

nickscali
L I M I T E D

Annual Report 2019

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Padrone queen bed, bedside table and dresser in solid Australian oak.

nickskali

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Solene 3 seater with chaise lounge in 100% leather.
Ines table nest. Daddy Long Leg floor lamp. Aromer floor rug.

Contents

| | <i>Page</i> | | <i>Page</i> |
|---|-------------|--|-------------|
| Chairman and Managing Director's Review | 5 | Notes to the consolidated financial statements | |
| Directors' Report | 6 | Note 1. Basis of preparation | 22 |
| Auditor's Independence Declaration | 16 | Note 2. Segment information | 24 |
| Consolidated Statement of comprehensive income | 18 | Note 3. Revenue | 24 |
| Consolidated Statement of financial position | 19 | Note 4. Expenses | 24 |
| Consolidated Statement of changes in equity | 20 | Note 5. Income tax expense | 25 |
| Consolidated Statement of cash flows | 21 | Note 6. Earnings per share | 26 |
| Directors' Declaration | 43 | Note 7. Equity – Dividends | 26 |
| Independent Auditor's Report | 44 | Note 8. Reconciliation of profit after income tax to net cash from operating activities | 27 |
| Shareholder Information | 48 | Note 9. Current assets – Cash and cash equivalents | 27 |
| Corporate Information | 51 | Note 10. Current assets – Receivables | 28 |
| | | Note 11. Current assets – Inventories | 28 |
| | | Note 12. Current assets – Other financial assets | 28 |
| | | Note 13. Non-current assets – Property, plant and equipment | 29 |
| | | Note 14. Non-current assets – Intangibles assets | 30 |
| | | Note 15. Current liabilities – Borrowings | 31 |
| | | Note 16. Current liabilities – Payables | 31 |
| | | Note 17. Current liabilities – Deferred revenue | 31 |
| | | Note 18. Current liabilities – Provisions | 32 |
| | | Note 19. Non-current liabilities – Borrowings | 32 |
| | | Note 20. Non-current liabilities – Deferred revenue | 32 |
| | | Note 21. Non-current liabilities – Provisions | 33 |
| | | Note 22. Equity – Issued capital | 33 |
| | | Note 23. Equity – Reserves | 34 |
| | | Note 24. Financing facilities | 35 |
| | | Note 25. Financial instruments | 35 |
| | | Note 26. Fair value measurement | 37 |
| | | Note 27. Key management personnel | 38 |
| | | Note 28. Remuneration of auditors | 38 |
| | | Note 29. Contingent liabilities | 38 |
| | | Note 30. Commitments | 38 |
| | | Note 31. Related party transactions | 39 |
| | | Note 32. Events after the reporting period | 39 |
| | | Note 33. Share-based payments | 39 |
| | | Note 34. Controlled entities | 40 |
| | | Note 35. Parent entity information | 40 |
| | | Note 36. Summary of significant accounting policies | 41 |

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Historical Performance

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Chairman and Managing Director's Review

Operating Performance

We are pleased to report that Nick Scali Limited has had another successful year, delivering a seventh successive year of revenue and profit growth, with earnings per share increasing 2.8% to 52.0 cents per share. In an environment in which same store sales growth has been depressed, earnings growth has been driven by the continuation of our disciplined store rollout program and further improvements in gross margin.

Sales revenue increased by 6.9% to \$268 million. A full year of revenue contribution from the six stores opened in the year ended 30 June 2018 and a part year contribution from the six stores opened during the year ended 30 June 2019, off-set a slight decline in same store sales.

Despite the decline in the value of the Australian Dollar, gross margin increased by 20 basis points to 62.9%, driven by new product initiatives.

Operating expenses increased to \$106 million, which represents 39% of sales revenue, up from 38% in the previous financial year. Costs remain tightly controlled, and this increase in operating expenses as a percentage of sales was due mainly to increased costs associated with new store openings, discretionary marketing investments and non-recurring expenditure, such as the relocation of the Victorian distribution centre, as well as the decline in same store sales.

The Company maintained its effective working capital management throughout the year and as a result, operating cash flow (before tax and interest) was \$63 million, on the back of EBITDA of \$64 million. After allowing for tax and interest, and with the Company requiring less than \$5m for capital projects, \$40m was returned to shareholders in dividends during the year. The Company expects to continue to deliver a strong cash flow result, and with a stable, well-managed balance sheet Nick Scali remains well placed to continue to grow its existing business and to take advantage of any new opportunities that may arise.

Following the opening of the first store in New Zealand in December 2017, a second New Zealand store opened during the year, with the New Zealand business delivering a positive contribution to the Group for the 2019 financial year. This provides a solid platform for the New Zealand business to make a significant contribution to profit growth over the next few years, as further stores are added to the network.

Other notable achievements during the year included the relocation of our Victorian distribution centre to a new purpose-built facility in Keysborough, the introduction of the bedroom and bedding category in 26 of our larger stores in December 2018, and the relocation of stores at Bundall (Qld) and Rutherford (NSW) into larger sites.

The Board recognises that the continued growth of Nick Scali Limited is the result of the dedication of our many employees and associates across Australia and New Zealand, and we would like to thank them for their hard work and commitment to the Company. The Board also takes this opportunity to thank our shareholders, customers and suppliers, whose continuing support underpins the success of the Company.

Store network

In addition to the new store in Hamilton, New Zealand, five new Nick Scali Furniture stores were opened in Australia during the year. These were in Morayfield, Mackay, Brisbane Airport, Prospect and Craigieburn. These openings brought the total number of Nick Scali Furniture stores at 30 June 2019 to 57.

The Company plans to open four new stores in the year to June 2020, including two further stores in New Zealand.

Alongside the Nick Scali Furniture stores, the Company currently operates five clearance stores, in a mixture of permanent and temporary locations, which are selected and managed to best minimise inventory holdings in our distribution centres.

Dividends

The directors declared a fully franked final dividend of 20 cents per share on 8th August 2019. The final dividend has a record date of 8th October 2019 and will be paid on 29th October 2019. This brings the total dividend for the year to 45 cents per share, representing a payout ratio of 87%, which the directors consider appropriately balances the distribution of profit to shareholders with the need to reinvest earnings for future growth.

Outlook

As a furniture retailer, Nick Scali Limited is very dependent on housing sales and renovations, which have been in decline in recent months. Trading conditions will likely only improve when there is an uplift in housing sales and refurbishments, the timing of which is presently uncertain.

Although there is a potentially somewhat favourable economic environment of very low interest rates and relatively low unemployment, same store sales growth continues to be challenging, and a continued period of negative same-store sales growth presents the possibility that the profit benefit from new stores will be offset by negative same-store trading in the short-term.

Directors' Report

The directors present their report, together with the financial statements, on the consolidated entity (referred to hereafter as the 'Group' or 'consolidated entity') consisting of Nick Scali Limited (referred to hereafter as the 'Company' or 'parent entity') and the entities it controlled at the end of, or during, the year ended 30 June 2019.

Directors

The names and details of the Company's directors (referred to hereafter as the 'Board') in office at any time during the financial year or until the date of this report are as follows. Directors were in office for this entire year unless otherwise stated.

John Ingram
Greg Laurie
Carole Molyneux
Stephen Goddard
Anthony Scali

Principal activities

The principal activities of the Group during the year were the sourcing and retailing of household furniture and related accessories.

No significant change in the nature of these activities occurred during the year.

Dividends

Dividends paid during the year were as follows:

| | 2019 \$'000 | 2018 \$'000 |
|---|----------------|----------------|
| Final franked dividend for 30 June 2018: 24.0 cents (2017: 20.0 cents) | 19,440 | 16,200 |
| Interim franked dividend for 30 June 2019: 25.0 cents (2018: 16.0 cents) | 20,250 | 12,960 |
| | <u>39,690</u> | <u>29,160</u> |

In addition to the above dividend, since the end of the financial year directors have declared a fully franked final dividend of 20.0 cents per fully paid ordinary share to be paid on 29 October 2019 out of retained profits at 30 June 2019.

Operating and financial review

Nick Scali Limited is a furniture retailer operating in Australia and New Zealand. Following a strategic review of the business during the previous year, the business operates under a single brand, Nick Scali Furniture.

Group Operating Results

| | 2019 \$m | 2018 \$m | % Change |
|-------------|-------------|-------------|----------|
| Revenue | 268.0 | 250.8 | 6.9% |
| EBITDA | 64.1 | 62.8 | 2.1% |
| EBIT | 59.9 | 59.0 | 1.5% |
| NPAT | 42.1 | 41.0 | 2.8% |
| EPS (cents) | 52.0 | 50.6 | 2.8% |
| DPS (cents) | 45.0 | 40.0 | |
| Net cash | 2.6 | 2.9 | |

For the financial year ended 30 June 2019 the Group reported a record NPAT result of \$42.1m, up 2.8% on the previous year. Sales revenue increased 6.9% to \$268m with the increase derived from a full year's contribution from the six stores opened during financial year 2018 and a smaller contribution from six stores opened during financial year 2019. Same store sales were flat for the first nine months of the year, with a noticeable decline in the fourth quarter.

Although the devaluation of the Australian Dollar adversely impacted the cost of imports, gross margins strengthened by 20 basis points to 62.9% due to the opening of clearance outlets which enabled the Group to dispose of excess inventory in a cost effective manner, and the successful launch of the Company's own accidental damage warranty product.

Despite tight cost control and well managed store openings, operating expenses as a percentage of sales increased due to the decline in same store sales.

Net cash flows from operating activities during the year were \$45.4m, up 5.4% on the previous year. Net cash outflows from all activities were \$0.3m after investment in fixed assets of \$5m.

The Group's working capital position remained strong, and with low debt and stable cash reserves, the Group is well positioned to take advantage of opportunities that may arise, and to remain competitive during any periods of retail uncertainty.

Net assets were \$85.2m as at 30 June 2019, up \$1.5m on last year.

Store network

During the year, the Group opened six new Nick Scali Furniture stores in Mackay (Qld), Morayfield (Qld), Skygate (Qld), Prospect (NSW), Craigieburn (Vic) and the second store in New Zealand, at Hamilton.

The Group anticipates opening between four and six new stores in financial year 2020, with at least two of these opening in the first half of the financial year in New Zealand.

Directors' Report (continued)

People

The Group remains committed to delivering industry best practice across all facets of the business by recruiting and retaining the best in the industry. All employees continue to be developed through a suite of training and leadership development programmes combined with detailed performance assessment. Competitive remuneration packages incorporating both short and long-term incentives ensure that good performance is appropriately rewarded and talent is retained.

The Group has a policy of equal opportunity and advocates diversity in the workplace. The supportive culture underpins the wellbeing of the staff and there are rigorous occupational health and safety practices in place. The Group's human resource and remuneration strategies are designed to ensure that it remains an employer of choice in its retail sector.

Outlook and risks

The Group operates in a competitive retail market which is subject to only moderate barriers to entry and changing consumer preferences. However, the directors continue to believe that the Group is well placed to maintain its market leading position as a result of the robust strategies and structures that are currently in place.

Same store sales were flat for most of the year with a decline in the fourth quarter. This trend has continued into the new financial year and July same store sales growth remained negative.

The performance of the New Zealand stores has been very encouraging with strong same store sales growth reflecting the high level of product and brand acceptance. With the New Zealand store network increasing to four this year, this market should make a significant contribution to profit growth in the medium term.

Whilst there is a favourable economic environment of very low interest rates and low unemployment combined with recent tax cuts, there is uncertainty as to whether this will translate to an improvement in consumer confidence. As a furniture retailer, the Company is very dependent on housing sales and renovations which have been in decline, and trading conditions will likely only materially improve when there is an uplift in housing sales and renovations.

With the store network continuing to grow, the Company has demonstrated it can deliver a solid profit performance in an environment of flat to negative same store sales growth.

Despite the current difficult trading conditions, the Company is well positioned with a strong balance sheet and solid cash flow. This will facilitate the continued growth of its store network and allow the Company to explore other growth opportunities as they arise.

Significant changes in the state of affairs

There were no significant changes in the state of affairs of the Company during the year.

Matters subsequent to the end of the financial year

Apart from the dividend declared as discussed above, no other matter or circumstance has arisen since 30 June 2019 that has significantly affected, or may significantly affect the consolidated entity's operations, the results of those operations, or the consolidated entity's state of affairs in future financial years.

Likely developments and expected results of operations

Refer to the Operating and financial review on page 6.

Environmental regulation

The Company is not subject to any significant environmental regulation under Australian Commonwealth or State law.

The Directors are not aware of any particular or significant environmental issues which have been raised in relation to the consolidated entity's operations during the financial year.

Information on directors

Name: John Ingram
Title: Independent Non-Executive Chairman
Qualifications: AM, FCPA

Experience and expertise:

John was appointed to the Board as non-executive Chairman on 7 April 2004. John was formerly Managing Director of Crane Group Limited.

Other current directorships:

Non-executive Chairman of Shriro Holdings Limited (SHM).

Former directorships (last three years):

Independent Director of Australian Super retired on 1 March 2017.

Special responsibilities:

Member of the Audit Committee and the Remuneration and Human Resources Committee.

Interests in shares: 360,000.

Name: Greg Laurie
Title: Independent Non-Executive Director
Qualifications: BCom, FAICD

Experience and expertise:

Greg was appointed to the Board on 7 April 2004. He has extensive experience in manufacturing and distribution industries, and was the Finance Director of Crane Group Limited from 1989 until his retirement from that role in 2003. Greg has been Chairman of various Audit and Risk Committees since 2004.

Other current directorships:

Independent Non-Executive Director of Shriro Holdings Limited (SHM).

Former directorships (last three years):

Independent Non-Executive Director of Bradken Limited and Independent Chairman of Big River Industries Limited (BRI).

Special responsibilities:

Chairman of the Audit Committee and a member of the Remuneration and Human Resources Committee.

Interests in shares: 30,000.

Directors' Report (continued)

Name: Carole Molyneux
Title: Independent Non-Executive Director

Experience and expertise:

Carole was appointed to the Board on 26 June 2014. She has extensive experience in retail and was the Chief Executive Officer of Suzanne Grae, (part of the Sussan Retail Group), for eighteen years until 2013.

Other current directorships:

Independent Non-Executive Director of White Ribbon Australia.

Former directorships (last three years):

None.

Special responsibilities:

Chairman of the Remuneration and Human Resources Committee and member of the Audit Committee.

Interests in shares: 7,500.

