

# Appendix 4E

## Preliminary final report for the year ending 30 June 2016

### Michael Hill International Limited ACN 610 937 598

**Reporting Period**

Reporting Period: 12 months ending 30 June 2016

Previous Reporting Period: 12 months ending 30 June 2015

<b>Results for Announcement to the Market</b>	<b>Current Reporting Period \$'000</b>	<b>Previous Reporting Period \$'000</b>	<b>Movement %</b>
Revenues from ordinary activities	551,127	503,370	9.5%
Profit from ordinary activities after tax attributable to ordinary equity holders	19,577	27,754	-29.5%
Net profit for the period attributable to ordinary equity holders	19,577	27,754	-29.5%

**Brief Explanation of figures reported above to enable the figures to be understood**

This report is based on the consolidated financial statements which have been audited and an unqualified opinion given. For commentary on the results, please refer to the attached full financial report for all other disclosures in respect of the Appendix 4E.

<b>Dividends</b>	<b>Amount per security AU cents</b>	<b>Franked amount per security AU cents</b>
Interim dividend (paid 1 April 2016)	2.25 cents (NZ 2.5)	Nil
Final dividend (to be paid 6 October 2016)	2.5 cents	2.5 cents
Record date for determining entitlements to the final dividend		8 September 2016

Signed



Emma Hill  
Chair  
18 August 2016

Webcast will take place at 10.00am (AEST) 19 August 2016. Please use the following link to register.

<http://edge.media-server.com/m/p/5nazm6dy>

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## DIRECTORS' REPORT

The Directors have pleasure in submitting their report on the consolidated entity (referred to hereafter as the 'Group') consisting of Michael Hill International Limited ACN 610 937 598 ('Michael Hill International' or the 'Company') and all controlled subsidiaries for the year ended 30 June 2016. As a result of the recent restructure of the Group which saw a new parent company, Michael Hill International, being interposed on the previous parent company, Michael Hill New Zealand Limited Company No. 342863 ('MHNZ') (formerly known as Michael Hill International Limited), certain sections of this report will reflect the position of Michael Hill International as well as the position of MHNZ (as the previous parent company for part of the financial year to which this report relates).

### Principal activities

The Group operates predominately in the retail sale of jewellery and related services sector in Australia, New Zealand, Canada and the United States.

There were no significant changes in the nature of the Group's activities during the year.

### Significant changes in state of affairs

The Company is a for profit company limited by shares and incorporated in Australia. The Company was admitted to the official list of the Australian Securities Exchange (ASX) on 7 July 2016 as its primary listing, and maintains a secondary listing on the New Zealand Stock Exchange (NZX).

Until 23 June 2016, MHNZ (formerly known as Michael Hill International Limited) was the parent of the Group. MHNZ is a public company registered under the Companies Act 1993 and remains domiciled in New Zealand. MHNZ had its primary listing on the New Zealand Stock Exchange. The listing was suspended on 22 June 2016 as part of the restructure of the Group.

### Likely developments and expected results of operations

Information on likely developments in the Group's operations and the expected results of operations have been included in the Operational Overview and Outlook sections of this report.

### Dividends

Dividends paid to ordinary equity holders of MHNZ during the financial year were as follows:

	2016 \$'000	2015 \$'000
Final dividend for the year ended 30 June 2015 of NZ 2.5c (2014 - NZ 4.0c) per fully paid ordinary share paid on 2 October 2015 (2014 - 3 October 2014).	8,870	13,765
Interim dividend for the year ended 30 June 2016 of NZ 2.5c (2015 - NZ 2.5c) per fully paid ordinary share paid on 1 April 2016 (2015 - 2 April 2015).	8,620	9,411

Dividends not recognised at year end relating to Michael Hill International:

	2016 \$'000	2015 \$'000
Since year end, the Directors have declared the payment of a final dividend of AU 2.5c per fully paid ordinary share (2015 - NZ 2.5c). The final dividend will be fully franked and imputed. The aggregate amount of the proposed dividend expected to be paid on 6 October 2016 out of retained profits at 30 June 2016, but not recognised as a liability at year end, is:	9,578	8,574

## Result overview

In Australian dollars, the Group has reported operating revenues of \$551.1m, with earnings before interest and tax of \$47.1m, up 11.9% on the prior year. The Group reported a net profit after tax of \$19.6m for the 2015-16 financial year.

### Cash, Cash flow and Dividends

The Group has an equity ratio of 48.5% at 30 June 2016 (53.5% in 2015), and a working capital ratio of 2.4:1 (3.3:1 in 2015). Net operating cash flows were \$47.8m compared to \$54.6m the previous year. Net debt at 30 June 2016 was \$32.0m compared to \$38.3m at 30 June 2015.

The Group remains in a sound financial position to take advantage of growth opportunities as they arise.

For shareholders, the dividend for the year was AU 4.57 cents (NZ 5.0 cents) per share. There will be final dividend of AU 2.5 cents per share being payable on 6 October 2016. The final dividend will be fully franked for Australian shareholders and fully imputed for New Zealand shareholders.

### Inland Revenue Dispute Settlement

On 17 August 2016, the Company reached a settlement with the Inland Revenue ('IR') on its long running tax dispute relating to the financing of the Intellectual Property transferred from its New Zealand subsidiary to its Australian subsidiary in 2008. As a result, the Company has recognised a tax liability payable of \$28.8m (NZ\$30.3m). All amounts payable under this settlement have been provided for in the 2015-16 year and this settlement resolves all matters in relation to these proceedings. The settlement does not involve the payment of any penalties by the Company. Tax pooling deposits, which the Company has entered into over a number of years, will fund a portion of the agreed settlement with the Commissioner, including UOMI (Use of Money Interest) and NZ \$7.7m of core tax. The residual amount due of NZ \$22.6m will be funded from the Group's existing financing facilities, without any impact on the Group's ongoing operations, and will not impact the planned store roll out program.

Implementation of the settlement will generate imputation credits enabling dividends to be fully imputed for the benefit of New Zealand shareholders for some years to come (assuming current levels of financial performance and dividend distribution are maintained), including the final dividend expected to be paid in October 2016.

The Board has been conscious of the increasing difficulties that this dispute has had for our shareholders in trying to understand and quantify the potential price impact of the contingency should an adverse outcome result (reflecting the uncertainty and risk involved in any formal litigation).

Accordingly, whilst the Board remains comfortable that the Group's tax treatment of the transaction, which has been the subject of the proceedings, fully complied with all relevant tax laws at that time, the Board is now of the opinion that removing the continued uncertainty and the significant cost associated with the dispute, is in the overall best interests of shareholders and that the settlement reached is accordingly a sensible commercial outcome.

### **Operational Review**

During the year, the Group achieved some key outcomes for the 12 months:

- Revenue increased 9.5% to \$551.1m
- Same store sales up 5.2%
- Branded Collection sales reached 14.9% of sales
- PCP sales up 10.6% to \$39.3m lifting deferred revenue from PCP sales to \$71.6m
- Gross profit lifted to 64.0%
- Earnings before interest and tax of \$47.1m, up from \$42.1m
- Net profit after tax (NPAT) of \$19.6m impacted by the booking of tax entries in relation to two separate matters being the settlement of the historical IR tax dispute and the tax consolidation cost base adjustments arising as a consequence of the ASX listing, down 29.5% from \$27.8m
- Net operating cash inflow remained strong at \$47.8m
- Net debt of \$32.0m down 16.4%
- 19 new stores opened across the Group giving a total of 313 stores (including 16 Emma & Roe stores)
- 8 new Emma & Roe stores opened bringing the total to 16 stores

2015-16 was a significant year for the Group with a record EBIT result being achieved on the back of solid performances by our Australian, New Zealand and Canadian businesses. The Group has several years of new store growth in the Canadian market which will further lift revenues and profits. Our US trial continues and while the bottom line slipped on the previous year some headway was made with real estate and merchandise refinements. Experimentation in the lucrative US market will continue in the year ahead with a view to positioning the brand for growth in future years. Emma & Roe brand was moved from trial mode to growth in June 2016 and up to 12 new stores are planned for the 16-17 year. While the Group will continue to be cautious with the rate of growth for this exciting new brand, this rate can be accelerated as each new market proves up in the coming months and years.

Branded collections revenue lifted to 14.4% of total revenue in 2015-16. This strategy will remain in coming years as more of our investment in inventory is shifted from generic product to proprietary branded collections that offer higher margin and superior return on investment.

The continued growth in Professional Care Plan (PCP) revenue has again provided strong cash flow for the Group. The PCP program is designed to provide a comprehensive suite of product care services to our customers to ensure their jewellery is cared for by experts to enhance the look of their jewellery and to ensure it is maintained in top condition. Total sales from these plans grew by 10.6% this year to \$39.3m and at 30 June 2016 there was \$71.6 million of deferred PCP revenue held on the Balance Sheet.

The Group e-commerce platform continues to support the business well with e-commerce revenues increasing by 48%, driven by an uplift in online activity in all regions. We will continue to work on initiatives that better integrate our online and physical store environments providing a superior omni-channel experience for our valued customers. We continued to experience strong levels of customer engagement across our digital and social channels.

As at 30 June 2016, the Group operated Michael Hill e-commerce sites in all four countries we operate in, and an Emma & Roe e-commerce site in the Australian market. As part of our multichannel strategy, Emma & Roe merchandise is also sold across all Michael Hill e-commerce sites.

The Group opened 19 new stores for the year and closed 2 giving a total of 313 stores trading at 30 June 2016. This was comprised of 11 new Michael Hill stores during the year; 3 in Australia, 7 in Canada and 1 in the United States. Two stores were closed during the period, resulting in a total of 297 Michael Hill stores trading as at 30 June 2016. We also opened 8 Emma & Roe stores giving a total of 16 stores open as at 30 June 2016.

## Review of 2015-16 Priorities

To drive same store sales and EBIT performance across the Group	Group revenue increased 9.5%, and same store sales increased 5.2%. Group EBIT reached a record \$47.1m
To make further progress across our 4 strategic themes; Delight the mid-market, Expand our footprint, Empower our people, Brighten our bridal experience	Strategies and initiatives were rolled out across all 4 markets to achieve these themes and they have proven successful with solid same store sales growth for the Group compared to the industry generally
To improve return on shareholders' funds and return on assets	If both the IR tax settlement of \$28.8m (NZ\$30.3m) and the income tax consolidation cost base adjustments of \$19.4m are removed from our results, the Group would have achieved a return on shareholder funds of 15.5% compared to 15.0% last year and on total opening assets of 8.1% compared to 8.0% last year
To open 20 new stores across the Group	19 new stores were opened during the year
To increase sales from our e-commerce platforms across both brands while integrating the online and in-store experiences	Online sales increased by 48% during the period. Work continues on the integration of on-line and off-line channels
To continue testing and refining our Michael Hill retail model in the US and our new Emma & Roe brand	The testing in the US market continues and progress has been made on topline sales and refinement of the investment mode. Emma & Roe was moved in to growth mode in June 2016 with up to 12 new stores planned for 2016-17
To continue to fine tune our in-house credit model in North America towards 'best practice' within our industry	Improvements have seen our model better support our two North American businesses and further adjustments will continue into 2016-17 around the data analysis and marketing opportunities
Improve branded assortments as a portion of total sales, which will in turn drive sales and margins	Branded collection sales lifted from 13.2% the previous year to 14.4% in 15-16. This has been a successful strategy and will continue in 2016-17

## Segment Results

The segments reported on reflect the performance of the Group's Michael Hill retail operations in each geographic segment and also includes the Emma & Roe brand as a separate segment. The segments exclude revenue and expenses that do not relate directly to the relevant Michael Hill or Emma & Roe retail segments. These predominately relate to corporate costs and Australian based support costs, but also include the trading activity through our online presence, manufacturing activities, warehouse and distribution, interest and company tax.

The results below are expressed in local currency.

### Australia

<b>OPERATING RESULTS (AU \$'000)</b>	<b>2016</b>	<b>2015</b>	<b>2014</b>	<b>2013</b>	<b>2012</b>
Revenue	307,333	294,442	298,474	289,333	259,032
EBIT	50,339	45,933	47,193	42,225	36,798
As a % of revenue	16.4%	15.6%	15.8%	14.6%	14.2%
Number of stores	168	167	164	162	153

The Australian retail segment revenue increased by 4.4% to \$307.3m and same store sales lifted 3.8% contributing to an EBIT result of \$50.3m, an increase of 9.6%. The operating surplus as a percentage of revenue was 16.4% (15.6% last year). This result is particularly pleasing against a backdrop of a continued challenging retail environment, especially in regions impacted by the resources sector downturn.

Three new stores were opened in Australia during the period as follows:

- Broadway Mall, New South Wales
- Casey, Victoria
- Halls Head, Western Australia

Two stores closed during the period. There were 168 stores trading at 30 June 2016.

### New Zealand

<b>OPERATING RESULTS (NZ \$'000)</b>	<b>2016</b>	<b>2015</b>	<b>2014</b>	<b>2013</b>	<b>2012</b>
Revenue	122,201	113,983	109,693	111,357	109,110
EBIT	27,296	23,545	22,062	22,128	21,550
As a % of revenue	22.3%	20.7%	20.1%	19.9%	19.8%
Number of stores	52	52	52	52	53
FX Rate for Profit Translation	1.09	1.07	1.10	1.25	1.28

The New Zealand retail segment revenue increased 7.2% to a record NZ\$122.2m for the twelve months, with an EBIT result of NZ\$27.3m, up 15.9% on the corresponding period last year. The operating surplus as a percentage of revenue was 22.3% (20.7% last year). The Company is delighted with the continued strong performance of this market and this result is a credit to the leadership team. No stores opened or closed during the year, with 52 stores trading at 30 June 2016.

## Canada

<b>OPERATING RESULTS (CA \$000)</b>	<b>2016</b>	<b>2015</b>	<b>2014</b>	<b>2013</b>	<b>2012</b>
Revenue	94,073	79,097	69,025	52,950	44,265
EBIT	9,454	6,041	3,794	1,121	518
As a % of revenue	10.0%	7.6%	5.5%	2.1%	1.2%
Number of stores	67	60	54	45	37
FX Rate for Profit Translation	0.97	0.97	0.98	1.03	1.03

The Canadian retail segment revenue increased by 18.9% for the twelve months to CA\$94.1m, with an operating surplus of CA\$9.5m compared to CA\$6.0m the previous year, a 56.5% increase on the previous corresponding period. Same stores sales increased 5.3% for the twelve months. The operating surplus as a percentage of revenue was 10.0% (7.6% last year). The Canadian segment continues to show strong growth as we gain traction in the larger provinces such as Ontario. The Company is confident this trend will continue in coming years as we grow out the brand across Canada towards 110 stores.

Seven new stores were opened in Canada during the period, as follows:

- Cataraqui, Ontario
- Erin Mills, Ontario
- Londonderry, Alberta
- Maple View, Ontario
- Sherway, Ontario
- Sherwood Park, Alberta
- Yorkdale, Ontario

There were 67 stores trading at 30 June 2016. The Group plans to open up to ten new stores during the 2016-17 year subject to availability of suitable sites.

## USA

<b>OPERATING RESULTS (US \$000)</b>	<b>2016</b>	<b>2015</b>	<b>2014</b>	<b>2013</b>	<b>2012</b>
Revenue	14,041	11,290	9,994	10,265	9,576
EBIT	(2,269)	(1,916)	(1,679)	(2,359)	(2,650)
As a % of revenue	(16.2%)	(17.0%)	(16.8%)	(23.0%)	(27.7%)
Number of stores	10	9	8	8	9
FX Rate for Profit Translation	0.73	0.83	0.92	1.03	1.03

The US retail segment increased its revenue by 24.4% to US\$14.0m for the twelve months, and there was an operating loss of US\$2.3m, in line with expectations. Same store sales in local currency increased 3.5% for the twelve months (adjusted for a temporary store closure at Woodfield Mall during the year for development). The focus in the US continues on the development of proprietary bridal and fashion collections to differentiate the brand in the market, new marketing initiatives to reach our target customer catchment, the development of a competitive in-house credit program, and delivering this through positioning the brand in malls with strong customer traffic flow and impressive retail mix.

A new store was opened at Roosevelt Field in New York during the period giving a total of ten stores operating at 30 June 2016.

## **Emma & Roe**

The Emma & Roe segment revenue increased by 91.6% for the twelve months to \$9.3m, with an operating deficit of \$2.4m compared to \$2.9m the previous year, a 15.8% improvement on the previous corresponding period. Same store sales increased 34.6% for the twelve months.

In June 2016, the Company announced that the Emma & Roe brand was going into expansion. Up to ten new Emma & Roe stores are planned for 2016-17 in the Australian market and two for New Zealand.

The Emma & Roe concept is positioned towards a new and emerging customer who likes to collect and create new looks, expressing their own individuality and fashion through the various assortments and collections of complimentary charms, bracelets, rings, pendants and earrings the brand offers. The frequency of purchase is higher for an Emma & Roe customer compared to a Michael Hill customer however the average transaction value is lower. We believe these two brands are well complimented, and will extend our reach further into the fine jewellery category.

## **Strategic Update**

The Group's strategies have been grouped into four key strategic themes. Under these themes we have grouped eleven areas of focus which will underpin the Group's growth going forward:

### **Delight the Mid-Market**

This strategy recognises that the mid-market continues to represent the largest and most sustainable financial opportunity for global growth and scale. The themes within this strategy are:

- Strengthen marketing and brand position. Win more customers and business through creating more desire for products and services, affinity for the brand and differentiated collections. Drive foot traffic, online traffic and enquiries.
- Build stronger team engagement. Improve our processes, tools and technology that allow teams to drive better customer outcomes, thereby increasing personal performance, productivity, income and engagement.
- Drive customer engagement. Ensuring that all customer channels, places of engagement and touch points are optimised to allow customers the best possible experience; where, when and how they choose to engage us. Also innovating with new merchandising approaches, including physical and digital, to deliver a world class and leading assortment of innovative products in the fashion space.
- Develop omni-channel capability. Continue to develop and integrate our channel capabilities to deliver a seamless customer experience and drive conversion rate and repeat purchase.
- Establish differentiated bridal and fashion brands. Within this strategy we are committed to ongoing development and honing of our proprietary bridal and fashion brands, supported by strong and relevant stories, to drive consumer preference and deliver incremental margin gains.

## **Expand our Foot Print**

This strategy focuses on building our global brand presence and profile through the expansion of our physical foot print internationally of stores and channels. The themes within this strategy are:

- Proving up the Michael Hill US model. To continue to refine the US model until we are confident we have a profitable model to expand in this market. The US still provides the Group the largest growth opportunity for the future.
- Grow the Emma & Roe business. To successfully transition the Emma & Roe business from trial mode to expansion mode, providing a complimentary business model to Michael Hill by engaging a new segment of jewellery consumer to drive market share growth, physical footprint and profitability.

## **Performance through People and Systems**

This strategy recognises the importance of building organisational capability to support the Group's strategic growth plan. The themes within this strategy are:

- Building a World-Class Team. Ongoing development of the Group's human resources across both Michael Hill and Emma & Roe businesses to provide a qualified talent pipeline to execute the retail model and grow the business. The focus will remain on building selling and leadership capabilities while ensuring key roles are adequately succession planned.
- Deliver Systems and Infrastructure to Support Growth. We will develop systems and infrastructure capability by investing in enabling technologies to support the Group's growth plan.

## **Drive Return on Investment**

This strategy recognises the importance of improved efficiency and a continued cost-control focus as the business scales. ROI will be driven through a focus on operational expenditure and continued tightening of capital control. The themes within this strategy are:

- Control operational costs. Increased focus on operational expenditures to lower Selling & General Administration expense as a percentage of sales, to drive profitability.
- Improve return on assets. To drive ROI through a stronger focus on capital expenditure and improved asset management.

## Outlook

We are committed to expanding the Michael Hill brand fully in all 3 proven markets of New Zealand, Australia and Canada. This will see up to 335 Michael Hill stores opened. We are also committed to continuing to test the US market with the vision of being able to open up to 400 stores in this market eventually. The Australian segment is reaching maturity in store numbers but now offers the potential for improved EBIT performance during its mature phase much in the same way the New Zealand business has in recent years. Canada still has several years of growth for the Michael Hill brand and will then also reach a maturity phase where EBIT performance can be honed and improved.

We have plans to expand the Emma & Roe brand in Australasia initially in coming years and expect to be able to open up to 200 stores in this market which is well known to us. We expect to expand the Emma & Roe brand into Canada in a few years' time once the Australasian growth is well underway and results are meeting expectations. Canada will offer the opportunity of up to another 100 Emma & Roe stores.

E-commerce and online revenue from both brands is expected to grow steadily in coming years as this channel grows in acceptance and our omni-channel strategy builds both in-store and online sales. Investment in online capability will be required to take full advantage of this opportunity.

Proprietary collection revenues will continue to grow as we move investment in inventory into these ranges. Collections offer a brand premium and are unique to Michael Hill and therefore help build and cement our Brand in our customer's minds.

