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Directors' Report

Preliminary announcement of results for year ended 30 June 2017

YEAR OF SIGNIFICANT TRANSITION FOR CAVALIER - RESTRUCTURING AND STABILISING PRODUCTION

Cavalier has released its financial statements for the year ended 30 June 2017, reporting a net loss after tax of $2.1 million.

The normalised net loss after tax of $1.9 million is consistent with the guidance given to the market on 1st June 2017. This is a non-GAAP measure which excludes one-off items.

This result reflects the significant manufacturing restructuring undertaken in the last twelve months, with rationalisation and plant consolidation between Christchurch, Wanganui and Napier. This extensive programme of investment and change saw major operational and production challenges that adversely affected sales and expenditure in the period.

Notwithstanding that, good progress was made in bedding down a number of critical work programmes relating to the restructuring and, as production and efficiency improves, there are good indications that the benefit will be seen and realised going forward.

The result is that Cavalier has now consolidated woollen spinning into Napier, with considerable efficiency gains possible, and relocated felted yarn manufacture to Wanganui, allowing for growth.

Results Summary

Year ended 30 June	**FY17 $000s**	FY16 $000s
Revenue	**$156,120**	$190,371
EBITDA	**(2,232)**	9,897
EBITDA (Normalised)	**2,572**	12,275
Net profit/(loss) after tax	**(2,124)**	3,115
Net profit/(loss) after tax (Normalised)	**(1,856)**	6,313
Bank debt	**41,500**	37,700
Capital investment	**2,123**	2,076

Revenue has fallen $34 million, including $7 million due to the sale of a loss making business in FY16, $15 million in Elco Direct and $9 million in our Australian carpet business.

The dramatic drop in wool price, caused by reduced demand from China, affected our wool buying business Elco Direct, with farmers and traders holding on to wool and waiting for prices to lift, rather than selling at current low prices and incurring the cost of scouring.

Australian sales have been impacted by the spinning consolidation and a softening in the market, particularly in the second half of the year.

EBITDA has fallen by $12 million. This was mainly as a result of the fall in Australian sales, a higher average wool price coming through in stock produced in the previous year impacting margin and a significant marketing investment to successfully refresh the Cavalier Bremworth brand.

The profitability of scouring has also been hit hard in FY17, due to the recent collapse of the wool market. Our share of Cavalier Wool Holdings earnings fell by $2.2 million.

Bank debt has increased by $3.8 million in FY17.

A number of one-off items impacted the reported result, including production rationalisation, a non-cash gain from the consolidation of our interests in wool scouring, offset by merger transaction costs and a non-cash write-back of plant and equipment. A full reconciliation is included in the financial statements.

Production Rationalisation

Following the improved FY16 performance there was a solid foundation which provided the resources required to undertake the manufacturing rationalisation to right size Cavalier's productive capacity. This included the consolidation of woollen spinning operations from Wanganui to Napier.

Meanwhile Cavalier's proprietary woollen felted production, initially manufactured in Christchurch, was struggling to meet increasing demand particularly from the Australian market. The felted yarn facility was relocated to Wanganui, to realise efficiencies and to provide a larger operational footprint. This will allow us to meet the increasing demand for this successful felted product.

While the decision to consolidate was necessary, it proved to be more costly than estimated and the move took longer to implement. Redundancy and plant relocation expenses were in-line with expectations, but the inefficiencies and disruption inherent in a major rationalisation took longer to be eliminated, affecting sales and giving rise to the one-off item reported.

The rationalisation regrettably impacted production of woollen ranges and therefore the company's ability to meet our customers' demand and our sales targets. This was particularly apparent in the Australian market where we sell a higher proportion of woollen carpets.

Banking and Covenants

Following the year end, Cavalier's banking facility has been renegotiated and we have a new facility in place for 18 months. This facility has covenants based on forecasts which Management and Directors have endorsed. The covenants have a degree of headroom should conditions soften resulting in Cavalier not meeting these forecasts.

Based on the performance of the business in FY17, where forecasts were not met due to the issues discussed above, the risk of this happening again needs to be noted. If that was to occur Cavalier may not be able to meet its banking covenants. More detailed commentary is provided in note 2 of the financial statements under the heading "Going concern".

Outlook for FY18 and Beyond

Whilst the consolidation of our manufacturing operations has cost us more and taken longer than anticipated, this is now largely behind us.

We can now move forward with a reduced cost base and an improving productive capacity, with gains expected in coming months. The capacity of our relocated felting operation is increasing and will result in our carpet business being able to meet the growing demand for these innovative new ranges.

In addition to the major restructuring undertaken in FY17 there have been a number of initiatives and macro factors that should positively impact the business going forward. Some will be seen in FY18 and others in FY19 onwards due to the delay between product development, manufacturing and the final sale of goods, up to six months in some cases.

While the recent and sudden plunge in the wool price had a negative impact on Cavalier this year, with reduced volumes through our wool buying and scouring businesses, the drop in wool price will have a positive impact in our core business of manufacturing and selling woollen carpets.

Our Australian business in particular is dominated by wool which makes up 60% of our sales there. As this lower cost wool moves through the production cycle it will positively impact and improve manufacturing margin.

While negatively impacting export receipts, the strength of the NZ dollar is helping with the importation of synthetic yarns which is a growing part of our production, especially for the New Zealand market. This, along with sourcing raw materials from alternative more competitive suppliers, is not only spreading our supplier risk, but will reduce manufacturing costs making us more competitive.

Our carpet business introduced new products early in the financial year. Woollen and felted carpet sales were subsequently affected by production constraints arising from the consolidation. However, we have recently started to gain traction and are seeing a steady lift in sales of these new products.

We will continue to innovate with on-going product development and range refreshment, a hallmark of the Cavalier Bremworth brand building on recent successes with new ranges launched.

Dividend

Considerable effort has gone into right sizing our production base and positioning the company for growth, but we have not yet reached the desired debt level relative to forecast performance.

For the next 12 months capital expenditure will be kept to a minimum and there are actions in place to reduce inventory holdings. The expected outcome of this focus is to reduce debt which will ultimately provide us greater flexibility in the future. The prospect of dividends is one which the directors regularly review, however, given the FY17 performance, Cavalier is not in a position to pay a dividend.

Paul Alston

Chief Executive Officer

For and on behalf of the Board of Directors

23 August 2017

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