

Rakon Limited

Telecoms Weakness Persists

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While Rakon (RAK) has previously said it expects customer inventory levels to normalise by the end of FY24 (to March 2024), our analysis of recent updates from listed telecoms infrastructure companies suggests challenging trading conditions persist and a recovery could take longer. On 17 July 2023, RAK said that a temporary slowdown in the telecoms sector meant up to NZ\$10m in downside risk to its FY24 underlying EBITDA guidance range of NZ\$24m–NZ\$36m. The temporary slowdown was, 'driven by a more conservative stance from the global mobile network operators for FY24', leading to a slower drawdown of stockpiled inventory amongst RAK's key telecoms infrastructure customers. In anticipation of RAK's 1H24 result on 23 November 2023, we reduce our FY24 EBITDA estimate by -22% to NZ\$19.3m. Our new estimate is now ~-NZ\$5m below the bottom end of the current guidance range. Longer-term growth dynamics in 5G infrastructure, Space and Defence, and industrial positioning remain intact. Earnings downgrades from operating deleverage and changes to our valuation inputs see our blended spot valuation fall -23% to NZ\$0.92.

NZX Code	RAK	Financials: Mar/	23A	24E	25E	26E	Valuation (x)	23A	24E	25E	26E
Share price	NZ\$0.69	Rev (NZ\$m)	180.7	147.5	169.7	205.3	PE	6.8	22.6	13.0	6.9
Spot Valuation	NZ\$0.92 (from 1.20)	NPAT* (NZ\$m)	23.2	7.0	12.2	23.0	EV/EBIT	n/a	n/a	n/a	n/a
Risk rating	High	EPS* (NZc)	10.1	3.1	5.3	10.0	EV/EBITDA	n/a	n/a	n/a	n/a
Issued shares	229.1m	DPS (NZc)	1.5	1.5	1.5	3.0	Price / NTA	1.1	1.0	1.0	0.9
Market cap	NZ\$158m	Imputation (%)	100	100	100	100	Cash div yld (%)	2.2	2.2	2.2	4.3
Avg daily turnover	61.3k (NZ\$57k)	*Based on normalised profits					Gross div yld (%)	3.0	3.0	3.0	6.0

What's changed?

- **Earnings:** FY24 underlying EBITDA falls -22% due to a weaker telecoms industry/inventory adjustment with FY25/FY26 EBITDA down -20% and -10% respectively. NPAT estimates fall -37%/-30%/-14% over FY24/FY25/FY26 respectively.
- **Blended spot valuation:** falls -28cps to NZ\$0.92.

Ongoing telecoms weakness – more conservative forecasts

Recent quarterly results from tier-1 telecoms infrastructure companies Ericsson (ERIC.O) and Nokia (NOKIA.HE) showed that weakness in activity within the telecoms industry is ongoing. Both Ericsson and Nokia reported weak sales numbers and spoke of macroeconomic uncertainty and challenging operating environments. A more detailed summary of these results and commentary is found in the Appendix. The sentiment displayed has been echoed by recent trading updates from other industry players. With little evidence that industry weakness is abating and inventory adjustments stabilising, we preemptively reduce our FY24 telecoms revenue estimate. Our FY24 underlying EBITDA estimate falls -22% to NZ\$19.3m and NPAT estimates fall -37%.

1H24 preview

RAK will report its 1H24 result on 23 November 2023, where we expect a result impacted heavily by the telecoms sector slowdown and ongoing inventory adjustment. We forecast 1H24 revenue of NZ\$67.8m (-22% versus 1H23) and EBITDA of NZ\$8.1m (-71%).

Valuation changes

Given recent interest rate movements, we have increased our risk-free rate input assumption to 5.25%, up +75bps from 4.5%. Our WACC for RAK is now 11.5%. Changes to WACC and other valuation inputs reduced our blended spot valuation by -3cps to NZ\$1.20 before today's earnings downgrades. Earnings downgrades decrease the blended spot valuation -28cps to NZ\$0.92, meaning the net impact of valuation changes since our last published report is -31cps.

