

Michael Hill International Limited

Independent Adviser's Report

In Respect of the Proposed Acquisition of the Shares Held by the Hill Family Trusts by Durante Holdings Pty Limited

October 2010

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1. Introduction

1.1 Background

Michael Hill International Limited (**MHI** or the **Company**) owns the brand *Michael Hill* and operates a retail jewellery chain of stores in Australia, New Zealand, Canada and the United States.

The Company had its origins in 1979 when Michael Hill and Christine Hill opened their first store in Whangarei. MHI grew steadily, expanding to 10 stores by 1987 and now has 53 stores in New Zealand.

MHI expanded into Australia in 1987, opening 4 stores in 4 weeks. It now has 141 stores throughout Australia in Western Australia, South Australia, Victoria, Australian Capital Territory, New South Wales and Queensland.

In 2002, the Company expanded into Canada, opening its first stores in Vancouver. It now has a presence right across Canada in British Columbia, Alberta, Manitoba and Ontario.

In 2008, the Company entered the United States market by acquiring 17 stores in Illinois and Missouri. The Company decided in 2010 to consolidate to a smaller platform of 9 stores in the Chicago area.

As at 30 June 2010, MHI had a total of 232 stores - 53 in New Zealand, 141 in Australia, 29 in Canada and 9 in the United States. The Company employs over 2,000 permanent staff in retail sales, manufacturing and administration.

MHI shares were listed on the main equities security market (**NZSX**) operated by NZX Limited (**NZX**) in 1987. The Company had a market capitalisation of \$272 million as at 14 October 2010 and audited equity of \$160 million as at 30 June 2010.

1.2 Consolidation Proposal

Three trusts associated with the Hill family (the **Hill Family Trusts**) currently hold 47.62% of the shares in MHI. A further 0.40% of the Company's shares are held by Emma Hill in her own name. We refer to the 3 Hill Family Trusts and Ms Hill collectively as the **Hill Family Interests**. The Hill Family Interests hold 48.02% of the shares in the Company.

Hill Family Interests' Shareholdings		
	No. of Shares Held	%
Quinten Trust	98,059,900	25.60%
Michael Hill International Share Trust	80,916,220	21.12%
Boxer Hill Trust	3,456,900	0.90%
Hill Family Trusts	182,433,020	47.62%
Emma Hill	1,524,750	0.40%
Hill Family Interests	183,957,770	48.02%

The trustees of the Hill Family Trusts are:

- Quinten Trust – Michael Hill, Christine Hill and Veritas Hill Limited (**Veritas**)
- Michael Hill International Share Trust – Donald Hewitt and Veritas
- Boxer Hill Trust – Michael Hill, Christine Hill and Veritas.

Durante Holdings Pty Limited (**Durante**) proposes to acquire the 182,433,020 shares held by the Hill Family Trusts in order to consolidate the Hill family's shareholdings in a single entity (the **Consolidation Proposal**). The Consolidation Proposal does not apply to the 1,524,750 shares held by Emma Hill in her own name.

Durante is wholly owned by the Boxer Hill Trust (one of the Hill Family Trusts). Its directors are Michael Hill and Emma Hill.

The key terms of the Consolidation Proposal are:

- Durante will acquire the 98,059,900 shares held by the Quinten Trust and the 80,916,220 shares held by the Michael Hill International Share Trust by way of capital distributions via the Hill Family Trusts. Accordingly, there is no consideration for these acquisitions
- Durante will acquire the 3,456,900 shares held by the Boxer Hill Trust for a consideration equal to the Company's volume weighted average share price (**VWAP**) in the 5 trading days prior to the acquisition
- the Consolidation Proposal is conditional on shareholder approval as discussed below in section 1.3
- it is intended that the Consolidation Proposal be implemented within 3 months of shareholder approval and any regulatory approvals, rulings or exemptions being obtained.

