

Directors' Report for the year ended 30 June 2011

Financial Performance

The Directors of Cavalier Corporation report an audited profit after tax for the year to 30 June 2011 of \$18.2 million, an increase of 60% on the \$11.4 million the previous year.

However, because the results as reported are affected by the accounting adjustments to deferred tax as a consequence of the further changes to the rules on depreciation of building and fit-outs for tax purposes - with this year's adjustment giving rise to a credit of \$0.9 million to profit, compared with the previous year's \$5.3 million charge - they do not reflect the actual underlying earnings of the Group.

Without these one-off non-cash accounting adjustments, the Group's normalised tax-paid earnings are \$17.3 million, an increase of 4% on the \$16.6 million the previous year and at the top end of the \$15.8 to \$17.5 million earnings guidance range previously provided to the market. The impact of the above-mentioned adjustments and the reconciliation between reported and normalised earnings are illustrated in the table below:

Consolidated Financial Performance Year ended 30 June 2011 Audited	2011 \$000s	2010 \$000s	Change
Revenue	229,373	220,274	4%
Earnings before interest and tax	25,601	21,676	18%
Interest	-3,545	-3,748	2%
Share of profit of equity-accounted investee (tax-paid) *	2,039	4,015	-49%
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Profit before tax	24,095	22,213	8%
Income tax *	-6,829	-5,586	22%
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Profit after tax from operations (Normalised)	17,266	16,627	4%
 <u>One-off non-cash items:</u>			
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	914	-5,258	
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Profit after tax (Reported)	\$18,180	\$11,369	60%
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Earnings per share (cents) (Normalised)	25.4	24.6	3%

* before the deferred tax adjustments arising from the non-deductibility of depreciation on buildings

Group revenue for the year was \$229 million, an increase of 4% on the previous year, with strong performances by our Australian operations. As a result, they now account for 57% of total revenue, compared with 54% the previous year.

The 4% increase in normalised earnings was largely the result of the better market conditions in Australia which helped offset the subdued market conditions encountered in New Zealand.

Financial Position

Total assets of the Group as at 30 June 2011 were \$216 million, an increase of \$25 million on the previous year. \$21 million, or 84%, of this increase relates to higher inventory values caused, in the main, by the substantial 80% lift in wool prices over the year and to the additional inventory to support higher activity levels in our carpet tile operation. As a result, cash flow from operating activities was substantially reduced to \$4.3 million for the year.

Shareholders' equity as at 30 June 2011 was \$99.3 million - up \$7.8 million on the previous year, mainly from increased retained earnings.

Net interest-bearing debt increased by \$16.5 million to \$66.3 million to give a gearing (expressed as debt over equity) of 67% as at 30 June 2011, versus 55% the previous year. Despite this higher level of net interest-bearing debt, the Group's financial position remains strong and well within its banking covenants.

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 \$204 million, up 3% on the previous year. Our 11% growth in sales in Australia was a follow on from the momentum built up in the previous year, but this was negated to a large extent by a 10% fall in sales in New Zealand.

Earnings before interest and tax (EBIT) for carpets were \$26.2 million, up 16% on the previous year.

As a result of the higher throughput, EBIT as a percentage of revenue, improved to 12.8%, up from 11.3% the previous year.

New Zealand market

New Zealand carpet revenues were down 10%. Market conditions in New Zealand for residential carpets and, to a lesser extent, commercial were soft throughout the year. Underpinning these market conditions were historically low new home starts and refurbishments. Normally, the low mortgage interest rates of the day would have provided some stimulus to housing, but the effects of the 2008 global financial crisis (GFC) continue to linger, particularly with discretionary spending on large ticket items such as carpets. At the same time, home building and renovation work in Christchurch have virtually come to a standstill as tremors following the two major quakes continue to halt any building reconstruction.

Australian market

In contrast, we enjoyed better market conditions in Australia. Carpet revenues there were 11% ahead of the previous year, with good levels of business recorded in both residential and commercial, particularly in the first half of the financial year. Market conditions in the second half were, however, softer as the tight monetary policies of the Reserve Bank of Australia and the high interest rates in place started to take hold.

Wool prices

Wool prices increased by 80% over the year with the magnitude and pace of the increase unprecedented.

This increase can be attributed to a world-wide shortage of cross-bred wools and the replenishing of stock levels - which had been allowed to run down during the GFC - by carpet mills around the world.

The wool price increase resulted in a 10 to 20% lift in the prices of our woollen carpets, and whilst the market is slowly coming to terms with these increases, we are ever mindful of the risks posed by the now comparatively much cheaper synthetic alternatives, particularly at the value end of the market. Only time will tell whether wool prices - which are currently at their 20 year highs - will remain at these levels over the longer term, but our view is that they are not sustainable and will ease back in time.