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

Priced as at 27 Oct 2023	0.69
52 week high / low	1.30 / 0.69
Market capitalisation (NZ\$m)	158.0

Key WACC assumptions

Risk free rate	5.25%
Equity beta	1.30
WACC	11.5%
Terminal growth	2.0%

Profit and Loss Account (NZ\$m)

	2022A	2023A	2024E	2025E	2026E
Revenue	173.6	180.7	147.5	169.7	205.3
Normalised EBITDA	50.4	41.1	18.7	26.2	40.6
Depreciation and amortisation	(8.9)	(7.8)	(9.3)	(10.4)	(10.8)
Normalised EBIT	41.4	33.3	9.4	15.8	29.8
Net interest	(1.9)	(0.5)	(0.1)	(0.3)	(0.4)
Associate income	2.4	(1.5)	0.1	0.8	1.3
Tax	(8.8)	(8.1)	(2.3)	(4.1)	(7.7)
Minority interests	0	0	0	0	0
Normalised NPAT	33.1	23.2	7.0	12.2	23.0
Abnormals/other	0	0	0	0	0
Reported NPAT	33.1	23.2	7.0	12.2	23.0
Normalised EPS (cps)	14.5	10.1	3.1	5.3	10.0
DPS (cps)	0	1.5	1.5	1.5	3.0

Growth Rates

	2022A	2023A	2024E	2025E	2026E
Revenue (%)	32.7	4.1	-18.4	15.1	20.9
EBITDA (%)	>100	-18.3	-54.6	40.6	54.7
EBIT (%)	>100	-19.5	-71.9	68.4	88.6
Normalised NPAT (%)	>100	-29.9	-69.7	73.3	88.7
Normalised EPS (%)	>100	-29.9	-69.8	73.3	88.7
Ordinary DPS (%)	n/a	n/a	0.0	0.0	100.0

Cash Flow (NZ\$m)

	2022A	2023A	2024E	2025E	2026E
EBITDA	50.4	41.1	18.7	26.2	40.6
Working capital change	(15.3)	(18.2)	12.6	(7.1)	(15.5)
Interest & tax paid	(2.3)	(10.5)	(2.4)	(4.4)	(8.1)
Other	(2.6)	(1.3)	0.1	0.8	1.3
Operating cash flow	30	11.1	29.0	15.5	18.3
Capital expenditure	(10.2)	(18.7)	(17.7)	(15.5)	(6.9)
(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)	9.2	(2.1)	9.3
Dividends paid	0	0	(3.4)	(3.4)	(6.9)
Equity raised/(returned)	0	0	0	0	0
(Increase)/decrease in net debt	17.4	(10.1)	5.8	(5.6)	2.4

Balance Sheet (NZ\$m)

	2022A	2023A	2024E	2025E	2026E
Working capital	65.8	84.1	71.4	78.5	94.0
Fixed assets	21.4	34.4	45.3	52.7	50.8
Intangibles	7.2	7.7	7.5	7.5	7.8
Right of use asset	4.8	3.4	11.6	14.3	11.9
Other assets	25.5	26.0	26.0	26.0	26.0
Total funds employed	124.6	155.6	161.8	179.0	190.6
Net debt/(cash)	(23.2)	(16.5)	(22.2)	(16.7)	(19.0)
Lease liability	3.4	2.5	10.9	13.8	11.6
Other liabilities	9.3	12.7	12.7	12.7	12.7
Shareholder's funds	135.2	156.9	160.4	169.2	185.3
Minority interests	0	0	0	0	0
Total funding sources	124.6	155.6	161.8	179.0	190.6

* 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	0.92
PE driven comparables valuation	0.99

DCF valuation summary (NZ\$m)

Total firm value	254
(Net debt)/cash	16
Less: Capitalised operating leases	-44
Value of equity	226

Valuation Ratios

	2022A	2023A	2024E	2025E	2026E
EV/Sales (x)	0.9	0.8	1.0	0.9	0.7
EV/EBITDA (x)	2.9	3.4	7.8	5.6	3.6
EV/EBIT (x)	3.6	4.2	15.5	9.3	4.9
PE (x)	4.8	6.8	22.6	13.0	6.9
Price/NTA (x)	1.2	1.1	1.0	1.0	0.9
Free cash flow yield (%)	11.0	-6.4	5.8	-1.3	5.9
Adj. free cash flow yield (%)	17.5	5.5	17.0	8.5	10.2
Net dividend yield (%)	0.0	2.2	2.2	2.2	4.3
Gross dividend yield (%)	0.0	3.0	3.0	3.0	6.0

