

DRAFT BUSINESS PLAN AND PROPOSAL
THE ACQUISITION BY ARROW PAPER LIMITED OF THE PAPER DIVISION
OF R T TANNER & CO LIMITED

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20th January 1993

(A) INTRODUCTION

This document summarises and analyses an opportunity that has arisen for a Management Buy Out ("MBO") of the paper division of R T Tanner & Co Limited, ("Tanners"). Tanners continue to experience financial difficulties, with the inevitable cash flow problems that accompany such a situation, and the disposal of this section of their business is perceived by the shareholders of that company as being an essential component in their recovery plan.

Tanners currently operate from Crayford (the head office), Dartford and Leeds, although the closure of the Dartford operation has recently been announced. Apart from paper merchanting, Tanners manufactures and sells envelopes, and its products are sold both to large users (direct consumers), such as Insurance Companies, Banks, Local Authorities and to other businesses such as printers and stationers. Tanners is a long established, family controlled company. Its current financial difficulties appear to rest with the uncompetitive position that it has found itself in within the envelope manufacturing industry, together with an excessively high cost base and out-of-date plant.

However, particularly in the paper division, it has an excellent customer base, and two of the directors of Tanners, Mike Kerlogue and Bill Pearson (who are being positively encouraged to engineer the MBO) strongly believe that there is a genuine opportunity to develop this division into a profitable and successful independent business.

The MBO Team has now reached agreement for the purchase and this is summarised in the draft Heads of Agreement shown in Appendix A. Completion is targeted for 31st January 1993.

(B) THE MBO TEAM AND THE MANAGEMENT STRUCTURE

- (1) The leaders of the MBO Team are Mike Kerlogue and Bill Pearson, both currently directors of Tanners. The team has been strengthened by the recruitment of Richard Shirtcliff.

A brief summary of the CVs of the MBO Team is set out below:-

MIKE KERLOGUE

Age 46. Employment with Tanners 15 years. Joined Tanners as Commercial Manager and appointed to the Board as Sales & Marketing Director 1983. Prior to Tanners was employed for 12 years with Domtar Paper Mills and their associate company, Howard Smith Papers Ltd. First experience in the paper trade was with Wiggins Teape as a management trainee. Is a director of Network Paper Stockists Ltd. and was Chairman designate prior to Tanners' announcement of re-structuring. Qualifications include Diploma in Marketing and is a member of the Chartered Institute of Marketing.

BILL PEARSON

Age 53. Employment with Tanners 26 years. Joined Tanners as sales representative in 1967 and in the mid-70s became responsible for the Leeds operation. Was appointed to the Board as Northern Director 1983. Joined Wiggins Teape in Leeds as a trainee in 1954, and moved to Jackson's Mill Board in 1962 as a sales representative.

RICHARD SHIRTCLIFF

A chartered accountant, aged 55. Previously Chief Executive of Tate & Lyle Sugars (Turnover £550m, profit £40m), with a wide range of general business experience and a number of senior financial roles.

- (2) Other key personnel, currently with Tanners, who will be offered employment with Arrow are:-

Kevin Collins - Office Manager, Leeds. Age 51. Employment with Tanners 2 years. Previous employment Buying Manager and Administration Manager with E.J. Arnold - Educational Stationery manufacturers (part of Maxwell Communications). Length of service 30 years.

Alan Herriott - Senior Sales Representative, Leeds. Age 48. Employment with Tanners 15 years and responsible for an area from Leeds to Newcastle.

Stuart Ogg - Warehouse & Distribution Manager, Leeds. Age 34. Employment with Tanners 5 years. Previous employment with British Road Services where he gained Certificate of Professional Competence in Road Transport and management experience of drivers. Is the holder of an HGV driving licence.

Jon Kippin - Inside Sales Executive London. Age 45. Employment with Tanners 8 years. Works currently in Crayford Sales Office and is responsible for all paper enquiries and stock replenishment. Previous employment was with trade paper merchant, Ernest Worsley & Co. Ltd.

