

Family Zone Cyber Security Ltd

(FZO \$0.62) Speculative Buy

EUROZ HARTLEYS

Analyst	Date	Price Target
Harry Stevenson	25 th June 2021	\$0.80/sh ▲ from 0.72/sh

Capital Raise and Acquisition

Event

FZO has completed a \$23m capital raise to fund the acquisition of Net-ref and position the business for future growth opportunities in the short term.

Impact

Funds will be used to:

- Grow school users in new and existing markets
- Launch Community Proposition into the US market.
- Invest in the product and layer services to improve yield.
- Invest in the organisation to prepare for further scale (in excess of current capacity)
- Pursue acquisitions for capability and acceleration of student numbers.

FZO is clearly positioning to become a major player in global markets; with the next 6 months likely to be transformative and catalyst rich.

Action

Buy, the raise positions FZO to take a meaningful slice of global education filtering and parental control market through acquisitions and organic growth.

Price target \$0.80/sh up from \$0.72/sh.

We see massive potential upside to our Price Target if FZO can execute on strategic acquisitions to rapidly grow their student growth rates.

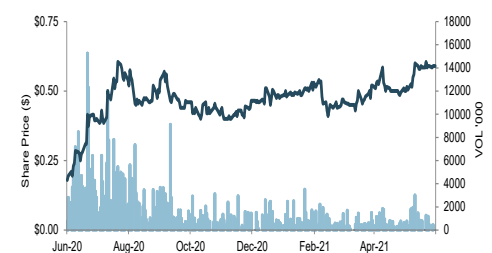
Key Catalysts

- Growth in student numbers – FZO on track to grow student base in FY'21 by 150%. We are forecasting 2.1m contracted students on platform by 30 June.
- FZO is gearing up to secure State Wide deals (500k+ Students). This is enormous step for FZO; leaving it well placed to accelerate growth
 - Finishing CY-21 in excess of 3m students should be looked for as a catalyst.
- Launch of consumer product in the US - results of pilot launch to over 40,000 Students in the US.
 - Conversion rates at similar levels to Australian pilot (17.5%) would see the business re-rate.
- Further acquisitions that:
 - Add to student Base
 - Add to ARPU per student.
 - Decrease COS
- Cashflow breakeven could occur in FY22, ahead of earnings given upfront payments of enterprise contracts.

Family Zone Cyber Sec Ltd	Year End 30 June	
Share Price	0.62	A\$/sh
Price Target	0.80	A\$/sh
Valuation (DCF)	0.89	A\$/sh
WACC	9.8%	
Terminal Growth	3.0%	
Shares on issue*	434	m
Fully Dilluted	473	m
Market Capitalisation	269.2	A\$m
Enterprise Value	226.3	A\$m
Cash (Proforma)	43.4	A\$m
Debt (1H'21)	0.5	A\$m

Key Financials	2020a	2021f	2022f
Revenue (A\$m)	4.8	10.4	22.1
EBITDA (\$m)	-13.1	-14.9	-7.9
EBIT (A\$m)	-17.2	-17.1	-9.1
Reported NPAT (A\$m)	-17.5	-17.3	-9.3
Normalised NPAT (A\$m)	-17.5	-17.3	-9.3
Gross Cashflow (A\$m)	-10.9	-12.8	-5.8
Capex (A\$m)	-1.4	-1.8	-1.5
Op. Free Cashflow (A\$m)	-10.0	-15.4	3.4
Revenue Growth (%)	14%	118%	112%
EBITDA Growth (%)	19%	14%	-47%
Norm. NPAT Growth (%)	22%	-1%	-46%
Normalised EPS (Ac)	-7.06	-3.99	-2.14
Norm. EPS growth (%)	-2%	-43%	-46%
PER (x)	-3.4	-15.5	-29.0
EV:EBITDA (x)	-4.2	-15.2	-28.7
EV:EBIT (x)	-3.2	-13.2	-25.0
EV: Revenue	11.5	21.8	10.3
DPS (Ac)	na	na	na
Dividend Yield (%)	na	na	na
Net Cash (A\$m)	4.2	37.2	38.8
Net Debt:Equity (%)	103%	94%	111%

Share Price Chart



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Analysis

Funds will be used to:

