Cavalier Corporation Ltd

7 Grayson Avenue, Papatoetoe, PO Box 97040, Manukau City, Manukau 2241, New Zealand
Phone 64-9-277 6000 Fax 64-9-279 4756

MANAGING DIRECTOR'S ADDRESS – 18 NOVEMBER 2011 ANNUAL MEETING OF SHAREHOLDERS

Thank you, Alan, and good morning everyone.

My overview this morning of the 2010/11 year will be brief on the basis that you have already read our annual report. These are available at the desk by the entrance should you require additional copies.

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

- Overview of 2010/11 year
- Carpet business
- Wool business
- Radford Yarns
- Wool scouring, and
- Earnings outlook

Overview of 2010/11 year

The 2010/11 year was a difficult, but satisfying one for the company.

It was difficult because of the very challenging market conditions that were encountered. And it was satisfying because we were able to not only hold last year's earnings despite these conditions, but lift them by 4% to be at the top end of our earnings outlook range.

Group revenues were also up 4% to $229 million, with strong performances by our Australian operations which accounted for 57% of total revenues, compared with 54% the previous year.

By operation:

- $204 million of revenue came from carpets, up 3% year on year, and
- $25 million of revenue came from wool buying, up 9% year on year.

Carpet business

We saw strong performances in Australia, with sales revenue 9% ahead of previous year. This would have been greater had it not been for the marked slow-down in the second half of the year due to concerns over the European debt crisis and the weak equity markets that followed.

In contrast, we performed relatively poorly in NZ with sales revenue down 10% on previous year. The state of the NZ housing market was very much in the doldrums all of the year, with building activity at record lows despite the attraction of low interest rates. Added to this was Christchurch at a virtual standstill. Normally, we would expect 10% of our NZ sales to come from this region.

We also saw a significant improvement in carpet earnings for the year:

- EBIT was $26.2 million, a 16% increase year on year, and
- EBIT margin on sales was 12.8%, an increase of 1.5 percentage points on the previous year's 11.3%

<u>Wool prices</u>

During the 2010/11 year, we saw the price of wool increased by 80% making it the largest increase in a year. In response to this, we had to increase carpet prices by 10 to 20%.

So where does this now leave wool carpets?

Unfortunately, at a large price disadvantage to carpet made from man-made fibres. If wool prices remain where they are, demand for wool carpets at the lower-end of the market will be harmed. But we do not believe this will be the case in the higher-quality-end of the market, where our brands stand out.

For instance, a 36oz wool carpet, which is a typical weight in the lower-end of the market, currently retails at a 15% price premium over its equivalent in weight in nylon. Compared to a year ago, this premium was just 2%. Hence, the price differential has widened in favour of nylon.

In our opinion, wool prices at their current levels are not sustainable, certainly in the Australasian markets where we operate.

Whilst Cavalier Carpets will do its utmost to support wool as a fibre, the company is an increasingly active participant in synthetic carpets largely through its sister company, Norman Ellison Carpets, which is adept to making carpet using all types of man-made fibres as well as wool and wool blends.

Wool buying business

The 2010/11 year was an excellent one for our wool buying business. It benefited from the strong demand for quality wool.

Sales revenue for the year, including those generated within the Group from the sales of wool for own use at Cavalier, was $40.4 million, up 41% on the previous year. However, the volume of wool sold was down 12%, implying an average increase of 60% in wool prices which is the largest increase we have seen in a given year.

The earnings (EBIT) achieved of $1.6 million for the year was an excellent performance by the operation and a great credit to the small and dedicated team there.

Radford Yarns

As previously announced to the market, Cavalier acquired a 75% interest in Radford Yarns in April 2011. We see this as a strategic investment for our premium branded products where the use of felted yarns from Radford provides the up-market product style that no other carpet manufacturer can duplicate. Plans are already well underway to introduce a greater number of these products into our premium brands.

Wool scouring

Our 50% owned wool scouring business, Cavalier Wool Holdings (CWH), had a quiet finish to the year.

Sales revenue for the 2010/11 year was $41.6 million, down 18% on the previous year.

Earnings were also down as a consequence of the lower volumes.

During the year, CWH obtained approval from the Commerce Commission to acquire the scouring assets of Wool Services International (WSI) in order to further rationalise the scouring industry. This decision is currently being appealed by Godfrey Hirst in the High Court.

