# EVERYONE'S A WINNER AT THE REJECT SHOP

## 2004 ANNUAL REPORT


# Your Company

➔ We are attracted to the discount variety sector because of its long-term growth prospects

➔ Our proven and focused business model provides the foundation for future sustainable growth

➔ Our success begins with our people; supported by a highly experienced management team with an extensive track record in the retail sector

# Contents



## Notice of Annual General Meeting

The Annual General Meeting of The Reject Shop Limited will be held at The ASX Theatrette, Ground Floor, 530 Collins Street, Melbourne Victoria at 3.30pm on Wednesday 27 October 2004.

EVERYONE'S A WINNER AT

THE REJECT SHOP

# Your Year

Successful ASX listing

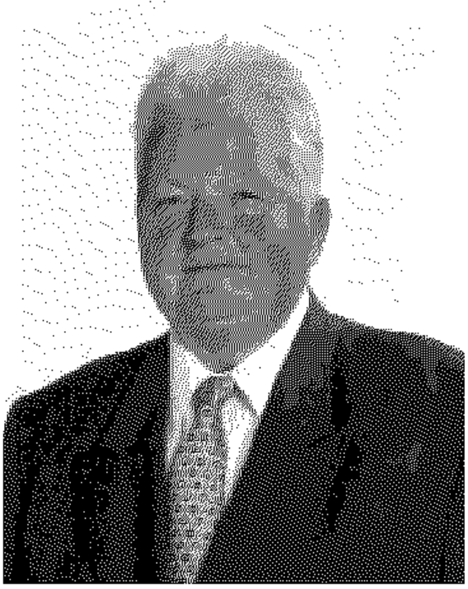
We exceeded our financial forecast with sales up 10.4% and net profit up 20.9% to $5.6 million


Comparable store sales growth of 6.1%

Our 100th store opened during 2004. Expansion into QLD commenced with opening of first QLD store. Initial performance very strong.

Eight new stores successfully opened during the year

# Chairman's Report



We are attracted to the discount variety sector because of its long-term growth prospects

Successful ASX listing

### Dear Shareholder,

It gives me great pleasure to present The Reject Shop annual report in a very significant year for the Company, which included listing on the Australian Stock Exchange on 1 June 2004. I would like to take this opportunity to welcome you as a shareholder in the Company.

### Financial Performance

The Reject Shop has achieved strong sales growth and profit in the year to 27 June 2004. Sales increased 10.4% to $180.6 million, comfortably exceeding the prospectus forecast. Net profit after tax increased 20.9% to $5.6 million, again comfortably exceeding the forecast in the Company's prospectus.

This strong performance was underpinned by the success of and our commitment to our proven and focused business model. We opened our 100th store in November 2003 and have been encouraged by the performance of our first store in Queensland which we opened in June 2004.

Our strong operating performance in the last quarter has warranted an increase from the dividend forecast in our prospectus from 2.1 to 2.5 cents per share.

Our Board was restructured during the year which resulted in some long serving and experienced directors retiring, namely Sandy Lockhart, John Fox and Rob Backwell; I sincerely thank them for their support and contribution to the Company. I believe the current Board has the right mix of retail and senior management experience, balanced with continuity of service, to oversee the Company's future. Your new Board is committed to high standards of corporate governance.

Our management team is stable with diverse retail experience and together with my fellow directors share a common understanding of the strategic direction of the Company.

### Outlook

The outlook for The Reject Shop continues to be strong. While this year's result is good, our focus is on future growth. The Company will actively pursue its extensive store roll-out program while managing the existing store portfolio. A renewed focus on enhancing the store layout will be complemented by the continual refinement of the product mix in each store. We are committed to investing in our people and will build during the new financial year added strength and depth to our merchandise and buying team. Having made good progress on the development of our information systems and processes in the

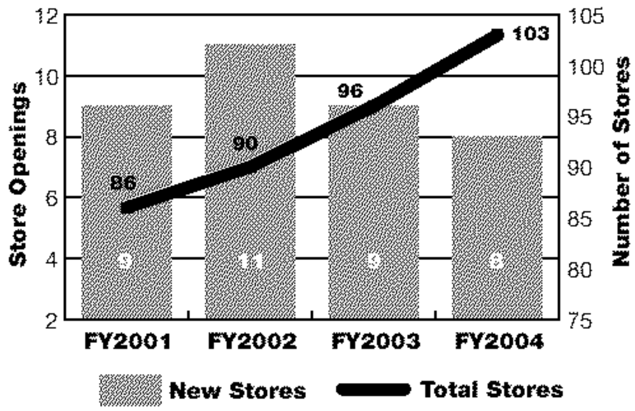
year ending 27 June 2004 we will seek to build and further refine these for added value.

Our growth is solid, and we are confident of delivering constantly improving value to our customers and future growth to shareholders.

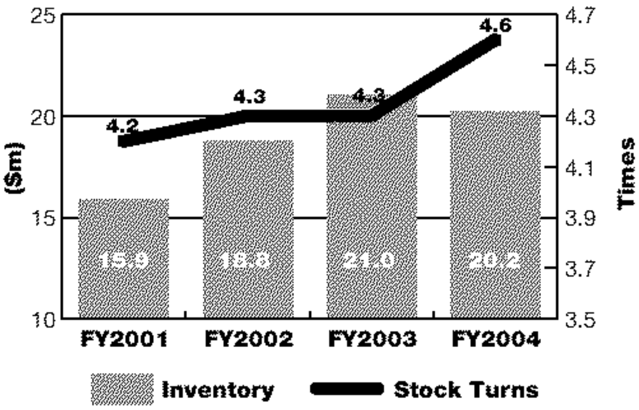
I would like to take this opportunity to thank the directors and staff, our suppliers and strategic partners all of which have helped us serve our customers during the year.

Brian J Beattie
Chairman

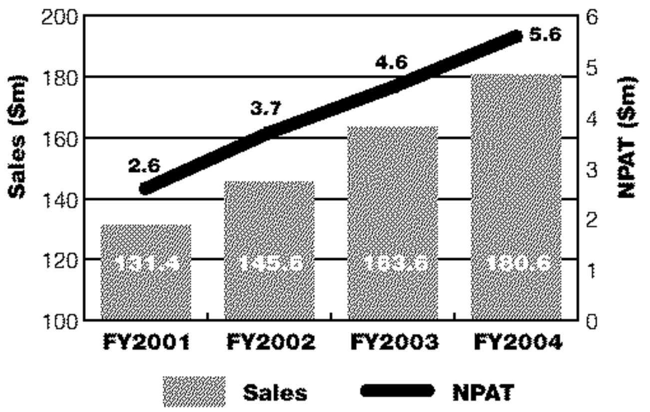
**Growth in Stores**



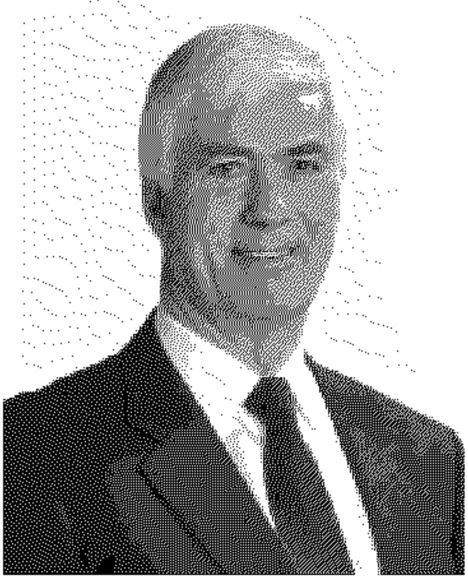

**Inventory Levels and Stock Turns**




**Growth in sales and NPAT**



# Managing Director's



We exceeded our financial forecast with sales up 10.4% and net profit up 20.9% to $5.6 million

We see numerous opportunities to further optimise our existing operations. During the year ahead we will strengthen our buying function by adding management resources, enhancing IT systems and strategies.

The strong trading result for the year is pleasing and I am encouraged by the progress we have made operationally. Through constant refinement of our proven business model we aim for continued sustainable growth. Whilst we believe we have established a solid foundation for growth, we continue to identify improvement opportunities across all functions that will enable us to serve our customers better.

## Overview of Financial Performance

Sales grew from $163.6 million to $180.6 million and net profit after tax from $4.6 million to $5.6 million, representing annual growth of 10.4% and 20.9% respectively. Sales growth was underpinned by comparable store sales growth of 6.1%, eight new store openings, and growth from stores opened during the prior year. Other significant influences on comparable stores growth were item selection by our merchandise team, increased availability of information from decision support systems, and a high level of store presentation maintained by our store people. Several key stores benefited from additional space and improved space utilization. Sales growth was also assisted by a surge in retail spending in the last quarter of the year.

Gross margin, inclusive of settlement discount, as a percentage of sales increased from 48.1% to 48.2% for the year due in part to stronger than anticipated sales in some of our higher margin product categories. While there was some element of price deflation during the year, there was a net favourable impact on our gross margin from the strength in the Australian dollar.

Operating costs, excluding depreciation and amortisation, as a percentage of sales decreased from 41.9% to 41.7%. This improvement was moderated by some project expenditure related to future productivity, for example in connection with the development of a data warehouse and enhancement of store layouts. Depreciation and amortisation as a percentage of sales remained stable at 1.7%, despite some accelerated depreciation related to store relocations over the next 12-18 months.

The business is highly seasonal, so it was extremely pleasing to record the company's first ever positive second half earnings result before interest, tax, depreciation and amortisation. This was driven by sustained attention to the everyday business, and targeting selected non-seasonal merchandise opportunities.

The Company listed on the Australian Stock Exchange on 1 June 2004. Several significant transactions occurred to facilitate the listing process including the issuing of new shares totalling $1.3 million, cancellation of vested options at a cost of $2.5 million and incurring listing costs of $0.8 million, all of which have been recorded as a movement in contributed equity during the year.

# Report

Our financial position is sound with strong cash flows and a robust balance sheet. In the near term our cash flows are more than adequate to support our planned dividend policy and store opening program. In the longer term we are well positioned for growth.

### Overview of Industry Trends

The Reject Shop operates in the Discount Variety segment of the retail industry. We believe this is a very attractive market segment, based on observations of the success of such operators overseas.

The 'unsustainable discounting' reported in our segment appears to have had limited impact on our business during the year. Our longer term organic growth strategies have continued to produce positive trading results.

### Overview of Operational Performance

The Company made widespread progress on our strategy for continuous improvement.

In merchandise we experienced excellent results on several high growth product categories as well as our everyday ranges. We made good early progress on our longer term plan to strengthen our experienced and successful merchandise team. Increasingly we were able to improve the level of decision making supported by improved data.

We opened eight new stores and finished the year with a total of 103 stores. We opened three stores in regional NSW, and one each in the ACT, South Australia, metropolitan NSW, regional Victoria, and Queensland. The early sales of our Pacific Fair store, our first in Queensland, were particularly pleasing. We are committed to actively managing our store portfolio and took the decision to close one store during the year. This closure was an Everything Here $2 store which duplicated our coverage of that trade area by a The Reject Shop store.

We improved the productivity of existing stores by extending the penetration of our 'drive aisle' configuration, upsizing selected stores in major shopping locations, and continuing the fine tuning of our space allocation by product category. We also made some good progress in logistics, especially phasing stock into stores at the right time.

Major progress was achieved on our store portal technology which in the near term will start to make a major contribution to improved intra company communications. This is important for better decision making and quicker execution of our operating program.

Our people continue to be our major strength with a stable, experienced senior team, consistent development across middle management, and highly motivated employees, especially those serving the day-to-day needs of the customer.

### Outlook for FY2005 and Beyond

We have already begun to further develop our merchandise capability which will drive future growth. The merchandise team is in the process of being strengthened with another level of management, additional buyers and more planning and administrative support. We are also improving the data flow which will enhance and support decision making.

We will continue our extensive, controlled program of store openings. Eight of the planned nine new stores have been identified and opening dates established. We will also continue the task of identifying areas where a more appropriately sized store with the correct product mix would better serve our needs, in some areas converting from Everything Here $2 to The Reject Shop banner.

A senior group will undertake a study tour of USA retail trends during the first half to keep the team up to date with developments in our market segment.

Empowerment of our people with improved technology will continue to be a priority. Assistance to replenishment ordering, allocation of central purchases, buying planning, intra company communications and enhanced financial reporting and analysis will be areas of focus. The protection of our future operations will be further enhanced by the full implementation of a revised disaster recovery plan.

We anticipate exceeding our prospectus forecast for financial year ending 26 June 2005 as we are starting from a higher base than anticipated when we formed that forecast. While it is possible that we will experience tougher trading conditions than existed in this financial year we will be aiming for net profit after tax between $6.0 and $6.2 million.

### Acknowledgements

I thank our people for their contribution to a successful year. It was a year of major transition and challenge for The Reject Shop, however our employees managed to retain a determined focus on the business and our key principle of serving the customer better. The success of the trading year is a tribute to their skill, focus and dedication.

