

Rakon Limited

Independent Report on the proposed sale of
80% of the shares in Rakon Crystal (Chengdu)
Co. Limited

August 2013

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Glossary

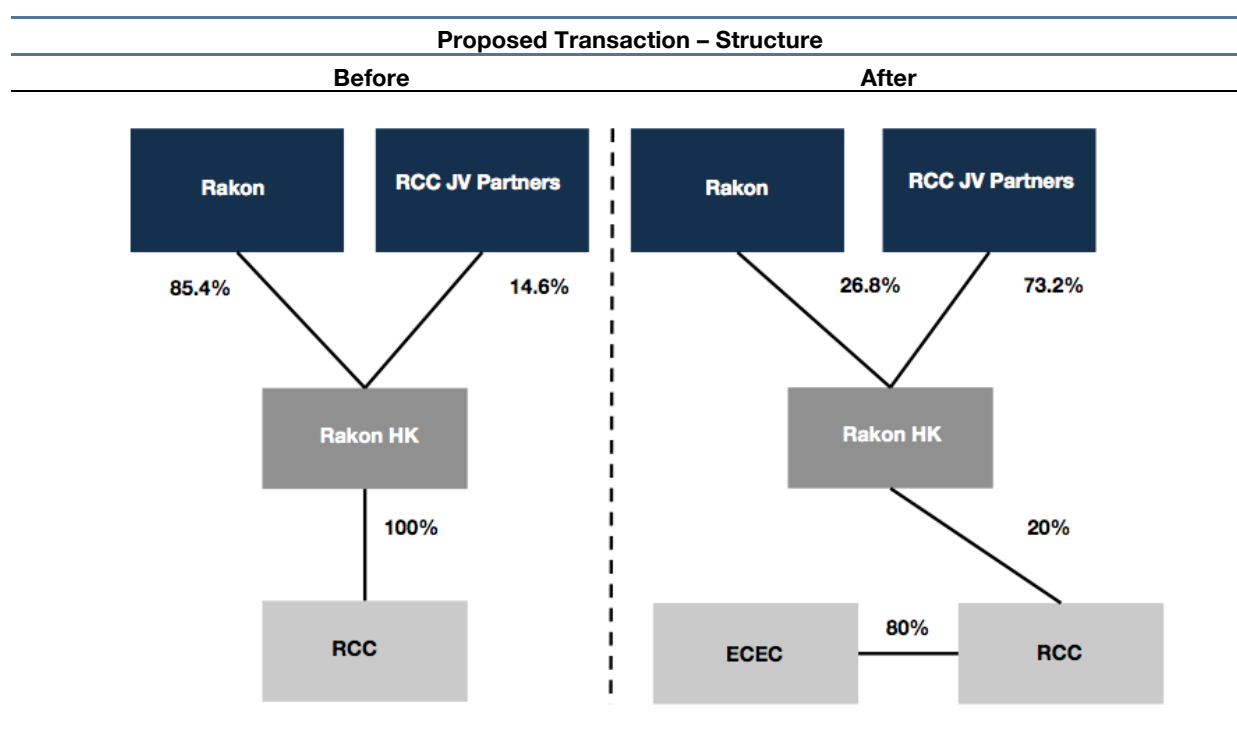
Term	Definition
ECEC	ZheJiang East Crystal Electronic Co.Ltd
EBIT	Earnings before interest and tax
EBITDA	Earnings before interest, tax, depreciation and amortisation
Etimes	Etimes Group International Limited
FY11	Financial year ending 31 March 2011
FY12	Financial year ending 31 March 2012
FY13	Financial year ending 31 March 2013
FY14	Financial year ending 31 March 2014
Grant Samuel	Grant Samuel & Associates Limited
HLR	HLR Holdings Company Limited
NPAT	Net profit after tax
Proposed Transaction	The proposed sale of 80% of the shares in Rakon Crystal (Chengdu) Co. Limited
Rakon	Rakon Group Limited
Rakon HK	Rakon HK Limited
RCC	Rakon Crystal (Chengdu) Co. Limited
RCC JV Partners	The minority shareholders in Rakon HK
RMB	Chinese Renminbi
SWD	Smart wireless device

1. Terms of the Proposed Transaction

1.1 Background

On 5 July 2013, Rakon Limited (**Rakon**) announced that it proposed to establish a strategic partnership with Zhejiang East Crystal Electronic Co.Ltd. (**ECEC**) to target the smart wireless device (**SWD**) market. ECEC is a specialised electronic components manufacturer listed on the Shenzhen Stock Exchange and primarily involved in the research, development, design, manufacture and distribution of electronic components. ECEC manufactures surface mount device quartz crystal resonators, oscillators, ceramic tubular capacitors and a range of other products, distributed in China and internationally. ECEC's products are mainly used in the communication, information, home appliances and automobile electronics sectors.

Under the terms of the proposed strategic partnership between Rakon and ECEC, ECEC will acquire 80% of the shares in Rakon Crystal (Chengdu) Co. Ltd (**RCC**) for US\$18.8m (**the Proposed Transaction**). RCC is a wholly owned 100% subsidiary of Rakon HK Limited (**Rakon HK**). Rakon owns 85.4% (199.8 million) of the shares in Rakon HK. Rakon HK intends to sell 80% of the shares it owns in RCC to ECEC. Under the framework of the Proposed Transaction, the minority shareholders (**the RCC JV Partners**) in Rakon HK have elected to allow the full sale proceeds of US\$18.8m to be paid to Rakon in exchange for 187.3 million ordinary shares and any remaining preference shares owned by Rakon in Rakon HK being cancelled¹. A consequence of this arrangement is that Rakon's shareholding in Rakon HK will reduce from 85.4% to 26.8% (being the residual holding of 12.6 million shares divided by the reduced number of shares on issue of 46.8 million shares). The RCC JV Partners will maintain their current indirect ownership of RCC as shown in the table below:



If the Proposed Transaction is completed, Rakon HK will be owned 26.8% by Rakon and 73.2% by the RCC JV Partners. As Rakon HK will continue to own 20% of RCC, the Rakon's indirect entitlement to RCC after the Proposed Transaction will be 5.4%. The RCC JV Partners indirect entitlement to RCC will remain at its current level of 14.6% (73.2% holding in Rakon HK x 20% holding in RCC).

ECEC and Rakon have entered into a Cooperation Framework Agreement (akin to a Heads of Agreement) setting out the terms of the Proposed Transaction and the underlying principles of the strategic partnership. The overarching framework of the strategic partnership is that ECEC will contribute its manufacturing capability and has committed to

¹ The exact amount of shares to be cancelled is not yet known and may be affected by amounts owing between Rakon HK and Rakon.

fund the future expansion of the Chengdu plant, allowing the partnership to benefit from increased scale. Rakon has committed to provide research and development, technology and marketing capability to the partnership.

Rakon announced on 13 August 2013 that it had now entered into formal agreements (the Equity Transfer Sale and Purchase Agreement and the Joint Venture Contract) with ECEC in relation to the Proposed Transaction. The Equity Transfer Sale and Purchase Agreement contains certain conditions to be met before the Proposed Transaction can occur. One of those conditions is for Rakon to gain shareholder's approval for the Proposed Transaction. A Special Shareholders Meeting is to be convened for this purpose, to be held immediately following the Annual Shareholders Meeting on 6 September 2013. If the Proposed Transaction is approved by Rakon shareholders, settlement of the transaction is expected to take place on 30 September 2013.

1.2 Details of the Proposed Transaction

A summary of the Proposed Transaction is set out in the table below:

Terms	Definition
Seller	Rakon HK
Purchaser	ECEC
Proposed Amount	No higher than US\$18.8m (for acquiring 80% shares), with a downwards adjustment mechanism in the event the net assets of RCC on completion are less than RMB 258 million (excluding any downward impact from depreciation up to completion).
Key Dates	Net assets reference date: 30 June 2013 Signing of the Cooperation Framework Agreement: 4 July 2013 Enter into Formal Documentation: 12 August 2013 ECEC Shareholder Meeting: 28 August 2013 Rakon Shareholder Meeting: 6 September 2013 Proposed Settlement: 30 September 2013
Cooperation Principles	<ul style="list-style-type: none"> ▪ Rakon and ECEC will make joint efforts in producing SWD for mobile communication, using RCC as the primary platform. ▪ ECEC will provide necessary capital and management support to the partnership. Rakon will provide its technology, market resources and industry reputation to the partnership. ▪ ECEC will use Rakon's technology and marketing support to upgrade its product quality and market capabilities.
Payment of share transfer fees	<ul style="list-style-type: none"> ▪ At the time the Cooperation Agreement was signed, ECEC paid Rakon US\$0.5m as a deposit. ▪ Following signing of the formal Share Transfer Agreement (12 August 2013), a further deposit of US\$1.0m is payable by ECEC.
Key Conditions	<ul style="list-style-type: none"> ▪ ECEC shareholder approval. The ECEC special shareholders' meeting to consider the Proposed Transaction will be held on 28 August 2013; ▪ Rakon shareholder approval. Rakon's special shareholders' meeting to consider the Proposed Transaction will be held on 6 September 2013; and ▪ Chinese government and local government approval. The transaction requires the approval of the Chinese government and the Chengdu Hi-Tech Industrial Development Zone Administration of Industry and Commerce.

