Morgans IN ALLIANCE WITH CIMB

TZ Limited

TZL AU

Market Cap	Free Float		
A$49m	65%		

Current	A$0.12
Target	A$0.17
Prev. Target	
Up/Downside	40.2%

STOCK RATING: ADD (HOLD / REDUCE)

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Morgans Financial Limited has been appointed by TZ Limited to manage its Share Purchase Plan (SPP) announced in February 2015 and may receive fees in this regard

Paving the path to profitability

TZL reported a steady improvement in the financials with revenue, gross profit and EBITDA all improving materially. TZL's cash balance should improve following customer payments this half and cash receipts from TZL's SPP which closes at the end of February. This result shows tight financial management and that TZL's path to profitability is within reach. We retain our Add recommendation.

Result snapshot

TZL reported another round of impressive growth. Revenue was up 130% yoy to A$7.6m and guidance for in excess of A$18m revenue for FY15 looks comfortably on-track. Gross profit doubled year on year to A$2.8m and TZL's gross profit margin was 37%. TZL's 1H results typically have a seasonally low gross profit margin due to higher inventory levels being held for customer orders and ahead of the Chinese new year shut downs of manufacturing facilities. Operating costs were tightly controlled at A$5.8m for the half resulting in an EBITDA loss of A$3.0m. We expect costs to remain stable in the 2H15 and gross profit margin expansion (which is typically experienced in the second half of the year) could push TZL close to EBITDA breakeven in the 2H15. If gross profit margins exceed 50% for 2H15 TZL could report an EBITDA profit for the next half. TZL's cash position is tight but payments due in the Q3 FY15 and the SPP should improve TZL's cash position in the rear term.

Divisional commentary

PAD (aka smart lockers) was the star of the result. It delivered 225% revenue growth with broad sales across a number of segments and geographies. IXP (aka data centre racks) reported a small decline in revenue which relates to timing difference, i.e. new projects kicking off in 2H15. IXP should still report yoy revenue growth for FY15. While IXP remains a solid business the PAD division is likely to do the heavy lifting over the next few years. We have detailed some of this growth trajectory overleaf.

Investment view – Add retained

TZL has commercialised a world class electronic lock and delivered significant sales and its revenue trajectory puts TZL on the path to break-even within 24 months of break-even, in our view. Should TZL successfully convert a meaningful portion of its pipeline profitability could be achieved quicker. The pipeline continues to build and grew 7%, since the last update, to $328m. Should TZL convert 50% of this this could result in EBITDA of A$60m over 4 years which could justify a valuation of over 30cps. The TZL investment thesis primarily relates to accelerating sales to push TZL through the profitability inflection point. We retain our Add recommendation and A$0.17 price target.

Key forecasts	Jun-13A	Jun-14A	Jun-15E	Jun-16E	Jun-17E
Revenue (A$m)	2.7	8.5	19.6	26.3	40.9
EBITDA (A$m)	-17.4	-10.3	-3.3	-0.4	5.0
Reported NPAT	-22.1	-12.1	-5.0	-2.4	2.7
Cash NPAT	-17.0	-7.7	-5.0	-2.4	2.7
Net Profit Growth (%)	n.m	54.6	35.1	51.6	210.9
Normalised Earnings Per Share (¢)	n.m	-0.04	-0.01	-0.01	0.01
EPS Growth (%)	n.m	n.m	71%	54%	208%
EV/Revenue (x)	12.4	5.2	2.4	1.9	1.2
EV/EBITDA (x)	-1.9	-4.3	-14.0	-135.0	9.6

SOURCE: MORGANS, COMPANY REPORTS

Figure 1: TZL Financial Summary

Profit and loss	Jun-13A	Jun-14A	Jun-15E	Jun-16E	Jun-17E
Revenue	2.7	8.5	19.6	26.3	40.9
Gross Profit	1.4	4.2	-1.9	16.4	23.7
Cash operating costs (ex COGS)	**7.9**	**9.8**	**1.4**	**16.7**	**18.8**
Total Operating Costs	18.8	14.5	1.4	16.7	18.8
EBITDA	**-17.4**	**-10.3**	**-3.3**	**-0.4**	**5.0**
Depreciation	-0.6	-0.7	-0.5	-0.9	-1.1
Amortisation & impairments	-0.4	-0.5	-1.3	-1.3	-1.3
EBIT	**-18.5**	**-11.4**	**-5.0**	**-2.5**	**2.6**
Net Interest Income	-3.7	-2.1	0.0	0.1	0.1
Pre-tax Profit	-22.1	-12.0	-5.0	-2.4	2.7
Tax	0.0	-0.1	0.0	0.0	0.0
Reported Profit	**-22.1**	**-12.1**	**-5.0**	**-2.4**	**2.7**
Add back exceptional items	5.1	4.4	0.0	0.0	0.0
Normalised Profit	**-17.0**	**-7.7**	**-5.0**	**-2.4**	**2.7**