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

Our wool acquisition operation had a very successful year with EBIT of \$1.6 million, which is up 49% on the previous year.

Sales for the year of \$40 million were up 41% on the previous year, with increased wool prices more than compensating for the slightly lower volumes of wool transacted during the year. Elco Direct has built up a network of loyal farmers through excellent service and providing the very valuable and strategic alternative to the wool auction system over many years.

Elco Direct has also played a significant and active role in securing wool for the Group's broadloom carpet operations at a time when these operations were having difficulty sourcing wool from their traditional suppliers. The consequence of this is, unfortunately, the impact it had on the Group's cash flows and working capital position. However, we expect to return to the wool exporters for much of our requirements, once wool prices settle and the market returns to normality.

Wool scouring

CWH, our 50%-owned wool scouring associate company, had a very subdued year.

The Group's \$2.0 million share of CWH's normalised tax-paid earnings was down 49% on the previous year.

Scouring revenue declined 16% as a result of:

- the shortfall in wool produced on the back of the reduction in sheep numbers;
- the loss in the lamb population from the severe storms in Southland and the Wairarapa at the start of the wool season; and
- the absence of greasy wool stocks brought forward from the previous 2009/10 season into the current 2010/11 season for scouring.

CWH was granted Commerce Commission authorisation to acquire the wool scouring business of New Zealand Wool Services International Limited during the year thereby paving the way for it to bring about further rationalisation of the Zealand wool scouring industry and to strengthen New Zealand's competitiveness in wool scouring internationally. However, that proposed acquisition is currently on hold whilst the Commerce Commission authorisation is being appealed.

Radford Yarn

In April 2011, Cavalier completed its purchase of a 75% interest in the Radford Yarn Technologies business with the founding shareholders and management retaining the other 25% interest. Details of this transaction were reported in our December 2010 interim report to shareholders.

For the three months to 30 June 2011, the operation recorded sales of \$2 million and a loss before interest and tax of \$76,000, which includes \$55,000 of preliminary expenses associated with the purchase.

The purchase of the Radford Yarn operation is a very positive and symbiotic initiative and will allow Cavalier Bremworth to continue to grow its iconic "Bremworth Collection" range and to access new market segments in Australia, North Asia and North America.

Outlook

We have come through the 2010/11 year reasonably well, with revenue and normalised earnings both up 4%, despite the mixed market conditions prevailing.

Looking forward to the new financial year, we do not see any immediate upside to the market conditions in New Zealand for carpets. For that to improve, we will need to see a lift in real estate turnover which is generally a good barometer for refurbishment work as well as new home starts. On a positive note, we can see some upside towards the latter part of the 2011/12 year from the Christchurch rebuild providing construction work there gets underway soon.

As for Australia, we have enjoyed the relatively better market conditions there. However, market conditions slowed markedly towards the end of the 2010/11 year due to the impact of high interest rates on real estate turnover and new housing developments, and this is expected to continue for the time being. That said, there is still a general shortage of housing in the main cities in Australia and this should help to underpin the residential segment of the market.

With the current high wool prices, there is every encouragement for farmers to lift wool production by changing farm practices and, in time, lifting stock numbers. Any additional wool volume gained here would obviously have flow-on benefits for our scours.

In light of the difficult and unpredictable trading conditions, it is too early in the year to provide a meaningful earnings outlook to shareholders. We should be in a better position to do this at our annual shareholders meeting in November 2011.

Dividends

The policy of paying dividends three times a year continues.

The Directors have declared a fully imputed final dividend for the year ended 30 June 2011 of 11 cents per share, unchanged on the previous year.

This, together with the first interim dividend of 3 cents per share paid in December 2010 and the second interim of 4 cents per share paid in March 2011, gives a total of 18 cents per share for the year, unchanged on the previous year.

This final dividend will be paid on Friday, 14 October 2011. The share register will close at 5 p.m. on Friday, 30 September 2011 for the purpose of determining entitlement to the dividend and will reopen on Monday, 3 October 2011.

Non-resident shareholders will also be receiving a supplementary dividend of 1.94118 cents per share together with their final dividend.

The Cavalier Corporation Limited Dividend Reinvestment Plan which allows shareholders to receive shares in the Company in lieu of dividends will apply to the final dividend. Shareholders wishing to participate and who have not previously notified the Company's Share Registrar must do so before 5

p.m. on Friday, 30 September 2011. A copy of the Participation Notice can be obtained from the Company's Share Registrar.

The Directors advise that the price for determining the number of shares to be issued in lieu of this dividend will be the volume weighted average sale price of all price-setting trades on the NZX over the five trading days from Monday, 3 October 2011 to Friday, 7 October 2011 without any discount.

For and on behalf of the Board of Directors

Wayne Chung

Managing Director

22 August 2011