

Introducing EVA[®] at the National

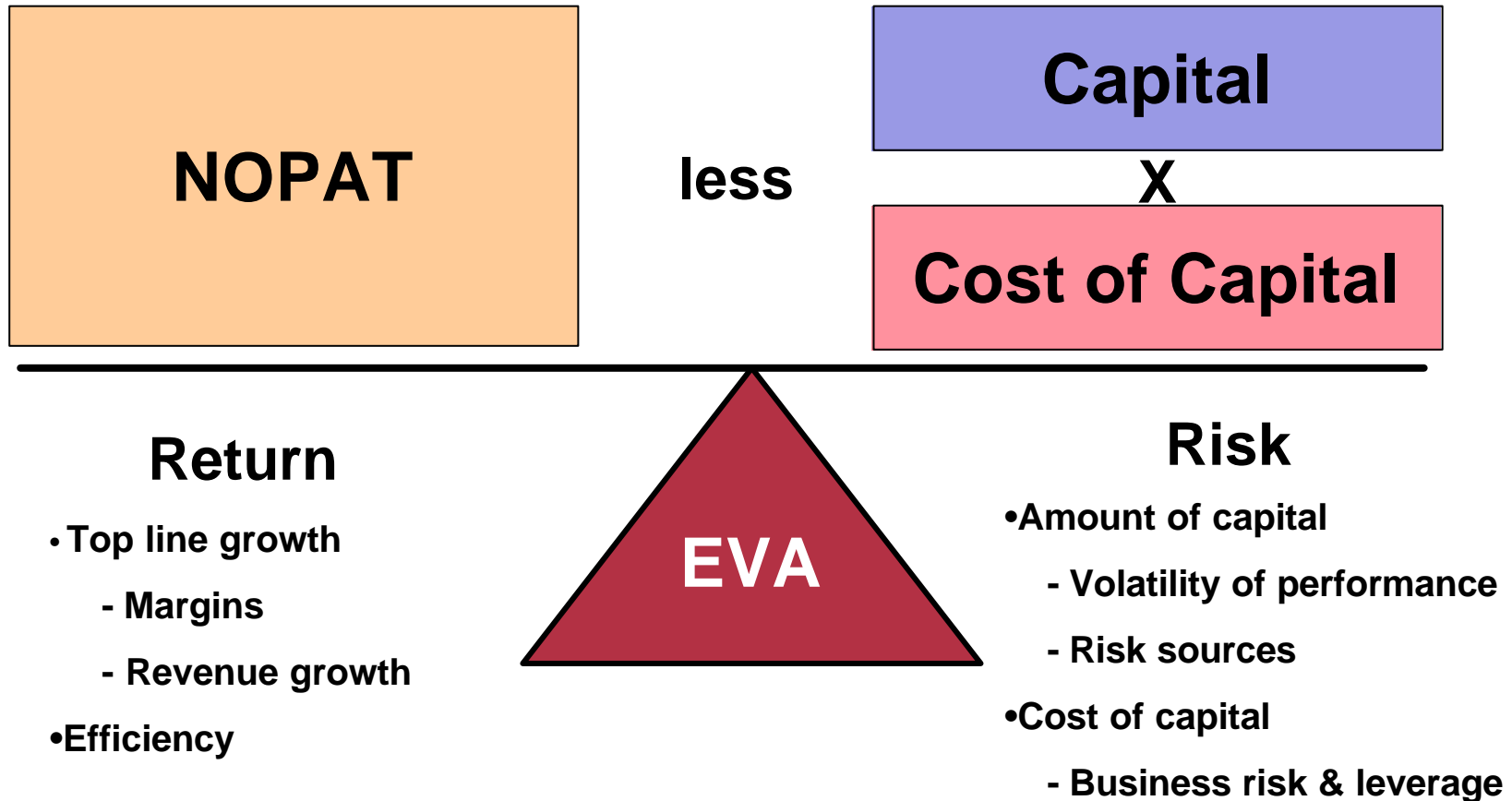
Gordon Wheaton, Executive General Manager,
Integrated Shareholder Value

11th October, 2000

The National is putting long term EVA growth at the centre of every key business process

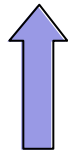


EVA accounts for the cost of risk



How will we improve EVA?

$$\text{EVA} = (\text{Return on Capital} - \text{Cost of Capital}) \times \text{Capital}$$

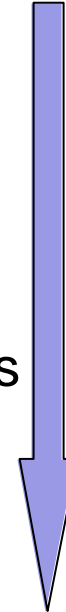


Improve the profit
on existing Capital

**More than a measure,
EVA is a *management*
tool to improve
decision making**



Invest Capital as long as
returns are adequate



Divest Capital earning inadequate
profit relative to investment

Measuring EVA is not enough to improve value



A recent academic study examined the impact of adopting EVA, comparing companies that tied EVA to incentive payments with those that choose not to

