2020 Annual General Meeting Chairman's Report

Welcome to the Annual General Meeting of Air Change International Limited for the financial year ended 30 June 2020.

This document has been distributed to update Shareholders on the position of the Group particularly given these COVID-19 challenging times.

This update should be read in conjunction with the Managing Directors review in the 2019/20 Annual Report.

The COVID-19 pandemic continues to disrupt Group operations but generally not in the manner that is commonly expected.

Sales orders have been very strong in the first quarter of this new financial year with the Group holding record forward orders at end of September 2020.
Orders received during the following six weeks to mid-November have slowed a little but have remained strong enough to almost maintain this record order book.

A small part of this substantial forward order backlog is due to supply chain issues with delays experienced in the delivery of parts and components from overseas suppliers that are required to manufacture the Group's range of products.

This delay in delivery has impacted Group profitability in the year to date because of manufacturing labour inefficiencies and lower overhead recovery resulting from lower sales volume. This will partly reverse when product is delivered and sales recognised but the additional manufacturing costs experienced cannot be recouped.

There is no indication at present as to when these freight and supply chain bottlenecks will totally cease but we expect the situation to improve in 2021.

An update on the Groups operations are detailed below.

(i) ***Australian Sales***
As noted above, Air Change product orders have been very strong in the first four and a half months of the year, particularly for the newer product lines that it now manufactures.

Dunnair product orders have been steady and in line with that achieved last financial year but there is no indication of significant growth at present.
This is partly due the higher level of competition in this segment of the HVAC market.
Where there is an overlap in the Dunnair and Air Change product offer, the sale has been assigned to Air Change.
New products have been developed that integrate different Air Change and Dunnair product attributes. These are marketed under the Air Change brand.

Fancoil Industry sales remain at subdued levels because of very significant price competition from imported air handing and fan coil units in the building services market. Fancoil sales primarily occur when individual bespoke solutions are specified that are not offered by the importers.
Fancoil enquiries often lead to Air Change product opportunities and sales.

Lastly, Summit Industrial Chiller sales have been steady and consistent with those achieved in the last financial year.
Summit again is not competitive in the building services sector and thus specialises in bespoke industrial cooling solutions which limits the available sales opportunities.

Provided that supply chain issues are resolved and orders continue at the present volume, then Group sales will be similar to that achieved last financial year.

(ii) ***Australian Manufacturing Operations***
As noted, Australian manufacturing operations are presently hindered by a lack of parts and components sourced from overseas suppliers.
Container services were reduced during the initial stages of the pandemic and have not been fully restored despite an increase in container traffic. This has caused shipping times to double on average.
This reduction in container services has also impacted the Groups component suppliers who have experienced delays in receiving their required component parts.
The overall result is that product supply times have increased and then take considerably longer to be shipped to Australia.

These delays have been exacerbated by the strikes at Australian ports with some shipping lines placing an additional surcharge on containers delivered to Sydney which has experienced the greatest delays.
To improve delivery times, the Group has shipped containers into Melbourne and road freighted them to Sydney at considerable extra cost.

As a result of these delays, labour efficiency has been impacted with many partly completed products awaiting the final part deliveries.
There have been instances where there are not enough parts to keep labour fully employed.

In addition to the impact on Group labour costs due to these delays, container freight rates have increased by over 40% since this time last year.
We expect container freight costs to increase by over $150,000 in this present financial year compared to last year for the same container volumes.

Airfreight has been even more severely impacted by the pandemic. With the cancellation of almost all passenger services to Australia, there are now only dedicated air freight services bringing goods into the country.
This has resulted in very large air freight price increases where services are available and delays in product manufacture where alternative sea freight has been necessary.

(iii) ***South East Asian Sales***
Sales that have occurred in Asia over the past 4 months were the fulfilment of orders taken earlier in 2020.
Although quotation volume has been very high, actual orders taken to date this financial year have been minimal.
There has been a reluctance in Asia to commence new projects but we expect this to change sometime in 2021.

(iv) ***Malaysian Manufacturing***
The Company has moved its Malaysian manufacturing operation to a new location in the state of Johor effective 1 November 2020.

The lessor of the vacated property had advised that the lease would not be renewed upon its expiry at end June 2021 and requested that we leave as soon as possible so that it could occupy the premises.
After nearly six months of investigation, a new property was found and a 3 + 3 year tenancy agreement agreed and executed effective from 1 December 2020.

The Group continues to use this manufacturing facility to produce products for South East Asia customers and to manufacture for the Australasian market.

(v) Government Assistance
Other than the Australian Governments cashflow boost program which has been applied to all companies in Australia, the Group has not received any other government support and has not presently sought to participate in the Job-keeper program.

(vi) Liquidity and Cashflow
As noted, shipping delays are impacting product deliveries and therefore Group cashflow.
All imported product and components are paid for prior to shipment.
As a result, partly completed product inventories have increased substantially with the corresponding impact on cashflow.

The Group has not breached any debt funding or other financial covenant or legal obligation as a result of these delays and is hopeful that this backlog of production will be cleared in the first quarter of 2021.

(vii) Insurances
The Group has just completed its insurance renewal program for the coming 12 months.
All insurances have suffered premium increases and for reduced cover in some cases.

Credit insurance has been most heavily impacted.
Premiums have risen nearly 50% with total coverage reduced at any point in time.
This reflects the economic uncertainty at this time.

ISR cover has similarly had a significant premium increase.

The ISR insurer has required improvements in the level of factory fire protection requiring the Group to commit additional capital expenditure.
This again reflects the heavy fire loss experienced by all insurers in Australia in the past 12 months.

Other insurance covers have had price increases but credit and ISR policies were most effected.

(viii) New Products and Product Improvements

The Group continues to research and develop new products and improve the quality and application of its existing product range.

(ix) Future Impact

It is very difficult to predict the future of any business at any time but this uncertainty has been heightened because of the pandemic and its impact on the Australasian and South East Asian economies where the Group both manufactures and sells its products.

There are positive trends in Australia with forecasts of a GDP rebound in 2021, albeit strongly consumer oriented.
Government stimulus though infrastructure spending may bring additional work in the next year for what are termed "shovel ready" projects.

Similarly, if quote volumes in South East Asia are a sign of future economic activity, then this market should see an improvement in 2021.

There are two worrying trends in the industry.
Firstly, contractors are quoting lower tender prices for projects on the expectation that suppliers will similarly discount their prices to secure the work.
This is forcing the industry to downgrade project specifications to meet these unrealistic price expectations.

Secondly, there is increased competition from overseas suppliers that have had a larger downturn in their local markets and are thus seeking to secure work in Australia at very low prices to maintain their operations.
The Group has lost a number of sales to foreign competitors at unrealistic prices in the past year.

The overall industry trend can be summarised as price reduction expectations in a market with increasing costs particularly for transport and insurances.

Alan Jones
Chairman
Air Change International Limited