1.3 Regulatory Requirements

Rule 6 of the Takeovers Code (the **Code**) prohibits:

- a person who holds or controls less than 20% of the voting rights in a code company from increasing its holding or control of voting rights (together with its associates) beyond 20%
- a person holding or controlling 20% or more of the voting rights in a code company from increasing its holding or control of voting rights

unless the person and that person's associates comply with exceptions to this fundamental rule.

One of the exceptions, set out in Rule 7(c) of the Code, enables a person and its associates to increase their holding or control of voting rights by an acquisition of shares if the acquisition is approved by an ordinary resolution of the code company.

Because the Consolidation Proposal will result in Durante acquiring 47.62% of the voting rights in the Company and the Boxer Hill Trust will increase its control of the voting rights in the Company from 0.90% to 47.62%, MHI is required to seek shareholder approval of the Consolidation Proposal.

Shareholders will vote on an ordinary resolution in respect of the Consolidation Proposal at MHI's annual meeting on 5 November 2010 (resolution 5). Only the Company's shareholders not associated with the Hill Family Interests (the **Non-associated Shareholders**) may vote on the resolution.

Rule 18 of the Code requires the directors of a code company to obtain an Independent Adviser's Report on the merits of an allotment under Rule 7(c).

This Independent Adviser's Report is to be included in the notice of meeting pursuant to Rule 15(h).

1.4 Purpose of the Report

The directors of MHI other than Christine Hill, Emma Hill and Michael Hill (the **Independent Directors**) have engaged Simmons Corporate Finance Limited (**Simmons Corporate Finance**) to prepare an Independent Adviser's Report on the merits of the Consolidation Proposal in accordance with Rule 18 of the Code.

Simmons Corporate Finance was approved by the Takeovers Panel on 15 September 2010 to prepare the Independent Adviser's Report.

Simmons Corporate Finance issues this Independent Adviser's Report to the Independent Directors for the benefit of the Non-associated Shareholders to assist them in forming their own opinion on whether to vote for or against the resolution in respect of the Consolidation Proposal.

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

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

2. Evaluation of the Merits of the Consolidation Proposal

2.1 Basis of Evaluation

Rule 18 of the Code requires an evaluation of the merits of the Consolidation Proposal.

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

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

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

We are of the view that an assessment of the merits of the Consolidation Proposal should focus on:

- the rationale for the Consolidation Proposal
- the Consolidation Proposal price
- the impact of the Consolidation Proposal on the control of the Company
- the impact of the Consolidation Proposal on MHI's share price
- other issues associated with the Consolidation Proposal
- the implications if the resolution in respect of the Consolidation Proposal is not approved.

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

2.2 Summary of the Evaluation of the Merits of the Consolidation Proposal

Our evaluation of the merits of the Consolidation Proposal is set out in detail in sections 2.3 to 2.8.

In our opinion, after having regard to all relevant factors, there are no material negative aspects of the Consolidation Proposal from the perspective of the Non-associated Shareholders:

- the rationale for the Consolidation Proposal is sound. The Consolidation Proposal is a transaction between the Hill Family Interests in order to enable their shareholdings in the Company to be managed more efficiently and with a greater degree of expertise
- the Consolidation Proposal will not change the Hill Family Interests' collective shareholding in the Company

- the Consolidation Proposal is being effected by way of either capital distributions via the relevant Hill Family Trusts or for consideration based on market values and therefore should not have any impact on the Company's share price
- the Consolidation Proposal will not have any impact on the liquidity of MHI's shares
- the Consolidation Proposal will not have any impact on the control of the Company
- the Consolidation Proposal will not have any dilutionary impact on the Non-associated Shareholders
- the Consolidation Proposal will not have any impact on the attraction of MHI as a takeover target
- the implications of the Consolidation Proposal not being approved by the Non-associated Shareholders are that the Consolidation Proposal cannot proceed or that the Company may seek shareholder approval of the transaction at a later date (at additional cost).

