

**Reasons for once again
stopping negotiations regarding
the possibility of a
joint venture
with
Schlafhorst**

March 1996

Saurer Ltd
CH-9320
Arbon

Attention : Dr. Ernst Thomke
Chief Executive Officer

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Please fax using
telephone number.

Date 14/2/96

Dear Mr. Thomke,

Further to the Option Plan contained in my fax of 23 January and after discussions with Dr. Brockmanns, Schlafhorst's Head of Fundamental Research, my brother prepared an internal report. I give an extract below :-

On the business side you are too optimistic that Schlafhorst's thinking will be changed by Dr. Thomke. You hope that it will become more in line with those included in our Option Plan as outlined in your fax dated 23 January to Dr. Thomke.

I do not share your view. The one negative feeling of working with Schlafhorst is still uppermost in my mind. My concern remains the same as when you negotiated with Schlafhorst in 1991 and we walked away from the negotiations.

- During our 1991 tour of the factory, Schlafhorst's methodology of machine building was demonstrated to us.
- It was explained that Schlafhorst's production techniques need high volume sales to keep the mass production lines operating efficiently.
- For example, the Production Manager was unhappy because a variation to the standard Autoconer winder had been introduced. He said this impaired Schlafhorst's manufacturing throughput.

As I got no indication to the contrary on 17 January at our yarn trials meeting in Monchengladbach, I still believe that unless, or until, friction yarns can be made at least as strong as rotor, then Schlafhorst, unlike Belroy, will find it difficult to move friction spinning beyond "the research phase".

- My opinion remains that Schlafhorst are simply searching for a faster Autocoro.

Also, this belief, when allied to :-

- (a) The much publicised high manufacturing costs in Germany.
- (b) Schlafhorst's re-organisation and staff reductions.

reminds me of the days in the late 1970s when my employers the massive UK engineering conglomerate Stone Platt Industries failed.

This resulted in the disastrous situation whereby I finished up working - with my then friction technology - for the American millionaire J. D. Hollingsworth whose organisation had no experience of building spinning machines.

Consequently, I remain to be convinced that locking the SpinWell into Schlafhorst is the best approach to getting a machine into the market in the near future.

We all know that once spinning machines are in operation, then ongoing improvements occur very quickly. But, with Schlafhorst's financial problems and machine building philosophy, I am concerned that, similarly to 1991, you will find it impossible to negotiate a joint venture type of deal which is satisfactory to both parties.

After reading the above, I am sure you will agree that before going any further, we need to know whether Schlafhorst, under your stewardship, will contemplate producing a friction spinning machine with the potential to generate sales of up to £60 million (DM 130 million) per annum within the first 5 years of production. Or, as my brother believes, Schlafhorst will still only consider marketing a product which, similar to your Autocoro rotor spinner, has the immediate potential of generating sales averaging £300 million (DM 660 million) per annum. I look forward to your answer.

In the long term, and given enough resources, Alan is confident of further refining the SpinWell so that its yarns can better rotor yarn in all aspects. However, I must obtain a fair return for our 10 years of risk capital investment well in advance of that ideal scenario.

To many engineering firms, a machine with a turnover of £60 million (DM 130 million) per annum is beyond their wildest dreams. But I do understand that unless Schlafhorst can afford to re-tool and change to a more flexible "cell-type" of manufacturing system, then the SpinWell, at its current stage of technological development, may very well not be for them.

Best regards.

Roy Parker

Offices: Sweden • U.S.A. • Malta



Saurer Ltd
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Attention : Dr. Ernst Thomke
Chief Executive Officer

Copies : Dr. Bernhard Schönung
President & CEO - Schlafhorst

Dr. Brockmanns
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Dear Mr. Thomke,

Friction Spinning

I refer to my fax dated 23 January and subsequent correspondence from ourselves to Dr. Brockmanns.

Our financial advisors finished their due diligence exercises last week. Consequently, I now have enough commercial intelligence to realise the scale of Schlafhorst's problems.

I learned a salutary lesson when Rolls Royce's bankers pulled out, leaving the Government to bail the company out. And whereby associates of mine lost money on cancelled joint venture projects.

Now understanding Schlafhorst's commercial reality, makes it impossible to take the risk of leaving our money in a large scale joint venture with that particular company at this point in time.

Particularly more so, when allied to the mass of TV coverage in the UK talking to CEOs of major German manufacturing companies - for example; last night's Money Programme gave 30 minutes to the topic of Germany's lack of manufacturing competitiveness, which is projected to get even worse.