Name: Stephen Goddard
Title: Independent Non-Executive Director

Experience and expertise:

Stephen was appointed to the Board on 1 March 2018. Stephen is an experienced retailer having held a broad range of senior executive positions in the industry. These include Finance Director and Operations Director for David Jones, founding Managing Director of Officeworks, and various senior management roles with Myer.

Other current directorships:

Independent Non-Executive Director of JB Hifi Limited (JBH), GWA Group Limited (GWA) and Accent Group Limited (AX1).

Former directorships (last three years):

Independent Non-executive director of Pacific Brands (PBG) and Surfstitch Group Limited (SRF).

Special responsibilities:

Member of the Audit Committee and Remuneration and Human Resources Committee.

Interests in shares: 6,000.

Name: Anthony Scali
Title: Managing Director

Qualifications: BCom

Experience and expertise:

Anthony is Managing Director of Nick Scali Limited. He joined the Company full-time in 1982 after completing his Bachelor of Commerce degree from the University of New South Wales. Anthony has over 30 years' experience in retail, and the selection and direct sourcing of product from manufacturers both in Australia and overseas.

Other current directorships:

None.

Former directorships (last three years):

None.

Special responsibilities:

As Managing Director, Anthony is responsible for the development and implementation of the Group's strategy for growth, as well as the overall operation of the business.

Interests in shares: 11,039,474.

'Other current directorships' quoted above are current directorships for listed entities only and exclude directorships of all other types of entities, unless otherwise stated.

'Former directorships (last three years)' quoted above are directorships held in the last three years for listed entities only and exclude directorships of all other types of entities, unless otherwise stated.

At the date of this report, no directors held options over ordinary shares.

Company Secretary

The Company Secretary since February 2019 is Christopher Malley. He is a current member of the Institute of Chartered Accountants in England and Wales and began his career in Audit and Advisory with Deloitte in their consumer business practices in London and Sydney. Following ten years with Pepsico International, Christopher's retail career began with MySale PLC before he joined Nick Scali as the General Manager Finance in November 2017.

Special responsibilities of directors

Audit Committee

The members of the Audit Committee are as follows:

- Greg Laurie (Chairman)
- John Ingram
- Carole Molyneux
- Stephen Goddard

Remuneration and Human Resources Committee

The members of the Remuneration and Human Resources Committee are as follows:

- Carole Molyneux (Chairman)
- John Ingram
- Greg Laurie
- Stephen Goddard

Directors' Report (continued)

Meetings of directors

The number of meetings of the Board and of each Board committee held during the year ended 30 June 2019, and the number of meetings attended by each director were:

| | Directors' meetings | | Remuneration and human resources committee | | Audit committee | |
|----------------------------|---------------------|----------|--|----------|-----------------|----------|
| | Held | Attended | Held | Attended | Held | Attended |
| John Ingram | 9 | 9 | 2 | 2 | 4 | 4 |
| Greg Laurie | 9 | 9 | 2 | 2 | 4 | 4 |
| Carole Molyneux | 9 | 9 | 2 | 2 | 4 | 4 |
| Stephen Goddard | 9 | 9 | 2 | 2 | 4 | 4 |
| Anthony Scali ¹ | 9 | 9 | – | – | – | – |

¹ Anthony Scali is not a member of the sub-committees, but was invited to attend these meetings and his attendance was noted in the minutes.

Remuneration Report – Audited

The remuneration report details the key management personnel remuneration arrangements for the consolidated entity, in accordance with the requirements of the Corporations Act 2001 and its Regulations. For the purposes of the report, key management personnel are defined as those persons having authority and responsibility for planning, directing and controlling the major activities of the business.

1. Details of key management personnel

The key management personnel of the consolidated entity consisted of the following directors:

| | |
|------------------------|--------------------------|
| John Ingram | – Non-Executive Chairman |
| Greg Laurie | – Non-Executive Director |
| Carole Molyneux | – Non-Executive Director |
| Stephen Goddard | – Non-Executive Director |
| Anthony Scali | – Managing Director |

And the following executives:

Kevin Fine – Chief Financial Officer & Company Secretary (resigned on 6 February 2019)

Christopher Malley – Chief Financial Officer & Company Secretary (appointed on 6 February 2019)

2. Remuneration strategy

The quality of Nick Scali Limited's directors and executives is a major factor in the overall performance of the consolidated entity. To this end, the consolidated entity believes that an appropriately structured remuneration strategy underpins a performance based culture which in turn drives shareholder returns. The remuneration strategy is designed to attract and retain high quality and committed non-executive directors and employees.

The executive remuneration and reward framework has two components:

- fixed remuneration comprising of salary and superannuation
- variable at risk incentives comprising
 - short-term incentives in the form of a cash based reward
 - long-term incentives in the form of an equity reward

The incentives are designed to deliver value to executives for performance against a combination of profitability and achievement against strategic goals. Short-term incentives motivate employees to achieve outstanding performance and are based on current year predetermined KPIs such as profit after tax, and non-financial activities that achieve short to medium term objectives, while long-term incentives align employees with shareholder interests and are based on maintaining long-term shareholder value using performance measures such as EPS.

Directors' Report (continued)

Remuneration Report – Audited (continued)

3. Remuneration and Human Resources Committee

The Remuneration and Human Resources Committee currently consists of the non-executive Board members and is responsible for:

- reviewing remuneration arrangements and succession planning of senior management, including the Managing Director and engaging external compensation consultants if necessary.
- reviewing and approving any discretionary component of short and long-term incentives for the Managing Director and senior executives.
- recommending to the Board any increase in the remuneration of existing senior employees of the consolidated entity for which Board approval is required.
- recommending to the Board the remuneration of new senior executives appointed by the consolidated entity.
- the setting of overall guidelines for Human Resources policy, within which senior management determines specific policies.
- reviewing the performance of the Board and its sub-committees, with the advice of external parties if appropriate.

The Committee has met twice in the last twelve months. In addition, matters for consideration by the Committee have been dealt with during various Board meetings, where Remuneration and Human Resources Committee members were in attendance.

4. Remuneration structure

In accordance with best practice corporate governance, the structure of non-executive directors and executive remunerations are separate.

4.2.1 Remuneration mix

The Group's executive remuneration is structured as a mix of fixed and variable remuneration through at risk short-term and long-term components. The mix of these components varies for different management levels.

The relative proportion and components of the senior executives total remuneration opportunity for the 2019 financial year was:

| | Base (Fixed) | | STI (Variable) | | LTI (Variable) | | Total | |
|---------------------------------|--------------|------------|----------------|------------|----------------|------------|-----------|------------|
| | \$ | % of Total | \$ | % of Total | \$ | % of Total | \$ | % of Total |
| Anthony Scali | 750,000 | 50 | 750,000 | 50 | – | – | 1,500,000 | 100 |
| Kevin Fine ¹ | 410,000 | 53 | 205,000 | 26 | 164,000 | 21 | 779,000 | 100 |
| Christopher Malley ¹ | 300,000 | 50 | 150,000 | 25 | 150,000 | 25 | 600,000 | 100 |

¹ Amounts for Kevin Fine and Christopher Malley represent annualised amounts and are not adjusted for the period in role.

4.2.2 Fixed remuneration

Fixed compensation is set to provide a base level of compensation which is appropriate to the position and responsibility and is competitive in the market. Fixed compensation is reviewed annually with effect from 1 September each year, by the Remuneration and Human Resources Committee by reviewing the performance of both the business and the individual, skills, experience and comparative market compensation and where appropriate, external advice.

The Group provides superannuation contributions in line with statutory obligations with benefits being delivered to the employee's choice of superannuation fund.

4.1 Non-executive directors' remuneration

Non-executive directors are paid an annual fee, which is periodically reviewed. Non-executive directors do not receive bonuses and they are not entitled to participate in the Executive Performance Rights Plan.

Non-executive chairman and directors' fees remain unchanged for the year ended 30 June 2019 as reflected below:

| | 2019 | 2018 |
|---|---------|---------|
| | \$ | \$ |
| Base fee for Non-Executive Chairman | 200,000 | 200,000 |
| Base fee for Non-Executive Director | 100,000 | 100,000 |
| Fee for Audit Committee Chairman | 17,000 | 17,000 |
| Fee for Audit Committee Member | 5,000 | 5,000 |
| Fee for Remuneration and Human Resources Committee Chairman | 7,000 | 7,000 |
| Fee for Remuneration and Human Resources Committee Member | 3,000 | 3,000 |

The pool for non-executive directors' fees is capped at \$750,000 per year as approved by shareholders at the 2015 Annual General Meeting.

4.2 Executive remuneration

The Group provides appropriate rewards to attract and retain key personnel. Base salaries and short and long-term incentives are established by the Remuneration and Human Resources Committee for each executive having regard to the nature of each role, the experience of the individual employee and the performance of the individual, and are then approved by the Board. External consultants are engaged as appropriate and market information is used to benchmark executive remuneration.

Directors' Report (continued)

Remuneration Report – Audited (continued)

4.2.3 Variable remuneration – Short-term incentives (STI)

The Group operates short-term incentive (STI) programs that reward key management personnel (KMP) on the achievement of predetermined key performance indicators (KPIs) established for each financial year, according to the accountabilities of their role and its impact on the organisation's performance.

KPIs include profit targets and personal performance criteria. Using a profit target ensures variable reward is paid only when value is created for shareholders and when profit meets or exceeds the profit target recommended by the Remuneration and Human Resources Committee for approval by the Board. There are minimum levels of performance to trigger payouts

and the profit targets are linked to a sliding scale set at the beginning of each financial year.

The STI is set as a variable annual incentive, where challenging performance measures are set to incentivise superior performance. The Managing Director may also recommend to the Board discretionary bonuses in exceptional circumstances to reward contributions from high performing employees. The STIs are cash bonuses.

The Remuneration and Human Resources Committee is responsible for assessing whether the KPIs are met. The following table shows the STI cash bonus target and the amount achieved for each KMP in the financial year 2019 and previous year:

| Year ended 30 June 2019 | Total \$ | STI Target | | Total \$ | STI Achieved | |
|----------------------------|----------|-----------------------------------|--------------------------|----------|-----------------------------------|--------------------------|
| | | Financial Measures ¹ % | Non-Financial Measures % | | Financial Measures ¹ % | Non-Financial Measures % |
| Anthony Scali | 750,000 | 80% | 20% | – | – | – |
| Kevin Fine | 205,000 | 100% | – | – | – | – |
| Christopher Malley | 150,000 | 100% | – | – | – | – |

¹ Financial Measures for the financial year 2019 included net profit before tax (excluding STIs)

| Year ended 30 June 2018 | Total \$ | STI Target | | Total \$ | STI Achieved | |
|----------------------------|----------|-----------------------------------|--------------------------|----------|-----------------------------------|--------------------------|
| | | Financial Measures ¹ % | Non-Financial Measures % | | Financial Measures ¹ % | Non-Financial Measures % |
| Anthony Scali | 750,000 | 80% | 20% | 438,000 | 48% | 100% |
| Kevin Fine | 205,000 | 100% | – | 98,400 | 48% | – |

¹ Financial Measures for the financial year 2018 included net profit after tax.

4.2.4 Variable remuneration – Long-term incentives (LTI)

Long-term incentives, in the form of the Executive Performance Rights Plan (EPRP), are provided to employees in order to align remuneration with the creation of shareholder value over the long-term. The EPRP is only made available to executives and other employees who are able to influence the generation of shareholder value and have a direct impact on the Group performance against relevant long-term performance hurdles.

To achieve this purpose, the Board has determined earnings per share growth over a period of time to be the most appropriate measure of performance. The plan operates to grant to employees rights to ordinary shares that will vest after a period of three years from the effective date of the grant subject to the achievement of specific performance hurdles

in relation to earnings per share (EPS) growth, which is not subject to retesting. Earnings per share is based on the Group total profit after tax and before non-recurring items, all as determined by the Board.

Rights to ordinary shares may also be granted in accordance with the EPRP as a retention award where the performance condition is continued employment with the Group to vesting date – no such retention rights were awarded during the 2019 financial year.

There is no exercise price for the shares and the employees are able to exercise the right up to two years following vesting, after which time the right will lapse.

The percentage of performance rights exercisable is dependent on the achievement of specific performance hurdles, as follows:

| Company's compound annual EPS growth | Percentage of rights exercisable |
|--------------------------------------|----------------------------------|
| Below 5% | Nil |
| 5% | 50% |
| Greater than 5% and less than 10% | Pro rata between 50% and 100% |
| 10% | 100% |

Directors' Report (continued)

Remuneration Report – Audited (continued)

The number of rights granted to a senior executive is then calculated by taking the relevant executive's fixed annual remuneration and multiplying it by the relevant predetermined LTI entitlement percentage of fixed remuneration and then dividing this by the Group's volume weighted average share price for the four week period prior to the date of the release of the Group's full year results.

The LTI entitlement of executives considered KMPs is calculated as a percentage of fixed annual remuneration as follows:

- Anthony Scali: 0%
- Christopher Malley: 50%

4.3 Group performance

The table below sets out the financial performance of the Company over the past five years:

| | | 2015 | 2016 | 2017 | 2018 | 2019 | CAGR (%) |
|-----------------------------------|-------|-------|-------|-------|-------|-------|----------|
| Revenue | \$m | 155.7 | 203.0 | 232.9 | 250.8 | 268.0 | 14.5 |
| EBITDA | \$m | 25.9 | 40.1 | 55.7 | 62.8 | 64.1 | 25.4 |
| Net profit after tax | \$m | 17.1 | 26.1 | 37.2 | 41.0 | 42.1 | 25.3 |
| Earnings per share | Cents | 21.1 | 32.3 | 46.0 | 50.6 | 52.0 | 25.3 |
| Ordinary dividends per share | Cents | 15.0 | 23.0 | 34.0 | 40.0 | 45.0 | 31.6 |
| Share price at financial year end | \$ | 3.10 | 4.68 | 6.09 | 6.73 | 6.26 | 19.2 |
| Stores | # | 46 | 47 | 50 | 55 | 62 | |
| Basic earnings per share growth | % | 19.9 | 53.1 | 42.4 | 10.1 | 2.8 | |

4.4 Remuneration outcomes

The tables below set out the remuneration outcomes for the KMPs for the years ended 30 June 2019 and 30 June 2018 respectively:

| Year ended | Salary & fees | Short-term benefits Cash incentive ³ | Share-based payments Share rights | Post-employment benefits Superannuation | Long-term benefits Long service leave | Total |
|--|---------------|--|--------------------------------------|--|--|-----------|
| 30 June 2019 | \$ | \$ | \$ | \$ | \$ | \$ |
| <i>Non-Executive Directors:</i> | | | | | | |
| John Ingram | 182,648 | – | – | 17,352 | – | 200,000 |
| Greg Laurie | 109,589 | – | – | 10,411 | – | 120,000 |
| Carole Molyneux | 102,283 | – | – | 9,717 | – | 112,000 |
| Stephen Goddard | 98,630 | – | – | 9,370 | – | 108,000 |
| <i>Executive Directors:</i> | | | | | | |
| Anthony Scali | 729,589 | 438,000 | – | 20,049 | 11,984 | 1,199,622 |
| <i>Other Key Management Personnel:</i> | | | | | | |
| Kevin Fine ¹ | 367,901 | 98,400 | 48,208 | 12,909 | – | 527,418 |
| Christopher Malley ² | 103,203 | – | – | 8,743 | – | 111,946 |
| | 1,693,843 | 536,400 | 48,208 | 88,551 | 11,984 | 2,378,986 |

¹ Kevin Fine resigned as Chief Financial Officer and Company Secretary on 6 February 2019.

