HILLS

ANNUAL REPORT

for the year ended 30 June 2018

Hills Limited ABN 35 007 573 417

Hills Limited

Annual report

For the year ended 30 June 2018

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Contents

Hills Limited

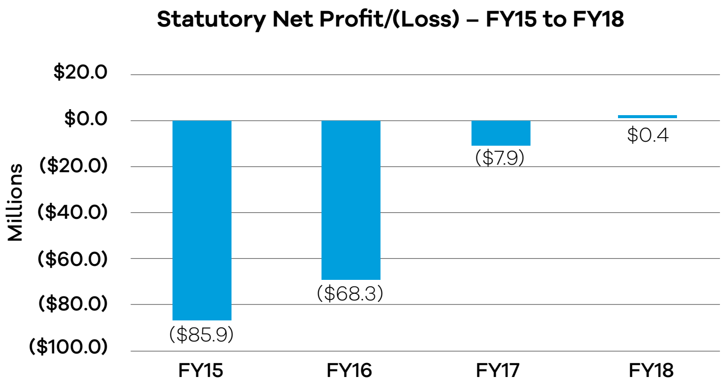
Shareholders' letter

For the year ended 30 June 2018

Dear Shareholder,

Financial Year 2018 (FY18) was another busy year for everyone at Hills as we continued to drive business improvements across all aspects of the organisation and delivered a small profit in line with guidance.

Our FY 18 net profit after tax (NPAT) result of $0.4 million was an $8.3 million improvement on the FY17 NPAT result and represented a significant turnaround within the business as indicated in the chart below.



This result was achieved whilst:

- investing in our E-Commerce platform which improves customer service levels by allowing our customers to search products and product specifications, view inventory levels and pricing, place and track orders, retrieve statements and make payments; and
- establishing a National Distribution Centre & Trade Centre at Seven Hills in NSW which consolidates our inventory into a single warehouse facility streamlining your Company's supply chain to deliver better customer service.

In addition, during the year in review we:

- further reduced our operating expenses by $21.2 million or 20.1% from $105.6 million to $84.4 million;
- continued our focus on inventory management reducing inventory from $46.5 million to $44.0 million;
- generated operating cashflows[1] of $12.0 million up by $12.8m from FY17; and
- reduced net debt by $3.1 million to $16.9 million.

Due to the efforts of our dedicated people, we delivered growth in our two largest businesses, Hills Health Solutions and Security, Surveillance and Communications (SSIT), with the Nurse Call business growing revenue by 26%, our Enterprise-focussed security business growing revenue by 14% and our IT businesses growing revenue by 20% being the standout performers in the Group.

The overall Health business continued to be profitable in FY18 and has a strong pipeline in Nurse Call and Patient Engagement projects as we enter FY19.

During the period we continued to strengthen our relationship with our key vendors and customers which was rewarded with the:

- extension of our appointment by Ericsson for the installation of fixed wireless services associated with the NBN rollout until 2020; and
- extension of our exclusive distribution relationship in Australia and NZ with Genetec, a leading provider of security and public safety solutions until 2020.

1 Operating cashflows includes $2.4 million for amounts paid out against restructure provisions during the year.

We experienced some changes in Vendor portfolios and were delighted to accept the:

- appointment by Dahua Technology as a distributor in Australia and NZ of some of the world's leading security and video surveillance equipment; and
- appointment by MC2 Audio, XTA Electronics and Xilica Audio Design as distributor of audio-visual solutions that complement our existing vendor portfolio including Community Speakers to enable Hills to deliver a complete professional audio solution to the market.

On the back of a successful year Hills secured several key contracts in our Health business, including projects at:

- Westmead Central Acute Services Building (NSW)
- Blacktown Hospital Acute Services Building Stage 1 and 2 (NSW)
- Joan Kirner Children's Hospital (Victoria)
- Royal Hobart Hospital (Tasmania)

as well as aged care facilities across Australia including:

- Fresh Hope Care
- Calvary Health Care; and
- Baptcare,

demonstrating our ability to deliver projects of any size and complexity in the Health sector.

In our SSIT business we engaged in many major infrastructure projects supplying:

- AXIS IP Cameras and Ipsotek analytics through SAAB for Queensland Corrections;
- a Genetec unified IP security solution together with Axis IP Cameras to Siemens for Brisbane Airport;
- together with Siemens, Genetec unified IP security solutions and AXIS IP Cameras to Woodside Petroleum HQ Perth; and
- Vivotek IP cameras at Sydney Trains together with Indra Australia.

It is a tribute to the whole Hills team that we won several key awards again during FY18, including:

- Genetec: Asia Pacific Distributor of the year and Software Development Kit (SDK) Developer of the year;
- Axis: Pacific Region Distributor of the Year;
- Ruckus: Distributor of the year ANZ; and
- Williams Sound: Outstanding Sales Growth Award.

Our key strategic focus in FY19 will be to:

- continue our investment in IT Projects including the implementation of both Customer Relationship Management (CRM) & Enterprise Resource Planning (ERP) software solutions in partnership with Microsoft;
- invest in research and development of our Nurse Call solutions to expand on our current capabilities and productise the next generation iP7500 & staff terminal solutions to maintain our market leadership;
- continue to strengthen our relationship with Vendors and Customers incorporating feedback through market surveys;
- add value by delivering high quality professional services and unequalled expertise to our Customers across the Company;
- build on the training and development of our dedicated team including our managers, sales, design, technical support, installation, internal quality and governance teams.

In July 2018, we welcomed two new members to our Management team; Roger Edgar who joined Hills to lead our Security, Surveillance and Communications team, and Andy Hall who has been promoted to lead our Hills Health Solutions business after managing the Health sales team since joining Hills in 2017.

Both Roger and Andy bring strong experience and ability to their roles and we look forward to working with them in growing their businesses.

Hills Limited

Shareholders' letter *(continued)*

For the year ended 30 June 2018

We were also pleased to welcome our Chief Executive Officer, David Lenz, to the Board in February 2018 as Managing Director. He has successfully led the Hills team in establishing a solid platform for growth in the healthcare, security and surveillance, communications and audio-visual sectors since his appointment as CEO in September 2016.

We thank the Hills team of loyal employees for their dedication and contribution during FY18.

Whilst we still have work to do, we are confident that the strategies undertaken in FY18 and the continued focus on reducing operating expenses, strengthening customer and vendor partnerships and the rollout of our digital transformation project will deliver an increased profit in FY19.

We look forward to welcoming you to the AGM on 23 November 2018 in Adelaide and providing you with an update on your Company's performance for the first quarter of the current financial year.

Yours sincerely

Jennifer Hill-Ling
Chairman

David Lenz
Chief Executive Officer & Managing Director

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 2018 (FY18), and the independent auditors 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

Kenneth James Dwyer

David John Joseph Lenz was appointed a director on 19 February 2018 and continues in office at the date of this report.

Principal activities

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

Review of operations

ABOUT THE GROUP

The Group operates in Australian and New Zealand and is a value-added distributor of technology products and services in the Security & Surveillance and Audio-Visual markets, and the supplier of Technology solutions in the Health market.

Hills commenced business in Adelaide, South Australia in 1945 and has a long history of developing and innovating products over the years whilst diversifying and divesting as market conditions and customer demands have changed.

OUR BUSINESS ACTIVITIES

The Principal activities of the Group are the valued-added distribution of technology products and services that connect, entertain and secure people's lives into the environments that people need and trust most: their homes, hospitals and healthcare facilities, places of learning, entertainment venues, retail spaces, houses of worship, workplaces and government institutions.

OUR BUSINESS MODELS

The Group provides its products and solutions to a similar customer base, primarily building contractors, consultants and system integrators via three key business divisions:

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

Hills develops strong relationships with key vendors in Australia and overseas, and designs and manufactures Hills own products. It maintains an experienced team of experts with a broad footprint in Australia and New Zealand which allows the Group to service its customers.

HILLS HEALTH SOLUTIONS

Hills Health Solutions (HHS) is a market leader and comprises the design, 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.

We continue to undertake research and development activities in Australia to enhance and develop our Nurse Call IP ensuring our products remain market leaders.

HILLS SECURITY, SURVEILLANCE AND COMMUNICATIONS (SSIT)

Hills is the leading value-added provider of technology for homes, hospitals and healthcare facilities, places of learning, entertainment venues, retail spaces, transport and infrastructure, banking and finance, workplaces and government institutions.

Together with maintaining strong vendor relationships and contracts Hills also invests in expert resources across Australia and New Zealand to offer products and solutions that allow customers to manage:

- Access Control solutions
- Alarms & Intruder solutions
- Card access control
- CCTV Cameras
- Video Management Solutions
- Wireless & networking solutions
- Analytics software for Facial recognition & People Counting solutions
- HillsTrak (asset management)
- Fire detectors and alarms
- Antenna, Set top boxes, Digital TV Systems
- Satellite Dishes
- Pre and Post installation service

HILLS AUDIO VISUAL

Hills Audio Visual (AV) provides audio visual products for education, infrastructure projects, businesses, sporting venues, healthcare facilities, houses of worship, enterprise and entertainment venues.

Solutions offerings include:

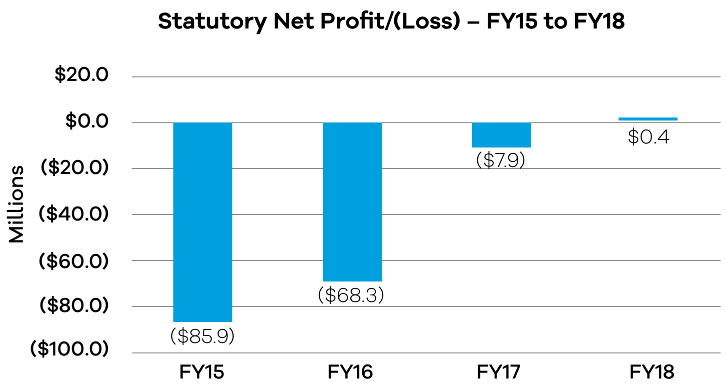
- Unified Communication
- Hearing Augmentation
- Professional LCD Displays
- Projectors
- Australian Monitor – Hills owned and designed product
- Professional Audio solutions for indoor & outdoor applications

Group performance highlights

The Group has announced a statutory net profit after tax (NPAT) of $0.4 million for the year ended 30 June 2018, an increase of $8.3 million on the prior year loss of $7.9 million as summarised in the table below.

