

CEO'S MANAGEMENT DISCUSSION & ANALYSIS



MK GOH

Chief Executive Officer

INDUSTRY OVERVIEW

Not too long ago, the global AIDS pandemic seemed unstoppable with more than 2.5 million people contracting HIV each year and AIDS claiming over 2 million lives a year. In the years since then, effective treatment and access to contraception have made a commendable impact. The Joint United Nations Programme on HIV/AIDS (“UNAIDS”) reports that an estimated 1.3 million new infections were reported in 2022, the fewest in decades.

Even more importantly, the most significant reduction in new infections over the past few decades have been among young people whom interventions were targeted at. These results are a testament to the efficacy of global humanitarian aid programmes as well as to the importance of ensuring that good quality and affordable contraception remain available to those most in need.

Furthermore, UNAIDS analysis shows that where HIV prevention funding has increased, HIV incidence has declined. In spite of the results, there remains concerns that the funding gap for global HIV is widening. Having increased substantially in the early 2010s, HIV funding has fallen back to the same level as in 2013. More funding for prevention programmes, especially among key populations, is badly needed as is smarter, more cost-effective use of those funds.

This is where condoms continue to play an integral role. Condoms remain the only method for simultaneously preventing HIV, other sexually transmitted infections, and unintended pregnancy. Moreover, they are inexpensive and have a cache of familiarity built up via decades of sexual health education. They are especially effective when used in conjunction with other prevention and treatment methods such as personal lubricants or antiretroviral therapy.

Recent years, however, have seen the defunding of condom programmes and reduced emphasis on sexual health education drives in many countries. As a result, there are concerns that future generations of young people will lack adequate information about condoms and access to them. A 2020 systematic review by UNAIDS reported that condom promotion programmes were still effective in changing attitudes, social norms and beliefs in favour of condom use. As a result, declining use of condoms since the pandemic points to a requirement to revive sexual health education drives in order to refresh demand for a very vital product.

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OPERATIONAL HIGHLIGHTS

The supply chain disruptions over the last few years coupled with the higher volume of sales following the pandemic created an urgent need to improve our inventory management systems. Some of the improvements that we implemented during the year include the construction of a new hub at our Hat Yai, Thailand facility allowing us to centralise packing operations as well as the expansion of our warehousing facilities to cater for greater volumes moving forward. These capital expenditure investments were supplemented with improvements to our enterprise resource planning system as well as a reorganisation of our planning teams in order to facilitate better internal communication and efficiencies throughout our supply chain.

As sexual health awareness improves, we receive an increasing number of enquiries from customers regarding personal lubricants. Customers are able to select from a variety of packaging styles as well as compounds ranging from silicone to water-based lubricants. As such, we have continued to explore new methods and equipment to scale up personal lubricant production to cater for the growing demand. Similarly, new machines were installed at our catheter facility that will yield better output and a lower reliance on manpower to cope with the growing demand of another key product segment.

As medical device regulations have evolved in recent times, our facilities are frequently subjected to independent audits conducted by third party regulators as well as international customers. Some of the upgrades to our facilities to improve quality consistency in line with these increasingly stringent requirements include enhancing the sterilisation and climate control of our personal lubricant facilities as well as installing electricity and pressure stabilisation systems to safeguard against surges or irregularities during the condom electronic testing process. Beyond merely quality audits, more of these compliance evaluations also consider aspects of operations such as social compliance and environmental emissions requiring more staff and expenditure in order to maintain certifications.

Our fully owned subsidiary Global Protection Corp. ("GPC") (based in the USA) was able to register significant sales growth as public sector condom distribution efforts resumed in the USA. We also expanded our direct-to-consumer operations for both ONE® Condoms and MyONE® Custom Fit™ online through collaborations with Amazon. GPC also built on its success from the previous year when the United States Food and Drug Administration acknowledged our brands as the first and only condom brands to be approved for anal sex.

We have since worked with a major retailer to develop the ONE® Backdoor Pack™, which launched on shelves nationwide across the USA during the year. This was highlighted in the media including on outlets such as Yahoo News and HIV Plus Magazine. In December 2022, Popular Science Magazine listed ONE® Condoms being cleared for anal use on its list of "The 100 Greatest Innovations of 2022".

Each year our research and development teams explore new ways to push the boundaries in search of the next generation of condoms. Several improvements were made to our formulation processes building on the commissioning of our own latex compounding plant several years ago. These improvements are aimed at providing us with a better control of the latex formulations used, allowing for greater yields of ultrathin condoms. Over the course of the last few years, we continued to ramp up our efforts to develop synthetic materials to offer customers a commercially viable alternative to traditional latex condoms. These investments in material development are expected to pay dividends once the requisite validations and clinical trials are completed.

