Hills Limited
Annual report
for the year ended 30 June 2017

ABN 35 007 573 417

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Contents

Shareholders' Letter

Dear Shareholder,

Today, the Company's spirit of innovation is focused on delivering technology products and service solutions that connect, entertain and secure people's lives. We have diversified and divested from clothes lines and metal products, and expanded our product range and solutions to include Audio Visual, Communications, Security and Surveillance, Fire, Nurse Call, Patient Engagement and asset tracking solutions, but our focus has remained constant:

> We are committed to delivering technology solutions into the environments that people need and trust most: their homes, hospitals, places of learning, entertainment venues, retail spaces, transport and infrastructure, banking and finance, workplaces and government institutions.

Financial Year 2017 (FY17) was another busy year for everyone at Hills.

David Lenz, our CEO, has completed 12 months in the role following the planned retirement of Grant Logan. Chris Jacka was promoted to the position of CFO and David Fox, our General Counsel and Company Secretary, was also promoted, having previously filled the role of General Counsel for a number of years.

Net profit performance of your Company improved during the year following the impairment charges booked in the prior year. Revenue declines within the core distribution business in part following changes in vendor portfolios did impact overall profitability along with Hills decision to exit NBN Co satellite installations, with significant effort during the year focussed on:

- a further reduction in corporate costs;
- selectively outsourcing some administrative functions to Cognizant;
- strengthened vendor and customer relationships;
- continued training and development of our people;
- integration of Hills Health Solutions (HHS) into the Group and continued improvement of its profitability in FY17;
- transition of the Hills Home Living assets to AMES Australasia from Woolworths following the exit of Woolworths from its Masters business; and
- reducing net debt by $1.6 million and working capital by $8.9 million on the back of a small operating cash outflow of $0.8 million.

It was disappointing that we recorded a net loss of $7.9 million for the year, which was in line with the market guidance provided in June 2017, after allowing for:

- professional costs associated with the termination of the proposed Lincor merger;
- redundancy costs incurred in further reducing overheads and "right-sizing" the Company;
- inventory write downs;
- incurring additional costs under the satellite installation services with Ericsson/NBN; and
- transition of the Hills Home Living assets to AMES Australasia from Woolworths, following the exit of Woolworths from its Masters business.

Shareholders' Letter (continued)

Most importantly, during the period we continued to establish a solid platform for growth in the healthcare, security and surveillance, communications and audio visual sectors which will have a positive impact on our profitability in FY18 and beyond.

These projects included:

- commencing our investment of $2-2.5 million in our market-leading Digital Platform, which will enable us to better service our customers early in the new calendar year with:
  - 24 x 7 e-commerce access;
  - Real-time inventory access;
  - customer statements, invoices and price books;
  - online payments;
  - product specifications; and
  - delivery information.
- implementing annualised cost savings of $12 million in FY17, with an $8 million benefit in FY18;
- continued development of our own IP, including our new dementia software and the refresh of our Australian Monitor portfolio;
- expansion of our patient engagement by including BYOD offerings and the securing of finance options for our healthcare customers;
- securing the sole distribution rights to UTC security and surveillance solutions; and
- launching new technologies such as TruVision CCTV solutions to address our low end CCTV market and HillsTrak providing our customers with an asset-tracking solution.

Hills again secured a number of large contracts, which will add to our FY18 profitability, including:

- working with Siemens to supply the **security solution** to **Perth Stadium**;
- delivery of a unified **Genetec Security Centre solution** with AXIS cameras to **NSW Parliament House**;
- supply of a **Genetec Video**, **AXIS cameras** and **Dell** hardware solution to **Mirvac Retail Properties**;
- delivery of a **Genetec Video** and **AXIS cameras solution** to **Transurban Limited** nationally;
- through Virtual Graffiti, supply of a **Ruckus solution** (station wifi) to **Sydney Trains**;
- delivery of **Samsung Panels** through Fredon and Telstra to the Melbourne and Sydney offices of PricewaterhouseCoopers;
- supply of **L'Acoustics** speakers for the **Asia Games Kuala Lumpur** and two hall upgrades at **Sydney Grammar School**;
- supply of **Williams Sound Hearing loops** as part of an overall upgrade for **Sydney Trains**;
- supply of the **Hills IP-Series nurse call** to the new **Joan Kirner's Women's and Children's Hospital** in Victoria;
- supply of a **nurse call solution** as part of the Stage 2 redevelopment for **Blacktown Hospital** in NSW;
- the supply of **nurse call and patient engagement** services to **Northern Beaches Hospital** (NSW);
- a five-year contract extension to provide **patient engagement** services to **Northern Health** (Victoria) including The Northern Hospital, the Bundoora Extended Care Centre and the Broadmeadows Health Service;
- supply of **patient engagement services** for over 1200 beds for **Sydney Local Health District** – Royal Prince Alfred, Concord, Canterbury and Balmain Hospitals; and
- a **patient engagement** contract extension for four hospitals in **Eastern Health** (Victoria), including Angliss, Box Hill, Maroondah and Peter James Centre Hospitals.

Shareholders' Letter (continued)

It is a tribute to the whole Hills team that we won a number of key awards again during FY17, including:

- **Genetec**: SDK Developer of the year APAC
- **Genetec**: Distributor of the year APAC
- **Ruckus**: Distributor of the year ANZ

Hills continues to add value by delivering high quality service and unequalled expertise to our Customers. We have invested in a dedicated and highly experienced team of experts, specialising in sales, design, technical support, installation, internal quality and governance. More than a distributor, Hills is a unique provider of managed services and end to end solutions, with competencies across the sectors in which we operate that few others can match.

Whilst we still have work to do we have now established a base for a platform from which to grow and this could not have been achieved without significant effort and commitment from all Hills employees and we thank them all for their contribution.

Yours sincerely

Jennifer Hill-Ling

Chairman

David Lenz

Chief Executive Officer

The Directors present their report on the consolidated entity (referred to hereafter as Hills, the Company or the Group) consisting of Hills Limited and the entities it controlled at the end of, or during, the year ended 30 June 2017 (FY17), and the independent auditor's report thereon.

Directors

The following persons were Directors of the Company during the whole of the financial year and up to the date of this report:

Jennifer Helen Hill-Ling
Fiona Rosalyn Vivienne Bennett
Philip Bullock AO

David Moray Spence was a director from the beginning of the period until his retirement on 20 September 2016.
Ian Elliot was a director from the beginning of the period until his retirement on 4 November 2016.
Kenneth James Dwyer was appointed a director on 20 September 2016 and continues in office at the date of this report.

Principal activities

The principal activities of Hills during the course of the year are outlined within the Review of operations.

Review of operations

Statutory Result Overview

The Company recorded a net loss after tax attributable to owners of $7.9 million for the year ended 30 June 2017. This loss includes the impact of costs associated with the proposed demerger of the Hills Health Solutions business and other net costs associated with structuring the Company in line with our future growth opportunities.

	2017 $'000	2016 $'000
Net loss after tax, attributable to the owners of the Company	**(7,932)**	(68,305)

The net loss for the year ended 30 June 2017 includes an expense of $4.395 million relating to the impairment of inventory (comprising inventory purchased on signing a distribution agreement with Tyco in February 2015 of $3.461 million and other exited brands of $0.934 million).

Reduced Net Debt and Working Capital

Hills net debt reduced by $1.6 million in the year, from $21.6 million at 30 June 2016 to $20.0m at 30 June 2017. This was driven by a reduction in working capital, which was achieved through continued focus on reducing the Group's inventory holding and reducing aged receivables. Hills investment in net working capital decreased from $74.6 million at 30 June 2016 to $65.7 million at 30 June 2017.

Reduced Operating Expenses

Hills reduced operating expenses by $6.4 million in the year ended 30 June 2017, a decrease of 6.3% (excluding depreciation and amortisation and net costs not considered part of segment EBITDA). This has been achieved by 'right sizing' the business and the outsourcing of certain administrative functions to Cognizant. The Company expects to see continued savings in operating expenses as a result of these changes.

Review of operations (continued)

Description of Operating Segment

During the year ended 30 June 2017, there were changes to elements of the business that led to a review of the Group's reportable operating segments. These changes included:

Lincor merger	On 13 September 2016, Hills announced that it had entered into a conditional merger agreement to combine its Hills Health Solutions (HHS) business with international healthcare technology business, Lincor Solutions, to create a new ASX listed company, Lincor Limited. As announced, the conditional merger agreement was terminated in December 2016. Following the termination, management have integrated HHS into the operational activities of the remainder of the Group.
Sale of Hills Home Living assets	The Hills Home Living (HHL) business was operated by Woolworths Limited (Woolworths) under a licencing arrangement until October 2016, when the agreement was terminated after the decision by Woolworths to exit its home improvement business and close its Masters stores. In December 2016, Hills entered into an agreement with AMES Australasia (AMES) to take over the manufacture and sale of HHL products. The transaction with AMES involved the sale of tooling equipment and trademarks related to HHL products, which are no longer used by the continuing Hills business. No further revenue, expenses or profit is expected from this business.

Hills operations are now integrated into a single segment, reflective of Hills business categories, which have:

- a common customer base, covering building contractors, consultants and system integrators; and
- products and services sold primarily through common channels: building contractors and system integrators.

The business operations fall into three areas:

- Hills Health Solutions
- Hills Security, Surveillance & Communication
- Hills Audio Visual

The businesses are described in detail below.

One Hills, One Vision

Today, Hills spirit of innovation is focused on delivering technology products and service solutions that connect, entertain and secure people's lives through our three businesses.

Review of operations (continued)

Hills is committed to delivering technology solutions into the environments that people need and trust most:

- their homes
- hospitals
- places of learning
- entertainment venues
- retail spaces
- transport and infrastructure
- banking and finance
- workplaces
- government institutions

Hills provides end to end solutions in the building technology sector, across all verticals, and offers shared services like asset management and service capabilities, to complement its portfolio.

Hills adds value by delivering high quality service and unequalled expertise through a dedicated and highly experienced team of experts, specialising in sales, technical support, installation, internal quality and governance. More than a distributor, Hills is a unique provider of managed services, with competencies across the sector that few others can match.

Hills Health Solutions

Hills Health Solutions (HHS) is a market leader and comprises the supply and installation of health technology solutions, nurse call and patient entertainment and other related solutions including security, Wi-Fi and telephony, into the health and aged care sectors. HHS has products and services located in 400 hospitals and 570 aged care facilities throughout Australia and New Zealand.

HHS continues to:

- maintain market leadership in patient engagement with over 18,000 beds;
- maintain its strategic distribution relationship with Lincor Inc.; and
- invest in research and development (R&D), Nurse Call, bring your own device (BYOD), dementia software and guest wi-fi – all Hills owned IP.

Key wins for HHS in FY17:

- Joan Kirner's Women's and Children's Hospital (VIC) – Hills has successfully tendered to supply the Hills IP-Series integrated nurse call system.
- Blacktown Hospital (NSW) – a $2.5 million nurse call solution as part of the hospital's Stage 2 redevelopment project.
- Northern Health (VIC) – a new five-year contract extension to provide patient engagement services to The Northern Hospital, Bundoora Extended Care Centre and the Broadmeadows Health Service.
- Sydney Local Health District (NSW) – Hills has been awarded the patient engagement services (1200+ beds) contract for Royal Prince Alfred, Concord, Canterbury and Balmain Hospitals.

Review of operations (continued)

Security, Surveillance and Communications

Hills is the leading value-added provider of electronic security systems, closed circuit television systems, home and commercial automation and control systems, consumer electronic equipment, communications related products and services, domestic and commercial antennas, master antenna television systems, communications antennas and amplifiers in the Australian and New Zealand market. This business has recently diversified to include Fire and Asset Management.

Hills provides solutions to consumers and businesses across the following vertical markets in Australia and New Zealand: homes, hospitals, places of learning, entertainment venues, retail spaces, transport and infrastructure, banking and finance, workplaces and government institutions.

Solutions offerings include:

- Integrated access
- Card access
- Intruder alert
- Cameras
- Home hub
- Locks
- Analytics software
- HillsTrak (asset management)
- Fire detectors and alarms
- Antenna, Set top boxes, Digital TV Systems
- Professional Services
- Installations

Key wins for Security, Surveillance and Communications in FY17:

- UTC Fire & Security: Hills signed a sole-distribution agreement with UTC Fire & Security, which will help the Company to compete in the low-end CCTV market.
- Perth Stadium: Hills, working with Siemens, supplied the security solution to Perth Stadium.
- NSW Parliament House: Hills delivered a unified Genetec Security Centre solution with AXIS cameras.
- Mirvac Retail Properties: Hills supplied a Genetec Video, AXIS cameras and Dell hardware solution.
- Transurban Limited: Hills delivered a Genetec Video and AXIS cameras solution nationally.
- Sydney Trains: through Virtual Graffiti, Hills supplied Ruckus solution (station wifi) to Sydney Trains.

Audio Visual

Hills Audio Visual provides businesses in Australia and New Zealand with the next generation of audio visual technologies for education, infrastructure projects, businesses, sporting venues, houses of worship, enterprise and entertainment venues.

Review of operations (continued)

Solutions offerings include:

- Unified Communication for Huddle and Conference spaces
- LCD Displays
- Projectors
- Hearing Augmentation
- Speakers systems to suit both indoor and outdoor applications

Key Wins for AV in FY17:

- PricewaterhouseCoopers Office Upgrade – Hills delivered Samsung Panels through Fredon and Telstra to the Melbourne and Sydney Offices.
- Asia Games Kuala Lumpur – Hills supplied L'Acoustics speakers
- Sydney Grammar School - Hills supplied L'Acoustics speakers to two Hall upgrades
- Sydney Trains – Hills supplied Williams Sound Hearing loops as part of an overall upgrade.

Hills Competitive Advantage

Hills competitive advantage in each business comes from:

Vendor Relationships	Long term vendor relationships allow Hills to provide its customers with access to the largest portfolios in the industry.
Customer Relationships	Hills adds value for its customers by providing them with a full "solution" to their security, communications, audio visual and health needs - Hills is a market-leading "one stop shop", which includes pre and post installation services.
Expert Resources	Hills has invested in a dedicated and highly experienced team of security, health and audio visual experts across Australia and New Zealand covering sales and technical support.
Geographic Footprint	Hills has the largest national footprint in Australia and New Zealand making its solutions accessible for its customers.
Size	Companies like dealing with Hills because of high levels of governance, ability to extend credit and sophisticated systems and processes.
Service Model	Hills has a unique service model – it is able to harness large teams of installers to service high volume contracts such as the wireless rollout on behalf of NBN and satellite dishes for Foxtel.
Local Manufacture	Hills ability to manufacture antennas and satellite dishes and consumables locally.
Intellectual Property	Well-respected products with patent protection, Hills owns the IP for its market leading Nurse Call solution.
Research and development	R&D teams making sure Hills products evolve and keep ahead of competitors.

Subsequent events

There have been no events subsequent to balance date that would have a material effect on the Group's financial statements at 30 June 2017.

Dividends

Year ended 30 June 2017	No dividends were paid during the year and no final dividend has been declared.
Year ended 30 June 2016	No dividends were paid during the year and no final dividend was been declared.

For more information regarding dividends please refer to note 16 of the financial statements.

Significant changes in the state of affairs

Significant changes in the state of affairs of Hills during the financial year are set out in the Review of operations section of the Directors' report.

FY18 Outlook

Given Hills investments, reduction of operating expenses, strong customer and vendor management, increased profitability of the Hills Health Solutions business and the investment in the digital transformation project, Hills expects to return to profitability in FY18.

As with any technology distribution business, Hills is exposed to the risk of potential loss of vendors, potential loss of customers, slippages associated with contracts, supply issues and exposure to foreign exchange rate fluctuations.

Information on Directors

Name	Details
Jennifer Helen Hill-Ling **LLB (Adel) FAICD** *Chairman Non-Independent Non-Executive Director* *Age 55*	**Experience and expertise** Appointed Director in August 1985. Appointed Deputy Chairman in June 2004. Appointed Chairman 28 October 2005. Jennifer Hill-Ling has extensive experience in corporate and commercial law, specialising in corporate and business structuring, mergers and acquisitions, joint ventures and related commercial transactions. She practiced law for some 25 years and was a senior partner in two Sydney law firms in that time. She was formerly a director of Tower Trust Limited and MS Limited. She is a fellow of the Australian Institute of Company Directors. **Other current listed company directorships** None. **Former listed company directorships in last 3 years** None. **Special responsibilities** Chairman of the Board; Member of the Remuneration and Nomination Committee. **Interests in shares and options at the date of this report** 18,146,677 ordinary shares in Hills Limited (including 1,188,918 shares owned by Hills Associates Limited and Poplar Pty Ltd (jointly held) and 16,768,441 shares owned by Hills Associates Limited of which JH Hill-Ling is a Director). She does not hold any options over ordinary shares in Hills Limited.

Information on Directors (continued)

Name	Details
Fiona Rosalyn Vivienne Bennett **BA (Hons) FCA FAICD FIML** *Independent Non-Executive Director* *Age 61*	**Experience and expertise** Appointed non-executive Director on 31 May 2010. Fiona Bennett is a Chartered Accountant with over 30 years' experience in business and financial management, corporate governance, risk management and audit. She has previously held senior executive positions at BHP Billiton Limited and Coles Group Limited and has been a Chief Financial Officer at several organisations in the health sector. She is currently Chairman of the Victorian Legal Services Board. **Other current listed company directorships** Director of Beach Energy Limited (since November 2012) Director of Select Harvests Limited (since July 2017) **Former listed company directorships in last 3 years** Director of Boom Logistics Limited (retired in June 2015) **Special responsibilities** Chairman of the Audit, Risk and Compliance Committee. **Interests in shares and options at the date of this report** 88,444 ordinary shares in Hills Limited. She does not hold any options over ordinary shares in Hills Limited.
Philip Bullock AO **BA, MBA, GAICD, Dip. Ed.** *Independent Non-Executive Director* *Age 64*	**Experience and expertise** Appointed non-executive Director on 23 June 2014. Mr Bullock AO was formerly Vice President of the Systems and Technology Group, IBM Asia Pacific, based in Shanghai, China. Prior to that he was CEO and Managing Director of IBM Australia and New Zealand. Mr Bullock AO is a non-executive director of Perpetual Limited, and formerly of CSG Limited and Healthscope Limited. He has also provided advice to the Federal Government, through a number of organisations, most notably as Chair of Skills Australia. **Other current listed company directorships** Non-executive director of Perpetual Limited (since June 2010) **Former listed company directorships in last 3 years** Non-executive Director of CSG Limited (August 2009 to November 2015). **Special responsibilities** Chairman of the Remuneration and Nomination Committee; Member of the Audit, Risk and Compliance Committee **Interests in shares and options at the date of this report** 100,000 ordinary shares in Hills Limited. He does not hold any options over ordinary shares in Hills Limited.

Information on Directors (continued)

Name	Details
Kenneth James Dwyer **BCom, GMQ, GAICD** *Independent Non-Executive Director* *Age 59*	**Experience and expertise** Mr Dwyer formerly worked in banking, including investment banking in the US and Australia specialising in M&A, debt and equity funding. Mr Dwyer has established and grown two businesses in the highly competitive audio industry in Australia and New Zealand via a combination of organic growth and acquisitions. Mr Dwyer also has experience in the distribution of premium European machinery for textile manufacturing. **Other current listed company directorships** None. **Former listed company directorships in last 3 years** None. **Special responsibilities** Member of the Remuneration and Nomination Committee; Member of the Audit, Risk and Compliance Committee. **Interests in shares and options at the date of this report** 200,000 ordinary shares in Hills Limited. He does not hold any options over ordinary shares in Hills Limited.
Ian Elliot **FAICD** *Independent Non-Executive Director* *Age 63*	**Experience and expertise** Appointed non-executive Director on 1 September 2010. Retired on 4 November 2016. Ian Elliot has spent 39 years in marketing. His speciality is brand building, with extensive involvement in a number of icon brands. Mr Elliot is a fellow of the Australian Institute of Company Directors and graduate of the Harvard Business School Advanced Management Program. In addition to his listed company directorships, he was formerly Chairman of Zenith Media Pty Ltd, Cordiant Communications Group, Allied Brands Limited, Promentum Limited and Artist & Entertainment Group Limited and Chairman and Chief Executive Officer of George Patterson Advertising and director of the National Australia Day Council. **Other current listed company directorships** Director of McMillan Shakespeare Limited (since May 2014) **Former listed company directorships in last 3 years** Director of Salmat Limited (from 2005 until November 2016).

