

CEO's Management Discussion & Analysis

MK GOH

Chief Executive Officer



INDUSTRY OVERVIEW

Over the last two years, the overlapping crises of the COVID-19 pandemic and war in Ukraine have rocked the world, leaving a devastating impact on the community living and affected by HIV/AIDS. The Joint United Nations Programme on HIV/AIDS (“UNAIDS”) reported that the new data received is especially frightening and there is legitimate concern that these crises have set back the global response to the AIDS pandemic. Insufficient investment and action over the past few years now leave millions to face AIDS-related deaths and new HIV infections if left unaddressed.

According to UNAIDS, faltering progress meant that approximately 1.5 million new HIV infections occurred last year—over 1 million more than global targets. The AIDS pandemic took a life every minute in 2021, with 650,000 AIDS-related deaths despite the development of effective HIV treatment and tools to prevent, detect and treat infections. Too many countries and too many communities observed rising numbers of new HIV infections when there needed to be rapid declines.

The statistics are even more dire within marginalised communities. The risk of contracting HIV is 26 times higher among men who have sex with men, 29 times higher among people who inject drugs, 30 times higher for sex workers, and 13 times higher for transgender people. This is because discrimination, harassment and punitive laws make it especially difficult for members of key populations to access and use condoms, despite their higher risk of HIV infection.

Greater sexual health education, legal reforms and better access to condoms are required in unison to address these growing inequalities, as recognising the equal worth of individuals is not only an ethical responsibility but one that is imperative for overcoming HIV/AIDS. If there is one lesson that the COVID-19 pandemic has taught us, it is that a pandemic cannot be overcome anywhere until it is overcome everywhere.

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OPERATIONAL HIGHLIGHTS

As ports around the world struggled to clear bottlenecks caused by the COVID-19 pandemic, vessels were often delayed causing the price of shipping to escalate to unprecedented levels. This combined with rising energy costs from the war in Ukraine translated into complicated supply chain problems around the world. This challenged our operations teams with having to optimise and synchronise the purchasing of raw materials, booking of containers and managing our storage facilities. Our teams ultimately responded admirably by developing improved communication protocols, inventory management systems as well as diversifying our service providers in order to insulate ourselves from short term volatility over the course of the year.

These same supply chain disruptions felt all around the world also resulted in inflationary pressures and an inability for many companies in Malaysia to source foreign labour. Fortunately for us, we had a few years prior, already embarked on a comprehensive automation programme that has allowed us to reduce our dependency on labour whilst also improving our quality standards. The application of technology to maximise efficiencies and keep costs at a minimum is likely to become more and more critical moving forward as global inflationary pressures persist.

Recent years also saw the impact of rapidly evolving medical device regulations across the world with regulators implementing a more holistic approach to manufacturer audits. Our quality assurance and compliance teams worked tirelessly during the year to ensure that no detail was overlooked despite the widespread changes to the regulatory landscape. Many of our commercial segment orders required our facilities to be audited by a variety of independent boards during the year so that our customers were always assured that product standards met their respective jurisdiction requirements.

Our distribution offices of Pasante Healthcare Limited ("Pasante") (based in the United Kingdom) and Global Protection Corporation ("GPC") (based in the United States of America ("USA")) continued to develop sales in various channels as western economies began to lift restrictions. GPC improved sales via its private label business as well as by continuing to capture notable health department contracts across the USA. Our Pasante team employed several creative social media campaigns and strategies that resulted in an improvement of over 20% in their online sales.



As our research and development teams continue to work to improve user experiences via the incorporation of new packaging and condom material science, we have also been working hard to push the agenda on reducing the social stigma surrounding condom usage. In February 2022, the United States Food and Drug Administration announced that ONE® and myONE™ Custom Fit™ became the first and only condom brands to be approved for anal sex, not just vaginal sex. This was achieved through clinical trial evidence collected by the Rollins School of Public Health at Emory University. The news was reported across the world, including notable outlets like The New York Times, Boston Globe, Metro UK, The Daily Beast, and even Saturday Night Live.

