CAVALIER CORPORATION

Directors' Report for the six months ended 31 December 2012

Directors' Review

For the six months ended 31 December 2012

Your directors present their report, including financial statements, for Cavalier Corporation for the financial period ended six months to 31 December 2012.

FINANCIAL PERFORMANCE

Consolidated Income Statement Six months ended 31 December Unaudited	2012 $000s	2011 $000s	% change
Operating revenue	**100,973**	107,992	-6%
EBIT (before restructuring costs)	**496**	6,341	-92%
Net interest expense	**-1,940**	-1,956	-1%
Share of profit of associate (net of tax)	**2,116**	1,178	80%
Profit before tax (normalised)	**672**	5,563	-88%
Tax	**340**	-1,284	
Profit after tax (normalised)	**1,012**	4,279	-76%
Restructuring costs (after tax)	**427**	-732	
Profit after tax (reported)	**1,439**	3,547	-59%
Earnings per share (cents) (normalised)	**1.5**	6.3	-76%

Unaudited profit after tax of $1.4 million for the period is a decrease of 59% on the $3.5 million reported in 2011.

The result includes, net of tax, $149,000 of redundancy costs and a $576,000 write back of over accrued restructuring costs from the 2012 financial year.

The first six months of 2012/13 was challenging, with the run out of high cost stocks due to unusually high wool prices from the preceding year and soft trading conditions in both New Zealand and Australia.

Group revenue for the six months was $101 million, a decrease of 6% on the $108 million in the previous year, with sluggish New Zealand and Australian based revenue.

Return on average shareholders' equity for the six months was 2.2% and earnings per share was 3.0 cents (both normalised and annualised) - compared with 8.8% and 12.5 cents respectively the previous year. It was a disappointing but not unexpected trading result for the first half of the year.

FINANCIAL POSITION

Shareholders' equity at 31 December 2012 of $92.1 million was down 4.3% on the $96.2 million reported a year ago.

In December 2011, the company's net interest-bearing debt was in excess of $78 million and the immediate trading outlook was not encouraging. At the time, the company decided it needed to strengthen its balance sheet by reducing debt. Since then, management have embarked on a programme to reduce the levels of inventory held, restrict capital spend to essential items only and cut overhead costs and discretionary spending where possible. Also included in the debt reduction plans was the suspension of the shareholder dividend. As a result, the company's net interest-bearing debt has dropped by $21.3 million or 27% since December 2011.

Net interest-bearing debt at balance date stood at $56.8 million and net interest-bearing debt to equity ratio was 38:62. The previous year's figures were $78.1 million and 45:55 respectively.

Total assets employed stood at $188.4 million, down $28.6 million on the $217.0 million reported in 2011. Inventories reduced by $25.6 million and debtors by $2.8 million, reflecting the efforts made by management to reduce stock levels and debtor days outstanding.

As a result, shareholders' equity accounted for 49% of total assets employed at balance date, compared with 44% a year ago and 45% in 30 June 2012.

CASH FLOWS

Net cash flows from operating activities were $8.9 million, an improvement of $13.0 million on the same period last year. This reflects the cash generated from the reduction in inventories and reduced debtor balances.

Since June 2012, net cash inflows from investing activities were $0.8 million with a modest amount of capital spend of $0.7 million offset by a $2.0 million dividend received from our 50% associate, Cavalier Wool Holdings.

In the six months since year-end, there has been a cash outflow of $9.3 million from financing activities which is the result of the debt repayment programme.

SEGMENT REVIEWS

Carpet Business

Our carpet business comprises broadloom carpets and carpet tiles which predominantly services the New Zealand and Australian markets, but with an increasing focus on the rest of the world.

In the six months to 31 December 2012, our carpet business produced a segment result before restructuring costs of $1.0 million on revenue of $88.0 million, compared with $6.7 million on revenue of $92.0 million the previous year - a decrease of 85% and 4% respectively.

