



# THE WATCHDOG GROUP

2 February 2010



get the worst out of the internet

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Case prepared by Mr. Patrick Hadfield, under the supervision of Mr Sunny Gu and Mr. Brendon Potter, Director of Student Development, The University of Auckland Business School. This case has been prepared solely for the Champions Trophy Case Competition. Data in this case has been obtained from private and public sources. This case is not intended to serve as an endorsement, a source of primary data, or an illustration of effective or ineffective management. Portions Copyright © 2010 The University of Auckland Business School. All rights reserved.

## **John Jobs**

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**From:** John Jobs  
**Sent:** Thursday, 2 February 2010 08:31  
**To:** The Watchdog Group of Companies Project Team  
**CC:** David Dollar; Benjamin Banker; Peter Partner; Warren Wallstreet  
**Subject:** The Watchdog Group of Companies Strategy Presentation

Team,

Our second client is the Watchdog group of companies.

Watchdog is a small organisation, founded with a vision to make the internet a more safe and productive resource for all. They provide internet filtering services to New Zealand schools, families and businesses. At the centre of their operations is a contract with the Ministry of Education (MoE) to supply filtering services to all New Zealand public schools. However Watchdog has successfully branched out into other services that align with their values and core competencies such as: firewall installation, student absentee systems ("TXTStream") and technical support services for schools using Google Applications.

Whilst the aim of these activities is to diversify revenue streams and extract more value from existing customers, the MoE contract for filtering services still accounts for 63% of Watchdog's revenues. And this contract is under threat.

In the last roll over, the contract was once again awarded to Watchdog and Telecom. The caveat was that the MoE would also run trials with Telstra, another large telecommunications company. Having expressed a keen interest in the education market, Telstra pose a significant threat to Watchdog's core revenue stream. Furthermore, with the election of the National government came pressure on government departments to reduce expenditure. Shortly after the contract roll over the MoE announced that they would be cutting the fees paid to Watchdog under the contract by 14%.

Watchdog seeks to mitigate the risks associated with a single contract by diversifying internationally. However, since the inception of Watchdog International Ltd in 2007, the international division has failed to turn a profit. Soon management will meet to determine whether Watchdog Corporation Ltd (the domestic operation) will continue to subsidise Watchdog International Ltd.

Rohan Meuli (Managing Director of Watchdog Corporation) and Peter Mancer (founder and Managing Director of Watchdog International) have asked you to analyse the company and provide strategic recommendations.

You will have ten minutes to give your presentation, which will be followed by ten minutes of question and answers. Interviews with the management team at Watchdog are summarised below. Relevant publically available information is also attached.

Regards,

**John Jobs,**  
Senior Vice President  
SYG Consulting Group



# THE WATCHDOG GROUP

The Business

THE UNIVERSITY OF AUCKLAND BUSINESS SCHOOL  
CHAMPIONS TROPHY CASE COMPETITION 2010



## The Business

*No important decision would be made without thinking: “right, would this decision fit with the vision of the company?”... We are prepared to suffer the commercial consequences of that... When we look at the Telecoms and Vodafones and their corporate responsibility, that’s all Watchdog was based on from square one... It’s a corner stone, as opposed to a retro-fitted thing... We’re not suggesting that these guys are wrong, they’re commercial organisations first and foremost... From our point of view it’s probably the other way around. We started with a social driver... and we’ve developed a business around it.*

- Rohan Meuli, Managing Director of Watchdog Corporation

## History

Watchdog was founded in 1999 by Peter Mancer. At the time there was a significant gap in the market for safe internet services. Identifying this need Peter founded the company with a vision to make the internet a more safe and productive resource for all. Underlying Peter’s vision was a Christian calling. Current managing director, Rohan Meuli, describes:

*There was, dare I say it, a Christian vision for the company... A biblical reference that we believe we are fulfilling. So that was the fundamental non-commercial driver for the company - to do something useful for the community by providing a service that wasn’t available at the time, to keep people safe on the internet. At the same time... because the internet was taking off in 1999 there was obviously opportunity, as families themselves realised, to keep their kids safe. There was obviously a commercial opportunity there too. But as time has proved, you’d be struggling to warrant getting into the business just based on the commercial terms.*

Starting a new venture was not without its challenges. To raise the initial capital, Peter had to mortgage the family home and fund the balance from “friends, family and fools” who shared in his vision. At the time Peter was raising a young family and received two generous employment offers from two telecommunications companies. Peter describes:

*I had to turn these two offers down and end up not earning any money for a couple of years... even though I had a young family.*

Coincidentally, the two companies that offered Peter these positions are now Watchdog’s two greatest competitors: Telecom and Telstra.

Watchdog began life as Familynet, a small Internet Service Provider (ISP) that targeted the family and households segment of the market. It was not long before Peter realised that this was a difficult market for a small player to tap, since successful ISPs are large players that compete with mass marketing campaigns and by offering bundled services. In 2000, after modest uptake of Familynet’s

services, Peter identified opportunities in the schools and businesses segments of the markets and renamed the company Watchdog Corporation Ltd.

