

10 November 2016

## Market update: end of trading halt

SurfStitch Group Limited (ASX:SRF) (**Company**) provides the following update to the market and ends the trading halt applied to the Company's ordinary shares on 8 November 2016.

## Recent announcements

As noted in the Company's announcement of 2 November 2016, the Company received a non-binding indicative and conditional proposal for 100% of the shares of SRF (**Proposal**), from Coastalwatch Pty Limited (**CW**). A copy of the Proposal is set out in Appendix 1 to this announcement.

This Proposal was rejected by the Board of Directors of the Company as it was not considered to be in the best interests of the Company or its shareholders.

On 8 November 2016, Crown Financial Pty Limited (**Crown Financial**) sent an open letter to the Company's Board of Directors (**Board**) and released that letter to the media (**Crown Financial Letter**). A copy of the Crown Financial Letter is set out in Appendix 2 to this announcement.

## Crown Financial group of companies

CW is a wholly owned subsidiary of Crown Financial and the Crown Financial Letter referenced the Proposal as an approach from Crown Financial.

CW is also a related entity of companies in the Crown Financial group which are engaged in litigation against entities in the SRF group (**Crown Financial Litigation**). The Company has announced that it is defending the Crown Financial Litigation.

The market was notified on 5 September 2016 that Crown Financial had become a substantial shareholder of the Company. The bulk of Crown Financial's share acquisitions occurred after the commencement of the Crown Financial Litigation.

The Crown Financial Letter contains no offer for the Company, nor any revision to the earlier Proposal.

The Crown Financial Letter contains a range of assertions and questions regarding the Proposal, the Company and the ongoing litigation commenced by Crown Financial group companies against the Company.

A number of the questions posed in the Crown Financial Letter are speculative or would require the Company to comment on ongoing and incomplete negotiations (which may or may not lead to a transaction) and matters to be considered in the course of the ongoing strategic review.

The Company does not propose to respond to these questions, and does not comment on or affirm any of the various assertions in the Crown Financial Letter, other than as noted below.

## SRF Register of Members

The Company has been in correspondence with Crown Financial regarding its request for a copy of the Company's register of members. Following general assurances by Crown Financial as to the purpose for which the register would be used, a copy of the register has been provided.

In accordance with the Corporations Act, the Company's register of members has been, and remains, available for inspection by shareholders and third parties. Crown Financial has not sought inspection at the Company's registry, nor has it been declined.

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## Rejection of the Proposal

As indicated in the Company's announcement of 2 November 2016, the Proposal was rejected by the Board on the following grounds:

- ) the Proposal was highly conditional and included conditions which were not capable of being satisfied by the Company;
- ) members of the Crown Financial group of companies had commenced litigation against SRF entities (being the Crown Financial Litigation) and continued to pursue those legal actions; and
- ) the Proposal comprised only a modest amount above the Company's recent VWAP, and failed to reflect an appropriate premium for securing control.

Price relative to the trading price was an important consideration, but was not the sole consideration.

The Crown Financial Letter questions the relevance of the Crown Financial Litigation when considering the merits of the Proposal. In assessing the Proposal and considering the matter of the Crown Financial Litigation, the Board took the following into account:

- ) as set out in the Company's Annual Report 2016, the Crown Financial Litigation relates to a series of contracts entered into between SRF entities and members of the Crown Financial group (**Contested Contracts**);
- ) the Company's in-depth review of the Contested Contracts formed the basis of the trading update contained in the ASX Announcement made by the Company on 9 June 2016, (**June Announcement**) in particular, the substantive amendment of the Contested Contracts and the corresponding reversal of \$20.3 million of revenue in the Company's full year results; and
- ) entities in the Crown Financial group commenced the Crown Financial Litigation in the months following the June Announcement, which the Company is defending.

It remains the view of the Board, that the status of Crown Financial's associated companies as parties to the Contested Contracts and as litigators against the Company, were relevant considerations in relation to the Proposal. In particular, the Board considered that, in all the circumstances, it was not in the interests of the Company or its shareholders to afford Crown Financial access to due diligence or other non-public information.

## ASIC – provision of information

The Company notes that ASIC has commenced an investigation into the Company's disclosures in connection with the Contested Contracts. The Company is co-operating fully with ASIC's inquiries.

## Current trading

Given the key trading periods for the Company are November and December, it would be premature to comment on guidance at this time. The Company's AGM is scheduled for 16 November 2016, where a general update on all key issues will be provided.

