

## CAVALIER ANNUAL SHAREHOLDERS MEETING

27 November 2019

### **SLIDE 3. CHAIR'S ADDRESS**

### **SLIDE 4. 50 YEARS**

This year we celebrated 50-plus years of craft, beauty and friendship at Cavalier. In 1959, the Bremworth brand was created, merging with Cavalier in 1988 to create a world leader in beautiful New Zealand wool carpets.

Growth and success followed for many years until the 2000s when market and consumer trends saw the start of a long term move away from wool carpets and towards cheaper synthetic carpets and hard flooring. While wool carpet has remained our focus, Cavalier had to adapt to this rapid market change which required a significant rationalisation of our manufacturing base and necessitated a reduction in operating costs.

Crucially, this necessitated a complete re-evaluation of our strategy and how we need to operate for the next 50 years. As a wise person once said ... "Doing the same thing and expecting a different outcome is the first sign of insanity".

To assist us in bringing about this change, we have formed a strategic partnership with the NZ Merino company who are now a key partner in our future wool supply, alongside our own Elco Direct supply, and importantly, they are an experienced strategic consultancy who will help us take our iconic New Zealand brand, capability and story into 2020 and beyond.

### **SLIDE 5. BUSINESS STRUCTURE**

Our business is structured around our customers – they are central to everything we do. We have a wool buying business that keeps us in close contact with our roots and the farmers that provide us with wool. We have plants and staff in Wanganui and Napier where we dye, card, spin and felt yarn. And we have a carpet making complex in Auckland where the R&D manufacture and support functions are housed.

We have in excess of 30 staff in sales and marketing with showrooms and offices in all major regions across New Zealand and Australia. We have our international sales team anchored in Auckland, and are targeting markets in Canada, the USA and Asia.

As part of our journey towards creating a stronger business focused on producing beautiful natural products, last year we sold our 27.5% interest in CWH for \$13.5 million.

Our other shareholders in the business were experienced investors, Direct Capital and ACC, and an international wool exporter, Lempriere. An offer was received from David Ferrier, who had actually

been involved in setting up the original scour business, and after several months of discussion, our three shareholder partners informed us they wished to sell.

Our options were to sell to Ferrier with them or buy them out, which would have required Cavalier to increase its debt significantly to fund that acquisition and our bankers were clear that this was not an investment they would fund. At the same time, we were aware that the scour was looking at significant deferred capital expenditure and there was limited prospect of a dividend anytime soon. We also knew that we did not need to own a scour in order to buy scoured wool and the sale would reduce bank debt and allow us to move ahead with our restructuring.

In recent weeks, the media has reported that David Ferrier has reportedly onsold a 35% interest in the scour for an estimated \$33 million.

As it was a private transaction, we have no idea what assets were included in the sale or the terms and conditions. We also do not know if the capital structure of the business had changed, whether debt had been reduced or whether some of the share purchase was new equity for debt reduction. We do not know how much of the necessary capital expenditure had been carried out.

In reviewing the original transaction, the Board is confident that the right decision was made, based on information available and market conditions at the time, and after considering the return on investment and other alternatives available.

#### **SLIDE 6.           CREATING A WORLD OF DIFFERENCE**

We have always been known as a leader in the wool sector and, going ahead, that will define us as we focus on creating “A World of Difference” in everything we do.

This means we don’t just sell carpets and rugs; we look to make a genuine difference, for our shareholders, our customers, our people, our suppliers, our communities and our environment....not only through what we make, but how we make it.

#### **SLIDE 7.           MARKET TRENDS**

It’s a new and different world out there now compared to when we first started.

- Hard flooring continues to grow at the expense of soft flooring.
- Synthetic carpets are now the dominant choice for consumers. However we are seeing increasing pressure on lower margin synthetic carpets, particularly in Australia, with the New Zealand market following the same trend. We believe that only the largest manufacturers, producing very large volumes of these low margin carpets, will be able to compete in this sector.
- Major synthetic producers are scrambling to paint themselves green with claims of using plant blends in their manufacturing processes, although these corn-based alternatives are far from a panacea for dealing with plastic waste. Whether from corn or oil, the polyethylene produced is not recyclable at all and not good for the environment.
- Demand for top end, high quality textured woollen carpets is increasing, while synthetic demand is dropping not just in New Zealand but worldwide, with profit warnings issued by several large American yarn and carpet manufacturers.

- Import competition is increasing, particularly from Asia; and the industry continues to consolidate, with several smaller manufacturers exiting the sector.
- Our retail client base also continues to consolidate and mature, with growing recognition of the value of specialist manufacturers such as Cavalier.

