EQUITIES RESEARCH

16 OCTOBER 2017

Family Zone Cyber Safety Limited (FZO) | Oct Presentation

Rating:	**BUY**
Target Price[1]:	**$1.33**
Projected Return:	**41%**

[1] 12 month target

Company Statistics

Share Price (A$)	0.945
Market Cap (A$m)	93.4
Enterprise Value (A$m)	85.3
Issued Shares (mil)	98.8
Options (mil)	26.9
Cash (A$m)	8.1
Debt (A$m)	0.0

Earnings Summary

FY End (June)	2017	2018e	2019e	2020e
Revenue (A$m)	1.6	6.0	19.8	31.3
EBITDA (A$m)	-7.7	-3.5	9.5	15.4
NPAT adj (A$m)	-8.8	-4.5	8.6	10.3
EV/EBITDA	N/A	N/A	9.6x	5.2x

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.

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*see research dated 03/10/2017

School mandates grow to 63

Investment Summary

Family Zone has provided a company update, which shows a significant increase in school mandates. The company has reported school mandates of 63 versus 20 schools at its June quarterly result. We see this as a strong result and have subsequently upgraded our near term forecasts. Schools typically plan for the year ahead between September and December, therefore we believe there could be further school sign ups before the end of the year.

Investment Highlights

- Australian school mandates continue to grow – FZO reported 63 at the quarterly result (our model assumes it will have 120 schools signed up by the start of the 2018 school year). FZO also reported having signed 16,000 consumer direct subscriptions
- Deal with Malaysian telecommunications company announced earlier this month
- Asian wholesale agreements in the Philippines and Indonesia through Telkomsel and PDLT are progressing with commercial launch of agreement with Telkomsel executed recently
- We believe the company has cash of c.A$8.1m (no debt), with the company presentation highlighting A$0.6m in customer revenue for the quarter, A$1m R&D claim, and A$5m capital raising. We see this as a positive given it should take the company through to cash break-even – which we expect to be during the March 2018 quarter
- We have upgraded our ANZ school mandate numbers (from 330 to 500 in FY20E) as well as lifting our direct subscription estimates (from 25k to 60k in FY20E). We have also lifted our costs in FY18E marginally as well as including 10.5m performance shares – which we expect will be triggered within the next 12 months. This adjusts our earnings in FY18E/19E/20E by -2.0¢/+1.6¢/+3.2¢

Investment Recommendation

Maintain Buy Rating and increase our 12 month Target Price to $1.33 (was A$0.95*) due to our subscription upgrades. Our price target methodology is based on an FY20E P/Sales multiple of 4.45x. Our target price reflects a 41% premium to the last traded price.

We recently remodelled the company and have included revenues from the Malaysian wholesale agreement as well as making a substantial increase in our FY20E Australian school mandates due to positive school sign-ups.

We model Family Zone on the assumption that it achieves 25,000 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$19.8m at an EBITDA margin of 48%.

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.

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Summary Financials

P&L (A$m)	FY17	FY18E	FY19E	FY20E
Total Revenue	**1.6**	**6.0**	**19.8**	**31.3**
COGS	1.0	6.5	8.3	10.9
Corporate	6.8	3.0	2.0	5.0
Other	1.5	0.0	0.0	0.0
EBITDA	**-7.7**	**-3.5**	**9.5**	**15.4**
D&A	1.1	1.0	1.0	1.1
EBIT	**-8.8**	**-4.5**	**8.5**	**14.4**
Net interest	0.0	0.1	0.1	0.4
Pretax profit	**-8.8**	**-4.5**	**8.6**	**14.7**
Tax	0.0	0.0	0.0	4.4
Minorities	0.0	0.0	0.0	0.0
NPAT (adj)	**-8.8**	**-4.5**	**8.6**	**10.3**
Abnormal items	0.0	0.0	0.0	0.0
NPAT (rep)	**-8.8**	**-4.5**	**8.6**	**10.3**
Ave shares (diluted)	**60.1**	**95.6**	**109.3**	**109.3**
EPS adj (A¢)	-14.6	-4.7	7.9	9.4
DPS (A¢)	**0.0**	**0.0**	**0.0**	**0.0**

