

Khandallah
Wellington 6035

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Ref: Cavalier/Wool Services International

I note with interest the application by Cavalier Wool Holdings (CWH) to acquire the wool scouring assets of NZ Wool Services International (WSI). I wish to express my support for such (further) rationalization of the New Zealand wool scouring industry.

I have no personal interest in the proposed transaction – I am not a shareholder nor do I have any other interest in either party. I was a director of a specialist USA carpet retailing company formed by Cavalier, a then leading Auckland carpet retailer and the Wool Board around 25 years ago, but I have had little direct involvement with the company subsequently. I was also a senior member of the Wool Board's staff when it established and subsequently transferred ownership of WSI to wool growers, but my direct association with the company subsequently has been limited. However, I do know a number of WSI's directors and senior staff personally.

My support is based on my earlier experiences as a director of a wool scouring company with a number of plants (not related to either party) and my observations of sector behaviour over the past 40 years, during which time I filled a number of roles in the NZ wool industry. I was CEO of the Wool Board at the time of its disestablishment in 2003 and have subsequently acted as a consultant since that time, including as CEO of Wool Board Disestablishment Co Ltd (DisCo). These observations are made in a private capacity and do not necessarily reflect the views of DisCo or its directors.

The wool scouring sector has suffered from the effects of over capacity for decades. Each rationalization has been driven by declining sheep numbers, exacerbated by a changing mix in demand from NZ's main export markets for greasy and scoured wool. My observation has been that joint ownership of wool trading and scouring operations has resulted in such companies habitually underselling the market in times of weak demand in order that these exporters, owning wool scours, maintained high utilization of their wool scours – it was better for the bottom lines of such companies for them to apparently forego a trading margin or even incur a trading loss but off-set that with a scouring profit. A wool scour operating at less than full capacity can incur substantial losses. A scour operating at or near capacity can be very profitable.

International market intelligence regularly indicated that those companies owning wool scours undersold the market, obliging their competitors not owning wool scours to match their pricing to secure business. The cumulative effect of this underselling has, in my opinion, been a significant factor in the steady decline in crossbred wool prices through the past 20 years. It has only been on about three occasions in this period when demand has significantly exceeded supply that this price trend has been temporarily relieved, the

most recent being the processor/retailer re-stocking that has occurred in the past year or so, the earlier de-stocking having been driven by depressed international economic conditions. The opportunity to rationalize wool scour ownership at a time when prices are well above their trend line is an opportunity that should be grasped as there is an opportunity to 'lock-in' at the currently higher price levels.

Crossbred wool comprises the great majority of NZ wool, up to ~90%, depending upon where the 'crossbred' line is drawn. It is interesting to observe that the finer wools, which with very few exceptions are exported greasy rather than scoured, have held their price internationally substantially better than has crossbred wool. It can reasonably be asserted that a significant factor in the better performance of the merino sector than the crossbred sector has been because a very significant portion of crossbred wool is scoured prior to export whereas merino is not subject to the negative pricing pressures of merchant scouring in NZ.

It is interesting to observe also that the price of New Zealand crossbred wool relative to competing British wool (the largest alternative source of internationally traded crossbred wool) has deteriorated markedly during the past 20 years. Other factors have been in play in reversing the premium previously enjoyed by NZ wool, including currency relativities, the demise of NZ promotional programmes and a changing market mix (ie increasing dominance by China), but it can reasonably be asserted that the ownership structure of the scouring industry has been a significant contributing factor.

In supporting the Cavalier proposal I am mindful of concerns at the market dominance that would create. Here I would make two points:

1. Most of NZ's crossbred wool customers have the option of scouring in NZ or in the country of further processing (spinning). There will be real competition for any dominant NZ scouring enterprise from international competitors.
2. Even if the price of wool scouring were to lift moderately in NZ as a consequence of the proposed acquisition there is every reason to be confident that a higher scouring charge would be recovered from international markets, increasing the return for NZ from each kilogram of wool scoured in NZ. The effect of a modest lift in scouring charge upon the consumers of wool carpets in NZ would be miniscule if detectable at all.

On balance, I am strongly of the opinion that it is in the interest of all New Zealanders, in particularly sheep farmers and those providing downstream services to them in the wool sector that Cavalier be authorised to acquire the wool scouring assets of Wool Services International, my only proviso being that a condition be that these are applied to the provision of a commission-based wool scouring service to the NZ wool industry and that they not be operated in conjunction with a wool trading business.

I would be happy to discuss these views should that be of any value.

Roger Buchanan