Cash flow statement	Jun-13A	Jun-14A	Jun-15E	Jun-16E	Jun-17E
EBITDA	-17.4	-10.3	-3.3	-0.4	5.0
Net interest & tax	0.0	-0.1	0.0	0.0	0.0
Changes in working capital	12.5	3.8	0.4	-0.4	-0.9
Operating cash flow	**-4.9**	**-6.5**	**-3.0**	**-0.8**	**4.0**
Capex	-0.9	-1.2	-0.5	-1.0	-1.5
Free Cash Flow	**-5.8**	**-7.8**	**-3.5**	**-1.8**	**2.5**
Acquisitions and divestments	4.6	0.0	0.0	0.0	0.0
Other inc capitalised R&D	-0.1	-0.4	-0.5	-1.1	-1.6
Investing cash flows	**3.6**	**-1.6**	**-1.0**	**-2.0**	**-3.2**
Increase / decrease in Equity	5.7	6.5	4.3	3.3	0.0
Increase / decrease in Debt	-1.2	-17.2	0.0	0.0	0.0
Other financing cash flows	0.0	0.0	0.0	0.0	0.0
Financing cash flows	**4.4**	**-10.7**	**4.3**	**3.3**	**0.0**

Balance Sheet	Jun-13A	Jun-14A	Jun-15E	Jun-16E	Jun-17E
Assets					
Cash And Deposits	4.1	2.6	3.0	3.5	4.4
Debtors	0.8	2.9	3.3	4.1	5.6
Inventory & other	0.0	0.0	0.0	0.0	0.0
Total Current Assets	**5.0**	**5.5**	**6.2**	**7.6**	**10.0**
Fixed Assets	0.0	1.3	1.4	1.5	2.0
Intangibles	0.0	0.0	0.0	0.0	0.0
Other non-current assets	0.5	0.3	0.0	0.0	0.0
Total Non-Current Assets	**0.5**	**1.5**	**1.4**	**1.5**	**2.0**
TOTAL ASSETS	**5.4**	**7.0**	**7.6**	**9.1**	**11.9**
Liabilities					
Short Term Debt	11.6	0.0	0.0	0.0	0.0
Creditors	4.8	2.0	2.0	2.4	3.0
Other current liabilities	0.3	0.3	0.1	0.1	0.1
Total Current Liabilities	**16.8**	**2.3**	**2.2**	**2.6**	**3.1**
Long Term & other debt	5.6	0.0	0.0	0.0	0.0
Other Non current liabilities	1.3	0.2	0.2	0.2	0.2
Total Non -Current liabilities	**6.9**	**0.2**	**0.2**	**0.2**	**0.2**
TOTAL LIABILITIES	**23.7**	**2.5**	**2.3**	**2.8**	**3.3**
Equity					
Issued capital	158.9	192.3	195.2	196.0	198.7
Retained earnings	-163.7	-174.7	-178.1	-178.1	-178.1
Other reserves and FX	-5.4	-5.1	-4.0	-4.0	-4.0
TOTAL EQUITY	**-10.2**	**12.5**	**13.2**	**14.0**	**16.7**

Valuation details	Jun-16E	Jun-17E	Jun-18E	Jun-18E
Share Price	$0.12		Market Cap	A$49.3m
Price Target	$0.16			
Total shareholder return	29.5%		WACC	14.9%
		Weighting	**Valuation**	
DCF (fully diluted)		100.0%	$0.16	
Premium / (discount)			0%	
Price Target			$0.16	

