Family Zone Cyber Safety Ltd (FZO)

Rating: Buy | Risk: High | Price Target: $0.77

Taking 7% Market Share a Year in the USA, Whilst Building an International Firewall

Key Information

Current Price ($ps)	0.64
12m Target Price ($ps)	0.77
52 Week Range ($ps)	0.25 - 0.64
Target Price Upside (%)	21.3%
TSR (%)	21.3%
Reporting Currency	AUD
Market Cap ($m)	245.4
Sector	Information Technology
Avg Daily Volume (m)	1.5
ASX 200 Weight (%)	0.01%

Fundamentals

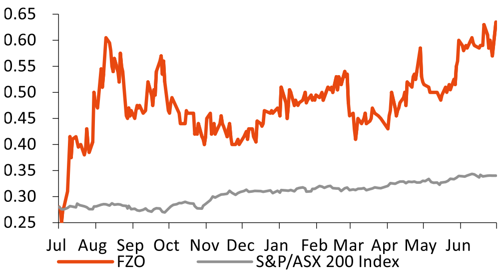
YE 30 Jun (AUD)	FY20A	FY21E	FY22E	FY23E
Sales ($m)	5.1	11.9	22.3	36.2
NPAT ($m)	(17.1)	(15.7)	(7.5)	2.5
EPS (cps)	(7.1)	(4.3)	(1.7)	0.6
EPS Growth (%)	29.3%	39.6%	59.5%	133.0%
DPS (cps) (AUD)	0.0	0.0	0.0	0.0
Franking (%)	0%	0%	0%	0%

Ratios

YE 30 Jun	FY20A	FY21E	FY22E	FY23E
P/E (x)	(2.8)	(14.9)	(36.7)	nm
EV/EBITDA (x)	(18.9)	(15.5)	(35.7)	58.8
Div Yield (%)	0.0%	0.0%	0.0%	0.0%
Payout Ratio (%)	0.0%	0.0%	0.0%	0.0%

Price Performance

YE 30 Jun	1 Mth	2 Mth	3 Mth	1 Yr
Relative (%)	5.6%	19.1%	34.1%	102.2%
Absolute (%)	5.8%	22.1%	41.1%	122.8%
Benchmark (%)	0.2%	3.0%	7.0%	20.6%



Price performance indexed to 100 *Source:*

Major Shareholders

Regal Funds Management Pty Ltd.	12.3%
McCusker Holdings Pty Ltd.	6.6%
LEVY TIM /FAMILY/	2.8%
Twynam Investments Pty Ltd.	2.6%
Sisu International Pty Ltd.	2.3%

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Event

FZO has announced an accelerated growth rate in market share, students and ARR growth across the USA. The international opportunity is accelerating & NTM is catalyst rich.

Highlights

- **4Q21 quarterly sees 2.4m contracted students / 3.0m on the platform** – FZO at FY21 has 2.4m contracted students (+164% YoY) and 3.0m students on its platform (+128% YoY) **which is a net add record** and infers 600k students in POC with a typical 4-week conversion timeline and historical ~90% conversion. Given some larger contracts in the POC mix, we conservatively estimate a net add of 460k students in 1Q22e and further estimate 4.1m contracted students at FY22e (+70% YoY) and 6.0m at FY23e (+47% YoY).
- **ARR accelerating in 4Q21** – ARR exited at $14.4m for 4Q21 (+78% YoY and +$3.3m organically in 4Q21) and accelerated after a seasonally slower 3Q21, with FZO delivering a significant result alongside TCV of $6.9m in the quarter (+91% YoY). Shaw estimates that **POC's currently in pipeline imply a 30% acceleration on ARR added to start 1Q22e (on 4Q21e) or up to $2m a month**. We expect FZO to deliver >$10m of net ARR added in FY22e, with our estimate for 1Q22e of $2.8m appearing conservative with continued execution.
- **International expansion** – The international opportunity is massive, and the group is winning in the USA and accelerating this opportunity. **Net market share added in 4Q21 was a whopping +1.7% or ~7.0% annualised and accelerating (+143% YoY)**. This compares to annualised market share take of 0.8% in 4Q19 and 2.8% in 4Q20. Market share growth and net students added remain the key metrics of the group and are accelerating.
- **Geographic expansion, cross-sell and pipeline support upside risk to forecast** – In addition to the large number of students in POC, we flag catalysts including the Canada launch showing immediate sales success, statewide procurement processes in USA / Canada underway, POC conversions rising to 90% (previously 83%) and B2C launch expected this quarter.
- **Acquisition of NetRef** – NetRef is a US based classroom management technology provider with a premium classroom tool that can be sold standalone or alongside FZO's own Classwize tool. With 250k contracted students, 450k on the platform and currently ~$400k in ARR, total consideration for NetRef is expected to be $5.8m over three tranches through to CY21 end representing an attractive acquisition multiple of ~5.0x ARR. Given growth of NetRef (250k contracted students in first 12 months of launch), quality of technology and cross-sell opportunities available, the acquisition and valuation appear highly attractive for FZO on several fronts. Assuming 100% cross-sell to FZO's School Manager (content filtering), an additional ~$1.4m ARR could be generated (+10%).
- **Further strategic acquisitions anticipated** – FZO has flagged the potential for further strategic acquisitions, which could include targets exhibiting a combination of scale, skilled software engineering and sales teams, proprietary technology and geographic reach. With estimated cash of ~$30m, FZO has capacity to undertake acquisition of niche providers and fund general working capital requirements in our view and could potentially add 35% to ARR through acquisitions involving balance sheet dry powder.
- **Key changes** – We have built in the acquisition of NetRef and our revised contracted students and revenue assumptions. The result is higher student numbers and moderated revenues across a larger than previously anticipated global and cross-sell opportunity. Our Price Target increases by 10% to $0.77 per share (previously $0.70), following a roll-forward of our DCF and increase in target ARR multiple.

