

Rakon Limited

5G Weakness Persisting, Inventory Stabilising?

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We adjust our Rakon (RAK) forecasts to account for prolonged market weakness in its key Telecommunications segment (~55% of FY24E revenue) following negative updates from key global telco players. Nokia (NOK) and Ericsson (ERIC) reported 1Q24 numbers in the last week, with both experiencing notable revenue declines. NOK reported a significant fall in sales, led by a deep contraction in its network infrastructure and mobile networks divisions. Similarly, ERIC experienced a downturn in sales, calling out a slowdown in 5G network deployment in its critical North American market as a key driver. While our FY24 estimates already align with the lower end of RAK's guidance, we reduce our FY25/FY26 estimates as we push out a recovery in Telecommunications. Our blended spot valuation falls -2cps to NZ\$0.98, and we await news regarding the potential NZ\$1.70 takeover offer.

NZX Code	RAK	Financials: Mar/	23A	24E	25E	26E	Valuation (x)	23A	24E	25E	26E
Share price	NZ\$1.11	Rev (NZ\$m)	180.7	141.8	158.5	188.6	PE	11.0	57.3	24.2	13.1
Spot Valuation	NZ\$0.98 (from 1.00)	NPAT* (NZ\$m)	23.2	4.5	10.6	19.6	EV/EBIT	n/a	n/a	n/a	n/a
Risk rating	High	EPS* (NZc)	10.1	1.9	4.6	8.5	EV/EBITDA	n/a	n/a	n/a	n/a
Issued shares	229.9m	DPS (NZc)	1.5	1.5	1.5	1.5	Price / NTA	1.7	1.7	1.6	1.5
Market cap	NZ\$255m	Imputation (%)	100	100	100	100	Cash div yld (%)	1.4	1.4	1.4	1.4
Avg daily turnover	87.8k (NZ\$88k)	*Based on normalised profits					Gross div yld (%)	1.9	1.9	1.9	1.9

What's changed?

- **Earnings:** Our underlying EBITDA estimates fall -5% in FY25 and FY26, while NPAT falls -9% and -6% respectively.
- **Spot valuation:** Our blended spot valuation falls -2% to NZ\$0.98, with weakness in peer comparables also driving the reduction.

Nokia – 1Q24

NOK 1Q24 showcased a challenging market environment, with net sales falling -20%. Its network infrastructure segment saw revenues drop -26%, while mobile network revenue was down -39%. NOK noted that it had seen improved order intake, providing confidence in a stronger 2H24 that should allow it to achieve its full-year operating profit guidance.

Ericsson – 1Q24 sales remaining weak but the company calls out that inventory levels have stabilised

ERIC reported a -15% year-over-year decline in 1Q24 net sales, dropping from SEK\$5.7bn to SEK\$4.8bn. The Networks segment saw a sales decrease of -21%. Reflecting lower 5G customer infrastructure investment, sales declined by -17% year-over-year in ERIC's primary global North American market. The company noted that customer inventory levels have now stabilised, and it expected a recovery in the second half of 2024 following recent contract wins. Despite market challenges and cautious customer investment, ERIC anticipates sales stabilisation in the latter half of 2024, supported by a strong pipeline and recent contract wins in North America.

Earnings preview – RAK FY24 result due 29 May 2024, we revise our FY25 and FY26 estimates

RAK is due to report its FY24 result on 29 May 2024. Management has guided to underlying EBITDA in the range of NZ\$13m to NZ\$19m. Our FY24 estimates have NZ\$141.8m in sales (down -21%), underlying EBITDA at the lower end of guidance at NZ\$13.9m (down -67%) and reported NPAT of NZ\$4.4m (down -81%). We anticipate RAK will update investors about the takeover offer, first announced on 11 December 2023. We cut our FY25 and FY26 revenue estimates by -2% and -3%, respectively, and our underlying EBITDA forecasts by -5% in both years, effectively pushing out the cyclical recovery by ~three months.

