

Corporate governance statement

This report sets out the Hills Limited (Hills) annual statement on its corporate governance framework for the year ended 30 June 2017. The Board considers that Hills corporate governance framework and practices continue to comply with the requirements of the ASX Corporate Governance Council's Corporate Governance Principles and Recommendations, 3rd Edition (Principles and Recommendations) and meet the interests of our shareholders.

Principle 1: Lay solid foundations for management and oversight

The Board and Management

The Board has adopted a formal Board Charter which sets out the roles, responsibilities, structure and composition of the Board of Directors of Hills. The matters which require approval by the Board are included. A copy of the Board Charter is available on the Corporate Governance section of the Hills website at <http://www.hills.com.au/about-us/governance>.

By providing the overall strategic direction for Hills, the Board ensures that Hills activities comply with its Constitution, and with all legal and regulatory requirements, and defines the powers to be reserved to the Board and those that are delegated to its committees and management. A copy of the Constitution is available on the Hills website at <http://www.hills.com.au/about-us/governance>.

A summary of duties for the Chairman and the Chief Executive Officer are reviewed and agreed by the Board. The Board has delegated to the Chief Executive Officer the authority to manage the day to day affairs of Hills. The Company Secretary has direct accountability to the Board through the Chairman on all matters associated with the proper functioning of the Board.

Director Appointments

When filling a casual vacancy the Board undertakes a formal process to identify and assess potential candidates. Hills retains a director search firm to identify and vet potential candidates. The Directors interview the shortlists candidates. Reference and probity checks are undertaken by both the search firm and reference checks of the final candidate by the Chairman.

At the first Annual General Meeting following the appointment of a director they stand for election. At that time their experience and qualifications are provided to shareholders to enable them to elect or not to elect the new director.

A formal letter of appointment is issued to all new directors setting out their terms of appointment.

New directors participate in a director induction programme to ensure that they are able to participate immediately.

Directors have the opportunity to attend conferences and other development opportunities to ensure that they remain up to date and can perform their role as directors effectively.

Diversity

Hills is committed to creating a diverse workplace that is fair and flexible, promotes personal and professional growth and enables employees to enhance their contribution to Hills by drawing from their different backgrounds, beliefs and experiences. The Board has adopted a Diversity Policy which requires Hills to embrace differences in backgrounds, qualifications and experiences and also differences in approach and viewpoints. It includes characteristics such as gender, age, ethnicity, cultural background, language, disability and other areas of potential difference.

The Diversity Policy also requires the setting of specific gender diversity objectives and a range of measures to determine achievement of those objectives. The objectives and measures are assessed annually by the Board and the Nomination and Remuneration Committee.

The Board is of the view that appointment of females to senior positions in the Company is the most effective way to encourage change in the workforce, specifically in achieving gender balance. The Hills achievement of the objectives for the period are set out in the table below:

| | Objective | Actual at 2017 |
|--|-----------|----------------|
| | % | % |
| Percentage of women on the Board | 33 | 50 |
| Percentage of women in executive positions | 40 | 26.32 |
| Percentage of women in the organisation | 35 | 34.27 |

Principle 2: Structure the Board to add value

Nomination and Remuneration Committee

The Board has established a Nomination and Remuneration Committee which consists of a majority of Independent Non-Executive Directors including Mr Philip Bullock as the Committee Chairman and Mr Ken Dwyer. Ms Jennifer Hill-Ling is also a member of the Committee. The Board's Nomination and Remuneration Committee, amongst other things, is to ensure that the Board is comprised of individuals with an appropriate range of skills, experience, expertise, and that the Board benefits from diversity of gender. The Committee met four times during the year and all committee members attended the meetings held during their tenure. ¹ The charter of Nomination and Remuneration Committee is available on the Company website at: <http://www.corporate.hills.com.au/about-us/governance>.

Skills Matrix

The Hills Board have developed a Skills Matrix which sets out the mix of skills necessary to achieve its strategic and operational priorities of the Company. When filling board positions candidates are assessed against the skill set outlined below. The current mix of directors provides coverage of all the skills identified.

| Strategic Priorities / Areas | SKILLS MATRIX | |
|--|--|--|
| | Functional | Industry Specialisation |
| <p>Improve Customer Advocacy</p> <p>Drive Value from the Core</p> <p>Build and acquire growth businesses</p> | <ul style="list-style-type: none"> ▪ Marketing, Retail, Sales, Distribution ▪ General Business Management & Entrepreneurship ▪ Highly Competitive & Dynamic Markets | <ul style="list-style-type: none"> ▪ Telecommunications ▪ Engineering & Networks ▪ Information and Technology ▪ Security and Monitoring ▪ Health Industry & Medical |
| <p>Other Areas</p> | <ul style="list-style-type: none"> ▪ Strategic Leadership ▪ Mergers and Acquisition ▪ Other Geographical Expertise and Experience | <ul style="list-style-type: none"> ▪ CEO Level Experience ▪ Other NED Experience ▪ Accounting , Finance and Audit ▪ Legal , Governance and Compliance ▪ Risk Management ▪ Human Resources and Remuneration |

¹ During the financial year, Mr Ken Dwyer was appointed as a director on 20 September 2016 and attended three of three meetings held during his tenure, and Mr David Spence retired as a director on 20 September 2017 and attended one of one meetings held during his tenure.