Recommendation

With a stronger balance sheet post-raise, a strategic acquisition under its belt and a significant quarterly result, we anticipate FZO to deliver continued scale and an improved market proposition. Maintain Buy recommendation.

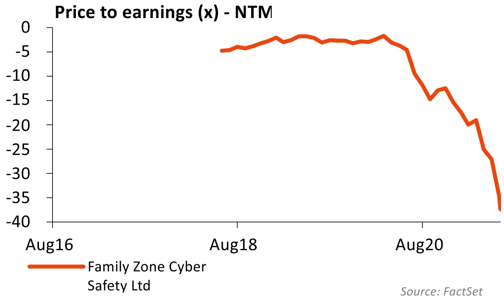
Family Zone Cyber Safety Ltd
Information Technology
Software & Services
FactSet: FZO-AU / Bloomberg: FZO AU

Key Items	Data
Recommendation	BUY
Risk	HIGH
Price ($ps)	0.64
Target Price ($ps)	0.77
52 Week Range ($ps)	0.25 - 0.64
Shares on Issue (m)	386.5
Market Cap ($m)	245.4
Enterprise Value ($m)	207.8
TSR (%)	21.3%

Company Description

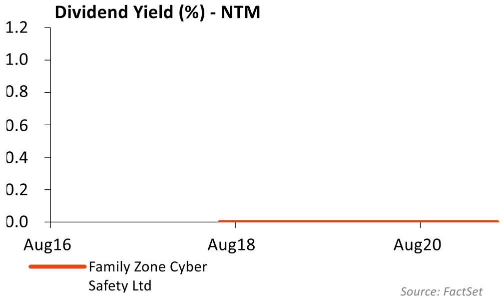
Family Zone Cyber Safety Ltd. engages in the development of parental control platform. It intends to create a system that manages the majority of the parental control functions in a cloud-based application. The company was founded by Tim Levy, Ben Trigger, Paul Robinson, and Crispin Swan in 2014 and is headquartered in West Perth, Australia.

Price to earnings (x) - NTM



Source: FactSet

Dividend Yield (%) - NTM



Source: FactSet

Financial Year End: 30 June

Investment Summary (AUD)	FY19A	FY20A	FY21E	FY22E	FY23E
EPS (Reported) (cps)	**(9.2)**	**(7.1)**	**(4.8)**	**(1.7)**	**0.6**
EPS (Underlying) (cps)	**(10.0)**	**(7.1)**	**(4.3)**	**(1.7)**	**0.6**
EPS (Underlying) Growth (%)	n/a	29.3%	39.6%	59.5%	133.0%
PE (Underlying) (x)	**(1.5)**	**(2.8)**	**(14.9)**	**(36.7)**	**nm**
EV / EBIT (x)	**(15.6)**	**(14.3)**	**(13.2)**	**(29.0)**	**88.0**
EV / EBITDA (x)	**(22.0)**	**(18.9)**	**(15.5)**	**(35.7)**	**58.8**
DPS (cps) (AUD)	0.0	0.0	0.0	0.0	0.0
Dividend Yield (%)	0.0%	0.0%	0.0%	0.0%	0.0%
Franking (%)	0%	0%	0%	0%	0%
Payout Ratio (%)	0.0%	0.0%	0.0%	0.0%	0.0%
Free Cash Flow Yield (%)	(43.3%)	(20.1%)	(8.6%)	(3.4%)	(0.0%)

Profit and Loss (AUD) (m)	FY19A	FY20A	FY21E	FY22E	FY23E
Sales	4.2	5.1	11.9	22.3	36.2
Sales Growth (%)	*n/a*	*21.6%*	*133.4%*	*88.0%*	*62.2%*
Other Operating Income	3.8	3.4	2.7	1.2	1.2
EBITDA	**(11.0)**	**(12.7)**	**(13.4)**	**(6.1)**	**3.7**
EBITDA Margin (%)	*nm*	*nm*	*nm*	*(27.4%)*	*10.2%*
Depreciation & Amortisation	(4.5)	(4.2)	(2.4)	(1.4)	(1.2)
EBIT	**(15.5)**	**(16.9)**	**(15.8)**	**(7.5)**	**2.5**
EBIT Margin (%)	*nm*	*nm*	*nm*	*(33.6%)*	*6.8%*
Net Interest	(0.1)	(0.2)	0.0	0.0	0.0
Pretax Profit	(15.6)	(17.1)	(15.7)	(7.5)	2.5
Tax	0.0	0.0	0.0	0.0	0.0
Tax Rate (%)	*0.0%*	*0.0%*	*0.0%*	*0.0%*	*0.0%*
NPAT Underlying	**(15.6)**	**(17.1)**	**(15.7)**	**(7.5)**	**2.5**
Significant Items	1.2	(0.1)	(2.0)	0.0	0.0
NPAT Reported	**(14.4)**	**(17.2)**	**(17.7)**	**(7.5)**	**2.5**

Cashflow (AUD) (m)	FY19A	FY20A	FY21E	FY22E	FY23E
EBIT	(15.5)	(16.9)	(15.8)	(7.5)	2.5
Tax Paid	0.0	0.0	0.0	0.0	0.0
Net Interest	(0.1)	(0.2)	0.0	0.0	0.0
Change in Working Capital	0.0	0.0	(4.0)	(4.4)	(4.7)
Depreciation & Amortisation	4.5	4.2	2.4	1.4	1.2
Other	(2.0)	1.5	0.0	1.3	1.9
Operating Cashflow	**(10.2)**	**(8.3)**	**(16.7)**	**(9.3)**	**0.9**
Capex	(0.7)	(1.4)	(1.3)	(1.0)	(1.0)
Acquisitions and Investments	0.0	0.0	(2.9)	0.0	0.0
Disposal of Fixed Assets/Investments	0.0	0.0	0.0	0.0	0.0
Investing Cashflow	**(0.7)**	**(1.4)**	**(4.2)**	**(1.0)**	**(1.0)**
Free Cashflow	**(10.9)**	**(9.7)**	**(21.0)**	**(10.3)**	**(0.1)**
Equity Raised / Bought Back	12.1	10.4	54.3	0.0	0.0
Dividends Paid	0.0	0.0	0.0	0.0	0.0
Change in Debt	1.4	0.0	(1.3)	0.0	0.0
Financing Cashflow	**13.5**	**10.4**	**53.0**	**0.0**	**0.0**
Exchange Rate Effect	0.0	0.0	(0.1)	0.0	0.0
Net Change in Cash	**2.7**	**0.7**	**32.0**	**(10.3)**	**(0.1)**

