

Family Zone Cyber Safety Limited (FZO) | Initiate Coverage with Buy Rating

Rating:	BUY
Target Price ¹ :	\$0.41
Projected Return:	37%

¹ 12 month target

A simple solution to online child safety

Investment Summary

Family Zone is a parental control software tool designed to protect children from inappropriate content on their PC's, smartphones and tablets. Its primary objective is to improve online child safety as well as providing parents with an easy-to-use tool to help manage their children's online activity – both the time their children spend on the devices as well as the content their children are exposed to.

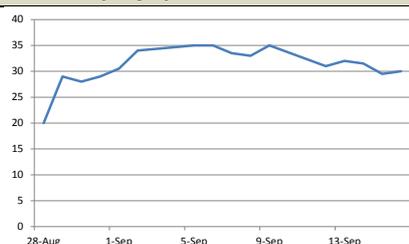
Company Statistics

Share Price (A\$)	0.30
Market Cap (A\$m)	18.6
Enterprise Value (A\$m)	11.9
Issued Shares (mil)	62.0
Options (mil)	14.1
Cash (A\$m)	6.7
Debt (A\$m)	0.0

Earnings Summary

FY End (June)	2016	2017e	2018e	2019e
Revenue (A\$m)	0.4	2.0	6.7	7.6
EBITDA (A\$m)	-1.5	-1.3	1.4	2.0
NPAT adj (A\$m)	-1.5	-1.8	0.9	1.5
EV/EBITDA	N/A	N/A	9.8x	5.8x

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

Brett Cottrell
61 3 9601 4808
bcottrell@bwequities.com.au

Investment Highlights

- One of very few companies with a product that works outside of the home (at school, cafés, in public and at friends' houses)
- Cyber Expert designed templates can be selected
- Price is comparable to competitors
- Wholesale agreement in place in The Philippines, with potential in other Asian countries
- Key relationships - David Baxby (former Virgin Co-CEO) and Hastings Singh (former Apple executive) – to help Family Zone secure wholesale agreements within Asia
- Secured access partners IgniteNet and Mesh Networks
- Significant upside potential in both the US and European markets (which are significantly larger than that of Australia)
- Competition the key risk, with several products globally that have similar features to Family Zone. Having said that, Family Zone is one of only a few parental control software products that offers the full range of features (works outside the home, easy to install/operate, cyber expert feature).

Investment Recommendation

Initiate with a Buy Rating and a \$0.41 target price.

Our target price reflects a 37% premium to the last traded price and is based on our DCF valuation using a WACC of 13.7%.

We model Family Zone on the assumption that it achieves 45,000 ANZ subscribers by FY18E. We also assume the company generates c.A\$2m in wholesale revenue within Asia by FY19E. This results in FY19E revenue of A\$7.6m at an EBITDA margin of 27%.

There is the potential for the company to expand into the US and UK markets, however we do not include any international revenue within our estimates, but we believe there is potential for the product to be rolled out globally.

The key risk to our view is competition within the parental control software market globally. Families can purchase products online from offshore companies, hence competition is not restricted to just Australian companies. Other risks include balance sheet flexibility, and cyber-crime.

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Summary Financials

P&L (A\$m)	FY16	FY17E	FY18E	FY19E	Balance sheet (A\$m)	FY16	FY17E	FY18E	FY19E
Total Revenue	0.4	2.0	6.7	7.6	Cash & equivalents	0.7	4.4	5.2	6.7
COGS	0.0	2.5	4.5	4.7	Receivables	0.0	0.0	0.0	0.0
Corporate	0.5	0.8	0.9	0.9	Inventory	0.2	0.3	0.8	0.9
Other	1.4	0.0	0.0	0.0	Other	0.0	0.0	0.0	0.0
EBITDA	-1.5	-1.3	1.4	2.0	Total current assets	1.0	4.7	6.0	7.6
D&A	0.0	0.6	0.6	0.7	Net PP&E	0.0	0.0	0.1	0.1
EBIT	-1.5	-1.9	0.7	1.4	Other	0.5	0.9	1.5	1.7
Net interest	0.0	0.1	0.1	0.2	Total non-current assets	0.5	0.9	1.6	1.8
Pretax profit	-1.5	-1.8	0.9	1.5	Total assets	1.4	5.6	7.6	9.4
Tax	0.0	0.0	0.0	0.0	Payables	0.2	0.7	1.9	2.1
Minorities	0.0	0.0	0.0	0.0	Short term debt	0.0	0.0	0.0	0.0
NPAT (adj)	-1.5	-1.8	0.9	1.5	Other	1.4	1.4	1.4	1.4
Abnormal items	-0.5	0.0	0.0	0.0	Total current liabilities	1.7	2.1	3.3	3.5
NPAT (rep)	-2.0	-1.8	0.9	1.5	Long term debt	0.0	0.0	0.0	0.0
Ave shares (diluted)	31.0	62.0	62.0	62.0	Other	0.0	0.0	0.0	0.0
EPS adj (A¢)	-4.8	-3.0	1.4	2.5	Total long term liabilities	0.0	0.0	0.0	0.0
DPS (A¢)	0.0	0.0	0.0	0.0	Total liabilities	1.7	2.1	3.3	3.5
					Total common equity	-0.2	3.5	4.3	5.8
Cash Flow (A\$m)	FY16	FY17E	FY18E	FY19E	Ratios & Valuations	FY16	FY17E	FY18E	FY19E
Cash receipts	0.4	2.0	6.7	7.6	ROE (%)	na	na	20%	26%
Cash payments	-1.0	-3.3	-5.4	-5.6	ROA (%)	na	na	11%	16%
Net interest	0.0	0.1	0.1	0.2	Net debt/equity (%)	na	na	na	na
Tax paid	0.0	0.0	0.0	0.0	Interest cover - EBIT (x)	na	na	na	na
Other	0.0	0.0	0.0	0.0	P/E (x)	na	na	21.8	12.2
Cash flow from operations	-0.6	-1.2	1.5	2.2	P/B (x)	na	na	4.3	3.2
Total capital	-1.3	-0.6	-0.7	-0.7	EV/EBITDA (x)	na	na	9.8	5.8
Acquisitions	0.0	0.0	0.0	0.0	Dividend yield (%)	na	na	0.0%	0.0%
Divestitures	0.0	0.0	0.0	0.0	Free cash flow yield (%)	na	na	4%	8%
Other	0.0	0.0	0.0	0.0	Sales growth (%)	na	na	na	13%
Cash flow from investments	-1.3	-0.6	-0.7	-0.7	EBITDA growth (%)	na	na	na	na
Dividends paid	0.0	0.0	0.0	0.0	EPS growth (%)	na	na	na	na
Capital raised	2.5	5.5	0.0	0.0	Gross margin (%)	na	na	33%	38%
Repaid debt/borrowed funds	0.0	0.0	0.0	0.0	EBITDA margin (%)	na	na	20%	27%
Other	0.0	0.0	0.0	0.0	EBIT margin (%)	na	na	11%	18%
Cash flow from financing	2.5	5.5	0.0	0.0					
Total cash flow	0.6	3.7	0.8	1.5					

