

Rakon Limited

2022 ASM – Initial FY23 Guidance Impresses

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Rakon (RAK) provided an upbeat shareholder update at its Annual Shareholder Meeting (ASM), giving its initial Underlying EBITDA FY23 guidance range of NZ\$36m to NZ\$44m. At the mid-point this amounts to a +6% uplift on our prior estimates. RAK noted that its core business (5G network infrastructure and industrial positioning) continues to grow, with Q1 performance being "very strong". This is consistent with our view that its sector positioning and product leadership are aiding top-line performance. The new plant in India is under construction and will likely be commissioned late in FY23 or potentially slipping into 1Q24. Once operating, it will provide substantial additional manufacturing capability and is a core part of the long-term strategy of taking advantage of the opportunities. We estimate RAK has been, and will be, running near capacity across its global manufacturing base through FY22 and FY23. Overall, we consider this a solid update, showing the continued benefits of the renewed strategy and operational leverage. We lift our FY23 EBITDA forecasts +6%, and our spot valuation rises +2cps to NZ\$2.11.

NZX Code	RAK	Financials: Mar/	22A	23E	24E	25E	Valuation (x)	22A	23E	24E	25E
Share price	NZ\$1.56	NPAT* (NZ\$m)	33.1	19.7	24.5	31.9	PE	10.8	18.1	14.6	11.2
Spot Valuation	NZ\$2.11 (from 2.09)	EPS* (NZc)	14.5	8.6	10.7	13.9	EV/EBIT	8.4	12.8	11.3	8.6
Risk rating	Medium	EPS growth* (%)	n/a	-40.5	24.2	30.3	EV/EBITDA	6.4	8.4	7.3	6.0
Issued shares	229.1m	DPS (NZc)	0.0	0.0	0.0	7.0	Price / NTA	2.8	2.4	2.1	1.9
Market cap	NZ\$357m	Imputation (%)	0	0	100	100	Cash div yld (%)	0.0	0.0	0.0	4.5
Avg daily turnover	193.2k (NZ\$294k)	*Based on normalised profits					Gross div yld (%)	0.0	0.0	0.0	6.2

What's changed?

- **Earnings:** We lift our FY23 Underlying EBITDA estimates +6% to NZ\$40.0m, from NZ\$37.7m prior, and +3% in FY24 and FY25.
- **Spot valuation:** Our spot valuation rises to NZ\$2.11 (from NZ\$2.09 prior) with higher earnings offset by higher capex, without immediate changes to our longer-term revenue estimates given that our forecasts already account for moderate growth.

ASM commentary a thorough and solid update

The company provided a thorough review of the year, market performance, strategy and outlook as it continues to improve its communication with the market. The update and progress on growing core margins impressed. The company highlighted the +21% four-year revenue compound annual growth rate (CAGR) of the Telecommunications segment revenue, which "is continuing", driven by strong demand for 5G infrastructure, cloud computing and data centres. Given that Telecommunications is ~57% of our FY23 revenue estimates, this bodes well for the future. We forecast medium-term strength on the back of the continued 5G tower and infrastructure roll-out. The company highlighted the opportunity in Positioning, calling out high precision industrial machines and its 80%+ global share in emergency locator beacons as growth opportunities. RAK is making substantial investments in R&D (10–12% of sales) to take advantage of the opportunities in front of the business. We anticipate higher expenses associated with commissioning the new Indian facility in Bengaluru and general inflationary pressures. The new manufacturing site is sizable, with management commenting that it could double output capacity over four years. An acquisition in the US appears more likely given the commentary.

Outlook and update

Management confidence is evident which we view as a positive sign for the remainder of FY23. We lift our EBITDA estimate despite increasing cost assumptions following commentary of inflationary pressures. RAK's updated strategy is clear and ambitious, and seeks to take advantage of numerous opportunities the company has identified.