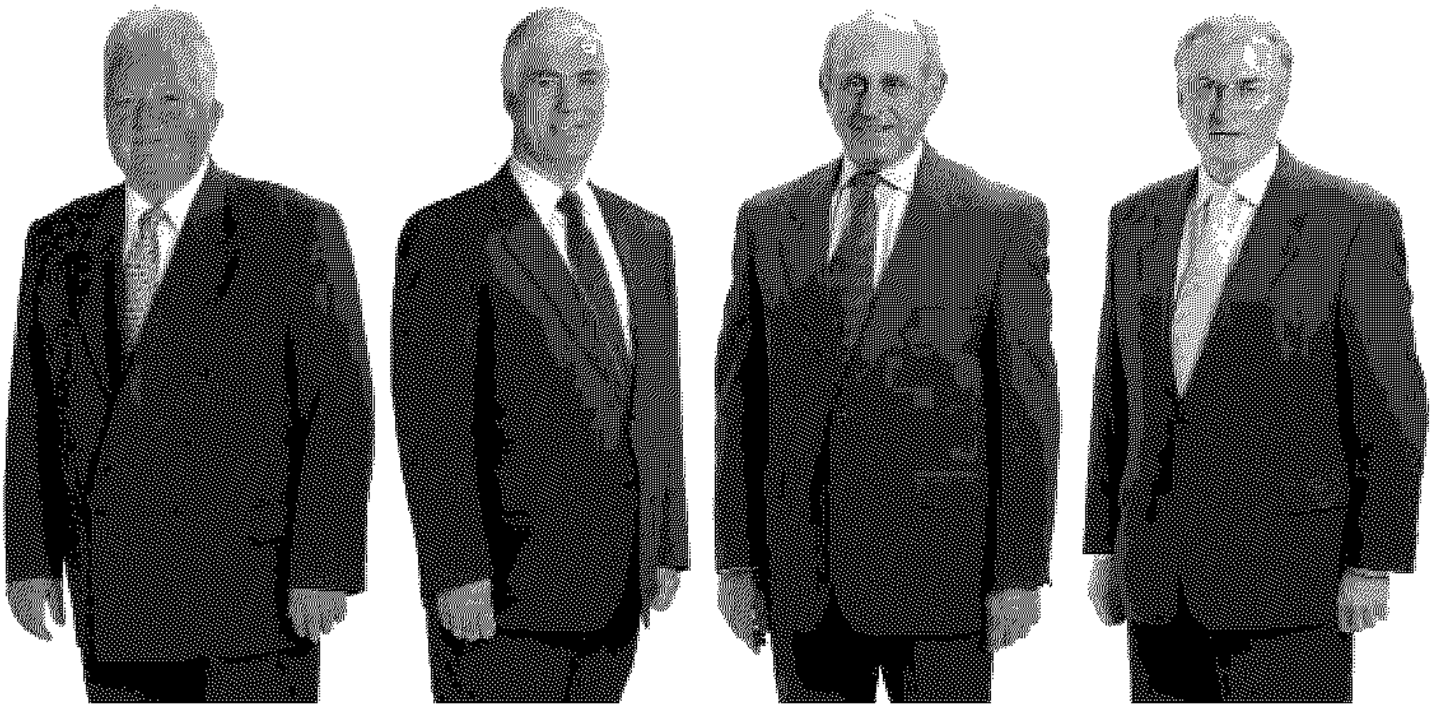
Barry Saunders
Managing Director

# Financial Highlights

| $'000 | FY2001 | FY2002 | FY2003 | FY2004 |
|---|---|---|---|---|
| **Income Statement** | | | | |
| Sales | 131,355 | 145,649 | 163,606 | 180,604 |
| Gross profit[1] | 60,844 | 68,302 | 78,648 | 87,128 |
| Operating costs | 54,496 | 59,884 | 68,599 | 75,267 |
| EBITDA | 6,348 | 8,418 | 10,049 | 11,861 |
| Depreciation and amortisation | 2,026 | 2,322 | 2,701 | 3,041 |
| EBIT | 4,322 | 6,096 | 7,348 | 8,820 |
| Interest | 516 | 656 | 746 | 796 |
| Income tax expense | 1,255 | 1,753 | 1,986 | 2,443 |
| NPAT | 2,551 | 3,687 | 4,616 | 5,581 |
| **Cash Flows** | | | | |
| Operating cash flows | 2,993 | 7,062 | 7,748 | 14,347 |
| Net capital expenditure | 2,748 | 3,663 | 4,416 | 3,813 |
| Free cash flows | 245 | 3,399 | 3,332 | 10,534 |
| **Balance Sheet** | | | | |
| Inventory | 15,908 | 18,777 | 21,026 | 20,249 |
| Net debt | 11,169 | 10,211 | 8,533 | 1,748 |
| Net assets | 9,283 | 10,964 | 15,579 | 17,410 |
| **Key Ratios and Statistics** | | | | |
| Sales growth | N/A | 10.9% | 12.3% | 10.4% |
| NPAT growth | N/A | 44.5% | 25.2% | 20.9% |
| Gross margin | 46.3% | 46.9% | 48.1% | 48.2% |
| EBIT margin | 3.3% | 4.2% | 4.5% | 4.9% |
| Operating costs as % of sales | 41.5% | 41.1% | 41.9% | 41.7% |
| Depreciation as % of sales | 1.5% | 1.6% | 1.7% | 1.7% |
| Interest cover (times) | 8.4 | 9.3 | 9.8 | 11.1 |
| Fixed charges cover (times) | 1.4 | 1.5 | 1.5 | 1.5 |
| Stock turn (times) | 4.2 | 4.3 | 4.3 | 4.6 |
| Store numbers as at the end of the financial year | 86 | 90 | 96 | 103 |
| Stores opened | 9 | 11 | 9 | 8 |
| Stores closed | 5 | 7 | 3 | 1 |
| **Earnings Per Share** | | | | |
| Basic (cents) | | | 20.1 | 23.9 |
| Diluted (cents) | | | 18.9 | 22.3 |

[1] The gross profit in FY2002 has been restated to provide a consistent classification of shrinkage. ("Shrinkage" is the difference between the value of inventory counted during stocktake and recorded inventory). The gross profit in all periods has been restated to include settlement discounts, treated as other income in the financial report. This has had no effect on reported EBIT or NPAT for these periods.

# Your Board Members



*Left to right, Brian Beattie, Barry Saunders, John Shuster and Craig McMorron*

**Brian Beattie - Non-Executive Chairman**

Brian has extensive and distinguished management experience in the retail industry spanning more than 30 years. This includes eight years with Woolworths Limited and thereafter 24 years at Coles Myer Ltd, including five years as Managing Director of Target and three years as Managing Director of Coles Supermarkets. Following that, he was Chief Executive Officer of the Victoria Racing Club and made major contributions to the structural change of the racing industry in Victoria and the growing success of the Spring Racing Carnival as a major tourist event. Brian is the Non-Executive Chairman of Austin Group Limited. Brian joined the Board in February 2004.

**Barry Saunders - Managing Director** BCom

Barry began his retail career with The Myer Emporium Ltd in 1963. He was the Chief Executive of both Target and BIG W in Australia, making significant contributions to the development stages of each. He has served on the boards of The Myer Emporium Ltd, Coles Myer Ltd and Woolworths Limited and on the Executive Committee at Pacific Dunlop Limited. He is the Non-Executive Chairman of an apparel import company, Longbeach Holdings Ltd, based in Christchurch, New Zealand. Barry has been the Managing Director of The Reject Shop since January 2000.

**John Shuster - Non-Executive Director** LLB

John is a lawyer and a former Chairman of the Company. He has a detailed knowledge of the discount variety retail sector in Australia and has contributed particular expertise on legal and property matters. John is the joint founder of The Reject Shop and has been a Director since 1983.

**A.C. (Craig) McMorron - Non-Executive Director**

Craig has held senior management positions in the financial services industry. His experience includes a wide range of general management and directorship responsibilities, the most recent appointments being with the Commonwealth Bank Group as General Manager - Americas, General Manager - CBFC Limited, General Manager- Commonwealth Development Bank and General Manager - Business and Risk Services. After retiring from full-time employment in 2002, Craig is practising as a consultant to public and private companies, with non-conflicting clients in other sectors of the retail industry. Craig joined the Board in April 2004.

# Your Management Team

*Left to right, Arnold Sloshberg, Ron Jones, Chris Bryce, Philip Beckett, Darren O'Connor, Jeff Bell, Phillip Nutbean and Barry Saunders.*

**Arnold Sloshberg – General Manager, Merchandising** BSc, MBA

Arnold commenced his retail career with the Edgars Group in South Africa over 30 years ago. He spent eight years with the Greatermans Group, including several as the Vice President of Development, and a further 13 years with the Wooltru Group, predominantly engaged in the Truworths Specialty Fashion Trade. He came to Australia as Chief Executive Officer of the Suzanne Grae organisation where he spent six years. Arnold joined The Reject Shop in January 2000 and is responsible for the Company's merchandise sourcing and management, as well as its marketing division.

**Ron Jones – General Manager, Retail Operations**

Ron started his retail career in the United Kingdom. During almost 35 years of experience in retailing, Ron has held senior store operational positions in New Zealand, the United States and Australia. In 1988, Ron came to Australia and joined Bi Lo Supermarkets (owned by Coles Myer Ltd) where he became the State General Manager for Victoria and then New South Wales. Ron was a partner in Giant Supermarkets in Queensland (subsequently sold to Franklins) and has also held senior positions with Davids Distribution (now Metcash) assisting independent retailers and was responsible for the company-owned stores. Ron joined The Reject Shop in February 2000 and is responsible for all aspects and activities of retail store operations.

**Chris Bryce – Chief Financial Officer and Company Secretary** BCom, ACA

Chris spent over ten years with PricewaterhouseCoopers providing audit and consulting advice to major retail and service companies in Australia and the United States. In 1999, Chris joined a computer and internet company as the Chief Financial Officer. He became the General Manager - Operations in 2000, a position he held until 2003. Chris has been the Chief Financial Officer and Company Secretary at The Reject Shop since joining the Company in February 2003.

**Philip Beckett – General Manager, Logistics**

Philip has over 33 years experience in senior management roles in retail distribution. He has 12 years experience in food distribution organisations which supplied major retailers in the United Kingdom, such as Marks & Spencer and Sainsburys. Philip spent 21 years with Coles Myer Ltd, including managing Myer stores' State distribution centres before assuming the role of National General Manager – Distribution. He was a key team member responsible for the conversion of Myer stores to full electronic trading. Philip is a member of the Logistics Association of Australia and joined the Company as General Manager - Logistics in January 2002.

**Darren O'Connor – Chief Information Officer** BAppSc

Darren has had a diverse career for over 20 years in information technology, including roles in IT development, analysis, testing, support and management in Australia and the United Kingdom. Darren has specialised in managing information systems in branch model organisations such as retailers, rural suppliers and gaming companies. He is a member of Institute of Electrical and Electronic Engineers. Darren joined The Reject Shop as Chief Information Officer in July 2001.

**Jeff Bell – General Manager, Human Resources**

Jeff has a broad and extensive background in human resources across a variety of industry sectors. He has held senior management positions in large automotive and manufacturing companies, including Arnott's, and retail companies, including Venture Stores. Jeff joined The Reject Shop in November 1995.

**Phillip Nutbean – General Manager, Property** AREI

Phillip has worked in commercial and retail real estate for 29 years and is a licensed real estate agent. His extensive retail property experience includes four years with Coles Myer Ltd as Property Executive for the Fosseys division. Phillip has been responsible for opening 67 of the existing 101 stores since joining The Reject Shop, first as a consultant from 1995 and then as Property Manager from May 2001.

# Corporate Governance

**THE REJECT SHOP**

**PRODUCT PROMISE**

**We are committed to providing merchandise that is:**

**★ GREAT VALUE**

**★ SAFE TO USE**

**★ FIT FOR PURPOSE**

In June 2004 we opened our first QLD store, now one of our Top 10 performers, demonstrating the potential of this previously untapped market.

Comparable store sales growth of 6.1%

The Company and the Board have set and aim to maintain high standards of corporate governance and intend, wherever practicable, to comply with the best practice recommendations released by the Australian Stock Exchange Corporate Governance Council in March 2003.

Whilst the Company formally adopted some corporate governance practices during the year as a result of its listing on the Australian Stock Exchange, the directors believe high standards of corporate governance have been maintained throughout the financial period.

A summary of the Company's main corporate governance practices are outlined below and were in place for the entire year, unless otherwise stated.

## The Board of Directors

The Board operates in accordance with the Board Charter adopted on 21 April 2004, which establishes the composition of the Board and its overall responsibilities which can be summarised as follows:

*Responsibilities of the Board*

The Board has delegated the responsibility for day-to-day management of the Company to the Managing Director and senior management, however it retains responsibility for:

- Establishing and reviewing the implementation of strategy;
- Monitoring senior management's performance;
- Ensuring appropriate resources are available to achieve the Company's objectives; and
- Promoting best practice corporate governance, including overseeing the Company's risk management policies.

In addition, to enable the directors to fulfil their responsibilities, each director may, at the Company's expense, seek independent professional advice.

To assist in meeting its responsibilities the Board has established audit and remuneration committees, each with their own separate charter and structure. Minutes of these committee meetings are tabled at the subsequent Board meetings:

Having regard to the size of the Board, it has not been considered necessary to appoint a separate nomination committee.

*Composition of the Board*

Under the Company's constitution and the Board Charter the following criteria must always be met:

- The Board must be comprised of at least 3 directors;
- The Board must be comprised of a majority of independent directors;
- The Chairman must be an independent director; and
- The Managing Director and the Chairman are separate roles and undertaken by separate people.

# Corporate Governance

*Independence*

There are currently four directors including three non-executive directors. Each director is individually assessed, for independence based on the following criteria:

- They must not be a substantial shareholder of the Company or an officer of, or otherwise associated directly with, a substantial shareholder of the Company
- they have not, within the last three years, been employed in an executive capacity by the company, or been a director after ceasing to hold any such employment
- They have not, within the last three years, been a principal of a material professional adviser or a material consultant to the Company, or an employee materially associated with the service provider
- They must not be a material supplier or customer of the Company, or an officer of or otherwise associated directly or indirectly with a material supplier or customer
- They must have no material contractual relationship with the Company or another group member other than as a director of the Company
- They have not served on the Board for a period which could, or could reasonably be perceived to, materially interfere with their ability to act in the best interests of the Company
- They must be free from any interest and any business or other relationship which could, or could reasonably be perceived to, materially interfere with their ability to act in the best interests of the Company
- Materiality is assessed on both qualitative and quantitative bases.

BJ Beattie (Chairman) and AC McMorron satisfy all criteria above and are considered independent directors. BAE Saunders as Managing Director is not considered an independent director based on the above criteria.

J Shuster is the co-founder of the Company and has been a director since 1981. He was an executive of the Company from inception until 1996 and Chairman from 1996 until 1998.

Despite his prior involvement as an executive and lengthy service as a director, the Board is treating him as an independent director. He has not been an executive of the Company since 1996 and has no material relationships with the Company. He ceased to be a substantial shareholder at the time of the Company's listing. He provides continuity of knowledge to the Board following the resignations of long serving directors as a result of the Company's listing.

Details of the directors including their experience and attendance at Board and committee meetings is contained in the Directors' Report.

*Annual Performance Reviews*

The Company intends to conduct an annual performance evaluation of all directors and will expand the current senior executive induction process to include new directors, as required. As the composition of the Board has significantly changed as a result of the Company's recent listing, no assessment of directors' performance has been deemed necessary for this financial period.

*Rotation of Directors*

Under the Company's constitution at least one third of the Company's directors must retire at each annual general meeting, as well as any director who has served for more than three years, excluding the Managing Director.

## Audit Committee

The Audit Committee Charter was adopted on 21 April 2004 and outlines the composition and responsibilities of the Audit Committee.

*Role of Audit Committee*

The role of the Audit Committee is to assist the Board in:

- Overseeing the reliability and integrity of financial and asset management;
- Ensuring compliance with the Company's accounting policies, financial reporting and disclosure practices;
- Monitoring internal controls including financial systems integrity and risk management; and
- Maintaining the relationship and reviewing the work of the external auditors.

*Responsibilities of Audit Committee*

- Reviewing the integrity of accounting principles adopted by management in the presentation of financial reports;
- Regularly review, assess and update internal controls and risk management;
- Review, monitor and assess related party transactions; and
- Monitoring the effectiveness and independence of the external auditor.

# continued

*Composition of the Audit Committee*

The Audit Committee Charter, in line with the recommendations outlined by the Corporate Governance Council, states the Committee should consist of at least three members, all of whom are non-executive directors and a majority being independent directors. The chairperson must be an independent director and not the Chairman of the Board.

In addition, the members of the Committee must have a working familiarity with basic finance and accounting practices, and at least one member of the Committee must have accounting or related financial management expertise.

The Audit Committee currently comprises the following members:
AC McMorron (Chairman)
J Shuster

The current composition of the Audit Committee does not comply with the total minimum number of members recommended by the Corporate Governance Council and the Committee Charter. However, the Board believes strongly that the Committee provides the appropriate level of expertise and focus to maintain integrity of the Company's financial reporting, in the context of smaller sized public companies. The Board believes that to comply with the recommendation would require all three independent directors to be members of the Committee which would limit the committee's ability to act separately and independently from the Board.

*Role of the External Auditor*

PricewaterhouseCoopers was appointed auditor effective 2 July 2001, and have provided a declaration of their independence to the Audit Committee. Whilst not a member of the Audit Committee, they are invited to attend all meetings. They will attend the annual general meeting to answer shareholder questions with regard to the conduct of their audit.

**Remuneration Committee**

The Remuneration Committee Charter was adopted on 21 April 2004 and outlines the composition and responsibilities of the Remuneration Committee.