June year end

Ratios calculated using FZO.AX share price of \$ 0.30

Source: Company data, BW Equities Research estimates

Investment thesis

Strengths

The primary driver of our Buy rating is the **quality of Family Zone's product**. The parental control software market is extremely fragmented with many different products available to consumers. In our view, many of the current products available have distinct flaws (complicated to install/operate, easy for the children to hack, unavailable on all devices, ineffective outside the home). It is for these reasons that many parents do not use any form of parental control software – and according to Parks Perspective research just 2-4% of parents in the United States have purchased parental control software, which we believe is likely to be a similar statistic in Australia. We therefore believe there is significant sales upside for Family Zone's product as it solves several of the issues common to the market. Family Zone's product is easy to install/operate, it works on all devices, works outside the home, and provides parents with the option to use the help of highly respected and successful cyber experts in determining what restrictions should be placed on their children.

The primary feature which is almost non-existent in other parental control software products is the option to mirror control settings designed by renowned **cyber experts**. Rather than manually adjust control settings, parents can select a cyber expert to determine the appropriate content their children are exposed to and the amount of time their children should spend on their electronic devices. We have not been able to find a competitor that also has this functionality. Examples of some of FZO's cyber experts are listed below.

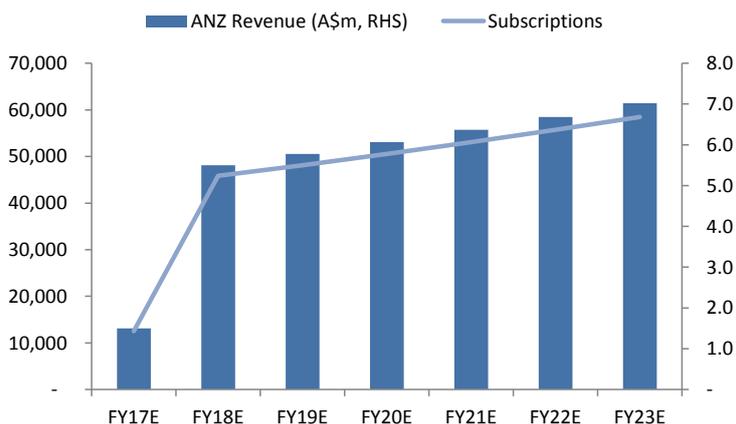


Source: Family Zone company release

Family Zone has employed the services of **two experienced global executives** to expand its wholesale offering within Asia. Its access partners, **David Baxby and Hastings Singh**, have been brought in to secure wholesale agreements within Asia. The company already has an agreement with a Tier 1 telecommunications company in The Philippines, and the role of Mr Baxby and Mr Singh will be to attempt to replicate this in other Asian countries (for example Hong Kong, Singapore, Vietnam, Thailand, India, Indonesia).

The company also has agreements with **access partners IgniteNet and Mesh Networks** to provide Family Zone's software within public hotspots such as businesses, hotels, universities and restaurants.

Valuation: we believe our estimates for ANZ subscriptions is conservative and forecast that over the course of the next 7 years Family zone will increase its subscription numbers to between 50-60k. Given there are approximately 5 million families in Australia at present (and growing) this represents c.1% of total ANZ families. While we **do not include any revenues from the US or UK** in our model, we do believe there is the potential for significant revenue upside in both of these locations.



