SurfStitch wipeout: How to lose $500m very fast

June 9, 2016

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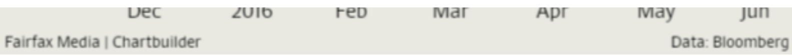
Surfstitch has downgraded earnings three times in six months. *Photo: Louie Douvis*

Want to know how to wipe out more than $500 million of value in six months, how to explain a chief executive who has gone AWOL and how to turn a prospective profit of $18 million into a loss of about $18 million. Ask the once darling of the stock market-turned disaster, SurfStitch.

Its shares were dumped again on Thursday when it confessed to yet another profit mega glitch. Shares fell by 30 per cent when news hit the market – plunging from 40¢ to 26¢ just before lunch. In November, the company was worth $580 million – at one stage on Thursday morning the value of the company had dropped as low as $74 million.

Over 18 months, SurfStitch raised about $180 million, bought a series of businesses, retail and surfing content. It paid up generously to amass a suite of brands in what, with the value of hindsight, is being considered corporate bingeing – from which the indigestion is now being fully felt.



Some of Australia's most savvy investors were captivated by this company, romanced by its e-commerce-meets-youth surf culture strategy and wowed by surfer Lex Pedersen and investment banker Justin Cameron, who founded it and had big ambitions to be the digital go-to for all things surfing.

The particulars around Thursday's announcement relate to the loss of a licensing contract SurfStitch entered into last year to sell its content. It will cost SurfStitch $20.3 million in revenue and profit.

It will be the final straw for some investors who had desperately hoped the company would stage a medium-term comeback.

The company had ambitions to be the digital go-to for all things surfing. *Photo: Justin McManus*

Since listing on the stock exchange in 2014, the company has failed to live up to shareholder expectations. The great and expensive vision that had been marketed to investors will produce a loss rather than a profit in 2016.

This is a picture of a company that is in shambles.

The man that promoted this company, was its chief executive and a significant shareholder, Justin Cameron, told shareholders in February that this year's profit wouldn't be as big as the company's prospectus had promised. Had something gone wrong?

According to Cameron the answer was no. The company's management was apparently wanting to invest more profit back into the business.

A few weeks later he shocked both investors and the board – ditched his job and disappeared. He left with nothing more than an email that explained he had teamed up with a potential financial private equity company that was looking to buy SurfStitch.

Within a month there was another profit warning – profits will be down.

The would-be buyer who had apparently been poised to make a very generous takeover offer never emerged.

The mystery of the disappearing boss – Cameron – has never been solved. While he apparently contacted SurfStitch chairman Howard McDonald a few weeks back, the call was not returned.

Now there is a new chief executive, Mike Sonand – one from outside the company who is talking up the future but not giving any time frame on it and not pretending it will be easy.

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GB | Syd June 09, 2016, 4:52PM

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»as a surfer, i buy many surfing products either from my local surf shop down the road or (mainly clothing and some accessories) on Surfstitch. Surfstitch is a good online site I trust and has wide variety of products and competitive prices (now the dollar is down against the US), and does reasonable sales. They may have overreached in the boardroom but the underlying ecommerce website is pretty much the go to site online for surf-related products. Would be sad to see it go under purely through bad management or unrealistic expectations by investors.«

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donut | June 09, 2016, 5:27PM

THE AUSTRALIAN

New SurfStitch boss Mike Sonand slams previous management

ELI GREENBLAT THE AUSTRALIAN 1:42PM JUNE 9, 2016

Mike Sonand, pictured when head of Globe in the early 2000s.

The new chief executive of disaster-prone online retailer SurfStitch, Mike Sonand, has delivered a damning assessment of the company's previous management, declaring a frenetic pace of capital raisings and acquisitions since its 2014 float had distracted the group.

The business model was unsustainable, compounded by a "unhealthy'' focus on top-line sales growth, worsened by a failure to properly integrate the string of acquisitions to squeeze out efficiencies.

This would end under his watch, Mr Sonand vowed today, as he returned the business to be a true retailer, with acquisitions and constant deal-making now pushed off the agenda.

He also said the business had been overly-exposed to discounting that turned off customers.

