

## STRATEGIC REVIEW OUTCOME FOR CLYDESDALE AND YORKSHIRE BANKS

*30 April 2012: National Australia Bank Group, owner of Clydesdale and Yorkshire Banks, today released the outcome of the Strategic Review and interim results for its UK Banking\* operations for the six months to 31 March 2012. Unless otherwise stated, figures are comparisons with the six months to 31 March 2011. Highlights are:*

### **Strategic Review**

- Simplify business model to focus on retail operations and SME business lending across traditional Scottish and Northern England / Yorkshire heartlands
- Retail network maintained at over 330 branches; retail frontline staffing levels maintained
- Geography, risk appetite and composition of business banking reshaped with tiered service model from direct to full service in the heartlands; 44 business centres focussed on heartlands including 9 serving the South; 29 centres to close and 9 to co-locate with retail
- £6.2bn commercial property and associated loans transferred to NAB for run-off
- Reduction of 1,400 roles by September 2015, relative to September 2011
- The proposals remain subject to final prudential regulatory approvals

### **Interim Performance**

- Underlying profits down 3.2% to £244m; Cash earnings loss of £25m
- Mortgage growth of 10.9%
- Average gross loans and acceptances up £1.1bn to £33.7bn
- Average retail deposit volumes up £800m to £24.2bn
- Charge to provide for bad and doubtful debts up £131m to £282m
- An additional provision of £120m for potential claims relating to PPI will be made

**David Thorburn, Chief Executive, said:** “Simplifying our business model and focussing on our strengths in Scotland and the North of England are key to ensuring that Clydesdale and Yorkshire Banks deliver improved returns.

“It is clear that we must adapt to the exceptionally challenging economic environment we are operating in. We have had to take some difficult decisions but they are the right decisions for our business.

“To secure a sustainable future we must concentrate on retail and SME banking in our traditional heartlands. While the vast majority of our customers will be unaffected by the changes, unfortunately we do need to streamline the business and lose jobs. I don’t underestimate the impact of this on the employees affected, but our half year results clearly demonstrate why we need to act.

“NAB’s support in taking over the run-off of our commercial property portfolio will also underpin a more autonomous funding position. All these changes add up to a stronger and more competitive business and, in the long-term, this can only be in the best interests of our customers and employees alike.”

### **Notes for editors:**

\*The results above are for NAB UK Banking and not those of Clydesdale Bank PLC. UK Banking consists of banking and wealth management activities in the UK operating under the Clydesdale Bank and Yorkshire Bank brands. It does not include NAB’s wholesale banking operations in the UK.

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**ASX ANNOUNCEMENT***Monday, 30 April 2012***NATIONAL AUSTRALIA BANK ANNOUNCES OUTCOME OF UK BANKING STRATEGIC REVIEW**

National Australia Bank advises the outcome of its UK Banking strategic review in response to deterioration in the economic and operating conditions in the region, particularly over the last half year with a “double dip” in the commercial property market as the UK economic recovery stalls. The strategic review was undertaken to identify the changes needed to best meet the Group’s overall objective of delivering sustainable and satisfactory returns for shareholders. National Australia Bank also provides a preliminary announcement of its unaudited Group and UK Banking Half Year cash earnings.

**Key points**

- The decisions coming out of the UK strategic review are to:
  - Simplify the business model to focus on retail operations and SME business lending in Scotland and Northern England;
  - Improve the UK Banking balance sheet structure by transferring the vast majority of its commercial real estate (CRE) assets to NAB in the first half of the 2013 financial year; and
  - Place the transferred portfolio into run-off, to be managed separately.
- The restructure reduces risk appetite and improves the return and cost profile of the ongoing UK Banking business;
- Restructuring costs of £195 million will be incurred in non-cash earnings for redundancy, software impairment, lease break fees and other costs (£36 million in the March 2012 half year and an estimated £139 million in the September 2012 half). The restructure is expected to deliver annual cost savings of approximately £74 million by 2015;
- Provisioning against the UK CRE portfolio has been increased to reflect the recent deterioration experienced in that asset class as a result of weaker economic and operating conditions. The Group has transferred to UK Banking £150m (\$230m) of the \$300m collective provision economic overlay that was expensed in 2008 and 2009;
- Goodwill associated with Clydesdale Bank of £141 million will be written off as at 31 March 2012 through non-cash earnings;
- UK Banking cash earnings for the March 2012 half year were a loss of £25 million;
- An additional provision of £120 million has been expensed in the March 2012 half year as non-cash earnings due to an increase in the rate of payment protection insurance (PPI) claims.