The economic environments in which we operate have been relatively stable and in the absence of a material economic downturn in one or a number of our key markets, the business should be able to continue to grow and achieve profitability goals.

## Priorities for 2016-17

To increase same store sales by more than CPI in each market and deliver improved EBIT performance across the Group
To deliver a minimum return on opening shareholder funds of 15% and a return on opening assets of 9%
To open more than 20 new stores across the Group. Ten Michael Hill stores and twelve Emma & Roe stores
To continue to evolve the Emma & Roe model and produce positive EBIT from the stores opened for the full year
To continue to evolve our omni-channel capability and lift revenue from our online channel for both brands
To improve efficiency of our inventory and lift return on investment
To continue experimentation and testing of our US segment and bringing the majority of ten US stores to a positive EBIT position
Improved CRM capability allowing our sales force to communicate effectively with their customers and to foster leads secured in store or via the web site
To drive branded collection sales to 15% of total revenue

## Risk management

<b>Risk</b>	<b>Strategies and mitigation</b>
Insufficient leadership talent to meet growth plans	People supply chain planning is in place and talent development workshops are being deployed to fast track talent through the system to meet new store openings
Inadequate Business Continuity Planning and/or Disaster Recovery Strategies	We are committed to undertaking and updating the Group's Business Continuity Plan and Disaster Recovery processes. The Group is also investing heavily in new software and systems to protect the key business systems
Economic downturn in key markets	The Group's Balance Sheet is positioned conservatively so if there is a downturn in any of our key economies or another global event the Company is well placed to deal with it. Growth in Canada, in particular, will offer some mitigation by spreading reliance on our two traditional Australasian markets
Supply Chain disruption	We use a number of key suppliers to spread risk of a key supplier losing their plant and factory through natural disaster or other adverse event. Our product also turns quite slowly so we generally will have time to find alternative suppliers or time to resolve any issues with freighters or import/export authorities before material damage is caused to the business
Cost controls inadequate	Sophisticated cost monitoring systems exist that manage key costs in the business and we also dedicate key financial staff to the monitoring of cost variances to budget. A robust budget and forecast cycle is in place to plan and control overheads in the business

## Information on Directors

Information on directors of Michael Hill International Limited ACN 610 937 598 in office during the financial year and until the date of this report are set out below. Michael Hill International was incorporated on 24 February 2016. Gary Smith, Mike Parsell and Phil Taylor were appointed as the initial directors of the Company. As a result of the recent restructure of the Group, on 9 June 2016 Mike Parsell and Phil Taylor resigned as directors and Emma Hill (Chair), Sir Michael Hill, Rob Fyfe and Janine Allis were appointed as directors from that date.

Director	Experience	Responsibilities	Directors' Share Interests
<p>Emma Jane Hill (Chair) B.Com, M.B.A.</p>	<p>Emma was appointed a Director of the Company on 9 June 2016.</p> <p>Emma has over 30 years' experience with subsidiaries of the Company commencing on the shop floor in Whangarei, New Zealand. She held a number of management positions in the Australian company before successfully leading the expansion of the Group into Canada as Retail General Manager in 2002.</p> <p>Emma was appointed a director of Michael Hill New Zealand Limited on 22 February 2007.</p> <p>In 2011 Emma was appointed as Deputy Chair of the listed New Zealand entity and was appointed by the Board as Executive Chair of that company in December 2015.</p> <p>Emma holds a Bachelor of Commerce degree and an MBA from Bond University.</p>	<p>Chair Non-Executive Director Member Audit and Risk Management Committee Member People Development and Remuneration Committee</p>	<p>185,012,276 Ordinary Shares</p>
<p>Sir Richard Michael Hill K.N.Z.M.</p>	<p>Sir Michael was appointed a Director of the Company on 9 June 2016.</p> <p>Sir Michael is the founder of Michael Hill Jeweller and was appointed as a director of Michael Hill New Zealand Limited on 30 March 1990. He had 23 years of jewellery retailing experience before establishing Michael Hill in 1979 which then listed on the New Zealand Stock Exchange in 1987. Sir Michael's visionary leadership has been the foundation for the Company's successful international expansion. In 2008 he was recognised as Ernst &amp; Young's 'Entrepreneur of the Year' and in 2011 was appointed a Knight Companion of the New Zealand Order of Merit for services to business and the arts.</p> <p>Sir Michael was appointed Founder President of the New Zealand listed entity in 2015 in recognition</p>	<p>Non-Executive Director</p>	<p>164,330,600 Ordinary Shares</p>

Director	Experience	Responsibilities	Directors' Share Interests
	<p>of his special connection with Michael Hill for over 35 years. Sir Michael led the Group as Chairman from 1987 until December 2015.</p>		
<p>Gary Warwick Smith B.Com, F.C.A., F.A.I.C.D.</p>	<p>Gary was appointed a Director of the Company upon incorporation on 24 February 2016.</p> <p>Gary was appointed a Director of Michael Hill New Zealand on 2 November 2012.</p> <p>Gary has had extensive Director experience. He is Chairman of Flight Centre, one of Australia's top 100 public companies and is a member of their Audit and Remuneration sub-committee. He is a Chartered Accountant and a Fellow of the Australian Institute of Company Directors.</p> <p>He has extensive Director experience in many tourism and leisure industry companies in Australia. He is also a Director of Tourism Events Queensland and Chair of its Audit and Risk Committee. His former governance roles include being Chairman of the Queensland Tourism Industry Council and being a Director of Ecotourism Australia.</p>	<p>Non-Executive and Independent Director Chair Audit and Risk Management Committee Member People Development and Remuneration Committee</p>	<p>30,000 Ordinary Shares</p>
<p>Robert Ian Fyfe</p>	<p>Rob was appointed a Director of the Company on 9 June 2016.</p> <p>Rob was appointed a Director of Michael Hill New Zealand on 6 January 2014.</p> <p>Rob served as CEO of Air New Zealand between 2005 and 2012, a period that saw a resurgence in Air New Zealand to become one of the most recognised and awarded airlines in the world and one of the best performers in a tough industry. Prior to Air New Zealand, Rob had gained extensive general management experience in various retail businesses operating in New Zealand, Australia and Great Britain.</p>	<p>Non-Executive and Independent Director Chair People Development and Remuneration Committee Member Audit and Risk Management Committee</p>	<p>Nil</p>

Director	Experience	Responsibilities	Directors' Share Interests
	He is currently CEO and director of New Zealand merino wool clothing company Icebreaker and a director of Antarctica New Zealand.		
Janine Suzanne Allis	<p>Janine was appointed a Director of the Company on 9 June 2016.</p> <p>Janine is the Founder and Executive Director of Retail Zoo which currently owns three brands – Boost Juice, Salsa's Fresh Mex Grill and Cibo. The Retail Zoo network has over 500 stores in 13 countries.</p> <p>Janine's strong retail experience was obtained by creating Boost Juice Bars and turning it into an iconic Australian brand with over 95% awareness rate in the Australian market. Drive and passion has translated into over \$2 billion in global sales from inception and has earned Janine many accolades, including Telstra Businesswoman of the Year, Amex Franchisor of the Year and ARA Retailer of the Year, she was inducted into the Australian Business Women Hall of Fame as well as BRW listing Janine in the top 15 people who have changed the way we do business in the last 20 years.</p> <p>Janine now shares her knowledge with others, including through her role as a 'Shark', investor and mentor on Channel Ten's Shark Tank.</p>	Non-Executive and Independent Director	Nil
Michael Robin Parsell	<p>Mike was appointed a Director of the Company upon incorporation on 24 February 2016.</p> <p>Mike resigned as Director of the Company on 9 June 2016.</p> <p>Mike resigned from his position as Chief Executive Officer of the Michael Hill Group on 8 August 2016.</p>	Former Chief Executive Officer of the Michael Hill Group	6,789,264 Ordinary Shares 6,000,000 Options

<b>Director</b>	<b>Experience</b>	<b>Responsibilities</b>	<b>Directors' Share Interests</b>
Philip Roy Taylor A.C.A., A.C.I.M., A.I.M.M.	<p>Phil was appointed a Director of the Company upon incorporation on 24 February 2016.</p> <p>Phil resigned as Director of the Company on 9 June 2016.</p> <p>Phil is currently the Acting CEO and Chief Financial Officer of the Michael Hill Group.</p> <p>Phil joined Michael Hill International in New Zealand in 1987 and moved with the Company to Australia later that year as part of a start-up team in the role of Financial Controller before assuming the role of Chief Financial Officer of the Group in 2003. In August this year Phil was appointed Acting Chief Executive Officer. Over the past 30 years with the Company, Phil has worked closely with most functions and departments within the Company. He has been instrumental in the success of both the Australian business in its establishment years, and the wider Group since assuming the role of CFO in 2003. More specifically Phil oversaw a major restructuring of the Group in 2008 and more recently led the successful ASX listing project.</p>	Acting CEO and Chief Financial Officer of the Michael Hill Group	2,000,000 Ordinary Shares 2,250,000 Options

Information on directors of MHNZ, the former parent company, who are not Directors of the Australian listed entity, Michael Hill International, and set out above, in office during the financial year and until the date of this report are set out below:

<b>Director</b>	<b>Experience</b>	<b>Responsibilities</b>	<b>Directors Share Interests</b>
Ann Christine Lady Hill	<p>Lady Hill has been associated with the Michael Hill Group since its inception in 1979 and has been closely involved with the artistic direction of the Michael Hill Group's store design and interior layouts over the years.</p> <p>Lady Hill joined the Board of Michael Hill New Zealand Limited on 23 February 2001 and resigned on 29 June 2016.</p>	Non-Executive Director	164,330,600 Ordinary Shares

Director	Experience	Responsibilities	Directors Share Interests
Gary John Gwynne	<p>Gary has an extensive background in marketing, retailing and property development. He is currently a Director of Oyster Property Group, the operator of Dress Smart Factory Shopping Centres and Sheppard Industries.</p> <p>Gary joined the Board of Michael Hill New Zealand Limited on 19 February 1998 and resigned on 29 June 2016.</p>	Non-Executive Director	1,972,000 Ordinary Shares

## Company Secretary

The names and details of the Company Secretaries of Michael Hill International in office during the financial year and until the date of this report are set out below:

Philip Roy Taylor      Appointed 24 February 2016      Resigned 11 July 2016  
A.C.A., A.C.I.M., A.I.M.M.,

Mary-Anne Greaves      Appointed 11 July 2016  
LL.M., LL.B., ACIS, AGIA

## Directors' meetings

The number of meetings held throughout the past year is detailed below for both Michael Hill International and MHNZ.

The agenda for meetings is determined by the Chair in conjunction with the Chief Executive Officer. Any member of the Board may request the addition of an item to the agenda. Board papers are circulated to Directors a week in advance of meetings.

The following table sets out the Board meetings attended by Directors during the course of the financial year for Michael Hill International. This Company was incorporated on 24 February 2016. A number of directors were appointed on 9 June 2016 and therefore were only eligible to attend a certain number of board meetings as set out below.

	Board of Directors		
	Meetings Held	No of Meetings eligible to attend	Meetings Attended
E.J. Hill <sup>2</sup>	9	5	5
Sir Michael Hill <sup>2</sup>	9	4	4
G.W. Smith	9	9	9
R.I. Fyfe <sup>2</sup>	9	4	4
J.S. Allis <sup>2</sup>	9	4	3
M.R. Parsell <sup>1</sup>	9	4	4
P.R. Taylor <sup>1</sup>	9	4	4

<sup>1</sup> Resigned 9 June 2016

<sup>2</sup> Appointed 9 June 2016

The table below sets out the Board and sub-committee meetings of MHNZ attended by Directors during the course of the financial year.

	Board of Directors		Audit Sub-committee		People Development and Remuneration Sub-committee		Nominations Sub-committee	
	Meetings Held	Meetings Attended	Meetings Held	Meetings Attended	Meetings Held	Meetings Attended	Meetings Held	Meetings Attended
E.J.Hill	8	8	2	2	2	2	1	1
Sir Michael Hill <sup>2</sup>	8	8	-	-	-	-	-	-
A.C Hill <sup>2</sup>	8	8	-	-	-	-	-	-
G.W. Smith	8	8	2	2	2	2	-	-
R.I. Fyfe	8	8	2	2	2	2	1	1
G.J. Gwynne <sup>2</sup>	8	7	-	-	-	-	1	1
M.R. Parsell <sup>1</sup>	4	3	-	-	-	-	-	-

1 Resigned 4 December 2015 reappointed 29 June 2016

2 Resigned 29 June 2016

## Committee membership

As at the date of this report, Michael Hill International has an Audit and Risk Management Committee and a People Development and Remuneration Committee.

No meetings of these Committees were held during the financial year as the Company was only incorporated on 24 February 2016. Members of these committees of the Board are:

### Audit and Risk Management Committee

Gary Smith (c)

Emma Hill

Rob Fyfe

(c) designates chair of the committee

### People Development and Remuneration Committee

Rob Fyfe (c)

Emma Hill

Gary Smith

As a result of the recent restructure and as at the date of this report, MHNZ does not now have any committees of the Board. MHNZ previously had an Audit and Risk Management sub-committee, a People Development and Remuneration sub-committee and a Nominations sub-committee during the financial year.

Members acting on those Committees of the Board of MHNZ during the financial year were:

**Audit and Risk  
Management Sub-  
committee**

Gary Smith (c)  
Emma Hill  
Rob Fyfe

**People Development and  
Remuneration Sub-committee**

Rob Fyfe (c)  
Emma Hill  
Gary Smith

**Nominations Sub-committee**

Rob Fyfe (c)  
Emma Hill  
Gary Gwynne

(c) designates chair of the committee

## **Indemnification and insurance of directors and officers**

The Company's Constitution provides that it may indemnify any person who is, or has been, an officer of the Group, including the Directors, the Secretaries and other Executive Officers, against liabilities incurred whilst acting as such officers to the extent permitted by law. The Company has entered into a Deed of Indemnity, Insurance and Access with each of the Company's Directors. No Director or officer of the Company has received benefits under an indemnity from the Company during or since the end of the year.

The Company has paid a premium for insurance for officers of the Group. This insurance is against a liability for costs and expenses incurred by officers in defending civil or criminal proceedings involving them as such officers, with some exceptions. The contract of insurance prohibits disclosure of the nature of the liability insured against and the amount of the premium paid.

## **Indemnification of auditors**

To the extent permitted by law, the Company has agreed to indemnify its auditor, Ernst & Young, as part of the terms of its audit engagement agreement against claims by third parties arising from the audit (for an unspecified amount). No payment has been made to indemnify Ernst & Young during or since the financial year.

## **Environmental regulations**

The Group has determined that no particular or significant environmental regulations apply to it.

## **Share options**

### **Unissued shares**

As at the date of this report, there were 12,550,000 unissued ordinary shares under options (12,550,000 at the reporting date). Option holders do not have any right, by virtue of the option, to participate in any share issue of the Company or any related body corporate.

### **Shares issued as a result of the exercise of options**

During the financial year, no employees and executives have exercised options to acquire fully paid ordinary shares in the Company.

## Non-audit services

The following non-audit services were provided by the entity's auditor, Ernst & Young Australia. The Directors are satisfied that the provision of non-audit services is compatible with the general standard of independence for auditors imposed by the *Corporations Act 2001*. The nature and scope of each type of non-audit service provided means that auditor independence was not compromised.

Ernst & Young Australia received or are due to receive the following amounts for the provision of non-audit services:

	\$'000
Advisory services	50
	50

## Auditor's independence declaration

A copy of the auditor's independence declaration, as required under section 37C of the *Corporations Act 2001*, is set out on page 32.

## Rounding

The amounts contained in the financial report have been rounded to the nearest \$1,000 (where rounding is applicable) where noted (\$000) under the option available to the Company under *ASIC Corporations (Rounding in Financial/Directors' Reports) Instrument 2016/191*.

The Company is an entity to which the legislative instrument applies.

# REMUNERATION REPORT - AUDITED

## Remuneration framework

### Principles of compensation

Remuneration is referred to as compensation throughout this report.

Key management personnel have authority and responsibility for planning, directing and controlling the activities of the Group, including directors of the Company and other executives. Key management personnel comprise the directors of the Company and senior executives for the Group.

For the 2015-16 financial year, it was determined that the KMP of Michael Hill International were:

Chief Executive Officer (CEO) – Mike Parsell (resigned 8 August 2016)

Chief Financial Officer (CFO) – Phil Taylor

Group Executive Merchandising (GEM) – Galina Hirtzel

Chief Marketing Officer (CMO) – Anna Shaw

Compensation levels for key management personnel of the Group are competitively set to attract and retain appropriately qualified and experienced directors and executives. The remuneration committee obtains independent advice on the appropriateness of compensation packages of the Group given trends in comparative companies both locally and internationally, and the objectives of the Group's compensation strategy.

The compensation structures explained below are designed to attract suitably qualified candidates, reward the achievement of strategic objectives, and achieve the broader outcome of creation of value for shareholders. The compensation structures take into account:

- The capability and experience of the key management personnel
- The key management personnel's ability to control the relevant segment/s' performance
- The Group's performance including:
  - The Group's earnings
  - The amount of incentives within each key management person's compensation
  - Delivering constant returns on shareholder wealth.

The Remuneration framework consists of:

- 1 Total Fixed Remuneration (TFR) - includes fixed cash remuneration, any car allowance and superannuation component.
- 2 Short term incentive (STI) – on target performance is determined at a percentage of TFR, which is then converted to a share of the return on assets (ROA) surplus above a minimum hurdle rate which would deliver the targeted STI in the 2015-16 financial year.

- a. In the 2015-16 financial year the STI payment was derived solely from the ROA calculation.
  - b. Commencing in the 2016-17 financial year, 30% of the STI will be at risk and assessed based on achievement of individual performance goals which will be agreed at the commencement of each financial year.
- 3 Long term incentive (LTI) – commencing in the 2016-17 financial year a regular allocation of performance rights will be introduced, the value of the issue will be determined as a percentage of the STI earned for the preceding year.

The structure of the benefits for key management personnel for the 2016-17 financial year is as follows:

<b>CEO</b>	<p>TFR set at 90% of market median</p> <p>On target STI set at 75% of TFR</p> <p>LTI commencing in 2016-17 set at 30% of STI achieved in the preceding year</p>
<b>CFO</b>	<p>TFR set at 90% of market median</p> <p>On target STI set at 70% of TFR (higher than market to recognise the broader scope of the current CFO/CEO role)</p> <p>LTI commencing in 2016-17 set at 30% of STI achieved in the preceding year</p>
<b>GEM</b>	<p>TFR set at 90% of market median</p> <p>On target STI set at 35% of TFR</p> <p>LTI commencing in 2016-17 set at 30% of STI achieved in the preceding year</p>
<b>CMO*</b>	<p>TFR set at 90% of market median</p> <p>On target STI set at 35% of TFR</p>

\*As the current CMO commenced in June 2016, there is no LTI component in the 2016-17 financial year. This benefit will commence in the 2017-18 financial year.

### **Fixed compensation**

Fixed compensation consists of base compensation (which is calculated on a total cost basis and includes any FBT charges related to employee benefits including motor vehicles), as well as leave entitlements and employer contributions to superannuation funds.

Compensation levels are reviewed annually by the People Development and Remuneration Committee through a process that considers individual, segment and overall performance of the Group. In addition, external consultants provide analysis and advice to ensure the directors' and senior executives' compensation is competitive in the market place. A senior executive's compensation is also reviewed on promotion.

### **Performance linked compensation**

Performance linked compensation includes both short-term and long-term incentives, and is designed to reward senior executives for meeting or exceeding their financial and personal objectives. The short-term incentive (STI) is an 'at risk' bonus provided in the form of cash, while the long-term incentive (LTI) is provided as rights over ordinary shares of the Company

under the rules of the Executive Incentive Plan. The board did not exercise any discretion on the payment of bonuses and rights as the plans provide for no such discretion.

### **Short-term incentive bonus**

The performance framework through which each senior executive's performance will be measured is through the use of agreed Personal Performance Plan's (PPP). These PPP's include relevant business KPIs as well as other goals and metrics which are assessed and measured. These plans set out the at-risk component of the STI as prescribed in the remuneration policy.

The process is designed to provide a basis for an ongoing performance management system, along with integrated reporting for visibility and transparency of progress by each senior executive. The framework aligns the senior executive KPIs to delivery of the strategic plan, divisional business plans along with critical operational measures and leadership measures of each role.