Rakon Limited (RAK)

Market Data (NZ\$)						Spot valuation (NZ\$)					
Priced as at 11 Aug 2022						2.11					
52 week high / low						2.22 / 0.93					
Market capitalisation (NZ\$m)						357.3					
Key WACC assumptions						DCF valuation summary (NZ\$m)					
Risk free rate						4.00%					
Equity beta						1.13					
WACC						9.5%					
Terminal growth						2.5%					
Profit and Loss Account (NZ\$m)						Valuation Ratios					
Sales revenue	2021A	2022A	2023E	2024E	2025E	EV/EBITDA (x)	2021A	2022A	2023E	2024E	2025E
Normalised EBITDA	23.5	54.4	40.0	45.5	55.3	EV/EBIT (x)	32.2	8.4	12.8	11.3	8.6
Depreciation and amortisation	(13.4)	(13.2)	(8.9)	(10.8)	(12.6)	PE (x)	37.1	10.8	18.1	14.6	11.2
Normalised EBIT	11.3	41.4	26.2	29.2	38.4	Price/NTA (x)	3.7	2.8	2.4	2.1	1.9
Net interest	(1.6)	(1.9)	(1.3)	(0.7)	(0.6)	Free cash flow yield (%)	4.2	5.6	1.8	3.2	5.9
Associate income	1.4	2.4	1.7	1.7	1.8	Net dividend yield (%)	0.0	0.0	0.0	0.0	4.5
Tax	(1.5)	(8.8)	(6.9)	(5.7)	(7.7)	Gross dividend yield (%)	0.0	0.0	0.0	0.0	6.2
Minority interests	0	0	0	0	0	Capital Structure					
Normalised NPAT	9.6	33.1	19.7	24.5	31.9	Interest cover EBIT (x)	2021A	2022A	2023E	2024E	2025E
Abnormals/other	0	0	0	0	0	Interest cover EBITDA (x)	7.1	21.7	20.8	40.2	62.8
Reported NPAT	9.6	33.1	19.7	24.5	31.9	Net debt/ND+E (%)	14.7	28.6	31.8	62.6	90.3
Normalised EPS (cps)	4.2	14.5	8.6	10.7	13.9	Net debt/EBITDA (x)	-5.1	-20.8	-20.9	-24.9	-32.0
DPS (cps)	0	0	0	0	7.0	Key Ratios					
Growth Rates						Return on assets (%)	2021A	2022A	2023E	2024E	2025E
Revenue (%)	2021A	2022A	2023E	2024E	2025E	Return on equity (%)	7.3	20.7	12.7	12.0	14.2
EBITDA (%)	10.0	32.7	1.3	13.7	15.5	Return on funds employed (%)	9.3	24.5	12.7	13.6	16.3
EBIT (%)	58.8	>100	-26.5	13.7	21.4	EBITDA margin (%)	6.2	16.6	9.6	10.9	12.4
Normalised NPAT (%)	>100	>100	-36.8	11.5	31.7	EBIT margin (%)	17.9	31.4	22.8	22.8	23.9
Normalised EPS (%)	>100	>100	-40.5	24.2	30.3	Capex to sales (%)	8.6	23.9	14.9	14.6	16.7
Ordinary DPS (%)	n/a	n/a	n/a	n/a	n/a	Capex to depreciation (%)	3.9	5.9	11.4	6.4	4.4
Cash Flow (NZ\$m)						Imputation (%)	45	89	283	144	98
EBITDA	2021A	2022A	2023E	2024E	2025E	Pay-out ratio (%)	0	0	0	100	100
Working capital change	23.5	54.4	40.0	45.5	55.3	0	0	0	0	0	50
Interest & tax paid	7.2	(15.3)	(3.3)	(12.7)	(13.6)	Segment Revenue (NZ\$m)					
Other	(1.8)	(2.3)	(8.2)	(6.5)	(8.3)	2021A	2022A	2023E	2024E	2025E	
Operating cash flow	(8.8)	(6.7)	(2.1)	(2.2)	(2.3)	Telecommunications	77.0	86.2	100.9	127.1	149.4
Capital expenditure	20.1	30.2	26.4	24.1	31.1	Positioning	14.0	27.1	32.3	27.0	29.9
(Acquisitions)/divestments	(5.1)	(10.2)	(20.0)	(12.7)	(10.2)	Space and Defence	29.8	26.3	26.9	29.6	35.0
Other	0	-	-	-	-	IoT, Emerging and Other	7.4	32.3	15.6	16.1	16.6
Funding available/(required)	(3.0)	(2.6)	(2.8)	(2.4)	(2.5)	Other revenues	2.5	1.6	0.0	0.0	0.0
Dividends paid	12.0	17.4	3.5	9.0	18.5	Total Revenue	130.8	173.6	175.8	199.9	230.8
Equity raised/(returned)	-	-	0	0	(6.9)	Segment Gross Margin (%)					
(Increase)/decrease in net debt	12.0	17.4	3.5	9.0	11.6	2021A	2022A	2023A	2024A	2025A	
						Telecommunications	40	44	45	44	43
Balance Sheet (NZ\$m)						Positioning	48	55	57	57	56
Working capital	2021A	2022A	2023E	2024E	2025E	Space and Defence	68	69	69	68	66
Fixed assets	50.6	65.8	69.2	81.9	95.5	IoT, Emerging and Other	14	56	28	15	15
Intangibles	18.3	21.4	33.2	36.0	35.6	Underlying EBITDA					
Right of use asset	7.6	7.2	7.8	8.5	9.3	2021A	2022A	2023E	2024E	2025E	
Other assets	7.2	4.8	2.4	14.8	11.7	Profit before income tax	11.2	41.9	26.6	30.2	39.6
Total funds employed	29.6	25.5	25.5	25.5	25.5	Depreciation and amortisation	(8.7)	(8.9)	(10.0)	(12.4)	(12.8)
Net debt/(cash)	113.3	124.6	138.0	166.5	177.5	Finance costs - net	(1.6)	(1.9)	(1.3)	(0.7)	(0.6)
Lease liability	(5.0)	(23.2)	(26.8)	(35.8)	(47.4)	Adjustments	(1.8)	(2.2)	(2.1)	(2.2)	(2.3)
Other liabilities	5.4	3.4	0.6	13.7	11.2	Other non-cash items	(0.2)	(0.1)	0	0	0
Shareholder's funds	9.0	9.3	9.3	9.3	18.4	Underlying EBITDA	23.5	54.4	40.0	45.5	55.3
Minority interests	103.9	135.2	154.9	179.3	195.3	Revenue Growth (%)					
Total funding sources	113.3	124.6	138.0	166.5	177.5	2021A	2022A	2023E	2024E	2025E	
						8	34	2	14	15	
						Underlying EBITDA Growth (%)					
						59	132	-26	14	21	