*Role of the Remuneration Committee*

The role of the Remuneration Committee is to review and make recommendations to the Board regarding:
- The remuneration and appointment of senior executives and non-executive directors;
- Policies for remuneration and compensation programs of the Company;
- All equity based compensation plans.

Eight new stores successfully opened during the year

Our continued investment in IT systems is another example of bringing the disciplines of large-scale retailers to our business.

# Corporate Governance
continued

To adequately fulfil their role, the Remuneration Committee obtains and considers all relevant advice and information including industry trends in remuneration policy, market rates for the positions of Managing Director, Chief Financial Officer, other senior executives and non-executive directors, and movements in general wage rates.

Information regarding director and executive remuneration is provided in note 27 of this financial report.

*Composition of the Remuneration Committee*

Under the Remuneration Charter, and consistent with the Corporate Governance Council recommendations, the Committee shall consist of at least three members, a majority of which must be non-executive directors, with the chairperson of the Committee being a non-executive director.

Each member of the Committee must also be independent of the management of the Company and free from any relationship that, in the business judgement of the board, would interfere with the exercise of their independent judgement as a member of the Committee.

The Remuneration Committee currently comprises the following members:

BJ Beattie (Chairman)
J Shuster
AC McMorron

The current composition complies with all aspects of the Company's charter.

### Code of Conduct

The Company has an established corporate code of conduct which forms the basis for a shared view of the Company, its mission and its ethical standards and code of conduct by senior management and employees. After approval by the Board this booklet has been adopted by all senior executives.

The Company adopted a Share Trading Policy on 21 April 2004 which restricts trading of securities by directors and employees to specified periods during the year, namely 30 working days after the release of the Company's half yearly results, annual results and after the close of the Company's annual general meeting.

### Risk Management and Assessment

It is the role of the Audit Committee to oversee the management of risk within the business on behalf of the Board. The Company has established policies and practices which mitigate business and financial risk including but not limited to the following key areas:

- Prevention and Detection of Fraud;
- Capital Expenditure;
- New Site Evaluations;
- Occupational, Health and Safety systems and processes;
- Public, Product and Regulatory liability exposure;
- Data Management; and
- Foreign Exchange.

The Company's Audit and Loss Prevention and Product Compliance functions provide ongoing assurance to the Board and management that established procedures and requirements are being met.

The Managing Director and the Chief Financial Officer have made the following certifications to the Board:

- The Company's financial reports are complete and present a true and fair view, in all material respects, of the financial condition and operational results of the Company and are in accordance with relevant accounting standards; and
- The above statement is founded on a sound system of risk management and internal compliance and control, which implements the policies adopted by the Board, and ensures that the Company's risk management and internal compliance is operating efficiently and effectively in all material respects.

The Company adopted this reporting structure for the year ended 27 June 2004.

### Continuous Disclosure Policy

The Company adopted its Continuous Disclosure Policy on 21 April 2004 which established the framework by which the Company will satisfy its continuous disclosure obligations as required by the Listing Rules of the Australian Stock Exchange and the Corporations Act. This policy ensures information is disclosed in a full and timely manner to enable all shareholders and the market to have an equal opportunity to obtain and review information about the Company.

All information disclosed to the ASX is posted on the Company's website. In addition, annual and half year reports, media and analysts' presentations and press releases are also available on the Company's website.

# Financial Report

**For the Financial Year Ended 27 June 2004**

# Directors' Report

Your directors present their report on the Company and its controlled entity for the financial year ended 27 June 2004.

**Directors**

The names of directors in office at any time during or since the end of the financial year are:

| NAME AND TITLE | SPECIAL RESPONSIBILITY | PERIOD AS DIRECTOR |
|---|---|---|
| **Continuing Directors** | | |
| BJ Beattie<br>*Chairman* | Chairman of Remuneration Committee | Appointed as a director on 27 February 2004. Chairman since 27 April 2004 and continues as a director to the date of this report. |
| BAE Saunders<br>*Executive director* | Managing Director | Director for the full financial year and continues as a director to the date of this report. |
| AC McMorron<br>*Non-executive director* | Chairman of Audit Committee and Member of Remuneration Committee | Appointed as a director on 21 April 2004 and continues as a director to the date of this report. |
| J Shuster<br>*Non-executive director* | Member of Audit and Remuneration Committees | Director for the full financial year and continues as a director to the date of this report. |
| **Other Directors during the year** | | |
| JK Fox | Associate, Macquarie Direct Investments. | Director and Chairman from the start of the financial year until resignation as a director on 26 April 2004. |
| AA Lockhart | Representative, Macquarie Direct Investments. | Director from the start of the financial year until resignation as a director on 26 April 2004. |
| RP Backwell | Representative, Macquarie Direct Investments. | Director from the start of the financial year until resignation as a director on 26 April 2004. |
| AE Sloshberg | General Manager, Merchandise and continues in this role to the date of this report. | Director from the start of the financial year until resignation as a director on 26 April 2004. |
| RD Jones | General Manager, Store Operations and continues in this role to the date of this report. | Appointed on 17 September 2003 and director until resignation on 26 April 2004. |

**Retirement of Directors**

In accordance with the Company's Constitution, BJ Beattie and J Shuster will retire as directors at the annual general meeting and, being eligible, will offer themselves for re-election.

**Meetings of Directors**

The number of meetings of the Board of directors and committees held during the year ended 27 June 2004 and the number of meetings attended by each director were:

| Director | Director Meetings A | Director Meetings B | Audit Committee Meetings A | Audit Committee Meetings B | Remuneration Committee Meetings A | Remuneration Committee Meetings B |
|---|---|---|---|---|---|---|
| **Continuing Directors** | | | | | | |
| BJ Beattie | 5 | 5 | XX | XX | 1 | 1 |
| BAE Saunders | 12 | 12 | XX | XX | XX | XX |
| AC McMorron | 4 | 4 | 1 | 1 | 1 | 1 |
| J Shuster | 12 | 12 | 1 | 1 | 1 | 1 |
| **Other Directors during the year** | | | | | | |
| JK Fox | 8 | 9 | XX | XX | XX | XX |
| AA Lockhart | 5 | 9 | XX | XX | XX | XX |
| RP Backwell | 8 | 9 | XX | XX | XX | XX |
| AE Sloshberg | 7 | 9 | XX | XX | XX | XX |
| RD Jones | 3 | 7 | XX | XX | XX | XX |

*The audit and remuneration committees were formed on 21 April 2004, prior to the Company's listing. The directors who resigned during the year were not members of either committee.*

*Note: A – Number of meetings attended*

*B – Number of meetings held during the time the director held office during the year*

*XX – Not a member of relevant committee*

**Principal Activities**

The principal activities of the consolidated entity during the financial year were the retailing of discount variety merchandise and no significant change in the nature of these activities occurred during the year.

**Dividends**

Dividends paid during the financial year were 8.5 cents per fully paid share totalling $2,000,000 on 17 September 2003.

Since the end of the financial year the directors have declared the payment of a dividend of 2.5 cents per share franked at a tax rate of 30% which will be paid on 24 September 2004.

The Company has established a dividend reinvestment plan which is not currently active.

**Review of Operations**

The profit of the consolidated entity for the financial year after providing for income tax amounted to $5,580,577 (2003: $4,615,475). A detailed review of operations is provided on pages 2 to 6 of this annual report.

**Significant changes in the state of affairs**

Significant changes in the state of affairs of the consolidated entity during the financial year were as follows:

(a) The Company changed its status from a proprietary company to a public company and changed its name from The Reject Shop (Aust) Pty Ltd to The Reject Shop Limited on 24 March 2004;

(b) The Company undertook a share split on a 3,780.93 for 1 basis on 28 May 2004;

# Directors' Report continued

| | $'000 |
|---|---|
| (c) Decrease in contributed equity of $1,749,161 (from $3,365,123 to $1,615,962) as a result of: | |
| • Issue of 446,150 shares at $0.6686 per share on exercise of options issued under the Executive Option Plan | 298 |
| • Issue of 625,782 shares at $1.9989 pursuant to the Company's public offer | 1,251 |
| • Transaction costs arising on issue of shares pursuant to the Company's public offer | (840) |
| • Cancellation of 1,758,132 vested options | (2,458) |
| Net decrease in Contributed Equity | (1,749) |

(d) The Company listed on the Australian Stock Exchange on 1 June 2004.

**Matters Subsequent to the end of the Financial Year**
No matters or circumstances have arisen since the end of the financial year which significantly affect or may significantly affect the operations of the consolidated entity, the results of those operations, or the state of affairs of the consolidated entity in future financial years.

**Likely Developments and Expected Results of Operations**
Likely developments in the operations of the consolidated entity and the expected results of those operations in future financial years are contained on pages 2 to 6 of this annual report.

**Environmental Regulation**
The consolidated entity's operations are not regulated by any significant environmental regulation under a law of the Commonwealth or of a State or Territory.

**Directors and Executives Disclosures**
Disclosure of directors' and executives' remuneration, option and share holdings and the Company's remuneration policies, has been included on pages 35 to 40 of this annual report.

**Option and Performance Rights Disclosures**
The amount of shares currently under options and performance rights and the shares issued during the year on the exercise of options is provided on pages 41 to 42 of this annual report.

**Insurance of Officers**
During or since the end of the financial year, the consolidated entity has given an indemnity or entered an agreement to indemnify, or paid or agreed to pay insurance premiums as follows:

The Company has paid premiums of $108,175 to insure all directors and officers against liabilities for costs and expenses incurred by them in defending any legal proceedings arising out of their conduct while acting in their capacity as a director or an officer of the Company, other than conduct involving a wilful breach of duty in relation to the Company.

**Proceedings on behalf of the Company**
No person has applied for Leave of Court to bring proceedings on behalf of the Company or 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 any part of those proceedings. The Company was not a party to any such proceedings during the year.

This report is made in accordance with a resolution of the directors.

BJ Beattie
Chairman

BAE Saunders
Managing Director

14 September, 2004

# Statements of Financial Performance

## FOR THE FINANCIAL YEAR ENDED 27 JUNE 2004

| | Note | CONSOLIDATED ENTITY 2004 $ | CONSOLIDATED ENTITY 2003 $ | PARENT ENTITY 2004 $ | PARENT ENTITY 2003 $ |
|---|---|---|---|---|---|
| Revenues from ordinary activities | | | | | |
| Sales revenue | 2 | 180,604,033 | 163,605,911 | 180,604,033 | 163,605,911 |
| Other revenues from ordinary activities | 2 | 3,281,274 | 3,017,535 | 3,281,274 | 3,017,535 |
| | | 183,885,307 | 166,623,446 | 183,885,307 | 166,623,446 |
| Cost of sales | | 94,787,332 | 86,118,709 | 94,787,332 | 86,118,709 |
| Store expenses | | 58,870,168 | 54,428,926 | 58,870,168 | 54,428,926 |
| Administrative expenses | | 15,241,104 | 13,523,154 | 15,241,104 | 13,523,154 |
| Distribution centre expenses | | 6,166,747 | 5,204,654 | 6,166,747 | 5,204,654 |
| | | 175,065,351 | 159,275,443 | 175,065,351 | 159,275,443 |
| Borrowing costs expense | 3 | 796,177 | 746,023 | 796,177 | 746,023 |
| Profit from ordinary activities before income tax expense | | 8,023,779 | 6,601,980 | 8,023,779 | 6,601,980 |
| Income tax expense relating to ordinary activities | 4 | 2,443,202 | 1,986,505 | 2,443,202 | 1,986,505 |
| Profit from ordinary activities after related income tax expense | | 5,580,577 | 4,615,475 | 5,580,577 | 4,615,475 |
| Total changes in equity other than those resulting from transactions with owners as owners | | 5,580,577 | 4,615,475 | 5,580,577 | 4,615,475 |
| Earnings per Share | | Cents | Cents | Cents | Cents |
| Basic | 31 | 23.9 | 20.1 | 23.9 | 20.1 |
| Diluted | 31 | 22.3 | 18.9 | 22.3 | 18.9 |

The above statements of financial performance should be read in conjunction with the accompanying notes.

# Statements of Financial Position

## AS AT 27 JUNE 2004

| | Note | CONSOLIDATED ENTITY 2004 $ | CONSOLIDATED ENTITY 2003 $ | PARENT ENTITY 2004 $ | PARENT ENTITY 2003 $ |
|---|---|---|---|---|---|
| **CURRENT ASSETS** | | | | | |
| Cash assets | 5 | 3,055,542 | 820,662 | 3,055,542 | 820,662 |
| Receivables | 6 | 180,429 | 191,749 | 180,429 | 191,749 |
| Inventories | 7 | 20,249,019 | 21,025,910 | 20,249,019 | 21,025,910 |
| Other | 8 | 250,652 | 798,570 | 250,652 | 798,570 |
| **TOTAL CURRENT ASSETS** | | 23,735,642 | 22,836,891 | 23,735,642 | 22,836,891 |
| **NON-CURRENT ASSETS** | | | | | |
| Other financial assets | 9 | - | - | 1,200 | 1,200 |
| Property, plant and equipment | 10 | 15,960,890 | 15,532,096 | 15,960,890 | 15,532,096 |
| Deferred tax assets | 11 | 1,106,833 | 455,091 | 1,106,833 | 455,091 |
| **TOTAL NON-CURRENT ASSETS** | | 17,067,723 | 15,987,187 | 17,068,923 | 15,988,387 |
| **TOTAL ASSETS** | | 40,803,365 | 38,824,078 | 40,804,565 | 38,825,278 |
| **CURRENT LIABILITIES** | | | | | |
| Payables | 12 | 10,689,288 | 7,795,636 | 11,692,968 | 8,799,316 |
| Interest bearing liabilities | 13 | 2,350,462 | 7,074,959 | 2,350,462 | 7,074,959 |
| Tax liabilities | 14 | 1,579,762 | 1,293,483 | 1,579,762 | 1,293,483 |
| Provisions | 15 | 2,996,217 | 2,395,834 | 2,996,217 | 2,395,834 |
| Other | 16 | 2,668,142 | 1,880,589 | 2,668,142 | 1,880,589 |
| **TOTAL CURRENT LIABILITIES** | | 20,283,871 | 20,440,501 | 21,287,551 | 21,444,181 |
| **NON-CURRENT LIABILITIES** | | | | | |
| Interest bearing liabilities | 17 | 2,453,592 | 2,278,996 | 2,453,592 | 2,278,996 |
| Provisions | 18 | 655,471 | 525,567 | 655,471 | 525,567 |
| **TOTAL NON-CURRENT LIABILITIES** | | 3,109,063 | 2,804,563 | 3,109,063 | 2,804,563 |
| **TOTAL LIABILITIES** | | 23,392,934 | 23,245,064 | 24,396,614 | 24,248,744 |
| **NET ASSETS** | | 17,410,431 | 15,579,014 | 16,407,951 | 14,576,534 |
| **EQUITY** | | | | | |
| Contributed equity | 19 | 1,615,962 | 3,365,123 | 1,615,962 | 3,365,123 |
| Capital profits reserve | 20 | 738,773 | 738,773 | 738,773 | 738,773 |
| Retained profits | 21 | 15,055,696 | 11,475,118 | 14,053,216 | 10,472,638 |
| **TOTAL EQUITY** | | 17,410,431 | 15,579,014 | 16,407,951 | 14,576,534 |