Capital Structure

	2022A	2023A	2024E	2025E	2026E
Interest cover EBIT (x)	21.7	64.1	92.7	53.5	69.7
Interest cover EBITDA (x)	26.4	79.1	>100x	88.9	95.1
Net debt/ND+E (%)	-20.8	-11.7	-16.1	-10.9	-11.4
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	4.4	7.0	12.4
Return on equity (%)	24.5	14.8	4.4	7.2	12.4
Return on funds employed (%)	16.6	11.2	3.4	5.6	9.9
EBITDA margin (%)	29.0	22.8	12.7	15.5	19.8
EBIT margin (%)	23.9	18.4	6.4	9.3	14.5
Capex to sales (%)	5.9	10.3	12.0	9.2	3.4
Capex to depreciation (%)	143	286	242	182	77
Imputation (%)	0	100	100	100	100
Pay-out ratio (%)	0	15	49	28	30

Segment Revenue (NZ\$m)

	2022A	2023A	2024E	2025E	2026E
Telecommunications	86.0	101.6	77.2	93.4	119.6
Positioning	28.1	33.8	27.4	29.3	32.3
Space and Defence	24.5	28.9	31.8	35.9	42.4
IoT, Emerging and Other	33.4	17.0	11.1	11.1	11.1
Other revenues	2.5	0.4	0.0	0.0	0.0
Total Revenue	174.5	181.7	147.5	169.7	205.3

Segment Gross Margin (%)

	2022A	2023A	2024E	2025E	2026E
Telecommunications	43.6	42.3	40.8	41.3	42.0
Positioning	58.4	53.5	51.2	51.5	52.5
Space and Defence	69.4	68.0	67.0	65.5	64.0
IoT, Emerging and Other	57.3	47.7	15.0	15.0	15.0

Segment Gross Margin (NZ\$m)

	2022A	2023A	2024E	2025E	2026E
Telecommunications	37.5	42.9	31.5	38.6	50.2
Positioning	16.4	18.1	14.0	15.1	16.9
Space and Defence	17.0	19.7	21.3	23.5	27.1
IoT, Emerging and Other	19.2	8.1	1.7	1.7	1.7

"Underlying EBITDA" (NZ\$m)

	2022A	2023A	2024E	2025E	2026E
Underlying EBITDA estimates	54.4	42.2	19.3	28.2	43.6