**Strategic review – orderly process**

As announced to the market on 2 November 2016, the Company has now commenced Stage 2 of its Strategic Review, and has engaged 333 Capital to advise the Company on its strategic options.

The Company is seeking to explore options to preserve and create value for the Company and its shareholders through an orderly and measured process, and anticipates that a range of alternatives will be considered.

**ENDS**

For further information please contact: Matthew Gregorowski or Helen McCombie at Citadel-MAGNUS on +61 (2) 8234 0100.

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**Appendix 1 – Proposal from Coastalwatch Pty Limited**

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**From:** Kim Sundell [REDACTED]  
**Sent:** Friday, 28 October 2016 5:16 PM  
**To:** Sam Weiss  
**Cc:** Karen Birner; lex [REDACTED]; justin.stone [REDACTED]  
**Subject:** Non-binding indicative proposal to SurfStitch Group Limited (SRF)

28 October 2016

**Strictly confidential – not for disclosure without consent**

Mr Samuel Weiss

Chairman

SurfStitch Group Limited

225 Burleigh Connection Road

Burleigh Heads Qld 4218

Sam

**Non-binding indicative proposal to SurfStitch Group Limited (SRF)**

This letter contains an indicative, incomplete and non-binding proposal by Coastalwatch PtyLtd (**Coastalwatch**).

Coastalwatch seeks to agree the basis upon which Coastalwatch can secure SRF board's recommendation for the proposal.

**1. Proposal overview**

1 Coastalwatch's proposal is to acquire all of the issued shares of SRF in which its associates do not already have an interest (being 276,834,645 shares less the 28,785,826 shares held by Crown Financial Pty Ltd) by way of a scheme of arrangement for a cash consideration of \$0.20 per share.

2 Coastalwatch believes that this will provide SRFshareholders an opportunity to realise their investment inSRF's businesses.

3 The exact mechanisms to effect the transaction and conditions precedent to completion would be subject to legal, tax and accounting advice, but will include all the necessary steps that would be required to effectively execute the transaction and secure all necessary approvals.

**2. Key Assumptions**

4 The cash consideration set out in this indicative proposal is based on the following assumptions:

- (a) an ex-cash enterprise value of SRF of \$17 million;
- (b) completion of the sale of Surf Hardware International to an independent third party for total cash consideration of at least \$20 million; and
- (c) at completion of the transaction, SRF having no borrowings and \$17 million cash at bank.

### 3. Funding

5 Coastalwatch confirms that it has the necessary cash resources and access to finance facilities to fund the cash consideration offered under this proposal.

### 4. Conditions to transaction proceeding to legally binding arrangements

6 This indicative proposal is subject to:

- (a) Coastalwatch completing comprehensive legal, financial and taxation due diligence in relation to SRF to the satisfaction of Coastalwatch in its absolute discretion, but excluding any documentation relating to the current proceedings between entities in the Three Crowns Investments Group (TCI) and entities in the SRF group. For the avoidance of doubt, the due diligence must include review of all documentation relating to any potential class action against SRF or its directors; and
- (b) Coastalwatch's agreement to proceed and SRF entering into a scheme implementation agreement (SIA) with Coastalwatch on acceptable terms.

### 5. Transaction documentation

7 Coastalwatch will require the SIA to include:

- obligations on Coastalwatch and SRF to implement the scheme, key transaction steps and conditions precedent;
- confirmation that SRF's board will unanimously recommend the transaction to SRF shareholders and agree to vote their own shares in favour of the transaction;
- provisions to ensure that SRF uses its best efforts to secure any approvals required under the transaction;
- deal protection arrangements reflecting each party's unequivocal commitment to the transaction and the key objective of both parties to maximise deal certainty, including no shop, no talk, no due diligence, break-fee arrangements and notification and matching rights, subject to customary fiduciary carve outs;
- conduct of business provisions including agreed limits of cash expenditure; and
- customary warranties by SRF, including regarding the full disclosure of material information.

8 The transaction itself would be subject to agreed conditions which will be specified in the SIA, including, but not limited to:

- all necessary legal, regulatory, shareholder and court approvals;
- SRF not being a party to any material litigation other than the current matters involving TCI;
- neither SRF nor any of its directors being the subject of any inquiry, hearing, investigation or prosecution by any regulatory authority, including ASIC or ASX;

- obtaining all other necessary approvals or consents that may be identified during the due diligence process (e.g. change of control consents from contract counterparties);
- either under the scheme or by separate agreement with each relevant holder or action of the SRF board, existing issued options (assumed to be out of the money) and unvested performance rights would be cancelled;
- no material adverse change in the financial position of SRF, no prescribed occurrences and no breaches of warranties in the SIA.

