michael hill

INTERNATIONAL LIMITED

NZX ANNOUNCEMENT

MICHAEL HILL INTERNATIONAL ANNOUNCES INTERNAL RESTRUCTURING

Summary Points:

1. Over the past 25 years the Michael Hill Jeweller System of retailing has been developed into a valuable Intellectual Property asset including copyright material, trade marks and brands and software. This intellectual property has been owned by the New Zealand subsidiary, Michael & Co Ltd.

2. In 2003 the company reached agreement with the Australian Taxation Office and the Inland Revenue Department to enter into a 5 year Advanced Pricing Arrangement (APA) which recognised the value of the System to the subsidiaries trading in the various countries where we operate the Michael Hill business. This agreement was due for review in 2009.

3. Over the past 5 years there has been a progressive shift in the Group's management and support functions from New Zealand to Australia. This fundamental shift in functions has required the Group to review its existing international transfer pricing arrangements and as a result of this review the decision has been made to transfer the Intellectual Property comprising the Michael Hill Jeweller System from New Zealand to Australia.

4. To this end the directors of Michael Hill International Ltd have resolved to transfer the Intellectual Property in the "Michael Hill Jeweller System of Retailing" from Michael & Co Ltd, to its Australian subsidiary, Michael Hill Franchise Pty Ltd, for NZ$293m with effect from Monday, 15 December 2008. This value was provided by Valuation Consulting Limited, a UK based specialist in IP valuation.

5. Settlement of the purchase price will be made through intra-group lending arrangements and will not involve any additional external borrowings for the group.

6. As a result of the transaction the after tax profit of the Group for the 2008-09 year will be increased by around NZ$57 million due primarily to the recognition of future Australian taxation deductions available for certain intellectual property rights acquired.

7. In addition to the benefits in 6 above, after tax profits in each subsequent year will also increase by around NZ$7.4 million per annum as a result of the impact for the Group of the inter company funding arrangements implemented for the transfer of the Intellectual Property. It is anticipated that this benefit should continue until at least 2012-13.

8. The cash-flow benefits for the group should increase by approximately $4.9 million for the 2008-09 year and should increase by around $9.5 million per annum for the four years from 2009 to 2013.

Restructure Commentary

Michael Hill International Ltd today announced an internal restructuring of the Group which will materially and positively affect the after-tax profits and cash flow of the Group in coming years, commencing from 15 December 2008.

The restructuring involves the sale of the Michael Hill Jeweller System, which comprises almost all the intellectual property held within the Group, from its current owner, the NZ subsidiary, Michael & Co Ltd, to the Australian subsidiary, Michael Hill Franchise Pty Ltd, with effect from 15 December 2008.

The sale transaction was necessitated by and forms part of the progressive shift of a substantial part of the Group's management and support functions from New Zealand to Australia over the past 5 years, including the movement of the Group's head office, manufacturing, distribution and key management functions to Australia. This fundamental shift in functions has also required the Group to review its existing international transfer pricing arrangements which are in place for taxation purposes with a view to improving efficiencies and governance structures. The transaction arises from that review.

This is an internal restructure and does not involve an external party. As such, no external financing is required. Notwithstanding that the sale is an internal transaction it does have significant financial reporting implications and it has been important to fix the price at which the Michael Hill Jeweller System is sold on an arm's length basis. In this respect the Board of Directors of Michael Hill International Ltd has obtained independent valuation advice from UK valuers, Valuation Consulting Limited, a subsidiary of BNP Paribas, and recognised as one of the leading Intellectual Property valuation authorities in the world.

Effect on 2008-09 Financial Results

The financial impacts of the above transaction on the 2008-09 consolidated group accounts of Michael Hill International Ltd, as reported under the New Zealand equivalents to International Financial Reporting Standards (NZ IFRS) are as follows:

	NZD $'000
Increase in group after-tax profit under NZ IFRS	57,000
Recognition of deferred tax asset under NZ IFRS	53,000
Reduction in current tax liability under NZ IFRS	4,000

The deferred tax asset reflects the recognition of future Australian taxation deductions available for certain Intellectual Property rights acquired. The reduction in current tax liability reflects the impact in 2008-09 of the inter company funding arrangements implemented for the transfer of the Intellectual Property.

Effects beyond 2008-09 Financial Results

In addition to the above financial impacts, the transaction should also result in an increase in consolidated group after tax profit under NZ IFRS of approximately NZD$7.4 million per annum from 2009-10 through to 2012-13. This reflects the ongoing impact of the inter company funding arrangements implemented for the transfer of the Intellectual Property.

Cash Flow Impacts of Restructuring

The forecast cash-flow benefits to the Group arising solely from this transaction estimated over the next five years are:

	NZD $'000
2008/09	4,900
2009/10	9,500
2010/11	9,500
2011/12	9,500
2012/13	9,500

The cash-flow benefits are a combination of the NZD $7.4 million per annum benefit outlined above and a NZD $2.1 million per annum benefit arising from Australian taxation deductions for the Intellectual Property rights acquired.

Cash-flow benefits for the Group from the transaction should continue after five years but at this stage other than a minimum continuing benefit of NZD $2.1 million per annum cannot be accurately forecast. The benefits arise from an expected reduction in future Group tax liabilities. The material Australian tax aspects of the acquisition of the Michael Hill Jeweller System by Michael Hill Franchise Pty Ltd have been confirmed by a private binding ruling issued by the Australian Taxation Office.

Dividend Implications

A consequence of the transaction is that the Company is unlikely to be able to fully impute dividends or fully frank dividends (for Australian tax purposes) from the 2009-10 financial year. Assuming that the past pattern of dividends continued the last dividend which would be paid with full imputation credits in New Zealand and full franking credits in Australia would be the dividend paid in April 2009. Thereafter dividends are expected to have very limited imputation credits in New Zealand and be around 50% franked for Australian tax purposes.

Michael Hill.

R.M. Hill 15/12/2008
Chairman
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