Information on Directors (continued)

Name	Details
David Moray Spence **BCom** *Independent Non-Executive Director* *Age 65*	**Experience and expertise** Appointed non-executive Director on 1 September 2010. Retired on 20 September 2016. David Spence has experience in a number of industries and more recently in the technology and communications industry. He has over 25 years of senior management experience, including as Chief Financial Officer of Freedom Furniture and OPSM, where he also assumed responsibility for manufacturing and logistics. He has been directly involved in many internet and communications companies, including the building of Australia's first and largest dial up ISP, OzEmail. Mr Spence was the Chief Executive Officer of Unwired Australia until February 2010. He has been involved in a number of listed and non-listed boards including WebCentral, uuNet, Access1, Emitch, Commander Communications, Chaosmusic, ubowireless, Vividwireless and is a past chairman of the Internet Industry Association. He is currently a non-executive Director of VOCUS Communications Limited and PayPal Australia Pty Ltd. **Other current listed company directorships** Chairman of Vocus Communications Limited (since June 2010) **Former listed company directorships in last 3 years** Director of SAI Global.

Company Secretary

David Fox LLB, BA

Mr Fox was appointed to the position of General Counsel on 11 March 2013 and, on 22 December 2016, to the position of General Counsel and Company Secretary.

As General Counsel and Company Secretary, Mr Fox is responsible for legal, risk and company secretarial matters associated with Hills. Mr Fox has vast experience in corporate law. He was first admitted to practise law in 2001 and previously held the position of Partner at a Sydney based law firm.

Meetings of Directors

The numbers of meetings of the Company's Board of Directors and of each Board Committee held during the year ended 30 June 2017, and the numbers of meetings attended by each Director were:

	Full meetings of Directors		Audit, Risk and Compliance Committee		Remuneration & Nomination Committee[1]	
	Held[2]	Attended	Held[2]	Attended	Held[2]	Attended
J Hill-Ling	28	27	-	-	2	2
F Bennett	28	25	4	4	-	-
P Bullock AO	28	28	4	4	2	2
I Elliot[3]	14	9	-	-	1	1
D Spence[4]	8	5	1	1	1	1
K Dwyer[5]	20	20	3	3	1	1

Insurance of officers

Since the end of the previous financial year, the Company has paid insurance premiums in respect of Directors' and officers' liability and legal expenses for current and former Directors and officers, including senior executives of the Company and Directors, senior executives and secretaries of its controlled entities.

The liabilities insured are legal costs that may be incurred in defending civil or criminal proceedings that may be brought against the officers in their capacity as officers of entities in Hills Group of Companies, and any other payments arising from liabilities incurred by the officers in connection with such proceedings. This does not include such liabilities that arise from conduct involving a wilful breach of duty by the officers or the improper use by the officers of their position or of information to gain advantage for themselves or someone else or to cause detriment to the Company. It is not possible to apportion the premium between amounts relating to the insurance against legal costs and those relating to other liabilities.

The Directors have not included details of the nature of the liabilities covered or the amount of the premiums paid in respect of the Directors' and officers' liability and legal expenses insurance contracts as such disclosure is prohibited under the terms of the contracts.

Indemnification of officers

The Company has agreed to indemnify the Directors and officers of the Company against all liabilities to another person (other than the Company or a related body corporate) that may arise from their position as Directors of the Company and its controlled entities, except where the liability arises out of conduct involving a lack of good faith.

[1] The Nomination Committee and the Remuneration Committee were amalgamated into the Remuneration and Nomination Committee on 26 May 2017. No Nomination Committee meetings were held prior to that date.

[2] Number of meetings held during the period that the Director held office or was a member of the committee during the year

[3] Mr Ian Elliot retired as a director on 4 November 2016

[4] Mr David Spence retired as a director on 20 September 2016

[5] Mr Kenneth Dwyer was appointed a director on 20 September 2016

Indemnification of officers (continued)

The agreement stipulates that the Company will meet the full amount of any such liabilities, including costs and expenses.

The Company has also agreed to indemnify the current Directors of its controlled entities for all liabilities to another person (other than the Company or a related body corporate) that may arise from their position, except where the liability arises out of conduct involving a lack of good faith. The agreement stipulates that the Company will meet the full amount of any such liabilities, including costs and expenses.

Environmental regulation

Manufacturing

Hills holds all required environmental licences, registrations and permits for its sole remaining manufacturing site in O'Sullivan Beach in South Australia. No significant environmental incidents were reported over the 2017 financial year and Hills continued to meet or exceed the requirements specified in relevant licenses and authorisations.

Australian Packaging Covenant

The Australian Packaging Covenant (APC) is a voluntary initiative by Government and industry to reduce the environmental impact of packaging. Hills became a signatory to the APC in 2010 and established ongoing action plans aimed at optimising packaging design, material recovery, recycling and product stewardship. Hills remains supportive of the goals and initiatives of the APC and remains compliant following the submission of its annual report during March 2017.

Auditor's independence declaration

A copy of the auditor's independence declaration as required under section 307C of the *Corporations Act 2001* is set out on page 35.

Non-audit services

The Company may decide to employ the auditor on assignments additional to their statutory audit duties where the auditor's expertise and experience with Hills are important.

Details of the amounts paid or payable to the auditor of Hills, KPMG, and its related practices for audit and non-audit services provided during the year are set out below.

The Board of Directors has considered the position and, in accordance with advice received from the Audit, Risk and Compliance Committee, is satisfied that the provision of the non-audit services is compatible with the general standard of independence for auditors imposed by the *Corporations Act 2001*. The Directors are satisfied that the provision of non-audit services by the auditor, as set out below, did not compromise the auditor independence requirements of the *Corporations Act 2001* for the following reasons:

- all non-audit services have been reviewed by the Audit, Risk and Compliance Committee to ensure they do not impact the impartiality and objectivity of the auditor; and
- none of the services undermine the general principles relating to auditor independence as set out in APES 110 *Code of Ethics for Professional Accountants.*

Non-audit services (continued)

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

	2017 $	2016 $
KPMG audit and non-audit services		
Audit and other assurance services		
KPMG Australia – audit and review of the financial statements	**298,000**	343,375
Overseas KPMG firms – audit and review of the financial statements	**42,223**	39,951
Total remuneration for audit services	**340,223**	383,326
KPMG Australia – other assurance services	**165,000**	-
Total remuneration for audit and other assurance services	**505,223**	383,326
Taxation services		
KPMG Australia – taxation and other services	**78,238**	76,239
Overseas KPMG firms – taxation services	**3,967**	11,605
Total remuneration for taxation services	**82,250**	87,844
Other services		
Other consulting services	**12,816**	8,342
Total remuneration for other services	**12,816**	8,342
Total remuneration of KPMG	**600,244**	479,512

Rounding of amounts

The Company is an entity to which the *ASIC Corporations (Rounding in Financial/Directors' Reports) Instrument 2016/191* applies. Amounts have been rounded off in accordance with the instrument to the nearest thousand dollars, or in certain cases, the nearest dollar.

Letter from the Chairman of the Remuneration Committee

Dear Shareholder,

On behalf of your Board, I am pleased to present Hills FY17 Remuneration Report, which sets out remuneration information for the Chief Executive Officer (CEO), the Key Management Personnel (KMP), the Non-Executive Directors and the broader employee group.

FY17 Remuneration Outcomes

FY17 remained a challenging year for Hills as we continued the task of right sizing and improving customer service. As part of this work, we saw the completion of the contract with the prior CEO, Grant Logan, and the appointment of David Lenz as the new CEO. In the process, we also transitioned to a new CFO in Chris Jacka. These changes have provided Hills with further opportunities to bring executive compensation more into line with market practices for a company of our size. Both appointments have been from within Hills and we are extremely fortunate to have people of their capabilities and energy leading Hills during these challenging times.

Consistent with this approach, the organisation has been flattened at the senior levels and we have seen a reduction in those employees at Hills who have a base salary above $150,000 (inclusive of superannuation) from 35 to 25. For employees earning over $150,000, increases have only been applied as job responsibilities have changed.

Overall Full Time Equivalent (FTE) has reduced from 665 to 557 over the period of the year.

As a result, Hills average monthly salary cost, comprised of all employees across Australia and New Zealand, has reduced from $5,979,172 in July 2016 to $5,242,290 in June 2017, which is a reduction of 12%.

None of this work is easy and it requires strong leadership from our managers and loyalty and dedication from our staff. We are grateful for the sacrifices they have and continue to make to help reshape the future of Hills to become a profitable and sustainable business.

CEO Remuneration

With the appointment of David Lenz, we adopted a new market based compensation framework as follows:

- Base Pay (including superannuation): $350,000
- Variable Pay: $200,000

The Variable Pay was to be determined as a result of the performance of Hills over FY17 and would be paid 50% in cash and 50% in equity. The equity would vest over three years at the rate of:

- 20% in year one;
- 30% in year two; and
- 50% in year three.

The hurdles associated with the variable pay were as follows:

Element	Measure
Financial (80%)	Net Profit After Tax (NPAT) Operating Cash Flow EBITDA / Sales Inventory Management
Non-financial (20%)	Employee Engagement Vendor Engagement

Letter from the Chairman of the Remuneration Committee (continued)

Given the financial performance by Hills in FY17, the Board determined that none of the financial targets have been met, with the exception of a reduction in inventory. From a business perspective, it was very pleasing to see that the Hills Health Solutions business achieved their financial targets.

With regard to the Company non-financial targets, we saw a concerted effort to help drive improved employee morale and vendor alignment and loyalty. As such, the non-financial targets have been deemed to be met by the Board.

Board Changes

During the year, we have also continued to refresh the Board with the appointment of Ken Dwyer. Ken was the former owner of an audio visual distribution business and brings with him years of experience, both in this critical area for Hills, but also the technology distribution industry more broadly.

At the same time, we farewelled two long serving directors, David Spence and Ian Elliott, both of whom made significant contributions to the ongoing transformation of Hills.

FY18 Outlook

As we move into FY18, our main focus is the continued alignment of reward to performance and the establishment of market based compensation at all levels through our organisation. This has included an agreement to hold any increases in salary until 1 January 2018, with total salary budget to increase by approximately the Consumer Price Index (CPI) with continued focus on those employees earning less than $150,000 per annum.

CEO and CFO measures are largely in line with FY17 and are distributed as follows:

Element	Measure
Financial (60%)	Operating Cash Flow Net Profit After Tax (NPAT) Reduce aged inventory > 180 days
Non-financial (40%)	Digital Transformation Employee Engagement Customer Satisfaction Supplier Partnership

At the same time, we continue to look to enhance employee morale and lift skills by focusing on programs and activities such as the:

- Relaunch of the Hills Employee Values, after completing a survey with our employees on the values that they believed best represented Hills.
- Introduction of the "Hills Giveback Charity Program" following a survey of our employees on whether they believed it was important to participate in a Charity program and what type of participation they were after.
- Launch of the FY18 strategy to all managers at a company sponsored workshop held on the 5th and 6th of July 2017, at which all managers across Australia and New Zealand with people responsibilities were brought together to hear the direction for FY18 and plan on how to deliver on the key outcomes as "one team".
- Compliance with the Workplace Gender Equality Act (2012) Act, whereby all non-public sector employers with 100 or more employees are required to submit a report by 31 May each year for the preceding 12-month period (1 April – 31 March reporting period).

Letter from the Chairman of the Remuneration Committee (continued)

- Continuation of flexible, family friendly work options and practices where there is a need for our employees to meet changing work and personal requirements. To augment our flexible work options, we also offer employees the opportunity to purchase up to 4 weeks of additional leave via salary sacrifice.

  This is particularly helpful for working parents that need more than their 4 weeks of annual leave to assist with family responsibilities or for employees that need to plan for a longer paid holiday.
- Investing in the capabilities of our sales and customer service employees by commencing two programs in August 2017:
  - Hills Dynamic Sales Training – for all Account Managers, Business Development Managers and Sales Managers across all our business areas and across both Australia and NZ operations.
  - Hills Customer Service Excellence Program – offering our employees engaged in customer service qualifications in Business Management and Leadership & Management via a Registered Training Organisation.

Thank you for taking the time to review the FY17 Remuneration Report. We have made progress in terms of better alignment of compensation to the market, however we must remain focused on talent development more broadly to help our people have the skills that they require in this new world. With this in mind, it is fitting to close by thanking the employees of Hills for their ongoing loyalty and dedication to our customers and suppliers; they have and continue to make a significant difference for Hills in the marketplace.

Yours sincerely

Philip Bullock

Philip Bullock AO

Chairman, Remuneration and Nominations Committee

Remuneration report – audited

This Remuneration Report explains Hills approach to executive remuneration, performance and remuneration outcomes for Hills and its Key Management Personnel (KMP) for the year ended 30 June 2017 (FY17). In this report, 'senior executives' refers to the KMP excluding non-executive directors.

The information provided in the Remuneration Report has been audited as required by Section 308 (3C) of the *Corporations Act 2001*.

The Remuneration Report comprises the following sections:

1 Key Management Personnel

KMP encompasses all Directors, as well as those senior executives who had specific responsibility for planning, directing and controlling material activities of Hills during FY17.

Name	Position	Term as KMP in FY17
Directors		
J Hill-Ling	Chairman, Non-Independent and Non-Executive Director	Full Year
F Bennett	Independent, Non-Executive Director	Full Year
P Bullock AO	Independent, Non-Executive Director	Full Year
K Dwyer	Independent, Non-Executive Director	Commenced September 2016
Former Directors		
D Spence	Independent, Non-Executive Director	Ceased September 2016
I Elliot	Independent, Non-Executive Director	Ceased November 2016
Senior Executives		
D Lenz	Chief Executive Officer	Commenced September 2016
C Jacka	Chief Finance Officer	Commenced November 2016
D Fox	Company Secretary & General Counsel	Commenced December 2016
D Osborne	Head of Hills Health Solutions	Commenced January 2017

Remuneration report – audited (continued)

1 Key Management Personnel (continued)

Name	Position	Term as KMP in FY17
Former Senior Executives		
G Logan[1]	Chief Executive Officer	Ceased September 2016
G Turner[2]	Chief Financial Officer	Ceased November 2016
G Stephens	Company Secretary, Legal & Risk	Ceased December 2016
D McKim-Smith	Head of Hills Health Solutions	Ceased November 2016

2 Remuneration Governance

2.1 Role of the Remuneration Committee

The Board, with assistance from the Remuneration Committee, is ultimately responsible for ensuring that the Hills remuneration framework is consistent with the business strategy and performance, supporting increased shareholder wealth over the long term.

The Remuneration Committee, consisting of non-executive directors: Philip Bullock AO (Chairman), Jennifer Hill-Ling, and Ken Dwyer have responsibility for reviewing the remuneration strategy annually and advises the Board on remuneration policies and practices generally.

The Remuneration Committee is responsible for:

- the ongoing appropriateness and relevance of the remuneration framework for the Chairman, the Board Committees and the non-executive Directors;
- Hills remuneration policy for the CEO, his direct reports and other senior executives, any changes to the policy, and the implementation of the policy including any shareholder approvals required; and
- incentive plans for the CEO, his direct reports and other senior executives.

Further detail on the Remuneration Committee's responsibilities is set out in its Charter, which is reviewed annually and which is available on the Hills website at: http://www.corporate.hills.com.au/about-us/governance.

2.2 Use of Independent Remuneration Consultants

In accordance with the Remuneration Committee Charter, the Remuneration Committee seeks advice and market data from independent remuneration consultants as required.

During the year no advisors were retained.

2.3 Hills Share Trading Policy

The Hills Share Trading Policy imposes trading restrictions on all Hills employees who are considered to be in possession of 'inside information' and additional restrictions in the form of trading windows for senior executives. Senior executives and members of the broader management team are prohibited from trading in Hills shares during specific periods prior to the announcement of the half and full year results. This policy applies equally to shares

[1] G Logan provided consultancy to the Board and CEO until February 2017
[2] G Turner became CFO of Lincor Limited in November 2016 and subsequently left Hills in January 2017 when the merger between Hills Health Solutions and Lincor did not proceed.

Remuneration report – audited (continued)

2 Remuneration Governance (continued)

2.3 Hills Share Trading Policy (continued)

received as part of remuneration. The Security Policy is available on the Hills website at: http://www.corporate.hills.com.au/about-us/governance.

2.4 Hills Clawback Policy

To strengthen the governance of the remuneration strategy, Hills has an executive remuneration Clawback Policy in place. The policy is designed to further align the remuneration outcomes of the Hills senior executive team with the long term interests of Hills and its shareholders, to ensure that excessive risk taking is not rewarded, and to provide the Board with the ability to claw back incentives paid, where there has been a material misstatement in Hills Financial Statements.

3 Executive remuneration

3.1 Alignment of Remuneration Strategy with Business Strategy

The Board has established a Remuneration Strategy that supports and drives the achievement of the Hills Business Strategy. The Board is confident that the remuneration framework aligns the remuneration of the senior executives with shareholder interests. Hills is a business that is heavily focused on key performance indicators (KPIs) and rewards its people at all levels on achievement of those KPIs.

Remuneration principles

The key principles on which the Hills remuneration strategy is based are:

Competitive	▪ Remuneration positioned at the appropriate level relative to the market to be competitive and attract, retain and reward employees
Equitable & Motivational	▪ Employees in similar roles, making similar contributions, with similar performance, received similar rewards ▪ Motivates employees to deliver business results ▪ Differentiates, but is fair and equitable in its application
Linked to Performance	▪ Directly links individual and company performance to remuneration outcomes ▪ Employees understand what results needed to be achieved ▪ Provides an integrated remuneration and performance system framework
Aligned	▪ Aligns remuneration and incentive outcomes with business goals and results ▪ Supports the completion of the transformation and delivery of the growth strategy ▪ Withstands external scrutiny
Straightforward	▪ Understood by all stakeholders and employees

Remuneration report – audited (continued)

3 Executive remuneration (continued)

3.2 Remuneration Mix

Senior executive remuneration is comprised of Fixed Remuneration (made up of base salary and superannuation), and Variable Incentive.

3.3 Chief Executive Officer Remuneration

The Board appointed David Lenz to the position of CEO on 1 September 2016. This appointment followed the retirement of Grant Logan at the end of his employment contract.

Mr Lenz has a fixed remuneration of $350,000 per annum (inclusive of superannuation).

Fixed Remuneration is reviewed annually by the Board with reference to performance of the Company, performance of the CEO and market information.

Variable Incentive FY17

Mr Lenz has a variable incentive opportunity of up to $200,000.

The variable incentive for FY17 adopts a balanced scorecard approach which is aligned to the Company's strategic plan. The balanced scorecard focuses on the following key areas:

Element	Measure
Financial (80%)	NPAT Operating Cash Flow EBITDA / Sales Inventory Management
Non-financial (20%)	Employee Engagement Vendor Engagement

Weighting is distributed across these measures.

The variable incentive is paid 50% as cash and 50% as Performance Rights (unless the Board determines otherwise), with vesting to take place over a 3-year period in the following manner:

- 20% after 1 year;
- 30% after 2 years; and
- 50% after 3 years.

The amount of equity that will be awarded will be determined by 50% of the total Variable incentive divided by the Company's share price. The share price will be determined by the 30-day volume weighted average price of the shares immediately following the announcement of the full year results.

In addition, Mr Lenz was awarded an initial sign-on bonus of 200,000 Hills Performance Rights on 1 September 2016. The first tranche of 100,000 shares are to be awarded on or around 1 September 2017 and the second tranche in September 2018.

The first 50% of Performances Rights will convert to shares on the first anniversary of Mr Lenz's Commencement Date as CEO, irrespective of whether Mr Lenz remains employed by the Company. The vesting of the second 50% of

Remuneration report – audited (continued)

3 Executive remuneration (continued)

3.3 Chief Executive Officer Remuneration (continued)

Performance Rights is subject to Mr Lenz being employed by Hills at time of vesting and will occur on the second anniversary of his commencement date. The fair value of performance rights was 34.0 cents per performance right, based on the quoted share price at grant.

