Wilson HTM
EQUITIES RESEARCH

12 October 2015

TZ (TZL)

BUY HOLD SELL

Financial results

Singapore Post becoming a regional player

TZL is well positioned to capitalize on Singapore Post's regional expansion into Australia after selling their ADAM locker network. The acquisition gives Singapore Post a small footprint and more importantly access to sites in Australia to grow the network. TZL also reported their FY15 financial results in August which contained few surprises. We remain positive about the outlook for TZL and expect further locker orders in the postal and corporate segment over the next 12 months. We upgrade our revenue forecasts by between 6.5% and 8.7% and retain our share price target of 16 cps and BUY rating.

12-mth target price (AUD)	**$0.16**
Share price @ 09-Oct-15 (AUD)	$0.08
Forecast 12-mth capital return	110.5%
Forecast 12-mth dividend yield	0.0%
12-mth total shareholder return	**110.5%**
Market cap	$35m
Enterprise value	$34m
Shares on issue	466m
Sold short	1.4
ASX 300 weight	0.0%
Median turnover/day	$0.0m

Joseph Michael, CFA
joseph.michael@wilsonhtm.com.au
Tel. 02 8247 3101

Key points

Singapore Post acquires ADAM locker network. TZL announced an agreement to sell the ADAM locker network in Australia to Couriers Please (a subsidiary of Singapore Post) with completion expected during October 2015. The deal sends a positive signal of Singapore Post's intention to build a logistics network in Australia with TZL smart lockers being part of the solution. Management estimates the Australian market would require about 1,000 locker banks to reach optimal coverage.

Moving to a working capital light business model. Management are actively seeking licensing arrangements in the US Corporate Postal management sector, which could increase sales capability, reduce working capital requirements and operating expenses.

FY15 result. Revenue of $15.2m increased 80% on pcp, driven by 130% revenue growth in PAD which was partially offset by IXP which declined by 28%. No quantitative guidance was provided.

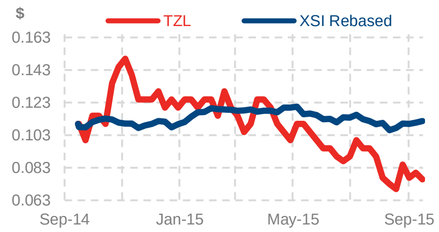
Forecasts. We upgrade our sales revenue forecasts by between 6.5% and 8.7% from FY16 to FY18 to reflect Singapore Post expanding their network in Australia. However, we moderate the upgrade by increasing our cost assumptions to reflect the delay in the shifting of manufacturing capability to China until early CY16.

Valuation. Our 12 month price target of $0.16 per share is unchanged and remains in line with our base case DCF valuation, using a WACC of 12.2%

Risks and catalysts

Risks: (i) Loss of customer contracts; (ii) competition; and (iii) cash control and cost containment. Catalysts: (i) Monetising the pipeline; (ii) contract wins; (iii) expansion into new segments; and (iv) licensing agreements.

12-mth share price performance



	1-mth	6-mth	12-mth
Abs return (%)	5.6	-27.6	-30.9
Rel return (%)	2.8	-21.9	-32.5

Year-end June (AUD)	FY14A	FY15A	FY16F	FY17F	FY18F
NPAT rep ($m)	-11.8	-6.0	-2.8	1.5	6.2
NPAT norm ($m)	-10.8	-4.6	-1.8	2.5	7.2
Consensus NPAT ($m)			0.0	2.1	
EPS norm (cps)	-3.5	-1.1	-0.4	0.5	1.5
EPS growth (%)	56.4	70.2	64.0	233.7	194.3
P/E norm (x)	-2.1	-7.2	-20.0	15.0	5.1
EV/EBITDA (x)	-4.0	-7.6	-24.8	11.3	4.3
FCF yield (%)	-18.9	-10.8	-6.9	11.4	14.9
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, WHTM estimates, S&P Capital IQ

KEY CHANGES		31-Jul	After	Var %
NPAT:	**FY16F**	-0.8	-1.8	>99%
norm	**FY17F**	3.1	2.5	-19.6%
($m)	**FY18F**	6.7	7.2	8.6%
EPS:	**FY16F**	-0.2	-0.4	>99%
norm	**FY17F**	0.6	0.5	-19.6%
(cps)	**FY18F**	1.4	1.5	8.6%
DPS:	**FY16F**	0.0	0.0	0.0%
(cps)	**FY17F**	0.0	0.0	0.0%
	FY18F	0.0	0.0	0.0%
Price target:		0.16	0.16	-0.7%
Rating:		**BUY**	**BUY**	

