

# WILSONS

## Posting strong growth

TZ Limited (TZL) reported its FY16 result with revenue in line with expectations, increasing by 36% on the pcp to \$20.9m. There was a high proportion of lower margin postal lockers sold in the period, which led the gross profit margin to decline from 43.6% in the pcp to 33.1% in FY16. EBITDA of -\$5.3m decreased by 18% on the pcp and was 10% below our expectations, due to a higher cost base. The company is expecting a strong start to FY17 with a backlog order book of \$10m, of which it expects to convert at least 50% into revenue in 1Q17. We remain positive about the outlook for TZ and expect further locker orders over the next 12 months. We retain our BUY rating and 12-month target price of 14cps.

### Key points

**FY16 result.** Revenue increased by 36% on the pcp to \$20.9m, in line with our forecasts. The PAD business (85% of FY16 revenue) grew by 43% on the pcp, underpinned by new (US Transport and Logistics company) and expanding contracts (Singapore Post, Pos Malaysia and Poste Italiane) in the Postal & Logistics sector. The IXP business (10% of FY16 revenue) increased by 22% on the pcp, with the business dependent on infrastructure starts and project timings. EBITDA of -\$5.3m decreased by 18% on the pcp and was 10% below our expectations, due to a higher cost base.

**Outlook.** The outlook remains positive with the company well positioned to win additional locker orders in the Postal & Logistics and corporate sectors across the US, Europe and Asia-Pacific. The company has a backlog order book of \$10m. It is expecting to book at least 50% of the order book in 1Q17, ie ~\$5m. This will secure 31% of our 1Q17 revenue forecast of \$16m and position the company for a solid start to FY17. The business model is becoming more efficient as the company shifts to a more working capital-light model with new orders signed with upfront cash payment terms. We are seeing evidence of this shift with TZ generating positive operating cash flow of \$1.0m in 2H17.

**Forecasts.** We have made minor adjustments to our forecasts, accounting for an increase in opex related to an additional office in the US and an increase in headcount to support the company's large US contract.

**Valuation.** Our 12-month price target of 14cps is unchanged and set in line with our DCF valuation, applying a WACC of 12.5% and TGR of 2.5%.

### Risks and catalysts

**Risks.** Loss of contracts, timing delays, competition, cash control and cost containment. **Catalysts.** Contract wins, expansion into new segments and licensing agreements.

Earnings forecasts					
Year-end June (AUD)	FY15A	FY16A	FY17F	FY18F	FY19F
NPAT rep (\$m)	-6.0	-7.0	-2.5	4.7	9.0
NPAT norm (\$m)	-4.6	-5.3	-0.6	6.6	10.9
Consensus NPAT (\$m)			-1.3	5.5	
EPS norm (cps)	-1.1	-1.0	-0.1	1.3	2.1
EPS growth (%)	70.2	0.8	89.3	1222.8	66.5
P/E norm (x)	-8.1	-8.1	-75.9	6.8	4.1
EV/EBITDA (x)	-9.4	-8.0	-326.0	6.0	3.7
FCF yield (%)	-8.9	-3.0	-7.6	12.6	24.5
DPS (cps)	0.0	0.0	0.0	0.0	0.0
Dividend yield (%)	0.0	0.0	0.0	0.0	0.0
Franking (%)	0	0	0	0	0

Source: Company data, Wilsons estimates, S&P Capital IQ

### Wilsons Research

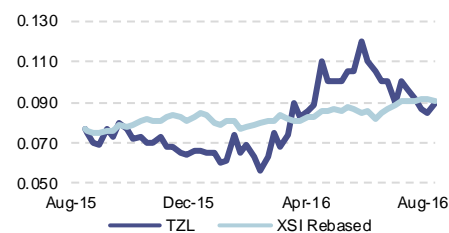
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Recommendation	BUY
12-mth target price (AUD)	\$0.14
Share price @ 30-Aug-16 (AUD)	\$0.09
Forecast 12-mth capital return	64.7%
Forecast 12-mth dividend yield	0.0%
<b>12-mth total shareholder return</b>	<b>64.7%</b>
Market cap	\$43m
Enterprise value	\$42m
Shares on issue	504m
Sold short	1.4%
ASX 300 weight	0.0%
Median turnover/day	\$0.0m