3.4 Senior Executive Variable Incentive FY17

Variable Incentive – How It Works

The variable incentive is an at risk component of remuneration and is designed to reward performance against the achievement of a balanced scorecard that is aligned to the Company's strategic plan. Senior executive variable incentives are determined on the same measures as the CEO.

Each senior executive has specific KPIs in each of these areas to achieve the results in the balanced scorecard.

The variable incentive performance period was from 1 July 2016 to 30 June 2017.

The maximum variable incentive available to each senior executive was set at a level based on role, responsibilities and market data for the achievement of targets against specific KPIs. The maximum variable incentive opportunity for each senior executive is listed at section 3.5 as an absolute dollar amount and as a percentage of the senior executive's fixed remuneration.

The following table summarises the potential FY17 variable incentive payments where a senior executive ceased employment with Hills:

Resignation and retirement	Any entitlement to a payment was subject to the participant being employed by Hills at the time of payment.
Company initiated termination	Any entitlement to a payment would be for completed months, with no pro-rata for partly completed months. The calculation of an entitlement was based on actual results for the year and paid on the scheduled date.
Summary dismissal	If summarily dismissed, a participant forfeits all rights to any payments under the FY17 variable incentive which had not already vested or been made.

Assessment of Performance and Approval of Payment

The Remuneration Committee assessed the individual senior executive's performance based on the CEO's recommendations, against the KPIs set at the beginning of the financial year. The assessment of individual performance was combined with the achievement of financial results to determine the amount of payment for each senior executive. The Remuneration Committee recommended the variable incentive payment outcome to the Board for approval. Details of Variable Incentive payments are provided in section 3.5.

3.5 FY17 Variable Incentive Performance and Outcomes

FY17 has been a difficult year for the Company which is reflected in the variable incentive plan results detailed in this report. A summary of Company performance compared to previous years is provided in section 5.

The KPIs for the senior executives were aligned to the CEO's KPIs. The variable incentives payable to the CEO and senior executives for FY17 (if any) are set out in the following table:

Remuneration report – audited (continued)

3 Executive remuneration (continued)

3.5 FY17 Variable Incentive Performance and Outcomes (continued)

	Target Variable Incentive opportunity (pro-rata)	% of fixed re-muneration	Financial outcome	Non-financial outcome	Actual Variable Incentive outcome	% Achieved	% Forfeited
G Logan[1]	$50,000	31%	-	-	-	0%	100%
D Lenz[2]	$200,000	57%	$20,000	$40,000	$60,000	30%	70%
G Turner[3]	$58,178	32%	-	$25,000	$25,000	43%	57%
C Jacka[4]	$62,740	35%	$10,000	$30,000	$40,000	64%	36%
G Stephens[5]	$71,268	26%	-	$5,000	$5,000	7%	93%
D Fox[6]	$41,863	29%	$4,000	$20,000	$24,000	57%	43%
D McKim-Smith[7]	$26,667	14%	-	-	-	0%	100%
D Osborne[8]	$49,589	31%	$32,400	$6,850	$39,250	79%	21%
TOTAL	**$560,305**	**34%**	**$66,400**	**$126,850**	**$193,250**	**34%**	**66%**

3.6 FY18 Variable Incentive Design for CEO

Variable Incentive Plan – FY18

For FY18, it has been decided to continue the variable incentive plan which involves remunerating the CEO on his annual performance by cash and shares which vest over a 3-year period according to the following vesting scale:

- 20% after 1 year;
- 30% after 2 years; and
- 50% after 3 years.

The annual performance against which the CEO will be measured are in accordance with the balanced scorecards which has the following measures.

[1] G Logan was CEO up to 1 September 2016.
[2] D Lenz was promoted to CEO from 1 September 2016. Prior to that he was Chief Operating Officer and a KMP; actual variable incentive vests in accordance with the requirements set out in section 3.3.
[3] G Turner was CFO, Hills Limited up to 14 November 2016. From 14 November 2016 he was CFO Lincor Limited and then subsequently left Hills on 10 January 2017.
[4] C Jacka became CFO on 14 November 2016, replacing G Turner.
[5] G Stephens was Company Secretary and Head of Legal and Risk up to 22 December 2016.
[6] D Fox became Company Secretary and General Counsel from 22 December 2016.
[7] D McKim-Smith ceased as Head of Hills Health Solutions on 1 November 2016.
[8] D Osborne became Head of Hills Health Solutions on 1 January 2017.

Remuneration report – audited (continued)

3 Executive remuneration (continued)

3.6 FY18 Variable Incentive Design for CEO (continued)

Element	Measure
1. **Financial Measures** - 60% of Variable Incentive	(a) Budgeted NPAT (b) Budgeted Operating Cash Flow (c) Budgeted Aged Inventory > 180 days
2. **Non-financial Measures** - 40% of Variable Incentive	(a) Digital Transformation delivered on time and on budget (b) Customer Satisfaction (c) Employee Engagement (d) Vendor Commitment

Weighting will be distributed across these measures.

4 Executive Contracts and Termination Arrangements

Employment contracts

The remuneration and other terms of employment for the CEO and senior executives are covered in their individual employment contracts and are summarised in this table:

Chief Executive Officer	▪ The contract for the Chief Executive Officer commenced on 1 September 2016 for an initial term of 12 months, following which the Chief Executive Officer will continue to be employed till either party provides notice. ▪ Hills or the Chief Executive Officer may terminate his employment at any time by giving three months' written notice.
Senior Executives	▪ The contracts may be terminated by either party by giving 3 months written notice.
Chief Executive Officer and Senior Executives	▪ There are no guaranteed base pay increases included in any senior executive contract. ▪ In the instance of serious misconduct, Hills may terminate employment at any time. The executive will only receive payment to the date of termination and any statutory entitlements. ▪ Retirement benefits comprise employer contributions to defined contribution superannuation funds.

Remuneration report – audited (continued)

5 Five Year Snapshot – Business and Remuneration Outcomes

An underlying principle of the Hills remuneration strategy is that remuneration must be linked to the performance of Hills.

The following is a summary of financial performance and share price information over the last five years.

Key Financials		FY17	FY16	FY15	FY14	FY13
Shareholders' funds	$000	60,931	69,077	136,600	245,228	271,018
Statutory net (loss) / profit	$000	(7,932)	(68,305)	(85,780)	26,387	(91,387)
Basic (loss) / earnings per share	cents	(3.4)	(29.4)	(37.0)	10.4	(38.2)
Dividends	cents	-	-	2.1	7.0	5.0
Share Price – as at 30 June	$	0.155	0.245	0.455	1.74	1.01
Short Term Incentive Payments – % of Target Opportunity	%	29%	19%	4%	85%	87%

Remuneration report – audited (continued)

6 Statutory remuneration tables

6.1 Senior Executive Remuneration

The following table of senior executives' remuneration has been prepared in accordance with accounting standards and the *Corporations Act 2001* requirements. The amounts shown are equal to the amounts expensed (and not necessarily paid) in the Company's financial statements.

FY17 $	Short-term benefits			Post-employment benefits	Long term benefits		Share based payments	
Name	**Cash salary & fees**	**Cash bonus**	**Other**	**Super-annuation**	**LSL[1]**	**Termination benefits[2]**	**Per-formance rights**	**TOTAL**
Senior Executives								
D Lenz[3]	310,818	30,000	8,606	26,491	2,237	-	48,167	426,319
C Jacka[4]	161,581	40,000	1,984	12,897	498	-	-	216,960
D Fox[5]	128,827	24,000	2,465	10,156	2,830	-	-	168,278
D Osborne[6]	138,448	39,250	4,906	13,163	2,015	-	-	197,782
Former Senior Executives								
G Logan[7]	130,400	-	12,484	18,286	-	-	-	161,170
G Turner[8]	105,543	25,000	-	15,232	-	63,765	(2,911)	206,629
G Stephens[9]	130,125	5,000	6,938	20,468	-	115,525	(4,756)	273,300
D McKim-Smith[10]	102,002	-	-	17,889	-	65,407	-	185,298
Total Senior Executives	**1,207,744**	**163,250**	**37,383**	**134,582**	**7,580**	**244,697**	**40,500**	**1,835,736**

[1] Long Service Leave
[2] In accordance with statutory and legal obligations
[3] D Lenz became CEO on 1 September 2016. Prior to that he was Chief Operating Officer.
[4] C Jacka became CFO on 14 November 2016.
[5] D Fox became Company Secretary & General Counsel on 22 December 2016.
[6] D Osborne became Head of Hills Health Solutions effective 1 January 2017
[7] G Logan ceased as CEO on 1 September 2016
[8] G Turner ceased as CFO and KMP at Hills 14 November 2016.
[9] G Stephens ceased as Company Secretary on 22 December 2016.
[10] D McKim-Smith ceased as Head of Hills Health Solutions on 1 November 2016.

Remuneration report – audited (continued)

6 Statutory remuneration tables (continued)

6.1 Senior Executive Remuneration (continued)

FY16 $	Short-term benefits			Post-employment benefits	Long term benefits	Share based payments	
Name	**Cash salary & fees**	**Cash bonus**	**Other**	**Super-annuation**	**LSL & Cash LTIP**	**Per-formance rights**	**TOTAL**
Senior Executives							
G Logan	826,059	45,000	18,110	6,428	94,382	-	989,979
G Turner	288,044	60,000	6,529	23,889	3,907	2,183	384,552
D Lenz	262,276	25,000	15,030	24,699	684	-	327,689
D McKim-Smith[1]	178,149	12,000	10,432	15,883	3,905	-	216,638
G Stephens	263,401	18,688	-	25,607	174	3,567	315,168
Total	**1,817,929**	**160,688**	**50,101**	**96,506**	**103,052**	**5,750**	**2,234,026**

6.2 Remuneration components as a proportion of total remuneration paid or expensed

The following table reflects the fixed remuneration and Variable Incentive for FY17 calculated in accordance with the accounting standards as a proportion of the total.

Name	Full Year Potential Variable Incentive	Pro-rata Potential Variable Incentive	Actual Variable Incentive paid / payable	Actual Variable Incentive paid / payable as % of Full Year Potential	Actual Variable Incentive paid / payable as % of Pro-rata	Variable Incentive paid / payable as % of Fixed Remuneration
Senior Executives						
D Lenz	$200,000	$200,000	$30,000	15%	15%	9%
C Jacka	$100,000	$62,740	$40,000	40%	64%	23%
D Fox	$80,000	$41,863	$24,000	30%	57%	17%
D Osborne	$100,000	$49,589	$39,250	39%	79%	25%
Former Senior Executives						
G Logan	$300,000	$50,000	$0	0%	0%	0%
G Turner	$155,000	$58,178	$25,000	16%	43%	14%
G Stephens	$149,500	$71,268	$5,000	3%	7%	2%
D McKim-Smith	$80,000	$26,667	$0	0%	0%	0%

[1] D McKim-Smith was appointed on 30 November 2015.

Remuneration report – audited (continued)

6 Statutory remuneration tables (continued)

6.2 Remuneration components as a proportion of total remuneration paid or expensed (continued)

The following table reflects the fixed remuneration, Variable Incentive and total performance based remuneration for FY17 calculated in accordance with the accounting standards as a proportion of the total remuneration.

Name	Fixed remuneration %	At risk Variable Incentive paid or payable %	Value of performance rights %	Total performance based %
Senior Executives				
D Lenz	82%	7%	11%	18%
C Jacka	82%	18%	0%	18%
D Fox	86%	14%	0%	14%
D Osborne	80%	20%	0%	20%
Former Senior Executives				
G Logan	100%	0%	0%	0%
G Turner	89%	12%	-1%	11%
G Stephens	100%	2%	-2%	0%
D McKim-Smith	100%	0%	0%	0%

The following table shows the proportion weighting of each element of remuneration for each of the senior executives employed during FY17 based on maximum potential outcome.

Name	Fixed remuneration %		Maximum Variable Incentive %		Maximum Long Term Incentive %	
	FY17	FY16	FY17	FY16	FY17	FY16
Senior Executives						
D Lenz	58%	67%	17%	33%	25%	-
C Jacka	74%	-	26%	-	-	-
D Fox	78%	-	22%	-	-	-
D Osborne	76%	-	24%	-	-	-
Former Senior Executives						
G Logan	76%	70%	24%	24%	-	6%
G Turner	77%	68%	24%	32%	-1%	-
G Stephens	80%	65%	21%	34%	-1%	1%
D McKim-Smith	87%	72%	13%	28%	-	-

Remuneration report – audited (continued)

6 Statutory remuneration tables (continued)

6.3 Number of performance rights granted, vested and expired / forfeited in FY17

	At 1 July 2016	Granted	Vested	Forfeited	At 30 June 2017
Senior Executives					
D Lenz	-	200,000	-	-	200,000
Former Senior Executives					
G Turner	19,588	-	-	(19,588)	-
G Stephens	32,010	-	-	(32,010)	-

7 Non-Executive Directors' Remuneration

The Board sets non-executive Director Remuneration at a level which enables the attraction and retention of directors of the highest calibre, while incurring a cost which is acceptable to shareholders. The remuneration of the non-executive directors is determined by the Board on recommendation from the Remuneration Committee within a maximum fee pool. Non-executive directors receive a base fee and statutory superannuation contributions. Non-executive directors do not receive any performance based pay. The Non-Executive Directors' fees were reduced by 20% in FY15 and have not been increased in FY17.

7.1 Fee Pool

The maximum amount of fees that can be paid to non-executive directors is capped by a pool approved by shareholders. At the FY11 Annual General Meeting, shareholders approved the current fee pool of $1.2 million per annum which is recorded on an accrual basis. The fee pool did not change in FY17.

7.2 Directors' FY17 Fee Structure

The following table outlines the main Board and Committee fees as at 30 June 2017.

	Chair fee $	Member fee $
Board	160,000	80,000
Audit and Risk Committee	16,000	8,000
Remuneration and Nomination Committee	16,000	Nil

Remuneration report – audited (continued)

7 Non-Executive Directors' Remuneration (continued)

7.3 Non-executive Directors' remuneration details

Non-Executive Directors	Year	Board and Committee fees $	Superannuation $	Total $
J Hill-Ling	**2017**	**146,119**	**13,881**	**160,000**
	2016	146,119	13,881	160,000
F Bennett	**2017**	**87,671**	**8,329**	**96,000**
	2016	87,671	8,329	96,000
P Bullock AO[1]	**2017**	**94,050**	**8,935**	**102,985**
	2016	82,507	8,312	90,820
K Dwyer[2]	**2017**	**63,056**	**5,990**	**69,046**
	2016	-	-	-
I Elliot[3]	**2017**	**49,905**	**4,741**	**54,646**
	2016	80,366	7,634	88,000
D Spence[4]	**2017**	**17,928**	**1,703**	**19,631**
	2016	85,096	8,084	93,180
TOTAL	**2017**	**458,729**	**43,579**	**502,308**
	2016	481,759	46,241	528,000

7.4 Retirement Allowance for Non-Executive Directors

Ms J Hill-Ling is the only Director entitled to receive benefits on retirement under a scheme that was discontinued on 1 August 2003. Under the scheme, Ms J Hill-Ling is entitled to a maximum retirement benefit of twice her annual Director's fee (calculated as an average of her fees over the last three years) with a vesting period of eight years, which has been achieved. Since the scheme was discontinued, no new Directors have become entitled to any benefit and the benefit multiple (up to a maximum of two times fees) remains fixed. The benefit is fully provided for in the financial statements.

[1] P Bullock AO was appointed Chair of the Remuneration and Nominations Committee, effective September 2016.
[2] K Dwyer was appointed as director, effective September 2016.
[3] I Elliot retired as a director, effective November 2016. Following his retirement, Mr Elliot was retained on a consultancy basis until February 2017.
[4] D Spence resigned as a director, effective September 2016.

8 Equity instrument disclosures relating to Key Management Personnel

8.1 Share Holdings

The numbers of shares in the Company held during the financial year by each Director of Hills Limited and other key management personnel of the Company, including their personally related parties, are set out below. There were no shares granted during the reporting period as compensation.

During the year, and as announced at the 2016 AGM, the Company has introduced a policy requiring directors to hold a minimum number of shares. Specifically, directors are required to hold a minimum of shares and are required to attain this shareholding within a 3-year period.

	Ordinary shares			
	Balance at start of the year	Received during the year on the exercise of options / rights	Other changes during the year	Balance at the end of the year
Directors				
J Hill-Ling	18,146,677	-	-	18,146,677
F Bennett	88,444	-	-	88,444
P Bullock AO	100,000	-	-	100,000
K Dwyer	95,000	-	105,000	200,000
Former Directors				
I Elliot	51,735	-	-	n/a[1]
D Spence	442,272	-	-	n/a[1]
Former Senior Executives				
G Logan	228,409	-	-	n/a[1]
G Turner	50,000	-	-	n/a[1]
G Stephens	1,011,408	-	-	n/a[1]

8.2 Loans to Key Management Personnel

There were no outstanding loans to KMP or their related parties at the reporting date.

8.3 Other Transactions with Key Management Personnel

A number of KMP or their related parties hold positions in other entities that result in them having control or significant influence over the financial or operating policies of those entities.

From time to time, KMP of the Company or its controlled entities, or their related entities, may purchase goods or services from Hills or make sales of goods or services to Hills. These purchases or sales are on the same terms and conditions as those entered into by Hills employees, customers or suppliers and are trivial and domestic in nature.

[1] No longer a KMP at 30 June 2017.

Hills Limited

Directors' report

For the year ended 30 June 2017

(continued)

This report is made in accordance with a resolution of Directors.

Jennifer Helen Hill-Ling
Director

Philip Bullock AO
Director

Sydney
29 August 2017

Lead Auditor's Independence Declaration under Section 307C of the Corporations Act 2001

To the Directors of Hills Limited

I declare that, to the best of my knowledge and belief, in relation to the audit of Hills Limited for the financial year ended 30 June 2017 there have been:

i. no contraventions of the auditor independence requirements as set out in the *Corporations Act 2001* in relation to the audit; and

ii. no contraventions of any applicable code of professional conduct in relation to the audit.

KPMG

Scott Fleming
Partner

Adelaide

29 August 2017

Hills Limited ABN 35 007 573 417

Consolidated financial statements for the year ended 30 June 2017

Contents

Hills Limited

Consolidated statement of profit or loss

For the year ended 30 June 2017

	Notes	2017 $'000	2016 $'000
Continuing operations			
Revenue	2	**298,068**	328,913
Other income	3	**13,100**	3,192
		311,168	332,105
Expenses excluding net finance expenses	4b		
Cost of goods sold (inventories)		**(172,095)**	(187,482)
Direct costs of services provided		**(38,205)**	(31,972)
Labour and related expenses		**(68,430)**	(75,595)
Operational and equipment expenses		**(7,867)**	(8,517)
Property expenses		**(7,865)**	(8,172)
Depreciation and amortisation	4a	**(7,072)**	(9,444)
Other expenses		**(14,348)**	(55,886)
Loss before net finance expense and income tax		**(4,714)**	(44,963)
Finance income		**66**	305
Finance expenses		**(3,356)**	(3,659)
Net finance expenses	4	**(3,290)**	(3,354)
Loss before income tax		**(8,004)**	(48,317)
Income tax benefit / (expense) from continuing operations	5	**72**	(19,988)
Loss from continuing operations		**(7,932)**	(68,305)
Loss for the year, attributable to owners of Hills Limited		**(7,932)**	(68,305)
		Cents	Cents
Loss per share for loss from continuing operations attributable to the ordinary equity holders of the Company:			
Basic and diluted loss per share	6	**(3.4)**	(29.4)

The above consolidated statement of profit or loss should be read in conjunction with the accompanying notes.