**SLIDE 8. CONSCIOUS CONSUMERISM**

The world is changing and purchasing decisions are more and more influenced by factors other than simply a product's price.

Consumers are starting to carefully consider the social, environmental and other impacts of the products they purchase and make positive buying decisions.

A recent study for the clothing industry in the UK, showed that about 1/3 of respondents were concerned about the origin of their products and 74% were willing to pay extra if there was a guarantee that they were made ethically.

In parallel there is also growing awareness of the impact of plastics and synthetics on the environment and on our health, with growing demand for eco-friendly, sustainable products.

Change is coming and it is coming fast. Therefore, we believe the time is right to pivot to wool and take advantage of the growing interest in natural fibres and sustainable products and the environmental responsibilities that our customers are looking for.

**SLIDE 9. BARKERS/MAX CLOTHING**

History is studded with examples of companies that have seen changing trends and transformed to take advantage of them, or have been successfully launched on the back of consumer movements.

Close to home is iconic NZ fashion brand, Barkers Clothing, which has not only reverted back to its roots but has also introduced a new, more sustainable and natural approach to its apparel.

Launched in the 70s, Barkers was an iconic brand that was always ahead of the curve. However, in the 2000's it had lost its way, was short of cash and had extremely limited resources.

New, passionate owners spent the first decade after acquisition reviving the brand as they created a men's lifestyle experience with motorcycles, cafes and barbers in store. The second decade has been described by the managers as 'making the brand as sustainable, ethical and environmentally low impact as possible'. They have discarded synthetic fabrics in favour of natural fibres and textiles.

In today's fast paced and cut throat fashion world, the success of Barkers' transformation back to its roots and its sustainable approach are evident in its longevity and growing presence in the market.

**SLIDE 10. LANACO**

This country was originally built on the wool cheque and our wool is recognised world-wide as being some of the best. New Zealand's clean green image is also a drawcard for many international consumers.

Innovative companies are using this to build positions in high value, niche sectors throughout the world, targeting those consumers looking for better, more sustainable, healthier products...and with the means to pay for them.

- There's Tauranga-based Kiwi surfboard maker, Paul Barron, who has developed a wool cloth to replace traditional fibreglass in the surfboard manufacturing process;
- Woolcool, which is actually a UK company using NZ wool to produce biodegradable insulated packaging for food delivery and which is being used by My Food Bag in NZ; and
- Lanaco which uses natural wool as a critical ingredient for air filtration products.

Lanaco's wool filters are far superior to the alternative synthetic fibres and leverage off the unique biological properties of wool. NASA is evaluating one of Lanaco's filter systems for possible use to protect astronauts in the event of onboard fires and the company is teaming up with fashion designers such as Karen Walker to create fashionable face masks for the Asia markets.

#### **SLIDE 11. ALL BIRDS**

Alongside Icebreaker, All Birds shoes is probably one of New Zealand's most well known wool brands.

Having created an innovative merino wool fabric specifically for footwear, the company is now celebrated for its fashionable merino wool runners that are as comfortable as they are sustainable and eco-friendly.

The demand for their shoes has taken off worldwide and their sales have been on an upward trajectory since launch, as more and more consumers seek out products that are very comfortable, ethically constructed, fashion endorsed and a shoe they can feel good about buying.

#### **SLIDE 12. THE JOURNEY BEGINS**

Every journey starts with taking just one step ... and then another and another. It takes commitment and confidence and yes, there is always risk involved.

Cavalier is well positioned to be the next New Zealand success story in the wool market. Like Barkers, we are looking to revert to our roots and build on our heritage; like Lanaco and All Birds, we can meet customer demand for high quality, sustainable products, with our beautiful New Zealand wool carpets. We are in a unique position, with many of our competitors having tried and failed to replicate Cavalier's strengths in the premium market sector.

The New Zealand Merino Company has been an important partner for many of these highly respected and successful New Zealand wool brands, assisting them with their go-to-market strategy as well as their supply of raw material. They are now bringing their extensive knowledge and expertise to the strong wool market.

There is absolutely no question that Cavalier must change to stay relevant and position for growth in today's world. The Board and I are excited about the journey that we are embarking on, as we build on Cavalier's 50 years of heritage and expertise in the NZ wool flooring market and leverage our strong brand and reputation for quality and innovation. We are delighted to be partnering and

working with the multi award winning NZ Merino company on a strategy to transform our company and I look forward to sharing details of this with you early next year.

