

Circular to the Members of Bako North Western (Group) Limited

20 October 2017

1. Introduction

The purpose of this circular letter is to enclose the notice of annual general meeting, provide you with updated financial information on the Group, to give you details on two proposed changes to the capital structure of the Group and to seek your authority to implement the proposed changes at the Annual General Meeting to be held on 22 November 2017. Enclosed with this letter you will find

- A. A Notice of Annual General Meeting
- B. A Form of Proxy for use in the event that you are unable to attend the AGM
- C. FAQs relating to the proposed Capital Ring –Fencing and Executive Incentive Scheme.
- D. Draft new Articles of Association of the Company
- E. An indemnity for lost share certificates for completion and return where appropriate
- F. A reply paid envelope for your use

Please read this circular letter and give careful consideration to its contents. Your Board, who unanimously support each of the proposals to be put to you at the AGM, urges you to vote in favour of the proposals at the AGM. Details of what we would like you to do and how to vote are set out at the last paragraph of this letter.

An electronic or hard copy of the consolidated accounts for BAKO North Western (Group) Limited for the year ended 31 March 2017 is available by completing the return slip at the bottom of the covering letter enclosed in this pack.

2. Annual Accounts

The Group has seen significant growth in the financial year as the businesses acquired in the year ended 30 September 2013 and the eighteen month period ended 30 September 2016 continued to perform in line with the long-term business growth strategy.

The trading results for the year and the financial position of the Group are shown in the financial statements. The key performance indicators for the Group are presented in the table below.

	Year ended 31 March 2017	18 month period ended 30 September 2016
	£'000	£'000
Turnover	131,258	128,771
Gross profit	26,102	25,019
Gross margin	19.9%	19.4%
Operating profit/(loss) before exceptional items	1,039	(296)
Exceptional items	-	(673)
EBITDA*	2,180	1,272
Profit/(loss) after tax	370	(1,195)
Shareholders' funds	6,499	6,129

*EBITDA represents earnings before interest, tax, depreciation and amortisation.

The Directors are pleased to report the Group's return to profitability with the profit before tax for the year ended 31 March 2017 of £0.6 million compared to a loss before tax of £1 million for the 18 months ended 31 March 2016. The profit after tax for the year ended 31 March 2017 was £0.4 million compared to a loss after tax of £1.2 million for the 18 months ended 31 March 2016. EBITDA for the year was £2.2 million, representing a substantial increase of £0.9m on the previous period of 18 months.

3. Background to and reasons for the proposed changes

The Incentive Scheme

The Board recommends the introduction of an Executive Incentive Scheme which looks to incentivise and retain the Group's Executive Management Team, as this is seen as key to the future development of the business. The objectives of the scheme are to give more certainty to the management team, encourage their retention for the longer term, to incentivise the Group's Executive Management Team to achieve long term sustainable growth for the business and to have financial targets related to profitability and sustained capital growth.

This will involve the issuing of a totally separate class of shares, B Shares, which will not have any dividends or voting rights. The value of the shares are only realised when a member of the executive team leaves the business and it has been independently validated that they have increased the value of the Group.

The Ring-Fencing

BAKO North Western was launched over 50 years ago as a regional buying cooperative. In recent years the Group has become more corporate in its nature with the Group acquiring Bako South Eastern in 2013 and Bako Northern & Scotland in 2015. The Group has also acquired additional stakeholders as a result of borrowings taken on (principally to help fund the acquisitions) and also as a result of a shift in the mix of its customer base away from trading with its shareholder members, such that 80% of its sales are now to non-shareholder customers. At the same time the Group has seen a decline in its shareholder membership numbers reflecting a change in the market place. The Board now wishes to embark upon a recruitment drive to attract new shareholder members and to further strengthen its customer base. The Board is, however, conscious that existing members have part funded the Group's acquisitions by way of sacrifice of their rebates.

These factors have caused the Board to look at the capital structure of the Company with a view to identifying a more appropriate share capital structure that:

- maintains the cooperative ethos of 'By bakers for bakers';
- enables the Group, should it so choose, to raise external funding to allow future investment and growth,
- recognises the investment by the current shareholders;
- is an attractive proposition for, and to help attract, new shareholders, and
- brings the current capital structure up to date.

The existing capital structure is that there is one class of Ordinary share and each shareholder member owns 50 Ordinary shares. No shareholder is entitled to own more than 50 shares. Those shares are not transferable other than to the Company for nominal value and must be transferred if there is an insolvency event relating to the member, if the member ceases to be a baker, if there is a change of control of the member or the member ceases to trade with Bako North Western Limited. As such there is no value in the shares (other than the rebate). The proposed change should allow the Group to grow its shareholder base and increase shareholder sales, whilst recognising and preserving the value of the stake currently held by existing shareholders.