Hills Limited

Consolidated statement of comprehensive income

For the year ended 30 June 2017

	Notes	2017 $'000	2016 $'000
Loss for the year		**(7,932)**	(68,305)
Other comprehensive income			
Items that may be reclassified to profit or loss			
Changes in the fair value of cash flow hedges	15	**(328)**	(113)
Exchange differences on translation of foreign operations	15	**(20)**	945
Income tax relating to components of other comprehensive income	5	**98**	34
Other comprehensive (loss) / income for the year, net of tax		**(250)**	866
Total comprehensive loss for the year, attributable to owners of Hills Limited		**(8,182)**	(67,439)

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

Hills Limited

Consolidated statement of financial position

As at 30 June 2017

	Notes	2017 $'000	2016 $'000
ASSETS			
Current assets			
Cash and cash equivalents	7	**8,651**	3,994
Trade and other receivables	8	**59,489**	69,346
Inventories	9	**46,460**	55,617
Current tax assets	5	**229**	183
Derivative financial instruments	18	**-**	103
Total current assets		**114,829**	129,243
Non-current assets			
Trade and other receivables	8	**-**	534
Investments		**2**	2
Property, plant and equipment	11	**16,600**	19,948
Intangible assets	12	**2,578**	753
Deferred tax assets	5	**10,917**	10,808
Total non-current assets		**30,097**	32,045
Total assets		**144,926**	161,288
LIABILITIES			
Current liabilities			
Trade and other payables	10	**40,266**	50,400
Borrowings	17	**295**	472
Provisions	13	**10,556**	12,512
Derivative financial instruments	18	**287**	-
Total current liabilities		**51,404**	63,384
Non-current liabilities			
Borrowings	17	**28,395**	25,130
Provisions	13	**4,196**	3,697
Total non-current liabilities		**32,591**	28,827
Total liabilities		**83,995**	92,211
Net assets		**60,931**	69,077
EQUITY			
Contributed equity	14	**278,439**	278,439
Reserves	15	**11,035**	11,249
Accumulated losses		**(228,543)**	(220,611)
Total equity		**60,931**	69,077

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

Hills Limited

Consolidated statement of changes in equity

For the year ended 30 June 2017

	Notes	Attributable to owners of Hills Limited			
		Contributed equity $'000	Reserves $'000	Accumulated losses $'000	Total $'000
Balance at 1 July 2015		278,439	10,467	(152,306)	136,600
Total comprehensive income / (loss) for the year		-	866	(68,305)	(67,439)
Transactions with owners in their capacity as owners:					
Employee share schemes	29	-	(84)	-	(84)
Balance at 30 June 2016		278,439	11,249	(220,611)	69,077
Balance at 1 July 2016		**278,439**	**11,249**	**(220,611)**	**69,077**
Total comprehensive (loss) for the year		**-**	**(250)**	**(7,932)**	**(8,182)**
Transactions with owners in their capacity as owners:					
Employee share schemes	29	**-**	**36**	**-**	**36**
Balance at 30 June 2017		**278,439**	**11,035**	**(228,543)**	**60,931**

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

Hills Limited
Consolidated statement of cash flows
For the year ended 30 June 2017

	Notes	2017 $'000	2016 $'000
Cash flows from operating activities			
Receipts from customers (inclusive of goods and services tax)		**345,464**	386,190
Payments to suppliers and employees (inclusive of goods and services tax)		**(343,007)**	(372,974)
		2,457	13,216
Net finance costs paid		**(3,255)**	(3,354)
Net income taxes received / (paid)		**13**	(486)
Net cash flows (used in) / from operating activities	7	**(785)**	9,376
Cash flows from investing activities			
Payments for acquisitions of subsidiaries / business operations, net of cash acquired		**-**	(2,653)
Payments for property, plant and equipment	11	**(1,507)**	(4,247)
Payments for intangible assets	12	**(2,249)**	(3,244)
Proceeds from sale of property, plant and equipment and intangible assets		**6,701**	6,902
Rent received		**4**	1,526
Net cash flows from / (used in) investing activities		**2,949**	(1,716)
Cash flows from financing activities			
Proceeds from borrowings		**8,004**	46,510
Repayment of borrowings		**(5,522)**	(69,175)
Net cash flows from financing activities		**2,482**	(22,665)
Net increase / (decrease) in cash and cash equivalents		**4,646**	(15,005)
Cash and cash equivalents at the beginning of the year		**3,994**	18,801
Effects of exchange rate changes on cash and cash equivalents		**11**	198
Cash and cash equivalents at end of the year	7	**8,651**	3,994

The above consolidated statement of cash flows should be read in conjunction with the accompanying notes.

Section A: About this report

These consolidated financial statements are for the group consisting of Hills Limited (the "Company" or "parent entity") and its subsidiaries (together referred to as the "Group" or "Consolidated Entity" and individually as "Group Entities").

The notes to the consolidated financial statements that follow present information relevant to understanding the Group's:

- business performance;
- operating assets and liabilities;
- capital and financing arrangements, including the Group's approach to risk;
- structure, including related party transactions and parent entity information; and
- unrecognised items at the end of the reporting period.

Other information that is required to be disclosed to comply with the accounting standards, the *Corporations Act 2001* or the Corporations Regulations, but are not considered significant to understand the financial performance or financial position of the Group are provided at the end of the notes.

Hills Limited is a for profit company limited by shares, incorporated and domiciled in Australia.

The consolidated financial statements were authorised for issue by the Directors on 29 August 2017. The Directors have the power to amend and reissue the consolidated financial statements.

Basis of preparation

These general purpose consolidated financial statements:

- are presented in Australian dollars;
- have been prepared in accordance with Australian Accounting Standards (AASBs), other authoritative pronouncements of the Australian Accounting Standards Board, and the *Corporations Act 2001*;
- comply with International Financial Reporting Standards (IFRS) as issued by the International Accounting Standards Board (IASB); and
- have been prepared on the basis of historical costs, except for financial instruments (derivatives) at fair value. The methods used to measure fair values are discussed further in note 20.

Key accounting estimates

In preparing these financial statements, management are required to make judgements, estimates and assumptions that affect the application of accounting policies and the reported amounts of assets, liabilities, income and expenses. Actual results may differ from these estimates.

Estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognised in the period in which the estimate is revised and in any future periods affected.

Key accounting estimates (continued)

In particular, information about significant areas of estimation, uncertainty and critical judgements in applying accounting policies that have the most significant effect on the amounts recognised in the consolidated financial statements are described in the following notes:

Note 2	Recognition of revenue accounted for using the percentage of completion method
Note 5	Tax losses for which no deferred tax asset has been recognised
Notes 11 and 12	Measurement of the useful lives of property, plant and equipment and intangible assets
Notes 13 and 25	Provisions and contingencies
Note 20	Measurement of fair value

Principles of consolidation

Subsidiaries

The consolidated financial statements incorporate the assets and liabilities of all subsidiaries of the Company as at 30 June 2017 and the results of all subsidiaries for the year then ended. A list of subsidiaries is included in note 21.

Subsidiaries are all entities over which the Group has control. The Group controls an entity when the Group is exposed to, or has rights to, variable returns from its involvement with the entity and has the ability to affect those returns through its power to direct the activities of the entity.

Subsidiaries are fully consolidated from the date on which control was obtained by the Group. They are de-consolidated from the date that control ceases.

The acquisition method of accounting is used to account for business combinations by the Group.

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

Non-controlling interests in the results and equity of subsidiaries are shown separately in the consolidated statement of profit or loss, consolidated statement of comprehensive income, consolidated statement of changes in equity and consolidated statement of financial position respectively.

Changes in ownership interests

The Group treats transactions with non-controlling interests that do not result in a loss of control as transactions with equity owners of the Group. A change in ownership interest results in an adjustment between the carrying amounts of the controlling and non-controlling interests to reflect their relative interests in the subsidiary. Any difference between the amount of the adjustment to non-controlling interests and any consideration paid or received is recognised in a separate reserve within equity attributable to owners of Hills.

When the Group ceases to have control, joint control or significant influence, any retained interest in the entity is

Principles of consolidation (continued)

remeasured to its fair value with the change in carrying amount recognised in profit or loss. This fair value becomes the initial carrying amount for the purposes of subsequently accounting for the retained interest as an associate, jointly controlled entity or financial asset. In addition, any amounts previously recognised in other comprehensive income in respect of that entity are accounted for as if the Group had directly disposed of the related assets or liabilities. This may mean that amounts previously recognised in other comprehensive income are reclassified to profit or loss.

Foreign currency translation

Functional and presentation currency

Items included in the consolidated 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 Australian dollar is the Company's functional and presentation currency and the functional and presentation currency of the majority of the Group.

Transactions and balances

Transactions in foreign currencies are translated to the respective functional currencies of Group Entities using exchange rates at the dates of the transactions. Monetary assets and liabilities denominated in foreign currencies at the reporting date are retranslated to the functional currency at the foreign exchange rate at that date. Non-monetary assets and liabilities denominated in foreign currencies that are measured at fair value are translated to the functional currency at the exchange rate at the date that the fair value was determined. Non-monetary assets and liabilities that are measured in terms of historical cost are translated using the exchange rate at the date of the transaction. Foreign currency differences arising on retranslation are recognised in profit or loss.

Group entities

The results and financial position of all Group Entities that have a functional currency different from the presentation currency are translated into the presentation currency as follows:

Closing rate	Assets and liabilities for each statement of financial position
Average rate	Income and expenses for each income statement: average rates, unless this is not a reasonable approximation of the cumulative effect of the rates prevailing on the transactions dates (in which case, the rates on the transaction dates are used)

All resulting exchange differences are recognised in other comprehensive income.

Rounding

The Company is an entity to which the *ASIC Corporations (Rounding in Financial/Directors' Reports) Instrument 2016/191* applies. Amounts have been rounded off in accordance with the instrument to the nearest thousand dollars, or in certain cases, the nearest dollar.

Section B: Business performance

This section contains information relevant to understanding the results and performance of the Group during the reporting period:

1 Segment information

During the year ended 30 June 2017, there were changes to elements of the business that led to a review of the Group's reportable operating segments. These changes include:

Lincor merger	On 13 September 2016, Hills announced that it had entered into a conditional merger agreement to combine its Hills Health Solutions (HHS) business with international healthcare technology business, Lincor Solutions, to create a new ASX listed company, Lincor Limited. As announced, the conditional merger agreement was terminated in December 2016. Following the termination, management have integrated HHS into the operational activities of the remainder of the Group.
Sale of Hills Home Living assets	The Hills Home Living (HHL) business was operated by Woolworths Limited (Woolworths) under a licencing arrangement until October 2016, when the agreement was terminated after the decision by Woolworths to exit its home improvement business and close its Masters stores. In December 2016, Hills entered into an agreement with AMES Australasia (AMES) to take over the manufacture and sale of HHL products. The transaction with AMES involved the sale of tooling equipment and trademarks related to HHL products, which are no longer used by the continuing Hills business. No further revenue, expenses or profit is expected from this business.

In light of the above changes, the Board of Directors (being the Chief Operating Decision Maker) consider that there is only one reportable segment for the year ended 30 June 2017.

Although the Group's divisions are managed on a products and services basis, they operate in two main geographical areas:

Australia	Comprises manufacturing facilities in South Australia and Victoria and sales offices and customers in most states and territories.
Overseas	Comprises sales offices and customers in New Zealand and customers in the Pacific Islands, the Middle East, Europe, Asia and North America.

1 Segment information (continued)

(a) Information about reportable segments

	Revenue		EBITDA[1]	
	2017 $'000	2016 $'000 (restated)	**2017 $'000**	2016 $'000 (restated)
Reportable segment				
Hills Limited	**298,068**	328,913	**6,353**	11,749
Total segment result[2]	**298,068**	328,913	**6,353**	11,749

(b) Other segment information

Segment revenue

The revenue from external customers reported to the CODM is measured in a manner consistent with that in the consolidated income statement. There are no sales between segments. Segment revenue reconciles to total revenue per note 2.

The Group derived revenue of $29.828 million from a single external customer during the period. The Group did not derive 10% or more of its revenues from any other single external customer.

Segment EBITDA

The CODM assesses performance based on a measure of EBITDA. This excludes the effects of non-recurring expenditure from the operating segments such as restructuring costs and goodwill and other intangible asset impairments when the impairment is the result of an isolated, non-recurring event and business combination acquisition transaction costs which, although expensed under IFRS, are considered to otherwise distort the operational view of the business.

Segment EBITDA reconciles to the loss before income tax as follows:

	Notes	**2017 $'000**	2016 $'000
Segment EBITDA		**6,353**	11,749
Depreciation and amortisation	4	**(7,072)**	(9,444)
Net finance expenses	4	**(3,290)**	(3,354)
Net costs not considered part of segment EBITDA[1]		**(3,995)**	(47,268)
Loss before income tax from continuing operations		**(8,004)**	(48,317)

[1] Earnings before interest, tax, depreciation, amortisation and impairment of intangible assets, goodwill and other receivables (EBITDA) is a non-IFRS measure not subject to audit or review. Segment EBITDA excludes the impact of costs associated with the proposed demerger of the Hills Health Solutions business and other net costs associated with structuring the Company in line with its future growth opportunities. This non-IFRS measure is relevant because it is consistent with the measures used internally by management and some in the investment community to assess the operating performance of the business.
[2] Total segment revenue represents revenue from external customers.

1 Segment information (continued)

(b) Other segment information (continued)

Net costs not considered part of segment EBITDA comprise:

	2017 $'000	2016 $'000
Costs related to proposed demerger of business	**2,207**	-
(Reversal of impairment) / impairment of property, plant and equipment	**(30)**	3,786
Impairment of goodwill	**-**	26,435
Impairment of intangible assets	**-**	12,685
Impairment of other receivables	**-**	2,900
Other net costs related to the Company's restructure and transformation program	**1,818**	1,462
	3,995	47,268

Segment assets and liabilities

The assets and liabilities of the reportable operating segment are as shown in the balance sheet.

Geographical information

Segment revenue and non-current assets (excluding financial instruments and deferred tax assets) by geographical location are shown below. Segment revenues are allocated based on the country in which the customer is located. Segment assets are allocated based on where the assets are located.

	Revenue		Non-current assets	
	2017 $'000	2016 $'000	**2017 $'000**	2016 $'000
Australia	**273,651**	302,606	**20,423**	20,203
Other countries	**24,417**	26,307	**715**	1,034
	298,068	328,913	**21,138**	21,237

Recognition and measurement

Operating segments are reported in a manner consistent with the internal reporting provided to the chief operating decision maker (CODM). The CODM, who is responsible for allocating resources and assessing the performance of the operating segments, has been identified as the Board of Directors.

Operating segments that exhibit similar long term economic characteristics, and have similar products, processes, customers, distribution methods and regulatory environments are aggregated.

2 Revenue

	2017 $'000	2016 $'000
Sales revenue		
Sale of goods	**231,154**	264,169
Services	**66,410**	61,218
	297,564	325,387
Other revenue		
Rents and sub-lease rentals	**4**	1,526
Licence fee revenue	**500**	2,000
Total revenue from continuing operations	**298,068**	328,913

Recognition and measurement

Revenue

Revenue is recognised for the major business activities as follows:

Sale of goods
Revenue from the sale of goods is measured at the fair value of the consideration received or receivable, net of returns, trade discounts and volume rebates. Revenue is recognised when the significant risks and rewards of ownership have been transferred to the buyer, recovery of the consideration is probable, the associated costs and possible return of goods can be estimated reliably, there is no continuing management involvement with the goods and the amount of revenue can be measured reliably.

Services
Revenue from services rendered is recognised in profit or loss in proportion to the stage of completion of the transaction at the reporting date. The stage of completion is assessed by reference to estimates of work performed.

Rental income
Rental income from property is recognised in profit or loss on a straight line basis over the term of the lease. Lease incentives granted are recognised as an integral part of the total rental income, over the term of the lease.

Licence fee revenue
Licence fee revenue is recognised on an accrual basis in accordance with the substance of the relevant licence agreement when it is probable that the economic benefits associated with the transaction will flow to the Group and the amount of revenue can be measured reliably.

3 Other income

	2017 $'000	2016 $'000
Net gain on disposal of non-current assets	**6,435**	155
Other income	**6,665**	3,037
	13,100	3,192

3 Other income (continued)

Net gain on disposal of non-current assets

The net gain on disposal of non-current assets for the year ended 30 June 2017 includes a gain on the sale of Hills Home Living assets (comprising intellectual property of $4 million and tooling, goodwill and other assets of $2.4 million), to AMES Australasia.

Other income

Other income for the year ended 30 June 2017 includes income of $6 million received from Woolworths on termination of the licence arrangement in relation to Hills Home Living products. Deferred costs of $0.651 million have been reflected in operating expenses for the period.

Other income in the prior year included income relating to the termination of Hills' distribution agreement with Crestron, which ceased during the year ended 30 June 2016.

4 Expenses

(a) Loss before income tax includes the following specific expenses:

	2017 $'000	2016 $'000
Depreciation		
Plant and equipment	**5,889**	6,652
Buildings	**-**	13
Total depreciation	**5,889**	6,665
Amortisation		
Software	**1,144**	1,253
Development costs	**39**	213
Customer contracts, relationships and brands	**-**	1,310
Patents and trademarks	**-**	3
Total amortisation	**1,183**	2,779
Total depreciation and amortisation	**7,072**	9,444
Employee benefits expenses		
Wages and salaries	**52,360**	59,587
Defined contribution superannuation expense	**4,532**	5,294
Other employee benefit expenses	**3,485**	4,231
Equity-settled share-based payment transactions	**36**	(84)
Total employee benefits expenses	**60,413**	69,028

4 Expenses (continued)

(a) Loss before income tax includes the following specific expenses (continued)**:**

Finance expenses		
Interest and finance charges paid/payable	**(3,321)**	(3,659)
Unwinding of discount on provisions	**(35)**	-
	(3,356)	(3,659)
Finance income		
Interest income	**66**	305
	66	305
Net finance costs expensed	**(3,290)**	(3,354)

(b) Information on expenses

Accounting standards require that an analysis of expenses is presented using a classification based on either their nature or their function. For the year ended 30 June 2017, the Group has presented expenses classified by nature in order to provide information that is more relevant and consistent with how management monitor business performance. Comparative information has been reclassified on the same basis (total expenses reported for the comparative period have not changed from the prior year).

Further information on expenses as shown in the Consolidated statement of profit and loss is provided below:

Cost of goods sold (inventories)	Cost of goods sold include expenses relating to the change in inventories of finished goods and work in progress, and raw materials used. Included in this balance for the year ended 30 June 2017 is an expense of $4.395 million relating to the impairment of inventory (comprising inventory purchased on signing a distribution agreement with Tyco in February 2015 of $3.461 million and other exited brands of $0.934 million).
Direct costs of services provided	Direct costs of services provided include subcontractor costs, commissions and subscriptions payable, and other direct costs associated with provision of services by Group entities. This balance does not include internal labour costs related to carrying out services, which are included in Labour and related expenses.
Labour and related expenses	Labour and related expenses include employee benefits expenses of $60.413 million (as shown in note 4a above) and other labour and related expenses such as third party logistics, labour hire, employee training and recruitment.
Operational and equipment expenses	Operational and equipment expenses include costs of freight, consumables, motor vehicle and other equipment expenses, repairs and maintenance.
Property expenses	Property expenses include rent, rates, utilities, cleaning and security expenses related to properties leases by the Group.
Other expenses	Other expenses include overhead expenses (such as insurance, advertising and marketing, professional and consulting fees, telecommunications and information technology related expenses) and other net costs not considered part of segment EBITDA of $3.995 million (2016: $47.268 million) (as shown in note 1b).

4 **Expenses** (continued)

Recognition and measurement

Depreciation and amortisation

Refer to notes 11 and 12 for recognition and measurement of depreciation and amortisation.

Employee benefits expense

Refer to note 13 for information relating to employee benefits expense.

Finance income and expense

Finance income comprises interest income on funds invested. Interest income is recognised in profit or loss as it accrues. Finance expenses comprise interest expense on borrowings and unwinding of the discount on provisions. Borrowing costs are recognised in profit or loss using the effective interest method.