Mr Sonand was speaking after SurfStitch (**SRF**) today reported another **sharp downgrade to its forecasts**, which sent its shares plunging over 30 per cent.

He takes over as CEO following the shock departure in March of co-founder Justin Cameron.

Mr Sonand said Mr Cameron's sudden departure, announced in an email to the board, had left the business "bewildered''.

''We had a very charismatic and visionary CEO who suddenly walked out, kind of left the business a bit bewildered, and somewhat lost,'' Mr Sonand told *The Australian.*

He emphatically denied reports Mr Cameron had approached the SurfStitch board to return as CEO and was knocked back.

"Not true. He didn't come to the board and the board did not rebuff him.''

The departure of Justin Cameron, left, pictured with co-founder Lex Pedersen, had left the business "bewildered", says Mr Sonand. Pic: Toby Zerna

A retail veteran, Mr Sonand once again finds himself at a company in crisis, having also led rival surfwear retailer Globe through a similar near-death experience.

Once again the CEO had suddenly quit and Mr Sonand was drafted in to revive the business's sliding fortunes.

SurfStitch's guidance downgrade was its **third profit warning this year**.

It said it now expected revenue to fall $20.3 million short of expectations due to an issue with the treatment of a licensing deal, resulting in its financial year 2016 earnings forecast shifting from a $2m-$3m profit to an expectation of a $17.3m-$18.3m loss.

Mr Sonand declined to further discuss the contract with a third party which triggered the $20 million revenue reversal, or who that contract was with.

The company only said in a statement that “recent information had come to hand” that would require further investigation into the contract and the termination of $20m in revenue for 2016 An update is expected at the full-year results in August.

Turning to the underperforming SurfStitch business, Mr Sonand said the retailer had been too frenetic since its 2014 sharemarket float and taken its attention off the engine of the company, its retail platform.

“Three capital raisings, six acquisitions and one closure, and that was in less than 12 months,’’ Mr Sonand said.

“And the failure to drive any operational improvements off our new acquisitions or properly integrate them.

“The pace was frenetic and created a lot of distraction, complexity and lack of accountability across the group, there was too much happening.”

Mr Sonand also said management was too focused on top-line growth, to the cost of profit.

“There is a real unhealthy focus on top-line growth, I accept it’s an e-commerce company and people value e-commerce companies on sales, and if it’s not growing by more than 30 per cent it’s not good, I think that focus on top-line growth came at a significant cost to the business.’’

SurfStitch had also been discounting too heavily, he said.

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THE AUSTRALIAN

Mike Sonand drafted to patch up struggling SurfStitch

ELI GREENBLAT THE AUSTRALIAN 12:00AM JUNE 10, 2016

The new boss of disaster-prone online retailer SurfStitch, Mike Sonand, has delivered a damning assessment of the company's previous management, declaring a frenetic pace of capital raisings and acquisitions since its 2014 float distracted the group to create a culture lacking in accountability and an "unhealthy'' focus on revenue growth at any price.

Worse still, the sudden departure of SurfStitch co-founder and previous CEO Justin Cameron left the group "bewildered, and somewhat lost" while a heavy reliance on product discounting turned off shoppers.

However, this would end under his watch as he vowed yesterday to return the business back to being a true retailer.

Mr Sonand, a global retail veteran, is determined to revive SurfStitch from its aimless state where "our hands were off the tiller and we were in rough seas''.

"This is why we find ourselves where we are today. It's not a good look; it's not great,'' Mr Sonand told *The Australian* yesterday.

Those rough seas crashed into SurfStitch yesterday, when the retailer came out of a two-day trading halt to issue its third profit warning this year, informing long-suffering shareholders the online surfwear and action sports retailer had ripped up its profit forecast for this year.

It said it now expected revenue to fall $20.3 million short of earlier expectations due to an issue with the treatment of a licensing deal, resulting in its earnings forecast for the 2016 financial year shifting from a $2m-$3m profit to an expectation of a loss of $17.3m-$18.3m.

Shares in SurfStitch were battered, slumping nearly 40 per cent to a low of 25c before closing down 8.5c, or 21 per cent, to finish yesterday's session at 32c. The collapse has stranded the stock a long way from its issue price of $1 at its December 2014 float.