These CEOs were all full of doom & gloom because they said they can see no way back to manufacturing competitiveness unless Germany can find a way of destroying the stranglehold of the unions; i.e. similar to what Margaret Thatcher did to the UK labour force. Germany's general economic malaise can only compound Schlafhorst's own particular problems in the near future.

I am sure you will agree there is no point contemplating building a SpinWell based machine unless such a machine's manufacturing competitiveness can be assured. Reluctantly, I have concluded this will not be possible in Germany for many years to come.

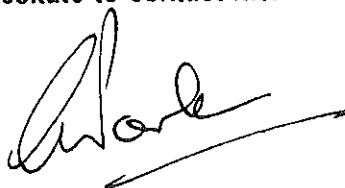
You already have a copy of my brother's opinion after our meeting with Dr. Brockmanns on 17 January that Schlafhorst was not the best way forward for myself and our investors.

I wish you well in your task of looking after your shareholder's interests and hopefully you can save a reborn Schlafhorst in the process.

However, if as CEO of Saurer Ltd., you wish to discuss business matters other than Schlafhorst, then do not hesitate to contact me.

Best regards.

Roy Parker - Chairman



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Dear Leopold,

Friction Spinning

On Monday afternoon, I decided it was time to inform Dr. Thomke that we have no interest in progressing friction spinning with any company who requires machine manufacturing to be in Germany. I enclose copy of my fax to him dated 4 March 1995.

There is not the slightest criticism about Schlafhorst's manufacturing or products; to the contrary. An analogy as to the cause of Schlafhorst's problems being Mercedes selling their superbly engineered cars at Fiat prices. But looking in dispassionately from the outside, we, living in the UK, can easily face up to the economic reality facing German industry.

During Monday morning we met with our financial advisors. The purpose of the meeting was to re-evaluate the situation regarding Schlafhorst because of information they had obtained from one of their European offices. This information convinced me that Schlafhorst is in such a bad financial shape that it would be too risky to leave any investment money in a joint venture with that company.

With its present financial gearing, our advisors believe Schlafhorst's Net Asset Book Value is in the negative. They pointed out what happened to the large UK electronics group - Ferranti - two years ago when GEC offered to take over the debt-ridden firm for just the proverbial £1.

However, the information said that providing the company can quickly reduce its debt burden, or the Swiss decide to continue their financial support, then Schlafhorst will survive as a German based force in the spinning machine industry. Unfortunately, our advisors concluded that over the next few years the company will not have access to enough money to fund the SpinWell's further development up to the trigger points for them to start buying us out. The feeling of the meeting was that if they did attempt to get a SpinWell/Schlafhorst friction spinner into production, then it would be with an inadequate shoe-string budget.

In any case, the advice was that any new machine made in Germany in the next decade or so, would simply be too expensive to generate the volume of sales which the SpinWell technology would warrant. Consequently, our final buy-out payment, due when a certain level of sales had been reached, would have taken an unacceptable number of years to materialise.

At Appendix A, I enclose a report to clarify matters further.

Best regards.


Roy Parker



Appendix A

1. Swiss based Saurer disgruntled with ownership of Germany's Schlafhorst.

1.1 The appointment of a textile industry outsider and company doctor such as Dr. Thomke of "Swatch" and company re-structuring fame, demonstrates that Saurer have to all intents and purposes put Schlafhorst into unofficial Administrative Receivership.

1.2 We have been unable to verify how much inter company debt exists, but our financial advisors understand that Dr. Thomke's brief is to recover as much money as he can for Saurer's share holders.

1.2.1 The message from our source being :-

- If this means selling off.
- Then so be it.
- The Swiss are ruthless businessmen.
- They do not enjoy subsidising a foreign overpriced labour force.
- They want their money back.

2. The German economy will make things worse for Schlafhorst.

2.1 The situation in Germany is reminiscent of the 1970s in the UK when our Government also had blinkers on and the Unions were in power.

2.1.1 Competition from a then vibrant Germany and also Japan forced into bankruptcy many UK engineering firms and machine manufacturers.

(i) This included the likes of the massive Stone Platt Industries Ltd.

(ii) They took into oblivion all their subsidiaries including the spinning machine manufacturer Platt Saco Lowell Ltd.

2.2 With the advent of Margaret Thatcher, the UK rot was slowed down, and now the tide is starting to turn.

2.2.1 No longer is the UK and the Americans subsidising the German economy by keeping a vast number of troops on German soil.