Independent Directors

The Board is composed of four Non-Executive Directors.

| Name | Non-Independent/ Independent | Tenure | Experience |
|--|---------------------------------|----------------------------|---|
| Jennifer Helen Hill-Ling LLB (Adel) FAICD <i>Chairman</i> | Non-Independent | 31 years (August 1985) | Jennifer Hill-Ling has extensive experience in corporate and commercial law, specialising in corporate and business structuring, mergers and acquisitions, joint ventures and related commercial transactions. She practiced law for some 25 years and was a senior partner in two Sydney law firms in that time. She was formerly a director of Tower Trust Limited and MS Limited. She is a fellow of the Australian Institute of Company Directors. |
| Fiona Rosalyn Vivienne Bennett BA (Hons) FCA FAICD FIML | Independent | 7 years (May 2010) | Fiona Bennett is a Chartered Accountant with over 30 years' experience in business and financial management, corporate governance, risk management and audit. She has previously held senior executive positions at BHP Billiton Limited and Coles Group Limited and has been a Chief Financial Officer at several organisations in the health sector. She is currently Chairman of the Victorian Legal Services Board and a director of Beach Energy Limited and Select Harvests Limited. She was formerly a director of Boom Logistics Limited. |
| Philip Bullock BA, MBA, GAICD, Dip. Ed. | Independent | 2 years (June 2015) | Mr Bullock was formerly Vice President of the Systems and Technology Group, IBM Asia Pacific, based in Shanghai, China. Prior to that he was CEO and Managing Director of IBM Australia and New Zealand. Mr Bullock is a non-executive director of Perpetual Limited and formerly of Healthscope Limited and CSG Limited. He has also provided advice to the Federal Government, through a number of organisations, most notably as Chair of Skills Australia. |
| Ken Dwyer BCom, GMQ, GAICD | Independent | 1 year (September 2016) | Mr Dwyer formerly worked in banking, including investment banking in the US and Australia specialising in M&A, debt and equity funding. Mr Dwyer has established and grown two businesses in the highly competitive audio industry in Australia and New Zealand via a combination of organic growth and acquisitions. Mr Dwyer also has experience in the distribution of premium European machinery for textile manufacturing. |

The Board regularly assesses the independence of each Non-Executive Director and considers all Non-Executive Directors to be independent except Ms Jennifer Hill Ling. Ms Jennifer Hill Ling holds the position of Chairman and is responsible for the leadership and effective performance of the Board. Given the depth of her company experience and her industry standing she is considered to be excellently placed to serve as Chairman, notwithstanding that pursuant to the ASX recommendation she is not considered an 'Independent' Chairman. For these reasons the ASX recommendation for an Independent Chairman has not been adopted.

Mr Philip Bullock is the Lead Independent Director.

Principle 3: Promote ethical and responsible decision making

The Hills Code of Conduct (the Code) provides guidance on what is acceptable behaviour, requiring all Directors, managers and employees to maintain the highest standards of integrity and honesty. The code is available at <http://www.hills.com.au/about-us/governance>.

Hills expects its Directors, management and staff to report conduct that is dishonest, fraudulent, corrupt or illegal, endangers health and safety, or is a suspected breach of the Code or any Hills policy. Hills has adopted a Whistle Blower Protection Policy to ensure concerns regarding unacceptable conduct can be raised on a confidential basis without fear of reprisal, dismissal or discriminatory conduct.

The Hills Securities Policy governs the trading in Hills shares by Directors, management and staff in compliance with the ASX Listing Rules requirements. This policy is available on the Hills website at <http://www.hills.com.au/about-us/governance>.

Principle 4: Safeguard integrity in financial reporting

Hills is committed to maintaining a transparent system for auditing and reporting of Hills financial performance. The Board has established an Audit, Risk and Compliance Committee which performs a central function in achieving this goal.

Members of the Audit, Risk and Compliance Committee are:

- Fiona Rosalyn Vivienne Bennett (Committee Chairman);
- Philip Bullock; and
- Ken Dwyer.

All members of the Committee are independent, Non-Executive Directors.

A copy of the Committee's charter is available on the Hills website at <http://www.hills.com.au/about-us/governance>. The Company also has an Auditor Independence Policy to ensure the integrity of its external audit. This policy is also available on the Hills website at <http://www.hills.com.au/about-us/governance>.