Source: BW Equities' estimates

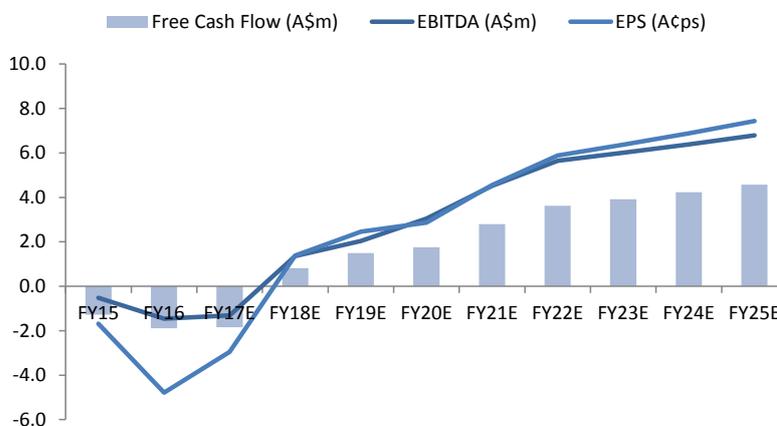
Earnings drivers and outlook

While we expect near term earnings growth to be driven by ANZ subscription numbers as well as the company's ability to secure wholesale agreements within Asia, we believe there is significant upside potential within the United States. There are ten times as many children with mobile phones in the US compared to Australia, and we estimate that the parental control market differential between the two countries is of a similar magnitude. Our modelling assumes Family Zone secure c.45,000 subscriptions within ANZ by FY18E – which represents less than 1% of families in Australia. We also expect the company to secure c.A\$2m in wholesale revenues by FY18E and for this to grow to c.A\$5.2m by FY22E before moving to a long term growth rate of 3-5%.

We do not include US revenues within our model at this point in time. We expect it to take FZO several years to gain a material footprint in the US as it has significant competition to overcome. Having said that, we do believe there is material upside potential within the US if the company is able to secure a sizable footprint given the magnitude of the US market.

We estimate that only c.2-4% of families use some form of parental control software within the US and Australia, thus the next few years is likely to be more of a 'land-grab' exercise for parental control software providers, rather than a market share/price competition dynamic.

We provide the below chart highlighting the long term earnings growth of Family Zone.



Source: BW estimates, Company Data

Valuation and 12 month target price of A\$0.41

We base our 12 month target price on our DCF valuation, and do not use an earnings or EBITDA multiple given the company is in its infancy stages of deriving revenue and earnings, and we believe that over the next 12 months investors will be focussed primarily on the long term prospects of the business rather than short term earnings. With that in mind, the stock is trading on an EV/EBITDA multiple in FY18E of 9.8x. **We value the company on a DCF valuation of A\$0.41** per share which is calculated using a WACC of 13.7% and long term growth rate of 3.5%.

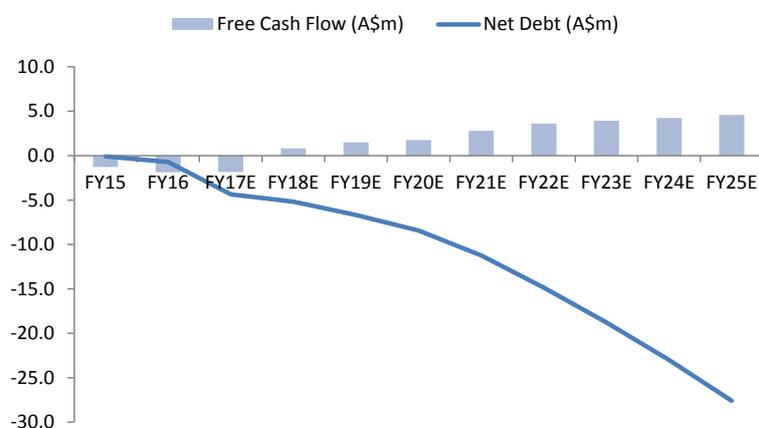
Key downside risks

Competition: The parental control software market is extremely fragmented, with hundreds of products available to parents globally. The offerings vary significantly – and many of the products are owned and operated by large conglomerate companies where the parental control software is just a fraction of the business. The risk to Family Zone is that a competitor develops a superior product and takes a significant market share. While this is a very real risk long term, we do not see this being a significant problem in the short term given (1) we believe Family Zone have one of the best products out there, and (2) just c.5% of families within ANZ and the US use some form of parental control software – hence in the near term there will likely be a land-grab situation in the market, rather than direct competition on price in an attempt to gain market share.

Family Zone hasn't provided detailed guidance/forecasts within its prospectus, which in our view highlights a lack of certainty around revenues and earnings. Our estimates within this report are based on our forecast of the company's ultimate market share, as well as our expectations of Asian wholesale agreements secured in the short-to-medium term. We do not include any revenues from the United States.

Cyber-crime and technical issues are inherent in any technology and software company – and Family Zone is no different. While the company has spent significant time and resources towards minimising this risk, we do feel it prudent to highlight this nonetheless.

The company's **balance sheet** is somewhat limited at present, and given the cash burn we forecast over the next 12-18 months, Family Zone's cash balance will remain tight. The funds received from the IPO raising will be used primarily to create a sales and marketing team; however we do highlight that the size of this team will be dependent on the health of the company's balance sheet. We also expect the speed at which the company can grow revenue will be dependent on the sales and marketing results the company is able to deliver.



Source: BW estimates, Company Data

Company overview and strategy

Who is Family Zone?

Family Zone was incorporated in January 2014 by a group of technology and telecommunications experts who have developed and operate a cloud-based parental control platform. The product was launched in March 2016, and is currently available to consumers. Family Zone listed on the ASX under the ticker FZO.AX on 29th August 2016 at an issue price of A20¢ per share.

The product

Family Zone's product is embedded within telecommunication networks and can be installed on all home computers, mobile phones and tablets. A customer purchases the Family Zone hardware box and plugs it in at home. The customer can then link its children's devices/smart phones/television/tablets to the Family Zone network. These devices will remain under the Family Zone network everywhere – at home, at school, at friend's houses, in public. Each device is registered to a particular child with their name and date of birth entered onto the device so Family Zone knows which restrictions to implement (restrictions for an 8 year old will be different to that of a 16 year old). There is also the option of device sharing between children. The product allows parents to have as little or as much control over their children's online activity as they desire, while providing parents with access to cyber safety experts – who can provide recommended settings and advice. Family Zone aims to not only provide its product to families, but to educators (for example, schools and universities) and other potential internet access points.

