rakon

2014 HALF YEAR REVIEW

synchronising
connectivity
everywhere

2014 HALF YEAR STATEMENT OF RESULTS

For the first half of FY2014, Rakon has reported revenue of NZ$80.5 million, down 10% on the previous half year and reports a net loss after tax of NZ$45.7 million. This number includes a loss from continuing operations of NZ$21.4 million and a loss from discontinued operations of NZ$24.3 million. Total impairments of NZ$32.7 million are reported in the net loss for the period.

Following Rakon's announcement on 5 July 2013 to divest an 80% equity interest in Rakon Crystal (Chengdu) Co. Ltd (RCC sale), the entity is classified as a discontinued operation (Statement of Comprehensive Income) with assets and liabilities held for sale (Balance Sheet), in the interim financial statements. Subsequent to 30 September the RCC sale completed and settled. As a consequence of the RCC sale, Rakon will have a reduced involvement in the Smart Wireless Device market (SWD). This results in additional impairment charges within the period of NZ$5.9 million against the property, plant and equipment assets of the New Zealand business unit and NZ$2.9 million of SWD related stock provisions.

EBITDA of NZ$-4.7 million[1] is reported (September 2012: NZ$4.7 million[1]), which includes NZ$3.8 million of provisions for a planned restructure in France and the increase in stock provisions of NZ$2.9 million. After the adjustment of restructure costs and stock provisions, EBITDA is NZ$2.0 million comparative to the previous half year of NZ$4.7 million. A detailed reconciliation of EBITDA to net loss after tax, is included in Note 4 of the interim financial statements.

The company's operating cash flow of NZ$7.8 million, reflects a release in working capital previously held in SWD and improvements in managing working capital over the period. Bank borrowings of NZ$36.9 million are reported for the period. Subsequent to 30 September and following the settlement of the RCC sale, bank borrowings have been reduced to NZ$17.0 million in line with the plans set out by the Board and structured with Rakon's bank.

Revenue and gross margins declined in the period due to the residual involvement in SWD, where further erosion in sales prices was experienced. Revenues for commercial OCXO[2] products (telecommunications market segment) grew strongly. This was reflected in the EBITDA contribution from Rakon's India Joint Venture of NZ$2.4 million, compared with NZ$1.6 million for the previous half year. The increase is reflective of the growth in the telecommunications infrastructure market, where Rakon has a strong market position and product offering in 4G.

Structural Realignment Progress

As we updated to shareholders at the Annual Shareholders Meeting (ASM) in September, the company is undertaking a number of structural realignment initiatives to ensure that Rakon returns to profitability in the financial year starting 1 April 2014. An update on the progress of key initiatives is set out as follows:

- **Divestment in Rakon Crystal Chengdu:** Following the approval by shareholders at the Special Shareholders Meeting in September, the divestment of an 80% equity interest in Rakon Crystal (Chengdu) Co. Ltd (RCC) was completed during October with the settlement by ZheJiang East Crystal Electronic Co. Ltd. (ECEC) of the US$18.8 million purchase price.
- **Rakon France:** During the HY14, a proposed restructure plan was discussed and accepted by the Works Council of Rakon France. The restructure includes a shift of OCXO[2] manufacturing from France to Centum Rakon in India that has now been completed. The remainder of the restructure plan is to be implemented over the second half FY2014, with the costs having been provisioned and reported in the half year financial statements. The changes will deliver improved financial results from the French business unit in FY2015.
- **Planned Reduction in Bank Debt:** Using the proceeds from the sale of RCC, we have significantly reduced the company's level of bank borrowings to NZ$17 million and net debt below NZ$8 million during October. The further benefit of a return of working capital from a reduced involvement in the SWD market, means that we are on track to have bank borrowings below NZ$12 million by 31 March 2014.
- **Focus on High Growth/Profitability Markets:** The structural realignment programme is driving the re-direction of internal resources with a core focus on the design, manufacturing and supply of crystal and oscillator components into three major market segments:

  1. Telecommunications Network Infrastructure: Targeting the latest generation of telecom architecture and ancillary equipment that is driving the global technology migration from 3G to 4G/LTE. The new infrastructure is designed to transport and deliver data volumes increasing at exponential rates.

