

Building momentum

TZ Limited (TZL) has reported a record-breaking quarterly result, with sales of \$7.4m (+48% on the pcp). Operating cash flows of -\$1.1m were slightly weaker than expectations; however, the cash balance was boosted post reporting date by \$2.75m in late payments. In our view, the cash flow conversion cycle is reaching an inflection point as new contracts are being signed with upfront cash payments. We continue to forecast the company reaching positive operating cash flow in 1HFY17. We remain positive about the outlook for TZ and expect further locker orders in the postal and corporate segment over the next 12 months. We retain a BUY rating on TZ and target price of \$0.14/sh.

Key points

Pipeline conversion beginning to materialise. TZ reported sales of \$10.4m (WHTMe: \$8.6m) in 1HFY16, representing growth of 34.6% on the pcp. Sales growth was underpinned by a strong performance in the Postal and Logistics division and continued momentum in the Australian corporate sector.

Cash position reaching inflection point. In the second quarter, cash declined by \$1.6m for the quarter to \$2.2m. Subsequent to that, in January 2016 TZ received \$2.75m in cash from late payments, making a significant positive impact on the cash balance. In our view, the working capital intensity of the business is reaching an inflection point with new contracts being signed with up to 50% cash upfront payments, compared with traditional contracts where cash was received post installation of the order. We continue to forecast the company reaching positive operating cash flow in 1HFY17.

Outlook increasingly positive. With a pipeline of more than \$10m from purchase orders in hand and contracts in the final stages, the outlook for TZ is increasingly positive. We believe that the majority of this pipeline is underpinned by two material contracts, which the company expects to sign in the near term.

Forecasts and valuation. We have increased first-half revenue but maintained our full-year revenue forecast of \$24.5m. We will wait for the interim results in mid-February and an update on anticipated contracts including margins before we review our forecasts. Valuation and target price are unchanged at \$0.14/sh.

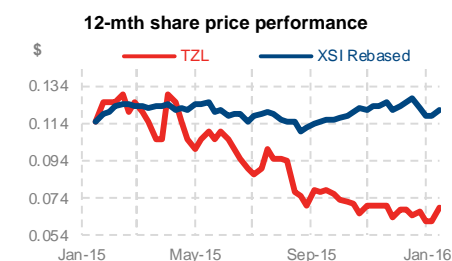
Risks and catalysts

Risks. Loss of customer contracts; competition; and cash control and cost containment. **Catalysts.** Monetising the pipeline; contract wins; expansion into new segments; and licensing agreements.

12-mth target price (AUD)	\$0.14
Share price @ 27-Jan-16 (AUD)	\$0.07
Forecast 12-mth capital return	102.9%
Forecast 12-mth dividend yield	0.0%
12-mth total shareholder return	102.9%

Market cap	\$32m
Enterprise value	\$26m
Shares on issue	466m
Sold short	1.4%
ASX 300 weight	0.0%
Median turnover/day	\$0.0m

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	1-mth	6-mth	12-mth
Abs return (%)	1.5	-25.0	-40.0
Rel return (%)	5.1	-27.1	-44.9

Year-end June (AUD)	FY14A	FY15A	FY16F	FY17F	FY18F
NPAT rep (\$m)	-11.8	-6.0	-2.7	1.4	5.7
NPAT norm (\$m)	-10.8	-4.6	-1.8	2.4	6.8
Consensus NPAT (\$m)			1.6	1.4	5.7
EPS norm (cps)	-3.5	-1.1	-0.4	0.4	1.3
EPS growth (%)	56.4	70.2	66.8	224.2	188.1
P/E norm (x)	-1.9	-6.5	-19.7	15.8	5.5
EV/EBITDA (x)	-3.1	-5.9	-19.8	9.1	3.5
FCF yield (%)	-20.8	-11.9	-6.7	11.5	15.8
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	30-Oct	After	Var %
NPAT: FY16F	-1.7	-1.8	N/A
norm FY17F	2.4	2.4	0.0%
(\$m) FY18F	6.8	6.8	0.0%
EPS: FY16F	-0.3	-0.4	N/A
norm FY17F	0.4	0.4	0.0%
(cps) FY18F	1.3	1.3	0.0%
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:	0.14	0.14	0.0%
Rating:	BUY	BUY	



PRICE TARGET

	Price target
Enterprise value	67.84
Net debt (cash)	-5.69
Equity value:	73.53
Shares on issue:	524.90
A\$/sh	0.14
WACC (%)	12.2
Terminal growth (%)	2.5