The following points outline the framework:

- The policy and framework cascades from the CEO to Group Executives with the intention in 2016-17 to cascade relevant KPIs further down through all levels of management. This aims to ensure key aspects of the Group's strategic plan, divisional business plans, along with critical drivers of business outcomes are clearly identified at each level of leadership. This includes personal development plans, and leadership performance.
- The metrics are updated monthly (on a YTD basis) and along with normal operational metrics, provides the basis for monthly work in progress (WIP) reviews. These metrics are cascaded through weekly WIP meetings with direct reports, which continue to track agreed progress and actions required to improve performance until the next rolled up monthly update.
- The framework consists of four sets of high level measures each representing 25% of the 'at-risk' component of the STI. Within each of the four groups there are between 3 and 5 KPIs that are tracked and managed.
- A subset of these KPI's, approximately 2 to 3, are agreed as critical success factors to meeting the overall performance objectives of the senior executive. This subset is referenced when assessing achievement of their STI.
- This framework provides for the future design and implementation of a scheme to add an incremental STI for management currently outside of this scheme, following approval by the People Development and Remuneration Committee. Under such a scheme full performance may trigger an additional 10% over and above senior executive's fixed remuneration.

The Group PPP and KPI frameworks are structured into four major groups.

- 1 **Financial Performance** – this focuses on high level financial results. Metrics measured at Group or divisional level - to budget or policy i.e. sales, GP%, expenses, EBIT, ROA (opening) balance sheet metrics, cash flow etc.
- 2 **Operational Performance** – this focuses on operational drivers, adherence to policy, key drivers of sales, margins, expense control, efficiency, drivers of ROA, and critical business measures etc.

- 3 **Business Growth** – this focuses on key drivers of business growth particularly expansion of business channels, delivery of new initiatives, physical foot print expansion, customer satisfaction, improving customer experience.
- 4 **Leadership Performance** – this focuses on our leadership capability, work force capability, training and development, staff engagement, productivity, and talent development and succession planning etc.

#### **Long-term incentive**

Options are issued under the Executive Incentive Plan (EIP) (made in accordance with thresholds set in plans approved by shareholders at the Company's AGM), and it provides for senior executives to receive options over ordinary shares for no consideration. The ability to exercise the options is conditional on continuing employment with the Company.

No further options will be issued to senior executives other than the tranches already in place for four senior executives including one KMP. The Company intends to introduce a new Incentive Plan commencing for the 2016-17 financial year which will be submitted to shareholders for approval at the Company's next Annual General Meeting.

#### **Short-term and long-term incentive structure**

The People Development and Remuneration Committee considers that the above performance-linked compensation structure is generating the desired outcome. The evidence for this is:

- The performance-linked element of the structure appears to be appropriate as all of the senior executives achieved their performance targets last year,
- This in turn led to strong growth in profits; and
- High levels of retention among senior executives.

The tenure of the KMP, as at the date of this report, are as follows:

<b>KMP</b>	<b>No of years of service</b>
Mike Parsell, former CEO	34 years
Phil Taylor, Acting CEO and CFO	29 years
Galina Hirtzel, GEM	24 years
Anna Shaw, CMO	2 months

Currently, the performance linked component of compensation comprises approximately forty-one percent of total payments to senior executives.

In the current year the Group exceeded its overall Board targets, with all major segments meeting budgeted results.

#### **Consequences of performance on shareholder wealth**

In considering the Group's performance and benefits for shareholder wealth, the People Development and Remuneration Committee have regard to the following indices in respect of the current financial year and the previous four financial years.

	<b>2016</b> (‘000)	<b>2015</b> (‘000)	<b>2014</b> (‘000)	<b>2013</b> (‘000)	<b>2012</b> (‘000)
EBIT	47,058	42,061	42,151	40,259	35,412
Net profit attributable to owners of the Company	19,577	27,754	25,041	32,099	28,210
Dividends paid	17,490	23,176	22,336	18,482	15,021
Share price as at 30 June	NZ\$1.14	NZ\$1.06	NZ\$1.24	NZ\$1.31	NZ\$0.98
Return on capital employed	10.5%	15.0%	14.1%	19.7%	19.4%

Profit is considered the primary financial performance target in setting the STI. Profit amounts for 2012 to 2016 have been prepared in accordance with the requirements of the Corporations Act 2001, Australian Accounting Standards and other authoritative pronouncements of the Australian Accounting Standards Board. This also complies with International Financial Reporting Standards (IFRS) as issued by the International Accounting Standards Board.

The overall level of compensation takes into account the performance of the Group over a number of years.

#### **Other benefits**

Key management personnel do not receive additional benefits such as non-cash benefits, as part of the terms and conditions of their appointment.

#### **Loans to Key Management Personnel**

The Company does not provide loans to KMP's or other senior executives.

#### **Service contracts**

It is the Group's policy that service contracts for senior executives, excluding the chief executive officer, are unlimited in term but capable of termination on six months' notice and that the Group retains the right to terminate the contract immediately, by making payment equal to six months' pay in lieu of notice.

The Group has entered into service contracts with each senior executive, excluding the chief executive officer, that are capable of termination on six months' notice. The Group retains the right to terminate a contract immediately by making payment equal to six months' pay in lieu of notice. The senior executives are also entitled to receive on termination of employment their statutory entitlements of accrued annual and long service leave, together with any superannuation benefits.

The service contract outlines the components of compensation but does not prescribe how compensation levels are modified year to year. The remuneration committee reviews compensation levels each year to take into account cost-of-living changes, any change in the scope of the role performed by the senior executive and any changes required to meet the principles of compensation policy.

Mr Mike Parsell, former chief executive officer, had a contract of employment with the Group. Mr Parsell commenced his employment with the Group in 1981 and in 2004 was engaged to act as CEO of the Group. The contract specifies the duties and obligations to be fulfilled by the chief executive officer. The CEO remuneration package is revised by the Board annually. Either party may terminate the contract of employment in writing by giving 1 year's notice, or payment in lieu of notice (or as otherwise agreed by both parties). On termination (other than by the Company for cause) the CEO contract provides for the payment of an exit package to the CEO of up to 2 years remuneration based on an increasing scale commensurate with the CEO's length of employment in the Group at the time of termination.

The services contract terminated on 8 August 2016 upon the resignation of Mr Mike Parsell.

The Company will be seeking shareholder support at the upcoming Annual General Meeting of the Company for a termination package at a level substantially below that specified in Mr Parsell's employment contract of 2004.

### **Services from remuneration consultants**

The People Development and Remuneration Committee engaged Mercer Consulting (Australia) Pty Ltd ('Mercer') as remuneration consultant to the board to review the amount and elements of the key management personnel remuneration and provide recommendations in relation thereto.

In addition to the remuneration recommendations, Mercer provided the following other services to the Company throughout the year:

- Summarised the key terms and conditions of each contract for services to enable the remuneration committee to assess whether the terms and conditions are consistent across different parts of the business;
- Advice in relation to the embodiment of risk in the assessment of performance for the vesting of remuneration awards; and
- Advice on structuring of various management roles and market trends.

Mercer was paid \$38,000 for the remuneration recommendations in respect of reviewing the amount and elements of remuneration.

Mercer was paid \$22,112 in total for all other services.

The engagement of Mercer by the People Development and Remuneration Committee was based on a documented set of protocols that would be followed by Mercer, members of the People Development and Remuneration Committee and members of the key management personnel for the way in which remuneration recommendations would be developed by Mercer and provided to the board.

The protocols included the prohibition of Mercer providing advice or recommendations to key management personnel before the advice or recommendations were given to members of the People Development and Remuneration Committee and not unless Mercer had approval to do so from members of the People Development and Remuneration Committee.

These arrangements were implemented to ensure that Mercer would be able to carry out its work, including information capture and the formation of its recommendations, free from undue

influence by members of the key management personnel about whom the recommendations may relate.

The board undertook its own enquiries and review of the processes and procedures followed by Mercer during the course of its assignment and is satisfied that its remuneration recommendations were made free from undue influence.

These enquiries included arrangements under which Mercer was required to provide the board with a summary of the way in which it carried out its work, details of its interaction with key management personnel in relation to the assignment and other services, and respond to questioning by members of the board after the completion of the assignment.

PWC assisted the Company in relation to taxation aspects of the remuneration recommendations.

### **Non-executive directors**

Total compensation for all non-executive directors, last voted upon by shareholders, is not to exceed \$840,000 per annum and is set based on advice from external advisors with reference to fees paid to other non-executive directors of comparable companies. Directors' base fees are presently up to \$95,000 per annum. Where a Director serves as Chair on a Board Committee they are entitled to an extra payment of \$20,000 per annum.

The Chairperson receives up to twice the base fee. Non-executive directors do not receive performance-related compensation. Directors' fees cover all main board activities and membership of committees.

Non-executive directors are not provided with retirement benefits apart from statutory superannuation.

### **Directors' and executive officers' remuneration**

Details of the nature and amount of each major element of remuneration of each Director of the Company, and other key management personnel of the consolidated entity and includes Michael Hill International and MHNZ are:

## Directors' and executive officers' remuneration

*In dollars*

		Short-term				Post-employment	Other long term	Termination benefits	Share-based payments	Total	Proportion of remuneration performance related	Value of options as proportion of remuneration
		Salary & fees	STI cash bonus	Non-monetary benefits (motor vehicle)	Total	Super-annuation benefits			Options and rights			
		\$	\$(A)	\$	\$	\$	\$		\$(B)	\$	\$	%
<b>Directors</b>												
<b>Non-executive Directors</b>												
Sir Richard Michael Hill	2016	136,735	-	30,000	166,735	-	-	-	-	166,735	-	-
	2015	148,915	-	27,922	176,837	-	-	-	-	176,837	-	-
Emma Jane Hill	2016	162,845	-	-	162,845	-	-	-	-	162,845	-	-
	2015	117,597	-	-	117,597	-	-	-	-	117,597	-	-
Ann Christine Lady Hill (resigned 29 June 2016)	2016	95,000	-	-	95,000	-	-	-	-	95,000	-	-
	2015	88,419	-	-	88,419	-	-	-	-	88,419	-	-
Gary Warwick Smith	2016	105,023	-	-	105,023	9,977	-	-	-	115,000	-	-
	2015	95,652	-	-	95,652	8,848	-	-	-	104,500	-	-
Robert Ian Fyfe	2016	115,000	-	-	115,000	-	-	-	-	115,000	-	-
	2015	94,370	-	-	94,370	-	-	-	-	94,370	-	-
Gary Gwynne (resigned 29 June 2016)	2016	95,000	-	-	95,000	-	-	-	-	95,000	-	-
	2015	88,419	-	-	88,419	-	-	-	-	88,419	-	-
Janine Suzanne Allis (appointed 9 June 2016)	2016	-	-	-	-	-	-	-	-	-	-	-
	2015	-	-	-	-	-	-	-	-	-	-	-
Total Directors' remuneration	2016	709,603	-	30,000	739,603	9,977	-	-	-	749,580	-	-
	2015	633,371	-	27,922	661,293	8,848	-	-	-	670,141	-	-

## Directors' and executive officers' remuneration (continued)

<i>In dollars</i>		Short-term				Post-employment	Other long term		Share-based payments			
		Salary & fees	STI cash bonus	Non-monetary benefits (motor vehicle)	Total	Super-annuation benefits		Termination benefits	Options and rights	Total	Proportion of remuneration performance related	Value of options as proportion of remuneration
		\$	\$(A)	\$	\$	\$	\$	\$	\$(B)	\$	%	%
<b>Executives</b>												
Mike Parsell, CEO	2016	824,000	794,481	-	1,618,481	35,000	-	-	-	1,653,481	48.04%	-
	2015	771,845	358,965	-	1,130,810	25,000	-	-	-	1,155,810	31.05%	-
Phil Taylor, CFO	2016	399,000	374,642	-	773,642	35,000	-	-	-	808,642	46.33%	-
	2015	301,256	143,586	-	444,842	25,000	-	-	-	469,842	30.56%	-
Galina Hirtzel, GEM	2016	250,000	133,184	-	383,184	30,000	-	-	32,826	446,010	29.86%	7.36%
	2015	215,549	44,871	-	260,420	24,089	-	-	37,340	321,849	13.94%	11.60%
Anna Shaw, CMO (appointed 20 June 2016)	2016	5,288	-	-	5,288	502	-	-	-	5,790	-	-
	2015	-	-	-	-	-	-	-	-	-	-	-
<b>Former</b>												
J Talcott, CMO (resigned 26 January 2016)	2016	201,821	63,232	-	265,053	25,180	-	-	-	290,233	21.79%	-
	2015	286,596	81,250	-	367,846	25,000	-	-	-	392,846	20.68%	-
Total executives' remuneration	2016	1,680,109	1,365,539	-	3,045,648	125,682	-	-	32,826	3,204,156	42.68%	1.02%
	2015	1,575,246	628,672	-	2,203,918	99,089	-	-	37,340	2,340,347	26.86%	1.60%
Total Directors' and executives' remuneration	2016	2,389,712	1,365,539	30,000	3,785,251	135,659	-	-	32,826	3,953,736	34.54%	0.83%
	2015	2,208,617	628,672	27,922	2,865,211	107,937	-	-	37,340	3,010,488	20.88%	1.24%

### Notes in relation to the table of Directors' and executive officers' remuneration

- A The short-term incentive bonus is for performance during the respective financial year using the criteria set out on pages 20 and 21. The amount was finally determined on 18 August 2016 after performance reviews were completed and approved by the People Development and Remuneration Committee.
- B The fair value of the options is calculated at the date of grant using the Binomial option-pricing model and allocated to each reporting period evenly over the period from grant date to vesting date. The value disclosed is the portion of the fair value of the options recognised as an expense in each reporting period.

### Details of performance related remuneration

Details of the Group's policy in relation to the proportion of remuneration that is performance related is discussed on page 20.

### Analysis of bonuses included in remuneration

Details of the vesting profile of the short-term incentive cash bonuses awarded as remuneration to each director of the Company, and other key management personnel are detailed below.

	Short-term incentive bonus		
	Included in remuneration \$(A)	% vested in year	% forfeited in year (B)
<b>Directors</b>	-	-	-
<b>Executives</b>			
Mike Parsell	794,481	100%	-
Phil Taylor	374,642	100%	-
Galina Hirtzel	133,184	100%	-
Anna Shaw	-	-	-

A Amounts included in remuneration for the financial year represent the amount related to the financial year based on achievement of personal goals and satisfaction of specified performance criteria. The People Development and Remuneration Committee approved these amounts on 18 August 2016.

B The amounts forfeited are due to the performance or service criteria not being met in relation to the current financial year.

### Equity instruments

All options refer to options over ordinary shares of Michael Hill International Limited, which are exercisable on a one-for-one basis under the Executive Incentive Plan.

### Options and rights over equity instruments granted as compensation

Details on options over ordinary shares in the Company that were granted as compensation to each key management person during the reporting period and details on options that vested during the reporting period are as follows:

	Number of options granted during 2016	Grant date	Fair value at grant date per option (\$)	Exercise price per option (\$)	Expiry date	Number of options vested during 2016
<b>Directors</b>	-	-	-	-	-	-
<b>Executives</b>						
Mike Parsell	-	-	-	-	-	-
Phil Taylor	-	-	-	-	-	-
Galina Hirtzel	100,000	22/01/16	NZ16.2¢	NZ\$1.14	30/09/25	-
Anna Shaw	-	-	-	-	-	-

All options expire on the earlier of their expiry date or within 3 months of termination of the individual's employment. The options are exercisable 5 years from grant date. The options are condition on continuing employment service. For options granted in the current year, the earliest exercise date is 30/09/20.

### **Modification of terms of equity-settled share-based payment transactions**

No terms of equity-settled share-based payment transactions (including options and rights granted as compensation to a key management person) have been altered or modified by the issuing entity during the reporting period or the prior period. The exercise price of any future option grants will be set using the same method, with reference to the Australian Securities Exchange. Upon exercise of any option previously granted, the NZ\$ exercise price will be converted to AUD\$ referenced to the Reserve Bank of Australia foreign exchange rate.

### **Exercise of options granted as compensation**

During the reporting period, no shares were issued on the exercise of options previously granted as compensation.

There are no amounts unpaid on the shares issued as a result of the exercise of the options in the 2016 financial year.

### **Analysis of options and rights over equity instruments granted as compensation**

Details of vesting profiles of the options granted as remuneration to each key management person of the Group are detailed below.

	Options granted			%	%	Financial	Financial
	Number	Date	Exercise price NZ\$	vested in Year	forfeited In year (A)	years in which option vests	years in which option exercisable
<b>Directors</b>	-	-	-	-	-	-	-
<b>Executives</b>							
Mike Parsell	2,000,000	Nov 2007	\$1.25	100%	-	07/08	2013-2017
	400,000	Nov 2009	\$0.94	100%	-	08/09	2014-2018
	400,000	Sep 2010	\$0.88	100%	-	09/10	2015-2019
	400,000	Sep 2011	\$1.16	100%	-	10/11	2016-2020
	400,000	Sep 2012	\$1.41	100%	-	11/12	2017-2021
	400,000	Sep 2013	\$1.82	100%	-	12/13	2018-2022
	2,000,000	Dec 2013	\$1.82	100%	-	12/13	2018-2022
<b>Total</b>	<b>6,000,000</b>						

	Options granted			%	%	Financial	Financial
	Number	Date	Exercise price NZ\$	vested in Year	forfeited In year (A)	years in which option vests	years in which option exercisable
Phil Taylor	750,000	Nov 2007	\$1.25	100%	-	07/08	2013-2017
	150,000	Nov 2009	\$0.94	100%	-	08/09	2014-2018
	150,000	Sep 2010	\$0.88	100%	-	09/10	2015-2019
	150,000	Sep 2011	\$1.16	100%	-	10/11	2016-2020
	150,000	Sep 2012	\$1.41	100%	-	11/12	2017-2021
	150,000	Sep 2013	\$1.82	100%	-	12/13	2018-2022
	750,000	Dec 2013	\$1.82	100%	-	12/13	2018-2022
Total	2,250,000						
Galina Hirtzel	500,000	Dec 2013	\$1.82	100%	-	2014-2019	2020-2024
	100,000	Sep 2014	\$1.63	100%	-	2015-2020	2021-2025
	100,000	Sep 2015	\$1.14	100%	-	2016-2021	2022-2026
	100,000	Sep 2016	n/a	-	-	2017-2022	2023-2027
	100,000	Sep 2017	n/a	-	-	2018-2023	2024-2028
	100,000	Sep 2018	n/a	-	-	2019-2024	2025-2029
Total	1,000,000						
Anna Shaw	-	-	-	-	-	-	-

A The percentage forfeited in the year represents the reduction from the maximum number of options available to vest due to performance criteria not being achieved.

**Analysis of movements in options**

The movement during the reporting period, by value, of options over ordinary shares in the Company held by each key management person is details below.

	<b>Value of options granted in year</b>	<b>Value of options exercised in year</b>	<b>Number of options lapsed in year</b>
Mike Parsell	-	-	-
Phil Taylor	-	-	-
Galina Hirtzel	NZ\$16,200	-	-
Anna Shaw	-	-	-

The value of options granted in the year is the fair value of the options calculated at grant date using the Binomial option-pricing model. The total value of the options granted is included in the table above. This amount is allocated to remuneration over the vesting period (i.e. in years 1 to 5).

The value of options exercised during the year is calculated as the market price of shares of the Company as at close of trading on the date the options were exercised after deducting the price paid to exercise the option.

The number of the options that lapsed during the year was nil.

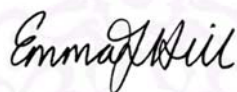
**Payments to persons before taking office**

No payments were made to any person as consideration for the person agreeing to hold office.

**Related Party Transactions**

As part of the reorganisation, Michael Hill International Limited acquired 100% of the share capital in Durante Holdings Pty Ltd (a company controlled by interests associated with the Hill Family which held 52.89% of the shares on issue in MHNZ). Durante Holdings Pty Ltd has been consolidated as a fully controlled subsidiary in accordance with the accounting policy described in note 2(b).

This Directors' Report is made out in accordance with a resolution of the Directors.



**Emma Hill**  
Chair

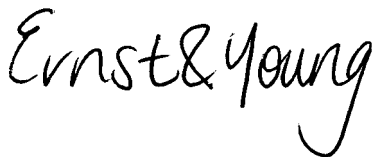
Dated at Brisbane this 18<sup>th</sup> day of August 2016.

## Auditor's Independence Declaration to the Michael Hill International Limited

As lead auditor for the audit of Michael Hill International Limited for the financial year ended 30 June 2016, I declare to the best of my knowledge and belief, there have been:

- a) no contraventions of the auditor independence requirements of the *Corporations Act 2001* in relation to the audit; and
- b) no contraventions of any applicable code of professional conduct in relation to the audit.

This declaration is in respect of Michael Hill International Limited and the entities it controlled during the financial year.



