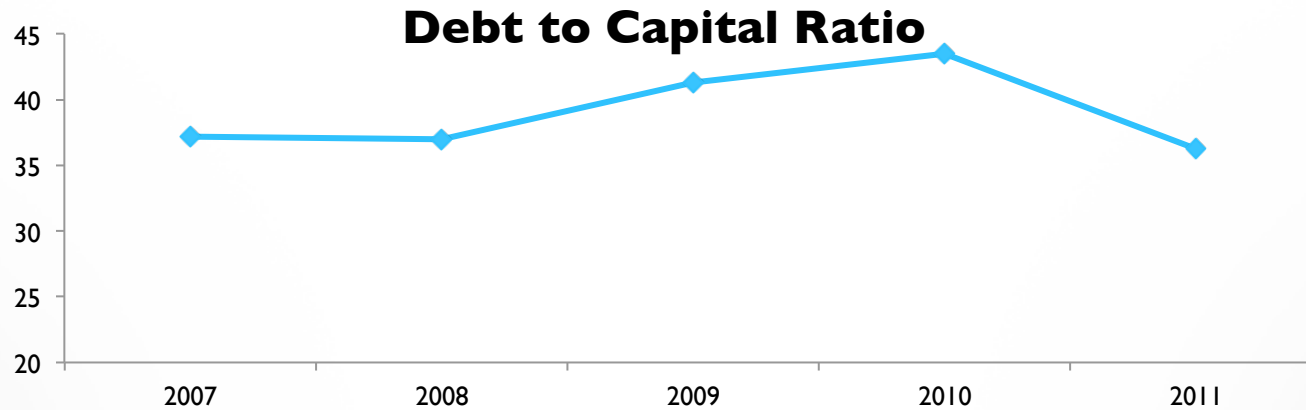
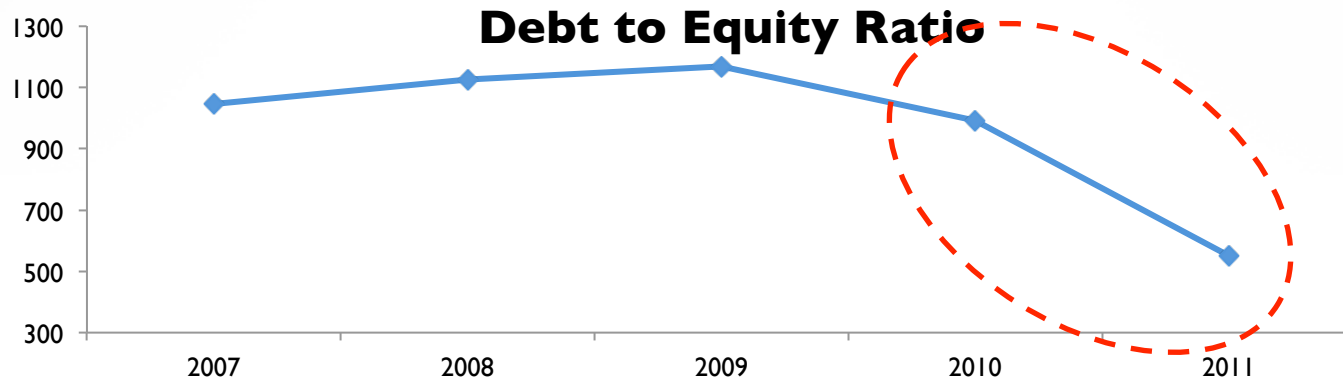
DELEVERAGING PROGRESS

- Remains on track with medium-term targets for deleveraging (2014)
- Completed targeted €10Bn in disposals in H1 2012 at a lower than expected discount
- Timeframe for rebuilding profitability is more elusive
- Achieving 2014 net interest margin target of ~2% may prove to be difficult

| Measure | 2011 | June 2012 | Target | BKIR outlook |
|------------------------------------|--------|-----------|-------------|--------------|
| Financial stability | | | | |
| Customer loans | €102bn | €98bn | c.€90bn | 2014 |
| Group loan-to-deposit (LTD) ratio | 144% | 136% | 120% | 2014 |
| Capital | | | | |
| Core tier 1 ratio | 15.1% | 14.9% | Buffer over | 2014 |
| Core tier 1 ratio (PCAR/EBA basis) | 14.3% | 14.0% | minimum | 2014 |
| ELG covered liabilities | €42bn | €36bn | | 2014 |
| ELG fees | €449m | €212m | Disengage | 2014 |
| Rebuilding profitability | | | | |
| Net interest margin (NIM) | 1.33% | 1.20% | >2% | Uncertain |
| Cost/income | 79% | 92% | <50% | Uncertain |
| Impairment charges | €1.9bn | €0.9bn | 55-65 bps | Uncertain |