Rakon Limited (RAK)
Market Data (NZ\$)

Priced as at 23 Apr 2024	1.11
52 week high / low	1.31 / 0.59
Market capitalisation (NZ\$m)	254.8

Key WACC assumptions

Risk free rate	5.00%
Equity beta	1.35
WACC	11.7%
Terminal growth	2.0%

Profit and Loss Account (NZ\$m)	2022A	2023A	2024E	2025E	2026E
Revenue	173.6	180.7	141.8	158.5	188.6
Normalised EBITDA	50.4	41.1	13.3	22.1	34.0
Depreciation and amortisation	(8.9)	(7.8)	(7.2)	(8.3)	(8.7)
Normalised EBIT	41.4	33.3	6.1	13.8	25.3
Net interest	(1.9)	(0.5)	(0.3)	(0.5)	(0.5)
Associate income	2.4	(1.5)	0.1	0.8	1.3
Tax	(8.8)	(8.1)	(1.5)	(3.5)	(6.5)
Minority interests	0	0	0	0	0
Normalised NPAT	33.1	23.2	4.5	10.6	19.6
Abnormals/other	0	0	0	0	0
Reported NPAT	33.1	23.2	4.5	10.6	19.6
Normalised EPS (cps)	14.5	10.1	1.9	4.6	8.5
DPS (cps)	0	1.5	1.5	1.5	1.5

Growth Rates	2022A	2023A	2024E	2025E	2026E
Revenue (%)	32.7	4.1	-21.6	11.8	18.9
EBITDA (%)	>100	-18.3	-67.6	66.3	53.9
EBIT (%)	>100	-19.5	-81.6	>100	83.4
Normalised NPAT (%)	>100	-29.9	-80.8	>100	85.5
Normalised EPS (%)	>100	-29.9	-80.9	>100	85.1
Ordinary DPS (%)	n/a	n/a	0.0	0.0	0.0

Cash Flow (NZ\$m)	2022A	2023A	2024E	2025E	2026E
EBITDA	50.4	41.1	13.3	22.1	34.0
Working capital change	(15.3)	(18.2)	5.1	7.3	(12.9)
Interest & tax paid	(2.3)	(10.5)	(1.8)	(4.0)	(7.0)
Other	(2.6)	(1.3)	0.1	0.8	1.3
Operating cash flow	30	11.1	16.7	26.2	15.5
Capital expenditure	(10.2)	(18.7)	(17.0)	(14.5)	(6.3)
(Acquisitions)/divestments	0	0	0	0	0
Other	(2.6)	(2.5)	(2.1)	(2.1)	(2.2)
Funding available/(required)	17.4	(10.1)	(2.4)	9.6	7.0
Dividends paid	0	0	(2.9)	(2.9)	(5.2)
Equity raised/(returned)	0	0	0	0	0
(Increase)/decrease in net debt	17.4	(10.1)	(5.3)	6.7	1.8

Balance Sheet (NZ\$m)	2022A	2023A	2024E	2025E	2026E
Working capital	65.8	84.1	79.0	71.7	84.6
Fixed assets	21.4	34.4	45.2	52.5	50.9
Intangibles	7.2	7.7	8.3	9.0	9.9
Right of use asset	4.8	3.4	12.2	15.5	13.8
Other assets	25.5	26.0	26.0	26.0	26.0
Total funds employed	124.6	155.6	170.8	174.7	185.2
Net debt/(cash)	(23.2)	(16.5)	(11.2)	(18.0)	(19.7)
Lease liability	3.4	2.5	10.9	13.8	11.6
Other liabilities	9.3	12.7	12.7	12.7	10.4
Shareholder's funds	135.2	156.9	158.4	166.1	182.8
Minority interests	0	0	0	0	0
Total funding sources	124.6	155.6	170.8	174.7	185.2

* 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

Spot valuation (NZ\$)

DCF	0.98
PE driven comparables valuation	0.95
	1.03

DCF valuation summary (NZ\$m)

Total firm value	234
(Net debt)/cash	16
Less: Capitalised operating leases	-29
Value of equity	222

Valuation Ratios	2022A	2023A	2024E	2025E	2026E
EV/Sales (x)	1.4	1.3	1.7	1.6	1.3
EV/EBITDA (x)	4.9	5.8	18.6	11.5	7.5
EV/EBIT (x)	5.9	7.1	40.4	18.4	10.1
PE (x)	7.7	11.0	57.3	24.2	13.1
Price/NTA (x)	2.0	1.7	1.7	1.6	1.5
Free cash flow yield (%)	6.8	-3.9	-0.9	3.8	2.7
Adj. free cash flow yield (%)	10.8	3.4	5.7	9.5	5.2
Net dividend yield (%)	0.0	1.4	1.4	1.4	1.4
Gross dividend yield (%)	0.0	1.9	1.9	1.9	1.9

