

# Rakon Limited

## Shooting for the Stars

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Rakon (RAK) has upgraded its FY22 underlying EBITDA earnings guidance range to NZ\$49m–NZ\$53m, up from its prior estimate of NZ\$44m–NZ\$49m. At the midpoint this is a solid +10% upgrade. The company has also shared its strategy going forward with investors, which includes winning in the high-growth 5G networks, cloud computing, LEO/NewSpace and autonomous vehicle markets. Given the underlying market strength and comments by RAK about mitigating supply chain issues, we now forecast FY22 underlying EBITDA at NZ\$51.0m, in the middle of the new guidance range and +3% on our prior estimate of NZ\$49.4m. Our spot valuation rises +3cps to NZ\$2.29.

NZX Code	RAK	Financials: Sep/	21A	22E	23E	24E	Valuation (x)	21A	22E	23E	24E
Share price	NZ\$1.90	NPAT* (NZ\$m)	9.6	34.6	19.8	24.2	PE	45.2	12.6	22.0	18.0
Spot Valuation	NZ\$2.29 (from 2.26)	EPS* (NZc)	4.2	15.1	8.6	10.5	EV/EBIT	39.1	11.4	17.8	14.4
Risk rating	Medium	EPS growth* (%)	n/a	n/a	-42.8	22.0	EV/EBITDA	18.9	8.4	11.0	9.2
Issued shares	229.1m	DPS (NZc)	0.0	0.0	0.0	5.3	Price / NTA	4.5	3.3	2.9	2.7
Market cap	NZ\$435m	Imputation (%)	0	0	0	100	Cash div yld (%)	0.0	0.0	0.0	2.8
Avg daily turnover	284.6k (NZ\$348k)	*Based on normalised profits					Gross div yld (%)	0.0	0.0	0.0	3.9

### What's changed?

- **Earnings:** Underlying EBITDA earnings estimate +3% to NZ\$51.0m.
- **Target price:** Spot valuation increased from NZ\$2.26 to NZ\$2.29.

### Investor presentation – sensible strategy update and noting strength in underlying markets

RAK's investor presentation provided a sensible strategic review showing strength in underlying markets contributing to the positive outlook. Notably, the company aims to grow its share in core markets, including 5G networks, cloud computing, LEO/NewSpace and autonomous vehicles, by bringing cutting-edge, new products to market faster. These objectives will be aided by (1) progress on building a sizeable and more flexible new Indian production facility, (2) an increase in its R&D spending target (from 10% to 10–12%), and (3) continued active risk management of cost inflation, supply chain disruptions, and COVID-19 risks. RAK has implemented stringent health protocols to mitigate the risk of Omicron. We consider the confidence from management and strength in underlying markets as good signs for the future.

### Earnings guidance raised despite COVID induced pressures

The company now expects FY22 underlying EBITDA to be between NZ\$49m–NZ\$53m, ahead of its guidance of NZ\$44m–NZ\$49m given in November 2021. Management has overcome many of the significant supply chain pressures driven by the COVID-19 pandemic following month-to-month management of raw materials and parts. RAK's FY22 results are expected on 26 May 2022.

### Earnings upgrades tempered by WACC adjustments

We upgrade our short and longer-term estimates given greater management confidence in mitigating supply chain issues, and our confidence in the output for the underlying markets. Somewhat countering the earnings upgrade, and given recent movements in bond yields, we have adjusted our risk-free rate (Rfr) used across all Forsyth Barr's WACC estimates from 2.3% to 2.8%. In isolation this would have reduced our spot DCF valuation. However, our earnings upgrade, confidence in the underlying markets and review of longer-term inputs have increased our valuation by a net +3cps, moving our spot valuation from NZ\$2.26 to NZ\$2.29.

