

# Memorandum

Date: 21 May 2015

To: Chairman and Members  
Commerce Commission

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**by email**

## **CAVALIER WOOL HOLDINGS AND NEW ZEALAND WOOL SERVICES INTERNATIONAL - ACQUISITION UNLIKELY TO BE PROCEEDED WITH**

- 1 The Commission will be aware of yesterday's announcement from the NZ Stock Exchange to the effect that Cavalier Corporation has announced that its earnings for the 14/15 year are likely to be at, or slightly below, the lower end of the previous advised earnings range of \$1 million to \$4 million tax paid. In addition to those reduced earnings, Cavalier has also announced that it anticipates write-downs of certain assets will be required, the impact of which will turn the 14/15 normalised tax paid profit into a loss.
- 2 Further, Cavalier Corporation has announced that its Managing Director and CEO, Colin McKenzie, has stepped down with the current CFO appointed as interim CEO with immediate effect. The company's updated strategy and business plan have been scrutinised by Deloitte and the company's bankers "fully apprised of this plan".
- 3 That announcement has attracted critical response in the media. Copies of the Stock Exchange announcement and media commentary are attached for the Commission's information.
- 4 The fact that Cavalier Corporation now finds itself in such parlous predicament means that there must be a real prospect that the proposed acquisition for which authorisation has been sought – namely, the acquisition by Cavalier Wool Holdings (in which company Cavalier Corporation through Cavalier Bremworth currently holds a 50% shareholding) of the wool scouring business and assets of New Zealand Wool Services International – is unlikely to be proceeded with.
- 5 Cavalier Bremworth, which is the wholly owned subsidiary of Cavalier Corporation, is by far the most substantial asset of Cavalier Corporation. Given that the Stock Exchange announcement identifies adverse effects on its Australian broadloom carpet operations and failure of the transition plan for its Ontera tile business to gain traction as the major contributing factors to Cavalier Corporation's downgrade, there

must be a real possibility that Cavalier Bremworth itself is no longer financially viable.

- 6 The question for the Commission must be how the updated strategy and plan, together with Cavalier Bremworth's financial situation, affects the prospect of the acquisition for which authorisation has been sought in fact being proceeded with.
- 7 Section 68(2) of the Commerce Act provides for the situation where an acquisition for which clearance or authorisation has been sought is unlikely to be proceeded with, for practical or financial reasons. It provides:
 

*Notwithstanding section 66 or section 67 of this Act, where the Commission is of the opinion that a proposed acquisition is, for reasons other than arising from the application of any provision of this Act, unlikely to be proceeded with, the Commission may, in its discretion, decline to give a clearance or grant an authorisation for that acquisition under this section.*
- 8 Authorisation is a protracted and expensive process for all of the applicant, the Commission and interested parties who are involved in that process (whether of their own volition or, as in the case of Godfrey Hirst, at the Commission's express request).
- 9 The Stock Exchange's announcement of Cavalier Corporation's reduced earnings, asset downgrade and projected loss all suggest that the proposed acquisition for which authorisation has been sought, now is unlikely to proceed.
- 10 The Commission should also be mindful that the current application relates to the same wool scouring assets that were the subject of an earlier authorisation the Commission granted to Cavalier in 2011. On that occasion too, the acquisition that was authorised in fact did not proceed. On that previous occasion that futile authorisation involved the Commission and interested parties not just in the Commission's own processes but also an appeal to the High Court.
- 11 Godfrey Hirst submits that Cavalier Corporation has put the Commission and other interested parties to too much distraction and expense already with applications seeking authorisation for acquisitions that are unlikely to be proceeded with. It is clear that, given Cavalier Corporation's just announced financial position, the acquisition for which authorisation has been sought cannot now proceed in its present form.
- 12 There is of course the possibility that other parties which are currently or potentially shareholders of Cavalier Wool Holdings may seek to take up Cavalier Corporation's slack. The Lempriere Option, which forms such a pivotal element in the transaction documents relating to the current authorisation, suggests both that Lempriere is most likely to be the party to step forward; and that Direct Capital and ACC are the parties most likely to exit (together with Cavalier Bremworth).
- 13 If there is to be a rearrangement of the prospective interests in Cavalier Wool Holdings – as the announced "updated strategy and business plan" suggest – a fresh

application seeking clearance or authorisation revealing in full detail the intentions and identity of the parties involved, should be made.