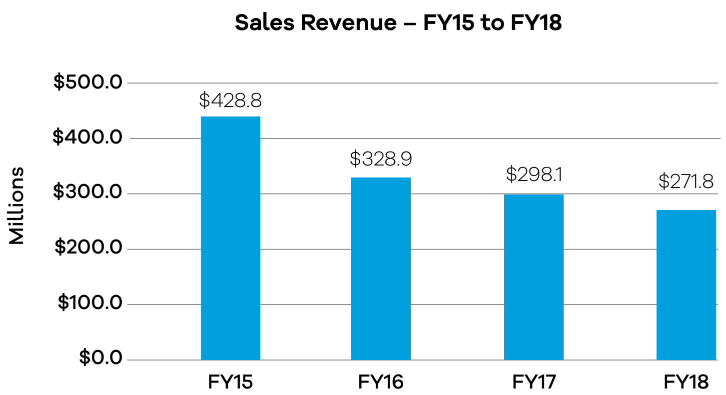
A$ million	2018	2017
Sales Revenue	**271.8**	**298.1**
Gross Margin (excluding other income)	86.7	87.8
Gross Margin%	31.9%	29.4%
Other Income	0.9	13.1
Operating Expenses (excluding non-operating)	(84.3)	(101.6)
Non-operating expenses	(0.1)	(4.0)
Interest & Tax	(2.8)	(3.2)
Net Profit/(Loss) After Tax	**0.4**	**(7.9)**

Although not yet at the target profitability levels it was encouraging to see the Group achieve the first statutory profit since FY14.



Revenue

Sales revenue was down by $26.3 million, or 8.8%, from $298.1 million to $271.8 million primarily due to the decision to focus on NBN fixed wireless installations and exit Satellite installations in March 2017 as well as lower Antenna sales due to the competitive Pay TV market in Australia and New Zealand. Operating expenses were reduced to offset the impact of these lower sales levels which are outlined later in this report.



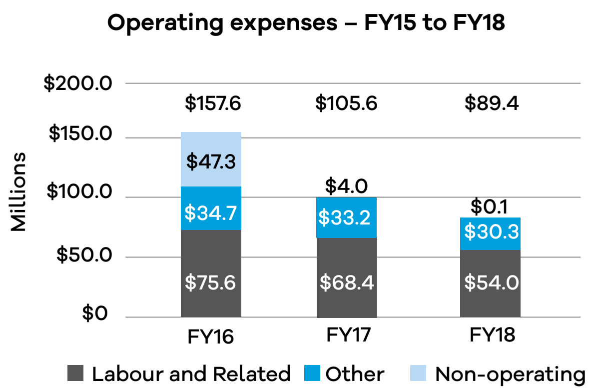
The remaining business divisions were down $3.0 million, or 1.2% in sales on the prior year, primarily due to lower audio visual sales which were offset in part by stronger SSIT and Health revenue.

NET PROFIT

The FY18 NPAT result of $0.4 million is a continuation of improved financial results over recent years and was an improvement of $8.3 million from the $7.9 million loss in FY17 and was supported by significantly lower expenses offsetting the one-off income from the HHL business exit in FY17.

Gross margins were 31.9% for FY18, up from 29.4% in FY17 offsetting in part the $26.3 million sales revenue decline noted earlier with gross margin down by $1.1 million on the prior year.

Operating expenses declined significantly during the year to $84.4 million down $21.2m or 20.1% from $105.6 million with reductions achieved across all 3 major expense areas and continuing the trend seen since FY15.



Labour and related costs reduced by $14.4 million, or 21.0% due to lower resources required to service the NBN satellite business, the transition from a third-party logistics provider to an in-house managed supply chain and general headcount reductions.

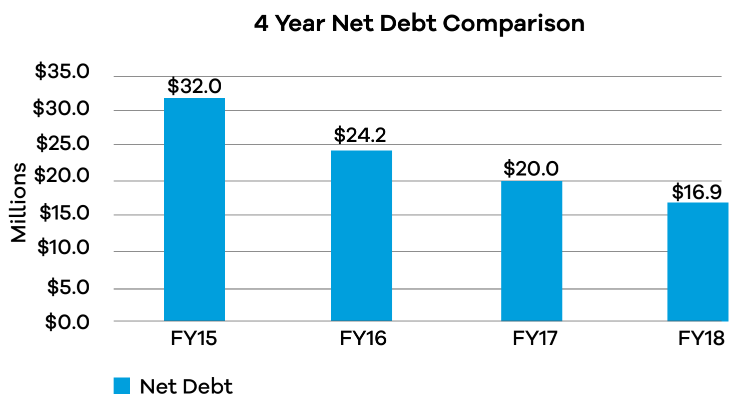
The prior year expenses included $4.0 million of one-off non-operating expenses relating to the proposed Lincor merger as well as further restructure costs. No such expenses of note were incurred in FY18.

Other expenses were lower by a further $2.9 million in FY18 with reductions achieved across most expense lines as the Group continues to make efforts to reduce costs.

Interest expenses were down 3.9% on the prior year and a small tax benefit of $0.2 million was recorded for the year. The Group retains significant unrecognised tax losses which remain available to reduce tax expenses for future periods as the Group's profitability continues to improve.

Financial Position

Net debt at June 2018 was $16.9 million, down from $20.0 million as the Group maintained a focus on managing working capital balances efficiently.



The improved net debt position was supported by an operating cash inflow for the year of $12.0 million, up from the prior year outflow of ($0.8 million).

Inventory levels decreased by a further $2.4 million during the year to $44.0 million following changes to the logistics approach noted above and refinements to purchasing disciplines driving this reduction.

Subsequent events

There were no events subsequent to balance date that would have a material effect on the Group's financial statements at 30 June 2018.

Dividends

Year ended 30 June 2018	No dividends were paid during the year and no final dividend has been declared.
Year ended 30 June 2017	No dividends were paid during the year and no final dividend was 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.

FY19 Outlook

Whilst we still have work to do, we are confident that the strategies undertaken in FY18 and the continued focus on reducing operating expenses, strengthening customer and vendor partnerships and the rollout of our digital transformation project will deliver an increased profit in FY19.

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

Information on Directors

Jennifer Helen Hill-Ling
LLB (Adel) FAICD

Chairman,
Non-Independent Non-Executive Director
Age 56

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 Nomination and Remuneration 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.

Fiona Rosalyn Vivienne Bennett
BA (Hons) FCA FAICD FIML

Independent Non-Executive Director
Age 62

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 Select Harvests Limited (since July 2017)

Former listed company directorships in last 3 years

Director of Beach Energy Limited (retired in November 2017)

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

178,444 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 65

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 & 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 Nomination and Remuneration 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.

Kenneth James Dwyer
BCom, GMQ, GAICD

Independent Non-Executive Director
Age 60

Experience and expertise

Appointed non-executive Director on 20 September 2016

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 Nomination and Remuneration Committee;

Member of the Audit, Risk and Compliance Committee.

Interests in shares and options at the date of this report

250,000 ordinary shares in Hills Limited.

He does not hold any options over ordinary shares in Hills Limited.

David John Joseph Lenz

Executive Director
Age 56

Experience and expertise

Appointed Managing Director 19 February 2018 and Chief Executive Officer on 1 September 2016.

Mr Lenz has over 30 years of proven experience in sales, business development, management and operational leadership across Australia and New Zealand, Asia Pacific and the Global ICT markets.

Other current listed company directorships

None.

Former listed company directorships in last 3 years

None.

Special responsibilities

Chief Executive Officer

Interests in shares and options at the date of this report

100,000 ordinary shares in Hills Limited.

He holds performance rights as detailed in section 6.3 of the Remuneration Report.

COMPANY SECRETARY

David Robert 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 2018, and the numbers of meetings attended by each Director were:

	Full meetings of Directors		Audit, Risk and Compliance Committee		Remuneration & Nomination Committee	
	Held[1]	Attended	Held[1]	Attended	Held[1]	Attended
J Hill-Ling	17	17	–	–	3	3
F Bennett	17	17	5	5	–	–
P Bullock AO	17	17	5	5	3	3
K Dwyer	17	17	5	5	3	3
D Lenz[2]	6	6	–	–	–	–

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 secretary 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.

1 Number of meetings held during the period that the Director held office as a Director or was a member of the committee during the year.

2 D Lenz was appointed Managing Director on 19 February 2018 and had attended Board meetings in the capacity of CEO up to that date.

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.

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 during the 2018 financial year and Hills continued to meet 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 June 2018.

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 28.

Non-audit services

The Company may decide to employ the auditor on assignments additional to their statutory audit duties where the auditors 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*.

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:

	2018 $	2017 $
KPMG audit and non-audit services		
Audit and other assurance services		
KPMG Australia – audit and review of the financial statements	**219,000**	298,000
Overseas KPMG firms – audit and review of the financial statements	**40,000**	42,223
Total remuneration for audit services	**259,000**	340,223
KPMG Australia – other assurance services	**–**	165,000
Total remuneration for audit and other assurance services	**259,000**	505,223
Taxation services		
KPMG Australia – taxation and other services	**16,000**	78,238
Overseas KPMG firms – taxation services	**4,390**	3,967
Total remuneration for taxation services	**20,390**	82,250
Other services		
Other consulting services	**7,250**	12,816
Total remuneration for other services	**7,250**	12,816
Total remuneration of KPMG	**286,640**	600,244

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 Nomination and Remuneration Committee

Dear Shareholder,

On behalf of your Board, I am pleased to present Hills' FY18 Remuneration Report which sets out remuneration information for the Chief Executive officer & Managing Director (CEO & MD), the Key Management Personnel (KMP), the Non-Executive Directors and the broader employee group.

FY18 REMUNERATION OUTCOMES

In my letter last year, the focus was largely on the actions that we had taken to bring executive compensation in line with a company the size of Hills Limited. This was appropriate at the time, but as our turnaround continues we need to retain and build the type of workforce that has the skills and motivation to sustain Hills into the future.

From a financial perspective you have seen the tremendous turnaround in profitability of our business, this has only been achieved through the leadership of our managers and the loyalty of our staff. We remain grateful for the efforts and sacrifices they have made.

In FY17, we took action to reduce the layers of management and levels of compensation such that, for those employees earning over $150,000 per year (Base Salary and Superannuation), the total salary costs reduced from $9,735,163 as at 30/6/16 to $7,258,437 as at 30/6/17 while at the same time reducing overall headcount (Full Time Equivalents – FTE) from 665 to 557. As we moved into FY18, we continued to maintain a strong focus on costs and as at 30/6/18 the total compensation for employees earning over $150,000 p.a. was $5,731,420 and our overall FTE sits at 534. As we did in FY17, we continued to look closely at those employees earning less than $150,000 to ensure that where increases and promotions are warranted, they occurred.

