

Independent Adviser's Report

In Respect of the Proposed Allotment of 100,000 Shares to Emma Hill

Michael Hill International Limited

September 2007

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1. Introduction

1.1 Background

Michael Hill International Limited (**MHI** or the **Company**) is listed on the main equities security market (**NZSX**) operated by New Zealand Exchange Limited with a market capitalisation of \$386 million as at 7 September 2007 and audited total equity of \$73 million as at 30 June 2007.

The Company operates *Michael Hill Jeweller* – a retail jewellery chain with 189 stores in New Zealand, Australia and Canada.

1.2 Proposed Issue of Shares to Emma Hill

On 22 August 2002, MHI and Emma Hill entered into an Option Agreement whereby MHI issued 100,000 options to Ms Hill (the **E Hill Options**) as part of her remuneration as Retail General Manager, MHI Canada.

The key terms of the E Hill Options are:

- Ms Hill could exercise up to 25% of the options in the period from 1 July 2005 to 30 June 2006
- in the period from 1 July 2006 to 30 June 2007, Ms Hill could exercise the aggregate of 25% of the options and any number of options not exercised in the previous period so that not more than 50% of the options were exercised prior to 30 June 2007
- in the period from 1 July 2007 to 30 June 2008, Ms Hill can exercise all of the options not previously exercised
- an exercise price of \$6.15 per share, being 15% above the weighted average price of the Company's shares over the calendar month following the announcement by the Company to NZSX of its consolidated results for the year ended 30 June 2002
- the options expire if not exercised by 30 June 2008.

The Company's shareholders approved the issue of the E Hill Options at its annual general meeting on 28 November 2002.

Ms Hill has not exercised any options as yet. She has confirmed to the Company that she intends to exercise the options in the period between April and June 2008.

MHI announced on 17 August 2007 that it will undertake a ten for one share split on 19 November 2007. Accordingly, upon exercise of the E Hill Options after this date, Ms Hill will be issued 1,000,000 shares at an issue price of \$0.615 per share rather than 100,000 shares at an issue price of \$6.15 per share. The total consideration paid by Ms Hill for the shares will remain at \$615,000.

For ease of comparison, all shareholding analyses in this report are based on the number of shares prior to the share split. Accordingly, we refer to 100,000 shares being allotted upon exercise of the E Hill Options.

Ms Hill is a director of the Company and could be considered to be associated with Hill family members and associated trusts (the **Hill Family Interests**) who collectively hold 48.11% of the voting securities in MHI.

1.3 Regulatory Requirements

Rule 6(1)(a) of the Takeovers Code (the **Code**) prohibits a person who holds or controls less than 20% of the voting rights in a code company from increasing their control of voting rights if, after that event, that person and that person's associates hold or control more than 20% of the voting rights in the code company unless the person and that person's associates comply with exceptions to this fundamental rule.

One of the exceptions, set out in Rule 7(d) of the Code, enables a shareholder and its associates to increase their shareholding beyond 20% of the voting rights by an allotment of shares if the allotment is approved by an ordinary resolution of the code company.

The allotment of 100,000 shares on the exercise of the E Hill Options will result in Ms Hill increasing her shareholding in the Company from 54,136 shares (0.14% of the voting securities in the Company) to 154,136 shares (0.4% of the voting securities) and the Hill Family Interests' collective shareholding in the Company increasing from 18,295,777 shares (48.11% of the voting securities) to 18,395,777 shares (48.25% of the voting securities).

Accordingly, MHI's shareholders will be asked to vote at the Company's annual meeting of shareholders on 8 November 2007 on a resolution in respect of the allotment of 100,000 shares to Ms Hill (resolution 5).

Shareholders will also be asked to vote on resolutions in respect of:

- the re-election of Michael Hill as a director (resolution 1)
- the re-election of Gary Gwynne as a director (resolution 2)
- the election of Emma Hill as a director (resolution 3)
- the directors fixing the remuneration of the Company's auditors (resolution 4)
- the issue of 200,000 options to Michael Parsell (resolution 6)
- an increase in directors fees (resolution 7).

Rule 16(h) of the Code requires that the notice of meeting in respect of an allotment of shares under Rule 7(d) must include or be accompanied by an Independent Adviser's Report.

