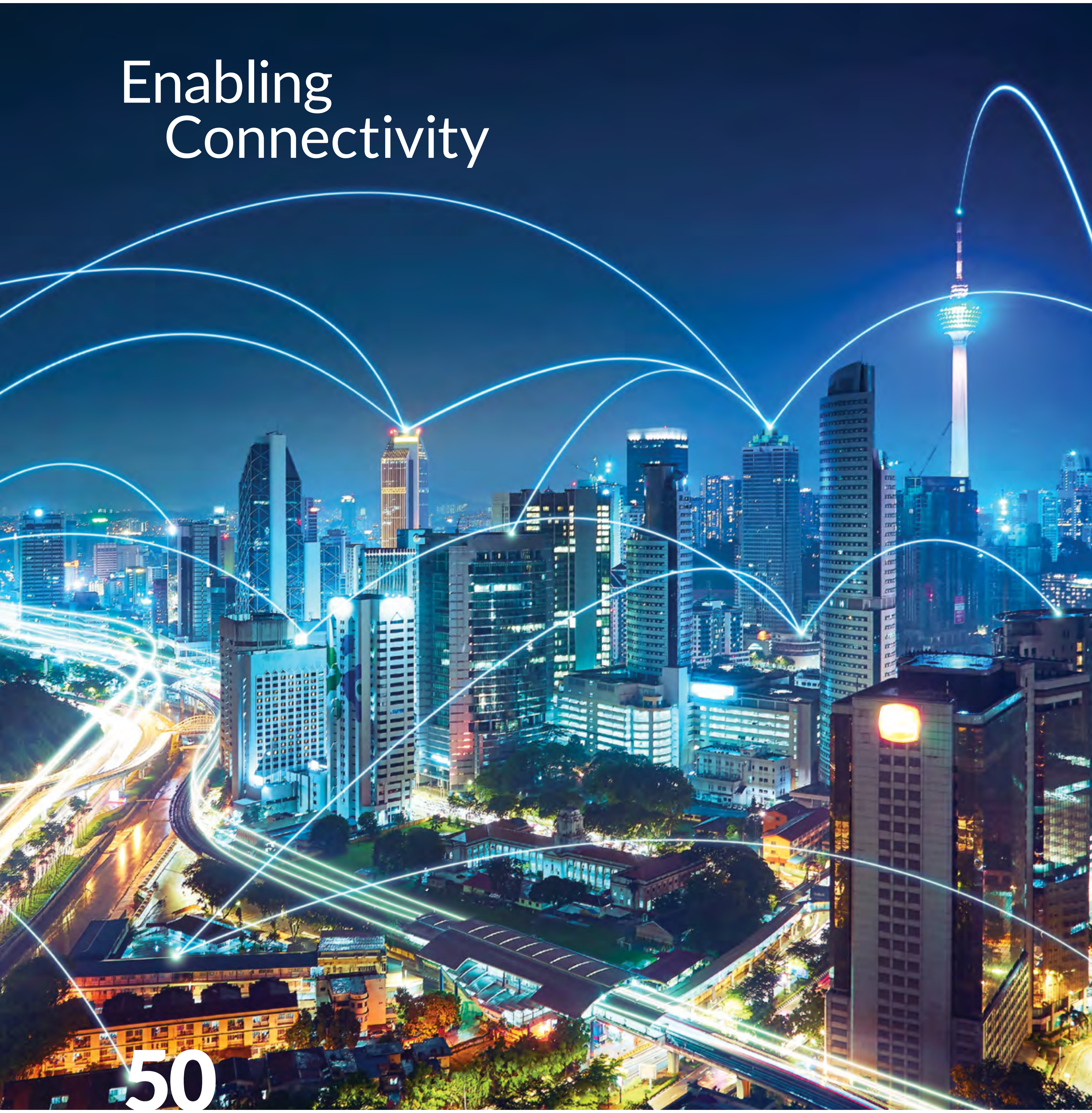
rakon

2018 Half Year Review



1967 ▸ 2017 50 YEARS OF INNOVATION

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2018 Half Year Statement of Results

HY2018 Financial Overview

For the six months to 30 September 2017 (HY2018) Rakon has returned to profit. The company reported an unaudited net profit after tax of $0.9 million[1]; an improvement from the $5.7 million net loss after tax reported in the prior period HY2017 (the six months to 30 September 2016). Rakon also reported Underlying EBITDA[2] of $3.8 million, an increase of $3.2 million from HY2017. Revenue of $48.3 million increased 5% (or 7% on a USD currency basis), on the prior period.

