

25 June 2021

Family Zone Cyber Security (FZO)

FZO looks to acquire US-based NetRef + raises \$23m

FZO has announced the signing of indicative terms to acquire US-based EdTech provider NetRef for an amount of up to ~US\$4.3m (including earn-outs) while simultaneously taking the opportunity to raise ~\$23m via the placement of ~43m shares at an issue price of \$0.535 per share. The proposed acquisition will add 250k students to FZO's US business and gives access to additional premium classroom tools, which can be sold alongside its Linewize product. Following the update we make minor changes to our estimates, lower our PT to \$0.89/Sh and maintain a BUY recommendation.

NetRef acquisition. While only indicative terms at this stage, the proposed acquisition of NetRef will add ~250k students/~US\$400k ARR to FZO's business immediately, which is then forecast to rise to ~450k/~US\$850k by year-end C21.

FZO is paying an attractive price... FZO will acquire NetRef on an attractive multiple of ~3.5-5.0x ARR; which will be funded over three tranches and depends on performance – an immediate amount of US\$1.4m (ie. 3.5x US\$400k ARR) is payable, with a total forecast purchase price of US\$4.3m (ie. 5.0x US\$850k) payable in tranche 3, by December 31st.

...However, cost synergies are the real prize. As we understand it, NetRef delivers its product @ ~US\$0.50/student; which is materially below FZO's current delivery price of ~US\$2/student. Accordingly, in the event FZO can use NetRef's technology to capture some (or all) of these savings, the potential cost synergies are significant – ie. ~US\$3m/year if the entire \$1.50 saving is realised over FZO's current student base of ~2m children. Note: At this stage, we do not model any cost savings from NetRef.

FZO to exceed 3m US students by CY21 year-end. The six-month period running 4Q21-1Q22 is FZO's major sales period in the US and should see the company add >800k students, or ~\$5m in new ARR on an underlying basis (ie. ex-NetRef). With the acquisition of a further ~250k students (via NetRef, growing to 450k by year-end) and incremental student growth in its core business, we see FZO ending CY21 with >3m student licences in the US (BW = 3.1m). For context, this see FZO with a ~6% market share.

Placement. Following the successful raising of \$23m, we expect FZO will end FY21 with ~\$38m in available funds. Placement proceeds will be used for (1) continued expansion, (2) the acquisition and integration of NetRef, (3) working capital needs and (4) potential strategic acquisitions. With a burn rate of ~\$10m/year (and slowing) we believe FZO has more-than sufficient funds to cover its working capital needs – raising the likelihood of more corporate activity to come, in our view.

PT reduced to \$0.89/Sh (from \$0.91/Sh), due to dilution. Despite the positive elements of today's announcement, our PT falls by a modest 2% given the dilutionary impacts of FZO issuing another ~43m shares.

Recommendation	BUY
Target Price (AUD)	0.89
Share Price (AUD)	0.59
Forecast Capital Return	51%
Forecast Dividend Yield	0%
Total Shareholder Return	51%
Market Cap	272,597
Net Cash (Debt)	37,656
Enterprise Value	234,942
Diluted Shares on Issue	462,030
Options on Issue	9,326

Lindsay Bettiol | Head of Research

Key Executives

Managing Director	Tim Levy
Executive Director - Sales	Crispin Swan
Non-Executive Chairman	Peter Pawlowitsch
Non-Executive Director	Matthew Stepka

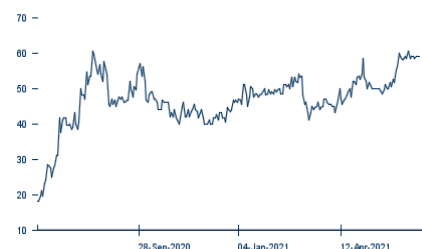
Catalysts

Key US Sales Period	4Q20/1Q21
US Schools Insights Launch	1Q21
Achievement of CF breakeven	Late-FY22
US Schools Stimulus	Ongoing