PRICE TARGET

	Price Target
Enterprise Value	**67.00**
Net Debt (cash)	-5.69
Equity Value:	**72.69**
Shares on issue:	465.60
A$ / sh	**0.16**
WACC (%)	12.2
Terminal Growth (%)	3.0

KEY ASSUMPTIONS

Year-end June (AUD)	FY13A	FY14A	FY15A	FY16F	FY17F	FY18F	FY19F
Revenue Growth (%)	-87.2	209.6	80.5	71.8	51.3	46.1	35.0
EBIT Growth (%)	83.1	-27.6	-46.5	-59.1	-227.1	198.7	54.8
NPAT Growth (%)	36.6	-30.9	-57.0	-60.2	-233.7	194.3	54.4
EPS Growth (%)	-6.5	-56.4	-70.2	-64.0	-233.7	194.3	54.4
EBIT / Sales (%)	-440.8	-103.2	-30.6	-7.3	6.1	12.5	14.3
Tax Rate (%)	0.0	-0.5	-0.9	0.0	0.0	0.0	0.0
ROA (%)	-59.8	-60.0	-25.1	-8.7	9.5	20.6	22.8
ROE (%)	-287.9	-1,898.6	-33.0	-12.4	16.3	35.6	38.2
PAD - Smart Lockers Sales	1.6	5.4	12.4	23.1	35.8	53.0	72.2
IXP - Data Centres Sales	1.2	2.4	1.7	2.1	2.8	3.7	4.5
PAD - Sales Growth (%)	n.a.	237.5	129.6	86.5	54.8	48.0	36.2
IXP - Sales Growth (%)	n.a.	100.0	-28.0	24.0	29.5	32.3	23.6

INTERIMS ($m)

Half-year (AUD)	Dec 14	Jun 15	Dec 15	Jun 16
	1HA	2HA	1HE	2HE
Sales revenue	7.6	7.5	10.2	15.8
EBITDA	-3.0	-1.4	-0.9	-0.4
EBIT	-3.7	-2.3	-1.8	-1.1
Net profit	**-3.1**	**-1.5**	**-1.3**	**-0.6**
Norm EPS	**-0.8**	**-0.3**	**-0.3**	**-0.1**
EBIT/sales (%)	-48.5	-31.1	-17.2	-6.8
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)	FY15A	FY16F	FY17F
Net debt	-5.7	-1.5	-2.9
Net debt/equity (%)	<0	<0	<0
Net debt/EV (%)	**<0**	**<0**	**<0**
Current ratio (x)	4.8	2.8	2.5
Interest cover (x)	>99	54.0	<0
Adj cash int cover (x)	**76.1**	**47.4**	**<0**
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)

	FY15A		FY16F	
	Rep	Norm	Rep	Norm
Sales revenue	15	15	26	26
EBIT	-6.0	-4.6	-2.8	-1.9
Net profit	**-6.0**	**-4.6**	**-2.8**	**-1.8**
Notional earn	0.0	0.0	0.0	0.0
Pref/conv div	0.0	0.0	0.0	0.0
Profit for EPS	**-6.0**	**-4.6**	**-2.8**	**-1.8**
Diluted shrs (m)	439	439	486	486
Diluted EPS (c)	**-1.4**	**-1.1**	**-0.6**	**-0.4**

RETURNS

	FY15A	FY16F	FY17F	FY18F
ROE (%)	-31.6	-11.8	16.4	38.4
ROIC (%)	-40.3	-16.6	7.6	28.5
Incremental ROE	280.6	297.8	-826.4	125.7
Incremental ROIC	422.0	127.6	335.5	159.7

PROFIT AND LOSS ($m)

