

CEO's Management Discussion & Analysis



INDUSTRY OVERVIEW

The COVID-19 pandemic represents one of the greatest challenges that humanity has faced in recent years. With over 30 million people infected at the time of writing, the outbreak has caused immeasurable disruption with almost all nations struggling to slow down transmission, develop new social protocols and fortify their public health systems. The resulting containment measures have caused unprecedented economic turmoil and the sexual wellness industry has not been spared.

The provision of condoms has long been a cornerstone of the global fight against HIV, however, during the pandemic, manufacturers like ourselves have faced extraordinary challenges to deliver condoms to key affected populations around the world. These disruptions coupled with volatile commodity prices and reduced humanitarian aid budgets have ushered in a period of unprecedented consolidation within the industry and threatened the world with a global condom shortage.

This is especially worrying as according to the UNAIDS Global AIDS Update 2020, 12.6 million people out of the 38.0 million people living with HIV around the world today are still awaiting life-saving treatment. Progress towards ending AIDS as a public health threat by 2030 was already off track before the COVID-19 outbreak. This crisis now has the potential to blow the world even further off course. They warn that a six-month disruption to medical supplies could result in an additional 500,000 AIDS-related deaths in sub-Saharan Africa alone by the end of 2021.

In order to avoid wasting decades of progress, it is critical that we continue to adapt our business and develop new routes-to-market that more effectively meet consumer needs. This requires evolving within a consumer goods space that has continuously transformed over the last few years with technology improvements and “new age” consumer behaviour changing the way that businesses interact with customers.

The severity of the COVID-19 pandemic also raised serious safety concerns for our own employees and communities. Safeguarding our Karex family has been a key priority amidst our ambitions to grow as an organisation during this period. We have undertaken several measures during this period that are aimed at reinforcing our commitment to building a sustainable business model for all our stakeholders. Further details on our sustainability efforts can be found in the Sustainability Statement on pages 16 to 29 of this Report.

OPERATIONAL HIGHLIGHTS

Much of our ability to respond quickly and appropriately to the challenges presented during the COVID-19 pandemic has been due to the investments in our core competencies and the efforts of our global teams. Our Group's unique ability to blend cutting edge brand campaigns with market leading manufacturing capabilities is a testament to the quality of collaboration between our teams around the world.



We have continued to automate our manufacturing processes in an effort to reduce our dependency on labour and improve our quality controls during the year. We incorporated machinery designed to improve our packing processes in addition to several more state-of-the-art automatic electronic testing machines during the year. This has in turn allowed us to roll out a new manpower redeployment plan between our facilities to more efficiently utilise our existing pool of talent.

An improved inventory management system also yielded significant benefits during the year. The efficient planning and production of condom orders has become increasingly challenging as many manufacturers struggle to cope with the sheer variety of product variants, packaging and flavouring that consumers are demanding in the recent times.

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Our efforts to expand our capacity and improve our processes have resulted in a slew of notable achievements at our Thailand facility during the year with an increase in overall production of ultrathin condoms and the award of the Industrial Estate Authority of Thailand's prestigious Eco-excellence award to name a few. Our Thailand facility is expected to continue to play an increasingly important role in our Group with the addition of additional catheter and personal lubricant lines completed during the year.

In a continued effort to explore new ways of making a positive impact on the health and wellbeing of our employees and other stakeholders, I am particularly proud of how we responded quickly to the developing crisis and re-tooled several of our lubricant manufacturing lines to produce hand sanitizers. The initial few production runs were reserved for our staff and donated to frontline healthcare workers. This experience contributed to us exploring the addition of new medical products to our portfolio, and eventually led to our decision to commence construction of our medical glove facility.

We have progressively increased the utilisation rate at our dedicated latex compounding facility. Aside from benefiting from improved quality consistency and cost efficiencies, we have also as a result of this venture been admitted as a member of the Fair Rubber Association. This provides our customers assurance that the products purchased from our Group will have been manufactured with latex that contributed to an improvement of the working and living conditions of the primary producers of natural latex.

In response to key public health site closures around the USA, Global Protection Corp launched ONE®@Home, a program to continue supplying condoms directly to individuals. This incorporated a partnership with some of our largest public sector customers, such as the Iowa Department of Public Health. The program was heralded as an innovative solution to pressing public health issues and was subsequently featured on the Colbert Report as well as media publications such as Time Out.