1.3 Requirements of the NZSX Listing Rules

Listing Rule 9.1.1 of the NZSX Listing Rules specifies that:

an Issuer “shall not enter into a transaction to sell or dispose of assets of the Issuer:

- (a) which would change the essential nature of the business of the Issuer; or*
- (b) in respect of which the gross value is in excess of 50% of the lesser of the Average Market Capitalisation or the Gross Value of the Assets of the Issuer;*

except which the prior approval of an Ordinary Resolution of the Issuer.” The notice of meeting containing the resolution to approve any transaction referred to in Listing Rule 9.1.1 shall contain or be accompanied by such information, reports, valuations and other material as are necessary to enable the holders of securities to appraise the implications of the Proposed Transaction.

The Gross Consideration of the Proposed Transaction is US\$18.8 (approximately NZ\$23.4m). The average market capitalisation of Rakon calculated from trades on the NZX Main Board over the 20 business days before 5 July 2013 (being the last day of trading before the Proposed Transaction was announced to the market) is NZ\$36.98m, meaning the transaction value exceeds the 50% threshold set out in Listing Rule 9.1.1. For this reason, in accordance with Listing Rule 9.1.1, the Proposed Transaction is being put to the shareholders of Rakon for their consideration and vote at a Special Shareholders Meeting. The Directors of Rakon have engaged Grant Samuel & Associates Limited (**Grant Samuel**) to prepare an Independent Report on the Proposed Transaction to assist the shareholders in appraising the implications of the Proposed Transaction.

2. Scope of the Report

2.1 Purpose of the Report

The purpose of this report is to assist Rakon shareholders in appraising the implications of the Proposed Transaction. A copy of this report will accompany the Explanatory Memorandum in relation to the Proposed Transaction to be sent to all Rakon shareholders. In addition to the Grant Samuel report, the Explanatory Memorandum will contain other information on material that the Board of Rakon considers will also assist shareholders in relation to the Proposed Transaction.

Grant Samuel is independent of Rakon and ECEC and has no involvement with, or interest in, the outcome of the Proposed Transaction. This report is for the benefit of the shareholders of Rakon. The report should not be used for any purpose other than as an expression of Grant Samuel's opinion as to the Proposed Transaction. This report should be read in conjunction with the Qualifications, Declarations and Consents outlined at Appendix A.

2.2 Basis of Evaluation

In Grant Samuel's opinion, the most appropriate basis on which to evaluate the Proposed Transaction is to assess its overall impact on the shareholders of Rakon and to form a judgement as to whether the expected benefits to the shareholders outweigh any disadvantages that might result. This involves a judgement as to the overall commercial effect of the Proposed Transaction, the circumstances that have led to the Proposed Transaction and the alternatives available. The analysis weighs up the advantages and disadvantages of the Proposed Transaction and forms an overall view as to whether the shareholders are likely to be better off if the proposal is implemented than if it is not.

Grant Samuel has evaluated the Proposed Transaction by reviewing the following factors:

- the current trading conditions for Rakon and RCC;
- the timing and circumstances surrounding the Proposed Transaction;
- the price of the Proposed Transaction;
- the likelihood of an alternative offer and alternative transactions; and
- any advantages or disadvantages for Rakon shareholders of accepting or rejecting the Proposed Transaction.

The decision of each Rakon shareholder as to whether or not to vote in favour of the Proposed Transaction is a matter for individual shareholders having considered all relevant factors and their own preference either in favour of or against the Proposed Transaction.

3. Profile of Rakon

3.1 Background

Rakon was founded by Warren Robinson in Auckland, New Zealand in 1967 and has been at the vanguard of advanced crystal and oscillator technology for many years. Since 2006, Rakon has transitioned to become one of the largest global providers of frequency control solutions, offering a complete and diversified product portfolio into multiple high growth markets including smart wireless devices, telecommunications, positioning and aerospace.

Rakon's reputation for innovation and quality has often been attributed to unique proprietary processes, continuous R&D, and constant technology advancement. To assist its growth, Rakon has entered into joint venture partnerships with other international manufacturers, and where appropriate, undertaken acquisitions.

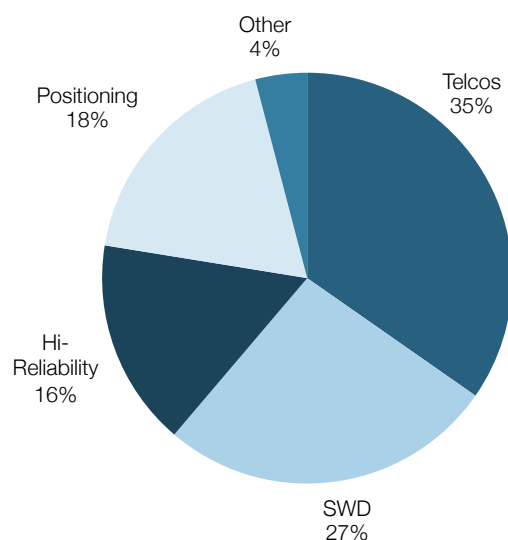
3.2 Markets

Rakon develops components for four key markets:

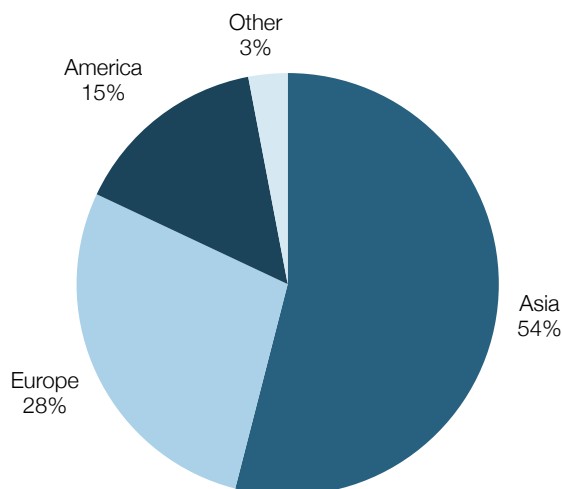
- the smart wireless device (**SWD**) market;
- network infrastructure supporting voice and data in the telecommunications industry;
- high reliability and precision products used in the avionics, space and military industries; and
- specialised location-based devices sold by global navigation and mapping manufacturers.

Rakon's revenue of \$176m for the year to 31 March 2013 split by market and geographical destination is set out in the charts below:

Revenue split by Market FY13



Revenue split by Destination FY13



Smart Wireless Devices

Rakon is a manufacturer of crystal resonators and crystal resonators for the SWD market. The manufacturing of SWD components takes place in Chengdu and in New Zealand. The sales and distribution of SWD components is primarily handled by Rakon's New Zealand division. The following comments are relevant to the SWD market and Rakon's activities in that market:

- In 2009, Rakon decided to invest in China through the establishment of RCC. The manufacturing plant in Chengdu, China was opened in 2011. The building was designed to cope with expected very strong growth in the SWD component market. Only approximately 20% of the building is currently utilised;
- global smartphone sales are expected to reach 1.3 billion units in 2016 driven by emerging markets in Asia, South America, Middle East and Africa;

- Rakon supplies five of the top seven Tier 1 global smartphone brands and a large number of Chinese smartphone manufacturers; and
- while the sophistication of SWD's is increasing on a monthly basis, the trend in component pricing is on a relentless downwards price path.