Realising that the cost of downloading in New Zealand made it infeasible to filter inappropriate content, Watchdog developed tunnelling technology by 2002. Essentially this technology allowed Watchdog to accept or deny a request made by a student, household or business to download information as they surf the internet, without Watchdog having to bear the cost of downloading the content themselves. Also, in 2002 Watchdog became the first filtering company to block peer-to-peer websites and provide email filtering services.

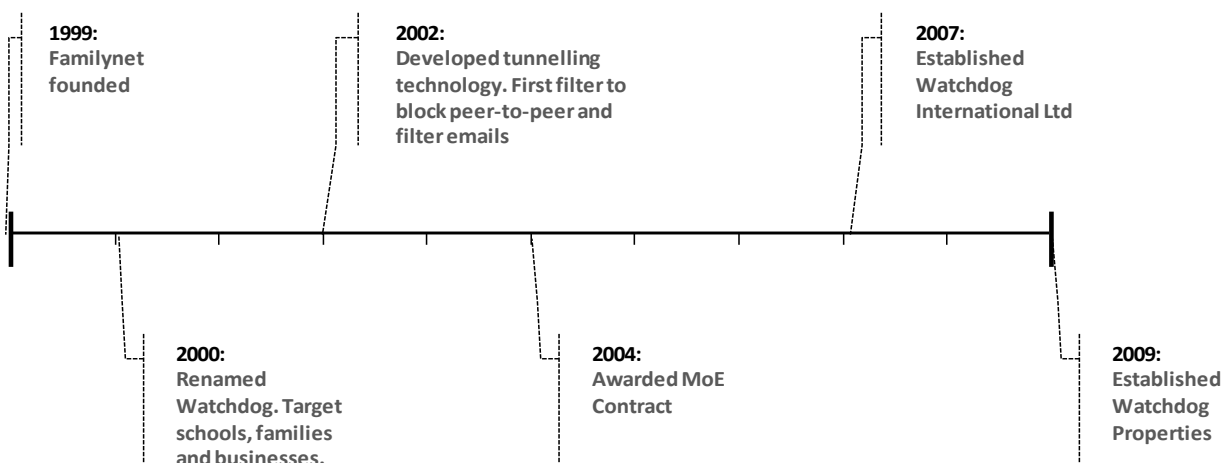
In 2004, Watchdog achieved its greatest milestone. The MoE awarded Watchdog the contract to supply all New Zealand public and integrated schools with filtering services. Whilst Watchdog had to overcome multiple bidders to be awarded the contract, they had to share it with another company. Telecom (New Zealand's largest publically listed company at the time) was also awarded the contract and continues to fight Watchdog for their share of the schools market.

By late 2004 Peter was struggling to fill demand. This, and the fact that Peter's background was technical as opposed to management prompted Peter to appoint Rohan Meuli as Managing Director.

By 2007, most of the schools market had been served by either Watchdog or Telecom. So Watchdog Corporation started a new company, Watchdog International Ltd. The shareholders in Watchdog Corporation each hold an ownership stake in Watchdog International equal to their holding in Corporation. Corporation advances money to International so that it can pursue offshore opportunities that are in line with Watchdogs vision.

In 2009 the final member of the Watchdog group was founded. Watchdog Properties was created as a limited partnership, which allows existing shareholders to profit from the capital gains of a new office block purchased by Watchdog. The properties division remains outside Watchdogs core operations, and merely represents a legal structure designed for the benefit of existing shareholders.

Today the Watchdog group of companies still comprises Watchdog Corporation, Watchdog International and Watchdog Properties. The Watchdog group of companies provide various services to cater to schools under the CampusNet brand, families under the Family Watchdog brand and business under the Corporate Watchdog brand.



## Services

### Filtering/Blocking

*Partly by necessity we've been a bit of a one-trick pony... When you think internet filtering in schools, you think Watchdog... We've worked hard for that association.*

- Rohan Meuli, Managing Director of Watchdog Corporation

Filtering or blocking refers to denying access to harmful content on the internet. The Watchdog website provides details of content that is deemed inappropriate. An extract is below:

#### *Anarchy*

*Sites contain information regarding militias, weapons, anti-government groups, terrorism, overthrowing of the government, killing methods, etc.*

#### *Drugs*

*Sites that promote the use or purchase of illegal drugs. These may include offering marijuana seeds for sale, growing methods, techniques and products for testing clean for drugs, information on acid and/or "mushrooms," and all other forms of narcotics.*

#### *Gambling*

*Sites which encourage gambling such as betting sites, bookmaker odds, lottery, bingo, horse/dog track, online sport betting, online casinos, etc.*

#### *Obscene/tasteless*

*Sites that involve such things as mutilation, murder, bodily functions, horror, death, candid scenes, executions, violence, etc.*

#### *Pornography*

*Sites that contain nudity of any sort, vulgarity, including the likes of Playboy, Hustler, and Penthouse.*