² Christopher Malley was appointed as Chief Financial Officer and Company Secretary on 6 February 2019. Remuneration outcomes for Christopher Malley relate only to the period subsequent to this appointment.

³ Short-term benefits paid during the year ended 30 June 2019 comprise STIs achieved in the year ended 30 June 2018.

Directors' Report (continued)

Remuneration Report – Audited (continued)

4.4 Remuneration outcomes (continued)

| Year ended | Salary & fees | Short-term benefits Cash incentive ² | Share-based payments Share rights | Post-employment benefits Superannuation | Long-term benefits Long service leave | Total |
|--|---------------|--|--------------------------------------|--|--|-----------|
| 30 June 2018 | \$ | \$ | \$ | \$ | \$ | \$ |
| <i>Non-Executive Directors:</i> | | | | | | |
| John Ingram | 200,000 | – | – | – | – | 200,000 |
| Greg Laurie | 109,589 | – | – | 10,411 | – | 120,000 |
| Carole Molyneux | 102,283 | – | – | 9,717 | – | 112,000 |
| Stephen Goddard ¹ | 30,441 | – | – | 2,892 | – | 33,333 |
| <i>Executive Directors:</i> | | | | | | |
| Anthony Scali | 668,720 | 560,000 | – | 20,049 | 39,324 | 1,288,093 |
| <i>Other Key Management Personnel:</i> | | | | | | |
| Kevin Fine | 390,042 | 193,125 | 139,579 | 20,049 | – | 742,795 |
| | 1,501,075 | 753,125 | 139,579 | 63,118 | 39,324 | 2,496,221 |

¹ Stephen Goddard was appointed as Non-Executive Director on 1 March 2018.

² Short-term benefits paid during the year ended 30 June 2018 comprise STIs achieved in the year ended 30 June 2017.

4.5 Service Agreements

Details of the service agreements between the Company and executives considered KMPs, are as follows:

| Name | Title | Term of agreement | Base salary including superannuation | Termination benefit |
|--------------------|---|-------------------------------------|--------------------------------------|----------------------|
| Anthony Scali | Managing Director | Ongoing, commencing 24 May 2004 | \$750,000 | – |
| Christopher Malley | Chief Financial Officer & Company Secretary | Ongoing, commencing 6 February 2019 | \$300,000 | 3 months base salary |

4.6 Performance rights granted

The terms and conditions of each grant of performance rights to ordinary shares affecting the remuneration of key executives in this financial year, or future reporting years, are as follows:

| Grant reference | Grant date ¹ | Vesting and exercisable date ² | Expiry date | Exercise price (\$) | Fair value per right at grant date (\$) | Vested and exercised 30 June 2019 | Vested and exercised 30 June 2018 |
|-----------------|-------------------------|---|-------------|---------------------|---|-----------------------------------|-----------------------------------|
| FY19/21 | 31 Aug 2018 | Aug 2021 | 30 Jun 2023 | 0.00 | 5.39 | – | – |
| FY18/20 | 31 Aug 2017 | Aug 2020 | 30 Jun 2022 | 0.00 | 5.00 | – | – |
| FY17/19 | 22 Nov 2016 | Aug 2019 | 30 Jun 2021 | 0.00 | 4.36 | – | – |

¹ The grant date is the date at which the performance rights are communicated to the employees. The effective date of the grant, from which the performance hurdles are measured, is the first day of the financial year in which the grant is made.

² The exact vesting and exercisable date is currently indeterminate, and depends on the date of meeting at which the Board can confirm the achievement of the long-term performance hurdles. This is typically six to eight weeks following the end of the financial year.

4.7 Performance rights holding

The table below sets out the balance of performance rights held by KMPs:

| | Balance 30 June 2018 | Granted | Vested and exercised | Forfeited | Balance 30 June 2019 |
|-------------------------|----------------------|---------|----------------------|-----------|----------------------|
| Anthony Scali | – | – | – | – | – |
| Kevin Fine ¹ | 106,310 | 23,993 | (45,876) | (51,258) | 33,169 |
| Christopher Malley | – | – | – | – | – |
| | Balance 30 June 2017 | Granted | Vested and exercised | Forfeited | Balance 30 June 2018 |
| Anthony Scali | – | – | – | – | – |
| Kevin Fine | 79,045 | 27,265 | – | – | 106,310 |

¹ Upon his resignation on 6 February 2019, Kevin Fine held 84,427 performance rights. It was determined by the Board that only those rights with a vesting date after 1 September 2019 would be forfeited, and all other rights would remain exercisable in August 2019.

Directors' Report (continued)

Remuneration Report – Audited (continued)

4.8 Additional disclosures relating to key management personnel

Interest in the Shares of the Company

The beneficial interest of each Director in the contributed equity of the Company are as follows:

| | Balance at 30 June 2018 | Received as part of remuneration | Purchases | Disposals | Balance at 30 June 2019 |
|---|-------------------------------|--|-----------|-----------|-------------------------------|
| <i>Ordinary shares</i> | | | | | |
| John Ingram | 310,000 | – | 50,000 | – | 360,000 |
| Greg Laurie | 30,000 | – | – | – | 30,000 |
| Stephen Goddard | 6,000 | – | – | – | 6,000 |
| Billcar Pty Ltd ¹ | – | – | 7,500 | – | 7,500 |
| Scali Consolidated Pty Ltd ² | 11,039,474 | – | – | – | 11,039,474 |
| | 11,385,474 | – | 57,500 | – | 11,442,974 |

¹ Billcar Pty Ltd is a director related entity of Carole Molyneux.

² Scali Consolidated Pty Ltd is a director related entity of Anthony Scali.

This concludes the remuneration report, which has been audited.

Indemnity and insurance of officers

During the financial year, the Company has indemnified all the directors and executive officers against certain liabilities incurred as such by a director or officer, while acting in that capacity. The premiums have not been determined on an individual director or officer basis.

The directors have not included details of the nature of the liabilities covered or the amount of the premium paid in respect of the directors' and officers' liability insurance contract, as such disclosure is prohibited under the terms of the contract.

No other agreement to indemnify directors or officers have been entered into, nor have any payments in relation to indemnification been made, during or since the end of the financial year, by the Company.

Indemnity and insurance of auditor

To the extent permitted by law, the Company has agreed to indemnify its auditors, Ernst & Young Australia (EY), as part of the terms of audit engagement agreement against claims by third parties arising from the audit (for an unspecified amount) – except for any loss in respect of any matters which are finally determined to have resulted from EY's negligent, wrongful or wilful acts or omissions. No payment has been made to indemnify EY during or since the financial year.

Proceedings on behalf of the Company

No person has applied to the Court under section 237 of the Corporations Act 2001 for leave to bring proceedings on behalf of the Company, or to intervene in any proceedings to which the Company is a party for the purpose of taking responsibility on behalf of the Company for all or part of those proceedings.

Officers of the Company who are former partners of Ernst & Young

There are no officers of the Company who are former partners of Ernst & Young.

Corporate Governance Statement

Nick Scali Limited's Corporate Governance Statement discloses how the Company complies with the recommendations of the ASX Corporate Governance Council (3rd Edition) and sets out the Group's main corporate governance practices. This statement has been approved by the Board and is current as at 30 June 2019. The Corporate Governance Statement of Nick Scali Limited can be found on the Company's website: www.nickscali.com.au/corporate-governance.

Rounding of amounts

The Company is of a kind referred to in Class Order 2016/191, issued by the Australian Securities and Investments Commission, relating to 'rounding-off'. Amounts in this report have been rounded off in accordance with that Class Order to the nearest thousand dollars, or in certain cases, the nearest dollar.

Non-audit services

The following non-audit services were provided by the entity's auditor, Ernst & Young Australia. The directors are satisfied that the provisions of non-audit services is compatible with the general standard of independence for auditors imposed by the Corporations Act 2001. The nature and scope of each type of non-audit service provided means the auditor independence was not compromised.

Ernst & Young Australia received or are due to receive \$17,500 for the provision of non-audit services relating to tax review services.

Directors' Report (continued)

Auditor's independence declaration

The Directors received the declaration from the auditor of Nick Scali Limited and is included on page 16 of the Financial Statements.

Auditor

Ernst & Young continues in office in accordance with section 327 of the Corporations Act 2001.

This report is made in accordance with a resolution of directors, pursuant to section 298(2)(a) of the Corporations Act 2001.

On behalf of the directors



John Ingram
Chairman



Anthony Scali
Managing Director

8 August 2019
Sydney

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Agoura queen bed, bedside table and dresser in full acacia.
Benjamin floor lamp. Zeya floor rug.

Auditor's Independence Declaration



**Building a better
working world**

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Auditor's Independence Declaration to the Directors of Nick Scali Limited

As lead auditor for the audit of the financial report of Nick Scali Limited for the financial year ended 30 June 2019, I declare to the best of my knowledge and belief, there have been:

- a) no contraventions of the auditor independence requirements of the *Corporations Act 2001* in relation to the audit; and
- b) no contraventions of any applicable code of professional conduct in relation to the audit.

This declaration is in respect of Nick Scali Limited and the entities it controlled during the financial year.

Ernst & Young

Lisa Nijssen-Smith
Partner
8 August 2019

A member firm of Ernst & Young Global Limited
Liability limited by a scheme approved under Professional Standards Legislation

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Consolidated statement of comprehensive income

For the year ended 30 June 2019

| | Note | 2019 \$'000 | 2018 \$'000 |
|--|------|----------------|----------------|
| Revenue from contracts with customers | 3 | 268,025 | 250,768 |
| Cost of goods sold | | (99,385) | (93,562) |
| Gross profit | | 168,640 | 157,206 |
| Other income | 3 | 2,185 | 1,948 |
| Expenses | | | |
| Marketing expenses | | (21,390) | (19,007) |
| Employment expenses | 4 | (38,128) | (36,255) |
| General and administration expenses | | (10,739) | (9,364) |
| Property expenses | | (33,933) | (29,935) |
| Distribution expenses | | (1,679) | (1,027) |
| Depreciation and amortisation | | (4,253) | (3,780) |
| Finance costs | | (1,053) | (928) |
| Profit before income tax expense | | 59,650 | 58,858 |
| Income tax expense | 5 | (17,534) | (17,879) |
| Profit after income tax expense for the year attributable to the owners of Nick Scali Limited | | 42,116 | 40,979 |
| Other comprehensive income | | | |
| <i>Items that may be reclassified subsequently to profit or loss</i> | | | |
| Exchange differences on translation of foreign operations | | 7 | (1) |
| Net change in the fair value of cash flow hedges taken to equity, net of tax | | (543) | 1,404 |
| Other comprehensive income for the year, net of tax | | (536) | 1,403 |
| Total comprehensive income for the year attributable to the owners of Nick Scali Limited | | 41,580 | 42,382 |
| | | CENTS | CENTS |
| Basic earnings per share | 6 | 52.0 | 50.6 |
| Diluted earnings per share | 6 | 52.0 | 50.6 |

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

Consolidated statement of financial position

As at 30 June 2019

| | Note | 2019 \$'000 | 2018 \$'000 |
|--------------------------------|------|----------------|----------------|
| Assets | | | |
| Current assets | | | |
| Cash and cash equivalents | 9 | 36,284 | 36,585 |
| Receivables | 10 | 1,108 | 1,863 |
| Inventories | 11 | 37,597 | 36,175 |
| Other financial assets | 12 | 679 | 1,453 |
| Prepayments | | 1,869 | 979 |
| Total current assets | | 77,537 | 77,055 |
| Non-current assets | | | |
| Property, plant and equipment | 13 | 92,664 | 91,888 |
| Intangibles assets | 14 | 2,378 | 2,378 |
| Total non-current assets | | 95,042 | 94,266 |
| Total assets | | 172,579 | 171,321 |
| Liabilities | | | |
| Current liabilities | | | |
| Borrowings | 15 | 13,600 | 20,362 |
| Payables | 16 | 17,479 | 17,658 |
| Deferred revenue | 17 | 26,323 | 26,397 |
| Current tax liabilities | | 362 | 1,308 |
| Provisions | 18 | 3,405 | 2,953 |
| Total current liabilities | | 61,169 | 68,678 |
| Non-current liabilities | | | |
| Borrowings | 19 | 20,062 | 13,300 |
| Deferred revenue | 20 | 171 | - |
| Provisions | 21 | 5,805 | 4,880 |
| Deferred tax | 5 | 189 | 800 |
| Total non-current liabilities | | 26,227 | 18,980 |
| Total liabilities | | 87,396 | 87,658 |
| Net assets | | 85,183 | 83,663 |
| Equity | | | |
| Issued capital | 22 | 3,364 | 3,364 |
| Reserves | 23 | 530 | 1,436 |
| Retained profits | | 81,289 | 78,863 |
| Total equity | | 85,183 | 83,663 |

