

**RESULTS FOR THE HALF YEAR ENDED 31 MARCH 2005**

GROUP PERFORMANCE OVERVIEW

## OVERVIEW

### Group performance

#### Movement on September 2004 half

For the National, activity in the March 2005 half has focused on making the operational changes required to start stabilising the Group's performance. The process of stabilisation, and putting in place sustainable performance improvements, will continue through the second half and beyond.

The Group's results during the March 2005 half reflect this environment. Cash earnings before significant items were \$1,618 million. The result was largely unchanged compared to the September 2004 half (but increased 1.7% at constant exchange rates). This is consistent with the guidance provided to the market in November 2004, when the Group indicated that it expected its earnings decline to bottom in the first half.

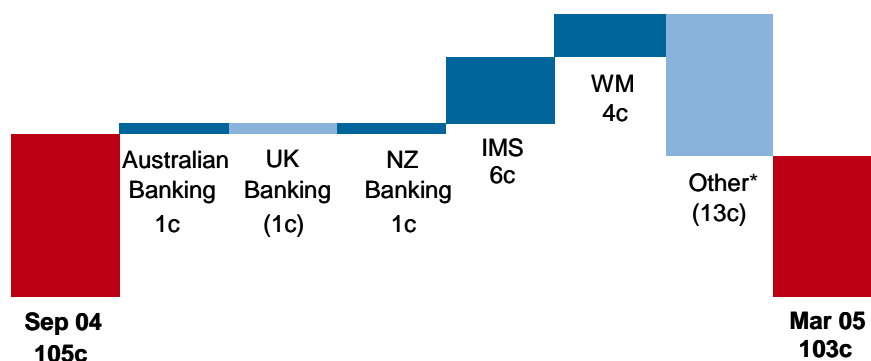
The performance was impacted by a range of factors:

- the earnings decline in the Group's banking businesses has been arrested;
- a steady result for Wealth Management in Australia and improving results for the UK, after adjusting for one-off factors in both the September and March halves; and
- two one-off costs incurred in relation to South Korea litigation and the Northern Bank robbery.

Further details are discussed below.

As a result, reflecting additional shares issued through the dividend re-investment program, diluted cash earnings per share before significant items decreased 1.8 cents (1.7%) from 104.8 cents to 103.0 cents.

#### Diluted cash earnings per share before significant items (cents)



\* Other includes Group Funding & Corporate Centre, which includes the cost of the Northern Bank robbery and the legal action in South Korea and the impact of movement in the weighted-average number of shares.

Cash earnings after significant items increased from \$1,100 million in the September 2004 half to \$2,439 million in the March 2005 half. The prior half included an after-tax significant items loss of \$(511) million, compared to an after-tax significant items profit of \$821 million in the March 2005 half. The March 2005 half significant items consisted of:

- net profit on the sale of Northern and National Irish Banks after all disposal costs including taxation of \$1,073 million;
- restructuring costs of \$(282) million (after-tax);
- reversal of provision in relation to foreign currency options trading loss of \$24 million (after-tax); and
- reversal of 2002 restructuring provisions of \$6 million (after-tax).

After including significant items, net profit attributable to members of the Company increased from \$1,011 million in the September 2004 half to \$2,535 million in the March 2005 half year. This included a \$51 million Wealth Management revaluation profit after tax compared with a loss of \$132 million in the prior half.

The interim dividend has been maintained at 83 cents per share and will be 80% franked.

### Movement on March 2004 half

Cash earnings before significant items of \$1,618 million decreased 12.5% on the March 2004 half year result of \$1,850 million.

Total Banking cash earnings were 15.4% lower, while Wealth Management experienced growth of 20.5% on the March 2004 half. The major performance declines relative to the prior comparative period were in Australian Banking, UK Banking and Institutional Markets & Services.

Cash earnings after significant items of \$2,439 million for the half were 23.3% higher than the March 2004 half year. The March 2005 half included favourable significant items of \$821 million, compared with the March 2004 half of \$127 million.

### Banking performance

Total Banking excludes the Wealth Management operations across all regions, and includes the results for Group Funding and the Corporate Centre.

Banking operations generated cash earnings of \$1,484 million, a decrease of 4.0% on the September 2004 half, or 3.4% at constant exchange rates. Adjusting for the impact of large one-off events in relation to the legal action in South Korea and the Northern Bank robbery, Banking cash earnings increased on the September 2004 half.