#### *Social networking*

#### *Web-based proxies and anonymizers*

*Sites which offer free anonymous proxy services.*

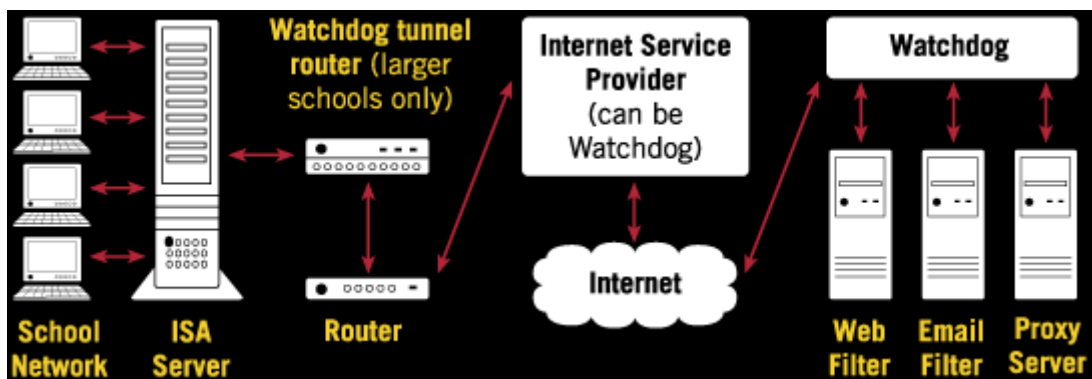
Source:

[http://www.watchdog.net.nz/index.php?option=com\\_content&task=view&id=63&Itemid=164](http://www.watchdog.net.nz/index.php?option=com_content&task=view&id=63&Itemid=164)

In addition to automatically blocking fixed content, Watchdog Corporation Ltd offers a customised blocking service whereby the customer can block content that does not fall under the above categories. This service is typically used by customers wanting to block non-productive content such as sport, web based email and travel websites.

The technology that allows Watchdog to offer filtering services is licensed from Optenet. Watchdog is the sole distributor of this technology in the Asia Pacific region, but the distributorship agreement is not exclusive. However, without the use of tunnelling technology, filtering would not be commercially feasible.

There are two internet connections from New Zealand to the rest of the world; The Southern Cross Cable passing through Hawaii into the United States, and Telstra’s fibre connection passing through Sydney and eventually into the United States. The relatively small population of internet users in New Zealand means that the large capital costs of these cables are spread across few users, so the cost of downloads per user is relatively high. A traditional internet filtering service must allow or block content requested by a customer by first downloading it themselves. Whilst this model is feasible for many developed nations, it is not economically feasible for a New Zealand internet filter due to the high costs of downloads in New Zealand. Thus Watchdog developed tunnelling technology to overcome this issue. Tunnelling allows Watchdog to accept or block a request for information by a user without having to incur the cost of downloading the content. The below figure depicts the process:

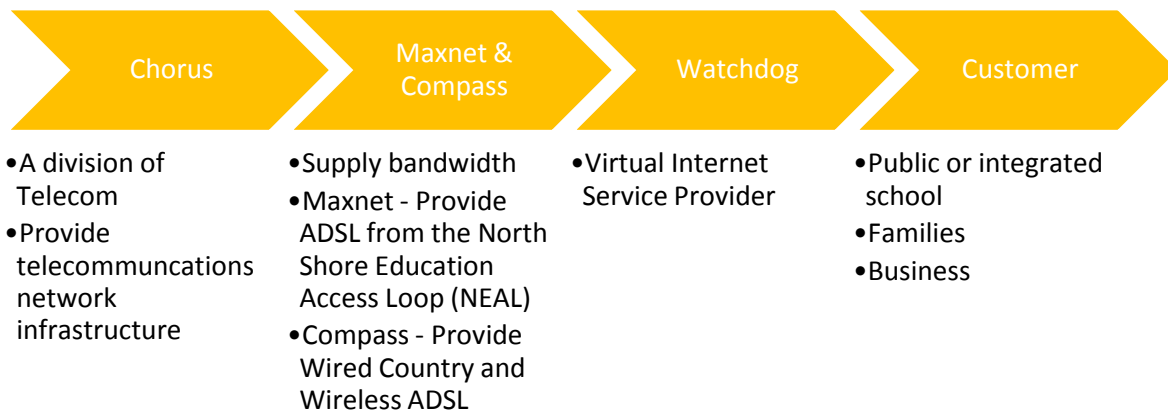


Source: [watchdog.net.nz](http://watchdog.net.nz)

In 2004 the MoE awarded a three year contract for Watchdog to supply filtering services to New Zealand public and integrated schools. Under the contract, a school will sign up to Watchdog’s filtering service for free and the MoE will pay Watchdog per school user. It has been renewed numerous times and the most recent contract lasts until 2012. Whilst the contract offers certainty of revenue and a government accreditation, it places Watchdog at the mercy of a single customer. In the most recent roll-over of the contract, the government announced that it would be cutting Watchdog’s revenue by 14% from 1 January 2010.

### ISP

An Internet Service Provider (ISP) is a company or organisation that has the equipment and telecommunication line access to provide connectivity to the Internet. Watchdog Corporation Ltd is a Virtual Internet Services Provider (VISP) to public and integrated schools, families and businesses. A VISP does not own the equipment necessary to be an ISP and buys their bandwidth from ISPs. The below figure depicts the value chain for a VISP.



Whilst Watchdog is not a VISIP for all its filtering clients, they are the second largest ISP in the public and integrated school market. Xtra is the largest and CallPlus is third. Unlike the filtering service, schools must pay for their internet connection.