- Grow school users in new and existing markets
 - Currently supporting 4.5% of US schools districts, up from 3% at 31 March.
- Launch Community Proposition into the US market.
 - 5 US Districts with 40,000 students to launch Community product over Summer break in the US.
 - Major Launch planned for the start of the US School year (Aug/Sep)
 - Community product offering significantly improved by the update of Apple API developer tools; potentially leading to greater consumer take up across IOS devices.
- Invest in the product and layer services to improve yield.
 - Conversion of POC trials now at 90%
- Invest in the organisation to prepare for further scale (in excess of current capacity)
 - In procurement process for State-wide deals in USA and Canada.
 - Potential to add an additional ~800k students to the platform through these organic growth opportunities.
- Pursue acquisitions for capability and acceleration of student numbers.
 - Given excess capital (we estimate in excess of \$30m) we would anticipate that management are actively seeking acquisition targets at a scale magnitudes larger than the recent acquisition.
 - Successful execution would be transformation to business and earnings growth profile.
- Acquisition of Net-Ref will add an additional 250k students to the platform; with consideration anticipated to be \$US4.325m (50/50 cash and equity).
- While this is positive acquisition in terms of additional students on the platform and potential synergies (management have highlighted Net-ref COS per student at \$0.60; which compares favourably to our estimate of \$1.50 per student for FZO).

There is clearly a bigger picture play; in which management envision major acquisitions over the coming 6 months.

We explore some theoretical outcomes below.

Valuation

- Our price target is updated to \$0.80/sh (diluted and proforma cash balance).
- Our price target consists of an NPV and ARR multiple components;

Components	Equity
NPV	418.6
FY'22 ARR x 8	342.0
mean	380.3
(/) Fully Dilluted	472.5
Blended	\$0.80

- There is the prospect for this Price Target to increase in the short term if FZO converts on the potential State Wide deals in the USA and Canada

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The following outlines our updated forecasts

Half on Half		6/20A	6/21F	1H'22	2H'22	6/22F	6/23F	6/24F	6/25F
Education		4.5	9.8	9.5	9.4	18.9	32.8	41.7	48.7
Consumer		0.3	0.6	0.4	2.9	3.2	21.6	38.1	51.4
Revenue	\$m	4.8	10.4	9.8	12.2	22.1	54.5	79.8	100.1
ARR	\$m	8.1	14.7	19.5	37.1	37.1	69.6	90.1	110.0
-Students	#m	0.9	2.09	3.0	4.0	4.0	5.9	7.0	7.6
-Consumers	#m	0.0	0.05	0.0	0.1	0.1	0.3	0.5	0.6
-US Student ARPU	\$AU	6.0	6.00	6.0	6.0	6.0	6.0	6.0	6.0
-US Consumer ARPU	\$AU	NA	108.00	108.0	108.0	108.0	108.0	108.0	108.0
EBITDA	\$m	-13.1	-14.9	-3.5	-4.4	-7.9	12.7	29.8	50.1
EBITDA Margins	%	-271%	-143%	-36%	-36%	-36%	23%	37%	50%
EBIT	\$m	-17.2	-17.1	-4.1	-4.9	-9.1	11.4	28.5	48.7
EBIT Margins	%	-357%	-165%	-42%	-40%	-41%	21%	36%	49%
NPAT	\$m	-17.5	-17.3	-4.2	-5.1	-9.3	7.8	19.8	33.9
NPAT Margin	%	-364%	-167%	-43%	-41%	-42%	14%	25%	34%

- If FZO can convert on State Wide deals there is further upside to our Student and consumers estimates
- We will look to update these forecasts with the release of Q'4 update; management commentary states "on track to grow our student base by FY'21 to +2m students"
- We have pulled back revenue forecasts which reflects revenue recognition of new contracts landed late in Q'4 occurring in Q'1 of the next financial year.

Acquisitions and Organic Growth Options

Management have made the first steps in articulating plans for potential acquisitions in the near future (we note cash ~\$30m in excess of capital requirements to fund cashflow breakeven / current acquisition).

Below we examine two likely scenarios:

1. Growth in student base (in excess of previous forecasts) to 10% of Total TAM through organic and acquisition growth.
2. Growth in ARPU student through additions to FZO's product offering.

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Scenario 1. Student Base +

- With on going consolidation in the in the cyber safety market place, we see a pathway for FZO to generate ~\$50m ARR within the education segment through acquisitions and organic student growth.
- **For instance; FZO is well on track to take 10% of US market by '23; similar rates of penetration in the US/UK/Canada through organic and acquisition growth could see the company generating ~\$50m ARR in the education segment alone.**

	Students (m)	Current Penetration Estimate*
US Students	58.4	4.5%
UK	11.7	na
Canada	4.9	na
Australia	3.8	2.0%
New Zealand	0.7	12.0%
TAM	79.4	
10% Penetration	7.9	
ARR \$m	47.6	@ 6\$ per Student

*Note these are EHSL penetraton estimates

Scenario 2. Student ARPU +

Rollout of AI analytical tools that focus on student safety and wellbeing could offer significant upside to current earnings profile.

We estimate a leading US provider of these tools charges students \$9 per student per year (without filtering or classroom tools).