**Rakon Limited (RAK)**

<b>Market Data (NZ\$)</b>						<b>Spot valuation (NZ\$)</b>					
Priced as at 10 Feb 2022						1.90					
52 week high / low						2.22 / 0.75					
Market capitalisation (NZ\$m)						435.2					
<b>Key WACC assumptions</b>						<b>DCF valuation summary (NZ\$m)</b>					
Risk free rate						2.80%					
Equity beta						1.15					
WACC						9.4%					
Terminal growth						2.5%					
<b>Profit and Loss Account (NZ\$m)</b>						<b>Valuation Ratios</b>					
	2020A	2021A	2022E	2023E	2024E		2020A	2021A	2022E	2023E	2024E
Sales revenue	119.0	130.9	175.0	173.5	196.4	EV/EBITDA (x)	30.8	18.9	8.4	11.0	9.2
<b>Normalised EBITDA</b>	<b>14.5</b>	<b>23.5</b>	<b>51.0</b>	<b>37.7</b>	<b>45.3</b>	EV/EBIT (x)	>100x	39.1	11.4	17.8	14.4
Depreciation and amortisation	(13.7)	(13.4)	(13.4)	(8.6)	(9.3)	PE (x)	>100x	45.2	12.6	22.0	18.0
<b>Normalised EBIT</b>	<b>3.5</b>	<b>11.3</b>	<b>37.4</b>	<b>23.4</b>	<b>28.8</b>	Price/NTA (x)	5.3	4.5	3.3	2.9	2.7
Net interest	(1.1)	(1.6)	(1.6)	(0.4)	(0.0)	Free cash flow yield (%)	3.2	5.8	8.3	10.5	7.6
Associate income	0.8	1.4	2.6	2.7	2.7	Net dividend yield (%)	0.0	0.0	0.0	0.0	2.8
Tax	0.7	(1.5)	(3.8)	(5.9)	(7.4)	Gross dividend yield (%)	0.0	0.0	0.0	0.0	3.9
Minority interests	0	0	0	0	0	<b>Capital Structure</b>					
<b>Normalised NPAT</b>	<b>4.0</b>	<b>9.6</b>	<b>34.6</b>	<b>19.8</b>	<b>24.2</b>		2020A	2021A	2022E	2023E	2024E
Abnormals/other	0	0	0	0	0	Interest cover EBIT (x)	3.4	7.1	23.7	65.1	>100x
<b>Reported NPAT</b>	<b>4.0</b>	<b>9.6</b>	<b>34.6</b>	<b>19.8</b>	<b>24.2</b>	Interest cover EBITDA (x)	13.7	14.7	32.3	>100x	>100x
Normalised EPS (cps)	1.7	4.2	15.1	8.6	10.5	Net debt/ND+E (%)	7.9	-5.1	-18.0	-26.0	-35.8
DPS (cps)	0	0	0	0	5.3	Net debt/EBITDA (x)	0.5	n/a	n/a	n/a	n/a
<b>Growth Rates</b>						<b>Key Ratios</b>					
	2020A	2021A	2022E	2023E	2024E		2020A	2021A	2022E	2023E	2024E
Revenue (%)	4.3	10.0	33.7	-0.8	13.2	Return on assets (%)	2.4	7.3	18.9	11.5	12.2
EBITDA (%)	9.2	62.1	>100	-26.1	20.2	Return on equity (%)	4.3	9.3	25.0	12.5	14.2
EBIT (%)	-31.5	>100	>100	-37.5	23.3	Return on funds employed (%)	0.0	0.0	0.0	0.0	0.0
Normalised NPAT (%)	18.3	>100	>100	-42.8	22.0	EBITDA margin (%)	12.2	17.9	29.1	21.7	23.1
Normalised EPS (%)	18.3	>100	>100	-42.8	22.0	EBIT margin (%)	3.0	8.6	21.4	13.5	14.7
Ordinary DPS (%)	n/a	n/a	n/a	n/a	n/a	Capex to sales (%)	-3.8	-3.9	-4.9	-8.9	-3.4
<b>Cash Flow (NZ\$m)</b>						<b>Segment Revenue (NZ\$m)</b>					
