

National Australia Bank Limited ABN 12 004 044 937 800 Bourke Street Docklands Victoria 3008 AUSTRALIA

www.nabgroup.com

ASX ANNOUNCEMENT

Thursday 9 October 2014

NAB earnings adjustments ahead of FY14 results

As part of the year-end review and financial close process, National Australia Bank (NAB) today announced the finalisation of certain provisions and write-downs to the carrying value of several assets for the 30 September 2014 Full Year result, to be released on 30 October 2014. The items - UK conduct charges, capitalised software, deferred tax assets and R & D tax policy change - discussed in this announcement remain subject to the finalisation and independent audit of those results.

While also subject to finalisation and independent audit and on the basis that these items will be reported in cash earnings, it is expected that cash earnings for the year ended 30 September 2014 will be in the range of \$5.1 to \$5.2 billion.¹

Executive commentary

National Australia Bank Group Chief Executive, Andrew Thorburn said that reporting larger UK conduct charges and impairments in today's announcement is disappointing but is being dealt with transparently and quickly and the underlying performance of the NAB Group remains strong.

"Taking these decisions gives us more clarity going into the future and allows us to focus on the core Australian and New Zealand franchises, which remain in good shape. NAB is committed to including these types of adjustments within cash earnings now and in the future," Mr Thorburn said.

"Our leadership team is focused on delivering a better customer experience, and through this an improved performance of the bank. I look forward to discussing this in more detail at our full year results on October 30 when we will provide a full briefing to the market"

Specific adjustments:

1. <u>UK conduct charges</u>

As announced at the third quarter trading update on 18 August 2014, additional provisions were expected to be required at the Full Year 2014 result in relation to both Payment Protection Insurance (PPI) and interest rate hedging product costs. These additional provisions have now been determined and comprise the following:

 Provisions of £420 million (£336 million or A\$605 million after tax) in relation to PPI for the September 2014 half year, which include £75 million

¹ Full detail on how cash earnings is defined, a discussion of non-cash earnings items and a reconciliation of cash earnings to statutory net profit attributable to owners for the year ended 30 September 2014 will be set out in the 2014 Full Year Results Announcement.

announced in August 2014. This includes amounts required to cover the increased costs of administering the PPI remediation program. It also includes amounts required for PPI redress in relation to the implementation of a new complaints handling process, which is leading to increased payments both for new complaints and in revisiting closed complaints; the need to extend our examination of historical records dating back to pre-2000 periods, including unindexed microfiche records; higher than expected levels of new complaints; and the fact that Clydesdale Bank is subject to an enforcement process with the Financial Conduct Authority (FCA) in relation to its previous PPI complaints handling process.

Provisions of £250 million (£200 million or A\$359 million after tax) in relation
to interest rate hedging products for the September 2014 half year, which
include £170 million announced in August 2014. This is based on a range of
developments, including further progress with reviews of in-scope tailored
business loans (TBLs) and derivative products and the receipt and review of
complaints on certain fixed rate TBLs. The extent of future complaints on outof-scope TBLs is uncertain.

Dealing with conduct matters continues to be a significant and ongoing issue for the UK banking sector generally and there remains a wide range of uncertain factors relevant to determining the total costs associated with conduct related matters, including any possible fines. The increased conduct provisions are adequate and appropriate based on the information available to us today as part of our year end review and financial close process.

2. Capitalised software

Following an annual impairment assessment of capitalised software, an impairment charge of \$297 million (\$220 million after tax) will be taken against individually significant assets, predominantly in the Wealth and Australian Banking businesses and other smaller assets in the UK and NZ region. The impairment charge follows a detailed review of the recoverable amount of the various assets. Where the benefits associated with the software were substantially reduced from what had originally been anticipated, the costs of development are in excess of expectations, or there is uncertainty when the technology capability will be deployed the software has been written down to its recoverable amount.

Included within the above impairment charge is \$106 million (\$74 million after tax) for certain assets related to the NextGen capitalised software balance, other than the core banking platform asset where no impairment is required. This represents approximately 10% of the total NextGen capitalised software balance.

The impairment to capitalised software does not impact NAB's Common Equity Tier One (CET1) capital position.

3. Deferred tax assets (DTA)

Following an assessment of regulatory changes and business model changes in the USA and their impact on the projections of future taxable income, and in turn the recoverability of the DTA held in the New York branch, a deferred tax asset provision of US\$120 million (A\$132 million) has been taken. The tax losses related to the DTA still remain available to the Group for up to 20 years. The DTA provision does not impact NAB's CET1 capital position.

4. R&D tax policy change

NAB has also reviewed its accounting policy for tax offsets. R&D offsets will now be recognised as a reduction to the related software expense or carrying value of software assets, as this better reflects the true cost of software development. The impact of the change is a \$68 million increase in tax expense, a \$40 million decrease in operating expenses, a \$40 million reduction in software assets and a \$12 million decrease to the Deferred Tax Liability. The net impact to cash earnings after tax is a \$28 million decrease.

Cash earnings reporting

For reporting purposes the capitalised software write-down, DTA provision, R&D tax changes and the additional UK conduct charges for both PPI and interest rate hedging products will all be reported as part of cash earnings within the Group Corporate Centre. To ensure comparability with reporting for prior periods, FY13 PPI costs (\$204 million pre-tax and \$163 million post tax) will be restated and reported as part of cash earnings within the Group Corporate Centre.

Dividend and capital update

Subject to finalisation and independent audit of the Group's September 2014 Full Year results, NAB intends to pay a final dividend of 99 cents per share, fully franked. This is consistent with the 2014 interim dividend and represents a 2.1% increase on the 2013 final dividend.

The NAB Group remains well capitalised. The capital impact of the above items reduces the CET1 capital ratio by approximately 33 basis points. As at 30 September 2014 the CET1 ratio after these items is estimated to be above 8.5%.

In addition, NAB intends to operate the dividend reinvestment plan (DRP) with a discount to encourage shareholder participation. NAB has also arranged the underwriting of the issuance of an additional \$800m of NAB shares over and above the expected take up under the DRP. Assuming a DRP participation rate of 35%, these initiatives will provide an expected increase in share capital of approximately \$1.6 billion and a 44 basis point increase in NAB's CET1 ratio.

For further information:

Media

Brian Walsh Meaghan Telford M: +61 (0) 411 227 585 M: +61 (0) 457 551 211

Investor Relations

Ross Brown Natalie Coombe

M: +61 (0) 477 302 010 M: +61 (0) 477 327 540

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