Annual Meeting of Shareholders - 16 November 2012 Managing Director's Address

In my address, I will be covering the following key items:

- Overview of 2011/12 year
- Carpet business
- Wool business
- Yarn business
- Earnings outlook, and
- Strategic planning and future growth

Overview of 2011/12 year

The operating conditions for 2011/12 year were certainly the worst the Group has ever experienced. One business journalist following Cavalier described the year as “annus horribilis” and another as “the perfect storm”.

I don’t want to dwell too much on the 2011/12 year as we cannot change history. I would rather simply provide a summary of performance for 2011/12 and will focus on the implementation of our Business Improvement Plan and the future outlook instead.

Results

The reported Group result for 2011/12 was a tax-paid loss of $1.6 million, compared with $18.2 million profit the previous year.

The operating profit after tax (normalised) for the year was $4.3 million, a decrease of 75% on the $17.3 million (normalised) the previous year. This excludes the impact of the $8.2 million pre-tax ($5.9 million after tax) costs relating to the business restructuring that had to be taken during the year in response to deteriorating trading conditions.

Group revenues were down 5% to $217 million. Revenues coming from our Australian operations accounted for 54% of total revenues, compared with 57% the previous year highlighting the difficult operating environment across the Tasman.

By operation,:

- $179 million of revenue came from carpets, down 12% year on year
- $34 million of revenue came from wool acquisition, up 47% year on year, and
- $4 million from yarn

Financial position

Total assets of the Group as at 30 June 2012 were $201.4 million, a decrease of $14.3 million on the previous year. $10.2 million or 72% of this decrease relates to the reduction in the level of inventory held at balance date as a consequence of the stock reduction programme that was implemented in response to the lower levels of activity.

This had a positive impact on cash flow from operating activities for the year of $8.1 million (up from $4.3 million the previous year).

Shareholders' equity as at 30 June 2012 was $90.9 million - down $8.4 million on the previous year to give a proprietorship ratio (expressed as shareholders' equity over total assets) of 45% compared to 46% the previous year.

Net interest-bearing debt of $66.6 million was virtually unchanged on the $66.3 million the previous year to give a gearing ratio (expressed as debt over equity) of 73% as at 30 June 2012, compared with 67% the previous year.

Carpet business

Our carpet business comprises the broadloom carpet operations, Cavalier Carpets and Norman Ellison Carpets, and the carpet tile operation, Ontera Modular Carpets.

The broadloom carpet operations have been under the most duress largely due to factors totally outside our control. These were:

- The nervousness emanating from the European sovereign debt crisis, coupled with the slowdown in China and general low consumer confidence
- The depressed residential and contract building activity on both sides of the Tasman
- The enormous spike in wool price from June 2010 to December 2011
- The strong NZD and AUD exchange rates favouring imports into New Zealand and Australia while penalising our exports to existing and developing markets
- The disruptions to business and delays in the Christchurch rebuild

We responded by embarking on a major program of restructuring (Business Improvement Plan) in order to realign production capacity with sales demand while continuing to exercise the same restraint on costs. At the same time, we also initiated a stock reduction programme aimed at reducing funds employed and debt.

Business Improvement Plan

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

Aimed at optimising capacity utilisation, it involved;

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

We have further business improvement initiatives scheduled for implementation during the 2012/13 year to continue to improve the level of efficiencies in our businesses.

We also implemented a stock reduction programme which resulted in a significant reduction in inventory from $73.1 million at June 2011 to $62.9 million at June 2012, a $10.2 million reduction or 14%.

We are forecasting further sizable inventory and debt reduction during the remainder of the 2012/13 year.

Wool business

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

Wool acquisition

The 2011/12 year was a challenging year with difficult trading conditions largely caused by the enormous wool price fluctuations. Sales revenue for the year, including those generated within the Group from the sales of wool for own use at Cavalier, was $40.8 million, up just 1% on the previous year.

However, the segment earnings of $0.56 million were down 65% on the prior year.

Wool scouring

Our 50% owned wool scouring business, Cavalier Wool Holdings (CWH), had a strong year although available wool for scouring was down 9.2% on the prior year. During 2011/12, 19.2% of New Zealand wool exports were shipped greasy and just over 50% of total exports went to China.