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### 12-mth price performance (\$)



	1-mth	6-mth	12-mth
Abs return (%)	-10.0	52.5	16.9
Rel return (%)	-9.7	38.2	-1.1

Key changes				
		29-Jul	After	Var %
NPAT:	FY17F	-0.3	-0.6	N/A
norm	FY18F	6.6	6.6	-0.2%
(\$m)	FY19F		10.9	
EPS:	FY17F	-0.1	-0.1	N/A
norm	FY18F	1.3	1.3	-0.2%
(cps)	FY19F		2.1	
DPS:	FY17F	0.0	0.0	0.0%
(cps)	FY18F	0.0	0.0	0.0%
	FY19F		0.0	
Price target:		0.14	0.14	0.0%
Rating:		BUY	BUY	

Price target	
	Price target
<b>Enterprise value</b>	<b>62.16</b>
Net debt (cash)	-6.10
<b>Equity value</b>	<b>68.26</b>
Shares on issue	501.97
<b>A\$/sh</b>	<b>0.14</b>
WACC (%)	12.5
Terminal growth (%)	2.5

Interims (\$m)					
Half-year (AUD)	Dec 15	Jun 16	Dec 16	Jun 17	
	1HA	2HA	1HE	2HE	
Sales revenue	10.6	10.2	16.3	16.4	
EBITDA	-2.4	-2.9	-0.4	0.3	
EBIT	-3.3	-3.9	-1.6	-0.9	
<b>Net profit</b>	<b>-2.4</b>	<b>-2.9</b>	<b>-0.7</b>	<b>0.1</b>	
<b>Norm EPS</b>	<b>-0.5</b>	<b>-0.6</b>	<b>-0.1</b>	<b>0.0</b>	
EBIT/sales (%)	-31.1	-38.0	-10.1	-5.3	
Dividend (c)	0.0	0.0	0.0	0.0	
Franking (%)	0.0	0.0	0.0	0.0	

Financial stability				
Year-end June (AUD)	FY16A	FY17F	FY18F	
Net debt	-6.1	-0.6	-3.7	
Net debt/equity (%)	<0	<0	<0	
<b>Net debt/EV (%)</b>	<b>&lt;0</b>	<b>&lt;0</b>	<b>&lt;0</b>	
Current ratio (x)	2.5	2.2	2.4	
Interest cover (x)	>99	85.4	<0	
<b>Adj cash int cover (x)</b>	<b>&gt;99</b>	<b>&gt;99</b>	<b>&lt;0</b>	
Debt/cash flow (x)	0.0	0.0	0.0	
Net debt (cash)/share (\$)	<0	0.0	<0	
NTA/share (\$)	0.0	0.0	0.0	
Book value/share (\$)	0.0	0.0	0.0	
Payout ratio (%)	0	0	0	
Adj payout ratio (%)	0	0	0	

EPS reconciliation (\$m)				
	FY16A		FY17F	
	Rep	Norm	Rep	Norm
Sales revenue	21	21	33	33
EBIT	-7.2	-5.4	-2.5	-0.6
<b>Net profit</b>	<b>-7.0</b>	<b>-5.3</b>	<b>-2.5</b>	<b>-0.6</b>
Notional earn	0.0	0.0	0.0	0.0
Pref/conv div	0.0	0.0	0.0	0.0
<b>Profit for EPS</b>	<b>-7.0</b>	<b>-5.3</b>	<b>-2.5</b>	<b>-0.6</b>
Diluted shrs (m)	504	504	522	522
<b>Diluted EPS (c)</b>	<b>-1.4</b>	<b>-1.0</b>	<b>-0.5</b>	<b>-0.1</b>

Returns				
	FY16A	FY17F	FY18F	FY19F
ROE (%)	-34	-5	48	53
ROIC (%)	-53	-19	28	49
Incremental ROE	-88	-173	649	64
Incremental ROIC	54	<-999	216	225

