CAVALIER
CORPORATION

CHIEF EXECUTIVE OFFICER'S ADDRESS – 31 OCTOBER 2017 ANNUAL MEETING OF SHAREHOLDERS

Operations

To state the obvious it has been a tough year for Cavalier. There's no shirking from the fact that we aren't yet where we'd like to be, or indeed where we said we'd be this time last year.

For that I apologise.

I will outline the reasons for this but most importantly I will look at where we are now headed.

While the full year result was well down on expectations, the business did achieve much in FY 2017 and it is my sincere belief that we are now on a strong course to recovery, based on the work we have done and also the opportunities and market conditions before us.

- We did underestimate the impact of combining and recommissioning three significant production facilities which involved extensive retraining of new and existing staff at both sites.
- The physical logistics of relocation was achieved on plan and within budget but the process of getting both plants up to capacity proved challenging. The end result is that we are now producing the required volumes out of the plants and efficiency is improving. This had an impact on sales volumes, increasing order lead times and we had to work closely with our customers to manage expectations
- This was combined with the largest single drop in wool price in many years which affected both our scouring and wool buying operations.
- All of these challenges hit us in a perfect storm. However, as of today these are largely behind us and we are fine tuning the plants to achieve optimum efficiency and filling current and back orders. The last of the equipment moved at the end of September and we are now focused on realising efficiency targets. Our customers have remained supportive and there is still strong demand for our products on both sides of the Tasman

So let us review the 2017 result in more detail.

Today Cavalier Corporation comprises:

- Our broadloom carpet business – including carpets sold under the Cavalier Bremworth and NEC brands, the Elco Direct wool procurement business and a 27.5% interest in wool scouring business Cavalier Wool Holdings.

These FY17 results are presented in our Annual Report and let's go through the headline points.

Revenue

Revenue reduced by $34m in FY17, around half, $15m can be attributed to the collapse of the wool market and another $7.0m due to the Ontera business we sold in 2016.

Our Australian carpet sales were down $9m, impacted by a softening in that market throughout 2017, and in the second half by the consolidation of our spinning operations causing supply issues felt more heavily in Australia where we sell more wool carpet. I will address the consolidation challenges in more detail shortly however we do see the supply side for Australia improving this financial year.

Profit

Our Normalised Net Profit after Tax dropped year-on-year. This is largely due to the following:

1) In 2017 higher than average wool price flowed through as raw materials to the carpet business. There is always a lag of flow through of the wool price into carpet production and the current low wool price will have the reverse effect in 2018 and 2019.

2) The reduction in Australian sales already referred to.

3) Essential marketing investment to protect and enhance the Group's core consumer property - the Cavalier Bremworth brand.

4) And finally, reduced profits from wool scouring due to the recent collapse of the wool market and farmers choosing to hold on to wool waiting for a price lift – as a consequence our share of wool scouring profits fell by $2.2m this year.

Our reported profit came in very close to the normalised result. There were two large offsets in abnormal items, being an accounting gain on the merger of wool scouring and abnormal spinning consolidation losses.

Net debt

Net debt has increased by $3.8m or 10.0% from last year reflecting the essential investments we made in manufacturing and in brand marketing. Note much of these costs are one off items such as redundancies and plant relocation. We had planned on reducing net debt overall by generating operating cash flows to more than cover these investments, but this didn't happen in 2017.

Inventory

Inventory dropped as a result of exiting Ontera in early 2017 and not having working capital tied up in tile stock. Pleasingly there has also been a reduction in aged stock across the carpet business which will be a continued focus for 2018.

I stood here last year and I explained that while we'd reduced debt successfully in 2016 we did need to continue to reinvest back into the business to ensure its long term survival. And that is what we have done – granted we have had some challenges but the foundations have been laid:

Spinning consolidation

The spinning consolidation started in the early part of the year where we moved the Christchurch felting plant to Wanganui. Christchurch had capacity constraints and could not produce the required volume in a growing segment of the market, whereas Wanganui has room for growth. We consolidated our yarn spinning operations in Napier to eliminate excess capacity and reduce fixed overheads.

While the redundancy and relocation costs were in line with expectations we underestimated the disruptions caused and the flow on effect to the rest of the business. In particular we underestimated the difficulty of getting over 50 new staff and a combined team of 150 up to speed with the new configuration and output requirements.