1.4 Purpose of the Report

The independent directors of MHI, being those directors not associated with the Hill Family Interests (the **Independent Directors**) have engaged Simmons Corporate Finance Limited (**Simmons Corporate Finance**) to prepare an Independent Adviser's Report on the merits of the allotment of 100,000 shares to Ms Hill in accordance with Rule 18 of the Code.

Simmons Corporate Finance was approved by the Takeovers Panel on 9 August 2007 to prepare the Independent Adviser's Report.

Simmons Corporate Finance issues this Independent Adviser's Report to the Independent Directors to assist the Company's shareholders not associated with the Hill Family Interests (the **Non-associated Shareholders**) in forming their own opinion on whether to vote for or against resolution 5 in respect of the allotment of 100,000 shares to Ms Hill.

We note that each shareholder's circumstances and objectives are unique. Accordingly, it is not possible to report on the merits of the allotment of 100,000 shares to Ms Hill in relation to each shareholder. This report on the merits of the allotment of shares is therefore necessarily general in nature.

The Independent Adviser's Report is not to be used for any other purpose without our prior written consent.

2. Evaluation of the Merits of the Allotment of 100,000 Shares to Ms Hill

2.1 Basis of Evaluation

Rule 18 of the Code requires an evaluation of the merits of the allotment of 100,000 shares to Ms Hill, having regard to the interests of the Non-associated Shareholders.

There is no legal definition of the term *merits* in New Zealand in either the Code or in any statute dealing with securities or commercial law.

In the absence of an explicit definition of *merits*, guidance can be taken from:

- the Takeover Panel guidance note on the role of independent advisers dated August 2007
- definitions designed to address similar issues within New Zealand regulations which are relevant to the proposed transaction
- overseas precedents
- the ordinary meaning of the term *merits*.

We are of the view that an assessment of the merits of the allotment of 100,000 shares to Ms Hill should focus on:

- the likely impact on the control of MHI if the 100,000 shares are allotted to Ms Hill
- the likely impact on MHI's share price of the allotment of shares
- the implications if the resolution in respect of the allotment of shares is not approved.

Our opinion should be considered as a whole. Selecting portions of the evaluation without considering all the factors and analyses together could create a misleading view of the process underlying the opinion.

We note that the rationale for the E Hill Options and the fairness of the terms and conditions of the E Hill Options are not matters for consideration in evaluating the merits of the allotment of 100,000 shares to Ms Hill. MHI's shareholders have already approved the issue of the E Hill Options on 28 November 2002. At that time, the Hill Family Interests held 51.87% of the shares in the Company.

2.2 Impact on Control

Shares on Issue

MHI currently has 38,105,319 ordinary shares on issue of which:

- 38,029,665 shares are held by 2,641 shareholders
- 75,654 shares are held by the Company as treasury stock.

Because voting rights are suspended on MHI shares held by the Company as treasury stock, the total number of voting securities for the purposes of the Code is 38,029,665.

MHI currently has 200,000 employee options outstanding (including the E Hill Options).

The Company proposes to issue a further 200,000 options to Mr Parsell (its chief executive officer and director), subject to shareholder approval of resolution 6.

Shareholders

Ms Hill currently holds 54,136 shares in the Company, representing 0.14% of the shares held by shareholders.

The Hill Family Interests currently collectively hold 18,295,777 shares in the Company, representing 48.11% of the shares held by shareholders.

The 100,000 shares allotted upon the exercise of the E Hill Options will represent 0.26% of the number of MHI shares held by shareholders following the allotment (assuming no other changes to the number of shares held by shareholders).

As set out below, Ms Hill's shareholding will increase to 154,136 shares (0.4%) and the Hill Family Interests' collective shareholding will increase to 18,395,777 shares (48.25%).

The next largest shareholder in the Company is Fisher Funds Management Limited (**Fisher Funds**) which holds 5,585,031 shares (14.69%) (based on its most recent substantial security holder notice filed on 27 April 2007).