The result is impacted by:

- flat income, with declining income in UK Banking being offset by moderate growth in income for Australian and New Zealand Banking and the impact of favourable market conditions on Institutional Markets & Services income;
- a 2.5% decline in underlying expenses (excluding the impact of the items mentioned above); and
- a 10.6% increase in the charge to provide for doubtful debts due to a volume-related increase in the general provision.

Banking cash earnings decreased 15.4% on the March 2004 half. At constant exchange rates cash earnings decreased 16.4%. This outcome reflects a large increase in expenses and a moderate decline in income compared to the March 2004 half.

### Wealth Management performance

Wealth Management reported cash earnings of \$229 million, increasing \$71 million on the September 2004 half year of \$158 million. The overall result was impacted by an insurance recovery of \$19 million (after-tax) and by the receipt of a retrospective profit share payment of \$17 million (after-tax). This compares to the negative impact of prior year adjustments of \$(40) million in the September 2004 half. Improved equity market performance contributed to higher earnings on shareholders' retained profits and capital.

In Australia (including Asia), the Investments business experienced a solid result, with average funds under management and administration growing \$5.5 billion, or 7.6%, over the half year, positively impacting fee revenue. The Insurance business results declined as the favourable claims experience of 2004 returned to expected levels.

## Results excluding Irish Banks

On 28 February 2005 the sale of Northern Bank and National Irish Bank (the 'Irish Banks') to Danske Bank A/S was completed on terms consistent with the original sale announcement on 14 December 2004. This generated a net profit on sale after all disposal costs including taxation of \$1,073 million. Adjustments have been made to set out what the March 2005 half results would have been had the Irish Banks been sold on 30 September 2004 as follows:

- exclusion of net profit on sale;
- exclusion of the Irish Banks' reported profits for the five months up to the sale date of 28 February 2005;
- inclusion of certain fixed UK head office expenses that can no longer be recharged to the Irish Banks and income recharges to be received by the UK for transitional services provided to the Irish Banks; and
- inclusion of the funding benefit from the sale proceeds of \$2,514 million calculated at an average rate of 5% per annum.

Refer to Significant Items on page 27 for further details.

The following table sets out a proforma Group cash earnings result excluding the Irish Banks for the March 2005 half.

	Group reported results (6 mths)	Adjust for			Ongoing results (6 mths)	
		Net profit on sale of Irish Banks	Irish Banks profit (5 mths)	Income & expense charges (6 mths)		Funding benefit (6 mths)
	\$m	\$m	\$m	\$m	\$m	
Net interest income	3,553	-	(197)	-	63	<b>3,419</b>
Net life insurance income	495	-	-	-	-	<b>495</b>
Investment earnings on shareholders' retained profits & capital from life bus.	63	-	-	-	-	<b>63</b>
Other operating income	2,490	-	(82)	27	-	<b>2,435</b>
Net operating income	6,601	-	(279)	27	63	<b>6,412</b>
Operating expenses	(3,576)	-	203	(61)	-	<b>(3,434)</b>
Charge to provide for doubtful debts	(281)	-	6	-	-	<b>(275)</b>
Cash earnings before tax	2,744	-	(70)	(34)	63	<b>2,703</b>
Income tax expense:						
Net life insurance income & IORE	(192)	-	-	-	-	<b>(192)</b>
Other	(685)	-	22	10	(19)	<b>(672)</b>
Cash earnings before significant items, outside equity interest & distributions	1,867	-	(48)	(24)	44	<b>1,839</b>
Significant items after tax	821	(1,073)	-	-	-	<b>(252)</b>
Net profit – outside equity interest	(154)	-	-	-	-	<b>(154)</b>
Distributions	(95)	-	-	-	-	<b>(95)</b>
<b>Cash earnings after significant items</b>	<b>2,439</b>	<b>(1,073)</b>	<b>(48)</b>	<b>(24)</b>	<b>44</b>	<b>1,338</b>

## Transition to Australian Equivalents of International Financial Reporting Standards

In July 2002, the Financial Reporting Council in Australia formally announced that Australian reporting entities would be required to comply with Australian accounting standards equivalent to International Financial Reporting Standards (AIFRS) and other pronouncements set by the International Accounting Standards Board (IASB) for financial years commencing on or after 1 January 2005.