The Board and I are clear. We have to change and build on our strengths. We want to see our share price start to reflect the considerable asset backing of your company and then grow from there, based on an improving bottom line performance. But we have to transition from where we are today to that vision and this will take investment, patience and time.

We are committed to seeing the return of an annual dividend and I look forward to the day that this can be announced at our AGM.

I will now hand over to Paul Alston, Cavalier's CEO, to talk more about our performance and initiatives we have underway.

**SLIDE 13.** PAUL ALSTON, CEO

**SLIDE 14.** COMPANY STRENGTHS

Cavalier has a long standing history of producing world leading carpets. It's what we're known for – premium wool carpets made from quality New Zealand wool. And this is where our focus will remain – creating and marketing a valuable natural product that is both sustainable and desirable, around the world.

Our Cavalier Bremworth brand is the most recognised and trusted carpet brand in the NZ market and very highly regarded in Australia.

We are renowned for our beautiful broadloom carpets and have felted yarn technology that is difficult to replicate.

And while we would struggle to compete in the high volume, low margin sector, our size allows us to easily switch between small production runs to create our unique and bespoke carpets.

**SLIDE 15.** FY19 EVENTS

We have already provided a lot of information on our FY19 results in our announcement and annual report so I'll just run through a quick summary today.

Last year we started to move our focus back towards wool and away from synthetics, something that we are now escalating.

We established a strategic relationship with The New Zealand Merino Company and started to invest in the changes that need to be made.

Our retailer distribution channels are an important part of our business and a key strategy for our future. We have invested in new instore displays which provide a unique retail experience and are proving popular.

In line with our new direction we are looking at compatible areas for growth, such as the introduction of rugs last year which will support our position in the increasing move towards hard flooring.

**SLIDE 16.**      FY19 RESULTS SNAPSHOT

Our FY19 results reflected the start of our strategic change and the continuing soft market and challenging trading conditions we spoke about last year, particularly towards the end of the second half. Wool prices also dropped due to decreased Chinese demand for strong wool, impacting on the revenue generated by our wool buying business.

Overall, revenue was down 9% for the year, to \$135.2m.

We reported an \$11.9m non-cash loss on the sale of Cavalier's interest in the wool scouring business and associated property, as well as \$6.8m after tax relating to impairments of goodwill and fixed assets. The result was a net loss after tax (NLAT) of \$(16.8)m.

Excluding these non-cash items, Cavalier's normalised EBITDA was \$7.1m and NPAT was \$1.9m.

At the end of June, net bank debt was \$17.8 million, with recent valuations assessing the value of Cavalier's land and buildings alone at more than \$30m, compared with our depreciated book value of \$21.5m.

**SLIDE 17.**      FY19 PERFORMANCE

Despite navigating the change in our business, we have improved a number of key metrics, including gearing ratio and margins (highlighting the higher percentage of woollen sales) and reduced debt and inventory.

**SLIDE 18.**      CAPITAL MANAGEMENT

Prudent capital management remains a key focus and debt has reduced by more than 70% since FY14, from \$58.8m down to \$17m as at the end of October this year.

We have tight control over capex and we have reduced inventories by \$21.2m over that same period.

**SLIDE 19.**      FY20 OUTLOOK

We are changing our business and, while we are well positioned to capture the demand from consumers seeking a more natural, more sustainable, healthier carpet alternative, we recognise that operational and marketing investment is essential.

Restructuring and production changes will be required to support the move away from synthetics and into the production of wool carpets.

This will require investment, which has already started, and the associated costs will impact in the FY20 year and we will also be required to assess the carrying value of assets as this change takes place.

We believe change is essential and further investment will be required to secure the future growth of Cavalier. The changes that are being made to our business will add long term value for our company and our shareholders.

## **SLIDE 20. HY20 FORECAST**

The challenging trading conditions noted early in 2019 are continuing and sales, particularly of low margin synthetic carpets, continue to be affected, with volumes down by approximately 10% year on year. Anecdotal feedback is that other suppliers are also experiencing the same challenges.

Demand for Cavalier's premium wool carpets continues to grow and whilst these are a small part of total sales, they provide a significant contribution to group profits.

Given the above, 1H20 revenue is expected to be between \$61m to \$64m (1H19: \$70.0m) and EBITDA is expected to be in the range of \$1.2m to \$1.9m (1H19: \$4.6m).

Included in forecast EBITDA is an approximate \$1m benefit from the adoption of the new accounting standard for leases (IFRS 16) and transformation costs of approximately \$0.8m associated with the development and implementation of Cavalier's new business model, as the company transitions into a design-led, wool focused business.