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DELEVERAGING PROGRESS



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STRONG MARKET POSITIONS

- The group offers a wide range of products including consumer banking, private banking, corporate banking, treasury and assurance
- Holds No. 1 and No. 2 positions in all of its principal segments
- Extensive distribution network of 250 branches and 1,300 ATMs

Market Share Summary

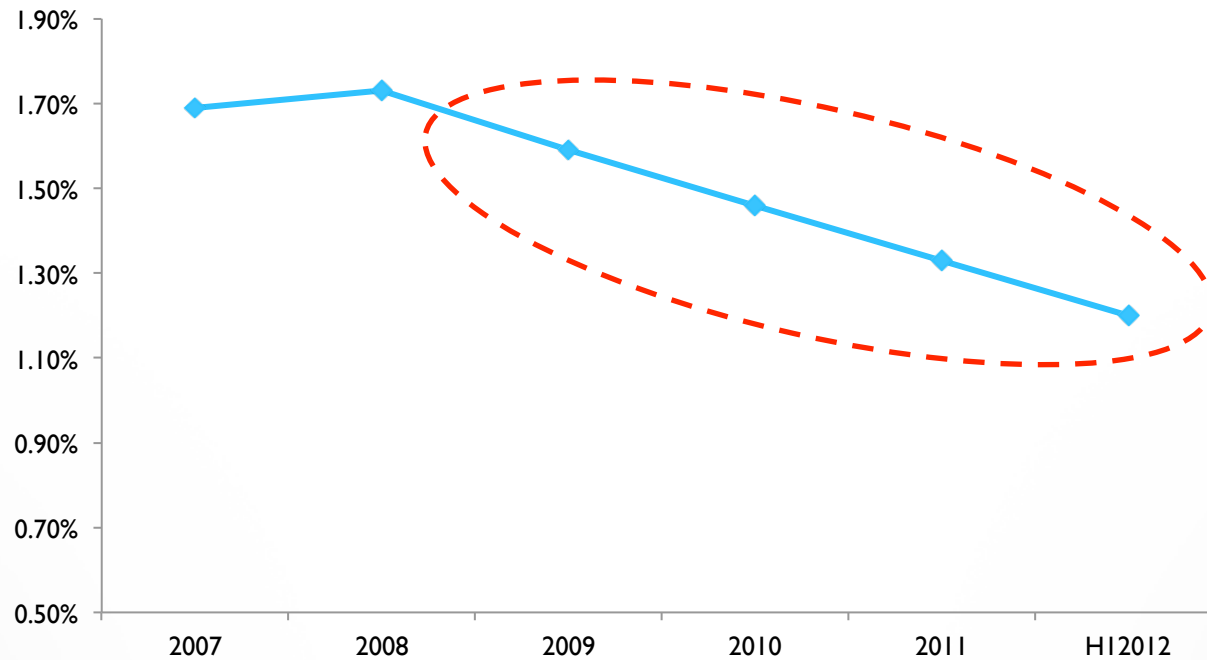
| | |
|---------------------------|------------|
| Personal Current Accounts | 35% |
| Mortgages | 20% |
| Credit Cards | 34% |
| MNC Current | 50% |
| Business Current | 36% |
| Business Loan | 35% |
| Life and Pension | 21% |



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NET INTEREST MARGINS

$$\text{NET INTEREST MARGIN} = \frac{[\text{INTEREST INCOME} - \text{INTEREST EXPENSE}]}{\text{AVERAGE INTEREST BEARING ASSETS}}$$