	2020A	2021A	2022E	2023E	2024E		2020A	2021A	2022E	2023E	2024E
<b>EBITDA</b>	<b>14.5</b>	<b>23.5</b>	<b>51.0</b>	<b>37.7</b>	<b>45.3</b>	Telecommunications	65.2	77.1	83.7	101.6	122.0
Working capital change	(6.6)	7.2	(15.6)	1.1	(8.9)	Positioning	18.9	14.0	25.6	27.5	25.0
Interest & tax paid	(1.4)	(1.8)	(5.4)	(6.3)	(7.4)	Space and Defence	28.2	30.2	30.2	31.1	35.8
Other	2.9	(8.8)	(2.3)	(2.4)	(2.5)	IoT, Emerging and Other	6.7	7.0	34.8	13.1	13.5
<b>Operating cash flow</b>	<b>9.4</b>	<b>20.1</b>	<b>27.7</b>	<b>30.1</b>	<b>26.5</b>	Other revenues	0.0	2.6	0.7	0.2	0.2
Capital expenditure	(4.5)	(5.1)	(8.5)	(15.4)	(6.7)	<b>Total Revenue</b>	<b>119.0</b>	<b>130.9</b>	<b>175.0</b>	<b>173.5</b>	<b>196.4</b>
(Acquisitions)/divestments	0.0	0	0	0	0	<b>Segment Gross Margin (%)</b>					
Other	(5.2)	(2.2)	(3.1)	(3.2)	(2.8)		2020A	2021A	2022E	2023E	2024E
<b>Funding available/(required)</b>	<b>(0.3)</b>	<b>12.8</b>	<b>16.1</b>	<b>11.5</b>	<b>17.1</b>	Telecommunications	40	40	42	42	42
Dividends paid	0	0	0	0	(4.8)	Positioning	36	48	54	51	49
Equity raised/(returned)	0	0	0	0	0	Space and Defence	69	68	67	67	65
<b>(Increase)/decrease in net debt</b>	<b>(1.0)</b>	<b>12.8</b>	<b>16.1</b>	<b>11.5</b>	<b>12.3</b>	IoT, Emerging and Other	-5	15	56	15	15
<b>Balance Sheet (NZ\$m)</b>						<b>Underlying EBITDA</b>					
	2020A	2021A	2022E	2023E	2024E		2020A	2021A	2022E	2023E	2024E
Working capital	57.8	50.6	66.1	65.0	73.9	<b>Profit before income tax</b>	<b>3.3</b>	<b>11.2</b>	<b>38.4</b>	<b>25.7</b>	<b>31.5</b>
Fixed assets	18.9	18.3	21.3	30.6	28.9	Depreciation and amortisation	(8.8)	(8.7)	(8.7)	(9.2)	11.3
Intangibles	9.0	7.6	7.1	6.7	6.7	Finance costs - net	(1.1)	(1.6)	(1.6)	(0.4)	(0.0)
Right of use asset	9.7	7.2	4.5	1.8	13.2	Adjustments	(1.4)	(1.8)	(2.2)	(2.3)	(2.3)
Other assets	27.5	29.6	29.6	29.6	29.6	Other non-cash items	(0.2)	(0.2)	0.1	(0.1)	(0.2)
<b>Total funds employed</b>	<b>122.9</b>	<b>113.3</b>	<b>128.7</b>	<b>133.8</b>	<b>152.2</b>	<b>Underlying EBITDA</b>	<b>14.8</b>	<b>23.5</b>	<b>51.0</b>	<b>37.7</b>	<b>45.3</b>
Net debt/(cash)	7.9	(5.0)	(21.1)	(32.7)	(44.9)						
Lease liability	6.7	5.4	2.3	(0.8)	10.5						
Other liabilities	16.4	9.0	9.0	9.0	16.2						
Shareholder's funds	91.9	103.9	138.5	158.3	170.4						
Minority interests	0	0	0	0	0						
<b>Total funding sources</b>	<b>122.9</b>	<b>113.3</b>	<b>128.7</b>	<b>133.8</b>	<b>152.2</b>						

