

## Director's Report for year ended 30 June 2013

### Financial Performance

The Directors of Cavalier Corporation announce an audited after tax profit for the year to 30 June 2013 of \$3.0 million, compared with the \$1.6 million after tax loss reported in 2012.

On 18 June this year, Cavalier Corporation advised the market that it will be consolidating its carpet tufting operations by relocating the Onehunga tufting operation of its subsidiary, Norman Ellison Carpets, to its main tufting site in Papatoetoe, Auckland. The restructuring will reduce the manufacturing cost base and improve future results. However, there were extraordinary costs in the form of provisions that had to be recognised at year-end. The tax paid costs associated with the tufting relocation are \$4.1 million which has partially been offset by releases of provisions taken up in the previous year to the value of \$519,000. Excluding these two one-off adjustments, the normalised operating profit after tax is \$6.6 million, compared with the previous year of \$ 4.3 million, a 55% increase.

Directors advised in June 2013 that they were expecting normalised earnings for the year ended 30 June 2013 to be at the lower end of the \$6 to \$10 million after tax range. At the same time, the Directors also advised that restructuring/relocation costs associated with the consolidation of tufting would reduce normalised earnings by \$4.0 to \$4.5 million after tax. As a consequence, final results as announced are within the guidance ranges previously provided.

Revenue for the Group of \$202 million is down 7% on the previous period, with New Zealand and Australian revenue down 9.4% and 5.6% respectively. Australia now represents 55% of total revenue, compared with 54% in 2012.

The normalised earnings improvement of 55% is a move in the right direction and a reflection of management's efforts to reduce the cost base in the last couple of years and the slightly better market conditions in New Zealand.

<b>FINANCIAL PERFORMANCE</b>	<b>2013</b>	<b>2012</b>	<b>Change</b>
<b>Year ended 30 June 2013</b>	<b>\$000</b>	<b>\$000</b>	
<b>Revenue</b>	<b>\$201,739</b>	<b>\$217,198</b>	<b>-7%</b>
Earnings before interest and tax (Normalised) <sup>1</sup>	5,814	5,540	5%
Interest	(3,740)	(4,049)	-8%
Share of equity-accounted investee profit (tax-paid)	5,013	3,302	52%
Profit before tax (Normalised) <sup>1</sup>	7,087	4,793	48%
Income tax	(463)	(510)	-9%
<b>Profit after tax (Normalised) <sup>1</sup></b>	<b>6,624</b>	<b>4,283</b>	<b>55%</b>
Restructuring costs (net of tax)	(3,594)	(5,916)	39%
<b>Profit/(Loss) after tax (Reported)</b>	<b>\$3,030</b>	<b>\$(1,633)</b>	
<b>Earnings per share (cents) (Normalised) <sup>1</sup></b>	<b>9.7</b>	<b>6.3</b>	<b>54%</b>
<b>Earnings per share (cents) (Reported)</b>	<b>4.4</b>	<b>(2.4)</b>	

**Notes:**

1 - Normalised is a non-GAAP (Generally Accepted Accounting Practice) measure.

The Directors acknowledge that the information presented in the table above includes financial information that is non-GAAP.

The Directors believe that the non-GAAP financial information provides useful information to investors regarding the performance of the Group because the calculations exclude items that are not normally expected to occur on a regular basis.

In arriving at this view, the Directors have taken into account regular requests by users of the financial statements, including analysts and shareholders, regarding the nature and quantum of one-off items within the GAAP-compliant results.

The disclosure of non-GAAP financial information is also consistent with how information is reported internally to key management as it provides a more meaningful view of the underlying financial performance of the Group and a better understanding of how the Group is tracking after taking into account items of a one-off, non-recurring or unusual nature.

A reconciliation between earnings per share reported and normalised has been included in the note accompanying this report.

Further commentary on the disclosure of non-GAAP financial information will also be included in the annual report to shareholders.

## **FINANCIAL POSITION**

The Group's financial position has improved with the focus on debt reduction and cost savings throughout the year.

The Group's net interest-bearing debt as at 30 June 2013 of \$53.3 million is down \$13.3 million on the \$66.6 million reported last year, a 20% improvement. This is largely due to lower levels of stock and debtors and reduced capital and discretionary spending.