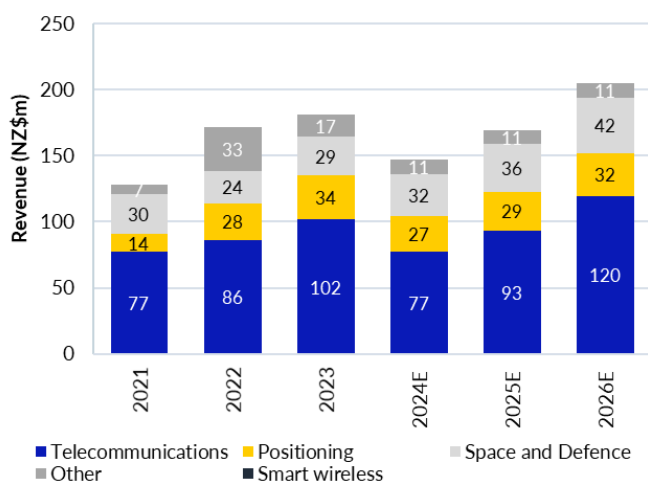
Earnings revisions

Figure 1. Earnings revisions

	FY24E			FY25E			FY26E		
	Old	New	Change	Old	New	Change	Old	New	Change
Revenue	159.3	147.5	-7%	183.9	169.7	-8%	214.3	205.3	-4%
Cost of sales	(84.4)	(79.0)	-6%	(97.8)	(90.9)	-7%	(113.6)	(109.3)	-4%
Gross Profit	74.8	68.5	-8%	86.1	78.9	-8%	100.7	95.9	-5%
Selling and marketing costs	(11.1)	(10.4)	-6%	(11.4)	(11.2)	-2%	(11.7)	(11.7)	+0%
Research and development	(17.4)	(17.1)	-1%	(20.0)	(19.9)	-1%	(21.9)	(21.9)	+0%
General and administration	(31.5)	(31.6)	+0%	(31.9)	(32.1)	+0%	(32.6)	(32.6)	+0%
Total operating expenses	(59.9)	(59.1)	-1%	(63.4)	(63.1)	-1%	(66.2)	(66.2)	+0%
Other gains/(losses)-net	-	-		-	-		-	-	
Operating profit	15.0	9.4	-37%	22.7	15.8	-30%	34.5	29.8	-14%
Finance income	0.5	0.4	n/a	0.4	0.4	n/a	0.3	0.2	n/a
Finance costs	(0.6)	(0.6)	n/a	(0.7)	(0.7)	n/a	(0.6)	(0.6)	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	15.0	9.4	-37%	23.2	16.2	-30%	35.5	30.6	-14%
Income tax expense	(3.7)	(2.3)	-37%	(5.8)	(4.1)	-30%	(8.9)	(7.7)	-14%
Net profit for the period	11.2	7.0	-37%	17.4	12.2	-30%	26.6	23.0	-14%
Profit before income tax	15.0	9.4	-37%	23.2	16.2	-30%	35.5	30.6	-14%
Depreciation and amortisation	(9.3)	(9.3)	n/a	(10.6)	(10.4)	n/a	(11.1)	(10.8)	n/a
Finance costs – net	(0.1)	(0.1)	n/a	(0.3)	(0.3)	n/a	(0.4)	(0.4)	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	24.9	19.3	-22%	35.2	28.2	-20%	48.7	43.6	-10%

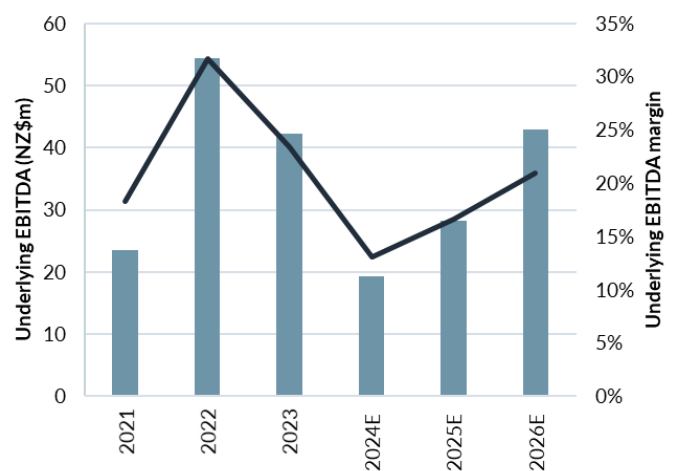
Source: Company Data, Forsyth Barr analysis

Figure 2. RAK – Revenue stack by division (NZ\$m)



Source: Company Data, Forsyth Barr analysis

Figure 3. RAK – Underlying EBITDA



Source: Company Data, Forsyth Barr analysis

Appendix

Telecoms infrastructure pulse check: recent results and updates

We analyse recent results and trading updates from tier-1 telecoms infrastructure companies Ericsson and Nokia. Commentary and trends seen in these results were consistent from other industry players. Key themes from this analysis are: 1) weak investment intentions from network deployers remain, 2) general trading conditions are extremely challenging, and 3) any decisive recovery still seems some way off.

Ericsson 3Q23

Ericsson (ERIC.O), the world's largest publicly held telecom equipment manufacturer by revenue, reported a weak set of 3Q23 results on 17 October 2023. Total revenue for the quarter was SEK\$5.9bn, down -5% relative to 3Q22, but organic revenues fell -10%. EBITA, excluding restructuring charges, was SEK\$432m versus SEK\$708m last year, representing a fall of -39% and an EBITA margin of 7.3% (down from 11.3%). Reported gross margin was 38.4% (41.4% in 3Q22).

Networks sales were SEK\$41.5bn, down -16%. By region, network equipment and services sales in North America, the company's largest market, dropped -49% year-over-year, representing ~21% of total 3Q23 sales, down from ~39% in 3Q22. The fall resulted from Mobile Network Operator (MNO) inventory adjustments and an overall slowdown of 5G deployments in the region. ERIC saw positive double-digit sales growth in India, with some early 5G markets resuming investments.