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With the pandemic affecting many of the routes to market in Europe, most significantly the National Health Service with clinic closures and redeployment of key personnel, Pasante Healthcare Limited leveraged on its online platforms to record encouraging sales growth during the year. Moreover, we strengthened our position as a medical product distributor and private label manufacturer with the addition of several key markets within the Europe region during the year.

In conjunction with our commitment to prioritising innovation within our Group, we completed the rebuilding of our dedicated research and development facility during the year. The new facility was outfitted with a full-fledged microbiological lab and particle analysis machinery to more closely scrutinise the quality of raw materials used in our production processes. These additional resources are also anticipated to assist with our efforts to develop new materials for the sexual health space.

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FINANCIAL REVIEW

For the financial year ended 30 June 2020 ("FY2020"), our Group recorded a revenue of RM395.1 million, representing a modest growth of 4.4% in comparison to the previous financial year. This result is encouraging as much of the second half of the financial year was characterised by disruptions to typical customer purchasing patterns and global supply chains.

During the initial stages of the COVID-19 pandemic, our Malaysian operations were fully suspended for a period of 10 days. We were subsequently allowed to resume operations in a limited capacity for the remainder of the Movement Control Order. In addition to the detrimental effect on our manufacturing output, this caused our Group to incur idle operations expenses that resulted in a reduction to the overall gross profit margin of 22.2% for the year.

Global logistic disruptions also resulted in an inability to deliver finished goods to certain customers during the second half of the financial year. This effect is registered by the build-up of inventories amounting to RM128.9 million at the end of FY2020, representing an increase of approximately 7.7% from the previous financial year.

In spite of the challenges posed in managing inventories during this period, improvements to credit controls and standardising payment terms lead to an improvement in the cash conversion cycle during the year. This helped us continue to preserve agility on our balance sheet with a sustainable cash balance of RM46.3 million and shareholders' funds totaling RM480.1 million translating into a gearing ratio of 0.11x for the year.

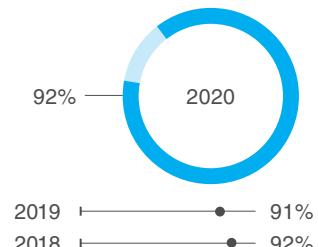
Capital expenditures for the year amounted to RM23.1 million as we incorporated greater degrees of automation into our production processes and invested in the expansion of the catheter and personal lubricant production capacity at our Thailand facility. This contributed to a total non-current asset base of RM348.2 million and a corresponding total asset base of RM621.8 million for the year.

Product Divisions

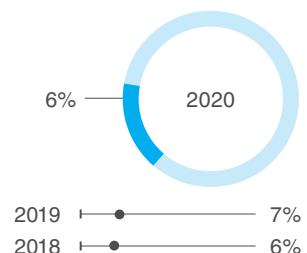
The Sexual Wellness division consisting mainly of sales of condoms and personal lubricants recorded an encouraging growth of approximately 5% compared to the previous year despite the complications presented above.

The Medical division consolidated its impressive performance from the previous year with our facilities running at full capacity for much of the year. Additional catheter production capacity was completed during the year that should galvanize the division looking ahead. The Medical division is expected to play a more integral role moving forward with the global emphasis on personal hygiene leading to an increase in demand for medical products worldwide.

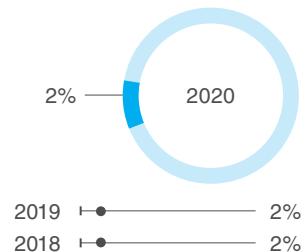
SEXUAL WELLNESS



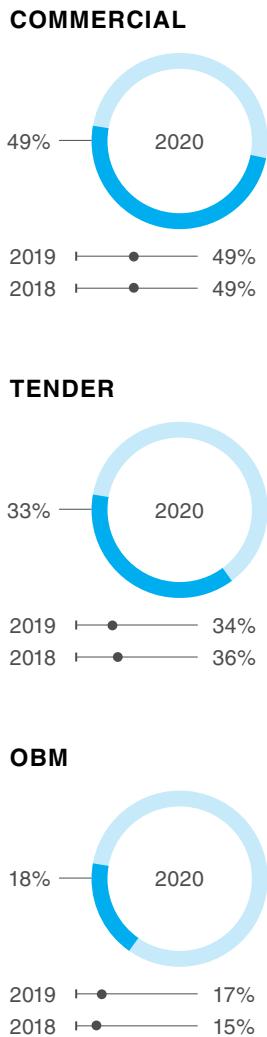
MEDICAL



OTHERS



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Market Segments

Sales to the Tender segment incurred another challenging year with many humanitarian aid programs turning their attention towards COVID-19 relief instead of sexual health issues. The immediate effect on stock levels and condom accessibility within key risk population areas prompted UNAIDS to issue a warning that the global response to reduce HIV, sexually transmitted infections ("STIs") and unintended pregnancies over the past three decades stood to be wasted if condoms access was not prioritised during this period.