Chris Sorrell - Senior Sales Representative, London. Age 37. Employment with Tanners 2½ years and responsible for City, West End and North London postal districts. Previously employed as Sales Manager for Dudley Stationery in part of City and West End.

(4) Proposed management structure as follows:-

Chairman and Finance Director	- Richard Shirtcliff
Managing Director based London	- Mike Kerlogue
Northern Director based Leeds	- Bill Pearson
Company Secretary	- Richard Shirtcliff

(C) THE PROPOSAL

Arrow has been formed as the vehicle to buy out the paper division of Tanners. The terms of the deal can be summarised as follows:-

1. The customer list belonging to the paper merchanting division is to be acquired by Arrow for the sum of £150,000, spread over three years. Tanners will not be permitted for a period of five years to merchant paper other than to the specific accounts designated in Appendix B, which presently purchase paper and envelopes. Arrow will not manufacture envelopes, but will, subject to a nine-month embargo in the south, be permitted to sell "bought in" envelopes to these and other customers for a competitive commercial range, and giving Tanners the opportunity to quote for supplying them where appropriate.
2. The interest in the leasehold premises in Leeds is to be taken over by Arrow. This will require the approval of the freeholder, and, in return for Tanners paying £6,000 to Arrow, Arrow will assume the accumulated liability to a claim for dilapidations.
3. The fixed assets situated at Leeds together with certain fixed assets currently situated at Crayford [and Dartford] are to be acquired by Arrow for the sum of £50,000. These assets are detailed in Appendix C.

The above values represent the estimated realisable written down values of the assets before taking into account future liabilities for hire purchase associated with one fork lift truck [and one motor car].

4. Stock, principally of paper, to be acquired by Arrow at the lower of cost or replacement value less reductions or allowances for damaged, obsolete or slow-moving items. 50% of such value will be paid for on completion with 25% after 30 days and the final 25% after 60 days (subject to Tanners having paid for such stock).
5. Arrow will not be responsible for any outstanding liabilities incurred by Tanners up to the date of completion.
6. Arrow will not acquire the trade debtors of Tanners at the date of completion. Any receipts by Arrow after the date of completion of sums due from trade debtors of Tanners at the date of completion will be accounted for and paid over to Tanners within [14] days of receipt.
7. Arrow will, by agreement, employ a number of the staff currently employed by Tanners. In these cases, Arrow will take over the accumulated responsibilities for redundancy and other similar contingent liabilities, as the basis of providing ongoing employment for those members of staff.
8. Accumulated pension rights. [further details required].
9. Tanners have agreed to contribute £10,000 towards Arrow's professional fees.
10. Shares in Network Paper Stockists Ltd. ("Network") will be acquired by Arrow and is included in the asset valuation.
11. In making the purchase of Tanners paper division, Arrow have the first refusal to buy the remainder of Tanners should they subsequently decide to sell. Likewise Tanners have the first refusal to buy Arrow's business should they decide to sell.

The sum due under paragraphs 1 to 11 above will be payable in accordance with the terms of the Purchase Agreement on the date of completion, with the exception of the deferred payment shown in paragraph 4.

Arrow will operate from London and Leeds. Whilst the existing premises of Tanners in Leeds are to be taken over, new premises in London have been located and will be available for occupation on 1993 (see section F). The MBO Team believe that the location of premises near to the centre of London will assist in the development of new business in Central London, and in particular with the expansion of inter-trading with the principal trade paper companies, a possibility that has been sorely restricted in the past.

The independence of Arrow from paper mills is considered to be a great advantage. Most of the existing customers value the importance that has always been attached by Tanners to quality, price and service, and the MBO Team are determined that those attributes will be continued and improved.