Key metrics/ multiples	Jun-14A	Jun-15E	Jun-16E	Jun-17E
P/E	n.m.	-9.6	-21.0	19.4
EV / Revenue	5.2	2.4	1.9	1.2
EV / EBITDA	-4.3	-14.0	-135.0	9.6
Price/ Book Value	3.8	3.7	3.7	3.1
Price/ Net Tangible Assets	3.8	3.7	3.7	3.1
Operating cash flow yield	-13.3%	-6.1%	-1.6%	8.2%
Free cash flow yield	-15.7%	-7.0%	-3.6%	5.1%

Per share data	Jun-14A	Jun-15E	Jun-16E	Jun-17E
Diluted shares on issue	392.8	411.1	436.1	436.1
Earnings per share (A$)	-0.04	-0.01	-0.01	0.01
Normalised EPS (A$)	-0.04	-0.01	-0.01	0.01

Result quality	Jun-14A	Jun-15E	Jun-16E	Jun-17E
Cash flow conversion	63.1%	89.1%	218.3%	81.4%
FCF vs. NPAT	100.4%	69.2%	73.2%	93.3%

Gearing	Jun-14A	Jun-15E	Jun-16E	Jun-17E
Net Debt	-2.65	-2.98	-3.47	-4.39
Net Debt / Equity	-21.2%	-22.6%	-24.8%	-26.3%
Net Debt / EBITDA (x)	0.26	0.90	9.57	-0.88
EBIT interest cover (x)	5.41	-177.13	-38.78	51.34
Invested Capital	13.6	10.6	10.1	11.4
Enterprise Value	44.5	46.4	48.9	47.9

Growth ratios	Jun-14A	Jun-15E	Jun-16E	Jun-17E
Revenue	212.7%	130.7%	34.5%	55.6%
Gross profit	214.0%	-145.0%	-956.7%	44.9%
Cash operating costs	*24.5%*	*-85.6%*	*1086.3%*	*12.0%*
EBITDA	17797.7%	3314.8%	20.3%	-280.2%
EBIT	*-38.1%*	*-55.8%*	*-50.6%*	*-206.3%*
NPAT	-45.4%	-58.5%	-51.6%	-210.9%
EPS growth	n.m.	-70.9%	-54.1%	-207.7%
Operating cash flow	32.9%	-54.3%	-73.6%	-611.8%
Free cash flow	33.5%	-55.3%	-48.8%	-241.3%

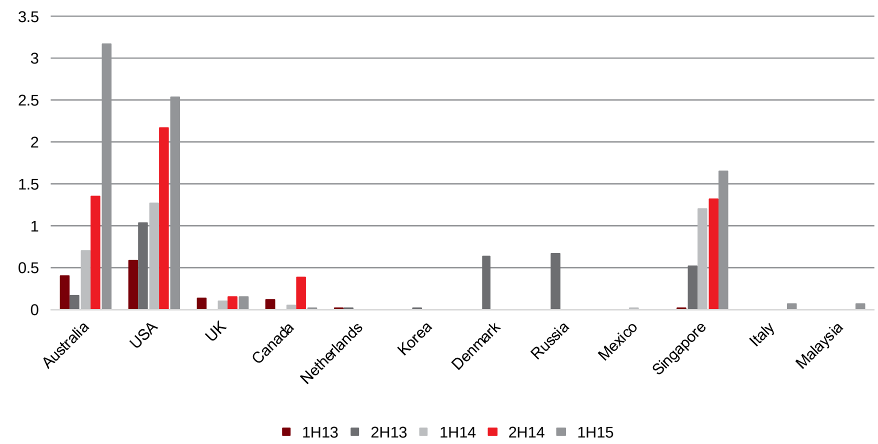
Margin analysis	Jun-14A	Jun-15E	Jun-16E	Jun-17E
Gross profit margin	50.1%	-9.8%	62.3%	58.0%
EBITDA Margin	-121.2%	-17.0%	-1.4%	12.2%
EBIT margin	-134.7%	-25.8%	-9.5%	6.5%
NPAT margin	-91.1%	-25.6%	-9.2%	6.6%
ROE	-62.0%	-38.1%	-17.3%	16.1%
ROIC	-83.9%	-47.8%	-24.6%	23.3%

SOURCES: MORGANS, COMPANY REPORTS

Path to revenue growth

TZL has delivered strong revenue growth across a number of product lines and geographies. Australia, the United States and Singapore were the key contributors in 1H15.