  2. High Reliability and Precision Products: Specialised products designed for avionics, space and defence industries.

  3. Specialised GPS Devices: Focusing on precision positioning applications with global navigation device and mapping manufacturers e.g. surveying, agriculture and beacons.

Rakon has a well-established and highly regarded reputation with customers in these segments which offer higher margins and leverages our core competitive strengths.

Telecommunications Infrastructure

As expected, globally, mobile operators are announcing significant tenders for 4G/LTE network infrastructure equipment. This is the start of the accelerating global technology migration from 3G to 4G/LTE technology which requires large scale investment by mobile operators to upgrade infrastructure and equipment. Recent examples include the following:

- **China:** China Mobile has awarded a RMB20 billion tender for 207,000 base stations and China Telecom is releasing a RMB10 billion tender at the end of 2013.
- **Japan:** KDDI is moving to phase two of their LTE rollout, which includes the deployment of a large number of macro cells.
- **USA:** Operators have strong demand for LTE base stations as they lead 4G/LTE deployments globally.

Rakon's customers, who are the equipment suppliers involved in these tenders, are increasing their demand for Rakon's high-end telecommunications product portfolio, which is designed into the next generation of communication network infrastructure.

Consequently, there are improving market conditions with OCXO[2] sales increasing, reflecting strong market share in equipment design wins and the global roll out of 4G/LTE infrastructure.

To capitalise on the opportunities in the telecommunications infrastructure market, Rakon has expanded its product range to cover more applications. Offering leading technology and achieving new design wins has further strengthened Rakon's position as a high quality and established vendor for all major Tier One, Original Equipment Manufacturers (OEMs).

For example, Rakon's strategic alliance with Huawei is progressing well in their telecom infrastructure division, while at Cisco, Rakon was recently nominated 'Leading Emerging Technology Supplier' (out of 200 suppliers) after being invited to attend the Cisco supplier conference for the first time.

In addition, the growth fuelling the 4G/LTE market is also beginning to drive the implementation of small cell test systems, with mobile operators expected to invest in deployments in 2015. This activity is also expected to propel investment in new backhaul infrastructure, which in turn is driving demand for more switches and faster transport networks. These market segments are all developing different types of next generation equipment, all requiring high performance OCXO[2], TCXO[2], VCXO[2] and XO[2] products for frequency and timing control. These are key components designed into the new electronic architecture required by the telecommunications industry, as it undergoes a major technology migration to 4G/LTE.

Rakon is well poised with high market share and many design wins in the growing network infrastructure equipment, small cell, backhaul, switch and transport markets.

High Reliability

Revenue from the high reliability business unit is on target for FY2014 due to a stronger sales pipeline for the second half.

The defence business is growing, with an encouraging order intake driven by the new Ultra Low-Noise series products which are generating strong interest. This is combined with a new product portfolio including highly ruggedised products which are also achieving design wins.

Rakon is now deploying radar upgrades for Nav Canada, who operate Canada's civil air navigation system, with digital sub-systems replacing old analogue systems in Canadian air traffic control radars. There is also similar digital sub-system radar upgrade business emerging in the Indian defence market.

The European space industry is relatively flat due to economic conditions.

Positioning

The Personal Navigation Device (PND) market continues to decline, being cannibalised by the use of GPS enabled smart phones. However, specialist industrial GPS applications are emerging that require greater positioning accuracy – aligning with Rakon's product strengths. Precision positioning market segments include location-based services, road, aviation, rail, maritime, agriculture, surveying and emergency locator beacons.

An important positioning market for Rakon is the global precision farming market, expected to be worth US$3.7 billion by 2018, at an estimated CAGR of 13%. (Source: Markets&Markets). There is increased use of precision GPS/GNSS devices as farmers opt for more advanced solutions to further increase crop productivity. The precision agriculture market utilises Rakon's high end products for GPS/GNSS applications such as tractor guidance, automatic steering and asset management.

