

FAMILY ZONE CYBER SAFETY LTD (ASX: FZO)

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SPLASH REPORT

DESCRIPTION

Family Zone Cyber Safety (FZO) is an Australian technology company focused on the rapidly growing global parental control and cyber safety market. FZO's unique platform permits world-first collaboration between parents and schools to keep children safe at home and school.

FZO targets consumers, schools and wholesalers in multiple geographies. FZO has a proven product, with over 100,000 paying accounts and 600,000+ daily users. New markets and distribution channels offer many catalyst opportunities.

KEY INVESTMENT HIGHLIGHTS

FZO is a high-growth subscriptions-based company positioned in the global cyber safety market. FZO distributes their innovative cloud-based platform via schools, telcos and device manufacturers.

The platform leverages the strength of online filtering, combining it with the features of on-device parental controls which are controlled via a singular cloud-based application. The Family Zone Platform filters content including social media, controls access through policies and calendars, supports device sharing, is both simple to install and use, and is low-cost.

The global cyber safety market is estimated to be worth ~US\$2.5bn annually, based on a 2-4% take-up in parental controls globally. The relatively low level of penetration reflects challenge for device-based parental controls which can't effectively bridge the gap between multiple environments (e.g. home & school). FZO's platform is addressing this issue head on.

In the March 2019 quarter FZO reported 83% growth QoQ on the total value of contracts sold to schools and 75% conversion of school trials. A consumer bundle offering with Alcatel via Woolworths was also launched with a strong debut.

COMPANY DATA

Closing price (AUD) 04.06.2019	\$0.11
Enterprise Value (\$m)	\$15.5m
Market Cap (\$m)	\$23.0m
Issued Capital (m)	200.6m
12-mth price range	\$0.11 - \$0.57
GICS Sector	Systems Software

SHARE PRICE CHART



MANAGEMENT

Tim Levy – Managing Director
Crispin Swan – Executive Director
John Sims – Chairman
Phil Warren – Non-Executive Director

MAJOR SHAREHOLDERS

Regal Funds Mgmt	6.06%
Tim Levy	5.31%
Herald Investment Mgmt	5.22%
Harry Hatch	4.40%
Top 20 Shareholders	38.72%

NOVEL APPROACH TO CYBER SAFETY

The proliferation of internet-enabled devices amongst children has contributed to a surge in cyber safety related issues, which include cyberbullying, sexting, gambling and excessive screentime. Competing parental control solutions such as OurPact and NetNanny are typically device-centric and thus struggle with deployment in a way that is both effective and complete across multiple environments.

The responsibility of device control is left to the current carer of the child, changing multiple times per day depending on the environment (usually between teachers and parents). This presents challenges in retaining a stable, effective solution. FZO takes responsibility away from the carer of the children by providing an umbrella solution that adapts with context.

FZO's platform sits in the cloud rather than on the device, so the solution is effective even when children use alternative devices or connect to different networks in an attempt to circumvent a carer's controls. The platform lets the current carer filter content, restrict social media, block apps, manage screen times, disable camera features etc, whilst offering discrete reporting and full transparency for all devices.

The platform allows schools to engage with parents in cyber safety programs, and offers direct interaction with cyber safety experts who can provide integration and support services and effectively support the distribution network.

PATENT PROTECTION

FZO's extensive list of IP claims are managed by Griffith Hack. FZO has been granted an innovation patent and is currently progressing through the PCT process for substantial claims which will lead to IP protection in key overseas markets.

MARKET OPPORTUNITY AND STRATEGY

The size of the global cyber safety market is estimated to have <4% take-up of parental controls globally. This penetration is quite low and we attribute this to the relative difficulty of implementation and administration. FZO believe its cloud-based platform, which solves these issues, help expand the addressable school market from ~A\$250m to ~\$3.7bn p.a. in their current targeted regions of Australia, NZ, UK and the US, with further early potential in India, Malaysia, and Indonesia. It is estimated that there is a US\$100b untapped, fragmented global cyber safety market in the education and direct customer space, with market size being a function of parental control take-up.