Telecommunications

Rakon's activities in the telecommunications infrastructure sector includes the supply of crystal oscillators and high performance, high reliability crystal oscillators and clock oscillators. These product solutions enable precision timing and synchronisation for telecommunication networks to deliver speed and reliability. Rakon's solutions for the telecommunications market are designed and manufactured at its facilities in the United Kingdom, France, New Zealand and India. The following comments are relevant to the telecommunications infrastructure market and Rakon's activities in that market:

- the Telecommunication Infrastructure sector is undergoing a substantial technology migration from 3G to 4G/LTE technology and the required infrastructure upgrades are accelerating in major markets globally;
- the demand for Rakon's crystal oscillators is increasing due to the growth in macro base stations as technology transitions to 4G/LTE; and
- Rakon has a high quality reputation and established vendor status at all major Tier 1 OEMs with market share growth fuelled by new designs and leading technology.

High reliability products

Rakon provides high reliability components that are found in space, defence, aviation and industrial applications, which demand high performance criteria. The following comments are relevant to the high reliability products market and Rakon's activities in that market:

- Rakon is now established as a world leader in the Space and High Reliability markets and is the largest non-US based producer and the strategic supplier to the European Space Agency for space grade oscillators;
- procurement and development of sensors, radar and communication technology is expected to remain strong, while the space sector is forecast to expand; and
- Rakon's unique ability to manufacture products in Europe, New Zealand and India provides it with a competitive advantage in serving high reliability customers with supply chain compliance constraints on where their products can be sourced.

Specialised location-based devices

Rakon provides components that are used in consumer devices (navigation, sport and recreation) and industry applications for high precision GPS instruments (surveying, mining, agriculture) and EPIRB rescue beacons. Products are supplied out of Rakon's facilities in New Zealand and the United Kingdom. The following comments are relevant to the specialised location-based devices market and Rakon's activities in that market:

- Rakon is recognised as the industry leader, with a dominant global market share in GPS and emergency beacons;
- Rakon's market leadership position ensures its technology is designed into many of the new consumer devices, high margin precision GNSS instruments and next generation solutions in new markets such as agriculture, construction and GIS mapping; and
- as the market continues to mature, there will be more GPS applications incorporated into a broader range of consumer devices. New business can be generated in areas where GPS is designed as the primary function, such as the sports and fitness sector and personal locator beacons.

3.3 Financial Performance

The financial performance of Rakon for the years ended 31 March 2011, 2012 and 2013 is summarised in the table below:

Rakon Financial Performance (NZ\$ millions)

Year end 31 March	2011	2012	2013
Revenue	189.3	178.2	176.3
Cost of sales	(131.0)	(126.2)	(134.9)
Gross Profit	58.3	52.0	41.4
<i>Gross margin</i>	30.8%	29.2%	23.5%
Other operating income	2.5	5.9	5.3
Selling and marketing costs	(15.3)	(15.5)	(14.9)
Research and development	(13.1)	(14.7)	(14.6)
General and administration	(21.2)	(28.8)	(30.1)
Other gains and losses	(1.9)	0.6	0.5
Operating profit (loss)	9.3	(0.4)	(12.4)
Net finance costs	0.1	(1.5)	(1.9)
Share of profit of associates and joint venture	2.9	0.9	1.3
Impairment	-	-	(17.3)
Loss before income tax	12.3	(1.1)	(30.3)
Income tax credit (expense)	(3.8)	0.6	(2.5)
Loss after income tax	8.5	(0.4)	(32.8)
Normalised EBITDA	24.8	13.1	5.1
<i>EBITDA margin</i>	13.1%	7.3%	2.9%

Source: Rakon Annual Reports 2012 and 2013

The following points should be taken into consideration when reviewing the table above:

- in the year to 31 March 2013, Rakon reported an EBITDA of \$5.1m and a net loss after tax of \$32.8m. \$17.3m of the loss is attributed to an impairment charge as a result of the write down of goodwill of Rakon's Chinese investments in associates (\$10.1 million) and in its NZ business unit (\$7.2 million). Both impairments were made due to a reduction in projected cash flow as a consequence of the forecast decline in margins from SWD sales;
- group revenue has declined by 7% since FY11 due to lower telecommunication revenue in FY11 and a higher New Zealand dollar in FY12 and FY13. In US dollar terms, revenue in FY13 was broadly in line with FY12;
- the decline in EBITDA in FY12 is largely explained by the impact of the higher New Zealand dollar. Rakon management consider that if the currency had remained at FY11 levels, EBITDA in FY12 would have been consistent with the previous years (approximately \$22 million);
- EBITDA in FY13 was also impacted by the high New Zealand dollar, a stock provision of \$2.1 million (relating to aged SWD inventory) and a marked decline in gross margin, largely due to the poor performance of SWD margins and RCC; and
- operating costs increased in FY12 and FY13 primarily due to the rapid expansion and commitment to RCC.

3.4 Financial Position

The financial position of Rakon as at 31 March 2011, 2012 and 2013 is outlined in the table below:

Rakon – Financial Position (NZ\$ millions)			
Year ended 31 March	2011	2012	2013
Cash and cash equivalents	22.8	15.9	9.8
Trade and other receivables	45.9	42.5	47.7
Inventories	54.9	49.2	45.8
Other current assets	1.1	1.1	1.9
Current assets	124.7	108.7	105.2
Trade and other receivables	3.7	7.9	5.9
Property, plant and equipment	79.0	90.4	86.5
Intangible assets	36.0	31.5	24.6
Investment in associates	16.5	19.2	8.2
Investment in joint ventures	4.5	3.7	5.2
Other non current assets	4.7	6.1	4.8
Non current assets	144.4	158.7	135.3
Total assets	269.1	267.5	240.5
Bank overdraft	0.8	3.4	6.5
Borrowings	-	-	22.6
Trade and other payables	39.0	30.8	35.7
Other current liabilities	1.1	2.8	2.9
Current liabilities	40.9	37.0	67.7
Borrowings	20.0	33.5	13.7
Provisions	3.3	2.7	2.4
Non current liabilities	23.2	36.2	16.1
Total liabilities	64.1	73.2	83.8
Net assets	205.0	194.3	156.7

Source: Rakon Annual Reports 2012 and 2013

The following points are relevant when considering the above table:

- as at 31 March 2013 Rakon had net debt of \$33 million, up from \$21 million as at 31 March 2012. Debt increased during the year to assist in funding the operating commitments of the business and to fund the capital expenditure associated with the RCC project;
- intangible assets and investments in associates declined due to the impairment of goodwill described above; and
- property, plant and equipment has increased since 31 March 2011 largely due to the \$23 million of additional investment in RCC in FY12 and FY13.

3.5 Company Ownership

As at 5 August 2013 Rakon had 191 million shares on issue held by approximately 6,117 shareholders. Approximately 30.4% of the company's shares are controlled by Rakon's Directors. The shareholding in Rakon owned by Directors and the RCC JV Partners is summarised below:

Rakon – Director's and RCC JV Partner's Shareholding as at 5 August 2013²

Shareholder	Shares (000s)	%
Warren Robinson	24,931	13.05
Charles Maire	10,713	5.61
Brent Robinson	10,439	5.46
Darren Robinson	10,437	5.46
Bryan Mogridge	1,510	0.79
Bruce Irvine	54	0.03
Peter Springford	40	0.02
Director's Shareholding	58,124	30.43
Etimes Group International Limited (Etimes)	3,698	1.94
HLR Holdings Company Limited (HLR)	1,585	0.83
RCC JV Partners Shareholding	5,282	2.77
Other Shareholders	127,632	66.81
Total	191,039	100.00

Source: NZX Company Research

² Does not include non-beneficial interests.