It has also cast another cloud over a sector that has had more than its fair share of financial woes in recent years across legacy brands including Billabong and Quiksilver.

SurfStitch said in a statement that “recent information had come to hand” that would require further investigation into a contract signed with an unnamed third party and that in the meantime would require the termination of $20m in revenue for 2016.

Mr Sonand declined to further discuss the contract at the centre of the disappearing revenue, who that contract was with or what the nature of the “recent information’’ was.

An update is expected at the full-year results in August.

Mr Sonand accused former managers of failing to properly integrate the six acquisitions racked up by SurfStitch since its float. He said the retailer lacked accountability and was overly exposed to discounting.

“Three capital raisings, six acquisitions and one closure, and that was in less than 12 months,’’ Mr Sonand said when asked about SurfStitch’s hectic first year as a public company.

“And the failure to drive any operational improvements off our new acquisitions or properly integrate them.

“The pace was frenetic and created a lot of distraction, complexity and lack of accountability across the group.”

Mr Sonand said management was too focused on top-line growth, to the cost of profit.

“I accept it’s an e-commerce company and people value e-commerce companies on sales, and if it’s not growing by more than 30 per cent it’s not good,” he said. “I think that focus on top-line growth came at a significant cost.’’

Mr Sonand said the departure of “a very charismatic and visionary’’ Mr Cameron, who walked out of the company in March, left the business “bewildered’’.

He denied reports that Mr Cameron had approached the SurfStitch board asking to return as CEO and had been knocked back.

Mr Sonand led rival surfwear retailer Globe through a similar near-death experience in 2003 when the CEO suddenly quit and Mr Sonand was drafted in to revive the business's sliding fortunes.

THE AUSTRALIAN

SurfStitch faces possible class action over share collapse

ELI GREENBLAT THE AUSTRALIAN 12:00AM JUNE 13, 2016

Online retailer SurfStitch, which has already endured three profit downgrades in six months, the walkout of its chief executive and a collapsing share price, could now be hit with a $500 million shareholder class action lawsuit after law firm Gadens began sifting through the company's soap opera-like life as a public company.

Gadens partner and chief counsel Glenn McGowan QC is leading the preliminary investigation into SurfStitch, focusing on up to 30 private briefings held with select investors before the surfwear and action sports apparel company's profit warning in May that sent its stock crashing.

The latest profit downgrade last week, which centred on a mysterious third-party licence that triggered a reversal of $20.3 million in revenue, will also be a target for the law firm's inquiry, leading to broader questions on SurfStitch management's basis for fashioning its profit forecasts, which have since been torn up three times this year.

Gadens, one of the nation's biggest law firms which advises more than a third of the top 200 companies listed on the ASX, believes its investigations could reveal misleading or deceptive conduct contrary to Australian consumer law, as well as the ASIC Act, breaches of the Corporation Act and breaches of the continuous disclosure obligations of the ASX.

The law firm is calling for SurfStitch shareholders to register their interest in a potential class action lawsuit, with the lost value of the company's market capitalisation, as much as $500 million, a possible basis for a court claim.

"We know from ASX data total value in the company dropped about $500m but actual losses by shareholders might be more than that … the claims might total less than that too, but it's in that sort of order,'' Mr McGowan told *The Australian*.

Mr McGowan said on top of the three profit downgrades, private briefings with shareholders and the unknowns around the $20.3 million licence contract — which represented the best candidates for a class-action lawsuit — there could be other grounds for investigation.

“SurfStitch were very aggressive with their acquisition program and they have already made concessions they couldn’t integrate those new businesses very quickly.

“In fact their new CEO has said that, and I think they probably got a bit of indigestion eating too quickly.

“Whether they all turn out to be actionable, I can’t say.’’

Last week SurfStitch issued its third and latest warning, and appointed a new CEO, Mike Sonand, who has vowed to refocus the company on its core retailing operations and rebuild the failing culture of the business. SurfStitch declined to comment yesterday.

Mr McGowan said he would also direct his inquiry into the sudden departure of SurfStitch co-founder and CEO Justin Cameron in March, who quit via a simple one-line email to the board and was reported to be joining forces with an unnamed private equity firm to make a takeover bid for the company.