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

2022 ASM

Key takeaways from RAK's 2022 Annual Shareholder Meeting (ASM) include:

- The solid core market performance continues to lead to gross margin improvements within RAK's initial EBITDA guidance range.
- The new Indian manufacturing facility, costing NZ\$12–14m, will significantly uplift capability in the next three to four years. The CEO noted it would come online substantially below the equivalent cost in New Zealand, estimated at NZ\$45m to NZ\$55m.
- R&D investment into growth opportunities continues at 10–12% of sales (see Figure 7) at returns well above WACC.
- An updated dividend policy pushes out dividends for the foreseeable future. Internal investment opportunities and a desire to maintain a conservative financial position are being prioritised.
- A US acquisition appears more likely, given commentary on its four key strategic objectives stating it will “*acquire market access, specifically into North America*”.
- RAK's updated growth strategy is clear:
 - **Grow the business:** via Telco market leadership, the Space & Defence market in North America and precision industrial positioning applications.
 - **Maintain product & technology leadership:** through in-house semiconductor chips, proprietary XMEMS® technology, and a move further up the value chain into Space & Defence subsystems.
 - **Expand into new markets:** NewSpace, Cloud computing and Autonomous vehicles.
 - **Deliver world-class manufacturing:** with a global manufacturing footprint, increasing manufacturing capacity and developing XMEMS® nanotechnology volume manufacturing.
- RAK provided a detailed three-year roadmap for the company (see Figure 1).

