CAVALIER
CORPORATION

CHAIRMAN'S ADDRESS – 25 NOVEMBER 2014 ANNUAL MEETING OF SHAREHOLDERS

Ladies and gentlemen,

On behalf of the Board, I thank Colin for his comments, and I thank Colin, his entire management team and all our staff throughout the Group for their efforts during what has been another challenging year.

Before Colin and I proceed to deal with any questions you may have on the material contained in the Annual Report and in Colin's address to the meeting, I would like to respond to the questions we received ahead of the Annual Meeting.

There is obvious concern about how the Company has been performing, particularly in terms of share price and dividends, and what we are doing about these.

Shareholders will be rightly very disappointed in the current performance of the Company, and we the Board and management share that disappointment. I wish to share a few facts and thoughts with you – not as an excuse, but perhaps to go some way towards explaining the current situation we find ourselves in.

You will be aware by now that the New Zealand carpet market has moved – in just a few short years - from being one that was predominantly wool and predominantly locally manufactured to one that is predominantly imported and synthetic.

The change has been driven by four factors: -

1. The abiding weakness of the US dollar that has made the importation of synthetic carpets from the United States a far more attractive proposition;
2. Surplus manufacturing capacity around the world and particularly in the US, after the GFC;
3. The emergence in New Zealand of retail groups who were in a position collectively to take advantage of those two factors; and
4. The periodic violent upswings in the price of wool that have so damaged the price competitiveness of wool carpets.

In this rapidly changing environment, the Company has been working hard to transform itself from being mainly a high end high margin wool carpet specialist to being a high volume operator in all carpet forms at much lower margins. Sadly, the former business model is no longer viable, and the transition has been, and continues to be, quite tough.

Nevertheless, we have been making progress, and we continue to make progress. Unfortunately, that progress is being masked by the headwinds that we find ourselves facing in the form of wool price rises and our hedged rate on the NZD/AUD cross. Those two factors combined to negatively impact our budgets by a massive $7 million pre-tax when compared to the actual rates and costs in the previous year, and completely swamp the $3.6 million that we took out of operating costs last year.

Ontera, our carpet tile operation, has been facing similar challenges that relate to the weakness of the US dollar in Australia, where a market that was previously served in the main by local manufacture has – again in a few short years - become dominated by US dollar denominated imports that come from China and other Asian sources as well as the US itself. We can now import a tile from the US at a cost that is little more than what we pay for the fibre content of the same tile! And we can get tiles from China that are even cheaper. So Ontera too is being forced to reinvent itself and is adding a substantial importing program to its manufacturing operation, which will focus on high end and highly differentiated products.

Our wool scouring business has also had a tough time with falling sheep numbers and wool available for scouring and a sudden drop in wool grease prices. However, sheep numbers look to have stabilised around at 30 million and the proposed merger with WSI will correct the current over capacity and retain wool scouring onshore, plus we are now seeing a strengthening in wool grease prices.

Ontera is projected to show no improvement on the loss it incurred in the previous year, which is disappointing. We have plans in place that should see improvements in the second half, but they are work in progress.

The broadloom carpet business is doing OK. Not marvellous, but OK. Sales volume is ahead of last year, and – notwithstanding the headwinds I mentioned earlier – it is turning a small profit.

And there are continuing signs of improvement.

And now to respond to specific questions that were received from shareholders ahead of this meeting: -

One shareholder asked ***why there was no dividend in October 2014*** before going on to say that ***the current share price is unacceptable.***

We took the decision to suspend dividend payments because of the weaker than expected earnings and the cash outflows relating to the increased inventory levels required to support the continuing expansion in synthetic and felted wool carpets.

We felt that the cash flow required to support a dividend simply was not there.

Yes, the current share price is unacceptable. However, the Cavalier share price is, and always has been, predicated on a steady and reliable dividend stream. Without that, the share price is going to languish. To address it, we have to rebuild profitability in the business and resume dividend payments.

Which leads me to what we are doing about share price and dividends, with a shareholder asking ***(1) for an outline of the strategies, if any, the Directors are implementing to restore shareholder value and dividend payments and (2) whether there are plans to arrest the decline in earnings or to reduce fixed expense by a commensurate amount, and when we expect this decline to reverse*****.**

To restore shareholder value and dividends, we have to rebuild the earnings in the business. You will have seen from the last couple of Annual Reports and Colin's presentation today the array of strategies that we have put, or are putting, in place to achieve this.

We have already taken a great deal of fixed cost out of the business, as evidenced by the closure of two manufacturing facilities, and a big reduction in headcount. The review of our cost base is ongoing, but we have to be careful not to throw the baby out with the bathwater. Right now, the focus is on growing top line revenue.

…. and another asking ***why more emphasis is not being placed on growing sales in the Australian market, given the opportunities and potential for Cavalier in Australia and the fact that Australia already accounts for more than 50% of total sales?***

We are working hard to increase our broadloom volume in Australia, and we are doing well in the better end of it, with Cavalier Bremworth sales well up on last year. However, the entry level end of it is tough – competition is intense and margins are slender.

And I have already alluded to the challenges with tiles, where the market is dominated by cheap imports.

A shareholder commented that ***Cavalier Corporation has lost around $80 million in share value over the past year. During this time, the Directors have three times announced a profit downgrade which has been the catalyst for this disastrous share price performance.***

The same shareholder also stated that ***the latest downgrade on 24 October 2014 was blamed on high wool prices and the relative strength of the New Zealand dollar against the Australian dollar*** and asked ***why the Managing Director, in his report issued on 22 August 2014, did not take these factors into account as they were known then and should have been recognised in the 2014/15 budget?***

The Board and I were embarrassed by the need for the second and third earnings guidance announcements, but the requirements of continuous disclosure are explicit.

