18 September 2015

Rakon Limited (NZX:RAK)

2015 ANNUAL SHAREHOLDERS' MEETING – MANAGING DIRECTOR'S ADDRESS

Welcome everyone to the Rakon Annual Shareholders Meeting of 2015. I'd like to start by firstly thanking you all for being here today.

As we have already announced in our FY2015 results, we had a strong 2015 financial year where we delivered on our promise of returning the business to profitability. This was no small feat and I'm personally very proud of our team for what they've been able to do. But of course, it doesn't stop there. The future success of the business requires continuous improvement to keep growing market share and remain ahead of our competitors through our ability to innovate.

Rakon is once again in a strong position in core markets and dominant in key market sectors – all of which have long term growth opportunities.
The business itself is robust; operating costs having reduced significantly, margins are up and we have a clear strategy and path forward.
We have stuck to what we said we would do and have clearly defined our markets and product offering.

Our move away from the mobile phone market has proven to be a success.
We are committed to higher margin products with long term viability and are seeing the benefits from this now.
Our underlying margins are further improving due to product mix, technology transition and currency benefit thanks to a favourable NZD:USD.
Margins have overall increased from 19% in FY2014 to 32% in FY2015 and we expect them to further jump in FY2016.

Not only are our margins up, our decision to shift the bulk of manufacturing back to New Zealand and close the Lincoln, UK plant is showing benefits.
The efficiencies we're seeing from streamlining the manufacturing process globally are solid and we're seeing increased revenue being generated directly from New Zealand.
After bringing a lot of manufacturing back to NZ, it's pleasing to see that more than 46% of our revenue is coming out of our NZ base. Furthermore, current forecasting indicates that NZ will account for in excess of 60% of revenue for FY2016.
One of our greatest strengths at Rakon is our ability to adapt and innovate. Our competitors do not have the same level of sophistication in their product offering that we do. The strong relationships we have with our customers enable us to solve problems alongside them – pushing us to continually update our product offerings to meet the market need.

Rakon has a very efficient global footprint that enables us to service markets effectively.
Our manufacturing operations suit the environments we are in, with NZ covering medium volume, China factories for mass volume, India focused in smaller volumes with high labour inputs and the French facilities servicing European markets in space & defence.
From New Zealand, we are in the centre of the Pacific Rim where over 60% of our customers exist, and this is supported with regional sales offices to give the best local service.
A strong regional presence in Europe with manufacturing, R&D and sales, fits well for our continental customers.

Rakon Limited
T +64 9 573 5554, **F** +64 9 573 5559
8 Sylvia Park Road, Mt Wellington, Auckland 1060, New Zealand
Private Bag 99943, Newmarket, Auckland 1149, New Zealand
www.rakon.com

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We continue to grow our portfolio of customers, focusing on where contracts are larger and our sophisticated technology is best suited. Our customer base is incredibly loyal to us at Rakon – a testament to our quality products and service delivery.
In telecommunications infrastructure we're proud to be working with some of the largest companies in the world; partnering with them as they lead the way in the future of networked connectivity.
We're also seeing increased interest from new and emerging players. There is an increased mix across the markets we serve as companies add positioning and networked functionality to their previously stand-alone products – also needing the robustness and precision that our sophisticated products can offer.

Our products are focused on serving telecommunications infrastructure, space & defence, and global positioning markets.
We are continuously releasing new products to market to serve changing technology, while also producing our core existing product lines to keep up with demand.
8.5% of revenue is going toward R&D and our focus is on adaptation and keeping products ahead of market expectation.

While it's still early, we are expecting profit results to be similar to last year for both Underlying EBITDA and Net Profit After Tax (NPAT). The first half year (H1) of FY2016 is looking higher than H1 of FY2015, while the full year profit for FY2016 (for both Underlying EBITDA and NPAT) is likely to be a similar result to FY2015, which is softer than expected. Current market conditions are challenging globally and are pointing to a temporary slowdown – largely impacting our telecommunications markets. As an example, across Northern America the providers have a short term strategy of acquisition and spectrum buying, in place of infrastructure investment.
This situation is not unique to Rakon, it is market-wide. However, as the overall demand for upgraded services has not subsided, it will pick up again and our preferred supplier arrangements will keep us in good stead.
Even with the slowdown, our expectation is to be consistent with last year, and maintain a modest net profit after tax.
I will cover more of the market specifics shortly, where we're seeing high demand and huge potential for long term growth.
In FY2016 we're forecasting an effective NZD:USD exchange rate of 0.7000. We have returned hedging back to policy levels and we've further increased our levels of cover at lower rates again in the current financial year. Benefits from the lower spot rate today won't be achieved until FY2017 due to the existing levels of hedging cover already in place.