### Applications

Applications are typically value added services provided by Watchdog Corporation Ltd with the aim of extracting more value from existing customers, or services provided by Watchdog to in relation to a strategic partnership. The following are applications:

#### *TxtStream*

Watchdog.net.nz explains three functions of the TxtStream service:

##### 1. *General Messaging*

*Upload your Student Management contact details to a web interface (takes 2 secs) and send an email or a TXT to all your parents at one click of a button! Great for reminders, notices and urgent notifications.*

##### 2. *Early Notification (includes small group messaging)*

*TXTStream is also an MoE Accredited absentee solution and integrates seamlessly with most MoE-accredited Student Management Systems (SMS). By automating this process, TXTStream can save your office team a tremendous amount of time and effort that is probably being currently spent in making (and fielding) calls each day. As soon as the class rolls have been updated in your SMS, it's just one push of a button to send texts to parents to check about their children's whereabouts. TXTStream will then field the parents' responses, thereby giving you an excellent method for policing truancy, as well as establishing a better working relationship with parents on attendance issues.*

##### 3. *Txt-In*

*Parents can TXT the school to let them know their child is away up front – not have to wait until the school contacts them!*

Source:

[http://www.watchdog.net.nz/index.php?option=com\\_content&task=view&id=85&Itemid=209](http://www.watchdog.net.nz/index.php?option=com_content&task=view&id=85&Itemid=209)



### *Google Applications (Google Apps)*

Watchdog Corporation Ltd has formed a strategic partnership with search engine giant Google, whereby Google pays Watchdog a service fee for providing technical support to schools using free Google Apps such as Google Docs (spreadsheets, documents, forms, presentations, etc) and Gmail (Google's Webmail service). Whilst revenue from the Google Apps business has been modest, Watchdog sees strategic value in the relationship. Rohan Meuli describes:

*Once you've talked to a school four times, and they've said "No. No. No. and No!" what's left to discuss? You only start irritating them. Well now we say "are you interested in Google?"... It allows us to have discussions with schools that otherwise don't want to talk with us.*

Furthermore, like the government accreditation from the MoE contract, association with Google adds credibility to a small organization. Google have recently acquired companies competing in the filtering space, including email filtering company Postini.

Whilst the Google partnership is valuable from a strategic perspective, the relationship is not without conflict. Watchdog recently bid against Google for an Australian schools opportunity. Also, the search filter built into the Google search engine could be seen as a substitute for Watchdog's filtering service.

### **Other**

Watchdog provides additional services that compliment their core business. These include firewalls, domain names and corporate services such as webhosting, network design and router installation.

### **Watchdog International Ltd**

Since its inception, Watchdog International Ltd has pursued the following opportunities:

#### *The United Kingdom*

In 2007 Watchdog was offered the right to sell Swedish company NetClean's "White Box" product in the UK. White Box blocks illegal child sexual abuse material before it enters the host country.

The five major ISPs have adopted similar technology, so Watchdog is focusing on the minor ISPs that have not adopted and aim to comply with government proposals. There has been modest uptake of the White Box product to date.

#### *Australia*

The following extract from the Australian Department of Broadband, Telecommunications and Digital Economy outlines the opportunity that Watchdog has been pursuing in Australia:

##### *Cyber-safety commitment*

*In May 2008 the Government committed \$125.8 million over four years to a comprehensive cyber-safety plan to combat online risks and help parents and educators protect children from inappropriate material. Measures include increased funding towards cyber-safety education and awareness raising activities, content filtering and law enforcement.*

##### *Internet Service Provider (ISP) filtering*

*ISP filtering is a key component of the Australian Government's cyber-safety plan. Filtering of online material at the ISP level reflects the view that ISPs should take some responsibility for enabling the blocking of such content on the internet.*

#### *ISP-level filtering of Refused Classification material*

*The Government has recently announced that in 2010 it will introduce legislative amendments to require all ISPs in Australia to use ISP-level filtering to block overseas hosted Refused Classification (RC) material on the Australian Communications and Media Authority's (ACMA) RC Content list.*

#### *ISP filtering pilot*

*As part of its plan to examine the introduction of ISP-level filtering, the Government conducted a live ISP filtering pilot in 2009 that provided valuable information on the effectiveness and efficiency of filters installed in 'real world' ISP networks.*

*The live pilot, managed by independent testing laboratory Enex Testlab, demonstrated that filtering of a defined list of online content can achieve 100 per cent accuracy and no noticeable performance degradation directly attributable to the filter.*

*Source: [http://www.dbcde.gov.au/funding\\_and\\_programs/cybersafety\\_plan/internet\\_service\\_provider\\_isp\\_filtering](http://www.dbcde.gov.au/funding_and_programs/cybersafety_plan/internet_service_provider_isp_filtering)*

Watchdog International Ltd has actively been involved in the Australian market for the last three years. Their involvement in the ISP filtering pilot programme has generated \$80,000 in sales and helped establish credibility with three out of six of the major ISPs. Watchdog have also met with the Minister of Broadband, Communications and Digital Economy, Senator Stephen Conroy, and expect to hear about the outcome of their efforts in the Australian market in early 2010.