As a result of the reduction in debt, net interest-bearing debt to equity ratio has improved from 42:58 last year to 36:64 this year.

The Group's total assets as at 30 June 2013 are \$197 million, a decrease of \$5 million on the previous year. This has been brought about by the decrease in inventory as a consequence of the continuation of the stock reduction programme initiated in 2012 and a \$6.1 million decrease in fixed assets caused by reduced capital expenditure. Offsetting this is a \$3.9 million increase in cash held at balance date and a \$2.5 million increase in derivative financial instruments reflecting the gains made on future hedging instruments.

Shareholders' equity as at 30 June 2013 was \$93.9 million - up \$3.1 million on the previous year, mainly from increased retained earnings.

## **CASH FLOWS**

Net cash flows from operating activities are \$11.7 million for the 2012/13 financial year which is a \$3.6 million or 44% improvement on last year on the back of improved earnings and reduced interest and taxation payments.

During the year, there was \$1.9 million spent on property, plant and equipment.

Dividends received from our 50% owned and equity accounted wool scouring operator amounted to \$3.8 million, an improvement of 25% from last year.

Overall, the positive cash flows for the year allowed for a substantial reduction in Group borrowings.

## **SEGMENT REVIEWS**

### **Carpet Business**

Our carpet business comprises broadloom carpets and carpet tiles, with New Zealand and Australia as its main markets and a small volume sold in the rest of the world.

Revenue for the year was \$169 million, down 6% on the previous year.

The carpet segment result before restructuring costs was in line with last year at \$6.4 million. For the first six months of the 2013 financial year, the carpet business suffered from the high carrying value of finished goods stock caused by the abnormal increase in the price of wool in the early part of 2012. This stock was finally sold out of inventory in the first six months of the 2012/13 year and the second half has seen the return of more reasonable margins due to lower stock values. This is in complete contrast to the 2012 year where the first six months was much stronger than the second, due again to the impact of high value wool-rich carpets in cost of sales in the latter part of that year.

Segment earnings as a percentage of revenue at 3.8% were on par with the 3.5% recorded in 2012.

#### New Zealand market

The New Zealand market was very sluggish in the first half of the year but conditions appear to be improving and in the last six months, there has been increased volumes sold with improved revenues.

The Christchurch rebuild will have an impact on the building sector and those companies associated with it, such as Cavalier, should benefit. There appears to be more confidence in the New Zealand economy, particularly with our agricultural exports and we expect this positive outlook to continue.

#### Australian market

Market conditions in Australia have been soft throughout the year for both residential and commercial carpets. The Australian economy appears to be struggling and the New

Zealand dollar is increasing rapidly against the Australian equivalent, particularly in recent months, eroding Cavalier's New Zealand dollar returns.

We are not expecting to see any improvement in the operating conditions until the second half of the 2013/14 year.

### Wool prices

Wool prices fell dramatically from the extraordinary peaks reached in December 2011 and for most of the 2012/13 year were at average historical levels.

In recent months, there has been a shortage of wool in the market caused by the drought in early 2013 when stock was sent to the works due to a shortage of feed. This has caused a rise in wool price. However, we do not expect to see those same conditions which caused the abnormal prices in late 2011 and believe values will normalise when shearing commences again later in the year.

### Business improvement plans.

Continuing on from the business improvement plans introduced in 2012 and implemented during the 2013 year, there have been additional initiatives undertaken which should further rationalise our cost base and simplify and grow the business.

During the 2013 year, we introduced the Habitat range of carpets, which is the first synthetic range sold under the Cavalier Bremworth stable of brands. While Cavalier Bremworth is still the premier wool carpet supplier in both New Zealand and Australia and we intend to grow and promote the virtues of wool offerings (leveraging off Cavalier Bremworth's heritage and brand equity), there has been a market shift to non-wool carpets, particularly in New Zealand, and Cavalier needed to respond with a premium offering. The Habitat range was launched in late March in New Zealand and July in Australia and we should see increased sales throughout 2014 as a result.

In 2013, the decision was made to simplify our brand offerings to avoid confusion and also to rationalise the number of SKUs of carpets we have in the market. Carpet ranges will now fall into two broad categories, the mid to high-end carpet sold under the Cavalier Bremworth banner (including the Habitat range) and the mid to lower-end carpet sold under the Norman Ellison brand. This will effectively eliminate the Knightsbridge and Kimberley ranges.