AN EFFICIENT SALES STRATEGY IS VITAL

In the past FZO has invested heavily in the school-by-school sales approach, which has weighed on its path to rapidly scale up. A more recent re-focus on a wholesale strategy is interesting as it presents FZO the opportunity to garner mass market share with minimal customer acquisition cost.

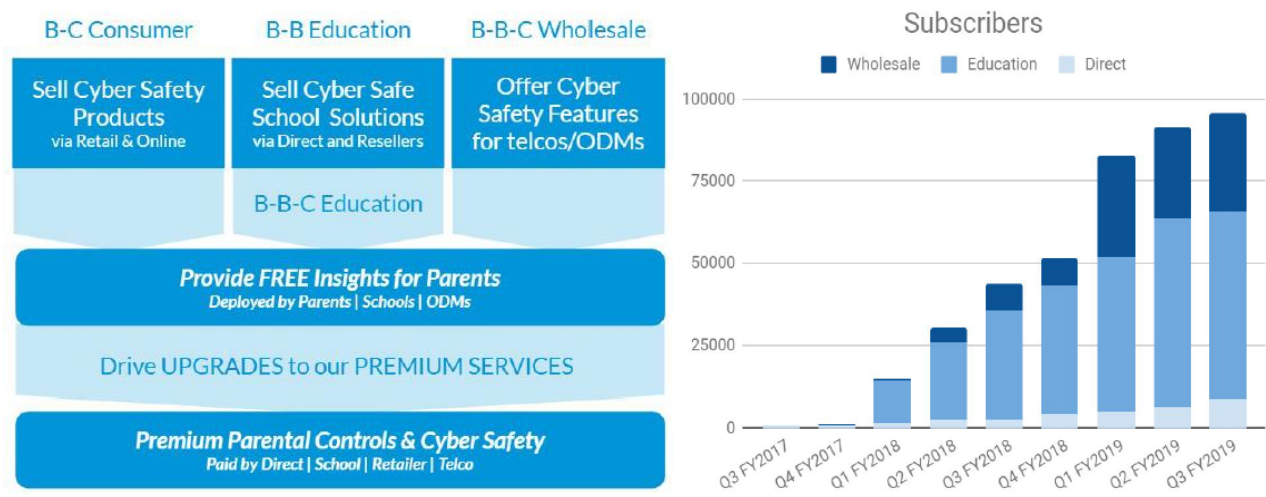
A common benchmark for SaaS businesses is to achieve a ratio of lifetime value of customers (LTV) to customer acquisition costs (CAC) of 3x. Given FZO's early juncture we are unable to make an assessment of this metric but consider it worthwhile watching as the business matures.

FZO's lean sales strategies include:

- Engagements with Vodafone and Bharti Airtel (two of the world's largest telecommunications providers) as resellers in India with a view to expand into other regions. The cyber safety market in India is expected to be worth \$1.25bn by 2025 alone. FZO have won-over former cricketer Michael Clarke as a brand ambassador to access this market.
- FZO has been appointed the provider of choice across many of the large telcos in the Asia-Pacific, incl. Telkomsel - Owned by SingTel (Indonesia), Maxis (Malaysia) and PLDT (Philippines). Collectively, these telcos manage over 600m subscribers of which 60m are children, and offer an estimated market opportunity of A\$340m p.a., assuming <\$7 of revenue p.a. per consumer.
- FZO has partnered with Alcatel (provider of Telstra branded devices) to supply a freemium version of the solution on all devices sold in Australia which began earlier this year.
- Woolworths Mobile has selected FZO's proprietary 'FZ One' first-of-a-kind mobile phone as its preferred child-friendly device for national marketing and online.

EARLY TRACTION & PROMISING RESULTS

Below shows an infographic of the FZO revenue model, paired with a subscriber count showing the components of its subscriber base.