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

# Statements of Cash Flow

## FOR THE FINANCIAL YEAR ENDED 27 JUNE 2004

| | Note | CONSOLIDATED ENTITY 2004 $ | CONSOLIDATED ENTITY 2003 $ | PARENT ENTITY 2004 $ | PARENT ENTITY 2003 $ |
|---|---|---|---|---|---|
| **CASH FLOW FROM OPERATING ACTIVITIES** | | | | | |
| Receipts from customers (inclusive of goods and services tax) | | 198,338,266 | 179,841,261 | 198,338,266 | 179,841,261 |
| Payments to suppliers and employees (inclusive of goods and services tax) | | (180,447,243) | (169,932,010) | (180,447,243) | (169,932,010) |
| Interest received | | 63,561 | 14,163 | 63,561 | 14,163 |
| Borrowing costs paid | | (796,177) | (746,023) | (796,177) | (746,023) |
| Income tax paid | | (2,811,138) | (1,428,703) | (2,811,138) | (1,428,703) |
| Net cash inflow from operating activities | 25 | 14,347,269 | 7,748,688 | 14,347,269 | 7,748,688 |
| **CASH FLOW FROM INVESTING ACTIVITIES** | | | | | |
| Proceeds from sale of property, plant and equipment | | 71,472 | 78,633 | 71,472 | 78,633 |
| Payments for property, plant and equipment | | (3,884,799) | (4,495,160) | (3,884,799) | (4,495,160) |
| Net cash outflow from investing activities | | (3,813,327) | (4,416,527) | (3,813,327) | (4,416,527) |
| **CASH FLOW FROM FINANCING ACTIVITIES** | | | | | |
| Proceeds from issue of shares | 19 | 1,549,227 | - | 1,549,227 | - |
| Payments for cancellation of options | 19 | (2,458,397) | - | (2,458,397) | - |
| Payment of transaction costs arising from issue of shares | 19 | (839,991) | - | (839,991) | - |
| Proceeds from sale and hireback | | 1,794,925 | 1,763,404 | 1,794,925 | 1,763,404 |
| Repayment of finance leases | | (2,013,383) | (2,072,998) | (2,013,383) | (2,072,998) |
| Repayment of borrowings | | (500,000) | (2,000,000) | (500,000) | (2,000,000) |
| Dividends paid | 30 | (2,000,000) | - | (2,000,000) | - |
| Net cash outflow from financing activities | | (4,467,619) | (2,309,594) | (4,467,619) | (2,309,594) |
| Net increase in cash held | | 6,066,323 | 1,022,567 | 6,066,323 | 1,022,567 |
| Cash/(overdraft) at the beginning of the financial year | | (3,569,936) | (4,592,503) | (3,569,936) | (4,592,503) |
| Cash at the end of the financial year | 25 | 2,496,387 | (3,569,936) | 2,496,387 | (3,569,936) |

The above statements of financial cash flow should be read in conjunction with the accompanying notes.

# Notes to the Financial Statements

**Note 1: Statement of significant accounting policies**

This general purpose financial report that has been prepared in accordance with Accounting Standards, other authoritative pronouncements of the Australian Accounting Standards Board, Urgent Issues Group Consensus Views and the Corporations Act 2001.

It is prepared in accordance with the historical cost convention. Unless otherwise stated, the accounting policies adopted are consistent with those of the previous year.

**(a) Principles of Consolidations**

A controlled entity is any entity controlled by The Reject Shop Limited. Control exists where The Reject Shop Limited has the capacity to dominate the decision-making in relation to the financial and operating policies of another entity so that the other entity operates with The Reject Shop Limited to achieve the objectives of The Reject Shop Limited. Details of the controlled entity are contained in Note 33.

The consolidated financial statements incorporate all the assets and liabilities of the entity controlled by The Reject Shop Limited as at 27 June 2004 and the results for the controlled entity for the year. The Reject Shop Limited and its controlled entity are referred to in this financial report as the consolidated entity. All inter-company balances and transactions between entities in the consolidated entity, including any unrealised profits or losses, have been eliminated on consolidation.

**(b) Income Tax**

The consolidated entity adopts the liability method of tax-effect accounting whereby the income tax expense shown is based on the profit from ordinary activities adjusted for any permanent differences.

Timing differences which arise due to the different accounting periods in which items of revenue and expense are included in the determination of accounting profit and taxable income are brought to account as either a provision for deferred income tax or as a future income tax benefit at the rate of income tax applicable to the period in which the benefit will be received or the liability will become payable.

Future income tax benefits are not brought to account unless realisation of the asset is assured beyond any reasonable doubt. Future income tax benefits in relation to tax losses are not brought to account unless there is virtual certainty of realisation of the benefit.

The amount of benefits brought to account or which may be realised in the future is based on the assumption that no adverse change will occur in income taxation legislation, and the anticipation that the consolidated entity will derive sufficient future assessable income to enable the benefit to be realised and comply with the conditions of deductibility imposed by the law.

**(c) Inventories**

Inventories are measured at the lower of cost and net realisable value. Costs are assigned on a first-in first-out basis and include an appropriate proportion of freight expenses.

**(d) Property, Plant and Equipment**

Each class of property, plant and equipment is carried at cost less, where applicable, any accumulated depreciation.

***Depreciation***

The depreciable amount of all fixed assets including leasehold improvements and capitalised leased assets, but excluding freehold land, are depreciated on a straight line basis over their estimated useful lives to the consolidated entity commencing from the time the asset is held ready for use.

The depreciation rates used for each class of assets are:

| CLASS OF FIXED ASSET | DEPRECIATION RATES | DEPRECIATION BASIS |
|---|---|---|
| Leasehold improvements | | |
| - At cost | 8-20 % | Straight Line |
| - Leased | 8-20 % | Straight Line |
| Plant and equipment | | |
| - At cost | 8-33 % | Straight Line |
| - Leased | 7-33 % | Straight Line |
| Motor vehicles | | |
| - At cost | 12-25 % | Straight Line |
| - Leased | 12-25 % | Straight Line |
| Office equipment | | |
| - At cost | 8-20 % | Straight Line |
| - Leased | 8-20 % | Straight Line |
| Computer equipment | | |
| - At cost | 20-33 % | Straight Line |
| - Leased | 25-33 % | Straight Line |
| Fixture and fittings | | |
| - At cost | 7-20 % | Straight Line |
| - Leased | 7-20 % | Straight Line |

**(e) Leases**

Leases of fixed assets, where substantially all the risks and benefits incidental to the ownership of the asset, but not the legal ownership, are transferred to the entities within the consolidated entity are classified as finance leases. Finance leases are capitalised, recording an asset and a liability equal to the present value of the minimum lease payments, including any guaranteed residual values. Leased assets are depreciated on a straight line basis over their estimated useful lives where it is likely that the consolidated entity will obtain ownership of the asset or over the term of the lease. Lease payments are allocated between the reduction of the lease liability and the lease interest expense for the period.

Lease payments for operating leases, where substantially all the risks and benefits remain with the lessor, are charged as expenses in the periods in which they are incurred.

Lease incentives received under operating leases are recognised in the balance sheet as both an asset and liability and are brought into account as income over the initial term of the lease.

**(f) Employee Entitlements**

*(i) Wage and salaries, annual leave and sick leave*

Liabilities for wages and salaries, annual leave and vested sick leave are recognised in respect of employees' services up to the reporting date, and are measured at the amounts expected to be settled within 12 months.

*(ii) Long service leave*

A liability for long service leave is recognised, and is measured as the present value of expected future payments to be made in respect of services provided by employees up to the reporting date. Expected future payments are discounted using interest rates on national government guaranteed securities with terms to maturity that match, as closely as possible, the estimated future cash outflows.

*(iii) Superannuation*

Contributions are made by the consolidated entity to employee personal superannuation funds and are charged as expenses when incurred.

# Notes to the Financial Statements continued

*(iv) Bonus plans*

A liability for employee benefits in the form of bonus plans is recognised when there is no realistic alternative but to settle the liability and at least one of the following conditions are met:

- There are formal terms in the plan for determining the amount of the benefit;
- The amounts to be paid are determined before the time of completion of the financial report; or
- Past practice gives clear evidence of the amount of the obligation.

Liabilities for short term cash incentives are expected to be settled within 12 months and are measured at amounts expected to be paid when settled.

*(v) Equity-based compensation benefits*

Equity-based compensation benefits are provided to employees via the Executive Option Plan and the Performance Rights Plan. Information relating to these plans is set out in note 28.

No accounting entries are made in relation to either plan until options or performance rights are exercised. The amounts disclosed for remuneration of directors and executives in note 27 include the assessed fair value of options at the date they were granted.

## (g) Cash

For the purposes of the statements of cash flows, cash includes cash on hand and at call deposits with banks and financial institutions, and investments in money market instruments maturing within two months, net of bank overdrafts.

## (h) Revenue

Revenue from the sale of goods is recognised at the point of sale. All revenue is stated net of the amount of goods and services tax (GST), returns and staff discounts.

Revenue from settlement discounts is recognised upon payment of supplier invoices and the deduction of settlement discount as agreed within the Company's supplier terms.

## (i) Foreign Currency Translation

*(i) Transactions*

Foreign currency transactions during the year are recorded in Australian currency at the date of the transaction. At balance date amounts receivable and payable in foreign currency are translated to Australian currency using the rate of exchange ruling at that date. Resulting exchange differences are recognised in determining profit for the year.

*(ii) Specific commitments*

Hedging is undertaken in order to avoid or minimise possible adverse financial effects of movements in exchange rates. Costs or gains arising at the time of entering hedged transactions for the purchase and sale of goods and services, and exchange differences that occur up to the date of purchase or sale are deferred and included in the measurement of the purchase or sale.

The net amounts receivable or payable under the hedging transaction are also recorded in the statement of financial position. Any gains or losses arising on the hedging transaction after the recognition of the hedged purchase or sale are included in the statement of financial performance.

When anticipated purchase or sale transactions have been hedged, actual purchases or sales which occur during the designated hedged period are accounted for as having been hedged until the amounts of those transactions in the designated period are fully allocated against the hedged amounts.

If the hedged transaction is terminated prior to its maturity date and the hedged transaction is no longer expected to occur as designated, deferral of any gains or losses which arose prior to termination continues and those gains and losses are included in the measurement of the hedged transaction.

In circumstances where a hedging transaction is terminated prior to maturity because the hedged transaction is no longer expected to occur as designated, any previously deferred gains or losses are recognised in the statement of financial performance on the date of termination.

If a hedge transaction relating to a commitment for the purchase or sale of goods is redesignated as a hedge of another specific commitment and the original transaction is still expected to occur as designated, the gains or losses that arise on the hedge prior to its redesignation continue to be deferred and included in the measurement of the original purchase or sale when it takes place. If the hedge is redesignated as a hedge of another commitment because the original purchase or sale transaction is no longer expected to occur as designated, the gains or losses that arise on the hedge prior to its redesignation are recognised in the statement of financial performance at the date of the redesignation.

**(j) Trade and other creditors**

These amounts represent liabilities for goods and services provided to the consolidated entity prior to the end of the financial year and which are unpaid. The amounts are unsecured and are usually paid within 30 days of recognition.

**(k) Borrowing costs**

Borrowing costs are recognised as expenses in the period in which they are incurred.

**(l) Recoverable amount of non-current assets**

The recoverable amount of an asset is the net amount expected to be recovered through the cash inflows and outflows arising from its continued use and subsequent disposal.

Where the written-down amount of a non-current asset is greater than its recoverable amount, the asset is written down to its recoverable amount. Where net cash inflows are derived from a group of assets working together, the recoverable amount is determined on the basis of the relevant group of assets. The decrement in the carrying amount is recognised as an expense in net profit in the reporting period in which the recoverable amount write-down occurs.

The expected net cash flows included in determining recoverable amount of non-current assets are not discounted to their present values using a market determined risk-adjusted discount rate.

**(m) Dividends**

Provision is made for the amount of any dividends declared, determined or publicly recommended by the Directors on or before the end of the financial period but not distributed at balance date.

**(n) Interest bearing liabilities**

Loans are carried at their principal amounts which represent the present value of future cash flows associated with servicing the debt. Interest is accrued over the period it becomes due and is recorded as part of other payables.

**(o) Earnings per share**

*(i) Basic earnings per share*

Basic earnings per share is determined by dividing net profit after income tax attributable to members of the Company, excluding any costs of servicing equity other than ordinary shares, by the number of ordinary shares outstanding at the end of the financial period, adjusted for bonus elements in ordinary shares issued during the period.

*(ii) Diluted earnings per share*

Diluted earnings per share adjusts the figures used in the determination of basic earnings per share to take into account the after income tax effect of interest and other financing costs associated with dilutive potential ordinary shares and the weighted average number of shares assumed to have been issued for no consideration in relation to dilutive potential ordinary shares.

**(p) Acquisition of assets**

The purchase method of accounting is used for all acquisition of assets. Cost is measured as the fair value of the assets given up, shares issued or liabilities undertaken at the date of acquisition plus incremental costs directly attributable to the acquisition.

# Notes to the Financial Statements continued

**(q) Web site costs**

Costs in relation to web sites are charged as expenses in the period in which they are incurred unless they relate to the acquisition of an asset, in which they are capitalised and amortised over the period of expected benefit.

**(r) Restoration Costs**

Upon the finalisation of a lease period and prior to return of the premises to a landlord, a store may require expenditure to return the store to its original format. An expense is provided for in the period that the closure is formally approved by the Company.

**(s) Store Opening Costs**

Costs associated in the setup of a new store are expensed in the period in which they are incurred.

**(t) Comparative Period**

Comparative period used in this report is the 52 week financial year ending 29 June 2003.

| | CONSOLIDATED ENTITY | | PARENT ENTITY | |
|---|---|---|---|---|
| | 2004 $ | 2003 $ | 2004 $ | 2003 $ |
| **Note 2: Revenue** | | | | |
| **Revenue from operating activities** | | | | |
| Sale of goods | 180,604,033 | 163,605,911 | 180,604,033 | 163,605,911 |
| **Revenue from outside the operating activities** | | | | |
| Interest | 63,561 | 14,163 | 63,561 | 14,163 |
| Settlement discount | 1,311,770 | 1,161,335 | 1,311,770 | 1,161,335 |
| Sale of non-current assets | 1,866,397 | 1,842,037 | 1,866,397 | 1,842,037 |
| Sundry | 39,546 | - | 39,546 | - |
| | 3,281,274 | 3,017,535 | 3,281,274 | 3,017,535 |
| | 183,885,307 | 166,623,446 | 183,885,307 | 166,623,446 |
| **Note 3: Profit From Ordinary Activities** | | | | |
| Profit from ordinary activities before income tax expense includes the following expenses: | | | | |
| Interest and finance charges paid/payable | 796,177 | 746,023 | 796,177 | 746,023 |
| Depreciation of plant and equipment | 2,225,008 | 2,178,240 | 2,225,008 | 2,178,240 |
| Amortisation of assets under finance leases | 816,202 | 522,971 | 816,202 | 522,971 |
| Net loss on disposal of property, plant and equipment | 343,323 | 189,892 | 343,323 | 189,892 |
| Write down of inventories to net realisable value | - | 30,000 | - | 30,000 |
| Rental expenses relating to operating leases | | | | |
| Base rentals | 22,171,196 | 19,791,663 | 22,171,196 | 19,791,663 |
| Rent paid on percentage of sales basis | 205,462 | 238,871 | 205,462 | 238,871 |
| Foreign exchange losses | 192,624 | 355,472 | 192,624 | 355,472 |

| | CONSOLIDATED ENTITY 2004 $ | 2003 $ | PARENT ENTITY 2004 $ | 2003 $ |
|---|---|---|---|---|
| **Note 4: Income Tax** | | | | |
| The income tax expense for the financial year differs from the amount calculated on the profit. The differences are reconciled as follows: | | | | |
| Profit from ordinary activities before income tax expense | 8,023,779 | 6,601,980 | 8,023,779 | 6,601,980 |
| Income tax calculated @ 30% | 2,407,134 | 1,980,594 | 2,407,134 | 1,980,594 |
| Tax effect of permanent differences | | | | |
| Sundry items | 36,068 | 5,975 | 36,068 | 5,975 |
| Income tax adjusted for permanent differences | 2,443,202 | 1,986,569 | 2,443,202 | 1,986,569 |
| (Over)/Under provision in previous year | - | (64) | - | (64) |
| **Income tax expense** | 2,443,202 | 1,986,505 | 2,443,202 | 1,986,505 |

The Reject Shop Limited implemented the tax consolidation legislation as of 1 July 2002. A tax sharing agreement between members of the tax consolidated group has not been entered into. As a consequence, The Reject Shop Limited, as the head entity in the tax consolidated group, recognises current and deferred tax balances in this group as if those transactions, events and balances were its own, in addition to the current and deferred tax amounts arising in relation to its own transactions, events and balances.