5 Income tax

	2017 $'000	2016 $'000
(a) Income tax (benefit) / expense		
Current tax	**(60)**	(100)
Deferred tax	**(12)**	20,088
	(72)	19,988
(b) Numerical reconciliation of income tax (benefit) / expense to prima facie tax payable		
Loss from continuing operations before income tax expense	**(8,004)**	(48,317)
Tax at the Australian tax rate of 30% (2016: 30%)	**(2,401)**	(14,495)
Tax effect of amounts which are not deductible / (taxable) in calculating taxable income:		
Goodwill and other intangible assets impairment	**-**	7,930
Non-deductible expenses	**153**	223
Acquisition costs	**175**	(304)
Utilisation of previously unrecognised capital losses	**(1,464)**	-
Capital losses for which no deferred tax asset is recognised	**-**	805
(Recognition) / derecognition of deferred tax assets	**(5,289)**	20,282
Tax losses for which no deferred tax asset is recognised	**20,599**	-
Tax effect of prior year adjustments	**(11,850)**	5,526
	(77)	19,967
Difference in overseas tax rates	**5**	21
Total income tax (benefit) / expense	**(72)**	19,988

5 **Income tax** (continued)

(c) Income tax expense relating to items of other comprehensive income

	2017 $'000	2016 $'000
Aggregate current and deferred tax arising in the reporting period and not recognised in net profit or loss but directly debited or credited to other comprehensive income:		
Losses on cash flow hedges	**(98)**	(34)
Aggregate income tax benefit	**(98)**	(34)

(d) Tax losses

At the end of the reporting period, the Group had unused tax losses in respect of revenue items of $194.3 million (2016: $125.6 million) and capital items of $49.5 million (2016: $54.4 million).

	Revenue items		Capital items	
	2017 $'000	2016 $'000	**2017 $'000**	2016 $'000
Unused losses for which no deferred tax asset has been recognised	**194,276**	125,613	**49,522**	54,398
Potential tax benefit	**58,283**	37,684	**14,856**	16,319

Revenue and capital tax losses do not expire under current legislation.

Revenue losses	Deferred tax assets have not been recognised in respect of revenue tax losses because the period over which the Group expects to utilise the benefits of these items extends beyond 3 years (the time horizon during which their recovery is considered probable).
Capital losses	Deferred tax assets have not been recognised in respect of capital losses because it is not probable that future capital gains will be available against which the Group can utilise the benefits from these items.

(e) Current tax assets and liabilities

The current tax asset for the Group of $0.229 million (2016: $0.183 million) represents the amount of income taxes refundable in respect of current and prior financial periods.

5 **Income tax** (continued)

(f) Deferred tax

	2017 $'000	2016 $'000
The balance comprises temporary differences attributable to:		
Property, plant and equipment	**450**	149
Inventories	**5,614**	9,009
Employee benefits	**2,054**	1,283
Receivables	**178**	16
Provisions	**2,039**	16
Other accruals	**515**	366
Derivative financial instruments	**67**	(31)
	10,917	10,808

	Balance at 1 July $'000	**Recognised in profit or loss $'000**	**Recognised in other comprehensive income $'000**	**Balance at 30 June $'000**
Movements 2016				
Property, plant and equipment	3,559	(3,410)	-	149
Inventories	2,503	6,506	-	9,009
Employee benefits	2,865	(1,582)	-	1,283
Receivables	846	(830)	-	16
Loans and borrowings	1,218	(1,218)	-	-
Provisions	5,471	(5,455)	-	16
Other accruals	66	300	-	366
Derivative financial instruments	(65)	-	34	(31)
Tax losses	16,014	(16,014)	-	-
Software & other intangible assets	(2,327)	2,327	-	-
Other	683	(683)	-	-
Exchange differences	-	(29)	29	-
	30,833	(20,088)	63	10,808
Movements 2017				
Property, plant and equipment	**149**	**301**	**-**	**450**
Inventories	**9,009**	**(3,395)**	**-**	**5,614**
Employee benefits	**1,283**	**771**	**-**	**2,054**
Receivables	**16**	**162**	**-**	**178**
Provisions	**16**	**2,023**	**-**	**2,039**
Other accruals	**366**	**149**	**-**	**515**
Derivative financial instruments	**(31)**	**-**	**98**	**67**
Exchange differences	**-**	**1**	**(1)**	**-**
	10,808	**12**	**97**	**10,917**

5 **Income tax** (continued)

(g) Tax consolidation legislation

The Company and its wholly owned Australian controlled entities have implemented the tax consolidation legislation.

Tax sharing agreement	On adoption of the tax consolidation legislation, the entities in the tax consolidated group entered into a tax sharing agreement that, in the opinion of the Directors, limits the joint and several liability of the wholly owned entities in the case of a default by the head entity, Hills Limited.
Tax funding agreement	The entities have also entered into a tax funding agreement under which the wholly owned entities fully compensate the Company for any current tax payable assumed and are compensated by the Company for any current tax receivable and deferred tax assets relating to unused tax losses or unused tax credits that are transferred to the Company under the tax consolidation legislation. The funding amounts are determined by reference to the amounts recognised in the wholly owned entities' financial statements.
	The amounts receivable / payable under the tax funding agreement are due upon receipt of the funding advice from the head entity, which is issued as soon as practicable after the end of each reporting period. The head entity may also require payment of interim funding amounts to assist with its obligations to pay tax instalments. The funding amounts are recognised as current intercompany receivables or payables and eliminated on consolidation.
	Assets or liabilities arising under tax funding agreements with the tax consolidated entities are recognised as amounts receivable from or payable to other entities in the Group.

Recognition and measurement

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 Company's subsidiaries operate and generate taxable income.

Current and 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

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

Deferred tax liabilities are not recognised if they arise from the initial recognition of goodwill. Deferred income tax is also not accounted for if it arises from initial recognition of an asset or liability in a transaction other than a business combination that at the time of the transaction affects neither accounting nor taxable profit or loss. Deferred income tax is determined using tax rates (and laws) that have been enacted or substantially enacted by the end of the

5 Income tax (continued)

Recognition and measurement (continued)

reporting period and are expected to apply when the related deferred income tax asset is realised or the deferred income tax liability is settled.

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 foreign operations where the Company 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.

Offsetting
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 tax 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
The head entity, Hills Limited, and the controlled entities in the tax consolidated group account for their own current and deferred tax amounts arising from temporary differences. These tax amounts are measured as if each entity in the tax consolidated group continues to be a standalone taxpayer in its own right.

In addition to its own current and deferred tax amounts, Hills Limited also recognises the current tax liabilities (or assets) and the deferred tax assets arising from unused tax losses and unused tax credits assumed from controlled entities in the tax consolidated group.

Key estimate: unrecognised deferred tax assets

Deferred tax assets are only recognised for deductible temporary differences and tax losses to the extent that it is probable that taxable profits will be available to utilise them. The financial projections used in assessing the probability of taxable profits are inherently subject to management judgement.

6 Loss per share

	2017 Cents	2016 Cents
(a) Basic and diluted loss per share		
From loss attributable to the ordinary equity holders of the Company	**(3.4)**	(29.4)

	2017 \$'000	2016 \$'000
(b) Reconciliation of earnings used in calculating loss per share		
Loss attributable to the ordinary equity holders of the Company used in calculating basic loss per share	**(7,932)**	(68,305)

6 Loss per share (continued)

	2017 Shares '000	2016 Shares '000
(c) Weighted average number of shares used as denominator		
Weighted average number of ordinary shares used as the denominator in calculating basic loss per share	**231,986**	231,986
Effect of performance rights on issue	**-**	-
Weighted average number of ordinary and potential ordinary shares used as the denominator in calculating diluted loss per share	**231,986**	231,986

Performance rights have not been included in the weighted average number of shares for diluted loss per share as no shares are expected to be issued to satisfy performance rights.

Recognition and measurement

Earnings per share

Basic earnings per share

Basic earnings per share is calculated by dividing:

- the profit attributable to owners of the Company, excluding any costs of servicing equity other than ordinary shares
- by the weighted average number of ordinary shares outstanding during the reporting period.

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 additional ordinary shares that would have been outstanding assuming the conversion of all dilutive potential ordinary shares.

Section C: Operating assets and liabilities

This section provides information on the operating assets used and the operating liabilities incurred by the Group:

7 Cash and cash equivalents
8 Trade and other receivables
9 Inventories
10 Trade and other payables
11 Property, plant and equipment
12 Intangible assets
13 Provisions

7 Cash and cash equivalents

	2017 $'000	2016 $'000
Cash at bank and in hand	**5,360**	3,994
Deposits	**3,291**	-
	8,651	3,994

(a) Reconciliation of loss after income tax to net cash flow from operating activities

	2017 $'000	2016 $'000
Loss for the period	**(7,932)**	(68,305)
Depreciation and amortisation	**7,072**	9,444
Net gain on sale of non-current assets	**(6,435)**	(141)
(Reversal of impairment) / impairment of property, plant and equipment	**(30)**	3,786
Impairment of goodwill	**-**	26,435
Impairment of other receivables	**-**	2,900
Impairment of intangible assets	**-**	12,685
Non-cash employee benefits expense / (credit) - share-based payments	**36**	(84)
Rent received	**(4)**	(1,526)
Fair value adjustment to derivatives	**62**	82
Unwinding of discount on provisions	**35**	-
Other non-cash items	**(7)**	-
Change in operating assets and liabilities:		
Decrease in trade and other receivables	**11,008**	17,893
Decrease in inventories	**9,126**	17,204
Decrease in trade and other payables	**(9,900)**	(17,632)
Decrease in provisions	**(3,756)**	(12,868)
Increase in provision for income taxes receivable	**(48)**	(593)
(Increase) / decrease in deferred tax assets	**(12)**	20,096
Net cash flows from operating activities	**(785)**	9,376

7 **Cash and cash equivalents** (continued)

Recognition and measurement

Cash and cash equivalents

Cash and cash equivalents includes cash on hand, deposits held at call with financial institutions, other short term, highly liquid investments with original maturities of three months or less that are readily convertible to known amounts of cash and that are subject to an insignificant risk of changes in value.

8 Trade and other receivables

	2017			2016		
	Current $'000	**Non-current $'000**	**Total $'000**	Current $'000	Non-current $'000	Total $'000
Trade receivables	**52,914**	**-**	**52,914**	61,319	-	61,319
Provision for impairment of receivables (a)	**(594)**	**-**	**(594)**	(1,275)	-	(1,275)
	52,320	**-**	**52,320**	60,044	-	60,044
Other receivables	**5,271**	**-**	**5,271**	6,573	534	7,107
Prepayments	**1,898**	**-**	**1,898**	2,729	-	2,729
	59,489	**-**	**59,489**	69,346	534	69,880

Unamortised borrowing costs, which were included in prepayments in the prior year, have been reclassified to borrowings. The amount at 30 June 2016 of $2.565 million is shown in note 17.

	2017 $'000	2016 $'000
(a) Impaired trade receivables		
The ageing of the Group's trade receivables at the reporting date is as follows:		
Not past due	**36,781**	39,462
Past due 0 – 30 days	**11,441**	13,819
Past due 31 – 90 days	**3,307**	5,610
Past due more than 90 days	**1,385**	2,428
	52,914	61,319
Movements in the provision for impairment of receivables are as follows:		
At 1 July	**1,275**	1,481
Provision for impairment recognised during the period	**283**	389
Receivables written off during the period as uncollectable	**(964)**	(595)
At 30 June	**594**	1,275

Based on low historic default rates, the Group believes that no impairment allowance is necessary in respect of trade receivables not yet past due.

The provision for impaired receivables for the Group of $0.594 million (2016: $1.275 million) relates to receivables past due more than 30 days, on a case by case assessment. Receivables past due between 0 and 30 days are not considered impaired.

8 **Trade and other receivables** (continued)

(b) Transfer of trade receivables

The Group has entered into a Receivables Purchase Facility, as described in note 17, under which trade receivables have been sold with recourse. These receivables have not been derecognised from the statement of financial position as the Group retains substantially all of the risks and rewards (primarily credit risk).

The carrying amount of transferred trade receivables not derecognised is show below:

	2017 $'000	2016 $'000
Carrying amount of trade receivables transferred	**35,597**	31,907
Carrying amount of associated liabilities	**(30,353)**	(27,695)

(c) Financial risk

See note 19 for information about the Group's exposure to foreign currency risk, interest rate risk and credit risk in relation to trade and other receivables.

The maximum exposure to credit risk at the reporting date is the carrying amount of each class of receivables mentioned above. The fair value of securities held for certain trade receivables is insignificant as is the fair value of any collateral sold or re-pledged.

Recognition and measurement

Trade receivables

Trade receivables are recognised initially at fair value and subsequently measured at amortised cost using the effective interest method, less provision for impairment. Trade receivables are generally due for settlement within 30 to 90 days. They are presented as current assets unless collection is not expected for more than 12 months after the reporting date.

The fair value of trade and other receivables is estimated as the present value of future cash flows, discounted at the market rate of interest at the reporting date. Cash flows relating to short term receivables are not discounted if the effect of discounting is immaterial.

Collectability of trade receivables is reviewed on an ongoing basis. The amount of the impairment loss is recognised in profit or loss. When a trade receivable for which an impairment allowance had been recognised becomes uncollectible in a subsequent period, it is written off against the allowance account. Subsequent recoveries of amounts previously written off are credited against expenses in profit or loss.

9 **Inventories**

	2017 $'000	2016 $'000
Raw materials and work in progress	**2,343**	3,028
Finished goods	**44,117**	52,589
	46,460	55,617

9 Inventories (continued)

Recognition and measurement

Inventories

Raw materials, work in progress 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. Cost includes the reclassification from equity of any gains/losses on qualifying cash flow hedges relating to purchases of inventory.

Costs are assigned to individual items of inventory on the basis of weighted average costs. Costs of purchased inventory are determined after deducting rebates and discounts. Net realisable value is the estimated selling price less the estimated costs of completion and the estimated costs necessary to make the sale.

The fair value of inventories acquired in a business combination is determined based on its estimated selling price in the ordinary course of business less the estimated costs of completion and sale, and a reasonable profit margin based on the effort required to complete and sell the inventories.

10 Trade and other payables

	2017 $'000	2016 $'000
Trade payables	**25,940**	29,538
Other payables and accrued expenses	**14,326**	20,862
	40,266	50,400

Other payables and accrued expenses include amounts payable in respect of employee benefits (including wages and salaries, superannuation / pension contributions, commissions and bonuses, payroll tax), Goods and Services Tax (GST), customer rebates and other sundry accrued expenses.

Recognition and measurement

Trade and other payables

Trade and other payables are recognised initially at fair value and subsequently measured at amortised cost.

They represent liabilities for goods and services provided to the Group prior to the end of the reporting period that are unpaid. The amounts are unsecured and are paid in accordance with the Group's terms of trade.

Trade and other payables are presented as current liabilities unless payment is not due within twelve months after the reporting period.

11 Property, plant and equipment

	Land $'000	Buildings $'000	Plant & equipment $'000	Total $'000
Year ended 30 June 2016				
Opening net book amount	6,841	2,057	23,924	32,822
Exchange differences	-	-	100	100
Additions	-	-	4,247	4,247
Disposals	(5,625)	(593)	(552)	(6,770)
Depreciation charge	-	(13)	(6,652)	(6,665)
Impairment charge	(1,216)	(1,451)	(1,119)	(3,786)
Closing net book amount	-	-	19,948	19,948
At 30 June 2016				
Cost	-	-	73,350	73,350
Accumulated depreciation and impairment	-	-	(53,402)	(53,402)
Net book amount	-	-	19,948	19,948
Year ended 30 June 2017				
Opening net book amount	**-**	**-**	**19,948**	**19,948**
Exchange differences	**-**	**-**	**(7)**	**(7)**
Additions	**-**	**-**	**2,770**	**2,770**
Disposals	**-**	**-**	**(252)**	**(252)**
Depreciation charge	**-**	**-**	**(5,889)**	**(5,889)**
Impairment reversal	**-**	**-**	**30**	**30**
Closing net book amount	**-**	**-**	**16,600**	**16,600**
At 30 June 2017				
Cost	**-**	**-**	**59,834**	**59,834**
Accumulated depreciation and impairment	**-**	**-**	**(43,234)**	**(43,234)**
Net book amount	**-**	**-**	**16,600**	**16,600**

Additions include an amount of $1.263 million (2016: nil) for the estimated costs to remove leasehold improvements from properties leased by the Group and restore the premises on which they are located. These estimated costs have been capitalised in accordance with *AASB 116 Property, Plant and Equipment* as an element of cost of the leasehold improvement assets. Payments for property, plant and equipment of $1.507 million as shown in the Consolidated statement of cash flows do not include these non-cash additions.

During the year ended 30 June 2017, fully depreciated assets with a cost of $13.8 million were written off.

11 Property, plant and equipment (continued)

(a) Assets in the course of construction

The carrying amounts of the assets disclosed above and in note 12 Intangible assets include the following expenditure recognised in relation to non-current assets (principally plant and equipment, leasehold improvements and software development), which are in the course of construction:

	2017 $'000	2016 $'000
Plant and equipment, leasehold improvements and software development	**3,626**	2,284

Key estimate: useful lives of property, plant and equipment

The assessment of the useful lives of property, plant and equipment requires management judgement based on past experience and industry practice. Management reassess the useful lives when there are indications of a change in economic circumstances that may impact the assets.

Recognition and measurement

Property, plant and equipment

Land and buildings
Land and buildings are shown at fair value less subsequent depreciation for buildings. Land and buildings are independently valued at least every four years on the basis of open market values, and in the intervening years are valued by the Directors based on the most recent independent valuation combined with current market information. Any accumulated depreciation at the date of revaluation is eliminated against the gross carrying amount of the asset and the net amount is restated to the revalued amount of the asset. The costs of additions since the valuations are deemed to be the fair value of those assets. The Directors are of the opinion that these bases provide a reasonable estimate of fair value.

Increases in the carrying amounts arising on revaluation of land and buildings are recognised, net of tax, in other comprehensive income and accumulated in reserves in equity. To the extent that the increase reverses a decrease previously recognised in profit or loss, the increase is first recognised in profit or loss. Decreases that reverse previous increases of the same asset are first recognised in other comprehensive income to the extent of the remaining surplus attributable to the asset; all other decreases are charged to profit or loss.

Plant and equipment
Plant and equipment is stated at historical cost less depreciation. Historical cost includes expenditure that is directly attributable to the acquisition of the items. Cost may also include transfers from equity of any gains or losses on qualifying cash flow hedges of foreign currency purchases of property, plant and equipment. The cost of self-constructed assets includes the cost of materials and direct labour, any other costs directly attributable to bringing the asset to a working condition for its intended use, and the costs of dismantling and removing the items and restoring the site on which they are located.

Purchased software that is integral to the functionality of the related equipment is capitalised as part of that equipment.

The fair value of property, plant and equipment recognised as a result of a business combination is based on market values.

11 **Property, plant and equipment** (continued)

Recognition and measurement (continued)

When parts of an item of property, plant and equipment have different useful lives, they are accounted for as separate items (major components) of property, plant and equipment.

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. The carrying amount of any component accounted for as a separate asset is derecognised when replaced. All other repairs and maintenance are charged to profit or loss during the reporting period in which they are incurred.

Depreciation

Land is not depreciated. Depreciation on other assets is calculated using the straight line method as considered appropriate to allocate their cost or revalued amounts, net of their residual values, over their estimated useful lives, as follows (current and comparative periods):

Buildings	2.5%
Plant and equipment, including leasehold improvements	5.0% to 66.7%

Impairment

The assets' residual values and useful lives are reviewed, and adjusted if appropriate, at the end of each reporting period.

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.

Gains and losses on disposals are determined by comparing proceeds with the carrying amount. These are included in profit or loss. When revalued assets are sold, it is Group policy to transfer any amounts included in other reserves in respect of those assets to the profits reserve.

12 Intangible assets

	Goodwill	Patents, trademarks & other rights	Distribution agreements, customer contracts & brands	Software[1]	Development costs	Total
	$'000	$'000	$'000	$'000	$'000	$'000
Year ended 30 June 2016						
Opening net book amount	26,280	254	5,958	5,778	967	39,237
Exchange differences	155	-	-	16	-	171
Additions	-	-	-	2,871	373	3,244
Transfers between categories	-	(208)	-	-	208	-
Amortisation charge	-	(3)	(1,253)	(1,310)	(213)	(2,779)
Impairment charge	(26,435)	(43)	(4,705)	(6,723)	(1,214)	(39,120)
Closing net book amount	-	-	-	632	121	753
At 30 June 2016						
Cost	146,131	58	15,125	23,234	1,779	186,327
Accumulated amortisation and impairment	(146,131)	(58)	(15,125)	(22,602)	(1,658)	(185,574)
Net book amount	-	-	-	632	121	753
Year ended 30 June 2017						
Opening net book amount	**-**	**-**	**-**	**632**	**121**	**753**
Exchange differences	**-**	**-**	**-**	**-**	**-**	**-**
Additions	**-**	**-**	**-**	**2,874**	**140**	**3,014**
Disposals	**-**	**-**	**-**	**(4)**	**(2)**	**(6)**
Amortisation charge	**-**	**-**	**-**	**(1,144)**	**(39)**	**(1,183)**
Closing net book amount	**-**	**-**	**-**	**2,358**	**220**	**2,578**
At 30 June 2017						
Cost	**145,634**	**58**	**15,125**	**17,238**	**1,895**	**179,950**
Accumulated amortisation and impairment	**(145,634)**	**(58)**	**(15,125)**	**(14,880)**	**(1,675)**	**(177,372)**
Net book amount	**-**	**-**	**-**	**2,358**	**220**	**2,578**

Additions for the year include $0.765 million (2016: nil) incurred but not yet paid at the end of the period. Payments for intangible assets of $2.249 million as shown in the Consolidated statement of cash flows do not include these additions.