At the same time, we turned our attention to how to enhance the capability of our staff. We had focused on senior appointments, such as our CEO & MD and CFO, and other key personnel, for example in the Operations, Marketing and Vendor Management areas, but we recognised that ongoing success depended upon the performance of our "people" managers. Statistically and from a "common sense" perspective, we know that our best people managers provide the leadership and motivation to help our employees deliver the types of service our customers require and therefore better results.

What are the characteristics of a Hills people manager? What are the expectations for their performance and behaviour? This is an ongoing project, however we embarked upon a Manager Forum in July 2017, followed by another in February 2018 with a further planned for August. These forums help our managers better understand the strategy of the Company, the focus areas and their individual role in achievement of the strategy. In addition, we have contracted to a third party to run an analysis of the skills of our managers benchmarked against global capabilities. We plan to utilize these results to help run a series of development sessions with our managers on those areas which are critical to Hills where skills are lacking. The first stage of this work will take place at the August Managers Forum.

Naturally this program is supported by on the job coaching, however I use this as an example of how we balance our cost focus. Later in the report we also cover some of the ongoing employee programs we undertake.

CEO & MD REMUNERATION

With the appointment of David Lenz in September 2016, we adopted a new market-based compensation framework. In FY18 the framework was 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 FY18 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 for FY18 were as follows:

Element	Measure
Financial (60%)	• Net Profit After Tax (NPAT) • Operating Cash Flow • Inventory Management
Non-financial (40%)	• Delivery of Digital Transformation • Customer Satisfaction • Employee Engagement • Vendor Engagement

During FY18, the Hills management team delivered a significant turnaround in the financial performance of the company. In addition, they implemented a new e-commerce platform as well as improved our vendor satisfaction and retained focus on employee satisfaction. However, given that our original financial targets were not met, the Board has determined that a reduced incentive payment was appropriate (as per table 3.5).

You should note that the "Non-Financial" measures typically focus on things that we need to put in place to help sustain and benefit Hills in the years ahead, for example the successful implementation of an e-commerce platform which enables our customers to purchase on-line.

FY19 OUTLOOK

As we move into FY19, our main focus is the continued alignment of reward to performance and the establishment of market-based compensation at all levels through our organisation.

CEO & MD and CFO measures are largely in line with FY18 and are distributed as follows:

Element	Measure
Financial (70%)	• Operating Cash Flow • Net Profit After Tax (NPAT) • Inventory Management
Non-financial (30%)	• Vendor Engagement • Employee Engagement • Board discretion

At the same time, we continue to look to enhance employee morale by improving the levels of communications and management capability not to mention the continuation of programs such as:

- Partnering with Make-A-Wish Foundation and running fund raising team-based events in all our Hills offices leading to the granting of a wish to a 4-year-old child battling a critical illness in June 2018.
- HillsXtra – recognising the hard work of everyone at Hills through employee reward, recognition and retail shopping discounts.
- Health insurance discounts through Bupa.
- Completing the Hills Microsoft Dynamics 365 Sales Training program for over 120 employees across the company's Australian and NZ operations, providing foundational skills and capabilities.
- Providing a flu vaccination program for all Australia and New Zealand employees as part of Hills Wellness Program and partnership with BUPA.
- Bringing together all of Hills people managers twice yearly – July 2017 and February 2018 to share Hills strategy and align business plans for FY18.
- The Hills Customer Service Excellence Training Program – offering our Customer Service Consultants a Certificate IV in Business. 16 Customer Service Consultants graduated with a Certificate IV qualification in FY18.
- The commencement of new online compliance training with initial focus on Workplace, Health & Safety and Bullying and Harassment Training.

Thank you for taking the time to review the FY18 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 develop the skills that they require in this new world. With this in mind, it is fitting to close by again thanking the employees of Hills for their ongoing loyalty and dedication to our customers and suppliers.

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 2018 (FY18). 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
2	Remuneration Governance
3	Executive Remuneration
4	Executive Contracts and Termination Arrangements
5	Five Year Snapshot – Business and Remuneration Outcomes
6	Statutory Remuneration Tables
7	Non-Executive Directors' Remuneration
8	Equity instrument disclosures relating to Key Management Personnel

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 FY18.

Name	Position	Term as KMP in FY18
Directors		
J Hill-Ling	Chairman, Non-Independent and Non-Executive	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	Full Year
D Lenz	Executive Director	CEO to 18 February 2018. CEO & MD from 19 February 2018
Senior Executives		
D Lenz	Chief Executive Officer	CEO to 18 February 2018. CEO & MD from 19 February 2018
C Jacka	Chief Finance Officer	Full Year
D Fox	Company Secretary & General Counsel	Full Year
Former Senior Executives		
D Osborne	Head of Hills Health Solutions	Resigned 26 June 2018

2 REMUNERATION GOVERNANCE

2.1 Role of the Nomination and Remuneration Committee

The Board, with assistance from the Nomination and 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 Nomination and 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 Nomination and 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 Nomination and 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 Nomination and Remuneration Committee Charter, the Nomination and 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. Board members, 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 received as part of remuneration. The Securities 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

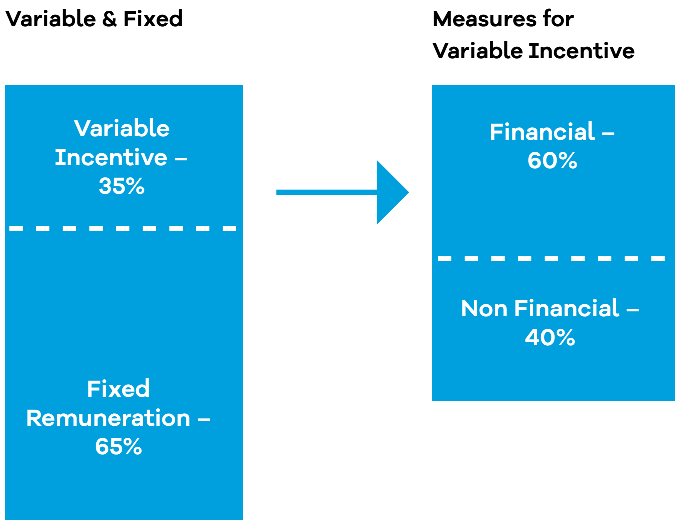
3.1 Alignment of Remuneration Strategy with Business Strategy

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.

3.2 Remuneration Mix

Senior executive remuneration is comprised of Fixed Remuneration (made up of base salary and superannuation), and Variable Incentive. The diagram below provides an illustration of the mix between Fixed Remuneration and Variable Incentive for the executives at Hills and the split between financial measures and non-financial measures for determining the variable portion. The CEO & MD split is 65% Fixed Remuneration and 35% Variable Incentive. Other executives have a split of approximately 70% Fixed Remuneration and 30% Variable Incentive.

Chart 3.2: CEO & MD Remuneration Mix FY1



3.3 Chief Executive Officer (CEO) and Managing Director (MD) Remuneration

The CEO & MD, Mr David 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 & MD, and market information.

Variable Incentive FY18

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

The variable incentive for FY18 adopted a balanced scorecard approach which was aligned to the Company's strategic plan. The balanced scorecard focused on the following key areas:

Element	Measure
Financial (60%)	• Net Profit After Tax (NPAT) • Operating Cash Flow • Inventory Management
Non-financial (40%)	• Delivery of Digital • Transformation Vendor Engagement • Customer Satisfaction • Employee 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.

Mr Lenz was awarded 159,152 Performance rights in FY18 relating to the FY17 variable incentive paid as Performance Rights of which 31,830 vested by 30 June 2018.

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 vested in September 2017 and the second tranche will vest in September 2018 subject to Mr Lenz being employed by Hills at the time of vesting.

3.4 Senior Executive Variable Incentive FY18

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 which is aligned to the Company's strategic plan. Senior executive variable incentives are determined on similar measures as the CEO & MD.

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

The variable incentive performance period was from 1 July 2017 to 30 June 2018.

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.

In any one year, there are always circumstances that may fall outside the scorecard and require special consideration. Hence the Board reserves its right to adjust the variable pay component both up or down, taking into consideration these factors.

The following table summarises the potential FY18 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 FY18 variable incentive which had not already vested or been made.

Assessment of Performance and Approval of Payment

The Nomination and Remuneration Committee assessed the individual senior executive's performance based on the CEO & MD's recommendations and 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 Nomination and Remuneration Committee recommended the variable incentive payment outcome to the Board for approval. Variable incentive payments for FY18 were delivered as cash payments following approval by the Board. Details of Variable Incentive payments are provided in section 3.5.

3.5 FY18 Variable Incentive Performance and Outcomes

FY18 has been a year of continued rebuilding and producing a profit 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.

Name	Target Variable Incentive opportunity (pro-rata)	% of fixed remuneration	Financial outcome	Non financial outcome	Actual Variable Incentive outcome	% Achieved	% Forfeited
D Lenz[1]	$200,000	57%	–	$75,000	$75,000	38%	62%
C Jacka	$100,000	43%	–	$44,000	$44,000	44%	56%
D Fox	$80,000	28%	–	$24,000	$24,000	30%	70%
D Osborne[2]	$100,000	32%	–	–	–	0%	100%
TOTAL	**$480,000**	**41%**	**–**	**$143,000**	**$143,000**	**30%**	**70%**

3.6 FY19 Variable Incentive Design for CEO

Variable Incentive Plan – FY19

For FY19, it was decided to continue the variable incentive plan which involved 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.

From 1 September 2018, the CEO & MD Total Remuneration package will increase. Base and Superannuation will remain at $350,000 with the variable incentive to increase from $200,000 to $250,000.

The annual performance against which the CEO will be measured is in accordance with the balanced scorecard which had the following measures.

Element	Measure
1. Financial Measures 70% of Variable Incentive	(a) Net Profit After tax (NPAT) (b) Operating Cash Flow (c) Inventory Management
2. Non-financial Measures 30% of Variable Incentive	(a) Employee Engagement (b) Vendor Commitment (c) Board Discretion

Weighting will be distributed across these measures.

1 D Lenz was promoted to CEO & Managing Director on 19 February 2018. Prior to that he was Chief Executive Officer.
2 D Osborne resigned as Head of Hills Health Solutions on 26 June 2018. The Board awarded an ex-gratia payment of $40,000.

4 EXECUTIVE CONTRACTS AND TERMINATION ARRANGEMENTS

Employment contracts

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

Chief Executive Officer	• Hills or the CEO & MD 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.

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		FY18	FY17	FY16	FY15	FY14
Shareholders' funds	$000	61,308	60,931	69,077	136,600	245,228
Statutory net profit/(loss)	$000	359	(7,932)	(68,305)	(85,780)	26,387
Basic earnings/(loss) per share	Cents	0.2	(3.4)	(29.4)	(37.0)	10.4
Dividends	Cents	–	–	–	2.1	7.0
Share Price – as at 30 June	$	0.23	0.16	0.25	0.46	1.74
Short Term Incentive Payments – % of Target Opportunity	%	30%	29%	19%	4%	85%

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.