As indicated earlier, the decision has been made to consolidate all tufting operations at the

one site in Papatoetoe resulting in a one-off restructuring cost of \$4.1 million after tax. This will result in a significant reduction in operating costs for the broadloom carpet business going forward.

### **Wool Business**

Our wool business comprises the Elco Direct wool acquisition operation and our 50% interest in commission woolscourer, Cavalier Wool Holdings (CWH).

#### Wool acquisition

Trading conditions in 2013 were significantly better than those experienced in 2012.

Volumes in 2013 were higher than last year despite revenues falling by 15% which is a function of the higher wool prices prevailing throughout the 2012 year.

Due to the increased volume, operating profit has increased by 157% in 2013 which is a pleasing result from a well-managed business.

#### Wool scouring

CWH also enjoyed a very good year with Cavalier's share of the tax-paid earnings for the year ended 30 June 2013 of \$5.0 million, a 52% increase on the \$3.3 million delivered the previous year.

The price of wool grease, a by-product of the scouring process, remained high for most of the year and was a large contributor to the improved performance.

### **Yarn Business**

Cavalier purchased the remaining 25% from the minorities in Radford Yarns (RYT) during the year while retaining the majority of the personnel within the existing business.

From what was a slow start to the year, volume increased significantly in the second half and the total volume produced was similar to the 2012 year. Approximately half of RYT production is still consumed by the Cavalier Bremworth broadloom carpet business and these exclusive yarns are those which we expect to grow for luxury markets offshore.

## **OUTLOOK**

The results for the first six months of 2013 were depressed and mirrored the last half of 2012 as a result of extremely high stock values brought forward from the previous year flowing through costs of sales. The last half of the 2013 financial year was, however, stronger and results lifted accordingly.

We do not expect to experience the same extreme conditions again and with the restructuring already undertaken and in progress, we expect to be trading off a lower cost base and producing improved profits.

Looking forward to the 2013/14 financial year, we do not see any immediate upside in market conditions in Australia for carpets. For that to improve, we need to see a lift in the economy and real estate turnover.

There are more positive signals coming from the New Zealand economy especially with the Christchurch rebuild well and truly underway. We expect our volumes and profits to lift in line with increased domestic demand.

Wool prices have lifted in recent months. However, we do not anticipate prices to reach the abnormal heights experienced a couple a seasons ago. We expect conditions for our wool operations to be steady for the upcoming year.

There has been a considerable effort to reorganise and reshape the business in terms of the cost base, product offerings and brand strategy, and we believe the Company is now well positioned to lift future profitability. There are still uncertainties in the operating conditions for the Group and as such, it is too early in the year to be providing guidance for the 2013/14 financial year. We should be in a better position to do this at our annual shareholders' meeting in November 2013.

## **DIVIDENDS**

The Directors have declared a fully imputed final dividend for the year ended 30 June 2013 of 4 cents per share.

This final dividend will be paid on Friday, 18 October 2013. The share register will close at 5 p.m. on Friday, 4 October 2013 for the purpose of determining entitlement to the dividend and will reopen on Monday, 7 October 2013.

Non-resident shareholders will also be receiving a supplementary dividend of 0.7059 cent per share together with their final dividend.

The Cavalier Corporation Limited Dividend Reinvestment Plan, which allows shareholders to receive shares in the Company in lieu of dividends, will apply to the final dividend.

Shareholders wishing to participate and who have not previously notified the Company's Share Registrar must do so before 5 p.m. on Friday, 4 October 2013. A copy of the Participation Notice can be obtained from the Company's Share Registrar.

The Directors advise that the price for determining the number of shares to be issued in lieu of this dividend will be the volume weighted average sale price of all price-setting trades on the NZX over the five trading days from Monday, 7 October 2013 to Friday, 11 October 2013 without any discount.

### **ACKNOWLEDGEMENTS**

This year has been a challenge for Cavalier and I take this opportunity to acknowledge the considerable effort made by staff during what has been not only a difficult year but also a period of unequalled change.

For and on behalf of the Board of Directors

A handwritten signature in black ink, appearing to read 'Colin McKenzie', with a small dot to its right.

Colin McKenzie  
Managing Director  
16 August 2013