“I’m rather puzzled by it. As far as I can tell he has disappeared without a trace and don’t know what he is doing now — it’s really strange.

“I don’t know if he thought better of it and has gone off the idea of making a takeover, or whether the company suffered because of his departure, because it might be said that a number of their problems arose after he left.

“I know there was a downgrade before he left, but I think there have been more problems after he left than before he left, and maybe he regards the business as not as attractive now that it is being managed by others.’’

Gadens is also keen to hear from any investors that were treated to a private briefing in April, just before another profit warning was issued.

“It has been reported that 30 private briefings were conducted with some shareholders between 25 and 29 April 2016.

“This was prior to the ASX update on 3 May 2016 when the profit forecast was downgraded.

“The fact of the private briefings raises questions about why the communications in those briefings were not made public until, at the earliest, 3 May 2016,’’ Gadens said in a statement.

Mr McGowan said he was hopeful of getting documents from those private briefings before he decided whether to issue proceedings against SurfStitch and begin a class action.

Gadens needs at least seven investors to sign up to the class action, with the law firm then to pick a lead litigant and decide if the action is viable.

“Already the responses I have got from mums and dads suggests they have lost quite a bit of money per head, so if that pans out over the next week or so then you would expect I could put together a pleading within a few weeks and could issue next month, but it could take longer.’’

SurfStitch has had a horrendous two years as a public company, with its share price crashing from an offer price of $1 to as low as 25c last week.

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$20m deal could wipe out SurfStitch

JUNE 11, 2016 5:30PM


SurfStitch founders Lex Pedersen (left) and Justin Cameron. Picture: Toby Zerna

Staff writers and AAP, news.com.au

A COLLAPSED $20 million deal with a mysterious company could be the final wave that wipes out struggling surfwear store SurfStitch.

On Thursday, more than $23 million was wiped from the market value of the online retailer after it warned it would post an annual loss.

It was the second time in a month that the company, founded in a garage by surfing mates Justin Cameron, Lex Pedersen and Haydn Smith in 2007, had downgraded its earnings forecast.

SurfStitch now expects to post a loss of between $17.3 million and $18.3 million.

Derek Rielly, of surfing website BeachGrit, describes the loss as the start of SurfStitch's "long goodbye" after a meteoric rise.

"In a nutshell. Two surfers, one with a banking background, start an online surf store in 2007," he wrote.

"They risk everything, mortgage their houses, work their asses off, get bought by Billabong in 2009, then buy it back, go public, buy Stab, Magic Seaweed, Garage Entertainment and FCS and build the dazzling company to a point where it's worth more than half a billion dollars.

"And then came the downward ride."

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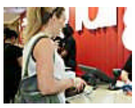
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The latest downgrade was caused by a $20.3 million shortfall from a licensing deal that apparently fell through.

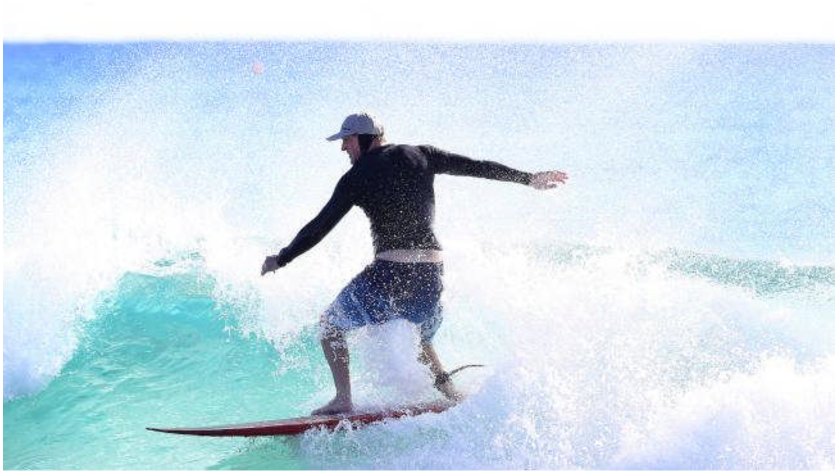
In a statement to the ASX, SurfStitch said the deal “related to the grant of perpetual licence to a third party to use the company’s content”.