During the year ended 30 June 2017, fully amortised or impaired intangible assets with a cost of $8.7 million were written off. Fully impaired goodwill of $0.497 million was derecognised on the deregistration of Audio Products Group Pty Limited (see note 21).

[1] Software includes capitalised development costs, being an internally generated intangible asset

12 **Intangible assets** (continued)

Recognition and measurement

Goodwill

Goodwill represents the excess of the cost of a business acquisition over the fair value of the Group's share of the net identifiable assets of the acquired subsidiary at the date of acquisition. Goodwill on acquisitions of subsidiaries is included in intangible assets. Goodwill is not amortised but is tested for impairment annually, or more frequently if events or changes in circumstances indicate that it might be impaired. It is carried at cost less accumulated impairment losses. Gains and losses on the disposal of an entity include the carrying amount of goodwill relating to the entity sold.

Goodwill is allocated to cash-generating units for the purpose of impairment testing. The allocation is made to those cash-generating units or groups of cash-generating units that are expected to benefit from the business combination in which the goodwill arose.

Patents and trademarks, customer relationships, distribution agreements and brands

Patents and trademarks, customer relationships and brands have a finite useful life and are carried at cost less accumulated amortisation and impairment losses. The Group's intangible assets were fully impaired at 31 December 2015.
To that date, amortisation was calculated using the straight line method to allocate the cost over their estimated useful lives, which varied from:

Patents and trademarks:	10 to 20 years
Customer relationships, distribution agreements and brands	2 to 5 years

IT development and software

Costs incurred in developing products or systems and costs incurred in acquiring software and licenses that will contribute to future period financial benefits through revenue generation and/or cost reduction are capitalised to software and systems. Costs capitalised include external direct costs of materials and service and direct payroll and payroll related costs of employees' time spent on the project. Amortisation is calculated on a straight-line basis over periods generally ranging from 3 to 5 years.

IT development costs include only those costs directly attributable to the development phase and are only recognised following completion of technical feasibility and where the Group has an intention and ability to use the asset.

Research and development

Research expenditure is recognised as an expense as incurred. Costs incurred on development projects (relating to the design and testing of new or improved products) are recognised as intangible assets when it is probable that the project will, after considering its commercial and technical feasibility, be completed and generate future economic benefits and its costs can be measured reliably. The expenditure capitalised comprises all directly attributable costs, including costs of materials, services, direct labour and an appropriate proportion of overheads. Other development expenditures that do not meet these criteria are recognised as an expense as incurred. Development costs previously recognised as an expense are not recognised as an asset in a subsequent period. Capitalised development costs are recorded as intangible assets and amortised from the point at which the asset is ready for use on a straight line basis over its useful life, which is estimated to be 5 to 20 years.

13 Provisions

	2017			2016		
	Current $'000	**Non-current $'000**	**Total $'000**	Current $'000	Non-current $'000	Total $'000
Employee benefits	**6,170**	**695**	**6,865**	7,040	926	7,966
Outstanding claims	**866**	**660**	**1,526**	2,188	954	3,142
Restructuring costs	**2,336**	**802**	**3,138**	3,200	1,153	4,353
Other provisions	**1,184**	**2,039**	**3,223**	84	664	748
	10,556	**4,196**	**14,752**	12,512	3,697	16,209

(a) Description of provisions

Employee benefits	Provisions for employee benefits include liabilities for annual leave and long service leave.
Outstanding claims	The provision for claims comprises the amounts set aside for estimated warranty claims. In the prior year, it also included the estimated future liability of the Group's self-insurance arrangements.
Restructuring costs	The restructuring costs provision comprises redundancy costs and other costs of closing and restructuring businesses (including onerous lease and make-good costs related to properties affected by restructure).
Other provisions	Other provisions comprise provisions for environmental monitoring of a site, make good obligations, onerous lease costs and other provisions as required.

(b) Movements in provisions

Movements in each class of provision during the reporting period, other than employee benefits, are set out below:

	Outstanding claims $'000	**Restructuring costs $'000**	**Other $'000**	**Total $'000**
Movements 2017				
Carrying amount at the start of the year	**3,142**	**4,353**	**748**	**8,243**
Additional provisions made during the period	**32**	**2,289**	**2,471**	**4,792**
Amounts used (incurred or charged against provision)	**(684)**	**(3,482)**	**(31)**	**(4,197)**
Unused amounts reversed during the period	**(964)**	**(22)**	**-**	**(986)**
Unwinding of discount	**-**	**-**	**35**	**35**
Carrying amount at the end of the year	**1,526**	**3,138**	**3,223**	**7,887**

13 **Provisions** (continued)

Recognition and measurement

Provisions

Provisions for legal claims, service warranties, make good obligations and onerous leases 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. Warranty provisions are recognised when the underlying products or services are sold. Restructuring provisions are recognised when the Group has approved a detailed and formal restructuring plan, and the restructuring has either commenced or been announced publicly. Provisions are not recognised for future operating losses.

Provisions are measured at the present value of management's best estimate of the expenditure required to settle the present obligation at the end of the reporting period. 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 the passage of time is recognised as interest expense.

Employee benefits

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. The liability for annual leave is recognised in the provision for employee benefits. All other short term employee benefit obligations are presented as payables.

Other long term employee benefits 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 end of the reporting period. 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 end of the reporting period on corporate bonds rates with terms to maturity and currency that match, as closely as possible, the estimated future cash outflows.

The obligations are presented as current liabilities in the consolidated statement of financial position if the Group does not have an unconditional right to defer settlement for at least twelve months after the reporting date, regardless of when settlement is expected to occur.

Retirement benefit obligations
A defined contribution plan is a post-employment benefit plan which receives fixed contributions from Group Entities and the Group's legal or constructive obligation is limited to these contributions.

Contributions to defined contribution plans are recognised as an expense as they become payable.

Profit-sharing and bonus plans
A liability is recognised for the amount expected to be paid under short term cash bonus or profit sharing plans if the Group has a present legal or constructive obligation to pay this amount as a result of past service provided by the employee and the obligation can be estimated reliably, or where there is past practice that has created a constructive obligation.

Section D: Capital and financing

This section provides information on how the Group manages its capital structure and financing, including its exposure to financial risk:

14 Contributed equity

(a) Share capital

	2017 Shares	2016 Shares	**2017 $'000**	2016 $'000
Ordinary shares - fully paid	**231,985,526**	231,985,526	**278,439**	278,439

(b) About share capital

Ordinary shares	Holders of ordinary shares are entitled to receive dividends as declared from time to time and are entitled to one vote per share at meetings of the Company. Ordinary shares have no par value. The Company does not have a limited amount of ordinary share capital.
Performance rights	Information relating to the Long Term Incentive Share Plan, including details of performance rights issued, exercised, lapsed and forfeited during the reporting period and performance rights outstanding at the end of the reporting period, is set out in note 28.

Recognition and measurement

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.

If the Company reacquires its own equity instruments, for example as the result of a share buyback, those instruments are deducted from equity and the associated shares are cancelled. No gain or loss is recognised in profit or loss and the consideration paid including any directly attributable incremental costs (net of income taxes) is recognised directly in equity.

15 Reserves

	2017 $'000	2016 $'000
Hedging reserve - cash flow hedges	**(158)**	72
Equity compensation reserve	**706**	670
Foreign currency translation reserve	**354**	374
Profits reserve	**10,133**	10,133
	11,035	11,249

(a) Movements in reserves

	2017 $'000	2016 $'000
Hedging reserve – cash flow hedges		
Opening balance 1 July	**72**	151
Revaluation - gross	**(328)**	(113)
Deferred tax	**98**	34
Closing balance 30 June	**(158)**	72
Equity compensation reserve		
Opening balance 1 July	**670**	754
Employee share plan expense / (credit)	**36**	(84)
Closing balance 30 June	**706**	670
Foreign currency translation reserve		
Opening balance 1 July	**374**	(571)
Currency translation differences arising during the year	**(20)**	945
Closing balance 30 June	**354**	374
Profits reserve		
Opening balance 1 July	**10,133**	10,133
Closing balance 30 June	**10,133**	10,133

(b) Nature and purpose of reserves

Hedging reserve – cash flow hedges	The hedging reserve is used to record changes in the fair value of derivative financial instruments designated in a cash flow hedge relationship that are recognised in other comprehensive income. Amounts are reclassified to profit or loss when the associated hedged transaction affects profit or loss.
Equity compensation reserve	The equity compensation reserve represents the value of performance rights held by an equity compensation plan of the Group. This reserve will be reversed against share capital when the underlying performance rights are exercised and shares vest in the employee. No gain or loss is recognised in profit or loss on the purchase, sale, issue or cancellation of the Group's own equity instruments.

15 Reserves (continued)

(b) Nature and purpose of reserves (continued)

Foreign currency translation reserve	Exchange differences arising on translation of the financial statements of a foreign controlled entity are recognised in other comprehensive income and accumulated in this reserve. The cumulative amount is reclassified to profit or loss when the net investment is disposed of.
Profits reserve	Current period and realised profits are transferred from retained earnings and other reserves to the profits reserve and dividends are paid out of the profits reserve.

16 Dividends

(a) Ordinary shares

Year ended 30 June 2017	No dividends were paid during the year and no final dividend has been declared.
Year ended 30 June 2016	No dividends were paid during the year and no final dividend has been declared.

(b) Franked dividends

	2017 $'000	2016 $'000
Franking credits available for subsequent reporting periods based on a tax rate of 30% (2016: 30.0%)	**1,787**	1,787

The above amounts represent the balance of the franking account as at the end of the reporting period, adjusted for franking credits that will arise from:

- the payment of the amount of the provision for income tax;
- the payment of dividends recognised as a liability at the reporting date; and
- the receipt of dividends recognised as receivables at the reporting date.

The consolidated amounts include franking credits that would be available to the Company if distributable profits of subsidiaries were paid as dividends.

Recognition and measurement

Dividends

Provision is made for the amount of any dividend 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.

17 Borrowings

	2017			2016		
	Current $'000	**Non-current $'000**	**Total $'000**	Current $'000	Non-current $'000	Total $'000
Loans	**295**	**30,353**	**30,648**	472	27,695	28,167
Transaction costs	**-**	**(1,958)**	**(1,958)**	-	(2,565)	(2,565)
Total borrowings	**295**	**28,395**	**28,690**	472	25,130	25,602

Non-current borrowings include transactions costs directly attributable to the issue of the borrowings. At 30 June 2017, unamortised borrowing costs totalled $1.958 million (2016: $2.565 million).

(a) Loans

The Group has its financing facilities with Commonwealth Bank of Australia (CBA) through a Bilateral Facility and with Recfin Nominees Pty Ltd through a Receivables Purchase Facility.

Bilateral Facility	The CBA facility was amended in December 2016 and now comprises a facility for an overdraft and contingent liabilities (bank guarantees / letter of credit), with the following sub limits (denominated in AUD): ▪ Overdraft: $3 million (nil drawn at 30 June 2017) ▪ Contingent liabilities: $4.472 million. Interest is charged at prevailing market rates plus a fixed margin. CBA hold a fixed and floating charge over the assets of the Group (excluding Accounts Receivable). The facility expires on 13 November 2017.
Receivables Purchase Facility	The Recfin Nominees Pty Ltd facility totals $36 million (denominated in AUD), with funding provided based upon the Group's accounts receivable book. The facility expires on 13 May 2021. The facility is secured on the Group's Accounts Receivable book, with a second mortgage over the other assets of the Group. Interest is charged at prevailing market rates plus a fixed margin.

The Company and its wholly owned subsidiaries have provided an interlocking guarantee and indemnity to its financiers for these facilities. An assessment of the contractual maturities of financial liabilities is provided in note 19, together with details of undrawn borrowing facilities at the period end.

Recognition and measurement

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 profit or loss over the period of the borrowings using the effective interest method. Fair value, which is determined for disclosure purposes, is calculated based on the present value of future principal and interest cash flows, discounted at the market rate of interest at the reporting date. Fees paid on the establishment of loan facilities are capitalised as a prepayment and amortised over the period of the facility to which it relates.

Borrowings are classified as current liabilities unless the Group has an unconditional right to defer settlement of the liability for at least 12 months after the reporting period.

17 Borrowings (continued)

Recognition and measurement (continued)

Borrowing costs

Borrowing costs incurred for the construction of any qualifying asset are capitalised during the period of time that is required to complete and prepare the asset for its intended use or sale. Other borrowing costs are expensed.

18 Derivative financial instruments

The Group is party to derivative financial instruments in the normal course of business in order to hedge exposure to fluctuations in interest and foreign exchange rates in accordance with the Group's financial risk management policies (refer to note 19).

	2017 $'000	2016 $'000
Current assets		
Forward foreign exchange contracts - cash flow hedges	-	103
Total current derivative financial instrument assets	-	103
Current liabilities		
Forward foreign exchange contracts - cash flow hedges	(225)	-
Forward foreign exchange contracts – held for trading	(62)	-
Total current derivative financial instrument liabilities	(287)	-
Net derivative financial instrument assets / (liabilities)	(287)	103

(a) Instruments used by the Group

Forward exchange contracts: cash flow hedges	The Group purchases goods and materials from overseas, principally in US dollars. In order to protect against exchange rate movements, the Group has entered into forward exchange contracts to purchase US dollars. These contracts are hedging highly probable forecasted purchases for approximately the following two to three months. The portion of the gain or loss on the hedging instrument that is determined to be an effective hedge is recognised in other comprehensive income. When the cash flows occur, the Group adjusts the initial measurement of the component recognised in the consolidated statement of financial position by removing the related amount from other comprehensive income. During the year ended 30 June 2017, no gain or loss was recognised in profit or loss for the ineffective portion of these hedging contracts (2016: loss of $5,000).
Forward exchange contracts: held-for-trading	Group Entities have entered into forward foreign exchange contracts that are economic hedges but do not satisfy the requirements for hedge accounting. These contracts are subject to the same risk management policies as all other derivative contracts, see note 19 for details. However, they are accounted for as held for trading.

Recognition and measurement

Derivatives and hedging activities

Derivatives are initially recognised at fair value on the date a derivative contract is entered into and are subsequently

18 **Derivative financial instruments** (continued)

Recognition and measurement (continued)

Derivatives and hedging activities (continued)

remeasured to their fair value at the end of each reporting period. The accounting for subsequent changes in fair value 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 hedges of a particular risk associated with the cash flows of recognised assets and liabilities and highly probable forecast transactions (cash flow hedges).

The Group documents at the inception of the hedging 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 full fair value of a hedging derivative is classified as a non-current asset or liability when the remaining maturity of the hedged item is more than 12 months; it is classified as a current asset or liability when the remaining maturity of the hedged item is less than 12 months. Trading derivatives are classified as a current asset or liability.

The fair value of forward exchange contracts is based on their listed market price, if available. If a listed market price is not available, then fair value is estimated by discounting the difference between the contractual forward price and the current forward price for the residual maturity of the contract using a risk free interest rate (based on government bonds). The fair value of interest rate swaps is determined by discounting estimated future cash flows based on the terms and maturity of each contract and using market rates at the measurement date.

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

Amounts accumulated in equity are reclassified to profit or loss in the periods when the hedged item affects profit or loss. The gain or loss relating to the effective portion of interest rate swaps hedging variable rate borrowings is recognised in profit or loss within ‘finance income' or 'finance costs'. The gain or loss relating to the effective portion of forward foreign exchange contracts hedging export sales is recognised in profit or loss within ‘sales'. However, when the forecast transaction that is hedged results in the recognition of a non-financial asset (for example, inventory or plant and equipment) the gains and losses previously deferred in equity are reclassified from equity and included in the initial measurement of the cost of the asset. The deferred amounts are ultimately recognised in profit or loss as cost of goods sold in the case of inventory, or as depreciation or impairment in the case of plant and equipment.

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 profit or loss. 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.

Derivatives that do not qualify for hedge accounting
Certain derivative instruments do not qualify for hedge accounting. Changes in the fair value of any derivative instrument that does not qualify for hedge accounting are recognised immediately in profit or loss.

19 Capital and financial risk management

(a) Capital risk management

The Group's objective when managing capital is to safeguard its ability to continue as a going concern to provide returns for shareholders and benefits for other stakeholders and to maintain an optimal capital structure to reduce the cost of capital.

To maintain or adjust the capital structure, the Group may vary the amount of dividends paid to shareholders, return capital to shareholders, issue new shares or sell assets to reduce debt.

The Group monitors capital by assessing its gearing ratio. The gearing ratio is calculated as:

$$\frac{\textbf{net debt}}{\textbf{net debt} + \textbf{total equity}}$$

Net debt	Total borrowings as shown in the consolidated statement of financial position less cash and cash equivalents
Total equity	Equity as shown in the consolidated statement of financial position (including non-controlling interests)

During 2017, the Group's strategy was to maintain a target gearing ratio (calculated as net debt divided by net debt plus equity) of less than 40%. The gearing ratios at 30 June 2017 and 30 June 2016 were as follows:

	Notes	2017 $'000	2016 $'000
Total borrowings	17	**28,690**	25,602
Less: cash and cash equivalents	7	**(8,651)**	(3,994)
Net debt		**20,039**	21,608
Total equity		**60,931**	69,077
Gearing ratio		**24.7%**	23.8%

(b) Financial risk management

Management manages the Group's exposure to financial risks under policies approved by the Board. Management identifies, evaluates and manages financial risks in close cooperation with the Group's business units. The Board provides written principles for overall risk management, as well as policies covering specific areas, such as foreign exchange risk, interest rate risk, credit risk, use of financial instruments and investment of excess liquidity.

The risk management approach 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 exclusively for risk mitigation and not as trading or other speculative instruments.

19 Capital and financial risk management (continued)

(b) Financial risk management (continued)

The Group holds the following financial instruments:

	2017 $'000	2016 $'000
Financial assets		
Cash and cash equivalents	**8,651**	3,994
Trade and other receivables	**57,591**	67,151
Derivative financial instruments	**-**	103
Investments	**2**	2
	66,244	71,250
Financial liabilities		
Trade and other payables	**40,266**	50,400
Borrowings	**28,690**	25,602
Derivative financial instruments	**287**	-
	69,243	76,002

The Group uses different methods to measure different types of risk, including sensitivity analysis (for interest rate, foreign exchange and other price risks) and aging analysis (for credit risk).

(i) Market risk

Price risk	The Group has no material financial exposure to other market price risk as it is not exposed to equity securities price risk. The Group does not enter into commodity contracts other than to meet the Group's expected usage requirements.
Foreign exchange risk	Foreign exchange risk arises when future commercial transactions and recognised financial assets and financial liabilities are denominated in currencies other than the Group's functional currency. The risk is measured using sensitivity analysis and cash flow forecasting. The Group's main foreign exchange risk exposure is to US dollars. Group Entities and business units are required to hedge their foreign exchange risk exposure using forward exchange contracts. The Group's policy is to hedge approximately three months' of anticipated cash flows (mainly purchases of inventories) in US dollars.
Cash flow and fair value interest rate risk	Borrowings issued at variable rates expose the Group to cash flow interest rate risk. See details of the Group's borrowings in note 17.