Key assumptions							
Year-end June (AUD)	FY13A	FY14A	FY15A	FY16A	FY17F	FY18F	FY19F
Revenue growth (%)	-87.2	209.6	80.5	37.2	57.1	44.0	38.6
EBIT growth (%)	83.1	-27.6	-46.5	16.8	-88.6	-1,164.0	66.8
NPAT growth (%)	36.6	-30.9	-57.0	13.8	-88.9	-1,222.8	66.5
EPS growth (%)	-6.5	-56.4	-70.2	-0.8	-89.3	-1,222.8	66.5
EBIT/sales (%)	-440.8	-103.2	-30.6	-26.0	-1.9	13.9	16.7
Tax rate (%)	0.0	-0.5	-0.9	1.7	0.0	0.0	0.0
ROA (%)	-59.8	-60.0	-25.1	-24.8	-2.9	24.0	27.5
ROE (%)	-287.9	-1,898.6	-33.0	-38.8	-4.9	43.8	47.9
PAD - Smart Lockers sales	1.6	5.4	12.4	18.0	29.0	42.4	59.7
IXP - Data Centres sales	1.2	2.4	1.7	2.2	2.7	3.6	4.4
PAD - sales growth (%)	n.a.	237.5	129.6	45.2	60.8	46.5	40.7
IXP - sales growth (%)	n.a.	100.0	-28.0	27.4	22.2	32.3	23.6

Profit and loss (\$m)							
Year-end June (AUD)	FY13A	FY14A	FY15A	FY16A	FY17F	FY18F	FY19F
Sales revenue	2.7	8.4	15.1	20.8	32.7	47.0	65.2
EBITDA	-11.8	-8.5	-4.5	-5.3	-0.1	7.0	11.4
Depn & amort	1.0	1.1	1.6	1.9	2.4	2.4	2.4
<b>EBIT</b>	<b>-12.9</b>	<b>-9.7</b>	<b>-6.0</b>	<b>-7.2</b>	<b>-2.5</b>	<b>4.7</b>	<b>9.0</b>
Net interest expense	3.6	2.1	-0.1	0.0	0.0	0.0	0.0
Tax	0.0	0.1	0.1	-0.1	0.0	0.0	0.0
Minorities/pref divs	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Equity accounted NPAT	0.0	0.0	0.0	0.0	0.0	0.0	0.0
<b>Net profit (pre-sig items)</b>	<b>-16.5</b>	<b>-11.8</b>	<b>-6.0</b>	<b>-7.0</b>	<b>-2.5</b>	<b>4.7</b>	<b>9.0</b>
Abns/exts/signif	0.0	0.0	0.0	0.0	0.0	0.0	0.0
<b>Reported net profit</b>	<b>-16.5</b>	<b>-11.8</b>	<b>-6.0</b>	<b>-7.0</b>	<b>-2.5</b>	<b>4.7</b>	<b>9.0</b>

Cash flow (\$m)							
Year-end June (AUD)	FY13A	FY14A	FY15A	FY16A	FY17F	FY18F	FY19F
EBITDA	-11.8	-8.5	-4.5	-5.3	-0.1	7.0	11.4
Interest & tax	-3.6	-2.1	0.0	0.1	0.0	0.0	0.0
Working cap/other	10.2	4.0	0.7	3.9	-3.1	-1.6	-0.9
<b>Operating cash flow</b>	<b>-5.2</b>	<b>-6.7</b>	<b>-3.8</b>	<b>-1.3</b>	<b>-3.2</b>	<b>5.4</b>	<b>10.5</b>
Maintenance capex	0.0	0.0	0.0	0.0	0.0	0.0	0.0
<b>Free cash flow</b>	<b>-5.2</b>	<b>-6.7</b>	<b>-3.8</b>	<b>-1.3</b>	<b>-3.2</b>	<b>5.4</b>	<b>10.5</b>
Dividends paid	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Growth capex	-0.7	-1.5	-1.9	-2.0	-2.2	-2.4	-2.5
Invest/disposals	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Other inv flows	9.2	0.4	0.0	0.0	0.0	0.0	0.0
<b>Cash flow pre-financing</b>	<b>3.2</b>	<b>-7.8</b>	<b>-5.7</b>	<b>-3.3</b>	<b>-5.5</b>	<b>3.0</b>	<b>8.0</b>
Funded by equity	6.1	6.7	9.0	4.0	0.0	0.0	0.0
Funded by debt	-1.2	0.0	0.0	0.0	0.0	0.0	0.0
Funded by cash	-8.1	1.1	-3.3	-0.7	5.5	-3.0	-8.0