In addition to furthering the social agenda, we also continued to recognise the importance of prioritising other aspects of sustainability to deliver long term results. Our facilities in Malaysia and Thailand continued to work with the Supplier Ethical Data Exchange (Sedex), opting for the comprehensive four pillar SMETA (Sedex Members Ethical Trade Audit) audits to provide an independent, holistic evaluation of our labour standards, health and safety, environment and business ethics. More details of our sustainability efforts can be found in our Sustainability Statement on pages 18 to 35 of this Report.

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FINANCIAL REVIEW

With many countries taking conservative approaches to COVID-19 prevention measures for much of the financial year ended 30 June 2022 ("FY2022"), sales to many markets were affected. A record-breaking year of personal lubricant sales helped to make up for the subdued demand for condoms. The capture of new markets and successful implementation of price increases resulted in our Group sustaining its year-on-year sales growth momentum with sales totalling RM421.6 million.

Despite these efforts, we were not spared from the inflationary pressures caused by the related disruptions to global supply chains and uncertainty stemming from the Russia-Ukraine war. Freight rates remaining heightened and were compounded by price volatility in key raw materials such as silicone oil and packaging. These combined with the implementation of an increased minimum wage in Malaysia to pressure profitability and resulted in a loss after tax for FY2022.

The challenges in managing the disruptions to the supply chain were reflected in an inventories total of RM152.4 million, representing an increase of over 16% from the previous financial year. This total captured the higher raw material stocks that had to be kept on hand in order to avoid disruptions to our operations, as well as goods that were unable to be delivered due to closures to logistics facilities.

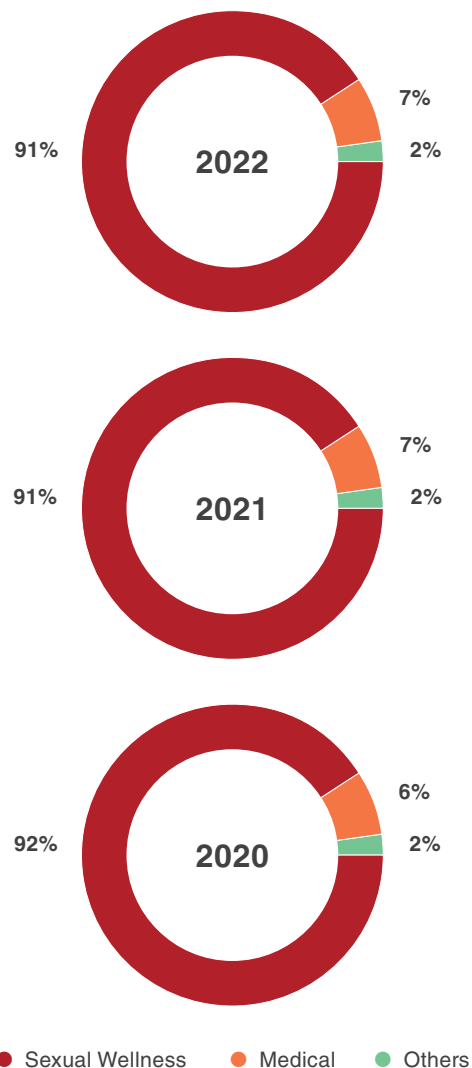
Although net operating cash flow remained positive for the year, the continued investment in our glove facility in Hat Yai, Thailand along with higher working capital requirements arising from increased sales and inventories resulted in a reduction to our year end cash balance to RM21.9 million. Shareholders' funds correspondingly decreased to RM457.8 million as at 30 June 2022. The increase in current assets was offset by an increase in trade payable arising from higher raw material purchases that corresponded to an increase in current liabilities and a current ratio of 1.84x for the year.

The investment in the plant and equipment at the glove facility contributed to the majority of the RM35.7 million of capital expenditures for the year expanding the non-current asset base to RM394.4 million and the total asset base to RM690.6 million. This investment also required the utilisation of additional term loans bringing the non-current liabilities total to RM71.9 million corresponding to an increase in gearing ratio to 0.27x and a net assets per share of RM0.43 at the close of the year.