In addition to paper merchanting, Arrow will supply ready manufactured envelopes to, amongst others, those existing customers who have traditionally purchased both paper and envelopes from Tanners. The expansion of the envelope business will be considered, but it is unlikely that Arrow will wish to become involved in envelope manufacturing in the short term.

(D) THE MARKET, THE COMPETITION AND THE PRINCIPAL PRODUCTS

1. The Market

The direct consumer market is defined by the paper trade as those organisations who use paper to run their businesses, as compared to printers and converters who buy paper as their raw material to use for their trade, thereby directly creating profit from it.

In the last 5 years, demand for office papers from the direct consumer market has increased faster than from printers and converters, by between 5% and 8% per annum. This increase in demand has coincided with the development of new office "non-impact" printing technology, and seems set to continue rising with the introduction of more sophisticated photo and laser copiers, colour copiers, ink-jet printers and desk-top publishing equipment.

Statistics show that the use of paper in the UK office environment amounts to approximately 400,000 tons per annum (£250m), of which Tanners has been selling in the region of 3,600 tons per annum, that is just under 1%. Arrow intends not only to maintain this share of the paper market, but to expand upon it.

In addition, the envelope business will be developed with the marketing of envelopes to both existing and newly recruited customers. The ultimate goal is to offer a complete range of paper and paper based products to the direct consumer market, purchased from both UK and overseas suppliers. Examples of the existing customer list, to be acquired by Arrow, are as follows:-

TYPES OF BUSINESS	CUSTOMERS INCLUDE:
a) Banks, Finance Houses and Insurance Companies	Midland Bank Scarborough Building Society Yorkshire Bank
b) Local Authorities Government Organisations and Trades Unions	London Borough of Bexley HMSO Post Office Counters Limited City of Kingston Upon Hull
c) Public Companies	Nestles British Gas Securicor plc Proctor & Gamble Ladbroke plc
d) Trade-Paper Merchants and Wholesale Stationers	Arjo Wiggins Paper Bunzl Fine Paper Members - throughout the UK Brother International (Business Machines Division)

As far as the Leeds operation is concerned, the existing customer list is almost exclusively orientated towards the paper merchanting activity. Any envelope business will be maintained by purchasing envelopes for those customers from Tanners or from other sources, with an upper limit of £22,000 per month for nine months after completion.

In the case of the London operation, paper merchanting will provide the major thrust for sales, but the development of envelope business will be a priority once the nine-month embargo has ceased. A 24-hour service will continue to be guaranteed for customers within the boundary of the M25, and in Central London, it is the intention that there will be two deliveries each day.

As an independent merchant, Arrow will be able to expand its inter merchant business to the trade, offering papers that are exclusive or franchised to the company. This opportunity will be enhanced by the siting of the London premises in SE16 as this area is renowned for the presence of companies who service the trade, and Arrow will have the opportunity of joining this exclusive club.

2. The Competition

As with all mature industries, the paper trade is extremely competitive but the strength of Arrow lies with its niche in the direct consumer market. This offers the greatest cross section of different types of businesses and when the current recession comes to an end, increased demand is likely to emanate from all those businesses which are prepared to grow and to expand. Those businesses will inevitably be using new office technology, and Arrow will be ideally placed to secure an increasing share of the market.

The U.K. paper merchant market is dominated by 14 companies who account for 80% of the total (see Appendix D).

Arrow will be in direct competition with the following:-

- a) National Paper Merchants - eg Arjo Wiggins Paper
R A Brand
Robert Horne
James McNaughton
Howard Smith Papers

Such companies have moved towards centralised warehousing with satellite delivery warehouses. The disadvantages for such companies are the high cost of their services, delays in promised 24-hour deliveries, and the lack of established customer bases and experienced direct consumer sales forces. In addition, most of the established larger paper merchants are either owned by paper mill groupings or have tied supply routes, and therefore do not have the advantages of independence that Arrow has.

b) Local Paper Merchants

These appear to have reduced in number through acquisition either by mergers or takeover by National Merchants. Local Merchants are individually strong in specific geographical areas due primarily to the "owner" being of the entrepreneur type and offer a wide range of papers to printer-orientated accounts in the main. Office papers are not usually a stronghold for these types of merchant due, in the main, to dual stocking of printer papers and an alternative range, and suppliers for direct consumers.

