CAVALIER
CORPORATION

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Directors' Report

For the six months ended 31 December 2014

The Directors of Cavalier Corporation present their report, including financial statements, for the period to 31 December 2014.

FINANCIAL PERFORMANCE

Consolidated Income Statement **Six months ended 31 December** **Unaudited**	**2014** **$000s**	2013 $000s	% change
Operating revenue	**103,722**	101,895	**2%**
EBIT	**2,181**	5,413	**-60%**
Net interest expense	**-1,919**	-1,733	**11%**
Share of profit of associate (net of tax)	**-157**	792	**-120%**
Profit before tax	**105**	4,472	**-98%**
Tax	**-73**	-1,025	
Profit after tax	**32**	3,447	**-99%**
Earnings per share (cents)	**0.0**	5.0	**-100%**

For the six months ended 31 December 2014, the unaudited group profit after tax is $32,000 and represents a $3.4 million reduction on the same period last year. The earnings decrease reflects the tough trading conditions encountered by most business units within the Group.

The gains made from restructuring the manufacturing operations by closing spinning and consolidating tufting plants over the recent past have been dwarfed by the impact of the high New Zealand dollar, increased wool prices and very low wool grease prices.

While these adverse macro events are beyond the Company's control, the Board and executive are focused on what it can impact and control. This includes simplifying our operations and reducing costs, growing our rest of world (ROW) markets through global partnerships particularly in the US where we are partnering with Mohawk, the world's largest flooring company, migrating Ontera to a blended tile-distribution model, leveraging the innovative felted yarn technology and merging wool scouring in New Zealand.

Operating revenue at $103.7 million is up 1.8% on the $101.9 million reported last year, with most of this increase coming from the carpet business, where operating revenue increased by $1.8million to $88.8 million.

More detail about the results for the Group divisions is contained in Segment Reviews.

Australian revenue is up 5.7% on last year and accounts for 53.9% of total revenue. New Zealand-based revenue is down 2.2% on last year and represents 42.8% of total revenue. While our ROW business currently only contributes 3.3% to total revenue, our strategy to develop our ROW markets and further align with our global channel partners is expected to deliver increased sales and profit growth in the near-to-medium term.

We are expecting a lift in second half results as the ongoing implementation of our business improvement plan begins to lift profits.

FINANCIAL POSITION

Total equity as at 31 December 2014 stood at $91.9 million, compared with $93.0 million last June and represents 47.1% of total assets compared with 46.9% in June 2014.

Total group assets, including intangibles, were $195.2 million at the half year, down 1.5% or $2.9 million on that reported in June 2014.

Net debt at $59.1 million is in line with the June 2014 balance of $58.8 million.

Our debt to equity ratio as at 31 December 2014 was 39:61, unchanged on that six months ago.

The Board and executive acknowledge, given the decline in earnings, that debt level is too high and have introduced a debt reduction programme that would see bank debt reduce to more acceptable levels.

CASH FLOWS

Net cash flows from operating activities were $12,000 for the six months, down on the $3.5 million in the previous comparable period due to the reduction in operating profits.

During the first six months there was a $1.7 million outflow for capital expenditure and $1.3 million dividend received from our equity-accounted investee, Cavalier Wool Holdings.

SEGMENT REVIEWS

Carpet Business

The carpet business includes carpet tiles, made in Australia, and broadloom carpets, manufactured in New Zealand. Australasia remains by far the largest market for the segment.

In the six month period to 31 December 2014, our carpet business produced a segment result of $2.2 million, a drop of $3.3 million on the $5.5 million the previous year.

Total revenue at $88.8 million is up $1.8 million on the $87.0 million generated last year.

Broadloom

We have implemented a strategy to grow our ROW broadloom sales and, while at an early stage, growth prospects are encouraging for the near-to-medium term.

Our global partnership with Mohawk has got off to a good start. Our wool products are already in US stores and early indications are positive. While US sales will provide some impetus to the 2014/15 result, the full impact of rolling out our product across the 500 Mohawk customer-stores will not emerge until 2015/16.

As part of this global partnership, we are also selling Mohawk broadloom carpet and have secured exclusive distribution rights to Mohawk tiles in Australia.

While our new channel partners in Canada, the UK and Europe are unlikely to materially affect results in 2014/15, they will deliver both revenue and profit growth in the future.

In broadloom carpets, total revenue and volumes are up on the same period last year. However, profits are down due mainly to reduced margins caused by higher wool prices and the strong NZD:AUD exchange rate. Sales volumes of Cavalier Bremworth products are up 22%, partially offset by Norman Ellison Carpets' 8% drop as it continues to struggle in the very competitive price-driven section of the market.

As noted above, we have targeted growth in ROW markets and further volume growth is anticipated from the introduction of additional products under the Habitat Collection range - Cavalier's high-end synthetic offering - and other focused products with selected retailer groups.