Despite cyclicity in the mobile networks business, the company said escalating mobile data demand and new 5G use cases remain underlying drivers for the recovery. Nonetheless, ERIC expects the prevailing uncertainty impacting its Mobile Networks business to persist into 2024. ERIC claims the global 5G deployment cycle is still early and that 75% of all its base station sites outside China still need to move to 5G.

Commenting on the result ERIC's President and CEO said, *'in a challenging operating environment, Ericsson delivered third quarter results in line with our guidance' and 'consistent with the rest of our industry, we expect the macroeconomic uncertainty to persist into 2024, which impacts our customers' investment ability. We are addressing these challenges with a focus on elements within our control, namely cost management and operational efficiency.'*

See [here](#) for more information.

Nokia 3Q23

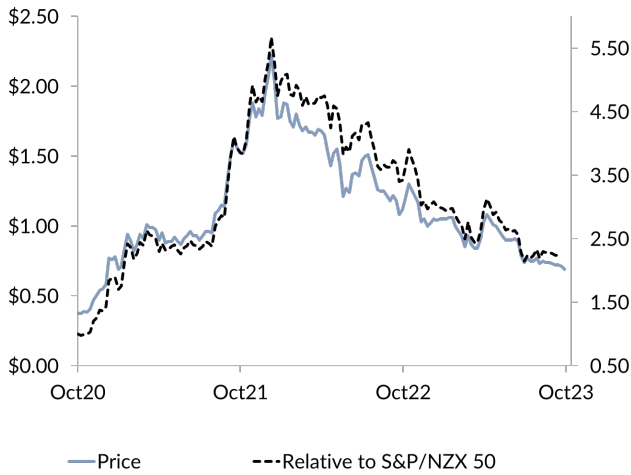
Nokia (NOKIA.HE) reported its 3Q23 result on 19 October 2023. In 3Q23, the company reported a -15% decline in constant currency net sales year-over-year. It attributed the drop to challenging macroeconomic conditions and higher interest rates affecting operator spending. The company's comparable gross margin declined -120bps to 39.2%.

The network and market conditions had a mixed impact on Nokia's business segments. However, sales in Mobile Networks declined -19% due to a moderation in the pace of 5G deployment in India, with growth there not enough to offset the slowdown in North America.

The President and CEO of Nokia emphasised the company's strategic resilience, *'In the last three years we have invested heavily to strengthen our technology leadership across the business, giving us a firm foundation to weather this period of market weakness.'* On future prospects, he noted, *'We expect to see a more normal seasonal improvement in our network businesses in the fourth quarter'*, indicating a cautiously optimistic outlook for the company moving forward.

See [here](#) for more information.

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 (metrics re-weighted to reflect RAK's balance date - March)	Code	Price	Mkt Cap (m)	PE		EV/EBITDA		EV/EBIT		Cash Yld 2025E	
				2024E	2025E	2024E	2025E	2024E	2025E		
Rakon	RAK NZ	NZ\$0.69	NZ\$158	22.6x	13.0x	n/a	n/a	n/a	n/a	2.2%	
Txc Corp	3042 TT	TWD98.90	TWD30,635	17.0x	14.4x	9.1x	9.0x	15.7x	12.7x	5.4%	
Sitime Corp	SITM US	US\$102.28	US\$2,272	>75x	73.4x	<0x	62.3x	<0x	>75x	n/a	
Microchip Technology Inc	MCHP US	US\$71.38	US\$38,855	11.7x	11.7x	10.2x	10.4x	11.0x	11.3x	2.8%	
Siward Crystal Technology Co	2484 TT	TWD30.65	TWD4,886	n/a	n/a	n/a	n/a	n/a	n/a	n/a	
Daishinku Corp	6962 T	¥733.00	¥26,532	14.9x	12.8x	6.1x	5.2x	18.9x	14.0x	3.8%	
Nihon Dempa Kogyo Co	6779 T	¥1205.00	¥27,870	6.8x	5.9x	4.5x	3.8x	7.1x	5.8x	1.7%	
Seiko Epson Corp	6724 JP	¥2210.50	¥851,092	10.7x	11.0x	5.2x	5.3x	8.9x	8.8x	3.5%	
Compco Average:				12.2x	21.5x	7.0x	16.0x	12.3x	10.5x	3.4%	
EV = Mkt cap+net debt+lease liabilities+min interests-investments				RAK Relative:		85%	-40%	n/a	n/a	n/a	-37%

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

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