The Commercial segment continued to replace condoms typically supplied by governments and NGOs in the past. Sales from this segment constituted an ever-changing range of product varieties and packaging, testing our capabilities as a global manufacturer. During the year, we continued to develop our relationships with several rapidly growing brands, working alongside them to revamp their product offerings and optimise production schedules to suit their respective markets.

Our Own Branded Manufacturing ("OBM") segment continued to build on previous year's performance to post yet another all-time high revenue contribution during FY2020. ONE® Condoms continued to expand its footprint with a new launch in Thailand in addition to expanding its e-commerce presence. Moreover, the brand's impressive performance across various direct-to-consumer sales channels underpinned the brand's appeal to the younger generation that have turned to e-commerce during the pandemic.



Geographical Regions

Sales to the Africa and Asia regions, primarily from the Tender segment were impacted during the second half of the year as a consequence of global logistic disruptions. Many ports and distribution networks were unable to receive and process goods during this period leading to lower revenue recognition from these regions.

The Europe region recorded a sales increase of approximately 12% from the previous year triggered by a surge of demand for medical products from one of the worst affected regions by the pandemic. We continued to consolidate our position as a key sexual health distributor in the region with the addition of several new distribution channels during the year.

Record high sales to Americas region underlined our Group's continued efforts to develop the OBM Segment. Sales to this region encompassed condom sales from all three market segments during the year. We remain optimistic that we will continue to strengthen our position in the region that is well-known for being extremely competitive in the past.

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OUTLOOK

I echo the message shared by UNAIDS in urging the world to learn from our decades-long fight against HIV when formulating our responses to the COVID-19 pandemic. In an April 2020 brief, UNAIDS emphasised the need to ensure the continuity of condom supply, distribution, promotion by actively working with partners to sustain condom programming throughout the crisis. This has presented a unique challenge to both the sexual health and medical industry worldwide, with the consequences of further disruptions potentially leading to a shortage in supply and an increased incidence of HIV, STIs and unintended pregnancies especially for members of key populations who already face increased vulnerability in this crisis.

Although it is impossible to determine the precise course of the pandemic and its economic consequences, what we can takeaway is that condoms remain essential tools for family planning as well as preventing the spread of HIV and other STIs. The widespread disruption to supply chains and emphasis on social compliance has challenged manufacturers like never before and in the process caused consolidation in the industry.

It is more critical than ever that we leverage on our manufacturing experience, cost competitiveness and breath of offerings as compelling competitive advantages to enable us to capture orders within the sexual wellness space that is poised for change.

On the branded side of the business, we have a strong set of brand initiatives in place to continue to excite and inspire our customers whilst maintaining our ambitious growth trajectory. Creating new ways of reaching our customers, such as through e-commerce platforms or social media, will remain critical over the next few months as lockdowns gradually ease and consumers slowly regain their confidence.

Though the threat to public health and economic recession is likely to persist for months to come, I am comforted by the fact that our Group continues to be driven by a culture of entrepreneurship. I have witnessed first-hand the resourcefulness and creativity of our teams in recent months and I am convinced that this will ultimately distinguish us from our peers and enable us to seize opportunities during these uncertain times.

ACKNOWLEDGEMENTS

I would like to thank our teams worldwide for their dedication and resilience over the past year. It will take time to heal from this terrible pandemic but I believe now more than ever, our communities are looking to Karex to provide them a sense of inspiration during this period of hardship.

I am also grateful to the Board of Directors who have, as always, provided us invaluable guidance through these challenging times.

Having served on the Board of Directors at Karex since our listing in 2013, Law Ngee Song has decided not to seek for re-election during the upcoming AGM. I would like to express my sincere gratitude on behalf of our organisation for his invaluable insight and advice over the years. He has undoubtedly played an integral role in our growth and I wish him all the best with his future endeavours.

Finally, thank you - our shareholders, for your continued trust and support, and most especially for the privilege of leading our Group as we continue to execute bold strategies, develop innovative solutions and products, and above all, ensure that sexual health is within reach of everyone, everywhere.

MK Goh
Chief Executive Officer