The premise of the product is to not allow children to be exposed to inappropriate content on their devices, and the product also allows parents to control the time their children spend online or playing games. The product is sophisticated and remains up to date with new smartphone applications hitting the market. Depending on the child's age, it will determine whether it is appropriate for the device to have access to various games and social media (such as Facebook, Twitter, Instagram etc). The product works on all devices within the household and continues to work when the device is taken away from the family home (school, friend's houses, café's etc).

Differentiators from its competitors:

- Simple to install and use
- Cyber expert settings available
- Compatible on all devices
- Works everywhere (not just at home)
- Cannot be hacked/disabled by children



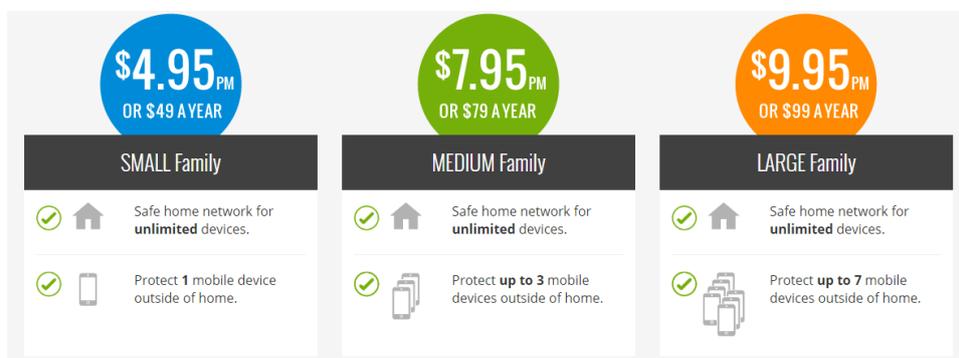
Source: Family Zone website

Parents can control all devices from their own phone, and can manually alter the restrictions, or select one of FZO’s cyber experts to decide what their children have access to and at what times. By inputting a child’s birth date, Family Zone will know whether or not certain applications/games are appropriate for the particular child. Access to Facebook might be acceptable for a 16 year old, but not for an 8 year old (for example).

Family Zone allow subscribers the option of implementing a **cyber expert’s** settings to all of its devices – thus can rely on a professional’s opinion as to what age is appropriate for a child to start using Facebook (for example). The cyber experts cover a range of professions – from police officers, psychologists and there are also some that have particular cultural or religious affiliations – which may have considerably different controls and restrictions to each other.

Price

The Family Zone hardware box can be purchased by consumers in Australia for A\$89 (the box costs Family Zone c.A\$60 to produce). Ongoing monthly network access cost varies from A\$4.95/month for one device to A\$9.95/month for five devices (with higher device plans available). The customer can elect to have its settings set by a Cyber expert which will incur an additional A\$2.95-3.95/month charge. Competitor prices are broadly similar, however we do note that there are a small number of free parental control software solutions available, but in our view they are of an inferior quality. We provide the below pricing summary.



Source: Company website

Costs

The bulk of Family Zone's costs at present are for marketing, sales and development. The company has indicated that once the business is fully scaled its overheads will amount to c.A\$300k per month (A\$3.6m annually), with service margins between 80-90%. We expect breakeven to be somewhere between 30-40k subscriptions within Australia. We model Family Zone on the assumption that it achieves 45k ANZ subscriptions by the end of FY18E, with additional wholesale agreements within Asia on top of that. This should ensure the company is break-even by FY18E – without taking into account any additional costs associated with expanding internationally (which could be a possibility at that time).

Customers

The end users of Family Zone's product are families. The company has distribution and wholesale agreements in place with telecommunication companies, while at the same time selling its product to individual consumers online.

Family Zone launched its product in March 2016 and we expect it will have c.45,000 families in Australia and New Zealand signed up by the end of FY18E. The company is in advanced stage discussions within the Philippines, which if successful we believe could add up to A\$2m in annual revenue by the end of FY18E. Family Zone has reached a strategic wholesale partnership agreement with a Tier 1 telecommunications company within the Philippines (FZO expects this to be launched by the end of this year). The arrangement in the Philippines should return Family Zone A\$1.10 per month per subscriber at a service margin of c.82%. The company is seeking further deals in India, Singapore, Vietnam, Thailand, Hong Kong, and Indonesia through its relationships with Virgin Executive David Baxby, and former Apple Executive Hastings Singh. The company hopes these two contacts can help it secure further wholesale agreements within Asia. The strategy is for Family Zone to charge a telecommunications company a wholesale fee per service – with the telecommunications carriers offering the product as a value added service.

Family Zone has a strategic sales agency arrangement with Fidelio Partners to promote the product and facilitate sales to telecommunication companies. Fidelio Partners was established by David Baxby and Hastings Singh to work with Family Zone.

The ANZ revenue model direct to consumers includes a one-off fee for the hardware of A\$89 (cost to produce c.A\$60), with an ongoing monthly fee of A\$4.95-9.95/month at a gross margin of close to 90%.

Substantial shareholders

Following the IPO CEO Tim Levy holds 5,801,118 ordinary shares (c.9% of the company) plus an additional c.11.6m performance shares. Crispin Swan holds 1,891,190 shares (c.3% of the company) as well as a further 6,616,150 performance shares.

Management performance rights

Management have the ability to earn up to 28m shares via three tranches of c.9.3m shares each provided it meets its milestones:

- Tranche 1: 15,000 paying subscribers generating a minimum of A\$100,000 revenue per month for three consecutive months within 24 months of listing
- Tranche 2: A\$10m of revenue over a 12 month period of which 30% must be subscription income within 36 months of listing
- Tranche 3: A\$20m of revenue over a 12 month period of which 30% must be subscription income within 48 months of listing

Our modelling assumes the company achieves Tranche 1 of the performance rights; however we do not currently have the company achieving Tranches 2 or 3 within our model.

