TZ Limited

H115 results

Strong pipeline and funding to execute

Tech hardware & equipment

TZ has had a strong H115 with revenue up 131% y-o-y, primarily driven by the PAD division, which successfully rolled out 100 lockers for Singapore Post. IXP's H1 performance was weaker than expected and down 20% y-o-y, but management attributes this to the timing of roll-outs rather than demand problems. PAD pipeline remains strong with multiple postal and corporate opportunities and the recently announced A$8m share issue provides much needed funding for working capital and balance sheet strength. Effective execution remains key to delivering shareholder return.

Year end	Revenue (A$m)	PBT* (A$m)	EPS* (c)	DPS (c)	P/E (x)	Yield (%)
06/13	3.0	(10.1)	(5.9)	0.0	N/A	N/A
06/14	10.0	(8.1)	(3.0)	0.0	N/A	N/A
06/15e	19.4	(1.6)	(0.4)	0.0	N/A	N/A
06/16e	26.1	1.8	0.4	0.0	32.5	N/A

Note: *PBT and EPS are normalised, excluding intangible amortisation, exceptional items and share-based payments.

Positive outlook for PAD

Management believes contracts with existing PAD customers could be extended to be worth more than A$300m. Most of this (A$250m) is from the postal locker opportunities in Singapore, Malaysia, Indonesia, the US and Italy, but corporate, educational and residential lockers are also showing significant promise and tend to be higher margin. Although there is still uncertainty over the timing of roll-out, the outlook remains very encouraging and raising A$8m (gross) with the share purchase plan and placement provides management with added flexibility in managing contracts and delivering them efficiently.

Timing of IXP roll-out difficult to predict

IXP has always been a lumpy business, so we are not concerned by the 20% decline in revenue y-o-y as it could easily swing significantly the other way in H2 with just a few large contracts. Management has given the sales potential of existing clients in the IXP business as A$27m, but the timing of roll-outs is very uncertain. Given the outperformance of PAD, the underperformance for IXP and the difficulty in predicting the timing of roll-outs, we have left our core revenue estimates unchanged. We have, however, slightly increased our revenue expectations for Infinity (TZ's design business) from A$0.2m to A$0.6m.

Valuation: Contract extensions are key catalyst

We have updated our valuation approach to reflect the wide range of potential revenue growth rates. With a WACC of 12%, terminal growth of 2% and conservative terminal EBITDA margins of 15%, the current share price requires revenue CAGR of 13% to 2024, resulting in revenue of A$60m in 2024. This compares to management's A$328m estimate of revenue potential from existing customers alone. Effective execution on existing contracts, announcements of contract extensions and signing new customers are catalysts for upside.

16 March 2015

Price	**A$0.13**
Market cap	**A$62m**
	A$1.95/£
Net cash (A$m) at 31 December 2014 (excluding A$8m share issue)	1.3
Shares in issue	480.0m
Free float	86%
Code	TZL
Primary exchange	ASX
Secondary exchange	N/A

Share price performance

%	1m	3m	12m
Abs	8.3	4.0	(16.1)
Rel (local)	9.2	(6.6)	(21.3)
52-week high/low		A$0.20	A$0.10

Business description

TZ Limited designs and produces intelligent, locking and fastening systems using its proprietary and patented technology. The three business units are infrastructure protection (IXP), packaged asset delivery (PAD) and aero asset maintainability.

Next event

Q3 results	30 April 2015

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Review of results

PAD goes from strength to strength

Revenue for the six months to 31 December 2014 was A$7.6m, which is over double the A$3.5m for the same period last year. Most of the growth has come from the PAD business, which has grown 226% from A$2m in H114 to A$6.5m in H115. The strength in PAD primarily came from the roll-out of the 100 Singapore Post lockers but the Poste Italiane and corporate locker deployments also contributed. The pipeline is strong with day locker sales to two banking groups (Westpac and undisclosed) and multiple opportunities with other companies for day lockers, property developers and managers for residential lockers and the "US logistics company". The quantification and timing of these opportunities is still uncertain but it is certainly encouraging. If H215 is as strong as H115, TZ should easily beat our FY15 forecasts, but given the uncertainty of value and timing of some of these large contracts, we are leaving our revenue forecasts for PAD unchanged.

Project implementation delays push back IXP growth

IXP revenue decreased by 20% y-o-y from A$1.0m to A$0.8m. Management attributes the decline to delays in project roll-outs rather than a lack of overall demand. Although the weak performance in H115 leaves a lot to be achieved in H2 to meet our A$4.1m annual forecast, IXP revenue is sensitive to large deployments, which are very difficult to predict, and therefore it is easily possible that IXP could grow considerably in the second half to meet or even beat our forecast of A$4.1m. We have therefore also left our revenue forecasts for IXP unchanged.

