

Rakon Limited

Looking Beyond a Solid FY23 Guidance Update

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Rakon (RAK) tightened FY23 guidance (ending March) by lifting the bottom of the range. Underlying EBITDA guidance range is now NZ\$40m to NZ\$44m (previously NZ\$38m to NZ\$44m). This is a +2% upgrade at the midpoint and aligns with our expectations of NZ\$41m. RAK also reported that "continued growth in global demand for our industry-leading products has meant we are on track to deliver a solid full year result". Its core business has been able to offset the tail-off in the short-term chip shortage business that gave RAK a significant boost in FY22 revenues. Consumer-focused peers have already seen sales pull back as customers adjust inventory levels. RAK has been insulated somewhat by its exposure to the 5G telecommunications infrastructure and industrial positioning sectors. However, this update hints at possible impacts to FY24. The company has said its new Indian facility remains on track for completion in mid-2023. We maintain our FY23 earnings estimates, but through a combination of lower revenue and gross margin estimates, we cut our FY24 and FY25 revenues by -5% and -7% respectively, and our underlying EBITDA estimates by -13% and -16% respectively. Comparable company multiples have de-rated as global economic demand softens. Our spot valuation, which now includes a blend of peer group multiples, falls to NZ\$1.39, down from NZ\$1.86.

NZX Code	RAK	Financials: Mar/	22A	23E	24E	25E	Valuation (x)	22A	23E	24E	25E
Share price	NZ\$0.92	NPAT* (NZ\$m)	24.3	19.9	15.8	22.6	PE	8.7	10.6	13.4	9.3
Spot Valuation	NZ\$1.39 (from 1.86)	EPS* (NZc)	10.6	8.7	6.9	9.8	EV/EBIT	n/a	6.9	9.1	6.5
Risk rating	High	EPS growth* (%)	n/a	-18.4	-20.5	42.9	EV/EBITDA	3.7	4.7	5.5	4.5
Issued shares	229.1m	DPS (NZc)	0.0	0.0	0.0	4.9	Price / NTA	1.6	1.4	1.3	1.2
Market cap	NZ\$211m	Imputation (%)	0	0	0	100	Cash div yld (%)	0.0	0.0	0.0	5.4
Avg daily turnover	72.0k (NZ\$96k)	*Based on normalised profits					Gross div yld (%)	0.0	0.0	0.0	7.4

What's changed?

- **Earnings:** We retain our NZ\$41.0m underlying EBITDA estimate in FY23 but reduce FY24 and FY25 forecasts to NZ\$35.1m and NZ\$43.5m, down from NZ\$40.3m and NZ\$51.6m respectively.
- **Spot valuation:** Our blended valuation falls -25% to NZ\$1.39. This now incorporates a mix of DCF and peer group multiples.

Near-term earnings remain solid with clouds on the horizon as customers adjust industry inventories. Acquisition approaching?

In forward-looking statements regarding FY24, RAK commented that "headwinds will continue into the first half of FY24, potentially impacting revenue and profit in the short-term" and "maintaining close customer relationships will be key to managing through inventory corrections". We factor in a slower growth trajectory in FY24 and FY25 (revenue +0% and +14%, respectively, on prior years) along with lower gross margins due to the continued inflationary environment and product mix changes. We make amendments to several other input lines (see Figure 1). RAK also mentioned accelerating its acquisition strategy with intentions to deliver access to new markets and technologies. At some stage, we expect a US-based acquisition, providing RAK with expanded R&D and manufacturing capability and for RAK to be seen as a 'local' manufacturer in the US.

Spot valuation now includes peer group multiples

Given the weakness in global economies, technology sector multiples have re-rated lower. We revise our spot valuation methodology to include a sector peer component at NZ\$1.14 (~13x FY23 PE). This revised methodology provides an improved link to industry performance and comparable companies. This, and the effects of lower revenue and margin assumptions on our NZ\$1.63 DCF, sees our spot valuation fall.