- c) Contract and Wholesale Stationers - eg Cartwright Brice
Ofrex
Dudley Stationers

These suppliers offer a wide range of paper and stationery products to large businesses by way of supplying all their stationery needs (single source supply). However it is becoming increasingly clear that many businesses find that such an arrangement loses control on pricing; it is therefore noticeable that as paper and envelopes are a significant element of the total stationery budget, this is being excluded from a single source contract and Arrow will therefore benefit from these changes.

(F) THE PREMISES

1. London. Premises have been found in Galleywall Road, SE16 and satisfactory terms have been negotiated. The site is approximately four miles from the City of London as well as being close to Docklands, and comprises approximately 6,500 sq ft of warehouse and office space of which 3,250 sq.ft. will initially be occupied. The lease will run for just under 3 years at an annual rental of £16,000, and it is hoped an option will be obtained to extend the lease from November 1995.
2. Leeds. Arrow will take over the existing lease of the warehouse and office premises at Lockwood Close, Hunslet. The premises extend to approximately 7,500 sq ft and the current rent of £19,500 per annum. The lease currently expires on 28th September 1994 but an extension to the present term is anticipated. As the tenant is responsible for dilapidations at the end of the lease, an independent report was commissioned by Tanners and there is nothing major in the way of costs to be incurred by Arrow but Tanners have agreed to contribute £6,000 towards dilapidations. The premises are situated 2 miles from Leeds City Centre, less than half a mile from the M1 and 3 miles from the M62, giving easy access to Manchester, Nottingham and Newcastle.

(G) THE FUTURE

1) Market Changes

Office technology is in the midst of a revolution; the typewriter is a thing of the past, laser printers and word processors are to-day and colour printers/ink jet are the future. Arrow will keep abreast of these developments and will be at the forefront of supplying and envelopes to the needs of the customer.

2) Quality Assurance BS5750

To give assurance to customers that quality and service are uppermost in the objectives of Arrow, the Company will work towards gaining Quality Assurance by way of BS5750 certification. This attribute is so important for trading with the larger direct consumers, Government bodies and Local Authorities.

3) Environmental Issues

The protection of the environment has emerged as being one of the major issues of our time, and the threat that this has posed to the paper industry has been of great concern. The larger direct consumers and government departments and institutions are insisting on using recycled paper. Arrow is well placed to meet this demand with all major product lines being available as recycled qualities, and invariably as the market leader. An example is "Repeat Laser Copier" paper. Arrow's policy will be actively to market these recycled papers, but being careful to focus its attention on those customers who have already indicated their desire to buy this type of product. It is the intention of Arrow to comply with the new British Standard BS7750 on environmental management.

4) Management Monitoring

With a company-wide computer system, linked to both locations, continuous monitoring of profitability by customer, product line and management information will ensure financial control is a paramount requisite.

5) Growth of Business

Arrow will plan to grow the business from a firm basis, by increased turnover by account as well as such new business from the direct consumer market. It is anticipated that new locations in the main business centres of U.K. will be planned, and these will depend on circumstances - staff, premises, customer needs; but likely targets are Birmingham, Bristol, Manchester and Glasgow.

(H) FINANCIAL INFORMATION

(I) FUNDING

As will be seen from the financial projections, a total sum of £450,000 must be raised to effect a successful MBO. Of this, the MBO Team intend to contribute £100,000, leaving a balance of £350,000 to be provided by a borrowings.

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The MBO Team are also keen to maintain the motivation and commitment of the staff, and to this end, it is intended that an Employees Share Option Scheme will be introduced at an early date.