2.2.2 Nor are there US dollar grants for German engineering to re-tool as there was 45 years ago after the Second World War.

2.3 Your workers' social costs are crippling Germany.

2.3.1 A German was interviewed on TV last Sunday.

- He had lost his job.
- He said he has no worry.
- The State gives him DM 550 (£250) per week.
- In the UK he would get DM 95 (£43) - 83% less !

2.3.2 It is reported that 50,000 UK construction workers are working in Germany.

- Not for much longer.
- New labour laws have brought in a minimum wage.
- Our boys will now be unable to work cheaper than their German counterparts.
- What a sorry state of affairs.
- It makes a mockery of workers' freedom of movement within the EEC.

2.3.3 In the press and on TV, international observers report their worry that as German job losses inevitably grow, then hyper inflation may take off once again.

- Kindled by the unquenchable flames of Government spending commitments.

2.4 On top of this, the German economy will further stagnate due to the horrendous and continuing costs of Unification.

2.4.1 A recent serious minded TV programme interviewed a variety of different German politicians.

→ A number drew similar parallels to the start of 1930's dole queues.

3. Our reasoning for re-opening dialogue with Schlafhorst in late 1994.

3.1 In September 1994, I froze the SpinWell's external interface technology so as to allow a full machine development to take place.

3.1.1 The yarns of 50% cotton and 50% polyester from Courtauld's raw material were not as strong as rotor.

3.1.2 But strong enough and, according to Courtaulds, ideal for knitted products.

→ A massive market place for a new spinning machine.

3.2 We decided not to file our patents until we got close to putting the SpinWell on the market.

3.3 To raise money to put a full length machine into commercial production we needed to know what new competition there might be from another friction spinning machine.

3.4 The only firm who might be able to compete in friction spinning was Schlafhorst.

3.5 We needed to know two things :-

3.5.1 What was the risk of not filing our patents ?

(i) By not filing we could keep the SpinWell's technology secret for a longer period.

(ii) As UK patents have a 20 year life span, the closer to production we could keep things secret, the longer the period of actual protection to stop anyone copying.

(iii) But we would risk losing out if someone else filed a similar patent in the meanwhile.

(iv) Our only worry was Schlafhorst.

(v) We needed to know if they were still working on friction spinning.

(vi) And if so, whether they were still going in the opposite direction to ourselves with two perforated rollers.

(vii) If this was so, then there would be no rush to file our patents.

3.5.2 How close to the market was Schlafhorst ?

(i) With the amount of money they had spent on friction spinning, we believed that Schlafhorst must have developed a fully automated machine of say 40 positions.

(ii) From information gleaned from their disgruntled friction spinning technology partner, Fehrer AG in Austria, we believed that the reason why they had not put their machine on the market was because their yarns were harsh due to wrapper fibres.

→ This being a feature of the Fehrer technology of using two perforated rollers.

→ A good thing for the specialist coarse yarns which Fehrer's own machines produce.

→ But not good for fine count yarns to make products which need a soft handle, particularly those touching the human skin such as underwear, sports shirts, towels, etc.

- 3.6 Our 1991 negotiations with Schlafhorst also ended when we walked away.
 - 3.6.1 Our excuse being that our new patents for the breakthrough of the Mark 9 box had not been prepared.
 - 3.6.2 However, the real reason was because we did not trust the Schlafhorst people.
 - 3.6.3 They had a reputation for pirating small firms.
 - (i) They had tried to suck us dry, but would tell us nothing.
 - (ii) Schlafhorst really wanted to see our patent information.
 - So much so, their patent department sent us an annual letter reminding us that we had said we would re-open talks once our patents were filed.
 - Again we made excuses.
 - But simply to keep the door open.
- 3.7 We knew from this 1991 experience that irrespective of the SpinWell's other yarn qualities, we would never make a deal with Schlafhorst unless its yarns were as strong as rotor yarn.
- 3.8 We believed the only reason Schlafhorst embarked on trying to develop their own technology was because yarn spinning firms such as yourself had bought the UK's ill-fated MasterSpinner friction spinning machine.
 - 3.8.1 And when that threat disappeared, we believed that Schlafhorst had decided to put friction spinning on a back burner.
- 3.9 We always wanted Schlafhorst to enter the market first.
 - 3.9.1 We would then be in a good position to sell the SpinWell to the likes of Rieter who would need to compete.
- 3.10 But our dilemma in raising money to go into production outside of an established spinning machine manufacturer was whether Schlafhorst could quickly become a competitor when a SpinWell machine hit the market.
- 3.11 So we decided to go on a fishing trip and re-opened dialogue with Schlafhorst.
 - 3.11.1 I talked to Dr. Brockmanns who told me that he was still working on friction spinning.
 - 3.11.2 Alan then sent him a lengthy report.
 - 3.11.3 Dr. Brockmanns arranged to visit us with one of Schlafhorst's directors on 14 February 1995.
 - 3.11.4 I was then asked to give Mackie International plc time to see if they could raise enough Government money for them to run with the SpinWell project.
 - 3.11.5 I cancelled Schlafhorst's visit in case Mackie found out and thought I was not dealing fair.