Another set of agreements, signed with the same company in the second half of the year, related to the provision of online services such as SurfStitch’s online store while also “[extending] the payment terms of the perpetual licence agreement”.

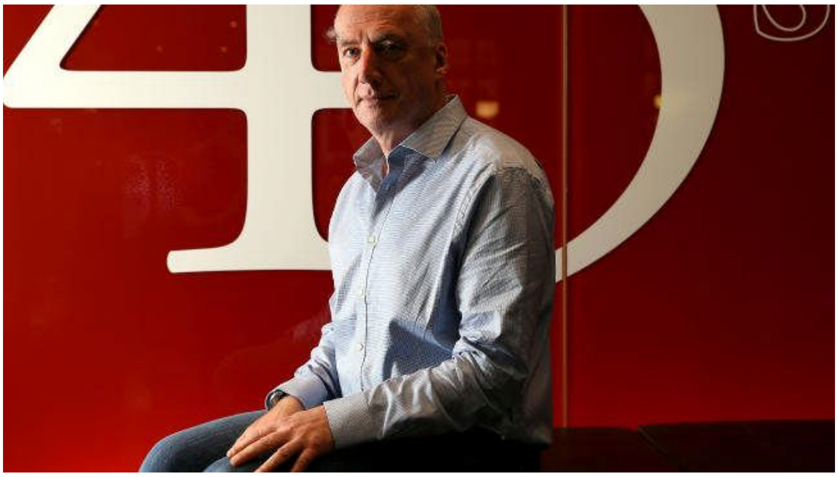
As a result of “recent information that has come to hand”, SurfStitch “believes in substance an amendment to the original contract” occurred.

“The effect of this is that $20.3 million of revenue will be reversed,” the statement said.

SurfStitch has refused to share any more information about the mysterious company or the nature of the “recent information” that came to hand.



The surfing industry is facing choppy seas. Picture: Adam Head Source:*News Corp Australia*



New SurfStitch CEO Mike Sonand is tasked with rescuing the business. Source:*News Corp Australia*

The company’s shares fell 21 per cent on the news. SurfStitch has now lost more than 70 per cent of its market value since May 3, when it first downgraded its earnings guidance, from an original forecast of up to $18 million.

In May, the company said trading conditions had become more challenging, meaning its advertising costs would rise.

It followed the abrupt departure of Mr Cameron in mid-March, who announced his resignation to the board in an email and hasn’t been heard from since.

A rumoured bid by Mr Cameron to buy back the company in partnership with private equity and take it private never eventuated.

SurfStitch shares dropped 8.5 cents to 32 cents on Thursday, reducing its market value to $88.3 million. The company said it expected to return to profitability in 2016/17.

It has also promoted chief operating officer Mike Sonand to chief executive, just a month after he joined the company.

He will replace joint CEOs Lex Pederson and Justin Stone, who will now become director of business development and director of global support, respectively.

“Mike has already had a very positive impact on the leadership team,” chairman Howard McDonald said. “He has already demonstrated a firm grasp of the company’s immediate priorities and growth initiatives.”

Mr Pederson and Mr Stone were appointed joint CEOs in March after the surprise departure of Mr Cameron.

Speaking to *The Australian*, Mr Sonand was critical of former management, saying “our hands were off the tiller and we were in rough seas’’ since the company went public in 2014.

“Three capital raisings, six acquisitions and one closure, and that was in less than 12 months,’’ Mr Sonand. “And the failure to drive any operational improvements off our new acquisitions or properly integrate them.

“The pace was frenetic and created a lot of distraction, complexity and lack of accountability across the group.”