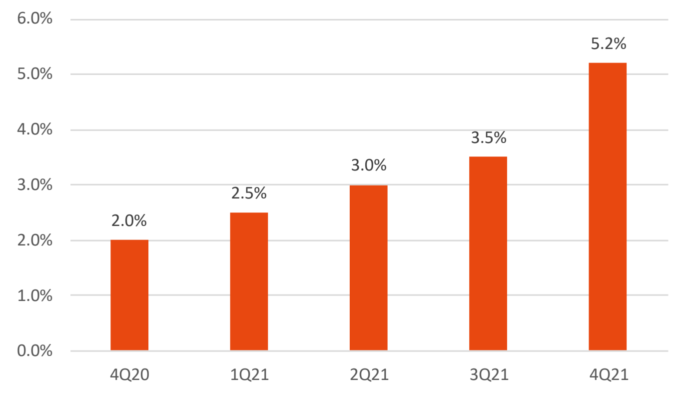
Balance Sheet (AUD) (m)	FY19A	FY20A	FY21E	FY22E	FY23E
Cash	5.1	5.8	37.6	27.4	27.3
Accounts Receivable	3.2	4.7	12.7	21.2	37.8
Inventory	0.2	0.2	0.7	1.1	1.8
Other Current Assets	0.8	0.2	0.5	0.9	1.4
PPE	0.7	1.5	1.9	1.5	1.3
Goodwill & Intangibles	4.8	1.3	2.9	2.9	2.9
Other Non Current Assets	0.1	0.4	0.9	1.2	1.6
Total Assets	**14.9**	**14.2**	**57.3**	**56.1**	**74.1**
Accounts Payable	2.5	3.3	7.5	7.5	15.9
Short Term Debt	1.5	1.3	0.0	0.0	0.0
Long Term Debt	0.0	0.0	0.0	0.0	0.0
Income Taxes Payable	0.0	0.0	0.0	0.0	0.0
Other	3.0	5.2	7.6	14.0	21.0
Total Liabilities	**7.0**	**9.8**	**15.1**	**21.5**	**36.9**

Ratios	FY19A	FY20A	FY21E	FY22E	FY23E
Gearing (%)	(85.1%)	3,541.7%	(824.1%)	(374.8%)	(277.5%)
Net Debt / EBITDA (x)	0.3	0.4	2.8	4.5	(7.4)

Taking on the international opportunity and accelerating run rates

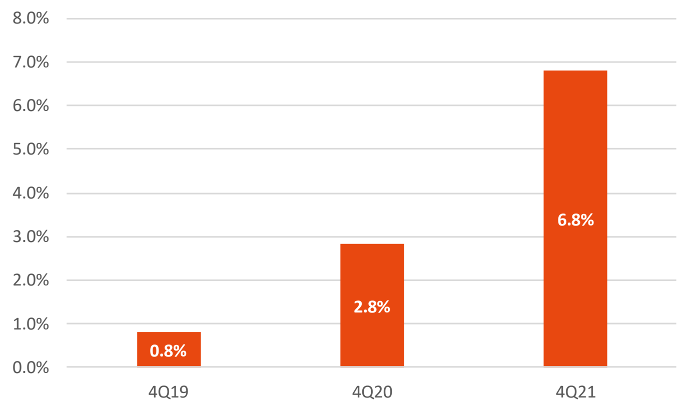
- FZO has impressively grown its market share in the US from **2.0% of districts at 4Q20 to 5.2% at 4Q21**.
- The international opportunity for FZO is massive and the group is winning in the USA and accelerating this opportunity. **Net market share added in 4Q21 was a whopping +1.7% or ~7.0% annualised and accelerating (+143% YoY).** This compares to annualised market share take of 0.8% in 4Q19 and 2.8% in 4Q20.
- We view this as significant validation of FZO's product in the largest global market against a range of established competitors which FZO has beaten on a number of occasions in competitive tenders (the likes of Cisco and GoGuardian).
- We expect over time that FZO could reach 10.0%+ market share in the US, which would represent a group approaching ~5.0m students and ~$25.0m in ARR (excluding the B2C opportunity).
- At scale, we anticipate FZO having the opportunity to then execute upon cross-sell opportunities (i.e. filtering into classroom products or vice versa, school access to parents into family products), further accretive acquisitions at attractive multiples and leveraging of its team into new geographies (such as the UK).

Figure 1: FZO's market share in the US



Source: Company data & Shaw and Partners

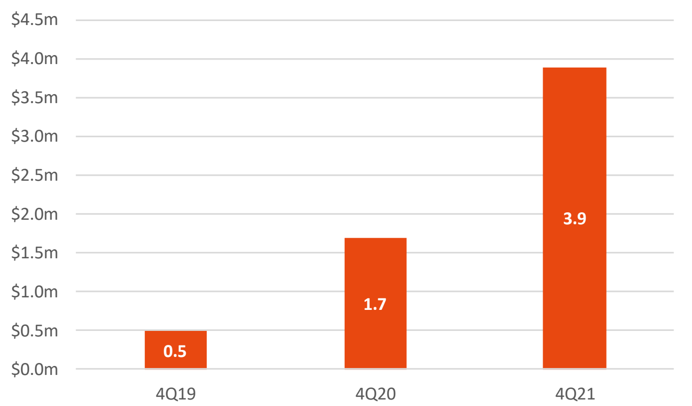
Figure 2: Annualised market share in the US