19 Capital and financial risk management (continued)

(b) Financial risk management (continued)

(i) Market risk (continued)

Foreign exchange risk

The Group's exposure to foreign exchange risk at the reporting date, expressed in Australian dollars at the closing exchange rates, was:

	USD $'000	EUR $'000	GBP $'000	Total $'000
30 June 2016				
Cash at bank	703	-	-	703
Trade receivables	1,126	-	-	1,126
Trade payables	(8,986)	(234)	(14)	(9,234)
Forward exchange contracts				
▪ buy foreign currency (cash flow hedges)	(22,955)	-	-	(22,955)
▪ buy foreign currency (FVTPL[1])	-	-	-	-
30 June 2017				
Cash at bank	**129**	**-**	**-**	**129**
Trade receivables	**823**	**-**	**-**	**823**
Trade payables	**(5,518)**	**(147)**	**(11)**	**(5,676)**
Forward exchange contracts:				
▪ buy foreign currency (cash flow hedges)	**(14,612)**	**-**	**-**	**(14,612)**
▪ buy foreign currency (FVTPL)	**(1,118)**	**-**	**-**	**(1,118)**

Cash flow interest rate risk

The Group's financing arrangement is principally a Receivables Purchase Facility, where the balance outstanding changes daily. Accordingly, the Group does not use interest rate swaps to hedge cash flow interest rate risk.

During 2017 and 2016, the Group's cash and borrowings at variable rate were denominated in Australian Dollars and NZ Dollars.

As at the end of the reporting period, the Group had the following variable rate cash and borrowings outstanding:

	2017		2016	
	Weighted average interest rate %	**Balance $'000**	Weighted average interest rate %	Balance $'000
Bank overdrafts and loans	**5.46%**	**(28,395)**	5.71%	(25,130)
Cash and cash equivalents	**1.16%**	**8,651**	0.67%	3,994
Other loans	**7.63%**	**(295)**	8.33%	(472)

[1] Fair Value Through Profit and Loss

19 Capital and financial risk management (continued)

(b) Financial risk management (continued)

(i) Market risk (continued)

An analysis by maturities is provided in section (iii) below.

Sensitivity analysis

Foreign exchange rates	The sensitivity of profit or loss to changes in exchange rates arises mainly from US dollar denominated financial instruments and the impact on other components of equity arises from forward exchange contracts designated as cash flow hedges.
Interest rates	Profit or loss is sensitive to higher / lower interest income and interest expense from cash and cash equivalents and borrowings respectively, as a result of changes in interest rates. Other components of equity change as a result of an increase / decrease in the fair value of the cash flow hedges of borrowings.

The following table summarises the sensitivity of the Group's financial assets and financial liabilities to interest rate risk and foreign exchange risk.

		Interest rate risk				Foreign exchange risk			
		-100 bps		+100 bps		-10%		+10%	
	Carrying amount $'000	Profit $'000	Other equity $'000	Profit $'000	Other equity $'000	Profit $'000	Other equity $'000	Profit $'000	Other equity $'000
30 June 2016									
Financial assets									
Cash and cash equivalents	3,994	(22)	-	44	-	78	-	(64)	-
Trade and other receivables	67,151	-	-	-	-	125	-	(102)	-
Derivatives - cash flow hedges	103	-	-	-	-	-	2,601	-	(2,045)
Total increase / (decrease) in financial assets		(22)	-	44	-	203	2,601	(166)	(2,045)
Financial liabilities									
Trade & other payables	(50,400)	-	-	-	-	(1,039)	-	850	-
Borrowings	(25,602)	282	-	(282)	-	-	-	-	-
Total increase / (decrease) in financial liabilities		282	-	(282)	-	(1,039)	-	850	-
Total increase / (decrease)		260	-	(238)	-	(836)	2,601	684	(2,045)

19 Capital and financial risk management (continued)

(b) Financial risk management (continued)

		Interest rate risk				Foreign exchange risk			
		-100 bps		+100 bps		-10%		+10%	
	Carrying amount $'000	Profit $'000	Other equity $'000	Profit $'000	Other equity $'000	Profit $'000	Other equity $'000	Profit $'000	Other equity $'000
30 June 2017									
Financial assets									
Cash and cash equivalents	8,651	(81)	-	110	-	14	-	(12)	-
Trade and other receivables	57,591	-	-	-	-	91	-	(75)	-
Total increase / (decrease) in financial assets		(81)	-	110	-	105	-	(87)	-
Financial liabilities									
Trade & other payables	(40,266)	-	-	-	-	(640)	-	524	-
Borrowings	(28,690)	306	-	(306)	-	-	-	-	-
Derivatives - cash flow hedges	(225)	-	-	-	-	-	1,253	-	(1,631)
Derivatives - FVTPL	(62)	-	-	-	-	68	-	(147)	-
Total increase / (decrease) in financial liabilities		306	-	(306)	-	(572)	1,253	377	(1,631)
Total increase / (decrease)		225	-	(196)	-	(467)	1,253	290	(1,631)

(ii) Credit risk

Nature of the risk	Credit risk is the risk of financial loss to the Group if a customer or counterparty to a financial instrument fails to meet its contractual obligations and arises principally from the Group's customers.
Risk management	Credit risk is managed at a Group level through a credit policy and trade credit insurance, which is carried for the majority of Group debtors. Each new customer is assessed for creditworthiness before the Group's standard payment and delivery terms and conditions are offered. The assessment considers external credit risk ratings.
	Purchase limits are established for each customer, which represent the maximum open amount without requiring further approval. These limits are reviewed periodically and credit worthiness is continually monitored. Limits in excess of $150,000 must be endorsed by the trade credit insurer. Customers that fail to comply with the terms of the Trade Credit Insurance Policy or meet the Group's benchmark creditworthiness may only transact with the Group on a prepayment basis.
	In most cases, goods are sold subject to retention of title clauses and this security is registered on the Personal Property Securities Register, so that in the event of non-payment the Group may have a priority claim. Depending upon the Group's assessment of industry or company risk, the Group may require personal guarantees from customer company directors and charging clauses over real property. Failure to pay Hills in accordance with the account terms may result in cessation of supply, loss of credit facilities, and/or recovery and legal action.

19 Capital and financial risk management (continued)

(b) Financial risk management (continued)

The ageing of the Group's trade receivables is analysed in note 8.

(iii) Liquidity risk

Nature of the risk	Liquidity risk is the risk that the Group will not be able to meet its financial obligations as they fall due. The Group's approach to managing liquidity is to ensure, as far as possible, that it will always have sufficient liquidity to meet its liabilities when due, under both normal and stressed conditions, without incurring unacceptable losses or risking damage to the Group's reputation.
Risk management	The Group manages liquidity risk by continuously monitoring forecast and actual cash flows and matching the maturity profiles of financial assets and liabilities. Surplus funds are generally only invested in instruments that are tradeable in highly liquid markets.

Financing arrangements

Details of the Group's borrowings are discussed in note 17. The Group had access to the following undrawn borrowing facilities from its bankers at the end of the reporting period:

	2017 $'000	2016 $'000
Floating rate		
- Expiring within one year (bank overdraft)	**3,000**	-
- Expiring beyond one year (loans)	**5,244**	4,212
	8,244	4,212

Maturities of financial liabilities

The tables below analyse the Group's financial liabilities, including derivative financial instruments, into relevant maturity groupings based on the remaining period at the reporting date to the contractual maturity date. The amounts disclosed in the table are the contractual undiscounted cash flows.

	Less than 6 months $'000	**6 – 12 months $'000**	**Between 1 and 2 years $'000**	**Between 2 and 5 years $'000**	**Total contractual cash flows $'000**	**Carrying amount liabilities $'000**
At 30 June 2016						
Trade and other payables	50,400	-	-	-	50,400	50,400
Borrowings	810	1,282	1,581	32,187	35,860	25,602
Total	51,210	1,282	1,581	32,187	86,260	76,002
At 30 June 2017						
Trade and other payables	**40,266**	**-**	**-**	**-**	**40,266**	**40,266**
Borrowings	**1,025**	**948**	**1,656**	**33,402**	**37,031**	**28,690**
Derivative financial instruments	**383**	**-**	**-**	**-**	**383**	**287**
Total	**42,674**	**948**	**1,656**	**33,402**	**77,680**	**69,243**

20 Fair value measurements

(a) Fair value measurements for financial assets and liabilities

The fair values of cash and cash equivalents, trade receivables, trade payables and borrowings approximate their carrying amounts due to their short term nature and the impact of discounting not being significant.

The Group measures and recognises derivative financial assets at fair value on a recurring basis.

AASB 13 requires disclosure of fair value measurements by reference to the following fair value measurement hierarchy:

Level 1	Quoted prices (unadjusted) in active markets for identical assets or liabilities.
Level 2	Inputs other than quoted prices included within level 1 that are observable for the asset or liability, either directly (as prices) or indirectly (derived from prices).
Level 3	Inputs for the asset or liability that are not based on observable market data (unobservable inputs).

The Group's financial assets and financial liabilities at fair value are as follows:

	Level 1 $'000	**Level 2 $'000**	**Level 3 $'000**	**Total $'000**
30 June 2016				
Assets				
Derivatives financial instruments	-	103	-	103
Total assets	-	103	-	103
30 June 2017				
Liabilities				
Derivatives financial instruments	**-**	**(287)**	**-**	**(287)**
Total liabilities	**-**	**(287)**	**-**	**(287)**

The Group recognises transfers between levels of the fair value hierarchy as of the end of the reporting period during which the transfer has occurred. There were no transfers between levels 1, 2 and 3 for recurring fair value measurements during the year.

The fair value of financial instruments that are not traded in an active market (for example, derivatives used for hedging) is determined using valuation techniques. These valuation techniques maximise the use of observable market data where it is available and rely as little as possible on entity specific estimates. All significant inputs required to fair value derivatives used for hedging are observable, and hence the instruments are included in level 2. There have been no movements between levels during the year ended 30 June 2017.

Section E: Group structure

This section provides information on the Hills Limited Group structure, including business acquisitions and disposals, controlled entities and related parties:

21 Interests in other entities

(a) Investments in subsidiaries

The controlled entities of the Group listed below were wholly owned during the current and prior year, unless otherwise stated.

Australia
Hills Finance Pty Ltd ▲
Hills Group Operations Pty Ltd ▲
Hills Integrated Solutions Pty Ltd (formerly DAS Security Wholesalers Pty Ltd) ▲
Audio Products Group Pty Ltd ▲
EMG Finance Pty Ltd
Pacific Communications (PACOM) Pty Ltd
Pacom Security Pty Ltd ▲
Hills Health Solutions Pty Ltd (formerly Hills Health Solutions Australia Pty Ltd, CBS Hardware Pty Ltd) ▲
New-Tone (Aust) Pty Ltd ▲
T.V Rentals Pty Ltd ▲
Hospital Telecommunications Pty Ltd ▲
Hills Polymers Pty Ltd ▲
Hills Hoists Pty Ltd ▲
Hills Share Plans Pty Ltd (formerly ACN 089 622 622 Pty Ltd)
Step Electronics 2005 Pty Ltd ●
Lan 1 Pty Ltd ▲
Woodroffe Industries Pty Ltd ▲
ACN 091 954 442 Pty Ltd (formerly Fielders Australia Pty Ltd) ▲
ACN 099 403 139 Pty Ltd (formerly Fielders Mobile Mill Pty Ltd)
Zen 99 Pty Ltd ▲
ACN 010 853 817 Pty Ltd (formerly Orrcon Holdings Pty Ltd) ▲
ACN 094 103 090 Pty Ltd (formerly Orrcon Operations Pty Ltd) ▲
ACN 093 760 895 Pty Ltd (formerly Orrcon Tubing Pty Ltd)
Access Television Services Pty Ltd ▲
Lincor Limited Pty Ltd *

New Zealand
Hills NZ Limited (formerly Hills Holdings NZ Limited)
Audio Products Group Pty Limited ■

▲These entities are party to a Deed of Cross Guarantee – see note 24.

● 50% ownership interest. Step Electronics 2005 Pty Ltd is controlled by virtue of the Company's control of this entity's Board through the Chairman's casting vote, effective management of the entity and exposure to the risks and benefits of ownership, or control of voting rights through the dilution of the minority shareholders. This is a dormant entity.

■ Audio Products Group Pty Limited was liquidated and removed from the Register of companies in New Zealand on 10 April 2017.

* Lincor Limited was incorporated on 29 August 2016 for the proposed merger of the Hill Health Solutions business with Lincor Solutions.

21 Interests in other entities (continued)

(b) Non-controlling interests (NCI)

There is no individual subsidiary that has non-controlling interests that are material to the Group in either the current or the prior reporting period.

22 Related party transactions

(a) Parent entities

The parent entity within the Group and the ultimate parent entity is Hills Limited.

(b) Subsidiaries

Interests in subsidiaries are set out in note 21.

(c) Key management personnel

	2017 $	2016 $
Short-term employee benefits (fixed and STI remuneration)	**1,867,106**	2,510,910
Post-employment benefits (superannuation)	**178,595**	142,314
Long term benefits (cash LTI and accrued long service leave)	**7,850**	103,052
Termination benefits[1]	**244,697**	-
Share-based payments (LTI expense and employee share bonus plan expense)	**40,500**	5,750
	2,338,478	2,762,026

Detailed remuneration disclosures are provided in the Remuneration Report.

(d) Loans to / from related parties

Subsidiaries

Group entity trading transactions and borrowings result in balances arising in respect of current and non-current assets and liabilities. At 30 June 2017 the Group current assets and liabilities that were eliminated totalled $32.651 million (2016: $37.355 million).

(e) Transactions with other related parties

The following transactions occurred with related parties:

Transactions with Director related entities

A number of KMP or their related parties hold positions in other entities that result in them having control or significant influence over the financial or operating policies of those entities.

During the year, the following related party transactions with director related entities took place:

Entity	Association	Details
CSG Limited	Associated with P Bullock AO	Goods and services purchased by the Group from CSG totalled $0.080 million (2016: $0.102 million)
Vocus Communications	Associated with D Spence	Goods and services purchased by the Group from Vocus totalled $0.018 million (2016: nil).

[1] Termination payments refer to statutory and legal obligations on cessation of employment.

22 Related party transactions (continued)

Amounts were billed and payable under normal commercial terms and conditions as a supplier and as a customer. There were no other transactions during the reporting period with KMP and their related parties. From time to time, KMP of the Company or its controlled entities, or their related entities, may purchase goods or services from Hills or make sales of goods or services to Hills. These purchases or sales are on the same terms and conditions as those entered into by Hills employees, customers or suppliers and are trivial or domestic in nature.

Subsidiaries

All transactions with partly owned controlled entities are on normal commercial terms and conditions. Transactions with controlled entities are determined on a cost basis.

Sales of goods and services	Sales of goods and services within the Group, that eliminated with cost of goods sold and services provided amounted to $3.767 million (2016: $13.757 million).
Loans and borrowings	Loans and borrowings with Australian wholly owned controlled entities are interest free and payable on demand while loans to or from non-wholly owned subsidiaries and overseas wholly controlled entities are charged interest at rates no more favourable than current market rates. Intragroup interest paid and received during the year was $0.013 million (2016: $0.152 million).
Dividends	Intragroup dividends paid and received during the year amounted to $1.278 million (2016: $3.837 million).

23 Parent entity financial information

(a) Summary financial information

The individual financial statements for the parent entity show the following aggregate amounts:

	2017	2016
	$'000	$'000
Balance sheet		
Current assets	**96,410**	107,667
Non-current assets	**42,496**	44,816
Total assets	**138,906**	152,483
Current liabilities	**66,809**	57,486
Non-current liabilities	**32,388**	28,827
Total liabilities	**99,197**	86,313
Net assets	**39,709**	66,170
Shareholders' equity		
Contributed equity	**278,439**	278,439
Reserves		
Hedging reserve - cash flow hedges	**(158)**	72
Equity compensation reserve	**706**	670
Profits reserve	**32,859**	32,859
Retained earnings	**(272,138)**	(245,870)
	39,709	66,170
Loss for the year	**(26,268)**	(59,384)
Total comprehensive income	**(26,498)**	(59,463)

23 Parent entity financial information (continued)

(b) Guarantees, contingent liabilities and commitments of the parent entity

Guarantees	Bank guarantees given by the Company in favour of customers and suppliers amounted to $2.778 million (2016: $5.788 million). Cross guarantees are given by the Company and its wholly owned subsidiaries as described in note 25. Under the terms of the Deed of Cross Guarantee the Company and its wholly owned subsidiaries have guaranteed the debt in each other's companies. Guarantees amount to $81.480 million (2016: $89.741 million). No material deficiency in net tangible assets exists in these companies at reporting date with net tangible assets amounting to $41.435 million (2016: $49.551 million).
Contingent liabilities	The parent entity had a contingent liability in respect of claims, as disclosed in note 25. For information about guarantees given by the parent entity, please see above.
Contractual commitments	As at 30 June 2017, the Company had contractual commitments for the acquisition of plant, equipment or intangible assets totalling $2.000 million (2016: $0.426 million). These commitments are not recognised as liabilities as the relevant assets have not yet been received.

Recognition and measurement

Parent entity financial information

The financial information for the parent entity has been prepared on the same basis as the consolidated financial statements.

24 Deed of cross guarantee

The wholly owned subsidiaries identified with a '▲' in note 21 are relieved from the *Corporations Act 2001* requirements for preparation, audit and lodgement of financial reports and Directors' reports, under *ASIC Corporations (Wholly-owned Companies) Instrument 2016/785*.

The Company and each of these subsidiaries have entered into a Deed of Cross Guarantee (the "Deed"), under which each company guarantees the debt of the others. No entities have become a party to the Deed during the reporting period.

Hills Limited is the Holding company and Pacom Security Pty Ltd is the Trustee under the Deed.

The entities identified with a '▲' in note 21 represent a 'closed group' for the purposes of the ASIC Instrument, and as there are no other parties to the Deed that are controlled by Hills Limited, they also represent the 'extended closed group'.

Set out below is a consolidated income statement, a consolidated statement of comprehensive income, a summary of movements in consolidated retained earnings for the year ended 30 June 2017 and a consolidated statement of financial position as at 30 June 2017 of the Company and controlled entities that are a party to the Deed, after eliminating all transactions between parties.

24 Deed of cross guarantee (continued)

(a) Consolidated statement of profit or loss and other comprehensive income and summary of movements in consolidated retained earnings

	2017 $'000	2016 $'000
Consolidated statement of profit or loss and other comprehensive income		
Revenue from continuing operations	**278,512**	309,809
Other income	**13,045**	2,949
Finance costs	**(3,295)**	(3,514)
Other expenses	**(294,363)**	(348,003)
Loss before income tax	**(6,101)**	(38,759)
Income tax expense	**-**	(20,282)
Loss for the year	**(6,101)**	(59,041)
Other comprehensive income		
Items that may be reclassified to profit or loss:		
Changes in the fair value of cash flow hedges	**(328)**	(113)
Income tax relating to these items	**98**	34
Other comprehensive loss for the period, net of tax	**(230)**	(79)
Total comprehensive loss for the year	**(6,331)**	(59,120)
Summary of movements in consolidated retained earnings		
Accumulated losses at the beginning of the reporting period	**(226,822)**	(167,781)
Loss for the year	**(6,101)**	(59,041)
Accumulated losses at the end of the reporting period	**(232,923)**	(226,822)

24 Deed of cross guarantee (continued)

(b) Consolidated statement of financial position

	2017 $'000	2016 $'000
Current assets		
Cash and cash equivalents	**5,921**	2,666
Trade and other receivables	**57,494**	65,376
Inventories	**42,802**	50,987
Derivative financial instruments	**-**	103
Total current assets	**106,217**	119,132
Non-current assets		
Trade and other receivables	**-**	534
Investments	**814**	814
Property, plant and equipment	**15,884**	18,915
Intangible assets	**2,578**	753
Deferred tax assets	**10,311**	10,212
Total non-current assets	**29,587**	31,228
Total assets	**135,804**	150,360
Current liabilities		
Trade and other payables	**38,622**	48,306
Borrowings	**295**	472
Provisions	**9,950**	12,136
Derivative financial instruments	**225**	-
Total current liabilities	**49,092**	60,914
Non-current liabilities		
Borrowings	**28,395**	25,130
Provisions	**3,993**	3,697
Total non-current liabilities	**32,288**	28,827
Total liabilities	**81,480**	89,741
Net assets	**54,324**	60,619
Equity		
Contributed equity	**278,439**	278,439
Reserves	**8,808**	9,002
Accumulated losses	**(232,923)**	(226,822)
Total equity	**54,324**	60,619

Section F: Unrecognised items

This section contains information about items that are not recognised in the financial statements but may have a significant impact on the Group's financial position or performance.

