



## COMPANY UPDATE

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## FAMILY ZONE CYBER SAFETY LTD (ASX:FZO)



### A pure growth company, a global leader in school cyber security, and motivated to keep children safe

**Family Zone** listed on the ASX in August 2016. Until recently, the company has failed to show any tangible evidence of being able to deliver consistent and sustainable growth. On October 13, 2017, the company's share price reached a high of A\$0.92 cents, to fall in subsequent years to a low of A\$0.04 cents (March 2020). Since this time, the company has managed to capitalise on significant COVID-19 tailwinds. With a large proportion of the world working, studying and schooling from home, the demand for IT services and all things related became increasingly important. Family Zone was in the right place at the right time, and remains so.

The company recently made two significant global acquisitions, supported by consistent revenue growth, and is well positioned to continue its upward momentum. Family Zone has advised of no intention to turn a profit over the short-term, but rather invest for maximum growth. Family Zone's recent acquisition of the United Kingdom's Smoothwall was a unique opportunity that has transformed the company. The merged entity will allow for multiple avenues for growth, exploit incumbent providers, and position Family Zone via a multi-service offering as a leader in a fragmented industry that lacks a child-centric approach.

#### What Family Zone does?

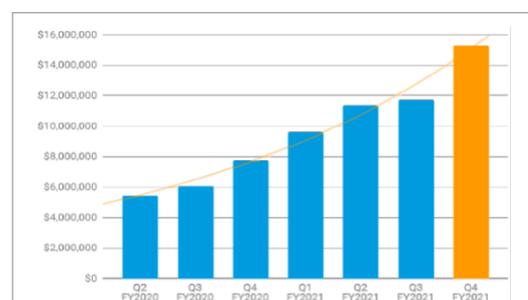
Family Zone has four pillars:

1. filtering and compliance (primary and leading division)
2. classroom management (competing)
3. data analytics and monitoring (leader)
4. parental control (leader)

Family Zone seeks to support and protect every child's digital journey via its patented cyber safety ecosystem - a platform enabling world-first collaboration between schools, parents and cyber safety educators. At present Family Zone has no competitors who offer a full suite of services. Traditional models have failed to incorporate the above four pillars (and have an active development team continuously refining and developing existing and new modules). Whilst all schools have an incumbent provider, Family Zone, with its recent advancements, has highlighted its competitors' shortcomings. It is for this reason, the company has enjoyed such rapid growth.

#### Highlights

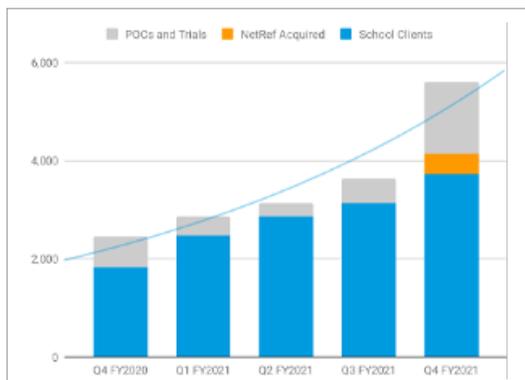
For the June quarter (prior to the Smoothwall acquisition), the company's predominantly U.S. based operations (accounting for 80% of revenue) grew exponentially. On aggregate, both the U.S. and Australia/New Zealand (ANZ) generated \$A15.3m (based on the previous corresponding period exchange rate, A\$14.1m ) in annualised recurring revenue (ARR).



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Family Zone has been operational in the U.S. for two years, and currently services around three million students (5.2% of total U.S. districts). The company believes they can reach 10% of this market comfortably, translating to A\$25m ARR (in the U.S. only, and not including an additional 10% of parents). As shown below, June quarter results build on a solid FY20/21:

1. Acquired NetRef June 2021 (an innovative classroom technology provider).
2. Added 1m students to the platform, ending with 3m (128% YoY growth).
3. Added 2,000 schools to the platform, ending with 5,602 (128% YoY growth).
4. Ended the quarter servicing 5.2% of U.S. school districts (with considerable runway remaining).
5. Ended the quarter with 4,129 contracted schools (127% YoY growth) adding 1,000 contracted schools including 395 acquired through Net Ref.



6. Ended the quarter with 2.4m contracted students (164% YoY growth) adding 760,000 students, including 237,000 acquired through NetRef.



7. Signed contracts with an annual value of A\$3.9m (92% YoY growth (including) 630,000 through the acquisition of NetRef.

8. Signed contracts with a total value of 6.86m (89% YoY growth) including 1m through the acquisition of NetRef  
*Note: POC's and Trials have traditionally converted to sales at roughly 85+%.*

*“The June quarter of 2021 transformed Family Zone to be a key player in the US Education market. We added over 1 million students and 2,000 schools to our platform. And we now service in excess of 3 million students and 5% of US schools. With US schools enjoying unprecedented funding, and with a pipeline exceeding 2 million students, we look forward to continued record growth”.*  
 Tim Levy, Managing Director

### The game changer - Smoothwall acquisition (United Kingdom)

Prior to acquiring Smoothwall, 80% of the company's revenue was derived from U.S. operations. As seen in the table below, the acquisition significantly diversifies cash flows across both an established business, Smoothwall (UK), and Family Zone (U.S./ANZ). The strategic rationale is many-fold; not only does the acquisition triple the size of the company's ARR, it provides a significant opportunity to cross sell Family Zone's suite of services globally.