Year-end June (AUD)	FY13A	FY14A	FY15A	FY16F	FY17F	FY18F	FY19F
Sales revenue	2.7	8.4	15.1	26.0	39.4	57.5	77.6
EBITDA	-11.8	-8.5	-4.5	-1.4	3.0	8.0	12.0
Depn & amort	1.0	1.1	1.6	1.5	1.6	1.9	2.1
EBIT	**-12.9**	**-9.7**	**-6.0**	**-2.8**	**1.4**	**6.1**	**9.9**
Net interest expense	3.6	2.1	-0.1	-0.1	-0.1	-0.1	-0.1
Tax	0.0	0.1	0.1	0.0	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
Net profit (pre-sig items)	**-16.5**	**-11.8**	**-6.0**	**-2.8**	**1.5**	**6.2**	**10.0**
Abns/exts/signif	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Reported net profit	**-16.5**	**-11.8**	**-6.0**	**-2.8**	**1.5**	**6.2**	**10.0**

CASH FLOW ($m)

Year-end June (AUD)	FY13A	FY14A	FY15A	FY16F	FY17F	FY18F	FY19F
EBITDA	-11.8	-8.5	-4.5	-1.4	3.0	8.0	12.0
Interest & tax	-3.6	-2.1	0.0	0.1	0.1	0.1	0.1
Working cap/other	10.2	4.0	0.7	-1.1	1.0	-2.8	-5.1
Operating cash flow	**-5.2**	**-6.7**	**-3.8**	**-2.4**	**4.0**	**5.3**	**7.0**
Maintenance capex	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Free cash flow	**-5.2**	**-6.7**	**-3.8**	**-2.4**	**4.0**	**5.3**	**7.0**
Dividends paid	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Growth capex	-0.7	-1.5	-1.9	-2.2	-2.7	-3.2	-3.7
Invest/disposals	0.0	0.0	0.0	0.5	0.0	0.0	0.0
Other inv flows	9.2	0.4	0.0	0.0	0.0	0.0	0.0
Cash flow pre-financing	**3.2**	**-7.8**	**-5.7**	**-4.2**	**1.3**	**2.1**	**3.3**
Funded by equity	6.1	6.7	9.0	0.0	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	4.2	-1.3	-2.1	-3.3

BALANCE SHEET SUMMARY ($m)

Year-end June (AUD)	FY13A	FY14A	FY15A	FY16F	FY17F	FY18F	FY19F
Cash	2.6	2.6	5.7	1.5	2.9	4.9	8.2
Current receivables	2.9	2.9	5.0	6.5	7.8	12.9	19.5
Current inventories	0.4	0.4	0.3	3.6	3.5	5.6	9.1
Net PPE	1.2	1.2	0.8	0.5	0.8	1.0	1.1
Investments	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Intangibles/capitalised	7.3	7.3	9.3	9.8	10.7	11.8	13.3
Other	0.5	0.5	0.3	0.6	0.6	0.6	0.6
Total assets	**14.9**	**14.9**	**21.5**	**22.6**	**26.3**	**36.9**	**51.8**
Current payables	2.0	2.0	4.2	7.8	10.0	14.5	19.5
Total debt	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Other liabilities	0.5	0.5	0.4	0.4	0.4	0.4	0.4
Total liabilities	**2.4**	**2.4**	**4.6**	**8.2**	**10.5**	**14.9**	**19.9**
Minorities/convertibles	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Shareholder equity	**12.5**	**12.5**	**16.8**	**14.3**	**15.8**	**21.9**	**31.9**
Total funds employed	**12.5**	**12.5**	**16.8**	**14.3**	**15.8**	**21.9**	**31.9**

Singapore Post expanding in Australia

TZL announced an agreement to sell the Australian-based ADAM Locker network in August 2015 to Couriers Please (a fully owned subsidiary of Singapore Post). The deal is part of Singapore Post's expansion in the Australian parcel delivery market with completion expected during October 2015.

This deal is consistent with the company's objective of divesting the ADAM network. More importantly the sale sends a positive signal on Singapore Post's intention to build a logistics network in Australia, with TZL smart lockers being part of the solution. Management estimates the Australian market would require about 1,000 locker banks to reach optimal coverage.

A successful locker bank network requires sites, lockers and parcel volume. Singapore Post already had access to TZL Lockers and Couriers Please's parcel volume. This deal is the final piece with access to sites around Australia including existing agreements with Westfield, Secured Parking, BP and Mirvac.

We expect orders for 10 locker banks per month, with 200 locker banks to be installed by December 2016. The small, continuous orders, in conjunction with the negotiated 30% upfront payment, will minimise the impact on working capital requirements.