Implementation of the proposed restructure remains subject to final prudential regulatory approval from the Australian Prudential Regulation Authority and the UK Financial Services Authority.

## **NAB Group March 2012 half year result and proposed dividend**

To provide context for these changes, the Group is announcing the unaudited Group half year cash earnings. Unaudited Group cash earnings for the March 2012 half year were \$2.82 billion. This is an increase of 5.7% on the prior corresponding period, largely driven by an improved performance in Wholesale Banking offsetting a higher charge to provide for bad and doubtful debts in UK Banking. On a statutory basis, unaudited net profit attributable to owners of the company is approximately \$2.05 billion, a decrease of 15.6% on the prior corresponding period<sup>1</sup>.

The Group's charge to provide for bad and doubtful debts on a cash earnings basis is \$1.13 billion, up 14.4% on the prior corresponding period driven by a higher charge in UK Banking and to a lesser extent Specialised Group Assets<sup>2</sup>.

Subject to finalisation of the Group's March 2012 Half Year Results and completion of the independent review by the Group's auditors, NAB intends to increase the interim dividend to be paid to 90 cents per share, fully franked.

### **UK Banking March 2012 half year result**

UK Banking unaudited cash earnings for the first half of the 2012 financial year is a £25 million loss compared to a £77 million profit in the prior corresponding period, reflecting a higher charge to provide for bad and doubtful debts and a decline in net interest income, predominantly due to increased funding costs. Operating expenses decreased by approximately 4.1%.

The charge to provide for doubtful debts on a cash earnings basis increased to £282 million<sup>3</sup>. The CRE portfolio was the main driver of the increase as a result of renewed weakness in the property market and the absence of a sustained economic recovery.

### **UK strategic review**

NAB considered a wide range of options as part of the strategic review and concluded that down-sizing the UK franchise, bringing it back to its more traditional business model and reducing its risk appetite, is the option that best serves the interests of shareholders. The main outcomes of the UK Banking strategic review are:

- UK Banking will simplify its business model and refocus on its retail operations and SME business lending in Scotland and Northern England. Customer service and distribution capabilities will be strengthened, and there will be a significant reduction in the number of Financial Solutions Centres (FSC). 29 of the 73 FSCs are planned to be closed, and nine consolidated with retail branches, with the changes predominantly taking place in the south of England. Six back office locations will also be closed. UK Banking's risk appetite will be modified and will no longer accommodate financing of property development or property investment, where the underlying purpose is to generate rental income and capital gains.
- Effective during the first half of the 2013 financial year, UK Banking will transfer the vast majority of its existing CRE exposures to NAB, together with some associated loans and

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1 The Group's cash earnings and statutory net profit are still in the process of finalisation and are under review by the Group's auditors. The results for the March 2012 Half Year will be released on 10 May 2012. The difference between the unaudited March 2012 Group cash earnings result and the unaudited statutory net profit is primarily attributable to the charges relating to UK Banking referred to in this Announcement and hedging costs on exited SCDO assets. Refer to note on cash earnings on page 5.

2 On a statutory basis, the charge for bad and doubtful debts was \$1.32 billion. The difference between the charge for bad and doubtful debts on a statutory basis and the charge for bad and doubtful debts on a cash earnings basis mainly relates to a charge arising from a default of two of the Group's SCDOs for which the Group has received off-setting compensation.