Doubling of ARPU to \$12 per student drives ~70\$m in ARR per year in the US education market.

Education Segment		Scenario 1	Scenario 2
Students	#m	7.9	5.6
Per Unit	\$	6	12
ARR	\$m	47.6	67.2
Consumer Segment			
Parents	%	5.00%	5.00%
Per Unit	\$	100	100
ARR	\$m	39.7	28
Total ARR	\$m	87.4	95.2
Multiple	x	10	10
\$/sh		1.85	2.01
SOI *		472.5	

*note we have not diluted for any potential acquisition required to fund these scenarios.

If management can execute, FZO's education segment has the potential to drive meaningful earnings in a short timeframe.

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Community Proposition

While the above highlights the potential growth in the Education Segment earnings; FZO has received a massive boost to its consumer product in the lead up to the US launch in August.

Apple has announced an update to its Application Programming Interface (API) which is the software that allows two applications to talk to each other.

Specifically: The new Apple Screen Time API offers developers (FZO) access to frameworks that will allow improvements to the parental control experience, usability and effectiveness.

What this means? FZO's effectiveness on IOS devices is limited by the child's ability to remove the FZO application from the device (we note the parent is notified if this occurs).

The new API will enable parents to set FZO as the designated parental control app on their children's device, which will prevent the child from removing the application from the device.

In our opinion, this significantly improves the likelihood of parental take up when the product is launched in the US.

Any meaningful conversion of student accounts to higher yielding parental control accounts (\$6 vs \$108 ARPU) will see the stock rerate.

We anticipate that successful pilot trials of consumer product in the US could be a major catalyst; management have highlighted that early feedback has been very positive.

FZO is clearly positioning for more transformational acquisitions in the future, the quantum of which likely has the potential to massively transform the current business and earnings profile.