The financial effect of the tax consolidation legislation has been recognised in these financial statements, with no material impact on the consolidated statement of financial performance or financial position.

| | CONSOLIDATED ENTITY 2004 $ | 2003 $ | PARENT ENTITY 2004 $ | 2003 $ |
|---|---|---|---|---|
| **Note 5: Current Assets - Cash Assets** | | | | |
| Cash on hand | 262,926 | 233,073 | 262,926 | 233,073 |
| Cash at bank | 2,792,616 | 587,589 | 2,792,616 | 587,589 |
| | 3,055,542 | 820,662 | 3,055,542 | 820,662 |
| **Note 6: Current Assets - Receivables** | | | | |
| Other debtors | 180,429 | 191,749 | 180,429 | 191,749 |
| **Note 7: Current Assets - Inventories** | | | | |
| Inventory at cost | 20,013,007 | 20,531,375 | 20,013,007 | 20,531,375 |
| Inventory at net realisable value | 236,012 | 494,535 | 236,012 | 494,535 |
| | 20,249,019 | 21,025,910 | 20,249,019 | 21,025,910 |
| **Note 8: Current Assets - Other** | | | | |
| Prepayments | 219,614 | 535,415 | 219,614 | 535,415 |
| Other current assets | 31,038 | 263,155 | 31,038 | 263,155 |
| | 250,652 | 798,570 | 250,652 | 798,570 |
| **Note 9: Non-Current Assets - Other Financial Assets** | | | | |
| Shares in controlled entities - at cost | - | - | 1,200 | 1,200 |

# Notes to the Financial Statements continued

| | CONSOLIDATED ENTITY 2004 $ | CONSOLIDATED ENTITY 2003 $ | PARENT ENTITY 2004 $ | PARENT ENTITY 2003 $ |
|---|---|---|---|---|
| **Note 10: Non-Current Assets - Property, Plant And Equipment** | | | | |
| **Leasehold improvements** | | | | |
| At cost | 6,915,370 | 6,718,817 | 6,915,370 | 6,718,817 |
| Less accumulated depreciation | (4,042,505) | (3,736,811) | (4,042,505) | (3,736,811) |
| | 2,872,865 | 2,982,006 | 2,872,865 | 2,982,006 |
| Under finance lease and hire purchase | 1,606,421 | 1,021,779 | 1,606,421 | 1,021,779 |
| Less accumulated amortisation | (181,909) | (88,073) | (181,909) | (88,073) |
| | 1,424,512 | 933,706 | 1,424,512 | 933,706 |
| **Plant and equipment** | | | | |
| At cost | 3,130,317 | 3,164,381 | 3,130,317 | 3,164,381 |
| Less accumulated depreciation | (2,306,381) | (2,155,332) | (2,306,381) | (2,155,332) |
| | 823,936 | 1,009,049 | 823,936 | 1,009,049 |
| Under finance lease and hire purchase | 701,837 | 651,144 | 701,837 | 651,144 |
| Less accumulated amortisation | (146,973) | (80,376) | (146,973) | (80,376) |
| | 554,864 | 570,768 | 554,864 | 570,768 |
| **Motor vehicles** | | | | |
| At cost | 341,637 | 416,216 | 341,637 | 416,216 |
| Less accumulated depreciation | (215,972) | (234,596) | (215,972) | (234,596) |
| | 125,665 | 181,620 | 125,665 | 181,620 |
| Under finance lease and hire purchase | 822,449 | 694,261 | 822,449 | 694,261 |
| Less accumulated amortisation | (203,195) | (128,377) | (203,195) | (128,377) |
| | 619,254 | 565,884 | 619,254 | 565,884 |
| **Office equipment** | | | | |
| At cost | 305,743 | 264,373 | 305,743 | 264,373 |
| Less accumulated depreciation | (237,734) | (224,815) | (237,734) | (224,815) |
| | 68,009 | 39,558 | 68,009 | 39,558 |
| Under finance lease and hire purchase | 67,309 | 43,276 | 67,309 | 43,276 |
| Less accumulated amortisation | (20,834) | (10,525) | (20,834) | (10,525) |
| | 46,475 | 32,751 | 46,475 | 32,751 |
| **Computer equipment** | | | | |
| At cost | 1,626,253 | 1,391,646 | 1,626,253 | 1,391,646 |
| Less accumulated depreciation | (1,011,409) | (928,499) | (1,011,409) | (928,499) |
| | 614,844 | 463,147 | 614,844 | 463,147 |
| Under finance lease and hire purchase | 4,203,498 | 4,017,115 | 4,203,498 | 4,017,115 |
| Less accumulated amortisation | (3,027,082) | (2,199,359) | (3,027,082) | (2,199,359) |
| | 1,176,416 | 1,817,756 | 1,176,416 | 1,817,756 |

| | CONSOLIDATED ENTITY 2004 $ | CONSOLIDATED ENTITY 2003 $ | PARENT ENTITY 2004 $ | PARENT ENTITY 2003 $ |
|---|---|---|---|---|
| **Furniture, fixtures and fittings** | | | | |
| At cost | 11,154,816 | 10,725,083 | 11,154,816 | 10,725,083 |
| Less accumulated depreciation | (6,354,584) | (5,847,778) | (6,354,584) | (5,847,778) |
| | 4,800,232 | 4,877,305 | 4,800,232 | 4,877,305 |
| Under finance lease and hire purchase | 3,522,617 | 2,523,158 | 3,522,617 | 2,523,158 |
| Less accumulated amortisation | (688,799) | (464,612) | (688,799) | (464,612) |
| | 2,833,818 | 2,058,546 | 2,833,818 | 2,058,546 |
| Total plant and equipment | 11,663,513 | 11,616,384 | 11,663,513 | 11,616,384 |
| Total property, plant and equipment | 15,960,890 | 15,532,096 | 15,960,890 | 15,532,096 |

**Movements in Carrying Amounts**

Movements in the carrying amounts for each class of property, plant and equipment between the beginning and the end of the current financial year are as follows:

| | LEASEHOLD IMPROVEMENTS At Cost $ | LEASEHOLD IMPROVEMENTS Leased $ | PLANT & EQUIPMENT At Cost $ | PLANT & EQUIPMENT Leased $ |
|---|---|---|---|---|
| Balance at the beginning of the year | 2,982,006 | 933,706 | 1,009,049 | 570,768 |
| Additions | 1,048,615 | 590,870 | 132,587 | 51,885 |
| Disposals | (736,034) | (4,772) | (75,874) | (914) |
| Depreciation/amortisation expense | (421,722) | (95,292) | (241,826) | (66,875) |
| Carrying amount at end of the year | 2,872,865 | 1,424,512 | 823,936 | 554,864 |

| | COMPUTER EQUIPMENT At Cost $ | COMPUTER EQUIPMENT Leased $ | MOTOR VEHICLES At Cost $ | MOTOR VEHICLES Leased $ |
|---|---|---|---|---|
| Balance at the beginning of the year | 463,147 | 1,817,756 | 181,620 | 565,884 |
| Additions | 538,405 | 187,357 | - | 232,160 |
| Disposals | (177,099) | (632) | (18,630) | (72,967) |
| Depreciation/amortisation expense | (209,609) | (828,065) | (37,325) | (105,823) |
| Carrying amount at the end of the year | 614,844 | 1,176,416 | 125,665 | 619,254 |

| | OFFICE EQUIPMENT At Cost $ | OFFICE EQUIPMENT Leased $ | FURNITURE, FIXTURES AND FITTINGS At Cost $ | FURNITURE, FIXTURES AND FITTINGS Leased $ |
|---|---|---|---|---|
| Balance at the beginning of the year | 39,558 | 32,751 | 4,877,305 | 2,058,546 |
| Additions | 68,053 | 24,348 | 1,773,410 | 1,032,034 |
| Disposals | (24,348) | (131) | (1,072,853) | (25,466) |
| Depreciation/amortisation expense | (15,254) | (10,493) | (777,630) | (231,296) |
| Carrying amount at the end of the year | 68,009 | 46,475 | 4,800,232 | 2,833,818 |

| | TOTAL $ |
|---|---|
| Balance at the beginning of the year | 15,532,096 |
| Additions | 5,679,724 |
| Disposals | (2,209,720) |
| Depreciation/amortisation expense | (3,041,210) |
| Carrying amount at the end of the year | 15,960,890 |

# Notes to the Financial Statements continued

| | Note | CONSOLIDATED ENTITY 2004 $ | CONSOLIDATED ENTITY 2003 $ | PARENT ENTITY 2004 $ | PARENT ENTITY 2003 $ |
|---|---|---|---|---|---|
| **Note 11: Non-Current Assets - Deferred Tax Assets** | | | | | |
| Future Income Tax Benefit | | 1,106,833 | 455,091 | 1,106,833 | 455,091 |
| No part of the future income tax benefit is attributable to tax losses. | | | | | |
| **Note 12: Current Liabilities - Payables** | | | | | |
| Unsecured liabilities | | | | | |
| Trade creditors | | 9,144,600 | 6,076,638 | 9,144,600 | 6,076,638 |
| Sundry creditors and accruals | | 1,544,688 | 1,718,998 | 1,544,688 | 1,718,998 |
| Amounts owing to controlled entities | | | | 1,003,680 | 1,003,680 |
| | | 10,689,288 | 7,795,636 | 11,692,968 | 8,799,316 |
| **Note 13: Current Liabilities - Interest Bearing Liabilities** | | | | | |
| Secured liabilities | | | | | |
| Bank overdrafts | | 559,155 | 4,390,598 | 559,155 | 4,390,598 |
| Bank loans | | - | 500,000 | - | 500,000 |
| Finance lease liability | 22 | 498,561 | 763,164 | 498,561 | 763,164 |
| Hire purchase liability | 22 | 1,292,746 | 1,421,197 | 1,292,746 | 1,421,197 |
| | | 2,350,462 | 7,074,959 | 2,350,462 | 7,074,959 |

Bank overdraft and bank loans are secured by:

Cross Guarantee and Indemnity between The Reject Shop Limited and TRS Trading Group Pty Ltd supported by :

First Registered Company Charge (Mortgage Debenture) over all the assets and undertakings of The Reject Shop Limited - this is a fixed and floating charge over all present and future assets, undertaking (including goodwill) and unpaid/uncalled capital of the Company.

First Registered Company Charge (Mortgage Debenture) over all the assets and undertakings of TRS Trading Group Pty Ltd - this is a fixed and floating charge over all present and future assets, undertaking (including goodwill) and unpaid/uncalled capital of the Company.

Letter of Set-Off by and on account of The Reject Shop Limited and TRS Trading Group Pty Ltd.

| | Note | CONSOLIDATED ENTITY 2004 $ | CONSOLIDATED ENTITY 2003 $ | PARENT ENTITY 2004 $ | PARENT ENTITY 2003 $ |
|---|---|---|---|---|---|
| **Note 14: Current Liabilities - Tax Liabilities** | | | | | |
| Income tax | | 1,579,762 | 1,293,483 | 1,579,762 | 1,293,483 |
| **Note 15: Current Liabilities - Provisions** | | | | | |
| Employment entitlements | 28 | 2,996,217 | 2,395,834 | 2,996,217 | 2,395,834 |
| **Note 16: Current Liabilities - Other** | | | | | |
| Accrued expenses | | 2,264,129 | 1,340,754 | 2,264,129 | 1,340,754 |
| Deferred income | | 404,013 | 539,835 | 404,013 | 539,835 |
| | | 2,668,142 | 1,880,589 | 2,668,142 | 1,880,589 |
| **Note 17: Non-Current Liabilities - Interest Bearing Liabilities** | | | | | |
| Secured liabilities | | | | | |
| Finance lease liability | 22 | 471,538 | 798,354 | 471,538 | 798,354 |
| Hire purchase liability | 22 | 1,982,054 | 1,480,642 | 1,982,054 | 1,480,642 |
| | | 2,453,592 | 2,278,996 | 2,453,592 | 2,278,996 |
| **Note 18: Non-Current Liabilities - Provisions** | | | | | |
| Employment entitlements | 28 | 655,471 | 525,567 | 655,471 | 525,567 |

| | CONSOLIDATED ENTITY 2004 $ | CONSOLIDATED ENTITY 2003 $ |
|---|---|---|
| **Note 19: Equity - Contributed Equity** | | |
| **Issued and paid up capital** | | |
| Ordinary shares fully paid | 1,615,962 | 3,365,123 |
| **Movement in contributed equity** | | |
| Balance at the beginning of the year | 3,365,123 | 3,365,123 |
| Shares issued on exercise of options (i) | 298,314 | - |
| | 3,663,437 | 3,365,123 |
| Shares issued on 1 June 2004 (iii) | 1,250,913 | - |
| Payment of transaction costs on listing (iv) | (839,991) | - |
| Cancellation of options (v) | (2,458,397) | - |
| Balance at the end of the year | 1,615,962 | 3,365,123 |
| **Movement in Shares on issue** | **No. of Shares** | **No. of Shares** |
| Balance at the beginning of the year | 6,084 | 6,084 |
| Shares issued on exercise of options (i) | 118 | - |
| | 6,202 | 6,084 |
| Share split (ii) | 23,443,126 | - |
| Shares issued on 1 June 2004 (iii) | 625,782 | - |
| Balance at the end of the year | 24,075,110 | 6,084 |

# Notes to the Financial Statements continued

(i) 118 shares issued on exercise of options on 16 September 2003 at an exercise price of $2,528.09 (on a post share split basis – 446,150 shares issued at an exercise price of $0.6686 per share)

(ii) Share split on a 3,780.93 for 1 basis, increasing the number of shares on issue from 6,202 to 23,449,328 on 28 May 2004;

(iii) 625,782 shares issued at $1.9989 per share pursuant to the Initial Public Offer;

(iv) Payment of $839,991 for costs associated with the Initial Public Offer; and

(v) Payment on cancellation of 1,758,132 existing vested options totalling $2,458,397 on 31 May 2004.