In short, while the decision to consolidate manufacturing was the right one, it has cost us more in operating inefficiency and taken longer to implement than expected.

This impacted yarn volumes which in turn impacted the supply of finished goods which impacted sales – particularly for the Australian market.

We are now producing close to the budgeted volumes from the Napier and Wanganui plants that we had planned to achieve some months ago. The production team is focused on the task ahead and is working hard to realise the planned savings.

While there is still work to be done to achieve the full efficiency we are targeting, we are making good progress. The end result will be we have less people producing the same or more volume with reduced fixed overheads.

Health & Safety

The safety of our workers is extremely important and being a manufacturer using large machinery with many moving parts requires risk to be managed. As part of a programme to enhance our health and safety processes, we commissioned an independent review of all operations and as a result increased targeted H&S capex and opex spending to ensure that all our people go "safe home every day".

Marketing

The Cavalier Bremworth brand is one of this organisation's most valuable assets. It speaks of New Zealand quality and innovation and of the value that Grant Biel and Tony Timpson poured into its creation.

However, our research has told us that, while we were still the most recognized and trusted carpet brand, we are losing ground with customers and retailers alike.

Essentially we weren't investing enough in the brand and its products to maintain its pedigree or heritage, let alone enhance or develop it.

We therefore developed the Cavalier Bremworth World of Difference positioning and invested in innovating and reinvigorating the brand.

As a result we've had overwhelmingly positive feedback from our end user customers – they are engaging with us online and actively seeking our products out in retail stores.

With the new brand platform established, our marketing focus in 2018 will be more trade related to continue to improve the customer in-store experience and assist in the sale process. This will be on top of our base layer of activity to maintain the strength of the brand.

We are delighted that yet again Cavalier Bremworth was voted Most Trusted Carpet Brand in the Annual Reader's Digest Survey.

New products

Product development is an important key contributor to the Cavalier Bremworth brand and overall success of our company. We were traditionally seen as innovators and it's an essential investment we must maintain to keep our brand and range relevant and fresh.

To meet the market and diversify we introduced Cavalier Bremworth Solution Dyed Nylon carpets in 2013 and as you may recall, our recycled fish net product Siren, which we introduced in 2017 has performed well.

Like all companies Cavalier must learn from its mistakes. We were the last manufacturer to introduce synthetic carpets and lost market share as retailers moved unexpectedly quickly to imported carpets at prices which proved attractive to consumers. Décor is all about being on trend and we need to always be one step ahead. The reality is, that while expensive, investment in product development is crucial to Cavalier's future.

Since the last AGM we have launched new products, both wool and synthetic, with a couple of particularly exciting ones on display today.

Samurai is a great example of how innovation in product development can really drive sales. This recently launched luxurious chunky woollen spun loop pile is already in hot demand, particularly in Australia. Last month it was one of our best-selling Cavalier Bremworth woollen products despite only being in the market for a couple of months. We are expecting big things from Samurai.

Katachi is a unique felted product with six strands that join together to form a loop. It's part of our high-end Bremworth Collection that we expect to perform well. Feedback to date is very positive.

It has been some time since we added new products to our Bremworth Collection so again we are expecting good things with more to come in 2018.

What we are doing this year?

2017 year was a year of investment - we had reduced our debt so that we could afford the necessary restructuring to right size the business, introduce new innovative products and invest in revitalising our brand and in-store presence.

Notwithstanding the manufacturing implementation problems of the last few months, our direction of travel has not changed.

The last three years have been changing and challenging ones for Cavalier, for our business, for our people and for you our shareholders.

The reality is that this business had to transform and must continue to transform in order to thrive. We have done much, although not all of the benefits of the hard work undertaken can be seen yet. It is time to take stock and give management and our people the opportunity and time to settle things down and focus on delivering on our promise.

Manufacturing efficiencies

The consolidation of the spinning plants is now complete and the large restructuring costs behind us. The plants are now consistently producing at the volumes required with further efficiency yet to be realised.

There is still more work to do in this area but there are steady improvements and the cost savings will progressively come. Unfortunately there is a long lag between producing the yarn and the final selling of product so any efficiency gains we achieve will take time to materialise.

The focus of front line production management this year is on fine tuning and improving the current configuration and managing our teams to achieve greater productivity.