Source: Company data & Shaw and Partners

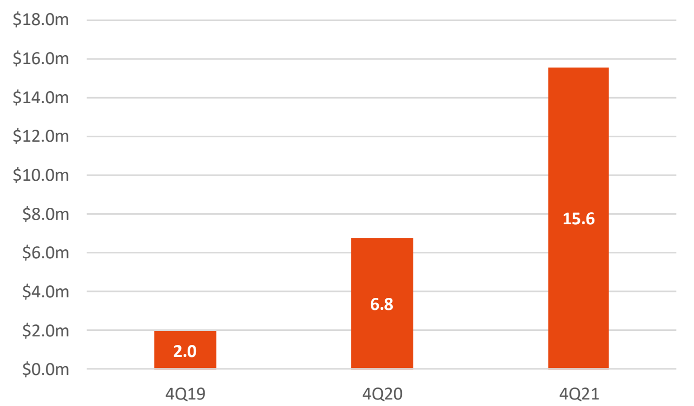
- When looking at ARR, we see accelerating net add rates particularly in 4Q periods which is a seasonally stronger period in FZO's largest US market.
- With $3.9m in ACV added in 4Q21 ($3.3m organically), FZO has the potential to deliver $10m+ of ARR across a full year (allowing for seasonality), which could see ~$200m added to its market cap annually assuming a 20.0x ARR multiple in line with the average multiple per the Nasdaq Emerging Cloud Index. This would represent a significant result given a market capitalisation of ~$275m as at the date of this report.

Figure 3: Net ARR added



Source: Company data & Shaw and Partners

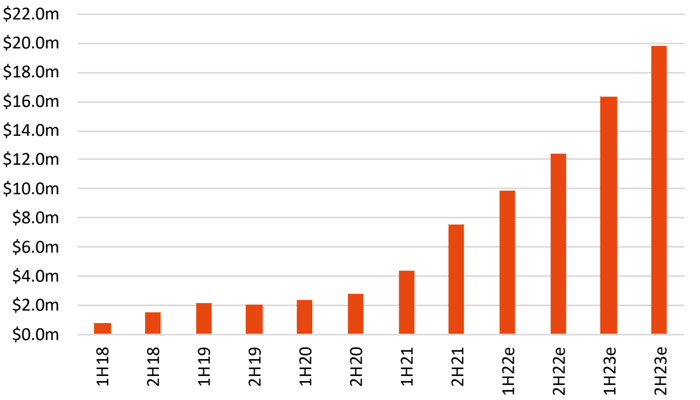
Figure 4: Net ARR added (annualised)



Source: Company data & Shaw and Partners

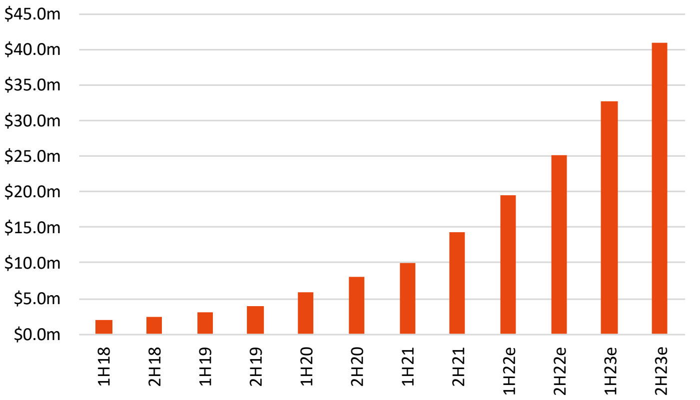
- FZO's ability to execute in a globally competitive market underpins our estimates of ARR growing to $25.1m in FY22e (+74% YoY) and $41.0m in FY23e (+63% YoY).
- We note that our forecasts for ARR and revenue at 1Q22e and 2Q22e appear conservative in the context of an accelerating international opportunity and the pipeline at hand.

Figure 5: Sales revenue



Source: Company data & Shaw and Partners

Figure 6: ARR

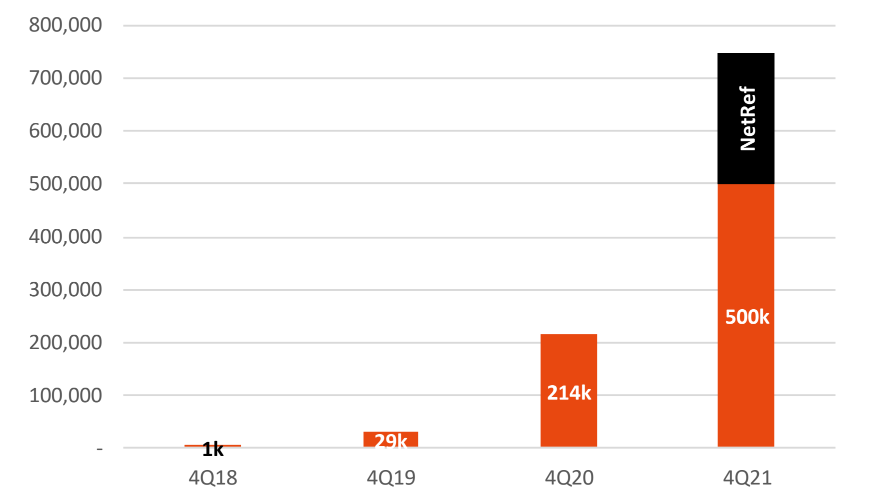


Source: Company data & Shaw and Partners

Significant student base and upside

- Market share gains have clearly been reflected in the number of students contracted on the FZO platform.
- The network effect of a larger group is taking hold, with 4Q21 seeing 500k students added organically which is +134% over 4Q20 or +250% inclusive of the students acquired as part of NetRef.

