

30 July 2021

Family Zone Cyber Security (FZO)

Another record quarter of student growth + operating leverage beginning to shine through

FZO has released its quarterly activities report and 4C, which confirms another very strong quarter for the company; with contracted students rising by 760k (~520k ex-NetRef), new contracts signed with an annual value of \$3.9m and a TCV of \$6.9m. Additionally, with 600k students in POC trials and a total of 2.4m students in the pipeline, FZO's growth for FY22 is already largely underwritten. Following the release, we maintain our BUY recommendation, with an \$0.88/Sh PT.

Note: As FZO pre-releases its results in early July, we focus only on key new information from this week's release below (ie. ARR's and cash performance).

FZO's ARR rose to \$14.1m in Q4 (+85% YoY), which comes despite being heavily impacted by unfavourable FX movements over the course of the year. FZO also releases a like-for-like ARR figure for comparative purposes, which was \$15.3m at the end of 4Q, up 95% YoY.

Cash outflows continue to grow, although we're not concerned. FZO's OCF burn was \$5.6m in 4Q21, with an additional ~850k in capex taking total outflows to ~\$6.5m – a large number for a company with only ~\$14m in recurring revenues. However, this headline figure distorts the real story, with mitigating factors to consider, including (1) cash flows being seasonally strong in 2H, (2) operating leverage is now beginning to come through, and (3) FZO's B2C product launch is imminent – which we expect to materially improve the unit economics of its business.

Cash flows are seasonally strong in 2HCY. While receipts for the quarter were only \$2.3m, FZO's sales were 'back-ended' which is reflected in the company's ~\$6m debtors balance at 30 June (we expect all of this to come through in 1Q22). These payment lags are typical in the June quarter, with receipts in 1Q21 being >2.5x those in 4Q20, for example.

Operating leverage beginning to come through. Following a multi-month period of FZO running both AWS and GCP for its hosting, the company has now entirely unwound its AWS relationship, with data and hosting costs plummeting in the quarter to ~A\$1.5/student, down from a peak of ~A\$5 per student in Sep 2021. With ARPUs running at an estimated ~A\$5.5 per student (incl. NetRef), GP's per student have increased from ~\$0.50 at the lows, to ~\$4 today – an 8-fold increase. FZO is aiming to reduce its hosting costs further, to <\$1.3/student by the end of FY22.

USA consumer launch imminent. Finally, FZO continues to progress with its US B2C launch; having trials currently running in 3 US districts, a further 15 to be added shortly and a full-scale launch planned for coming months. We expect the B2C launch to be a major catalyst, given our expectation that ARPUs could rise from ~A\$5.5/student to ~A13/student if penetration rates of ~17.5% (ie. current trials) are achieved across all districts.

Recommendation	BUY
Target Price (AUD)	0.88
Share Price (AUD)	0.585
Forecast Capital Return	51%
Forecast Dividend Yield	0%
Total Shareholder Return	51%
Market Cap	271,548
Net Cash (Debt)	35,594
Enterprise Value	235,954
Diluted Shares on Issue	464,185
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
US Schools Stimulus	Ongoing

Substantial Shareholders

Regal Funds Management	11.09%
McCusker Holdings	5.14%
Tolga Kumova	2.39%
BNP Paribas Nominees	2.35%
Tim Levy	2.26%
Twynam Investments	1.52%

Recent Performance



This report should be read in conjunction with the risks, disclaimer and disclosures sections which form part of this report and can be found at the end of this document.

P&L (A\$m)	FY20	FY21E	FY22E	FY23E	FY24E
Customer Revenue	5.1	10.3	19.9	34.2	53.0
COGS	2.2	7.1	7.0	8.6	9.8
Gross Profit	2.8	3.2	12.9	25.5	43.2
Other	3.4	3.0	4.0	4.0	4.0
Corporate	23.8	29.1	33.1	36.3	39.5
EBITDA	-13.2	-19.6	-13.1	-3.8	10.7
D&A	4.2	3.3	3.0	3.0	3.0
EBIT	-17.4	-22.9	-16.1	-6.8	7.7
Net interest	0.0	0.0	0.0	0.0	0.0
Pretax profit	-17.6	-22.9	-16.1	-6.8	7.7
Tax	0.0	0.0	0.0	0.0	2.3
Minorities	0.0	0.0	0.0	0.0	0.0
NPAT (rep)	-17.6	-23.0	-16.1	-6.8	5.4
Abnormal items	0.0	0.0	0.0	0.0	0.0
NPAT (adj)	-17.6	-23.0	-16.1	-6.8	5.4
Ave shares (diluted)	251.4	395.4	466.5	470.9	474.8
EPS adj (A¢)	-7.0	-5.8	-3.5	-1.4	1.1
DPS (A¢)	na	na	na	na	na

Cash Flow (A\$m)	FY20	FY21E	FY22E	FY23E	FY24E
Net income	-17.6	-23.0	-16.1	-6.8	5.4
D&A	4.2	3.3	3.0	3.0	3.0
Stock-based comp	2.9	2.6	2.5	2.5	2.5
Deferred taxes	0.0	0.0	0.0	0.0	0.0
Other	2.3	2.8	-1.1	0.0	2.3
Cash flow from operations	-8.3	-14.3	-11.8	-1.3	13.2
Capital expenditures	-1.3	-2.1	-2.7	-3.5	-4.3
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	-2.1	-2.7	-3.5	-4.3
Dividends paid	0.0	0.0	0.0	0.0	0.0
Capital raised	10.3	46.2	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	46.2	0.0	0.0	0.0
Total cash flow	0.7	29.8	-14.5	-4.8	8.9

