TRANSCRIPTION

Title:	**UK Restructure Analyst Briefing** **Lynne Peacock - European CEO** **Michael Ullmer - Director, Finance & Risk**
Date:	**30 March 2005**
Chairperson:	**Callum Davidson**

Callum: Thank you for joining us everybody. Apologies for the short notice on the announcement and also the call this afternoon. Obviously with these things we need to consider the requirements of communicating to our internal audiences in the UK and as a result of that, it is necessary to do it in the afternoon our time which coincides with the morning in the UK.

We've got a brief presentation here to run through. If anybody had any problems getting that, it should have been emailed to you but it is also on our website. We will run through the presentation. Michael Ullmer will take you through that and then we'll have some Q and A following that. We also have Lynne Peacock on the line from the UK to answer questions as well. I'll now hand over to Michael to kick things off.

Michael: Thanks Callum and welcome everyone and I should note that we have both the analyst community as well as media who will be listening in to the call.

Today in the UK as Callum's mentioned, we're making announcements regarding restructuring initiatives. These initiatives build on the plans that we communicated in the briefing in February where we set out the UK strategy and represent the progressive roll out of the restructuring across the National.

So this afternoon I want to provide you with an overview of the initiatives that impact all our businesses in the UK other than institutional markets and services and then we can go to Q and A where Lynne and I can take your questions.

If you can turn to slide one, in terms of the three core principles which underlie all of the restructuring activity we're taking across the group, firstly any initiative we take has to be consistent with our corporate principles. Secondly, where we are reducing the number of people involved in an area of activity, this must be done by changing processes, removing duplication of work or stopping that activity that's being unnecessary and not adding value. Thirdly, the development and implementation of the initiatives must be owned by the businesses themselves rather than be imposed from the corporate or group centre. That ensures that the initiatives are appropriate for the business and there is full accountability and ownership within the business for the implementation of those plans.

Now as we've discussed on a number of occasions, the progress of planning and implementing the restructure across the group is at different stages for the different regions. As you would have seen in February, the UK is the most advanced given that their leadership team has been in place for a while and they commenced planning work back in 2004 for the restructure which is much earlier than other areas across the group.

Many of the UK initiatives were flagged in that briefing and the implementation in some areas has already commenced. With the announcements today, restructuring charges associated with this activity in the UK will be booked as a significant item in the first half result for the six month to 31 March 2005.

Just talking generally across the group, planning in our other regions and the corporate centre is progressing well, and in May we will provide an overview of our anticipating restructuring activity for the remainder of the group. That would include an outline of the key streams of work, associated benefits and restructuring charges expected to be booked in the second half. In line with what we did for the UK, we will be undertaking in the second half briefings on the strategies that are being developed for both the Australian region and separately for Institutional Markets and Services.

Let's get back to the UK, if we turn to slide two, this is a repeat of the slide that Lynne and her team used in February, and the strategy in the UK first is twofold. Firstly it's around doing what we do but doing it better, and that's around realigning our distribution footprint, increasing the capability of our staff, simplifying the product set that we have, refreshing the brands and better at understanding what our customers are looking for, and generating efficiencies in back office processing.

The second phase when we've achieved that is around playing a different game and I should say, we're doing not necessarily when we've achieved the first because we're doing these two together. Playing a different game is around expanding into the south of England with a differentiated relationship management proposition which we call integrated financial solutions, targeted very much at the business market, the middle market customer base as well as the high end of the retail customer base, premium customers as well as more expansive use of third party distribution.

So the announcements in terms of restructuring are primarily related to doing what we do better, but it's important to be aware that these plans are part of this broader UK strategy which we talked about in February.

Turning to slide three, let me just recap the starting point of the cost challenge and specifically, the challenge we faced in the UK. We started the year in the UK facing significant headwinds from several cost drivers. These included spend on mandatory projects such as Basel, Sarbanes-Oxley and IFRS as well as underlying inflation in our overall cost base. In addition to this, we have the increasing investment in expanding the IFS and third party distribution, as well as increasing marketing spend to rebuild and reposition our brand in the UK.