Escrow arrangements

Escrow period	Number of securities
Shares	
12 months from official quotation	4,652,141
24 months from official quotation	12,985,112
Performance Shares	
24 months from official quotation	28,000,000
Options	
12 months from official quotation	2,593,750
24 months from official quotation	4,000,000

Source: ASX release

Board and governance (as per company website and company releases)

Family Zone's board consists of four members: two independent directors (Phil Warren and the Non-Executive Chairman) as well as the CEO, and Executive Director of Sales (Crispin Swan). John Sims is the Non-Executive Chairman who is an experienced technology and telecommunications executive. He was most recently President (global enterprise services and global sales) of Blackberry. He is based in California, United States. Tim Levy is the CEO, who was also one of the founders of the company.

Senior management (as per company website and company releases)

Tim Levy (Chief Executive Officer)

Tim Levy is a telecommunications and technology entrepreneur who is the founder of Vodafone's largest Australian retail partner (Mo's Mobiles). He was also CEO/COO of Optus reseller, B Digital Limited. He also held a management consulting role at Arthur Andersons (in technology and change projects). Mr Levy is a Chartered Accountant, and studied at the University of Western Australia.

Crispin Swan (Executive Director – Sales)

Crispin Swan has had extensive sales executive and general manager experience in several global companies. He was most recently Vice President of Sales in Asia Pacific at Mavenir, and has also held executive and manager positions at Airwide Solutions, Sema, and Cisco Systems.

Ben Trigger (Vice President – Technology Applications)

Ben Trigger has had technology consultancy experience, and is based in Perth, Western Australia. He is the founder of Living Networks, which is an aged-care telecommunications operator. He was also previously a Director of Ultimatum and also the CEO of Netlink Group.

Paul Robinson (Vice President – Technology Services)

Like Mr Trigger, Paul Robinson has had technology consultancy experience, and is based in Perth, Western Australia. He is the co-founder of Permeance Technologies, which is an information technology provider.

Sam Price (Executive Manager – Development and Engineering)

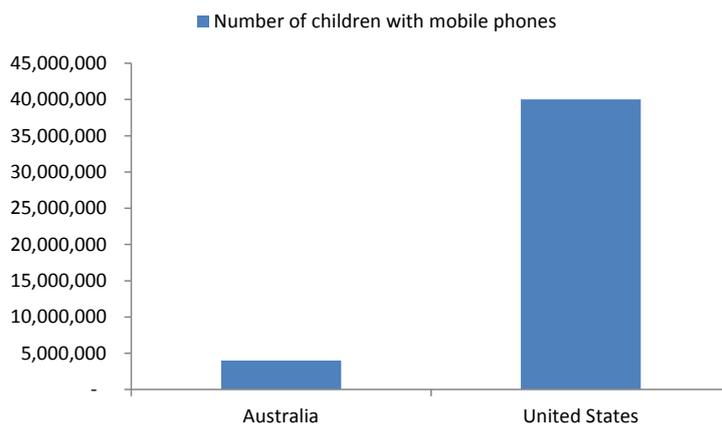
Sam Price has experience in software and technology roles across the globe. He recently managed software engineering at Groupon and he has an honours degree in computer science at the University of Western Australia.

The industry

Online access is becoming easier for children, with c.40 million children having mobile phones in the United States today (as per Family Zone presentation). Within the United Kingdom, 76% of children aged 12-15 had social media profiles in 2015 compared to 71% in 2014. With this increased usage by children comes increased threats and unwanted content. If not filtered or blocked correctly, children can be exposed to negative experiences such as digital dementia, infomania, online grooming, excessive screen time, digital footprint, cyber bullying, cyber stalking, sexting as well as being exposed to other inappropriate online content such as pornography and gambling.

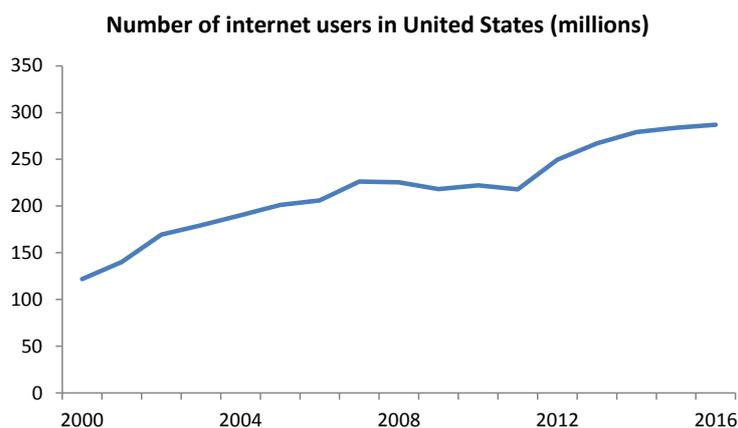
- **Digital dementia:** reduced cognitive abilities due to excessive use of technology
- **Infomania:** stress caused to people while waiting for a reply (email/messaging etc)
- **Online grooming:** gaining an emotional connection with a child in order to lower their inhibitions
- **Digital footprint:** the data trail left behind after visiting websites, sending emails, etc
- **Cyber bullying:** using technology to bully someone (threatening/intimidating tactics)
- **Cyber stalking:** harassing someone via emails/messages etc
- **Sexting:** sexually explicit pictures/photos/text messages sent via email/phone

The market size in the United States is understandably much larger than that of Australia. As per Family Zone's presentation, there are approximately 5 million families within Australia and c.4 million children with mobile phones. In the United State these figures are ten times the size of Australia (c.50 million families and c.40 million children with mobile phones).



