21 April 2016

TZ (TZL)

Wilson HTM EQUITIES RESEARCH

BUY HOLD SELL

Company update

Turning the corner

TZ Limited is turning the corner, with the company delivering on key strategic initiatives this year, including: 1) expanding its contract with SingPost; 2) signing a new supply order with a US logistics company for 300 postal lockers; and 3) most recently launching an American distribution agreement with Ricoh. In combination, TZ is signing new contracts with partial upfront cash payments, reducing the working capital intensity of the business. As a result of recent contracts with more favourable terms, we forecast the company reaching positive operating cash flow in 1H17. There is considerable potential if Ricoh can penetrate its customer base (more than 2,500) with TZ locker solutions. We retain our BUY rating and target price of $0.14/sh.

Key points

Ricoh deal. TZ recently launched a distribution agreement with Ricoh (signed in December 2015) for locker solutions in North and Latin America. Under the agreement, TZ will provide Ricoh with lockers for mail management and day lockers, which it will resell to its corporate, education and government customers. TZ is responsible for the supply, installation, commissioning and ongoing hardware and software maintenance of the lockers. Importantly, TZ will continue to receive annuity revenue as it will service the software.

WHTM view. In our view, the distribution agreement has a number of positives including: 1) the ability to achieve faster scale in the US corporate market; 2) economic benefits for all parties including cost savings for Ricoh; 3) enhancing Ricoh's service offering enabling it to maintain market share; 4) the potential to sign affiliate agreements with Ricoh for distribution in other continents; and 5) the potential to sign further distribution agreements with other players in the corporate postal management sector.

Forecasts. We have made minor changes to our forecasts. Our forecasts do not include any potential upside from SingPost expanding regionally, which in our view is likely.

Valuation. Our valuation is unchanged at $0.14/sh based on our discounted cash flow valuation, using a weighted average cost of capital of 13.5% and a terminal growth rate of 2.5%.

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 @ 20-Apr-16 (AUD)	$0.08
Forecast 12-mth capital return	68.7%
Forecast 12-mth dividend yield	0.0%
12-mth total shareholder return	**68.7%**

Market cap	$39m
Enterprise value	$38m
Shares on issue	466m
Sold short	1.4%
ASX 300 weight	0.0%
Median turnover/day	$0.0m

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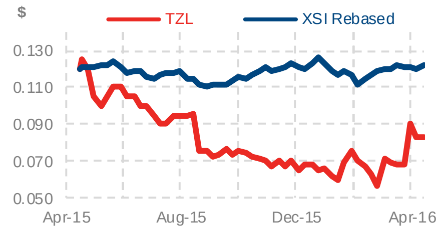
12-mth share price performance



	1-mth	6-mth	12-mth
Abs return (%)	20.3	15.3	-30.8
Rel return (%)	19.9	9.9	-32.9

Year-end June (AUD)	FY14A	FY15A	FY16F	FY17F	FY18F
NPAT rep ($m)	-11.8	-6.0	-4.1	0.2	6.1
NPAT norm ($m)	-10.8	-4.6	-2.8	1.2	7.2
Consensus NPAT ($m)			-4.1	0.2	5.8
EPS norm (cps)	-3.5	-1.1	-0.6	0.3	1.5
EPS growth (%)	56.4	70.2	43.7	144.1	487.4
P/E norm (x)	-2.3	-7.9	-14.0	31.7	5.4
EV/EBITDA (x)	-4.4	-8.4	-15.0	21.0	4.8
FCF yield (%)	-17.3	-9.9	-6.3	7.4	17.3
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		01-Apr	After	Var %
NPAT:	**FY16F**	-2.8	-2.8	N/A
norm	**FY17F**	1.2	1.2	0.1%
($m)	**FY18F**	6.9	7.2	3.5%
EPS:	**FY16F**	-0.6	-0.6	N/A
norm	**FY17F**	0.3	0.3	0.1%
(cps)	**FY18F**	1.5	1.5	3.5%
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	**61.92**
Net debt (cash)	-2.25
Equity value	**64.17**
Shares on issue	465.60
A$/sh	**0.14**
WACC (%)	13.5
Terminal growth (%)	2.5