So in total, those pressures added of the order of 80 million pounds sterling to the planned cost base for the current year. That effectively meant that we came into 04 with a planned cost base that was something of the order of 10% above the 2004 FSE or European cost base for 03/04. Clearly, that is something that is unacceptable and we talked back in November generally about these cost pressures and the cost momentum we were facing across the group and the need to really progress some important restructuring activity to deal with that.

I should note here that it's assumed that the pension charge in the UK as you will all recall was higher in 03 and 04 than in previous years, we're assuming that the pension charge will continue to be in line going forward with the charge that we experienced in 03/04.   So what we're facing generally in the UK is the legacy of complex business operations and processes which make it more difficult to mitigate these cost pressures and really, the whole thing points to the need for fundamental restructuring to deal with this.

Our response to date has been to, as a short-term measure, reduce discretionary spend wherever possible. Accelerating the integration of Clydesdale and Yorkshire, and there was a very important milestone reached earlier on where the legal integration occurred with Clydesdale is now the continuing operation and obviously, using both the Yorkshire and Clydesdale brands off that platform and disposing of the two Irish banks. Now the next step is initiating the restructuring program as we're outlining today. These actions are designed to mitigate cost pressures, stripping away underlying complexity and bureaucracy within our UK operations.

On slide four, we outline there the four streams of work that Lynne and her team took to in the February briefing. The first is distribution where our operations in the UK have too many branches, often in the wrong locations and with a skew towards less attractive demographic profile. The average number of customers per branch is approximately half that of our peers, and there is little representation in the south east of England where there is obviously a more wealthy demographic. In response to this, we are reconfiguring our distribution. This includes expanding the IFS infrastructure, developing a number of our branches as flagship branches which I will come back to, and an alliance with the post office in the UK to provide access to transactional banking services for our customers. We are also reconfiguring our existing distribution footprint which will result in the closure of some of the branches.

If we look at the production side, a lot of processing work is still undertaken within the branch network rather than in centralised processing units. This is inefficient and impacts revenue growth because our branch staff are often distracted from serving customers. We have begun the process of removing workload from the branches and standardising processes between the banking franchises of Clydesdale and Yorkshire. We're also rationalising the number and location of processing centres.

If we turn to products, after the sale of the Irish banks, we still have over 350 different products across Clydesdale and Yorkshire with less than 30 products common to both brands. We plan to reduce the number of products by over half with the majority of our remaining product set to be common across the Clydesdale and Yorkshire brands.

We've operated our wealth management business separately from our consumer finance and retail banking operations. Going forward, these functions will be integrated giving rise to synergies of approximately 100 FTEs and to date, we've already achieved 20% of this integration.

Finally, if we look at the support areas, in the UK we've operated several distinct business units. These has seen a duplication in the number of support roles in areas such as finance, people and culture and technology for both banking and wealth management business units across a number of independent businesses. Lynne and her team are moving to a simplified single business model with support functions provided once which again will see the opportunity to rationalise our processing activity.

Turning to slide six where we set out the overall financial picture of what we will be achieving, the restructuring initiatives are expected to deliver net run rate savings of £117m per annum against the planned 2005 expense base. Around half of those benefits will come from initiatives in support areas, a quarter from distribution initiatives, and the remaining quarter split between products and production streams. A provision of approximately £109m for redundancy costs and the exit of surplus lease space will be taken in this current half, and I should note here, these numbers are still subject to external audit.

Approximately 20% of the restructure charges are expected to be incurred in the current year with about 80% being utilised by September 2006. We expect to have completed 80% of the FTE reductions by the end of 2006 financial year. These savings and costs relate to restructuring activity, further savings will be derived from systems convergence and other efficiency initiatives.

In summary on slide seven, we are now into the implementation phase of our plan to turn around our UK operations. The program announced today outlines the significant opportunities available, driven primarily by doing what we do better. This will support our growth ambitions, improving the customer experience, and see us improve returns. Work will be ongoing to achieve in the UK performance measures in line with our peer group. The remainder of our restructuring plans for other parts of our group will be quantified at our results announcement in May and booked in the second half. With that, what I'd like to do is to open up the call to questions which both I will take here in Melbourne and Lynne will take in London.