The need for the first of these two arose very late in the last financial year when – after an unexpectedly poor May result – we realised that we were likely to just miss the bottom end of the earnings guidance previously issued.

The need for the second arose when we were advised that the market would take the previous year's result as de facto earnings guidance, despite our statement in our report on the 13/14 year that we were not offering any earnings guidance at that time as it was too early! Then once we knew, after the first quarter result, that last year was unlikely to be achieved, we were compelled to say so.

The high wool prices and the high NZ dollar were indeed incorporated in the budgets for the current year. However, also included was forecast sales growth that would offset these downsides. Whilst there has been some sales growth in broadloom, it has not, thus far, been to the extent budgeted.

It also came to our attention after the 24 October earnings guidance that some market commentators had taken our comments about the 2015 budget as earnings guidance. The budget was never intended to be taken as earnings guidance. We obviously have to be more careful in what we say!

In addition, he also asked ***why there was no mention, in the latest downgrade announcement, as to the potential size of the downgrade, whether Cavalier Corporation continued to have the unqualified support of its bank or anything positive.***

The reason why we were unable to be more specific is simply that it was too early to say, and it really still is. Right now margins in the business are very slender, and profit or loss is a small difference between two very large numbers – being sales revenue and the total cost of running the business. Management are working very hard to improve things and there are many initiatives in play, but they are mostly work in progress.

Yes, Cavalier does have the ongoing support of its bank. If this were not the case, you would have heard so by now. The continuous disclosure requirements of the NZX are explicit in this regard!

There are also a couple of questions on Board composition, with one shareholder stating ***Despite the unacceptable results, with the exception of the retirement of Keith Thorpe in December 2013 and appointment of Graeme Edmond in February 2014, there have been no other changes to Board membership. There has also been no change to senior management despite ongoing poor performance. Why?***

I think the inference in this question is why, in view of the poor performance, there have not been a clean out of senior management and the Board, including perhaps the Chair? Believe me when I say that the board has asked itself these questions frequently.

I think that the answer is this. The reality is that manufacturing in this part of the world is a tough game and the carpet market is no exception with now more than 50% of carpet sold in New Zealand being imported and the fibre mix rapidly moving from close to 80% wool rich a few years ago to 25% wool today, and the Company has had to reinvent itself and implement significant change.

Many of these programs are now bedded down and we are now gaining traction, it's just that the recovery is taking longer than we hoped. The Board believes that the current management team is the best option available to carry the Company through the present crisis.

The Board itself comprises three very long-standing Directors, being Grant Biel, Graeme Hawkins and myself, who have a long and intimate understanding of the business, and two relatively new independent Directors in Sarah Haydon and Graeme Edmond. Sarah and Graeme Edmond bring a fresh perspective and are well placed to challenge the status quo and help us towards the best possible decisions at Board level.

So far as my position as Chair is concerned, perhaps it could be said that I have been here too long and it's about time that I stepped down. Perhaps this is so, but the Chairmanship of Cavalier might well be regarded as something of a poisoned chalice at this time, and the Board thinks it best that I continue in the role for the time being.

Another shareholder asked … ***Where is the interest and particular knowledge in sheep farming, wool industries including scouring, carpet and fashion evident in the Directors?***

I think that both Grant Biel and I can claim reasonable knowledge of the carpet and wool industries, including scouring. So too can Graeme Hawkins – having served on this Board for over 15 years.

Fashion expertise is vested in the management team, as to an extent is sheep farming, through the team at Elco Direct.

A shareholder asked … ***What had happened to Cavalier's share of the NZ carpet market over the past five years and what picture do we paint of share in five years' time?***

While there is no official market share data available on the NZ carpet market, our own analysis tells us that we have lost market share in the past five years, given the move away from wool carpets and the influx of imported synthetic carpets. Our share in five years' time would depend on how the NZD performs against the USD, but all things being equal, we would expect our share to grow in tandem with the growth in sales, particular of our high-end synthetics.

That same shareholder also ***asked whether imports were gaining share and if so, what sustainable advantages Cavalier had to counter that from the small defensible wool carpet segment.***

I would refer the shareholder to what I said earlier about the challenges facing the Group and the steps we have taken or are taking to address these.

He also commented that ***Cavalier has had three finance background MDs in succession and asked whether marketing has suffered because of this.***

The statement that Cavalier has had three finance background MDs in succession is incorrect. Marketing, like a number of other disciplines within the Group, is vested in the management team.

Now, a question on the level of debt … ***What is the feeling of the Board in regard to the present level of the Company's debt, taking into account the Company's present circumstances?***

The present level of debt is higher than we would like. It increased over the 13/14 year mainly as a result of the increased inventory required to support the synthetic carpet program. However we are expecting it to decline over the current year, and indeed that is one of our explicit objectives.

And, finally a question on shareholder communications … ***Is the Company planning to allow shareholders to post votes electronically and receive reports, notice of meetings, etc. by e mail as do most other companies?***

We have noticed that there is that trend towards allowing shareholders the ability to vote electronically and communicating with shareholders by e mail and this is something we are in the process of implementing. We will be contacting shareholders early in the New Year about this.

I now call on Colin to answer some specific questions received on the operational side of the business.