Source: FZO Quarterly Report

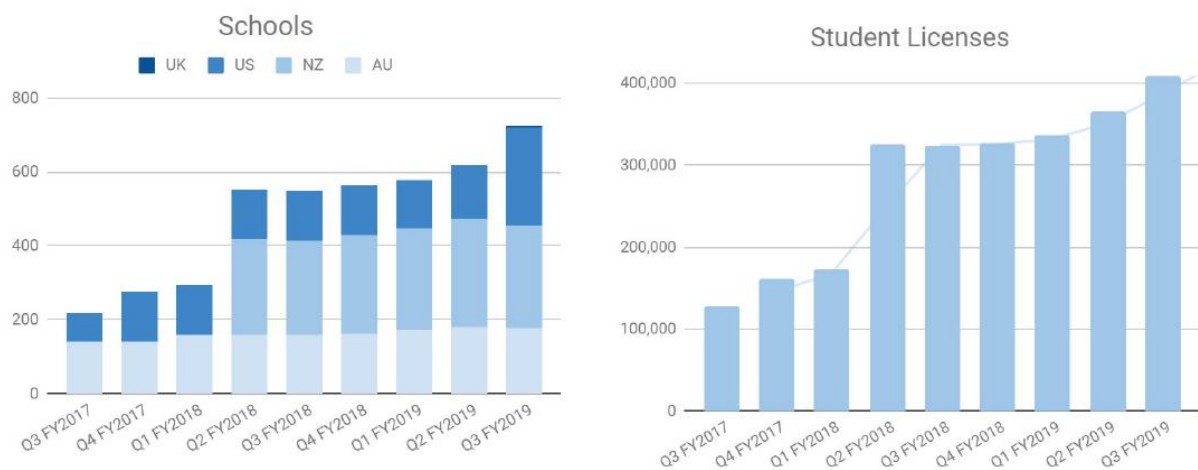
Revenues are largely subscriptions, worth ~US\$100-120/account/year for the direct channel, US\$60-70 for the education channel and ~US\$3 for the wholesale channel. FZO sells directly to parents, schools and telcos. FZO currently has a **\$6M pipeline of education opportunities (up from \$2m in the previous quarter)** in Australia, NZ, USA, UK & India.

FZO's revenue grew to \$2.2m Q3FY19, up from \$1.95m last quarter. Previous to this, their revenue had been doubling every 6 months since launch (excluding grants and tax incentives).

The education distribution strategy has been delivering strong results. These include consistent doubling of sales YoY without increased investment in marketing in the direct to customer market and >45% parent take-up in schools under the school partnering model in Australia, demonstrating the power of school influence over parents.

FZO enjoys a quasi-network effect associated with heightened social responsibility pressures to combat cyber safety related issues. As a result, user acceptance through direct and school channels is validated by the improving penetration in schools, where revenues per school grew from ~A\$1,600 to A\$5,400 per school in 2.5 years.

Total user accounts have continued to grow, with ~725 school clients (32% YoY growth) which reach ~410k students via licenses (up from 365k in the December 2019 quarter). Within this channel, licenses generate ~A\$7-8 per student per year under the SaaS revenue model, with ~500 students per school on average.



Source: FZO Quarterly Report

Notable high schools partnered with FZO in Australia include Waverly College (Sydney), Kambala Girls School (Sydney), John XXIII College (Perth), and Mazenod College (Perth).

The recent entry into the UK market has been swift and low cost. UK schools and student licenses are yet to be reflected in the growth shown above. In the UK, FZO is directing sales efforts through edu-tech resellers at commercial rates to minimise incremental marketing expenditure. As a revenue comparison, FZO entered the US market late CY2018 and now has 292 schools under contract, rapidly approaching the \$1m revenue mark.

FZO's has converted 75% of US proof of concept trials in USA school districts into paying clients so far. Also in the US, by end of CY2019 FZO will be selling via the B2B2C channel. The vast US market serves as a huge opportunity for revenue potential far higher than the Australian market.

The wholesale strategy is still relatively new and yet to be fully validated. There are promising results as early wholesale agreements have maintained subscriber numbers as trials continue. Success in this sales channel can materially enhance growth via the massive scale opportunity.