Figure 1. RAK's three-year roadmap

	FY23	FY24	FY25
 <p>New manufacturing facility in India</p>	<ul style="list-style-type: none"> • Construction completed • Fitout / capacity expansion • Existing manufacturing transferred 	<ul style="list-style-type: none"> • Select NZ products transferred • Select NewSpace products transferred 	<ul style="list-style-type: none"> • Select French NewSpace subsystem modules transferred
 <p>New Rakon designed semiconductor chips</p>	<ul style="list-style-type: none"> • Substantial increase in R&D and chip design capability in NZ & UK • Release of Niku next generation chip 	<ul style="list-style-type: none"> • Release of Vulcan next generation chip • Chip based product revenue growing to over 60% 	<ul style="list-style-type: none"> • Chip based product revenue growing • Release of Caduceus & Kepler chips
 <p>Commercialisation of XMEMS® nanotechnology manufacturing capability</p>	<ul style="list-style-type: none"> • Continued investment in XMEMS® capability • Release of initial XMEMS® based products 	<ul style="list-style-type: none"> • Volume production of XMEMS® based products 	<ul style="list-style-type: none"> • Leadership in targeted market segments • Expansion into other product categories
 <p>NewSpace business</p>	<ul style="list-style-type: none"> • R&D and supply chain investment • Strategic relationships established 	<ul style="list-style-type: none"> • Recognised player in the ecosystem • Significant orders secured 	<ul style="list-style-type: none"> • Become a top 3 player in subsystems • Delivery of orders

Source: RAK August 2022 ASM update

Figure 2. Progress at RAK's new manufacturing facility in Bengaluru, India



Source: RAK August 2022 ASM update

Earnings revisions

We have upgraded our earnings estimates, given management's new FY23 Underlying EBITDA guidance range of NZ\$36m to NZ\$44m. Gross margin improvement is pleasingly evident in the core business. We estimate that RAK will be running near capacity across its global manufacturing base during FY23. We only marginally uplift our FY23 revenues by +0.5% to NZ\$175.8m (from NZ\$175.0m).

The confidence shown in the outlook aids in reducing our conservatism on gross margins. We lift our FY23 EBITDA estimates by +6% to NZ\$40.0m (up from our prior forecast of NZ\$37.7m) and FY24 and FY25 by +3% despite increasing several expense lines following commentary of inflationary impacts on the business. This places our estimates in the middle of the EBITDA guidance range. FY23 EBITDA estimates are lower than the record achieved in FY22 due to the benefits RAK saw of higher margin business in FY22, that is now rolling off, following the global chip shortage and a fire at another manufacturer's factory. In later years, we make minor revisions to EBITDA on improvements in gross margins despite higher costs.

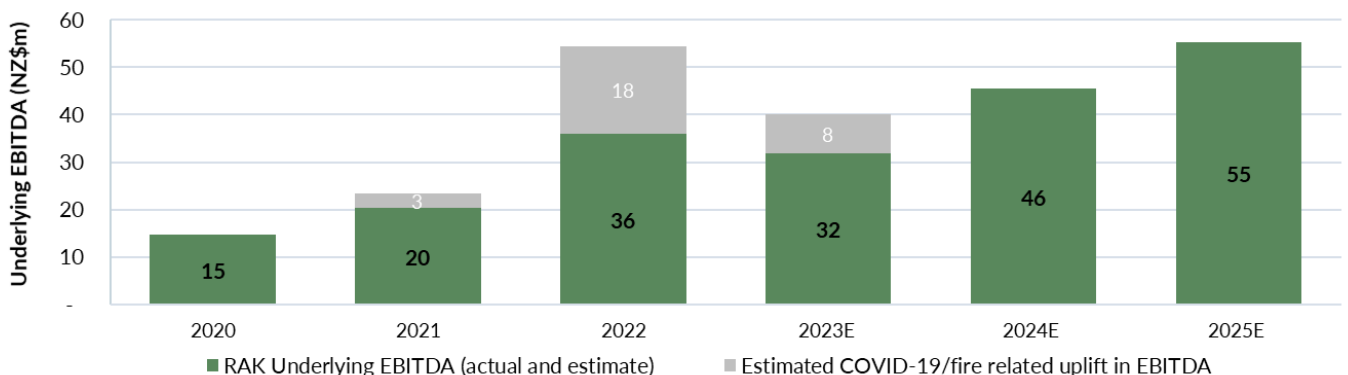
Following the updated dividend policy and commentary, we shift out the commencement of dividends in our estimates by one year to FY25.