KPMG increasing day locker network

In September, 2015 TZL announced a multi-million dollar contract for the supply of employee day lockers to KPMG Australia through a distribution partner. The lockers are to be deployed immediately at KPMG's offices at Barangaroo, Sydney and Collins Street, Melbourne. KPMG have 14 locations across Australia and have initially deployed locker banks at two sites in Adelaide and Sydney.

Accessing new sales channels

TZL are actively seeking licensing arrangements in the US Corporate Postal management sector. Licensing arrangements should improve their sales reach, decrease working capital intensity with the requirement of upfront payments and reduce operating costs as the channel partner will provide the after sales service and support. Importantly, TZL would continue to earn an annuity revenue stream from the software maintenance.

TZL is currently in discussions with market-leaders in the US Corporate Postal market including Ricoh, Novitex and SPS. These providers of mail management systems would market TZL lockers to their enterprise customers.

For example, Ricoh has about 50% market share and over 2,700 enterprise customers which would provide TZL with an option for much faster and higher penetration of the US corporate sector.

FY15 result review

On August 31 2015, TZL released their FY15 financial results. A summary of the result is provided in the table below. With the result pre-released in their 4C in late July, the FY15 accounts contained few surprises.

Table 1: FY15 result summary

Results summary							
$m	FY14a	FY15a	% Chg	WHTMe	% var	FY16e	% Chg
Sales Revenue	**8.4**	**15.1**	***80.5%***	**15.1**	***0.1%***	**26.0**	***71.8%***
PAD	5.4	12.4	*130.0%*	12.7	*-2.0%*	25.0	*101.6%*
IXP	2.4	1.7	*-28.0%*	1.7	*0.0%*	2.1	*24.0%*
Infinity	0.7	0.7	*2.9%*	0.7	*0.0%*	0.8	*5.0%*
Gross Profit	5.7	6.7	*17.7%*	6.7	*0.0%*	13.7	*103.7%*
Margin	*68.0%*	*44.3%*	*-34.8%*	*44.4%*	*-0.2%*	*52.5%*	*18.6%*
Operating expenses	14.2	11.2	*-21.4%*	9.4	*19.4%*	15.0	*34.5%*
EBITDA	**-8.5**	**-4.5**	***-47.6%***	**-2.6**	***68.7%***	**-1.4**	***-69.5%***
Margin	*-101.6%*	*-29.5%*	*-71.0%*	*-17.5%*	*68.5%*	*-5.2%*	*-82.2%*
EBIT	-9.7	-6.0	*-37.6%*	-4.1	*48.1%*	-2.7	*-54.4%*
NPAT (normalised)	**-11.8**	**-6.0**	***-48.8%***	**-4.0**	***49.4%***	**-2.7**	***-55.4%***
EPS (cps)	**-4.4**	**-1.6**	***-64.2%***	**-1.0**	***50.8%***	**-0.6**	***-63.2%***

Source: TZL & WHTM Research.

Key points

Revenue – TZL reported revenue of $15.1m (+80.5% pcp) which was at the bottom end of the company's recently revised guidance of $15.0m to $16.0m and in line with WHTMe.

Packaged Asset Delivery (80% FY15 revenue) – The Smart Locker division continues to be the growth driver of the business achieving revenue of $12.4m (+130%), which was in line with our estimates. The strong performance was driven by the corporate sector (Day Lockers and Mail Accountability Lockers). There is a backlog of over $5.5m in hand for Day Lockers (Westpac and KPMG).

Infrastructure Protection (11% FY15 revenue) – The Data Centre rack lock division result was disappointing with revenue of $1.7m (-28% pcp). Revenue was impacted by a delay in infrastructure project schedules. However, we expect to see revenue growth resume in FY16 as these projects begin to roll out.