INTERIMS (\$m)

Half-year (AUD)	Dec 14	Jun 15	Dec 15	Jun 16
	1HA	2HA	1HE	2HE
Sales revenue	7.6	7.5	10.3	14.2
EBITDA	-3.0	-1.4	-0.9	-0.4
EBIT	-3.7	-2.3	-1.8	-1.0
Net profit	-3.1	-1.5	-1.3	-0.5
Norm EPS	-0.8	-0.3	-0.3	-0.1
EBIT/sales (%)	-48.5	-31.1	-17.1	-7.3
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)	FY15A	FY16F	FY17F
Net debt	-5.7	-5.8	-6.8
Net debt/equity (%)	<0	<0	<0
Net debt/EV (%)	<0	<0	<0
Current ratio (x)	4.8	3.5	2.9
Interest cover (x)	>99	53.3	<0
Adj cash int cover (x)	76.1	42.3	<0
Debt/cash flow (x)	0.0	0.0	0.0
Net debt (cash)/share (\$)	<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	24	24
EBIT	-6.0	-4.6	-2.8	-1.9
Net profit	-6.0	-4.6	-2.7	-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	-2.7	-1.8
Diluted shrs (m)	439	439	516	516
Diluted EPS (c)	-1.4	-1.1	-0.5	-0.4

RETURNS

	FY15A	FY16F	FY17F	FY18F
ROE (%)	-31.6	-10.3	12.5	30.2
ROIC (%)	-40.3	-16.5	7.2	26.8
Incremental ROE	280.6	95.6	287.7	125.5
Incremental ROIC	422.0	140.3	324.7	147.7

KEY ASSUMPTIONS

Year-end June (AUD)	FY13A	FY14A	FY15A	FY16F	FY17F	FY18F	FY19F
Revenue growth (%)	-87.2	209.6	80.5	61.6	51.8	46.8	42.8
EBIT growth (%)	83.1	-27.6	-46.5	-59.8	-224.6	192.5	64.8
NPAT growth (%)	36.6	-30.9	-57.0	-61.0	-231.3	188.1	64.3
EPS growth (%)	-6.5	-56.4	-70.2	-66.8	-224.2	188.1	64.3
EBIT/sales (%)	-440.8	-103.2	-30.6	-7.6	6.2	12.4	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	-8.0	8.1	17.9	21.3
ROE (%)	-287.9	-1,898.6	-33.0	-10.7	12.5	28.5	34.2
PAD - Smart Lockers sales	1.6	5.4	12.4	21.5	33.4	49.8	72.2
IXP - Data Centres sales	1.2	2.4	1.7	2.2	3.0	3.9	4.8
PAD - sales growth (%)	n.a.	237.5	129.6	73.2	55.5	49.1	45.0
IXP - sales growth (%)	n.a.	100.0	-28.0	29.8	31.7	32.3	23.6

PROFIT AND LOSS (\$m)

Year-end June (AUD)	FY13A	FY14A	FY15A	FY16F	FY17F	FY18F	FY19F
Sales revenue	2.7	8.4	15.1	24.5	37.1	54.5	77.9
EBITDA	-11.8	-8.5	-4.5	-1.3	2.9	7.6	12.1
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	1.3	5.7	10.0
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	-2.7	1.4	5.7	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	-2.7	1.4	5.7	10.0

CASH FLOW (\$m)

Year-end June (AUD)	FY13A	FY14A	FY15A	FY16F	FY17F	FY18F	FY19F
EBITDA	-11.8	-8.5	-4.5	-1.3	2.9	7.6	12.1
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	-0.9	0.7	-2.5	-5.3
Operating cash flow	-5.2	-6.7	-3.8	-2.2	3.7	5.1	6.9
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	-2.2	3.7	5.1	6.9
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	-3.9	1.0	1.9	3.1
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	-0.1	-1.0	-1.9	-3.1

BALANCE SHEET SUMMARY (\$m)