\* Forsyth Barr target prices reflect valuation rolled forward at cost of equity less the next 12-months dividend

## Investor presentation update

On 9 February 2022, RAK released an investor presentation to update the market on the company’s strategy, underlying markets and forward focus. The call introduced CEO designate Dr Sinan Altug. Dr Altug is well qualified and has 20 years of experience at RAK; he holds an MBA and a PhD in Electrical Engineering. He was appointed COO in January 2020 and will become the CEO on 1 April 2022. The investor presentation slides are linked here <https://www.nzx.com/announcements/387016>. RAK’s forward direction to be bolder and win in the growth markets of 5G networks, cloud computing, LEO/NewSpace, and autonomous vehicles appears achievable. The company aims to grow its share in these markets by focussing on:

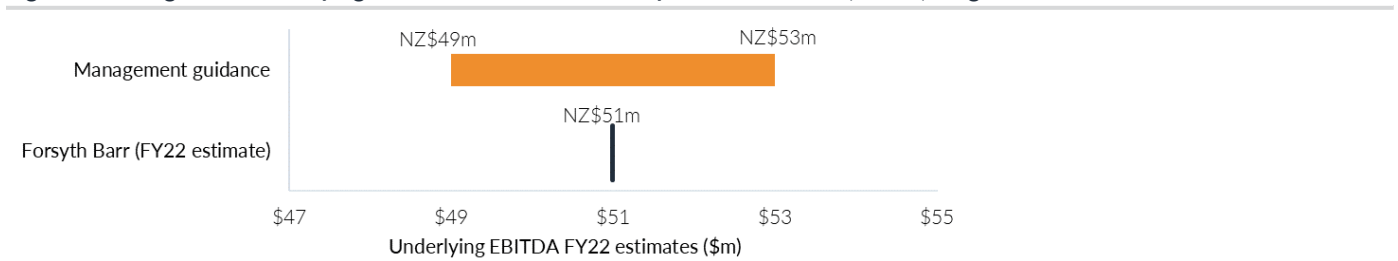
- **Creating cutting edge new products** – RAK’s R&D framework provides a strong pipeline of next-generation technologies such as its latest proprietary chip, Niku, and multiple product families based on XMEMS®, a photolithography-based technology that uses NanoQuartz™.
- **Relentlessly pursuing continuous innovative improvement** – RAK aims to increase its R&D spending target from 10% to 10–12% of revenue each year and reinforce a culture of innovation.
- **New Indian facility** – RAK’s new high-tech Indian facility, once finished, will expand existing capacity, generate global manufacturing flexibility, redundancy for outages and will see a broader spectrum of products manufactured there.
- **Continuing active risk management of cost inflation, supply chain disruptions and COVID-19** – RAK continues efforts to mitigate supply chain disruptions and the risks of Omicron with efficient inventory management and the implementation of stringent health protocols.
- **Continuing to retain a conservative balance sheet** – RAK’s working capital is returning to normal after the significant increase in 1H22. Additionally, RAK states that it aims to maintain a positive cash balance in the future, even after capital expenditure and R&D spending. We now expect trade and other receivables to normalise and decrease from NZ\$51.2m at 1H22 to NZ\$49.5m by FY22 end, versus our prior estimates of an increase. Countering this, we expect the company to build inventories to help mitigate ongoing supply chain pressures in FY23. We forecast inventories to grow from NZ\$43.6m at 1H22 to \$48.2m at FY22.