Balance sheet summary (\$m)							
Year-end June (AUD)	FY13A	FY14A	FY15A	FY16A	FY17F	FY18F	FY19F
Cash	2.6	2.6	5.7	6.1	0.6	3.7	11.7
Current receivables	2.9	2.9	5.0	6.1	9.0	12.9	17.9
Current inventories	0.4	0.4	0.3	0.8	1.1	1.5	2.0
Net PPE	1.2	1.2	0.8	0.5	0.5	0.5	0.5
Investments	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Intangibles/capitalised	7.3	7.3	9.3	9.5	9.4	9.4	9.5
Other	0.5	0.5	0.3	0.3	0.3	0.4	0.5
<b>Total assets</b>	<b>14.9</b>	<b>14.9</b>	<b>21.5</b>	<b>23.4</b>	<b>20.9</b>	<b>28.4</b>	<b>42.0</b>
Current payables	2.0	2.0	4.2	9.0	9.0	11.6	16.1
Total debt	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Other liabilities	0.5	0.5	0.4	0.5	0.5	0.7	0.7
<b>Total liabilities</b>	<b>2.4</b>	<b>2.4</b>	<b>4.6</b>	<b>9.5</b>	<b>9.5</b>	<b>12.3</b>	<b>16.8</b>
Minorities/convertibles	0.0	0.0	0.0	0.0	0.0	0.0	0.0
<b>Shareholder equity</b>	<b>12.5</b>	<b>12.5</b>	<b>16.8</b>	<b>13.9</b>	<b>11.4</b>	<b>16.1</b>	<b>25.1</b>
<b>Total funds employed</b>	<b>12.5</b>	<b>12.5</b>	<b>16.8</b>	<b>13.9</b>	<b>11.4</b>	<b>16.1</b>	<b>25.1</b>

## TZ (TZL)

### Business description

TZ Limited (TZL) is an emerging technology company which owns an internally developed smart locking system based on shape memory alloy (SMAs). The system includes embedded intelligence at the lock level, networking hardware and software for the management, control and monitoring of assets. The embedded intelligence is a key point of differentiation with alternative locking systems and provides the customer with two-way information from the lock level. The smart locking system has multiple applications with management focusing on commercialising the technology in the smart locker (postal and corporate) and data centre verticals.

### Investment thesis

Positioned to capitalise on e-commerce growth: TZ is commercialising its proprietary locking system in the smart locker and data centre verticals. These industries are experiencing solid growth due to the shift towards online shopping and cloud computing.

Recurring revenue stream: The TZ revenue model consists of both upfront fees and recurring revenue from software and service maintenance fees, driven by an expanding installed base of lockers.

High switching costs: The back-end integration process is customised according to customer's requirements. Changing locking hardware and associated software would be time-consuming, expensive and increase operational risk for customers. This leads to sticky long-term customers.

### Revenue drivers

- Expansion of existing contracts
- Winning new contracts
- Entering new verticals

### Margin drivers

- Software and service maintenance fees generate higher margins
- Shifting manufacturing to China driving higher gross margins

### Key issues/catalysts

- Monetising the pipeline
- Contract wins
- Licensing agreement

### Risk to view

- Loss of customer contracts
- Competition
- Cash control and cost containment

### Balance sheet

FY16:

- Net cash: \$6.1m
- Intangibles: \$9.5m
- Inventories: \$0.8m

### Board

- Mr Mark Bouris (Chairman and Executive Director)
- Mr Kenneth Ting (Executive Director)
- Mr Paul Casey (Non-Executive Director)

### Management

- Mr Brett Henley (CFO)
- Mr John Wilson (co-founder)

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