9 This is not an exhaustive list of conditions and there may be additional conditions resulting from Coastalwatch's due diligence investigations.

## **6. Status of this letter, confidentiality and announcements**

### **10 Status**

11 The proposal set out in this letter is indicative and is subject to Coastalwatch's agreement to proceed with the proposal following due diligence and the negotiation of transaction documents. Coastalwatch unconditionally reserves the right to withdraw this proposal at any time.

12 This letter is being submitted to SRF on the basis that it is not legally binding and will not give rise to any obligation on any party until formal contracts are entered into, even if the parties subsequently work together and take action or refrain from taking action on the assumption or in the expectation that any transaction will proceed.

### **13 Confidentiality**

14 This letter and any potential discussions are confidential and should not be disclosed by SRF to any person other than SRF's directors, senior management and professional advisers to whom disclosure is necessary without the written consent of Coastalwatch.

### **15 Announcements and public statements**

16 Except for any public announcement required by law or ASX, SRF will not make any public announcement of the proposal unless the content and form of the announcement and the time, place and format are mutually agreed.

17 In relation to any announcement required by law or ASX, SRF will prior to announcement, first give reasonable notice to and consult with Coastalwatch in relation to the content, form and timing of the announcement.

## **7. Next steps and timing**

18 Coastalwatch is prepared to immediately move forward with our formal due diligence review of SRF and commence negotiation of the definitive agreements necessary to consummate the transaction.

19 This would include a formal confidentiality and exclusivity agreement to be entered into to cover the due diligence period prior to the execution of a formal SIA.

20 The proposed confidentiality and exclusivity agreement will include an exclusive negotiation and due diligence period of 21 days during which SRF will undertake not to solicit a third party proposal and not to do any of the following:

- commence discussions with a third party that leads to or which may reasonably be expected to lead to, a third party proposal being made or the Proposed Transaction not proceeding;
- furnish to any person any information, or otherwise assist or co-operate in any way with any person, in connection with or for the purposes of a third party proposal;
- enter into any agreement, arrangement or understanding in relation to or which may reasonably be expected to lead to a third party proposal being made

or the Proposed Transaction not proceeding, or approve, recommend or endorse, or propose to approve, recommend or endorse, any third party proposal, without providing Coastalwatch with an opportunity to match or better any such third party proposal;

- end discussions with Bidder other than by reason of default of Bidder; or
- communicate to any person an intention to do any of the things referred to above,

21 in each case subject to a carve out where the directors of SRF are advised that such actions are required to comply with their fiduciary duties or with an order of a court or the Takeovers Panel.

22 If SRF receives a third party proposal, whether solicited or not, it will inform Coastalwatch.

Coastalwatch is seeking confirmation that SRF is prepared to enter into a confidentiality and exclusivity agreement and proceed with due diligence by 5.00pm (Sydney time) on Friday, 4 November 2016.

We look forward to the Board's favourable consideration of this proposal. I am happy to discuss the proposal with you at your convenience.

Kim Sundell  
Managing Director  
CoastalWatch



**Appendix 2 – Letter from Crown Financial Pty Limited**

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# Crown Financial

Attn. The Directors  
SurfStitch Group Limited  
ABN 48 602 288 004

8 November 2016

Morning Sam

This is an open letter to the Board of SurfStitch Group Limited (“**SurfStitch**”, “**the Company**”)

The Company's response to our recent approach is disappointing.

As you know, our formal requests for shareholder contact details so we can communicate with them directly have met nothing but running interference from the Company and its lawyers (which we assume you are aware of). Section 173(3) of the Corporations Act is pretty plain when it says that SurfStitch 'MUST' give a copy of the register to us. It is concerning that the Company has refused to meet its statutory obligations and instead set on a course to frustrate our request without, in our opinion, having a proper legal basis for doing so.