4. Schoeller Textil's involvement in the SpinWell project

- 4.1 Mackie employed the market research firm David Rigby & Associates who wanted to contact potential customers and this led me to telephoning yourself.
 - 4.1.1 You said you had only two weeks previously been complaining to both Schlafhorst & Rieter that their upgraded rotor machines were not giving enough advantage to make Western spinners such as yourself reinvest in new machinery.
 - 4.1.2 And that in fact you had told them they were crazy guys and had to bring out something new, such as a friction spinning machine.

- 4.2 You decided to visit Bolton to see the SpinWell.
 - 4.2.1 Unfortunately, on the day before your visit, the SpinWell and its test rig were damaged by a fire in the machine room.
- 4.3 You still came to Bolton, and during discussions you expressed the opinion that the best spinning machine builders are Schlafhorst.
- 4.4 Also, you believed there was the possibility of a deal between Schlafhorst and Belroy.
 - 4.4.1 It was your understanding that Schlafhorst's friction spinning process was turning out to be uneconomical to incorporate in a commercial machine.
 - 4.4.2 So it was agreed that you should re-open dialogue on our behalf with Dr. Brockmanns, Schlafhorst's Head of Fundamental Research.
- 4.5 You agreed to become part of the SpinWell project.
 - 4.5.1 This was with a view to Schoeller Textil having the first machine on trial in your mill.
 - 4.5.2 Thus getting early yarn making experience to hopefully keep Schoeller Textil in front of your competitors.
5. Belroy saw nothing but benefit in a customer approaching Schlafhorst.
 - 5.1 Dr. Brockmanns offered to exchange yarns.
 - 5.2 But we, not trusting Schlafhorst, asked you to take charge of yarn trials.
 - 5.3 At the time we simply wanted to see how their yarns were and find out where they were up to.
 - 5.3.1 But we wondered whether you were right and there was some way a deal could be struck.
6. With the benefit of hindsight the fire was a blessing in disguise.
 - 6.1 We now have detailed yarn test results showing the best that Schlafhorst's friction spinning box can produce.
 - 6.1.1 Most importantly this is on Schlafhorst headed paper.
 - 6.2 Whilst Schlafhorst know very little of the SpinWell's capability.
 - 6.2.1 After to the fire, I decided not to even bother spending money on trying to present our best yarns.
 - 6.2.2 I told Alan to do the best he could without a new trash removal system.
 - 6.2.3 Also, not to incur the cost of altering the SpinWell components to optimize its yarn production for your raw materials.
 - 6.2.4 As you know, this caused considerable argument between Alan and myself when he came back from Zambia and found I had arranged the 17 January meeting in Mönchengladbach.
 - 6.2.5 So much so, that it took you agreeing with me that it was worth keeping to the 17 January meeting simply to try to flush out Schlafhorst into talking about the possibility of a deal.

- 6.3 I now feel fully vindicated as we have got what we wanted in the first place.
- 6.3.1 We now have a measure to demonstrate to our potential investors how better the SpinWell yarns are than the Schlafhorst friction yarn.
- 6.3.2 We also know Schlafhorst are nowhere near the market place.
- (i) If they were anywhere near the market, then Dr. Brockmanns would not want DM 5½ million (£2½ million) to develop a new single friction box.
- (ii) Knowing something of the vast sums Schlafhorst have spent on friction spinning.
- Alan was absolutely "gobsmacked" when Dr. Brockmanns told us that Schlafhorst have not progressed beyond a single friction box.
- 6.3.3 A bonus is knowing that Dr. Brockmanns will find it difficult to progress friction spinning.
- (i) It will not be easy re-organising his R & D department with 67 staff cuts out of a work force of 140.
- (ii) Neither will falling in line with Dr. Thomke's short term priorities of establishing better customer confidence.
- (ii) Both these factors will curb Schlafhorst's activity in friction spinning.