Chart 1: PAD revenue

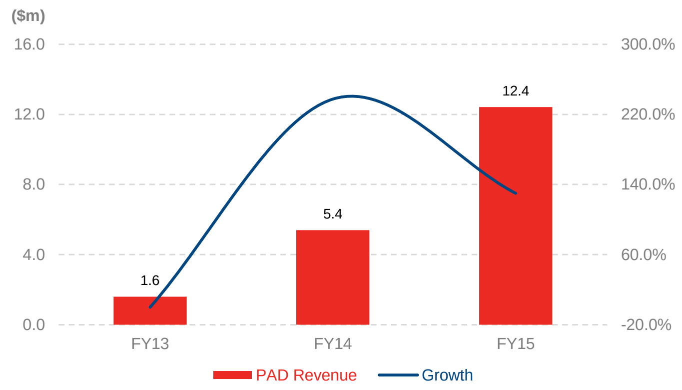
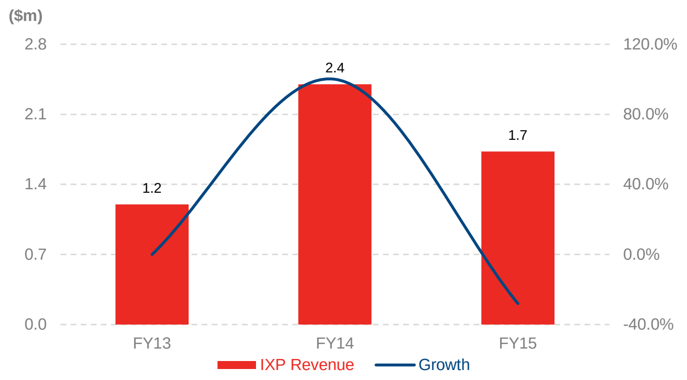


Chart 2: IXP revenue



Source: TZL & WHTM Research.

Gross profit – TZL achieved gross profit of $6.7m and a GP of 44%. There has been a delay in moving the manufacturing facilities to China, however once this is fully implemented we expect margins to increase to over 60%.

EBITDA – The company reported EBITDA of -$4.9m which was lower than our estimate of -$2.6m due to higher operating expenses.

Cash flow – Operating cash flow of -$4.0m was impacted in the 4QFY15 where strong sales were experienced, but collection (i.e. payment) will not be made until 1QFY16. The cash balance was $5.7m as at June 30 which increased by $3.0m on the pcp due to an equity raising of $8.7m in February.

Balance Sheet – The balance sheet remains comfortable with no borrowings. We note receivables increased from $2.7m to $5.0m which is consistent with the timing differences between order delivery and cash collection.

Forecasts and valuation

A summary of the changes to our forecasts are provided in the table below.

Forecast changes	FY16e	FY17e	FY18e
Revenue - Before	23.9	37.7	54.0
Revenue - After	26.0	39.4	57.5
% Change	*8.8%*	*4.5%*	*6.5%*
EBITDA - Before	0.0	3.8	7.5
EBITDA - After	-1.4	3.0	8.0
% Change	*n.m.*	*-21.7%*	*6.2%*
NPAT - Before	-1.6	2.1	5.7
NPAT - After	-2.7	1.5	6.2
% Change	*64.2%*	*-27.8%*	*9.3%*

Source: TZL & WHTM Research.

Our changes are driven by the following:

- **Sales revenue –** We have upgraded our revenue numbers on the back of Singapore Post's expansion into Australia.
- **Costs –** We have increased manufacturing costs due to delays in transitioning the Chinese manufacturing facilities.