Improved margins, but higher operating costs

Exhibit 1 shows a summary of the results and our changes to estimates. Gross margins improved y-o-y from 29% in H114 to 37% in H115 due to some components being manufactured at lower cost in China. Full production from the China based contract manufacturer is expected in Q4 which should improve margins further, and in addition H2 has seasonally stronger gross margins because costs increase over the Christmas period due to the holidays followed by Chinese New Year. We therefore think it is reasonable to expect gross margins approaching 70% in H2, against 63% for H214. Total normalised operating costs (excluding share based payments and exceptionals) were A$5.6m for H1, up from A$3.6m in H114. This was primarily due to a A$1.6m increase in staff costs which relates to expansion of the software development team and the technical services and implementation team. We assume similar staff levels in H2 and that's the main reason we now forecast an operating loss for FY15.

Exhibit 1: Review of results and changes to estimates

A$m	H114	H214	H115	H115 y-o-y (%)	H2e y-o-y growth (%)	H215e	FY15e (new)	FY15e (old)	% change to est	FY16e (new)	FY16e (old)	% change to est
PAD revenue	2.0	3.4	6.5	225.5	142.6	8.2	14.8	14.8	0.0	19.9	19.9	0.0
IXP revenue	1.0	1.4	0.8	(20.0)	134.7	3.3	4.1	4.1	0.0	6.1	6.1	0.0
Infinity design	0.3	0.4	0.3	8.0	(31.1)	0.3	0.6	0.2	289.6	0.1	0.1	0.0
Total revenue	**3.3**	**5.2**	**7.6**	131.3	127.2	**11.8**	**19.4**	**19.0**	**2.3**	**26.1**	**26.1**	**0.0**
Gross profit	**1.0**	**3.3**	**2.9**	201.3	150.2	**8.2**	**11.1**	**10.8**	**2.7**	**15.2**	**15.2**	**0.0**
Gross margin (%)	29	63	37	201.3	150.2	70%	57%	57%	0.3	58%	58%	0.0
Total operating costs (excluding D&A)	(3.6)	(5.5)	(5.6)	56.0	2.9	(5.7)	(11.3)	(9.0)	24.7	(12.2)	(10.4)	17.4
Adj EBITDA*	**(2.6)**	**(2.2)**	**(2.7)**	21.1	27.7	**2.6**	**(0.2)**	**1.8**	**(109.2)**	**3.0**	**4.8**	**(37.4)**
D&A	(0.6)	(0.6)	(0.7)	3.6	(215.7)	(0.8)	(1.4)	(1.4)	0.0	(1.2)	(1.2)	0.0
Adj operating profit*	**(3.2)**	**(2.8)**	**(3.4)**	6.7	(164.3)	**1.8**	**(1.6)**	**0.4**	**(549.2)**	**1.8**	**3.6**	**(49.6)**
Ending net debt/(cash)							(9.8)	(4.0)		(9.5)	(6.7)	(40.6)

Source: Edison Investment Research. Note: *Adjusted EBITDA and operating profit exclude share-based payments, amortisation of acquired intangibles and other income, which primarily relates to FV movements in derivative liabilities (ie convertible notes).

Business update

A$8m raised from share purchase plan and share issue

TZ has announced the completion of a further share placing following the share purchase plan, which raised a combined total of A$8m before costs. Cash at 30 December 2014was A$1.3m compared to total operating and investing cash outflow of A$2.5m for the six months to 30 December 2014, so additional funding was required to fund working capital and enable TZ to make the deliver on the opportunities available to it. The cash should allow an accelerated roll-out of existing orders and help win new clients due to the strengthened balance sheet. Careful working capital management will still be required to maximise sales growth, but the raising significantly reduces the pressure and gives management flexibility to maximise the value of each contract it signs.

MoU with KPMG for Day Lockers

Post the interim results on 3 March 2015, TZ announced that KPMG intended to appoint TZ as its preferred supplier for its offices across Australia. While this does not yet represent a firm commitment for large-scale orders, it is another positive indicator that TZ's products are gaining traction and have the potential for widespread roll-outs. Initial deployments, once commercial terms have been agreed, will be made in Adelaide, South Australia and Parramatta, New South Wales. KPMG Australia employees 5,000 people over 14 locations in the country, so assuming a locker ASP of c A$400, a full roll-out could be worth up to A$2m.

Valuation

We have updated our DCF scenario analysis to reflect the wide range of revenue opportunities. It now looks at the total revenue growth between 2015 and 2024 and compares the resulting revenue in 2024 (see Exhibit 3) to current estimates. The sensitivity analysis in Exhibit 2 shows the DCF valuation per share (A$) for a range of revenue growth rates and EBITDA assumptions. The current share price is implying revenue CAGR of 13% from 2015 to 2024 at 15% EBITDA margins, which results in revenue of A$60m by 2024 (and cumulative revenue between 2016 and 2024 of A$466m). Management estimates the total revenue opportunity from existing customers alone is A$328m, so the share price is not factoring in significant additional client wins. The assumed EBITDA margin of 15% is also, in our view, relatively conservative. Catalysts for share price upside include continuing strong revenue growth and announcements of new orders, and a growing track record of delivering on these projects.