Inventory reduction

While inventory reduced from last year we still have too much working capital tied up in inventory and there will be a big push to reduce stock and operate on a leaner base.

New product development

As mentioned earlier we have introduced new products during the year and we have more innovation planned for 2018. Our dual wool and Solution Dyed Nylon strategy will continue to cater for market needs. Product development and staying true to our values around quality and innovation are essential for the long term prosperity of the company and its shareholders.

Further manufacturing costs savings

To keep our carpets competitive in the market, our team continuously reviews all aspects of our manufacturing process to find further ways of reducing our costs. This work has been ongoing for the past year and we have a number of initiatives we are about to implement that will further reduce the cost to manufacture and enable us to compete more aggressively.

Reduction in bank debt

Now that the cost of the manufacturing consolidation is behind us we will work solidly to reduce debt. This will be an outcome of reducing inventory, having a lower cost of raw materials (especially wool) flowing through to cash flow and having a lean capital spend year. This will ultimately enable us to expand and grow the business.

In summary,

The work and challenges we faced in FY2017 are what will form the basis of our future success. We have invested in significant restructuring costs and increased marketing spend. The spinning consolidation took longer to implement and cost us more than expected but was necessary to enable the company to successfully move forward.

We see the performance of the business steadily improving in FY18 with even greater positive impacts being realised in FY19.

- The carpet business will benefit significantly from the current lower wool price.
- Our manufacturing efficiencies will be realised.
- We see more and more opportunity for our unique felted products as our increased capacity in Whanganui comes into play.
- Our newly introduced products are already performing well.
- And finally we will remain focused on cost reduction.

While the significant plant manufacturing rationalisation is mostly behind us we are carefully assessing all our non-core carpet assets and activities with a view to ensure we have the optimum operating structure going forward.

A note to our people

Structural changes to the business have impacted our people significantly – both for those that left the company and those that remain or were newly employed.

Without good people we would not have been able to undertake the changes we have introduced and I acknowledge all of those who have gone well beyond the call of duty to help make the consolidation work.

Our staff remain hugely passionate about the wonderful products they produce and the work they do – in that regard we must invest in them and enhance our culture to retain this engagement - we will not be successful without people who believe in what we do.

I am constantly being told by our customers that we have the best people and product in the market. This is a fantastic platform to be working from.

The rest will come down to good business, and as I've outlined today, we have invested heavily to try and get that last part right so we can see increased sales and profitability for shareholders in years to come.

To Finish

The political climate has changed considerably in the last few weeks and there has been much uncertainty leading up to the election. We have a great story and for us…

- We have a new government in place and we welcome a new focus on NZ jobs and retaining NZ expertise as well as the focus that "Made in NZ" by New Zealanders is important.

- While we are generally thought of as an Auckland-based company, we have strong, proud and long connections with regional New Zealand – some dating back to the very early days of the Company. This year, we bring up 50 years of operation in Napier and our involvement with Wanganui dates back to the mid-1970's.

- Through Elco Direct, our wool acquisition business, we also have operations in several regional towns – Cambridge, Taumarunui, Raetihi, Taihape and Stratford. And, of course, the wool scours based in Hawkes Bay and Timaru.

- Almost half of the Group's 500 employees are based in regional New Zealand – where we have been, and continue to be, a strong employer in addition to our role as a significant manufacturer in Auckland.

- We are therefore heartened to see the Government's focus on creating more jobs for New Zealanders by supporting Kiwi-made whenever possible and the significant investment being earmarked for regional development in order to unlock the economic potential of the regions.

I welcome the opportunity to put quality New Zealand made carpets in all government controlled entities.

Thank you

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CHAIRMAN'S ADDRESS – 31 OCTOBER 2017 ANNUAL MEETING OF SHAREHOLDERS

Review of FY17

As Paul has outlined, during the last year we have completed the spinning consolidation, a very significant undertaking.

Disruption during the process affected our ability to deliver what our customers wanted in an already difficult market and we did not deliver a profit, but we are now looking forward to achieve production efficiencies and realise the benefits in our gross margin. To reiterate, the consolidation was the right thing to do and absolutely necessary to support a successful future for Cavalier.

Paul has talked about some of key operational matters and it is appropriate for me to further discuss the funding position of the company.