3 This does not include the transfer of the £150 million economic overlay from the Group.

other assets. As at 31 March 2012, the portfolio to be transferred has an outstanding balance before provisions of approximately £6.2 billion. This restructure will improve Clydesdale Bank's balance sheet structure, reducing the reliance on wholesale funding which has become more expensive due to Clydesdale Bank's credit rating downgrades, and moving to a more deposit funded base. The Stable Funding Index of Clydesdale Bank will improve from 97% to 115% (on a pro forma basis as at March 2012)<sup>4</sup>. The transferred portfolio will be run-off as the assets reach maturity, subject to customers' ability to refinance or repay. It will be managed separately by an experienced and dedicated team of bankers led by a senior risk executive from NAB. The transfer will occur at book value (i.e. net of provisions) and proceeds from the transfer will be used to repay intragroup funding. Residual UK Banking CRE assets that are impracticable to transfer will be retained by the business. These assets will be run off in a manner similar to the transferred portfolio.

- Provision coverage for the UK CRE portfolio has been strengthened by the transfer to the UK of £150 million of the existing \$300 million economic overlay to the Group's collective provision. Clydesdale Bank will record this as an additional £150 million charge for bad and doubtful debts in its statutory accounts offset in NAB Group's consolidated accounts by a release of provisions in the same amount. The total provision coverage against the UK CRE portfolio will increase to 7.5% of CRE Gross Loans and Advances as at 31 March 2012.
- UK Banking will also reduce its cost base by streamlining operations, technology and support functions to improve efficiency and effectiveness. There is a planned reduction of over 1,400 full time equivalent employees (FTEs) in UK Banking by the end of the 2015 financial year, relative to September 2011, including a reduction of 205 FTEs in the March 2012 half year and the proposed transfer of 191 FTEs to NAB in the first half of the 2013 financial year, to manage the CRE run-off. When fully implemented in the 2015 financial year the restructure is expected to result in cost savings of approximately £74 million per annum.
- Some charges relating to the outcome of the strategic review will be reported outside of cash earnings.
  - Goodwill of £141 million associated with the UK has been written off as at 31 March 2012.
  - Costs of £195 million will be expensed as non-cash earnings by the end of the 2015 financial year for redundancy, software impairment, lease break fees and other implementation costs, £36 million of which will be expensed in the March 2012 half year, and an estimated £139 million in the September 2012 half year.
  - The goodwill write-off and software impairment will not have any effect on Group capital.
- In response to a substantial increase in the volume of PPI complaints since January 2012, an additional provision of £120 million for potential claims relating to PPI will be recognised in the March 2012 half. This brings the total PPI provision balance remaining to £169 million as at 31 March 2012, and reflects an updated assessment of future PPI claims. This assessment is based upon estimates, statistical analysis and assumptions in relation to a wide range of factors that remain uncertain as disclosed on page 21 of the Group's 2011 Full Year Results.

Implementation of the UK Banking restructure remains subject to final prudential regulatory approvals.

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<sup>4</sup> The Stable Funding Index is based on spot balances.

## Capital impact

- The Group Tier 1 capital ratio as at 31 March 2012 was approximately 10.1%. The pro forma Group Tier 1 capital ratio (adjusted for restructuring and other costs announced today that will be recorded following the March 2012 half year) is approximately 10.0%.
- On a pro-forma basis at 31 March 2012, the expected capital impact of the outcomes of this review on the stand-alone capital position of National Australia Bank and Clydesdale Bank will be to:
  - reduce the stand-alone Tier 1 capital ratio of National Australia Bank Limited by circa 17 basis points; and
  - increase the Tier 1 capital ratio of Clydesdale Bank PLC to circa 11.3% on an FSA basis.

## Executive commentary

“Today we have announced a significant restructure of our UK Banking operations,” National Australia Bank Group Chief Executive Officer, Cameron Clyne said today.