FY18 $	Short-term benefits			Post-employment benefits	Long term benefits		Share based payments	
Name	Cash salary & fees	Cash bonus[1]	Other	Super-annuation	LSL[2]	Term-ination benefits[3]	Perfor-mance rights	TOTAL
Executive Director								
D Lenz[4]	327,756	37,500	–	21,978	3,736	–	32,075	422,828
Senior Executives								
C Jacka	211,305	44,000	–	19,727	1,562	–	–	276,594
D Fox	246,040	31,643	–	22,257	20,767	–	–	320,707
Former Senior Executives								
D Osborne	278,410	–	–	24,696	–	–	–	303,106
Total Senior Executives	**1,063,511**	**113,143**	–	**88,658**	**26,065**	**–**	**32,075**	**1,323,235**

FY17 $	Short-term benefits			Post-employment benefits	Long term benefits		Share based payments	
Name	Cash salary & fees	Cash bonus[1]	Other	Super-annuation	LSL[2]	Term-ination benefits[3]	Perfor-mance rights	TOTAL
Senior Executives								
D Lenz[4]	310,818	30,000	8,606	26,491	2,237	–	48,167	426,319
C Jacka[5]	161,581	40,000	1,984	12,897	498	–	–	216,960
D Fox[6]	128,827	24,000	2,465	10,156	2,830	–	–	168,278
D Osborne[7]	138,448	39,250	4,906	13,163	2,015	–	–	197,782
Former Senior Executives								
G Logan[8]	130,400	–	12,484	18,286	–	–	–	161,170
G Turner[9]	105,543	25,000	–	15,232	–	63,765	(2,911)	206,629
G Stephens[10]	130,125	5,000	6,938	20,468	–	115,525	(4,756)	273,300
D McKim-Smith[11]	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 MD & CEO cash bonus reflects the 50% of variable incentive paid as performance share rights as noted in Section 3.3 of this report.
2 Long Service Leave.
3 In accordance with statutory and legal obligations.
4 D Lenz became CEO on 1 September 2016. Prior to that he was Chief Operating Officer.
5 C Jacka became CFO on 14 November 2016.
6 D Fox became Company Secretary & General Counsel on 22 December 2016.
7 D Osborne became Head of Hills Health Solutions effective 1 January 2017.
8 G Logan ceased as CEO on 1 September 2016.
9 G Turner ceased as CFO on 14 November 2016.
10 G Stephens ceased as Company Secretary on 2 2 December 2016.
11 D McKim-Smith ceased as Head of Hills Health Solutions on 1 November 2016

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

The following table reflects the fixed remuneration and Variable Incentive for FY18 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
Executive Director						
D Lenz	$200,000	$200,000	$75,000	38%	38%	21%
Senior Executives						
C Jacka	$100,000	$100,000	$44,000	44%	44%	19%
D Fox	$80,000	$80,000	$24,000	30%	30%	8%
Former Senior Executives						
D Osborne	$100,000	$100,000	–	0%	0%	0%

The following table reflects the fixed remuneration, Variable Incentive and total performance-based remuneration for FY18 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 %
Executive Director				
D Lenz	84%	9%	8%	17%
Senior Executives				
C Jacka	84%	16%	0%	16%
D Fox	90%	10%	0%	10%
Former Senior Executives				
D Osborne	100%	0%	0%	0%

The following table shows the proportion weighting of each element of remuneration for each of the senior executives employed during FY18 based on maximum potential outcome.

	Fixed remuneration %		Maximum Variable Incentive %		Maximum Long-Term Incentive %	
Name	**FY18**	**FY17**	**FY18**	**FY17**	**FY18**	**FY17**
D Lenz	62%	58%	35%	17%	3%	25%
Senior Executives						
C Jacka	70%	74%	30%	26%	–	–
D Fox	78%	78%	22%	22%	–	–
Former Senior Executives						
D Osborne	75%	76%	25%	24%	–	–

6.3 Number of performance rights granted, vested and expired / forfeited in FY18

Name	At 1 July 2017	Granted	Vested	Forfeited	At 30 June 2018
Executive Director					
D Lenz	200,000[1]	159,152[2]	(131,830)[3]	–	227,322

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 Nomination and 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 remained at the same level through to FY18.

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 which is recorded on an accrual basis. The fee pool did not change in FY18.

1 As at 1 July 2017 a sign-on bonus of 200,000 Hills Performance Rights had been granted (See section 3.3).
2 During FY18 the share of the FY17 variable incentive (50% of the amount payable) provided by way of Hills Performance Rights were granted (See section 3.3).
3 During FY18 50% of the sign-on bonus Hills Performance Rights and 20% of the FY17 variable incentive Performance Rights vested.

7.2 Directors' FY18 Fee Structure

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

7.3 Non-executive Directors' remuneration details

Non-Executive Directors	Year	Board and Committee fees $	Superannuation $	Total $
J Hill-Ling	2018	146,119	13,881	160,000
	2017	146,119	13,881	160,000
F Bennett	2018	87,672	8,328	96,000
	2017	87,671	8,329	96,000
P Bullock AO[1]	2018	94,978	9,022	104,000
	2017	94,050	8,935	102,985
K Dwyer[2]	2018	80,367	7,633	88,000
	2017	63,056	5,990	69,046
I Elliot[3]	2018	–	–	–
	2017	49,905	4,741	54,646
D Spence[4]	2018	–	–	–
	2017	17,928	1,703	19,631
TOTAL	**2018**	**409,136**	**38,864**	**448,000**
	2017	**458,729**	**43,579**	**502,308**

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 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.

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 equal to 1 year of Director Fees after tax and are required to attain this shareholding over a reasonable time and after taking into account share price fluctuations.

	Ordinary shares			
Directors	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
J Hill-Ling	18,146,677	–	–	18,146,677
F Bennett	88,444	–	90,000	178,444
P Bullock AO	100,000	–	100,000	200,000
K Dwyer	200,000	–	50,000	250,000
D Lenz	–	100,000	–	100,000

8.2 Loans to Key Management Personnel

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

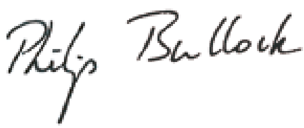
8.3 Other Transactions with Key Management Personnel

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.

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

Jennifer Hill-Ling
Director



Philip Bullock AO
Director

Sydney
27 August 2018

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 2018 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

Paul Cenko
Partner

Adelaide

27 August 2018

KPMG, an Australian partnership and a member firm of the KPMG network of independent member firms affiliated with KPMG International Cooperative ("KPMG International"), a Swiss entity.

Liability limited by a scheme approved under Professional Standards Legislation.

Contents

Hills Limited

Consolidated statement of profit or loss

For the year ended 30 June 2018

	Notes	2018 $'000	2017 $'000
Continuing operations			
Revenue	2	**271,781**	298,068
Cost of sales	4a	**(185,101)**	(210,300)
Gross Margin		**86,680**	87,768
Other income	3	**910**	13,100
Expenses excluding net finance expenses			
Labour and related expenses		**(54,044)**	(68,430)
Operational and equipment expenses		**(7,163)**	(7,867)
Property expenses		**(7,711)**	(7,865)
Depreciation and amortisation	4a	**(6,519)**	(7,072)
Other expenses	4b	**(8,950)**	(14,348)
Expenses excluding net finance expenses		**(84,387)**	(105,582)
Profit/(Loss) before net finance expense and income tax		**3,203**	(4,714)
Finance income		**121**	66
Finance expenses		**(3,284)**	(3,356)
Net finance expenses	4a	**(3,163)**	(3,290)
Profit/(Loss) before income tax		**40**	(8,004)
Income tax benefit/(expense) from continuing operations	5	**319**	72
Profit/(Loss) from continuing operations		**359**	(7,932)
Profit/(Loss) for the year, attributable to owners of Hills Limited		**359**	(7,932)
		Cents	Cents
Profit/(Loss) per share for loss from continuing operations attributable to the ordinary equity holders of the Company:			
Basic and diluted profit/(loss) per share	6	**0.2**	(3.4)

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

Consolidated statement of comprehensive income

For the year ended 30 June 2018

	Notes	2018 $'000	2017 $'000
Profit/(Loss) for the year		**359**	(7,932)
Other comprehensive income			
Items that may be reclassified to profit or loss			
Changes in the fair value of cash flow hedges	15	**318**	(328)
Exchange differences on translation of foreign operations	15	**(237)**	(20)
Income tax relating to components of other comprehensive income	5	**(95)**	98
Other comprehensive (loss)/income for the year, net of tax		**(14)**	(250)
Total comprehensive income/(loss) for the year, attributable to owners of Hills Limited		**345**	(8,182)

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

Hills Limited

Consolidated statement of financial position

For the year ended 30 June 2018

	Notes	2018 $'000	2017 $'000
ASSETS			
Current assets			
Cash and cash equivalents	7	**15,783**	8,651
Trade and other receivables	8	**59,651**	59,489
Inventories	9	**44,043**	46,460
Current tax assets	5	**–**	229
Derivative financial instruments		**93**	–
Total current assets		**119,570**	114,829
Non-current assets			
Investments		**2**	2
Property, plant and equipment	11	**14,915**	16,600
Intangible assets	12	**6,267**	2,578
Deferred tax assets	5	**11,122**	10,917
Total non-current assets		**32,306**	30,097
Total assets		**151,876**	144,926
LIABILITIES			
Current liabilities			
Trade and other payables	10	**47,731**	40,266
Borrowings	17	**6,357**	295
Provisions	13	**6,206**	10,556
Derivative financial instruments	18	**–**	287
Total current liabilities		**60,294**	51,404
Non-current liabilities			
Borrowings	17	**26,339**	28,395
Provisions	13	**3,935**	4,196
Total non-current liabilities		**30,274**	32,591
Total liabilities		**90,568**	83,995
Net assets		**61,308**	60,931
EQUITY			
Contributed equity	14	**278,439**	278,439
Reserves	15	**11,053**	11,035
Accumulated losses		**(228,184)**	(228,543)
Total equity		**61,308**	60,931

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

Consolidated statement of changes in equity

For the year ended 30 June 2018

	Notes	Contributed equity $'000	Reserves $'000	Accumulated losses $'000	Total $'000
		Attributable to owners of Hills Limited			
Balance at 1 July 2016		278,439	11,249	(220,611)	69,077
Total comprehensive income/(loss) for the year		–	(250)	(7,932)	(8,182)
Transactions with owners in their capacity as owners:					
Employee share schemes	28	–	36	–	36
Balance at 30 June 2017		**278,439**	**11,035**	**(228,543)**	**60,931**
Balance at 1 July 2017		**278,439**	**11,035**	**(228,543)**	**60,931**
Total comprehensive income/(loss) for the year		**–**	**(14)**	**359**	**345**
Transactions with owners in their capacity as owners:					
Employee share schemes	28	**–**	**32**	**–**	**32**
Balance at 30 June 2018		**278,439**	**11,053**	**(228,184)**	**61,308**