Ernst & Young



Alison de Groot  
Partner  
Brisbane  
18 August 2016

**Michael Hill International Limited**  
**Statement of comprehensive income**  
**For the year ended 30 June 2016**

	Notes	2016 \$'000	2015 \$'000
<b>Revenue from continuing operations</b>	6	<b>551,127</b>	503,370
Other income	7	<b>555</b>	2,259
Cost of goods sold		<b>(197,302)</b>	(181,135)
Employee benefits expense		<b>(144,724)</b>	(130,937)
Occupancy costs	8	<b>(54,238)</b>	(50,640)
Marketing expenses		<b>(30,158)</b>	(31,906)
Selling expenses		<b>(24,621)</b>	(22,748)
Depreciation and amortisation expense	8	<b>(18,760)</b>	(15,738)
Loss on disposal of property, plant and equipment	8	<b>(328)</b>	(204)
Other expenses		<b>(33,910)</b>	(30,211)
Finance costs	8	<b>(6,107)</b>	(4,708)
<b>Profit before income tax</b>		<b>41,534</b>	37,402
Income tax expense	9	<b>(21,957)</b>	(9,648)
<b>Profit for the year</b>		<b><u>19,577</u></b>	<u>27,754</u>
<b>Other comprehensive income</b>			
<i>Items that may be reclassified subsequently to profit or loss</i>			
Cash flow hedges		<b>(116)</b>	(491)
Currency translation differences arising during the year		<b>(3,443)</b>	2,115
<b>Other comprehensive income for the year, net of tax</b>		<b><u>(3,559)</u></b>	<u>1,624</u>
<b>Total comprehensive income for the year</b>		<b><u>16,018</u></b>	<u>29,378</u>
<b>Total comprehensive income for the year is attributable to:</b>			
<b>Owners of Michael Hill International Limited</b>		<b><u>16,018</u></b>	<u>29,378</u>

		Cents	Cents
<b>Earnings per share attributable to the ordinary equity holders of the Company during the year, attributable to continuing operations:</b>			
Basic earnings per share	30	<b>5.11</b>	7.24
Diluted earnings per share	30	<b>5.09</b>	7.22

*The above statement of comprehensive income should be read in conjunction with the accompanying notes.*

**Michael Hill International Limited**  
**Statement of financial position**  
**As at 30 June 2016**

	Notes	2016 \$'000	2015 \$'000
<b>ASSETS</b>			
<b>Current assets</b>			
Cash and cash equivalents	10	8,853	6,797
Trade and other receivables	11	26,263	20,575
Inventories	12	199,961	182,232
Current tax receivables	13	-	11,376
Other current assets	14	5,035	7,427
Total current assets		<u>240,112</u>	<u>228,407</u>
<b>Non-current assets</b>			
Trade and other receivables	15	325	422
Property, plant and equipment	16	71,933	64,845
Deferred tax assets	17	64,074	48,381
Intangible assets	18	5,561	6,491
Other non-current assets	19	2,192	2,467
Total non-current assets		<u>144,085</u>	<u>122,606</u>
<b>Total assets</b>		<u><b>384,197</b></u>	<u><b>351,013</b></u>
<b>LIABILITIES</b>			
<b>Current liabilities</b>			
Trade and other payables	20	46,377	43,739
Current tax liabilities	21	25,022	-
Provisions	22	4,902	4,624
Deferred revenue	23	24,685	21,516
Total current liabilities		<u>100,986</u>	<u>69,879</u>
<b>Non-current liabilities</b>			
Borrowings	24	40,887	45,116
Provisions	25	5,198	4,254
Deferred revenue	26	50,725	44,143
Total non-current liabilities		<u>96,810</u>	<u>93,513</u>
<b>Total liabilities</b>		<u><b>197,796</b></u>	<u><b>163,392</b></u>
<b>Net assets</b>		<u><b>186,401</b></u>	<u><b>187,621</b></u>
<b>EQUITY</b>			
Contributed equity	27	3,767	3,760
Reserves	28	4,131	7,445
Retained profits	28	178,503	176,416
<b>Total equity</b>		<u><b>186,401</b></u>	<u><b>187,621</b></u>

*The above statement of financial position should be read in conjunction with the accompanying notes.*

**Michael Hill International Limited**  
**Statement of changes in equity**  
**For the year ended 30 June 2016**

Attributable to members of Michael Hill International Limited						
Notes	Contributed equity \$'000	Options reserve \$'000	Foreign currency translation reserve \$'000	Cash flow hedge reserve \$'000	Retained profits \$'000	Total equity \$'000
<b>Balance at 1 July 2014</b>	3,651	1,918	4,155	(277)	171,838	181,285
Profit for the year	-	-	-	-	27,754	27,754
Currency translation differences	-	-	2,115	-	-	2,115
Currency forward contracts	-	-	-	77	-	77
Interest rate swaps	-	-	-	(568)	-	(568)
Total comprehensive income	-	-	2,115	(491)	27,754	29,378
<b>Transactions with owners in their capacity as owners:</b>						
Dividends paid 29	-	-	-	-	(23,176)	(23,176)
Employee shares issued 33(b)	109	-	-	-	-	109
Option expense through share based payments reserve 33(c)	-	162	-	-	-	162
Forfeiture of issued options 33(c)	-	(137)	-	-	-	(137)
	<u>109</u>	<u>25</u>	<u>-</u>	<u>-</u>	<u>(23,176)</u>	<u>(23,042)</u>
<b>Balance at 30 June 2015</b>	<u>3,760</u>	<u>1,943</u>	<u>6,270</u>	<u>(768)</u>	<u>176,416</u>	<u>187,621</u>
Profit for the year	-	-	-	-	19,577	19,577
Currency translation differences	-	-	(3,443)	-	-	(3,443)
Currency forward contracts	-	-	-	360	-	360
Interest rate swaps	-	-	-	(476)	-	(476)
Total comprehensive income	-	-	(3,443)	(116)	19,577	16,018
<b>Transactions with owners in their capacity as owners:</b>						
Dividends paid 29	-	-	-	-	(17,490)	(17,490)
Cancellation of treasury stock 33(b)	7	-	-	-	-	7
Option expense through share based payments reserve 33(c)	-	132	-	-	-	132
Forfeiture of issued options - reversal 33(c)	-	113	-	-	-	113
	<u>7</u>	<u>245</u>	<u>-</u>	<u>-</u>	<u>(17,490)</u>	<u>(17,238)</u>
<b>Balance at 30 June 2016</b>	<u>3,767</u>	<u>2,188</u>	<u>2,827</u>	<u>(884)</u>	<u>178,503</u>	<u>186,401</u>

*The above statement of changes in equity should be read in conjunction with the accompanying notes.*

**Michael Hill International Limited**  
**Cash flow statement**  
**For the year ended 30 June 2016**

	Notes	2016 \$'000	2015 \$'000
<b>Cash flows from operating activities</b>			
Receipts from customers (inclusive of GST and sales taxes)		617,024	566,544
Payments to suppliers and employees (inclusive of GST and sales taxes)		<u>(521,904)</u>	<u>(462,663)</u>
		<u>95,120</u>	<u>103,881</u>
Interest received		583	49
Other revenue		555	477
Interest paid		(5,950)	(4,626)
Income tax paid		(2,257)	(9,105)
Net GST and sales taxes paid		<u>(40,257)</u>	<u>(36,110)</u>
<b>Net cash inflow / (outflow) from operating activities</b>	34	<u>47,794</u>	<u>54,566</u>
<b>Cash flows from investing activities</b>			
Proceeds from sale of property, plant and equipment		213	283
Payments for property, plant and equipment		(22,949)	(20,190)
Payments for intangible assets		<u>(1,600)</u>	<u>(1,925)</u>
<b>Net cash inflow / (outflow) from investing activities</b>		<u>(24,336)</u>	<u>(21,832)</u>
<b>Cash flows from financing activities</b>			
Proceeds from borrowings		124,500	68,507
Repayments of borrowings		(128,500)	(79,500)
Proceeds from sale of treasury stock		-	98
Dividends paid to Company's shareholders	29	<u>(17,490)</u>	<u>(23,176)</u>
<b>Net cash inflow / (outflow) from financing activities</b>		<u>(21,490)</u>	<u>(34,071)</u>
<b>Net increase / (decrease) in cash and cash equivalents</b>		1,968	(1,337)
Cash and cash equivalents at the beginning of the year		6,797	8,109
Effects of exchange rate changes on cash and cash equivalents		<u>88</u>	<u>25</u>
<b>Cash and cash equivalents at the end of the financial year</b>	10	<u>8,853</u>	<u>6,797</u>

*The above cash flow statement should be read in conjunction with the accompanying notes.*

## **1 Corporate information**

The consolidated financial statements of Michael Hill International Limited and its subsidiaries (collectively, the Group) for the year ended 30 June 2016 were authorised for issue in accordance with a resolution of the directors on 18 August 2016. Michael Hill International Limited (the Company or Parent) is a for profit company limited by shares incorporated in Australia. The Company listed on the Australian Securities Exchange ('ASX') on 7 July 2016 as its primary listing, and maintains a secondary listing on the New Zealand Stock Exchange ('NZX').

Until 23 June 2016, Michael Hill New Zealand Limited (formerly known as Michael Hill International Limited) was the parent of the Group. Until that time, Michael Hill New Zealand Limited was a public company registered under the Companies Act 1993 and remains domiciled in New Zealand. Michael Hill New Zealand Limited had its primary listing on the New Zealand Stock Exchange. The listing was suspended on 22 June 2016 as part of the scheme of arrangement to move the primary listing to the ASX.

Michael Hill International Limited obtained control of the former parent, Michael Hill New Zealand Limited (formerly known as Michael Hill International Limited) on 23 June 2016. The reason for obtaining control was the move to the ASX. Michael Hill International Limited issued equity in exchange for the equity of Michael Hill New Zealand Limited. The assets and liabilities of the new group and the original group were the same immediately before and after the reorganisation. The owners of the original parent before the reorganisation had the same absolute and relative interests in the new assets of the original group and the new group immediately before and after the reorganisation. As it was a common control transaction, it is outside the scope of AASB 3 Business Combinations. The transaction is accounted for as a group reorganisation by applying the principles of reverse acquisition accounting. The Group financial statements represent a continuation of the original group.

As part of the reorganisation, Michael Hill International Limited acquired 100% of the share capital in Durante Holdings Pty Ltd (a company controlled by interests associated with the Hill Family which held 52.89% of the shares on issue in Michael Hill New Zealand Limited). Durante Holdings Pty Ltd has been consolidated as a fully controlled subsidiary in accordance with the accounting policy described in note 2(b).

## **2 Summary of significant accounting policies**

### **(a) Basis of preparation**

The financial report is a general purpose financial report, which has been prepared in accordance with the requirements of the Corporations Act 2001, Australian Accounting Standards and other authoritative pronouncements of the Australian Accounting Standards Board.

Prior to the change in parent, as described in note 1, the financial statements were prepared in accordance with New Zealand Generally Accepted Account Practice (NZ GAAP). They complied with New Zealand equivalents to International Financial Reporting Standards (NZ IFRS), and other applicable New Zealand Financial Reporting Standards, as appropriate for profit-oriented entities. They also complied with the requirements of the Financial Reporting Act 2013, Financial Markets Conduct Act 2013 and the Companies Act 1993. There has been no significant changes in the statement of comprehensive income or statement of financial position as a result of the change.

The financial report is presented in Australian dollars and all values are rounded to the nearest thousand (\$'000), except when otherwise indicated.

The financial statements have been prepared on a historical cost basis, except for derivative financial instruments that have been measured at fair value. The consolidated financial statements provide comparative information in respect of the previous period.

### **Compliance with IFRS**

The financial report also complies with International Financial Reporting Standards (IFRS) as issued by the International Accounting Standards Board.

### **(b) Principles of consolidation**

#### **Subsidiaries**

Subsidiaries are all those entities (including special purpose entities) over which the Group has control. Control is achieved when the Group is exposed, or has rights, to variable returns from its involvement with the investee and has the ability to affect those returns through its power over the investee.

## 2 Summary of significant accounting policies (continued)

Subsidiaries are fully consolidated from the date on which control is transferred to the Group. They are de-consolidated from the date that control ceases.

As described in note 1, the Group inserted a new parent during the year. As it was a common control transaction, it is outside the scope of AASB 3 Business Combinations. The transaction is accounted for as a group reorganisation by applying the principles of reverse acquisition accounting. The Group financial statements represent a continuation of the original group.

The acquisition method of accounting is used to account for the acquisition of subsidiaries by the Group. The cost of an acquisition is measured as the fair value of the assets given, equity instruments issued and liabilities incurred or assumed at the date of exchange. Identifiable assets acquired and liabilities and contingent liabilities assumed in a business combination are measured initially at their fair values at the acquisition date, irrespective of the extent of any non-controlling interest. The excess of the cost of acquisition over the fair value of the Group's share of the identifiable net assets acquired is recorded as goodwill. If the cost of acquisition is less than the fair value of the net assets of the subsidiary acquired, the difference is recognised directly in the statement of comprehensive income. Investments in subsidiaries are accounted for at cost in the individual financial statements of Michael Hill International Limited.

Intercompany transactions, balances and unrealised gains on transactions between Group companies are eliminated on consolidation. Unrealised losses are also eliminated unless the transaction provides evidence of the impairment of the asset transferred. Accounting policies of subsidiaries have been changed where necessary to ensure consistency with the policies adopted by the Group.

Michael Hill Trustee Company Limited was formed to administer the Group's Employee Share Scheme. Shares held by the Trust are disclosed as treasury shares and deducted from contributed equity. All treasury shares on hand at 24 June 2016 were cancelled as part of the move to the Australian Securities Exchange.

### (c) Segment reporting

Operating segments are reported in a manner consistent with the internal reporting provided to the chief operating decision makers. The chief operating decision makers, who are responsible for allocating resources and assessing performance of the operating segments, have been identified as the Executive Management team.

### (d) Foreign currency translation

#### (i) Functional and presentation currency

Items included in the financial statements of each of the Group's entities are measured using the currency of the primary economic environment in which the entity operates ('the functional currency'). The Group financial statements are presented in Australian dollars, which is the Group's functional and presentation currency.

#### (ii) Transactions and balances

Foreign currency transactions are translated into the functional currency using the exchange rates prevailing at the dates of the transactions. Foreign exchange gains and losses resulting from the settlement of such transactions and from the translation at year-end exchange rates of monetary assets and liabilities denominated in foreign currencies are recognised in the income statement, except when deferred in equity as qualifying cash flow hedges and qualifying net investment hedges or are attributable to part of the net investment in a foreign operation.

#### (iii) Group companies

The results and financial position of all the Group entities (none of which have the currency of a hyperinflationary economy) that have a functional currency different from the presentation currency are translated into the presentation currency as follows:

- assets and liabilities for each statement of financial position presented are translated at the closing rate at the date of the statement of financial position;
- income and expenses for each profit and loss component of the statement of comprehensive income are translated at average exchange rates, unless this is not a reasonable approximation of the cumulative effect of the rates prevailing on the transaction dates, in which case income and expenses are translated at the dates of the transactions; and
- all resulting exchange differences are recognised as other comprehensive income.

## 2 Summary of significant accounting policies (continued)

On consolidation, exchange differences arising from the translation of any net investment in foreign entities, and of borrowings and other financial instruments designated as hedges of such investments, are recognised in other comprehensive income. When a foreign operation is sold or any borrowings forming part of the net investment are repaid, a proportionate share of such exchange differences is reclassified to profit or loss, as part of the gain or loss on sale where applicable.

Goodwill and fair value adjustments arising on the acquisition of foreign entities are treated as assets and liabilities of the foreign entities and translated at the closing rate.

### (e) Revenue recognition

#### (i) Sales of goods - retail

Sales of goods are recognised when a Group entity delivers a product to the customer. Retail sales are usually by cash, payment plan or credit card. The recorded revenue is the gross amount of sale (excluding taxes), including any fees payable for the transaction.

It is the Group's policy to sell its products to the end customer with a right of return. Accumulated experience is used to estimate and provide for such returns at the time of sale.

#### (ii) Rendering of services - deferred service revenue

The Group offers a professional care plan ('PCP') product which is considered deferred revenue until such time that service has been provided. A PCP is a plan under which the Group offers future services to customers based on the type of plan purchased. The Group subsequently recognises the income in revenue in the statement of comprehensive income once these services are performed. An estimate is used as a basis to establish the amount of service revenue to recognise in the statement of comprehensive income.

#### (iii) Rendering of services - repairs

Sales of services for repair work performed is recognised in the accounting period in which the services are rendered.

#### (iv) Interest revenue from in-house customer finance program

Interest revenue is recognised on the in-house customer finance program when consideration is deferred. It is calculated as the difference between the nominal cash and cash equivalents received from customers and the discounted cashflows, on both interest and non-interest bearing products. Interest revenue is brought to account over the term of the finance agreement, and the rate used for non-interest bearing products is in line with current, comparable market rates.

#### (v) Interest income

Interest income is recognised using the effective interest method.

### (f) Taxes

#### Current income tax

The income tax expense or revenue for the period is the tax payable on the current period's taxable income based on the applicable income tax rate for each jurisdiction adjusted by changes in deferred tax assets and liabilities attributable to temporary differences and to unused tax losses.

The current income tax charge is calculated on the basis of the tax laws enacted or substantively enacted at the end of the reporting period in the countries where the Group operates and generates taxable income. Management periodically evaluates positions taken in tax returns with respect to situations in which applicable tax regulation is subject to interpretation. It establishes provisions where appropriate on the basis of amounts expected to be paid to the tax authorities.

Current tax is recognised in profit or loss, except to the extent that it relates to items recognised in other comprehensive income or directly in equity. In this case, the tax is also recognised in other comprehensive income or directly in equity, respectively.

#### Deferred income tax

Deferred income tax is provided in full, using the liability method, on temporary differences between the tax bases of assets and liabilities and their carrying amounts in the consolidated financial statements.

## 2 Summary of significant accounting policies (continued)

Deferred tax assets are recognised for deductible temporary differences and unused tax losses only if it is probable that future taxable amounts will be available to utilise those temporary differences and losses.

Deferred tax liabilities and assets are not recognised for temporary differences between the carrying amount and tax bases of investments in controlled entities where the Parent Entity is able to control the timing of the reversal of the temporary differences and it is probable that the differences will not reverse in the foreseeable future.

Deferred tax is recognised in profit or loss, except to the extent that it relates to items recognised in other comprehensive income or directly in equity. In this case, the tax is also recognised in other comprehensive income or directly in equity, respectively.

Deferred tax assets and liabilities are offset when there is a legally enforceable right to offset current tax assets and liabilities and when the deferred tax balances relate to the same taxation authority. Current tax assets and liabilities are offset where the entity has a legally enforceable right to offset and intends either to settle on a net basis, or to realise the asset and settle the liability simultaneously.

### *Tax consolidation group*

Michael Hill International Limited and its wholly-owned Australian controlled entities formed a tax consolidation group on 29 June 2016. As a consequence, one income tax return is completed for the Australian tax group and is treated for income tax purposes as one taxpayer.

Formerly, Michael Hill Jeweller (Australia) Pty Ltd and all wholly-owned Australian controlled entities formed the Australian tax consolidation group who completed one income tax return and was treated for income tax purposes as one taxpayer.

The tax balances have been attributed for reporting purposes to each of the entities on the basis of their individual results. Amounts of tax due to and receivable from the Australian Taxation Office are made by Michael Hill International Limited as nominated member of the Australian tax consolidated group. The current tax balance for the Australian tax group has been allocated between the members based on each entity's current tax movement for the period. Where tax losses are incurred by Australian tax group members, these are offset within the group without payment.

As a result of the formation of the Australian tax consolidated group, the general income tax consolidation provisions apply relating to the setting of the tax cost base of the assets of the subsidiary members of the tax consolidated group. This includes resetting of the tax cost base of the assets of the Australian group including intellectual property, depreciating assets and trading stock. The resetting of the tax bases resulted in recognition of a deferred tax asset amounting to \$19,438,000.

### **(g) Goods and Services Tax (GST)**

Revenues, expenses and assets are recognised net of the amount of GST, except:

- When the GST incurred on a sale or purchase of assets or services is not payable to or recoverable from the taxation authority, in which case the GST is recognised as part of the revenue or the expense item or as part of the cost of acquisition of the asset, as applicable; or
- When receivables and payables are stated with the amount of GST included.

The net amount of GST recoverable from, or payable to, the taxation authority is included as part of receivables or payables in the statement of financial position. Commitments and contingencies are disclosed net of the amount of GST recoverable from, or payable to, the taxation authority.

Cash flows are included in the statement of cash flows on a gross basis and the GST component of cashflows arising from investing and financing activities, which is recoverable from, or payable to, the taxation authority is classified as part of operating cash flows.

## 2 Summary of significant accounting policies (continued)

### (h) Leases

Leases of property, plant and equipment where the Group, as lessee, has substantially all the risks and rewards of ownership are classified as finance leases. Finance leases are capitalised at the lease's inception at the fair value of the leased property or, if lower, the present value of the minimum lease payments. The corresponding rental obligations, net of finance charges, are included in other short term and long term payables. Each lease payment is allocated between the liability and finance charges. The finance cost is charged to the statement of comprehensive income over the lease period so as to produce a constant periodic rate of interest on the remaining balance of the liability for each period. The property, plant and equipment acquired under finance leases is depreciated over the shorter of the asset's useful life and the lease term.

