Cavalier
CORPORATION

Directors' Report

For the six months ended 31 December 2011

Financial Performance

Consolidated Income Statement Six months ended 31 December Unaudited	**2011($000s)**	**2010($000s)**	**% change**
Operating revenue	107,992	116,663	-7%
EBIT	5,325	12,774	-58%
Net interest expense	(1,956)	(1,704)	15%
Share of profit of associate (net of tax)	1,178	819	
Profit before tax	4,547	11,889	-62%
Tax	(1,000)	(3,363)	-70%
Profit after tax	3,547	8,526	-58%
Earnings per share - annualised (cents)	5.2	12.5	-58%

The Directors of Cavalier Corporation report an unaudited profit after tax for the six months to 31 December 2011 of $3.5 million, a decrease of 58% on the $8.5 million the previous year.

This result includes $0.7 million of restructuring costs, net of tax, but otherwise reflects the very difficult and challenging conditions that the Group has been encountering in both the New Zealand and Australian markets in which it participates.

Group revenue for the six months was $108 million, a decrease of 7% on the $117 million the previous year, with New Zealand-based revenue unchanged on the previous year, but Australian-based revenue down a significant 14% on the previous year.

Return on average shareholders' equity for the six months was 7.3% and earnings per share was 10.4 cents (both annualised) - compared with 18.5% and 25.1 cents respectively the previous year - as a result of the disappointing financial performance.

Financial Position

Shareholders' equity at 31 December 2011 stood at $96.2 million, which is an improvement of $3.3 million on the $92.9 million a year ago, but down $3.1 million on the $99.3 million at 30 June 2011.

At the same time, total assets employed stood at $217 million as at 31 December 2011 - up $19 million on the $198 million a year ago because of the increased stocks held, the impact of the substantial lift in wool prices on the carrying value of our carpet stocks and the assets acquired as part of the acquisition of the Radford Yarn operation, but little changed on the $216 million at 30 June 2011.

As a result, shareholders' equity accounted for 44% of total assets employed at balance date, compared with 47% a year ago and 46% at 30 June 2011.

Net interest-bearing debt at balance date stood at $78.1 million and net interest-bearing debt to equity ratio was 45:55. The previous year's figures were $59.5 million and 39:61 respectively and those six months ago were $66.3 million and 40:60 respectively.

The Group's financial position is expected to improve once the stock reduction programme gains traction and it is able to reduce net interest-bearing debt.

Segment Reviews

Carpet Business

Our carpet business comprises broadloom carpets and carpet tiles, and although some of its products can be found elsewhere in the world, New Zealand and Australia continue to remain the main markets by far.

In the six months to 31 December 2011, our carpet business produced earnings before interest and tax (EBIT) of $5.6 million on revenue of $93.0 million, compared with EBIT of $13.4 million on revenue of $108.3 million the previous year - a decrease of 58% and 14% respectively.

As a consequence, EBIT as a percentage of revenue fell to 6.0% in this latest six month period, compared with 12.4% in the previous year. The fall was the result of competitive pricing pressures, fixed overheads on lower sales volume and the one-off restructuring costs of $1 million to better match manufacturing capacities with lower sales.

In comparing the results for the six months to 31 December 2011 against those for the previous year, the persistent soft market conditions on both sides of the Tasman stood out.

We were faced with some of the most difficult trading conditions ever experienced by the business during the period. New housing and commercial building activity levels in New Zealand remained soft. They were also in the process of slowing down in Australia heading into the 2011/12 financial year, but these were hastened by the European sovereign debt crisis that unfolded and the fear that another global recession would soon follow.

At the same time, the business also had to implement a substantial 10 to 20% price increase on its wool carpets due to an 80% increase in wool prices during the 2010/11 season which had the effect of giving carpets made from alternative fibres a pricing advantage over wool carpets.

Wool Business

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

Elco Direct volumes for the six months to December 2011 were down 6% on the previous year, but revenue of $17.8 million was up 32% due to higher wool prices. New Zealand's total wool exports over the same period fell by 11%, highlighting the challenging conditions in this operating segment.

EBIT for Elco Direct for the period came in at $359,000 which is an improvement on the previous year's $216,000.