During the year, the Group had financial covenants with the bank that required us to meet, amongst other matters, certain equity ratio, EBITDA, revenue and inventory targets. At no point has the Group been in breach of our financial covenants, instead we were able to work through a renegotiation process with the bank which better reflected the operating conditions we were faced with. We have been pleased to receive significant support from the BNZ to continue our transformation, and we thank them for their understanding and support as we worked through 2017.

Following the financial year end, the facility and covenants have been reset for the following 18 months. Underpinning our ability to meet these covenants is a range of forecasts of future performance. A number of key assumptions are required to be made to produce the range of possible outcomes; for example, economic and market conditions, our manufacturing performance, wool prices, and above all sales and margin outcomes. Given our performance in 2017, the directors saw it as appropriate to recognise that there was material uncertainty around the FY18 outcome when we signed off the 2017 financial statements.

It is very important to note that the uncertainty is around our ability to forecast the future with accuracy, not our ability to continue in business. The accounts have been prepared on a going concern basis and the external auditors have concurred with this approach. Four months into the year we are making progress. A level of uncertainty in our forecast of sales and margin will however remain until we can demonstrate a track record of profitable outcomes.

Board composition and remuneration

The board has worked tirelessly to support management to overcome the issues encountered during the last year and achieve their objective to turn the business around.

The board, myself in particular, appreciated the significant input of Steve Bootten not only as a director but also as Audit Committee chairman. Today we formally record our gratitude to Steve for his insight, experience and contribution to Cavalier and specifically for support in managing the relationships with KPMG and BNZ. Due to his heavy workload and the significant time commitment needed as director and the Audit Committee Chairman of Cavalier, he was unable to make another two-year commitment to the shareholders today.

As you can see from the agenda, Dianne is standing for re-election and she will speak to you shortly to seek your support. She has the full support of the board.

As heralded last year, in line with our director succession planning, we were very pleased to announce the appointment to the board of Alan Clarke last week. This appointment will take effect from 1 November and I will ask Alan to introduce himself towards the end of our agenda today.

This brings me on to the subject of directors' fees.

The pool for directors' fees was last adjusted to $350k in 2007 with the allocation of the pool unchanged since 2011. At the start of the last financial year we re-allocated the pool to recognise the roles of the committee chairmen and also to increase the basic director fee by $5,000 per annum. The full details of the fees are in the annual report. As part of the review process to implement this change, we commissioned a study by PwC and the adjustments we made placed the fee levels within the lower end of the range. In the ten years since the pool was last increased and the six years since the allocation changed, the time commitment and risk profile that directors face has changed significantly. I understand that increases to director fees may not be welcome, particularly when the company is not performing, however, I have the responsibility to ensure we can secure and keep the directors we need. I felt it appropriate to draw your attention to this matter today and flag the likelihood of the request to increase the total fee pool next year.

Future strategy and performance

A run rate of acceptable profitability is within our reach, and we know what we have to do in order to get there. In line with the disclosure made in the accounts two months ago, a situation of uncertainty still exists over our forecasts and the board do not expect to be in a position to give you meaningful earnings guidance until after the half year results at the earliest. We certainly expect a better normalised earnings outcome than in FY17. Our customers remain supportive and the Cavalier Bremworth brand remains strong.

The board has implemented the key tasks it anticipated in the strategic plan we set back in early 2015 for the FY16 and FY17 years. In addition to the short term operational plans that Paul has talked about, we are constantly examining the status of our business and our options for go forward. Completing the spinning consolidation is the right time to reflect and reconsider all our options with respect to our long term future and refresh the strategic plan – and that is what we are doing. This work is being completed by our CEO and his senior team and the board will be critically examining the next phase of our strategy.

To conclude;

Cavalier has consolidated woollen spinning to Napier with considerable efficiency gains possible. We have relocated felted yarn spinning to Wanganui allowing for output growth to meet increasing demand for the unique felted carpets in our range.

We have the funding facility we need and a very clear set of objectives to take the company forward.

We welcome the new government's focus on NZ jobs, the regional economy and the importance of exporting for New Zealand.

We continue to look at how the Company will position itself to address the challenges and the opportunities that are ahead for the long term to ensure we remain a relevant investment opportunity.

Fellow shareholders, the board and management remain dedicated to delivering acceptable levels of profitability at a sustainable level of debt. As soon as we are in a position to confirm an ongoing improvement in underlying performance with our debt firmly under control, we will look to resume dividend payments.

Thank you