Leases in which a significant portion of the risks and rewards of ownership are retained by the lessor are classified as operating leases. Payments made under operating leases (net of any incentives received from the lessor) are charged to the comprehensive income statement on a straight-line basis over the period of the lease.

### (i) Impairment of assets

At each annual reporting date (or more frequently if events or changes in circumstances indicate that they might be impaired), the Group assesses whether there is any indication that an asset may be impaired. Where such an indication is identified, the Group estimates the recoverable amount of the asset and recognises an impairment loss where the recoverable amount is less than the carrying amount. The recoverable amount is the higher of an asset's fair value less costs to sell and value-in-use.

In addition, at least annually, goodwill and intangible assets with indefinite useful lives are tested for impairment by comparing their estimated recoverable amounts with their carrying amounts. Where the recoverable amount exceeds the carrying amount of an asset, an impairment loss is recognised.

The pre-tax discount rates used in determining the recoverable amount ranged between 10.3% and 13.3% (2015: 10.2% and 11.9%), depending on the geographical segment of the assets.

### (j) Cash and cash equivalents

Cash and cash equivalents includes cash on hand, deposits held at call with financial institutions, other short-term and highly liquid investments with original maturities of three months or less that are readily convertible to known amounts of cash and which are subject to an insignificant risk of changes in value. Bank overdrafts are shown within borrowings in current liabilities on the balance sheet.

### (k) Trade and other receivables

Trade receivables are amounts due from customers for goods sold or services rendered in the ordinary course of business. If collection is expected in one year or less (or in the normal operating cycle of the business if longer), they are classified as current assets. If not, they are presented as non-current assets.

Collectibility of trade receivables is reviewed on an ongoing basis. Debts which are known to be uncollectible are written off. A provision for impaired receivables is established when there is objective evidence that the Group will not be able to collect all amounts due according to the original terms of receivables. The amount of the provision is the difference between the asset's carrying amount and the present value of estimated future cash flows, discounted at the original effective interest rate. Cash flows relating to short-term receivables are not discounted if the effect of discounting is immaterial. The amount of the provision is recognised in the statement of comprehensive income.

### (l) Deferred expenditure

Direct and incremental bonuses associated with the sale of professional care plans are deferred and amortised in proportion to the professional care plan revenue recognised. Management reviews trends in current and estimated future services provided under the plan to assess whether changes are required to the cost recognition rates used.

## 2 Summary of significant accounting policies (continued)

### (m) Inventories

Raw materials and finished goods are stated at the lower of cost and net realisable value. Cost comprises direct materials, direct labour and an appropriate proportion of variable and fixed overhead expenditure, the latter being allocated on the basis of normal operating capacity. Costs are assigned to individual items of inventory on the basis of weighted average costs. Net realisable value is the estimated selling price in the ordinary course of business less the estimated costs of completion and the estimated costs necessary to make the sale.

### (n) Investments and other financial assets

The Group classifies its investments and other financial assets into the following categories: financial assets at fair value through profit or loss, loans and receivables, held-to-maturity investments and available-for-sale financial assets. The classification depends on the purpose for which the investments were acquired. Management determines the classification of its investments at initial recognition.

#### (i) *Financial assets at fair value through profit or loss*

Financial assets at fair value through profit or loss are financial assets held for trading. A financial asset is classified in this category if acquired principally for the purpose of selling in the short term. Derivatives are classified as held for trading unless they are designated as hedges. Assets in this category are classified as current assets.

#### (ii) *Loans and receivables*

Loans and receivables are non derivative financial assets with fixed or determinable payments that are not quoted in an active market. They are included in current assets, except for those with maturities greater than 12 months after the reporting date which are classified as non-current assets. Loans and receivables are included in trade and other receivables in the balance sheet.

The Group assesses at the end of each reporting period whether there is objective evidence that a financial asset or a group of financial assets is impaired.

### (o) Derivatives

Derivatives are initially recognised at fair value on the date a derivative contract is entered into and are subsequently remeasured to their fair value at the end of each reporting period. The method of recognising the resulting gain or loss depends on whether the derivative is designated as a hedging instrument, and if so, the nature of the item being hedged. The Group designates certain derivatives as either: (1) hedges of the fair value of recognised assets or liabilities or a firm commitment (fair value hedge); or (2) hedges of highly probable forecast transactions (cash flow hedges).

The Group documents at the inception of the transaction the relationship between hedging instruments and hedged items, as well as its risk management objective and strategy for undertaking various hedge transactions. The Group also documents its assessment, both at hedge inception and on an ongoing basis, of whether the derivatives that are used in hedging transactions have been and will continue to be highly effective in offsetting changes in fair values or cash flows of hedged items.

The fair values of various derivative financial instruments used for hedging purposes are:

#### (i) *Fair value hedge*

Changes in the fair value of derivatives that are designated and qualify as fair value hedges are recorded in the income statement, together with any changes in the fair value of the hedged asset or liability that are attributable to the hedged risk.

#### (ii) *Cash flow hedge*

The effective portion of changes in the fair value of derivatives that are designated and qualify as cash flow hedges are recognised in other comprehensive income and accumulated in reserves in equity. The gain or loss relating to the ineffective portion is recognised immediately in the profit or loss within other income or other expenses.

Amounts accumulated in equity are reclassified to profit or loss in the periods when the hedged item will affect profit or loss. However, when the forecast transaction that is hedged results in the recognition of a non-financial asset or a non-financial liability, the gains and losses previously deferred in equity are transferred from equity and included in the initial measurement of the cost of the asset.

## **2 Summary of significant accounting policies (continued)**

When a hedging instrument expires or is sold or terminated, or when a hedge no longer meets the criteria for hedge accounting, any cumulative gain or loss existing in equity at that time remains in equity and is recognised when the forecast transaction is ultimately recognised in the income statement. When a forecast transaction is no longer expected to occur, the cumulative gain or loss that was reported in equity is immediately reclassified to profit or loss.

### **(p) Fair value estimation**

The fair value of financial assets and financial liabilities must be estimated for recognition and measurement or for disclosure purposes.

The fair value of forward exchange contracts is determined using forward exchange market rates at the balance sheet date.

The carrying value less impairment provision of trade receivables and payables are assumed to approximate their fair values due to their short-term nature. The fair value of financial liabilities for disclosure purposes is estimated by discounting the future contractual cash flows at the current market interest rate that is available to the Group for similar financial instruments.

### **(q) Property, plant and equipment**

All property, plant and equipment is stated at historical cost less depreciation. Historical cost includes expenditure that is directly attributable to the acquisition of the items.

Subsequent costs are included in the asset's carrying amount or recognised as a separate asset, as appropriate, only when it is probable that future economic benefits associated with the item will flow to the Group and the cost of the item can be measured reliably. All costs are charged to the profit and loss component of the statement of comprehensive income during the financial period in which they are incurred.

Depreciation on other assets is calculated using the straight line method to allocate their cost or revalued amounts, net of their residual values, over their estimated useful lives, as follows:

- Plant and equipment	5 - 6 years
- Motor vehicles	3 - 5 years
- Fixtures and fittings	6 - 10 years
- Leasehold improvements	6 - 10 years
- Display material	6 - 10 years

The assets' residual values and useful lives are reviewed, and adjusted if appropriate, at each balance sheet date.

An asset's carrying amount is written down immediately to its recoverable amount if the asset's carrying amount is greater than its estimated recoverable amount (note 2(i)).

Gains and losses on disposals are determined by comparing proceeds with the carrying amount. These are included in the comprehensive income statement.

### **(r) Intangible assets**

#### **Computer software**

Acquired computer software licences are capitalised on the basis of the costs incurred to acquire and bring to use the specific software. These costs are amortised over their estimated useful lives (three to five years).

Costs associated with developing or maintaining computer software programs are recognised as an expense as incurred. Costs that are directly associated with the production of identifiable and unique software products controlled by the Group, and that will probably generate economic benefits exceeding costs beyond one year, are recognised as intangible assets. Direct costs include the software development employee costs and an appropriate portion of relevant overheads.

Computer software development costs recognised as assets are amortised over their estimated useful lives (not exceeding five years).

## **2 Summary of significant accounting policies (continued)**

### **(s) Trade and other payables**

These amounts represent liabilities for goods and services provided to the Group prior to the end of the financial year which are unpaid. The amounts are unsecured and are usually paid within 30 days of recognition.

Deferred revenue represents lease incentives for entering new lease agreements and revenue from PCPs. The accounting policy used to recognise the revenue is detailed in note 2(e)(ii).

### **(t) Borrowings**

Borrowings are initially recognised at fair value, net of transaction costs incurred. Borrowings are subsequently measured at amortised cost. Any difference between the proceeds (net of transaction costs) and the redemption amount is recognised in the income statement over the period of the borrowings using the effective interest method.

Borrowings are removed from the balance sheet when the obligation specified in the contract is discharged, cancelled or expired. The difference between the carrying amount of a financial liability that has been extinguished or transferred to another party and the consideration paid, including any non-cash assets transferred or liabilities assumed, is recognised in other income or finance costs.

Borrowings are classified as current liabilities when repayment is due within twelve months.

### **(u) Provisions**

Provisions for legal claims, sales returns, lifetime battery replacement and make good obligations are recognised when the Group has a present legal or constructive obligation as a result of past events; it is probable that an outflow of resources will be required to settle the obligation; and the amount has been reliably estimated. Provisions are not recognised for future operating losses.

Where there are a number of similar obligations, the likelihood that an outflow will be required in settlement is determined by considering the class of obligations as a whole. A provision is recognised even if the likelihood of an outflow with respect to any one item included in the same class of obligations may be small.

Provisions are measured at the present value of management's best estimate of the expenditures required to settle the present obligation at the balance sheet date. The discount rate used to determine the present value is a pre-tax rate that reflects current market assessments of the time value of money and the risks specific to the liability. The increase in the provision due to passage of time is recognised as interest expense.

### **(v) Employee benefits**

#### **(i) Short-term obligations**

Liabilities for wages and salaries, including non-monetary benefits and annual leave expected to be settled within 12 months after the end of the period in which the employees render the related service are recognised in respect of employees' services up to the end of the reporting period and are measured at the amounts expected to be paid when the liabilities are settled. All short-term employee benefit obligations are presented as payables.

#### **(ii) Other long-term employee benefit obligations**

The liability for long service leave and annual leave which is not expected to be settled within 12 months after the end of the period in which the employees render the related service is recognised in the provision for employee benefits and measured as the present value of expected future payments to be made in respect of services provided by employees up to the reporting period using the projected unit credit method. Consideration is given to expected future wage and salary levels, experience of employee departures and periods of service. Expected future payments are discounted using market yields at the reporting period on corporate bonds with terms to maturity and currency that match, as closely as possible, the estimated future cash outflows.

#### **(iii) Retirement benefit obligations**

All Australian and Canadian employees of the Group are entitled to benefits on retirement, disability or death from the Group's defined contribution superannuation plans. The defined contribution superannuation plans receive fixed contributions from Group companies and the Group's legal or constructive obligation is limited to these contributions.

## 2 Summary of significant accounting policies (continued)

Contributions to the defined contribution funds are recognised as an expense as they become payable. Prepaid contributions are recognised as an asset to the extent that a cash refund or a reduction in the future payments is available.

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

Share-based compensation benefits are provided to employees via the Michael Hill International Limited Employee Share Scheme and from time to time options are issued to Executives of Michael Hill International Limited in accordance with the Company's constitution. The Board of Directors pass a resolution approving the issue of the options. The fair value of options granted is recognised as an employee benefit expense with a corresponding increase in equity.

The fair value is measured at grant date and recognised over the period during which the employees become unconditionally entitled to the options. The fair value at grant date for options issued during 2016 were independently determined using a Binomial option pricing model, which is an iterative model for options that can be exercised at times prior to expiry. The model takes into account the grant date, exercise price, the vesting and performance criteria, the impact of dilution, the non-tradeable nature of the option, the share price at grant date and expected price volatility of the underlying share, the expected dividend yield and the risk-free interest rate for the term of the option. It also assumes the options will be exercised at the mid-point of the exercise period.

The fair value of the options granted is adjusted to reflect market vesting conditions, but excludes the impact of any non-market vesting conditions (for example, profitability and sales growth targets). Non-market vesting conditions are included in the assumptions about the number of options that are expected to become exercisable. At each balance sheet date, the entity revises its estimate of the number of options that are expected to become exercisable. The employee benefit expense recognised each period takes into account the most recent estimate. The impact of the revision to original estimates, if any, is recognised in the statement of comprehensive income with a corresponding adjustment to equity.

Upon the exercise of options, the balance of the share-based payments reserve relating to those options is transferred to share capital. Proceeds received net of any directly attributable transaction costs are credited to share capital when the options are exercised. The ten percent discount on the market value of shares issued to employees under the Employee Share Scheme is recognised as an employee benefits expense when the shares are issued.

### (v) *Profit-sharing and bonus plans*

The Group recognises a liability and an expense for bonuses and profit-sharing based on a formula that takes into consideration the profit attributable to the Company's shareholders after certain adjustments. The Group recognises a provision where contractually obliged or where there is a past practice that has created a constructive obligation.

### (w) **Contributed equity**

Ordinary shares are classified as equity.

Incremental costs directly attributable to the issue of new shares or options are shown in equity as a deduction, net of tax, from the proceeds. Incremental costs directly attributable to the issue of new shares or options for the acquisition of a business are included in the cost of the acquisition as part of the purchase consideration.

If the entity reacquires its own equity instruments, e.g. as the result of a share buy-back, those instruments are deducted from equity until the associated shares are cancelled, reissued or disposed of. No gain or loss is recognised in the profit or loss and the consideration paid including any directly attributable incremental costs (net of income taxes) is recognised directly in equity.

### (x) **Dividends**

Provision is made for the amount of any dividends declared, being appropriately authorised and no longer at the discretion of the entity, on or before the end of the reporting period but not distributed at the end of the reporting period.

### (y) **Earnings per share**

#### (i) *Basic earnings per share*

Basic earnings per share is calculated by dividing the profit attributable to equity holders of the Company, excluding any costs of servicing equity other than ordinary shares, by the weighted average number of ordinary shares outstanding during the financial year, adjusted for bonus elements in ordinary shares issued during the year.

## 2 Summary of significant accounting policies (continued)

### (ii) *Diluted earnings per share*

Diluted earnings per share adjusts the figures used in the determination of basic earnings per share to take into account the after income tax effect of interest and other financing costs associated with dilutive potential ordinary shares and the weighted average number of shares assumed to have been issued for no consideration in relation to dilutive potential ordinary shares.

### (z) **Standards, amendments and interpretations to existing standards that are not yet effective**

Certain new standards, amendments and interpretations of existing standards have been published that are not mandatory for 30 June 2016 reporting periods.

- **AASB 9 Financial Instruments: Classification and measurement** (effective 1 January 2018). AASB 9 addresses the classification, measurement and derecognition of financial assets and financial liabilities. The standard is not applicable until 1 January 2018 but is available for early adoption. The Group has not yet assessed the potential impact of this change.
- **AASB 15 Revenue from Contracts with Customers** (effective 1 January 2018). AASB 15 deals with revenue recognition and establishes principles for reporting useful information to users of financial statements about the nature, amount, timing and uncertainty of revenue and cash flows arising from an entity's contracts with customers. Revenue is recognised when a customer obtains control of a good or service and thus has the ability to direct the use and obtain the benefits from the good or service. AASB 15 supersedes:
  - (a) AASB 111 Construction Contracts ;
  - (b) AASB 118 Revenue ;
  - (c) Interpretation 13 Customer Loyalty Programmes ;
  - (d) Interpretation 15 Agreements for the Construction of Real Estate;
  - (e) Interpretation 18 Transfers of Assets from Customers ;
  - (f) Interpretation 131 Revenue - Barter Transactions Involving Advertising Services; and
  - (g) Interpretation 1042 Subscriber acquisition costs in the Telecommunications Industry.

The core principle of AASB 15 is that an entity recognises revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services.

The standard is not applicable until 1 January 2018 but is available for early adoption. The Group has not yet assessed the potential impact of this change.

- **AASB 16 Leases** (effective 1 January 2019). AASB 16 addresses the recognition and measurement of assets and liabilities for all leases with a term of more than 12 months, unless they are of low value. It also contains the disclosure requirements for lessees and lessors. AASB 16 supersedes:
  - (a) AASB 117 Leases;
  - (b) Interpretation 4 Determining whether an Arrangement contains Lease;
  - (c) SIC-15 Operating Leases - Incentives; and
  - (d) SEC - 27 Evaluating the Substance of Transactions involving the Legal Form of a Lease.

The standard is not applicable until 1 January 2019 but is available for early adoption provided the new revenue standard, AASB 15 Revenue from Contracts with Customers, has been applied or is applied at the same date as AASB 16. The Group has not yet assessed the potential impact of this change.

### 3 Financial risk management

The Group's activities expose it to a variety of financial risks: market risk (including currency risk, interest rate risk and price risk), credit risk and liquidity risk. The Group's overall risk management program focuses on the unpredictability of financial markets and seeks to minimise potential adverse effects on the financial performance of the Group. The Group uses derivative financial instruments such as foreign exchange contracts and interest rate swaps to hedge certain risk exposures. Derivatives are exclusively used for hedging purposes, i.e. not as trading or other speculative instruments. The Group uses different methods to measure different types of risk to which it is exposed. These methods include sensitivity analysis in the case of interest rate and foreign exchange risks and aging analysis for credit risk.

The Board of Directors are responsible for risk management. The Group's overall risk management program includes a focus on financial risk including the unpredictability of financial markets and foreign exchange risk.

The policies are implemented by the central finance function that undertakes regular reviews to enable prompt identification of financial risks so that appropriate actions may be taken.

#### (a) Market risk

##### (i) Foreign exchange risk

Foreign exchange risk arises from future commercial transactions and recognised assets and liabilities that are denominated in a currency that is not the entity's functional currency and net investments in foreign operations.

The Group operates internationally and is exposed to foreign exchange risk arising from various currency exposures. Where it considers appropriate, the Group enters into forward foreign exchange contracts to buy specified amounts of various foreign currencies in the future at a pre-determined exchange rate.

Foreign exchange forward contracts measured through Other comprehensive income are designated as hedging instruments in cash flow hedges of forecast purchases in USD. These forecast transactions are highly probable.

The cash flow hedges of the expected future purchases were assessed to be highly effective and a net unrealised gain of \$360,000 (2015: \$77,000 gain) is included in Other comprehensive income. Fair value gain adjustments are included in Trade and other receivables. Fair value loss adjustments are included in Trade and other payables.

#### Forward exchange contracts - cash flow hedges

The cash flows are expected to occur at various dates up to six months from the balance date. At balance date, the details of outstanding contracts are:

	Sell Australian Dollars		Average Exchange Rate	
	2016	2015	2016	2015
	US\$'000	US\$'000		
<b>Buy US Dollars</b>				
Maturity 0 - 3 months	11,000	2,810	0.7608	0.7800
Maturity 3 - 6 months	4,000	-	0.7459	-
	<u>15,000</u>	<u>2,810</u>		

Amounts disclosed above represent currency sold, measured at the contracted rate.

The Group's exposure to foreign currency risk at the reporting date was as follows:

	30 June 2016			30 June 2015		
	USD	NZD	CAD	USD	NZD	CAD
	\$'000	\$'000	\$'000	\$'000	\$'000	\$'000
Cash and cash equivalents	11	37	30	30	80	106
Trade receivables	2,967	-	10	1,392	-	-
Trade payables	867	3	60	2,590	7	102

#### Group sensitivity

The Group's principal foreign currency exposures arise from trade payables and receivables outstanding at year end.

### 3 Financial risk management (continued)

Based on the USD trade payables due for payment at 30 June 2016, had the Australian dollar weakened/strengthened by 10% against the USD with all other variables held constant, the Group's equity for the year would have been \$130,000 lower / \$107,000 higher (2015: \$377,000 lower / \$308,000 higher).

Most trade payables are repaid within 30 days so there is minimal equity impact arising from foreign currency exposures.

Based on the USD receivables at 30 June 2016, had the Australian dollar weakened/strengthened by 10% against the USD with all other variables held constant, the Group's equity for the year would have been \$446,000 higher / \$365,000 lower (2015: \$203,000 higher / \$166,000 lower).

The Group does not hedge either economic exposure or the translation exposure arising from the profits, assets and liabilities of New Zealand, Canada and United States. The effect on the FX translation reserve is contained in the statement of changes in equity.

#### (ii) Cash flow and fair value interest rate risk

The Group's main interest rate risk arises from long-term borrowings and cash. Borrowings issued at variable rates expose the Group to cash flow interest rate risk. Borrowings issued at fixed rates expose the Group to fair value interest rate risk. Group policy is to maintain fixed interest cover of between 50% and 100% of core debt up to 12 months, between 50% and 75% of core debt between 1 and 3 years, and between 25% and 50% of core debt between 3 and 5 years.

To manage variable interest rate borrowings risk, the Group enters into interest rate swaps in which the Group agrees to exchange, at specified intervals, the difference between fixed and variable rate interest amounts calculated by reference to an agreed-upon notional principal amount.