For companies that tied incentives to EVA:

- EVA went up
- Asset turnover went up
- Share repurchases went up
- Share price outperformed

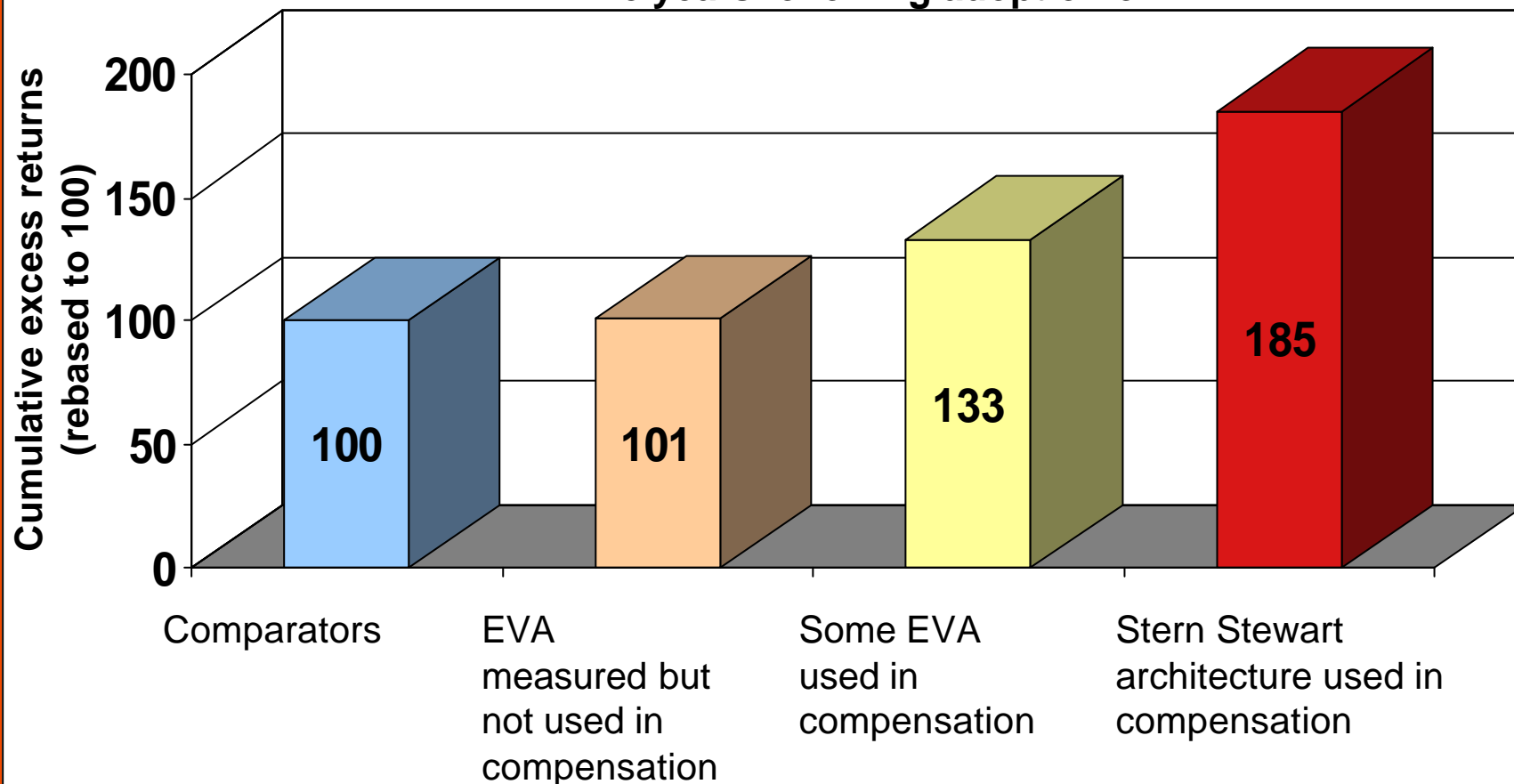
But, for companies that did not:

'...the results contrasted strongly ... this group revealed much weaker or non-existent results, supporting what I had posited at the outset. If the EVA measure is not taken to the level of compensation, it may not have any impact at all.'