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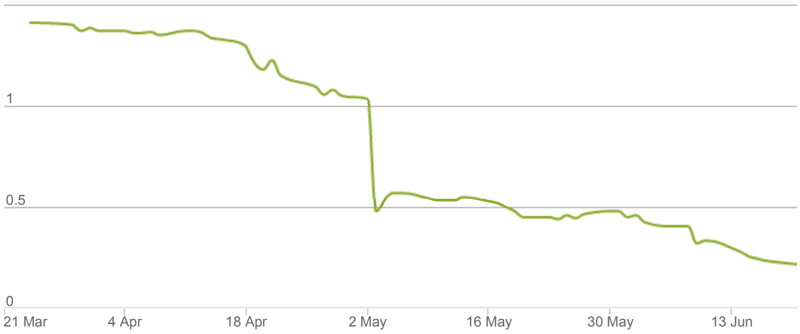

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Surfstitch seeks direction after CEO wipe-out

Justin Cameron (left) co-founder and ex-CEO of Surfstitch, Howard McDonald, chairman. **David Rowe**

by **Michael Smith**

Australia's surfwear companies have a history of extraordinary growth followed by sudden wipe-outs so it is no surprise investors are nervous about the information vacuum surrounding Surfstitch.

There has been radio silence from the online action sports retailer since its co-founder and chief executive Justin Cameron quit abruptly six weeks ago with news he was considering a possible takeover bid.

The extraordinary turn of events has understandably rattled investors. One substantial investor describes it as "funky, a bit strange and weird". Things came to a head this week when the company's stock sank back towards its $1 issue price on the assumption that no news was bad news.

Chairman Howard McDonald's phone has been ringing off the hook with shareholders wanting to know what is going on. Some have been asking him to at least make a statement to the market to give some assurances about the company's performance.

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Justin Cameron (left) co-founder and ex-CEO of Surfstich, Howard McDonald, chairman. **David Rowe**

McDonald is the kind of chairman who likes to have all the information in front of him before and something to say before going to the market. The sudden departure of Cameron, who resigned in a one-line email, destabilised the company at a time when it needed to restructure and consolidate following a string of acquisitions.

The company's position will become clearer next week when McDonald is expected to update the market on its current position. Cameron's intentions remain a mystery though and there has been no contact between him, the rumoured private equity bidder and the board since the resignation bombshell.

People close to Cameron believe a takeover is still in the works though. They say Cameron, who started the company from his Sydney garage and is said to be frustrated with the market's reaction to a profit downgrade earlier this year, is a savvy entrepreneur who would not have resigned if he did not think there was a realistic chance of taking the company private.

There are also suggestions UK fast fashion outfit ASOS and Chinese e-commerce giant Alibaba also have looked at the company

Others say the chance of a bid is 50:50 or less and even then would a private equity firm be prepared to pay $2 per share or more, which is what it raised equity at last year, for a company that is currently valued at a little above $1.

Responding to criticism he had left the market uninformed, McDonald told Chanticleer he takes umbrage with suggestions he has put up the drawbridge. He has had 30 briefings with shareholders this week, with four on Friday afternoon alone.

He will be working his two co-chief executives Justin Stone is in London and Lex Penderson in California, who have been reviewing the European and US operations, over the weekend to reaffirm where the company is at and there are expectations the market will be updated next week.

McDonald also wants to strengthen management where the departure of Cameron, who ran the company from a high level, left gaps. He is expected to appoint a new Australian-based chief operating officer (COO) who will act as a bridge between the two co-chiefs in London and California.

The message to shareholders is that strategy is on track but the business needs to go through a period of consolidating its brands and e-commerce platforms after a period or rapid growth as the company focused on beefing up its content assets.

Not everyone is happy with the company's approach which is reflected in the sagging price. Mark Maloney, the executive chairman of private equity firm Intrepic, picked up just under 5 per cent of the company when Cameron acquired his Garage Entertainment business last year.

Maloney, who ran his family's mining services company MAC Services which was sold for $650 million in 2010, is seeking a directorship at Surfstitch and is believed to have an eye on the chairman's role. Cameron spoke to him about a board seat, attracted to his background running a listed company and knowledge of the action sports industry, at the time of the Garage deal.

Kidman deal on hold

The upcoming federal election has effectively killed off the Chinese takeover of S.Kidman & Co. The political environment makes it impossible for Treasurer Scott Morrison to approve the sale of the country's largest landholder to foreign interests.

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The sensible thing for China-based Dakang Holdings and Kidman to take the offer for around 11 million hectares of cattle stations off the table and sit tight until things calm down.

Dakang has until May 3 to respond but it is safe to assume it will withdraw rather than trying to tweak an offer which will pass this "national interest" test this side of an election, or even shortly after.