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 2018

	Notes	2018 $'000	2017 $'000
Cash flows from operating activities			
Receipts from customers (inclusive of goods and services tax)		**300,312**	345,464
Payments to suppliers and employees (inclusive of goods and services tax)		**(285,947)**	(343,007)
		14,365	2,457
Net finance costs paid		**(2,607)**	(3,255)
Net income taxes received		**219**	13
Net cash flows from/(used in) operating activities	7	**11,977**	(785)
Cash flows from investing activities			
Payments for property, plant and equipment	11	**(1,233)**	(1,507)
Payments for intangible assets	12	**(5,193)**	(2,249)
Proceeds from sale of property, plant and equipment and intangible assets		**188**	6,701
Rent received		**–**	4
Net cash flows (used in)/from investing activities		**(6,238)**	2,949
Cash flows from financing activities			
Proceeds from borrowings		**3,461**	8,004
Repayment of borrowings		**(1,961)**	(5,522)
Net cash flows from financing activities	17	**1,500**	2,482
Net increase in cash and cash equivalents		**7,239**	4,646
Cash and cash equivalents at the beginning of the year		**8,651**	3,994
Effects of exchange rate changes on cash and cash equivalents		**(107)**	11
Cash and cash equivalents at end of the year	7	**15,783**	8,651

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 27 August 2018. 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.

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
Note 9	Net realisable value of inventory
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 2018 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.

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.

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 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**

2 **Revenue**

3 **Other income**

4 **Expenses**

5 **Income tax**

6 **Profit/(Loss) per share**

1 Segment information

In line with FY17 the Board of Directors (being the Chief Operating Decision Maker) consider that there is only one reportable segment for the year ended 30 June 2018.

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 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.

(A) INFORMATION ABOUT REPORTABLE SEGMENTS

	Revenue		EBITDA[1]	
	2018 $ '000	2017 $ '000	2018 $ '000	2017 $ '000
Reportable segment				
Hills Limited	271,781	298,068	**9,371**	**6,353**
Total segment result[2]	271,781	298,068	**9,371**	**6,353**

(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 did not derive 5% or more of its revenues from any single external customer.

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.

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	2018 $'000	2017 $'000
Segment EBITDA		**9,371**	6,353
Depreciation and amortisation	4	**(6,519)**	(7,072)
Net finance expenses	4	**(3,163)**	(3,290)
Net costs not considered part of segment EBITDA		**(67)**	(3,995)
Other income not considered part of segment EBITDA		**418**	–
Profit/(Loss) before income tax from continuing operations		**40**	(8,004)

Net costs not considered part of segment EBITDA comprise:

	2018 $'000	2017 $'000
Costs related to proposed demerger of business	**(121)**	(2,207)
Reversal of impairment of property, plant and equipment	**165**	30
Other net costs related to the Company's restructure and transformation program	**(111)**	(1,818)
	(67)	(3,995)
Other income relating to recovery of previously written off bad debt (see note 3)	**418**	–
Total net income/(costs) not considered part of segment EBITDA	**351**	(3,995)

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	
	2018 $'000	2017 $'000	2018 $'000	2017 $'000
Australia	**252,326**	273,651	**20,703**	20,423
Other countries	**19,455**	24,417	**481**	715
	271,781	298,068	**21,184**	21,138

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.

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

	2018 $'000	2017 $'000
Sales revenue		
Sale of goods	**225,739**	231,154
Services	**46,042**	66,410
	271,781	297,564
Other revenue		
Rents and sub-lease rentals	**–**	4
Licence fee revenue	**–**	500
Total revenue from continuing operations	**271,781**	298,068

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

	2018 $'000	2017 $'000
Net gain on disposal of non-current assets	**52**	6,435
Other income	**858**	6,665
	910	13,100

Net gain on disposal of non-current assets

The net gain on disposal of non-current assets for the year ended 30 June 2017 included a gain on the sale of Hills Home Living assets (comprising intellectual property of $4.0 million and tooling, goodwill and other assets of $2.4 million), to AMES Australasia.

Other income

Other income for the year ended 30 June 2018 includes settlement of a previously written off customer receivable relating to a discontinued operation for $0.4 million and income of $0.26 million from chargeable repair income.

Other income for the year ended 30 June 2017 included income of $6.0 million received from Woolworths on termination of the licence arrangement in relation to Hills Home Living products. Deferred costs of $0.65 million were reflected in operating expenses for FY17.

4 Expenses

(A) PROFIT/(LOSS) BEFORE INCOME TAX INCLUDES THE FOLLOWING SPECIFIC EXPENSES:

	2018 $'000	2017 $'000
Cost of Sales		
Cost of goods sold (inventories)	**165,955**	172,095
Direct cost of services provided	**19,146**	38,205
Total cost of sales	**185,101**	210,300
Depreciation		
Plant and equipment	**5,018**	5,889
Total depreciation	**5,018**	5,889
Amortisation		
Software	**1,442**	1,144
Development costs	**59**	39
Total amortisation	**1,501**	1,183
Total depreciation and amortisation	**6,519**	7,072
Employer benefits expenses		
Wages and salaries	**40,203**	52,360
Defined contribution superannuation expense	**3,829**	4,532
Other employee benefit expenses	**2,910**	3,485
Equity-settled share-based payment transactions	**32**	36
Total employee benefits expenses	**46,974**	60,413

	2018 $'000	2017 $'000
Finance expenses		
Interest and finance charges paid/payable	**(3,243)**	(3,321)
Unwinding of discount on provisions	**(41)**	**(35)**
	(3,284)	(3,356)
Finance income		
Interest income	**121**	66
	121	66
Net finance costs expensed	**(3,163)**	(3,290)

(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. The Group presents expenses classified by nature in order to provide information that is relevant and consistent with how management monitors business performance.

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 2018 is an expense of $0.20 million. Included in this balance for the year ended 30 June 2017 is an expense of $4.4 million relating to the impairment of inventory (comprising inventory purchased on signing a distribution agreement with Tyco in February 2015 of $3.46 million and other exited brands of $0.93 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 $46.97 million (as shown in note 4(A) 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 leased 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 $0.07 million (2017: $3.99 million) (as shown in note 1(B).

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

	2018 $'000	2017 $'000
(A) INCOME TAX (BENEFIT)/EXPENSE		
Current tax	–	(60)
Deferred tax	**(319)**	(12)
	(319)	(72)
(B) NUMERICAL RECONCILIATION OF INCOME TAX (BENEFIT)/EXPENSE TO PRIMA FACIE TAX PAYABLE		
Profit/(Loss) from continuing operations before income tax expense	**40**	(8,004)
Tax at the Australian tax rate of 30% (2017: 30%)	**12**	(2,401)
Tax effect of amounts which are not deductible (taxable) in calculating taxable income:		
Non-deductible expenses	**54**	153
Acquisition costs	**(22)**	175
Utilisation of previously unrecognised capital losses	–	(1,464)
(Recognition)/Derecognition of deferred tax assets	**(3,429)**	(5,289)
Tax losses for which no deferred tax asset is recognised	**3,305**	20,599
Tax effect of prior year adjustments	**(231)**	(11,850)
	(311)	(77)
Difference in overseas tax rates	**(8)**	5
Total income tax benefit	**(319)**	(72)

	2018 $'000	2017 $'000
(C) INCOME TAX EXPENSE RELATING TO ITEMS OF OTHER COMPREHENSIVE INCOME		
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:		
Income/(Losses) on cash flow hedges	**95**	(98)
Aggregate income tax benefit	**95**	(98)

(D) TAX LOSSES

At the end of the reporting period, the Group had unused tax losses in respect of revenue items of $205.7 million (2017: $194.3 million) and capital items of $31.0 million (2017: $49.5 million).

	Revenue items		Capital items	
	2018 $'000	2017 $'000	2018 $'000	2017 $'000
Unused losses for which no deferred tax asset has been recognised	**205,744**	194,276	**31,012**	**49,522**
Potential tax benefit	**61,715**	58,283	**9,304**	**14,856**

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

There were no current tax assets for the Group at 30 June 2018 (2017: $0.23 million).

(F) DEFERRED TAX

The balance comprises temporary differences attributable to:

	2018 $'000	2017 $'000
Property, plant and equipment	**2,953**	450
Inventories	**4,768**	5,614
Employee benefits	**1,665**	2,054
Receivables	**120**	178
Provisions	**1,263**	2,039
Other accruals	**381**	515
Derivative financial instruments	**(28)**	67
	11,122	10,917

	Balance at 1 July	Recognised in profit or loss	Recognised in other comprehensive income	Balance at 30 June
	$'000	$'000	$'000	$'000
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
Movements 2018				
Property, plant and equipment	450	2,503	–	2,953
Inventories	5,614	(846)	–	4,768
Employee benefits	2,054	(389)	–	1,665
Receivables	178	(58)	–	120
Provisions	2,039	(776)	–	1,263
Other accruals	515	(134)	–	381
Derivative financial instruments	67	–	(95)	(28)
Exchange differences	–	19	(19)	–
	10,917	319	(114)	11,122

(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 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 Profit/(Loss) per share

	2018 Cents	2017 Cents
(A) BASIC AND DILUTED PROFIT/(LOSS) PER SHARE		
From profit/(loss) attributable to the ordinary equity holders of the Company	**0.2**	(3.4)

	2018 $'000	2018 $'000
(B) RECONCILIATION OF EARNINGS USED IN CALCULATING PROFIT/(LOSS) PER SHARE		
Profit/(Loss) attributable to the ordinary equity holders of the Company used in calculating basic profit/(loss) per share	**359**	(7,932)

	2018 Shares '000	2018 Shares '000
(C) WEIGHTED AVERAGE NUMBER OF SHARES USED AS DENOMINATOR		
Weighted average number of ordinary shares used as the denominator in calculating basic profit/(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 profit/(loss) per share	**231,986**	231,986

Performance rights have not been included in the weighted average number of shares for diluted profit/(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

	2018 $'000	2017 $'000
Cash at bank and in hand	**10,704**	5,360
Deposits	**5,079**	3,291
	15,783	8,651

(A) RECONCILIATION OF PROFIT/(LOSS) AFTER INCOME TAX TO NET CASH FLOW FROM OPERATING ACTIVITIES PROFIT/(LOSS) FOR THE PERIOD