MHI Shareholders				
Shareholder	Current		Post Allotment	
	No. of Shares Held	%	No. of Shares Held	%
Quinten Trust	10,116,260	26.60%	10,116,260	26.53%
Michael Hill International Share Trust	7,736,636	20.34%	7,736,636	20.29%
Boxer Hill Trust	356,630	0.94%	356,630	0.94%
Emma Hill	54,136	0.14%	154,136	0.40%
Wilemena Stephen	32,115	0.09%	32,115	0.09%
Hill Family Interests	18,295,777	48.11%	18,395,777	48.25%
Fisher Funds ¹	5,585,031	14.69%	5,585,031	14.64%
Others (2,634 shareholders)	14,148,857	37.20%	14,148,857	37.11%
Total shares held by shareholders	38,029,665	100.00%	38,129,665	100.00%

¹ held by TEA Custodians Limited and NZ Superannuation Fund Nominees Limited

Source: NZX Data

Shareholder Voting

The increase in the Hill Family Interests' shareholding from 48.11% to 48.25% of the shares held by shareholders will have negligible impact on its ability to influence the outcome of ordinary resolutions and special resolutions.

Board of Directors

The directors of MHI are:

- Michael Hill – chair, associated with the Hill Family Interests
- Christine Hill - associated with the Hill Family Interests
- Emma Hill - associated with the Hill Family Interests
- Mike Parsell – chief executive officer
- Wayne Peters - non executive director
- Murray Doyle – non executive and independent director
- Gary Gwynne – non executive and independent director.

Emma Hill was appointed to the board of directors on 23 February 2007.

The allotment of 100,000 shares to Ms Hill will have no impact on the composition of the Company's board of directors or the Hill Family Interests' level of influence at board level.

Operations

In addition to being a director, Ms Hill was until recently General Manager of MHI's Canadian retail operations.

The allotment of 100,000 shares to Ms Hill will have no discernible impact on the operations of the Company.

2.3 Impact on Share Price and Liquidity

Share Price

Shareholders approved the issue of the E Hill Options on 28 November 2002 and the terms of the options have been disclosed in MHI's annual reports each year since then. Accordingly, the market is fully informed of the terms of the options and we would expect that the options have been fully priced into MHI's share price.

The allotment of 100,000 shares at \$6.15 per share compared with the Company's current share price of \$10.15 (as at 7 September 2007) will have a negligible dilutionary impact on MHI's share price.

The 100,000 shares allotted will represent 0.26% of the number of MHI shares held by shareholders following the allotment (assuming there are no other changes to the number of shares held by shareholders). Non-associated Shareholders' relative shareholdings in the Company will be diluted by this percentage which we consider to be negligible.

Based on the above, we are of the view that the allotment of 100,000 shares to Ms Hill will have negligible impact on the Company's share price.

Liquidity

The size of the pool of shares held by the Non-associated Shareholders will not change as a result of the allotment of 100,000 shares to Ms Hill.

In our view, the allotment of shares to Ms Hill will not have any effect on the liquidity of MHI's shares.

2.4 Summary of Evaluation of Merits

The proposed allotment of 100,000 shares to Ms Hill arises from any future exercise of the E Hill Options. The issue of the E Hill Options was considered and approved by the Company's shareholders on 28 November 2002.

Any allotment of 100,000 shares to Ms Hill following exercise of the E Hill Options will have negligible impact on the Hill Family Interests' level of shareholding voting control and will have no impact on its control over the board of directors or the Company's operations. Furthermore, we do not envisage that the issue of shares will have any noticeable impact on the Company's share price or the liquidity of the shares.

2.5 Implications of the Resolution not Being Approved

In the event that resolution 5 in respect of the allotment of 100,000 shares to Ms Hill is not approved, then the Company may be denied the opportunity to reward Ms Hill for performance in her senior management role in the manner contemplated on the issue of the E Hill Options and which was approved by the Non-associated Shareholders.

In such circumstances, the Company may look to remunerate Ms Hill in some other form and such form may or may not require the approval of the Non-associated Shareholders.

2.6 Voting For or Against the Resolution

Voting for or against resolution 5 in respect of the allotment of 100,000 shares to Ms Hill is a matter for individual shareholders based on their own views as to value and future market conditions, risk profile and other factors. Shareholders will need to consider these consequences and consult their own professional adviser if appropriate.

3. Sources of Information, Reliance on Information, Disclaimer and Indemnity

3.1 Sources of Information

The statements and opinions expressed in this report are based on the following main sources of information:

- the draft MHI notice of 2007 annual meeting
- the MHI full year preliminary announcement for the year ended 30 June 2007
- the MHI annual report for the year ended 30 June 2006
- the MHI half year report to 31 December 2006
- the Option Agreement between MHI and Ms Hill dated 22 August 2002
- the notice of 2002 annual meeting
- the minutes of the 2002 annual meeting
- an analysis of MHI shares on issue
- MHI shareholder data from NZX Data.