Source: Family Zone presentation

A report published by ABI Research in 2013 estimated that the parental control software market was over US\$1b globally with the primary drivers of the market being parental spending – with educational institutions also contributing to growth within the industry. With the advancement of technological devices coupled with the increased hours kids spend online, we expect this figure to grow substantially over time – however it is extremely difficult to predict exact market growth.



Source: statista.com

Cyber bullying

A 2014 report by McAfee highlighted that although children have become much more tech-savvy than their parents, they are not mature enough to know how to deal with online threats. The report believes it can therefore be beneficial for parents to take an active role in their children's online activities. This doesn't mean looking over their shoulder – this could simply be making sure their child is aware of the threats out there and how to manage these threats. Of the c.1,000 parents surveyed for the report, just 19% of parents used some form of parental control on their children's online devices and one third of parents have not had any discussions with their children about online safety. One of the key reasons for this is parents' lack of knowledge of social networks and of the internet. We therefore believe a successful parental control software tool must be simple for parent's to install and use.

Some additional statistics from the report (the report surveyed 1,012 children between 10-17 years of age in the United Kingdom, and 1,013 parents with at least one child between 10-17 years of age in the UK):

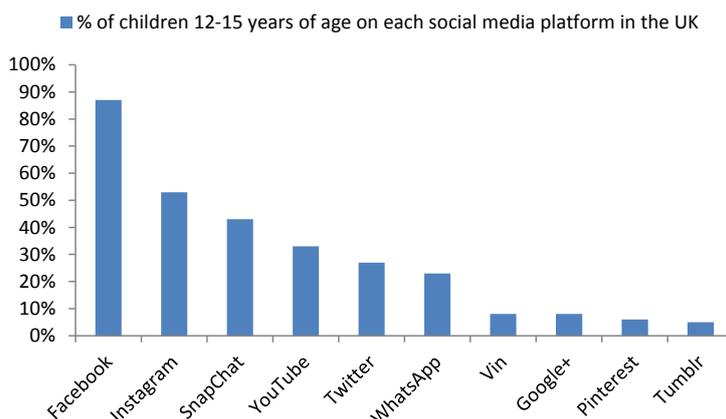
- Almost half of parents (45%) see cyber bullying as a key concerns in relation to their children's online safety.
- 35% of children have posted their email address online, 32% have posted a photo of themselves, and 27% have posted the name of their school
- 22% of children have witnessed cruel behaviour towards their classmate or a friend online
- 38% of parents think their child may have been bullied and 33% think their child might be the bully
- 36% of children who received online bullying told their parents

2011-2012 Australian health survey

While parental control software is primarily designed to limit the inappropriate content children are exposed to, there is also a strong need for parents to simply control the amount of time children are looking at screens – as opposed to being active outside. We sourced the below statistics from the 2011-2012 Australian health survey (health.gov.au), which highlights that many children are spending too much time on electronic devices, and are not gaining a sufficient amount of physical activity.

- Children aged 2-4 spend 6 hours per day on physical activity and 83 minutes watching TV, DVDs or video games.
- Children aged 5-17 spend 91 minutes per day on physical activity and 136 minutes watching TV, DVDs or video games.
- 44% of children aged 2-17 had at least one of TV, computer or game console in their bedroom.
- Physical inactivity is the 4th leading cause of death due to non-communicable disease globally (heart disease, stroke, diabetes, cancer). The study believes it contributed to 3 million preventable deaths annually (6% of global deaths). Physical inactivity is the primary cause of 21-25% of breast and colon cancers, 27% of diabetes and 30% of ischaemic heart disease burden. Behind tobacco smoking, it is the second largest contributor to the cancer burden in Australia.

A key feature of parental control software is the functionality for parents to restrict the amount of time their children can use laptops/phones/tablets. Almost all parental control software products have this feature.



Source: statista.com

Cyber safety experts

There has been an emergence of cyber safety experts in recent times. The cyber experts are

often psychologists, or ex-police officers who run blogs or speak to children and parents through school-run talks to educate families on the risks of cyber safety. The Australian Federal Government recently initiated a Voluntary Certification scheme for individuals to become certified online safety program providers. Family Zone is the only parental control software product that we know of that offers parents the option to have its control settings matched to those designed by their preferred cyber safety expert.

Competitive landscape

There are a significant number of companies globally that offer parental control software for families. The offerings each product provides varies from ease of use/installation, number of devices available, the types of devices it is available on, whether the product works outside the home, as well as many other features.

Parental control software falls under four distinct categories:

- **Internet filtering:** Filters the internet content and restricts certain web pages a reader can have access to
- **Location services:** Tracks where a device is at any one time – which can be useful for parents to monitor truancy
- **Device restrictions:** Devices such as smartphones and tablets can be controlled remotely – where restrictions are placed on certain apps
- **Purchase blockers:** Restricts the users from making online purchases

Many of the current parental control software available use installed software – as opposed to a Wi-Fi network (which Family Zone's product uses). While some of these companies have had some success, we do note that quite often smart children can find ways to hack the software, as well as issues arising when new technology becomes available (new phones, televisions etc).

One potential problem for parental control software companies is that technology and electronic devices (as well as apps) are starting to add parental control systems within the product. While this technology is easier for children to hack and is applied on an app-by-app or game-by-game basis (hence time consuming and complex for parents), some parents may simply use these methods due to cost saving and think that at least they are using some form of parental control. We do not believe this mentality will last long term, and expect more parents to adopt one system to cover all devices and all apps/games for each of their children.