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 2019

| | Issued capital \$'000 | Equity benefits reserve \$'000 | Capital profits reserve \$'000 | Cash flow hedge reserve \$'000 | Foreign exchange reserve \$'000 | Retained profits \$'000 | Total equity \$'000 |
|--|-----------------------------|---|---|---|--|-------------------------------|---------------------------|
| Balance at 1 July 2017 | 3,364 | 284 | 78 | (386) | – | 67,044 | 70,384 |
| Profit after income tax expense for the year | – | – | – | – | – | 40,979 | 40,979 |
| Other comprehensive income for the year, net of tax | – | – | – | 1,404 | (1) | – | 1,403 |
| Total comprehensive income for the year | – | – | – | 1,404 | (1) | 40,979 | 42,382 |
| Share-based payments (note 33) | – | 57 | – | – | – | – | 57 |
| Dividends paid (note 7) | – | – | – | – | – | (29,160) | (29,160) |
| Balance at 30 June 2018 | 3,364 | 341 | 78 | 1,018 | (1) | 78,863 | 83,663 |
| Balance at 1 July 2018 | 3,364 | 341 | 78 | 1,018 | (1) | 78,863 | 83,663 |
| Profit after income tax expense for the year | – | – | – | – | – | 42,116 | 42,116 |
| Other comprehensive income for the year, net of tax | – | – | – | (543) | 7 | – | (536) |
| Total comprehensive income for the year | – | – | – | (543) | 7 | 42,116 | 41,580 |
| Share-based payments (note 33) | – | (370) | – | – | – | – | (370) |
| Dividends paid (note 7) | – | – | – | – | – | (39,690) | (39,690) |
| Balance at 30 June 2019 | 3,364 | (29) | 78 | 475 | 6 | 81,289 | 85,183 |

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

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Consolidated statement of cash flows

For the year ended 30 June 2019

| | Note | 2019 \$'000 | 2018 \$'000 |
|--|------|-----------------|-----------------|
| Cash flows from operating activities | | | |
| Receipts from customers | | 295,766 | 274,178 |
| Payments to suppliers and employees | | (232,425) | (214,555) |
| | | 63,341 | 59,623 |
| Interest received | | 827 | 750 |
| Income taxes paid | | (18,805) | (17,323) |
| Net cash from operating activities | 8 | 45,363 | 43,050 |
| Cash flows from investing activities | | | |
| Purchase of property, plant and equipment | 13 | (5,283) | (28,821) |
| Proceeds from the sale of plant and equipment | | 362 | - |
| Net cash used in investing activities | | (4,921) | (28,821) |
| Cash flows from financing activities | | | |
| Payment of dividends on ordinary shares | 7 | (39,690) | (29,160) |
| Proceeds from borrowings | | - | 12,500 |
| Interest paid | | (1,053) | (928) |
| Net cash used in financing activities | | (40,743) | (17,588) |
| Net decrease in cash and cash equivalents | | (301) | (3,359) |
| Cash and cash equivalents at the beginning of the financial year | | 36,585 | 39,944 |
| Cash and cash equivalents at the end of the financial year | 9 | 36,284 | 36,585 |

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

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Notes to the consolidated financial statements

For year ended 30 June 2019

Note 1. Basis of preparation

Corporate information

Nick Scali Limited (the Company or the parent) is a for profit company limited by shares incorporated in Australia whose shares are publicly traded on the Australian Stock Exchange.

Basis of preparation

These general purpose financial statements have been prepared in accordance with Australian Accounting Standards and Interpretations issued by the Australian Accounting Standards Board ('AASB') and the Corporations Act 2001. These financial statements also comply with International Financial Reporting Standards as issued by the International Accounting Standards Board ('IASB'). The financial statements have been prepared under the historical cost convention, except for derivative financial instruments, which have been prepared at fair value. The financial report was authorised for issue in accordance with a resolution of the directors on 8 August 2019.

Basis of consolidation

The consolidated financial statements comprise the financial statements of the Company and its subsidiaries as at 30 June 2019. A subsidiary is an entity that is controlled by the Company. The Company controls an entity when it 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 over the entity.

The financial statements of the subsidiaries are included in the consolidated financial statements from the date on which control commences until the date on which control ceases. Intercompany transactions, balances and unrealised gains on transactions between the Company and its subsidiaries are eliminated. Accounting policies of the subsidiaries are consistent with the policies adopted by the Company.

Changes in accounting policies, accounting standards and interpretations

The accounting policies adopted in the preparation of the annual financial statements are consistent with those followed in the preparation of the annual financial statements for the period 30 June 2018, except as noted below.

AASB 9 Financial Instruments

The Group early adopted the hedge accounting components of the standard in relation to its forward exchange contracts on 1 July 2016, and has adopted the standard in full on 1 July 2018.

The Group's financial assets are classified, at initial recognition, and subsequently measured at amortised cost, and fair value through profit and loss, depending on the financial asset's contractual cash flow characteristics and the Group's business model to manage them.

The Group's financial liabilities are classified, at initial recognition, as financial liabilities at fair value through profit or loss, loans and borrowings, payables, or as derivatives designated as hedging instruments in an effective hedge, as appropriate. All financial liabilities are recognised initially at fair value and, in the case of loans and borrowings and payables, net of directly attributable transaction costs. Financial liabilities are subsequently measured depending on their categorisation, as follows:

Loans and borrowings

After initial recognition, interest-bearing loans and borrowings are subsequently measured at amortised cost.

Derivatives designated as hedging instruments

The Group uses derivative financial instruments, such as forward currency contracts to hedge its foreign currency risks. Such derivative financial instruments are initially recognised at fair value on the date on which a derivative contract is entered into and are subsequently remeasured at fair value through profit and losses.

For the purpose of hedge accounting, hedges are classified as fair value hedges when hedging the exposure to changes in the fair value of a recognised asset or liability or an unrecognised firm commitment, or cash flow hedges when hedging the exposure to variability in cash flows that is attributable to a particular risk associated with a highly probable forecast transaction.

At the inception of a hedge relationship, the Group formally designates and documents the hedge relationship to which it wishes to apply hedge accounting and the risk management objective and strategy for undertaking the hedge. Hedges that meet the qualifying criteria for hedge accounting are accounted for as a fair value hedge or a cash flow hedge.

AASB 15 Revenue from contracts with customers

This standard was adopted by the Company on 1 July 2018.

Revenue is recognised at an amount that reflects the consideration to which the Group is expected to be entitled in exchange for transferring goods to a customer. For each contract with a customer, the Group identifies the contract with a customer; identifies the performance obligations in the contract; determines the transaction price; allocates the transaction price to the performance obligations; and recognises revenue when or as each performance obligation is satisfied in a manner that depicts the transfer to the customer of the goods promised. Revenue from contracts with the Group's customers is recognised when control of the related goods or services are transferred to the customer, generally on delivery of the goods to the customer.

The Group recognises as revenue an amount that reflects the consideration to which it expects to be entitled in exchange for the goods, and considers whether its contracts with customers contain further separate performance obligations to which a portion of the transaction price should be allocated. The Group's normal credit terms are payment on delivery.

Notes to the consolidated financial statements for year ended 30 June 2019 (continued)

Significant accounting judgements, estimates and assumptions

In the process of applying the Company's accounting policies, management has made judgements, estimates and assumptions. All judgements, estimates and assumptions made are believed to be reasonable, based on the most current information available to management. Actual results may differ from these judgements, estimates and assumptions. Judgements, estimates and assumptions which have the most significant effect on the amounts recognised in the financial statements:

Operating Lease Commitments

The Company has entered into commercial property leases for its stores. The Company has determined that the lessors retain all the significant risks and rewards of ownership of these properties and has thus classified the leases as operating leases.

Impairment of goodwill

The Company determines whether goodwill is impaired on an annual basis. This requires an estimation of the recoverable amount of the cash-generating unit to which the goodwill is allocated. The assumptions used in this estimation of recoverable amount and the carrying amount of goodwill is discussed in the financial report.

Estimation of useful lives of assets

The estimation of the useful lives of assets has been based on historical experience as well as consideration of lease terms (for assets used in or affixed to leased premises) and replacement policies (for motor vehicles). In addition, the condition of the assets is assessed at least once per year and considered against the remaining useful life. Adjustments to useful lives are made when considered necessary.

Net realisable value of inventory

Inventories are valued at the lower of cost and net realisable value. Weighted average cost is used to value inventories. Costs incurred in bringing each product to its present location and condition including freight, cartage and import duties are included in the cost of finished goods.

Net realisable value is the estimated selling price in the ordinary course of business, less estimated costs necessary to make the sale. Judgment is applied in assessing the net realisable value.

New accounting standards and interpretations not yet mandatory

The Groups assessment of the impact of new and revised accounting standards, which are not yet effective, is set out below.

AASB 16 Leases

This standard includes requirements to improve the recognition, measurement and presentation of leases, and applies to annual reporting periods beginning on or after 1 January 2019.

AASB 16 Leases will replace existing accounting requirements for leases under AASB 117 and will result in the recognition of a right-of-use asset and an associated lease liability in the consolidated statement of financial position in respect of each of the Group's property leases. Subsequently, an interest expense will be recognised in relation to the lease liabilities and depreciation will be charged for the right-of-use assets.

The Group's current accounting policy for leases, under AASB 117, requires that operating leases are recognised as an expense in the statement of comprehensive income on a straight line basis over the term of the lease. This policy results in deferred lease incentives being recorded as a liability in the statement of financial position.

The new standard will be adopted by the Company on 1 July 2019, using the modified retrospective approach and will have a material impact on the Group's financial statements. When adopting the new standard, the Company will measure the right-of-use asset at the date of implementation as if the standard had been applied since the commencement date, but discounted using the company's incremental borrowing rate at the date of implementation. The cumulative effect of this approach will be recognised as an adjustment to equity on 1 July 2019, and the Company will not be required to restate any of comparative information in the Group's financial statements for the year ended 30 June 2020.

At the reporting date, the Group had 59 property leases for retail stores and warehouse facilities across Australia and New Zealand, and the impact of the standard on the Group's financial statements is dependent on the Group's borrowing rate and management's view of the likelihood of exercising future lease options. The Company has assessed these factors and the estimated impact of adopting the standard at 1 July 2019 will be the recognition of a right-of-use asset of between \$180 million and \$200 million (within property, plant and equipment), and an increase in lease liabilities of between \$200 million and \$220 million. The net difference between these balances, will be recognised as an adjustment to retained profits.

Based on the Group's current lease portfolio, the adoption of the standard is not expected to have a material impact on net profit after tax for the year ending 30 June 2020.

The practical expedients that have been adopted under this approach, and which will be used by the Group in its implementation of AASB 16, are to apply a single discount rate to the entire portfolio of leases and to exclude initial direct costs incurred on establishment of existing leases.

Notes to the consolidated financial statements for year ended 30 June 2019 (continued)

Note 2. Segment information

The Company has identified the Managing Director and the Board of Directors as the chief operating decision makers. The Company has one reportable segment being the retailing of furniture in Australia and New Zealand.

| | 2019 \$'000 | 2018 \$'000 |
|---|----------------|----------------|
| Note 3. Revenue | | |
| Revenue | | |
| Revenue from contracts with customers | 268,025 | 250,768 |
| Other revenue | | |
| Rent received | 1,085 | 790 |
| Interest income | 827 | 750 |
| Net gain on disposal of plant and equipment | 31 | - |
| Sundry income | 242 | 408 |
| Total other revenue | 2,185 | 1,948 |

Recognition and measurement – Revenue and income recognition

Revenue is recognised at an amount that reflects the consideration to which the consolidated entity is expected to be entitled in exchange for transferring goods or services to a customer. Revenue is recognised for major business activities as follows:

Sale of goods

When recognising revenue in relation to the sale of goods to customers, the key performance obligation of the consolidated entity is considered to be the point of delivery of the goods to the customer, as this is deemed to be the time that the customer obtains control of the promised goods.

| | 2019 \$'000 | 2018 \$'000 |
|--|----------------|----------------|
| Note 4. Expenses | | |
| Profit before income tax includes the following specific expenses: | | |
| <i>Included within employee benefits expenses</i> | | |
| Salaries and wages | 30,376 | 28,604 |
| Superannuation expense | 2,751 | 2,695 |
| Share-based payments | 102 | 280 |
| Other ¹ | 4,899 | 4,676 |
| | 38,128 | 36,255 |

¹ Other employee benefits include commissions, payroll tax, workers compensation and contract staff.

Included within property expenses

| | | |
|--------------------------|--------|--------|
| Operating lease payments | 28,224 | 23,975 |
|--------------------------|--------|--------|

Recognition and measurement – Expenses

Leases and operating leases

Leases are classified at their inception as either operating or finance leases based on the economic substance of the agreement so as to reflect the risks and benefits incidental to ownership. Leases where the lessor retains substantially all the risks and benefits of ownership of the asset are classified as operating leases. Operating leases are recognised as an expense in the statement of comprehensive income on a straight-line basis over the lease term of the lease.

| | 2019 | 2018 |
|---|------|------|
| <i>Number of employees</i> | | |
| Number of full-time and part-time employees at balance date | 515 | 468 |

Notes to the consolidated financial statements for year ended 30 June 2019 (continued)

| | 2019 \$'000 | 2018 \$'000 |
|---|----------------|----------------|
| Note 5. Income tax expense | | |
| Income tax expense | | |
| Current income tax charge | 17,385 | 17,401 |
| Adjustments in respect of current income tax of previous years | (200) | 193 |
| Relating to origination and reversal of temporary differences | 349 | 285 |
| Aggregate income tax expense | <u>17,534</u> | <u>17,879</u> |
| Numerical reconciliation of income tax expense and tax at the statutory rate | | |
| Profit before income tax expense | <u>59,650</u> | <u>58,858</u> |
| Tax at the statutory tax rate of 30% | 17,895 | 17,657 |
| Adjustments in respect of current income tax of previous years | (200) | 193 |
| Adjustment for difference in overseas tax rates | (9) | 1 |
| Adjustment for share rights exercised | (128) | 10 |
| Other items | (24) | 18 |
| Income tax expense | <u>17,534</u> | <u>17,879</u> |
| Deferred tax recognised comprises temporary differences attributable to: | | |
| Deferred capital gains | (1,612) | (1,612) |
| Property, plant and equipment | (1,534) | (1,572) |
| Inventory | 190 | 202 |
| Employee entitlements | 1,099 | 1,092 |
| Deferred lease incentives | 1,486 | 1,101 |
| Lease make good provisions | 166 | 156 |
| Cashflow hedge (Note 24) | (204) | (436) |
| Future share rights | 187 | - |
| Other | 33 | 269 |
| Total deferred tax liability | <u>(189)</u> | <u>(800)</u> |

Recognition and measurement – Income tax

Current tax assets and liabilities for the current and prior years are measured at the amount expected to be recovered from or paid to the taxation authorities. The tax rates and tax laws used to compute the amount are those that are enacted or substantively enacted by the reporting date.

