7 August 2018

Rakon 2018 Annual Shareholders' Meeting – Chair's Address

Dear fellow shareholders, welcome to this the 13th Annual Shareholders' Meeting of your company and what is really the beginning of the refreshed Rakon.

We had an adequate result for the year ended 31 March 2018 where the company produced a net profit after tax of NZ$10.0 million and Underlying EBITDA of NZ$12.1 million, which after adjusting for non-recurring items was 100% better than the prior year. I have every reason to believe that given Rakon's refreshed confidence this result will be improved upon over the coming years.

So, refreshed how? Well given our significantly improved balance sheet, recent value adding acquisition in India, a new slim focused operating structure and growing market opportunities, your firm is well placed to grow its profit every year for the foreseeable future.

Rakon has a net cash position with effectively no debt – a unique position for a hi-tech company to be in.

As you know Rakon now owns 100% of what was Centum Rakon India (CRI) – now Rakon India.

Rakon India is a world class hi-tech manufacturing business in Bangalore and something unique that none of our competitors have. This places Rakon in a strong position to compete at the highest level of technology and if necessary absorb price shocks equal to or better than our competition. Besides supplying specialist frequency control products into the growing 5G space, Rakon India will be more than capable of delivering a wide range of other activities at a very competitive global rate.

Our major shareholder Siward Crystal Technology Co. Limited of Taiwan, is developing into a significant and valuable manufacturing partner, using Rakon's IP and their low-cost manufacturing skills, opening up new markets and profits to both companies.

Despite the difficulties Rakon has had since the GFC, the Board has been very diligent ensuring that significant amounts of money have been invested in research & development (in FY2018 it was NZ$9.7 million), so that when the markets awoke again, Rakon would be ready with leading edge products. This is now starting to occur and Rakon's new leading-edge products are being designed into new network rollouts within the fast arriving 5G. As well as Telecommunications our R&D has also got us further ahead than our competitors within two other key markets, Global Positioning and Space & Defence.

Our investment in Thinxtra, has turned out to be good for Rakon financially, but the strategic reasons we invested; to get more closely involved in the IoT sensor business haven't materialised due to lower production costs elsewhere. Never the less, we have made some money currently from our investment in Thinxtra.

We initially invested AU$5.7 million, sold some shares last year for AU$3.0 million making a profit of NZ$1.9 million, leaving the remaining 784,886 shares valued at close to NZ$12.5 million but only owing us NZ$3.0 million from the original investment. Thinxtra is currently in its final round of capital raising

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and if successful over the next 5 years the current share value of AU$15.02 could rise to somewhere above AU$50.

Since listing Rakon in 2006 we have delivered a total Underlying EBITDA of NZ$144.4 million at an average of NZ$12.0 million per year with two years in the mid-twenties. During those 12 years we have had six with positive net profit after tax results and six without. Most of those negative results relate to asset write-downs and in particular our venture into China and production of TCXOs in Chengdu.

Given that this is my last address as Chairman, I would like to explain more about the reasons why we established a factory in China and what caused the losses we sustained. Yes, the media and others will focus on the losses, but it is important to hear some of the background as to why a New Zealand based tech company would begin to manufacture there, totally under its own control.

You may recall that at the time we were a large supplier of TCXOs to Apple for smartphones and the market was growing at a rapid rate. We were selling those TCXOs for between NZ$2—NZ$3 but we knew that the competition would bring that price down as the anticipated demand grew. We knew we couldn’t meet significant price drops from our New Zealand manufacturing base and so our decision was to go to China under our quality control. We figured this would give us access to very low production costs with our same Rakon based high quality controls. We also figured our competitors wouldn’t go to China for production, so this would give us a competitive advantage and we had a model that showed we could make a profit from the anticipated high-volume demand for TCXOs with prices as low as 20 cents. Importantly, our model showed that we could grow our Underlying EBITDA to around NZ$80 million. About five times higher than we were at that time, so on the surface it all made sense. Unfortunately, some competitors were able to reduce their prices to as low as 9 cents (US$) and sit there happily making losses supported by other divisions within their groups to burn us off. As well, this steep price-down coincided with the GFC which saw our other markets in Telecommunications contract markedly. So, the writing was on the wall and we had to move very quickly to exit. Brent to his credit managed to sell the plant for NZ$27 million which admittedly cost us NZ$54 million, but that was better than waiting and losing everything – a decision which may have been the end of Rakon.

Since then we have returned to profitability and got our balance sheet to a strong position with 100% ownership of all our manufacturing plants and research & development, plus our strong relationship with Siward. All underpinned by no debt.

The other subject I would like to cover relates to the elephant in the room: Where some shareholders say to me “Well Bryan you guys have done a great job of restructuring the business; bringing debt down by in excess of NZ$30 million, you’ve pulled around NZ$10 million out of operating expenses, you’ve bought the other half of CRI, you’ve refreshed the Board, you’ve profitably sold some shares in Thinxtra and refreshed our company, you’ve continued to invest in R&D and the markets are awakening – but where’s our refreshment? where is our dividend?!”

Let me tell you this is a subject very dear to my heart and as the other Directors will tell you I am the proverbial pain in the backside bringing this up every year and particularly this year. After vigorous debate we decided not to have a dividend for the year ending 31 March 2018, as the development requirements of Rakon India were not yet fully known. However, I would like to think that with the expected improvement in the state of the business and my continual pestering ringing in their ears, that the new Board will have a very close look at the subject during the coming year and consider rewarding we shareholders, for our outstanding patience.

With my retirement and Bruce Irvine taking over as Chair, we have conducted a search for a replacement Director and that search has brought forward some excellent candidates well suited to our business. In the near future an appointment will be made to fill a casual vacancy as allowed under Rakon's constitution with formal shareholder ratification to occur at the 2019 Annual Shareholders' Meeting.

The last 13 years have been a wonderful experience with many highs and lows with the lows usually the things that gain the wider attention. But never mind, when you're in the hi-tech business like Rakon (and has been for 51 years – a unique position in its world) you have to expect bumps along the way. To succeed, Rakon needs to be brave and I would like to think that the events of the most recent years don't turn the team into one that becomes too afraid to take risks both within its business, or in the way it rewards its shareholders.

Thank you and I will now hand over to our CEO and Managing Director Brent Robinson, for an update on the business…

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About Rakon

Rakon is a global high technology company and a world leader in its field. The company designs and manufactures advanced frequency control and timing solutions for telecommunications, global positioning and space and defence applications. Rakon products are found at the forefront of communications where speed and reliability are paramount. The company's products create extremely accurate electric signals which are used to generate radio waves and synchronise time in the most demanding communication applications. Rakon has five manufacturing plants and has six research and development centres. Customer support is available from sixteen locations worldwide. Rakon is proud of its New Zealand heritage; it was founded in Auckland in 1967. It is a public company listed on the New Zealand stock exchange, NZSX, ticker code RAK.
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