The Committee has met four times in the 2017 financial year. The attendance of the Committee members is as follows:

| Committee Member | Number of Meetings | Number of Meetings Attended |
|--------------------------------|--------------------|-----------------------------|
| Fiona Rosalyn Vivienne Bennett | 4 | 4 |
| Philip Bullock | 4 | 4 |
| Ken Dwyer ² | 3 | 3 |
| David Spence ³ | 1 | 1 |

The Chief Executive Officer and the Chief Financial Officer have provided the Board with a written declaration in accordance with s295A of the *Corporations Act* that the full year financial statements are founded on a sound system of risk management and internal control, which implements the policies adopted by the Board, and that Hills risk management and internal control systems are operating efficiently and effectively in all material respects in relation to financial reporting risks. The external auditors attend each Annual General Meeting to answer any questions from shareholders.

Principle 5: Make timely and balanced disclosures

Hills has established, and complies with, the Communication and Market Disclosure Policy to ensure the market is informed of matters in compliance with the ASX Listing Rules disclosure requirements. A copy of the policy is available on the Hills website at <http://www.hills.com.au/about-us/governance>.

Principle 6: Respect the rights of shareholders

Hills provides its shareholders with high quality, relevant, factual and useful information in a timely manner and encourages shareholders to access this information primarily from the Hills website. Shareholders are encouraged to make their views known to Hills and to directly raise matters of concern. The Annual General Meeting remains the main opportunity for shareholders to comment on, and to question, the Hills Board and management, and shareholders are encouraged to attend.

Hills seeks questions from shareholders in its notice of meetings in written format which are then addressed at the meeting. Shareholders are also encouraged to ask questions and participate in Annual General Meetings both during the formal part of the meeting and then following the meeting informally. In other communications to shareholders they are encouraged to contact the Company Secretary if they need further assistance.

Our share registry has the facility to handle communications electronically and shareholders are encouraged to do so. However, Hills also continues to communicate through the postal service or on the telephone for shareholders who do not have access to a computer.

² Mr Ken Dwyer was appointed a director on 20 September 2016

³ Mr David Spence retired as a director on 20 September 2016

Principle 7: Recognise and manage risk

Hills does not have a dedicated Risk Committee, however, the Hills Audit, Risk and Compliance Committee (“AR&C”) oversees risk. Details of the AR&C Committee are outlined at Principle 4 above.

The AR&C Committee review the Hills risk management framework annually in June each year. The Hills Board also considers risk in developing and implementing strategy and monitors appropriate mitigation strategies that have been put in place.

Hills has established policies for the oversight of material business risks. These policies are designed to ensure that strategic, operational, compliance, reputation and financial risks are identified, assessed, effectively and efficiently managed and monitored to enable achievement of Hills business objectives.

The Board has directed management to design, assess, monitor and review the risk management and internal control framework in place to manage risks. Detailed control procedures cover management accounting, financial reporting, project appraisal, environment, health and safety, IT security, compliance and other risk management functions.

The Board requires management to provide reports during the financial year as to effective management of material business risks. During the financial year the AR&C, the Board and relevant management were provided with reports on material risks, including an assessment of the inherent risks, and the effectiveness of controls in place to manage such risks where possible. During the year our risk review did not identify any material environmental, economic or social sustainability risk.

The Company does not have an internal audit function, however the Board gains assurance over the adequacy of the Company’s internal control environment through commissioning specific reviews by external specialists and internal personnel independent of the area under review. The AR&C Committee reviews the output of these reviews and monitors the remediation of any control weaknesses.

The AR&C Committee reviews the annual insurance program to ensure Hills insurable risks are covered by appropriate insurances.

Principle 8: Remunerate fairly and responsibly

The Board has established a Nomination and Remuneration Committee whose responsibility it is to consider remuneration strategy and policy and to make recommendations to the Board that are in the best interests of Hills and its shareholders. The Committee monitors recruitment and development policies which encourage workplace diversity across individual characteristics, backgrounds and skill levels.

Members of the Nomination and Remuneration Committee are:

- Philip Bullock (Committee Chairman)
- Jennifer Helen Hill Ling; and
- Ken Dwyer.

All members of the Committee are Non-Executive Directors and Philip Bullock and Ken Dwyer are independent.

The Committee operates in accordance with its Charter, which is available on the Hills website at <http://www.hills.com.au/about-us/governance>.

The Nomination and Remuneration Committee met twice in the 2017 financial year. The attendance of the Nomination and Remuneration Committee members is as follows:

| Committee Member | Number of Meetings | Number of Meetings Attended |
|--------------------------|--------------------|-----------------------------|
| Philip Bullock | 2 | 2 |
| Jennifer Helen Hill Ling | 2 | 2 |
| Ken Dwyer ⁴ | 1 | 1 |
| Ian Elliot ⁵ | 1 | 1 |

Further information on Directors' and senior executives' remuneration, including principles used to determine remuneration, is set out in the Directors' report on pages 20 to 33.

Hills has comprehensive performance guidelines in place. For the period, each senior executive has had their performance assessed against clearly defined objectives and measures developed through the overall process of performance management.

On an annual basis the Board conducts a review of Board, Committee and individual member performance along with a review of Director Independence.

⁴ Mr Ken Dwyer was appointed a director on 20 September 2016

⁵ Mr Ian Elliot retired as a director on 4 November 2016