

## Family Zone Cyber Safety Limited (FZO) | Company Update

Rating: **BUY**  
 Target Price<sup>1</sup>: **\$0.63**  
 Projected Return: **152%**

<sup>1</sup> 12 month target

### Subscriptions and school sign-ups continue to grow

#### Company Statistics

Share Price (A\$)	0.25
Market Cap (A\$m)	20.2
Enterprise Value (A\$m)	18.0
Issued Shares (mil)	80.8
Options (mil)	26.7
Cash (A\$m)	2.2
Debt (A\$m)	0.0

#### Earnings Summary

FY End (June)	2016	2017e	2018e	2019e
Revenue (A\$m)	0.4	1.0	4.8	12.3
EBITDA (A\$m)	-1.5	-5.6	-2.7	3.1
NPAT adj (A\$m)	-1.5	-5.6	-2.7	2.8
EV/EBITDA	N/A	N/A	N/A	5.6x

#### 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

\*see research dated 01/05/2017

#### Investment Summary

Family Zone continues to report increased subscription numbers, school sign-ups and has also progressed its offering into the United States. We have subsequently remodelled the company which includes revenue generated from the company's US offering. Our 12 month Target Price methodology – now uses a Price to Sales multiple (previously we used a DCF valuation methodology given the company was not earning revenue when we initiated coverage).

#### Investment Highlights

- Consumer direct subscription numbers now sits at 7,000 in ANZ
- Mandated school sign-ups in ANZ now total 6
- Asian wholesale agreements in the Philippines and Indonesia through Telkomsel and PDLT are progressing
- United States school installations continues to grow
- Agreement with IgniteNet reached – which should help increase subscriptions into the US
- We have remodelled the company and now include revenues from the US
- Discussions with telecommunication companies continues in Australia, the United States and Asia

#### Investment Recommendation

**Maintain Buy Rating and lift 12 month Target Price to \$0.63 (was A\$0.46\*).** We have updated our target price, changing our valuation methodology to an FY19E P/Sales multiple of 4.17x (previously we used a DCF valuation). Our target price reflects a 152% premium to the last traded price.

We have remodelled the company and have included revenues from the US, which results in earnings changes in FY17E/18E/19E of +0.0¢/-3.4¢/+1.9¢.

We model Family Zone on the assumption that it achieves 12,000 consumer direct subscriptions and 120 school sign-ups in ANZ by the end of FY18E. We also assume the company generates c.A\$3.0m in wholesale revenue within Asia by FY19E and A\$2.7m revenue within the US by FY19E. This results in FY19E revenue of A\$12.3m at an EBITDA margin of 25%.

Our DCF valuation remains unchanged at A\$0.46.

The key risk to our view is competition within the parental control software market. Other risks include balance sheet flexibility, and cyber-crime.