Capital Structure	2022A	2023A	2024E	2025E	2026E
Interest cover EBIT (x)	21.7	64.1	21.1	30.4	54.4
Interest cover EBITDA (x)	26.4	79.1	45.7	48.8	73.2
Net debt/ND+E (%)	-20.8	-11.7	-7.6	-12.1	-12.1
Net debt/EBITDA (x)	n/a	n/a	n/a	n/a	n/a

Key Ratios	2022A	2023A	2024E	2025E	2026E
Return on assets (%)	20.7	16.1	2.9	6.3	10.8
Return on equity (%)	24.5	14.8	2.8	6.4	10.7
Return on funds employed (%)	16.6	11.2	2.1	4.9	8.6
EBITDA margin (%)	29.0	22.8	9.4	14.0	18.1
EBIT margin (%)	23.9	18.4	4.3	8.7	13.4
Capex to sales (%)	5.9	10.3	12.0	9.2	3.4
Capex to depreciation (%)	143	286	277	201	84
Imputation (%)	0	100	100	100	100
Pay-out ratio (%)	0	15	77	33	18

Segment Revenue (NZ\$m)	2022A	2023A	2024E	2025E	2026E
Telecommunications	86.0	101.6	78.7	89.7	107.7
Positioning	28.1	33.8	18.3	21.0	25.6
Space and Defence	24.5	28.9	35.4	38.2	45.5
IoT, Emerging and Other	33.4	17.0	9.4	9.5	9.7
Other revenues	-1.0	0.4	0.0	0.0	0.0
Total Revenue	171.0	181.7	141.8	158.5	188.6

Segment Gross Margin (%)	2022A	2023A	2024E	2025E	2026E
Telecommunications	43.6	42.3	37.0	41.0	41.5
Positioning	58.4	53.5	47.8	44.0	45.0
Space and Defence	69.4	68.0	62.0	66.0	64.5
IoT, Emerging and Other	57.3	47.7	54.0	49.0	49.0

Segment Gross Margin (NZ\$m)	2022A	2023A	2024E	2025E	2026E
Telecommunications	37.5	42.9	29.1	36.8	44.7
Positioning	16.4	18.1	8.7	9.2	11.5
Space and Defence	17.0	19.7	22.0	25.2	29.4
IoT, Emerging and Other	19.2	8.1	5.1	4.7	4.8

"Underlying EBITDA" (NZ\$m)	2022A	2023A	2024E	2025E	2026E
Underlying EBITDA estimates	54.4	42.2	13.9	24.1	37.1

Earnings revisions

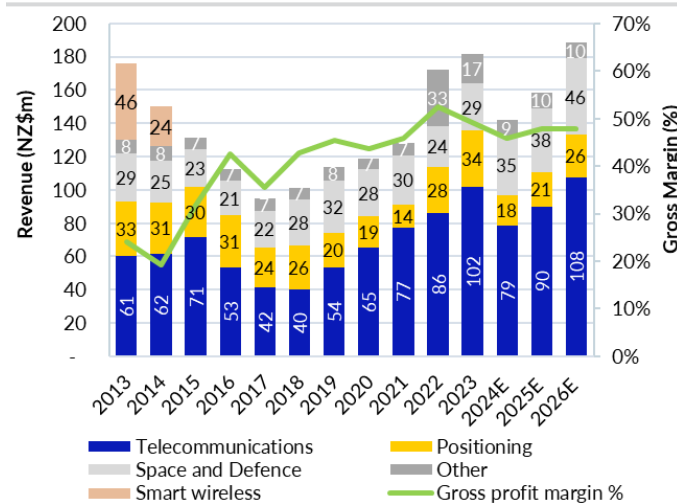
We reduce our Telecommunications segment revenue expectations for FY25 and FY26 segment revenue by -6% and -5%, respectively, given the softer start to FY24 among global telecommunication companies. This sees an overall RAK reduction in sales by -2% and -3% in FY25 and FY26 respectively. Overall, this update sees a further three months delay in our timing for the cyclical recovery. We anticipate the new Indian facility capacity allowing for a quicker recovery in sales in FY25 and FY26 than in prior cycles. Still, we will watch 5G infrastructure comparables for ongoing weakness or green shoots for the turn in the cycle.