Figure 2: revenue splits



SOURCES: COMPANY REPORTS

The key short term growth engines are:

1) PAD in the United States including accountable mail (for corporates and governments), multi-purpose residential parcel collection (for apartment blocks), and parcel collection for transportation and logistics (for agencies like the Chicago trial).
2) PAD in Asia including expansion of project with agencies like Singapore Post and Malaysia Post
3) PAD in Australia for a number of corporations including Westpac and Hills industries

Newly added, medium term growth could also come from:

1) Upgradeable swing handles – TZL recently signed its first distribution agree with a UK based data centre cabinet provider. They will fit TZL's mechanical lock to their newly built racks. This will allows customers to purchase an upgradable lock for the same price as an old fashion mechanical lock. It will allow for infield upgrade to the TZL electronic lock which is disruptive to the status quo and should be the first of several more deals to complete. We don't expect that base lock sales to be material to TZL but expect over time the upgrade cycle will be. This could also be fast tracked as/if government increase data centre and data storage related security mandates.
2) New generation of lower cost parcel systems. TZL have commercialised a lower cost parcel locker system which is aimed to more cost conscious emerging economies, i.e. some parts of Asia, South America etc.

2H15 gross margin and scenario analysis

Gross margin commentary

TZL's 1H15 gross profit margin was subdued due to a number of seasonal factors and TZL holding customer inventory (which isn't recognised as revenue or profit until it's received by the customer). TZL booked a gross profit margin of 50% for FY14 and aspires to achieve a similar outcome in FY15. Should this occur then TZL may report an EBITDA profit in 2H15 as based on revenue guidance, this gross profit margin, and operating costs staying broadly flat on 1H15, then TZL could recognise EBITDA in excess of A$1m which would be 12 months ahead of our forecast breakeven. Margins are expected to expand to ~65% as TZL's new manufacturing facility comes online at the end of FY15. See below for financials under the different scenarios.

Gross profit margin commentary

Our published forecasts are based around the **2H15 base** detailed below. This assumes FY15 gross profit margins are below the ideal 50% as the second manufacturing facility has not had sufficient time to cover have a meaningful contribution so is unlikely, in our view, to cover costs since it only contributes from Q3FY15.

2H15V2 illustrates the outcome if TZL achieves the ideal 50% gross profit margin for FY15. This would necessitate a 76% gross profit margin in 2H15 which seems unlikely in our view. However should this occur, TZL would book a 2H15 EBITDA profit of A$3.8m.

2H15V3 illustrates the outcome if TZL achieves a 2H15 gross profit margin that is the average of TZL's gross profit margin in the last two reported halves (average of 59% in 2H13 and 64% in 2H15). In this instance, TZL would report an 2H15 gross profit margin of 61% and a A$1.3m EBITDA profit.