“The strategic review was undertaken because recovery in the region is now considered a longer term prospect, and recent deterioration in credit quality and an increase in the cost of funding following the downgrades to Clydesdale Bank’s credit rating have combined to reverse the recovery in UK Banking’s financial performance.

“In the last half year there has been a significant downgrade in the growth prospects of the UK economy, in part reflecting the drag on its recovery from heightened weakness in the Euro-zone. In addition, the commercial property market, which had previously seen signs of recovery, has recently experienced a “double dip” as the recovery stalls and other banks accelerate the reduction in their CRE exposures. This has contributed to the current downturn in the UK being longer and slower to recover than experienced in the 1930s following the Great Depression, and has led us to take these actions at this time.

“The action we are taking is needed to adapt to this current economic environment in the UK, and to reposition the UK Banking business to improve returns for the Group over the medium term.

“These changes will refocus UK Banking on its retail and SME-oriented franchise in Scotland and Northern England, while substantially reducing costs, improving the balance sheet structure of UK Banking and reducing the risk appetite for business banking in the UK.

“Retail banking in the UK continues to deliver reasonable returns and despite challenging market conditions, achieved growth in both deposits and mortgages. Business banking in the UK will run a simpler business model focussed on Scotland and Northern England.

“The cash earnings loss in UK Banking in the March half reflects the economic and market conditions which have increased funding costs and driven higher lending losses primarily in relation to our CRE exposures. We have taken action to address the challenging operating environment through the planned transfer of the CRE assets to NAB, which is better able to accommodate the current portfolio on its balance sheet, in order to actively manage its run-off. We expect that the CRE portfolio performance will remain challenging in the foreseeable future given the longer term prospects for recovery in the UK economy, and we have transferred to the UK £150 million of collective provision from the Group economic overlay established in 2008 and 2009.

“The UK Banking balance sheet will be reshaped as a result of these changes, reducing the current reliance on wholesale funding and Group support and moving to a more locally deposit funded structure.

“The UK Banking cost base will be reduced by streamlining operations and technology and support functions to improve efficiency and effectiveness. While every effort will be made to support our people, the substantive repositioning of the business will impact roles in the UK. The employee consultation process will commence shortly.

“We recognise that the current operating conditions in the UK are also challenging for our customers and we will continue to work to improve customer outcomes.

“NAB has a strong management team which has driven positive cultural and business change across the Group. The strategy announced today will reshape UK Banking for the challenging operating environment and provide a sustainable future for the business,” he said.

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**Disclaimer**

This announcement contains certain forward-looking statements. The words "anticipate", "believe", "expect", "project", "estimate", "likely", "intend", "should", "could", "may", "target", "plan" and other similar expressions are intended to identify forward-looking statements. Indications of, and guidance on, future earnings and financial position and performance are also forward-looking statements. Such forward-looking statements are not guarantees of future performance and involve known and unknown risks, uncertainties and other factors, many of which are beyond the control of the Group, which may cause actual results to differ materially from those expressed or implied in such statements. There can be no assurance that actual outcomes will not differ materially from these statements. Further information on important factors that could cause actual results to differ materially from those projected in such statements is contained in the Group's Annual Financial Report.

**Note on Cash Earnings**

Cash earnings is a key financial performance measure used by NAB, the investment community and NAB's Australian peers with a similar business portfolio. NAB also uses cash earnings for its internal management reporting as it better reflects what NAB considers to be the underlying performance of the Group. It is not a statutory financial measure and is not presented in accordance with Australian accounting standards. "Cash earnings" is calculated by excluding some items which are included within the statutory net profit attributable to owners of the company. A definition of cash earnings, discussion of non-cash earnings items, and a full reconciliation of the 2011 full year cash earnings to statutory net profit attributable to owners of the company, will be included in the 2012 March Half Year Results dated 10 May 2012. The Group's audited financial statements, prepared in accordance with Corporations Act 2001 (Cth) and Australian Accounting Standards, will also be included in the 2012 March Half Year Results dated 10 May 2012.