Sheep numbers seem to have stabilised around 32 million and we are anticipating the 2012/13 wool clip to be a similar size as last year.

Our share of tax-paid earnings was $3.3 million, a 50% increase on the $2.2 million the previous year.

CWH's plans to further consolidate the New Zealand woolscouring industry have been well publicised.

Lempriere, an Australian based wool exporter, has entered into a pre-bid lock up agreement with the major shareholders and management for 75% of the shares in New Zealand Wool Services

International (WSI).

Lempriere said, in its takeover notice, that it is aware of CWH's interest in the WSI scours but at this stage has no intention of selling the scours. It also said that it intends completing a full strategic review of the business.

It is early days and Lempriere still has to get Overseas Investment Office approval, and the WSI Board has to obtain an independent valuation and recommend the takeover.

We believe consolidation of onshore woolscouring capacity is still the right move for the overall industry.

Yarn business

Radford Yarn (RYT) is our specialist felted yarn manufacturer.

Yarns from RYT are destined for the luxury end of the carpet market in Australasia, North America, North Asia and Western Europe. The conditions in these markets have not helped its performance in the past year.

With approximately half of RYT's production consumed by the Cavalier Bremworth broadloom carpet business, its success is also very much linked to the success of Cavalier Bremworth.

RYT and its felted yarns will continue to underpin Cavalier Bremworth's differentiation strategy in the high-end of the residential Australasian and rest of world markets.

Earnings outlook

We have previously indicated a turnaround in earnings to $10 to $12 million profit after tax for the 2012/13 year. This is based on the benefits generated from the implementation of our business improvement plans, gains from lower wool prices and a modest improvement in market conditions.

I am afraid we have had a slow start to the new financial year which is disappointing given all the changes we have implemented and the expectation that the worst was finally behind us.

The main shortfall came from carpet sales in Australia. We were predicting that the Australian market had suffered a temporary setback, and that we would experience gradually improving conditions throughout the year – unfortunately there was no improvement during the first quarter. We are now expecting to see improved business performance from both our Australian broadloom and tile businesses in quarters three and four - largely due to customer and product portfolio initiatives rather than market expansion.

Conversely, carpet sales in New Zealand and rest of world have held up reasonably well and we are predicting a further lift in the second half of the year. It is particularly pleasing to see new customers and sustainable growth with high-end residential sales in rest of world markets.

The woolscouring business has started the year strongly with better than anticipated volumes and margins. We believe wool prices, sheep numbers and wool production have now plateaued providing a more stable operating environment for the wool acquisition and wool scouring operations.

Given the slow start for quarter one and little or no improvement in Australian market activity, our previous earnings indication of $10 to $12 million is looking to be a bit of a stretch. Our earnings are difficult to predict in this uncertain environment because they are so sensitive to carpet sales volumes. The best guidance we can offer at this stage is for normalised earnings between $6 and $10 million tax-paid.

Strategic planning and future growth

I want to assure shareholders that the sun is certainly not setting on Cavalier. We know the landscape has changed substantially. Continual cost cutting is simply not sustainable so we are compelled to reinvent ourselves to some degree. But we also need to remind ourselves that we are probably at the trough of what has been the most severe contraction phase in the building cycle.

We are in the process of finalising the 2013-15 strategic plans for our main operations. We have had a cold hard look in the mirror and developed robust plans and initiatives that we will be implementing over the next six months to 12 months.

In conclusion, the message I would like to leave you with is that we have endured the worst operating conditions the Company has ever experienced. We have faced up to unprecedented changes in the marketplace, and we are well-advanced in repositioning our broadloom business in terms of cost base, capacity, structure, product portfolio, channels and markets.

Our tile and woolscouring businesses are in good shape and just need to be well managed and supported.

I take this opportunity to thank all our shareholders for their loyalty and patience in these difficult times.

We have robust plans for the future, we believe the worst is now behind us, and we will resume paying dividends as soon as we are able to.

Finally, I would like to thank all our staff for their on-going contribution and unwavering commitment in what has been a very difficult year.

Ladies and gentlemen, that concludes my presentation.

Thank you.

Colin McKenzie
Managing Director