michael hill
INTERNATIONAL LIMITED

NZX Announcement - Changes in IP Value

On 16 December 2008 the Company announced an internal restructuring of the Michael Hill Group.

The restructuring involved the sale of all the intellectual property represented in the Michael Hill Jeweller System held within the Group, from the New Zealand subsidiary, Michael & Co Limited, to an Australian subsidiary, Michael Hill Franchise Pty Limited. The restructuring was effective from 15 December 2008 and the sale price was $294 million. The price had been determined following independent expert valuation advice from Valuation Consulting Limited (now named BNP Paribas Business Assets Valuation Limited ("BAV Limited"), a UK based specialist in IP valuation, which is a wholly owned subsidiary of BNP Paribas.

There were a number of financial consequences of the restructuring, details of which were provided at the time of the December 2008 announcement and further described in the company's 2009 Annual Report. In summary these were the recording of a deferred tax asset of $52.9 million and some further reductions in income tax expense of approximately $7.4 million annually for a number of years.

At the time of the announcement the Australian Tax Office (ATO) had provided rulings on the various technical aspects of the transaction. Following steps being taken by the Company to renew its ongoing Advance Pricing Agreement, with the ATO and NZ IRD, for cross border transactions, the ATO, whilst not revisiting the technical aspects of the transfer, raised a query with the Company as to the value at which the transfer of the Michael Hill System occurred. In this respect, the ATO requested a response from the Company on a report the ATO had received from another valuation consultant commissioned by the ATO which had arrived at a lower value.

As a consequence, the Company referred the issues raised by the ATO back to BAV Limited for their comment and assessment. The Company has just received a revised report from BAV Limited, the conclusion of which is that the original valuation should be adjusted by $20 million from $294 million to $274 million. The major reasons for the adjustment relates to a correction in the financial models for the allocation of franchise fees between the franchisee and the franchisor, adjustment to discount rates and foreign exchange rates used in the original valuation. BAV Limited has otherwise confirmed their original valuation.

The board has considered the revised valuation from BAV Limited and has decided that the original value, at which the Michael Hill System was transferred, should be amended to the revised value of $274 million.

This amendment will have the following accounting consequences.

Reduction of deferred tax asset recorded in 2008/09 of $2.8m (from $52.9m to $50.1m)

Increased tax expense in 2008/09 of $2.8m resulting from the corresponding change in sale price

Increased tax expense in 2009/10 of $0.8m (18 months impact)

While, at this stage the ATO has not advised the Company that it does not accept the original valuation on which the transaction was based, the Company has taken the view that the value of the transaction should not exceed the adjusted valuation of the Company's own valuers. The ATO will be advised of these changes and provided with a copy of the revised valuation from BAV Limited.

While the ATO had provided rulings on the technical aspects of the transaction, no rulings were sought at that time from the New Zealand IRD. However, subsequently the Company has sought an IRD ruling to obtain certainty on some of the New Zealand aspects.

The full year preliminary result announcement for the year ended 30 June 2010 will be made to NZX on Friday, 20 August 2010.

Michael Hill.

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