2.3 The Rationale for the Consolidation Proposal

The Hill family advised MHI on 25 August 2010 that it wished to implement the Consolidation Proposal as the current 3 separate Hill Family Trusts' shareholdings in the Company were a consequence of historical circumstances. These circumstances are no longer deemed to be relevant and a single entity is now considered to be more appropriate.

The Hill family has advised the Company that the Consolidation Proposal will assist in achieving greater efficiency in the administration of the Hill Family Trusts' shareholdings in MHI by reducing administrative procedures such as bank records, tax returns and voting forms from 3 entities down to 1 entity. A single entity in the form of a company wholly owned by the Boxer Hill Trust will also enable the Hill family's MHI shareholdings (which they regard as business assets) to be separated from the personal and family assets of the Hill family. It can then be managed in a manner more appropriate to its nature as an investment and business asset and with the benefit of an appropriate governance structure.

We consider the rationale for the Consolidation Proposal to be reasonable.

2.4 Transaction Structure

Durante will acquire a total of 178,976,120 shares in MHI by way of capital distributions from the Hill Family Trusts. Accordingly, there is no consideration for these acquisitions.

Durante will acquire 3,456,900 shares from the Boxer Hill Trust for a consideration based on the 5 day VWAP up to the acquisition.

An analysis of the Company's share price is set out in section 2.6. Given that the Consolidation Proposal is to be effected by way of capital distributions at no consideration or for consideration based on market values, we are of the view that the transaction will have no impact on the Company's share price.

2.5 Impact on Control

Share Capital and Shareholders

MHI currently has 383,053,190 fully paid ordinary shares on issue, held by 3,725 shareholders.

The names, number of shares and percentage holding of the 10 largest shareholders as at 1 October 2010 are set out below.

MHI's 10 Largest Shareholders		
Shareholder	No. of Shares Held	%
Trustees of the Quinten Trust	98,059,900	25.60%
Trustees of the Michael Hill International Share Trust	80,916,220	21.12%
Accident Compensation Corporation	19,571,144	5.11%
Bond Street Custodians Limited	16,568,400	4.33%
Citibank Nominees (New Zealand) Limited	11,882,485	3.10%
T.E.A. Custodians Limited	11,636,671	3.04%
Peters MacGregor Investments Limited	7,444,600	1.94%
Peters MacGregor Pty Limited	7,367,000	1.92%
Mike Parsell	5,859,890	1.53%
Peters MacGregor Holdings Pty Limited	4,633,000	1.21%
Subtotal	263,939,310	68.90%
Others (3,715 shareholders)	119,113,880	31.10%
Total	383,053,190	100.00%

Source: NZX Data

The Hill Family Trusts collectively hold 182,433,020 shares, representing 47.62% of the total shares on issue and the Hill Family Interests collectively hold 183,957,770 shares (48.02%).

Shareholding Voting

The Consolidation Proposal is merely a transfer of shares between members of the Hill Family Interests. The Consolidation Proposal will result in Durante holding 47.62% of the shares in the Company instead of the Hill Family Trusts. However, the Hill Family Interests' collective shareholding will remain unchanged at 48.02%.

Accordingly, the Consolidation Proposal will not change the Hill Family Interests' level of influence over shareholder voting.

Board Control

The directors of MHI are:

- Murray Doyle
- Gary Gwynne
- Christine Hill
- Emma Hill, deputy chair
- Michael Hill, chair
- Mike Parsell, chief executive officer
- Wayne Peters.

We are advised that other than Christine Hill, Emma Hill and Michael Hill, none of the Company's directors are deemed to be associates of the Hill Family Interests, as defined in the Code.