Balance sheet (A\$m)	FY20	FY21E	FY22E	FY23E	FY24E
Cash & equivalents	5.8	35.6	21.1	16.3	25.3
Receivables	4.7	4.9	6.1	6.1	6.1
Inventory	0.2	0.3	0.3	0.3	0.3
Other	0.2	0.3	0.3	0.3	0.3
Total current assets	11.0	41.1	27.8	23.0	32.0
Net PP&E	1.5	1.7	1.4	1.9	3.2
Intangibles	1.3	0.0	0.0	0.0	0.0
Total non-current assets	0.0	0.0	0.0	0.0	0.0
Total assets	14.2	43.5	29.8	25.6	35.8
Payables	3.1	5.0	5.0	5.0	5.0
Short term debt	0.0	0.0	0.0	0.0	0.0
Other	3.0	4.0	4.0	4.0	4.0
Total current liabilities	7.6	9.3	9.3	9.3	9.3
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	2.5	2.5	2.5	2.5
Total liabilities	9.8	11.8	11.8	11.8	11.8
Total common equity	4.4	30.4	16.7	12.5	22.7

Ratios & Valuations	FY20	FY21E	FY22E	FY23E	FY24E
Gross margin (%)	56%	31%	65%	75%	82%
EBITDA margin (%)	-260%	-190%	-66%	-11%	20%
EBIT margin (%)	na	-223%	-81%	-20%	15%
NPAT margin (%)	na	-224%	-81%	-20%	10%

Incrementals					
Gross margin (%)	76%	7%	101%	88%	94%
EBITDA margin (%)	-874%	-122%	67%	66%	77%
EBIT margin (%)	-837%	-106%	70%	66%	77%
NPAT margin (%)	-849%	-104%	71%	66%	64%

P/E (x)	na	na	na	na	51.3
P/B (x)	33.4	7.6	16.3	22.1	12.2
EV/EBITDA (x)	na	na	na	na	23.5

Customer Rev growth (%)	22%	102%	94%	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

Why we're not concerned with rising cash outflows...

Cash flows are seasonally stronger in Q4 vs Q1

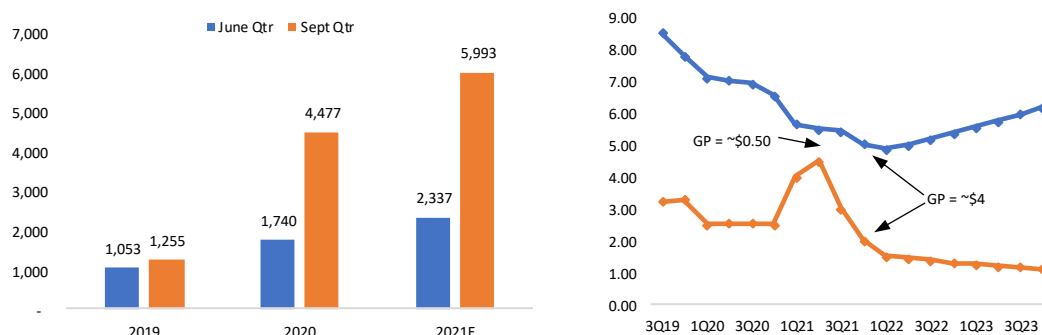
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Figures 1 & 2: Q4/Q1 cash flow seasonality, A\$000s & ARPUs vs Hosting Costs per Student (BW est.)



USA consumer launch imminent

While the market's focus is likely to be on student growth, we believe it is the penetration of parental control sales in the US that will ultimately drive FZO's profitability over time.

Accordingly, we expect FZO's upcoming full-scale B2C launch to be a major catalyst, given our expectation that ARPUs could rise from ~A\$5.5/student to ~A13/student if penetration rates of ~17.5% are achieved across all districts (Figure 3).

For reference; 17.5% penetration was achieved in FZO's early US trials **and compares favourably with our modelling of ~6% by FY24**. The sensitivity analysis below highlights how meaningful penetration rates can prove – ie. at 17.5%, our **FY24 US ARR estimate rises from ~\$61m to ~\$98m**.

As a reminder, A/NZ penetration rates currently run in-excess of 40%.

Figure 3: US Parental Controls, Sensitivity Analysis

FY24 estimates	8% (BW est.)	10%	17.5% (Trial)	25%	40%
FZO US Students (000s)	7,330	7,330	7,330	7,330	7,330
Filtering ARPU (A\$/student)	4.0	4.0	4.0	4.0	4.0
Family Pack Penetration (%)	8.0%	10.0%	17.5%	25.0%	40.0%
Family Pack Students (000s)	586	733	1,283	1,832	2,932
Family Pack ARPU (A\$/student)	53.3	53.3	53.3	53.3	53.3
Total US ARR (A\$000s)	60,591	68,409	97,727	127,045	185,681
All-in US ARPU (A\$/student)	8.3	9.3	13.3	17.3	25.3

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