INTERIMS ($m)

Half-year (AUD)	Dec 14	Jun 15	Dec 15	Jun 16
	1HA	2HA	1HA	2HE
Sales revenue	7.6	7.5	10.6	15.3
EBITDA	-3.0	-1.4	-2.4	-0.2
EBIT	-3.7	-2.3	-3.3	-0.9
Net profit	**-3.1**	**-1.5**	**-2.4**	**-0.4**
Norm EPS	**-0.8**	**-0.3**	**-0.5**	**-0.1**
EBIT/sales (%)	-48.5	-31.1	-31.1	-5.9
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	-1.0	-1.5
Net debt/equity (%)	<0	<0	<0
Net debt/EV (%)	**<0**	**<0**	**<0**
Current ratio (x)	4.8	2.6	2.2
Interest cover (x)	>99	81.6	<0
Adj cash int cover (x)	**76.1**	**49.1**	**<0**
Debt/cash flow (x)	0.0	0.0	0.0
Net debt (cash)/share ($)	<0	0.0	0.0
NTA/share ($)	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	-4.2	-2.9
Net profit	**-6.0**	**-4.6**	**-4.1**	**-2.8**
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**	**-4.1**	**-2.8**
Diluted shrs (m)	439	439	466	466
Diluted EPS (c)	**-1.4**	**-1.1**	**-0.9**	**-0.6**

RETURNS

	FY15A	FY16F	FY17F	FY18F
ROE (%)	-32	-19	10	46
ROIC (%)	-40	-26	1	35
Incremental ROE	281	<-999	-188	189
Incremental ROIC	422	156	>999	497

KEY ASSUMPTIONS

Year-end June (AUD)	FY13A	FY14A	FY15A	FY16F	FY17F	FY18F
Revenue growth (%)	-87.2	209.6	80.5	70.7	42.6	41.2
EBIT growth (%)	83.1	-27.6	-46.5	-38.2	-140.7	509.8
NPAT growth (%)	36.6	-30.9	-57.0	-40.3	-144.1	487.4
EPS growth (%)	-6.5	-56.4	-70.2	-43.7	-144.1	487.4
EBIT/sales (%)	-440.8	-103.2	-30.6	-11.1	3.2	13.7
Tax rate (%)	0.0	-0.5	-0.9	1.1	0.0	0.0
ROA (%)	-59.8	-60.0	-25.1	-14.1	5.0	23.2
ROE (%)	-287.9	-1,898.6	-33.0	-21.5	9.7	41.7
PAD - Smart Lockers sales	1.6	5.4	12.4	22.7	33.2	47.4
IXP - Data Centres sales	1.2	2.4	1.7	2.2	2.7	3.6
PAD - sales growth (%)	n.a.	237.5	129.6	82.9	46.2	43.0
IXP - sales growth (%)	n.a.	100.0	-28.0	27.4	22.2	32.3

PROFIT AND LOSS ($m)

Year-end June (AUD)	FY13A	FY14A	FY15A	FY16F	FY17F	FY18F
Sales revenue	2.7	8.4	15.1	25.9	36.9	52.0
EBITDA	-11.8	-8.5	-4.5	-2.5	1.8	7.8
Depn & amort	1.0	1.1	1.6	1.7	1.6	1.8
EBIT	**-12.9**	**-9.7**	**-6.0**	**-4.2**	**0.2**	**6.0**
Net interest expense	3.6	2.1	-0.1	-0.1	-0.1	-0.1
Tax	0.0	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
Equity accounted NPAT	0.0	0.0	0.0	0.0	0.0	0.0
Net profit (pre-sig items)	**-16.5**	**-11.8**	**-6.0**	**-4.1**	**0.2**	**6.1**
Abns/exts/signif	0.0	0.0	0.0	0.0	0.0	0.0
Reported net profit	**-16.5**	**-11.8**	**-6.0**	**-4.1**	**0.2**	**6.1**

CASH FLOW ($m)