FZO has a team of approximately 70 employees. With significant investments made into product and sales, FZO has initiated a program to bring forward its targeted cashflow breakeven to the first half of CY2020 via productivity improvements and overhead reductions, paired with growing subscription revenue and R&D incentive income. FZO expects effective annual overhead costs to fall to \$10-11m from circa \$12-14m. FZO relies heavily on the practices of the sales team that continues to refine the sales strategies with the aim to bring forward the projected breakeven.

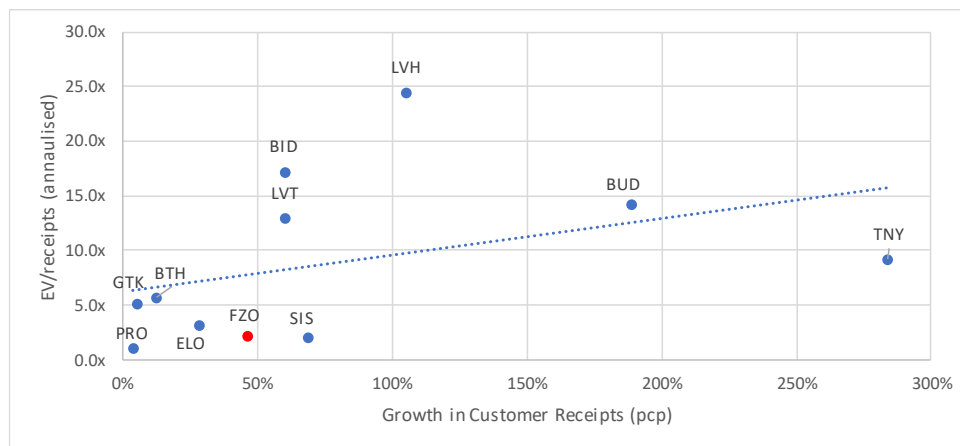
FZO TRADES SIMILARLY TO LOWER GROWTH PEERS

Since FZO is one of very few cyber security stocks on the ASX, we compare FZO to similarly styled micro-cap SaaS or software-based companies. That is, companies that have a relatively small market cap in similar maturity states that primarily use a recurring license fee as the revenue model.

Company	LVH	BID	BUD	LVT	TNY	BTH	GTK	FZO	ELO	SIS
Receipts (\$m) (quarter)	0.93	1.28	1.38	5.20	1.09	5.40	23.63	1.75	9.50	0.48
Mkt Cap (\$m)	113.0	88.3	104.6	281.0	39.0	136.0	489.0	23.0	158.0	6.0
EV (\$m)	91.0	88.0	79.0	269.0	40.0	123.0	488.0	16.5	122.0	4.0
EV/receipts (annualised)	24.5x	17.2x	14.3x	12.9x	9.2x	5.7x	5.2x	2.4x	3.2x	2.1x
Receipt Growth (pcp)	105%	60%	189%	60%	284%	13%	5%	46%	28%	69%

Source: BOEQ, Company Accounts

EV / CUSTOMER RECEIPTS VS LATEST REPORTED GROWTH VS PCP



Source: BOEQ, Company accounts

The table and graph compare the Enterprise Value to annualised customer receipts ratio with the customer receipt growth (pcp) across a basket of stocks to establish a common benchmark. FZO sits below the trend line, indicating that it could be undervalued relative to micro cap tech peers.

It should be noted that this is a crude analysis that is only designed to give a general feel for the space FZO sits in, and should not represent a formal assessment of its valuation.

KEY RISKS

FZO is subject to all the usual risks associated with early-stage technology companies, including:

- **Funding Risk:** There is a risk FZO may need to go back to the market for capital and the investor's appetite may be diminished for this type of product, depending on timing and progress.
- **Sales Channel:** If a diversified sales channel is not emphasised, FZO could be stuck selling a non-scalable school-by-school and direct customer product. The flip side of wholesale sales is that the time length of the sales pipeline is lengthened, and probability of success is diminished. An effective sales team must be a priority for FZO.
- **Competition:** Although FZO currently sit technologically ahead of their competitors, the barriers for entry may not seem so high for large, well-funded peers.

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