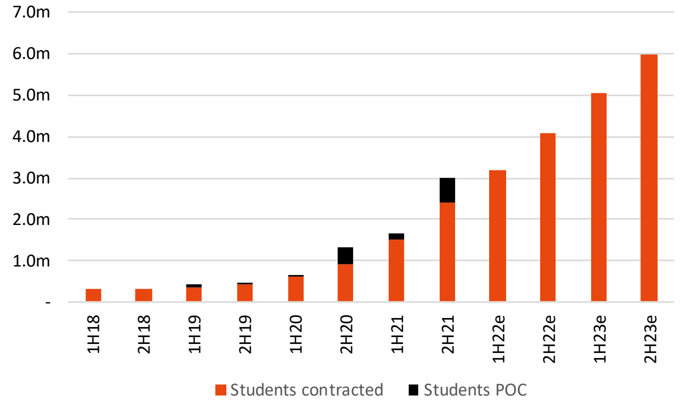
Figure 7: Net contracted student add rate



Source: Shaw and Partners analysis

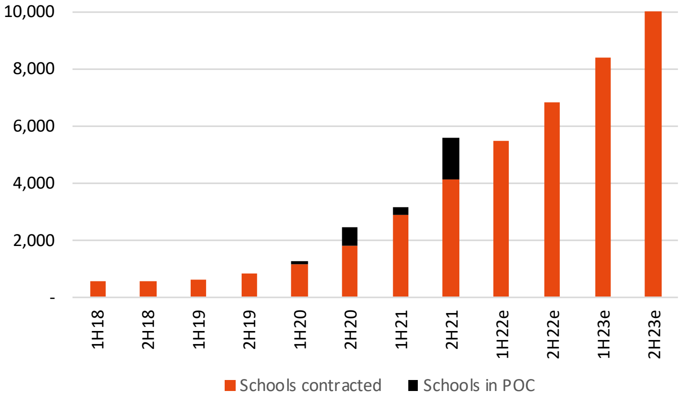
- Student numbers ended 4Q21 at 2.4m, which was +164% YoY and +136% YoY (excluding NetRef), a marked acceleration and underwriting our continued taking of market share in the USA.

Figure 8: Contracted students and POC



Source: Company data & Shaw and Partners

Figure 9: Contracted schools and POC



Source: Company data & Shaw and Partners

- We also note that FZO is set to launch its B2C product in the current quarter with an ARPU considerably higher than the B2B product, also leading to potential for a step change to ARR growth into the future.
- FZO has also flagged the potential for further strategic acquisitions, which could include targets exhibiting a combination of scale, skilled software engineering and sales teams, proprietary technology and geographic reach.
- Given a broadly disaggregated market and a number of smaller players which are subscale in their own right, we believe FZO has the ability to act as an industry consolidator given its balance sheet and relative attractiveness to potential targets as part of a larger group.

Refresher – what is FZO's strategy?

The broader strategy

- The FZO platform offers a world first, singular approach to enable schools, parents and cyber safety experts to collaborate to keep children safe anywhere, at any time, on any device and any network. FZO is building a business that incorporates school administration, teachers, all kinds of devices and the community surrounding children, empowering parents with tools and content that support learning.

- With 3.0m students currently utilising the FZO platform and a large proportion in the US, we expect FZO to continue to plug their existing student base and parents into their Community product (B2B2C) during 1Q21. This sees an opportunity to upsell to parents with a very low CAC into a product with up to ~12x the ARPU of the traditional School Manager or filtering product.

- FZO's core products of the business are summarised as follows:

	School Manager	Classwize	Community
Channel	Schools **B2B**		Families (home) **B2C**
Function	Device administration and content filtering	Classroom control & empowerment	Parental control tool in the home
Feature summary	• Cloud network management • Content filtering • Data reporting	• View student activity • Real time alerts	• Parental controls • Manage screentime • Internet filter
ARPU	~$3.00 - $10.00pa per student	~$3.00 - $10.00pa per student	~$7.00pm per family

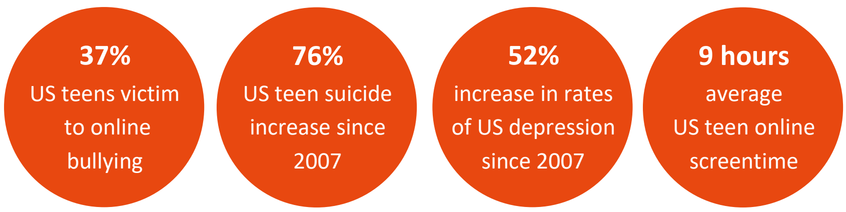
- With the global shift towards digital, SaaS model businesses have seen material acceleration through the COVID change event. Businesses with scalability, ease of deployment and consumer relevance have experienced phenomenal growth that in our view is proving likely to be sustainable into the future.

- FZO has benefited from COVID which we view as a change event for the company. COVID has materially contributed to the acceleration in the ARR of FZO and will continue to be an agent for a permanent change in the edu-tech sector in our view.

Risks for children in the digital age

- Given the reliance on technology platforms in day-to-day life, risks for children are rapidly escalating:
  - Cyberbullying – 37% of US teens have been victims of online bullying, whilst only 10% of bullying incidents are reported to parents.
  - Illicit content – 69% of males and 23% of females have viewed pornographic materials by age 13, with the first exposure typically being between the ages of 8 and 10, with 88% of pornography containing violence against women.
  - Mental health – Youth and teen suicide in the US is up 56% and 76% respectively since 2007, whilst rates of depression is in US teens has also risen by 52% since 2007. Suicide is the leading cause of death of children in Australia.
  - Screen time – It is estimated that US teens spend 9 hours per day online, and 75% of US teens get less sleep than recommended.

Figure 10: Prevalence of risks for children in the digital age



Source: CDC, World Health Organization, American Psychological Association, The Clinics

Classroom continuity in a COVID world

- The merits of a digital teaching model are clear and universally agreed amongst key decision makers in the education system. Studies in the US have shown that 86% of teachers and 93% of administrators considered the use of technology in the classroom as essential (*Source: Teaching with Technology: The Promise and Reality of the U.S. Digital Classroom, Common Sense Media*).