As at the reporting date, the Group had the following borrowings outstanding:

	30 June 2016		30 June 2015	
	Weighted average interest rate %	Balance \$'000	Weighted average interest rate %	Balance \$'000
Variable rate fully drawn down advance facility	<u>2.64 %</u>	<u>40,887</u>	<u>2.84 %</u>	<u>45,116</u>

An analysis by maturity and a summary of the terms and conditions is in note 24.

In order to reduce the variability of the future cash flows in relation to the interest bearing loans, the Group has entered into Australian dollar interest rate swap contracts under which it has a right to receive interest at variable rates and to pay interest at fixed rates. Swaps in place cover approximately 85.6% (2015: 55.4%) of the variable rate principal outstanding.

The interest rate swaps are designated as cash flow hedging instruments. Changes in the interest paid on the variable rate fully drawn down advance facility are measured at fair value through Other comprehensive income.

The cash flow hedges were assessed to be highly effective and a net realised loss of \$476,000 (2015: \$568,000) is included in Other comprehensive income. Fair value gain adjustments are included in Trade and other receivables. Fair value loss adjustments are included in Trade and other payables.

### 3 Financial risk management (continued)

The notional principal amounts and period of expiry of the interest rate derivatives contracts are as follows:

	Rate %	2016 \$'000	Group 2015 \$'000
Swap terminating 1 July 2016	3.29	5,000	5,000
Swap terminating 1 September 2017	3.46	5,000	5,000
Swap terminating 1 May 2018	3.58	5,000	5,000
Swap terminating 12 September 2018	3.44	5,000	5,000
Swap terminating 1 October 2018	2.30	5,000	-
Swap terminating 12 September 2019	3.60	5,000	5,000
Swap terminating 1 October 2019	<u>2.43</u>	<u>5,000</u>	<u>-</u>
		<u>35,000</u>	<u>25,000</u>

The interest rate derivatives require settlement of net interest receivable or payable each 30 days and are settled on a net basis.

#### Group sensitivity

At 30 June 2016, if interest rates had changed by +/- 100 basis points from the year end rates with all other variables held constant, the Group's equity for the year would have been \$409,000 higher / lower (2015: \$451,000 higher / lower), mainly as a result of lower / higher interest expense on variable borrowings. All other non-derivative financial liabilities have a contractual maturity of less than 6 months.

#### (b) Credit risk

Credit risk is managed on a Group basis and refers to the risk of a counterparty failing to discharge an obligation. In the normal course of business, the Group incurs credit risk from trade receivables and transactions with financial institutions. The Group places its cash and short term deposits with only high credit quality financial institutions. Sales to retail customers are required to be settled via cash, major credit cards or passed onto various credit providers in each country.

In-house customer finance was established in Canada and the United States in October 2012. Customer credit risk is managed subject to the Group's established policy, procedures and control relating to customer credit risk management. Credit quality of a customer is assessed based on an extensive credit rating scorecard and individual credit limits are defined in accordance with this assessment.

An impairment analysis is performed at each reporting date. The maximum exposure to credit risk is the carrying value of in-house customer finance program as disclosed in note 11. The Group does not hold collateral as security. The Group evaluates the concentration of risk with respect to trade receivables as low.

#### (c) Liquidity risk

The Group maintains prudent liquidity risk management with sufficient cash and marketable securities and the availability of funding through an adequate amount of committed credit facilities.

Please see note 24 for more information on the Group's borrowings, financing arrangements and interest rate exposures.

#### (d) Capital risk management

The main objective of capital risk management is to ensure the Group operates as a going concern, meets debts as they fall due, maintains the best possible capital structure, and reduces the cost of capital. Group capital is regarded as equity as shown in the statement of financial position. To maintain or alter the capital structure, the Group has the ability to review the size of the dividends paid to shareholders, return capital or issue new shares, reduce or increase debt or sell assets.

There are a number of external bank covenants in place relating to debt facilities. These covenants are calculated and reported to the bank quarterly. The principal covenants relating to capital management are the earnings before interest and taxation (EBIT) fixed cover charge ratio, the consolidated debt to earnings before interest, taxation, depreciation and amortisation (EBITDA) and consolidated debt to capitalisation. There have been no breaches of these covenants or events of review for the current or prior period.

#### **4 Critical accounting estimates and assumptions**

Estimates and judgements are continually evaluated and are based on historical experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances.

The Group makes estimates and assumptions concerning the future. The resulting accounting estimates will, by definition, seldom equal the related actual results. The estimates and assumptions that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial year are addressed below.

##### **Share-based payment transactions**

The Group measures the cost of equity-settled transactions with employees by reference to the fair value of the equity instruments at the date at which they are granted. The fair value is determined with the assistance of an external valuer using the Binomial model. The related assumptions are detailed in note 33. The accounting estimates and assumptions relating to equity-settled share-based payments would have no impact on the carrying amounts of assets and liabilities within the next annual reporting period but may impact expenses and equity.

##### **Make good provisions**

A provision has been made for the present value of anticipated costs of future restoration of leased store premises. The provision includes future cost estimates associated with dismantling and closure of stores. The calculation of this provision requires assumptions such as discount rates, store closure dates and lease terms. These uncertainties may result in future actual expenditure differing from the amounts currently provided. The provision recognised is periodically reviewed and updated based on the facts and circumstances available at the time. Changes for the estimated future costs for sites are recognised in the statement of financial position by adjusting both the expense or asset (if applicable) and provision. The related carrying amounts are disclosed in note 22 and note 25.

##### **Estimation of useful lives of assets**

The estimation of the useful lives of assets has been based on historical experience, lease terms (for leased equipment) and policies (for motor vehicles). In addition, the condition of the assets is assessed at least once per year and considered against the remaining useful life. Adjustments to useful lives are made when considered necessary.

##### **Critical judgements in applying the entity's accounting policies**

##### **Revenue recognition**

Professional care plan revenue is recognised as sales revenue in the statement of comprehensive income. Management judgement is required to determine the amount of service revenue that can be recognised based on the usage pattern of PCPs and general information obtained on the operation of service plans in other markets. Those direct and incremental bonuses associated with the sale of these plans are deferred and amortised in proportion to the revenue recognised. Management reviews trends in current and estimated future services provided under the plan to assess whether changes are required to the revenue and cost recognition rates used.

Due to management reviews conducted during the year, an adjustment to the revenue recognition pattern has been deemed necessary. As a result of this, an additional \$2,214,000 has been recognised as revenue in the current financial year. Of this, \$138,000 relates to the current financial year, and \$2,076,000 relates to prior financial years. The change in estimate will result in lower revenue in future periods by the corresponding amount.

##### **Taxation and recovery of deferred tax assets**

The Group is subject to income taxes in Australia and jurisdictions where it has foreign operations. Significant judgement is required in determining the worldwide provision for income taxes. There are many transactions and calculations for which the ultimate tax determination is uncertain during the ordinary course of business.

Deferred tax assets are recognised for deductible temporary differences as management considers that it is probable that future taxable profits will be available to utilise those temporary differences. Management judgement is required to determine the amount of deferred tax assets that can be recognised.

##### **Impairment of non-financial assets other than goodwill and indefinite life intangibles**

The Group assesses impairment of all assets at each reporting date by evaluating conditions specific to the Group and to the particular asset that may lead to impairment. These include store performance, product and manufacturing performance, technology and economic environments and future product expectations. If an impairment trigger exists the recoverable amount of the asset is determined.

## **5 Segment information**

### **Identification and description of segments**

Management have determined the operating segments based on the reports reviewed by the Board and Executive Team that are used to make strategic decisions. This definition was updated after it was announced on 10 June 2016 that the Emma & Roe brand was moving from the trial phase into growth mode. Prior year comparatives were also restated in line with the updated definition.

The Board and Executive Team consider, organise and manage the business primarily from a brand perspective. For the Michael Hill brand, they also consider, organise and manage the business from a geographic perspective, being the country of origin where the sale and service was performed. Discrete financial information about each of these operating businesses is reported to the Board and Executive Team monthly, via the preparation of the Group financial reports.

The amounts provided to the Board and Executive Team in respect of total assets and liabilities are measured in a manner consistent with the financial statements. These reports do not allocate total assets or total liabilities based on the operations of each segment or by geographical location.

The Group operates in 4 geographical segments: Australia, New Zealand, Canada and the United States of America (see note 32).

The corporate and other segment includes revenue and expenses that do not relate directly to the relevant Michael Hill or Emma & Roe retail segments. These predominately relate to corporate costs and Australian based support costs, but also include the trading activity through our online presence, manufacturing activities, warehouse and distribution, interest and company tax. Inter-segment pricing is at arm's length or market value.

### **Types of products and services**

Michael Hill International Limited and its controlled entities operate predominately in the sale of jewellery and related services. As indicated above, the Group is organised and managed globally into geographic areas.

### **Major customers**

Michael Hill International Limited and its controlled entities sell goods and provide services to a number of customers from which revenue is derived. There is no single customer from which the Group derives more than 10% of total consolidated revenue.

### **Accounting policies and inter-segment transactions**

The accounting policies used by the Group in reporting segments internally are the same as those contained in note 2 to the accounts and in the prior period.

5. Segment Information (continued)

Segment Information By Brand

for the period ended 30 June 2016	MICHAEL HILL \$'000	EMMA & ROE \$'000	CORPORATE & OTHER \$'000	GROUP \$'000
Operating revenue	536,424	9,347	5,356	551,127
EBITDA	96,840	(1,817)	(29,205)	65,818
Depreciation and amortisation	(14,733)	(611)	(3,416)	(18,760)
EBIT	82,107	(2,428)	(32,621)	47,058
Interest income	-	-	583	583
Finance costs	(149)	(14)	(5,944)	(6,107)
Net profit before tax	81,958	(2,442)	(37,982)	41,534
Income tax expense				(21,957)
Net profit after tax				19,577

for the period ended 30 June 2015	MICHAEL HILL \$'000	EMMA & ROE \$'000	CORPORATE & OTHER \$'000	GROUP \$'000
Operating revenue	495,580	4,879	2,911	503,370
EBITDA	84,621	(2,539)	(24,283)	57,799
Depreciation and amortisation	(12,766)	(345)	(2,627)	(15,738)
EBIT	71,855	(2,884)	(26,910)	42,061
Interest income	-	-	49	49
Finance costs	(135)	8	(4,581)	(4,708)
Net profit before tax	71,720	(2,876)	(31,442)	37,402
Income tax expense				(9,648)
Net profit after tax				27,754

## 5. Segment Information (continued)

### Michael Hill Retail Segment Information by Country

for the period ended 30 June 2016	MHJ AUSTRALIA \$'000	MHJ NEW ZEALAND \$'000	MHJ CANADA \$'000	MHJ UNITED STATES \$'000	MICHAEL HILL \$'000
Segment operating revenue	307,333	112,473	97,322	19,296	536,424
Segment EBITDA	57,540	27,729	13,475	(1,904)	96,840
Segment depreciation and amortisation	(7,201)	(2,542)	(3,753)	(1,237)	(14,733)
Segment EBIT	50,339	25,187	9,722	(3,141)	82,107
Segment EBIT as a % of revenue	16.4%	22.4%	10.0%	(16.3%)	15.3%
Segment finance costs	(135)	(12)	-	(2)	(149)
Segment net profit before tax	50,204	25,175	9,722	(3,143)	81,958

for the period ended 30 June 2015	MHJ AUSTRALIA \$'000	MHJ NEW ZEALAND \$'000	MHJ CANADA \$'000	MHJ UNITED STATES \$'000	MICHAEL HILL \$'000
Segment operating revenue	294,442	106,180	81,348	13,610	495,580
Segment EBITDA	52,492	24,434	9,289	(1,594)	84,621
Segment depreciation and amortisation	(6,559)	(2,496)	(2,963)	(748)	(12,766)
Segment EBIT	45,933	21,938	6,326	(2,342)	71,855
Segment EBIT as a % of revenue	15.6%	20.7%	7.8%	(17.2%)	14.5%
Segment finance costs	(96)	(37)	(2)	-	(135)
Segment net profit before tax	45,837	21,901	6,324	(2,342)	71,720

## 6 Revenue

	2016 \$'000	2015 \$'000
<b>From continuing operations:</b>		
<i>Sales revenue</i>		
Revenue from sale of goods and repair services	517,820	476,253
Revenue from professional care plans	30,758	25,208
Interest and other revenue from in-house customer finance program	<u>1,966</u>	<u>1,860</u>
	<u>550,544</u>	<u>503,321</u>
<i>Other revenue</i>		
Interest income	<u>583</u>	<u>49</u>
	<u>551,127</u>	<u>503,370</u>

## 7 Other income

	2016 \$'000	2015 \$'000
Insurance recoveries	102	137
Net foreign exchange gains (Net foreign exchange losses in 2016)	-	1,783
Other income	<u>453</u>	<u>339</u>
	<u>555</u>	<u>2,259</u>

## 8 Expenses

	2016 \$'000	2015 \$'000
<b>Profit before income tax includes the following specific expenses:</b>		
<i>Depreciation</i>		
Plant and equipment	3,681	3,499
Furniture and fittings	3,498	2,987
Motor vehicles	214	212
Leasehold improvements	7,126	5,826
Display materials	<u>1,720</u>	<u>1,354</u>
Total depreciation	<u>16,239</u>	<u>13,878</u>
<i>Amortisation</i>		
Software	<u>2,521</u>	<u>1,860</u>
Total amortisation	<u>2,521</u>	<u>1,860</u>
Total depreciation and amortisation	<u>18,760</u>	<u>15,738</u>
Bank and interest charges	2,793	3,508
Interest expense - make good provision	161	127
Interest paid in regards to tax pooling arrangement.	<u>3,153</u>	<u>1,073</u>
Total finance costs	<u>6,107</u>	<u>4,708</u>
Net foreign exchange losses (Net foreign exchange gains in 2015)	352	-

## 8 Expenses (continued)

	Group
2016 \$'000	2015 \$'000

### **Remuneration of auditors**

During the year the following fees were paid or payable for services provided by the auditor of the Parent Entity, its related practices and non-related audit firms:

2016 \$'000	2015 \$'000
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#### **(a) Assurance services**

*Ernst & Young Australian Firm*

Audit and review of financial reports

367	337
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*Grant Thornton New Zealand Firm*

Audit of ordinary shares register

<u>2</u>	<u>2</u>
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Total remuneration for assurance services

<u>369</u>	<u>339</u>
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#### **(b) Advisory services**

*Ernst & Young Australian firm*

Advisory fees

<u>50</u>	<u>5</u>
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Total remuneration for advisory services

<u>50</u>	<u>5</u>
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<u>419</u>	<u>344</u>
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## 9 Income tax expense

	2016 \$'000	2015 \$'000
<b>(a) Income tax expense</b>		
Current tax	12,139	7,139
Deferred tax	332	1,532
Over provided in prior years	(65)	(24)
Derecognised tax losses	208	1,001
Tax consolidation cost base adjustments (see note 2(f))	(19,439)	-
Inland Revenue tax settlement provision	28,782	-
Income tax expense	<u>21,957</u>	<u>9,648</u>
<b>(b) Numerical reconciliation of income tax expense to prima facie tax payable</b>		
Profit from continuing operations before income tax expense	<u>41,534</u>	<u>37,402</u>
Tax at the Australian tax rate of 30% (2015: at the New Zealand tax rate of 28%)	12,460	10,473
Tax effect of amounts which are not deductible (taxable) in calculating taxable income:		
Non deductible entertainment expenditure	178	171
Non deductible legal expenditure	89	98
Debt deduction denied	-	28
Share of partnership	(515)	(3,601)
Unrealised foreign exchange loss not included in accounting profit	(500)	39
Sundry items	1	3
Tax consolidation cost base adjustments	(19,439)	-
Inland Revenue tax settlement provision	28,782	-
	<u>21,056</u>	<u>7,211</u>
Difference in overseas tax rates	(414)	325
Over provided in prior years	(65)	(24)
Tax losses not recognised	1,380	2,136
Income tax expense	<u>21,957</u>	<u>9,648</u>
<b>(c) Tax losses</b>		
Unused United States tax losses for which no deferred tax has been recognised	15,199	10,451
Potential tax benefit @ 40%	<u>6,079</u>	<u>4,181</u>
Unused New Zealand tax losses for which no deferred tax has been recognised	413	4,330
Potential tax benefit @ 28%	<u>116</u>	<u>1,212</u>

## 10 Current assets - Cash and cash equivalents

	2016 \$'000	2015 \$'000
Cash at bank and on hand	<u>8,853</u>	<u>6,797</u>
	<u>8,853</u>	<u>6,797</u>

### (a) Cash at bank and on hand

Interest rates for the bank accounts have been between 0.00% and 1.15% during the year (2015: between 0.00% and 4.00%).

## 11 Current assets - Trade and other receivables

	2016 \$'000	2015 \$'000
Trade receivables	4,533	4,917
Provision for impaired receivables	(675)	(455)
	<u>3,858</u>	<u>4,462</u>
In-house customer finance	13,911	11,881
Provision for impaired receivables	(879)	(751)
	<u>13,032</u>	<u>11,130</u>
<b>Other receivables</b>		
Sundry debtors	8,923	4,923
Financial assets *	450	60
	<u>9,373</u>	<u>4,983</u>

\* See note 3 for more information on derivative contracts

### (a) Impaired trade receivables

Trade receivables from sales made to customers through third party credit providers are non-interest bearing and are generally on 0-30 day terms. A provision for impairment loss is recognised when there is objective evidence that an individual trade receivable is impaired. An impairment loss of \$252,000 (2015: \$452,000) has been recognised by the Group. All trade receivables related to third party credit providers past 90 days have been impaired.

At 30 June 2016, the ageing analysis of trade receivables related to third party credit providers is as follows:

	2016 \$'000	2015 \$'000
0 - 30 days	3,600	4,271
31 - 60 days	243	188
61 - 90 days	107	32
91 + days	583	426
	<u>4,533</u>	<u>4,917</u>

Movements in the provision for trade receivables impairment loss were as follows:

	2016 \$'000	2015 \$'000
Opening balance	455	731
Amounts written off	(252)	(452)
Additional provisions recognised	468	178
Exchange differences	4	(2)
	<u>675</u>	<u>455</u>

### (b) In-house customer finance

In October 2012, Michael Hill launched an in-house customer finance program in the Canadian and United States markets. The terms available to customers range from a revolving line of credit through to 18 months, although 12 to 18 months is the typical financing period, and interest bearing and non-interest bearing products are offered.

## 11 Current assets - Trade and other receivables (continued)

The receivables from the in-house customer finance program are comprised of a large number of transactions with no one customer representing a significant balance. The finance portfolio consists of contracts of similar characteristics that are evaluated collectively for impairment. The allowance is an estimate of the losses as of the balance date, and is calculated using such factors as delinquency and recovery rates.

The credit quality and ageing of these receivables is as follows:

	2016 \$'000	2015 \$'000
Performing:		
Current, aged 0 - 30 days	13,437	11,564
Past due, aged 31 - 90 days	397	364
Non performing:		
Past due, aged more than 90 days	424	404
	<u>14,258</u>	<u>12,332</u>

Ageing has been calculated with reference to payment due dates.

This has been disclosed as:

Current receivables	13,911	11,881
Non-current receivables	347	451
	<u>14,258</u>	<u>12,332</u>

Movements in the provision for in-house customer finance receivables impairment loss were as follows:

	2016 \$'000	2015 \$'000
Opening balance	780	675
Amounts written off	(1,814)	(1,407)
Additional provisions recognised	1,945	1,446
Exchange differences	(10)	66
	<u>901</u>	<u>780</u>

This has been disclosed as:

Current receivables	879	751
Non-current receivables	22	29
	<u>901</u>	<u>780</u>

Only trade receivables and in-house customer finance contain impaired assets. The remaining classes within trade and other receivables do not contain impaired assets and are not past due. Based on the credit history of these other classes, it is expected that these amounts will be received when due.

### (c) Other receivables

Other receivables relate to supplier credits, security deposits, revaluation of derivatives and other sundry receivables.

## 11 Current assets - Trade and other receivables (continued)

### (d) Effective interest rates

Other than in-house customer finance, all receivables are non-interest bearing. The majority of in-house customer finance receivables are also non-interest bearing.

## 12 Current assets - Inventories

	2016 \$'000	2015 \$'000
Raw materials	7,461	7,128
Finished goods	188,723	172,827
Packaging and other consumables	3,777	2,277
	<u>199,961</u>	<u>182,232</u>

All inventories are held at cost.

## 13 Current assets - Current tax receivables

	2016 \$'000	2015 \$'000
Income tax (Current tax liability in 2016)	-	11,376
	<u>-</u>	<u>11,376</u>

## 14 Current assets - Other current assets

	2016 \$'000	2015 \$'000
Prepayments	4,050	3,192
Deferred expenditure	985	1,092
Tax pool deposits	-	3,143
	<u>5,035</u>	<u>7,427</u>

Tax pooling deposits have been applied to the estimated IR tax settlement liability provided for in Current tax liabilities (see note 21).