Rakon Limited (RAK)

Market Data (NZ\$)						Spot valuation (NZ\$)				
Priced as at 07 Mar 2023						0.92				
52 week high / low						1.72 / 0.91				
Market capitalisation (NZ\$m)						210.7				
Key WACC assumptions						DCF valuation summary (NZ\$m)				
Risk free rate						4.50%				
Equity beta						1.13				
WACC						9.9%				
Terminal growth						2.0%				
Profit and Loss Account (NZ\$m)						Valuation Ratios				
Sales revenue	2021A	2022A	2023E	2024E	2025E	2021A	2022A	2023E	2024E	2025E
Normalised EBITDA	23.5	54.4	41.0	35.1	43.5	9.3	3.7	4.7	5.5	4.5
Depreciation and amortisation	(13.4)	(13.2)	(8.9)	(10.4)	(9.9)	EV/EBIT (x)	>100x	6.9	9.1	6.5
Normalised EBIT	11.3	0.0	27.9	21.3	29.7	PE (x)	21.9	8.7	10.6	13.4
Net interest	(1.6)	0.4	(1.3)	(0.7)	(0.6)	Price/NTA (x)	2.2	1.6	1.4	1.3
Associate income	1.4	41.9	1.0	0.5	1.0	Free cash flow yield (%)	7.1	9.5	-1.5	11.4
Tax	(1.5)	(8.8)	(7.7)	(5.3)	(7.5)	Net dividend yield (%)	0.0	0.0	0.0	0.0
Minority interests	0	0	0	0	0	Gross dividend yield (%)	0.0	0.0	0.0	0.0
Normalised NPAT	9.6	24.3	19.9	15.8	22.6	Capital Structure				
Abnormals/other	0	0	0	0	0	2021A	2022A	2023E	2024E	2025E
Reported NPAT	9.6	24.3	19.9	15.8	22.6	Interest cover EBIT (x)	7.1	n/a	22.1	29.9
Normalised EPS (cps)	4.2	10.6	8.7	6.9	9.8	Interest cover EBITDA (x)	14.7	n/a	32.4	49.3
DPS (cps)	0	0	0	0	4.9	Net debt/ND+E (%)	-5.1	-20.8	-12.6	-29.4
						Net debt/EBITDA (x)	n/a	n/a	n/a	n/a
Growth Rates						Key Ratios				
2021A	2022A	2023E	2024E	2025E	2021A	2022A	2023E	2024E	2025E	
Revenue (%)	10.0	32.7	3.4	-1.7	14.3	Return on assets (%)	7.3	0.0	13.4	9.4
EBITDA (%)	58.8	>100	-24.6	-14.5	24.0	Return on equity (%)	9.3	18.0	12.8	9.3
EBIT (%)	>100	-99.7	>100	-23.7	39.6	Return on funds employed (%)	6.2	12.2	9.6	7.3
Normalised NPAT (%)	>100	>100	-18.2	-20.5	42.9	EBITDA margin (%)	17.9	31.4	22.9	19.9
Normalised EPS (%)	>100	>100	-18.4	-20.5	42.9	EBIT margin (%)	8.6	0.0	15.5	12.1
Ordinary DPS (%)	n/a	n/a	n/a	n/a	n/a	Capex to sales (%)	3.9	5.9	12.2	4.4
						Capex to depreciation (%)	45	89	309	91
Cash Flow (NZ\$m)						Segment Revenue (NZ\$m)				
2021A	2022A	2023E	2024E	2025E	2021A	2022A	2023E	2024E	2025E	
EBITDA	23.5	54.4	41.0	35.1	43.5	Telecommunications	77.0	86.2	98.3	103.2
Working capital change	7.2	(15.3)	(11.3)	6.0	(6.0)	Positioning	14.0	27.1	32.2	23.3
Interest & tax paid	(1.8)	(2.3)	(9.0)	(6.0)	(8.1)	Space and Defence	29.8	26.3	30.5	33.8
Other	(8.8)	(6.7)	(1.9)	(3.5)	(2.8)	IoT, Emerging and Other	7.4	32.3	15.6	16.1
Operating cash flow	20.1	30.2	18.8	31.6	26.6	Other revenues	2.5	1.6	2.9	0.0
Capital expenditure	(5.1)	(10.2)	(21.9)	(7.7)	(7.7)	Total Revenue	130.8	173.6	179.5	176.5
(Acquisitions)/divestments	0	0	0	-	-					
Other	(3.0)	(2.6)	(2.8)	(2.4)	(2.5)	Segment Gross Margin (%)				
Funding available/(required)	12.0	17.4	(5.9)	21.5	16.4	2021A	2022A	2023E	2024E	2025E
Dividends paid	0	0	0	0	(4.6)	Telecommunications	40	44	43	43
Equity raised/(returned)	0	0	0	0	0	Positioning	48	55	57	57
(Increase)/decrease in net debt	12.0	17.4	(5.9)	21.5	11.8	Space and Defence	68	69	69	68
						IoT, Emerging and Other	14	56	28	14
Balance Sheet (NZ\$m)						Underlying EBITDA				
2021A	2022A	2023E	2024E	2025E	2021A	2022A	2023E	2024E	2025E	
Working capital	50.6	65.8	77.1	71.1	77.0	Profit Before Income Tax	11.2	41.9	27.6	21.1
Fixed assets	18.3	21.4	34.9	35.0	34.8	R&D government grant	(8.7)	(8.9)	(10.2)	(9.8)
Intangibles	7.6	7.2	7.8	8.2	8.7	Financial Costs - Net	(1.6)	(1.9)	(1.3)	(0.7)
Right of use asset	7.2	4.8	2.4	9.8	12.3	Adj for Associate share of ITD	(1.8)	(2.2)	(1.9)	(2.7)
Other assets	29.6	25.5	25.5	25.5	25.5	Adj for Non Cash Items	0.2	(0.5)	0	0.8
Total funds employed	113.3	124.6	147.6	149.5	158.2	Underlying EBITDA	23.5	54.4	41.0	35.1
Net debt/(cash)	(5.0)	(23.2)	(17.3)	(38.9)	(50.7)					
Lease liability	5.4	3.4	0.6	8.2	10.7	Revenue Growth (%)	8	34	3	0
Other liabilities	9.0	9.3	9.3	9.3	16.0	Underlying EBITDA Growth (%)	59	132	-25	-15
Shareholder's funds	103.9	135.2	155.1	170.9	182.2					
Minority interests	0	0	0	0	0					
Total funding sources	113.3	124.6	147.6	149.5	158.2					