Substantial Shareholders

Regal Funds Management	11.09%
McCusker Holdings	5.14%
Tolga Kumova	2.40%
BNP Paribas Nominees	2.36%
Tim Levy	2.27%
Twynam Investments	1.53%

Recent Performance



P&L (A\$m)	FY20	FY21E	FY22E	FY23E	FY24E
Customer Revenue	5.1	10.8	21.5	36.9	57.2
COGS	2.2	6.1	8.8	11.9	14.6
Gross Profit	2.8	4.7	12.7	25.0	42.6
Other	3.4	3.0	3.0	3.0	3.0
Corporate	23.8	27.8	30.2	34.0	38.3
EBITDA	-13.2	-18.2	-13.0	-4.4	9.1
D&A	4.2	1.8	1.4	1.5	1.6
EBIT	-17.4	-20.0	-14.4	-5.9	7.5
Net interest	0.0	0.0	0.0	0.0	0.0
Pretax profit	-17.6	-20.1	-14.5	-6.0	7.4
Tax	0.0	0.0	0.0	0.0	2.2
Minorities	0.0	0.0	0.0	0.0	0.0
NPAT (rep)	-17.6	-20.1	-14.5	-6.0	5.1
Abnormal items	0.0	0.0	0.0	0.0	0.0
NPAT (adj)	-17.6	-20.1	-14.5	-6.0	5.1
Ave shares (diluted)	251.4	394.3	463.4	466.5	470.0
EPS adj (A¢)	-7.0	-5.1	-3.1	-1.3	1.1
DPS (A¢)	na	na	na	na	na

Cash Flow (A\$m)	FY20	FY21E	FY22E	FY23E	FY24E
Net income	-17.6	-20.1	-14.5	-6.0	5.1
D&A	4.2	1.8	1.4	1.5	1.6
Stock-based comp	2.9	1.0	1.5	2.0	2.5
Deferred taxes	0.0	0.0	0.0	0.0	0.0
Other	2.3	5.3	0.0	0.0	2.2
Cash flow from operations	-8.3	-12.0	-11.6	-2.5	11.5
Capital expenditures	-1.3	-1.9	-1.9	-2.0	-2.0
Acquisitions	0.0	0.0	0.0	0.0	0.0
Divestitures	0.0	0.0	0.0	0.0	0.0
Other	0.0	0.0	0.0	0.0	0.0
Cash flow from investment:	-1.3	-1.9	-1.9	-2.0	-2.0
Dividends paid	0.0	0.0	0.0	0.0	0.0
Capital raised	10.3	45.8	0.0	0.0	0.0
Repaid debt/borrowed funds	0.0	0.0	0.0	0.0	0.0
Other	0.0	0.0	0.0	0.0	0.0
Cash flow from financing	10.3	45.8	0.0	0.0	0.0
Total cash flow	0.7	31.9	-13.6	-4.5	9.4

Balance sheet (A\$m)	FY20	FY21E	FY22E	FY23E	FY24E
Cash & equivalents	5.8	37.7	24.1	19.6	29.0
Receivables	4.7	3.1	3.1	3.1	3.1
Inventory	0.2	0.2	0.2	0.2	0.2
Other	0.2	0.2	0.2	0.2	0.2
Total current assets	11.0	41.2	27.6	23.2	32.6
Net PP&E	1.5	2.8	3.9	4.9	5.8
Intangibles	1.3	0.1	-0.4	-0.9	-1.4
Total non-current assets	0.0	0.0	0.0	0.0	0.0
Total assets	14.2	44.5	31.5	27.5	37.4
Payables	3.1	7.7	9.2	11.2	13.7
Short term debt	0.0	0.0	0.0	0.0	0.0
Other	3.0	3.0	3.0	3.0	3.0
Total current liabilities	7.6	12.1	13.6	15.6	18.1
Long term debt	0.0	0.0	0.0	0.0	0.0
Other	0.0	0.0	0.0	0.0	0.0
Total long term liabilities	2.2	2.2	2.2	2.2	2.2
Total liabilities	9.8	14.3	15.8	17.8	20.3
Total common equity	4.4	30.2	15.6	9.7	17.0