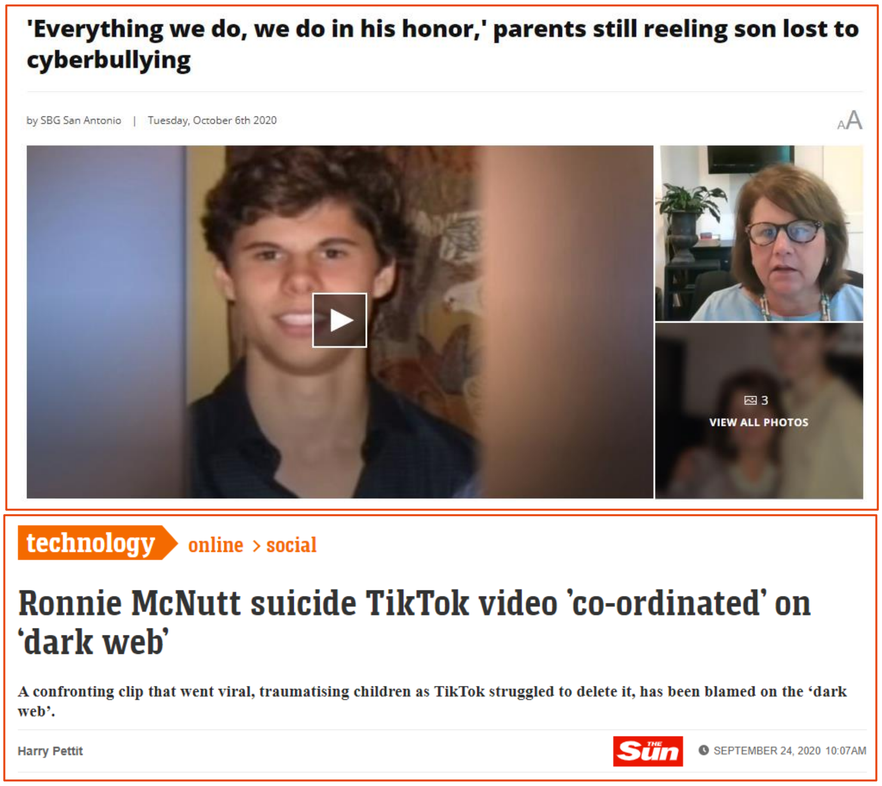
- Laptop usage in the classroom has accelerated due to benefits including:
  - Curriculum distribution and support.
  - Fostering digital collaboration amongst students.
  - More efficient and well organised delivery of curriculum, supporting knowledge retention.
  - Improvement in technology-based skills required in everyday life and the workforce.
  - Creating a more engaging and interesting learning environment.

- The rapid growth of the digital classroom has created a chasm between the penetration and the quality of delivery. Teaching resources continue to be under pressure as student numbers per teacher rise, decreasing teacher's ability to monitor student learning outcomes.

- This environment of limited teacher resources and increasing uptake in technology have highlighted the need for classroom monitoring platforms and content filtering platforms. FZO's solution enables teachers to safely administer digital classroom materials to their students.

- We see COVID as a change event accelerating the uptake of platforms that enhance the quality and delivery of digital curriculums in the classroom.

Figure 11: Examples of cyber dangers in the media



Source: News4SA, news.com.au

Estimate revisions

- As a result of the latest quarterly result, capital raising and acquisition, we have revisited our forecasts and provide our changes below.
- We note that our earnings estimates in early years are off a low base, however we have broadly increased the operating cost base, whilst remaining conservative on gross margins.
- Broadly students and market share are accelerating ahead of Shaw expectations, whilst as larger clients are added by the group, ARPU's are pushing marginally lower before product bundling/cross-sell.
- We have pushed B2C back by ~6 months from our original initiation estimates. We remain conservative on our expectations for this segment, instead waiting to see traction. We note that ARPU's in B2C remain materially higher than B2B and there is significant potential in this division and the product is currently trialling and slated to be launched shortly.
- We see upside risk across the group to our forecasts now, particularly in the short term where we estimate 1Q22e ARR of $2.8m being added. Typically, the September quarter is a seasonally stronger quarter across the group.
- We forecast operating leverage as emerging and FY23e, being cash flow and earnings positive. We note that gross margin leads from the recent acquisition of NetRef provide support for upside to our margin and leverage forecasts in FY22e.

Figure 12: Estimate revisions

	FY20a	FY21e			FY22e			FY23e		
Metric	**Actual**	**Old**	**New**	**Change**	**Old**	**New**	**Change**	**Old**	**New**	**Change**
Students contracted	0.9m	2.1m	2.4m	16.9%	3.7m	4.1m	10.8%	5.5m	6.0m	9.0%
Sales revenue	$5.1m	$12.0m	$11.9m	(1.1%)	$25.6m	$22.3m	(12.7%)	$45.1m	$36.2m	(19.7%)
Underlying EBITDA	($12.7m)	($12.7m)	($13.4m)	(5.2%)	($3.8m)	($6.1m)	(59.1%)	$7.1m	$3.7m	(47.9%)
Underlying NPAT	($17.1m)	($15.1m)	($15.7m)	(4.4%)	($5.2m)	($7.5m)	(43.3%)	$5.9m	$2.5m	(57.9%)
Operating cashflow	($8.3m)	($14.1m)	($16.7m)	(18.9%)	($7.6m)	($9.3m)	(21.5%)	$3.2m	$0.9m	(71.1%)
Free cashflow	($8.3m)	($15.4m)	($21.0m)	(36.1%)	($8.6m)	($10.3m)	(19.0%)	$2.2m	($0.1m)	na

Source: Company data, Shaw and Partners analysis

Valuation

- As a result of our estimate revisions and utilising an equal weighted target ARR multiple and DCF methodologies, we make revise our 12-month Price Target to $0.77 per share from our prior Price Target of $0.70 per share (+10.0%).