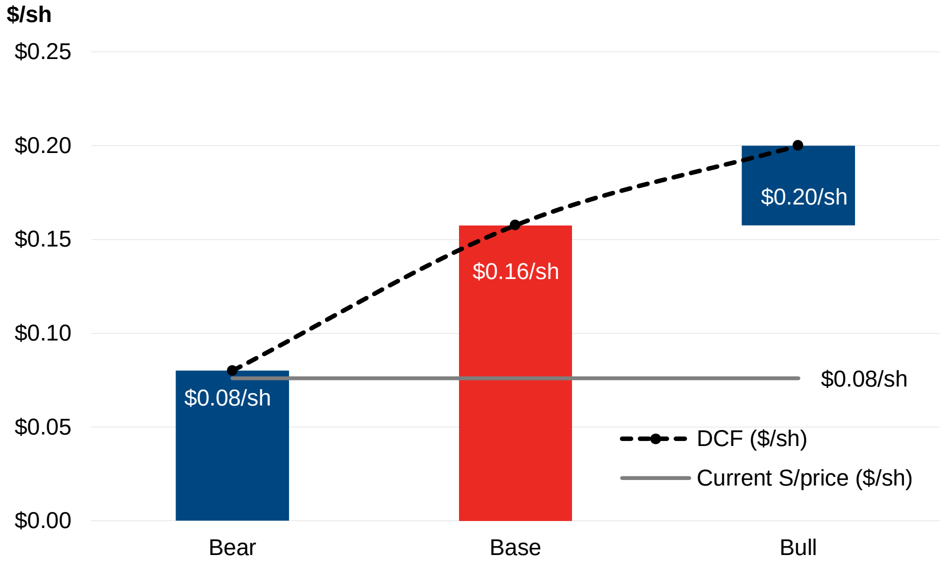
Table 2: DCF

Discounted Cash Flow - Details				
DCF Inputs		**DCF**		
Risk free rate	4.5%	Enterprise Value	$m	67.6
Market risk premium	5.0%	Net Debt (cash)	$m	-5.7
Beta	1.70x	Equity Value:	$m	73.3
Cost of equity	13.0%			
Cost of debt	7.0%	Shares on issue:	m	465.6
Target Gearing (D/D+E)	10%	**Value per share**	**$**	**0.16**
Tax rate	30.0%			
TGR	3.0%			
WACC	**12.2%**			

Source: TZL & WHTM Research.

Our DCF valuation and earnings forecasts are highly sensitive to a number of key assumptions including revenue and cost assumptions. Given the timing and value of contract wins is difficult to forecast, and as such we provide three valuations based on different scenarios below.

Chart 3: Bull-Base-Bear Scenario Analysis



Source: TZL & WHTM Research.

TZ Limited (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 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 have 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 & cost containment

BALANCE SHEET

- No debt
- Intangibles: $9.3m
- Inventories: $0.3m

BOARD

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

MANAGEMENT

- Mr Craig Holden (CFO)
- Mr John Wilson (co-founder)

CONTACT DETAILS

Address: Level 11, 1 Chifley Square, Sydney, NSW Australia 2000
Phone: +61 2 9222 8890
Website: www.tz.net

Disclosures and disclaimers

Recommendation structure and other definitions

Definitions at http://www.wilsonhtm.com.au/Disclosures

Disclaimer

While Wilson HTM Ltd believes the information contained in this communication is based on reliable information, no warranty is given as to its accuracy and persons relying on this information do so at their own risk. To the extent permitted by law Wilson HTM Ltd disclaims all liability to any person relying on the information contained in this communication in respect of any loss or damage (including consequential loss or damage) however caused, which may be suffered or arise directly or indirectly in respect of such information. Any projections contained in this communication are estimates only. Such projections are subject to market influences and contingent upon matters outside the control of Wilson HTM Ltd and therefore may not be realised in the future.

The advice contained in this document is general advice. It has been prepared without taking account of any person's objectives, financial situation or needs and because of that, any person should, before acting on the advice, consider the appropriateness of the advice, having regard to the client's objectives, financial situation and needs. Those acting upon such information without first consulting one of Wilson HTM Ltd investment advisors do so entirely at their own risk. This report does not constitute an offer or invitation to purchase any securities and should not be relied upon in connection with any contract or commitment whatsoever. If the advice relates to the acquisition, or possible acquisition, of a particular financial product – the client should obtain a Product Disclosure Statement relating to the product and consider the Statement before making any decision about whether to acquire the product. This communication is not to be disclosed in whole or part or used by any other party without Wilson HTM Ltd's prior written consent.

Disclosure of interest. TZ Limited

The Directors of Wilson HTM Ltd advise that at the date of this report they and their associates have relevant interests in TZ Limited. They also advise that Wilson HTM Ltd and Wilson HTM Corporate Finance Ltd A.B.N. 65 057 547 323 and their associates have received and may receive commissions or fees from TZ Limited in relation to advice or dealings in securities. Some or all of Wilson HTM Ltd authorised representatives may be remunerated wholly or partly by way of commission.

In producing research reports, members of Wilson HTM Ltd Research may attend site visits and other meetings hosted by the issuers the subject of its research reports. In some instances the costs of such site visits or meetings may be met in part or in whole by the issuers concerned if Wilson HTM Ltd considers it is appropriate and reasonable in the specific circumstances relating to the site visit or meeting.

Please see disclosures at http://www.wilsonhtm.com.au/Disclosures. Disclosures applicable to companies included in this report can be found in the latest relevant published research.

Wilson HTM national offices

BRISBANE Ph: 07 3212 1333	**SYDNEY** Ph: 02 8247 6600	**MELBOURNE** Ph: 03 9640 3888
GOLD COAST Ph: 07 5509 5500	**DALBY** Ph: 07 4660 8000	**HERVEY BAY** Ph: 07 4197 1600

Website: www.wilsonhtm.com.au