25 Contingencies

(a) Contingent liabilities

The Group had contingent liabilities at 30 June 2017 in respect of:

Claims	In consultation with the Environmental Protection Authority, ground water contamination potentially originating from the Company's former Edwardstown site continues to be monitored by the Company. It is anticipated that ongoing monitoring will be required to be undertaken by Hills. The Company has provided for the anticipated costs of ongoing assessments. The Group has various commercial legal claims common to businesses of its type that constitute contingent liabilities, none of which are deemed material to the Group's financial position. The Directors are of the opinion that provisions are not required in respect of these matters, as it is not probable that a future outflow of economic benefits will be required.
Guarantees	Bank guarantees in favour of customers and suppliers totalling $2.778 million (2016: $5.788 million). The decrease from 30 June 2016 is due to bank guarantees no longer required being cancelled during the year ended 30 June 2017.

26 Commitments

(a) Capital commitments

Capital expenditure contracted for at the reporting date but not recognised as liabilities is as follows:

	2017 **$'000**	2016 $'000
Plant, equipment and intangible assets	**2,000**	426

(b) Lease commitments: Group as lessee

Non-cancellable operating leases

The Group leases a number of office, warehouse and factory facilities under operating leases.

The leases run for a period from 1 to 12 years with the majority running for a period of 3 to 5 years, with options to renew the lease after that date. Lease payments are increased each renewal period to reflect market rentals. Some leases provide for additional rent payments that are based on changes in the consumer price index, local capital city consumer price indices or a fixed percentage.

The Group also leases motor vehicles and materials handling equipment under operating leases.

26 **Commitments** (continued)

(b) Lease commitments: Group as lessee (continued)

	2017	2016
	$'000	$'000
Commitments for minimum lease payments in relation to non-cancellable operating leases are payable as follows:		
Within one year	**6,312**	6,914
Later than one year but not later than five years	**9,289**	8,294
Later than five years	**-**	478
	15,601	15,686

(c) Lease commitments: where a Group company is the lessor

The future minimum lease payments receivable under non-cancellable operating leases are as follows:

	2017	2016
	$'000	$'000
Within one year	**104**	375
Later than one year but not later than five years	**78**	-
	182	375

Recognition and measurement

Leases

Leases in which a significant portion of the risks and rewards of ownership are not transferred to the Group as lessee are classified as operating leases. Payments made under operating leases (net of any incentives received from the lessor) are charged to profit or loss on a straight-line basis over the period of the lease.

27 Events after the reporting period

There have been no events subsequent to balance date that would have a material effect on the Group's financial statements at 30 June 2017.

Section G: Other

This section contains disclosures required for the Group to comply with the accounting standards and other pronouncements, the *Corporations Act 2001* or the Corporations Regulations but are not considered to be significant in understanding the financial position or performance of the Group:

28 Share-based payments
29 Remuneration of auditors
30 Other accounting policies

28 Share-based payments

(a) Executive share options

All executive share options were forfeited or cancelled during the previous reporting period.

(b) Employee performance rights

In 2010, the Group established the Long Term Incentive Share Plan (LTIP). The LTIP was designed to provide long term incentives to eligible senior employees of the Group and entitled them to acquire shares in the Company, subject to the successful achievement of performance hurdles related to earnings per share (EPS) and total shareholder returns (TSR).

Details of performance rights under the LTIP are as follows:

Grant date	Expiry date	Exercise price	Balance at start of the year	Granted during the year	Exercised during the year	Forfeited / cancelled during the year	Balance at the end of the year	Vested & exercisable at the end of the year
			Number	Number	Number	Number	Number	Number
2016								
Performance rights								
27 Feb 2015	30 Jun 2017	-	122,012	-	-	(38,404)	83,608	-
Total			122,012	-	-	(38,404)	83,608	-
2017								
Performance rights								
27 Feb 2015	30 Jun 2017	-	**83,608**	**-**	**-**	**(83,608)**	**-**	**-**
1 Sep 2016	1 Sep 2017	-	**-**	**100,000**	**-**	**-**	**100,000**	**-**
1 Sep 2016	1 Sep 2018	-	**-**	**100,000**	**-**	**-**	**100,000**	**-**
Total			**83,608**	**200,000**	**-**	**(83,608)**	**200,000**	**-**

Fair value of performance rights granted

The fair value assessed in accordance with AASB 2 *Share Based Payments* at grant date of performance rights granted on 1 September 2016 was 34.0 cents per performance right, based on the quoted share price at grant.

The fair value of performance rights granted on 27 Feb 2015 was assessed as 52.0 cents per performance right for the performance rights subject to market hurdles and 77.0 cents per performance right for the performance rights subject to non-market hurdles. The fair value at grant date was independently determined using a Black Scholes methodology for the non-market hurdles and a Monte Carlo valuation methodology for the market

28 Share-based payments (continued)

(b) Employee performance rights (continued)

hurdles, that took into account the exercise price, the expected life and vesting period of the performance right, the share price at grant date and expected price volatility of the underlying shares, the expected dividend yield and the risk free interest rate for the term of the performance rights. The model inputs for the valuation of performance rights granted during the year ended 30 June 2015 included:

Exercise price	$0.00
Life	2.3 years
Grant date (for Accounting Standards)	27 February 2015
Expiry date	30 June 2017
Share price at grant	$0.88
Expected price volatility	40%
Expected dividend yield	5.7%
Risk free interest rate	1.8%

(c) Expenses arising from share-based payment transactions

Total expense / (credit) arising from share-based payment transactions recognised during the period as part of employee benefit expense were as follows:

	2017 **$'000**	2016 $'000
Performance rights issued under Long Term Incentive Share Plan	**36**	(84)

Recognition and measurement

Share-based payments

Share based compensation benefits are provided to employees via the Long Term Incentive Share Plan – see below:

Long Term Incentive Share Plan
The Long Term Incentive Share Plan allows Group executives to acquire shares of the Company.

The fair value of performance rights granted under the Long Term Incentive Share Plan is recognised as an employee benefits expense with a corresponding increase in equity. The total amount to be expensed is determined by reference to the fair value of the performance rights granted, measured at the grant date, which includes any market performance conditions and the impact of any non-vesting conditions but includes the probability of meeting any service and non-market performance vesting conditions.

The valuation method takes into account the exercise price of the performance right, the life of the performance right, the current price of the underlying shares, the expected volatility of the share price, the dividends expected of the shares and the risk free interest rate for the life of the performance right.

Non market vesting conditions are included in assumptions about the number of rights that are expected to vest. The total expense is recognised over the vesting period, which is the period over which all of the specified vesting

28 Share-based payments (continued)

Recognition and measurement (continued)

conditions are to be satisfied. At the end of each period, the entity revises its estimates of the number of rights that are expected to vest based on the non-market vesting conditions. It recognises the impact of the revision to original estimates, if any, in profit or loss, with a corresponding adjustment to equity. No change is made for changes in market conditions.

29 Remuneration of auditors

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

	2017	2016
	$	$
KPMG audit and non-audit services		
Audit and other assurance services		
KPMG Australia – audit and review of the financial statements	**298,000**	343,375
Overseas KPMG firms – audit and review of the financial statements	**42,223**	39,951
Total remuneration for audit and other assurance services	**340,223**	383,326
KPMG Australia – other assurance services	**165,000**	-
Total remuneration for audit and other assurance services	**505,223**	383,326
Taxation services		
KPMG Australia – taxation and other services	**78,238**	76,239
Overseas KPMG firms – taxation services	**3,967**	11,605
Total remuneration for taxation services	**82,205**	87,844
Other services		
Other consulting services	**12,816**	8,342
Total remuneration for other services	**12,816**	8,342
Total remuneration of KPMG	**600,244**	479,512

30 Other accounting policies

(a) New and amended standards adopted by the Group

The Group has not applied any new accounting standards and amendments for the first time for the annual reporting period commencing 30 June 2017.

(b) Early adoption of standards

The Group has not elected to early adopt any new accounting standards and amendments.

(c) New accounting standards and interpretations not yet adopted

Certain new accounting standards and interpretations have been published that are not mandatory for 30 June 2017 reporting periods and have not been early adopted by the Group. The Group's assessment of the impact of these new standards and interpretations is set out below.

30 Other accounting policies (continued)

(c) New accounting standards and interpretations not yet adopted (continued)

Title	Effective date (reporting periods beginning on or after...)	Details
AASB 9 *Financial Instruments*	1 January 2018 (early adoption permitted) Hills Group: Applicable for the year ending 30 June 2019	Addresses the classification, measurement and derecognition of financial assets and financial liabilities and sets out new rules for hedge accounting. It is likely to affect the Group's accounting for its financial assets and financial liabilities, with an increase in the provision for impairment against trade receivables expected under AASB 9. The Group does not expect to early adopt AASB 9.
AASB 15 *Revenue from Contracts with Customers*	1 January 2018 (early adoption permitted) Hills Group: Applicable for the year ending 30 June 2019	Replaces AASB 118 Revenues and applies to contracts with customers. The Group has commenced an assessment of the likely impact of AASB 15 on its reported results. It is expected that the results of the Hills Health Solutions business will be most impacted by the change; in particular revenue currently recognised in accordance with *AASB 111 Construction Contracts*, which totalled $7.5 million in the year ended 30 June 2017. The Group does not expect to early adopt AASB 15.
AASB 16 *Leases*	1 January 2019 (early adoption permitted) Hills Group: Applicable for the year ending 30 June 2020	Removes the classification of leases as either operating or finances leases for the lessee, effectively treating all leases as finance leases. Short term leases and leases of low value assets are exempt from the lease accounting requirements. The Group has not yet decided when to adopt AASB 16 and has not yet determined the potential effect of the standard. The Group leases property, motor vehicles and materials handling equipment under operating leases, the accounting for which will be affected by AASB 16. Details of the Group's operating lease commitments at 30 June 2017 are shown in note 26.

(d) Goods and Services Tax (GST)

Revenues, expenses and assets are recognised net of the amount of associated GST, unless the GST incurred is not recoverable from the taxation authority. In this case it is recognised as part of the cost of acquisition of the asset or as part of the expense.

Receivables and payables are stated inclusive of the amount of GST receivable or payable. The net amount of GST recoverable from, or payable to, the taxation authority is included with other receivables or payables in the consolidated statement of financial position.

Cash flows are presented on a gross basis. The GST components of cash flows arising from investing or financing activities that are recoverable from, or payable to the taxation authority, are presented as operating cash flows.

Directors' declaration

For the year ended 30 June 2017

In the opinion of the Directors of Hills Limited (the Company):

(a) the consolidated financial statements and notes set out on pages 37 to 92 and the Remuneration Report on pages 20 to 33 are in accordance with the *Corporations Act 2001*, including:

(i) complying with Australian Accounting Standards and the *Corporations Regulations 2001;* and

(ii) giving a true and fair view of the Group's financial position as at 30 June 2017 and of its performance for the financial year ended on that date; and

(b) there are reasonable grounds to believe that the Company will be able to pay its debts as and when they become due and payable; and

(c) there are reasonable grounds to believe that the Company and the Group Entities identified in note 21 will be able to meet any obligations or liabilities to which they are, or may become, subject to by virtue of the Deed of Cross Guarantee between the Company and those Group Entities pursuant to *ASIC Corporations (Wholly-owned Companies) Instrument 2016/785.*

Section A of the notes confirms that the consolidated financial statements also comply with International Financial Reporting Standards as issued by the International Accounting Standards Board.

The Directors have been given the declarations by the Chief Executive Officer and Chief Financial Officer required by section 295A of the *Corporations Act 2001.*

This declaration is made in accordance with a resolution of the Directors.

Jennifer Helen Hill-Ling
Director

Philip Bullock AO
Director

Sydney
29 August 2017

Independent Auditor's Report

To the shareholders of Hills Limited:

Report on the audit of the Financial Report

Opinion

We have audited the Financial Report of Hills Limited (the Company).

In our opinion, the accompanying Financial Report of the Company is in accordance with the *Corporations Act 2001*, including:

- giving a true and fair view of the Group's financial position as at 30 June 2017 and of its financial performance for the year ended on that date; and
- complying with *Australian Accounting Standards* and the *Corporations Regulations 2001*.

The Financial Report comprises:

- Consolidated statement of financial position as at 30 June 2017;
- Consolidated statement of profit or loss, consolidated statement of comprehensive income, consolidated statement of changes in equity, and consolidated statement of cash flows for the year then ended;
- Notes including a summary of significant accounting policies; and
- Directors' Declaration.

The Group consists of the Company and the entities it controlled at the year end and from time to time during the financial year.

Basis for opinion

We conducted our audit in accordance with *Australian Auditing Standards*. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Our responsibilities under those standards are further described in the *Auditor's responsibilities for the audit of the Financial Report* section of our report.

We are independent of the Group in accordance with the *Corporations Act 2001* and the ethical requirements of the *Accounting Professional and Ethical Standards Board's APES 110 Code of Ethics for Professional Accountants* (the Code) that are relevant to our audit of the Financial Report in Australia. We have fulfilled our other ethical responsibilities in accordance with the Code.

KPMG

Key Audit Matters

The Key Audit Matter we identified is:

- Valuation of inventories.

Key Audit Matters are those matters that, in our professional judgment, were of most significance in our audit of the Financial Report of the current period.

These matters were addressed in the context of our audit of the Financial Report as a whole, and in forming our opinion thereon, and we do not provide a separate opinion on these matters.

<table>
<tr><th colspan="2">Valuation of inventories</th></tr>
<tr><td colspan="2">Inventories $46,460,000 – Note 9</td></tr>
<tr><th>The key audit matter</th><th>How the matter was addressed in our audit</th></tr>
<tr><td>At 30 June 2017, the group held inventory with a net carrying value of $46.5m

The audit of the carrying value of inventory is a key audit matter due to the extent of judgement involved in determining the recoverable value, particularly in relation to slow moving, obsolete or excessive inventory.

The Group has a broad range of technology products that are at risk of being superseded by technological advances or have been sourced under specific distribution arrangements, or for a specific customer, which increases the amount of judgement required in assessing the carrying value of inventory.</td><td>Our procedures included:

• Assessing the appropriateness of the Group's policies for the valuation of inventory against the requirements of the accounting standards.

• Examining the processes, and testing controls, relating to inventory movements, standard costing and the application of the inventory valuation policy.

• Obtaining management's calculation for the inventory obsolescence provision, including the ageing of inventory, and assessing it against the Group's accounting policies, sales trends, analysis of slow moving inventory and future usage estimates.

• Analysing the future selling price and resulting gross margin for inventory items to identify evidence of negative or declining gross margins and comparing to the inventory obsolescence provision.

• Gaining an understanding of the Board's review and assessment of the adequacy of the provision for slow moving and obsolete inventory.

• Assessing the level of provision in light of our understanding of the business, and knowledge of the industry in which the group Group operates.</td></tr>
</table>

KPMG

Other Information

Other Information is financial and non-financial information in Hills Limited's annual reporting which is provided in addition to the Financial Report and the Auditor's Report. The Directors are responsible for the Other Information.

Our opinion on the Financial Report does not cover the Other Information and, accordingly, we do not express an audit opinion or any form of assurance conclusion thereon, with the exception of the Remuneration Report and our related assurance opinion.

In connection with our audit of the Financial Report, our responsibility is to read the Other Information. In doing so, we consider whether the Other Information is materially inconsistent with the Financial Report or our knowledge obtained in the audit, or otherwise appears to be materially misstated.

We are required to report if we conclude that there is a material misstatement of this Other Information, and based on the work we have performed on the Other Information that we obtained prior to the date of this Auditor's Report we have nothing to report.

Responsibilities of Directors for the Financial Report

The Directors are responsible for:

- preparing the Financial Report that gives a true and fair view in accordance with *Australian Accounting Standards* and the *Corporations Act 2001*;
- implementing necessary internal control to enable the preparation of a Financial Report that gives a true and fair view and is free from material misstatement, whether due to fraud or error; and
- assessing the Group's ability to continue as a going concern. This includes disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless they either intend to liquidate the Group or to cease operations, or have no realistic alternative but to do so.

Auditor's responsibilities for the audit of the Financial Report

Our objective is to:

- obtain reasonable assurance about whether the Financial Report as a whole is free from material misstatement, whether due to fraud or error; and
- issue an Auditor's Report that includes our opinion.

Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with Australian Auditing Standards will always detect a material misstatement when it exists.

Misstatements can arise from fraud or error. They are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of this Financial Report.

A further description of our responsibilities for the Audit of the Financial Report is located at the Auditing and Assurance Standards Board website at: http://www.auasb.gov.au/auditors_files/ar2.pdf. This description forms part of our Auditor's Report.

KPMG

Report on the Remuneration Report

Opinion

In our opinion, the Remuneration Report of Hills Limited for the year ended 30 June 2017, complies with *Section 300A* of the *Corporations Act 2001*.

Director's responsibilities

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 responsibilities

We have audited the Remuneration Report for the year ended 30 June 2017.

Our responsibility is to express an opinion on the Remuneration Report, based on our Audit conducted in accordance with *Australian Auditing Standards*.

KPMG

Scott Fleming
Partner

Adelaide

29 August 2017

Shareholder information

The shareholder information set out below was applicable as at 25 July 2017.

Distribution of equity securities

Analysis of numbers of ordinary shareholders by size of holding:

Size of holding	Number of holders
1 - 1000	3,953
1,001 - 5,000	5,690
5,001 - 10,000	2,410
10,001 - 100,000	2,409
100,001 and over	193

There were 7,248 holders of less than a marketable parcel of ordinary shares.

Twenty largest shareholders

The names of the 20 largest holders of ordinary shares are listed below:

Name	Number of shares	% of shares issued
Hills Associates Limited	16,768,441	7.23
Poplar Pty Ltd	16,550,845	7.13
Dimensional Fund Advisors	6,950,000	3.00
Mr Peter J Roach	6,891,872	2.97
McGrath Family	5,968,699	2.57
Realindex Investments	4,877,837	2.10
Mr Gregory V Shalit	4,676,510	2.02
Greybox Holdings Pty Ltd	4,550,042	1.96
Mr John R Homewood	2,800,000	1.21
Hart Capital Partners	2,662,949	1.15
Mr Brian S Blythe	2,280,000	0.98
Norges Bank Investment Mgt	2,193,901	0.95
AcomeA	2,100,000	0.91
Mr Jack G Mordes & Ms Leanne J Howard	1,633,828	0.70
Mr Leonard A Milner	1,500,000	0.65
Mr Gregory V Shalit & Ms Miriam Faine	1,435,000	0.62
Mr & Mrs Donald P Cant	1,337,578	0.58
Mr & Mrs Robert E Purves	1,255,000	0.54
Mr John Gassner	1,250,001	0.54
Mr & Mrs Joseph Zanca	1,250,000	0.54

Shareholder information (continued)

Substantial holders

Substantial holders in the Company are set out below:

Name	Number held	% of shares issued
Poplar Pty Ltd[1]	17,775,724	7.66
Hills Associates Limited	16,768,441	7.23

Voting rights

The voting rights attaching to each class of equity securities are set out below:

Ordinary shares	On a show of hands every member present at a meeting in person or by proxy shall have one vote and upon a poll each share shall have one vote.
Rights/options	No voting rights.

On-market buyback

There is no current on-market buyback in place.

Direct payment to shareholder accounts

Dividends may be paid directly to bank, building society or credit union accounts in Australia. Payments are electronically credited on the dividend date and confirmed by mailed payment advice. Shareholders who want their dividends paid this way should advise the Company's share register in writing.

Securities exchange

The Company is listed on the Australian Securities Exchange. The home exchange is Sydney.

[1] The total number of shares held includes the joint shareholding held by Poplar Pty Ltd and Hills Associates Limited and the shareholding held by Ling Nominees Pty Ltd

Corporate directory

Registered office

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Executives

David Lenz, *Chief Executive Officer*

Chris Jacka, *Chief Financial Officer*

Non-executive directors

Jennifer Helen Hill-Ling
Fiona Rosalyn Vivienne Bennett
Philip Bullock AO
Kenneth James Dwyer

Company secretary

David Fox

Share registry

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