Deferred income tax is provided on all temporary differences at the reporting date between the tax bases of assets and liabilities and their carrying amounts for financial reporting purposes. Deferred income tax, assets and liabilities are measured at the tax rates that are expected to apply to the year when the asset is realised or the liability is settled, based on tax rates (and tax laws) that have been enacted or substantively enacted at the reporting date.

Income taxes relating to items recognised directly in equity are recognised in equity and not in profit or loss. Deferred tax assets and deferred tax liabilities are offset only if a legally enforceable right exists to set off current tax assets against current tax liabilities and the deferred tax assets and liabilities relate to the same taxable entity and the same taxation authority.

Notes to the consolidated financial statements for year ended 30 June 2019 (continued)

| | 2019 \$'000 | 2018 \$'000 |
|---|----------------|----------------|
| Note 6. Earnings per share | | |
| Profit after income tax attributable to the owners of Nick Scali Limited | 42,116 | 40,979 |
| | Number | Number |
| Weighted average number of ordinary shares used in calculating basic earnings per share | 81,000,000 | 81,000,000 |
| Weighted average number of ordinary shares used in calculating diluted earnings per share | 81,000,000 | 81,000,000 |
| | Cents | Cents |
| Basic earnings per share | 52.0 | 50.6 |
| Diluted earnings per share | 52.0 | 50.6 |

Recognition and measurement – Earnings per share

Basic earnings per share

Basic earnings per share (EPS) is calculated as net profit attributable to members, adjusted to exclude costs of servicing equity (other than dividends), divided by the weighted average number of ordinary shares, adjusted for any bonus element.

Diluted earnings per share

Diluted EPS adjusts the Basic EPS to take account of the after tax effect of dividends and interest associated with dilutive potential ordinary shares that have been recognised as expenses; and other costs associated with dilutive potential ordinary shares and the weighted average number of shares assumed to have been issued for no consideration.

| | 2019 \$'000 | 2018 \$'000 |
|--|----------------|----------------|
| Note 7. Equity – Dividends | | |
| Dividends | | |
| Dividends paid during the financial year were as follows: | | |
| Final fully franked dividend for 30 June 2018: 24.0 cents (2017: 20.0 cents) | 19,440 | 16,200 |
| Interim fully franked dividend for 30 June 2019: 25.0 cents (2018: 16.0 cents) | 20,250 | 12,960 |
| | 39,690 | 29,160 |

In addition to the above dividend, since the end of the financial year directors have declared a final fully franked dividend of 20.0 cents per fully paid ordinary share to be paid on 29 October 2019 out of retained profits at 30 June 2019.

Franking credits

| | | |
|--|--------|--------|
| Franking credits available at the reporting date based on a tax rate of 30% | 32,790 | 30,996 |
| Franking credits that will arise from the payment of the amount of the provision for income tax at the reporting date based on a tax rate of 30% | 114 | 1,488 |
| Franking credits available for subsequent financial years based on a tax rate of 30% | 32,904 | 32,484 |
| Franking credits available for future reporting periods based on a tax rate of 30% | 25,961 | 24,152 |

The above amounts represent the balance of the franking account as at the end of the financial year, adjusted for:

- franking credits that will arise from the payment of the amount of the provision for income tax at the reporting date
- franking debits that will arise from the payment of dividends recognised as a liability at the reporting date
- franking credits that will arise from the receipt of dividends recognised as receivables at the reporting date

The tax rate at which paid dividends have been franked is 30% (30 June 2018: 30%).

Dividends declared and unpaid will be franked at the rate of 30% (30 June 2018: 30%).

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Notes to the consolidated financial statements for year ended 30 June 2019 (continued)

| | 2019 \$'000 | 2018 \$'000 |
|--|----------------|----------------|
| Note 8. Reconciliation of profit after income tax to net cash from operating activities | | |
| Profit after income tax expense for the year | 42,116 | 40,979 |
| Adjustments for: | | |
| Depreciation of property, plant and equipment | 4,253 | 3,780 |
| Net gain on disposal of property, plant and equipment | (31) | – |
| Share-based payments | (370) | 57 |
| Interest expense classified as investing cash flows | 1,053 | 928 |
| Net foreign currency differences | (70) | (1) |
| Net fair value change on derivatives | (543) | 1,404 |
| Change in operating assets and liabilities: | | |
| Decrease/(increase) in trade and other receivables | 755 | (1,667) |
| Increase in inventories | (1,422) | (6,972) |
| Decrease in deferred tax assets | – | 105 |
| (Decrease)/increase in deferred tax liabilities | (611) | 800 |
| Increase in prepayments | (890) | (377) |
| Decrease/(increase) in value of other financial asset | 774 | (1,453) |
| (Decrease)/increase in trade and other payables | (179) | 3,324 |
| Decrease in deferred revenue | 97 | – |
| (Decrease)/increase in provision for income tax | (946) | 251 |
| Increase in other provisions | 1,377 | 1,892 |
| Net cash from operating activities | 45,363 | 43,050 |

| | 2019 \$'000 | 2018 \$'000 |
|---|----------------|----------------|
| Note 9. Current assets – Cash and cash equivalents | | |
| Cash at bank and on hand | 10,600 | 8,518 |
| Short-term deposits | 25,684 | 28,067 |
| Cash at bank and on hand | 36,284 | 36,585 |

Recognition and measurement – Cash and cash equivalents

Cash and short-term deposits in the statement of financial position comprise cash at bank and on hand and short-term deposits with an original maturity of six months or less. For the purposes of the statement of cash flows, cash and cash equivalents consist of cash and cash equivalents as defined above.

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Notes to the consolidated financial statements for year ended 30 June 2019 (continued)

| | 2019 \$'000 | 2018 \$'000 |
|--|----------------|----------------|
| Note 10. Current assets – Receivables | | |
| Trade debtors | 289 | 379 |
| Other debtors | 819 | 1,484 |
| | 1,108 | 1,863 |

Trade receivables are initially recognised at fair value, less any allowance for expected credit losses. Trade receivables are generally due for settlement within 30 days. The consolidated entity had no expected credit losses at reporting date.

Other debtors includes contributions from landlords and claims due from suppliers. These are non-interest bearing and have repayment terms of up to 240 days.

| | 2019 \$'000 | 2018 \$'000 |
|--|----------------|----------------|
| Note 11. Current assets – Inventories | | |
| Finished goods – at net realisable value | 32,017 | 30,993 |
| Stock in transit – at cost | 5,580 | 5,182 |
| | 37,597 | 36,175 |

During the year ended 30 June 2019, \$38,000 (2018: expense of \$156,000) was recognised as a reduction in cost of goods sold for inventories carried at net realisable value.

Recognition and measurement – Inventories

Inventories are valued at the lower of cost and net realisable value. Weighted average cost is used to value inventories. Costs incurred in bringing each product to its present location and condition includes purchase price plus freight, cartage and import duties. Net realisable value is the estimated selling price in the ordinary course of business, less estimated costs necessary to make the sale.

| | 2019 \$'000 | 2018 \$'000 |
|---|----------------|----------------|
| Note 12. Current assets – Other financial assets | | |
| Derivative hedge receivable (Note 25) | 679 | 1,453 |
| | | |

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Notes to the consolidated financial statements for year ended 30 June 2019 (continued)

| | 2019 \$'000 | 2018 \$'000 |
|--|----------------|----------------|
| Note 13. Non-current assets – Property, plant and equipment | | |
| Land and buildings – at cost | 81,496 | 80,610 |
| Less: Accumulated depreciation | (4,461) | (2,978) |
| | 77,035 | 77,632 |
| Leasehold improvements – at cost | 18,019 | 15,229 |
| Less: Accumulated depreciation | (8,536) | (6,437) |
| | 9,483 | 8,792 |
| Fixtures and fittings – at cost | 953 | 2,770 |
| Less: Accumulated depreciation | (690) | (2,241) |
| | 263 | 529 |
| Motor vehicles – at cost | 673 | 815 |
| Less: Accumulated depreciation | (322) | (538) |
| | 351 | 277 |
| Office equipment – at cost | 11,994 | 10,619 |
| Less: Accumulated depreciation | (6,462) | (5,961) |
| | 5,532 | 4,658 |
| | 92,664 | 91,888 |

Reconciliations

Reconciliation of the carrying amounts of property, plant & equipment at the beginning and end of the financial year:

| Consolidated | Land & buildings \$'000 | Leasehold improvements \$'000 | Fixtures & fittings \$'000 | Motor vehicles \$'000 | Office equipment \$'000 | Total \$'000 |
|-------------------------|----------------------------|----------------------------------|-------------------------------|--------------------------|----------------------------|-----------------|
| Balance at 1 July 2017 | 55,212 | 6,717 | 493 | 283 | 4,142 | 66,847 |
| Additions | 23,243 | 3,653 | 269 | 68 | 1,588 | 28,821 |
| Impairment of assets | 59 | 14 | – | – | – | 73 |
| Depreciation expense | (882) | (1,592) | (233) | (74) | (1,072) | (3,853) |
| | 77,632 | 8,792 | 529 | 277 | 4,658 | 91,888 |
| Balance at 30 June 2018 | 77,632 | 8,792 | 529 | 277 | 4,658 | 91,888 |
| Additions | 239 | 2,400 | 41 | 186 | 2,417 | 5,283 |
| Disposals | – | (185) | (3) | (34) | (109) | (331) |
| Exchange fluctuation | – | 68 | – | 1 | 3 | 72 |
| Transfers | 230 | (77) | (207) | – | 54 | – |
| Depreciation expense | (1,066) | (1,515) | (97) | (79) | (1,491) | (4,248) |
| | 77,035 | 9,483 | 263 | 351 | 5,532 | 92,664 |
| Balance at 30 June 2019 | 77,035 | 9,483 | 263 | 351 | 5,532 | 92,664 |

Land and buildings totalling \$75.7m (2018: \$76.5m) are used to secure bank loans relating to their purchase.

Notes to the consolidated financial statements for year ended 30 June 2019 (continued)

Note 13. Non-current assets – Property, plant and equipment (continued)

Recognition and measurement – Property, plant and equipment

All classes of property, plant and equipment are measured at cost, less accumulated depreciation and any impairment in value. Depreciation is provided on a straight line basis on all property, plant and equipment.

Major depreciation periods are:

| | |
|---------------------------------|---------------|
| Buildings | 20 – 40 years |
| Leasehold improvements | 5 – 15 years |
| Furniture and fittings | 3 – 15 years |
| Motor vehicles | 6 years |
| Office equipment (including IT) | 3 – 12 years |

The residual values, useful lives and depreciation methods are reviewed, and adjusted if appropriate, at each reporting date. Leasehold improvements are depreciated at the shorter of the useful life or the term of the lease. Land is not depreciated.

An item of property, plant and equipment is derecognised upon disposal or when there is no future economic benefit to the Company. Gains and losses between the carrying amount and the disposal proceeds are taken to profit or loss.

The carrying values of property, plant and equipment are reviewed for impairment when events or changes in circumstances indicate the carrying value may not be recoverable. For an asset that does not generate largely independent cash inflows, the recoverable amount is determined for the cash-generating unit to which it belongs. If any such indication exists and where the carrying values exceed the estimated recoverable amount, the assets or cash-generating units are written down to their recoverable amount.

| | 2019 \$'000 | 2018 \$'000 |
|---|----------------|----------------|
| Note 14. Non-current assets – Intangibles assets | | |
| Goodwill on acquisition of stores in Adelaide | 2,378 | 2,378 |

Goodwill acquired through business combinations has been allocated to the Adelaide stores and related distribution centre for impairment testing. The recoverable amount of the Adelaide stores and related distribution centre has been determined based on a value in use calculation using cash flow projections.

The key assumptions used in determining the value in use are as follows:

| | 2019 | 2018 |
|----------------------------------|-------|-------|
| Long-term growth rate | 2.0% | 2.0% |
| Weighted average cost of capital | 10.3% | 10.3% |

It would require a significant adverse change in these assumptions to impact the existing assessment and such change is not expected.

Recognition and measurement – Intangible assets

Goodwill on acquisition is initially measured at cost being the excess of the cost of the business combination over the acquirer's interest in the net fair value of the identifiable assets, liabilities and contingent liabilities. Following initial recognition, goodwill is measured at cost less any accumulated impairment losses. Goodwill is reviewed for impairment annually or more frequently if events or changes in circumstances indicate that the carrying value may be impaired. Impairment is determined by assessing the recoverable amount of the cash-generating unit to which the goodwill relates.

When goodwill forms part of a cash-generating unit and an operation within that unit is disposed of, the goodwill associated with the operation disposed of is included in the carrying amount of the operation when determining the gain or loss on disposal of the operation. Goodwill disposed of in this manner is measured based on the relative values of the operation disposed of and the portion of the cash-generating unit retained.

Notes to the consolidated financial statements for year ended 30 June 2019 (continued)

| | 2019 \$'000 | 2018 \$'000 |
|--|----------------|----------------|
|--|----------------|----------------|

Note 15. Current liabilities – Borrowings

| | | |
|--------------------------|--------|--------|
| Commercial bills payable | 13,600 | 20,362 |
|--------------------------|--------|--------|

Recognition and measurement – Interest-bearing loans and borrowings

All loans and borrowings are initially recognised at the fair value of the consideration received less directly attributable transaction costs.

After initial recognition, interest-bearing loans and borrowings are subsequently measured at amortised cost using the effective interest method. Fees paid on the establishment of loan facilities that are yield related are included as part of the carrying amount of the loans and borrowings. Borrowing costs are recognised as an expense when incurred, unless they are directly attributable to the acquisition, construction or production of a qualifying asset whereby they are capitalised.

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

| | 2019 \$'000 | 2018 \$'000 |
|--|----------------|----------------|
|--|----------------|----------------|

Note 16. Current liabilities – Payables

| | | |
|------------------------------|--------|--------|
| Trade creditors | 11,194 | 11,578 |
| Other creditors and accruals | 6,285 | 6,080 |
| | 17,479 | 17,658 |

Trade creditors are non-interest bearing financial instruments and are normally settled on 30 day terms.

Other creditors are non-interest bearing financial instruments and are normally settled on 30 to 60 day terms.