Ross — Ross Brown, Deutsche Bank. Just a couple of questions around the cost saves. The announcement about the European restructure earlier in the year had £60m for back office savings. Is that inclusive in the £117m or is that in addition? Another question in relation to the £80m increment to the starting cost base, how much of that do you expect to be an ongoing baked in cost, and how much of that is expected to run off as these projects and some of the extra investment is run down?

Michael	Perhaps Ross if I just give an initial response and then hand over to Lynne to give more detail. In terms of the £60m that was mentioned in the February briefing, to the extent that part of that £60m relates to activities that required restructuring, then that is included in the £117m, so some of the £60m is in there, another part of it relates to then the more general efficiencies that I alluded to and I think Lynne, it's of the order of about £40m, is in the restructuring of £117m, and the other £20m relates to my comment about more general efficiencies.

Lynne	Michael that's correct. If you refer back to the presentation in February, it was £60m on the combined IT and operations cost base of about £250m and in that, you will see specifically there was £20m for running IT more efficiently, ie systems convergence. Clearly, that's not part of this.

Michael	Secondly Ross, in terms of how much of the £80m is in a sense baked in, you are quite right to allude to the fact that in some respects we are incurring the peak of the cost in the current financial year, in 04/05 relating to things like Basel and IFRS has been a reasonable cost burden in the first quarter and rolling into this second quarter as well. SOX will continue throughout this year on the basis that we are pressing ahead with achieving internal SOX compliance notwithstanding the deferral from the SEC for foreign [registrants] of one year for external compliance. But having said that, the majority of the £80m may reoccur hence the need for a fundamental restructure to be done in order to put our cost base onto a more sensible footing.

Lynne	Michael, if I could just add, obviously some of that £80m includes the investment in the growth initiatives in the south.

Ross	What I'm trying to get to is really a number as you can imagine. That's a fairly chunky increment to the cost base and obviously it potentially dilutes a lot of the cost saves. Roughly, I'm only after a rough number, roughly how much of the incremental compliance spend and that roll out of the additional business centres, most of that would drop off in the next 12 months I would imagine, would it be fair to say that could be half of the £80m or is it a much larger or smaller number?

Michael	In terms of dropping off, firstly the compliance spend, yes you're right. As we move into 05/06 what we will have left is Basel as IFRS should be mainly behind us and SOX, we'll probably still be doing some work there, but it would be largely Basel. The roll out of the IFS centres will continue through 05 and into 06 so that is more of an ongoing cost there. In terms of the relative proportions, those two together would still be less than half of that overall cost base.

Ross	Right, so effectively you're saying at least half of that £80m is here to stay for the near future?

Michael	Yes, subject to the initiatives that have already been taken Ross, in terms of cutting down discretionary expenditure wherever possible in the prelude to then implementing the more fundamental restructuring.

Ross	So of that £80m increment, that is before any reduction in discretionary spend, is that right?