Product Divisions

With many condom markets remaining affected by lockdowns and inaccessibility during the year, personal lubricant sales delivered a record year that helped to make up the shortfall within the Sexual Wellness division. This improvement reflects the huge potential for the product division moving forward as social life normalises and humanitarian aid projects resume around the world.

Sales of catheters and probe covers continued on a stable growth trajectory following a record year during the previous year. Although setbacks to the glove venture meant that there was no contribution for the year, we made strides to progress to the final stages of validating our production lines. Sales of gloves are expected to complement the offerings in the growing Medical division once commercial production commences in the upcoming financial year.



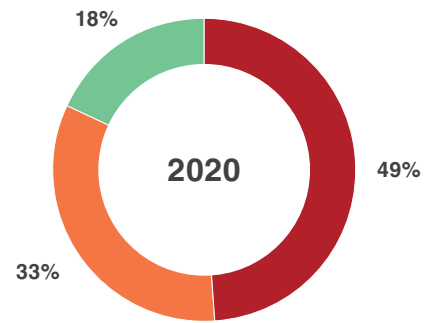
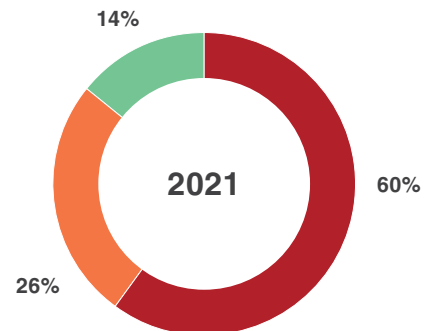
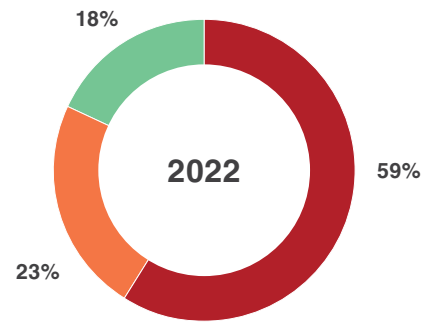
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Market Segments

Tender segment sales that typically rely on social welfare channels for distribution in developing parts of the world remained the most affected by recent global events. Not only did non-governmental organisations struggle to re-establish supply lines following a two-year hiatus, but humanitarian aid budgets were again redirected to new emergency relief requirements in Europe. As a result, the contribution of tender segment sales dipped below 24% of Group revenue for the first time since our Group’s listing.

The disruption to social welfare channels in many markets along with the increase in adoption of e-commerce platforms continued to catalyse the switch towards private market providers. We continued to work hand in hand with a wider range of brand owners to design and manufacture products intended to keep up with the rapid change in consumer preferences. Commercial segment sales remained core to our Group during the year as they leveraged most on our experience as a proven manufacturer to provide customers creative products that are also competitively priced.

Despite facing fierce competition for shelf and online advertising space, our Own Branded Manufacturing (“OBM”) segment continued to make inroads in many markets by employing unique digital strategies. ONE® Condoms in particular, continued to garner top results and recognition from agencies that have enabled us to expand our brand visibility and trust amongst consumers. New distribution arrangements have been planned to continue to facilitate the growth of our in-house brands in a segment that has become integral over the past few years.



● Commercial ● Tender ● OBM



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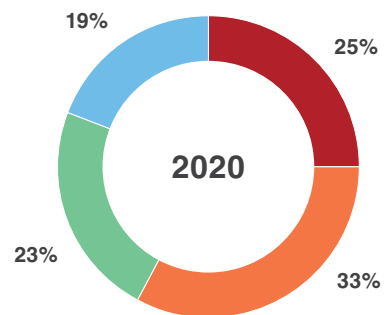
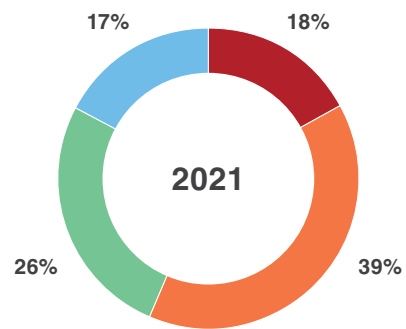
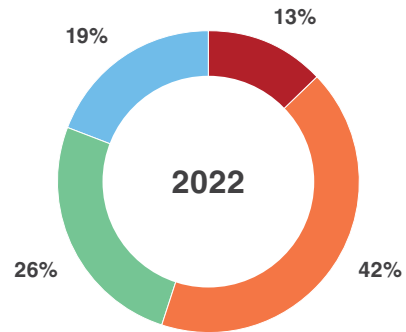
FINANCIAL REVIEW