## Earnings guidance

RAK has updated its earning guidance after overcoming significant supply chain challenges identified last year. RAK expects FY22 underlying EBITDA to be between NZ\$49m–NZ\$53m. This is ahead of its prior guidance of NZ\$44m–NZ\$49m from November 2021. Accordingly, we now forecast underlying EBITDA at NZ\$51.0m, at the middle of the new range and +3% on our prior estimate of NZ\$49.4m. This update displays significant company-wide efforts to alleviate supply chain risks by implementing month-to-month raw materials and parts management. RAK continues its efforts to mitigate the risk of Omicron infection among staff in France, India, and New Zealand. In New Zealand, protection measures including random rapid antigen testing, wearable Bluetooth-enabled contact tracing cards and mandatory mask-wearing have been implemented. Staff have a high level of vaccination.

RAK’s FY22 results will be released on 26 May 2022.

**Figure 1. Management underlying EBITDA forecasts and Forsyth Barr estimate (NZ\$m) ranges**



Source: Company data, Forsyth Barr analysis

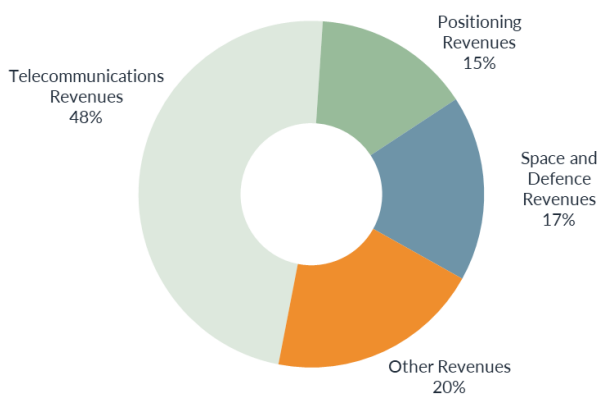
**Figure 2. Earnings forecast revisions**

NZ\$m	FY22E			FY23E			FY24E		
	Old	New	Change	Old	New	Change	Old	New	Change
<b>Operating Performance</b>									
<b>Revenue</b>	172.6	174.3	+1.0%	170.9	173.3	+1.4%	188.0	196.2	+4.4%
Cost of sales	(85.5)	(85.5)	+0.0%	(92.4)	(93.9)	+1.7%	(102.3)	(107.4)	+5.0%
<b>Gross Profit</b>	87.1	88.8	+1.9%	78.5	79.4	+1.1%	85.6	88.7	+3.6%
Other operating income	0.7	0.7	+0.0%	0.2	0.2	+0.0%	0.2	0.2	+0.0%
Selling and marketing costs	(9.8)	(9.8)	+0.0%	(10.1)	(10.1)	+0.0%	(10.4)	(10.4)	+0.0%
Research and development	(15.5)	(14.8)	-4.6%	(18.4)	(18.2)	-0.9%	(20.0)	(21.2)	+5.8%
General and administration	(27.0)	(27.0)	+0.0%	(27.8)	(27.8)	+0.0%	(28.5)	(28.5)	+0.0%
<b>Total operating expenses</b>	(52.4)	(51.7)	-1.4%	(56.3)	(56.2)	-0.3%	(58.9)	(60.1)	+2.0%
Other gains/(losses)-net	(0.4)	(0.4)		-			-		
<b>Operating profit</b>	35.0	37.4	+6.8%	22.4	23.4	+4.6%	26.9	28.8	+7.1%
Finance income	0.1	0.1		0.1	0.1		0.1	0.1	
Finance costs	(1.6)	(1.6)		(0.5)	(0.5)		(0.1)	(0.1)	
Share of net profits of associates	3.3	2.6		3.4	2.7		3.4	2.7	
<b>Profit before tax</b>	36.7	38.4	+4.8%	25.3	25.7	+1.5%	30.3	31.5	+4.1%
Tax expense	(5.5)	(3.8)	-30.1%	(5.8)	(5.9)	+1.5%	(7.1)	(7.4)	+4.1%
<b>Net profit for the period</b>	31.2	34.6	+11.0%	19.5	19.8	+1.5%	23.2	24.2	+4.1%
Profit before income tax	36.7	38.4	+4.8%	25.3	25.7	+1.5%	30.3	31.5	+4.1%
Depreciation and amortisation	(8.7)	(8.7)		(9.2)	(9.2)		11.2	11.3	
Finance costs - net	(1.6)	(1.6)		(0.4)	(0.4)		(0.0)	(0.0)	
Adj. for associate share of interest, tax & depn	(2.4)	(2.2)		(2.4)	(2.3)		(2.5)	(2.3)	
Other non-cash items	0.1	0.1		(0.1)	(0.1)		(0.2)	(0.2)	
<b>Underlying EBITDA</b>	49.4	51.0	+3.2%	37.5	37.7	+0.5%	44.2	45.3	+2.5%