We have also targeted areas where we can achieve cost reductions and are confident these measures will deliver benefits to the overall result in time.

Tiles

Our carpet tile operation, Ontera Modular Carpets, is having a poor year, making a loss for the first six months and having the largest variation in profitability from last year. Average selling prices have been falling, costs have been increasing and Ontera has a product range that is largely confined to the shrinking upper end of the market. It has also been forced to compete with cheaper, mostly imported, graphically tufted alternatives.

Most of these changes have been driven by the strength of the AUD, which rose from $0.80 to $1.04 against the USD over the period from 2010 to 2013. With the AUD now having declined sharply, we may be able to look forward to some relief in the form of upward pressure on prices in the marketplace.

Ontera have embarked on a blended supply model, supplementing sales of own manufactured premium-end tiles with imported products in segments of the market it has not been able to successfully compete in recently – in the process giving Ontera a much broader product offering and market reach. The bulk of these products will commence selling in the last quarter of the financial year and manufacturing will be sized according to requirements.

Wool Business

Wool scouring and wool buying are the operations within our wool business.

Cavalier owns 50% of the wool scour, Cavalier Wool Holdings Limited (CWH), and for the six months, Cavalier's share of tax-paid earnings is a loss of $157,000 compared with a profit of $792,000 for the same period last year. This loss in the first six months was expected as a result of very low wool grease prices compared to last year.

It is pleasing to note that wool grease prices appear to have reached the bottom of the current cycle and have recently started to lift.

During the year, we announced that an agreement to merge CWH with the scouring operations of New Zealand Wool Services International (the only other woolscourer in New Zealand) had been reached. This agreement is still subject to Commerce Commission approval and a draft determination is expected to be received shortly. We are confident that the merger will be approved and the synergies created from taking out excess capacity in the industry will increase scour efficiency.

Elco Direct, Cavalier's wool buying business, had revenue of $16.8 million which was down 4.5% on the $17.6 million reported last year. The segment result at $351,000 for the six months is down $207,000 on the $558,000 reported in the same period last year, with the decrease caused by reduced volume and margin.

Yarn Business

The Radford Yarn Technologies (RYT) operation is a supplier of premium felted woollen yarns to the Cavalier Bremworth broadloom carpet operation and to up-market broadloom carpet and rug manufacturers in North America and Europe. It is one of only two felted yarn producers in the world. Production has doubled during the past 12 months to meet internal requirements and international demand.

While RYT profit to sales margins have dropped, this is due entirely to the decision made at the start of the financial year to price products sold within the Group at manufactured cost. As a result, although volume has increased, profitability has dropped and gains will be recognised further down the value chain on sale of finished product.

RYT volume of yarn sales into Europe is set to increase with the securing of a supply agreement with a large European manufacturer. As a result, the Company has invested in extra felting capacity at its Wanganui spinning plant.

EARNINGS OUTLOOK

We are expecting a lift in second half results due to the ongoing implementation of our strategy to turn around the business. Therefore, the earnings outlook for the Group for the 2014/15 financial year remains unchanged from the $1 to $4 million normalised profit after tax range presented to shareholders at the Annual Meeting.

In arriving at this outlook, we anticipate further volume increases in the broadloom business, including offshore growth, introduction of new ranges under the Habitat Collection and new business in New Zealand and Australia. There has also been recent price increases in some products in Australia which will help returns that are being adversely affected by the strong New Zealand dollar.

Ontera's tile import programme is in place, with product ready for sale and reasonable volumes anticipated in the last quarter of the financial year. While this is more of a 2015/16 story, we will see some profits from the incremental sales in the remainder of this financial year.

With wool grease prices lifting and increased volumes through the scour, second half earnings from the scour should be an improvement on the first.

The high wool price looks to have settled at a level much higher than historical averages and with approximately 50% of our products predominately wool based, this will continue to depress results.

The New Zealand dollar is now at its highest level against the Australian dollar since the currency was floated in 1985. This makes it increasingly difficult for New Zealand-based manufacturers to profitably export to Australia.

The Board and executive are acutely aware that current profitability is unacceptable but remain confident their strategies are appropriate and will return the Company to acceptable profitability in time.

DIVIDENDS

The results in the first half of the year do not support the payment of a dividend and the Directors are therefore not recommending an interim dividend payment.

With the full year forecast as it currently stands, it is also unlikely that a final dividend will be paid for 2014/15.

Company profitability needs to lift and the financial position has to improve before dividend payments can resume.

The Board will revisit its decision to suspend dividend payments at the appropriate time.

A M James
Chairman

C A McKenzie
Managing Director

20 February 2015

For more information regarding this announcement, please contact Colin McKenzie on 09 277 1138 (during office hours) or 027 292 4080 (outside office hours).