Figure 3. Earnings revisions (NZ\$m)

	FY23E			FY24E			FY25E		
	Old	New	Change	Old	New	Change	Old	New	Change
Revenue	175.0	175.8	+0%	199.3	199.9	+0%	230.0	230.8	+0%
Cost of sales	(91.1)	(88.8)	-3%	(108.1)	(106.9)	-1%	(125.9)	(125.2)	-1%
Gross Profit	83.8	87.0	+4%	91.3	93.0	+2%	104.2	105.6	+1%
Operating expenses									
Selling and marketing costs	(10.0)	(10.3)	+3%	(10.5)	(10.8)	+3%	(10.8)	(11.1)	+3%
Research and development	(18.7)	(18.6)	-0%	(18.9)	(19.0)	+0%	(21.2)	(21.2)	+0%
General and administration	(31.0)	(31.9)	+3%	(32.8)	(34.0)	+4%	(33.8)	(34.9)	+3%
Total operating expenses	(59.8)	(60.8)	+2%	(62.2)	(63.8)	+3%	(65.7)	(67.2)	+2%
Operating profit	24.0	26.2	+9%	29.1	29.2	+0%	38.4	38.4	+0%
Finance income	0.0	0.0		0.0	0.0		0.0	0.0	
Finance costs	(1.3)	(1.3)		(0.8)	(0.8)		(0.7)	(0.7)	
Share of net profits of associates	1.7	1.7	+0%	1.8	1.7	-2%	1.8	1.8	-3%
Profit before income tax	24.5	26.6	+9%	30.1	30.2	+0%	39.6	39.6	-0%
Income tax expense	(6.4)	(6.9)	+9%	(5.7)	(5.7)	+0%	(7.7)	(7.7)	-0%
Net profit for the period	18.1	19.7	+9%	24.4	24.5	+0%	31.9	31.9	-0%
Profit before income tax	24.5	26.6	+9%	30.1	30.2	+0%	39.6	39.6	-0%
Depreciation and amortisation	(9.9)	(10.0)		11.2	12.4		10.9	12.8	
Finance costs - net	(1.3)	(1.3)		(0.7)	(0.7)		(0.6)	(0.6)	
Adjustments (associates, tax and depreciation)	(2.1)	(2.1)		(2.2)	(2.2)		(2.3)	(2.3)	
Underlying EBITDA	37.7	40.0	+6%	44.3	45.5	+3%	53.5	55.3	+3%

Source: company data, Forsyth Barr analysis

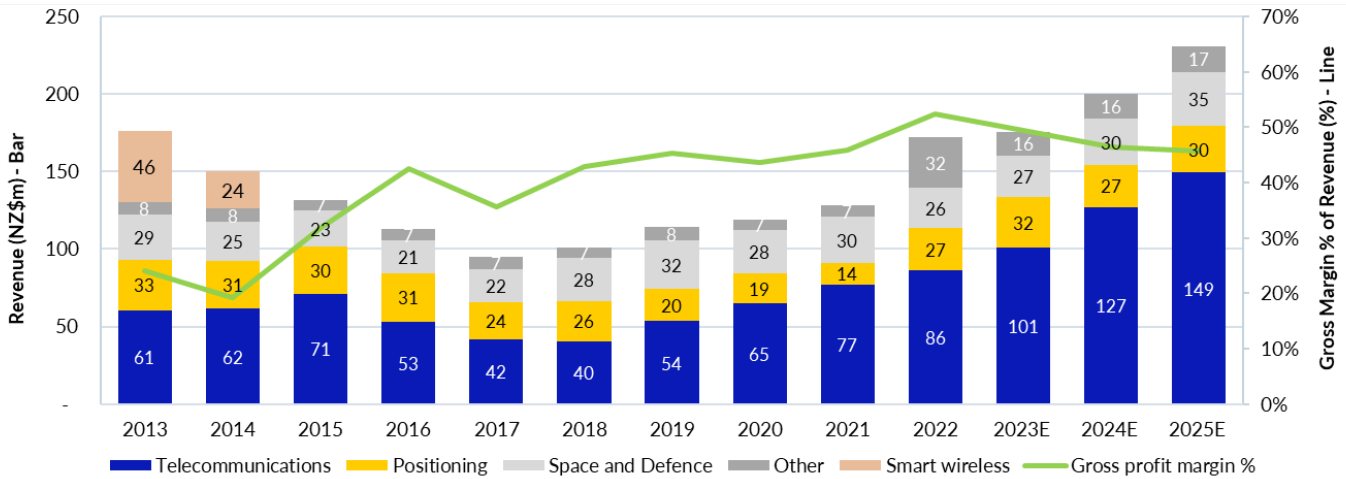
Figure 4. RAK – reported and estimated underlying EBITDA (with and without COVID/fire uplift)