## Summary Financials

P&L (A\$m)	FY16	FY17E	FY18E	FY19E	Balance sheet (A\$m)	FY16	FY17E	FY18E	FY19E
<b>Total Revenue</b>	<b>0.4</b>	<b>1.0</b>	<b>4.8</b>	<b>12.3</b>	Cash & equivalents	0.7	2.9	0.1	3.1
COGS	0.0	3.5	5.5	7.2	Receivables	0.0	0.2	1.1	2.9
Corporate	0.5	2.6	2.0	2.0	Inventory	0.2	0.5	2.7	7.0
Other	1.4	0.5	0.0	0.0	Other	0.0	0.5	0.5	0.5
<b>EBITDA</b>	<b>-1.5</b>	<b>-5.6</b>	<b>-2.7</b>	<b>3.1</b>	<b>Total current assets</b>	<b>1.0</b>	<b>4.0</b>	<b>4.5</b>	<b>13.5</b>
D&A	0.0	0.0	0.0	0.3	Net PP&E	0.0	0.1	0.1	-0.1
<b>EBIT</b>	<b>-1.5</b>	<b>-5.6</b>	<b>-2.7</b>	<b>2.8</b>	Other	0.5	9.9	7.1	16.7
Net interest	0.0	0.0	0.1	0.0	<b>Total non-current assets</b>	<b>0.5</b>	<b>9.9</b>	<b>7.2</b>	<b>16.6</b>
<b>Pretax profit</b>	<b>-1.5</b>	<b>-5.6</b>	<b>-2.7</b>	<b>2.8</b>	<b>Total assets</b>	<b>1.4</b>	<b>14.0</b>	<b>11.7</b>	<b>30.1</b>
Tax	0.0	0.0	0.0	0.0	Payables	0.2	9.6	10.0	25.6
Minorities	0.0	0.0	0.0	0.0	Short term debt	0.0	0.0	0.0	0.0
<b>NPAT (adj)</b>	<b>-1.5</b>	<b>-5.6</b>	<b>-2.7</b>	<b>2.8</b>	Other	1.4	0.0	0.0	0.0
Abnormal items	-0.5	0.0	0.0	0.0	<b>Total current liabilities</b>	<b>1.7</b>	<b>9.6</b>	<b>10.0</b>	<b>25.6</b>
<b>NPAT (rep)</b>	<b>-2.0</b>	<b>-5.6</b>	<b>-2.7</b>	<b>2.8</b>	Long term debt	0.0	0.0	0.0	0.0
<b>Ave shares (diluted)</b>	<b>31.0</b>	<b>71.7</b>	<b>81.4</b>	<b>81.4</b>	Other	0.0	0.0	0.0	0.0
EPS adj (A¢)	-4.8	-7.8	-3.3	3.4	<b>Total long term liabilities</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>
<b>DPS (A¢)</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>	<b>Total liabilities</b>	<b>1.7</b>	<b>9.6</b>	<b>10.0</b>	<b>25.6</b>
					<b>Total common equity</b>	<b>-0.2</b>	<b>4.4</b>	<b>1.7</b>	<b>4.5</b>
Cash Flow (A\$m)	FY16	FY17E	FY18E	FY19E	Ratios & Valuations	FY16	FY17E	FY18E	FY19E
Cash receipts	0.4	0.9	4.8	12.3	ROE (%)	na	na	na	62%
Cash payments	-1.0	-6.2	-7.5	-9.2	ROA (%)	na	na	na	9%
Net interest	0.0	0.0	0.1	0.0	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	na	7.3
<b>Cash flow from operations</b>	<b>-0.6</b>	<b>-5.2</b>	<b>-2.7</b>	<b>3.1</b>	P/B (x)	na	na	12.0	4.6
Total capital	-1.3	-0.1	-0.1	-0.1	EV/EBITDA (x)	na	na	na	5.6
Acquisitions	0.0	-1.1	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	na	15%
Other	0.0	0.0	0.0	0.0	Sales growth (%)	na	na	na	156%
<b>Cash flow from investments</b>	<b>-1.3</b>	<b>-1.2</b>	<b>-0.1</b>	<b>-0.1</b>	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	8.6	0.0	0.0	Gross margin (%)	na	na	-15%	41%
Repaid debt/borrowed funds	0.0	0.0	0.0	0.0	EBITDA margin (%)	na	na	-57%	25%
Other	0.0	0.0	0.0	0.0	EBIT margin (%)	na	na	-57%	23%
<b>Cash flow from financing</b>	<b>2.5</b>	<b>8.6</b>	<b>0.0</b>	<b>0.0</b>					
<b>Total cash flow</b>	<b>0.6</b>	<b>2.2</b>	<b>-2.8</b>	<b>3.0</b>					

June year end

Ratios calculated using FZO.AX share price of \$ 0.25

Source: Company data, BW Equities Research estimates

## Updating our model

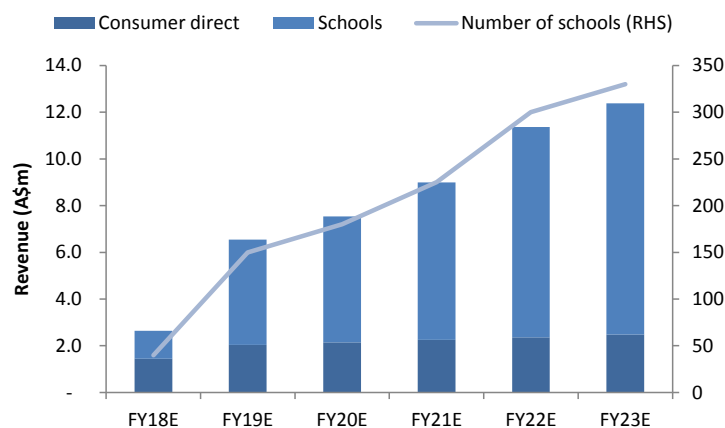
### Reconfiguring the Australian business

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 previously modelled the Australian revenue according to the total number of subscriptions – whether that be through the school, or a private home subscription. We now model the company's Australian revenue via two streams: (1) consumer direct subscriptions, and (2) school subscriptions.