- 14 Godfrey Hirst would be pleased to elaborate on any of the above. Its counsel are available to meet with the Commission at short notice in this regard.



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# CAVALIER CORPORATION

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## **Earnings outlook and related matters**

The Board of Cavalier Corporation advises that normalised earnings for the 14/15 year are likely to be at, or slightly below, the lower end of the previously advised earnings guidance range of \$1 to \$4 million tax-paid. Earnings from its Australian broadloom carpet operations have been adversely affected by the very high cross rate with the Australian dollar that has prevailed since the beginning of 2015. At the same time, the transition plan for its Ontera tile business of supplementing its manufacturing with a substantial importing programme has been slow to materialise and is only now starting to gain traction.

The Board has overseen the preparation of an updated strategy and business plan for the Company that has been closely reviewed by a specialist team from Deloitte. This plan projects improved profitability in the 15/16 year together with a substantial reduction in bank debt, and a return to adequate levels of profitability, by the 16/17 year by focusing on its core businesses. Our bankers are fully apprised of this plan.

In reviewing the updated strategy and business plan, the Board has also been reviewing the carrying value of certain assets and anticipates that write downs will be required in the 14/15 financial statements. This exercise is ongoing, but the impact of these write downs, which will be largely non-cash, will turn the 14/15 normalised tax-paid profit into a loss. The Directors will further advise shareholders when they are in the position to do so.

With the new plan now in place, Managing Director and CEO, Colin McKenzie has expressed a desire to relinquish his roles. Accordingly, the Board has appointed CFO, Paul Alston, as interim CEO with immediate effect, whilst Colin will continue to work for the Board on certain projects during the duration of his notice period.

The Board takes this opportunity to thank Colin for guiding the Company through a period of the toughest trading conditions ever faced, and for initiating and overseeing a range of vital initiatives – including consolidation and rationalisation of manufacturing operations, the introduction of a highly successful range of synthetic carpets, and the creation of alliances with key global players in the carpet industry. These achievements form the foundation stones upon which the future of the Company is based.



Alan James  
Chairman  
For and on behalf of the Board of Directors  
20 May 2015

For more information regarding this announcement, please contact Paul Alston on 021 918 033 or 09 277 1135.

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# The New Zealand Herald



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## Christopher Adams

The Business Herald's markets and banking reporter.

### High kiwi dollar piles pressure on Cavalier's earnings



Cavalier said earnings from its Australian broadloom carpet business had been adversely affected by the kiwi's strong run against the Australian dollar since the start of the year. Photo / Thinkstock

Talk of a "parity party" may have died down but the New Zealand dollar's strength against its Aussie counterpart has been squeezing Cavalier Corporation's earnings and adding to the carpet maker's woes.

In a market update yesterday, the Auckland-based firm said normalised net earnings for the current financial year were likely to be at, or slightly below, the lower end of a previously advised guidance range of \$1 million to \$4 million.

However, the impact of asset write-downs would result in a full-year loss for the company, which had net debt of \$59.1 million at the end of last year.

Cavalier said earnings from its Australian broadloom carpet business had been adversely affected by the kiwi's strong run against the Australian dollar since the start of the year.

The exchange rate nudged parity last month but the New Zealand dollar has since lost ground. It was trading at A92.95c at 5pm last night - still well above the historical average of about A84c.

Harbour Asset Management analyst Shane Solly said that in addition to the currency impact, Australia's "economic transition" was creating challenges for some New Zealand businesses operating there.

Cavalier said an additional challenge was slow progress in a transition plan for its Ontera tile business, which involved supplementing manufacturing with importing.

The company also announced that its chief executive, Colin McKenzie, had stepped down and chief financial officer Paul Alston had been made interim CEO.

McKenzie would continue to work with the board on "certain projects" for the duration of his notice period, the firm said.

Cavalier's board copped a grilling from investors at the company's annual meeting last year, including complaints about a lack of communication around the firm's turnaround strategy.

The company, which has also been impacted by wool price volatility, has seen a 90 per cent slump in its share price since May 2011.

Shares in Cavalier closed steady at 36c last night, giving the once NZX 50 company a market capitalisation of \$24.7 million.

The company said its updated strategy and business plan was projected to result in a return to "adequate levels of profitability" by the 2016/2017 financial year through a focus on Cavalier's core businesses.

Richard Stubbs, of fund manager Castle Point, said Cavalier had turned its business around before and it could do it again with the right leadership.

"It will be a long journey to recovery, probably," he said.