The Group will be required to adopt these standards for the financial year commencing 1 October 2005 and they will be first reflected in the Group's financial statements for the half year ending 31 March 2006. Comparative financial information prepared in compliance with AIFRS will be required for the year commencing 1 October 2004. Comparative information is not required for AASB 132 "Financial Instruments: Disclosure and Presentation" (AASB 132), AASB 139 "Financial Instruments: Recognition and Measurement" (AASB 139) and AASB 4 "Insurance Contracts" (AASB 4).

A program board is monitoring the Group's AIFRS implementation. Dedicated work streams are responsible for evaluating the impact of specific accounting changes and how the necessary changes will be made. The program is well progressed through these phases and is achieving scheduled plan milestones. There are several future changes expected to AIFRS that the Group will need to address, including Phase II of the IASB's insurance project and proposed further amendments to IAS 39 "Financial Instruments: Recognition and Measurement". The Group continues to monitor these and other developments, including emerging industry interpretations and practice.

AIFRS frequently require application of fair value measurement techniques. This will potentially introduce greater volatility to the Group's reported financial performance. The adoption of these standards is expected to have a material effect on the Group's reported financial performance and financial position; however, the underlying economics of the business will not change.

On the date of transition to AIFRS, the Group will effect two types of changes:

- those concerning recognition and measurement of items in the financial statements; and
- those concerning presentation and disclosure of items in the financial statements.

Any recognition and measurement adjustments that arise as a result of the transition process will be recognised in either retained earnings or an appropriate equity reserve at the date of transition. They will affect reported profit or equity for periods after that date.

The transitional process to AIFRS must comply with the requirements of AASB 1 "First Time Adoption of Australian Equivalents to International Financial Reporting Standards" (AASB 1). Upon transition to AIFRS, a number of the Group's accounting policies will be altered. Based on AIFRS as currently issued, the areas of most significant impact and the known estimable transitional differences from application of AIFRS are summarised below. The transitional adjustments identified are based on the work-in-progress of the AIFRS work streams and are best estimates as at reporting date. The information provided in this note is focused upon material items; it does not represent a complete list of expected adjustments.

The transitional adjustments provided in this note are based upon known interpretations of AIFRS at this time. The actual effects of transition to AIFRS may differ from the estimates disclosed due to ongoing work being undertaken by the Group or potential amendments to AIFRS or interpretive guidance. Whilst some individual comments address tax issues, all estimates presented are on a pre-tax basis. It should be noted therefore that the net impact of some of the AIFRS adjustments will be lessened following adjustments for tax effect accounting. Further, the ongoing impact of some adjustments (for example, pension deficit liability) will be lessened as a consequence of the sale of the Irish banks on 28 February 2005.

### (a) Post-employment benefits

AIFRS requires defined benefit pension and superannuation plan surpluses and deficits to be recognised on the balance sheet. Consequently, a transitional adjustment is required to recognise defined benefit pension surpluses and deficits on balance sheet with a corresponding entry made to retained earnings.

The estimated transitional adjustments for each of the Group's material pension and superannuation plans in accordance with AASB 119 "Employee Benefits" (AASB 119) have been, in the case of Australia and New Zealand, calculated based on a roll-forward of the last triennial actuarial valuations performed between 2002 and 2003. For the European funds (including those relating to the Irish Banks) the estimated transitional adjustment has been based on the latest available information from the triennial actuarial valuations currently undertaken in respect of the valuation as at 30 September 2004. Work to date indicates that the Group will recognise a defined benefit pension liability in the range of \$1,200 million to \$1,400 million relating to the Group's European pension plans. As the valuations performed by the actuary are currently not finalised, the defined benefit pension liability may be subject to change.

In addition, a defined benefit pension asset of approximately \$100 million will be recognised relating to the Group's New Zealand and Australian plans.

Additionally, the prepaid pension cost asset currently recognised under Australian generally accepted accounting principles (GAAP) of \$582 million predominantly in respect of the Yorkshire Bank and Bank of New Zealand pension and superannuation plans will be de-recognised upon transition to AIFRS.

In total, retained earnings is expected to decrease on a pre-tax basis within a range of \$1,700 million to \$1,900 million or \$1,200 million to \$1,300 million after allowance for the related net deferred tax asset. Note, no change arises to the ongoing cost of the pension schemes as a result of this accounting change. The schemes remain in actuarial surplus and compliant with all relevant regulatory requirements.