Year-end June (AUD)	FY13A	FY14A	FY15A	FY16F	FY17F	FY18F
EBITDA	-11.8	-8.5	-4.5	-2.5	1.8	7.8
Interest & tax	-3.6	-2.1	0.0	0.1	0.1	0.1
Working cap/other	10.2	4.0	0.7	0.0	1.0	-1.2
Operating cash flow	**-5.2**	**-6.7**	**-3.8**	**-2.4**	**2.8**	**6.7**
Maintenance capex	0.0	0.0	0.0	0.0	0.0	0.0
Free cash flow	**-5.2**	**-6.7**	**-3.8**	**-2.4**	**2.8**	**6.7**
Dividends paid	0.0	0.0	0.0	0.0	0.0	0.0
Growth capex	-0.7	-1.5	-1.9	-2.3	-2.4	-2.5
Invest/disposals	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
Cash flow pre-financing	**3.2**	**-7.8**	**-5.7**	**-4.7**	**0.5**	**4.2**
Funded by equity	6.1	6.7	9.0	0.0	0.0	0.0
Funded by debt	-1.2	0.0	0.0	0.0	0.0	0.0
Funded by cash	-8.1	1.1	-3.3	4.7	-0.5	-4.2

BALANCE SHEET SUMMARY ($m)

Year-end June (AUD)	FY13A	FY14A	FY15A	FY16F	FY17F	FY18F
Cash	2.6	2.6	5.7	1.0	1.5	5.6
Current receivables	2.9	2.9	5.0	6.3	6.7	9.4
Current inventories	0.4	0.4	0.3	2.0	3.4	4.7
Net PPE	1.2	1.2	0.8	0.7	0.8	0.9
Investments	0.0	0.0	0.0	0.0	0.0	0.0
Intangibles/capitalised	7.3	7.3	9.3	10.0	10.6	11.3
Other	0.5	0.5	0.3	0.4	0.4	0.4
Total assets	**14.9**	**14.9**	**21.5**	**20.4**	**23.4**	**32.3**
Current payables	2.0	2.0	4.2	7.5	10.3	13.0
Total debt	0.0	0.0	0.0	0.0	0.0	0.0
Other liabilities	0.5	0.5	0.4	0.4	0.5	0.6
Total liabilities	**2.4**	**2.4**	**4.6**	**8.0**	**10.8**	**13.6**
Minorities/convertibles	0.0	0.0	0.0	0.0	0.0	0.0
Shareholder equity	**12.5**	**12.5**	**16.8**	**12.4**	**12.6**	**18.7**
Total funds employed	**12.5**	**12.5**	**16.8**	**12.4**	**12.6**	**18.7**

Distribution agreement with Ricoh

TZ recently launched a distribution agreement with Ricoh for locker solutions in North and Latin America. Under the agreement, TZ will provide Ricoh with lockers for mail management and day lockers, which it will resell to its corporate, education and government customers. TZ is responsible for the supply, installation, commissioning and ongoing hardware and software maintenance of the lockers. Importantly, TZ will continue to receive annuity revenue as it will service the software.

Ricoh is a global technology company generating about US$18.5bn of sales in FY15. Ricoh provides a range of services including document management systems, IT services, printer solutions, digital cameras and industrial solutions. In the corporate mail sector, Ricoh provides managed services for their customers, managing the mail rooms of corporates.

WHTM view

In our view, this agreement has a number of positives including:

- **Ability to achieve faster scale**. Ricoh has a strong market position in the US corporate postal management sector with more than 2,500 customers. This agreement allows TZ to leverage Ricoh's sales capabilities to target new customers and incumbent position to replace the traditional mail room with a locker solution to manage internal postal services. Some of Ricoh's customers are Fortune 100 companies with the potential to place orders for more than 1,000 locker banks, ie larger than TZ's installed base.
- **Economic benefits for all parties**. There are significant cost savings for Ricoh, as operating a mail locker solution is less labour intensive and more space efficient than the traditional mail room. Ricoh will market the lockers similar to printers, where the end-user pays a monthly subscription fee and Ricoh carries the asset on its balance sheet. Therefore, the economics are more compelling for the end-user, as the opex model spreads out the cost over a period of time. Importantly, TZ will continue to receive annuity revenue as it will service the software.
- **Enhances Ricoh's service offering**. The mail room is largely a commoditised business with Ricoh now able to differentiate itself using the white-labelled, TZ locker solution. This should assist Ricoh in maintaining its dominant market position.
- **Ricoh a global player**. Ricoh operates in more than 190 countries. Under this agreement, TZ can sign affiliate agreements, providing the potential to expand this arrangement into other continents such as Europe.
- **Further distribution agreements**. The agreement was signed on a non-exclusive basis. We understand TZ is in discussions with other players in the US corporate postal management sector.