It has been a difficult first six months for the carpet business. As a result of soft demand, we were unable to pass on the high carrying value of brought forward finished goods stocks and had to therefore absorb this through lower margins. The retailing landscape also continues to change, with increased consolidation and direct importing helped by the ever increasing strength of the New Zealand Dollar.

There are signs that the economy is picking up in New Zealand with increased building consents being issued and the Christchurch rebuild underway. However, the sentiment in Australia is more worrying and the economy across the Tasman appears to be slowing down.

We expect to launch Cavalier's new high-end synthetic products before year-end, and with the high valued finished goods stock now fully run out of the system, margins going forward should be closer to long term averages.

In the last six months, there has been a major reorganisation of the manufacturing business, with consolidation of the spinning and warehousing activities that we commenced in June. The cost benefits of this restructuring will flow through into future years.

Wool Business

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

Elco Direct's revenue of $13.9 million was down 22% due to reduced wool prices in the second half of 2011/12. However, EBIT at $353,000 was on par with the $359,000 achieved in December 2011 and the business is currently tracking above expectations.

Cavalier's share of the tax-paid earnings of CWH for the six months to 31 December 2012 is $2.1 million compared with $1.2 million the previous year. CWH has had an excellent start to the year and the outlook remains positive for the remaining six months.

There were plans to rationalise the scouring industry by consolidating the New Zealand Wool Services International (NZWSI) scouring business with CWH. An extensive process was undertaken in an attempt to make this happen. However, the rationalisation did not occur. NZWSI is currently being taken over by Lempriere Holdings, an Australian wool trader, and we will watch this development with interest.

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

Yarn Business

The Radford Yarn Technologies operation is a supplier of premium felted woolen yarns to the Cavalier Bremworth broadloom carpet operation and to up-market broadloom carpet and rug manufacturers in North America and Europe. Sales were down on last year and as a result, it made a small loss for the first six months.

In December, Cavalier purchased the remaining 25% of the business.

BUSINESS IMPROVEMENT PLANS

Last year, we embarked on a business improvement plan aimed at optimising capacity utilisation.

It involved:

- The closure of one of our three carpet yarn spinning plants; and
- The consolidation of our New Zealand based warehousing and distribution operations

The cost of this program was recognised in the 2011/12 financial results with an $8.2 million (pre-tax) or $5.9 million (post-tax) cost incurred or provided.

We indicated at the November Annual Meeting of shareholders that we had further business improvement initiatives scheduled for implementation during the 2012/13 year in order to continue to improve the level of efficiencies in our businesses. We are continuing to work on these and will update shareholders as they unfold.

EARNINGS OUTLOOK

The results for the first six months were disappointing and reflected soft demand in both New Zealand and Australia and the high cost of stocks being sold with associated reduced margins.

The directors expect an improvement in the next six months and the latest normalised after tax earnings outlook remains in the $6 to $10 million range as indicated at the Annual Meeting of shareholders in November.

In arriving at this earnings outlook, we anticipate the demand for carpet to lift in New Zealand alongside increased building activity helped by the Christchurch rebuild and a general uplift in real estate turnover, while we expect Australia to remain relatively flat. Now that the high stock value has run its course, we will benefit from increased margins over the next six months. The feedback on our new synthetic carpet range is encouraging and we expect sales of the product before year-end.

There has been significant reduction in headcount in the previous 12 months and the business has been reorganised to operate more efficiently. The reduced costs as a consequence of these will flow through into future earnings.

DIVIDENDS

The first half trading results do not support the payment of a dividend at this stage, and the directors are therefore not recommending an interim dividend payment.

Whilst the company is in a much better financial position with considerably less interest-bearing debt, there needs to be a lift in earnings to justify a payment of a dividend.

If earnings improve as forecast and the outlook remains positive, directors expect to be able to declare a dividend with the announcement of the full year results in August, subject to capital requirements and the cost of any further restructuring.

A M James
Chairman

C A McKenzie
Managing Director

15 February 2013

For more information regarding this announcement, please contact Colin McKenzie on 09 277 1138 or 027 292 4080.