Recognition and measurement – Payables

Trade and other payables are carried at amortised cost and due to their short-term nature they are not discounted. They represent liabilities for goods and services provided to the Company prior to the end of the financial year that are unpaid and arise when the Company becomes obliged to make future payments in respect of the purchase of these goods and services.

| | 2019 \$'000 | 2018 \$'000 |
|--|----------------|----------------|
|--|----------------|----------------|

Note 17. Current liabilities – Deferred revenue

| | | |
|------------------------------|--------|--------|
| Customer deposits | 26,276 | 26,397 |
| Accidental damage warranties | 47 | – |
| | 26,323 | 26,397 |

Customer deposits are amounts received from customers for orders not yet completed. A customer deposit is recognised as revenue when the customer accepts delivery of the order. The opening balance of customer deposits was all recognised as revenue in the current financial year.

Accidental damage warranties are purchased by the customer in conjunction with the purchase of a piece of furniture and are recognised as revenue over the life of the warranty. Amounts classified as current will be recognised as revenue within twelve months of the reporting date.

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Notes to the consolidated financial statements for year ended 30 June 2019 (continued)

| | 2019 \$'000 | 2018 \$'000 |
|--|----------------|----------------|
|--|----------------|----------------|

Note 18. Current liabilities – Provisions

| | | |
|---------------------------|-------|-------|
| Employee entitlements | 2,784 | 2,723 |
| Deferred lease incentives | 621 | 230 |
| | 3,405 | 2,953 |

Recognition and measurement – Provisions

Employee entitlements

Liabilities for annual leave and long service leave expected to be settled within twelve months of the reporting date are measured as the amounts to be paid when the liabilities are settled and are discounted to net present value.

Deferred lease incentive

The Company has received financial incentives from the lessor of certain properties. These are recorded as a liability and amortised over the term of the lease.

| | 2019 \$'000 | 2018 \$'000 |
|--|----------------|----------------|
|--|----------------|----------------|

Note 19. Non-current liabilities – Borrowings

| | | |
|--------------------------|--------|--------|
| Commercial bills payable | 20,062 | 13,300 |
|--------------------------|--------|--------|

Recognition and measurement – Interest-bearing loans and borrowings

All loans and borrowings are initially recognised at the fair value of the consideration received less directly attributable transaction costs.

After initial recognition, interest-bearing loans and borrowings are subsequently measured at amortised cost using the effective interest method. Fees paid on the establishment of loan facilities that are yield related are included as part of the carrying amount of the loans and borrowings. Borrowing costs are recognised as an expense when incurred, unless they are directly attributable to the acquisition, construction or production of a qualifying asset whereby they are capitalised.

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

| | 2019 \$'000 | 2018 \$'000 |
|--|----------------|----------------|
|--|----------------|----------------|

Note 20. Non-current liabilities – Deferred revenue

| | | |
|------------------------------|-----|---|
| Accidental damage warranties | 171 | – |
|------------------------------|-----|---|

Accidental damage warranties have a life of up to five years from the date of purchase. The non-current deferred revenue relates to the portion of revenue which will be recognised more than twelve months after the reporting date.

Notes to the consolidated financial statements for year ended 30 June 2019 (continued)

| | 2019 \$'000 | 2018 \$'000 |
|--|----------------|----------------|
| Note 21. Non-current liabilities – Provisions | | |
| Deferred lease incentives | 4,367 | 3,441 |
| Employee entitlements | 883 | 919 |
| Lease make good | 555 | 520 |
| | 5,805 | 4,880 |

Recognition and measurement

Deferred lease incentives

The Company has received financial incentives contributions from the lessor of certain properties. These are recorded as a liability and amortised over the term of the lease.

Employee entitlements

Liabilities for annual leave and long service leave not expected to be settled within twelve months of the reporting date are measured as the present value of expected future payments to be made in respect of services provided by employees up to the reporting date using the projected unit credit method. Consideration is given to the expected future wage and salary levels, experience of employee departures and periods of service. Expected future payments are discounted using market yields at the reporting date on corporate bonds with terms to maturity and currency that match, as closely as possible, the estimated future cash outflows.

Lease make good

A provision has been made for the present value of anticipated costs of future restoration of leased properties. The provision includes future cost estimates associated with restoring the premises to its condition at the time the Company initially leased the premises, subject to fair wear and tear.

| | 2019 Shares | 2018 Shares | 2019 \$'000 | 2018 \$'000 |
|---|----------------|----------------|----------------|----------------|
| Note 22. Equity – Issued capital | | | | |
| Authorised and fully paid ordinary shares | 81,000,000 | 81,000,000 | 3,364 | 3,364 |

Ordinary shares

Ordinary shares entitle the holder to participate in dividends and the proceeds on the winding up of the Company in proportion to the number of and amounts paid on the shares held.

Capital risk management

The Board policy is to maintain a strong capital base so as to maintain investor, creditor and market confidence and to sustain future development of the business. The Board seeks to maintain a balance between the higher returns that might be possible with higher levels of borrowings and the advantages and security afforded by a sound capital position. There were no changes in the Company's approach to capital management during the year.

The Company may look to raise capital when an opportunity to invest in a business is seen as value adding. The Company has established specific borrowing facilities in relation to property purchases, which are secured over those specific properties. The Company may consider using external equity when required for specific investments.

The Company pays dividends at the discretion of the Board. The dividend amount is based on market conditions and the profitability of the Company.

Recognition and measurement

Ordinary share capital is recognised at the fair value of the consideration received by the Company.

Any transaction cost arising on the issue of ordinary shares are recognised directly in equity as a reduction of the share proceeds received, net of tax.

Notes to the consolidated financial statements for year ended 30 June 2019 (continued)

| | 2019 \$'000 | 2018 \$'000 |
|-----------------------------------|----------------|----------------|
| Note 23. Equity – Reserves | | |
| Capital profits reserve | 78 | 78 |
| Cash flow hedge reserve | 475 | 1,018 |
| Foreign exchange reserve | 6 | (1) |
| Equity benefits reserve | (29) | 341 |
| | 530 | 1,436 |

Movements in reserves

| | Equity benefits reserve \$'000 | Capital profits reserve \$'000 | Cash flow hedge reserve \$'000 | Foreign exchange reserve \$'000 | Total \$'000 |
|--|---|---|---|--|-----------------|
| Balance at 1 July 2017 | 284 | 78 | (386) | – | (24) |
| Amounts recognised for cash flow hedges | – | – | 1,430 | – | 1,430 |
| Income tax on items taken directly to or transferred from equity | – | – | (602) | – | (602) |
| Amounts transferred to non-financial assets | – | – | 576 | – | 576 |
| Foreign exchange reserve | – | – | – | (1) | (1) |
| Share-based payment | 57 | – | – | – | 57 |
| | | | | | |
| Balance at 30 June 2018 | 341 | 78 | 1,018 | (1) | 1,436 |
| Amounts recognised for cash flow hedges | – | – | (774) | – | (774) |
| Income tax on items taken directly to or transferred from equity | 53 | – | 204 | – | 257 |
| Amounts transferred to non-financial assets | – | – | 27 | – | 27 |
| Purchase of shares under executive plan | (525) | – | – | – | (525) |
| Foreign exchange reserve | – | – | – | 7 | 7 |
| Share-based payment | 102 | – | – | – | 102 |
| | | | | | |
| Balance at 30 June 2019 | (29) | 78 | 475 | 6 | 530 |

Equity benefits reserve

This reserve is used to record the value of share-based payments provided to employees as part of their remuneration. Refer to Note 33 for further details of these plans.

Capital profits reserve

This reserve is comprised wholly of the surplus on disposal of assets that were acquired prior to the introduction of Capital Gains Tax provisions.

Cash flow hedge reserve

This reserve is used to recognise the effective portion of the gain or loss of cash flow hedge instruments that is determined to be an effective hedge.

Foreign exchange reserve

This reserve is used to recognise where assets and liabilities denominated in foreign currencies are translated at the functional currency spot rates of exchange at the reporting date.

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Notes to the consolidated financial statements for year ended 30 June 2019 (continued)

| | 2019 \$'000 | 2018 \$'000 |
|---|----------------|----------------|
| Note 24. Financing facilities | | |
| Unrestricted access was available on the following lines of credit at the reporting date: | | |
| Total facilities: | | |
| Bank loans expiring within 12 months | 14,500 | 21,262 |
| Bank loans expiring in greater than 12 months | 20,062 | 13,300 |
| Bank guarantees | 2,000 | 2,000 |
| Interchangeable facilities, including letters of credit | 5,000 | 5,000 |
| | 41,562 | 41,562 |
| Facilities used at reporting date: | | |
| Bank loans expiring within 12 months | 13,600 | 20,362 |
| Bank loans expiring in greater than 12 months | 20,062 | 13,300 |
| Bank guarantees | 1,706 | 1,477 |
| Interchangeable facilities, including letters of credit | – | 223 |
| | 35,368 | 35,362 |
| Facilities unused at reporting date: | | |
| Bank loans expiring within 12 months | 900 | 900 |
| Bank loans expiring in greater than 12 months | – | – |
| Bank guarantees | 294 | 523 |
| Interchangeable facilities, including letters of credit | 5,000 | 4,777 |
| | 6,194 | 6,200 |

Note 25. Financial instruments

Financial risk management objectives

The Company has exposure to foreign exchange risk, interest rate risk, credit risk and liquidity risk.

The Company's financial risk management policies are established to identify and analyse the risks faced by the Company, to set appropriate risk limits and controls, and to monitor risks and adherence to limits. Risk management policies and systems are reviewed regularly to reflect changes in market conditions and the Company's activities.

The Board of Directors has overall responsibility for the establishment and oversight of the Company's risk management framework. The Board of Directors has established an Audit Committee, which is responsible for developing and monitoring the Company's risk management policies. The Committee provides regular reports to the Board of Directors on its activities.

The Company's principal financial instruments comprise bank loans, and cash and short-term deposits. The main purpose of these financial instruments is to raise finance for and fund the Company's operations. The Company has various other financial instruments such as trade debtors and trade creditors, which arise directly from its operations. It is, and has been throughout the year, the Company's policy that no trading in financial instruments is undertaken.

Market risk

Market risk is the risk that changes in market prices such as foreign exchange rates and interest rates will affect the Company's income or the value of its holdings of financial instruments. The objective of market risk management is to manage and control exposure within acceptable parameters while maximising return.

Foreign currency risk

All of the Company's sales are denominated in either Australian dollars or New Zealand dollars, whilst the majority of inventory purchases are denominated in currencies other than Australian dollars, primarily US dollars. Where appropriate the Company uses forward currency contracts and options to manage its currency exposures; and where the qualifying criteria are met, these are designated as hedging instruments for the purposes of hedge accounting.

As at 30 June 2019, the Company has trade payables of \$3,145,000 (2018: \$3,557,000) denominated in US dollars and stock in transit of \$5,580,000 (2018: \$5,182,000) denominated in US dollars, all of which are covered by designated cash flow hedges. As a result, the sensitivity to a reasonably possible change in the US dollar exchange rate is minimal. The cash flows relating to cash flow hedge positions held at year end are expected to occur in July 2019 through to November 2019, and the profit and loss is expected to be affected through cost of sales as the hedged items (inventory) are sold to customers. All forecast transactions subject to hedge accounting have occurred or are highly likely to occur.

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Notes to the consolidated financial statements for year ended 30 June 2019 (continued)

Note 25. Financial instruments (continued)

During the year, the Company designated foreign currency forward contracts as hedges of highly probable purchases of inventory in US dollars. The forecast purchases are expected to occur during July 2019 through to November 2019.

The terms of the foreign currency forward contracts have been negotiated to match the terms of the forecasted transactions. Both parties of the contract have fully cash collateralised the foreign currency forward contracts, and therefore, effectively eliminated any credit risk associated with the contracts (both the counter-party's and the Company's own credit risk). Consequently, the hedges were assessed to be highly effective. As at 30 June 2019, an unrealised loss of \$543,000 (30 June 2018: an unrealised gain of \$1,403,000) is recorded in other comprehensive income.

Interest rate risk

Financial instruments utilised that are subject to interest, and therefore interest rate risk, are cash and commercial bills. Management continually monitor the exposure to interest rate risk. The following table sets out the carrying amount by maturity of the financial instruments exposed to interest rate risk at reporting date.

The fair value of the cash and commercial bills shown below are based on the face value of those financial instruments.

| | 2019 | | 2018 | |
|---|----------------------------------|----------------|----------------------------------|----------------|
| | Weighted average interest rate % | Balance \$'000 | Weighted average interest rate % | Balance \$'000 |
| Floating rate | | | | |
| Cash – Assets less than one year | 2.36 | 36,284 | 2.19 | 36,582 |
| Commercial Bills – Liabilities less than one year | 2.73 | (13,600) | 3.28 | (20,362) |
| Commercial Bills – Liabilities between one and five years | 3.31 | (20,062) | 3.28 | (13,300) |
| Net exposure to cash flow interest rate risk | | 2,622 | | 2,920 |

A reasonably possible increase/(decrease) in the interest rate of 100 basis points would result in an increase/(decrease) of profit of \$18,000 (2018: \$29,000).

Credit risk

Credit risk refers to the risk that a counter-party will default on its contractual obligations resulting in a financial loss to the Company.

In most cases, the Company requires full and final payment either prior to, or upon delivery of the goods to the customer. In limited cases where credit is provided, the Company trades on credit terms with recognised, creditworthy third parties. Customers who wish to trade on credit terms are subject to credit verification procedures. In addition, receivable balances are monitored on an ongoing basis with the result that the Company's exposure to bad debts is not significant. There are no significant concentrations of credit risk within the Company.

With respect to credit risk arising from financial assets of the Company, which comprise of cash and cash equivalents and receivables, the Company's maximum exposure to credit risk, excluding the value of any collateral or other security, at reporting date to recognised financial assets is in the carrying amount, net of any provisions for doubtful debts, as disclosed in the statement of financial position and notes to the financial statements. Cash and cash equivalents are only invested with corporations which are approved by the Board.

Liquidity risk

Liquidity risk is the risk that the Company will not be able to meet its financial obligations as they fall due. The Company'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.

The Company manages liquidity risk by maintaining adequate cash reserves and available borrowing facilities by continuously monitoring actual and forecast cash flows and matching the maturity profiles of financial assets and liabilities.

The following tables detail the Company's remaining contractual maturity for its financial instrument liabilities. The tables have been drawn up based on the undiscounted cash flows of financial liabilities based on the earliest date on which the financial liabilities are required to be paid. The tables include both interest and principal cash flows disclosed as remaining contractual maturities and therefore these totals may differ from their carrying amount in the statement of financial position.