Balance sheet (A$m)	FY17	FY18E	FY19E	FY20E
Cash & equivalents	1.4	3.1	12.2	23.1
Receivables	1.0	7.3	24.1	38.0
Inventory	0.2	0.7	2.2	3.5
Other	0.0	0.0	0.0	0.0
Total current assets	**2.5**	**11.1**	**38.5**	**0.0**
Net PP&E	0.2	-0.8	-1.3	-1.8
Other	4.3	4.0	8.7	77.2
Total non-current assets	**4.5**	**3.3**	**7.4**	**75.4**
Total assets	**7.1**	**14.4**	**45.9**	**75.4**
Payables	3.5	10.0	32.9	52.1
Short term debt	0.0	0.0	0.0	0.0
Other	0.2	0.2	0.2	0.2
Total current liabilities	**3.7**	**10.2**	**33.1**	**52.3**
Long term debt	0.0	0.0	0.0	0.0
Other	0.8	0.8	0.8	0.8
Total long term liabilities	**0.8**	**0.8**	**0.8**	**0.8**
Total liabilities	**4.5**	**11.0**	**33.9**	**53.1**
Total common equity	**2.6**	**3.4**	**12.0**	**22.3**

Cash Flow (A$m)	FY17	FY18E	FY19E	FY20E
Cash receipts	1.3	6.0	19.8	31.3
Cash payments	-7.4	-9.5	-10.3	-15.9
Net interest	0.0	0.1	0.1	0.4
Tax paid	0.0	0.0	0.0	-4.4
Other	0.7	0.0	0.0	0.0
Cash flow from operations	**-5.3**	**-3.5**	**9.6**	**11.4**
Total capital	0.0	0.0	-0.5	-0.5
Acquisitions	-3.0	0.0	0.0	0.0
Divestitures	0.0	0.0	0.0	0.0
Other	0.0	0.0	0.0	0.0
Cash flow from investments	**-3.1**	**0.0**	**-0.5**	**-0.5**
Dividends paid	0.0	0.0	0.0	0.0
Capital raised	9.1	5.2	0.0	0.0
Repaid debt/borrowed funds	0.0	0.0	0.0	0.0
Other	0.0	0.0	0.0	0.0
Cash flow from financing	**9.0**	**5.2**	**0.0**	**0.0**
Total cash flow	**0.6**	**1.7**	**9.1**	**10.8**

Ratios & Valuations	FY17	FY18E	FY19E	FY20E
ROE (%)	na	na	72%	46%
ROA (%)	na	na	19%	14%
Net debt/equity (%)	na	na	na	na
Interest cover - EBIT (x)	na	na	na	na
P/E (x)	na	na	12.0	10.0
P/B (x)	na	26.9	8.6	4.6
EV/EBITDA (x)	na	na	9.6	5.2
Dividend yield (%)	na	0.0%	0.0%	0.0%
Free cash flow yield (%)	na	na	9%	10%
Sales growth (%)	na	na	229%	58%
EBITDA growth (%)	na	na	na	na
EPS growth (%)	na	na	na	na
Gross margin (%)	na	-9%	58%	65%
EBITDA margin (%)	na	-59%	48%	49%
EBIT margin (%)	na	-75%	43%	46%

June year end

Ratios calculated using FZO.AX share price of $ 0.95

Source: Company data, BW Equities Research estimates

Updating our model

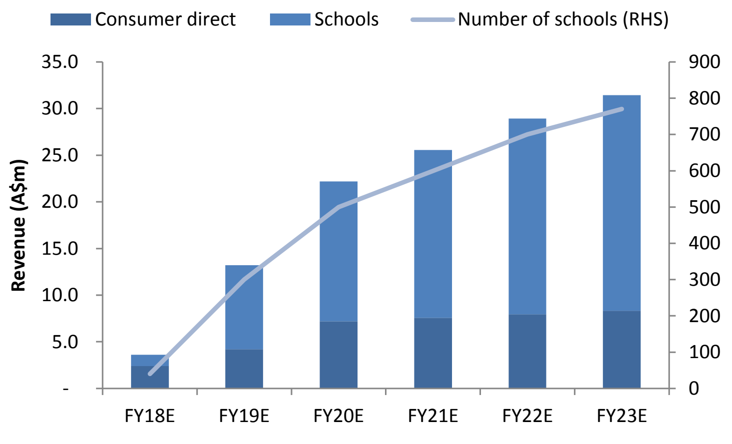
Upgrading Australian school revenues

Within Australia, FZO is primarily targeting independent schools to grow its subscription numbers. Of the c.10,000 schools within Australia, c.1,000 are independent schools – and FZO is targeting these independent schools directly. This exposes the company to c.700,000 families. FZO plans to approach each independent school individually and ask them to mandate every family at the school to subscribe to FZO's product. This will typically be achieved by the school including Family Zone on the school's booklist. We therefore see these 700,000 families as FZO's target market – with the company also potentially able to achieve subscriptions on the remaining c.4.3m Australian families through radio advertising/word of mouth (consumer direct subscriptions). Given the company will target the independent schools specifically, we expect it to generate a much higher penetration rate with these families than through consumer direct subscriptions.

We model the company's Australian revenue via two streams: (1) consumer direct subscriptions, and (2) school subscriptions.