Based on our analysis of Family Zone's competitors, the two advantages Family Zone has is the product's ability to continue to control the device outside of the home, as well as the fact that Family Zone has a cyber experts option. A large number of other parental control software products do not offer these two features.

Typically the products cost somewhere between A\$50-150 for the box (including delivery), then there will normally be an ongoing service charge which can vary in price. There are also several companies that do not charge an ongoing rate. Sales numbers for each individual product are extremely difficult to source given almost all of the companies are unlisted, and do not publish sales figures. We provide the below table listing some of the many parental control software products available in the market (this is merely a portion of them), and we have selected a handful of those companies we believe are Family Zone's key competitors to take a closer look at their offering.

ParentalControl Bar Verity	Bitdefender Parental Control	ContentBarrier	Parental Controls in Settings
Symantec Norton Family Premier	Anti-Porn	Spytech Spy Agent	Andriod Devices - Play Store App
Mobicip	Net Nanny	CYBERSitter	Microsoft Family Account
OpenDNS Home VIP	K9 Web Protection	Qustodio	Circle with Disney
uKnowKids Premier	Golden Filter Premium	Elite Keylogger	Phone Sheriff
SafeDNS	JuniorWatch	Broadband Shield	Family Time
Web Watcher	Spyrix Free Keylogger	KidsWatch	Time Boss Pro
McAfee Safe Eyes	Parental Filter	Spyagent	KoalaSafe
	Big Mother	Witigo Parental Filter	Naomi

Source: BW Equities

Key competitors:

Product	Country	Price per year	Device limit	Easy to set up and use	Continues to protect outside the home	Available on all devices	Cyber experts
Family Zone	Australia	A\$50-100	Unlimited - higher fees if > 7	Yes	Yes	Yes	Yes
Circle With Disney	USA	US\$120	10	Yes	No (but new Circle Go product can)	Yes	No
Qustodio	USA	US\$50-88	10	Yes	Yes	Yes	No
Net Nanny	USA	US\$90	9	Yes	No	Yes	No
KoalaSafe	Australia	Free	10*	Yes	No	Yes	No

* Customers can link more devices, however the wifi begins to slow

Source: BW estimates, Company data, Company websites

Circle with Disney

We believe Circle with Disney is Family Zone’s biggest competition within the United States. Disney combined with tech company Circle Media to create the product. The offering is similar to that of Family Zone, and Circle with Disney is available from various websites (including the Disney store) as well as in retail shops (for example Target) in the United States. Given the significant brand that Disney has globally, we expect it will be a challenge for Family Zone to take away customers from Circle with Disney. There is also an advanced product available for purchase called Circle Go, which continues to control the children’s devices outside the home.

Qustodio

Qustodio is a United States based parental control software company which also has an office in Europe. The product has an offering to families, businesses and also schools. One of the positive features is the option to set time limits (eg total of 30 minutes on a Sunday) rather than forcing the kids to have their play-time at a particular time period of the day. Another positive feature is its ‘panic-button’ which (when pressed three times) Qustodio texts an alert to the three pre-arranged contacts within the product.

Net Nanny

Net Nanny is a parental control software tool owned by technology company ContentWatch, Inc. The company is based in the United States and its products are used in over 125 countries. The Net Nanny product is a similar product to that of Family Zone in that provides protection for children against inappropriate content they may become exposed to on their home computers, smartphones and tablets. We haven’t found evidence that Net Nanny continues to protect the smartphone/tablet outside the family’s home Wi-Fi network. The other difference from Family Zone’s product is that Net Nanny does not have a cyber expert option for parents to select. Net Nanny’s original product was launched in 1995.

KoalaSafe

KoalaSafe was created by two Sydney-based IT students (Steven Pack and Adam Mills) back in 2014. The product can be purchased for US\$99 and there is no yearly subscription fee to use the product. Families can connect as many devices to the home Wi-Fi network as they wish, however we understand that once more than 10 devices are connected the Wi-Fi starts to slow. In our view, we see KoalaSafe as a cost effective solution given there is no ongoing service charge, however Family Zone does offer additional features.

Market share

According to a study by Parks Perspectives just 2-4% of parents in the United States use some form of parental control software in their homes. While we believe this number is low and expect it to rise, we estimate that many families rely on in-built parental controls within smartphone apps rather than purchasing their own additional control function.

Given almost all of the parental control software products are owned privately or are just a small part of a larger listed company, sales data (and hence exact market share figures) are extremely difficult to estimate. Given only 2-4% of families use parental control software, we expect the next 5-10 years will turn into a land-grab exercise for the many parental control software companies until we hit a steady state figure – before the market share mix moves to account for product quality and price.

Barriers to entry

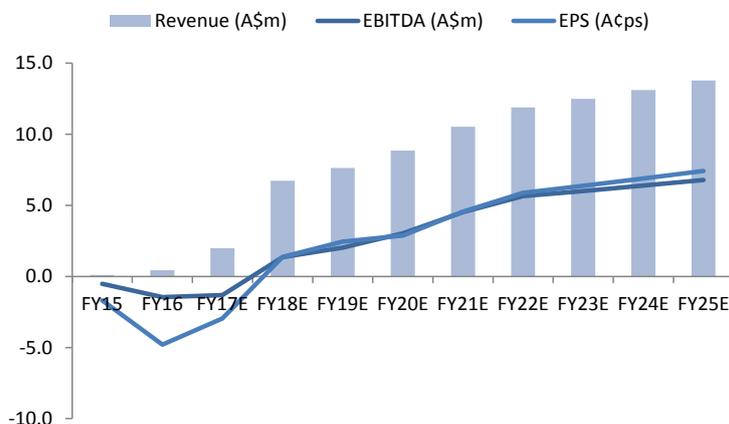
The key barriers to entry are technology intellectual property and also business relationships. Parental control software is heavily dependent on telecommunications networks and thus companies must have a deep understanding of telecommunications/technology – and we believe senior management will need to have experience in these fields to be successful. In addition, in order to expand and achieve significant market share, the product must be marketed correctly and strong business relationships (particularly with governments and large telecommunication companies) is a large advantage.