	2018 $'000	2017 $'000
Profit/(Loss) for the period	**359**	(7,932)
Depreciation and amortisation	**6,519**	7,072
Net gain on sale of non-current assets	**(52)**	(6,435)
(Reversal of impairment) impairment of property, plant and equipment	**–**	(30)
Non-cash employee benefits expense (credit) – share-based payments	**32**	36
Rent received	**–**	(4)
Fair value adjustment to derivatives	**(59)**	62
Unwinding of discount on provisions	**552**	35
Other non-cash items	**–**	(7)
Change in operating assets and liabilities:		
(Increase)/Decrease in trade and other receivables	**(257)**	**11,008**
Decrease in inventories	**2,300**	9,126
Increase/(Decrease) in trade and other payables	**7,571**	(9,900)
Decrease in provisions	**(4,888)**	(3,756)
Increase/(Decrease) in provision for income taxes receivable	**220**	(48)
(Increase)/Decrease in deferred tax assets	**(320)**	(12)
Net cash flows from operating activities	**11,977**	(785)

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

	2018			2017		
	Current $'000	Non-current $'000	Total $'000	Current $'000	Non Current $'000	Total $'000
Trade receivables	**51,483**	**–**	**51,483**	52,914	–	52,914
Provision for impairment of receivables (a)	**(402)**	**–**	**(402)**	(594)	–	(594)
	51,081	**–**	**51,081**	52,320	–	52,320
Other receivables	**5,819**	**–**	**5,819**	5,271	–	5,271
Prepayments	**2,751**	**–**	**2,751**	1,898	–	1,898
	59,651	**–**	**59,651**	59,489	–	59,489

Unamortised borrowing costs, which were included in prepayments in the prior year, have been reclassified to borrowings. The amount at 30 June 2018 of $1.404 million is shown in note 17.

(A) IMPAIRED TRADE RECEIVABLES

The ageing of the Group's trade receivables at the reporting date is as follows:

	2018 $'000	2017 $'000
Not past due	**33,476**	36,781
Past due 0–30 days	**12,851**	11,441
Past due 31–90 days	**3,115**	3,307
Past due more than 90 days	**2,041**	1,385
	51,483	52,914
Movements in the provision for impairment of receivables are as follows:		
At 1 July	**594**	1,275
Provision for impairment recognised/(released) during the period	**(108)**	283
Receivables written off during the period as uncollectable	**(84)**	(964)
At 30 June	**402**	594

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 $0.402 million (2017: $0.594 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.

(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:

	2018 $'000	2018 $'000
Carrying amount of trade receivables transferred	**35,016**	35,597
Carrying amount of associated liabilities	**(31,091)**	(30,353)

(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

	2018 $'000	2017 $'000
Raw materials and work in progress	**2,674**	2,343
Finished goods	**41,369**	44,117
	44,043	46,460

Inventories stated above are net of provisions for net realisable value of $4.37 million (2017: $6.39 million)

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

	2018 $'000	2017 $'000
Trade payables	**33,521**	25,940
Other payables and accrued expenses	**14,210**	14,326
	47,731	**40,266**

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

	Plant & equipment $'000
Year ended 30 June 2017	
Opening net book amount	19,948
Exchange differences	(7)
Additions	2,770
Disposals	(252)
Depreciation charge	(5,889)
Impairment reversal	30
Closing net book amount	16,600
At 30 June 2017	
Cost	59,834
Accumulated depreciation and impairment	(43,234)
Net book amount	16,600
Year ended 30 June 2018	
Opening net book amount	**16,600**
Exchange differences	**(24)**
Additions	**3,489**
Disposals	**(297)**
Depreciation charge	**(5,018)**
Impairment reversal	**165**
Closing net book amount	**14,915**
At 30 June 2018	
Cost	**60,611**
Accumulated depreciation and impairment	**(45,696)**
Net book amount	**14,915**

Additions include an amount of $0.303 million (2017: $1.26 million) 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.

Additions includes an amount of $1.95 million (2017: nil) for equipment installed at hospitals to generate service rental income which have been funded by finance leases. See note 17(a) for further details of these loans.

Payments for property, plant and equipment of $1.23 million (2017: $1.50 million) as shown in the Consolidated statement of cash flows do not include either of these non-cash additions.

During the year fully depreciated assets with a cost of $2.39 million were written off (2017: $13.80 million).

(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:

	2018 $'000	2017 $'000
Plant and equipment, leasehold improvements and software development	–	3,626

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

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.

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

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

Depreciation 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

	Software[1] $'000	Development Costs $'000	Total $'000
Year ended 30 June 2017			
Opening net book amount	632	121	753
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	17,238	1,895	19,133
Accumulated amortisation and impairment	(14,880)	(1,675)	(16,555)
Net book amount	2,358	220	2,578
Year ended 30 June 2018			
Opening net book amount	**2,358**	**220**	**2,578**
Additions	**4,379**	**814**	**5,193**
Disposals/transfers	**28**	**(28)**	**–**
Amortisation charge	**(1,442)**	**(59)**	**(1,501)**
Impairment charge	**(3)**	**–**	**(3)**
Closing net book amount	**5320**	**947**	**6,267**
At 30 June 2018			
Cost	**20,531**	**2,681**	**23,217**
Accumulated amortisation and impairment	**(15,211)**	**(1,734)**	**(16,950)**
Net book amount	**5,320**	**947**	**6,267**

There were no additions for the year incurred but not yet paid at the end of the period (2017: $0.765 million).

During the year ended 30 June 2018, fully amortised or impaired intangible assets with a cost of $1.1 million (2017: $8.7 million) were written off.

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

RECOGNITION AND MEASUREMENT

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

	2018			2017		
	Current $'000	Non-current $'000	Total $'000	Current $'000	Non-current $'000	Total $'000
Employee benefits	**5,087**	**475**	**5,562**	6,170	695	6,865
Outstanding claims	**545**	**660**	**1,205**	866	660	1,526
Restructuring costs	**118**	**668**	**786**	2,336	802	3,138
Other provisions	**456**	**2,132**	**2,588**	1,184	2,039	3,223
	6,206	**3,935**	**10,141**	10,556	4,196	14,752

(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 2018				
Carrying amount at the start of the year	**1,526**	**3,138**	**3,223**	**7,887**
Additional provisions made during the period	**–**	**47**	**127**	**174**
Amounts used (incurred or charged against provision)	**(321)**	**(2,295)**	**(762)**	**(3,378)**
Unused amounts reversed during the period	**–**	**(104)**	**–**	**(104)**
Carrying amount at the end of the year	**1,205**	**786**	**2,588**	**4,579**

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

	2018 Shares	2017 Shares	2018 $'000	2017 $'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 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

	2018 $'000	2017 $'000
Hedging reserve – cash flow hedges	**65**	(158)
Equity compensation reserve	**738**	706
Foreign currency translation reserve	**117**	354
Profits reserve	**10,133**	10,133
	11,053	11,035

(A) MOVEMENTS IN RESERVES

Hedging reserve – cash flow hedges		
Opening balance 1 July	**(158)**	72
Revaluation – gross	**318**	(328)
Deferred tax	**(95)**	98
Closing balance 30 June	**65**	(158)
Equity Compensation reserve		
Opening balance 1 July	**706**	670
Employee share plan expense/(credit)	**32**	36
Closing balance 30 June	**738**	706
Foreign currency translation reserve		
Opening balance 1 July	**354**	374
Currency translation differences arising during the year	**(237)**	(20)
Closing balance 30 June	**117**	354
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.
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 2018	No dividends were paid during the year and no final dividend has been declared.
Year ended 30 June 2017	No dividends were paid during the year and no final dividend has been declared.

(B) FRANKED DIVIDENDS

	2018 $'000	2017 $'000
Franking credits available for subsequent reporting periods based on a tax rate of 30% (2017: 30%)	**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

	2018			2017		
	Current $'000	Non-current $'000	Total $'000	Current $'000	Non-current $'000	Total $'000
Loans	**6,357**	**27,743**	**34,100**	295	30,353	30,648
Transaction costs	**–**	**(1,404)**	**(1,404)**	–	(1,958)	(1,958)
Total borrowings	**6,357**	**26,339**	**32,696**	295	28,395	28,690

Non-current borrowings include transactions costs directly attributable to the issue of the borrowings.
At 30 June 2018, unamortised borrowing costs totalled $1.404 million (2017: $1.958 million).

(A) LOANS

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

Bilateral Facility

The CBA facility was amended in January 2018 and now comprises a facility for contingent liabilities (bank guarantees/letter of credit), with the following limits (denominated in AUD):

- Contingent liabilities: $4.472 million.

Interest is charged at prevailing market rates plus a fixed margin.

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.

DLL Financing

In December 2017, the Group entered into a Progressive Payment Agreement (PPA) with DLL for the provision of finance for equipment purchases in the Hills Health Solutions business. At 30 June 2018, the Group had drawn down $1.95 million.

The PPA is an unsecured, interest only facility, which will be replaced by a set term Chattel Mortgage once the equipment is installed.

(B) RECONCILIATION OF MOVEMENTS OF LIABILITIES TO CASHFLOWS ARISING FROM FINANCING ACTIVITIES

	Total $'000
Balance at 30 June 2016	**28,167**
Changes from financing cash flows	
Proceeds from loans and borrowings	8,004
Repayment of borrowings	(5,522)
Total changes from financing cash flows	**2,482**
Other changes	
Reclassify capitalised borrowing costs from Trade and other receivables	(1,958)
Other	(1)
Total Other changes	(1,959)
Balance at 30 June 2017	**28,690**

Balance at 30 June 2017	**28,690**
Changes from financing cash flows	
Proceeds from loans and borrowings	3,461
Repayment of borrowings	(1,961)
Total changes from financing cash flows	1,500
Other changes	
Amortise capitalised borrowing costs	554
New finance leases	1,952
Total Other changes	2,506
Balance at 30 June 2018	**32,696**

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 date.

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).

	2018 $'000	2017 $'000
Current assets		
Forward foreign exchange contracts – cash flow hedges	**93**	–
Total current derivative financial instrument assets	**93**	–
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)	**93**	(287)

(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 2018, no gain or loss was recognised in profit or loss for the ineffective portion of these hedging contracts (2017: nil).

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.

DERIVATIVES AND HEDGING ACTIVITIES

Derivatives are initially recognised at fair value on the date a derivative contract is entered into and are subsequently remeasured to their fair value at the end of each reporting period. The 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:

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

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)

The Group continues to maintain a strategy of a target gearing ratio (calculated as net debt divided by net debt plus equity) of less than 40%. The gearing ratios at 30 June 2018 and 30 June 2017 were as follows:

	Notes	2018 $'000	2017 $'000
Total borrowings	17	**32,696**	28,690
Less: cash and cash equivalents	7	**(15,783)**	(8,651)
Net debt		**16,913**	20,039
Total equity		**61,308**	60,931
Gearing ratio		**21.6%**	24.7%

(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.