#### *The Philippines*

Facing pressure from Non-Government Organisations (NGOs) concerned with child sexual abuse content, the Philippines government amended anti-child pornography legislation. The amendment forces ISPs to adopt child sexual abuse blocking technology within the next six months. Since this is a recent development, Watchdog is yet to generate revenue from this opportunity. Watchdog would serve this market with the NetClean product.

### **Competitive Advantage**

Watchdog has three key competitive advantages:

#### *Tunneling Technology*

Apart from bypassing the need to download all content that passes through a filter, tunnelling allows Watchdog to filter a customer on any ISP. Competitors such as Telecom must offer customers their ISP service before the customers can use Telecom's filtering product. Thus, tunnelling technology allows Watchdog to reach more customers.

#### *"Best of the Breed"*

Watchdog is the only major company that specialises in distributing internet safety solutions. Competitors typically sell products that they have developed themselves. So Watchdog is able to choose the "best of the breed" and market it to the customer. This model allows Watchdog to be more independent, develop credibility and offer a superior product.

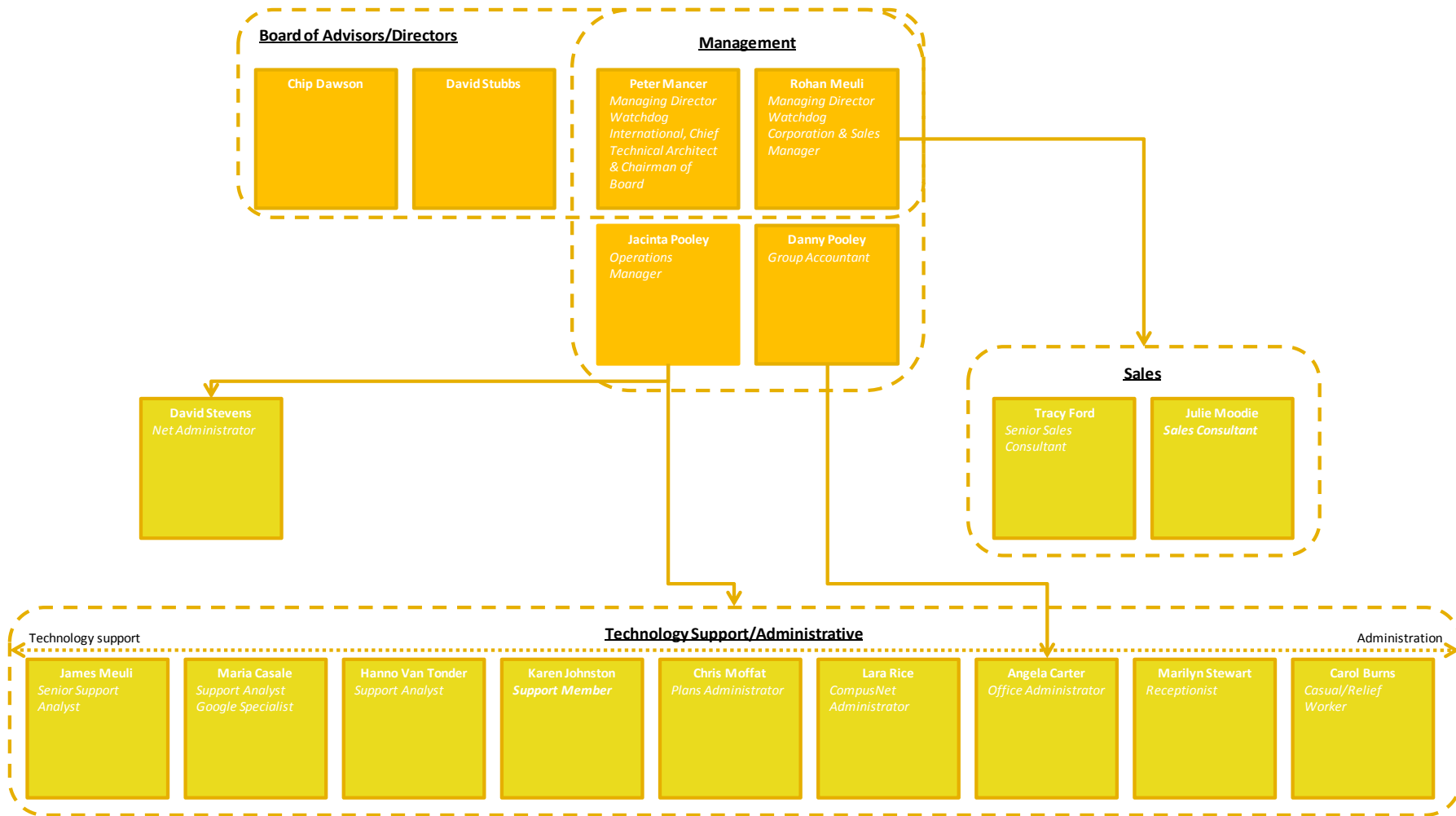
### *VISP Expertise*

Having had experience as a VISP, Watchdog is better able to understand the needs of the ISPs that they sell services to. Competitors typically design their own technology which is then sold to ISPs. They place little emphasis on the wants of the ISP (such as positioning as an above commodity service and reducing customer churn) in their sales pitch.

