

Family Zone (FZO) | Deal signed with Malaysian Telco

Rating: **BUY**
 Target Price¹: **\$0.95**
 Projected Return: **10%**

¹ 12 month target

Company Statistics

Share Price (A\$)	0.86
Market Cap (A\$m)	81.5
Enterprise Value (A\$m)	73.4
Issued Shares (mil)	94.8
Options (mil)	26.7
Cash (A\$m)	8.1
Debt (A\$m)	0.0

Earnings Summary

FY End (June)	2017	2018e	2019e	2020e
Revenue (A\$m)	1.6	5.0	15.4	18.9
EBITDA (A\$m)	-7.7	-2.5	6.1	8.5
NPAT adj (A\$m)	-8.8	-2.4	5.9	5.9
EV/EBITDA	N/A	N/A	11.7x	7.7x

Share Price (A¢ps)



Company Description

Family Zone is a parental control software product aimed at protecting children against inappropriate online content as well as helping parents control the time their children spend on their devices.

Analyst

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*see research dated 09/08/2017

Deal with Maxis Communications

Investment Summary

Family Zone has announced that it has signed a deal with Malaysia's No.1 telecommunications company Maxis Communications. We have updated our wholesale estimates on the back of this and have also rolled forward our 12 month Target Price calculation following the financial result, which results in an upgrade to our 12 month Target Price.

Investment Highlights

- FZO now has three wholesale deals with Asian telecommunication companies following their agreements announced with Telkomsel and PDLT in Indonesia and the Philippines respectively
- Maxis has 12 million subscribers compared to Telkomsel at 160 million
- The agreement is for Maxis to resell Family Zone in both bundled and standalone offerings
- Asian wholesale agreements in the Philippines and Indonesia through Telkomsel and PDLT are progressing with commercial launch of agreement with Telkomsel executed recently
- We have updated our model to now include revenues from Maxis, which adjusts our earnings in FY18E/19E/20E by +0.6¢/+0.1¢/+1.2¢

Investment Recommendation

Maintain Buy Rating and increase our 12 month Target Price to \$0.95 (was A\$0.73*) due to our subscription upgrades as well as our roll forward of our target price after the financial year.

Our price target methodology is now based on an FY20E P/Sales multiple of 4.45x (previously FY19E multiple of 4.17x). Our target price reflects a 10% premium to the last traded price.

Today we have updated our model for the Maxis deal, which results in changes to our earnings in 18E/19E/20E of +0.6¢/+0.1¢/+1.2¢ to -A2.7¢/+A6.3¢/+A6.3¢.

We model Family Zone on the assumption that it achieves 12,000 consumer direct subscriptions and 120 school sign-ups in ANZ by the start of the 2018 school year. We also assume the company generates c.A\$3.9m in wholesale revenue within Asia by FY19E and A\$2.7m revenue within the US by FY19E. This results in FY19E revenue of A\$15.4m at an EBITDA margin of 40%.

The key risk to our view is competition within the parental control software market (leading to limited sign ups – particularly overseas), as well as cyber-crime.

Summary Financials

P&L (A\$m)					Balance sheet (A\$m)				
	FY17	FY18E	FY19E	FY20E		FY17	FY18E	FY19E	FY20E
Total Revenue	1.6	5.0	15.4	18.9	Cash & equivalents	1.4	4.2	9.9	15.6
COGS	1.0	5.5	7.3	8.3	Receivables	1.0	6.0	18.2	22.4
Corporate	6.8	2.0	2.0	2.1	Inventory	0.2	0.6	1.7	2.1
Other	1.5	0.0	0.0	0.0	Other	0.0	0.0	0.0	0.0
EBITDA	-7.7	-2.5	6.1	8.5	Total current assets	2.5	10.7	29.8	0.0
D&A	1.1	0.0	0.3	0.3	Net PP&E	0.2	0.2	0.4	0.6
EBIT	-8.8	-2.5	5.8	8.2	Other	4.3	5.5	12.6	55.0
Net interest	0.0	0.1	0.1	0.3	Total non-current assets	4.5	5.7	13.0	55.7
Pretax profit	-8.8	-2.4	5.9	8.5	Total assets	7.1	16.4	42.8	55.7
Tax	0.0	0.0	0.0	2.5	Payables	3.5	10.0	30.5	37.4
Minorities	0.0	0.0	0.0	0.0	Short term debt	0.0	0.0	0.0	0.0
NPAT (adj)	-8.8	-2.4	5.9	5.9	Other	0.2	0.2	0.2	0.2
Abnormal items	0.0	0.0	0.0	0.0	Total current liabilities	3.7	10.2	30.7	37.6
NPAT (rep)	-8.8	-2.4	5.9	5.9	Long term debt	0.0	0.0	0.0	0.0
Ave shares (diluted)	60.1	88.3	94.8	94.8	Other	0.8	0.8	0.8	0.8
EPS adj (A¢)	-14.6	-2.7	6.3	6.3	Total long term liabilities	0.8	0.8	0.8	0.8
DPS (A¢)	0.0	0.0	0.0	0.0	Total liabilities	4.5	11.0	31.5	38.4
					Total common equity	2.6	5.4	11.3	17.3
Cash Flow (A\$m)					Ratios & Valuations				
	FY17	FY18E	FY19E	FY20E		FY17	FY18E	FY19E	FY20E
Cash receipts	1.3	5.0	15.4	18.9	ROE (%)	na	na	52%	34%
Cash payments	-7.4	-7.5	-9.3	-10.3	ROA (%)	na	na	14%	11%
Net interest	0.0	0.1	0.1	0.3	Net debt/equity (%)	na	na	na	na
Tax paid	0.0	0.0	0.0	-2.5	Interest cover - EBIT (x)	na	na	na	na
Other	0.7	0.0	0.0	0.0	P/E (x)	na	na	13.8	13.7
Cash flow from operations	-5.3	-2.4	6.2	6.3	P/B (x)	na	14.0	7.2	4.7
Total capital	0.0	0.0	-0.5	-0.5	EV/EBITDA (x)	na	na	11.7	7.7
Acquisitions	-3.0	0.0	0.0	0.0	Dividend yield (%)	na	0.0%	0.0%	0.0%
Divestitures	0.0	0.0	0.0	0.0	Free cash flow yield (%)	na	na	7%	7%
Other	0.0	0.0	0.0	0.0	Sales growth (%)	na	na	205%	23%
Cash flow from investments	-3.1	0.0	-0.5	-0.5	EBITDA growth (%)	na	na	na	na
Dividends paid	0.0	0.0	0.0	0.0	EPS growth (%)	na	na	na	na
Capital raised	9.1	5.2	0.0	0.0	Gross margin (%)	na	-9%	53%	56%
Repaid debt/borrowed funds	0.0	0.0	0.0	0.0	EBITDA margin (%)	na	-49%	40%	45%
Other	0.0	0.0	0.0	0.0	EBIT margin (%)	na	-49%	38%	43%
Cash flow from financing	9.0	5.2	0.0	0.0					
Total cash flow	0.6	2.8	5.7	5.7					