Gross profit of $20.1 million, increased 21% on HY2017 due to revenue growth and changes in product mix. Gross margin percentage increased to 42%, up from 36% in HY2017. Also included in the result was a release of $0.7 million in deferred revenue from the technology license agreement with Siward Crystal Technology Co. Limited ('Siward'), which was put in place at the end of FY2017.

Operating expenses decreased by $1.2 million – a particularly satisfying result, given the work that has gone into improving our operational structure in recent years.

Finance costs were down by $0.5 million on HY2017, the result of lower debt levels. Overall, the company generated positive operating cash flow of $4.9 million for the half year, which has allowed us to further reduce net debt to $0.3 million. The company is expecting to turn to a net positive cash position in the coming six months.

Operational Overview

The relationship between Rakon and Siward has continued to strengthen and develop. We have made good progress on the technology license transfer, which covers technology originally developed for the smartphone market and some Global Navigation Satellite System (GNSS) products. Siward also manufactures a wide range of clock crystals and oscillator products, which complement the products Rakon produces for our Tier One customers and will generate growth opportunities and other benefits for both Rakon and Siward. Progress also continued on a combined Rakon and Siward contract manufacturing and Original Design Manufacturer (ODM) offering; this is on track for release in FY2019.

Rakon continued its focus on technology development with the release of two world-first product platforms, which are attracting strong interest from customers. These TCXOs[3] and OCXOs[4] are market-leading in size, cost and performance and are now being sampled into high speed networks and 5G applications.

Market Update

Rakon achieved modest revenue growth across all of its key market segments – telecommunications, global positioning and space & defence.

Telecommunications The company has continued to position itself for the future with strong sampling of two new product platforms that can lead customers' next generation technology requirements.

Mobile base station revenue continued on from the final quarter of FY2017 with a stronger run rate in the first quarter of the current year; however this eased in Q2.

Data centre demand, in particular the growing requirement for time synchronisation in data centres, contributed strongly to an improved performance in HY2018. As applications move into the cloud, the need for extremely accurate timing increases. Rakon's telecom OCXOs are accurate to within 1.5 microseconds (1 second = 1 million microseconds).

We expect demand in the US and Europe to remain flat during the coming three months, with a small upside forecast for the final quarter of the current year. Further upside in the developing regions, is dependent on the timing of when a major operator in India is expected to release new equipment contracts.

Global Positioning Revenue from global positioning was up 13% from HY2017. The high volume GNSS module business remained strong with good volumes, especially in Europe. Growth also continued in the higher margin industrial markets such as agriculture, surveying and avionics.

Current run rates and forecasts support the view that this market is returning to growth after years of decline, resulting from smartphones cannibalising the market for traditional personal navigation devices.

Space and Defence Overall space and defence revenue is up 8% from the prior period, largely driven by improved sales of New Zealand-manufactured products into the US defence market.

Delivery of open orders from France will generate higher revenue from the defence market in the second half of the current year.

[1]**All amounts in this document are in NZ$ unless otherwise specified.**
[2]**Disclosure of Non-GAAP Financial Information.** Rakon has used 'Underlying EBITDA' as a measure of non-GAAP financial information in this 2018 Half Year Review document and it is defined as: "earnings before interest, tax, depreciation, amortisation, impairment, employee share schemes, non-controlling interests, adjustments for associates and joint ventures' share of interest, tax & depreciation, loss on disposal of assets and other cash and non-cash items (Underlying EBITDA)."

Underlying EBITDA is a non-GAAP measure that has not been presented 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 document for the half year of FY2018 has been extracted from unaudited financial statements. The use of Underlying EBITDA in this document for FY2017 has been extracted from audited financial statements. This document should be read in conjunction with the Rakon Limited Interim Report September 2017. A detailed reconciliation of Underlying EBITDA to net profit after tax is contained at note B2 c) (Segment information) of the financial statements.

[3] TCXO Temperature Compensated Crystal Oscillator.
[4] OCXO Oven Controlled Crystal Oscillator.

In the space market, US demand is expected to drive further growth – in particular, strong interest has been expressed in a new ultra-miniature, light-weight, ultra-stable OCXO.

Emerging and Other Markets New applications for the Internet of Things (IoT) continue to drive considerable activity in this market; however, volumes remain small. As trials conclude and deployment increases, we expect demand to grow, but this is unlikely to occur to any great extent in the current year.

