

First positive operating cash flow quarter

TZ Limited released its quarterly cash flow statement showing positive operating cash flow of \$0.5m. The cash position increased to \$2.3m and the company has subsequently received an additional \$1.1m post the reporting date. The positive operating cash flow result is further evidence of the company turning the corner and reflective of the more recent contracts which have been signed with partial upfront payments. In addition, TZ has delivered 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) launching a distribution agreement with Ricoh. There is considerable potential if Ricoh can successfully penetrate its US corporate customer base (more than 2,500) with TZ locker solutions. We retain our BUY recommendation and target price of \$0.14/sh.

Key points

Quarterly update. TZ Limited released its quarterly cash flow statement showing positive operating cash flow of \$0.5m. The cash position increased to \$2.3m and the company has subsequently received an additional \$1.1m post the reporting date. The company achieved sales of \$2.7m (+22% on the pc) for the quarter, underpinned by the SingPost and US logistics contracts. These contracts are expected to deliver a strong pipeline for FY17. The quarter also saw full-scale manufacturing of TZ smart locking devices shift to China, which should underpin stronger gross margins.

WHTM view. Recording a positive operating cash flow of \$0.5m represents a significant milestone for the company. The result reflects recent contracts which have been signed with partial upfront cash payments of up to 50%. As the historical contracts begin to roll off, we expect the working capital position to continue improving with the more recent contracts. We continue to forecast the company reach positive EBITDA and cash flow in 1H17.

Forecasts and valuation. Our forecasts are unchanged and do not include any potential upside from SingPost expanding regionally, which our view is likely. Our valuation is unchanged at \$0.14/sh based on our discounted cash flow valuation, using a WACC of 13.5% and a TGR of 2.5%.

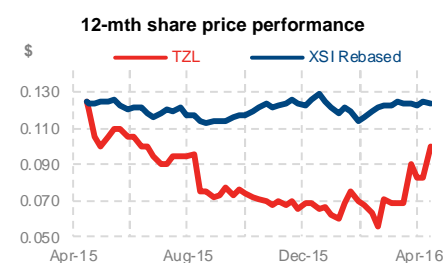
Risks and catalysts

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 @ 27-Apr-16 (AUD)	\$0.10
Forecast 12-mth capital return	40.0%
Forecast 12-mth dividend yield	0.0%
12-mth total shareholder return	40.0%
Market cap	\$47m
Enterprise value	\$46m
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 (%)	33.3	37.0	-20.0
Rel return (%)	34.2	34.8	-19.2

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	6.1
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)	-2.8	-9.5	-16.8	38.2	6.5
EV/EBITDA (x)	-5.3	-10.2	-18.1	25.4	5.8
FCF yield (%)	-14.3	-8.2	-5.2	6.1	14.3
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	21-Apr	After	Var %
NPAT: FY16F	-2.8	-2.8	0.0%
norm FY17F	1.2	1.2	0.0%
(\$m) FY18F	7.2	7.2	0.0%
EPS: FY16F	-0.6	-0.6	0.0%
norm FY17F	0.3	0.3	0.0%
(cps) FY18F	1.5	1.5	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	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
Deprn & 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



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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