Ratios & Valuations	FY20	FY21E	FY22E	FY23E	FY24E
Gross margin (%)	56%	43%	59%	68%	74%
EBITDA margin (%)	-260%	-168%	-61%	-12%	16%
EBIT margin (%)	na	-185%	-67%	-16%	13%
NPAT margin (%)	na	-185%	-68%	-16%	9%

Incrementals	FY20	FY21E	FY22E	FY23E	FY24E
Gross margin (%)	76%	33%	75%	80%	87%
EBITDA margin (%)	-874%	-86%	49%	56%	66%
EBIT margin (%)	-837%	-45%	52%	55%	66%
NPAT margin (%)	-849%	-43%	52%	55%	55%

P/E (x)	na	na	na	na	53.9
P/B (x)	33.7	7.7	17.5	28.5	16.3
EV/EBITDA (x)	na	na	na	na	27.4
Customer Rev growth (%)	22%	113%	98%	72%	55%
EBITDA growth (%)	na	na	na	na	na
EPS growth (%)	na	na	na	na	na

June year end

Ratios calculated using FZO share price of \$ 0.59

Source: Company data, BW Equities Research estimates

NetRef: Company and Product Overview

NetRef's EdTech product suite appears to be very synergistic with FZO's existing product suite, given both companies aim to help educators maximize their EdTech investments by ensuring all tech tools are being used for learning.

Like FZO, NetRef has been developed with input from teachers, while NetRef also looks to solve top EdTech challenges by combining unprecedented insight into online activity with easy-to-use, one-click internet management controls.

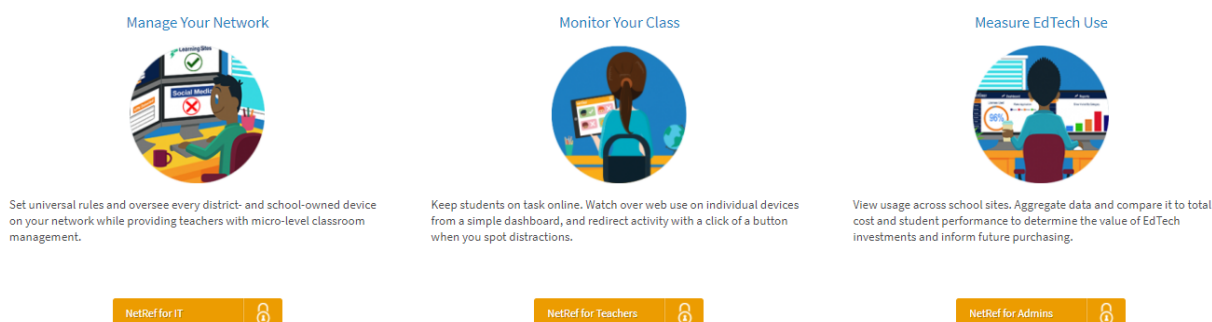
- **IT teams** can use NetRef to manage the increasing number of devices on their networks.
- **Teachers** can observe web use on individual devices — both in a classroom and when teaching remotely — and lock down or allow activity in a click; and
- **Administrators** can collect usage data for students, classrooms, schools, and even districts to inform purchasing and professional development decisions.

NetRef's key products include:

- **Classroom Management.** As with FZO, NetRef's classroom management tools allow teachers to view screens in real-time, content filter in real-time, close tabs and send URL's out to individual students and receive reporting on individual and class histories.
- **EdTech Usage Reporting.** NetRef also allows schools and districts to gain valuable insights into EdTech use across their jurisdictions, with additional purchase options including usage reporting, EdTech effectiveness tools and multi-level permission admin features.
- **Network Management.** Focusing on macro-level network management of district and school-owned devices, this set of tools includes scheduling tools, oversight and rules allocation at more of a district level.
- **Content Filtering.** Working with any content filtering solution, NetRef can provide additional classroom-level controls, which can be bundled alongside other NetRef products.

Figure 1: NetRef's product suite

Three Essential EdTech Management Tools, One Comprehensive Subscription



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