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Notes to the consolidated financial statements for year ended 30 June 2019 (continued)

Note 25. Financial instruments (continued)

| 2019 | Less than 3 months \$'000 | 3 to 12 months \$'000 | 1 to 5 years \$'000 | Over 5 years \$'000 | Remaining contractual maturities \$'000 |
|------------------------------------|---------------------------------|-----------------------------|---------------------------|---------------------------|--|
| Non-derivatives | | | | | |
| <i>Non-interest bearing</i> | | | | | |
| Trade creditors | 11,194 | – | – | – | 11,194 |
| Other creditors | 6,285 | – | – | – | 6,285 |
| <i>Interest bearing – variable</i> | | | | | |
| Borrowings | 5,538 | 8,260 | 21,584 | – | 35,382 |
| Total non-derivatives | 23,017 | 8,260 | 21,584 | – | 52,861 |

The cash flows in the maturity analysis above are not expected to occur significantly earlier than contractually disclosed above.

| 2018 | Less than 3 months \$'000 | 3 to 12 months \$'000 | 1 to 5 years \$'000 | Over 5 years \$'000 | Remaining contractual maturities \$'000 |
|------------------------------------|---------------------------------|-----------------------------|---------------------------|---------------------------|--|
| Non-derivatives | | | | | |
| <i>Non-interest bearing</i> | | | | | |
| Trade Creditors | 11,578 | – | – | – | 11,578 |
| Other creditors | 6,080 | – | – | – | 6,080 |
| <i>Interest bearing – variable</i> | | | | | |
| Borrowings | 277 | 21,177 | 14,988 | – | 36,442 |
| Total non-derivatives | 17,935 | 21,177 | 14,988 | – | 54,100 |

Note 26. Fair value measurement

Fair value hierarchy

All financial instruments for which fair value is recognised or disclosed are categorised with the fair value hierarchy, described as follows, based on the lowest level input that is significant to the fair value measurement as a whole:

Level 1: Quoted market prices in an active market (that are unadjusted) for identical assets or liabilities

Level 2: Valuation techniques for which the lowest level input that is significant to the fair value measurement is directly or indirectly observable

Level 3: Valuation techniques for which the lowest level input that is significant to the fair value measurement is unobservable

At the reporting date the fair value of derivative financial instrument represented a derivative hedge receivable of \$679,000 (2018: \$1,453,000). All foreign currency forward contracts were measured at fair value using the Level 2 method. Unless otherwise stated, the carrying amounts of financial instruments reflect their fair value.

Recognition and measurement – Derivative financial instruments

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 each reporting date. Recognition of the resulting gain or loss depends on whether the derivative is designated as a hedging instrument and the nature of the item being hedged.

As appropriate, the Company designates derivatives as either hedges of the fair value of recognised assets or liabilities of firm commitments (fair value hedges) or hedges of highly probable forecast transactions (cash flow hedges).

Recognition and measurement – Fair value measurement

Assets and liabilities measured at fair value are classified, into three levels, using a fair value hierarchy that reflects the significance of the inputs used in making the measurements. Classifications are reviewed at each reporting date and transfers between levels are determined based on a reassessment of the lowest level of input that is significant to the fair value measurement.

For recurring and non-recurring fair value measurements, external valuers may be used when internal expertise is either not available or when the valuation is deemed to be significant. External valuers are selected based on market knowledge and reputation. Where there is a significant change in fair value of an asset or liability from one year to another, an analysis is undertaken, which includes a verification of the major inputs applied in the latest valuation and a comparison, where applicable, with external sources of data.

Notes to the consolidated financial statements for year ended 30 June 2019 (continued)

| | 2019 | 2018 |
|--|------|------|
| | \$ | \$ |

Note 27. Key management personnel

The aggregate compensation made to directors and other members of key management personnel of the Company is set out below:

| | | |
|------------------------------|-----------|-----------|
| Short-term employee benefits | 2,230,243 | 2,254,200 |
| Long-term employee benefits | 11,984 | 39,324 |
| Post-employment benefits | 88,551 | 63,118 |
| Share-based payments | 48,208 | 139,579 |
| | 2,378,986 | 2,496,221 |

| | 2019 | 2018 |
|--|------|------|
| | \$ | \$ |

Note 28. Remuneration of auditors

During the financial year the following fees were paid or payable for services provided by Ernst & Young, the auditor of the Company, and its network firms:

Audit services

| | | |
|---|---------|---------|
| Audit or review of the financial statements | 150,000 | 149,000 |
|---|---------|---------|

Other services

| | | |
|----------------------------------|---------|---------|
| Tax review services | 17,500 | 17,500 |
| New Zealand legal and tax advice | – | 42,540 |
| | 17,500 | 60,040 |
| | 167,500 | 209,040 |

Note 29. Contingent liabilities

There are no contingent liabilities as at 30 June 2019 (2018: Nil).

| | 2019 | 2018 |
|--|--------|--------|
| | \$'000 | \$'000 |

Note 30. Commitments

Operating lease commitments

Committed at the reporting date but not recognised as liabilities, payable:

| | | |
|----------------------|---------|---------|
| Within one year | 27,585 | 22,570 |
| One to five years | 80,578 | 65,305 |
| More than five years | 18,821 | 13,875 |
| | 126,984 | 101,750 |

Operating leases commitments exist in respect of the Group's leased premises. Leases are entered into for varying terms and rent reviews are based on CPI increases or fixed increases. In some cases there are market reviews, particularly when exercising renewal options. A number of the leases contain options to renew in favour of the Group.

Capital Commitments

At 30 June 2019, the Group had capital commitments of \$1,118,000 (2018: \$945,000) relating to the fit out of a new showroom and warehouse in New Zealand and solar panels to upgrade energy efficiency to owned stores in Australia.

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Notes to the consolidated financial statements for year ended 30 June 2019 (continued)

Note 31. Related party transactions

Other related party transactions

Dealings between the Company and the directors and personally-related entities were made during the year in the ordinary course of business on normal commercial terms and conditions. The nature of these dealings were primarily the reimbursement of personal expenses incurred on Company paid credit cards and the purchase of products for their own use.

Receivable from and payable to related parties

There were no trade receivables from or trade payables to related parties at the current and previous reporting date.

Loans to/from related parties

There were no loans to or from related parties at either the current or previous reporting date.

Note 32. Events after the reporting period

Apart from the dividend declared as disclosed in Note 7, no other matter or circumstance has arisen since 30 June 2019 that has significantly affected, or may significantly affect the Group's operations, the results of those operations, or the Company's state of affairs in future financial years.

Note 33. Share-based payments

The Company has an Executive Performance Rights Plan which is provided for executives and other employees. In accordance with the provisions of the plan, executives and employees are awarded rights to ordinary shares that will vest after a period of three years subject to the achievement of specific performance hurdles in relation to earnings per share (EPS) growth. There is no exercise price for the shares and the employees are able to exercise the right for up to two years following vesting, after which time the right will lapse.

In the year ended 30 June 2019 rights to ordinary shares were issued which include performance hurdles requiring compound annual EPS growth of between 5% and 10%. Under the grant, 50% of the rights are exercisable on the achievement of 5% EPS growth, 100% on the achievement of 10% EPS growth, and for the achievement of between 5% and 10% EPS growth the number of rights exercisable is calculated on a pro-rata basis.

The expense recognised in relation to employee share rights during the year was \$102,250 (2018: \$280,480).

The following table reconciles the outstanding employee share rights granted under the Executive Performance Rights Plan at the beginning and end of the financial year:

| | 2019 | 2018 |
|----------------------------------|----------|----------|
| Balance at the start of the year | 207,375 | 177,621 |
| Granted | 52,375 | 64,172 |
| Exercised | (78,241) | (34,418) |
| Forfeited | (51,258) | - |
| Balance at the end of the year | 130,251 | 207,375 |

Fair value of rights granted

The fair value of rights at grant date is valued under risk neutral conditions. Under these conditions the value of the right is equivalent to the share price reduced by the present value of dividends payable on the shares until vesting. The present value of the dividends is deducted from the share price because the right holder is not entitled to dividends until the rights are exercised. The valuation assumes that the rights are exercised as they vest.

The key assumptions used for determining fair value at grant date are as follows:

| | 2019 | 2018 |
|--|--------|--------|
| Share price at grant date | \$6.85 | \$6.40 |
| Dividend yield | 5.8% | 6.0% |
| Franking rate | 30.0% | 30.0% |
| Implied pre-tax effective dividend yield | 8.3% | 8.6% |

Notes to the consolidated financial statements for year ended 30 June 2019 (continued)

Note 33. Share-based payments (continued)

Recognition and measurement – Share-based payments

Share-based payments are measured at the fair value of the rights at grant date and are expensed on a straight line basis over the vesting period, with a corresponding increase in equity, based on the Company's estimate of the number of shares that will eventually vest, giving consideration to the likelihood of employee turnover and the likelihood of non-market performance conditions being met.

At each reporting date the Company revises its estimate of the number of rights expected to vest. The impact of the revision of the original estimates, if any, is recognised in profit or loss over the remaining vesting period, along with the reversal of any previous charges relating to rights which may have lapsed.

Note 34. Controlled entities

Subsidiaries

The consolidated financial statements incorporate the assets, liabilities and results of the following subsidiaries in accordance with the accounting policy described in this financial report.

| Name of entity | Country of incorporation | Class of shares | Equity holding | |
|--|--------------------------|-----------------|----------------|-----------|
| | | | 2019 % | 2018 % |
| Nick Scali (New Zealand) Limited | New Zealand | Ordinary | 100 | 100 |
| Nick Scali Employee Share Scheme Pty Ltd | Australia | Ordinary | 100 | – |

Note 35. Parent entity information

Set out below is the supplementary information about the parent entity.

| | Parent | |
|--|----------------|----------------|
| | 2019 \$'000 | 2018 \$'000 |
| Statement of comprehensive income | | |
| Profit after income tax expense | 41,663 | 41,010 |
| Total comprehensive income | 41,127 | 42,414 |
| Statement of financial position | | |
| Total current assets | 76,478 | 77,556 |
| Total assets | 169,721 | 170,297 |
| Total current liabilities | 59,034 | 67,636 |
| Total liabilities | 84,965 | 86,602 |
| Equity | | |
| Issued capital | 3,364 | 3,364 |
| Capital profits reserve | 78 | 78 |
| Cash flow hedge reserve | 475 | 1,017 |
| Equity benefits reserve | (29) | 341 |
| Retained profits | 80,868 | 78,895 |
| Total equity | 84,756 | 83,695 |

Recognition and measurement – Principles of consolidation

The consolidated financial statements incorporate the assets and liabilities of all subsidiaries of Nick Scali Limited ('Company' or 'parent entity') as at 30 June 2019 and the results of all subsidiaries for the year then ended. Nick Scali Limited and its subsidiaries together are referred to in these financial statements as the 'consolidated entity'.

Subsidiaries are all those entities over which the Company has control. The Company controls an entity when it 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 is transferred to the consolidated entity. They are de-consolidated from the date that control ceases.

Intercompany transactions, balances and unrealised gains on transactions between entities in the consolidated entity are eliminated. Unrealised losses are also eliminated unless the transaction provides evidence of the impairment of the asset transferred.

Notes to the consolidated financial statements for year ended 30 June 2019 (continued)

Note 36. Summary of other significant accounting policies

Current and non-current classification

Assets and liabilities are presented in the statement of financial position based on current and non-current classification.

An asset is classified as current when: it is either expected to be realised or intended to be sold or consumed in normal operating cycle; it is held primarily for the purpose of trading; it is expected to be realised within 12 months after the reporting year; or the asset is cash or cash equivalent unless restricted from being exchanged or used to settle a liability for at least 12 months after the reporting year. All other assets are classified as non-current.

A liability is classified as current when: it is either expected to be settled in normal operating cycle; it is held primarily for the purpose of trading; it is due to be settled within 12 months after the reporting year; or there is no unconditional right to defer the settlement of the liability for at least 12 months after the reporting year. All other liabilities are classified as non-current.

Deferred tax assets and liabilities are always classified as non-current.

Other taxes

Revenues, expenses and assets are recognised net of the amount of Goods and Services Tax ("GST") except:

- when the GST incurred on a purchase of goods and services is not recoverable from the taxation authority, in which case the GST is recognised as part of the cost of acquisition of the asset or as part of the expense item as applicable; and
- receivables and payables, which are stated with the amount of GST included.

The net amount of GST recoverable from, or payable to, the taxation authority is included as part of receivables or payables in the statement of financial position.

Cash flows are included in the statement of cash flows on a gross basis and the GST component of cash flows arising from investing and financing activities, which is recoverable from, or payable to the taxation authority are classified as operating cash flows.

Commitments and contingencies are disclosed net of the amount of GST recoverable from, or payable to, the taxation authority.

Foreign currency translation

The financial statements are presented in Australian dollars, which is Nick Scali Limited's functional and presentation currency.

Foreign currency transactions

Foreign currency transactions are translated into Australian dollars using the exchange rates prevailing at the dates of the transactions or at the hedged rate if qualifying financial instruments have been used to reduce exposure. Monetary assets and liabilities denominated in foreign currencies are retranslated at the financial year-end exchange rates and recognised in profit or loss.

All exchange differences are recognised in the statement of comprehensive income, except when deferred in equity as qualifying cash flow hedges.

Foreign operations

The assets and liabilities of foreign operations are translated into Australian dollars using the exchange rates at the reporting date. The revenues and expenses of foreign operations are translated into Australian dollars using the average exchange rates, which approximate the rates at the dates of the transactions, for the period. All resulting foreign exchange differences are recognised in other comprehensive income through the foreign currency reserve in equity.

Notes to the consolidated financial statements for year ended 30 June 2019 (continued)

Note 36. Summary of other significant accounting policies (continued)

Derecognition of financial assets and financial liabilities

Financial assets

A financial asset (or, where applicable, a part of a financial asset or part of a group of similar financial assets) is derecognised when:

- the rights to receive cash flows from the asset have expired;
- the Company retains the right to receive cash flows from the asset, but has assumed an obligation to pay them in full without material delay to a third party under a 'pass-through' arrangement; or
- the Company has transferred its rights to receive cash flows from the asset and either (a) has transferred substantially all the risks and rewards of the asset, or (b) has neither transferred nor retained substantially all the risks and rewards of the asset, but has transferred control of the asset.

