

Woop, woop! Cavalier pulls up at last minute but danger still lurks

Desperate times call for desperate measures, which explains why Cavalier Corporation is putting its carpet business through the cash wringer.

The company's financial position has weakened significantly over the past 24 months, largely due to a combination of rising fibre input costs, a strong New Zealand dollar against the Australian dollar and low greasy wool prices.

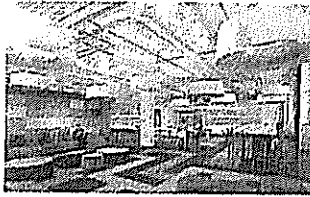
But it can also be argued that Cavalier was slow to react to these dynamics, leaving it with little room to manoeuvre, considering its concerning debt load, which stood at \$59 million at the end of December against assets of \$195 million.

In the past few weeks Cavalier has refreshed its board via the departure of former long-serving chairman Alan James and managing director Colin McKenzie.

With consultancy firm Deloitte working closely with Cavalier's bankers, the new board, led by chairwoman Sarah Haydon, is now firmly focused on debt reduction.

On Monday Cavalier announced it is selling assets, outsourcing operations and reducing staff, while an inventory reduction programme has so far yielded about \$6 million for the bank.

Of particular note is that Cavalier has decided to offload the assets of its Australian carpet tile manufacturer, Ontera Modular Carpets to US-based Milliken



ASSET SALE: Cavalier is selling Ontera

& Company.

No price has been disclosed for these assets, although one can assume that Milliken is paying a low price for the business, which Cavalier bought back in 2002 for \$2 million.

Cavalier says further information will be provided once the transaction is complete.

The loss-making Ontera has been a drag on Cavalier's earnings in recent times, so it's not altogether surprising it is being jettisoned.

Ontera and Milliken already had a relationship, with the Australian company holding an exclusive license for Milliken's leading edge tile printing technology.

Shoeshine understands about 70% of Ontera's output incorporates the Milliken printing technology.

Cavalier investors are unlikely to be too concerned about this though.

What they will be concerned

about is the extent of Cavalier's asset writedowns.

The company said it expects tax-paid writedowns of \$20-23 million, the bulk of it from the tile manufacturing business.

By any measure, this is a hefty blow to the balance sheet, but one that is necessary for Cavalier to return to its core business.

The issue is what effect this will have on the company's key banking covenants, which as Shoeshine has pointed out previously, are already being stretched.

Although it is not uncommon for bank lenders to waive any technical

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breaches of covenants, they will only do so for a short time.

Based on a \$20 million writedown, Cavalier's key financial ratios will be looking worryingly sick - even if bank debt is trimmed to \$50 million.

This also assumes Cavalier will meet its latest earnings guidance, which is pretty loose as it is.

In May, Cavalier said normalised earnings for the 2015 financial year are likely to be at, or slightly below, the lower end of the previously advised guidance range of \$1-4 million tax paid.

There was no mention of this target in this week's strategy and business plan update announced to the stock exchange.

Cavalier is prone to revising its forecasts - there have been five earnings downgrades since November 2013 - and it now faces additional overhangs, including whatever Deloitte is charging for its services (unlikely to be cheap).

Consensus broker forecasts are for normalised NPAT of \$400,000 for 2015, compared to the reported \$2.4 million in the 12 months to December 2014.

For all this, Cavalier's share price has found some leverage recently as investors look at the latest restructuring as something that is more tangible for the company's future.

Cavalier still has a long way to go and paying down debt may appease the banks, if not investors.