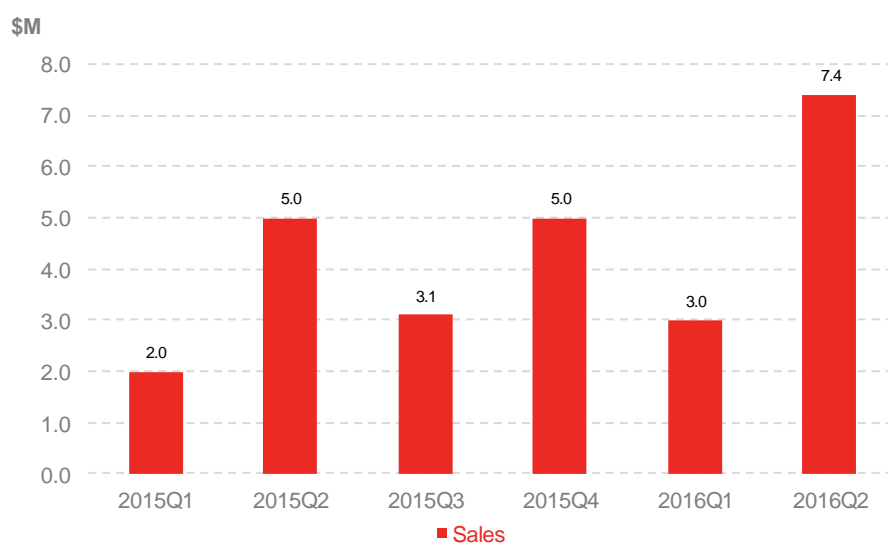
Year-end June (AUD)	FY13A	FY14A	FY15A	FY16F	FY17F	FY18F	FY19F
Cash	2.6	2.6	5.7	5.8	6.8	8.7	11.8
Current receivables	2.9	2.9	5.0	5.8	7.8	12.3	19.5
Current inventories	0.4	0.4	0.3	3.2	3.5	5.4	9.1
Net PPE	1.2	1.2	0.8	0.5	0.8	1.0	1.1
Investments	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Intangibles/capitalised	7.3	7.3	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	25.8	30.2	39.7	55.5
Current payables	2.0	2.0	4.2	7.0	10.1	13.8	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	7.4	10.5	14.2	20.0
Minorities/convertibles	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Shareholder equity	12.5	12.5	16.8	18.4	19.7	25.5	35.5
Total funds employed	12.5	12.5	16.8	18.4	19.7	25.5	35.5



Announcement highlights

- TZ reported sales of \$10.4m (WHTMe: \$8.6m) in 1HFY16, representing growth of 34.6% on the pcp.
- Sales growth was underpinned by a strong performance in the Postal and Logistics division and continued momentum in the Australian corporate sector, which offset a slightly weaker US corporate sector.
- In the second quarter, cash declined by \$1.6m for the quarter to \$2.2m. Subsequent to that, in January 2016 TZ received \$2.75m in cash from late payments.
- The outlook remains positive with a pipeline of more than \$10m from purchase orders in hand and contracts in the final steps of conversion.

Chart 1: TZL quarterly sales



2QFY16 sales of \$7.4m is a record-breaking quarter, demonstrating the building momentum in the business

Source: Company data

WHTM view

- The headline result of record quarterly sales of \$7.4m is positive and should build momentum into the second half of this year.
- A more interesting feature of the result was the receipt of \$2.75m in January 2016, which will make a significant positive impact on the balance sheet.
- We are positive on the outlook for TZ, with the company in the final stages of closing a material contract, which underpins the \$10m pipeline. Furthermore, the reseller agreement with a leading Manager Services Provider (which we believe to be Ricoh) has started to generate sales despite the official national launch planned for April 2016.
- In our view, the working capital intensity of the business is reaching an inflection point with new contracts being signed with up to 50% cash upfront payments, compared with traditional contracts where cash was received post installation of the order. We continue to forecast the company reaching positive operating cash flow in 1HFY17.



Forecast changes

Forecast changes			
	FY16e	FY17e	FY18e
Revenue - Before	24.5	37.1	54.5
Revenue - After	24.5	37.1	54.5
% Change	0.0%	0.0%	0.0%
EBITDA - Before	-1.2	2.9	7.6
EBITDA - After	-1.3	2.9	7.6
% Change	9.2%	0.0%	0.0%
NPAT Reported - Before	-2.6	1.4	5.7
NPAT Reported - After	-2.7	1.4	5.7
% Change	4.2%	0.0%	0.0%
EPS Reported (cps) - Before	-0.6	0.3	1.1
EPS Reported (cps) - After	-0.6	0.3	1.1
% Change	4.5%	0.0%	0.0%

Source: Company data & WHTM estimates



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 and 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

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Recommendation structure and other definitions

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

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