When the Company has transferred its rights to receive cash flows from an asset and has neither transferred nor retained substantially all the risks and rewards of the asset nor transferred control of the asset, the asset is recognised to the extent of the Company's continuing involvement in the asset. Continuing involvement that takes the form of a guarantee over the transferred asset is measured at the lower of the original carrying amount of the asset and the maximum amount of consideration received that the Company could be required to repay.

Financial liabilities

A financial liability is derecognised when the obligation under the liability is discharged, cancelled or expires. When an existing financial liability is replaced by another from the same lender on substantially different terms, or the terms of an existing liability are substantially modified, such an exchange or modification is treated as a derecognition of the original liability and the recognition of a new liability, and the difference in the respective carrying amounts is recognised in profit or loss.

Provisions

Provisions are recognised when the Group has a present obligation (legal or constructive) as a result of a past event, it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation and a reliable estimate can be made of the amount of the obligation.

When the Company expects some or all of a provision to be reimbursed, for example under an insurance contract, the reimbursement is recognised as a separate asset but only when the reimbursement is virtually certain. The expense relating to any provision is presented in the income statement net of any reimbursement.

If the effect of the time value of money is material, provisions are discounted using a current pre-tax rate that reflects the risks specific to the liability. When discounting is used, the increase in the provision due to the passage of time is recognised as a borrowing cost.

Dividends

Dividends are recognised when declared during the financial year and no longer at the discretion of the Company.

Rounding of amounts

The Company is of a kind referred to in Class Order 2016/191, issued by the Australian Securities and Investments Commission, relating to 'rounding-off'. Amounts in this report have been rounded-off in accordance with that Class Order to the nearest thousand dollars, or in certain cases, the nearest dollar.

Directors' Declaration

In the directors' opinion:

- the attached financial statements and notes comply with the Corporations Act 2001, the Accounting Standards, the Corporations Regulations 2001 and other mandatory professional reporting requirements;
- the attached financial statements and notes comply with International Financial Reporting Standards as issued by the International Accounting Standards Board as described in Note 1 to the financial statements;
- the attached financial statements and notes give a true and fair view of the Company's financial position as at 30 June 2019 and of its performance for the financial year ended on that date; and
- there are reasonable grounds to believe that the Company will be able to pay its debts as and when they become due and payable.

The directors have been given the declarations required by section 295A of the Corporations Act 2001.

Signed in accordance with a resolution of directors made pursuant to section 295(5)(a) of the Corporations Act 2001.

On behalf of the directors



John Ingram
Chairman



Anthony Scali
Managing Director

8 August 2019
Sydney

Aix dining table in black American
Smoked Oak and Ash.
Fifi and Fleur dining chairs.
Aromer floor rug.



Independent Auditor's Report to the Members of Nick Scali Limited



**Building a better
working world**

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Independent Auditor's Report to the Members of Nick Scali Limited

Report on the Audit of the Financial Report

Opinion

We have audited the financial report of Nick Scali Limited (the Company) and its subsidiaries (collectively the Group), which comprises the consolidated statement of financial position as at 30 June 2019, the consolidated statement of comprehensive income, consolidated statement of changes in equity and consolidated statement of cash flows for the year then ended, notes to the financial statements, including a summary of significant accounting policies, and the directors' declaration.

In our opinion, the accompanying financial report of the Group is in accordance with the *Corporations Act 2001*, including:

- a) giving a true and fair view of the consolidated financial position of the Group as at 30 June 2019 and of its consolidated financial performance for the year ended on that date; and
- b) complying with Australian Accounting Standards and the *Corporations Regulations 2001*.

Basis for Opinion

We conducted our audit in accordance with Australian Auditing Standards. 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 auditor independence requirements of 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 also fulfilled our other ethical responsibilities in accordance with the Code.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Key Audit Matters

Key audit matters are those matters that, in our professional judgment, were of most significance in our audit of the financial report of the current year. These matters were addressed in the context of our audit of the financial report as a whole, and in forming our opinion thereon, but we do not provide a separate opinion on these matters. For each matter below, our description of how our audit addressed the matter is provided in that context.

We have fulfilled the responsibilities described in the *Auditor's Responsibilities for the Audit of the Financial Report* section of our report, including in relation to these matters. Accordingly, our audit included the performance of procedures designed to respond to our assessment of the risks of material misstatement of the financial report. The results of our audit procedures, including the procedures performed to address the matters below, provide the basis for our audit opinion on the accompanying financial report.

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Inventory valuation

| Why significant | How our audit addressed the key audit matter |
|---|---|
| <p>As at 30 June 2019, the Group held \$37.6 million in inventories representing 22% of total assets.</p> <p>As detailed in Note 11 of the financial report, inventories are valued at the lower of cost and net realisable value. There is judgement involved in determining the cost of inventories and in assessing net realisable value.</p> <p>The cost of inventories includes elements relating to the costs of freight and customs duties. Judgements were involved in the process of allocating these costs to inventories.</p> <p>There is judgement in estimating the value of inventory which may be sold below cost and determining the net realisable value of this inventory. Such judgements include expectations for future sales and inventory clearance plans.</p> | <p>Our audit procedures assessed the valuation of inventories and the related financial report disclosures. These procedures included the following:</p> <ul style="list-style-type: none"> - Assessed the application of inventory costing methodologies, specifically in relation to freight and customs clearance, and whether this was consistent with Australian Accounting Standards. - Assessed the effectiveness of relevant controls in relation to the inventory costing process and assessed the accuracy of the Group's inventory valuation model, on a sample basis. - Assessed the basis by which the Group ensures inventory was recorded at the lower of cost and net realisable value, including the rationale for recording specific adjustments. In doing so, we examined the ageing profile of inventories, sales margin achieved, the process for identifying specific slow moving inventories and historical inventory turnover. |

Information other than the Financial Statements and Auditor's Report

The directors are responsible for the other information. The other information comprises the information included in the Company's 2019 Annual Report other than the financial report and our auditor's report thereon. We obtained the Directors' Report that is to be included in the Annual Report, prior to the date of this auditor's report, and we expect to obtain the remaining sections of the Annual Report after the date of this auditor's report.

Our opinion on the financial report does not cover the other information and we do not and will not express 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 and, in doing so, 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.

If, based on the work we have performed on the other information obtained prior to the date of this auditor's report, we conclude that there is a material misstatement of this other information, we are required to report that fact. We have nothing to report in this regard.

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Responsibilities of the Directors for the Financial Report

The directors of the Company are responsible for the preparation of the financial report that gives a true and fair view in accordance with Australian Accounting Standards and the *Corporations Act 2001* and for such internal control as the directors determine is necessary to enable the preparation of the financial report that gives a true and fair view and is free from material misstatement, whether due to fraud or error.

In preparing the financial report, the directors are responsible for assessing the Group's ability to continue as a going concern, disclosing, as applicable, matters relating to going concern and using the going concern basis of accounting unless the directors either intend to liquidate the Group or to cease operations, or have no realistic alternative but to do so.

Auditor's responsibilities for the Audit of the Financial Report

Our objectives are 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 the Australian Auditing Standards will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of this financial report.

As part of an audit in accordance with the Australian Auditing Standards, we exercise professional judgment and maintain professional scepticism throughout the audit. We also:

- Identify and assess the risks of material misstatement of the financial report, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.
- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Group's internal control.
- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by the directors.
- Conclude on the appropriateness of the directors' use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Group's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditor's report to the related disclosures in the financial report or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditor's report. However, future events or conditions may cause the Group to cease to continue as a going concern.
- Evaluate the overall presentation, structure and content of the financial report, including the disclosures, and whether the financial report represents the underlying transactions and events in a manner that achieves fair presentation.



- Obtain sufficient appropriate audit evidence regarding the financial information of the entities or business activities within the Group to express an opinion on the financial report. We are responsible for the direction, supervision and performance of the Group audit. We remain solely responsible for our audit opinion.

We communicate with the directors regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that we identify during our audit.

We also provide the directors with a statement that we have complied with relevant ethical requirements regarding independence, and to communicate with them all relationships and other matters that may reasonably be thought to bear on our independence, and where applicable, related safeguards.

From the matters communicated to the directors, we determine those matters that were of most significance in the audit of the financial report of the current year and are therefore the key audit matters. We describe these matters in our auditor's report unless law or regulation precludes public disclosure about the matter or when, in extremely rare circumstances, we determine that a matter should not be communicated in our report because the adverse consequences of doing so would reasonably be expected to outweigh the public interest benefits of such communication.

Report on the Audit of the Remuneration Report

Opinion on the Remuneration Report

We have audited the Remuneration Report included in pages 9 to 15 of the directors' report for the year ended 30 June 2019.

In our opinion, the Remuneration Report of Nick Scali Limited for the year ended 30 June 2019, complies with section 300A of the Corporations Act 2001.

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

A handwritten signature in black ink, appearing to read 'Ernst & Young'.

Ernst & Young

A handwritten signature in black ink, appearing to read 'Lisa Nijssen-Smith'.

Lisa Nijssen-Smith
Partner
Sydney
8 August 2019

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Shareholder Information

Additional information required by the Australian Securities Exchange and not shown elsewhere in this report is as follows. The information is current as at 15 July 2019.

Distribution of equitable securities

Analysis of number of equitable security holders by size of holding:

| Shareholders Category | Number of holders of ordinary shares |
|-----------------------|--------------------------------------|
| 1 to 1,000 | 1,304 |
| 1,001 to 5,000 | 1,452 |
| 5,001 to 10,000 | 390 |
| 10,001 to 100,000 | 275 |
| 100,001 and Over | 27 |
| Total | 3,448 |

Equity security holders

Twenty largest quoted equity security holders

The names of the twenty largest security holders of quoted equity securities are listed below:

| | Ordinary shares | |
|---|-----------------|--------------------------|
| | Number held | % of total shares issued |
| HSBC Custody Nominees (Australia) Limited | 15,837,318 | 19.55 |
| Scali Consolidated Pty Limited | 11,039,474 | 13.63 |
| Kuka Investment and Management Co. Limited | 11,039,473 | 13.63 |
| Citicorp Nominees Pty Limited | 10,536,567 | 13.01 |
| J P Morgan Nominees Australia Limited | 6,866,778 | 8.48 |
| National Nominees Limited | 3,859,970 | 4.77 |
| Grahger Retail Securities Pty Limited | 2,200,000 | 2.72 |
| BNP Paribas Nominees Pty Limited | 1,427,076 | 1.76 |
| Molvest Pty Limited | 1,300,000 | 1.60 |
| Citicorp Nominees Pty Limited | 619,859 | 0.77 |
| Ecapital Nominees Pty Limited | 492,185 | 0.61 |
| Little Blue Porsche Pty Limited | 450,000 | 0.56 |
| Netwealth Investments Limited | 411,944 | 0.51 |
| Lan Trading Capital Pty Limited | 337,471 | 0.42 |
| Grahger Capital Securities Management Pty Limited | 330,000 | 0.41 |
| Urb Investments Limited | 248,907 | 0.31 |
| Mr Nicholas Debenham & Mrs Annette Debenham | 225,913 | 0.28 |
| BNP Paribas Nominees Pty Limited | 212,540 | 0.26 |
| 28421 Pty Limited | 211,500 | 0.26 |
| Mr Yonatan Widjaya & Mrs Mela Widjaya | 168,000 | 0.21 |
| | 67,814,975 | 83.75 |

Shareholder Information (continued)

| | Number held | Ordinary shares % of total shares issued |
|--|-------------|--|
| Substantial holders | | |
| <i>Substantial holders in the Company are set out below:</i> | | |
| Scali Consolidated Pty Limited | 11,039,474 | 13.63 |
| Kuka Investment and Management Co. Limited | 11,039,473 | 13.63 |
| Perpetual Investments | 6,100,232 | 7.53 |
| Ethical Partners | 5,081,527 | 6.27 |
| Colonial First State | 4,834,268 | 5.97 |
| | 38,094,974 | 47.03 |

Voting rights

Ordinary shares

All ordinary shares carry one vote per share without restriction.

There are no other classes of equity securities.

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Carlina TV unit with a natural timber frame and marble top.

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Karma dining table with acacia frame and Italian Carrara marble top.
Karma buffet, console. Pippin dining chair in 100% leather. Zeya floor rug. Benjamin pendant lamps.

Corporate Information

Nick Scali Limited

ABN 82 000 403 896

Store Locations

nickscali

New South Wales

Alexandria
Auburn
Bankstown
Belrose
Campbelltown
Campbelltown Clearance
Caringbah
Castle Hill
Casula
Kotara
Marsden Park
Moore Park
Penrith
Prospect
Prospect Clearance
Rutherford
Tuggerah
Warrawong
West Gosford

Australian Capital Territory

Fyshwick
Fyshwick Clearance

Victoria

Chirnside
Craigieburn
Essendon
Frankston
Geelong
Moorabbin
Nunawading
Nunawading Clearance
Preston
Richmond
Springvale
South Wharf
Taylors Lakes

Queensland

Aspley
Bundall
Cairns
Fortitude Valley
Jindalee
Macgregor
Mackay
Maroochydore
Maroochydore Clearance
Morayfield
North Lakes
Robina
Skygate (Brisbane Airport)
Toowoomba
Townsville

South Australia

Gepps Cross
Glynde
Marion
Mile End

Tasmania

Hobart

Western Australia

Cannington
Jandakot
Joondalup
Midland
O'Connor
Osborne Park

New Zealand

Hamilton
Mt Wellington

Registered Office

Level 7, Trinita 2
39 Delhi Road
North Ryde NSW 2113
Telephone: 02 9748 4000
Website: www.nickscali.com.au

Company Secretary

Christopher Malley

Auditors

Ernst & Young
200 George Street
Sydney NSW 2000

Solicitors

Ashurst
Level 11, 5 Martin Place
Sydney NSW 2000

Share Registry

Link Market Services Limited
Level 12, 680 George Street
Sydney NSW 2000

Stock Exchange

Nick Scali Limited shares are listed on the Australian Securities Exchange
The home exchange is Sydney
ASX code: NCK

Annual General Meeting

The Annual General Meeting will be held at 12H00 on Tuesday 29th October 2019 at Nick Scali Limited Head Office

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L I M I T E D

For personal use only

Savoy 2.5 seater electric recliner with chaise in 100% leather. Trista armchair.
Tanami coffee table and buffet in Australian oak. Chill floor lamp. Kerson floor rug.



For persons interested

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L I M I T E D