Figure 3: Scenario analysis

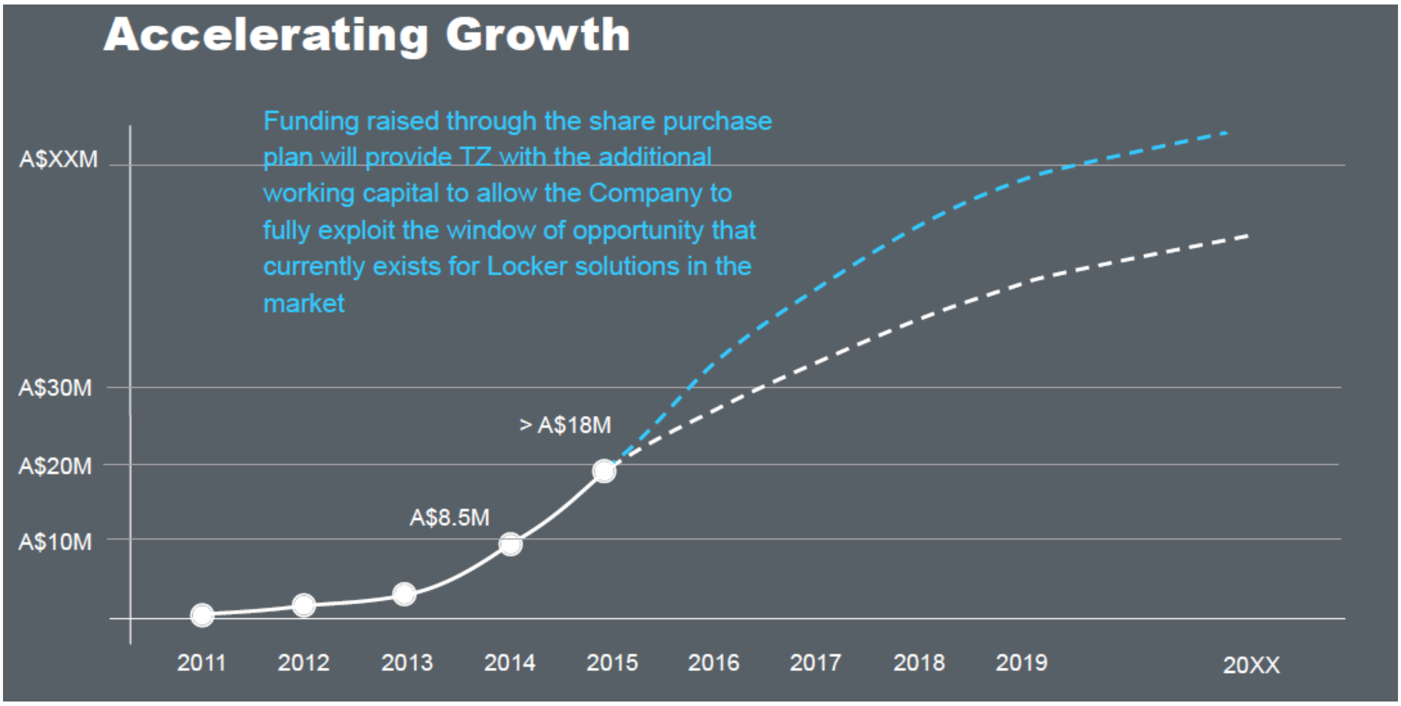
	1H13	2H13	1H14	2H14	1H15	2H15 Base	FY15 Base	2H15 V2	FY15 V2	2H15 V3	FY15 V3
Revenue	1.3	1.4	3.3	5.2	7.6	11.9	19.6	11.9	23.8	11.9	19.6
Gross profit	0.5	0.8	0.9	3.3	2.8	5.7	8.6	9.1	11.9	7.3	10.2
Gross profit margin	40%	59%	28%	64%	37%	48%	44%	76%	50%	61%	52%
opex	10.4	8.4	4.0	10.5	5.9	6.0	11.9	6.0	12.0	6.0	11.9
EBITDA	-9.9	-7.5	-3.1	-7.2	-3.0	-0.3	-3.3	3.8	-0.1	1.3	-1.7
NPAT	-12.5	-9.5	-5.3	-6.8	-3.7	-1.3					
Cash NPAT	-12.46	-9.47	-5.28	-6.80	-3.69	-1.32					
Operating cash flow	-2.46	-2.56	-3.67	-3.01	-2.31	-0.66					
Net cash	-13.10	-13.10	-15.35	2.65	1.31	2.98					

SOURCES: MORGANS, COMPANY REPORTS

Capital commentary

TZL have not participated in a number of open tenders given the payment terms are detrimental to working capital and TZL's limited capital. Strengthening the balance sheet with additional capital should assist TZL with winning additional work and enlarging the pipeline, in our view.

Figure 4: Funding the growth trajectory



SOURCES: COMPANY REPORTS

Forecasts, valuation and recommendation changes

We have made immaterial changes to our forecasts and retain out A$0.17c DCF based price target.

Figure 5: Forecast and valuation changes

	2015 old	2015 new	% change	2016 old	2016 new	% change
Revenue	19.0	19.6	3%	26.2	26.3	0%
EBITDA	-2.9	-3.3	14%	-1.0	-0.4	-64%
EBIT	-4.1	-5.0	22%	-2.3	-2.5	10%
NPAT	-4.1	-5.0	23%	-2.2	-2.4	10%
EPS	-1.0	-1.2	25%	-0.5	-0.6	14%
DCF	$0.17	$0.17	n.m			
Premium / (discount)	0%	0%	n.m			
Price target	$0.17	$0.17	n.m			

SOURCES: MORGANS, COMPANY REPORTS

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RECOMMENDATION STRUCTURE

For a full explanation of the recommendation structure, refer to our website at https://www.morgans.com.au/research_disclaimer.

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