Initially Kidman & Co hoped the Treasurer would put off making a decision until after the election to avoid any political backlash from the Nationals but sign off on it then.

The growing hostility around Chinese investment in agriculture and infrastructure at a time when Australia is trying to attract more investment from Asia is at odds with the former Prime Minister Tony Abbott's "open for business" mantra in his election night victory speech three years ago.

PNG ruling blows Broadspectrum defence

Papua New Guinea's Supreme Court blew Broadspectrum's last line of defence against Ferrovial's $813 million takeover bid out of the water this week when it ruled the Manus Island detention centre was illegal.

Ferrovial says its $1.50 per share offer had always factored in the risks associated with the detention centre contracts. That is true to a point but there is no denying in an ideal world it would have secured the bid and kept the revenues from Manus Island to restructure the maintenance and services businesses which attracted it to Broadspectrum in the first place.

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SurfStitch selective briefings under spotlight as class action looms

Melbourne law firm Gadens has urged aggrieved major shareholders in SurfStitch to provide details about private briefings with the board and senior management as it investigates whether to launch a $500 million class action claim.

Gadens partner and chief counsel Glenn McGowan QC wants to know what SurfStitch chairman Howard McDonald told shareholders in a series of private briefings the week before the company warned that earnings could fall 61 per cent.

While some shareholders complained at the time the board had been on "radio silence", Mr McDonald told Chanticleer on April 29 he had had 30 briefings with shareholders in the past week, including four alone that afternoon.

SurfStitch shares fell from $1.22 to $1.03 that week on above average volumes – attracting the attention of the Australian Securities Exchange – before dropping 53 per cent to 48¢ when SurfStitch finally issued a profit warning on May 3.

Mr McGowan believes SurfStitch may have breached its continuous disclosure obligations and failed to keep all shareholders properly informed of what was going on at the former market darling after former chief executive Justin Cameron resigned unexpectedly in March, triggering a chain of events that wiped almost $500 million off the company's market value.

"I can't think of reasons why private briefings to shareholders are ever justified – if you need to brief shareholders you need to inform the markets," Mr McGowan told *The Australian Financial Review* on

Monday.

"There's a reasonable amount of anger on the part of the shareholders I've been in touch with," he said. "They seem to think they have not been looked after."

Mr McGowan hopes that major shareholders who participated in the private briefings will come forward with details about what was discussed, saying: "I don't think there's any downside for them, it's not as if they were colluding."

A SurfStitch spokeswoman said the company declined to comment on the potential class action or the issue of selective briefings, which are banned by the corporate regulator.

Mr McGowan is also looking into deficiencies in SurfStitch's December 2014 prospectus and whether the online surf and action sports retailer should have warned investors it planned to embark on an aggressive acquisition spree.

During 2015 SurfStitch outlaid more than $80 million in cash and shares on non-core acquisitions, including Stab, an online surf content platform, Magicseaweed, a user-generated surfing network, Garage Entertainment, which makes surfing videos, and surfboard manufacturer Surf Hardware International.

Co-founders Justin Cameron and Lex Pedersen wanted SurfStitch to become the Amazon Prime of the action sports market, using unique content to attract customers. However, problems integrating the acquisitions have contributed to the retailer's problems.

"It's one thing to say generally they want to expand and another to go on a spending binge the way they did," Mr McGowan said.

After reviewing one content sharing agreement in the wake of Mr Cameron's departure, SurfStitch was forced last week to reverse $20.3 million in revenues and issue its third profit downgrade in six months, forecasting an $18 million EBITDA loss.

Morgan Stanley analyst John Stavliotis said in a note on Friday the circumstances behind the revenue reversal raised concerns about SurfStitch's previously reported accounts.

"The company has guided for a return to profitability in 2017 and positive cashflows, but we have no confidence that this can be achieved in view of the poor performance and lack of evidence that this online retailer can make money," said Mr Stavliotis, who has forecast net losses of $18.7 million this year and $7.8 million in 2017.

Mr McGowan has urged current and past SurfStitch shareholders to register their interest in participating in a class action claim, which would seek to recover funds from the company's insurers.