## Other matters:

a)

In its ASX release of the 2nd November 2016 the Company said that:

*“The Board has formed the view that the indicative proposal is not in the best interests of the Company and its shareholders, based on the following:*

*The highly conditional nature of the indicative proposal including conditions which are not capable of being satisfied by the Company “*

For good order the two Key Assumptions of the indicative proposal are:

1. completion of the sale of Surf Hardware International to an independent third party for total cash consideration of at least \$20 million and at completion of the transaction, SRF having no borrowings and \$17 million cash at bank; and
2. that the Company had no pending litigation outside of our related entities and was not subject to investigation by ASX or ASIC.

The statements to the ASX warrant additional clarification for the benefit of all shareholders.

Is the Company under any form of investigation by either the ASX or ASIC?

Is there ligation threatened or commenced by others aside from us?

In the same 2nd November statement another reason the Company gave for rejecting the scheme approach was that entities related to us have “raised legal action against SRF”. As you know, this action has resulted purely due to SurfStitch's continual failure or refusal to meet its contractual obligations under the various contracts between our companies.

The legal action is generally irrelevant to the bid. Additionally, nowhere did the bidder seek any legal or sensitive disclosure documents in regards to this matter. In fact they specifically carved out any aspect of the legal case from any due diligence process. The Company's response to the market omitted any reference to these matters.

It seems to us that the reasons given by the Company to the market are incomplete or obfuscatory. We expect you to correct this.

With the potential claim against the Company being in our view worth circa 5c a share (which continues to get larger due to ongoing defaults by SRF under its agreements) the Board should disclose to the market what weighting was given to this in arriving at its decision.

We note that we have been the only significant recent buyer of shares in the market.

What is the price that the Board thinks is appropriate and how does it arrive at that calculation? No guidance at all has been given to the shareholders.

What is the business / financial methodology behind the Board's assessment of the Company being significantly in excess of 20c? Nothing of substance has been provided to the shareholders.

**b)**

SHI was impaired significantly in the Annual Report even though it was purchased only 6 months prior in December 2015 for total consideration of \$24,259,000.

We note that in its statement of the 2nd November 2016 the Company also claimed that the sale process is "*well advanced and the Company is considering a number of proposals*". Please tell us/shareholders:

What is the price expected by the Company on the disposal of SHI?

Does this differ significantly to the written down value of the business?

Additionally, can you confirm that the Company is compliant with its continuous disclosure obligations under ASX Listing rule 3.1?

**c)**

The cash balance for the Company as at 30th June 2016 was reportedly \$21.37m. Please be clear to us and the other shareholders:

Is the Company now informing the market that the cash balance of the Company is currently below \$17m?

On the 30th August 2016 your CEO informed the market that the cash position would fall for the year between \$6 & \$7m. This would be split between underlying loss and capital expenditure. Please tell us/shareholders:

What then is the particular break down between loss and CapEx and what are the areas of investment? .

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If the Company cannot meet the requirement of having a \$17m cash position, are you in fact telling us/shareholders that there has been a fall of over \$4.37m in cash reserves since balance date?

This would then only allow for only another \$1.6 to \$2.6m fall for the remainder of FY 16/17 - which seems perilous.

Please tell us/shareholders what the true position is?

Please also confirm having regard to the guidance given already by the Company that the company is and remains compliant with its continuous disclosure obligation in relation to this matter in accordance with ASX Listing rule 3.1.

Please update us/shareholders on the guidance for FY/16/17 and the key assumptions applied by the Board to conclude a sound basis for an opinion that there is expected to be a return to profitability in 2017 as previously stated.

We estimate that the Company is on course to be making a pro forma \$5 to \$6m loss post the sale of SHI. Please tell us/shareholders:

Is this a fair assessment? If not, on what basis isn't it?

How does the Board value the Company at more than 20c if the assessment is true?

Enterprise Value and DCF valuations for the Company indicate its value is as low as 13c per share.

How does the Board justify a realistic assessment of a share price in excess of 20c?

Having rejected our related entity's recent proposal at 20c is the Company planning on returning capital to Shareholders?

The Company has published specific guidance for both cash and EBITDA and we note that there is more than 5% difference from that guidance.

Can you confirm that the guidance remains true and correct?

Finally, please ensure that the Board informs us/shareholders at the AGM, if not before, as to what the contribution of SHI is to be to the overall performance in EBITDA terms.

I look forward to hearing from you by 4pm AEDT Tuesday 15th November 2016 and we reserve the right to raise this and other financial issues at the AGM.

Yours sincerely  
Crown Financial Pty Ltd

Joakim Sundell  
Managing Director