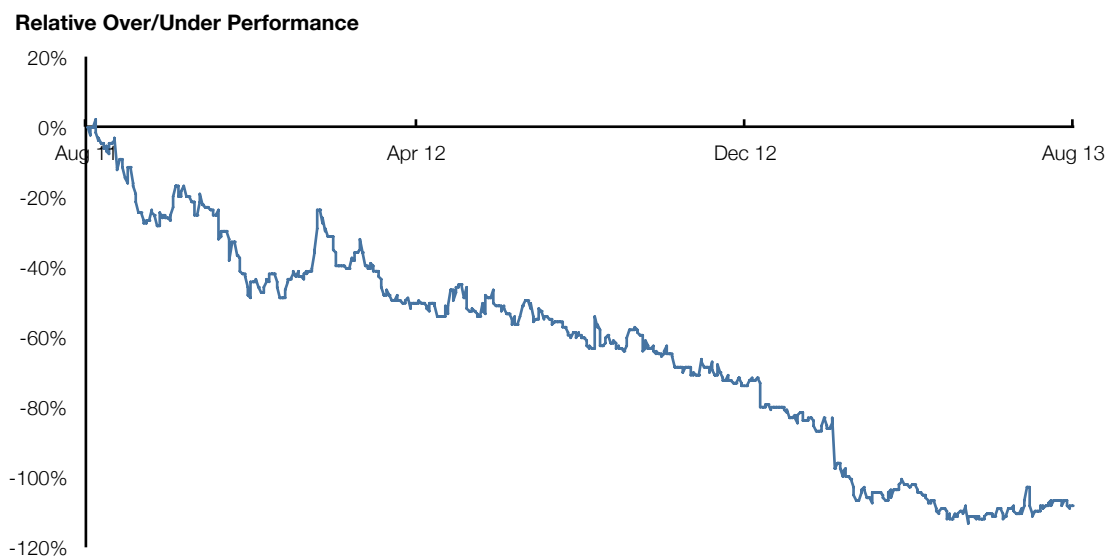
3.6 Share Price Performance

The share price and trading volume history of Rakon shares and its relative performance against the NZX All Capital Index is depicted graphically below:

Rakon Share Price Performance from August 2011 to August 2013



Rakon Share Price Performance relative to the NZX All Capital Index



Over the last two years Rakon's share price has significantly underperformed relative to the NZX All Capital Index. Over this period Rakon's share value has declined by approximately 70% and under performed the NZX All Capital Index by approximately 107%.

During February 2013, Harbour Asset Management Limited sold 8.2 million shares on market, decreasing its shareholding from 9.04% to 4.74%. Over this period, Rakon's share value decreased from 38 cents to 24 cents.

4. Profile of RCC

4.1 Background

In 2009, Rakon raised \$45 million via an institutional placement to fund its Chinese ambitions and the RCC project. RCC was specifically established to manufacture Rakon components designed for the high growth SWD industry.

After considerable investment, Rakon opened the RCC's 12,000m² facility in Chengdu, China in July 2011 via a joint venture with the RCC JV Partners (Etimes and HLR). Being located in Chengdu (a designated centre of science and technology for South West China) provided Rakon with direct access to the high growth Chinese market and a higher quality labour resource. It also provided Rakon with proximity to global SWD vendors' operations and suppliers including Foxcon (Apple), Nokia, Huawei, Alcatel and Ericsson.

Prior to the Chinese expansion and establishment of RCC, Rakon was serving the SWD market through product supplied from its New Zealand manufacturing operations and where it achieved strong demand due to the proliferation of smart phones and tablets. RCC's new state-of-the-art facility in Chengdu provided Rakon with a platform to continue its manufacturing of world-class products with the capacity to achieve economies of scale and in a location far closer to its customers.

By the end of the FY13 RCC was supplying five of the top seven Tier 1 global smartphone brands and a large number of Chinese smartphone manufacturers. Despite the strong sales growth, RCC's margins began deteriorating in FY13, largely due to strong competition from the Japanese manufacturers. From September 2012 the Japanese Yen depreciated significantly against the USD and Chinese Renminbi (**RMB**), providing a cost advantage to Japanese component manufacturers (as component pricing has historically been benchmarked in US\$). Japanese component manufacturers aggressively searching for market share growth passed this cost advantage directly back to the SWD vendors, driving the prices of SWD components down in the process. With its cost base in US\$, RMB and NZ\$, RCC was not able to recover its operating cost base as margins decreased.

The margin erosion led to an EBITDA loss of \$2.8 million in FY13 at RCC (versus the \$6.3 million EBITDA profit forecast for RCC in the original business plan).

4.2 Overview of the SWD industry

A SWD is a portable device with added data functionality such as internet access, computing and video capability (e.g. smart phones such as iPhones and Android phones and tablet PCs such as iPads).

The global smart connected device market is dominated by a small number of manufacturers, with five vendors representing approximately 55%³ of the total market. Samsung and Apple have between them approximately 41% market share, due to their strong offering in the smartphone and tablet markets⁴. The strength of SWD vendors limits the bargaining power of suppliers to this industry.

The growth of Google's Android operating system, which has an estimated market share of 79%⁵ of the operating system market, has enabled Chinese vendors Huawei, Lenovo, and ZTE to achieve strong growth. The development of the Android operating system allows low cost SWD manufacturers to focus on developing a physical product, without the additional concern of having to develop and maintain a complimentary operating system. This ease of access to the market may increase the level of competition and place additional pressure on SWD suppliers' margins as SWD vendor's focus on lowering manufacturing costs to remain price competitive.

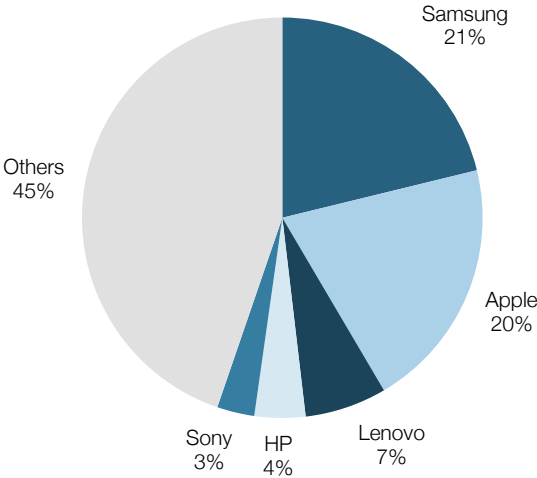
³ IDC Worldwide Quarterly Smart Connected Device Tracker

⁴ In Q4 2012 Apple and Samsung had approximately 44% and 15% tablet market share respectively. In the smartphone market Apple and Samsung has market share of 13% and 39% respectively.

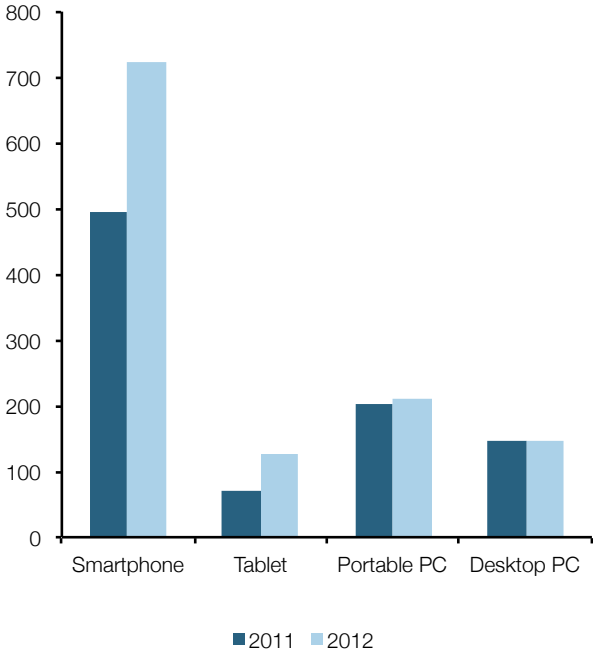
⁵ IDC Press Release August 2013

Global smartphone sales are expected to more than double between 2012 and 2017, reaching approximately 1.3 billion units in 2016 driven by large emerging markets in Asia, South America, Middle East and Africa as phone makers launch more affordable 3G handsets⁶.

Top 5 Smart Connected Device Vendors (Q4 2012)



Smart Connected Device Market by Product Category (millions shipped)



Rakon believes that competition in the manufacturing of componentry for SWD devices segment will remain intense, potentially leading to industry consolidation over the next two to three years as manufacturers chase efficiencies. The acquisition of RCC by ECEC is an example of this consolidation.

⁶ Rakon Annual Report 2013

4.3 Financial Summary

A brief financial profile of RCC for the years ended 31 March 2011, 2012 and 2013 and the most recent projection for the first half of FY14 year to 30 September 2013 (i.e. settlement date) are shown in the table below. The forecast for FY14 is an estimate of RCC's financial performance if it continued to operate under the current ownership structure for all of FY14:

RCC Financial Profile (NZ\$ millions)	Year end 31 March			Q1+Q2	31 March
	2011	2012	2013	2014F	2014F
Revenue	-	1.1	12.0	8.6	17.7
Costs of Goods Sold	-	na	(13.1)	(7.7)	(16.1)
Gross Profit	-	na	(1.1)	0.9	1.5
Gross Margin %	-	na	(10%)	10%	9%
EBITDA (before foreign exchange gains (losses))	(0.8)	(1.6)	(3.0)	(0.7)	(1.8)
EBITDA	(1.1)	(1.0)	(2.8)	(0.6)	(1.6)
EBIT	(1.2)	(1.8)	(5.7)	(2.4)	(5.5)
Capital Expenditure	31.6	18.4	4.6	0.1	-
Total Assets ⁷	45.3	59.6	59.2	60.4	-
Total Liabilities ⁸	6.9	4.9	4.0	4.2	-
Net Assets	38.4	54.8	55.2	56.2	-

Source: Rakon Annual Report 2012 and 2013 and Rakon's Management Accounts (unaudited) for the 2014 year to date.