Update on Joint Ventures and Associates

Centum Rakon India

Rakon has a 49% joint venture interest in Centum Rakon India (CRI). This company, which manufactures our discrete OCXO products, has performed below expectations. Focus continues on improving the profit contribution from this company.

Thinxtra

Thinxtra completed a successful Series B capital raising (A$20 million) at a significant premium to the price Rakon paid for our investment. With the capital raise oversubscribed, Rakon took the opportunity to do a partial share sale that will generate a total consideration of A$3.0 million and a profit before costs of A$1.8 million on our initial investment. The gain will be included in the second half FY2018 result.

The sale of Thinxtra shares was completed at an average price of A$15.05, an excellent return on the original investment of A$5.86 per share. Following the completion of the capital raise in Q3, Rakon will hold 785,407 shares in Thinxtra. Once all options are exercised this will equate to a shareholding of around 18%.

The Directors will consider in the second half whether Rakon's investment in Thinxtra will be fair value accounted for reporting purposes.

Half Year 2018 Performance Key Points

- Net profit after tax of $0.9 million vs. net loss of $5.7 million in HY2017.
- Revenue up 5% on HY2017; All key market segments showing growth vs. HY2017.
- Strong positive operating cash flow of $4.9 million.
- Closing net debt of $0.3 million, reduced from $19.7 million at HY2017 and $4.5 million at FY2017.
- New world-first product platforms market-leading in size, cost and performance; now sampled into high speed networks and 5G applications.

Timemaker

The Timemaker group of companies has had a good turnaround in the past 18 months, which has contributed to Rakon's profit. Timemaker has reached scale at two times the size of any of its competitors and now is regarded as very competitive globally.

Timemaker opened another factory in Sichuan, China to expand manufacturing for crystal blanks in readiness for expected growth.

Outlook

Rakon expects improved earnings for the second half of the current year, generated by increased revenues and the gain from the partial sale of our shareholding in Thinxtra. Revenue growth is expected to come from the phased delivery of space and defence orders.

The company expects to report full year Underlying EBITDA of between NZ$10.7 million and NZ$12.7 million.

Brent Robinson
CEO/Managing Director

Bryan Mogridge
Chairman

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2018 Half Year Financial Summary

Summary of Revenue and Profit/(Loss)	Six months ended 30 September 2017 $000s	Six months ended 30 September 2016 $000s	Year ended 31 March 2017 $000s
Revenue	48,278	45,957	94,738
Underlying EBITDA[1]	**3,800**	**647**	**4,032**
Depreciation and amortisation	(2,307)	(2,800)	(5,609)
One off cash gains realised on derivatives closed out	941	(1,361)	(1,096)
Interest	(227)	(687)	(1,432)
Adjustment for associates and joint venture share of interest, tax and depreciation	(1,032)	(980)	(2,079)
Impairment	–	–	(6,594)
Other non-cash items	(114)	(248)	(713)
Income tax credit/(expense)	(153)	(269)	(67)
Net profit/(loss) for the period	**908**	**(5,698)**	**(13,558)**

[1]Refer to page 2 for explanation of Underlying EBITDA.

Summary Statement of Cash Flows	Six months ended 30 September 2017 $000s	Six months ended 30 September 2016 $000s	Year ended 31 March 2017 $000s
Net cash flow:			
– Operating activities	4,929	(612)	9,503
– Investing activities	(943)	(6,312)	(8,364)
– Financing activities	(2,027)	6,911	(346)
Net increase/(decrease) in cash and cash equivalents	**1,959**	**(13)**	**793**
Foreign currency translation adjustment	169	(114)	(156)
Cash and cash equivalents at the beginning of the period	76	(561)	(561)
Cash and cash equivalents at the end of the period	**2,204**	**(688)**	**76**

Balance Sheets	As at 30 September 2017 $000s	As at 30 September 2016 $000s	As at 31 March 2017 $000s
Current assets	55,512	59,076	58,086
Non-current assets	46,345	57,316	46,110
Total assets	**101,857**	**116,392**	**104,196**
Current liabilities	22,019	39,267	26,675
Non-current liabilities	3,134	2,599	2,964
Total liabilities	**25,153**	**41,866**	**29,639**
Net assets	**76,704**	**74,526**	**74,557**
Equity	76,704	74,526	74,557
Total equity	**76,704**	**74,526**	**74,557**