The voting rights of ordinary shares are that each share shall have one vote.

| | Note | CONSOLIDATED ENTITY 2004 $ | 2003 $ | PARENT ENTITY 2004 $ | 2003 $ |
|---|---|---|---|---|---|
| **Note 20: Equity – Capital Profits Reserve** | | | | | |
| Capital profits reserve | | 738,773 | 738,773 | 738,773 | 738,773 |
| There have been no movements in the Capital Profits Reserve during the financial year. | | | | | |
| **Note 21: Equity – Retained Profits** | | | | | |
| Retained profits at the beginning of the financial period | | 11,475,119 | 6,859,643 | 10,472,639 | 5,857,163 |
| Net profit attributable to members of the consolidated entity | | 5,580,577 | 4,615,475 | 5,580,577 | 4,615,475 |
| Dividends provided for or paid | | (2,000,000) | - | (2,000,000) | - |
| Retained profits at reporting date | | 15,055,696 | 11,475,118 | 14,053,216 | 10,472,638 |
| A dividend was paid on 17 September 2003 of 8.5 cents per share (on a post split basis) totalling $2,000,000. | | | | | |
| **Note 22: Capital And Lease Commitments** | | | | | |
| **Finance lease commitments** | | | | | |
| Payable | | | | | |
| not later than one year | | 577,079 | 886,023 | 577,079 | 886,023 |
| later than one year and not later than five years | | 510,746 | 874,321 | 510,746 | 874,321 |
| Minimum lease payments | | 1,087,825 | 1,760,344 | 1,087,825 | 1,760,344 |
| Less future finance charges | | 117,726 | 198,826 | 117,726 | 198,826 |
| Total lease liability | | 970,099 | 1,561,518 | 970,099 | 1,561,518 |
| Represented by: | | | | | |
| Current liability | 13 | 498,561 | 763,164 | 498,561 | 763,164 |
| Non-current liability | 17 | 471,538 | 798,354 | 471,538 | 798,354 |
| | | 970,099 | 1,561,518 | 970,099 | 1,561,518 |

Finance leases are 3 year lease terms for the purchase of motor vehicles and computer equipment.

| | Note | CONSOLIDATED ENTITY 2004 $ | CONSOLIDATED ENTITY 2003 $ | PARENT ENTITY 2004 $ | PARENT ENTITY 2003 $ |
|---|---|---|---|---|---|
| **Hire Purchase Commitments** | | | | | |
| Payable | | | | | |
| Not later than one year | | 1,639,919 | 1,673,142 | 1,639,919 | 1,673,142 |
| later than one year and not later than five years | | 2,196,355 | 1,681,326 | 2,196,355 | 1,681,326 |
| Minimum hire purchase payments | | 3,836,274 | 3,354,468 | 3,836,274 | 3,354,468 |
| Less future finance charges | | 561,474 | 452,629 | 561,474 | 452,629 |
| Total hire purchase liability | | 3,274,800 | 2,901,839 | 3,274,800 | 2,901,839 |
| Hire purchase contracts are 3 year agreements for the purchase of new store fixtures and fittings. | | | | | |
| Represented by: | | | | | |
| Current liability | 13 | 1,292,746 | 1,421,197 | 1,292,746 | 1,421,197 |
| Non-current liability | 17 | 1,982,054 | 1,480,642 | 1,982,054 | 1,480,642 |
| | | 3,274,800 | 2,901,839 | 3,274,800 | 2,901,839 |
| **Operating lease commitments** | | | | | |
| Non-cancellable operating leases contracted for but not capitalised in the financial statements: | | | | | |
| Payable | | | | | |
| not later than one year | | 22,521,322 | 17,909,967 | 22,521,322 | 17,909,967 |
| later than one year and not later than five years | | 40,605,018 | 30,395,021 | 40,605,018 | 30,395,021 |
| later than five years | | 1,274,842 | 1,590,211 | 1,274,842 | 1,590,211 |
| | | 64,401,182 | 49,895,199 | 64,401,182 | 49,895,199 |
| **Note 23: Contingent Liabilities** | | | | | |
| Estimates of the maximum amounts of contingent liabilities that may become payable: | | | | | |
| Letters of credit established for acquisition of goods for resale | | 243,704 | 352,206 | 243,704 | 352,206 |
| ANZ Bank indemnity guarantee to landlords | | 955,478 | 894,060 | 955,478 | 894,060 |
| | | 1,199,182 | 1,246,266 | 1,199,182 | 1,246,266 |
| **Note 24: Related Party Transactions** | | | | | |
| Stock purchased by TRS Trading Group Pty Ltd | | - | 24,732,028 | - | 24,732,028 |

Related party transactions for director related entities are disclosed in note 27.

# Notes to the Financial Statements continued

| | CONSOLIDATED ENTITY 2004 $ | CONSOLIDATED ENTITY 2003 $ | PARENT ENTITY 2004 $ | PARENT ENTITY 2003 $ |
|---|---|---|---|---|
| **Note 25: Cash Flow Information** | | | | |
| **Reconciliation of cash** | | | | |
| Cash at the end of the financial year as shown in the statements of cash flows is reconciled to the related items in the statements of financial position as follows: | | | | |
| Cash on hand | 262,926 | 233,073 | 262,926 | 233,073 |
| Cash at bank | 2,792,616 | 587,589 | 2,792,616 | 587,589 |
| Bank overdrafts | (559,155) | (4,390,598) | (559,155) | (4,390,598) |
| | 2,496,387 | (3,569,936) | 2,496,387 | (3,569,936) |
| **Reconciliation of cash flow from operations with profit from ordinary activities** | | | | |
| Profit from ordinary activities after Income Tax | 5,580,577 | 4,615,475 | 5,580,577 | 4,615,475 |
| Non-cash flows in profit from ordinary activities | | | | |
| Amortisation of leased assets | 816,202 | 522,971 | 816,202 | 522,971 |
| Depreciation | 2,225,008 | 2,178,240 | 2,225,008 | 2,178,240 |
| Loss on sale of property, plant and equipment | 343,322 | 189,892 | 343,322 | 189,892 |
| Changes in assets and liabilities, net of effects of purchase and disposal of subsidiaries | | | | |
| (Increase) / Decrease in receivables and other assets | 559,238 | (554,573) | 559,238 | (554,573) |
| (Increase) / Decrease in inventories | 776,891 | (1,908,289) | 776,891 | (1,908,289) |
| Increase in trade and other creditors and other provisions | 4,411,494 | 2,147,170 | 4,411,494 | 2,147,170 |
| Increase in income tax payable | 286,279 | 871,114 | 286,279 | 871,114 |
| (Increase) in deferred taxes | (651,742) | (313,312) | (651,742) | (313,312) |
| Net cash provided by operations | 14,347,269 | 7,748,688 | 14,347,269 | 7,748,688 |
| **Non-cash financing and investing activities** | | | | |
| Acquisition of plant & equipment by means of finance lease | 2,118,654 | 3,157,595 | 2,118,654 | 3,157,595 |

**Credit standby arrangement and loan facilities**

The ongoing funding requirements of the Company are provided under the terms of a facility agreement. The key facilities and their utilisation are as follows:

| | 2004 Limit $ | 2004 Utilised $ | 2003 Limit $ | 2003 Utilised $ |
|---|---|---|---|---|
| Interchangeable Working Capital Facility | 11,000,000 | (1,365,893) | 11,000,000 | 5,428,625 |
| Interchangeable Asset Finance Facility | 5,000,000 | 3,939,680 | 5,000,000 | 4,107,244 |
| Foreign Currency Settlement | 3,400,000 | - | 3,400,000 | 645,554 |
| Other Facilities | 4,992,000 | 955,478 | 4,992,000 | 894,060 |
| Total Facility | 24,392,000 | 3,529,265 | 24,392,000 | 11,075,483 |

A seasonal facility of $12,000,000 was utilised from 1 July 2003 and repaid in full by 31 December 2003.

## Note 26: Financial Instruments

**Derivative Financial Instruments**

Derivative financial instruments are used by the consolidated entity to hedge exposure to exchange rate risk associated with foreign currency transactions which impact on the borrowings of the consolidated entity. The derivative financial instruments used by the entity are not recognised in the financial statements. Transactions for hedging purposes are undertaken without the use of collateral as only reputable institutions with sound financial positions are dealt with.

The consolidated entity enters into forward exchange contracts to buy and sell specified amounts of foreign currency in the future at stipulated exchange rates. The objective in entering the forward exchange contracts is to protect the consolidated entity against unfavourable exchange rate movements for both the contracted and anticipated future sales and purchases undertaken in foreign currencies.

The accounting policy in regard to forward exchange contracts is detailed in note 1(i) (ii)

At balance date, the details of outstanding forward exchange contracts to be settled within 6 months are:

| SELL | BUY | 2004 $ | 2003 $ | 2004 $ AVERAGE EXCHANGE RATE | 2003 $ |
|---|---|---|---|---|---|
| Australian Dollars | United States Dollars | 3,511,729 | 7,599,314 | 0.71 | 0.66 |
| Australian Dollars | Euro | - | 349,319 | - | 0.57 |
| Australian Dollars | Pounds Sterling | 243,902 | 492,009 | 0.41 | 0.37 |
| Australian Dollars | Denmark DK | - | 68,751 | - | 4.22 |

**Interest Rate Risk**

The consolidated entity's exposure to interest rate risk, which is the risk that a financial instrument's value will fluctuate as a result of changes in market interest rates and the effective weighted average interest rates on classes of financial assets and financial liabilities, is as follows:

| | WEIGHTED AVERAGE EFFECTIVE INTEREST RATE | | FLOATING INTEREST RATE | | FIXED INTEREST RATE MATURING WITHIN 1 YEAR | |
|---|---|---|---|---|---|---|
| | 2004 % | 2003 % | 2004 $ | 2003 $ | 2004 $ | 2003 $ |
| *Financial Assets* | | | | | | |
| Cash | 3.50 | 3.75 | 3,055,542 | 820,662 | | - |
| *Financial Liabilities* | | | | | | |
| Bank loans and overdrafts | 5.25 | 4.95 | - | - | 559,155 | 4,890,598 |
| Hire purchase liabilities | 6.85 | 6.50 | - | - | 1,292,746 | 1,421,197 |
| Lease liabilities | 7.25 | 6.80 | - | - | 498,561 | 763,164 |
| Total Financial Liabilities | | | - | - | 2,350,462 | 7,074,959 |

# Notes to the Financial Statements continued

| | FIXED INTEREST RATE MATURING 1 TO 5 YEARS 2004 $ | 2003 $ | OVER 5 YEARS 2004 $ | 2003 $ |
|---|---|---|---|---|
| *Financial Assets* | - | - | - | - |
| *Financial Liabilities* | | | | |
| Hire purchase liabilities | 1,982,054 | 1,480,642 | - | - |
| Lease liabilities | 471,538 | 798,354 | - | - |
| Total Financial Liabilities | 2,453,592 | 2,278,996 | - | - |

| | NON-INTEREST BEARING 2004 $ | 2003 $ | TOTAL 2004 $ | 2003 $ |
|---|---|---|---|---|
| *Financial Assets* | | | | |
| Cash | - | - | 3,055,542 | 820,662 |
| Receivables and other debtors | 105,676 | 338,789 | 105,676 | 338,789 |
| Total Financial Assets | 105,676 | 338,789 | 3,161,218 | 1,159,451 |
| *Financial Liabilities* | | | | |
| Bank loans and overdrafts | - | - | 559,155 | 4,890,598 |
| Trade, sundry, and other creditors | 13,357,430 | 9,676,225 | 13,357,430 | 9,676,225 |
| Hire purchase liabilities | - | - | 3,274,800 | 2,901,839 |
| Lease liabilities | - | - | 970,099 | 1,561,518 |
| Total Financial Liabilities | 13,357,430 | 9,676,225 | 18,161,484 | 19,030,180 |

**Credit Risk**

The maximum exposure to credit risk, excluding the value of any collateral or other security, at balance date to recognised financial assets is the carrying amount of those assets, net of any provisions for doubtful debts of those assets, as disclosed in the statement of financial position and notes to the financial statements.

Credit risk for derivative financial instruments arises from the potential failure by counterparties to the contract to meet their obligations. The credit risk exposure to forward exchange contracts is the net fair value of these contracts.

The consolidated entity does not have any material credit risk exposure to any single debtor or group of debtors under financial instruments entered into by the consolidated entity.

**Net Fair Values**

For other assets and other liabilities the net fair value approximates their carrying value.

No financial assets and financial liabilities are readily traded on organised markets in standardised form other than listed investments, forward exchange contracts and interest rate swaps.

The aggregate net fair values and carrying amounts of financial assets and financial liabilities are disclosed in the statement of financial position and in the notes to the financial statements.

## Note 27: Directors and Executives Disclosures

### *Directors*

The following persons were directors of The Reject Shop Limited during the financial year:

*Continuing Directors*

BJ Beattie – Chairman

BAE Saunders – Managing Director

AC McMorron – Non-executive director

J Shuster – Non-executive director

*Other Directors during the year*

JK Fox – Non-executive director (Chairman to 26 April 2004)

AA Lockhart – Non-executive director

RP Backwell – Non-executive director

AE Sloshberg – General Manager, Merchandise

RD Jones – General Manager, Store Operations

### *Specified Executives*

The following persons were the five executives, excluding executive directors, with the greatest authority for strategic direction and management of the consolidated entity ("specified executives") during the financial year:

CJ Bryce – Chief Financial Officer and Company Secretary

PG Beckett – General Manager, Logistics

DJ O'Connor – Chief Information Officer

PJ Nutbean – General Manager, Property

JJ Bell – General Manager, Human Resources

All of the above persons were employed by The Reject Shop Limited and were specified executives for the entire year ended 27 June 2004.

## Remuneration of Directors and Executives

The Company ensures that directors and executives are remunerated fairly and within accepted market and industry rates.

### *Directors' Fees*

The current base remuneration for non- executive directors was established just prior to the Company listing on 1 June 2004. The Chairman's remuneration is inclusive of committee fees while non-executive directors who take on additional responsibilities receive additional yearly fees. The current aggregate limit for directors' fees is $250,000 per annum and will be periodically recommended for approval by shareholders. The base fee payable to a non-executive director currently stands at $40,000 per annum.

### *Executive Salaries*

The objective of the Company's executive reward framework is to ensure every bonus, either monetary or share basis reward for performance, is appropriate for the results delivered. The framework aligns executive reward with achievement of strategic objectives and the creation of value for shareholders and emphasises cross-functional collaboration.
The Board ensures the Company follows appropriate corporate governance in establishing executive remuneration including reference to external remuneration consultants and/or available market information.

# Notes to the Financial Statements continued

The executive salary and reward framework has four components:

- Base pay and benefits
- Cash incentives
- Long-term incentives through participation in the Company's Performance Rights Plan and Executive Option Plan, and
- Other remuneration such as superannuation

The combination of these comprises the executive's total remuneration.

*Base Pay and Benefits*

Executive salaries are structured as a total employment cost package which may be delivered as a mix of cash and prescribed non-financial benefits at the executive's discretion.

Executives are offered a competitive base pay that comprises the fixed component of pay and rewards. External remuneration consultants provide analysis and advice to ensure base pay is set to reflect the market for a comparable role. Base pay for senior executives is reviewed annually to ensure competitiveness with the market but there are no guaranteed base pay increases in any senior executive's contracts, except as specifically stated in this note. An executive's pay is also reviewed on promotion.