CWH's single focus is to make its scouring operation as efficient as possible so that it can continue to support the wool industry with its outstanding quality of scouring and to deliver excellent customer service. With the current scouring capacity in the industry, there is sufficient redundancy to leave CWH inefficient and uncompetitive as compared to the Chinese scours which have decimated the Australian scouring industry.

Rationalisation in the scouring industry has been an essential and on-going process for decades in the face of sheep numbers reducing from 70 million in 1983 to 32 million today. CWH has been involved with a number of these over the last 10 years with closures of the E Lichtenstein, Seaview, Winchester, Fairlie and, more recently, Godfrey Hirst scours.

It just so happens that the next round of rationalisation, which will see the combining of the WSI and CWH scours, will be the final one and will leave CWH as the sole operator in the industry. The trade can take comfort that whilst it appears on paper to be a monopoly, it will not be in practice. Why? Simply the market will not allow CWH to behave as such. The Chinese scours that currently scour over 21% of our wool exports will keep CWH honest in this regard. Also, there are a number of existing wool exporters with the ability to set up their own scours should CWH misbehave or fail to live up to its customers' expectations.

We are aware that a certain party who is also vying for the WSI scours has stated that the combining of the WSI and CWH scours will result in a $2/kg fall in wool prices for farmers. This is an absurd statement to make and is completely without logic or foundation. How a serious and committed provider of scouring services can have anything to do with damaging wool prices is beyond one's belief. The fact is that scouring charges account for only around 5% of the price of scoured wool which is not a significant component of costs.

Yes, it is true that CWH has no interest in wool trading because this does not fit its business model of being a service provider to all those involved in the wool trading business. But CWH has every commercial interest to make sure that the wool trading operation of WSI is sold as a going concern and not be just closed and dismantled – the Commerce Commission is well aware of the importance of this point.

Earnings outlook

I am afraid we have had a rather poor start to the new financial year which is disappointing given the good performance of the previous year.

Our carpet sales volumes for the first four months of the year are down 18% which is a slight improvement on what we advised the NZX last month when we said volumes were down 20% after the first quarter.

There are a number of underlying reasons behind this, all of which were market related and beyond our control.

The first was the sharp fall in business and consumer confidence as the European debt crisis unfolded. As a result, we saw the deferral of many commercial refurbishment projects which explains a 24% volume shortfall in our carpet tile business over the last four months.

The second was the continuation of the soft market conditions for our residential carpets. In Australia, this was due to a slowing domestic economy, even though the mining industry there continues to do well. In NZ, the level of building activity remains at near historic lows along with the inactivity of the Christchurch region.

And the third reason was the widening pricing advantage of synthetic carpets over wool due to an 80% plus lift in wool prices over the last year. This is hurting woollen carpet sales at the budget end of the market where buyers are less discerning, but demand for wool at the premium end of the market still remains strong.

Our outlook for the 2011/12 year is for tax-paid earnings to be in the range of $8.5 million to $10.5 million which is a 40% to 50% shortfall on the previous year's earnings of $17.3 million. This is a substantial shortfall on the previous year, but it is largely down to the poor start to the year. This outlook is based on a gradual improving of market conditions for the remainder of the year, and we are seeing some glimmers of this in the commercial segment.

We want to assure shareholders that we are responding to the challenges before us in a proactive way and are doing our utmost to protect earnings where we can. We have recently downsized capacity at all our carpet plants to be more in line with sales. Also, we have initiatives in place to grow sales in other market segments, reduce working capital and closely manage all costs. We went through a similar exercise three years ago at the time of the GFC.

We want to also assure shareholders that the company is well-managed and well-resourced to confront the current difficult times ahead.

Despite the disappointing 2011/12 earnings outlook, there will be a number of positives for us in the following 2012/13 year. One of these will be the boost to confidence from the latest interest rate cut by the Reserve Bank Australia with the prospect that more could follow. The eventual outcome of this will be a stronger domestic economy, an increase in business and consumer confidence and improved affordability and availability of housing. All these will benefit our carpet business in Australia.

Another positive will be the Christchurch re-build which should be well underway by the 2012/13 year.

At the same time, we expect that there will be more wool for our scours as farmers should be financially incentivised by current wool prices to lift sheep numbers and wool production.

The company is well placed to take advantage of an upturn when it occurs – we believe, given the positives as outlined, that we could see this in our following 2012/13 year.

Ladies and gentlemen, that concludes my presentation.

Thank you.

Wayne Chung
Managing Director

For more information regarding this address, please contact Wayne Chung on 09 277 6000 or 021 772 277.