4. Details of the Ring-Fencing.

Current Capital Structure

At present each member of the Company has 50 ordinary shares in the capital of the Company and can only transfer those shares back to the Company. There are 493 members meaning that if there were ever a capital event, for example a sale or flotation or a distribution to members by way of a return of capital (**Capital Transaction**), each member would be entitled to 0.2028% of those proceeds. If your Board was successful in increasing the membership, new shares would be issued which would reduce the percentage of proceeds to which everyone was entitled, for example, if the Board was able to double the membership, 0.2028% would be halved to 0.1014%.

The Board has been considering for some time the creation of a structure which

- Maintained our cooperative ethos and structure
- Allowed new members to be attracted to the Group; whilst
- Compensating the current members for the investment they have made to date in the Group as detailed above

Valuation

The Board instructed the auditors of the Group, RSM, to produce a formal valuation of the Group as at 27 July 2017 for the purposes of the Executive Incentive Scheme. This has resulted in the Group being valued at £9.2 million and the Board have decided to adopt this valuation for the purposes of the Ring-Fencing proposals. We want to make it clear that there is no present or immediately foreseeable Capital Transaction in mind and no such discussions have or are taking place. In any event, no such transaction could be undertaken without the consent of a significant majority of members voting in favour.

What will this mean?

Our proposals will, if approved by the requisite majority, give the shareholders on the register on the 30 September 2017 the right to receive, in priority to all other members, the first £9.2 million of proceeds of any Capital Transaction.

How will this be achieved?

We intend to convert 10 of your existing Ordinary Shares into 10 A Shares, leaving each member of the Company on the Record Date with 10 A Shares and 40 Ordinary Shares. Each A Share will entitle a holder to £1,858.58 in priority to the Ordinary Shareholders on a capital transaction. The A Shares will be non-voting and will not attract a dividend.

As this represents compensation for the investment made by the current membership in recent years, the Board think it appropriate that the A Shares are transferable in a limited way. If the proposals are approved at the AGM the A Shares will be transferable to close family members in accordance with the Articles of Association. There is no change to the transfer provisions relating to the Ordinary Shares nor will the B Shares be transferrable or receive a dividend.

In practice this would mean that if the Company were sold for £10 million, £9.2 million would be distributed to the A Shareholders and the balance of £0.8 million would be distributed to B Shareholders up to their entitlement followed by the balance split equally amongst the Ordinary shareholders. If the Group were sold for £9.2 million or less then only the A Shareholders would receive any value.

New members joining the Company after the Record Date will be issued with 40 Ordinary Shares and will not be issued any A Shares.

What is the taxation impact on members of these proposals?

The following is intended to briefly summarize certain tax consequences associated with the proposal, by shareholders who are resident and ordinarily resident in the United Kingdom.

It may not apply to your particular tax or financial situation and the Group is not in a position to assure any shareholder of any particular tax result. Accordingly, you are strongly advised to seek appropriate professional advice as to how the tax or other laws apply to your specific situation.

The conversion of some of your Ordinary Shares into the A Shares will be treated as a disposal by HMRC but should not give rise to a capital gains tax liability on the basis that the conversion is treated as a reorganisation of share capital for tax purposes.

Where a reorganisation of share capital occurs, the existing shares and the new shares are treated as the same asset, and both assets are treated as having been acquired when the existing holding was acquired.

Recommendation

Your Board unanimously urges you to vote in favour of each of the resolution to be proposed at the Annual General Meeting as they intend to do in respect of their own shareholdings. If you are unable to attend the meeting in person then a form of proxy is enclosed with this letter for your use.

Other Changes to the Articles

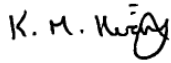
In making changes to the Articles of Association of the Company to accommodate the Executive Incentive Scheme and the Ring-Fencing proposals, we have taken the opportunity to reflect on current practice in a small number of areas and update the Articles. These provide that to be a qualifying member you are to undertake a

minimum level of trade with any company in the Bako North Western Group (and not just Bako North Western Limited) and that the appointment of Non-Executive Directors and Executive Directors to the Board (who are not bakers) is permitted provided that the Baker Directors will always outvote the Non-Executive and Executive Directors.

ACTION

You will find enclosed with this circular a form of proxy and a prepaid envelope for use in relation to voting at the Annual General Meeting in the event that you are unable to attend. Please complete the form of proxy and return it to the Company Secretary in the prepaid envelope. In order to be valid, a form of proxy must be signed and delivered to the Company Secretary no later than 10am on 20 November 2017, being 48 hours before the start of the Annual General Meeting. In order to assist with the processing of the Ring-Fencing, if you are in favour of the proposals please also send us in the same envelope, your share certificate (or if lost, the enclosed indemnity duly signed). If the resolution is passed we will cancel that certificate and issue you two share certificates, one for 10 A Shares and one for 40 Ordinary Shares. If the resolution is not passed we will return your share certificate to you.

Yours Faithfully



Kirti Hirani
Company Secretary