Financials

Profit & Loss

We estimate Family Zone will ultimately achieve subscriptions from c.1% of ANZ families. Our model assumes 45,000 subscriptions in ANZ by FY18E (there are c.5 million families in Australia), with that figure growing 3-5% per year into perpetuity. We also assume c.A\$2m per annum revenue by FY19E through the company's Asian wholesale agreements (the company has already secured a wholesale agreement within The Philippines). At present, just 2-4% of parents within ANZ and the US use some form of parental control software – and we believe the primary reason for this is the complexity of installation and operation of the product. With the introduction of Family Zone and potentially other easy-to-use software products, as well as the increased usage of smart phones/tablets by children, we expect many more parents to take up some form of parental control software. **Our estimates only include revenue from Australia – and do not include any overseas earnings.**

Family Zone is in the infancy stage in terms of sales revenue and we expect a step change in the company’s revenue and earnings in FY18E. We anticipate cost variances year-on-year will be due to movements in sales, marketing and business development. The business is in its infancy with regards to client subscriptions, therefore we expect marketing and sales expenses to lift materially over the short to medium term in order to build the company’s client base. We forecast the company to generate negative earnings in FY16-17E before moving positive in FY18E.



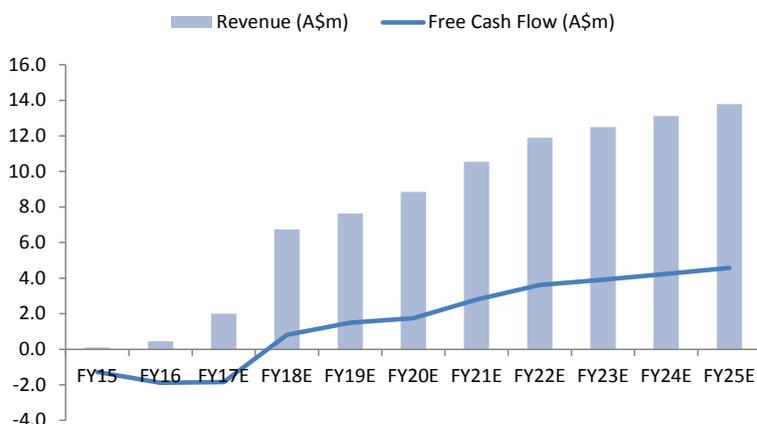
Source: BW estimates, Company Data

Balance Sheet

FZO has no debt and its published pro-forma post-IPO cash position is A\$6.7m. We expect cash burn to be c.A\$2m in FY17E before moving positive in FY18E. This doesn’t take into account any cash inflow or outflow in relation to the company’s desire to expand into the US. We expect cash flow could be tight over the next two years depending on the company’s expansion plans.

Cash Flow

We expect Family Zone will remain cash flow negative between FY16E-17E before moving positive in FY18E. We expect the company to gradually gain customer traction over the coming 12-18 months through advertising, implementation into schools as well as word of mouth. We also expect the stock’s listing on the ASX to also generate publicity.



Source: BW estimates, Company Data

Valuation

We initiate on Family Zone with a Buy and a 12 month DCF based price target of A\$0.41. Given the company is still in its infancy in terms of deriving revenue, we calculate our 12 month price target based on our DCF valuation rather than an earnings or EBITDA multiple.

We provide our valuation below, which uses a Weighted Average Cost of Capital (WACC) of 13.7% - which we believe adequately reflects the risks with this early stage company. Our WACC is calculated using a market risk premium of 7.5%, equity beta of 1.5 and a target debt to capital ratio of 20%, while our post-tax cost of debt is 5.3%. Our long term growth rate for revenue and costs is 3.5%.

Valuation	
Cumulative Present Value of Cash Flows	25.9
Add: Market value of investments	0.0
Add: Cash	6.2
Equity Value	32.1
Number of ordinary shares outstanding	62.0
Intrinsic value per share (pre imputation credits)	\$ 0.52
Value of imputation credits per share	\$ -
Risk adjusted option and performance share value	-\$ 0.10
Intrinsic per share valuation	\$ 0.41

Source: BW estimates

Sensitivities

We provide the below sensitivities to the company's DCF valuation. While we are comfortable with our assumptions for the Weighted Average Cost of Capital, revenue and cost projections, we provide the below sensitivity table to indicate the change in our DCF valuation (in A\$ per share) under various WACC assumptions as well as three scenarios for percentage take-up of ANZ families.

Scenario 1: Subscriptions from 1.5% of ANZ families by FY20E.

Scenario 2: Base case (current BW Equities estimate of c.1% of ANZ families by FY20E).

Scenario 3: Subscriptions from 0.5% of ANZ families by FY20E.

	Weighted Average Cost of Capital						
	10.7%	11.7%	12.7%	13.7%	14.7%	15.7%	16.7%
Scenario 1	\$0.92	\$0.80	\$0.71	\$0.64	\$0.59	\$0.53	\$0.50
Scenario 2	\$0.60	\$0.52	\$0.46	\$0.41	\$0.37	\$0.35	\$0.32
Scenario 3	\$0.26	\$0.22	\$0.21	\$0.18	\$0.17	\$0.15	\$0.14

Source: BW estimates

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