The Group holds the following financial instruments:

	2018 $'000	2017 $'000
Financial assets		
Cash and cash equivalents	**15,783**	8,651
Trade and other receivables	**59,651**	57,591
Derivative financial instruments	**93**	–
Investments	**–**	2
	75,527	66,244
Financial liabilities		
Trade and other payables	**47,731**	40,266
Borrowings	**32,696**	28,690
Derivative financial instruments	**–**	287
	80,427	69,243

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.

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 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])	(1,118)	–	–	(1,118)
30 June 2018				
Cash at bank	**–**	**–**	**–**	**–**
Trade receivables	**413**	**–**	**–**	**413**
Trade payables	**(10,028)**	**(280)**	**(12)**	**(10,320)**
Forward exchange contracts:				
• buy foreign currency (cash flow hedges)	**(6,366)**	**–**	**–**	**(6,366)**
• buy foreign currency (FVTPL)	**(543)**	**–**	**–**	**(543)**

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 2018 and 2017, 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:

	2018		2017	
	Weighted average interest rate %	Balance $'000	Weighted average interest rate %	Balance $'000
Bank overdrafts and loans	**5.86%**	**(31,639)**	5.46%	(28,395)
Cash and cash equivalents	**1.43%**	**15,783**	1.16%	8,651
Other loans	**4.91%**	**(1,057**	7.63%	(295)

1 Fair Value Through Profit and Loss.

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 2017									
Financial assets									
Cash and cash equivalents	8,651	(81)	–	110	–	14	–	(12)	–
Trade and other receivables	57,591	–	–	–	–	91	–	(75)	–
Derivatives – cash flow hedges									
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)**

		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 2018									
Financial assets									
Cash and cash equivalents	**15,783**	**(162)**	**–**	**225**	**–**	**–**	**–**	**–**	–
Trade and other receivables	**59,651**	**–**	**–**	**–**	**–**	**46**	**–**	**(38)**	–
Derivatives – FVTPL	**272**	**–**	**–**	**–**	**–**	**45**	**–**	**(62)**	–
Total increase/(decrease) in financial assets		**(162)**	**–**	**225**	**–**	**91**	**–**	**(100)**	–
Financial liabilities									
Trade & other payables	**(47,731)**	**–**	**–**	**–**		**(1,169)**	**–**	**956**	–
Borrowings	**32,696**	**341**	**–**	**(341)**				**–**	
Derivatives – cash flow hedges	**(179)**	**–**	**–**	**–**	**–**	**–**	**849**	**–**	**(463)**
Derivatives – FVTPL									
Total increase/(decrease) in financial liabilities		**341**	**–**	**(341)**	**–**	**(1,169)**	**849**	**956**	**(463)**
Total increase/(decrease)		**179**	**–**	**(116)**	**–**	**(1,078)**	**849**	**856**	**(463)**

(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 including external credit risk ratings before the Group's standard terms and conditions are offered.

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 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.

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:

	2018 $'000	2017 $'000
Floating rate		
Expiring within one year (bank overdraft)	–	3,000
Expiring beyond one year (loans)	**3,925**	5,244
	3,925	8,244

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 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	**41,674**	**948**	**1,656**	**33,402**	**77,680**	**69,243**
At 30 June 2018						
Trade and other payables	**47,731**	**–**	**–**	**–**	**47,731**	**47,731**
Borrowings	**2,221**	**6,117**	**2,234**	**29,035**	**39,607**	**32,696**
Derivative financial instruments	**(113)**	**–**	**–**	**–**	**(113)**	**(93)**
Total	**49,839**	**6,117**	**2,234**	**29,035**	**87,225**	**81,334**

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 2017				
Liabilities				
Derivatives financial instruments	–	(287)	–	(287
Total liabilities	–	(287)	–	(287
30 June 2018				
Assets				
Derivatives financial instruments	–	**93**	–	**93**
Total assets	–	**93**	–	**93**

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 2018.

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 ▲
Audio Products Group Pty Ltd ▲
EMG Finance Pty Ltd
Pacific Communications (PACOM) Pty Ltd
Pacom Security Pty Ltd ▲
Hills Health Solutions 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
Step Electronics 2005 Pty Ltd ●
Lan 1 Pty Ltd ▲
Woodroffe Industries Pty Ltd ▲
ACN 091 954 442 Pty Ltd ▲
ACN 099 403 139 Pty Ltd
Zen 99 Pty Ltd ▲
ACN 010 853 817 Pty Ltd ▲
ACN 094 103 090 Pty Ltd ▲
ACN 093 760 895 Pty Ltd
Access Television Services Pty Ltd ▲
ACN 614 478 090 Pty Ltd

New Zealand
Hills NZ 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.

(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

	2018 $	2017 $
Short-term employee benefits (fixed and variable incentive remuneration)	**1,585,791**	1,867,106
Post-employment benefits (superannuation)	**127,521**	178,595
Long term benefits (cash variable component under the Incentive Share Plan and accrued long service leave)	**26,065**	7,850
Termination benefits[1]	**–**	244,697
Share-based payments (performance rights variable component under the Incentive Share Plan and employee share bonus plan expense)	**32,075**	40,500
	1,771,452	2,338,748

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 2018 the Group current assets and liabilities that were eliminated totalled $35.138 million (2017: $32.651 million).

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

(E) TRANSACTIONS WITH OTHER RELATED PARTIES

The following transactions occurred with related parties:

Transactions with Director related entities

During the year no related party transactions with director related entities took place.

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 $2.977 million (2017: $3.767 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 nil (2017: $0.013 million).
Dividends	There were no intragroup dividends paid and received during the year (2017: $1.278 million).

23 Parent entity financial information

(A) SUMMARY FINANCIAL INFORMATION

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

	2018 $'000	2017 $'000
Balance sheet		
Current assets	**96,204**	96,410
Non-current assets	**42,562**	42,496
Total assets	**138,766**	138,906
Current liabilities	**76,743**	66,809
Non-current liabilities	**27,022**	32,388
Total liabilities	**103,765**	99,197
Net assets	**35,001**	39,709
Shareholders' equity		
Contributed equity	**278,439**	278,439
Reserves		
Hedging reserve – cash flow hedges	**65**	(158)
Equity compensation reserve	**738**	706
Profits reserve	**32,859**	32,859
Retained earnings	**(277,100)**	(272,138)
	35,001	39,709
Loss for the year	**(4,963)**	(26,268)
Total comprehensive income	**(4,740)**	(26,498)

() GUARANTEES, CONTINGENT LIABILITIES AND COMMITMENTS OF THE PARENT ENTITY

Guarantees	Bank guarantees given by the Company in favour of customers and suppliers amounted to $2.466 million (2017: $2.778 million). Cross guarantees are given by the Company and its wholly owned subsidiaries as described in note 24. 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.
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 2018, the Company had $2.9 million contractual commitments for the acquisition of plant, equipment or intangible assets (2017: $2 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 2018 and a consolidated statement of financial position as at 30 June 2018 of the Company and controlled entities that are a party to the Deed, after eliminating all transactions between parties.

(A) CONSOLIDATED STATEMENT OF PROFIT OR LOSS AND OTHER COMPREHENSIVE INCOME AND SUMMARY OF MOVEMENTS IN CONSOLIDATED RETAINED EARNINGS

	2018 $'000	2017 $'000
Consolidated statement of profit or loss and other comprehensive income		
Revenue from continuing operations	**255,360**	278,512
Other income	**787**	13,045
Finance costs	**(3,189)**	(3,295)
Other expenses	**(253,299)**	(294,363)
Loss before income tax	**(341)**	(6,101)
Income tax expense	**478**	–
Profit/(Loss) for the year	**137**	(6,101)
Other comprehensive income		
Items that may be reclassified to profit or loss:		
Changes in the fair value of cash flow hedges	**318**	(328)
Income tax relating to these items	**(95)**	98
Other comprehensive profit/(loss) for the period, net of tax	**223**	(230)
Total comprehensive profit/(loss) for the year	**360**	(6,331)
Summary of movements in consolidated retained earnings		
Accumulated losses at the beginning of the reporting period	**(232,923)**	(226,822)
Profit/(Loss) for the year	**137**	(6,101)
Accumulated losses at the end of the reporting period	**(232,786)**	(232,923)

(B) CONSOLIDATED STATEMENT OF FINANCIAL POSITION

	2018 $'000	2017 $'000
Current assets		
Cash and cash equivalents	**13,195**	5,921
Trade and other receivables	**55,211**	57,494
Inventories	**40,903**	42,802
Derivative financial instruments	**93**	–
Total current assets	**109,402**	106,217
Non-current assets		
Investments	**814**	814
Property, plant and equipment	**14,433**	15,884
Intangible assets	**6,267**	2,578
Deferred tax assets	**10,693**	10,311
Total non-current assets	**32,207**	29,587
Total assets	**141,609**	135,804
Current liabilities		
Trade and other payables	**45,877**	38,622
Borrowings	**6,357**	295
Provisions	**5,985**	9,950
Derivative financial instruments	**–**	225
Total current liabilities	**58,219**	49,092
Non-current liabilities		
Borrowings	**24,935**	28,395
Provisions	**3,739**	3,993
Total non-current liabilities	**28,674**	32,388
Total liabilities	**86,893**	81,480
Net assets	**54,716**	54,324
Equity		
Contributed equity	**278,439**	278,439
Reserves	**9,063**	8,808
Accumulated losses	**(232,786)**	(232,923)
Total equity	**54,716**	54,324

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 2018 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 $2.466 million (2017: $2.778 million). The decrease from 30 June 2017 is due to bank guarantees no longer required being cancelled during the year ended 30 June 2018.

26 Commitments

(A) CAPITAL COMMITMENTS

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

	2018 $'000	2017 $'000
Plant, equipment and intangible assets	**2,931**	2,000

(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 7 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.

Commitments for minimum lease payments in relation to non-cancellable operating leases are payable as follows:

	2018 $'000	2017 $'000
Within one year	**6,579**	6,312
Later than one year but not later than five years	**11,526**	9,289
Later than five years	**2,159**	–
	20,264	15,601

(C) LEASE COMMITMENTS: WHERE A GROUP COMPANY IS THE LESSOR

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

	2018 $'000	2017 $'000
Within one year	**150**	104
Later than one year but not later than five years		78
	150	182

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 2018.

