



8 June 2017

Market update: response to further open letter

SurfStitch Group Limited (ASX:SRF) (**Company**) confirms that Crown Financial Pty Ltd (**Crown Financial**) has sent an “open” letter to the Company’s Board of Directors (**Board**) dated 7 June 2017 (**Crown Financial Letter**). A copy of the Crown Financial Letter is set out in Appendix 1 to this announcement.

Crown Financial group of companies

Crown Financial is a member of the Crown Financial group of companies which is engaged in litigation against entities in the SRF group (**Crown Financial Litigation**). The Company is defending the Crown Financial Litigation and has lodged substantial counter claims against Coastalcoms Pty Ltd, Three Crowns Investments Pty Limited and two directors, Joakim Sundell and David Wooldridge.

As noted in the Company’s announcement to the market of 6 June 2017, Crown Financial has served the Company with a notice of requisition of a shareholders’ meeting pursuant to section 249D of the Corporations Act, for the purposes of considering a resolution to remove the current Chairman of the Board of Directors as a Director of the Company.

Regulatory compliance

The Crown Financial Letter states that the Company’s compliance with its continuous disclosure obligations has been “superficial”. The Company considers that it is fully compliant with all statutory and regulatory obligations in relation to continuous disclosure.

Open Letter

The Crown Financial Letter contains a number of questions relating to, among other things, the recent suspension of trading of the Company’s shares and recent sales of Company assets. Many of these questions are speculative or would require the Company to comment on ongoing or incomplete negotiations. The Company does not propose to respond to these questions and does not comment or affirm any of the various assertions in the Crown Financial Letter, other than as noted below. In addition, many of the questions would require disclosure of financial, strategic and/or management information at a granular level. This information has not previously been made available and will not be provided in this instance.

Class Action

The Crown Financial Letter refers to the current class action proceedings brought against the Company in the Supreme Court of Queensland (**Class Action**). The Company notes that:

- the Class Action documents and proceedings are a matter of public record;
- the plaintiffs in the Class Action (**Plaintiffs**) are being funded by Vannin Capital (**Vannin**). Neither the Plaintiffs nor Vannin made any approach to the Company prior to commencing the Class Action;
- in June 2016, the Company was threatened with a class action. That threat is unrelated to the current Class Action.

ASIC Investigation

As noted in the Company's announcement of 10 November 2016, ASIC is conducting an investigation into the Company's disclosures in connection with the various contracts which are the subject of the Crown Financial Litigation (**Investigation**). The Company is co-operating fully with ASIC and is not able to comment on the timing or content of the Investigation, which are matters for ASIC.

Board and Executive Remuneration

Full details of the remuneration entitlements of the Company's Non-Executive Directors, Executive Directors and Key Management Personnel are set out in the Remuneration Report contained in the Company's 2016 Annual Report. This information will be updated in the Annual Report for 2017.

The Company has entered into Deeds of Indemnity and Access with each of the current and former directors. Details of the extent of this indemnity is set out in the Company's 2016 Annual Report. This information will be updated in the Annual Report for 2017.

Rejection of proposal from Coastalwatch Pty Limited

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 the Company from Coastalwatch Pty Limited, a member of the Crown Financial group of companies (**Proposal**). The Proposal was rejected by the Company for the reasons set out in the Company's announcement of 10 November 2016. If Crown Financial or its associated entities wish to make a genuine, commercial offer for the Company, it will of course be given all due consideration by the Board of Directors.

ENDS

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

Appendix 1 – Crown Financial Letter



Crown Financial

ABN 63 000 188 367

7 June 2017

By email to sbelton@surfstitch.com and express post
SurfStitch Group Limited
225 Burleigh Connection Road
Burleigh Heads QLD 4220

Attention: The board of directors, SurfStitch Group Limited (ACN 602 288 004)
(SRF)

Questions about the trading suspension of SRF and conduct of the SRF board

This is an open letter to the board of SRF from Crown Financial Pty Ltd (Crown) in respect of matters to be disclosed by SRF to its shareholders.

As a substantial shareholder in SRF, Crown is deeply concerned by the recent suspension of trading of SRF and the uncertainty of SRF's ongoing viability. Crown is also deeply concerned that SRF has been and continues to be operated in a manner which is contrary to the best interests of the company and its shareholders.

SRF is in a precarious position and disclosure to the market to date has been superficial at best. In the circumstances Crown requests that SRF responds to the following questions by way of general disclosure to the market.

Suspension of trading

On 26 May 2017 the ASX published a market release regarding SRF announcing that SRF securities were suspended from trading. SRF's request for voluntary suspension stated, amongst other matters, that SRF intends to expand and expedite a planned restructure and rationalisation process, and that proposed transactions could have a potential impact on SRF's continued viability.

Shareholders are entitled to answers to the following questions:

1. What is the planned restructure and rationalisation process?
2. How is the SRF board addressing these issues and what actions are being taken to ensure the continued viability of SRF?
3. Based on SRF's financial projections, including projected losses, projected legal costs and projected write-downs on discounted inventory, does SRF expect to be solvent by the end of the calendar year?
4. Will SRF book and bank \$6 million in cash by 30 June 2017 as deferred consideration from the Surf Hardware International sale?
5. What are the estimated costs incurred by SRF associated with the closure of USA operations?
6. What are the expectations that SRF has of income from Surfdomo?

Crown Financial Pty Ltd ABN 63 000 188 367
681 Barrenjoey Rd, Avalon Beach NSW 2107 (PO Box 603)
Phone: 02 9965 7380 * Fax: 02 9918 8439

7. In the circumstances of the voluntary suspension and to enable shareholders to make proper and informed decisions regarding SRF, will SRF make current aged inventory analysis reports, current aged accounts receivable reports and current aged accounts payable reports available prior to the end of the voluntary suspension?
8. Please provide details of provisions for inventory write-off and doubtful debts.