We continue to recognise that a commitment towards all aspects of sustainability will be the best avenue to deliver long term value for our stakeholders. We have continued to build on the success of previous years by yet again improving our Environmental, Social and Governance sustainability score, achieving our highest ever score since being included on the FTSE4Good Index of Bursa Malaysia in June 2020. More details of these efforts and their results can be found in our Sustainability Statement on pages 17 to 39 of this Report.



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FINANCIAL REVIEW

As the dust settled in many communities following the COVID-19 pandemic, customers around the world found themselves searching for competent manufacturers to refill depleted inventories of condoms and lubricants that had been neglected during the past few years. Unfortunately, many manufacturers had also ceased operations or significantly downsized owing to the challenges of the pandemic. This provided our Group with the opportunity to capture new markets and offer fresh product solutions to customers leading to a record year of sales totalling RM532.1 million for the financial year ended 30 June 2023 ("FY2023"). This represents an increase of approximately 26.2% from the previous financial year that had also been a record sales total at the time.

The regularisation of logistics networks also facilitated the gradual normalisation of raw material prices and freight rates during the year. Although not fully returned to pre-pandemic levels during the financial year, this enabled better planning of raw material inventories and product deliveries to customers, ultimately resulting in an improvement in aggregate gross profit margins which surpassed 25% for the first time since the financial year ended 30 June 2020.

The effects of record sales and improving gross profitability were however dampened by elevated administrative expenses comprising of costs associated with maintaining certifications as well as investments into research and development. This spending represents the growing cost of business related to operating in such a globally regulated consumer products industry. Notwithstanding that, we recorded a profit before tax of RM15.1 million, representing an increase of RM21.6 million from the previous financial year and a return to profitability.

Cashflows from operations totalled RM7.0 million for the FY2023 which was also a marked improvement from the previous financial year and helped to contribute to a year end cash balance of RM31.8 million. The easing of logistics disruptions also eased the burden of uncertainty allowing us to normalise raw material inventories from previous year, however, the increase in semi-finished and finished goods and goods held in transit from a higher sales base ultimately resulted in an increase in inventories to RM157.7 million. Correspondingly, the current ratio improved marginally from the previous financial year to 1.86 times.

With the majority of equipment already installed at our glove facility in Hat Yai, Thailand, capital expenditures were reduced from the previous year to RM19.2 million and were mainly related to the installation of additional condom lines and expanding warehouse space. These investments continued to increase the non-current assets total to RM401.4 million and consequently total assets to RM721.7 million. We utilised several short-term facilities to fund increased working capital requirements during the year resulting in an increase in gearing ratio to 0.33 times and an increase in net assets per share to RM0.45 for the FY2023.

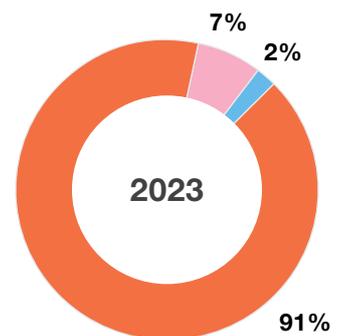
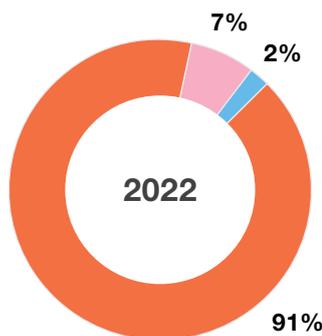
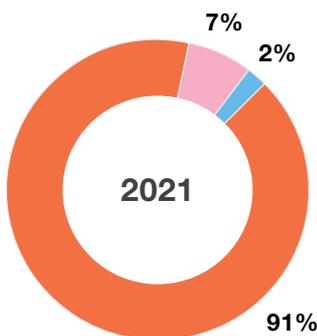


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Product Divisions

The Sexual Wellness division continued to account for 91% of overall sales. Whilst a recovery in condom sales was the main contributor to the division's performance, personal lubricants also registered yet another stellar year, growing over 25% from the previous year's record sales total. There remains a huge potential for this product sub-category as the market for personal lubricants continues to become increasingly regulated and sexual health education surrounding the product improves.