Michael	Correct.
Ross	And how much is the reduction in discretionary spend?
Michael	You can keep trying Ross but I would also keep going the same way. The important thing is the coming in position that we identified and spoke to in November was one where in our plan, we were looking at costs increases of this quantum which is why we've gone to the need for a fundamental look at our business. You will have to wait until you see the results with everybody else on May the 11th to see actually how that played out as a result of the discretionary cut backs we've done in the first half.
Ross	Just one final question if I can, just on the broader profitability of the UK operations, obviously it was flagged as a down year in 05, to what extent is that mainly a cost issue of this 10% planned expense growth, or is it both a combination of down revenue and much higher costs?
Michael	Again, if I give a high level response and then Lynne if you add to that, clearly the cost pressures we've spoken to here, on the revenue front, the volumes have been going well in terms of originating at system in the markets that we operate in, but as we have flagged previously, been ongoing margin compression where you should be expecting margins to compress over 04/05 in much the same quantum as 03/04. So Lynne, have you got any comments?
Lynne	No, I think that that's covered Michael. I think the only thing I would add is that if we go back to the presentation in February, we also said that this was a two to three year turnaround and there's nothing we're saying today that detracts from that.
Ross	No, that does seem to be the case. Thanks for that.
Jonathon	Jonathon Mott of UBS. I've just got a question; last year you stated that the cash spend on the UK restructuring was around £110m. This restructuring is about £109m to the whole fix of the UK. Is £109m sufficient or will you need to have more restructuring spend in coming years going forward?
Michael	In terms of what we're talking about today, this is the restructuring that we're talking about in terms of changed processes that will lead then to redundancies and which will also lead to us having surplus space which we will need to exit. There will be then ongoing investments in developing our capability in various areas, so we've already talked to the integrated financial solution centres both rolling out in the south east and also converting some of our network in the Yorkshire and Clydesdale franchises, but there could be other activity around bringing together information systems, convergence of those which will lead to inefficiencies which are not of the nature of restructuring, and therefore, there could be additional costs in other areas which will lead to more benefits over and above what we're talking about today.
Jonathon	Will they be expensed or will they be capitalised and amortised in future periods?
Michael	They will be capitalised and amortised in future periods and where significant and where we are sufficiently well advanced in our thinking, I

will endeavour to give some updates to the market in May as to the quantum of that, and the likely benefits that will flow.

Nick — Nick Selvaratnam of Credit Suisse First Boston. Thanks Michael and Lynne, I've got a couple of questions, still back to the cost increase from the £764m in 04 increasing by at least 10% or around about 10%, could you tell us, compared to the revenue in total reported in 04 of 1.2 billion, is that likely to show increase or decrease in terms of balancing out the margin pressure with the volume increase?

Michael — So what is our revenue growth profile?

Nick — Yes, because you've got a 10% increase and that's been explained in terms of several factors influencing that on the cost side, but how does that compare with the revenue profile? Are we likely to see revenue numbers go up in pounds sterling compared with the 1.2 billion, or a reduction in terms of making up the margin pressure with volume growth?

Michael — Overall, we would still be expecting to achieve some revenue growth, but as you point out, that's around having a good performance on volumes but still our margins compressing from the levels that they were previously at that were unsustainable. Lynne, have you got a comment?

Lynne — No Michael, I think that covers it.

Nick — So modest revenue growth and 10% increase in costs is roughly what you're suggesting here?

Michael — Well the 10% increase in costs Nick would have been, had we done nothing. So there's two things, firstly in this first half, we've implemented a number of initiatives to curtail discretionary spend and that of course is not just in the UK but that's across the group as a prelude to undertaking the more fundamental work to understand what we needed to do to restructure our business.

Nick — Related to that still, when you sold the two Irish businesses, off memory there was about £15m worth of cost recharges that then had to be absorbed by the rest of the UK business. Where is that being factored in in this consideration here?

Michael — Those recharges come back into obviously the UK cost base, where they always were, so the activities that are causing that cost to arise are part of the UK and need to be dealt with as part of this overall activity that we're undertaking to reduce our costs. So in a sense Nick, they are implicitly in that opening number, but we're not having the benefit now of a revenue base in Ireland in which to absorb those recharges so that just adds to the cost challenge that Lynne and her team face.

Nick — Thanks. Finally, just one quick question, in relation to the provision itself, is that going to be booked by way of a significant item?

Michael — Yes.

Nick — Thank you.

Neil — Neil Murchie of Citigroup. Just two questions, the first to Lynne and the second probably for Michael. We've consistently heard that happy staff lead to happy customers and shareholders. The management have previously pointed to low staff engagement as a key issue. Firstly, are you concerned about the ability to maintain morale and grow revenue following a 15% reduction in the FSE workforce? Secondly, I think the general expectation in the market had been for an update and restructuring announcement on the Australian business prior to the second half, and potentially even booked in the first half, given earlier statements regarding the time frame of at least two years to fix the business, to what extent, I guess if any, is the likely bottoming of earnings and subsequent improvement in trajectory possibly lagging original expectations?

Michael	Lynne, do you want to take the first question on morale in the UK and I'll handle the second one.