Sale of SRF Assets

In December 2016, it was reported that SRF subsidiary Surf Hardware International was sold for a multi-million dollar loss.

In April 2017, it was reported that SRF had sold Garage Entertainment. This was another multi-million dollar loss as SRF paid \$15 million for Garage and reportedly sold Garage for nominal consideration.

In an ASX announcement dated 22 May 2017 the SRF board notes that it has a dual strategy of delivering a cash flow positive business and maximising value to shareholders, including the consideration of the sale of some or all of its business assets.

9. Which assets is SRF contemplating will be sold?
10. When does SRF expect that assets will be sold?
11. Have negotiations commenced with prospective buyers?
12. Outline the evaluation process SRF has adopted in connection with the sale of assets.
13. The Chairman's address at the last AGM claimed that SRF had received unsolicited interest in the Group as a whole as well as individual business units, and that 333 Capital had been engaged to advise on strategic options. What strategic options did the company decide to pursue as a result of that engagement?
14. Given the involvement of KPMG in transactions which are the subject of legal proceedings, please confirm that KPMG has not been engaged to provide services in connection with the sale of SRF assets.
15. SRF has a track history of selling off assets at significant losses. Please explain how these sales, at significant losses, are in the best interests of the shareholders of SRF?
16. What strategies are in place to deliver a cash flow positive business? Is it just the sale of assets? What levels of income/consideration does SRF expect to receive, given its track history of selling assets for significant losses?
17. Explain how further asset sales are in the best interests of shareholders?
18. Does SRF expect that the sale of any further parts of the business will also involve selling assets at significant losses? If so, please explain how further sales at further significant losses are expected to be in the best interests of the company and its shareholders?

Class action

Crown is aware of the class action brought in the Supreme Court of Queensland (court number 5111/17). The plaintiffs in those proceedings allege, amongst other matters, that SRF has engaged in misleading and deceptive conduct and breached its continuous disclosure obligations, in breach of sections 1041H(1) and 674(2) of the Corporations Act 2001 (Cth).

The allegations in the statement of claim from the plaintiff shareholders in the class action identify a continued series of nondisclosures to the market alleging that SRF engaged in misleading and deceptive conduct and failed to appropriately disclose

that transaction to the market. The board was aware of these allegations for a significant amount of time before the class action was commenced and therefore none of the allegations in the class action should come as a surprise to [SRF|CU1].

19. What is the current status of the class action proceedings?
20. Does SRF intend to defend the class action?
21. Has SRF commenced any negotiations to settle the class action proceedings?
22. SRF was made aware of the subject matter or expected focus of threatened class action proceedings almost a year before the class action claim was filed at court. Why has the SRF board failed to take appropriate action to address or disclose the allegations?

ASIC Investigation

On 10 November 2016, SRF announced that ASIC had commenced an investigation into SRF in respect of questions over SRF's disclosures to the market in connection with the transaction with the TCI group. SRF has not made any further disclosures to shareholders in respect of this investigation.

23. When did the ASIC investigation actually commence?
24. Has the ASIC investigation completed or is it ongoing?
25. How much is the investigation costing SRF?
26. How much funds are budgeted and set aside for dealing with the ASIC investigation on an ongoing basis?
27. What allegations have been made against SRF?
28. Has ASIC's investigation extended to any particular individual SRF board members?

Board and executive remuneration

Given SRF's exceedingly poor results, shareholders are entitled to know if the remuneration of the board and executives has changed. Crown understands from the FY16 SRF Remuneration Report that the director's fee for Sam Weiss is \$185,000 per year. Crown also understands that while Lex Pederson was removed as a director of SRF, received remuneration in excess of \$2m over the last 2 years and is still being paid in excess of \$600,000 per year. This is particularly surprising given Mr Pederson's involvement in events which directly contributed to SRF's poor financial performance and may result in a civil penalty or criminal penalty matter.

29. Please provide the details of any changes to directors' and executives' remuneration since the last public disclosure.

The proceedings and investigations noted in this letter may involve allegations against past and present directors of SRF.

30. Has SRF ever paid or is SRF currently paying the legal fees for any individual director of SRF in connection with any allegation against such individual director that might amount to a civil penalty or criminal penalty matter?

Previous takeover bid

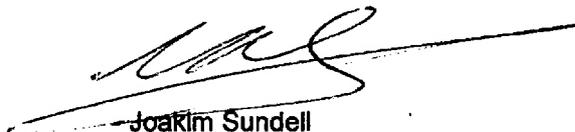
On 28 October 2016, Coastalwatch Pty Ltd (a company associated with Crown) sent a proposal to SRF to acquire all of the issued shares in SRF for cash consideration of 20 cents per share. That proposal was rejected by SRF. Since that proposal was rejected SRF has issued 4 profit downgrades and the price of suspended shares is 0.068. Had the proposal been accepted, SRF shareholders would be much better off than they are now.

31. How does SRF justify the rejection of the previous takeover proposal? Explain the rationale for that decision.
32. What board processes were applied to consideration of the proposal?

33. As at 28 October 2016 SRF had knowledge of the various issues it faced, particularly with the ongoing profitability of SRF businesses. Please explain how a blanket rejection of the previous takeover proposal was in the best interests of shareholders?

Crown looks forward to your detailed responses to these questions by way of market update for the benefit of all SRF shareholders.

Yours sincerely,



Joakim Sundell
Managing Director