7. We also have a benchmark in the Yarn Test Results.

- 7.1 Alan is absolutely sure that even with the constraint of the Mark 12 box's external interface technology being frozen, the SpinWell's internal components can be optimized to :-
- Better all the good aspects of Schlafhorst's friction yarns.
- Whilst also spinning a bulky yarn with a soft handle.

8. Your reasoning as to why a deal may have been possible was correct.

- 8.1 I had thought after listening to Dr. Thomke's speech at ITMA last October, that you could possibly be right.
- 8.2 Also, Saurer's Chairman (not long ago Volkswagen's Chairman) saying in Saurer's 1994 Annual Report that work must be sent outside Germany, seemed a good pointer.
- 8.3 So I did hope to have the chance of discussing a deal with Dr. Thomke.
- 8.3.1 But we did not understand how badly fixed Schlafhorst is as a viable entity.
- For example, simple measures such as profitability in relation to capital employed in the business have been abysmal for a number of years.
- 8.4 However, our financial advisors convinced us on Monday morning that we should not go along with anything which meant manufacturing in Germany.
- 8.5 Just after the meeting I telephoned Dr. Brockmanns and then sent the enclosed fax to Dr. Thomke.
- 8.6 As you will note; with wishful thinking I have left my door open.
- Just in case Saurer are really intent on dumping Schlafhorst.
- And, perhaps still being cash rich from the sale of their shares in Unitech plc which raised about DM 130-175 million (£60-80 million), they may want take a relatively small flyer with ourselves.

Roy Parker
6 March 1995

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Attention : Mr. Leopold Schoeller jr.

Dear Leopold,

Schlafhorst

I enclose copy of fax from Dr. Schönung dated 7 March 1996.

But as you will see on the heading, this was only sent today 12 March.

Dr. Schönung acknowledges receiving my fax dated 4 March.

Consequently, he knew before writing his fax that Belroy had already withdrawn our offer to co-operate with Schlafhorst on friction spinning.

Therefore, Schlafhorst bothering to officially inform us of their ostensibly similar decision, is indicative of the strange machine orientated culture we have always found in our dealings with people employed by the company.

Schlafhorst's problems are not new. An article 5 years ago in the December 1990 issue of the magazine 'Industrie Magazin', was critical saying :-

- Schlafhorst reacted too late to the price war - when they eventually reacted, they dropped prices for the Autocoro to a degree they were making no profit whatsoever.
- With some sectors of the market having by then substantially increased, Schlafhorst were well and truly caught with their pants down.
- Paetzold (Schlafhorst's then CEO) was criticised for using market problems to cover up internal company problems.

The above sounds somewhat familiar to the 1994/95 USA fiasco. Also you told me yesterday of recent 30% price reductions in both their Winders and the Autocoro rotor spinner !

I bet the Schlafhorst people rue the day when from 1 July 1991 Walter Reiners decided enough was enough; and with 1991 projected sales of DM 800 million (£365 million); down 30% from the 1990 results of DM 1,150 million (£520 million); the Reiners family sold out to the Swiss based Saurer.

I congratulate our financial advisors for identifying that Schlafhorst have no culture of making money: just good textile machinery.

Schlafhorst's fax only confirms their advice that as a German based textile machine manufacturer with Swiss owners, Schlafhorst has more pressing needs to address over the next couple of years than trying to find the large sums needed to get a new spinning process into the market place, and as such would not be a good joint venture partner.

You have told me how hard it is trying to make money spinning yarn in Germany at this point in time.

But just think what it would be like if Schoeller Textil was not a self-financed family firm and instead were financially over geared with a Swiss owning Corporation worryingly watching or dictating your every move.

Best regards,

Roy Parker
Office - Sweden • U.S.A. • Malta

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Number of pages: (Including cover sheet) 1

Date: 07.03.1996

Reference:

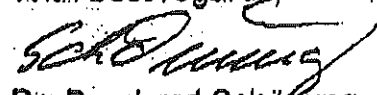
Dear Mr. Parker,

I refer to your faxes of the 23rd of January 1996, 15th of February 1996 and 4th of March 1996 and thank you for the different suggestions you have made in order to establish a cooperation between our companies.

We decided not to pursue further negotiations in that direction and will continue the developments based on our product and company strategy.

Thank you again for your engagement.

With best regards,



Dr. Bernhard Schönung
W. Schlafhorst AG&Co.