Figure 1. Earnings revisions

	FY24E			FY25E			FY26E		
	Old	New	Change	Old	New	Change	Old	New	Change
Revenue	141.8	141.8	+0%	162.1	158.5	-2%	193.5	188.6	-3%
Cost of sales	(76.9)	(76.9)	+0%	(84.8)	(82.6)	-3%	(101.3)	(98.2)	-3%
Gross Profit	64.9	64.9	+0%	77.3	76.0	-2%	92.1	90.4	-2%
Selling and marketing costs	(12.2)	(12.2)	+0%	(12.4)	(12.4)	-0%	(13.9)	(13.9)	-0%
Research and development	(18.4)	(18.4)	+0%	(20.3)	(20.3)	+0%	(20.9)	(20.9)	+0%
General and administration	(28.1)	(28.1)	+0%	(29.5)	(29.5)	+0%	(30.2)	(30.2)	+0%
Total operating expenses	(58.7)	(58.7)	+0%	(62.2)	(62.2)	-0%	(65.1)	(65.0)	-0%
Other gains/(losses)-net	-	-		-	-		-	-	
Operating profit	6.1	6.1	+0%	15.2	13.8	-9%	27.1	25.3	-6%
Finance income	0.4	0.4	n/a	0.3	0.3	n/a	0.2	0.2	n/a
Finance costs	(0.6)	(0.6)	n/a	(0.8)	(0.8)	n/a	(0.7)	(0.7)	n/a
Share of net profits of associates	0.1	0.1	+0%	0.8	0.8	+0%	1.3	1.3	+0%
Profit before income tax	5.9	5.9	+0%	15.5	14.1	-9%	27.9	26.1	-6%
Income tax expense	(1.5)	(1.5)	+0%	(3.9)	(3.5)	-9%	(7.0)	(6.5)	-6%
Net profit for the period	4.5	4.5	+0%	11.6	10.6	-9%	20.9	19.6	-6%
Profit before income tax	5.9	5.9	+0%	15.5	14.1	-9%	27.9	26.1	-6%
Depreciation and amortisation	(7.2)	(7.2)	n/a	(8.3)	(8.3)	n/a	(8.8)	(8.7)	n/a
Finance costs – net	(0.3)	(0.3)	n/a	(0.5)	(0.5)	n/a	(0.5)	(0.5)	n/a
Adjustments for associate share of interest, tax and depreciation	(0.1)	(0.1)	n/a	(0.8)	(0.8)	n/a	(1.3)	(1.3)	n/a
Other non-cash items	(0.4)	(0.4)	n/a	(0.4)	(0.4)	n/a	(0.5)	(0.5)	n/a
Underlying EBITDA	13.9	13.9	+0%	25.5	24.1	-5%	38.9	37.1	-5%

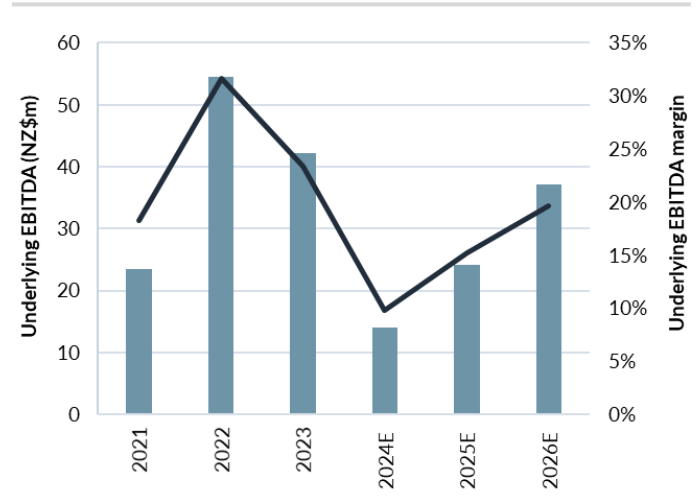
Source: Forsyth Barr analysis

Figure 2. RAK – Divisional revenue stack and gross margin (%)