Cavalier's share of the tax-paid earnings of CWH for the six months to 31 December 2011 is $1,178,000, compared with $819,000 the previous year.

CWH's scour volumes were down 13% for the six months, which is against earlier predictions of an increase in wool volumes for the season. In fact, national scouring volumes fell by 15% over this same period. It is difficult to know how much of this will be made up in the second half of the year, but it appears, for now, that the industry's earlier estimates of sheep numbers could have been too high. However, sheep farmers remain highly incentivised to increase sheep numbers which would mean more wool available for scouring further down the track.

CWH's plans to rationalise the scouring industry by consolidating the New Zealand Wool Services International scours with its own have to date been a protracted process, but it is continuing to look at all possible options.

The Directors will continue to inform shareholders of any significant developments as they unfold.

Yarn Business

The Radford Yarn Technologies operation - which 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 - also struggled with the high wool price and the high NZD against the USD and the EUR.

As a result, sales have fallen behind earlier expectations.

Retirement of Wayne Chung, and appointment of Colin McKenzie as Chief Executive Officer

The Directors advise that Chief Executive Officer and Managing Director, Mr Wayne Chung, will be retiring from his executive role on 15 March 2012 and that Chief Operating Officer, Mr Colin McKenzie, has been appointed as Chief Executive Officer Designate.

Mr Chung will, however, remain on the Board as a non-executive director.

Mr Chung has been responsible for a number of significant initiatives during his eight years as CEO and MD and the Directors take this opportunity to acknowledge Mr Chung's contribution and to thank him for his leadership and dedication to the Company.

The Directors are particularly pleased that Mr Chung has agreed to continue in a non-executive capacity and hence will be able to contribute, in a mentoring and supporting role, from the considerable experience and knowledge he has amassed during his almost 40 years in the carpet industry.

Mr McKenzie joined the Cavalier Bremworth broadloom carpet operation as General Manager Manufacturing in February 2003 before being appointed Group General Manager Operations in 2005 and Chief Operating Officer in 2008.

Mr McKenzie's appointment as Chief Executive Officer has been the result of a robust succession programme aimed at developing high-calibre executives for key roles within the Company and will enable the Company to continue to pursue and develop, in a coordinated and measured manner, the strategies formulated when Mr Chung was CEO and MD.

In anticipation of the eventual appointment of Mr McKenzie as Managing Director, the Directors will also be appointing Mr McKenzie to the Board with effect from 15 March and look forward to introducing him to shareholders at the Annual Meeting of shareholders in November.

Earnings Outlook

Unfortunately, we do not see any immediate relief from the current very soft market conditions for our carpet business.

For the second half of the year, we expect to see market conditions remain similar to those experienced in the first half. This is against our earlier predictions in November last year when we were expecting an improvement in market conditions.

As a result, the earnings guidance range that was provided in November last year of $8.5 million to $10.5 million tax-paid is now no longer attainable.

Given these difficult and unpredictable trading conditions, it is also not possible to provide shareholders with a full year earnings guidance update at this stage.

Naturally, the Directors are very disappointed with this situation, but wish to take this opportunity to assure shareholders that the management team is doing everything it can under these very trying conditions to optimise performance.

The Directors will inform shareholders should conditions change.

Looking ahead to the following 2012/13 year, there is cause for some optimism. The Reserve Bank of Australia's recent lowering of the cash rate in early November, and again in December, have already flowed through into mortgage interest rates and should, over time, help to restore confidence in the housing market in Australia. The much talked about re-build of Christchurch should be well underway by then. We should also expect to see some relief from lower wool prices, which have fallen 15% over the last few months, on the cost of our woollen carpets and the pricing differentials between these and carpets made from non-wool fibres.

Dividends

Given the disappointing results for the first half and the short term earnings outlook, the Directors have decided not to pay any interim dividend for the current 2011/12 financial year.

This will come as a disappointment to shareholders, but the Directors believe that it is important that we focus on strengthening the Group's financial position and reducing debt during these challenging times.

The Directors will review the dividend position again at the end of the year when we ought to have a better feel for the trading conditions and the earnings outlook further out.

For and on behalf of the Board.

A M James - Chairman

W K Chung - Managing Director

17 February 2012