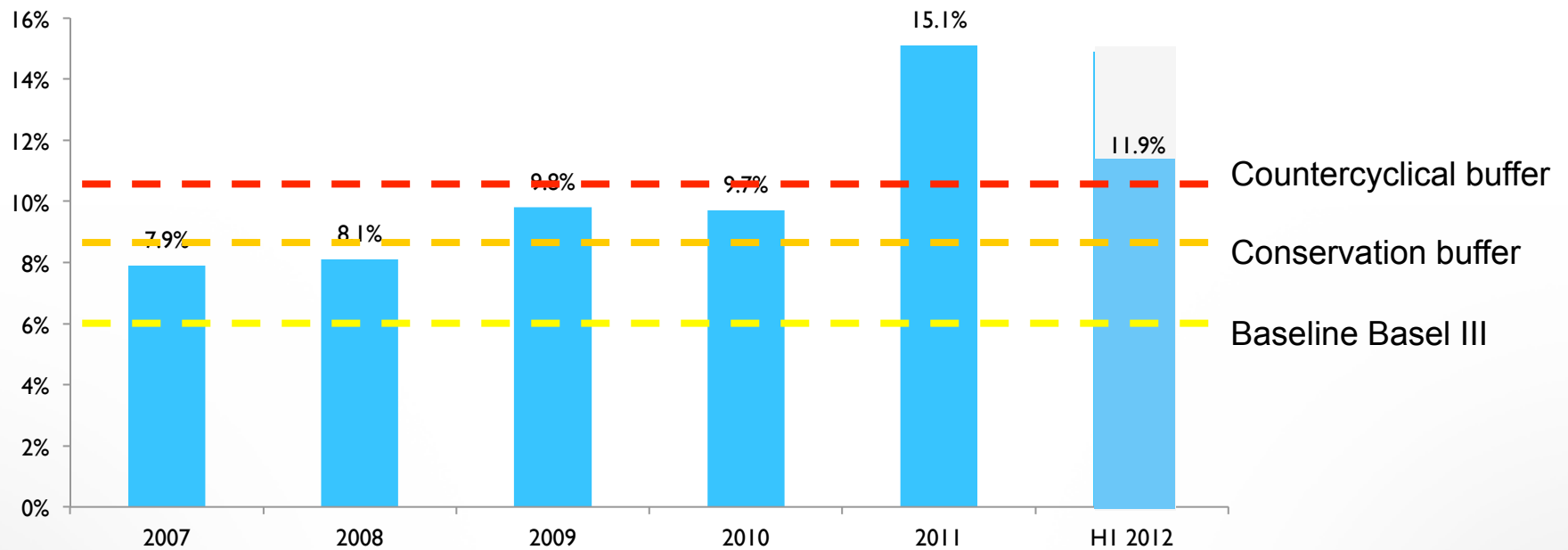


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TIER 1 CAPITAL

TIER 1 CAPITAL RATIO =

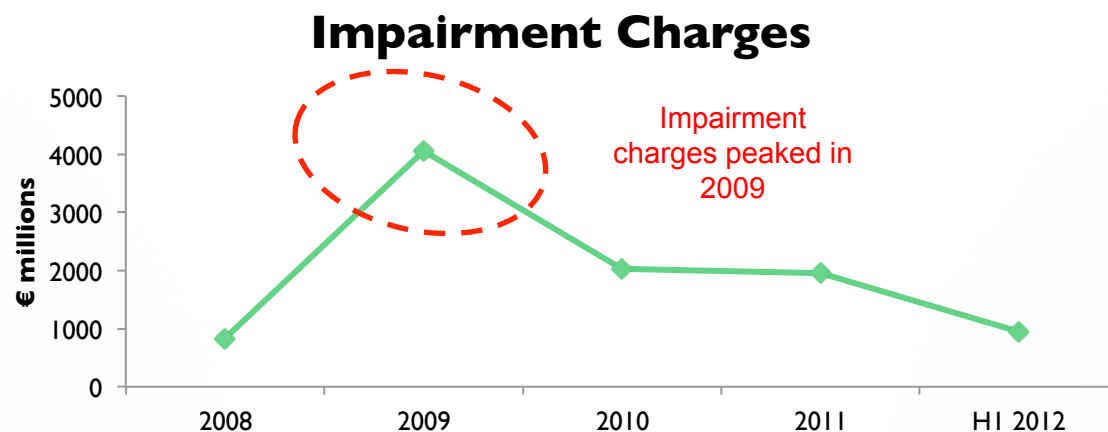
CORE CAPITAL
RISK-WEIGHTED ASSETS



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FURTHER LOAN IMPAIRMENT

- Overall impaired loans stood at 14.7% of the loan book at the end of June 2012
- Biggest deterioration in the Irish residential mortgage book where impaired loans rose from 4.8% to 8.2%
- Other impaired segments include investment property loans, small/medium enterprise loans, and corporate loans
- Shows no real improvements in IRE's asset base as pro forma 2012 impairment charges should be about the same as FY 2011



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DECLINING CASH FLOWS

Free Cash Flow as Percentage of Sales



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COMPARABLES ANALYSIS

| | Market Cap (€) | LTM Sales (€) | Net Income Margin (%) | Loans/ Deposits | Debt/ Equity | Price/ Book Value |
|--|-------------------|------------------|--------------------------|--------------------|-----------------|----------------------|
|  | 28,415 | 4,485 | NM | 1.62 | 3.39 | 1.79 |
|  <i>The Royal Bank of Scotland</i> | 37,324 | 41,180 | (7.5%) | 1.60 | 5.14 | 0.32 |
|  | 34,754 | 53,498 | (2.7%) | 1.42 | 5.01 | 0.48 |
|  | 2,953 | 6,417 | (8.9%) | 1.51 | 6.11 | 0.34 |

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SUMMARY

- Original investment thesis no longer holds true
- Structural reforms and government bail-out has not seemed to improve the asset base of the bank
- The track to profitability still remains questionable – IRE has consistently missed its profitability expectations
- Negative cash flows and decreasing net interest margins seem to be a trend and medium-term targets will be hard to achieve
- Economic outlook in Europe remains bleak, low interest rates will continue to put pressure on margins
- WIC does not see the benefits of holding this equity as a macroeconomic play

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CONCLUSION

Sell 50 shares of IRE.N at \$5.50

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