Cavalier expects a net loss after tax of between \$(1.1) million and \$(1.6) million for the six-month period (1H19: \$(10.0)m<sup>1</sup>).

While our performance in today's more challenging market is disappointing, it further enforces our need to transform our business and focus on our areas of strength, particularly premium wool flooring which provides better margins and growth opportunities.

## **SLIDE 21. OUR ASPIRATIONS**

With the assistance of The NZ Merino Company, the Board and senior management are currently developing a detailed business strategy and plans which will direct our future journey. However, our aspirations remain unchanged:

We want to be recognised as a leader in beautiful wool carpets, made from New Zealand wool.

We want to continue our heritage of design and craftsmanship, delivering uncompromising quality and exceeding our customers' expectations.

We are committed to operational and manufacturing excellence and have a company culture that harnesses the pride, passion and expertise of our people.

We want to continue building a business that rewards our shareholders and customers, but also adds value for our people, local communities and New Zealand's wool growing sector, while protecting our environment for future generations.

## **SLIDE 22. WOOL IS THE NATURAL CHOICE**

Wool is the natural choice for carpet and our future. Not only is it sustainable, 100% renewable and bio-degradable; we believe it is also the optimal fibre for carpet design and performance.

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<sup>1</sup> 1H19 NLAT included the non-cash write down of \$12.0m on Cavalier's carrying value of its 27.5% in Cavalier Wool Holdings (CWH), following its sale at the end of September 2018.

It also has multiple attributes for a healthier and more comfortable home – it's hypo allergenic, keeps you warm in winter and cool in summer, is naturally stain and fire resistant, takes moisture out of the air, is a great noise insulator and is less odorous. Why would you choose anything else?

**SLIDE 23. THE VALUE STORY**

Our move back to wool is not just good for our customers, it's also good for our business. Margins on synthetic carpets continue to drop, and with the current market conditions and trends in fibre preferences, we expect there to be further margin pressure in this segment of the market.

Wool carpet margins, particularly at the premium end of the market, remain healthy. While these are a smaller part of our business, they are highly valuable and with new products about to be launched in the new year in all markets, we expect further growth in the near future.

**SLIDE 24. THE OPPORTUNITY**

The global flooring and carpet market is worth an estimated \$380 billion US dollars and is expected to grow to \$450 billion by 2025. Approximately 40% of this is for soft floor coverings, providing an estimated market sector size of \$180 billion by 2025.

While hard flooring may have grown in popularity, carpet still represents about 40% to 50% of flooring surface in homes and remains the single biggest flooring category. In fact, individually, ceramics, hardwood floors and laminates don't even come close. Many consumers still like the benefits of a wool carpet – its soft, warm, more comfortable and looks good. And customers like having rugs on top of their hard floors in their homes.

The industry is evolving and innovation will drive a revitalisation of the carpet sector. Our opportunity lies in promoting the benefits of wool and crafting beautiful carpets that are fashionable, more appealing and exciting for our customers, and better performing.

One of Cavalier's main strength is our brand. We believe we can build on this to cement and grow our position in the high value, high end wool and natural fibre carpet sector.

We are the leader in the wool carpet sector in NZ and, while we are still a small player, our market share in Australia is growing and represents our most accessible near term growth opportunity.

The US market is mostly white label, that is, they take our carpets and put them under their own brands. We are looking closely at this model and at ways we can leverage the value and reputation of the Cavalier Bremworth brand, with passionate advocates selling our carpets to both commercial and residential customers.

Canada and Asia also offer opportunities for our company.

**SLIDE 25. PARTNERSHIP WITH NZ MERINO**

We will be leveraging The NZ Merino Company's unique skills, experience and indepth knowledge of wool to help us take our wool carpets to the world, and as Alan has said, we are very excited about this new partnership.

Everyone has different strengths and while Cavalier is a leader in the production of beautiful wool carpets, we recognise that our story telling needs to improve and fresh eyes will assist in this.

We have been working with NZ Merino for nearly six months now, undertaking a strategic review of the business and our opportunities. We expect to have this work completed in coming weeks and will then move to the next stage of the process, which is to create detailed implementation plans.

I'd now like to introduce you to John Brakenridge, to tell you a bit more about the business and their view of the potential for Cavalier.

**Alan Clarke, Chair**

The strategic review has been a very tangible process, involving members of Cavalier's team, retailers, shareholders and other key stakeholders. We are 100% committed to the belief that wool is our future, particularly the high value, premium carpets for which there is increasing demand. John's team are incredibly knowledgeable and can see real potential for our business. This is an exciting time for Cavalier and we look forward to keeping you updated on our progress.

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