AASB 119 was amended in December 2004 to permit the application of three options for the recognition of ongoing actuarial gains and losses related to defined benefit pension and superannuation plans. In respect of ongoing actuarial gains and losses, the standard now permits: full and immediate recognition through the income statement; deferred recognition through the income statement (corridor approach); or full and immediate recognition through retained earnings.

The Group has determined that it will recognise actuarial gains and losses directly in retained earnings. While the choice of option will impact the income statement subsequent to transition, it will not impact the calculation of the transitional adjustment. The amendment does not impact other components of pension expense, which will continue to be recognised in the income statement.

### **(b) Wealth Management revaluation – excess of market value over net assets (EMVONA)**

On transition to AIFRS the Group will derecognise the asset representing the excess of net market value over net assets of life insurance controlled entities (EMVONA) and cease to recognise the movement in EMVONA in the Group's income statement.

Broadly, EMVONA represents:

- acquired goodwill in respect of life insurance controlled entities remaining at balance date;
- increases in the value of goodwill of the controlled entities since acquisition; and
- the difference between the values assigned to assets and liabilities of the controlled entity within the Group's financial report and those in the report of the controlled entity arising due to valuation methodology differences.

The whole of the EMVONA balance will be written off to retained earnings upon transition to AIFRS. Under AASB 1 EMVONA may be partially replaced by acquired goodwill and other intangible assets such as the value of business in force (VBIF) arising from the acquisition of the MLC group in 2000 and other subsequent acquisitions, directly or indirectly, by life businesses within the Group.

Based on the above, the estimated opening adjustments as at 1 October 2004 are:

- de-recognition of the EMVONA asset of \$4,904 million;
- recognition of goodwill of \$2,677 million;
- recognition of other intangible assets of \$1,482 million; and
- a decrease in retained earnings of \$746 million.

Under the rules of AASB 1, the acquired goodwill recognised does not include any notional amortisation from the date of acquisition until transition. In future periods, the goodwill will be subject to an annual impairment test. The other intangible assets recognised will be amortised over a period equivalent to their useful life.

### **(c) Securitisation**

The combined effect of financial asset de-recognition rules and the consolidation of special purpose entity rules will impact both existing and new securitisation arrangements involving both the Group's assets and those of its customers. The rules provide more stringent criteria for the de-recognition of financial assets. The interpretation of AIFRS consolidation rules will now require the Group to consolidate securitisation special purpose vehicles that were not consolidated under Australian GAAP. In addition, special purpose entities holding assets originated outside the Group will require consolidation where the Group has access to the majority of the residual income or is exposed to the majority of the residual risk associated with the special purpose entity.

The estimated opening adjustments as at 1 October 2004 are:

- an increase in total assets of \$5.6 billion;
- an increase in total liabilities of \$5.6 billion; and
- a minimal decrease in retained earnings.

As a consequence of the new rules and changes to interpretation the Group is currently considering structural changes to its special purpose entities involved in various securitisation programs such that some of these entities would not then be consolidated into the Group's financial statements from that point in time onwards.

### **(d) Taxation**

AASB 112 requires the Group to adopt a balance sheet approach to determining deferred tax items, based upon a comparison of accounting carrying amounts of assets and liabilities with their tax base. This method will identify a broader range of differences than those that arise currently. Consequently, the Group will be required to recognise additional levels of deferred tax assets and liabilities.

There are two major tasks involved in the first time application of AASB 112, the first being the need to determine the tax effect of any transitional adjustments (at both 1 October 2004 and 1 October 2005) required in the move to AIFRS. The second major task involves applying the rules of the balance sheet method to the Group's existing balance sheet. This is a very complex exercise and remains work in progress for the AIFRS project. As a consequence, in combination it is estimated that the changes will result in a higher level of deferred tax assets and a lower level of deferred tax liabilities being recognised by the Group.

### **(e) Share-based payments**

AIFRS introduces the requirement for the Group to recognise an expense in respect of all share-based remuneration (performance options, performance rights and shares issued to employees) determined with reference to the fair value of the equity instruments issued. The fair value of the performance options and performance rights at grant date will be expensed over their expected vesting period on a straight-line basis. Shares issued under the Company's staff share schemes will be recognised as an expense when issued.

The rules require the transition adjustment at 1 October 2004 to be calculated in respect of performance options and performance rights granted from 7 November 2002 that remain unvested at 1 January 2005.