Source: Company data, Forsyth Barr analysis

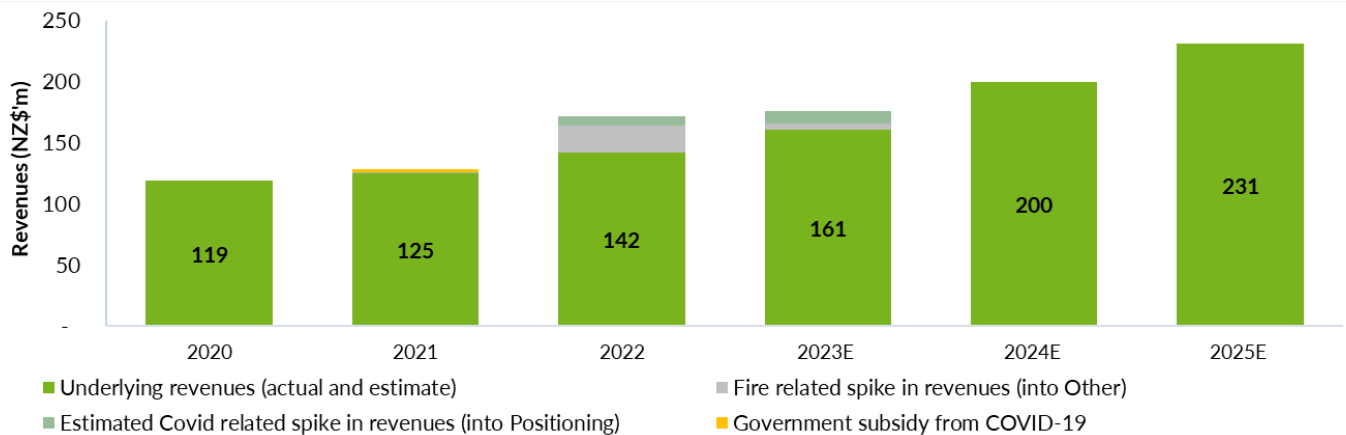
Key charts

Figure 5. RAK – Revenue stack by division (NZ\$m) and gross margin (%) reported and estimated, showing Telco market strength



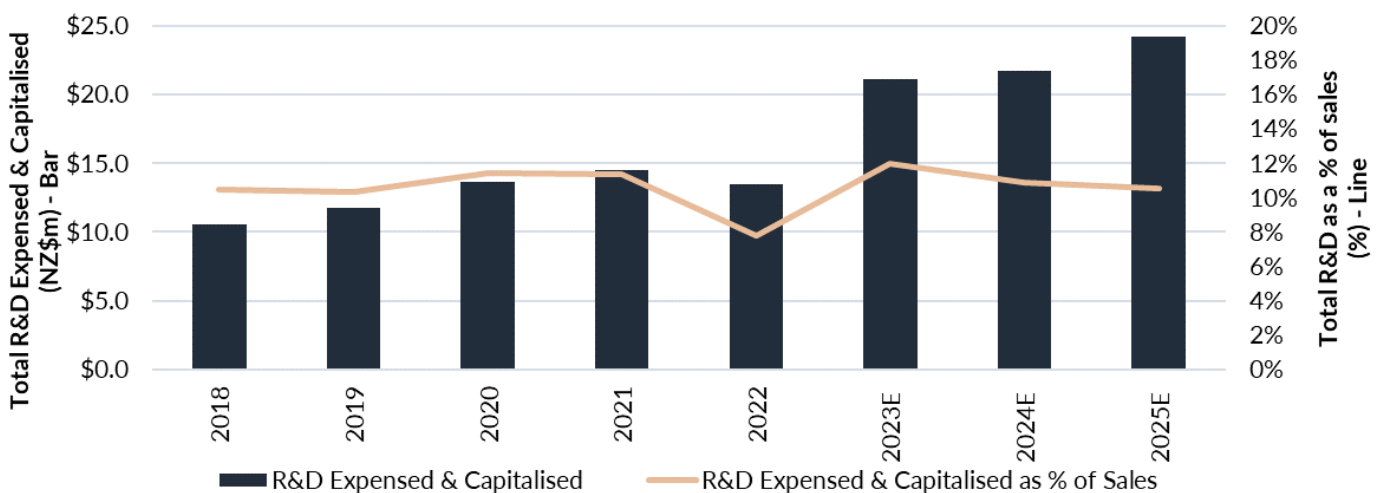
Source: Company data, Forsyth Barr analysis

