

Folkestone Limited

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10 February 2011

Dear Shareholder,

EREP PROPOSAL AND BELL POTTER PROPOSAL

I am writing to update you in relation to recent developments regarding your company.

As shareholders are aware, your Board wrote to you on 10 January 2011 with notice of meeting and explanatory memorandum documentation regarding a proposal to transform Folkestone through a significant capital raising initiative and the conditional acquisition of EREP, with shareholders to consider the terms at a meeting on 17 February 2011 (which has now changed as set out below).

Since then, Folkestone has received an alternative and competing proposal to the EREP proposal, being a proposal from Bell Potter Securities Limited (Bell Potter) to underwrite a 2.5 for 1 renounceable rights issue at 10 cents each to raise \$25million (Bell Potter Proposal). Details of this in the form provided by Bell Potter are set out in **Attachment 1** which you are encouraged to read.

As a consequence of the Bell Potter Proposal, Folkestone has received a revised and improved proposal from EREP which has requested that shareholders vote on the revised basis that now encompasses its proposal (EREP Proposal). Details of this in the form provided by EREP are set out in **Attachment 2** showing revisions from the original proposal which you are encouraged to read, in conjunction with the notice of meeting and explanatory memorandum documentation described above.

Given that Folkestone was subject to 2 competing alternative proposals, Folkestone initiated a trading halt and voluntary suspension of its shares over the past week (which has now been lifted) in order to provide time for the Board to assess the merits of the proposals. In order to assist in that regard, the independent directors of the Board engaged a major accounting firm which provided an assessment of the merits of the two proposals.

Having exercised its business judgment, the Board has determined, by majority (representing each of the Directors who do not have a conflict of interest) that the Bell Potter Proposal is a superior proposal to the EREP Proposal.

The key reason behind this determination relates to the nature of the proposed capital raising. Folkestone is a small company with a market capitalisation of only \$12 million. In circumstances where each of the two proposals contemplate a capital raising significantly in excess of that, it is preferable that this occur in a manner which is equitable to existing shareholders, particularly in circumstances where the capital raising price is at a discount to net tangible asset value. In that context, in the view of the majority of the Board:

- The Bell Potter Proposal satisfies the test of fairness to existing shareholders. Each shareholder is to be offered a pro rata entitlement to subscribe for shares. Shareholders will be given the ability to apply for additional shares arising out of any shortfall, and in the event of surplus demand and subject to any regulatory requirements Folkestone will allocate shares on a proportional basis having regard to the shareholdings of the applicants for additional

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shares as at the record date. If and only if there is insufficient demand from existing shareholders for the shortfall shares will the underwriter step in, and in those circumstances may result in the underwriting parties obtaining control. The Bell Potter Proposal is also renounceable. Accordingly, if any shareholder does not wish to take up an entitlement then the sale of those rights on ASX is potentially available to that shareholder.

- The EREP Proposal contemplates that a minimum of \$20 million and potentially as much as \$40 million is intended to be issued by way of placement to institutions and sophisticated investors which will have a dilutionary effect on existing shareholdings. This will be followed by a broader issue to the public including all shareholders who will be given the opportunity to participate at the same offer price as the placement.

Notwithstanding this majority preference for the Bell Potter Proposal, the Board recognises that the Bell Potter Proposal has risks and uncertainties, for example if the Bell Potter Proposal capital raising does not proceed as contemplated. The EREP Proposal has attractive features, a key feature being the 12 cent or more capital raising price which is greater than the Bell Potter Proposal of 10 cents. Mr Greg Paramor and Mr Hugh Gurner recommend the EREP Proposal (although noting that they have a conflict of interest as stated in the notice of meeting documentation).

In view of these factors and as a matter of good corporate governance and consistent with shareholder democratic principles, the Board has resolved unanimously to give shareholders the ability to form their own assessment in relation to the EREP Proposal.

In order to give shareholders sufficient time to consider aspects set out in this letter, the Board has unanimously resolved to postpone the shareholders' meeting previously scheduled for Thursday, 17 February 2011, and the venue of the meeting has also changed. The meeting will now be held at **10.00 am on Tuesday, 22 February 2011** at the offices of **Baker & McKenzie at Level 19, 181 William Street, Melbourne**. You are encouraged to attend the meeting or if you are unable to do so you should vote following the process set out in the notice of meeting documentation.