Executive benefits made available are car allowances, private use of company owned vehicles (disclosed as non-monetary benefits) and salary sacrifice superannuation arrangements.

*Short Term Cash Incentives*

The Remuneration Committee establishes the appropriate financial performance targets to trigger payment of cash incentives for each year.

Further incentives may also be paid at the discretion of the Remuneration Committee to individual executives as recognition of exceptional achievement in any given year.

*Long Term Incentive Plans*

*Executive Option Plan*

The Executive Option Plan was the long-term incentive plan for the Company prior to the introduction of the Company's Performance Rights Plan (PRP). Options were granted to executives under the plan during the current year in relation to negotiations completed the prior year, however the Board does not intend to issue further options under this plan.

*Performance Rights Plan*

The Company implemented the PRP on 27 April 2004, to form the basis of The Reject Shop's ongoing long-term incentive scheme for selected senior employees.

*Details of grants made under both plans are contained in note 28 of this financial report.*

Details of the remuneration of each director of The Reject Shop Limited, including their personally-related entities, for the financial year is set out in the following table:

| DIRECTORS | PRIMARY BENEFITS | | | POST-EMPLOYMENT | | EQUITY | TOTAL |
|---|---|---|---|---|---|---|---|
| | Salary and Fees $ | Bonus $ | Non-monetary Benefits $ | Super-annuation $ | Retirement Benefits $ | Options/ Rights $ | Total $ |
| ***Continuing Directors*** | | | | | | | |
| BJ Beattie | 27,841 | - | - | 2,506 | - | - | 30,347 |
| BAE Saunders[1] | 430,000 | 92,400 | 28,683 | 38,700 | - | 19,939 | 609,722 |
| AC McMorron | 11,774 | - | - | 1,060 | - | - | 12,834 |
| J Shuster | 18,719 | - | - | 447 | - | - | 19,166 |
| ***Other Directors during the year*** | | | | | | | |
| JK Fox | 41,154 | - | - | 3,721 | - | - | 44,875 |
| AA Lockhart[2] | - | - | - | - | - | - | - |
| RP Backwell[2] | - | - | - | - | - | - | - |
| AE Sloshberg[3] | 281,312 | 58,954 | - | 25,318 | - | 9,092 | 374,676 |
| RD Jones[4] | 238,706 | 42,706 | - | 20,044 | - | 9,092 | 310,548 |
| Total | 1,049,506 | 194,060 | 28,683 | 91,796 | - | 38,123 | 1,402,168 |

1. BAE Saunders is the Managing Director of the Company and amounts shown above include all remuneration during the reporting period. Amounts received as a director amounted to nil.
2. AA Lockhart and RP Backwell are employees of Macquarie Direct Investment (the major shareholder prior to the Company's listing) to which fees totalling $12,500 were paid for their services.
3. AE Sloshberg resigned as a director on 26 April 2004 and during the entire year he was and continues to be the Company's General Manager, Merchandise. Amounts shown above include all remuneration during the reporting period. Amounts received as a director amounted to nil.
4. RD Jones was appointed as a director on 17 September 2003 and resigned as a director on 26 April 2004. During the entire year he was and continues to be the Company's General Manager, Store Operations. Amounts shown above include all remuneration during the reporting period. Amounts received as a director amounted to nil.

Details of the remuneration of each of the five specified executives and the five highest paid officers of the consolidated entity, including their personally-related entities, for the financial year is set out in the following table:

| SPECIFIED EXECUTIVES | PRIMARY BENEFITS | | | POST-EMPLOYMENT | | EQUITY | TOTAL |
|---|---|---|---|---|---|---|---|
| | Salary and Fees $ | Bonus $ | Non-monetary Benefits $ | Super-annuation $ | Retirement Benefits $ | Options/ Rights $ | Total $ |
| ***Specified Executives and Highest Paid Officers*** | | | | | | | |
| CJ Bryce | 179,168 | 53,716 | - | 14,532 | - | 4,470 | 251,886 |
| PG Beckett | 143,184 | 17,400 | 18,000 | 11,000 | - | 2,861 | 192,445 |
| DJ O'Connor | 157,933 | 18,000 | - | 11,000 | - | 3,576 | 190,509 |
| PJ Nutbean | 116,833 | 12,300 | - | 9,165 | - | 1,788 | 140,086 |
| JJ Bell | 77,928 | 9,438 | 15,000 | 7,028 | - | 1,788 | 111,182 |
| Total | 675,046 | 110,854 | 33,000 | 52,725 | - | 14,483 | 886,108 |

The share-based compensation included in the directors and specified executives remuneration above has been measured using a Black-Scholes option pricing model. Details of grants made under both plans are contained in note 28 of this financial report.

# Notes to the Financial Statements continued

Total remuneration of directors or specified executives of the consolidated entity for the year ended 29 June 2003 is not included as this is the first financial report prepared since the issue of AASB 1046 Directors and Executive Disclosures by Disclosing Entities.

**Service Agreements**

Certain directors and specified executives have service agreements which provide additional terms or benefits not already disclosed. The major provisions of these agreements are set out below:

*BAE Saunders, Managing Director*

- Term of agreement – 2 years and 1 month commencing 1 June 2004;
- Annual incentive of 1.5% of base salary for each 1% EBIT is higher than 6% over the prior year;
- A long-term cash incentive of $100,000 is payable based on the achievement of the current financial period EBIT target result and continued service to 30 June 2006;
- $85,000 p.a. payable from 1 July 2006 for 2 years for consulting services, if no longer serving as Managing Director;
- Payment of termination benefit on early termination by the employer, other than for gross misconduct, equal to the base salary for the remaining term of the agreement or 12 months, whichever is less.

*AE Sloshberg, General Manager, Merchandise*

- Term of agreement – 3 years commencing 1 January 2003;
- Base Salary has guaranteed increases of 4.8% and 5.2% for the calendar years ending 31 December 2004 and 2005 respectively;
- Annual incentive of 1.5% of base salary (exclusive of company superannuation contribution) for each 1% EBIT is higher than 6% over the prior year;
- Payment of termination benefit on early termination by the employer, other than for gross misconduct, 9 months' base salary or the remainder of the term of the contract, whichever is less, with a minimum of 6 months.

*Other Specified Executives*

All the specified executives are on employment terms consistent with the remuneration framework outlined in this note.

## Options and Performance Rights Holdings

The number of options or rights over shares in the company held during the financial year by each director of The Reject Shop Limited and each specified executive of the consolidated entity, including their personally related entity, are set out below:

| Name | Balance at the start of the year | Options granted during the year as remuneration | Rights granted during the year as remuneration | Options or Rights exercised during the year | Other changes during the year | Balance at end of the year | Vested and exercisable at end of the year | Options/ Rights vested during the year |
|---|---|---|---|---|---|---|---|---|
| ***Continuing Directors*** | | | | | | | | |
| BJ Beattie | - | - | - | - | - | - | - | - |
| BAE Saunders | 336,503 | 461,273 | 125,000 | (223,075) | (113,428) | 586,273 | 461,273 | 574,701 |
| AC McMorron | - | - | - | - | - | - | - | - |
| J Shuster | - | - | - | - | - | - | - | - |
| ***Other Directors during the year*** | | | | | | | | |
| JK Fox | 1,300,640 | - | - | - | (1,300,640) | - | - | 124,771 |
| AA Lockhart | - | - | - | - | - | - | - | - |
| RP Backwell | - | - | - | - | - | - | - | - |
| AE Sloshberg | 336,503 | 230,637 | 80,000 | (223,075) | (113,428) | 310,637 | 230,637 | 344,065 |
| RD Jones | 336,503 | 230,637 | 80,000 | - | (168,251) | 478,889 | 398,889 | 344,065 |
| ***Specified Executives*** | | | | | | | | |
| CJ Bryce | - | - | 62,500 | - | - | 62,500 | - | - |
| PG Beckett | - | - | 40,000 | - | - | 40,000 | - | - |
| DJ O'Connor | - | - | 50,000 | - | - | 50,000 | - | - |
| PJ Nutbean | - | - | 25,000 | - | - | 25,000 | - | - |
| JJ Bell | - | - | 25,000 | - | - | 25,000 | - | - |

1. The other changes represent the cancellation of vested options effective 1 June 2004, totalling $2,458,397
2. The value of each option or right granted during the financial year is detailed in note 28 of this financial report.

Subsequent to the end of the financial year and up to the date of this report there has been no grant or exercise of options or rights to or by a director or specified executive.

# Notes to the Financial Statements continued

## Share Holdings

The number of shares in the company held during the financial year by each director of The Reject Shop Limited and each specified executive of the consolidated entity, including their personally-related entity, are set out below:

| Name | Balance at the start of the year | Received during the year on the exercise of options | Other changes during the year | Balance at end of the year |
|---|---|---|---|---|
| ***Continuing Directors*** | | | | |
| BJ Beattie | - | - | - | - |
| BAE Saunders | 691,910 | 223,075 | (393,279) | 521,706 |
| AC McMorron | - | - | 70,000 | 70,000 |
| J Shuster | 4,264,889 | - | (3,689,889) | 575,000 |
| ***Other Directors during the year*** | | | | |
| JK Fox | 495,302 | - | (495,302) | - |
| AA Lockhart | - | - | 20,000 | 20,000 |
| RP Backwell | - | - | 15,000 | 15,000 |
| AE Sloshberg | - | 223,075 | (54,823) | 168,252 |
| RD Jones | - | - | - | - |
| ***Specified Executives*** | | | | |
| CJ Bryce | - | - | 35,000 | 35,000 |
| PG Beckett | - | - | 5,000 | 5,000 |
| DJ O'Connor | - | - | 13,500 | 13,500 |
| PJ Nutbean | - | - | - | - |
| JJ Bell | - | - | 2,500 | 2,500 |

## Loans to directors and specified executives

No loans were made to or from directors of The Reject Shop Limited or to or from the five specified executives of the consolidated entity, including their personally-related entities or are outstanding as of 27 June 2004.

## Other transactions with directors or specified executives

Personally related entities of J Shuster provided legal and property advice to the Company and received fees totalling $12,000 and $36,650 respectively for the financial year ($12,000 and $33,333 for 2003). A personally-related entity of JK Fox received consulting fees totalling $7,000 for the financial year ($nil for 2003). No amounts were outstanding at balance date ($nil as at 29 June 2003).

Subsequent to the end of the financial year and up to the date of this report there has been no change to director share holdings as outlined above.

| | CONSOLIDATED ENTITY 2004 $ | CONSOLIDATED ENTITY 2003 $ | PARENT ENTITY 2004 $ | PARENT ENTITY 2003 $ |
|---|---|---|---|---|
| **Note 28: Employee Benefits** | | | | |
| Employee Benefits and related on-costs liabilities | | | | |
| Included in other creditors - current (note 12) | 867,735 | 935,595 | 867,735 | 935,595 |
| Provision for employee benefits – current (note 15) | 2,996,217 | 2,395,834 | 2,996,217 | 2,395,834 |
| Provision for employee benefits – non-current (note 18) | 655,471 | 525,567 | 655,471 | 525,567 |
| Aggregate employee benefits and related on-costs liabilities | 4,519,423 | 3,856,996 | 4,519,423 | 3,856,996 |
| | **Number** | | **Number** | |
| **Employee numbers** | | | | |
| Average number of employees during the financial year | 1,920 | 1,795 | 1,920 | 1,795 |

**Performance Rights Plan (PRP) and Executive Option Plan**

*Performance Rights Plan*

The Company implemented the PRP on 27 April 2004, and intends this to be the basis of The Reject Shop's long term incentive scheme for selected senior employees. In summary, eligible executives identified by the Board may be granted performance rights, which is an entitlement to a share subject to satisfaction of exercise conditions on terms determined by the Board.

An initial grant of 625,000 performance rights in aggregate was made on 1 June 2004 divided into the following tranches:

| Tranche | Grant date | Expiry Date | No. of rights issued | Earnings Per Share (EPS) Hurdle | Date Exercisable | Value at date of grant |
|---|---|---|---|---|---|---|
| ***Participants excluding the Managing Director*** | | | | | | |
| Tranche A | 1 June 2004 | 31 May 2009 | 125,000 | $0.27 in FY2004 | 27 June 2005 | $1.85 |
| Tranche B | 1 June 2004 | 31 May 2009 | 125,000 | $0.23 in FY2005 | 26 June 2006 | $1.73 |
| Tranche C | 1 June 2004 | 31 May 2009 | 125,000 | $0.25 in FY2006 | 2 July 2007 | $1.61 |
| Tranche D | 1 June 2004 | 31 May 2009 | 125,000 | $0.28 in FY2007 | 30 June 2008 | $1.50 |
| ***Managing Director*** | | | | | | |
| Tranche X | 1 June 2004 | 31 May 2009 | 75,000 | $0.23 in FY2005 | 2 July 2006 | $1.73 |
| Tranche Y | 1 June 2004 | 31 May 2009 | 50,000 | $0.25 in FY2006 | 2 July 2006 | $1.61 |

For all tranches the right is only exercisable if the EPS hurdle is met each year and the participant remains employed until 1 day after the end of the following year, with the exception of tranche Y which is exercisable on achievement of the EPS hurdle specified. In instances where an EPS hurdle is not met, the rights granted for that year automatically convert to and are added to the following year's tranche. The total exercise price payable on the exercise of one or more performance rights on a particular day is $1.00, irrespective of the number of rights exercised on that day.

The values per tranche of Performance Rights granted during the year have been based on a Black-Scholes option pricing model.

No vested performance rights were exercised or lapsed during the financial year. Performance rights do not carry voting or dividend entitlements.

# Notes to the Financial Statements continued

*Executive Option Plan*

The Executive Option Plan was the long-term incentive plan for the Company prior to the introduction of the Company's Performance Rights Plan (PRP). The Board does not intend to issue further options under this plan, however options were granted to executives under the plan in the prior year and formally issued during the current year. Set out below is a summary of options granted under the plan since its inception.

| Grant Date | Expiry Date | Exercise Price | Balance at start of year | Issued during the year | Exercised during the year | Lapsed/ Cancelled during the year | Balance at end of year |
|---|---|---|---|---|---|---|---|
| 3 December 1996 | 3 December 2006 | $0.00 | 124,771 | - | - | (124,771) | - |
| 3 December 1996 | 3 December 2006 | $0.56 | 1,175,869 | - | | (1,175,869) | - |
| 4 January 2000 | 4 January 2005 | $0.67 | 673,006 | - | (446,150) | (226,856) | - |
| 28 February 2000 | 28 February 2005 | $0.67 | 336,503 | - | - | (168,251) | 168,252 |
| 10 September 2001 | 10 September 2006 | $0.67 | 124,771 | - | - | (62,385) | 62,386 |
| 17 September 2003 | 17 September 2008 | $1.52 | - | 922,547 | - | - | 922,547 |
| Total | | | 2,434,920 | 922,547 | (446,150) | (1,758,132) | 1,153,185 |

All grants of options were made prior to the Company's decision to list on the Australian Stock Exchange. The exercise price was generally set at, or at a premium to, the Company's value at that time, based on an illiquid market for the shares and as determined by the shareholders' best estimate. The value of the options granted during this financial year, based on a Black-Scholes option pricing model, is one cent.

The grants made on 3 December 1996 were pursuant to a service agreement with JK Fox prior to the establishment of the Executive Option Plan.