The estimated opening adjustment as at 1 October 2004 is a decrease in retained earnings of \$34 million with a corresponding amount recognised in a share option reserve within shareholders' equity.

### **(f) Intangible assets and impairment**

On transition to AIFRS goodwill will no longer be amortised but will be assessed for any potential indication of impairment at each reporting date and tested for impairment at least annually. If an impairment loss is identified it must be recognised immediately in the income statement. The Group does not currently anticipate an impairment adjustment to opening retained earnings arising at 1 October 2004 in respect of this change in accounting policy but are in the process of completing the review.

This change in policy under AIFRS may result in increased volatility of future earnings where impairment losses are incurred.

Other intangibles will be amortised on a systematic basis that best reflects the expected pattern of consumption of the assets' benefits over their respective useful lives. In addition, application software assets with a carrying value of \$655 million will be reclassified from 'Property, Plant and Equipment' to 'Intangible Assets' on transition.

### **(g) Foreign currency translation**

Under the AIFRS transitional rules the Group will apply an exemption that permits the resetting of the foreign currency translation reserve (FCTR) to nil as at the date of transition to AIFRS. This decision will give rise to a debit adjustment against the FCTR estimated at \$166 million with a corresponding increase to retained earnings.

Translation differences in relation to foreign controlled entities subsequent to transition to AIFRS will continue to be recorded in the FCTR. The gain or loss recognised in the income statement on a future disposal of a foreign controlled entity will include any translation differences that arose after 1 October 2004.

### **(h) Deferred acquisition costs**

Current accounting policy allows the Group's life insurance and funds management controlled entities to defer acquisition costs incurred to gain new business. This deferral gives rise to an asset known as deferred acquisition costs (DAC). Under AIFRS this treatment will change in respect of those contracts classified as investment contracts. Costs relating to investment contracts may only be deferred if they are direct and incremental business unit costs relating to new business. Costs relating to insurance contracts may continue to be deferred as the treatment of acquisition costs under the current 'Margin on Services' (MoS) policy is effectively grandfathered under AASB 4 "Insurance Contracts".

The application of AIFRS in this regard is currently being considered by the industry, both within Australia and internationally, and various approaches are under consideration.

As the eventual accounting treatment is currently uncertain, the Group cannot reliably estimate the financial impact of this issue.

### **(i) Treasury shares**

Under current accounting policy, direct investments in National Australia Bank Limited shares by the Group's life insurance statutory funds are recognised as 'Investments relating to life insurance business' in the balance sheet at market value. On transition to AIFRS, these investments will be classified as 'treasury shares' and deducted from share capital.

The opening adjustments at 1 October 2004 arising from the transition to AIFRS are estimated to be decreases in investments relating to life business (\$551 million) and contributed equity (\$645 million) and an increase in retained earnings (\$94 million).

### **Transitional changes as at 1 October 2005**

The following transitional changes relate to application of AASB 132 "Financial Instruments: Disclosure and Presentation", AASB 139 "Financial Instruments: Recognition and Measurement" and AASB 4 "Insurance Contracts" and will occur on 1 October 2005. No comparative adjustments are required for the 2005 year.

Work is ongoing with regard to the impact of these transitional adjustments. Definitive impacts have yet to be quantified and in some cases are not able to be quantified until after 1 October 2005 as they will be based on market information as at that date.

### **(j) Recognition of derivative financial instruments and hedging**

Under AIFRS, the Group will be required to recognise all derivative financial instruments at fair value on the balance sheet, irrespective of whether the instrument is used in a hedging relationship or otherwise.

Where fair value hedge accounting criteria are met, fair value changes on both the hedged item (attributable to the hedged risk) and the hedging instrument will be recognised directly in the income statement. Where cash flow hedge accounting criteria are met, the carrying value of the hedged item is not adjusted and the fair value changes on the related hedging instrument (to the extent the hedge is effective) will be deferred in a separate equity reserve and will then be transferred to the income statement at the time the hedged item affects the income statement. Hedge ineffectiveness is recognised in the income statement immediately.

It should be noted that the underlying economics and risks of the Group will not change. The change affects only the manner by which the Group will account for the way it mitigates its interest rate and foreign currency risk. Under AIFRS, the Group will most likely use a hybrid of approaches with a predominance of cash flow hedge accounting. As a consequence, this will create volatility in the balance of the cash flow hedge reserve within equity.