* Forsyth Barr target prices reflect valuation rolled forward at cost of equity less the next 12-months dividend** Information on Forsyth Barr's Carbon and ESG (CESG) ratings can be found at www.forsythbarr.co.nz/corporate-news-events/cesg-report

Earnings revisions

Figure 1. RAK – Earnings revisions (NZ\$m)

	FY23E			FY24E			FY25E		
	Old	New	Change	Old	New	Change	Old	New	Change
Revenue	176.6	176.6	+0%	185.7	176.5	-5%	217.5	201.7	-7%
Cost of sales	(90.3)	(90.3)	+0%	(98.0)	(93.2)	-5%	(115.1)	(106.2)	-8%
Gross Profit	86.3	86.3	+0%	87.6	83.2	-5%	102.4	95.5	-7%
Operating expenses									
Selling and marketing costs	(10.2)	(10.2)	-0%	(10.6)	(10.6)	-0%	(11.0)	(10.9)	-0%
Research and development	(17.8)	(17.8)	+0%	(18.0)	(17.8)	-1%	(20.9)	(20.6)	-1%
General and administration	(33.2)	(33.2)	-0%	(34.7)	(33.6)	-3%	(35.6)	(34.2)	-4%
Total operating expenses	(61.2)	(61.2)	-0%	(63.4)	(62.0)	-2%	(67.5)	(65.7)	-3%
Other gains/(losses)-net	2.9	-	n/a	-	-	n/a	-	-	n/a
Operating profit	27.9	27.9	+0%	24.3	21.3	-12%	34.9	29.7	-15%
Finance income	0.0	0.0	+3%	0.0	0.0	n/a	0.0	0.0	n/a
Finance costs	(1.3)	(1.3)	+0%	(0.8)	(0.7)	n/a	(0.7)	(0.7)	n/a
Share of net profits of associates	1.0	1.0	+0%	1.3	0.5	-60%	1.5	1.0	-33%
Profit before income tax	27.6	27.6	+0%	24.8	21.1	-15%	35.8	30.1	-16%
Income tax expense	(7.7)	(7.7)	+0%	(6.2)	(5.3)	-15%	(9.0)	(7.5)	-16%
Net profit for the period	19.9	19.9	+0%	18.6	15.8	-15%	26.9	22.6	-16%
Profit before income tax	27.6	27.6	+0%	24.8	21.1	-15%	35.8	30.1	-16%
Depreciation and amortisation	(10.2)	(10.2)	+0%	(12.6)	(9.8)	n/a	(12.9)	(9.9)	n/a
Finance costs - net	(1.3)	(1.3)	-0%	(0.8)	(0.7)	n/a	(0.6)	(0.6)	n/a
Adjustments for associate share of interest, tax and depreciation	(1.9)	(1.9)	+0%	(2.1)	(2.7)	n/a	(2.3)	(2.0)	n/a
Other non-cash items	-	-	n/a	-	(0.8)	n/a	-	(0.9)	n/a
Underlying EBITDA	41.0	41.0	+0%	40.3	35.1	-13%	51.6	43.5	-16%