In the longer term, the rise of Machine-2-Machine (M2M) connectivity and the Internet of Everything (IoE) will increasingly integrate new GPS applications and will offset decline in the PND market. Cisco estimates the Internet now connects anywhere between 10 to 15 billion devices, but predicts there could be 50 billion connections joining the Internet by 2020. New developments in wireless technologies and GPS chipset design will focus on specific industry applications such as the following: intelligent vehicles, smart grids, consumer M2M devices, smart buildings/factories, connected healthcare/patient monitoring and location based marketing and advertising.

Change for a Profitable Rakon

The net loss reported in the first half of FY2014 is substantial and not one that we wanted to report to you, our shareholders. As communicated at the ASM, the structural changes are to align Rakon to those parts of our business where there are growth opportunities and stronger profit margins.

Our first half results include major impacts for structural realignment initiatives. Over the second half we expect our high reliability market segment to deliver higher revenues compared to the first half. Results in the first half indicate that the telecommunications market is growing in line with our expectations and forecasts.

The programme of change that we announced to you at the ASM is on track to return Rakon to profitability in FY2015. We continue to expect to report a net loss after tax for the full financial year (FY2014) of NZ$54.0 million.

Bryan Mogridge
Chairman

Brent Robinson
Managing Director

2014 HALF YEAR FINANCIAL SUMMARY

- EBITDA forecast to be profitable in second half (2H) FY2014
- Structural realignment impacts taken up in 1H
- High reliability business unit forecast to generate higher 2H revenues (vs. 1H)
- Telecom market growing in line with expectations and forecasts
- On track to reduce bank borrowings to NZ$12.0m by 31 March 2014
- Full year 2014 earnings guidance is unchanged

1 *A detailed reconciliation of EBITDA to net loss after tax is included at Note 4 of the 30 September 2013 Interim Financial Statements.*
2 **OCXO:** *Oven Controlled Crystal Oscillator.* **TCXO:** *Temperature Compensated Crystal Oscillator.* **VCXO:** *Voltage Controlled Crystal Oscillator.* **XO:** *Crystal Oscillator.*

Income Statement

	Six months ended 30 September 2013 ($000s)	Six months ended 30 September 2012 ($000s)	Year ended 31 March 2013 ($000s)
Revenue	80,481	89,414	176,259
EBITDA*	(4,709)	4,695	5,054
Depreciation, amortisation and others	(5,182)	(6,568)	(13,263)
Impairment	(32,568)	-	(17,331)
Adjustment for associate and joint venture share of interest, tax and depreciation	(1,552)	(1,475)	(2,912)
EBIT	(44,011)	(3,348)	(28,452)
Interest	(1,224)	(880)	(1,897)
Net loss before tax	(45,235)	(4,228)	(30,349)
Income tax credit/(expense)	(447)	268	(2,472)
Net loss after tax	**(45,682)**	**(3,960)**	**(32,821)**

** A detailed reconciliation of EBITDA to net loss after tax is included at Note 4 of the 30 September 2013 Interim Financial Statements.*

Statement of Cash Flow

	Six months ended 30 September 2013 ($000s)	Six months ended 30 September 2012 ($000s)	Year ended 31 March 2013 ($000s)
Net cash flow:			
- Operating activities	7,775	(2,188)	(2,670)
- Investing activities	181	(7,146)	(11,936)
- Financing activities	-	863	6,641
Net increase/(decrease) in cash and cash equivalents	**7,956**	**(8,471)**	**(7,965)**
Foreign currency translation adjustment	(1,207)	(15)	(1,179)
Cash and cash equivalents at the beginning of the period	3,290	12,434	12,434
Cash and cash equivalents at the end of the period	**10,039**	**3,948**	**3,290**

Balance Sheet

	As at 30 September 2013 ($000s)	As at 30 September 2012 ($000s)	Year ended 31 March 2013 ($000s)
Current assets	84,201	109,837	105,212
Non-current assets	76,328	157,165	135,299
Assets held for sale	36,165	-	-
Total assets	**196,694**	**267,002**	**240,511**
Current liabilities	69,663	42,616	67,696
Non-current liabilities	2,731	35,394	16,129
Liabilities held for sale	8,152	-	-
Total liabilities	**80,546**	**78,010**	**83,825**
Net assets	**116,148**	**188,992**	**156,686**
Equity	115,661	184,701	152,796
Minority interest	487	4,291	3,890
Total equity	**116,148**	**188,992**	**156,686**