All hedging arrangements will be subject to rigorous effectiveness testing and where an arrangement fails effectiveness tests, hedge accounting cannot be applied and fair value changes on the hedging instrument will generally be recognised in the income statement. This raises the potential for income statement volatility.

Whilst hedge accounting rules may alter the accounting for the Group's interest rate risk management activities, the treatment of trading derivatives is not expected to be affected by hedge accounting.

In certain circumstances, the Group will either be unable to achieve hedge accounting or it will not be the most appropriate approach. Where this is the case the Group will in certain circumstances seek to minimise the impact of the fair value measurement requirements by recognising both the item that is subject to an economic hedge and the accompanying derivative instrument at fair value in the balance sheet with movements in fair value recognised immediately in the income statement. The effect of this will be to reflect the economic substance of the transaction and reduce income statement volatility.

### **(k) Loan provisioning**

Under AIFRS, the Group will recognise loan impairment (currently referred to as provision for doubtful debts) when objective evidence is available that a loss event has occurred and as a consequence the Group will not likely receive all amounts owed to it. Loan impairment is calculated as the difference between the carrying amount of the loan and the present value of future expected cash flows associated with the loan discounted at the loan's original effective interest rate.

Significant loans will be individually assessed for impairment. Those significant loans that are not assessed as impaired will then be placed into portfolios of assets with similar risk profiles and be subjected to a collective assessment of impairment. Smaller loans will not be individually assessed but impairment tested in portfolios based upon similar risk profiles. Objective evidence of impairment will be based on historical experience for such portfolios adjusted to reflect the effects of current conditions at each balance date. The impact of AIFRS on the Group's current methodology for calculating the provision for doubtful debts is still being evaluated.

### **(l) Insurance contracts**

Contracts that do not have significant insurance risk will no longer be treated as insurance contracts but as financial instruments. For non-insurance contracts these changes will likely have a negative impact on accounting profit in respect of new business. Accounting profits will be higher in later periods as a result of a greater proportion of contract acquisition expenses being recognised upfront.

For those contracts that continue to meet the definition of an insurance contract, the Group will account for those under the existing Margin on Services (MoS) approach.

These changes do not require comparatives for the 2005 financial year. It is expected that further changes to insurance accounting will arise under Phase II of the IASB's insurance project at which time the existing MoS approach will be phased out.

### **(m) Revenue recognition**

At present, loan origination fee revenue is either recognised upfront or deferred in the balance sheet and amortised as an adjustment to yield over the expected life of the loan. It is likely that a greater volume of fees will be deferred and amortised over the expected life of the respective loans under AIFRS. Revenue that is deferred must be amortised on an effective interest rate basis. AIFRS also requires deferral of related costs where these are both direct and incremental to origination of the loan.

### **(n) Valuation of financial instruments using bid and offer prices**

AASB 139 requires that in valuing financial instruments at fair value, the appropriate quoted market price to be used is usually the bid or offer price. Currently all financial instruments of the Group measured at fair value and transacted in an active market are valued at a mid-price. It is acceptable to continue to use the mid-price where there is an off-setting market risk position. Consequently, where there is no off-setting market risk position an adjustment is required to re-measure those assets and liabilities at either a bid or offer price instead of a mid price. The impact of this change on the income statement is not expected to be significant.

### **(o) Available for sale securities**

Under AIFRS, the Group's available for sale debt securities and equity investments will be valued at fair value in the balance sheet with unrealised gains and losses recognised in a separate reserve account within equity.

### **Format of financial statements**

In addition to the transitional adjustments detailed above, which will impact the measurement and recognition of certain items, the adoption of AIFRS will introduce a number of changes to the format of the income statement, balance sheet and other financial statement disclosures. In general, these changes introduce more detail rather than less to the required disclosures. The Group is currently evaluating these requirements.

### **Capital implications**

The Australian Prudential Regulation Authority (APRA) released a discussion paper in February 2005, outlining their proposed approach to calculation of regulatory capital following the adoption of AIFRS. Several of the transitional adjustments detailed above affect the calculation of the Group's regulatory capital and are affected by APRA's proposed approach. The Group is working with APRA and the Australian banking industry to ensure these implications are fully understood.

It is important to note that APRA's proposals will not take effect until 1 January 2006 and the calculation of regulatory capital will remain unchanged until then.