Exhibit 2: DCF sensitivity analysis (A$ per share)

		2015-24 revenue CAGR					
		13%	**18%**	**22%**	**26%**	**30%**	**34%**
Peak EBITDA margin	10%	0.04	0.05	0.06	0.07	0.09	0.11
	15%	0.12	0.14	0.18	0.23	0.30	0.39
	20%	0.20	0.23	0.30	0.40	0.52	0.68
	25%	0.27	0.31	0.42	0.56	0.74	0.97

Source: Edison Investment Research. Figures in table are DCF valuation per share in A$. WACC: 12%, terminal growth 2%.

Exhibit 3: Revenue in 2024

	2015-24 revenue CAGR					
	13%	**18%**	**22%**	**26%**	**30%**	**34%**
Revenue (A$m)	59.5	83.5	115.0	155.8	208.0	274.0

Source: Edison Investment Research

Exhibit 4: Financial summary

A$'000s	2012	2013	2014	2015e	2016e
30-June	AUS GAAP	AUS GAAP	AUS GAAP	AUS GAAP	AUS GAAP
PROFIT & LOSS					
Revenue	6,383	2,967	9,984	19,446	26,128
EBITDA	(3,298)	(5,348)	(4,858)	(163)	3,015
Operating Profit (before amort. and except.)	(4,366)	(6,388)	(6,003)	(1,588)	1,832
Intangible Amortisation	0	0	0	0	0
Exceptionals	(1,783)	(6,455)	(3,621)	(773)	(773)
Other	(1,396)	(6,680)	0	0	0
Operating Profit	(7,545)	(19,523)	(9,624)	(2,361)	1,059
Net Interest	(4,815)	(3,675)	(2,112)	0	0
Profit Before Tax (norm)	(9,181)	(10,063)	(8,115)	(1,588)	1,832
Profit Before Tax (AUS GAAP)	(12,360)	(23,198)	(11,736)	(2,361)	1,059
Tax	(1)	(6)	(53)	0	(212)
Profit After Tax (norm)	(9,182)	(10,069)	(8,168)	(1,588)	1,621
Profit After Tax (AUS GAAP)	(12,361)	(23,204)	(11,789)	(2,361)	848
Average Number of Shares Outstanding (m)	128.7	170.9	268.6	388.9	392.9
EPS - normalised (c)	(7.13)	(5.89)	(3.04)	(0.41)	0.41
EPS - normalised and fully diluted (c)	(7.13)	(5.89)	(3.04)	(0.41)	0.41
EPS - (reported) (c)	(9.60)	(13.57)	(4.39)	(0.61)	0.22
Dividend per share (c)	0.0	0.0	0.0	0.0	0.0
EBITDA Margin (%)	N/A	N/A	N/A	N/A	11.5
Operating Margin (before GW and except.) (%)	N/A	N/A	N/A	N/A	7.0
BALANCE SHEET					
Fixed Assets	22,256	8,482	8,774	7,598	6,666
Intangible Assets	19,553	7,590	7,253	6,038	5,064
Tangible Assets	1,575	474	1,257	1,296	1,337
Investments	1,128	418	264	264	264
Current Assets	6,790	5,639	6,150	15,245	17,516
Inventory	342	402	394	1,998	3,442
Debtors	5,544	823	2,876	3,241	4,354
Cash	904	4,146	2,646	9,772	9,485
Other	0	268	234	234	234
Current Liabilities	(16,550)	(16,811)	(2,254)	(3,413)	(3,903)
Creditors	(6,169)	(5,166)	(2,254)	(3,413)	(3,903)
Short term borrowings	(10,381)	(11,645)	0	0	0
Long Term Liabilities	(6,101)	(6,878)	(207)	(62)	(62)
Long term borrowings	(3,720)	(5,599)	0	0	0
Other long term liabilities	(2,381)	(1,279)	(207)	(62)	(62)
Net Assets	6,395	(9,568)	12,463	19,369	20,216
CASH FLOW					
Operating Cash Flow	(9,157)	(4,936)	(6,488)	(1,624)	175
Net Interest	(602)	(103)	(135)	0	0
Tax	(19)	15	(53)	0	(212)
Capex	(570)	(718)	(1,460)	(250)	(250)
Acquisitions/disposals	0	4,594	0	0	0
Financing	9,904	5,613	6,636	9,000*	0
Dividends	0	0	0	0	0
Net Cash Flow	(444)	4,465	(1,500)	7,126	(287)
Opening net debt/(cash)	9,789	13,197	13,098	(2,646)	(9,772)
HP finance leases initiated	0	0	0	0	0
Other	(2,964)	(4,366)	17,244	0	(0)
Closing net debt/(cash)	13,197	13,098	(2,646)	(9,772)	(9,485)

Source: Edison Investment Research, TZ Ltd accounts. Note: *Includes A$8m gross as net figure not disclosed.

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