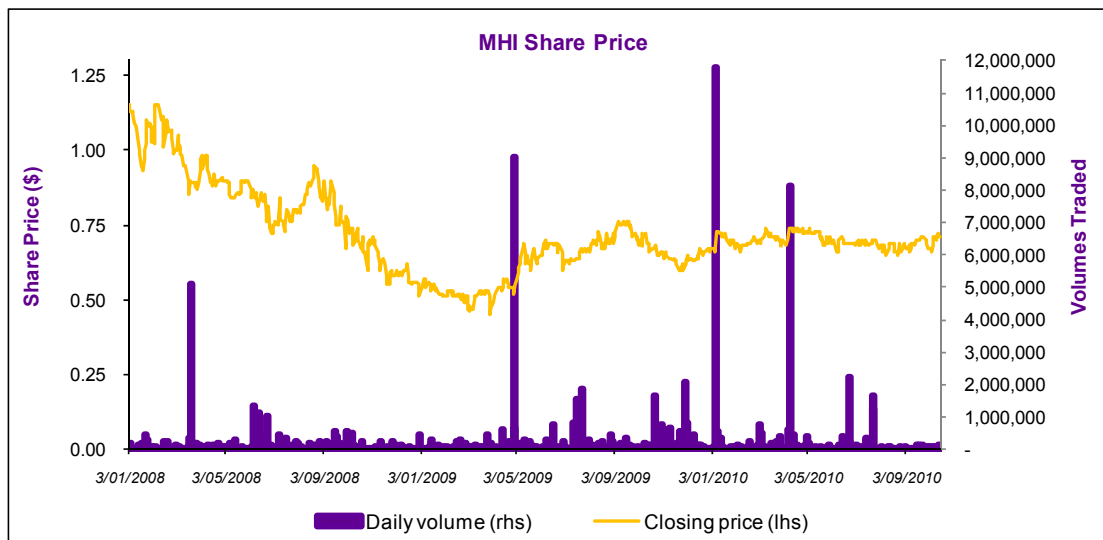
We are advised by the Independent Directors that the Consolidation Proposal will have no impact on the composition of the Company's board of directors or the Hill Family Interests' level of influence at board level.

Operations

We are advised by the Independent Directors that the Consolidation Proposal will have no impact on the Company's operations.

2.6 Impact on Share Price and Liquidity

Set out below is a summary of MHI's daily closing share price and daily volumes of shares traded from 3 January 2008 to 14 October 2010.



During the period, the shares have traded between \$0.45 and \$1.15 at a VWAP of \$0.69.

Trading in the Company's shares is relatively thin, reflecting that approximately 48% of the shares are held by the Hill Family Interests.

Share Trading						
Period	Low ¹	High ¹	VWAP ¹	Volume Traded ¹ (000)	Liquidity ¹	
					Total	Free Float ²
1 month	0.66	0.72	0.70	1,403	0.4%	0.7%
3 months	0.65	0.72	0.69	5,554	1.4%	2.8%
6 months	0.65	0.74	0.70	12,687	3.3%	6.4%
12 months	0.60	0.75	0.67	52,167	13.6%	26.2%

¹ To 14 October 2010
² Public pool, excluding shares held by the Hill Family Interests

As the Consolidation Proposal is a transfer of shares between members of the Hill Family Interests, it is unlikely to have a positive or negative effect on the liquidity of MHI's shares in the near term.

2.7 Other Issues

No Dilutionary Impact

As the Consolidation Proposal is a transfer of shares between members of the Hill Family Interests, it will have no dilutionary impact on the Non-associated Shareholders. No new shares are being issued by the Company.

No Change to the Attraction of MHI as a Takeover Target

As the Consolidation Proposal is a transfer of shares between members of the Hill Family Interests, it is unlikely to have any impact on the attraction of MHI as a takeover target:

- the Hill Family Interests' collective shareholding in the Company does not change and therefore there will be no impact on their desire to increase their level of control
- any bidder looking to fully take over the Company would need to ensure that the Hill Family Interests would accept its offer.