Rakon forecasts that RCC will make an EBITDA loss of NZ\$0.6 million for the first half of the financial year. In the current financial year RCC's margins have improved in NZ dollar terms relative to FY13 due to a favourable foreign exchange movement against the Chinese Renminbi and production efficiency gains. RCC's forecast EBITDA and EBIT loss for FY14 is NZ\$1.6 million and NZ\$5.5 million respectively. It is important to note that capital expenditure has effectively been halted at the facility. Expansion of the production capacity will require substantial capital expenditure in new plant and equipment.

⁷ Excludes intercompany receivables balances eliminated upon consolidation.

⁸ Excludes intercompany payables balances eliminated upon consolidation.

A forecast balance sheet of RCC as at the proposed settlement date of the Proposed Transaction (30 September 2013) is shown in the table below:

RCC Forecast Balance Sheet as at Settlement	
As at 30 September	2013
Cash	0.3
Intercompany Debtors	2.4
Inventory	3.7
Current assets	6.4
Buildings	19.7
Machinery & Equipment	25.2
Other Fixed Assets	5.2
Intangibles	0.2
Tax assets	6.1
Non current assets	56.4
Total assets	62.8
Trade Creditors	4.2
Intercompany Trade Creditors and Liabilities	4.1
Total Liabilities	8.3
Net assets	54.5

Source: Rakon Management Accounts for the FY14 year to date (unaudited)

The following points are relevant when considering the above table:

- a large portion of other fixed assets relates to assets under construction and a revaluation of fixed assets due to currency movements. Assets under construction is primarily made up of machinery and equipment that is not fully installed into the Chengdu plant. The Chengdu plant is sized for a significantly higher level of production;
- the intercompany trade creditors and liabilities is the balance owing to Rakon Limited by RCC predominantly for the supply of raw materials from New Zealand. This amount will remain on RCC's balance sheet and be settled by RCC in the normal course of business; and
- consistent with Chinese legislation, RCC does not own the land the manufacturing facility is located on, but does own the buildings.

5. The Proposed Transaction in Isolation

5.1 Background

Rakon committed to the investment in RCC in 2009 to seek to meet the anticipated demand for Rakon's SWD components due to the forecast growth in SWD devices. The establishment of a factory in Chengdu provided Rakon with:

- a world class facility enabling Rakon to become a low cost manufacturer;
- access to high quality low cost labour resource; and
- close proximity to global and Chinese SWD vendors.

To date, the total investment by Rakon in RCC has been approximately NZ\$55 million, comprising primarily of an investment in buildings, machinery and robotics, and general establishment costs. Chengdu was selected as the location for the facility, being recognised as one of the global centres of manufacturing of consumer electronics.

RCC competes with Epson, TXC, Murata and Semco⁹ in the manufacture and supply of SWD components. The market practice demanded by customers is for these components to be priced in US\$. Unfortunately for Rakon, shortly after the RCC facility was opened, the SWD component sector experienced a sustained period of price competition. The devaluation of the YEN against the US\$ (down 27% in the 9 months to 30 June 2013) has enabled RCC's Japanese competitors to gain a significant competitive advantage and ultimately an improvement in the market share.

These factors quickly drove RCC and Rakon's SWD business into a loss making position that negatively impacted Rakon's results to the year 31 March 2013.

The market capitalisation of Rakon has fallen \$120 million from early 2012 to \$45 million¹⁰ currently. As the market capitalisation reduced, institutional interest in the company waned, placing further pressure on the share price as those institutional holders exited their investments in Rakon. Today, institutional shareholders hold less than 5% of the issued shares in the company. Broker coverage of Rakon is limited.

As Rakon's earnings reduced and market capitalisation fell, the Board of Rakon became increasingly conscious of the position of the debt providers to the company, which had supported Rakon's expansion and assisted with the funding of RCC initiative. The Directors and management of Rakon reviewed the underlying cost structure of the company and concluded that major changes were required:

- the losses in RCC needed to be halted. In the absence of a fundamental upward shift in SWD component market pricing the Board resolved to either sell or close the RCC facility;
- Rakon's French operations were identified as being in need of reorganisation; and
- group debt needed to be substantially reduced.

Taking a proactive stance, the Board of Rakon committed to the company's debt providers to reduce debt to approximately \$15m by the end of 31 March 2014. The proceeds from the Proposed Transaction, coupled with the release of working capital invested in that business should (if the Proposed Transaction is completed) enable the debt reduction target to be exceeded and met earlier than the commitment to Rakon's debt providers.

5.2 Overview of the process that was followed

Having committed to either sell or close the RCC facility, in February 2013 management entered into discussions with prospective purchasers. Given the current market dynamics (declining component pricing), Rakon's ability to maximize the sale value of RCC was compromised. The opportunity to buy a state-of-the-art facility and potentially enjoy access to Rakon's renowned technological capability through a partnership framework was a unique proposition for potential purchasers or partners.

⁹ Semco is a subsidiary of Samsung

¹⁰ From 1 February 2012 to 8 August 2013

As with many negotiations, Rakon had to elect at an early juncture which party to transact with. In such scenarios there can be a trade off between optimising certainty in a transaction and gaining comfort that value has been maximised. Of the parties approached, ECEC demonstrated the highest level of commitment and enthusiasm to the potential strategic partnership. The opportunity for ECEC to undertake a transaction that resulted in industry consolidation and access to advanced technology received the support of its financiers, and was a strategy consistent with an aggregation policy endorsed by the Chinese Government. The Proposed Transaction would assist ECEC in ensuring component supply to Chinese SWD vendors such as Huawei, by reducing of the dependence on foreign manufacturers. As a consequence of this commitment, Rakon proceeded to negotiate with ECEC on an exclusive basis. The subsequent negotiation and due diligence timeframe has been relatively fast, culminating in a proposed settlement date of 30 September 2013. As announced to the NZX, ECEC also intends to also acquire a 5% shareholding in Rakon, endorsing the Rakon brand and perceived benefits of the strategic partnership in the process.

In establishing the price of the Proposed Transaction, the Board and management of Rakon had regard to the likely value outcomes of alternative potential purchasers and under a liquidation scenario. The management of Rakon has a good understanding of the market for SWD components and the likely values that competitors and potential partners might attribute to the RCC opportunity. Rakon management advised Grant Samuel that it is satisfied with the eventual sale price negotiated in the Proposed Transaction of US\$18.8m.

5.3 Impact if the Proposed Transaction does not proceed

In the event the Proposed Transaction does not proceed to settlement for any reason (including as a result of a rejection by Rakon shareholders), the Board of Rakon has resolved to close or liquidate the business. The Board of Rakon believes that if the Proposed Transaction does not proceed, the prospects of negotiating an alternative transaction with a new party in a compressed time frame would be slim. While an alternative sale (to a different partner) could not be ruled out, the liquidation scenario is the Board's default strategy in the absence of a sale to ECEC. Rakon has not undertaken a detailed assessment of the likely proceeds under a liquidation scenario. The management of Rakon make the following observations:

- the machinery and robotics in the RCC facility are state-of-the-art and range from being new to only 24 months old. However, the market for second hand specialised machinery in a sector suffering from extreme price competition is limited. Rakon management believe the machinery could eventually be sold, but a substantial discount would be incurred. Management estimates that the discount may range between 60-80% off the book value of these machines;
- the Chengdu facility is also state-of-the-art and purpose built to suit specific industries. However, the facility is only 20% utilised at this time, which inevitably impacts its value from an investment perspective. It is however considered saleable, despite its specialist nature. The level of discount that may apply or the likely timeframe to achieve a sale has not been estimated;
- RCC employs approximately 221 people. While the Chengdu region is thriving and employment opportunities exist, RCC would incur redundancy costs in a liquidation scenario. Rakon has not sought to quantify this amount;
- 14.6% of Rakon HK (which owns 100% of RCC) is held by the RCC JV Partners. These partners viewed a potential liquidation unfavourably. The RCC JV Partners will not receive any of the proceeds from the Proposed Transaction, preferring instead to maintain their shareholding in RCC at current levels;
- Rakon has a strong brand in the markets in which it operates. A liquidation scenario would almost certainly result in Rakon brand damage in China and in the SWD market, but the ramifications of such an action may also extend to other divisions of the Rakon group. This was an outcome the Rakon Board was keen to avoid, including potential customer disruption and reputational damage in other markets.