## 15 Non-current assets - Trade and other receivables

	2016 \$'000	2015 \$'000
In-house customer finance	347	451
Provision for impaired receivables	(22)	(29)
	<u>325</u>	<u>422</u>

## 16 Non-current assets - Property, plant and equipment

	Plant and equipment \$'000	Fixtures and fittings \$'000	Motor vehicles \$'000	Leasehold improvements \$'000	Display materials \$'000	Total \$'000
<b>At 1 July 2014</b>						
Cost	24,587	21,092	1,000	55,665	10,076	112,420
Accumulated depreciation	(14,465)	(10,392)	(553)	(27,010)	(4,600)	(57,020)
Net book amount	<u>10,122</u>	<u>10,700</u>	<u>447</u>	<u>28,655</u>	<u>5,476</u>	<u>55,400</u>
<b>Year ended 30 June 2015</b>						
Opening net book amount	10,122	10,700	447	28,655	5,476	55,400
Exchange differences	264	139	3	1,083	182	1,671
Additions	5,696	5,631	363	5,917	2,583	20,190
Additions - make good asset	-	-	-	2,116	-	2,116
Disposals	(154)	(62)	(91)	(171)	(8)	(486)
Reclassification to intangible assets	(10)	1	-	-	-	(9)
Depreciation charge	(3,499)	(2,987)	(212)	(5,826)	(1,354)	(13,878)
Impairment charge	(29)	(23)	-	(107)	-	(159)
Closing net book amount	<u>12,390</u>	<u>13,399</u>	<u>510</u>	<u>31,667</u>	<u>6,879</u>	<u>64,845</u>
<b>At 30 June 2015</b>						
Cost	29,856	26,393	953	63,697	12,576	133,475
Accumulated depreciation	(17,466)	(12,994)	(443)	(32,030)	(5,697)	(68,630)
Net book amount	<u>12,390</u>	<u>13,399</u>	<u>510</u>	<u>31,667</u>	<u>6,879</u>	<u>64,845</u>
<b>Year ended 30 June 2016</b>						
Opening net book amount	12,390	13,399	510	31,667	6,879	64,845
Exchange differences	51	101	12	117	19	300
Additions	4,350	4,865	367	10,730	2,637	22,949
Additions - make good asset	-	-	-	713	-	713
Disposals	(218)	(65)	(141)	(71)	(44)	(539)
Depreciation charge	(3,681)	(3,498)	(214)	(7,126)	(1,720)	(16,239)
Impairment charge	(20)	(39)	-	(37)	-	(96)
Closing net book amount	<u>12,872</u>	<u>14,763</u>	<u>534</u>	<u>35,993</u>	<u>7,771</u>	<u>71,933</u>
<b>At 30 June 2016</b>						
Cost	33,203	30,206	930	72,926	12,767	150,032
Accumulated depreciation	(20,331)	(15,443)	(396)	(36,933)	(4,996)	(78,099)
Net book amount	<u>12,872</u>	<u>14,763</u>	<u>534</u>	<u>35,993</u>	<u>7,771</u>	<u>71,933</u>

## 17 Non-current assets - Deferred tax assets

	2016 \$'000	2015 \$'000
<b>The balance comprises temporary differences attributable to:</b>		
Doubtful debts	391	298
Fixed assets and intangibles	1,414	2,664
Intangible assets from intellectual property transfer	30,304	33,873
Deferred expenditure	(841)	(932)
Prepayments	(1)	(53)
Deferred service revenue	4,400	4,408
Unearned income	888	769
Employee benefits	2,597	2,437
Retirement benefit obligations	789	692
Provision for warranties and legal costs	722	739
Straight-line lease provision	1,401	1,501
Other provisions	2,371	1,988
Unrealised foreign exchange losses	(17)	(3)
Sundry items	217	-
Tax consolidation cost base adjustments	19,439	-
Net deferred tax assets	<u>64,074</u>	<u>48,381</u>
<b>Movements:</b>		
Opening balance at 1 July	48,381	62,324
Credited / (charged) to the income statement (note 9)	19,107	(1,532)
Prior year adjustment - deferred service revenue	-	(9,300)
Prior year adjustment - other	(65)	(41)
Losses utilised	-	(155)
Derecognised tax losses	-	(1,001)
Foreign exchange differences	(3,349)	(1,914)
Closing balance at 30 June	<u>64,074</u>	<u>48,381</u>
<b>Expected settlement</b>		
Within 12 months	14,943	6,852
In excess of 12 months	<u>49,131</u>	<u>41,529</u>
	<u>64,074</u>	<u>48,381</u>

## 18 Non-current assets - Intangible assets

	Patents, trademarks and other rights \$'000	Computer software \$'000	Total \$'000
<b>At 1 July 2014</b>			
Cost	24	13,206	13,230
Accumulated amortisation	-	(6,817)	(6,817)
Net book amount	<u>24</u>	<u>6,389</u>	<u>6,413</u>
<b>Year ended 30 June 2015</b>			
Opening net book amount	24	6,389	6,413
Exchange differences	1	4	5
Additions	54	1,871	1,925
Disposals	-	(1)	(1)
Reclassification from property, plant and equipment	-	9	9
Amortisation charge *	-	(1,860)	(1,860)
Closing net book amount	<u>79</u>	<u>6,412</u>	<u>6,491</u>
<b>At 30 June 2015</b>			
Cost	79	15,085	15,164
Accumulated amortisation	-	(8,673)	(8,673)
Net book amount	<u>79</u>	<u>6,412</u>	<u>6,491</u>
<b>Year ended 30 June 2016</b>			
Opening net book amount	79	6,412	6,491
Exchange differences	-	(6)	(6)
Additions	-	1,600	1,600
Disposals	-	(2)	(2)
Amortisation charge *	-	(2,521)	(2,521)
Impairment	-	(1)	(1)
Closing net book amount	<u>79</u>	<u>5,482</u>	<u>5,561</u>
<b>At 30 June 2016</b>			
Cost	79	16,675	16,754
Accumulated amortisation	-	(11,193)	(11,193)
Net book amount	<u>79</u>	<u>5,482</u>	<u>5,561</u>

\* Amortisation of \$2,521,000 (2015: \$1,860,000) is included in depreciation and amortisation expense in the statement of comprehensive income.

## 19 Non-current assets - Other non-current assets

	2016 \$'000	2015 \$'000
Deferred expenditure	2,038	2,253
Prepayments	<u>154</u>	<u>214</u>
	<u>2,192</u>	<u>2,467</u>

## 20 Current liabilities - Trade and other payables

	2016 \$'000	2015 \$'000
Trade payables	23,734	24,505
Annual leave liability	7,725	7,354
Accrued expenses	8,553	5,772
Financial liabilities *	1,333	828
Other payables	5,032	5,280
	<u>46,377</u>	<u>43,739</u>

\* See note 3 for more information on derivative contracts

## 21 Current liabilities - Current tax liabilities

	2016 \$'000	2015 \$'000
Income tax (Current tax receivable in 2015)	<u>25,022</u>	-

Tax pooling deposits of NZ\$7.7m have been applied to the estimated IR tax settlement liability (see note 37). These were previously accounted for as tax pool deposits, included in Other current assets (see note 14).

## 22 Current liabilities - Provisions

	2016 \$'000	2015 \$'000
Employee benefits - long service leave	2,081	1,704
Returns provision	2,609	2,818
Make good provision	212	102
	<u>4,902</u>	<u>4,624</u>

### (a) Employee benefits - long service leave

The liability for long service leave is measured as the present value of expected future payments to be made in respect of services provided by employees up to the reporting date using the projected unit credit method. Consideration is given to expected future wage and salary levels, experience of employee departures and periods of service. Expected future payments are discounted using market yields at the reporting date on corporate bonds with terms to maturity and currency that match, as closely as possible, the estimated future cash outflows.

### (b) Returns provision

Provision is made for the estimated sale returns for the Group's return policies, being 30 day change of mind, 12 month guarantee on the quality of workmanship and the 3 year watch guarantee. In addition, all Michael Hill watches are sold with a lifetime battery replacement guarantee. Management estimates the provision based on historical sale return information and any recent trends that may suggest future claims could differ from historical amounts.

### (c) Make good provision

The Group has an obligation to restore certain leasehold sites to their original condition upon store closure or relocation. This provision represents the present value of the expected future make good commitment. Amounts charged to the provision represent both the cost of make good costs incurred and the costs incurred which mitigate the final liability prior to the closure or relocation.

## 22 Current liabilities - Provisions (continued)

### (d) Movements in provisions

Movements for the Group in each class of provision during the financial year are set out below:

	Employee benefits \$'000	Returns provision \$'000	Make good provision \$'000	Total \$'000
Carrying amount at the start of the year	1,704	2,818	102	4,624
Additional provisions recognised	671	2,611	458	3,740
Amounts incurred and charged	(297)	(2,817)	(350)	(3,464)
Exchange differences	3	(3)	2	2
Carrying amount at the end of the year	<u>2,081</u>	<u>2,609</u>	<u>212</u>	<u>4,902</u>

## 23 Current liabilities - Deferred revenue

	2016 \$'000	2015 \$'000
Deferred service revenue	23,421	20,504
Lease incentive income	1,006	731
Deferred interest free revenue	<u>258</u>	<u>281</u>
	<u>24,685</u>	<u>21,516</u>

## 24 Non-current liabilities - Borrowings

	2016 \$'000	2015 \$'000
Bank loans	<u>40,887</u>	<u>45,116</u>
Total non-current borrowings	<u>40,887</u>	<u>45,116</u>

These advances, together with the bank overdraft, are secured by floating charges over all of the Group's assets.

### (a) Financing arrangements

The Group's objectives when managing capital are to ensure sufficient liquidity to support its financial obligations and execute the Group's operational and strategic plans. The Group continually assesses its capital structure and makes adjustments to it with reference to changes in economic conditions and risk characteristics associated with its underlying assets. Accordingly, the Group entered into an agreement with ANZ on 24 June 2015 that provides for a \$110,000,000 multi option borrowing facility, the availability of which is adjusted throughout the year in line with business requirements. At balance date, \$70,000,000 was available, and of that, \$40,887,000 was utilised.

The Group also has access to various uncommitted credit facility lines serving working capital needs that, at balance date, totalled \$1,957,000. No amounts were drawn under these credit facility lines as at balance date.

## 24 Non-current liabilities - Borrowings (continued)

### (b) Interest rate risk exposures

The following table sets out the Group's exposure to interest rate risk, including the contractual repricing dates and the effective weighted average interest rate by maturity periods.

Exposures arise predominantly from liabilities bearing variable interest rates. To manage this exposure the Group has taken out interest rate swaps, as described in note 3(a)(ii).

The carrying amount of the fully drawn advance facility reflects fair value.

	Floating interest rate \$'000	Fixed interest rate Less than 6 months \$'000	6 - 12 months \$'000	Over 1 less than 5 years \$'000	Over 5 years \$'000	Total \$'000
<b>2016</b>						
Variable rate fully drawn advance facility	<u>40,887</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>40,887</u>
	<u>40,887</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>40,887</u>
Weighted average interest rate	2.64 %	- %	- %	- %	- %	
<b>2015</b>						
Variable rate fully drawn advance facility	<u>45,116</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>45,116</u>
	<u>45,116</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>45,116</u>
Weighted average interest rate	2.84 %	- %	- %	- %	- %	

The Group retains the discretion to maintain the required borrowing levels under the fully drawn advance facility until the borrowing facility terminates on 1 July 2019, so long as the facility limit has not been reached.

## 25 Non-current liabilities - Provisions

	2016 \$'000	2015 \$'000
Employee benefits - long service leave	1,789	1,641
Make good provision	<u>3,409</u>	<u>2,613</u>
	<u>5,198</u>	<u>4,254</u>

### (a) Employee benefits - long service leave

The basis used to measure the liability for long service leave is set out in note 22(a).

### (b) Make good provision

The basis used to calculate the make good provision is set out in note 22(c).

### (c) Movements in provisions

Movements for the Group in each class of provision during the financial year are set out below:

	Employee benefits \$'000	Make good provision \$'000	Total \$'000
Carrying amount at the start of the year	1,641	2,613	4,254
Additional provisions recognised	145	759	904
Exchange differences	<u>3</u>	<u>37</u>	<u>40</u>
Carrying amount at the end of the year	<u>1,789</u>	<u>3,409</u>	<u>5,198</u>

## 26 Non-current liabilities - Deferred revenue

	2016 \$'000	2015 \$'000
Deferred service revenue	48,201	41,805
Lease incentive income	2,509	2,318
Deferred interest free revenue	<u>15</u>	<u>20</u>
	<u>50,725</u>	<u>44,143</u>

## 27 Contributed equity

	2016 Shares	2015 Shares	2016 \$'000	2015 \$'000
<b>(a) Share capital</b>				
Ordinary shares				
Fully paid (b)	383,138,513	383,153,190	3,767	3,767
Treasury stock held for Employee Share Scheme (c)	-	(14,677)	-	(7)
	<u>383,138,513</u>	<u>383,138,513</u>	<u>3,767</u>	<u>3,760</u>

### (b) Fully paid ordinary share capital

Opening balance of ordinary shares issued	383,153,190	383,153,190	3,767	3,702
Issues of ordinary shares during the year				
Employee Share Scheme issue	-	96,907	-	109
Transfer from treasury stock	-	(96,907)	-	(44)
Cancellation of treasury stock	(14,677)	-	-	-
Closing balance of ordinary shares issued	<u>383,138,513</u>	<u>383,153,190</u>	<u>3,767</u>	<u>3,767</u>

Refer to note 1 for details of the change in parent company that occurred during the year.

### (c) Treasury stock

Treasury shares were shares in Michael Hill New Zealand Limited (formerly known as Michael Hill International Limited) that were held by Michael Hill Trustee Company Limited for the purpose of issuing shares under the Michael Hill International Employee Share Scheme. As part of the reorganisation described in note 1, all shares not allocated to employees were cancelled on 24 June 2016. (see note 33).

	Former parent 2016 Shares	2015 Shares	Former parent 2016 \$'000	2015 \$'000
Opening balance of treasury stock shares issued	14,677	111,584	7	51
Allocated to Employee Share Scheme	-	(96,907)	-	(44)
Cancelled shares	(14,677)	-	(7)	-
Closing balance of treasury stock shares issued	<u>-</u>	<u>14,677</u>	<u>-</u>	<u>7</u>

### (d) Ordinary shares

Ordinary shares entitle the holder to participate in dividends and the proceeds on winding up of the Company in proportion to the number of and amounts paid on the shares held.

On a show of hands every holder of ordinary shares present at a meeting in person or by proxy, is entitled to one vote, and upon a poll each share is entitled to one vote.

### (e) Employee Share Scheme

Information relating to the Michael Hill International Limited Employee Share Scheme, including details of shares previously issued under the scheme, is set out in note 33.

## 27 Contributed equity (continued)

### (f) Options

Information relating to the Michael Hill International Limited Employee Option Plan, including details of options issued, exercised and lapsed during the financial year and options outstanding at the end of the financial year, is set out in note 33.

## 28 Reserves and retained profits

### Nature and purpose of reserves

#### (i) Hedging reserve - cash flow hedges

The hedging reserve is used to record gains or losses on a hedging instrument in a cash flow hedge. The amounts are recognised in the profit and loss component of the statement of comprehensive income when the associated hedged transactions affect profit or loss, as described in note 2(o).

#### (ii) Options reserve

The share-based payments reserve is used to recognise the fair value of options issued but not exercised. Refer to note 33(a) for further details.

#### (iii) Foreign currency translation reserve

Exchange differences arising on translation of the foreign controlled entities are taken to the foreign currency translation reserve, as described in note 2(d).

## 29 Dividends

	2016 \$'000	2015 \$'000
<b>(a) Ordinary shares</b>		
Final dividend for the year ended 30 June 2015 of NZ 2.5c (2014 - NZ 4.0c) per fully paid share paid on 2 October 2015 (2014 - 3 October 2014).	8,870	13,765
Interim dividend for the year ended 30 June 2016 of NZ 2.5c (2015 - NZ 2.5c) per fully paid share paid on 1 April 2016 (2015 - 2 April 2015).	<u>8,620</u>	<u>9,411</u>
	<u>17,490</u>	<u>23,176</u>
<b>(b) Dividends not recognised at year end</b>		
Since year end, the Directors have declared the payment of a final dividend of AU 2.5c per fully paid ordinary share (2015 - NZ 2.5c). The final dividend will be fully franked and imputed. The aggregate amount of the proposed dividend expected to be paid on 6 October 2016 out of retained profits at 30 June 2016, but not recognised as a liability at year end, is:	<u>9,578</u>	<u>8,574</u>
<b>(c) Franking and imputation credits</b>		
Franking credits available for subsequent reporting periods based on a 30% tax rate for the Group in AUD are:	2,710	(3,727)
Imputation credits available for subsequent reporting periods based on the New Zealand 28% tax rate for the Group in NZD are:	<u>13,118</u>	<u>5,840</u>

## 29 Dividends (continued)

The dividends paid during the current financial period and corresponding previous financial period were not franked or imputed.

The above franking credit amounts represent the balance of the franking account as at the end of the financial year, adjusted for franking credits that will arise from the payment of income tax payable.

The above imputation credit amounts represent the balance of the imputation account as at the end of the financial year, adjusted for imputation credits that will arise from the payment of income tax payable. It has not been adjusted to reflect amounts payable under the IR settlement.

The impact on the franking account of the dividend recommended by the Directors since year end, but not recognised as a liability at year end, will be a reduction in the franking account of \$4,105,000 (2015: Nil).

The impact on the imputation credit account of the dividend recommended by the Directors since year end, but not recognised as a liability at year end, is estimated to be a reduction in the imputation credit account of NZ\$3,890,000 (2015: Nil). The amount of imputation credits is dependant on the NZD exchange rate at the time of the dividend.

## 30 Earnings per share

	2016 Cents	2015 Cents
<b>(a) Basic earnings per share</b>		
Profit attributable to the ordinary equity holders of the Company	<u>5.11</u>	<u>7.24</u>
<b>(b) Diluted earnings per share</b>		
Profit attributable to the ordinary equity holders of the Company	<u>5.09</u>	<u>7.22</u>
<b>(c) Reconciliation of earnings used in calculating earnings per share</b>		
	2016 \$'000	2015 \$'000
<b>Basic earnings per share</b>		
Profit attributable to the ordinary equity holders of the Company used in calculating basic earnings per share	<u>19,577</u>	<u>27,754</u>
<b>Diluted earnings per share</b>		
Profit attributable to the ordinary equity holders of the Company used in calculating diluted earnings per share	<u>19,577</u>	<u>27,754</u>

### 30 Earnings per share (continued)

**(d) Weighted average number of shares used as the denominator**

	2016 Number	2015 Number
<b>Weighted average number of ordinary shares used as the denominator in calculating basic earnings per share</b>	<b>383,138,513</b>	383,117,273
Adjustments for calculation of diluted earnings per share:		
Options	1,700,000	1,300,000
Treasury stock	-	14,677
<b>Weighted average number of ordinary shares for diluted earnings per share</b>	<b><u>384,838,513</u></b>	<b><u>384,431,950</u></b>

**(e) Information concerning the classification of securities**

*(i) Options*

Options granted to employees under the Michael Hill International Limited Employee Option Plan are considered to be potential ordinary shares and have been included in the determination of diluted earnings per share to the extent to which they are dilutive. The options have not been included in the determination of basic earnings per share. Details relating to the options are set out in note 33.

*(ii) Treasury Stock*

Treasury stock held under the Michael Hill International Limited Employee Share Scheme are considered to be potential ordinary shares and have been included in the determination of diluted earnings per share. Treasury stock has not been included in the determination of basic earnings per share. Details relating to treasury stock are set out in note 27.

### 31 Related party transactions

**(a) Key management personnel compensation**

Key management personnel compensation for the years ended 30 June 2016 and 2015 is set out below. Those determined to be key management personnel was reviewed during the year with reference to the applicable accounting standard. Prior year comparatives have been restated to include the updated definition of who is key management.

	Short-term benefits \$'000	Post- employment benefits \$'000	Share-based payments \$'000	Total \$'000
<b>2016</b>	<b>3,785</b>	<b>136</b>	<b>33</b>	<b>3,954</b>
2015	2,900	108	37	3,045

**(b) Subsidiaries**

The ultimate parent and controlling entity of the Group is Michael Hill International Limited. Interests in subsidiaries are set out in note 32.

As part of the reorganisation, Michael Hill International Limited acquired 100% of the share capital in Durante Holdings Pty Ltd (a company controlled by interests associated with the Hill Family which held 52.89% of the shares on issue in Michael Hill New Zealand Limited). Durante Holdings Pty Ltd has been consolidated as a fully controlled subsidiary in accordance with the accounting policy described in note 2(b).