Stubbs said the firm's high level of debt needed to be addressed.

- NZ Herald

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## Another Cavalier downgrade, managing director quits

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JENNY RUTHWEDNESDAY MAY 20, 2015 2

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Colin McKenzie

Cavalier Corporation's [NZX:CAV] managing director has resigned in the wake of the carpet maker's sixth successive profit downgrade.

Cavalier is now warning investors to expect a normalised annual profit at or below \$1 million, down from the previous guidance of between \$1 million and \$4 million.

But the bottom line will be a loss after further yet-to-be-quantified asset writedowns compared with a net profit of \$5.8 million in the year ended June 2014.

It's the third time the carpet maker has downgraded its annual forecast for the current year after three downgrades last year.

Cavalier shares were unchanged at 36 cents after the announcement but have fallen from \$1.91 in February last year, shaving more than \$100 million off the company's market value.

Colin McKenzie has stepped down from the top job and will be replaced temporarily by chief financial officer Paul Alston.

Mr Alston tells NBR ONLINE he's been appointed for six months to implement a recovery plan and says he hopes his success at that will mean he will be a contender when the board makes a permanent appointment.

The company says earnings from its Australian broadloom carpet operations have been hurt by the strength of the New Zealand dollar against the Australian dollar since the beginning of this year.

Cavalier says its transition plan for its Ontera tile business of supplementing its manufacturing with substantial imports has been slow to materialise and is only now starting to gain traction.

It says the board has prepared an updated strategy and business plan, which has been reviewed by a specialist team from accounting firm Deloitte, and which projects improved profitability in the year ending June 2016, as well as a substantial reduction in bank debt.

The company expects to return to adequate levels of profitability by the year ending June 2017 by focusing on its core businesses.

It says its bank is fully aware of these projections.

At December 31, Cavalier's debt to equity ratio stood at 39% with net debt rising slightly to \$59.1 million from \$58.8 million in June.



The balance sheet valued the equity at almost \$92 million at December 31 but the market currently values the company at just \$24.7 million.

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## 2 COMMENTS & QUESTIONS

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#1 by **A Verified NBR Reader**  18 hours ago

*The wealth destruction at this company is nothing short of impressive. Cavalier used to be in the top 50 NZX companies and was worth \$240m around four years ago, now it's worth less than \$25m.*

*I guess Colin Mackenzie didn't want this "poisoned chalice" anymore, as his Chairman so famously described his own role only six months ago. However, it's not the CEO who should be walking but the board of has-beens and ancients.*

*This company has consistently failed to plan for consumer needs, missing the boat on synthetic carpets, mismanaging forex, and misjudging people's tastes.*

REPLYSHARE      

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#2 by **David Bridewell**  16 hours ago

*Although it's probably too late for this company by now, but what it needs to do is to form a design partnership with one or two of the major European and American fashion houses. It needs to bring the sexy back to carpet. I mean let's face it, who wants to shag on a wooden floor, or stone cold hard porcelain tiles, no matter how Italian? Bring some Austin Powers back. Now he'd shag on the shag pile.*

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# Cavalier's bank will have 'almost infinite patience'

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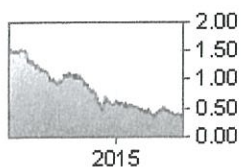
JENNY RUTH THURSDAY MAY 21, 2015 1  
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Cavalier's [NZX: [CAV](#)] chairman says the carpet maker's bank will give it "as long as it takes" to turn the struggling company around.

"As long as they understand what we're facing and what we're doing, they have almost infinite patience," Alan James told NBR.

Mr James wouldn't comment on the likelihood of further hitches in Cavalier's recovery plans or that they will take longer than currently projected to achieve results.

"The company has faced, and continues to face, incredibly challenging circumstances," he says. "I'm sure the current plan will restore the company's fortunes to an adequate level of profitability."

Yesterday, Cavalier announced its sixth successive profit downgrade, forecast a bottom line loss because of asset writedowns and that its managing director had resigned.

Cavalier is now warning investors to expect a normalised annual profit at or below \$1 million, down from the previous guidance of between \$1 million and \$4 million.

But the bottom line will be a loss after further yet-to-be-quantified asset writedowns compared with a net profit of \$5.8 million in the year ended June 2014.

The company said it has prepared an undated strategy and business plan, which has been reviewed by accounting firm Deloitte and which has been laid before Cavalier's bank, Bank of New Zealand.