Source: Forsyth Barr analysis

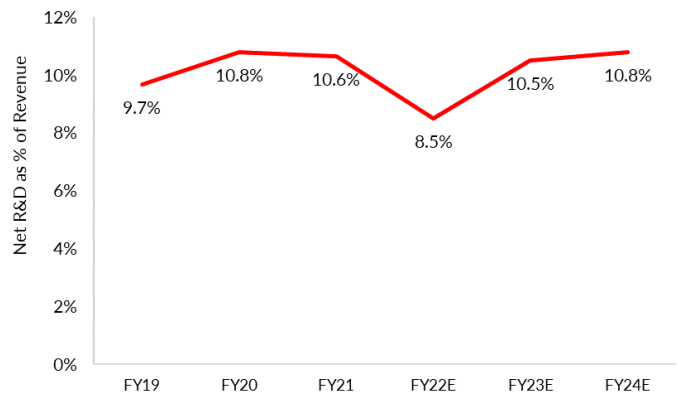
**Key charts**

**Figure 3. RAK Estimated revenue by division (2022)**



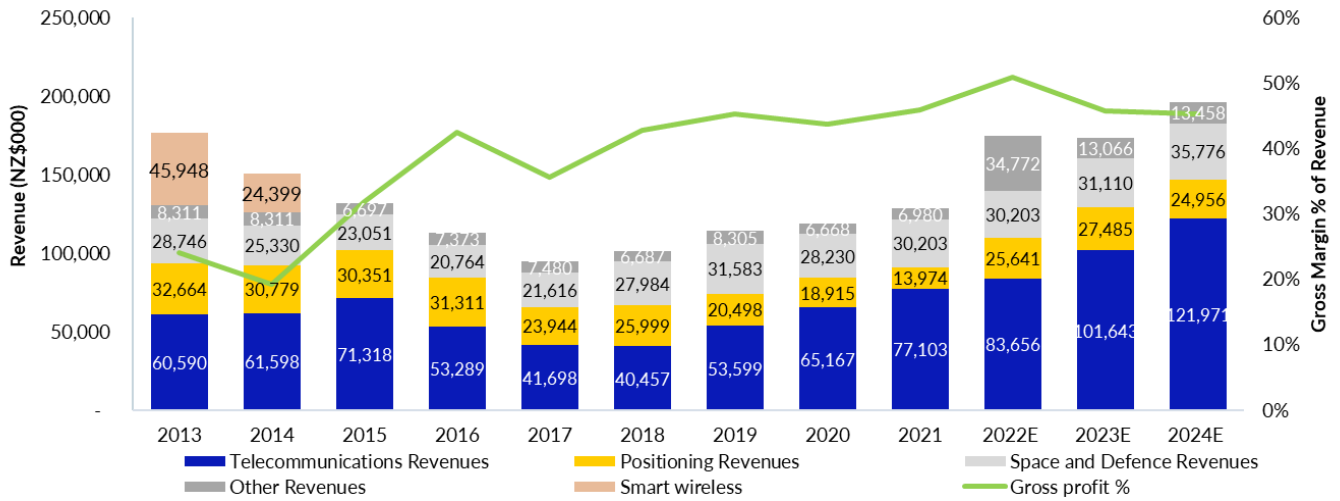
Source: Company data, Forsyth Barr analysis