Outlook

The outlook appears positive for TZ with the company delivering on key strategic initiatives this year, including: 1) expanding its contract with SingPost; 2) signing a new supply order with a US logistics company for 300 postal lockers; and 3) most recently launching an American distribution agreement with Ricoh.

In combination, TZ is signing new contracts with partial upfront cash payments, reducing the working capital intensity of the business. As a result of recent contracts with more favourable terms, we forecast the company reaching positive operating cash flow in 1H17. There is considerable potential if Ricoh can penetrate its customer base (more than 2,500) with TZ locker solutions.

Forecast changes

Earnings revisions

		FY16e	FY17e	FY18e
Revenue - Before	$m	27.9	38.7	56.0
Revenue - After	$m	25.9	36.9	52.0
- Change	*%*	*-7.2%*	*-4.8%*	*-7.1%*
EBITDA - Before	$m	-2.5	1.8	7.6
EBITDA - After	$m	-2.5	1.8	7.8
- Change	*%*	*-0.8%*	*0.1%*	*3.2%*
NPAT (normalised) - Before	$m	-2.8	1.2	6.9
NPAT (normalised) - After	$m	-2.8	1.2	7.2
- Change	*%*	*n.a*	*0.1%*	*3.5%*
EPS (normalised) - Before	cps	-0.6	0.3	1.5
EPS (normalised) - After	cps	-0.6	0.3	1.5
- Change	*%*	*n.a*	*0.1%*	*3.5%*

Source: Wilson HTM

Revised forecasts

Earnings Summary

Y/E: 30 June		FY15	FY16e	FY17e	FY18e
Sales revenue	**$m**	**15.1**	**25.9**	**36.9**	**52.0**
Growth	*%*	*80.5%*	*70.7%*	*42.6%*	*41.2%*
Gross Profit	$m	6.7	9.9	16.5	23.7
Growth	*%*	*17.7%*	*48.2%*	*65.4%*	*44.0%*
Margin	*%*	*44.3%*	*38.5%*	*44.6%*	*45.5%*
EBITDA	**$m**	**-4.5**	**-2.5**	**1.8**	**7.8**
Growth	*%*	*-47.6%*	*-43.7%*	*n.m.*	*336.3%*
Margin	*%*	*-29.5%*	*-9.7%*	*4.9%*	*15.0%*
D&A	$m	1.6	1.7	1.6	1.8
EBIT	$m	-6.0	-4.2	0.2	6.0
Growth	*%*	*-37.6%*	*-30.4%*	*-103.6%*	*3909.6%*
Margin	*%*	*-39.8%*	*-16.2%*	*0.4%*	*11.6%*
NPAT (normalised)	**$m**	**-6.0**	**-4.1**	**0.2**	**6.1**
Growth	*%*	*-48.8%*	*-32.0%*	*-105.0%*	*2876.8%*
Margin	*%*	*-39.8%*	*-15.9%*	*0.6%*	*11.7%*
EPS (normalised)	**cps**	**-1.6**	**-0.3**	**0.0**	**1.3**
Growth	*%*	*-64.2%*	*-83.7%*	*-117.1%*	*2876.8%*

Source: Wilson HTM

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 (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

- Cash: $2.3m
- 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 Brett Henley (CFO)
- Mr John Wilson (co-founder)

CONTACT DETAILS

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Recommendation structure and other definitions

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

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Disclosure of interest. TZ Limited

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