During the course of preparing this report, we have had discussions with and / or received information from the executive management and Independent Directors of MHI and MHI's legal advisers.

The Independent Directors of MHI have confirmed that we have been provided for the purpose of this Independent Adviser's Report with all information relevant to the allotment of shares to Ms Hill that is known to them and that all the information is true and accurate in all material aspects and is not misleading by reason of omission or otherwise.

Including this confirmation, we have obtained all the information that we believe is necessary for the purpose of preparing this Independent Adviser's Report.

In our opinion, the information set out in this Independent Adviser's Report is sufficient to enable the Independent Directors and the Non-associated Shareholders to understand all the relevant factors and to make an informed decision in respect of the allotment of shares to Ms Hill.

3.2 Reliance on Information

In preparing this report we have relied upon and assumed, without independent verification, the accuracy and completeness of all information that was available from public sources and all information that was furnished to us by MHI and its advisers.

We have evaluated that information through analysis, enquiry and examination for the purposes of preparing this report but we have not verified the accuracy or completeness of any such information or conducted an appraisal of any assets. We have not carried out any form of due diligence or audit on the accounting or other records of MHI. We do not warrant that our enquiries would reveal any matter which an audit, due diligence review or extensive examination might disclose.

3.3 Disclaimer

We have prepared this report with care and diligence and the statements in the report are given in good faith and in the belief, on reasonable grounds, that such statements are not false or misleading. We assume no responsibility arising in any way whatsoever for errors or omissions (including responsibility to any person for negligence) for the preparation of the report to the extent that such errors or omissions result from our reasonable reliance on information provided by others or assumptions disclosed in the report or assumptions reasonably taken as implicit.

We have had no involvement in the preparation of the notice of meeting issued by MHI and have not verified or approved the contents of the notice of meeting. We do not accept any responsibility for the contents of the notice of meeting except for this report.

3.4 Indemnity

MHI has agreed that, to the extent permitted by law, it will indemnify Simmons Corporate Finance and its directors and employees in respect of any liability suffered or incurred as a result of or in connection with the preparation of the report. This indemnity does not apply in respect of any negligence, wilful misconduct or breach of law. MHI has also agreed to indemnify Simmons Corporate Finance and its directors and employees for time incurred and any costs in relation to any inquiry or proceeding initiated by any person. Where Simmons Corporate Finance or its directors and employees are found liable for or guilty of negligence, wilful misconduct or breach of law or term of reference, Simmons Corporate Finance shall reimburse such costs.

4. Qualifications and Expertise, Independence, Declarations and Consents

4.1 Qualifications and Expertise

Simmons Corporate Finance is a New Zealand owned specialist corporate finance advisory practice. It advises on mergers and acquisitions, prepares independent expert's reports and provides valuation advice.

The person in the company responsible for issuing this report is Peter Simmons, B.Com, DipBus (Finance), CFIP, CA.

Simmons Corporate Finance and Mr Simmons have significant experience in the independent investigation of transactions and issuing opinions on the merits and fairness of the terms and financial conditions of the transactions.

4.2 Independence

Simmons Corporate Finance does not have at the date of this report, and has not had, any shareholding in or other relationship with MHI that could reasonably be regarded as capable of affecting our ability to provide an unbiased opinion in relation to this transaction.

Simmons Corporate Finance has not had any part in the formulation of the allotment of shares to Ms Hill or any aspects thereof. Our sole involvement has been the preparation of this report.

Simmons Corporate Finance will receive a fixed fee for the preparation of this report. This fee is not contingent on the conclusions of this report or the outcome of the voting in respect of the allotment of shares to Ms Hill. We will receive no other benefit from the preparation of this report.

4.3 Declarations

Advance drafts of this report were provided to the Independent Directors. Certain changes were made to the drafting of the report as a result of the circulation of the drafts. However, there was no material alteration to any part of the substance of this report, including the methodology or conclusions as a result of issuing the drafts.

Our terms of reference for this engagement did not contain any term which materially restricted the scope of the report.

4.4 Consents

We consent to the issuing of this report in the form and context in which it is to be included in the notice of meeting to be sent to MHI's shareholders. Neither the whole nor any part of this report, nor any reference thereto may be included in any other document without our prior written consent as to the form and context in which it appears.

Simmons Corporate Finance Limited

7 September 2007