Medical division product sales comprising mainly of catheters and probe covers also increased by over 25% to keep pace with overall Group sales growth. Sales of catheters continued to account for the majority of Medical division sales with a significant improvement being registered following the installation of additional capacity that had limited production in the past few years. Delays in obtaining certifications coupled with unfavorable market conditions resulted in glove production being kept at a minimum during FY2023. Notwithstanding the current market conditions, sales of gloves are expected to pick up in the near-medium term in order to complement our Medical product portfolio.



● Sexual Wellness
 ● Medical
 ● Others

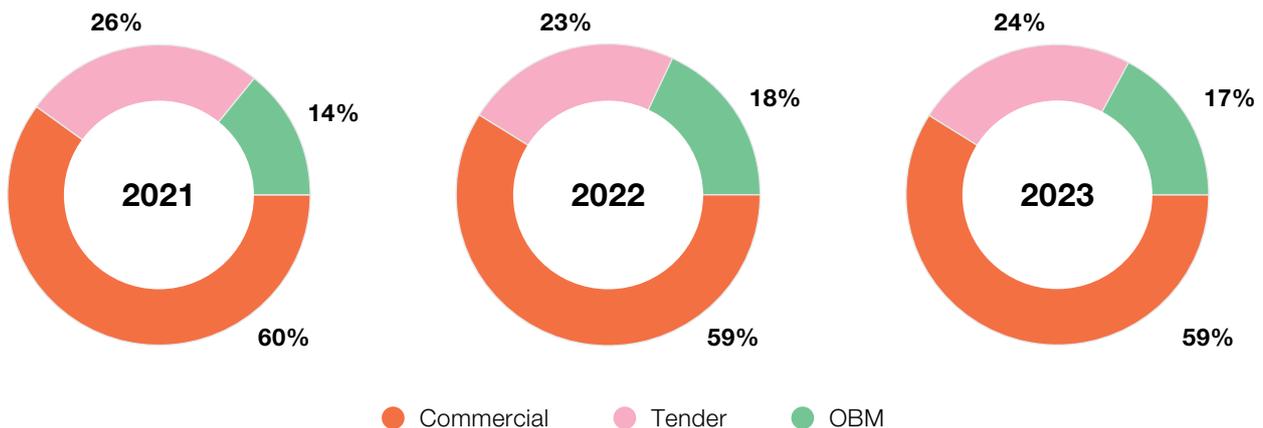
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Market Segments

The recommencement of humanitarian aid projects around the world, specifically those focused on combating the spread of HIV/AIDS resulted in the receipt of many urgent orders during the year. Many non-governmental organisations that had been relying on past inventories whilst the world was focused on the COVID-19 pandemic began to place orders during the year, resulting in our highest tender segment sales total since 2018. These orders encompassed sales of both condoms and personal lubricants, further establishing that the baseline of sexual health education had progressed since the beginning of the COVID-19 pandemic.

Commercial segment sales remained the core sales channel for both condoms and lubricants with many brand owners around the world acknowledging the value proposition that we offer as a manufacturer. We continue to remain competitive in terms of quality, cost, range of features as well as design capabilities. These traits along with our established track record as a proven manufacturer continue to be distinguishing factors as we continue to be the preferred choice for sexual health brands around the world. This segment is expected to continue to play a significant role as more of our research and development projects progress to commercialisation allowing us to offer our customers greater product differentiation.

Our Own Branded Manufacturing (“OBM”) segment continued to thrive utilising a multi-brand approach. Our most premium offering, ONE® Condoms continued to make inroads by expanding to several markets in Asia. Our healthcare brands such as Pasante and Trustex also registered strong growth in sales during the year. The growth of sales within this market segment is expected to be catalyzed by the increasing adoption of e-commerce platforms around the world.