**Figure 4. RAK Net R&D as % of revenue**



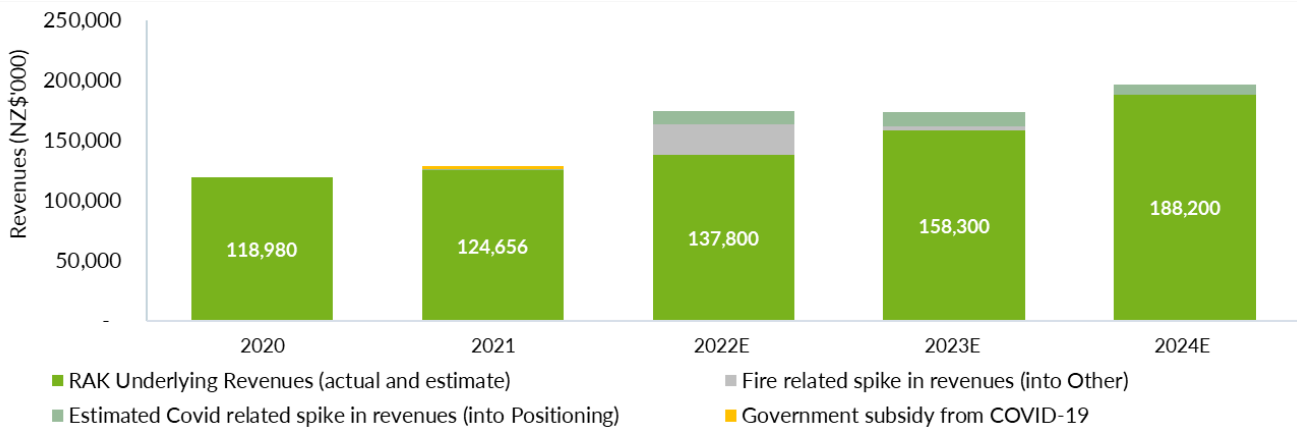
Source: Company data, Forsyth Barr analysis