Geographical Regions

Deliveries of orders to the African region during FY2022 were particularly problematic due to port closures and disruptions to distribution networks. These issues caused many orders to be delayed and held in transit over the course of the year. This region has typically been associated with humanitarian aid efforts in the form of tender sales that also reflected a corresponding decline in contribution.

Demand from the Asian region was also negatively affected with many countries including China and Japan observing stricter COVID-19 immigration controls in contrast to their Western counterparts. This impacted tourism and limited social interactions which led to a stagnant contribution from what was previously the fastest growing region in terms of condom usage. With healthcare and humanitarian aid budgets being directed to assist victims of the war in Ukraine, condom distribution in the European region also remained dampened.

As many markets began to lift restrictions in the Americas region, healthcare and education providers were able to resume sexual health education programs. This combined with the development of e-commerce providers and a return of tourism led to a surge in condom orders within the region. On the OBM front specifically, we were able to conduct many prospective discussions with retailers to start to extend and deepen the market presence of our brands within the region.



● Africa ● Americas ● Asia ● Europe



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OUTLOOK

Even with all the radical changes and technological advancements in the world over the past few years, condoms remain the most widely used method for preventing HIV and other sexually transmitted infections, and for preventing unintended pregnancies. They continue to be produced inexpensively and regulated strictly with the United Nations re-affirming that increased condom use since 1990 is estimated to have averted 117 million new HIV infections globally.

There is an obvious need to revive large-scale distribution and education of condoms and lubricants especially within the populations of greatest need. As detailed in our geographical revenue segmentation, these happen to be the areas that have had their supply of condoms most affected by recent global events. Fresh attention and investment is expected to commence imminently to address the neglect for these programmes and to get back on track to meet global targets to end AIDS by 2030.

In addition to the resumption of condom programmes where they are most required, we envisage that opportunities will also arise from a world seeking to rekindle social interactions. As schools and health centres reopen, we are already observing a surge in orders intended to restock empty inventories. E-health services are another promising innovation resulting from the pandemic that have allowed younger populations to access condoms over discrete digital platforms that help to facilitate healthier choices without embarrassment or stigma.

Although the business climate remains challenging with the logistics backlogs and inflationary pressures persisting around the world, we have invested the necessary time and effort to transform our organisation into a more robust entity. The investments in sustainability and innovation put us in prime position to understand the changing needs of consumers and capture opportunities as the world emerges from the COVID-19 pandemic and seeks to re-establish its foothold in the battle against HIV/AIDS.

ACKNOWLEDGEMENTS

As many of you would undoubtedly have read, Tun Dato' Seri Arshad Ayub who served as the Chairman of our Board of Directors passed away during the year. I am forever grateful for the opportunity of having worked alongside him and in the process benefited from his unique perspective. His guidance and contributions were instrumental to our Group's progress over the years, and he leaves behind a legacy of having made an impactful improvement to sexual health for millions around the world during his tenure at Karex.

During a period particularly filled with trials and tribulations, I am sincerely appreciative of our family at Karex that encompass not only our staff but also the many customers, suppliers and partners that have worked tirelessly with us. I remain confident about the progress that we have made and very much look forward to what our future holds.

Finally, I want to thank and acknowledge our shareholders for your patience and continued support. We are working very hard to repay your belief and remain fully focused on delivering long term value.

MK Goh
Chief Executive Officer