Taking these factors into consideration, Rakon preferred to seek to sell rather than liquidate the RCC business. The eventual transaction with ECEC provided Rakon with an opportunity to not only divest substantially all of RCC, but to form a strategic partnership that draws on the strengths of the Rakon business (innovation and product development) while enabling preservation of the Rakon brand and allowing the retention of a minority shareholding in the business.

5.4 Value Assessment

The sale price for 80% of the shares in RCC is US\$18.8m. The price implies a value for the whole facility and business of US\$23.5m:

RCC Value Assessment

80% of RCC sales price	US\$18.8m
Implied value of 100% of RCC	US\$23.5m
Implied value of 100% of RCC in NZ Dollars¹¹	NZ\$29.3m
Net assets of RCC in NZ Dollars ¹²	NZ\$54.5m
Implied discount	(NZ\$25.2m)
Implied value of RCC / Net Assets	53.7%
Discount to NTA	46.3%

A breakdown of the RCC's forecast balance sheet as at settlement if provided in section 4.3 above. The majority of the net assets relate to land and buildings (NZ\$19.7m), machinery and equipment (NZ\$25.2m) and other fixed assets of (NZ\$5.4m - which also includes machinery and equipment under construction).

The net proceeds to Rakon from the transaction are forecast to be NZ\$24.4m. Rakon expects to receive approximately NZ\$22.7m from the Proposed Transaction and receive a further NZ\$1.7m from the payment of intercompany payables due at closing. A breakdown of the net proceeds is outlined in the table below:

Proposed Transaction Proceeds

Sale price of 80% of RCC	US\$18.8m
Sale price of 80% of RCC in NZ Dollars¹³	NZ\$23.4m
Less RCC trading losses from June to September 2013	NZ\$(0.6)m
Overseas taxes on share transfer	NZ\$(0.1)m
Net proceeds on Settlement¹⁴	NZ\$22.7m
Settlement of intercompany payables	NZ\$1.7m ¹⁵
Net Proceeds Post the settlement of intercompany payables	NZ\$24.4m

¹¹ USD/NZD \$1.246

¹² NZD/CNY ¥4.919

¹³ USD/NZD \$1.246

¹⁴ Prior to settlement Rakon will have received US\$1.5 million as a deposit from ECEC.

¹⁵ This is the balance of intercompany payables as at 30 June 2013 (based on unaudited accounts).

5.5 Impact on the structure of Rakon

Rakon HK owns 100% of RCC. RCC itself is owned (indirectly through Rakon HK) 85.4% by Rakon and 14.6% by the RCC JV Partners. The effect of the Proposed Transaction is that Rakon will own 26.8% of Rakon HK and the RCC JV Partners will own 73.2% of Rakon HK. Rakon HK will continue to own 20% of RCC, with the balance now being held by ECEC.

The RCC JV Partners are Etimes and HLR. Etimes is owned by Mr George Ye, who is also the General Manager of RCC, and the major shareholder in Timemaker, a supplier of crystals to RCC. Given these other relationships, it is understandable that Etimes is not a supporter of the liquidation scenario for the RCC.

5.6 Impact on Operations

If the Proposed Transaction is implemented the impact on Rakon's other global operations is expected to be minimal, as RCC primarily operated as a stand-alone business. Rakon will be required to maintain customer relationships until such a time that RCC has replicated the customer interface systems in place. This may include the functionality of managing the sales and distribution to these customers, as Rakon does today. Once RCC has established systems, Rakon will provide technology and marketing support to both RCC and ECEC as agreed in the framework of the partnership. Rakon's technology support may be extended to assist ECEC in the upgrade of its manufacturing technology and product quality.

The Proposed Transaction will allow Rakon to reduce costs in its New Zealand business. Rakon's New Zealand employees that assist in the support of RCC and the SWD market will remain in the business as they are tightly integrated into Rakon's global operations. The manufacturing of SWD components in New Zealand, which includes the manufacturing of third party crystals into Rakon's products, will continue to support existing clients until Rakon has completed the phased exit from the SWD market. The Proposed Transaction also incorporates a supply guarantee of Rakon's SWD components to existing RCC customers, maintaining Rakon's brand in the market place.

Rakon's SWD customers, for the most part, do not purchase products from other divisions of Rakon.

5.7 Impact on Earnings and Cash flow

RCC's forecast EBITDA and EBIT loss for FY14 is NZ\$1.6 million and NZ\$5.5 million respectively. Under both the liquidation and Proposed Transaction alternatives (reflecting either a 5.4% indirect shareholding or a closure scenario), the current impact of the forecast losses from RCC on Rakon will reduce substantially. There would be no significant change to Rakon New Zealand's cost base in FY14 under either scenario as the existing resource is required to support Rakon's global operations. Rakon will be providing ongoing technical support to ECEC. The terms of this support are still being finalised but it does provide Rakon with the opportunity to recover support costs provided in New Zealand.

The Proposed Transaction has a positive impact on Rakon's cash flow. Rakon estimates that a further US\$20 to US\$25 million in capital expenditure would be required for the RCC facility to be fully fitted out with the requisite operating machinery. Rakon also estimates that a further significant investment (potentially another US\$20m) may be required to fund the operation through to a breakeven position. Under the framework of the Proposed Transaction this capital commitment to RCC will be funded by ECEC.

5.8 Impact on Financial Position

The impact of the Proposed Transaction on Rakon's financial position is outlined in the table below:

Rakon – Proforma Financial Position (NZ\$ millions)						
	30 Jun¹⁶	Removal of RCC balance sheet (exc intercompany payables)¹⁷	Other adjustments¹⁸	Net Proceeds (including intercompany trade payables)¹⁹	SWD inventory impairments²⁰	Proforma 30 Sep
Current assets	101.8	(4.1)	1.4	4.1	(4.5)	98.7
Non current assets	110.0	(56.2)	(0.1)	-	-	53.7
Intangibles	25.8	(0.2)	-	-	-	25.6
Total Assets	237.6	(60.4)	1.3	4.1	(4.5)	178.0
Borrowings	37.2	-	-	(22.7)	-	14.5
Other liabilities	39.9	(4.2)	(0.0)	2.4	-	38.0
Total liabilities	77.1	(4.2)	(0.0)	(20.3)	-	52.6
Net assets	160.5	(56.2)	1.3	24.4	(4.5)	125.4
Key metrics						
Number of shares	191.0					191.0
Net assets per share	\$0.84					\$0.66
Net tangible assets per share	\$0.71					\$0.52
Equity ratio ²¹	64%					66%

Source: Rakon Management Accounts (unaudited)

The Proposed Transaction leads to a reduction in total net assets of approximately NZ\$36 million. If the full amount of the net proceeds is applied in debt reduction, Rakon's debt will reduce to approximately \$14.5 million. The reduction in overall net assets is primarily a function of selling the RCC shareholding at a discount to net assets, RCC trading losses over this period, and additional SWD inventory impairments. As a result of the Proposed Transaction, the equity ratio remains broadly constant at 65% while the net asset backing per share falls from approximately \$0.84 to \$0.66.

¹⁶ Unaudited accounts as at 30 June 2013.

¹⁷ The removal of the forecast balance sheet at settlement (excluding intercompany payables). See Section 4.3 for a breakdown of the balance sheet.

¹⁸ Other adjustments relate to the residual changes that will result in Rakon's balance sheet due to the change in ownership in Rakon HK. This includes a \$1.5 million intercompany loan to Rakon HK from Rakon, that would no longer be eliminated on consolidation.

¹⁹ The estimated net proceeds of \$22.7 million (see Section 5.4) and the inclusion of intercompany payables due at closing.

²⁰ \$4.5 million for additional SWD inventory impairments. This adjustment is not directly related to the Proposed Transaction.