Managing director Colin McKenzie has been replaced for a six-month term by Paul Alston, the former chief financial officer.

Mr James says Mr Alston is "a very competent and seasoned executive. We think he's very qualified to take on the chief executive role.

"In due course, we may put him up against other candidates we can identify and he may well come through that as the best candidate anyway."

### **Delays, high New Zealand dollar blamed**

Cavalier blamed the latest delay to its long-promised turn-around on a slower-than-

expected transition for its Ontera tile business to supplementing its manufacturing with substantial imports and on the strong New Zealand dollar hurting its Australian broadloom carpet operations.

It is now forecasting an improved result coupled with substantial debt reduction in the year ending June, 2016 and a return to “adequate” levels of profitability the following year.

Cavalier’s share price didn’t budge after yesterday’s clanger, closing unchanged at 36, but the company’s market value has fallen from nearly \$200 million in early 2014 to just \$24.7 million.

While the December balance sheet puts Cavalier’s gearing ratio at 39% with net debt of \$59.1 million, the nominal equity then was nearly \$92 million.

Mr James says the market has always valued Cavalier as a dividend stock. “In the absence of a dividend, the shares will be valued at a very low number.”

Cavalier hasn’t paid a dividend since the first half of last year and that was after it paid nothing in the first half of 2013 or in 2012.

An analyst at Craigs Investment Partners, Dennis Lee, has downgraded his forecasts further in the wake of yesterday’s announcement, now expecting Cavalier to barely break even in the year ending June 2016, and kept his “sell” recommendation on the stock.

Mr Lee says until the company provides more details about both its debt reduction plans and its recovery strategy, he can’t assess how achievable these plans are.



Read more from **Jenny Ruth**

Email Jenny: [jruth@nbr.co.nz](mailto:jruth@nbr.co.nz)

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# 1 COMMENT & QUESTION

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**#1** by **A Verified NBR Reader** *8 minutes ago*

Famous last words I wonder? The Chairman has a habit of making comments he regrets.

Firstly, he mistakes Cavalier's banking support as almost infinite. As we all know, banks are in the habit of handing out umbrellas when sunny but take them back when it starts raining. It is nothing short of naive for him to assume the banks are friendly. And as we know, the Chairman himself referred to his role at CAV as a "poisoned chalice" only six months ago.

Suggest the Chairman hedge his almost infinite banking support by raising some capital to help tidy up the balance sheet.

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The company's first-half results, published in February, showed a 99 percent drop in profit for the six months ended Dec. 31, reflecting a strong New Zealand dollar, higher wool prices and low wool grease prices. At the time it projected a second-half improvement.

However, today it said normalised net earnings for the current year would be "at, or slightly below, the lower end of its guidance of \$1 million to \$4 million."

Earnings from broadloom carpets in Australia had been hurt by the strength of the kiwi dollar against its Australian counterpart since the beginning of 2015.

At the same time, its plan to increase the amount of imported tile to supplement the synthetic carpet tiles made by its Sydney-based Ontera Modular Carpets unit, "has been slow to materialise and is only now starting to gain traction."

(BusinessDesk)

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BusinessDesk

## Colin McKenzie steps down as Cavalier CEO ahead of FY loss

Wednesday, 20 May 2015, 4:32 pm

Article: [BusinessDesk](#)

### Colin McKenzie steps down as Cavalier CEO ahead of writedowns that will lead to FY loss

By Jonathan Underhill

May 20 (BusinessDesk) - Colin McKenzie has stepped down as managing director and chief executive of Cavalier Corp ahead of asset write downs that will result in a full-year loss for the carpet maker.

The Auckland-based company named chief financial officer Paul Alston as interim chief executive with immediate effect, and said McKenzie will work out his notice doing certain projects for the board.

The departure comes six months after chairman Alan James defended his board and management from shareholder criticism about the company's poor financial performance, suspension of dividends and slumping share price. The shares have fallen 76 percent in the past 12 months to trade recently at 37 cents, with a sell rating from two analysts polled by Reuters.

Since the November annual meeting the board has completed an updated strategy and business plan with advice from Deloitte, that it projects will result in improved profitability and a "substantial" reduction in bank debt in 2015/16 and "a return to adequate levels of profitability" in 2016/17 by focusing on its core business.

As a result of the review, the carrying value of certain assets will be written down, resulting in a net loss this year. Further charges may be necessary, as the company said the exercise is ongoing.

"Our bankers are fully appraised of this plan," chairman James said in a statement today.