Lynne	Neil, we're not at all complacent around the size of this restructure, but basically we spent a lot of time communicating with all of our stakeholders here including our people and our union and what we have been constantly saying is that we need to restructure this business if we're going to have a healthy growing business in the longer term with good prospects for our people. This is something we need to manage through and I think we manage through by being open and honest about what we're doing.

Michael	Neil, that sort of general theme from Lynne clearly applies across the whole group, where it's about being open and honest and transparent in talking to people about where we're heading, why and what it means in their particular area, and that's why it's been critical that as the detailed plans reach an appropriate stage, that we then flag that to our people and then that crystallises the external events such as this and briefing the market more generally. When you look at Australia and the rest of the group, my sense is that the markets have been expecting us to handle this in the way that it will play out, and that is the market saw in February how advanced the thinking was from the UK team and that clearly set up an expectation of a provision for restructuring for the UK in this half and clearly from the Australian perspective, as well as the institutional business and the corporate centre, that activity is still in development and that is why there will be further announcements in the second half.

What I am endeavouring to do to the extent the work is sufficiently formulated, is that at the May 11 briefing, to talk to the total group picture as best we can and give an indication of the size of the benefits that we think we can derive and the likely cost of doing that. In terms of what that means for our results, we continue to be on the trajectory that we talked to last year and that is around an expectation of bottoming in this half and then returning to a more acceptable trajectory in our earnings for the second half of 05 and into 06 and beyond, and John from the beginning has been talking consistently around this being a program that could take up to three years to achieve, and so we are still on that trajectory. The fact that we have not announced anything in detail in relation to Australia or anywhere else other than the UK does not mean that there's not a lot of work going on, and it does not mean that we are not attacking costs as well as growing revenues. What it simply means is the detailed restructuring activity that needs to be put in place for the sustainable long-term change is still under development.

Neil Thank you.

Richard Richard Wiles of JP Morgan. Michael, just following on from Ross's question regarding the £80m, on slide five you stated the benefits are against the planned 2005 expense base. Would it be fair to say that you've got an increase of expenses of £80m in 05, you are then looking to get £117m of savings against that, that means you've got £40m of savings relative to the 04 cost base. In addition, Lynne referred to the £20m of savings from I think IT rationalisation, is that a reasonable way to look at it?

Michael I think in a sense of getting to what's the final number, that will play out at the half year and full year announcements, but essentially you're getting the right pieces of the jigsaw. The missing pieces obviously are what else have we done with respect to discretionary expenditure and other activities that don't involve a restructuring of this nature.

Richard Just following on from that, you talk about having underlying inflationary impacts on your expense base in 04, would it be reasonable to assume that going forward, an impact of underlying inflation, but you'll also have the impact of the investments that you were talking about such as the roll out of IFS network and other developments there?

Michael That's correct Richard, I'd note there that we of course through 03/04 had a fairly significant investment program in the UK in the first place, and so what we need to get our minds fully around is what is the normal ongoing run rate we should expect for that sort of expenditure going forward.

Richard So stay in business capex?

Michael Correct.

Richard That's a way to describe that, and finally Michael, in terms of the realisation of benefits, would it be fair to assume that they'll in some ways match the utilisation of the provision and the FTE reductions which I think you've said will be 80% done by the end of 06?

Michael That's correct.

Nick Nick Selvaratnam of Credit Suisse First Boston. A question for Lynne, notwithstanding the commitment of the group to restructure what's going on in the UK, have you received any expressions of interest from other banks for an acquisition of your business?

Lynne Nick I think John covered everything that we wanted to say about our portfolio review at our briefing in February. Last year we had a look at all of our businesses, we decided to keep and invest Yorkshire and Clydesdale and we decided to dispose of Ireland.

Nick But that doesn't stop interested parties from expressing their interest.

Lynne It certainly doesn't but I don't think you'd expect me to really comment on anything like that. If it were something of significance then you'd hear about it.

Nick Thank you.

Michael To echo Callum's comments, thank you everybody for addressing this at such short notice and we will be putting a transcript of the presentation up onto the website and other than that, I look forward to seeing you all on May 11th.

[END OF TRANSCRIPT]