**Figure 5. RAK revenue stack by division and gross margin %**



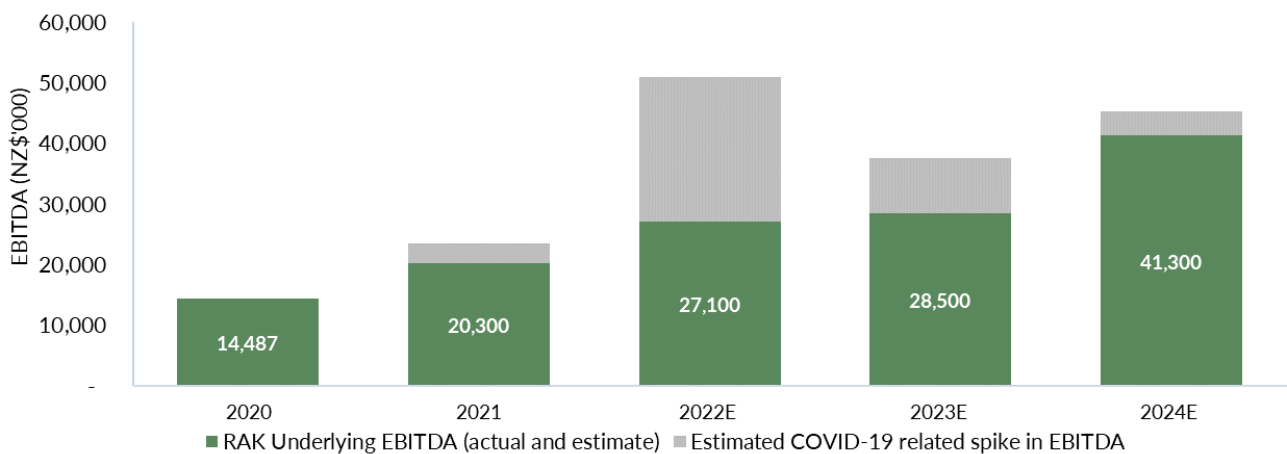
Source: Company, Forsyth Barr analysis

**Figure 6. RAK actual and estimated revenues (with and without COVID spike)**

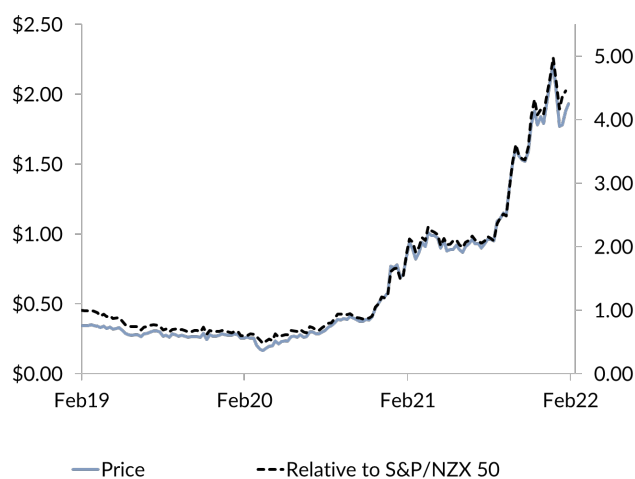


Source: Company, Forsyth Barr analysis

**Figure 7. RAK actual and estimated EBITDA (with and without COVID spike)**



Source: Company, Forsyth Barr analysis

**Figure 8. Price performance**


Source: Forsyth Barr analysis

**Figure 9. 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 10. International valuation comparisons**

Company	Code	Price	Mkt Cap (m)	PE		EV/EBITDA		EV/EBIT		Cash Yld 2023E	
				2022E	2023E	2022E	2023E	2022E	2023E		
(metrics re-weighted to reflect RAK's balance date - September)											
<b>Rakon</b>	<b>RAK NZ</b>	<b>NZ\$1.90</b>	<b>NZ\$435</b>	<b>12.6x</b>	<b>22.0x</b>	<b>8.4x</b>	<b>11.4x</b>	<b>11.5x</b>	<b>18.4x</b>	<b>0.0%</b>	
Txc Corp	3042 TT	TWD97.20	TWD30,108	10.0x	9.7x	6.6x	6.0x	9.1x	8.6x	7.2%	
Sitime Corp	SITM US	US\$214.78	US\$4,415	>75x	49.3x	<0x	32.9x	63.3x	37.3x	n/a	
Microchip Technology Inc	MCHP US	US\$78.04	US\$43,390	16.1x	14.6x	15.3x	13.8x	16.3x	15.0x	1.7%	
Siward Crystal Technology Co	2484 TT	TWD34.50	TWD5,500	11.5x	n/a	n/a	n/a	9.6x	n/a	n/a	
Daishinku Corp	6962 T	¥1233.00	¥44,631	14.0x	10.7x	5.5x	4.4x	10.2x	8.2x	2.0%	
Nihon Dempa Kogyo Co	6779 T	¥1310.00	¥27,193	5.7x	4.9x	5.2x	4.7x	8.1x	6.9x	3.2%	
Seiko Epson Corp	6724 JP	¥1852.00	¥740,124	11.3x	11.4x	4.6x	4.7x	8.2x	8.4x	3.5%	
<b>Compco Average:</b>				<b>11.5x</b>	<b>16.7x</b>	<b>7.4x</b>	<b>11.1x</b>	<b>17.8x</b>	<b>14.1x</b>	<b>3.5%</b>	
<b>EV = Current Market Cap + Actual Net Debt</b>				<b>RAK Relative:</b>	<b>10%</b>	<b>31%</b>	<b>13%</b>	<b>3%</b>	<b>-36%</b>	<b>31%</b>	<b>-100%</b>

Source: \*Forsyth Barr analysis, Bloomberg Consensus, Compco metrics re-weighted to reflect headline (RAK) companies fiscal year end

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