

Materials for Seminar 6

Instructions to Counsel

Karen Walker plc
and
River Bank plc

WILLIAM TRUMAN & CO

SOLICITORS

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In the matter of:-

Karen Walker plc

and

River Bank plc

Instructions to Counsel to Advise in relation to a Loan Agreement

You are asked to advise River Bank plc in relation to a loan of £400 million which is sought by Karen Walker plc to expand that company's manufacture and marketing of products in China and India. River Bank plc seeks advice on the structure of the loan agreement. In particular, you are asked to consider the following questions:

1. The comparative advantages and disadvantages of (a) a single loan made by River Bank plc, (b) a syndicated loan agreement and (c) a bond issue.
2. The covenants which River Bank plc would be advised to include in a loan agreement with Karen Walker plc.
3. The different types of covenant which would be used in relation to (a) a syndicated loan agreement and (b) a bond issue.
4. The obligations which River Bank plc would face if it were to act as a syndicated loan agent in relation to Karen Walker plc.
5. The obligations which River Bank plc would face if it were to act as trustee in a bond issue.

6. The other means of taking security which River Bank plc should use in relation to an ordinary loan made by River Bank plc alone to Karen Walker plc.

In the attachments to these Instructions to Counsel are the following items of information:

- (a) a description of the Karen Walker plc group of companies.
- (b) financial information relating to Karen Walker plc.
- (c) the summary of the business case for a loan of £400 million made by Karen Walker plc.

We look forward to your advice at your earliest convenience.

Yours sincerely,

Will Truman

William Truman

For William Truman & Co, Solicitors

WILLIAM TRUMAN & CO, SOLICITORS

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An analysis of the business of Karen Walker plc

Prepared by Analysis Analysts Ltd

Introduction

Karen Walker plc is the holding company for the group of companies which manufacture and market Karen Walker products. The Karen Walker brand, with its silhouette logo of a stiletto heel wearing female executive, is synonymous with expensive, rococo luxury items which are marketed at women who travel internationally. The sixty boutique shopping outlets are positioned nearest to the VIP and Executive lounges at international hub airports and on exclusive shopping streets. The image is one of indulgent luxury but many of the best selling items from the range are practical and reliable technology and travel products used by busy executives.

The group of companies is organised as follows:

Karen Walker plc – holding company. This is the company through which the Karen Walker Group seeks to do all of its financial activities. There are only two items of property owned by Karen Walker plc. First, the 100% shareholding in the three other group companies (KWM, KWF, and OP, below). Second, the intellectual property rights behind the trade mark of the Karen Walker brand name, logo, etc..

KW Manufacture Ltd (“KWM”) – incorporated in the UK. KWM owns three large factories in the English Midlands, employing four hundred employees in total. In 2007 it closed two other factories in Scotland. KWM manufactures ranges of jewellery, wristwatches, luggage and knitwear. The jewellery and wristwatches show profits each year. However, luggage and knitwear manufacture requires one factory each and is difficult to alter and expensive to adapt so as to manufacture other products. By contrast, the third factory manufacturing jewellery and watches has demonstrated itself to be easy to update or adapt to manufacture other items like travel paraphernalia other than luggage. Sales of the smaller items have been more resilient in the global recession as “feel better” purchases among executives. The jewellery costs and leatherware cost an average of £100 per piece, and watches £200 each; whereas the average cost for luggage and travel items is £800.

KW Franchise Ltd (“KWF”) – incorporated in the UK. KWF is involved in the business of placing Karen Walker branded products in department stores (such as Harvey Nichols in the UK). The smaller items manufactured by KWM are more easily placed in department stores around the world because they take up little space but have a strong brand image which department stores like because they attract customers to the store generally.

Offshore Production Inc (“OP”) – incorporated in Delaware, USA. OP specialises in the outsourcing of manufacture of Karen Walker products to countries outside the UK. Shoes have been manufactured in Vietnam and Thailand since 2005, belts and clothing in the Philippines since 2006. OP has operated the worldwide Karen Walker internet site, selling and shipping merchandise directly to customers, since 2007.

It is intended that luggage will be manufactured in the Philippines from 2010, although there are concerns about quality control because the manufacture of products will be conducted by arm's length manufacturers and not by KWM. OP will licence the brand to those manufacturers, reduce the cost of each item manufactured by those third party manufacturers (because their workers are paid much less than UK staff), and then organise international sales in China and other new markets. OP owns no property other than the power to license the Karen Walker brand (which it does on licence in turn from Karen Walker plc).