Any proxies lodged by shareholders will remain valid for the re-scheduled meeting. However, if you wish to revoke or change your previously lodged proxy or have any queries in relation to the voting process, you should contact the Company's share registry, Link Market Services Limited on 1300 554 474. Your proxy must be received by the Company by no later than 48 hours before commencement of the re-scheduled meeting.

Yours sincerely



Alister T L Maitland

Chairman

**Attachment 1
Bell Potter Proposal**

Item	Proposal
Nature of capital raising	Fully underwritten renounceable rights issue. Available to all eligible shareholders as at the applicable record date.
Name of Underwriter	Bell Potter Securities Limited.
Shareholder Entitlement	2.5 to 1.
Underwriting Quantum	249,248,070 shares (approximately \$25 million).
Rights Issue Price	10 cents.
Renounceable?	Renounceable.
Top Ups	Top up applications for shortfall shares by existing shareholders are permitted. If there are excess oversubscription applications, then subject to any regulatory requirements Folkestone will allocate shares on a proportional basis having regard to the shareholdings of the applicants for additional shares as at the record date.
Form of Underwriting Agreement	In the form provided to Folkestone, standard form.
Conditionality	Not conditional on any outstanding subunderwriting commitments (all of which have been obtained). Not conditional on credit or other internal approvals (all of which have been obtained). Standard conditions only.
Shareholder Approval Requirements	No shareholder approval is required.
Timing	Able to proceed promptly.
Key Commitments Received	Wilbow Pty Ltd (controlled by Mr Bill Bowness) has agreed to subscribe for \$2.67 million of shares representing the takeup of his entitlement being 10.7% of shares. Subunderwriting commitment from Thorney Investments Pty Ltd for \$10 million has been received, Thorney having a 9.6% shareholding in Folkestone.
Directors	Mr Bill Bowness will join the Board as a non-executive director. Mr Bowness is the chairman of Wilbow Group, Folkestone's largest shareholder with a 10.7% shareholding. He has over 30 years experience in all facets of property investment and development and sits on the Centro Retail Trust Board. Mr Bowness will add relevant expertise at board level in regard to development and execution of strategy and oversight of management. This will also assist Mr Scott Martin in his capacity as acting CEO and ensure a smooth transition for Folkestone during the search for a suitable CEO candidate. Mr Bowness' appointment will enhance the current governance structure maintaining a majority of non-executive directors.
Termination Events	If any of the S&P/ASX All Ordinaries Index, 200 Index or Small Ordinaries Index is for 2 consecutive trading days 10% or more below its level at the close of trading immediately preceding the date of the Underwriting Agreement. Other standard termination events.
Underwriting Fees	4% underwriting fee plus a management fee of 1% plus \$60,000 plus GST.

Attachment 2 EREP Proposal

1. Change of Business

To consider and, if thought fit, pass the following as an ordinary resolution:

"Subject to all other Resolutions (other than Resolution 10) being passed and subject to the Company raising gross proceeds of at least \$20 million pursuant to the capital raising proposed in Resolution 2, that for the purposes of ASX Listing Rule 11.1.2 and for all other purposes, the Company is authorised to acquire all of the issued share capital of Equity Real Estate Partners Pty Ltd on the terms and conditions of the Share Sale Agreement described in the Explanatory Memorandum, and to effect a consequential change in the activities of the Company from real estate development to real estate investment, development and funds management as described in the Explanatory Memorandum."

2. Capital Raising

To consider and, if thought fit, pass the following as an ordinary resolution:

"Subject to all other Resolutions (other than Resolution 10) being passed, that for the purposes of ASX Listing Rule 7.1 and for all other purposes, the shareholders of the Company approve the proposed issue of up to ~~833,333,333~~ 1,250,000,000 fully paid ordinary shares in the capital of the Company at a minimum issue price of ~~128~~ cents per share to raise gross proceeds of a minimum of \$20 million and up to \$100 million on the basis set out in the Explanatory Memorandum."

3. Issue of Shares to the EREP Vendors

To consider and, if thought fit, pass the following as an ordinary resolution:

"Subject to all other Resolutions (other than Resolution 10) being passed and subject to the Company raising gross proceeds of at least \$20 million pursuant to the capital raising proposed in Resolution 2, that for the purposes of ASX Listing Rule 10.11 and for all other purposes, the shareholders of the Company approve the following proposed issues of shares in the capital of the Company, each at a deemed issue price of ~~12~~ cents per share, as may be adjusted on the basis set out in the Explanatory Memorandum as consideration for the acquisition of Equity Real Estate Partners Pty Ltd:

- The issue of ~~2,083,333~~ 2,500,000 shares to an entity controlled by Adrian Harrington by the name of Adkar Investments Pty Ltd as trustee for the Harrington Family Trust;
- The issue of ~~2,083,333~~ 2,500,000 shares to an entity controlled by Jonathan Sweeney by the name of Serrano Investments Pty Ltd as trustee for the ES and JS Family Trust; and
- The issue of ~~4,166,666~~ 5,000,000 shares to an entity controlled by Greg Paramor by the name of ERE Holdings Pty Ltd as trustee for the Para EREP Trust."