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Financial Statements	2019a	2020a	2021f	2022f	Performance Ratios	2019a	2020a	2021f	2022f
Income Statement					Growth & Margins				
Revenue	4.2	4.8	10.4	22.1	Revenue Growth	80%	14%	118%	112%
Other Revenue	3.8	3.4	5.0	7.5	EBITDA Growth	17%	19%	14%	-47%
OPEX	-19.0	-21.2	-30.3	-37.5	EBITDA margin	-262%	-273%	-143%	-36%
EBITDA	-11.0	-13.1	-14.9	-7.9					
Depreciation & amortisation	-0.1	-0.2	-0.2	-0.2	EBIT margin	-370%	-361%	-165%	-41%
EBIT	-15.5	-17.2	-17.1	-9.1	Normalized net profit margin	-344%	-367%	-167%	-42%
Borrowing Costs	-0.1	-0.2	-0.2	-0.2	Effective tax rate	0%	0%	0%	0%
Interest Income	0.0	0.0	0.0	0.0	Liquidity				
FX	0.0	0.0	0.0	0.0	Capex/depreciation (x)	0.1	0.3	0.8	1.3
Other income/(expense)	1.2	-0.1	0.0	0.0	Current ratio (x)	1.4	1.4	3.5	3.5
EBT	-14.4	-17.5	-17.3	-9.3	Quick ratio (x)	3.3	3.2	7.8	6.9
Tax expense	1.2	-0.1	0.0	0.0	Receivable days	147	211	244	136
Reported Earnings	-14.4	-17.5	-17.3	-9.3	Payable days	48	57	76	72
Abnormal Expenses / (Incomes)	0.0	0.0	0.0	0.0	Risk Measures				
Normalized Net Profit	-14.4	-17.5	-17.3	-9.3	Dividend Cover (x)	na	na	na	na
Cash flow (A\$m)					Payout ratio (%)	na	na	na	na
Profit before Tax	-14.4	-17.5	-17.3	-9.3	Net interest cover (x)	-154.3	-80.3	-79.8	-42.3
(+) D&A	4.5	4.2	2.3	1.2	Net debt/equity (%)	46.0%	102.9%	94.1%	111.1%
(+) FX loss/(gain)	0.0	0.0	0.0	0.0	Returns				
(-) Lease expense	0.0	-0.2	-0.2	-0.2	ROIC (%)	-330.5%	-244.7%	-30.9%	-15.2%
(+/-) Share Based Payments	5.8	2.5	2.5	2.5	Return on assets (%)	-96.7%	-123.5%	-29.0%	-14.6%
(+/-) Other	-1.2	0.1	0.0	0.0	Return on average equity (%)	-181.5%	-397.6%	-43.4%	-26.3%
(-) Tax Paid	0.0	0.0	0.0	0.0	Share Data/Valuation				
Gross Cashflow	-5.2	-10.9	-12.8	-5.8	Share Data				
(-) Capital Expenditure	-0.7	-1.4	-1.8	-1.5	Issued shares (m)	201	296	434	434
(-) Change in WC	-1.9	2.4	-0.9	10.6	Weighted ave shares (m)	201	248	365	434
Operating Free cashflow	-7.8	-10.0	-15.4	3.4	Fully diluted shares (m)	202	306	473	473
(-) Payment for Acqui	0.0	0.0	-0.9	-2.0	Basic EPS (c)	-7.2	-7.1	-4.0	-2.1
(+) proceeds from disp of FA/subs	0.0	0.0	0.0	0.0	YoY change (%)	258%	-2%	-43%	-46%
(+/-) Equity issued	12.1	10.7	48.9	0.0	Fully diluted EPS (c)	-7.1	-5.7	-5.7	-3.0
(+/-) Other	-4.3	-0.1	0.3	0.0	YoY change (%)	258%	-20%	-1%	-46%
Net Cashflow	0.0	0.6	32.8	1.4	Fully diluted normalised EPS (c)	-7.1	-5.7	-5.7	-3.0
Bop Net Cash	3.7	3.6	4.2	37.2	YoY change (%)	258%	-20%	-1%	-46%
(+/-) Net Cashflow	0.0	0.6	32.8	1.4	Dividend/share (c)	na	na	na	na
(+/-) Lease Adjustment	0.0	-0.1	0.2	0.2	Franking (%)	na	na	na	na
EOp Net Cash	3.6	4.2	37.2	38.8	Gross cashflow/share (c)	-2.61	-3.70	-2.94	-1.33
Balance Sheet (\$m)					NBV/share (c)	4.0	1.5	9.2	8.1
Cash	5.1	5.8	38.8	40.5	NTA/Share (c)	1.55	1.07	7.86	6.80
Receivables	3.2	4.7	10.3	11.0	Valuation				
Inventories	0.2	0.2	0.4	0.6	PER (Basic) (x)	-2.1	-3.4	-15.5	-29.0
Other Assets	0.8	0.2	1.5	2.2	PER (Fully diluted) (x)	-8.7	-10.8	-10.9	-20.5
Total Current Assets	9.3	10.9	51.1	54.3	PER (Fully diluted, normalized) (x)	-2.1	-10.8	-10.9	-20.5
Receivables	0.1	0.1	0.1	0.1	P/CFPS (x)	-5.8	-5.4	-21.1	-46.6
Property/plant/equipment	0.7	1.5	2.5	3.0	Price/NBV (x)	3.8	13.4	6.7	7.6
Right of Use Assets	0.0	0.4	0.4	0.4	Price/NTA (x)	9.7	18.7	7.9	9.1
Other Assets	4.8	1.3	5.8	5.8	market Cap (EOFY)	30.1	59.1	269.2	269.2
Total Non-Current Assets	5.6	3.2	8.7	9.2	EV	26.6	55.1	226.3	226.3
Total Assets	14.9	14.2	59.8	63.5	EV/EBITDA (x)	-2.4	-4.2	-15.2	-28.7
Trade and other payables	2.5	3.3	6.3	7.4	EV/EBIT (x)	-1.7	-3.2	-13.2	-25.0
Deferred Revenue	1.6	2.2	2.4	6.1	EV/Revenue (x)	6.4	11.5	21.8	10.3
Provisions	0.5	0.6	0.6	0.6	Other Information				
Borrowings	1.5	1.3	1.3	1.3	Estimated free float				85%
Lease Liabilities	0.0	0.2	0.2	0.2	12-mth High/Low (A\$/sh)			0.63/0.063	
Contingent Consideration	0.6	0.0	3.9	0.0	Average daily volume (A\$'000s)				0.3
Total Current Liabilities	6.7	7.6	14.7	15.7	ASX Code			FZO	
Trade and Other Payables	0.0	0.0	0.0	0.0	Next result			Aug-21	
Deferred revenue	0.2	1.9	4.8	12.3	Company Description				
Contingent Consideration	0.0	0.0	0.0	0.0	Family Zone Limited (FZO) is an Australian based technology company. FZO provides internet filtering and monitoring services to education and consumer sectors.				
Provisions	0.0	0.1	0.1	0.1					
Lease liabilities	0.0	0.2	0.2	0.2					
Total Non-Current Liabilities	0.2	2.2	5.1	12.6					
Total Liabilities	7.0	9.8	19.8	28.2					
Net Assets	7.9	4.4	39.9	35.3					
Issued capital	45.6	56.7	106.6	108.5					
Reserves	7.5	10.0	13.1	15.7					
Retained profits	-45.1	-62.3	-79.6	-88.9					
Total Equity	7.9	4.4	39.9	35.3					

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