FZO has announced that it has over 7,000 consumer direct subscriptions – which we estimate are charged at A\$10/month. The company has also announced that it has signed up 6 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 7,000 consumer direct subscriptions to 12,000 in FY18E and 17,000 in FY19E.** 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.330 schools by FY23E.

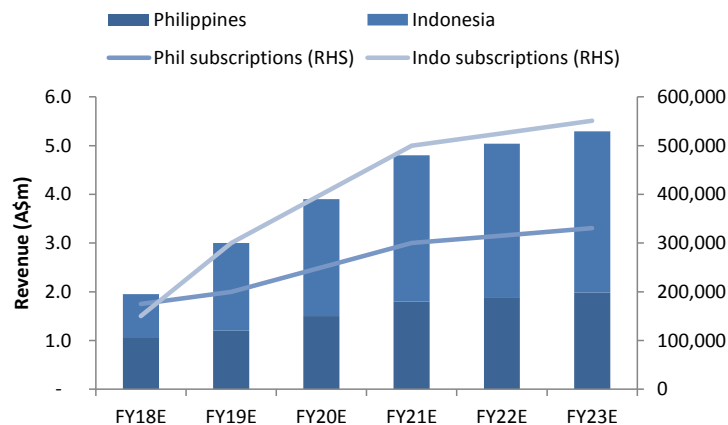


Source: BW estimates

### Reconfiguring the Asian Wholesale business

Given FZO has announced two wholesale deals (one within the Philippines and one within Indonesia), we believe we can now more accurately model revenue within the company's wholesale business. 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.



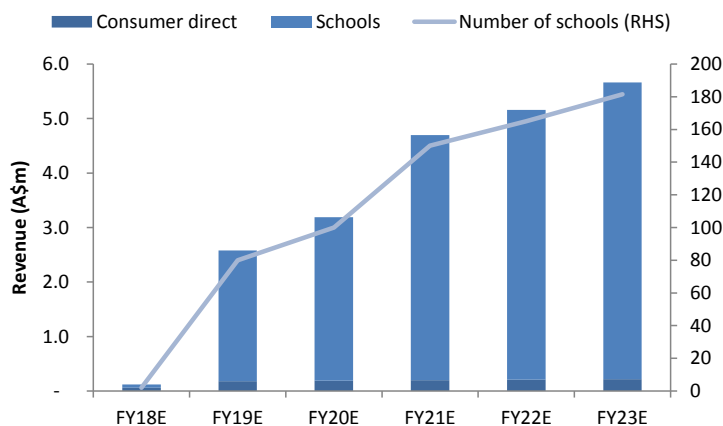
Source: BW estimates

### Introducing US revenue

FZO has reported that its technology has been implemented within 81 schools in West Virginia. We note that this is not mandated subscriptions to its students. FZO hopes to convert these schools in a similar way to its School Zone product in Australia whereby the schools would mandate the use of Family Zone by all parents through the school booklist. School Zone will be available to schools in the United States by the end of Q2 2017.

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 (planned launch in 2Q17).