Figure 13: Price Target changes

Methodology	Output	Weight	Contribution
Target ARR multiple	$0.80	50%	$0.40
DCF	$0.73	50%	$0.37
Valuation (per share)			**$0.77**

Variable	Valuation
Previous Valuation	$0.70
New Valuation	$0.77
Change	**10.0%**

Source: Shaw and Partners analysis

Key assumptions and financials

In general, we model FZO on a quarterly basis. We utilise several drivers based upon number of schools, students and ARPU to generate our financial forecasts. We model FZO over 10 financial years and see our assumptions in general as being conservative, particularly in the context of the global and US opportunity.

Figure 14: Key assumptions and forecasts

	1H20 Dec19	2H20 Jun20	FY20 Jun20	1H21 Dec20	2H21e Jun21	FY21e Jun21	1H22e Dec21	2H22e Jun22	FY22e Jun22	1H23e Dec22	2H23e Jun23	FY23e Jun23
Core drivers												
Students contracted	**0.61m**	**0.91m**	**0.91m**	**1.50m**	**2.40m**	**2.40m**	**3.18m**	**4.09m**	**4.09m**	**5.05m**	**6.01m**	**6.01m**
Net students added	0.18m	0.30m	**0.47m**	0.59m	0.90m	**1.49m**	0.78m	0.91m	**1.69m**	0.96m	0.96m	**1.92m**
% change YoY	*68%*	*108%*	***108%***	*145%*	*164%*	***164%***	*111%*	*70%*	***70%***	*59%*	*47%*	***47%***
Schools contracted	**1,168**	**1,815**	**1,815**	**2,862**	**4,129**	**4,129**	**5,471**	**6,813**	**6,813**	**8,412**	**10,011**	**10,011**
% change YoY	*89%*	*116%*	***116%***	*145%*	*127%*	***127%***	*91%*	*65%*	***65%***	*54%*	*47%*	***47%***
ARR total	**$5.8m**	**$8.1m**	**$8.1m**	**$10.0m**	**$14.4m**	**$14.4m**	**$19.6m**	**$25.1m**	**$25.1m**	**$32.7m**	**$41.0m**	**$41.0m**
ARR excl US B2C	$5.8m	$8.1m	**$8.1m**	$10.0m	$14.4m	**$14.4m**	$18.1m	$22.5m	**$22.5m**	$26.7m	$31.8m	**$31.8m**
ARR US B2C	na	na	**na**	na	$0.0m	**$0.0m**	$1.4m	$2.6m	**$2.6m**	$5.9m	$9.2m	**$9.2m**
ARPU	$9.44	$8.90	**$8.90**	$6.65	$6.00	**$6.00**	$5.70	$5.50	**$5.50**	$5.30	$5.30	**$5.30**
Financials												
Profit and loss												
Sales revenue	$2.4m	$2.7m	**$5.1m**	$4.4m	$7.5m	**$11.9m**	$9.9m	$12.5m	**$22.3m**	$16.4m	$19.9m	**$36.2m**
Gross profit	$1.5m	$1.3m	**$2.8m**	$0.7m	$5.0m	**$5.7m**	$6.8m	$8.9m	**$15.7m**	$11.8m	$14.5m	**$26.3m**
Underlying EBITDA	($5.8m)	($6.9m)	**($12.7m)**	($7.7m)	($5.7m)	**($13.4m)**	($3.5m)	($2.6m)	**($6.1m)**	($0.1m)	$3.8m	**$3.7m**
Underlying NPAT	($8.2m)	($8.9m)	**($17.1m)**	($9.3m)	($6.4m)	**($15.7m)**	($4.2m)	($3.3m)	**($7.5m)**	($0.8m)	$3.3m	**$2.5m**
Cashflow												
Operating cashflow	($4.1m)	($4.2m)	**($8.3m)**	($3.5m)	($13.2m)	**($16.7m)**	($3.4m)	($5.8m)	**($9.3m)**	$10.8m	($9.9m)	**$0.9m**
Free cashflow	($4.5m)	($5.3m)	**($9.7m)**	($4.4m)	($16.6m)	**($21.0m)**	($3.9m)	($6.3m)	**($10.3m)**	$10.3m	($10.4m)	**($0.1m)**
Balance sheet												
Cash balance	$4.5m	$5.8m	**$5.8m**	$25.9m	$37.6m	**$37.6m**	$33.7m	$27.4m	**$27.4m**	$37.7m	$27.3m	**$27.3m**
Contributed equity	$50.6m	$56.7m	**$56.7m**	$82.8m	$111.2m	**$111.2m**	$111.2m	$111.2m	**$111.2m**	$111.2m	$111.2m	**$111.2m**
Financial ratios												
Growth rates (YoY)												
Sales revenue growth	11%	33%	**22%**	85%	176%	**133%**	125%	66%	**88%**	66%	60%	**62%**
Underlying EBITDA growth	(6%)	44%	**16%**	32%	(18%)	**5%**	(54%)	(54%)	**(54%)**	(97%)	(248%)	**(161%)**
Underlying NPAT growth	(3%)	25%	**10%**	14%	(28%)	**(8%)**	(55%)	(48%)	**(52%)**	(81%)	(199%)	**(133%)**
Margins												
Underlying EBITDA margin	(245%)	(255%)	**(250%)**	(176%)	(76%)	**(113%)**	(36%)	(21%)	**(27%)**	(1%)	19%	**10%**
Underlying NPAT margin	(345%)	(329%)	**(336%)**	(213%)	(85%)	**(132%)**	(43%)	(26%)	**(34%)**	(5%)	16%	**7%**

Source: Company data, Shaw and Partners analysis

Core drivers and catalysts

Our investment thesis is driven by the following and should be read in conjunction with our key risks:

1. **Acceleration of student licenses into the US** – FZO is gaining material market share into the large and material US market (57m students). We expect that the acceleration of US ARR is likely to continue and strengthen (~100% YoY in the near term). Over time we expect FZO market share to grow to north of 10%.
2. **Material above market growth profile to ARR** – FZO is likely to have a growth profile to ARR materially above the market. We expect that over the medium to long term FZO ARR has the potential to grow to >$50m.
3. **Upside to ARR from further entry into B2C products** – FZO is likely to launch further value-added products into market, particularly within the US. This includes family and device specific products. These products on a per user/student basis have 12x the revenue upside to FZO's B2B model and significantly higher margin at scale. Successful expansion of B2C products into the US could result in FZO achieving revenue materially above forecast.
4. **Structural industry tailwinds driving growth** – There is significant tailwinds towards the adoption of public cloud-based products. Further the educational market for cyber protection products for schools and families is large and growing, as government funding allocations to the industry rise. We see these positive industry tailwinds supporting FZO's growth.
5. **Product competitive advantages** – FZO has a best in breed solution in our view and is supported by a desire to lead from a technology point of view. With a strong back end, large body of work with integrations and public cloud hosting, FZO's product exhibits significant advantages over competitors in market.
6. **Potential M&A and inbound interest** – FZO may be of potential interest to strategic buyers and is likely to see significant interest as the company gains US market share. There are several modern and legacy companies that provide cyber products targeted at educational and family markets, and there may be an opportunity for FZO to be an active consolidator in the market.
7. **Entry into further markets likely** – Whilst ANZ and US markets are currently in focus for the group, there is potential for entry into further markets. Further market entries could result in further upside to our estimates.

Key risks

Risks to our investment thesis include although are not limited to:

Technological change – We see FZO's application as purpose built and technologically competitive with other products in market. However, this may not always be the case due to technological changes. These changes may lead to a requirement for FZO to redevelop its products in order to meet dynamic customer requirements. We flag that FZO must continue to invest in value added services and other products to overlay on its core filtering product.

Competition – Whilst FZO's product is one of several available in its key markets, new competition or intensified competition from existing operators may result in margin erosion, or even a loss of existing contracts.

Growth aspirations – FZO has global ambitions and has attained a level of penetration amongst schools in the US, Australia, New Zealand and the UK. The company has ambitions to continue to grow materially and deliver a step change in growth. There is no guarantee that FZO has the team in place or skills to navigate its growth aspirations.

Key board and management risk – FZO's CEO is a co-founder of the business and one of the largest shareholders of the group. Failure to retain and grow executive talent may adversely impact the group's growth. Moreover, this risk is elevated for businesses experiencing material growth over a short time horizon, such as FZO.

Cash burn – FZO has historically delivered negative cash flows and is forecast to reach positive cash flows in FY23. There is risk that positive cashflow is not achieved in line with forecast, and companies that have negative cash flows typically exhibit greater volatility and there is no guarantee that FZO will be able to continue financing the business or that the group will reach profitability.

Data failure – FZO utilises cloud-based storage for the majority of school and student data. However, FZO may experience hacking or stolen information that could adversely affect the operations and reputation of the group.

Churn, stickiness, and LTV – FZO is still at the inception of growth and its customer base. Currently the group exhibits relatively low churn and a consistently growing user base. There is no guarantee that these users will continue with the group. Higher churn may in turn decrease the total LTV of FZO, which may impact valuation considering FZO is likely being valued on its ARR and a consistent growth trajectory.

International operations – The company offers products and services via the cloud, but services these operations through sales and support across multiple countries across several geographic regions. As such FZO is subject to an elevated level of currency, execution and cost risk.

Small cap liquidity and volatility – As a small cap company, FZO exhibits higher levels of volatility and lower liquidity than the broader market in general. This beta is magnified during periods of market upheaval, such as the current COVID environment.

Revenues and cash flows – FZO delivers products and services predominantly to schools, students and parents globally. As such, FZO may from time to time see delays to cash flows or potential differences to revenue recognition from ARR stemming from various revenue profiles of its income streams. This is likely to be magnified through periods of extreme user growth wherein POC or trial periods are not immediately billed.

COVID – We view COVID as a far-reaching global event that has caused a global recession and material upheaval across all markets, products and services. Whilst COVID has been a change event and positive for FZO in our view, the pandemic elevates the risk profile of all listed companies. Further, FZO has experienced a step change of user growth associated with COVID and this demand may subside in a more normalised economic environment.

Rating Classification

Buy	Expected to outperform the overall market
Hold	Expected to perform in line with the overall market
Sell	Expected to underperform the overall market
Not Rated	Shaw has issued a factual note on the company but does not have a recommendation

Risk Rating

High	Higher risk than the overall market – investors should be aware this stock may be speculative
Medium	Risk broadly in line with the overall market
Low	Lower risk than the overall market

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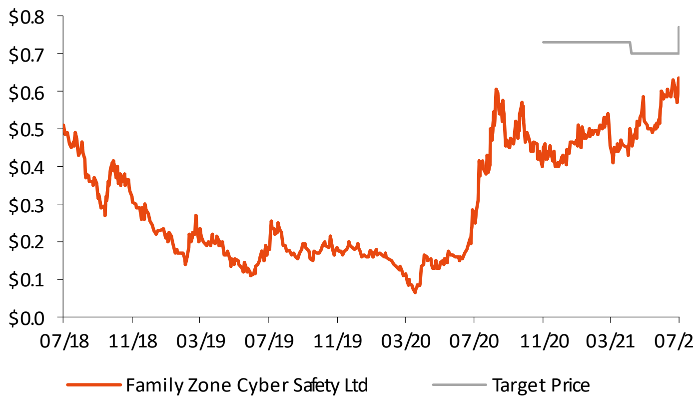
Distribution of Investment Ratings

Rating	Count	Recommendation Universe
Buy	68	81%
Hold	14	17%
Sell	2	2%

History of Investment Rating and Target Price - Family Zone Cyber Safety Ltd

Date	Closing Price ($)	Target Price ($)	Rating
5-Jul-21	0.64	0.77	Buy
12-Apr-21	0.47	0.70	Buy
6-Nov-20	0.45	0.73	Buy



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