**Professor James Wallace
University of California at Irvine**

How we tie pay to EVA can further enhance out-performance

Relative wealth creation of Stern Stewart clients - five years following adoption of EVA

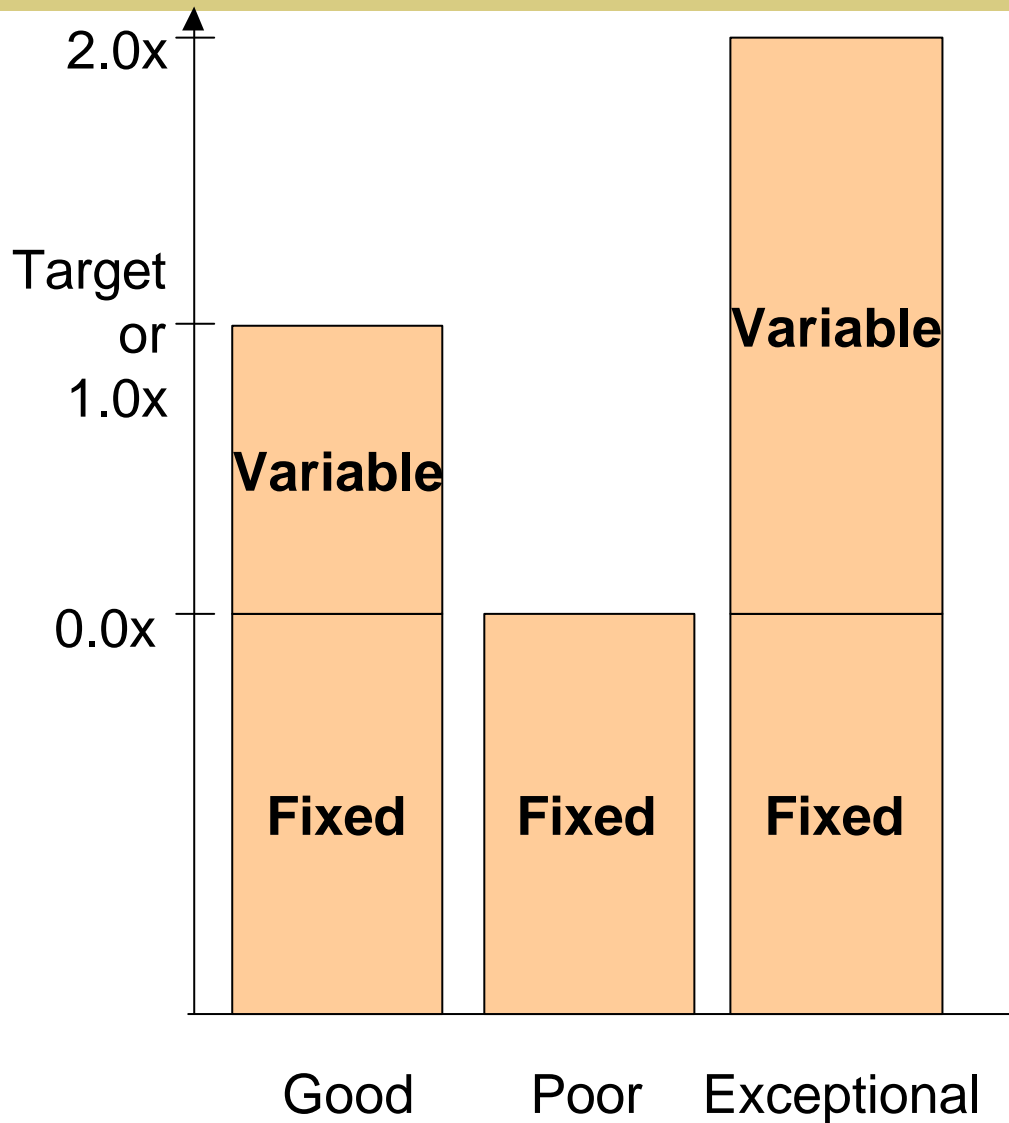


Source: Stern Stewart analysis

Key characteristics of the National's senior management compensation architecture