### **Organisation**

The below organisation chart depicts the structure of Watchdog Corporation Ltd.

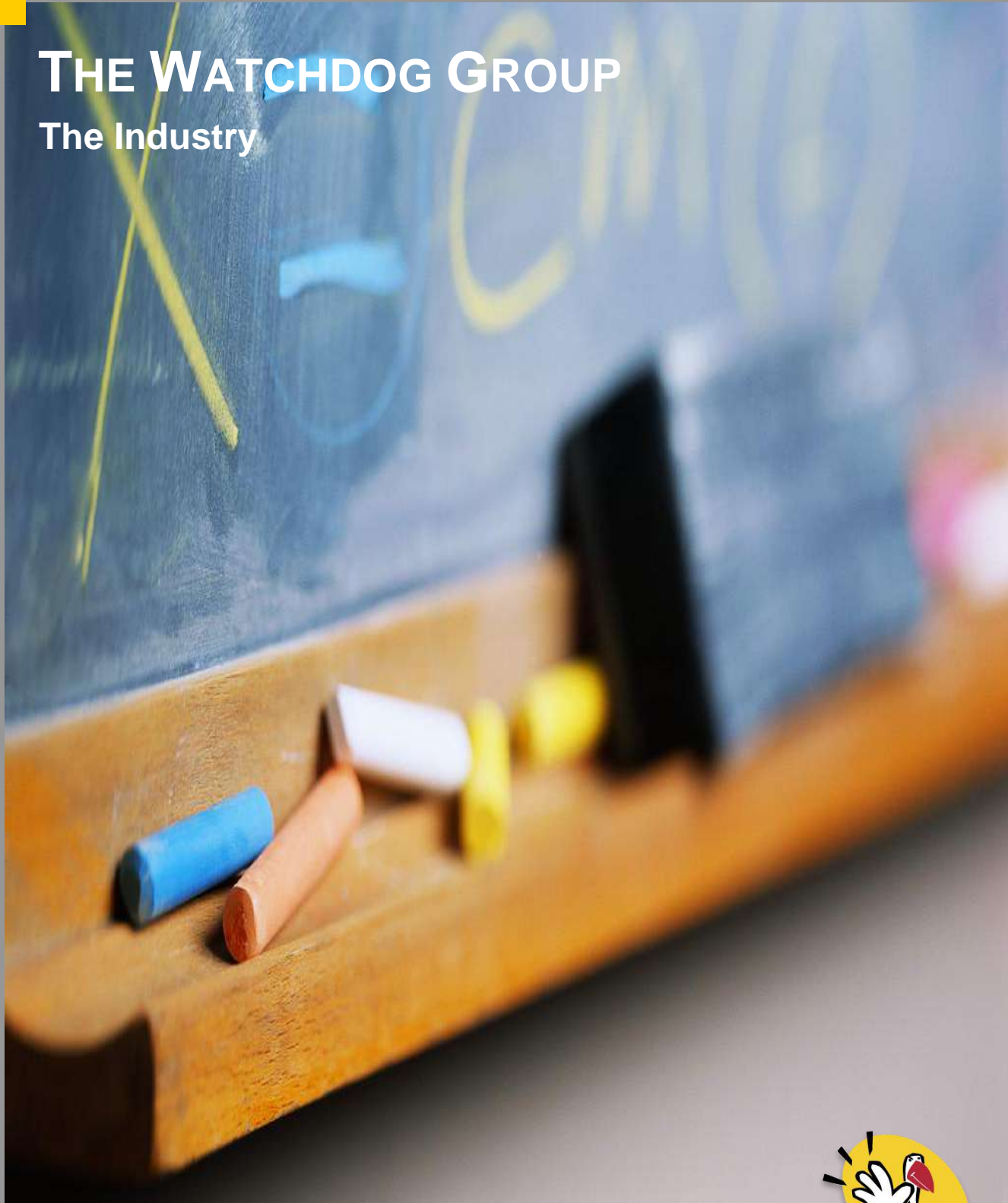
Peter Mancer and Rohan Meuli serve on both the Board of Directors and the senior management team. Jacinta Pooley and Danny Pooley are the other members of management. Whilst Jacinta has worked her way to a management position over years spent in operations, her husband Danny has recently joined the team externally. Danny is a Chartered Accountant specialising in management accounting, with a background in general management. Jacinta manages most of the office staff. As Operations Manager she is responsible for coordinating the nine technology support and administration staff. Roles are designed to overlap and staff members are expected to be flexible enough to handle tasks outside of their formal job title.





# THE WATCHDOG GROUP

## The Industry



## The Industry

*There are technological changes out there that we probably can't even dream of. It [technological change] may be five years or it may be sooner... but it'll have a significant impact on people's requirements for us.*

- Rohan Meuli, Managing Director of Watchdog Corporation

The following information is summarised from interviews with management and publically available sources. It concerns competition, market segments and trends that are shaping the future of the industry.