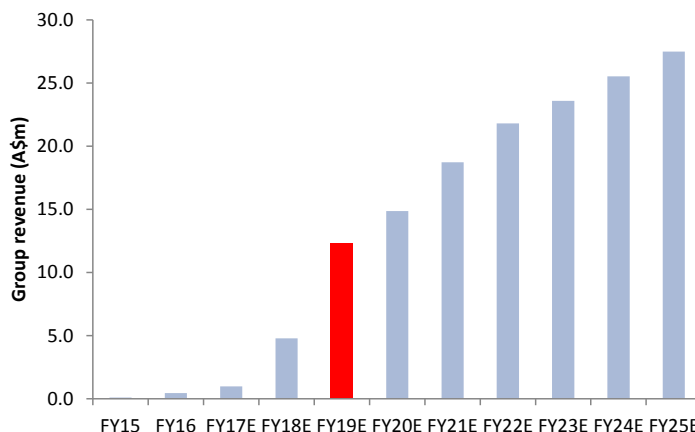
We believe there is material upside potential within the US if the company is able to secure a sizable footprint given the magnitude of the US market. **The market in the US is 10 times the size of Australia**, thus the upside is significant. As per the below chart, we expect the company to generate 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

### Moving to a P/Sales based target price

As FZO ramps up its subscription numbers and starts to generate meaningful revenue, we feel it appropriate to move our 12 month target price methodology to one based on a P/Sales multiple (previously we used a DCF valuation methodology). We source our sales multiple from the below XIJ index (currently 4.17x) which we apply to FZO's sales in FY19E (A\$12.3m).



Source: BW Equities' estimates

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
30.29	23.40	5.25	2.20%	4.17	23.26

As of April 28, 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 remodelled the company and now include US revenues within our estimates. We expect the company to make a loss in FY17E and 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
<b>FY16</b>	-1.5	-1.5	0.0%	-4.8	-4.8	0.0%	0.0	0.0	na
<b>FY17E</b>	-5.6	-5.6	0.0	-7.8	-7.8	0.0	0.0	0.0	na
<b>FY18E</b>	0.0	-2.7	-2.7	0.1	-3.3	-3.4	0.0	0.0	na
<b>FY19E</b>	1.8	3.1	1.3	1.5	3.4	1.9	0.0	0.0	na
				Old	New	Change			
<b>DCF Valuation (A\$ps)</b>				\$ 0.46	\$ 0.46	0.0%			
<b>12 mo Price Target (A\$ps)</b>				\$ 0.46	\$ 0.63	37.0%			

Source: BW estimates, Company Data

**Disclaimer**

This research was prepared for wholesale investors only as defined by section 708 of the Corporations Act. This report was prepared as a private communication to clients and was not intended for public circulation or publication or for the use of any third party, without the approval of BW Equities Pty Ltd (BW Equities). While this report is based on information from sources which BW Equities considers reliable, its accuracy and completeness cannot be guaranteed. Any opinions expressed reflect BW Equities judgment at this date and are subject to change. BW Equities has no obligation to provide revised assessments in the event of changed circumstances.

BW Equities, its directors and employees do not accept any liability for the results of any actions taken or not taken on the basis of information in this report, or for any negligent misstatements, errors or omissions. This report is made without consideration of any specific client's investment objectives, financial situation or needs. Those acting upon such information do so entirely at their own risk. This report does not constitute an offer or invitation to purchase any securities and should not be relied upon in connection with any contract or commitment whatsoever.

**DISCLOSURE OF INTEREST**

BW Equities and/or its affiliated companies may make markets in the securities discussed. Further, BW Equities and/or its affiliated companies and/or their employees from time to time may hold shares, options, rights and/or warrants on any issue included in this report and may, as principal or agent, sell such securities. BW Equities acted as Lead Manager to the placement discussed in this report and may do or seek to do business with companies covered in this report.

The Directors of BW Equities advise that they and persons associated with them may have an interest in the above securities and that they may earn brokerage, commissions, fees and other benefits and advantages, whether pecuniary or not and whether direct or indirect, in connection with the making of a recommendation or a dealing by a client in these securities, and which may reasonably be expected to be capable of having an influence in the making of any recommendation, and that some or all of our Authorised Representatives may be remunerated wholly or partly by way of commission.

**ANALYST DISCLOSURE**

I, Brett Cottrell, certify that the views expressed in this report accurately reflect my personal views about the company and no part of my compensation was, is or will be directly or indirectly related to the specific recommendations or views expressed in this report.

The analyst(s) responsible for preparing this research report received compensation based on several factors including BW's total revenues, a portion of which are generated by corporate advisory activities.

**BW Equities Pty Ltd ABN 66 146 642 462 AFS Licence No. 389353**