Equity capital – the principal shareholder with 80% of the only class of shares in Karen Walker plc is Ms Karen Walker herself. Karen began the business in 1968 selling objects d'art on the King's Road, Chelsea, London. Karen is now 80. She has expressed her intention as being "to keep control of the company within the family". She has two unmarried children, Karenina and Leo, neither of whom has any children.

Outstanding debt – the expansion of the Karen Walker group of companies has been funded by loans. At present the group has £700 million of outstanding bank loans, with half of that debt due to be repaid in 2012.

Alan Alansson

for Analysis Analysts Ltd

10 June 2009

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Item 2

Article from *The Banking Times*, 12 March 2009.

There are rumours that the Karen Walker group of companies is considering the sale of the Karen Walker Manufacturing Ltd heart of the organisation. Ms Walker, aged 80, has the problem of dividing her empire between her two children (both approaching retirement age, and both with young spouses) Karenina and Leo. The sale of Karen Walker Manufacturing Ltd would be a wrench for the grande dame of global luxury goods, but in recent years the group has seen enormous growth in its on-line businesses and among the new rich in India and China. Selling that company makes enormous sense because it would provide cash to pay off the large tranche of debt which matures in 2012 and to float the expansion into China and India. The offshore outsourcing model is the future for Karen Walker. The most valuable asset which the Karen Walker group owns is that iconic logo of the younger Mme Walker on high heels: the most valuable asset is therefore still Ms Walker herself. Sale of the manufacturing operation will therefore require some careful thinking to decide what happens to the trade marked goods made in the UK: does the trade mark go with the factories, or should it simply be franchised and the land sold for the value of its buildings? This would leave the two other companies to be divided between the adult children. Either way, there is bound to be some serious restructuring in the world's favourite trinket house.

ACCOUNT INFORMATION FOR KAREN WALKER GROUP.

Profit & Loss, and Net Worth statement for the companies within the Karen Walker Group 2004-2009, and a management forecast for 2010. Numbers in brackets indicate a loss.

£m	KW plc	KWM	KWF	OP	Total
2004					
Sales	0	100	40	0	140
Cost of sales	0	72	23	0	95
Profit	0	28	17	0	45
Net Worth	200 ¹	20 ²	1	0	221
2005					
Sales	0	110	45	10	165
Cost of sales	0	78	23	3	104
Profit	0	32	22	7	61
Net Worth	220	20	1	0	241
2006					
Sales	0	120	50	20	190
Cost of sales	0	85	21	3	109
Profit	0	35	29	17	81
Net Worth	240	22	240 ³	140 ³	642
2007					
Sales	0	130	60	50	240
Cost of sales	0	90	20	5	115
Profit	0	40	40	45	125
Net Worth	300 ⁴	45 ⁴	280	300	925
2008					
Sales	0	90	40	50	180
Cost of sales	0	92	20	6	118
Profit	0	(2)	20	44	62
Net Worth	150 ⁵	25	150	250	575
2009					
Sales	0	75	38	56	169
Cost of sales	0	80 ⁶	18	6	104
Profit	0	(5)	20	50	65
Net Worth	110	25	150	250	535

Projection for 2010⁷					
Sales	0	100	60	80	240
Cost of sales	0	72	10	5	87
Profit	0	28	50	75	153
Net Worth	150	50	200	300	700

Notes to the accounting information:

¹ This relates to an estimated value for the goodwill attached to the Karen Walker brand.

² This is the value of the factory premises.

³ This value is an estimate of the increased goodwill of this company if it were sold off on its own.

⁴ Based on an increased market perception of the Karen Walker brand during the high point of the economy.

⁵ Downgraded forecast due to expectation of upcoming recession.

⁶ Sales cut after sacking 30% of the workforce and closing two factories for two months.

⁷ These projections were prepared entirely by management and submitted to River Bank plc together with the request for the loan of £400 million.

This accounting information contains items taken from the audited accounts of all of the companies comprising the Karen Walker group of companies and a projection presented by the board of directors of Karen Walker plc to River Bank plc in May 2009.

Summary of the business case for Karen Walker plc's application for a loan, as presented to River Bank plc.

Karen Walker plc has a net worth of £535 million, which is expected to rise to £700 million in the next accounting period as the global economy rebounds.

New markets in the rapidly growing Chinese and Indian markets since early 2007 will double group profitability by 2015.

The outsourcing of Karen Walker products manufacture outside the UK has maintained group profitability, while reducing costs markedly.

Focus on smaller jewellery and clothing items, as opposed to high cost luggage products, will increase profitability by keeping costs (manufacture, transport, raw materials, etc) low.