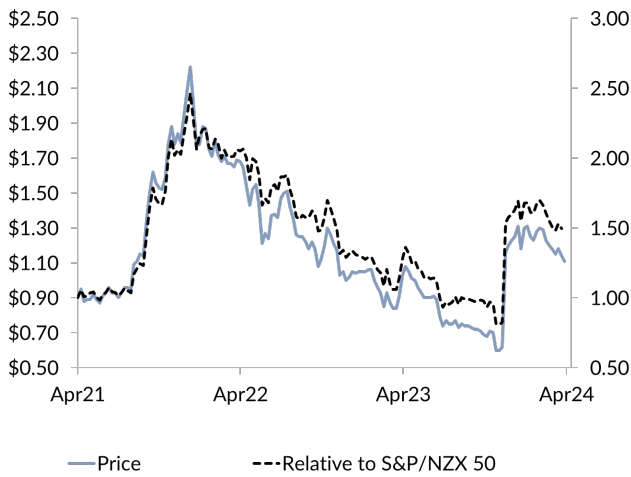
Source: Company, Forsyth Barr analysis

Figure 3. RAK – Underlying EBITDA



Source: Company, Forsyth Barr analysis

Figure 4. Price performance



Source: Forsyth Barr analysis

Figure 5. Substantial shareholders

Shareholder	Latest Holding
Brent John Robinson	15.2%
Siward Crystal Technology	12.2%
Wairahi Investments and Wairahi Holdings Limited	6.1%

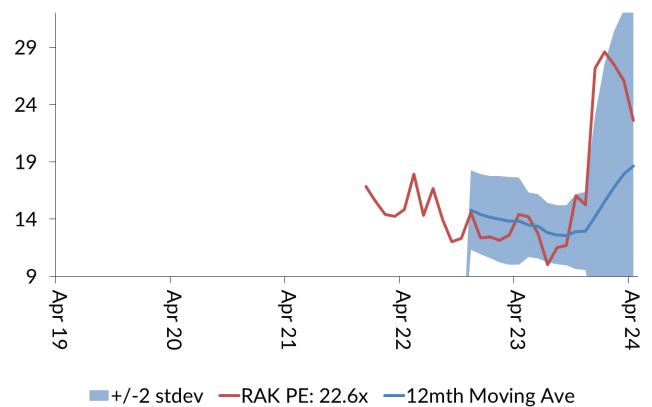
Source: NZX, Forsyth Barr analysis, NOTE: based on SPH notices only

Figure 6. International valuation comparisons

Company	Code	Price	Mkt Cap (m)	PE		EV/EBITDA		EV/EBIT		Cash Yld 2025E	
				2024E	2025E	2024E	2025E	2024E	2025E		
Rakon	RAK NZ	NZ\$1.11	NZ\$255	57.3x	24.2x	n/a	11.5x	n/a	18.5x	1.4%	
Txc Corp	3042 TT	TWD106.50	TWD32,989	18.8x	n/a	n/a	n/a	16.9x	n/a	n/a	
Sitime Corp	SITM US	US\$73.44	US\$1,680	16.3x	>50x	24.7x	>75x	<0x	<0x	n/a	
Microchip Technology Inc	MCHP US	US\$81.68	US\$44,139	16.6x	26.7x	13.7x	20.3x	14.9x	23.8x	2.3%	
Siward Crystal Technology Co	2484 TT	TWD31.85	TWD5,078	n/a	n/a	n/a	n/a	n/a	n/a	n/a	
Daishinku Corp	6962 T	¥751.00	¥27,184	15.7x	16.2x	6.7x	5.6x	21.6x	15.3x	3.7%	
Nihon Dempa Kogyo Co	6779 T	¥1171.00	¥27,084	10.0x	7.0x	5.6x	4.6x	9.8x	7.5x	2.1%	
Seiko Epson Corp	6724 JP	¥2629.50	¥1,012,416	16.2x	14.7x	6.9x	6.3x	13.4x	11.5x	2.9%	
Compco Average:				15.6x	16.2x	11.5x	9.2x	15.3x	14.5x	2.8%	
EV = Mkt cap+net debt+lease liabilities+min interests-investments				RAK Relative:	267%	50%	n/a	25%	n/a	27%	-51%

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

Figure 7. One year forward PE (x)



Source: Forsyth Barr analysis

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