²¹ Shareholders Funds (less intangible assets) / Total assets (less intangible assets)

6. Evaluation of the Proposed Transaction

6.1 Summary

In Grant Samuel's opinion, the Proposed Transaction is in the best interests of Rakon shareholders. The rationale for Rakon's entry into the SWD component manufacturing market in 2010 was based on the view that the SWD market was going to continue to expand rapidly and that Rakon was well positioned with its advanced technology to achieve attractive market share. The projected strong growth in the market did eventuate, but for Rakon the twin effects of severe price competition fuelled by a devaluation of the yen relative to the USD, has rendered the RCC business uneconomic for the time being. Rakon could not have foreseen such a change in the competitive landscape when it made the decision to proceed.

For RCC to return to profitability the market price of components would need to increase significantly and the plant utilisation would need to be improved dramatically, which itself will require a substantial investment in machinery. Neither of these changes appears likely in the medium term, meaning that RCC will continue to drain Rakon's resources in the interim. Over the past year Rakon has suffered a marked reduction in market capitalisation as the RCC losses in particular have affected group performance. The price of Rakon's shares (at a substantial discount to Net Assets) reflects, in part, the difficulties Rakon is facing with RCC. If the losses and capital commitments to RCC continue without a commensurate reduction in debt, Rakon would likely breach its bank covenants in the short term. While Rakon has other mechanisms it could employ to reduce debt (such as an equity raising or the reduction in operating cost in the group), the Proposed Transaction is the fastest way to address the pending problem.

If the Proposed Transaction fails to complete for any reason, the Board of Rakon will pursue the liquidation scenario in the absence of a substitute divestment proposal. Rakon management expect the value outcome under a liquidation to be less than under the Proposed Transaction. This factor, when coupled with the adverse ramifications of a liquidation on the wider Rakon group, including customer base and brand, means the Proposed Transaction is the preferred alternative.

6.2 Operational Impact

RCC is the most stand-alone business owned by Rakon. It supports a specific component market, has its own manufacturing, and its customers have relatively little interface with other divisions of Rakon. The Proposed Transaction will have the following operational implications for Rakon:

- Rakon will no longer be a manufacturer of SWD components in China, but it will be a provider of technology and marketing support to both RCC and ECEC. This may lead to Rakon developing intellectual property for RCC in return for ongoing royalty streams;
- Rakon's technology support may be extended to assist ECEC in the upgrade of its manufacturing technology and product quality;
- RCC's existing customers base will continue to have supply of Rakon's SWD components, maintaining Rakon's brand in the market place which may have been impaired under the liquidation option;
- Resources in the New Zealand office that have supported RCC will be utilised in other areas of the business and for the continued support of RCC and the SWD market where required; and
- Rakon can focus on supporting and developing its core product portfolio.

6.3 Benefits from the Proposed Transaction

Proceeds applied into reduction of debt

The Proposed Transaction will result in proceeds of approximately \$18.8m (NZ\$22.7m) that will be applied to reduce Rakon's net debt down from approximately \$34 million to approximately \$14.5 million. The debt reduction is critical to alleviate the debt burden from the company.

Retention of intercompany trade accounts

The intercompany trade amounts due from RCC to Rakon (approximately NZ\$1.7m) primarily from the supply of components from Rakon NZ will become trade payables of the new owners of RCC. It is likely in a liquidation scenario of RCC, that these intercompany payables would need to be written off.

Losses in RCC stemmed

The direct impact of the Proposed Transaction on the cash flows and operating earnings of Rakon is significant. The RCC operation incurred EBITDA losses of NZ\$2.8m in the year to 31 March 2013, with NZ\$1.6m forecast for the current year based on the current run rate. The Proposed Transaction will result in these losses being stemmed, which would not otherwise be able to be achieved without a marked price increase in the SWD component market. Critically, the residual capital expenditure to complete the machinery fit out of the facility and the cashflow cost until breakeven is achieved will now be funded by ECEC.

Opportunity to retain an involvement in RCC

The Proposed Transaction enables Rakon to retain a 5% shareholding in RCC and its exposure to the high growth SWD market. Rakon will provide technical and marketing support to RCC and it may choose to continue to develop products/intellectual property for the SWD market. The revenue received from Rakon's support to ECEC will enable Rakon to recover support costs that were previously being incurred in New Zealand to subsidise RCC. If Rakon develops intellectual property for SWD, it can sell the rights to use this technology to ECEC or RCC and receive ongoing royalty streams. If the SWD industry remains very competitive, Rakon may elect to take a more passive role in the joint venture.

Investor interest may be encouraged

As Rakon incurred losses and the share price fell, institutional interest in Rakon waned and institutional investment in Rakon dropped. An outcome of the Proposed Transaction is that the business will be able to focus on its profitable divisions and will benefit from a de-gearred balance sheet, fundamentally making the company stronger. In addition, ECEC has publically signalled an intention to acquire a 5% shareholding in Rakon after the Proposed Transaction is completed. Collectively, these events should renew investor interest in Rakon.

Proposed Transaction may lead to greater management and board focus

The RCC initiative and its subsequent problems have and continue to consume significant time at Rakon Board and management level. The Proposed Transaction will enable the management of Rakon to focus on the core operating divisions of the business. These benefits are difficult to quantify.

6.4 Disadvantages of the Proposed Transaction

Significant write down to book value

The sale price of the RCC shareholding reflects a substantial 46% discount to book value of the assets being sold. The Proposed Transaction will result in Rakon's net asset backing per share reducing from \$0.84 to \$0.66 per share. This compares with the current share price of \$0.23²².

End of a strategic initiative to develop a manufacturing business in the SWD market in China

Rakon's initiative to develop the RCC project was a major investment into the component manufacturing market in China. It will be immensely frustrating for Rakon management not to continue to pursue this project, especially as the projected strong growth in SWD appears to have been validated. If the Proposed Transaction is completed, the prospects of reigniting the initiatives are very unlikely in the medium term.

6.5 The impact if the Proposed Transaction does not proceed

If the Proposed Transaction is not completed for any reason (including rejection by Rakon shareholders), the Board will likely proceed with the liquidation of RCC. The possibility of resurrecting a similar transaction with another potential purchaser is considered remote. Rakon is committed to substantial debt repayment by March 2014, and in the absence of being able to sell this division, the cost base of the group will still need to be reduced. RCC is losing

²² As at 14 August 2013

money monthly and still requires a substantial and ongoing capital investment. The liquidation scenario should yield some value to Rakon, albeit less than the Proposed Transaction. It is also likely that the liquidation would take some time to effect, potentially extending the losses being generated by RCC, as well as resulting in collateral damage to the wider Rakon group.

In the scenario the Proposed Transaction is not completed, the immediate debt reduction within Rakon would not occur. Depending on the level of losses within RCC and the results of other debt redemption initiatives (e.g. equity raising) within RCC in due course, this would likely result in Rakon breaching its bank covenants in September or October 2013. The consequence of a breach in bank covenant may include greater requirements from the bank, possibly including the sale of other divisions or assets or the increase in interest costs on the outstanding balance. Such an outcome would have negative connotations on the Rakon share price.

6.6 Costs and risks of the Proposed Transaction

Costs of sale

Rakon will incur costs from the Proposed Transaction of approximately NZ\$0.2m whether the transaction is completed or not.

Risk of customers leaving RCC

Existing RCC customers will be encouraged to transition their requirements under the new ownership. One major customer has indicated to RCC that this is an issue and it will be seeking replacement suppliers to meet accreditation standards. Whether this ultimately results in the customer withdrawing from RCC is yet to be known. ECEC is aware of the notice from this major customer. It is, however, a risk to the future of RCC, in which Rakon HK will have a small shareholding.

Risk of shareholders of ECEC and/or Rakon not approving the deal

The ECEC shareholder meeting to consider the Proposed Transaction is scheduled to be held on 28 August 2013. The outcome of the meeting will be known before the proposal is considered by Rakon shareholders. If ECEC shareholders reject the transaction then the Proposed Transaction will not be put to Rakon shareholders. The Rakon Board collectively control 30.4% of the shares in Rakon. Given the Board is supportive of the Proposed Transaction, it is likely that the resolution to consider the Proposed Transaction will pass.

Chinese Regulatory Approvals

There is a risk that the requisite Chinese regulatory approvals are not obtained, in which case the Proposed Transaction would not proceed. This is a normal commercial risk and is typically a purchaser responsibility.

6.7 Alternatives

It was not considered a feasible strategy for the RCC facility to be “mothballed” until such time as better margins existed in the SWD component market. To maintain the facility as a state-of-the-art manufacturer requires constant machinery upgrading, and it was likely the plant would have quickly fallen below market standards if “mothballed”.