## Competition

### Telecom

The following information is sourced from Telecom's website:

#### *About Telecom New Zealand*

*Telecom is New Zealand's largest telecommunications service provider, and touches almost every New Zealander through the range of products and services we provide, and the work we do within our communities.*

*We employ almost 7,000 people here in New Zealand and around 1,600 more in Australia and around the world.*

*On 31 March 2008 our business was operationally separated in line with amendments to the Telecommunications Act.*

*As a result, Telecom is now made up of five customer-facing businesses: Chorus; Telecom Wholesale & International; Telecom Retail; Gen-i and AAPT.*

#### *Our business units*

##### *Telecom retail*



*Telecom Retail is responsible for providing fixed line, mobile and internet services to consumers and the small/medium business market.*

##### *Gen-i*



*Gen-i provides converged technology and telecommunications solutions for Telecom's business customers across New Zealand and Australia. Gen-i has a team of more than 2,000 people who*

are among the most highly skilled and experienced ICT integrators in Australasia.

Chorus



*Chorus is the operationally separate business unit managing Telecom's local access network in New Zealand. Chorus also operates the national field services group and takes the lead on significant developments like access fibre and Telecom's cabinetisation programme, which will deliver high-speed broadband to New Zealanders in all towns with 500 lines or more.*

Telecom Wholesale



*Telecom Wholesale is an operationally separate business unit that delivers next generation wholesale network connectivity products to service providers throughout New Zealand. Its broadband, business data, voice and interconnect products give wholesale customers the foundation on which to build their own network or telecommunications services for their end-users.*

AAPT



*AAPT is Telecom's Australian subsidiary and is the third largest telecommunications provider in Australia. Telecom acquired PowerTel Limited in 2007 to enable AAPT to leverage its investment in service capability and bring more customers onto the combined access network.*

*Source: <http://www.telecom.co.nz/stream/0,8747,200630-100,00.html>*

Since 2004 when the MoE announced that both Watchdog and Telecom would be sharing the contract to supply New Zealand public and integrated schools, Telecom has been Watchdog's primary competitor. Despite once being New Zealand's largest publically listed company, Telecom only serve 800-900 schools whereas Watchdog serves 1,350. Rohan Meuli explains why Watchdogs market share is greater:

*"They've [Telecom have] always been there but their enthusiasm has waxed and waned...They can't quite make money out of it but they can't quite get their head around whether they should get rid of it, whether they should put more money into it and make it go, or just to leave it as a slightly worse than break even scenario"*

In addition to Telecom's lack of enthusiasm for such a small business segment, the nature of their filtering service may also have contributed to a lower market share. Telecom sell a service to schools

called SchoolZone. SchoolZone offers a suite of products that cater to the needs of public and integrated schools. As described by the Telecom website:

*SchoolZone is a secure managed internet solution for schools, providing a host of services, including a safe and secure Internet connection, video conferencing, email, school websites, student home pages and more. SchoolZone brings together all the future-focused requirements schools like yours have told us they need...*

- Internet connection*
- SchoolZone service speeds*
- High-quality video conferencing*
- Flat-rate subsidised pricing*
- Network security (Managed Firewall)*
- Safer browsing and email (Content Filtering)*
- Virus protection*
- Spam protection*
- Email for staff and students*
- School intranet application*
- Monitoring and reporting tools*
- School website and student homepages*
- Secure remote access*
- Independent governance*
- Future proof*
- Shared Networking (VPN)*

*Source: <http://www.telecom.co.nz/content/0,8748,202797-202298,00.html>*

Whilst the wide range of features of the SchoolZone product is popular amongst many schools, the MoE only fund the filtering component of the suite. In the past the suite was bundled so schools had to purchase all of the other features. As described by Rohan Meuli:

*"People aren't prepared to buy into big packages on long contracts... The market has moved on to shorter contracts, if any contracts, and choice. You pick and choose what you want"*

Telecom has recently unbundled the SchoolZone product.

### **Telstra**

*Telstra are probably the dark horse... We could be having this conversation in two years time and we could be sweating blood over Telstra's aggressive impact into the market. In about April they made a big pitch for phone business in schools and in their pitch they implied that they were going to get ministry funding or accreditation... It's tailed off since then but we don't know what that means in terms of their strategy.*

- Rohan Meuli, Managing Director of Watchdog Corporation



The following information is sourced from Telstra's website:

We are Australia's leading telecommunications and information services company, with one of the best known brands in the country. We offer a full range of services and compete in all telecommunications markets throughout Australia, providing more than 9.0 million Australian fixed line and 10.2 million mobile services, including 6.3 million 3G services.

*One of our major strengths in providing integrated telecommunications services is our vast geographical coverage through both our fixed and mobile network infrastructure. This network and systems infrastructure underpins the carriage and termination of the majority of Australia's domestic and international voice and data telephony traffic.*

*Telstra owns 50% of FOXTEL®, and its international businesses include:*

- *CSL New World Mobility Group, one of Hong Kong's leading mobile operators*
- *TelstraClear Limited, the second largest full service carrier in New Zealand*

*Source: <http://www.telstra.com.au/abouttelstra/corp/profile.cfm>*

Telstra has recently identified education as a market segment that they are particularly interested in. In the last rollover of the MoE contract for filtering public and integrated schools, the MoE announced that it would also be running trials with Telstra. Whilst Telstra's intentions are uncertain, Watchdog view Telstra as a threat. Like Telecom, Telstra are much more resourced than Watchdog. But unlike Telecom, Telstra appear to be committed to the education segment of the market. Management at Watchdog fear that Telstra will aggressively market their phone and internet services at schools and that filtering services will be sold as a part of the bundle.