4. Executive Incentive Performance Rights Plan

To consider and, if thought fit, pass the following as an ordinary resolution:

"Subject to all other Resolutions (other than Resolution 10) being passed and subject to the Company raising gross proceeds of at least \$20 million pursuant to the capital raising proposed in Resolution 2, that for the purposes of ASX Listing Rule 7.2 Exception 9(b) and for all other purposes, the directors of the Company are authorised to implement and maintain a plan to be called the "Folkestone Incentive Performance Rights Plan" and to issue Performance Rights under that plan from time to time to persons who are eligible to participate in the plan upon the terms and conditions specified in the Folkestone Incentive Performance Rights Plan Rules (the terms of which are summarised in the Explanatory Memorandum), and to issue shares in the capital of the Company upon vesting of those Performance Rights from time to time, as an exception to ASX Listing Rule 7.1".

5. Issue of Performance Rights to Greg Paramor

To consider and, if thought fit, pass the following as an ordinary resolution:

"Subject to all other Resolutions (other than Resolution 10) being passed and subject to the Company raising gross proceeds of at least \$20 million pursuant to the capital raising proposed in Resolution 2, that for the purpose of ASX Listing Rule 10.14 and for all other purposes, the shareholders of the Company authorise and approve the grant by the Company to Mr Greg Paramor of up to 12.5 million Performance Rights and the issue of shares upon vesting of those Performance Rights from time to time, in accordance with the Folkestone Incentive Performance Rights Plan and otherwise on the terms and conditions set out in the Explanatory Memorandum."

6. Issue of Performance Rights to Jonathan Sweeney

To consider and, if thought fit, pass the following as an ordinary resolution:

"Subject to all other Resolutions (other than Resolution 10) being passed and subject to the Company raising gross proceeds of at least \$20 million pursuant to the capital raising proposed in Resolution 2, that for the purpose of ASX Listing Rule 10.14 and for all other purposes, the shareholders of the Company authorise and approve the grant by the Company to Mr Jonathan Sweeney of up to 6.257.5 million Performance Rights and the issue of shares upon vesting of those Performance Rights from time to time, in accordance with the Folkestone Incentive Performance Rights Plan and otherwise on the terms and conditions set out in the Explanatory Memorandum."

7. Issue of Performance Rights to Adrian Harrington

To consider and, if thought fit, pass the following as an ordinary resolution:

"Subject to all other Resolutions (other than Resolution 10) being passed and subject to the Company raising gross proceeds of at least \$20 million pursuant to the capital raising proposed in Resolution 2, that for the purpose of ASX Listing Rule 10.14 and for all other purposes, the shareholders of the Company authorise and approve the grant by the Company to Mr Adrian Harrington of up to 6.257.5 million Performance Rights and the issue of shares upon vesting of those Performance Rights from time to time, in accordance with the Folkestone Incentive Performance Rights Plan and otherwise on the terms and conditions set out in the Explanatory Memorandum."

8. Appointment of Garry Sladden as a Director

To consider and, if thought fit, pass the following as an ordinary resolution:

"Subject to all other Resolutions (other than Resolution 10) being passed, Garry Sladden, being eligible and having offered himself for election, be elected as a Director of the Company".

9. Appointment of Ross Strang as a Director

To consider and, if thought fit, pass the following as an ordinary resolution:

"Subject to all other Resolutions (other than Resolution 10) being passed, Ross Strang, being eligible and having offered himself for election, be elected as a Director of the Company".

10. Participation in placement by Mr Greg Paramor

To consider and, if thought fit, pass the following as an ordinary resolution:

"That, for the purpose of ASX Listing Rule 10.11 and for all other purposes, the shareholders of the Company authorise and approve the issue of up to 40 million fully paid ordinary shares in the capital of the Company at a minimum issue price of 128 cents per share to Greg Paramor, or an entity associated with Greg Paramor, pursuant to, and on the same terms as, the capital raising proposed in Resolution 2 and on the basis set out in the Explanatory Memorandum".