In the absence of the Proposed Transaction, Rakon would still need additional funding to meet debt reduction requirements or operating cash flow needs. It is conceivable in these circumstances that Rakon would consider a share placement to existing or new shareholders. Given the circumstances, any placement would need to incorporate a heavy discount to the prevailing share price. Shareholders who did not participate in such a placement would be disadvantaged, as their shareholding would be diluted. The Board of Rakon is currently not in favour of an equity raising.

6.8 Other matters

Tax Losses

From the establishment of RCC to 30 June 2013, RCC has accumulated tax losses of NZ\$13.6 million²³. These tax losses will carry forward and be able to be utilised by RCC after the change of ownership. The losses can be carried forward for five years from the year of the loss. The tax losses are not available to Rakon in New Zealand.

²³ RMB 67 million as at 30 June 2013

1. Qualifications

The Grant Samuel group of companies provides corporate advisory services in relation to mergers and acquisitions, capital raisings, corporate restructuring and financial matters generally. One of the primary activities of Grant Samuel is the preparation of corporate and business valuations and the provision of independent advice and expert's reports in connection with mergers and acquisitions, takeovers and capital reconstructions. Since inception in 1988, Grant Samuel and its related companies have prepared more than 400 public expert and appraisal reports.

The persons responsible for preparing this report on behalf of Grant Samuel are Michael Lorimer, BCA, Simon Cotter, BCom, MAppFin, F Fin and Christopher Smith, BCom, PGDipFin, MAppFin. Each has a significant number of years of experience in relevant corporate advisory matters.

2. Limitations and Reliance on Information

Grant Samuel's opinion is based on economic, market and other conditions prevailing at the date of this report. Such conditions can change significantly over relatively short periods of time. The report is based upon financial and other information provided by the directors, management and advisers of Rakon. Grant Samuel has considered and relied upon this information. Grant Samuel believes that the information provided was reliable, complete and not misleading and has no reason to believe that any material facts have been withheld.

The information provided has been evaluated through analysis, enquiry, and review for the purposes of forming an opinion as to the underlying value of the Proposed Transaction. However in such assignments time is limited and Grant Samuel does not warrant that these inquiries have identified or verified all of the matters which an audit, extensive examination or "due diligence" investigation might disclose. This timeframe restricts the ability to undertake a detailed investigation of Rakon. In any event, an analysis of the Proposed Transaction is in the nature of an overall opinion rather than an audit or detailed investigation. Grant Samuel has not undertaken a due diligence investigation of Rakon. In addition, preparation of this report does not imply that Grant Samuel has audited in any way the management accounts or other records of Rakon. It is understood that, where appropriate, the accounting information provided to Grant Samuel was prepared in accordance with generally accepted accounting practice and in a manner consistent with methods of accounting used in previous years.

An important part of the information base used in forming an opinion of the kind expressed in this report is the opinions and judgement of the management. That information was also evaluated through analysis, enquiry and review to the extent practicable. However, it must be recognised that such information is not always capable of external verification or validation.

The information provided to Grant Samuel included projections of future revenues, expenditures, profits and cash flows of Rakon prepared by the management of Rakon. Grant Samuel has used these projections for the purpose of its analysis. Grant Samuel has assumed that these projections were prepared accurately, fairly and honestly based on information available to management at the time and within the practical constraints and limitations of such projections. It is assumed that the projections do not reflect any material bias, either positive or negative. Grant Samuel has no reason to believe otherwise.

However, Grant Samuel in no way guarantees or otherwise warrants the achievability of the projections of future profits and cash flows for Rakon. Projections are inherently uncertain. Projections are predictions of future events that cannot be assured and are necessarily based on assumptions, many of which are beyond the control of management. The actual future results may be significantly more or less favourable.

To the extent that there are legal issues relating to assets, properties, or business interests or issues relating to compliance with applicable laws, regulations, and policies, Grant Samuel assumes no responsibility and offers no legal opinion or interpretation on any issue. In forming its opinion, Grant Samuel has assumed, except as specifically advised to it, that:

- the title to all such assets, properties, or business interests purportedly owned by Rakon is good and marketable in all material respects, and there are no material adverse interests, encumbrances, engineering, environmental, zoning, planning or related issues associated with these interests, and that the subject assets, properties, or business interests are free and clear of any and all material liens, encumbrances or encroachments;
- there is compliance in all material respects with all applicable national and local regulations and laws, as well as the policies of all applicable regulators other than as publicly disclosed, and that all required licences, rights, consents, or legislative or administrative authorities from any government, private entity, regulatory agency or organisation have been or can be obtained or renewed for the operation of the business of Rakon, other than as publicly disclosed;
- various contracts in place and their respective contractual terms will continue and will not be materially and adversely influenced by potential changes in control; and
- there are no material legal proceedings regarding the business, assets or affairs of Rakon, other than as publicly disclosed.

3. Disclaimers

It is not intended that this report should be used or relied upon for any purpose other than as an expression of Grant Samuel's opinion as to the Proposed Transaction. Grant Samuel expressly disclaims any liability to any Rakon security holder who relies or purports to rely on the report for any other purpose and to any other party who relies or purports to rely on the report for any purpose whatsoever.

This report has been prepared by Grant Samuel with care and diligence and the statements and opinions given by Grant Samuel in this report are given in good faith and in the belief on reasonable grounds that such statements and opinions are correct and not misleading. However, no responsibility is accepted by Grant Samuel or any of its officers or employees for errors or omissions however arising in the preparation of this report, provided that this shall not absolve Grant Samuel from liability arising from an opinion expressed recklessly or in bad faith.

Grant Samuel has had no involvement in the preparation of the Explanatory Statement issued by Rakon and has not verified or approved any of the contents of the Explanatory Statement. Grant Samuel does not accept any responsibility for the contents of the Explanatory Statement (except for this report).

4. Independence

Grant Samuel and its related entities do not have any shareholding in or other relationship or conflict of interest with Rakon or ECEC that could affect its ability to provide an unbiased opinion in relation to the Proposed Transaction. Grant Samuel had no part in the formulation of the Proposed Transaction. Its only role has been the preparation of this report. Grant Samuel will receive a fixed fee for the preparation of this report. This fee is not contingent on the outcome of the Proposed Transaction. Grant Samuel will receive no other benefit for the preparation of this report.

5. Information

The following information was used and relied upon in preparing this report:

5.1 Publicly Available Information

- Rakon Annual Reports for the financial years ended 31 March 2011, 2012 and 2013;
- Rakon Annual Presentation to shareholders for the financial years ended 2012 and 2013;
- Rakon China Expansion Investor Presentation September 2009;
- NZX company research;
- Capital IQ;
- Rakon's website and marketing collateral;
- IDC Worldwide Quarterly Research; and
- NZX announcements.

5.2 Non Public Information

- Equity Joint Venture Contract between RCC and ECEC;
- Equity Transfer Agreement between Rakon HK Limited and ECEC;
- Cooperation Framework Agreement between ECEC and Rakon Limited;
- Board Minutes and Board Papers from 12 February 2013 to 26 June 2013;
- FY14 Strategic Operating Plan with and without SWD;
- Rakon management accounts for Q1 FY14;
- Rakon's Forecast for FY14;
- Rakon's Proforma financial position after the sale of RCC; and
- Rakon's RCC Business Case.

6. Declarations

Rakon has agreed that it will indemnify Grant Samuel and its employees and officers in respect of any liability suffered or incurred as a result of or in connection with the preparation of the report. This indemnity will not apply in respect of the proportion of any liability found by a Court to be primarily caused by any conduct involving gross negligence or wilful misconduct by Grant Samuel. Rakon has also agreed to indemnify Grant Samuel and its employees and officers for time spent and reasonable legal costs and expenses incurred in relation to any inquiry or proceeding initiated by any person. Where Grant Samuel or its employees and officers are found to have been grossly negligent or engaged in wilful misconduct Grant Samuel shall bear the proportion of such costs caused by its action. Any claims by Rakon are limited to an amount equal to the fees paid to Grant Samuel.

Advance drafts of this report were provided to the directors and executive management of Rakon. Certain changes were made to the drafting of the report as a result of the circulation of the draft report. There was no alteration to the methodology, evaluation or conclusions as a result of issuing the drafts.

7. Consents

Grant Samuel consents to the issuing of this report in the form and context in which it is to be included in the Explanatory Statement to be sent to security holders of Rakon. Neither the whole nor any part of this report nor any reference there to may be included in any other document without the prior written consent of Grant Samuel as to the form and context in which it appears.