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 Incentive Share Plan. The Incentive Share Plan 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 Incentive Share Plan 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
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	–
2018								
Performance Rights								
1 Sep 2016	1 Sep 2017	–	**100,000**	**–**	**(100,000)**	**–**	**–**	**–**
1 Sep 2016	1 Sep 2018	–	**100,000**	**–**	**–**	**–**	**100,000**	**–**
31 Jul 2017	30 Jun 2020	–	**–**	**159,152**	**(31,830)**	**–**	**127,322**	**–**
Total			**200,000**	**159,152**	**(131,830)**	**–**	**227,322**	**–**

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 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:

	2018 $'000	2017 $'000
Performance rights issued under Incentive Share Plan	**32**	36

RECOGNITION AND MEASUREMENT

Share-based payments

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

Incentive Share Plan

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

The fair value of performance rights granted under the 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 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:

	2018 $	2017 $
KPMG audit and non-audit services		
Audit and other assurance services		
KPMG Australia – audit and review of the financial statements	**219,000**	298,000
Overseas KPMG firms – audit and review of the financial statements	**40,000**	42,223
Total remuneration for audit and other assurance services	**259,000**	340,223
KPMG Australia – other assurance services	**–**	165,000
Total remuneration for audit and other assurance services	**259,000**	505,223
Taxation services		
KPMG Australia – taxation and other services	**16,000**	78,238
Overseas KPMG firms – taxation services	**4,390**	3,967
Total remuneration for taxation services	**20,390**	82,250
Other services		
Other consulting services	**7,250**	12,816
Total remuneration for other services	**7,250**	12,816
Total remuneration of KPMG	**286,640**	600,244

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 2018.

(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 2018 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.

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	This standard will change the classification and measurement of financial instruments, introduce new hedge accounting requirements including changes to hedge effectiveness testing, treatment of hedging costs, risk components that can be hedged and disclosures, and introduce a new expected-loss impairment model that will require more timely recognition of expected credit losses. The Group has completed a preliminary assessment of the requirements of the standard and expects that there will not be a significant impact on the financial statements on transition to AASB 9. ***(i) Classification and measurement*** The Group does not expect any impact on its balance sheet or equity on applying the classification and measurement requirements of AASB 9. Financial assets currently held at fair value will continue to be measured at fair value. Trade and other receivables are held to collect contractual cash flows and these contractual cash flows are solely payments of principle and interest. These receivables will be measured at amortised cost. ***(ii) Impairment*** It is expected that the revised methodology for calculation of impairment will not have a significant impact on the financial statements. The Group will use the simplified approach to determining the expected credit loss provision. ***(iii) Hedge accounting*** As permitted by AASB 9 the group has chosen to continue to apply the hedge accounting requirements of AASB 139 *Financial Instruments: Recognition and Measurement*. The Group will adopt AASB 9 from 1 July 2018. The transition approach to be applied on adoption of AASB 9 has not yet been determined as it is dependent on the Group finalising its assessment.

Title	Effective date (reporting periods beginning on or after...)	Details
AASB 15 *Revenue from Contracts with Customers*	**1 January 2018** (early adoption permitted) Hills Group: Applicable for the year ending 30 June 2019	The standard outlines a single comprehensive model for entities to use in accounting for revenue arising from contracts with customers. The core principle is that an entity recognises revenue to depict the transfer of promised goods and services to customers in an amount that reflects the consideration to which the entity expects to be entitled to receive. The Group is continuing its analysis and assessment of the impact of AASB 15 on its financial results. The preliminary assessment has included an analysis of the specific requirements of the standard and the consideration of material contracts entered into by the Group that give rise to revenue. Sale of goods represent around 83% of total revenue. Product sales include a number of variable considerations such as discounts, rebates and rights of return, which may change the way that revenue is recognised under AASB 15. Services revenue represents around 17% of total revenue. Revenue recognition for contracts within the Hills Health Solutions division may be impacted because of timing differences between invoicing and the delivery of performance obligations. The new standard also introduces expanded disclosure requirements and changes in presentation. These are expected to change the nature and extent of the Group's disclosures about its revenue from contracts with the customer and associated assets, particularly in the year of the adoption of the new standard. The transition approach to be applied on adoption of AASB 15 has not yet been determined as it is dependent on the Group finalising its assessment.
AASB 16 *Leases*	**1 January 2019** (early adoption permitted) Hills Group: Applicable for the year ending 30 June 2020	This standard introduces a single lessee accounting model that eliminates the requirement for leases to be classified as operating or finance leases. The main changes introduced by the new standard include: a) Recognition of a right-to-use asset and liability for all leases (excluding short term leases with less than 12 months of tenure) b) Deprecation of right-to-use assets in-line with AASB 116 *Property, plant and equipment* in profit or loss and unwinding of the liability in principal and interest components; c) Additional disclosure requirements. The Group leases property, motor vehicles and materials handling equipment under operating leases, the accounting for which will be affected by AASB 16. It is expected that this change will have a material impact on the balance sheet particularly via the recognition of the respective right-of-use asset and corresponding liability. It is not practicable to provide a reasonable estimate of the financial effect until a full assessment of the potential impact is completed by the Group. Details of the Group's operating lease commitments at 30 June 2018 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 2018

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

(a) the consolidated financial statements and notes set out on pages 29 to 86 and the Remuneration Report on pages 18 to 27 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 2018 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 & Managing Director, 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 Hill-Ling
Director

Philip Bullock AO
Director

Sydney
27 August 2018

KPMG

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 2018 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 2018;
- 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 Hills Limited (the Company) and the entities it controlled at the year end or 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.

Key Audit Matter

The Key Audit Matters we identified are:

- Valuation of inventories; and
- Revenue cut-off.

Key Audit Matters are those matters that, in our professional judgement, 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.

KPMG, an Australian partnership and a member firm of the KPMG network of independent member firms affiliated with KPMG International Cooperative ("KPMG International"), a Swiss entity.

Liability limited by a scheme approved under Professional Standards Legislation.

<table>
<tr><th colspan="2">Valuation of inventories</th></tr>
<tr><td colspan="2">Inventories $44.043 million – 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 2018, the group held inventory with a net carrying value of $44.043 million.

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.
• Attending year-end stocktakes in significant locations which included observing the process of identifying slow moving and potentially obsolete inventory.
• 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.
• Assessing the level of provision in light of our understanding of the business, and knowledge of the industry in which the Group operates.</td></tr>
</table>

<table>
<tr><th colspan="2">Revenue cut-off</th></tr>
<tr><td colspan="2">Revenue $271.781 million – Note 2</td></tr>
<tr><th>The key audit matter</th><th>How the matter was addressed in our audit</th></tr>
<tr><td>For the year ended 30 June 2018, total revenue for the Group from continuing operations was $271.781 million.

The Group derived revenue from two main sources, being the sale of goods and provision of services.

The audit of revenue cut-off is a key audit matter due to the high number of transactions, and the judgement involved in recording revenue in the appropriate financial period. This includes consideration of when the risks and rewards of ownership have been transferred to the buyer for the sale of goods, or in proportion to the stage of completion for services rendered.</td><td>Our procedures included:
• Assessing the appropriateness of the Group's policies for the recognition of revenue against the requirements of the accounting standards.
• Testing controls with respect to matching of sales invoices to goods delivery notes and sales orders.
• Sample testing significant sales recorded pre and post balance date to check they had been recorded in the correct financial period.
• Obtaining and assessing the appropriateness of management’s adjustment for sales invoiced, but not delivered by balance date.
• Sample testing sales recorded on a percentage of completion basis to obtain evidence that revenue has been recognised based on the progress of the project.</td></tr>
</table>

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 the 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
- assessing the Group and Company's ability to continue as a going concern and whether the use of the going concern basis of accounting is appropriate. 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 and Company 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
- to 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 the 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_responsibilities/ar1.pdf. This description forms part of our Auditor's Report.

Report on the Remuneration Report

Opinion

In our opinion, the Remuneration Report of Hills Limited for the year ended 30 June 2018, complies with *Section 300A of the Corporations Act 2001*.

Directors' 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 included in the Directors' report for the year ended 30 June 2018.

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

KPMG

KPMG

Paul Cenko
Partner

Adelaide

27 August 2018

Hills Limited

Shareholder information

For the year ended 30 June 2018

The shareholder information set out below was applicable as at 11 July 2018.

Distribution of equity securities

Analysis of numbers of ordinary shareholders by size of holding:

Size of holding	Number of holders
1–1000	3,838
1,001–5,000	5,279
5,001–10,000	2,170
10,001–100,000	2,168
100,001 and over	237

There were 6,476 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
Mr Peter J Roach	6,891,872	2.97
Jacaranda Pastoral Pty Ltd	5,868,699	2.53
Mr Gregory V Shalit	4,676,510	2.02
Greybox Holdings Pty Ltd	3,650,042	1.57
Hart Capital Partners	3,434,198	1.48
Mr John R Homewood	3,200,000	1.38
Realindex Investments	3,100,345	1.34
Dimensional Fund Advisors	2,676,153	1.15
Mr James A Middleweek	2,609,826	1.13
Norges Bank Investment Mgt	2,156,565	0.93
Mr & Mrs Alan R Bignell	2,103,530	0.91
AcomeA	2,100,000	0.91
Mr Leonard A Milner	2,000,000	0.86
Mrs Leora Shamgar	1,600,000	0.69
Mr Gregory V Shalit & Ms Miriam Faine	1,435,000	0.62
Mr John Gassner	1,377,501	0.59
Mr & Mrs Joseph Zanca	1,303,750	0.56
Mr Jack G Mordes & Ms Leanne J Howard	1,208,298	0.52

Shareholder information

For the year ended 30 June 2018

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.

Hills Limited

Corporate directory

For the year ended 30 June 2018

Registered office

Unit 1, Building F, 3-29 Birnie Avenue, Lidcombe, NSW 2141

Telephone: (02) 9216 5510

Facsimile: (02) 9216 5999

Web: http://www.hills.com.au

Executives

David John Joseph Lenz, *Chief Executive Officer and Managing Director*

Christopher Stuart Jacka, *Chief Financial Officer*

Non-executive directors

Jennifer Helen Hill-Ling

Fiona Rosalyn Vivienne Bennett

Philip Bullock AO

Kenneth James Dwyer

Company secretary

David Robert Fox

Share registry

Link Market Services Limited

Locked Bag A14, Sydney South, NSW 1235, Australia

Telephone

- Australia: +61 1300 554 474

Facsimile

- Australia and International: +61 2 9287 0303

ASX code: HIL

Email: registrars@linkmarketservices.com.au

Web: www.linkmarketservices.com.au

Notes

For the year ended 30 June 2018

Notes

For the year ended 30 June 2018

Hills Limited

Registered Office
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