CAVALIER
CORPORATION

Director's Report for the year ended 30 June 2012

Financial Performance

The Directors of Cavalier Corporation report an audited tax paid loss for the year to 30 June 2012 of $1.6 million, compared with $18.2 million profit the previous year.

Excluding 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, 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.

The Directors advised in April 2012 that they were expecting normalised earnings for the year ended 30 June 2012 to be in the range of $3 to $5 million after tax, with restructuring costs having the effect
of reducing these normalised earnings to a loss of $1 to $3 million after tax.

The final results as announced are therefore within the earnings guidance ranges previously provided.

FINANCIAL PERFORMANCE **Year ended 30 June 2012** **Audited**	**2012** **$000s**	**2011** **$000s**	**Change**
Revenue	217,198	229,373	(5%)
Earnings before interest and tax (Normalised) [1]	5,540	25,601	(78%)
Interest	(4,049)	(3,545)	14%
Share of profit of equity-accounted investee (tax-paid) [2]	3,302	2,039	62%
Profit before tax	4,793	24,095	(80%)
Income tax [2]	(510)	(6,829)	(93%)
Profit after tax (Normalised)	4,283	17,266	(75%)
Restructuring costs (net of tax)	(5,916)	0	
Deferred tax adjustments following non-deductibility of depreciation on buildings on Group's earnings and on Group's share of equity-accounted investee's earnings	0	914	
Profit/(Loss) after tax (Reported)	(1,633)	18,180	(109%)
Earnings per share (cents) (Normalised)	6.3	25.4	(75%)
[1] 2012 excluding restructuring costs of $8.2 million			
[2] 2011 before the restatement of deferred tax following the changes to tax law on depreciation of buildings as announced by the Government in its 2010 budget			

Group revenue for the year was $217 million, a decrease of 5% on the previous year, with 54% of revenue coming from our Australian operations.

The 75% decrease in normalised earnings was the result of very soft market conditions for our carpet business on both sides of the Tasman, with both volumes and margins under pressure.

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. $10.3 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.

Shareholders' equity as at 30 June 2012 was $90.9 million - down $8.4 million on the previous year.

Net interest-bearing debt of $66.6 million, while virtually unchanged on the $66.3 million the previous year, was down $11.5 million on the $78.1 million at 31 December 2011.

Gearing ratio (expressed as debt over equity) was 73% as at 30 June 2012, compared with 67% the previous year, as a consequence of the reduction in shareholders' equity during the year.

Segment Reviews

Carpet Business

Our carpet business comprises broadloom carpets and carpet tiles, with New Zealand and Australia as its main markets.

Revenue for the year was $179 million, down 12% on the previous year.

Segment results before restructuring costs for carpets were $6.2 million, down 76% on the previous year.

As a result, segment earnings as a percentage of revenue deteriorated to 3.5%, down from 12.8% the previous year. Lower volumes brought about by the very competitive operating environment and the increased costs which we were not able to fully recover impacted adversely on the results.

Business improvement plan

In April 2012, we signalled that our earnings would be affected by substantial restructuring costs as we repositioned the broadloom carpet business to cope with the difficult operating environment.

We also indicated at the time that the impact of the restructuring would be difficult to project because of uncertainties as to timing.

We did, in the event, implement two significant initiatives before balance date, the first relating to the closure of one of our three spinning mills that was announced on 27 June and the second relating to the consolidation of our two New Zealand based warehousing and distribution operations. These were on top of others taken earlier in the 2011-12 year to realign production capacity with reduced sales demand.

It is these initiatives that have given rise to the $5.9 million tax paid restructuring costs that have impacted on the 2011-12 results. However, they will result in a significant reduction in operating costs for the broadloom carpet business and are an integral part of the comprehensive business improvement plan aimed at turning around the decline in earnings of the last 12 months.

<u>New Zealand market</u>

Market conditions in New Zealand for both residential and commercial carpets were extremely soft throughout the year. We were expecting market conditions to improve in the second half, but if anything they deteriorated further. We are now not expecting to see any real improvement in operating conditions until the second half of the 2012-13 year.

<u>Australian market</u>

The nervousness emanating from the European sovereign debt crisis, coupled with the slowdown in China and general low consumer confidence meant that we fared no better in the Australian market.

However, we view the situation in the Australian market as short term, and we are forecasting market conditions to gradually improve throughout 2012-13.

<u>Wool prices</u>

The 80% increase in wool prices during the 2010-11 season, which we were not able to fully recover through pricing as a result of the depressed market conditions on both sides of the Tasman, meant that margins of our woollen broadloom carpet business were under severe pressure.

While wool prices have declined significantly since the peak reached in December 2011 and are now back at those levels prevailing before the 2010-11 season, it will take at least another four months before we would start to experience the benefits of lower wool prices in the cost of goods sold.

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

As a result of the difficult trading environment, our wool acquisition operation had a challenging year as well, with segment earnings of $0.6 million, down 65% on the previous year.

Revenue for the year of $40.8 million was up very slightly on the $40.4 million the previous year, but this was more a function of the higher wool prices prevailing during the year. The volume of wool bought and sold was actually slightly down on the previous year in sympathy with the difficult conditions encountered.

Wool scouring

Cavalier's share of the tax-paid earnings of CWH for the year ended 30 June 2012 is $3.3 million, a 50% increase on the $2.2 million the previous year.

CWH performed extremely well under trying conditions to finish the year with earnings well up on the previous year.

Yarn Business

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

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.

However, it is well positioned to capitalise on the initiatives that have been put in place when market conditions improve.

OUTLOOK

Operating conditions for 2011-12 were certainly the worst the Group has ever experienced. Virtually every variable within our businesses worked against us, with many of these totally outside our control. There included:

- the GFC and European sovereign debt crisis and the flow on of these into our markets overseas and here in New Zealand;
- the 80% spike in wool prices in the preceding 2010-11 season;
- the depressed residential and contract building activity on both sides of the Tasman;
- the strong NZD and AUD exchange rates favouring imports into New Zealand and Australia while penalising our exports into some of our long-standing markets in North America, Europe and Asia; and
- the disruptions to business in Christchurch followed by the delays to its rebuilding programme.

As a result, we embarked upon a major programme of restructuring 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.

Looking forward to the new financial year, we see the first half remaining tough in New Zealand. However, we can see some upside in the second half as demand from new home building and real-estate related refurbishment work improves.

As for Australia, we believe that the market has suffered a temporary setback, and we are predicting gradually improving conditions there. Both our residential and commercial carpet businesses are well positioned to take advantage of that market uplift.

Wool prices have retraced to pre-June 2010 levels, and supply and demand for wool should now stabilise at this new equilibrium giving wool merchants and exporters renewed confidence to trade wool in meaningful quantities. Sheep numbers and wool production should also stabilise at current levels. All these would not only provide for a more stable operating environment for the wool acquisition and wool scouring operations, but also see the Group’s woollen carpet business better positioned with the lower wool price that would eventually flow through to earnings in the second half and beyond.

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.

The Directors will provide shareholders with an update at the Annual Meeting of shareholders in November.

DIVIDENDS

As previously advised, the Company will not be paying a final dividend for the year ended 30 June 2012.

For and on behalf of the Board of Directors

Colin McKenzie

Managing Director

20 August 2012