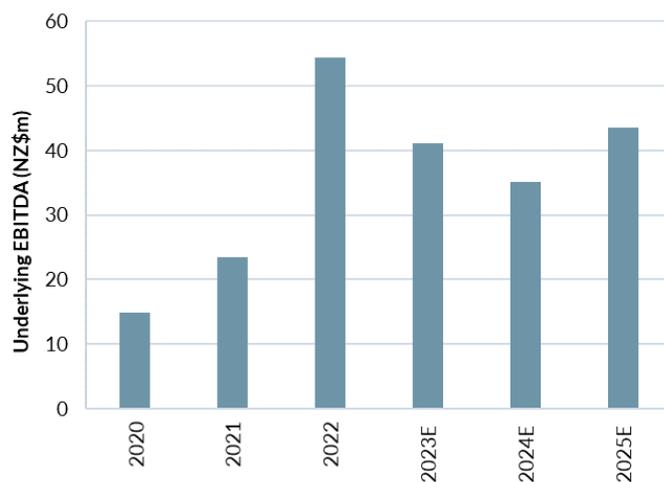
Source: Company, Forsyth Barr analysis

Figure 2. RAK – Revenue (NZ\$m)



Source: Company, Forsyth Barr analysis

Figure 3. RAK – Underlying EBITDA (NZ\$m)



Source: Company, Forsyth Barr analysis

Figure 4. Price performance


Source: Forsyth Barr analysis

Figure 5. Substantial shareholders

Shareholder	Latest Holding
Siward Crystal Technology	12.2%
Ahuareka Trust	10.9%
Wairahi Investments and Wairahi Holdings Limited	5.1%

Source: NZX, Forsyth Barr analysis, NOTE: based on SPH notices only

Figure 6. International valuation comparisons

Company	Code	Price	Mkt Cap (m)	PE		EV/EBITDA		EV/EBIT		Cash Yld 2024E
				2023E	2024E	2023E	2024E	2023E	2024E	
Rakon	RAK NZ	NZ\$0.92	NZ\$211	10.6x	13.4x	4.7x	5.5x	6.9x	9.1x	0.0%
Txc Corp	3042 TT	TWD89.40	TWD27,692	10.5x	n/a	6.2x	n/a	12.0x	n/a	n/a
Sitime Corp	SITM US	US\$131.86	US\$2,862	>75x	>50x	>75x	>75x	>75x	>75x	n/a
Microchip Technology Inc	MCHP US	US\$82.37	US\$45,122	13.8x	13.3x	12.2x	12.5x	13.0x	12.9x	2.0%
Siward Crystal Technology Co	2484 TT	TWD39.75	TWD6,337	n/a	n/a	n/a	n/a	n/a	n/a	n/a
Daishinku Corp	6962 T	¥752.00	¥27,220	8.1x	10.2x	5.4x	4.9x	10.6x	10.3x	3.7%
Nihon Dempa Kogyo Co	6779 T	¥1433.00	¥33,143	5.3x	5.7x	4.8x	4.5x	6.7x	6.9x	2.2%
Seiko Epson Corp	6724 JP	¥1887.00	¥754,111	8.4x	9.2x	4.0x	4.1x	6.7x	7.1x	3.8%
Compco Average:				9.2x	9.6x	6.5x	6.5x	9.8x	9.3x	2.9%
RAK Relative:				15%	39%	-28%	-15%	-30%	-2%	-100%

 EV = Mkt cap+net debt+lease liabilities+min interests-investments
 Source: *Forsyth Barr analysis, Bloomberg Consensus, Compco metrics re-weighted to reflect headline (RAK) companies fiscal year end

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