### 31 Related party transactions (continued)

#### (c) Transactions with other related parties

The following transactions occurred with related parties for the relevant financial year:

	<b>2016</b> <b>\$'000</b>	2015 \$'000
Services rendered for typing and editing the annual and half year reports by a related party of board members	<b>13</b>	12
<i>Other transactions</i>		
Annual sponsorship of the New Zealand PGA	<b>214</b>	215
Annual sponsorship of the Michael Hill Violin Charitable Trust	<b>52</b>	59

All transactions with related parties were in the normal course of business and provided on commercial terms.

### 32 Investments in subsidiaries

The consolidated financial statements incorporate the assets, liabilities and results of the following subsidiaries in accordance with the accounting policy described in note 2(b):

Name of entity	Country of incorporation	Class of shares	Equity holding	
			2016 %	2015 %
Michael Hill Jeweller (Australia) Pty Limited	Australia	Ordinary	<b>100</b>	100
Michael Hill Wholesale Pty Limited	Australia	Ordinary	<b>100</b>	100
Michael Hill Manufacturing Pty Limited	Australia	Ordinary	<b>100</b>	100
Michael Hill Franchise Pty Limited	Australia	Ordinary	<b>100</b>	100
Michael Hill Franchise Services Pty Limited	Australia	Ordinary	<b>100</b>	100
Michael Hill Finance (Limited Partnership)	Australia	-	<b>100</b>	100
Michael Hill Group Services Pty Limited	Australia	Ordinary	<b>100</b>	100
Michael Hill Charms Pty Limited	Australia	Ordinary	<b>100</b>	100
Michael Hill Online Pty Limited	Australia	Ordinary	<b>100</b>	100
Emma & Roe Pty Limited	Australia	Ordinary	<b>100</b>	100
Emma & Roe Online Pty Limited	Australia	Ordinary	<b>100</b>	100
Durante Holdings Pty Limited	Australia	Ordinary	<b>100</b>	-
Michael Hill New Zealand Limited (formerly known as Michael Hill International Limited)	New Zealand	Ordinary	<b>100</b>	-
Michael Hill Jeweller Limited	New Zealand	Ordinary	<b>100</b>	100
Michael Hill Trustee Company Limited	New Zealand	Ordinary	<b>100</b>	100
Michael Hill Finance (NZ) Limited	New Zealand	Ordinary	<b>100</b>	100
Michael Hill Franchise Holdings Limited	New Zealand	Ordinary	<b>100</b>	100
MHJ (US) Limited	New Zealand	Ordinary	<b>100</b>	100
Emma & Roe NZ Limited	New Zealand	Ordinary	<b>100</b>	100
Michael Hill Online Holdings Limited	New Zealand	Ordinary	<b>100</b>	100
Michael Hill Jeweller (Canada) Limited	Canada	Ordinary	<b>100</b>	100
Michael Hill LLC	United States	Ordinary	<b>100</b>	100

### 33 Share-based payments

#### (a) Employee Option Plan

Options are granted from time to time at the discretion of Directors to Senior Executives within the Group. Motions to issue options to related parties of Michael Hill International Limited are subject to the approval of shareholders at the Annual General Meeting in accordance with the Company's constitution.

Options are granted under the plan for no consideration. Options are granted for a ten year period and are exercisable at any time during the final five years.

Options granted under the plan carry no dividend or voting rights. When exercisable, each option is convertible into one ordinary share.

The exercise price of the options previously granted was set at 30% above the weighted average price at which the Company's shares were traded on the New Zealand Stock Exchange for the calendar month following the announcement by the Group to the New Zealand Stock Exchange of its annual results.

The exercise price of any future option grants will be set using the same method, with reference to the Australian Securities Exchange.

Set out below are summaries of options granted under the plans:

	<b>2016 Weighted average exercise price in NZ\$ per share</b>	<b>2016 Number of options</b>	<b>2015 Weighted average exercise price in NZ\$ per share</b>	<b>2015 Number of options</b>
Outstanding at the beginning of the year	1.48	12,150,000	1.48	12,750,000
Granted during the year	1.14	400,000	1.63	400,000
Forfeited during the year	-	-	1.54	(1,000,000)
Outstanding at the end of the year	<u>1.47</u>	<u>12,550,000</u>	<u>1.48</u>	<u>12,150,000</u>

Share options outstanding at the end of the year have the following expiry date and exercise prices:

	<b>Exercise price in NZ\$ per share</b>	<b>2016 Number of options</b>	<b>2015 Number of options</b>
Expiry Date			
30 September 2017	1.25	3,750,000	3,750,000
30 September 2019	0.94	650,000	650,000
30 September 2020	0.88	650,000	650,000
30 September 2021	1.16	650,000	650,000
30 September 2022	1.41	650,000	650,000
30 September 2023	1.82	5,400,000	5,400,000
30 September 2024	1.63	400,000	400,000
30 September 2025	1.14	400,000	-

The weighted average remaining contractual life of share options outstanding at the end of the period was 5.0 years (2015: 5.9 years).

The range of exercise prices for options outstanding at the end of the year was NZ\$0.88 - NZ\$1.82. Refer to the table above for detailed information on each issue.

The exercise price will be converted to Australian dollars using the Reserve Bank of Australia exchange rate on the day the option is exercised.

### 33 Share-based payments (continued)

The fair value at grant date for the options issued during the 2016 financial year were independently determined using a Binomial option pricing model, which is an iterative model for options that can be exercised at times prior to expiry. The model takes into account the grant date, exercise price, the expected life, the expiry date, the share price at grant date, expected price volatility of the underlying share, the expected dividend yield and the risk-free interest rate for the term of the option. The expected life assumes the option is exercised at the mid-point of the exercise period, and reflects the ability to exercise early and the non-transferability of the option.

The expected price volatility is based on the historic volatility (based on the remaining life of the options), adjusted for any expected changes to future volatility due to publicly available information.

The following table lists the inputs to the models used for the options issued during the years ended 30 June 2016 and 30 June 2015:

	<b>June 2016 22 January 2016</b>	<b>June 2015 10 November 2014</b>
Number of options	400,000	400,000
Dividend yield (%)	5.00	5.00
Expected volatility (%)	25	25
Risk - free interest rate (%)	4.78	4.78
Expected life of option (years)	7.5	7.5
Option exercise price (NZ\$)	1.14	1.63
Share price at grant date (NZ\$)	1.00	1.46
Weighted average fair value per option (NZ cents)	<u>16.2</u>	<u>17.0</u>

#### (b) Employee Share Scheme

The Michael Hill International Limited Employee Share Scheme was established by Michael Hill International Limited in 2001 to assist employees to become shareholders of the Company. Employees are able to purchase shares in the Company at a 10% discount to the average market price over the two weeks prior to the invitation to purchase. The shares were held by a Trustee for a one year period during which time any dividends derived would be paid to the employee.

As part of the reorganisation described in note 1, all shares not allocated to employees were cancelled on 24 June 2016.

	<b>2016 Number</b>	2015 Number
The plan held the following ordinary shares at the end of the year:		
Shares issued to participating employees (fully paid)	-	96,907
Not yet allocated to employees	<u>-</u>	<u>14,677</u>
	<u>-</u>	<u>111,584</u>

During the year, no shares (2015: 96,907) were issued to the Michael Hill Employee Share Scheme. The average 2015 price was NZ\$1.25.

Michael Hill International Limited acquired no shares through on-market purchases on the New Zealand Stock Exchange during the year that related to the Employee Share Scheme.

### 33 Share-based payments (continued)

#### (c) Expenses arising from share-based payment transactions

Total expenses arising from share-based payment transactions recognised during the period as part of employee benefits expense were as follows:

	2016 \$'000	2015 \$'000
Options issued under employee option plan	245	25
Shares issued under Employee Share Scheme	6	11
	<u>251</u>	<u>36</u>

### 34 Reconciliation of profit after income tax to net cash inflow from operating activities

	2016 \$'000	2015 \$'000
Profit for the year	19,577	27,754
Depreciation	16,239	13,878
Amortisation	2,521	1,860
Non-cash employee benefits expense - share-based payments	245	38
Other non-cash expenses	65	-
Net loss on sale of non-current assets	328	204
Deferred taxation	(19,501)	12,343
Net exchange differences	371	(1,732)
Decrease / (increase) in trade and other receivables	(6,280)	1,306
Decrease / (increase) in inventories	(19,472)	136
Decrease / (increase) in other non current assets	2,762	380
(Increase) in other non current assets	192	(3,248)
(Decrease) in tax payables	36,557	(11,279)
Increase / (decrease) in trade and other payables	2,999	1,500
Increase in deferred revenue	10,791	10,731
Increase in provisions	400	695
Net cash inflow from operating activities	<u>47,794</u>	<u>54,566</u>

### 35 Commitments

#### Operating leases

The Group leases all shops and in addition, various offices and warehouses under non-cancellable operating leases expiring within various periods of up to fifteen years. The leases have varying terms, escalation clauses and renewal rights. On renewal, the terms of the leases are renegotiated.

The Group also leases various plant and machinery under cancellable operating leases. The Group is required to give six months notice for termination of these leases.

### 35 Commitments (continued)

	2016 \$'000	2015 \$'000
Commitments for minimum lease payments in relation to non-cancellable operating leases are payable as follows:		
Within one year	41,624	41,279
Later than one year but not later than five years	92,417	99,239
Later than five years	<u>16,083</u>	<u>20,597</u>
	<u>150,124</u>	<u>161,115</u>

### 36 Contingencies

#### (a) Contingent liabilities

The Group had contingent liabilities in respect of guarantees to bankers and other financial institutions in respect of overdraft facilities and fixed assets at 30 June 2016 of \$547,000 (30 June 2015 - \$457,000). \$72,000 has been released subsequent to 30 June 2016 in respect of a guarantee by the former parent (Michael Hill New Zealand Limited) to the New Zealand Stock Exchange.

The Group is not aware of any significant events occurring subsequent to balance date that have not been disclosed.

#### (b) Contingent assets

The Group has no material contingent assets existing as at balance date.

### 37 Events occurring after the reporting period

On 17 August 2016, the Company reached a settlement with the Inland Revenue ('IR') on its long running tax dispute relating to the financing of the Intellectual Property transferred from its New Zealand subsidiary to its Australian subsidiary in 2008. As a result, the Company has recognised a tax liability payable of \$28.8m (NZ\$30.3m). All amounts payable under this settlement have been provided for in the 2015-16 year and this settlement resolves all matters in relation to these proceedings. There are no penalties payable by the Company in respect of the settlement. Tax pooling deposits, which the Company has entered into over a number of years, will fund a portion of the agreed settlement with the Commissioner, including UOMI (Use of Money Interest) and NZ \$7.7m of core tax. The residual amount due of NZ \$22.6m will be funded from the Group's existing financing facilities, without any impact on the Group's ongoing operations, and will not impact the planned store roll out program.

### 38 Information relating to Michael Hill International Ltd (the Parent)

	2016 \$'000	2015 \$'000
Current assets	1,672	-
<b>Total assets</b>	<b>328,677</b>	-
<b>Net assets</b>	<b>328,677</b>	-
Issued capital	283,910	-
Retained earnings	1,672	-
Acquisition reserve	40,907	-
Option reserve	2,188	-
<b>Total equity</b>	<b>328,677</b>	-
 <b>Profit or loss of the Parent entity</b>	 <b>1,672</b>	 <b>-</b>
<b>Total comprehensive income of the Parent entity</b>	<b>1,672</b>	<b>-</b>

The Parent has issued the following guarantees in relation to the debts of its subsidiaries:

- Pursuant to Class Order 98/1418, Michael Hill International Limited and the subsidiaries listed below entered into a deed of cross guarantee on 30 June 2016. The effect of the deed is that Michael Hill International Limited has guaranteed to pay any deficiency in the event of winding up of any controlled entity or if they do not meet their obligations under the terms of overdrafts, loans, leases or other liabilities subject to the guarantee. The controlled entities have also given a similar guarantee in the event that Michael Hill International Limited is wound up or if it does not meet its obligations under the terms of overdrafts, loans, leases or other liabilities subject to the guarantee.
- The subsidiaries subject to the deed are: Durante Holdings Pty Ltd, Michael Hill Group Services Pty Ltd, Michael Hill Jeweller (Australia) Pty Ltd, Michael Hill Manufacturing Pty Ltd, Michael Hill Wholesale Pty Ltd, Michael Hill Franchise Services Pty Ltd, Michael Hill Franchise Pty Ltd, Michael Hill New Zealand Ltd, Michael Hill Jeweller Ltd, Michael Hill Franchise Holdings Ltd, Michael Hill Finance (NZ) Ltd, Michael Hill Online Pty Ltd, Michael Hill Charms Pty Ltd, Emma & Roe Pty Ltd, Emma & Roe Online Pty Ltd, Michael Hill Online Holdings Ltd and Emma & Roe NZ Ltd.

The Parent entity had contingent liabilities in respect of guarantees to bankers and other financial institutions in respect of overdraft facilities and fixed assets at 30 June 2016 of \$72,000.

### **39 Deed of cross guarantee**

Pursuant to ASIC Class Order 98/1418 (as amended) dated 13 August 1998, the Australian wholly-owned subsidiaries listed below are relieved from the Corporations Act 2001 requirements for preparation, audit and lodgement of financial reports and directors' report in Australia.

The subsidiaries subject to the deed are: Durante Holdings Pty Ltd, Michael Hill Group Services Pty Ltd, Michael Hill Jeweller (Australia) Pty Ltd, Michael Hill Manufacturing Pty Ltd, Michael Hill Wholesale Pty Ltd, Michael Hill Franchise Services Pty Ltd, Michael Hill Franchise Pty Ltd, Michael Hill New Zealand Ltd, Michael Hill Jeweller Ltd, Michael Hill Franchise Holdings Ltd, Michael Hill Finance (NZ) Ltd, Michael Hill Online Pty Ltd, Michael Hill Charms Pty Ltd, Emma & Roe Pty Ltd, Emma & Roe Online Pty Ltd, Michael Hill Online Holdings Ltd and Emma & Roe NZ Ltd.

The Class Order requires the Parent Company and each of the subsidiaries to enter into a Deed of Cross Guarantee. The effect of the deed is that the Company guarantees each creditor payment in full of any debt in the event of winding up of any of the subsidiaries under certain provisions of the Corporations Act 2001. If a winding up occurs under other provisions of the Corporations Act 2001, the Company will only be liable in the event that after six months any creditor has not been paid in full. The subsidiaries have also given similar guarantees in the event that the Company is wound up.

The above companies represent a Closed Group for the purposes of the Class Order and, as there are no other parties to the Deed of Cross Guarantee that are controlled by Michael Hill International Limited, they also represent the Extended Closed Group.

### 39 Deed of cross guarantee (continued)

#### Statement of comprehensive income

Set out below are the consolidated statement of comprehensive income and statement of changes in equity of the Closed Group consisting of Michael Hill International Limited and the subsidiaries listed above.

	2016 \$'000	2015 \$'000
<b>Revenue from sale of goods and services</b>	<b>448,800</b>	424,064
Sales to Group companies not in Closed Group	44,699	33,707
Other income	532	457
Cost of goods sold	(196,809)	(177,894)
Employee benefits expense	(118,525)	(110,301)
Occupancy costs	(41,529)	(40,738)
Marketing expenses	(21,342)	(23,938)
Selling expenses	(21,580)	(20,452)
Depreciation and amortisation expense	(13,494)	(11,997)
Loss on disposal of property, plant and equipment	(290)	(83)
Other expenses	(16,852)	(15,796)
Finance costs	(6,468)	(5,077)
<b>Profit before income tax</b>	<b>57,142</b>	51,952
Income tax expense	(25,460)	(13,129)
<b>Profit for the year</b>	<b>31,682</b>	38,823
<b>Other comprehensive income</b>		
Currency translation differences arising during the year	4,207	(7,855)
<b>Total comprehensive income for the year</b>	<b>35,889</b>	30,968
<b>Statement of changes in equity</b>		
<b>Balance at 1 July</b>	<b>461,184</b>	466,503
Total comprehensive income	35,889	30,968
Cancellation of treasury stock	7	-
Employee shares issued	-	109
Option expense through share based payments reserve	245	25
Dividends paid	(17,490)	(36,421)
<b>Balance at 30 June</b>	<b>479,835</b>	461,184

### 39 Deed of cross guarantee (continued)

#### Statement of financial position

Set out below are the statement of financial position as at 30 June for the Closed Group consisting of Michael Hill International Limited and the subsidiaries listed above.

	2016 \$'000	2015 \$'000
<b>Current assets</b>		
Cash and cash equivalents	2,779	2,060
Trade and other receivables	11,758	8,375
Inventories	147,595	134,767
Loans to related parties	213,978	103,045
Current tax receivables	-	11,060
Other current assets	3,131	5,412
<b>Total current assets</b>	<b>379,241</b>	<b>264,719</b>
<b>Non-current assets</b>		
Trade and other receivables	-	-
Property, plant and equipment	44,543	39,928
Deferred tax assets	60,131	45,192
Intangible assets	4,944	6,429
Investments in subsidiaries	121,033	200,565
Other non-current assets	1,799	1,982
<b>Total non-current assets</b>	<b>232,450</b>	<b>294,096</b>
<b>Total assets</b>	<b>611,691</b>	<b>558,815</b>
<b>Current liabilities</b>		
Trade and other payables	37,053	36,387
Current tax liabilities	25,033	-
Provisions	4,542	4,232
Deferred revenue	19,485	17,175
<b>Total current liabilities</b>	<b>86,113</b>	<b>57,794</b>
<b>Non-current liabilities</b>		
Provisions	5,198	4,255
Deferred revenue	40,545	35,582
<b>Total non-current liabilities</b>	<b>45,743</b>	<b>39,837</b>
<b>Total liabilities</b>	<b>131,856</b>	<b>97,631</b>
<b>Net assets</b>	<b>479,835</b>	<b>461,184</b>
<b>Equity</b>		
Contributed equity	302,756	302,749
Reserves	1,582	(2,870)
Retained profits	175,497	161,305
<b>Total equity</b>	<b>479,835</b>	<b>461,184</b>

## Independent auditor's report to the members of Michael Hill International Limited

### Report on the financial report

We have audited the accompanying financial report of Michael Hill International Limited, which comprises the consolidated statement of financial position as at 30 June 2016, the consolidated statement of comprehensive income, the consolidated statement of changes in equity and the consolidated statement of cash flows for the year then ended, notes comprising a summary of significant accounting policies and other explanatory information, and the directors' declaration of the consolidated entity comprising the company and the entities it controlled at the year's end or from time to time during the financial year.

### *Directors' responsibility for the financial report*

The directors of the company are responsible for the preparation of the financial report that gives a true and fair view in accordance with Australian Accounting Standards and the *Corporations Act 2001* and for such internal controls as the directors determine are necessary to enable the preparation of the financial report that is free from material misstatement, whether due to fraud or error. In Note 2, the directors also state, in accordance with Accounting Standard AASB 101 *Presentation of Financial Statements*, that the financial statements comply with *International Financial Reporting Standards*.

### *Auditor's responsibility*

Our responsibility is to express an opinion on the financial report based on our audit. We conducted our audit in accordance with Australian Auditing Standards. Those standards require that we comply with relevant ethical requirements relating to audit engagements and plan and perform the audit to obtain reasonable assurance about whether the financial report is free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial report. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial report, whether due to fraud or error. In making those risk assessments, the auditor considers internal controls relevant to the entity's preparation and fair presentation of the financial report in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal controls. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by the directors, as well as evaluating the overall presentation of the financial report.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

### *Independence*

In conducting our audit we have complied with the independence requirements of the *Corporations Act 2001*. We have given to the directors of the company a written Auditor's Independence Declaration, a copy of which is included in the directors' report.

### **Opinion**

In our opinion:

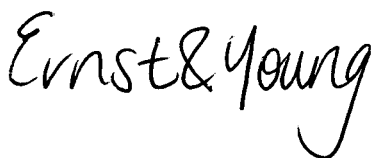
- a. the financial report of Michael Hill International Limited is in accordance with the *Corporations Act 2001*, including:
  - i giving a true and fair view of the consolidated entity's financial position as at 30 June 2016 and of its performance for the year ended on that date; and
  - ii complying with Australian Accounting Standards and the *Corporations Regulations 2001*; and
- b. the financial report also complies with *International Financial Reporting Standards* as disclosed in Note 2.

### **Report on the remuneration report**

We have audited the Remuneration Report included in the directors' report for the year ended 30 June 2016. The directors of the company are responsible for the preparation and presentation of the Remuneration Report in accordance with section 300A of the *Corporations Act 2001*. Our responsibility is to express an opinion on the Remuneration Report, based on our audit conducted in accordance with Australian Auditing Standards.

### **Opinion**

In our opinion, the Remuneration Report of Michael Hill International Limited for the year ended 30 June 2016, complies with section 300A of the *Corporations Act 2001*.



Ernst & Young



Alison de Groot  
Partner  
Brisbane  
18 August 2016