Effective 1 June 2004, the Company cancelled 1,785,132 existing vested options at a cost of $2,458,397. This has been recorded as a reduction of contributed equity, which is detailed in note 19 of this financial report.

Options do not carry voting or dividend rights.

**Total shares under options or performance rights**

Unissued shares of The Reject Shop Limited under options or performance rights as the date of this financial report are:

| Type | Date of grant | Expiry Date | Exercise Price | No. on issue | No. vested |
|---|---|---|---|---|---|
| Options | 28 February 2000 | 28 February 2005 | $0.67 | 168,252 | 168,252 |
| Options | 10 September 2001 | 10 September 2006 | $0.67 | 62,386 | 62,386 |
| Options | 17 September 2003 | 17 September 2008 | $1.52 | 922,547 | 922,547 |
| Performance Rights | 1 June 2004 | 31 May 2009 | - | 625,000 | - |
| Total | | | | 1,778,185 | 1,153,185 |

No options are vested and unexercisable at the end of the year.

**Shares issued on the exercise of options**

The following shares of The Reject Shop Limited were issued during the year ended 27 June 2004 on the exercise of options granted under the Executive Option Plan:

| Date of Exercise | Number of shares issued* | Fair value of each share at issue date $ | Fair value of shares issued on exercise of options $ | Exercise Price* | Aggregate proceeds received on exercise of options and recognised in contributed equity $ |
|---|---|---|---|---|---|
| 16 September 2003 | 446,150 | $1.36 | 606,764 | $0.6686 | 298,314 |

* The number and fair value of shares issued and the exercise price have been adjusted to reflect the share split on a 3,780.93 to 1 basis as if it had occurred prior to the exercise of options (refer note 19).

No further options have been exercised since that date. No amounts are unpaid on any of these shares.

| | Consolidated Entity 2004 $ | Consolidated Entity 2003 $ | Parent Entity 2004 $ | Parent Entity 2003 $ |
|---|---|---|---|---|
| **Note 29: Remuneration of Auditors** | | | | |
| During the year the following services were paid to PricewaterhouseCoopers as the auditor of the parent entity and its related practices: | | | | |
| Audit and review work | 100,200 | 72,742 | 100,200 | 72,742 |
| Due diligence services | 244,866 | - | 244,866 | - |
| Tax compliance | 15,000 | 12,000 | 15,000 | 12,000 |
| Total remuneration | 360,066 | 84,742 | 360,066 | 84,742 |
| **Note 30: Dividends** | | | | |
| Paid interim fully franked dividend of $Nil (2003: $Nil) Since year end the directors have declared the payment of a final dividend of 2.5 cents per share, fully franked based on tax paid at 30%. The amount of the proposed dividend to be paid on 24 September 2004 out of retained profits, but not recognised as a liability at year end, is | 601,878 | 2,000,000 | 601,878 | 2,000,000 |
| Balance of franking account at year-end adjusted for franking credits arising from payment of provision for income tax and dividends recognised as receivables, franking debits arising from payment of proposed dividends and any credits that may be prevented from distribution in subsequent years | 9,150,229 | 6,909,957 | 8,726,851 | 6,486,579 |

| | Consolidated 2004 Cents | Consolidated 2003 Cents |
|---|---|---|
| **Note 31: Earnings per share** | | |
| Basic earnings per share | 23.9 | 20.1 |
| Diluted earnings per share | 22.3 | 18.9 |
| Weighted average number of ordinary shares used as the denominator in calculating basic earnings per share. | 23,396,118 | 23,003,178 |
| Weighted average number of ordinary shares and potential ordinary shares used as the denominator in calculating diluted earnings per share. | 25,009,968 | 24,395,116 |

Options granted to employees under The Reject Shop Executive Option Plan and Performance Rights granted under the Performance Rights Plan are considered to be potential ordinary shares and have been included in the determination of diluted earnings per share. The options or rights have not been included in the determination of basic earnings per share. Details relating to the options and rights are set out in note 28.

## Note 32: Segment information

The Reject Shop operates within with the one geographic segment (Australia) and the one business segment (retailing of discount variety merchandise).

## Note 33: Controlled Entities

The Reject Shop Limited has a 100% owned subsidiary, TRS Trading Group Pty Ltd incorporated in Australia.

# Notes to the Financial Statements continued

**Note 34: Matters Subsequent to the End of the Financial Year**
No matters or circumstances have arisen since the end of the financial year which have significantly affected or may significantly affect the operations of the consolidated entity, the results of those operations, or the state of affairs of the consolidated entity in future financial years.

**Note 35: International Financial Reporting Standards**
The Financial Reporting Council has announced that Australia will adopt the standards of the International Accounting Standards Board (IASB) for application to reporting periods beginning on or after 1 January 2005. First time application of Australian International Financial Reporting Pronouncements (AIFRP) by the Company will be for the financial year ending 25 June 2006 (inclusive of prior period comparatives).

The Australian Accounting Standards Board (AASB) will issue the AIFRP. AIFRP means AASB Accounting Standards equivalent to IASB standards and UIG Abstracts corresponding to the Interpretations adopted by the IASB. Pending standards have been released, with further standards to come; in as much as the Company is continuing to evaluate the impact that these new standards will have, adoption of AIFRP may result in changes to accounting policies that have significant impacts on the financial statements of the Company. The Company currently expects that the most significant impacts will be in the areas described below. Reliable estimation of the impacts of these changes in accounting policies is impracticable as the actual impacts will depend on the particular circumstances and conditions prevailing at the time of application of AIFRP.

*Share Based Payments*

AASB 2 "Share based payments" - the company will be required to determine the fair value of options issued to employees as remuneration and recognise the expense in the Statement of Financial Performance. This standard is not limited to options and also extends to other forms of equity based remuneration, such as performance rights. It applies to all share-based payments issued after 7 November 2002 which have not vested as at 1 January 2005. Reliable estimation of the future financial effects of this change in accounting policy is impracticable as the details of future equity based remuneration plans are unknown.

*Income Taxes*

AASB 112 "Income taxes" - the company will be required to use a balance sheet liability method which focuses on the tax effects of transactions and other events that affect amounts recognised in either the Statement of Financial Position or a tax-based balance sheet. This change in accounting policy is likely to result in an increase in the level of deferred taxes recognised in the Statement of Financial Position.

*Classification of Financial Instrument*

AASB 139 "Financial Instruments: Recognition and Measurement" - financial instruments will be required to be classified into one of five categories which will, in turn, determine the accounting treatment of the item. The classifications are loans and receivables – measured at amortised cost, held to maturity – measured at amortised cost, held for trading – measured at fair value with fair value changes charged to net profit or loss, available for sale – measured at fair value with fair value changes taken to equity and non-trading liabilities – measured at amortised cost. This will result in a change in the current accounting policy that does not classify financial instruments. Current measurement is at amortised cost, with certain derivative financial instruments not recognised on balance sheet. The future financial effect of this change in accounting policy is not yet known as the classification and measurement has not yet been fully completed.

*Employee Benefits*

Under AASB 119 "Employee Benefits" - non current liabilities for annual leave will need to be discounted. This is a change from the current accounting policy which does not require discounting. It is not expected that there will be any material impact as a result of the adoption of this standard.

*Hedge Accounting*

AASB 139 "Financial Instruments: Recognition and Measurement" – under hedge accounting changes in the fair value of hedging instruments classified as cash flow hedges are recognised in equity to the extent they are effective hedges, and are recycled to the income statement when the hedged transaction affects the profit or loss. Any movement in the fair value of the hedging instrument that is not effective is recognised immediately in the profit and loss. It is not possible to determine the impact of the change in hedging requirements until a full analysis of the impact of the standard has been conducted.

The Company is well placed to evaluate the impact of these standards and be able to implement them in the financial year ending 25 June 2006.

# Directors' Declaration

The Directors declare that the financial statements and notes set out on pages 17 - 44:

(a) comply with Accounting Standards, the Corporations Regulations 2001 and other mandatory professional reporting requirements; and

(b) give a true and fair view of the Company's and consolidated entity's financial position as at 27 June 2004 and of their performance, as represented by the results of their operations and their cash flows, for the financial year ended on that date.

In the Director's opinion

(a) the financial statements and notes are in accordance with the Corporations Act 2001; and

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

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

BJ Beattie
Chairman

BAE Saunders
Managing Director

14 September, 2004

# Independent Audit Report to the Members of The Reject Shop Limited

**Independent Audit Report to the Members of The Reject Shop Limited**

**Audit opinion**
In our opinion, the financial report of The Reject Shop Limited:

- gives a true and fair view, as required by the *Corporations Act 2001* in Australia, of the financial position of The Reject Shop Limited and The Reject Shop Group (defined below) as at 27 June 2004, and of their performance for the period ended on that date, and
- is presented in accordance with the *Corporations Act 2001*, Accounting Standards and other mandatory financial reporting requirements in Australia, and the *Corporations Regulations 2001*.

This opinion must be read in conjunction with the rest of our audit report.

**Scope**

***The financial report and Directors' responsibility***
The financial report comprises the statement of financial position, statement of financial performance, statement of cash flows, accompanying notes to the financial statements, and the Directors' declaration for both The Reject Shop Limited (the Company), and The Reject Shop Group (the consolidated entity) for the period ended 27 June 2004. The consolidated entity comprises both the Company and the entities it controlled during that period

The Directors of the Company are responsible for the preparation and true and fair presentation of the financial report in accordance with the *Corporations Act 2001*. This includes responsibility for the maintenance of adequate accounting records and internal controls that are designed to prevent and detect fraud and error, and for the accounting policies and accounting estimates inherent in the financial report.

***Audit approach***
We conducted an independent audit in order to express an opinion to the members of the Company. Our audit was conducted in accordance with Australian Auditing Standards, in order to provide reasonable assurance as to whether the financial report is free of material misstatement. The nature of an audit is influenced by factors such as the use of professional judgement, selective testing, the inherent limitations of internal control, and the availability of persuasive rather than conclusive evidence. Therefore, an audit cannot guarantee that all material misstatements have been detected

We performed procedures to assess whether in all material respects the financial report presents fairly, in accordance with the *Corporations Act 2001*, Accounting Standards and other mandatory financial reporting requirements in Australia, a view which is consistent with our understanding of the Company's and the consolidated entity's financial position, and of their performance as represented by the results of their operations and cash flows.

We formed our audit opinion on the basis of these procedures, which included:

- examining, on a test basis, information to provide evidence supporting the amounts and disclosures in the financial report, and
- assessing the appropriateness of the accounting policies and disclosures used and the reasonableness of significant accounting estimates made by the Directors.

When this audit report is included in an Annual Report report, our procedures include reading the other information in the Annual Report to determine whether it contains any material inconsistencies with the financial report.

While we considered the effectiveness of management's internal controls over financial reporting when determining the nature and extent of our procedures, our audit was not designed to provide assurance on internal controls.

Our audit did not involve an analysis of the prudence of business decisions made by Directors or management

***Independence***
In conducting our audit, we followed applicable independence requirements of Australian professional ethical pronouncements and the *Corporations Act 2001*.

PricewaterhouseCoopers

Len Hogan
Partner

Melbourne
14 September 2004

# Shareholder Information

The shareholder information set out below was applicable as at 31 August 2004.

**(a) The distribution of shareholding was as follows:**

| Size of Shareholding | Shareholders |
|---|---|
| 1 - 1,000 | 242 |
| 1,001 - 5,000 | 651 |
| 5,001 - 10,000 | 220 |
| 10,001 - 100,000 | 176 |
| 100,001 and over | 32 |

**(b) 4 shareholders hold less than a marketable parcel of shares, being a market value of less than $501.28**

**(c) Substantial shareholders were:**

| Shareholder | Shares held | % |
|---|---|---|
| AMP Limited | 2,320,900 | 9.64 |
| K2 Asset Management Pty Ltd | 2,263,126 | 9.40 |
| Acorn Capital Limited | 2,004,064 | 8.32 |
| Macquarie Bank Limited | 1,448,129 | 6.02 |

**(d) The fully paid issued capital of the Company consisted of 24,075,110 shares held by 1,321 shareholders.**

Each share entitles the holder to one vote.

**(e) Unquoted Equity Securities**

| | Number | Number of holders |
|---|---|---|
| Options | 1,153,185 | 4 |
| Rights | 625,000 | 11 |

# Shareholder Information continued

## (f) Twenty largest shareholders

| Shareholder | Number | % Held |
|---|---|---|
| Westpac Custodian Nominees | 2,768,016 | 11.50% |
| National Nominees Limited | 2,526,368 | 10.49% |
| Cogent Nominees Pty Limited | 1,619,913 | 6.73% |
| RBC Global Services Australia | 1,384,225 | 5.75% |
| Bond Street Custodians Limited | 1,256,564 | 5.22% |
| JP Morgan Nominees Australia | 849,500 | 3.53% |
| Permanent Trustee Australia Limited | 677,900 | 2.82% |
| ANZ Nominees Limited | 583,200 | 2.42% |
| Mr Charlie McShanag | 557,687 | 2.32% |
| HSBC Custody Nominees | 546,346 | 2.27% |
| Highmont Heights Pty Limited | 514,206 | 2.14% |
| AMP Life Limited | 500,000 | 2.08% |
| Kembla No 20 Pty Limited | 415,902 | 1.73% |
| Guardian Trust Australia Limited | 364,000 | 1.51% |
| Mr Neville & Mrs Noelene Duffy | 266,225 | 1.11% |
| Invia Custodian Pty Limited | 262,935 | 1.09% |
| Health Super Pty Limited | 222,064 | 0.92% |
| Gang-Gang Pty Limited | 200,000 | 0.83% |
| Maskal Pty Limited | 200,000 | 0.83% |
| Mr Trevor Maguire | 198,877 | 0.83% |
| Total Top 20 | 15,913,928 | 66.10% |

The twenty members holding the largest number of shares together held a total of 66.10% of the issued capital.

| **(g) Restricted Shares** | **Number on Issue** | **Number of Holders** |
|---|---|---|
| **Escrow Shares (1)** | **1,257,458** | **3** |
| **Escrow Shares (2)** | **557,687** | **1** |

1. Voluntary escrow until the company has reported it's audited financial results for the financial year ended 26th June 2005.
2. As above, except that up to 60% is available to be sold, subject to certain conditions after the issuance of the audited financial results for the year ended 27 June 2004.

# Corporate Directory

| | |
|---|---|
| **Company** | The Reject Shop Limited<br>ABN 33 006 122 676 |
| **Directors** | BJ Beattie<br>Chairman |
| | BAE Saunders<br>Managing Director |
| | AC McMorron<br>Non-executive Director |
| | J Shuster<br>Non-executive Director |
| **Company Secretary** | CJ Bryce |
| **Principal Registered Office** | 5 Lloyd Street<br>West Melbourne Vic 3003 |
| **Share Registry** | ASX Perpetual Registrars Ltd<br>333 Collins Street<br>Melbourne Vic 3000 |
| **Auditors** | PricewaterhouseCoopers<br>333 Collins Street<br>Melbourne Vic 3000 |
| **Stock Exchange Listing** | The Reject Shop Limited shares are listed on the Australian Stock Exchange. |
| **Website** | www.rejectshop.com.au |

**EVERYONE'S A WINNER AT THE REJECT SHOP**

*Designed and produced by BTB Financial Documents*

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5 Lloyd Street
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**www.rejectshop.com.au**