June year end

Ratios calculated using FZO.AX share price of \$ 0.86

Source: Company data, BW Equities Research estimates

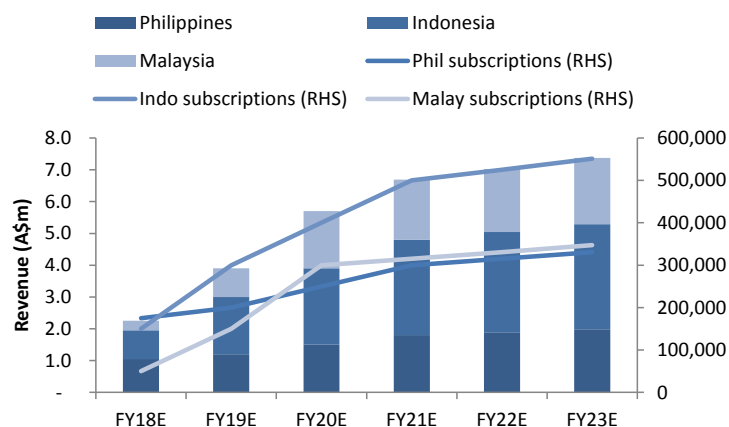
Updating our model

Upgrading our Asian Wholesale estimates

FZO announced last week that it has secured a deal with Malaysia’s largest telecommunications company, Maxis Communications. This follows on from the two deals FZO already has with Telkomsel (Indonesia) and PLDT (Philippines).

Telkomsel (FZO’s Indonesian telecommunications counterpart) has approximately 10-20m subscriptions to children under the age of 18, and we model FZO securing 400k of these by FY20E (at a subscription revenue to FZO of A\$0.50/month per subscription). Similarly within the Philippines, PLDT has approximately half the number of subscriptions as Telkomsel, and we expect the company to secure 250k subscriptions by FY20E at A\$0.50/month per subscription.

Maxis has just 12 million subscribers, of which we estimate 1-2 million are to children under the age of 18. Given the plan to bundle the product, we estimate that c.300k subscriptions will be achieved by FY20E. Maxis and FZO have agreed to share the revenues from the mobile customers during Phase 1 – which will be the initial roll-out to all mobile customers. Phase 2 will involve the promotion to broadband users, which will offer bundled plans to residential homes as well as mobile subscribers. FZO will charge a wholesale fee for the bundled customer plans.



Source: BW estimates

Upgrading target price multiple

As FZO ramps up its subscription numbers and starts to generate meaningful revenue, we feel it appropriate to base our 12 month target price methodology on a P/Sales multiple. We source our sales multiple from the below XIJ index (currently 4.45x, from the previous 4.17x) which we apply to FZO’s sales in FY20E (previously we applied it to FY19E).

We provide the below chart from S&P Global, which highlights the average multiples on the XIJ Index (Information Technology stocks within the ASX200). We must preface that the companies included in the index are much larger, and more established companies compared to FZO (market caps range from A\$300m to A\$7b).

P/E (TRAILING)	P/E (PROJECTED)	P/B	INDICATED DIV YIELD	P/SALES	P/CASH FLOW
33.67	23.12	5.50	2.44%	4.45	20.03

As of August 31, 2017. Fundamentals are updated on approximately the fifth business day of each month.

Source: S&P Dow Jones Indices LLC, a division of S&P Global

We have updated our model for recent announcements and have lifted our revenue estimates in Australia which results in material upgrades throughout the forecast period. We expect the company to make a loss in FY18E before moving to profitability in FY19E. Our earnings changes are summarised below.

	EBITDA (A\$m)			EPS (Acps)			DPS (Acps)		
	Old	New	Change	Old	New	Change	Old	New	Change
FY17	-5.6	-7.7	-2.1	-7.8	-14.6	-6.9	0.0	0.0	na
FY18E	-2.8	-2.5	0.3	-3.3	-2.7	0.6	0.0	0.0	na
FY19E	5.3	6.1	0.8	6.1	6.3	0.1	0.0	0.0	na
FY20E	6.9	8.5	1.6	5.1	6.3	1.2	0.0	0.0	na
				Old	New	Change			
DCF Valuation (A\$ps)				\$ 0.62	\$ 0.69	11.3%			
12 mo Price Target (A\$ps)				\$ 0.74	\$ 0.95	28.4%			

Source: BW estimates, Company Data

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