Durante will hold 47.62% of the Company's shares. Durante will not be able to increase the level of its shareholding in MHI unless it complies with the provisions of the Code. It will only be able to acquire more shares in the Company if:

- it makes a full or partial takeover offer or
- the acquisition is approved by way of an ordinary resolution of the Non-associated Shareholders or
- the Company makes an allotment of shares which is approved by way of an ordinary resolution of the Non-associated Shareholders.

Durante could also increase its level of shareholding in the Company if MHI undertook a share buyback that was approved by the Company's shareholders and Durante did not accept the offer of the buyback.

Durante will not be able to increase its shareholding under the *creep* provisions of Rule 7(e) of the Code as these provisions are only available to entities that hold between 50% and 90% of the voting securities in a code company. However, the Consolidation Proposal will place the Hill Family Interests in a position where *creeping* will be possible if Durante eventually holds or controls over 50% of the voting rights in MHI.

Non-associated Shareholder Approval is Required

Pursuant to Rule 7(c) of the Code, the Non-associated Shareholders must approve by ordinary resolution the Consolidation Proposal.

The Consolidation Proposal will not proceed unless the Non-associated Shareholders approve the resolution.

2.8 Implications of the Resolution not Being Approved

If the resolution is not approved then the Consolidation Proposal cannot proceed.

If the Consolidation Proposal is not approved, the Hill family may decide not to pursue the aggregation of the Hill Family Trusts' shareholdings.

Alternatively, MHI may consider seeking shareholder approval of the Consolidation Proposal at a later date, which would incur additional costs.

2.9 Voting For or Against the Resolution

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

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

3.1 Sources of Information

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

- the draft notice of annual meeting
- the MHI annual reports for the years ended 30 June, 2008 to 2010
- shareholder and share price data from NZX Data.

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

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

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

In our opinion, the information to be provided by MHI to the Non-associated Shareholders is sufficient to enable the Independent Directors and the Non-associated Shareholders to understand all the relevant factors and to make an informed decision in respect of the Consolidation Proposal.

3.2 Reliance on Information

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

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

3.3 Disclaimer

We have prepared this report with care and diligence and the statements in the report are given in good faith and in the belief, on reasonable grounds, that such statements are not false or misleading. However, in no way do we guarantee or otherwise warrant that any forecasts of future profits, cash flows or financial position of MHI will be achieved. Forecasts are inherently uncertain. They are predictions of future events that cannot be assured. They are based upon assumptions, many of which are beyond the control of MHI and its directors and management. Actual results will vary from the forecasts and these variations may be significantly more or less favourable.

We assume no responsibility arising in any way whatsoever for errors or omissions (including responsibility to any person for negligence) for the preparation of the report to the extent that such errors or omissions result from our reasonable reliance on information provided by others or assumptions disclosed in the report or assumptions reasonably taken as implicit.

Our evaluation has been arrived at based on economic, exchange rate, market and other conditions prevailing at the date of this report. Such conditions may change significantly over relatively short periods of time. We have no obligation or undertaking to advise any person of any change in circumstances which comes to our attention after the date of this report or to review, revise or update this report.

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

3.4 Indemnity

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

4. Qualifications and Expertise, Independence, Declarations and Consents

4.1 Qualifications and Expertise

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

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

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

4.2 Independence

Simmons Corporate Finance does not have at the date of this report, and has not had, any shareholding in or other relationship with MHI or the Hill Family Interests or any conflicts of interest that could affect our ability to provide an unbiased opinion in relation to this transaction.

Simmons Corporate Finance has not had any part in the formulation of the Consolidation Proposal or any aspects thereof. Our sole involvement has been the preparation of this report.

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

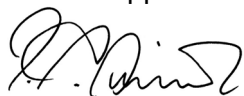
4.3 Declarations

An advance draft of this report was provided to the Independent Directors for their comments as to factual accuracy of the contents of the report. Changes made to the report as a result of the circulation of the draft have not changed the methodology or our conclusions.

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

4.4 Consents

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



Peter Simmons
Director

Simmons Corporate Finance Limited
15 October 2010