Our current revenue split is now 54% telecommunications. This is a big shift from 2014. We expect this trend to continue, and predict further growth as we move deeper into emerging markets in the coming years and leverage the growth in data demand driven by the Machine to Machine (M2M) and Internet of Things (IoT) markets.

We continue to place a high focus on the telecommunications infrastructure market. There is an insatiable appetite for fast, reliable networks from consumers – and Rakon's precision products enable that.
A key area of our telecommunications offering is servicing the small cell network – a huge market growing at 20% and where we currently have a dominant share in this market.
As mentioned, there's a slight slowdown across the entire market right now, but the overall drive for data from consumers is not slowing at all.

It's important to note that each new wave of telecommunications infrastructure comes approximately every 10 years. 4G/LTE is only 3 years in right now, giving us a long lead time until full penetration, all while developing countries are still rolling out 3G. This is an important factor for Rakon, as our product offering supports all of these uses and the upgrade cycle at an infrastructure level guarantees longevity and better protects us against market shifts.

The global positioning market continues to be an area of interest. And again, as we keep to our strategic focus for higher margin products, we're seeing a lot of promise from specialised uses across aviation, marine and agriculture.
While revenue is flat, margins are showing improvement due to the shift from personal navigation to industrial.

Rakon's patented technology application enables GPS to work in harsh and rugged environments, servicing advancements such as self-driving tractors in farming.

The appetite for space exploration continues, however government budgets are more conservative toward investment. As such, we are diversifying our customer base with the additions of private companies such as Space-X who in addition to travel, are also working on putting a satellite internet network in space.
While defence budgets in general are constrained, the available budget allocation is weighted predominantly toward technology, which is where we stand to benefit.
We are introducing three new significant space & defence products this year and continue to work closely with our customers to meet future needs.
A big goal for us right now is to move further into the US, India & China – reducing our reliance on the European market.

As M2M connectivity continues to grow and the Internet of Things heads toward the predicted 50 billion connected devices by 2020, so too will the data traffic. At Rakon, we have positioned ourselves to take advantage of the increased demand as we supply the infrastructure layer with our timing devices.
We are also anticipating growth as the 'Other 3 billion' (O3b) currently without access to the internet get connected.

More than just global, our products are used across land, sea air & space in all manner of devices. We've evolved into being in all parts of the planet as the need for the measurement of time continues to grow.
In summary, in 2015, Rakon delivered consistent earnings growth, increased returns to our shareholders and generated strong operating momentum as we moved into 2016.
Our focus remains on continuing to improve our product offering for maximum customer benefit and we believe that focus is positioning us well for long term growth.
This is an exciting time for Rakon and we see a great future as we work to create a brilliantly connected future for everyone.

- Managing Director's Speech ends -

About Rakon

Rakon is a global high technology company and a world leader in its field. The company design and manufacture advanced frequency control and timing solutions. Rakon has six manufacturing plants including three joint ventures plants and five research and development centres. Customer support centres are located in eleven offices worldwide. Rakon is a public company listed on the New Zealand stock exchange, NZSX, ticker code RAK.

Disclosure of Non-GAAP Financial Information

Rakon has used 'Underlying EBITDA' as a measure of non-GAAP financial information in this announcement and it is defined as:

"earnings before interest, tax, depreciation, amortisation, impairment, loss on disposal of assets, employee share schemes, non-controlling interests, adjustments for associates and joint ventures share of interest, tax & depreciation, and other non-cash items."

'Underlying EBITDA' is a non-GAAP measure, with its presentation not being in accordance with GAAP. The Directors present 'Underlying EBITDA' as a useful non-GAAP measure to investors, in order to understand the underlying operating performance of the Group and each operating segment, before the adjustment of specific non-cash charges and before cash impacts relating to the capital structure and tax position. 'Underlying EBITDA' is considered by the Directors to be the closest measure of how each operating segment within the Group is performing. Management uses the non-GAAP measure of 'Underlying EBITDA' internally, to assess the underlying operating performance of the Group and each operating segment.

The use of 'Underlying EBITDA' in this release for the full years of FY2014 and FY2015 has been extracted from audited financial statements. The use of 'Underlying EBITDA' in this release for FY2016 is based on a forecast and is unaudited.