FZO has announced that it has 16,000 consumer direct subscriptions – which we estimate are charged at A$10/month. The company has also announced that it has signed up 63 schools which have mandated the use by its students. We work off an average of 500 families per school at a cost of A$5/month per family.

- **We forecast FZO to lift the 16,000 consumer direct subscriptions to 35,000 in FY19E and 60,000 in FY20E**. We then model a 5% growth rate for the following five years.
- **We forecast FZO to secure close to 120 mandated schools by the start of the 2018 school year**, however given the school year starts in early February of 2018 we expect the company to only realise approximately one third of these subscriptions in terms of cash flow in the 2018 financial year. We expect the company to grow its mandated school numbers to c.500 schools by FY20E.



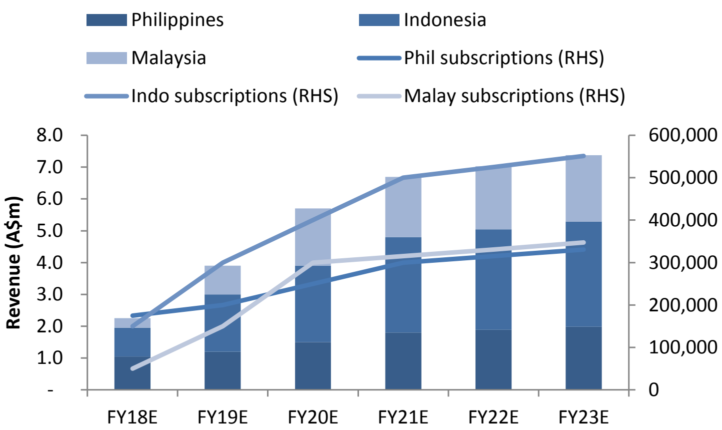
Source: BW estimates

No change to Asian Wholesale business

FZO announced earlier this month 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 Telcomsel (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. Given the Telkomsel deal is still in its infancy (only a trial has been agreed upon) we highlight there is risk to our estimates.

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.



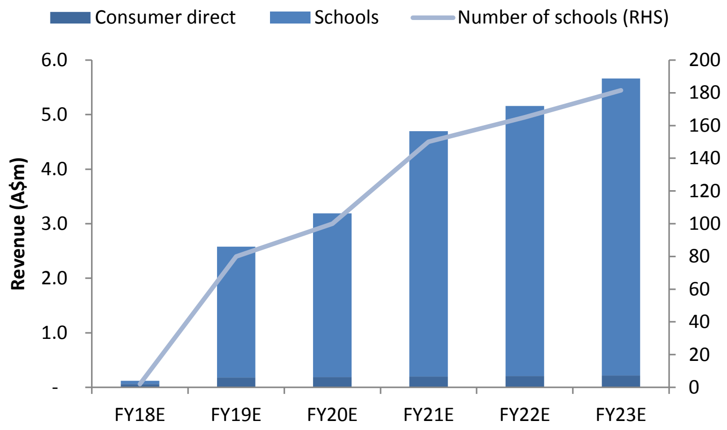
Source: BW estimates

No change to US revenue

FZO recently reported that its technology has been implemented within 81 schools in West Virginia. We note that this does not mandate subscriptions to its students. FZO hopes to convert these schools in a similar way to its School Zone product in Australia whereby the schools mandate the use of Family Zone by all parents through the school booklist.

The company has also announced a commercial launch of its product to Utah based internet service provider, Innovative Air. The company has also reached an agreement with technology company IgniteNet to embed FZO's technology into the IgniteNet wireless access points. IgniteNet has access to 2,000 internet service providers (ISP) and resellers through the United States – hence IgniteNet's ISP customers can provide FZO's product as a bundle service.

We believe there is material upside potential within the US if the company can secure a sizable footprint. **The market in the US is 10 times the size of Australia**, thus the upside is significant. As per the below chart, we expect the company to generate almost all of its revenue through schools, where we expect it to achieve 180 mandated schools by FY23E. Within our calculations, we assume each school represents 500 subscriptions at A$5/mth.



Source: BW Equities' estimates

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 (A¢ps)			DPS (A¢ps)		
	Old	New	Change	Old	New	Change	Old	New	Change
FY17	-7.7	-7.7	0.0	-14.6	-14.6	0.0	0.0	0.0	na
FY18E	-2.5	-3.5	-1.0	-2.7	-4.7	-2.0	0.0	0.0	na
FY19E	6.1	9.5	3.4	6.3	7.9	1.6	0.0	0.0	na
FY20E	8.5	15.4	6.9	6.3	9.4	3.2	0.0	0.0	na

	Old	New	Change
DCF Valuation (A$ps)	$ 0.69	$ 1.05	52.2%
12 mo Price Target (A$ps)	$ 0.95	$ 1.33	40.0%

Source: BW estimates, Company Data

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