Figure 6. RAK – reported and estimated revenues (with and without COVID/fire related uplift) showing steady earnings progress

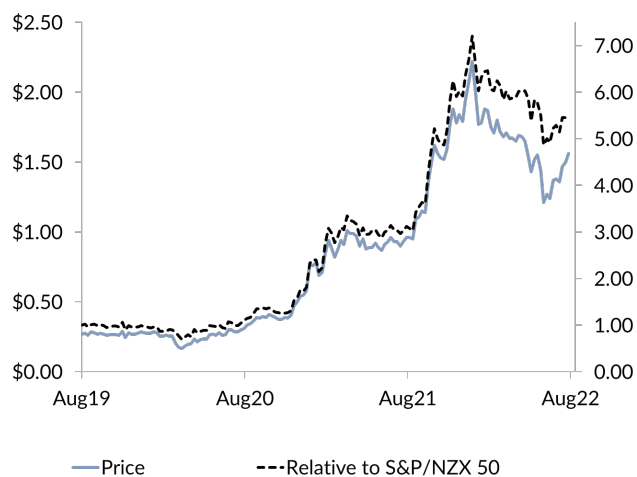


Source: Company data, Forsyth Barr analysis

Figure 7. RAK – Total R&D expensed and capitalised (NZ\$) and total R&D as a % of sales (%) displaying the heavy R&D investment



Source: Company data, 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 (metrics re-weighted to reflect RAK's balance date - March)	Code	Price	Mkt Cap (m)	PE		EV/EBITDA		EV/EBIT		Cash Yld	
				2023E	2024E	2023E	2024E	2023E	2024E		
Rakon	RAK NZ	NZ\$1.56	NZ\$357	18.1x	14.6x	8.4x	7.3x	12.8x	11.3x	0.0%	
Txc Corp	3042 TT	TWD88.50	TWD27,413	9.3x	9.4x	5.8x	5.6x	8.3x	7.8x	8.3%	
Sitime Corp	SITM US	US\$134.88	US\$2,871	34.6x	30.5x	24.7x	21.3x	26.4x	22.2x	n/a	
Microchip Technology Inc	MCHP US	US\$71.37	US\$39,431	12.6x	12.4x	11.7x	12.0x	12.6x	12.6x	2.0%	
Siward Crystal Technology Co	2484 TT	TWD40.80	TWD6,504	n/a	n/a	n/a	n/a	n/a	n/a	n/a	
Daishinku Corp	6962 T	¥940.00	¥34,025	7.8x	6.8x	4.3x	3.6x	7.1x	6.2x	3.2%	
Nihon Dempa Kogyo Co	6779 T	¥1265.00	¥29,258	6.7x	5.4x	5.5x	4.8x	8.8x	7.2x	4.3%	
Seiko Epson Corp	6724 JP	¥2139.00	¥854,819	10.7x	10.6x	5.0x	5.0x	8.3x	8.2x	3.3%	
Compco Average:				13.6x	12.5x	9.5x	8.7x	11.9x	10.7x	4.2%	
EV = Mkt cap+net debt+lease liabilities+min interests-investments				RAK Relative:		33%	17%	-12%	-16%	7%	6%

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

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