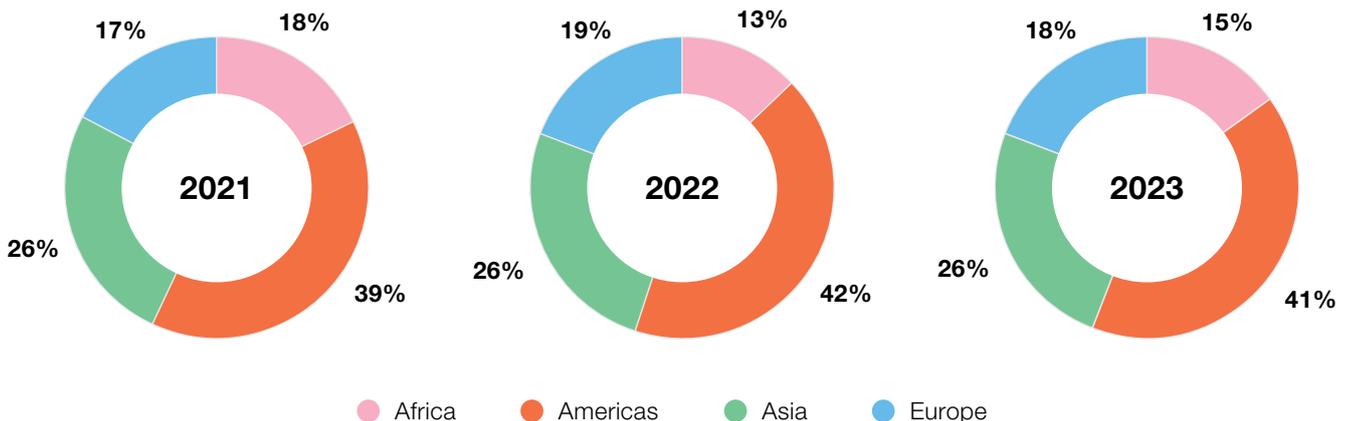
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Geographical Regions

Despite maritime trade normalising following the COVID-19 pandemic, high levels of uncertainty and geopolitical unrest resulted in complications that meant many supply chains in Africa were slow to recover to pre-pandemic functionality. Many of these effects eased towards the end of 2022 and sales to the region followed suit, demonstrating growth in excess of 40% from the previous year's affected totals. These orders mainly comprised of tender sales as has been historically the case.

Sales to the Asia region continued to encompass a blend of both physical and digital channels, contributing 26% of overall Group revenue. Although China's stringent lockdown policies affected physical retail spending for an extended period even up till the end of 2022, many retailers expressed optimism as international tourism began to resume across the region indicating that the period ahead would be one to watch for sales to this region. Sales to the Europe region in comparison exhibited a much stronger recovery during the year as exemplified by sales to the National Health Service in the United Kingdom increasing by 31% from the previous financial year.

As social activities resumed, sales to the Americas region, led by our subsidiary, GPC, continued to play a key role. Public sector channel sales were the highest ever in FY2023, as healthcare and education providers were able to expand sexual health education programs following the pandemic. This also meant that in the USA specifically, we were able to add more than 400 new customers in the public sector channel. This region is expected to represent a very diversified stream of revenue with sales from all market segments showing potential for growth.



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OUTLOOK

For all the gains made in the war against HIV, AIDS still claims 630,000 lives each year, mostly in marginalised and vulnerable communities. It is evident that investing into HIV prevention programmes has a tangible impact and a real chance of eradicating the HIV pandemic given sufficient consistency over the next few years. Unfortunately, there is also a growing funding gap in many of these areas putting the onus on affordable and effective solutions. We believe that condoms offered both through the tender market as well as via the private sector will have a very important role to play if the world is to achieve its goal of building the foundations of a sustainable AIDS response in the next few years.

With the increased use of personal lubricants during sexual encounters as well as by healthcare professionals for vaginal and rectal examinations, the industry has been increasingly regulated over the last few years. The United Nations Population Fund contributed to this by issuing a technical brief in May 2022 with the intention of ensuring that global efforts would result in the production, procurement and distribution of safe lubricants for all. These efforts have raised the barriers to entry and left many manufacturers who were unfamiliar with medical device regulations unable to compete, leaving fewer manufacturers to fill the rising demand. These developments undoubtedly represent an opportunity for us to capitalise on.

Whilst these developments illustrate the growth trajectory of the sexual health industry, it is also our belief that the investments in sustainability will continue to distinguish us from our competition. The consistent and transparent manner in which we have communicated our efforts towards achieving our sustainable goals has provided customers with the comfort and confidence that they are working with an organisation focused on building long-term value.

Market conditions moving forward are expected to remain challenging, with further inflation and consumers facing continued financial pressures. Whilst we are mindful of these issues, we believe that we have emerged as a much more formidable organisation following these past few years and possess the necessary tools including a diverse team, a strong innovation pipeline and most importantly a culture focused on delivering effective solutions to our customers.

ACKNOWLEDGEMENTS

I have always asserted that Karex's greatest assets are our people. The changes that we have implemented in order to survive these past few years and begin our path to recovery would not have been possible without the dedication and efforts of our employees. I am grateful to each and every one of you, as well as our exceptional Board of Directors whom have offered invaluable guidance during this challenging period.

Finally, thank you to our shareholders for your trust and continued support. I strongly believe that our best days are in front of us, and I look forward to achieving new heights together.

MK GOH

Chief Executive Officer