Pro-forma metrics	Smoothwall	Family zone	Merged entity
Employees	113	190	303
Students	6,100,000	3,000,000	9.1 million
Schools	12,400	5,600	18,000
Estimated ARR at June 30, 21	A\$ 30 million	A\$ 14 million	A\$ 44 million

Smoothwall as a stand-alone business has both 'Filtering and Compliance' and 'Data Analytics and Monitoring' (a leader in both with 38% of the market), and is without 'Classroom Management' and 'Parental Controls'. With this in mind, we see huge potential in the combined entity, due to the sheer size of additional users. Not only is the company able to offer a more dynamic suite of services in the UK, but extend Smoothwall's intellectual property and technology in the U.S.

The acquisition is earnings accretive to Family Zone shareholders, acquired for A\$146.4m (4.7x ARR), or 21x EBITDA (EBITDA A\$7m). This could be considered high for some, however, given the nature of earnings (high quality ARR), the high conversion rate of proof-of-concept (POC's) (85+%), market position, cost-out and cross-sell synergies, and addressable market, we are comfortable with these terms. The acquisition was paid for 100% in cash, as the previous owner, UK Private Equity firm, [Tenzing](#), had a fixed term mandate and was essentially a forced seller. Tenzing's mandate did not allow for any other terms, thus a traditional earn out arrangement, or scrip transaction was not available.

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### Terms of the acquisition

A fully underwritten capital raising of A\$146m via a 5-for-16 Non-Renounceable Accelerated Entitlement Offer to eligible shareholders, issuing approximately 137m new ordinary fully paid shares to raise approximately A\$75m (A\$37.1m institutional offer and a retail component to raise A\$38.2m), which was followed by an upsized single tranche placement to raise an additional A\$71m (129m shares). Shares were issued at 55 cents (a 6.5% discount to the closing price of \$0.60 as at August 6). The retail round (final round) closing August 20.

### General discussion

Tim Levy believes the Smoothwall acquisition will instantly provide around A\$3m in cost savings, whilst stating the company's engineering/ technology development team has doubled from 40 to 80 specialists. This is a great outcome as previously Family Zone was constrained by having to prioritise the development of particular modules over others due to lack of experienced headcount. Tim states this is no longer a problem, as his staffing has increased from 84 to 150 employees, and all in the necessary divisions.

Adding to already strong tailwinds, 'monitoring' of students has recently been mandated by the UK government and is a fast growing segment in the U.S.. The [U.S. CARES Act](#) will remain in place until December 2021, with continuing COVID-19 support funding still to flow through, as well as promised increased spending on education from the Biden administration.

Currently under law, schools are required to have a 'Filtering and Compliance' service, thus, all schools have an incumbent provider. This is not a concern for Family Zone (rather an opportunity), as they are the only provider with a child-centric approach, offering a suite of products their competitors do not. Family Zone has been able to win all its revenue from schools which decided to transition away from their incumbent provider once their existing service contract expired. Tim argues the cost for schools to transition is more than offset by the value the company provides, which is clearly evident by their above average growth rates.

### A broader view

Based on Family Zone's recent acquisition of Smoothwall, we consider it reasonable to expect the company to be a likely addition to the ASX300 when the index is reviewed in September 2021. The following window of opportunity would be March 2022. For more information, go to Family Zone's investor information on their [website](#).

### Summary

Family Zone's management has been outspoken in their continued endeavour to grow aggressively. We wait to see if the company will look to expand in the U.S. by acquisition or organically. Currently we believe the latter, given the company's acquisition of Net Ref in June this year.

What is exciting is Family Zone's mission to solve a worldwide problem, with the company stating the current geographic regions are just the beginning. The company will focus on English speaking countries first, and will then look to expand into Europe.

Whilst it may be considered overly optimistic to compare Family Zone to Afterpay, they do share similarities. Family Zone's business model is 24/7, scalable, and a portable solution for minors through to year 12 students, thus the addressable market is huge and continually expanding. Revenue as highlighted is subscription and transaction based, with the ability to grow the average revenue per user significantly. Further, schools are considered incredibly sticky, with students and parents a potential customer for the full education cycle (12 years).

**Family Zone's Managing Director Timothy Levy is incredibly proud of the company's ability and states, "Every day we are making a positive impact on kids lives, and in some cases, literally saving lives".**

**We were fortunate to have Tim visit earlier in the year and were impressed by his professionalism and humble nature. What is most pleasing is everything Tim was able to share with us transpired. We value his integrity and look forward to seeing what he and his management team are capable of in subsequent quarters. Family Zone, however, is a speculative investment and we recommend seeking advice from an adviser prior to making an investment.**

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