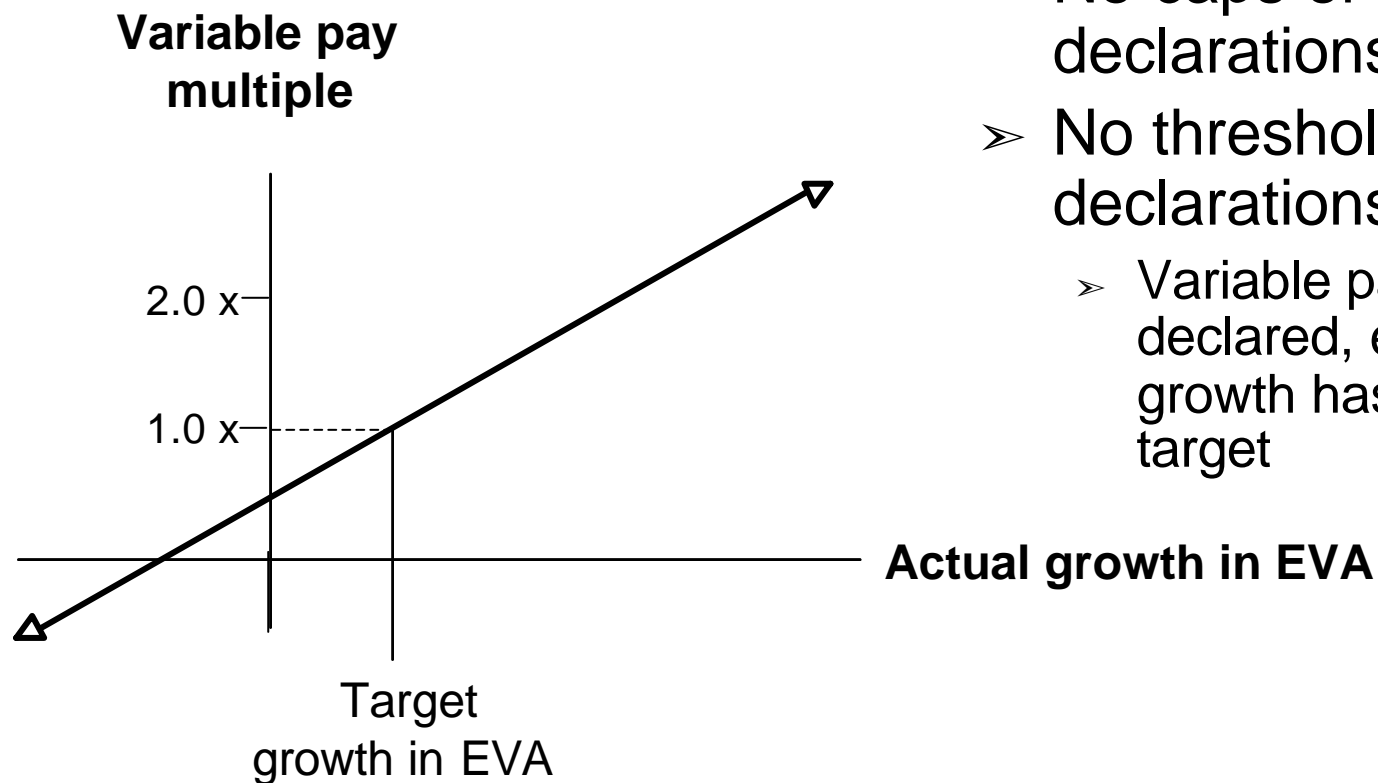
- Pay at risk is transparent and known in advance
- Rewards are based on growth in EVA, with no caps and no floors on declarations
- Above target variable pay is only earned when performance is sustained
- Multi-year targets

Pay at risk is transparent and known in advance



➤ Total remuneration varies dependent on performance

Rewards are based on growth in EVA, with no caps and no floors on declarations



- No caps or floors on declarations
- No threshold on declarations
 - Variable pay can be declared, even when EVA growth has fallen short of target

Rewards to managers mirror rewards to shareholders

Above target variable pay is only earned when performance is sustained

ILLUSTRATIVE

	Year 1	Year 2	Year 3	Year 4	Year 5	Year 6
__Target variable pay__	\$60	\$60	\$60	\$60	\$60	\$60
Variable pay multiple	1.0x	0.5x	1.5x	1.0x	-0.5x	2.0x
Variable pay declared	\$60	\$30	\$90	\$60	-\$30	\$120
+ Carried over from last year	0	0	0	20	13	-\$17
= Available for payment	60	30	90	80	-17	103
- Payout up to target (1)	60	30	60	60	0	60
= Leaving an excess of	0	0	30	20	0	43
- 1/3rd is paid out this year (2)	0	0	10	7	0	14
= Balance carried forward	0	0	20	13	-17	29
Total payout (1) + (2)	\$60	\$30	\$70	\$67	\$0	\$74

Deferring payouts lengthens the decision horizon



Multi-year targets encourage continuous improvement

ILLUSTRATIVE

	<u>2000</u>	<u>2001</u>	<u>2002</u>	<u>2003</u>	<u>3 Year cum.</u>
Last year's EVA		1450	1700	1500	1450
Expected Improvement		100	100	100	300
Target EVA		1550	1800	1600	1750
Actual EVA	1450	1700	1500	1750	1750
Variance from target		150	(300)	150	0
Variable pay declared		1.25x	0.50x	1.25x	3.00x
Variable pay paid		1.08x	0.67x	1.08x	2.83x

The plan rewards bringing forward sustainable improvements as soon as possible

How will the National's adoption of EVA impact strategic decision making?

- Longer term decision horizon encouraged
- Increased focus on the capital management
- Acquisition and divestiture candidates reviewed in terms of long term EVA growth
- Pro-active risk management encouraged - managers are charged for risk in the portfolio



Discussion