### **Kiwi Advanced Research Network in Education**

Information on The Kiwi Advanced Research and Education Network (KAREN) from the KAREN website follows:

*KAREN provides lightning fast, unrestricted broadband for the New Zealand education, research and innovation communities.*

#### ***KAREN in a nutshell***

*The Kiwi Advanced Research and Education Network (KAREN) is your exclusive broadband network, linking education, research and innovation organisations in New Zealand, and across the world.*

*KAREN provides super fast, unrestricted broadband – many hundreds times faster than a standard internet connection – and with no use based charges. The network reaches across the country between 16 points of presence or 'meet me' points. Our international network extends all the way to Sydney and Seattle, connecting us with the rest of the world.*

*More than 220,000 students, researchers and educators at over 60 New Zealand universities, polytechnics, schools and government agencies have access to KAREN, as well as scientists at our Crown Research Institutes across the country. Our international network links you to over 200 million advanced network users worldwide.*

### *All you can eat at high quality*

*New Zealand researchers and educators need KAREN to:*

- *access digital resources, content and services*
- *exchange large volumes of data quickly*
- *gain access to large scale national and international infrastructure*
- *collaborate better on research and education projects at a distance*

*Source: <http://www.karen.net.nz/about/>*

The extent that schools will use the KAREN network to bypass the ordinary internet will determine their future need for filtering services in the future.

## **Market Segments**

Watchdog serves three market segments; schools, families and businesses. The nature of each segment is summarised below:

### **Schools**

There are 2,400 public and integrated schools in New Zealand. Watchdog defines their market as the public and integrated schools covered by the MoE contract because private schools tend to not be receptive to filtering products. This is because they often have their own internal systems and the MoE will not pay for their filtering service.

Providing support services for schools is often challenging from an operations perspective. Operations manager, Jacinta Pooley explains:

*That's the nature of the beast - high turnover of staff and the left hand often doesn't know where the right hand is, particularly in small schools. So the school market is a very specific market and we've got to know our way around it... It's a difficult market. You have so many expectations.*

Jacinta explains that expectations often make relationships difficult. For example, due to a lack of proper technical expertise, schools may mistakenly blame the Watchdog's filtering system for their slow internet connection when in fact it is a problem with their bandwidth supplier.

### **Families & Businesses**

Families refers to the households / residential segments of the market. Watchdog serve approximately 200 family and business clients, most being families. Rohan Meuli describes why these have been difficult segments of the market to tap:

*I guess what we've been trying to find, both in the business area and the residential, is a cost effective and productive way of targeting those parts of the market. And that has been quite challenging... The traditional way that we've provided filtering to residential customers has not flown and probably never will. That is by providing them with their internet connection... [In] the residential market... there is endless ways you can spend your money... part of what we have got to acknowledge is that we are not experts in that.*

The families and business segments of the market are typically served by large Telecommunications companies that develop brand awareness with large nationwide marketing campaigns. Mass marketing is not Watchdog's core competency and would require more resources than they can afford. Furthermore families and businesses often purchase bundled phone and internet services, providing them with a discount. This makes families and businesses unwilling to switch ISP. Also, expectations once again make Watchdogs role difficult. Jacinta Pooley explains:

*We're not a call centre. People are used to phoning Telecom and 24 hours there's somebody there...We're offering highly skilled technical assistance for a very unique product. We cannot afford to have thirty people sitting there and waiting for your call*

## **International Markets**

*[The] initial plan was to duplicate the Watchdog model. But we soon realised that the international business was going to be different to the New Zealand business.*

- Peter Mancer, Managing Director of Watchdog International

Watchdog International Ltd defines international markets in three ways:

### **Implemented Internet Filtering**

Countries include the United Kingdom, Canada and most of Scandinavia. These markets tend to be developed countries with regulations in place making some degree of filtering mandatory. However, filtering is sometimes not mandatory for small players since it is often infeasible for governments to enforce compliance to hundreds of minor ISPs only serving five percent of the market.

### **Implementing Internet Filtering**

Countries include the Philippines, Australia, France and Germany.

### **Not Implementing Internet Filtering**

Whilst it is tempting to neglect this market segment, Watchdog continues to monitor developments in these markets. For example, Watchdog is watching Ireland, who has recently established The Office for Internet Safety.

In the New Zealand market, schools make decisions about allocating their budgets and whether to purchase filtering products. So domestically Watchdog markets to schools. Internationally, schools tend to be less autonomous, and governed by the rules of their region. For example, schools in South Australia must use a particular filtering product. So Watchdog International's focus in the world market has been on selling to ISPs.

Another important distinction between the international market and the domestic is the importance of relationships. As a small company from New Zealand, Watchdog must first earn credibility with key decision makers before generating business. Watchdog achieves this through association with government departments, ministers, NGOs and membership in industry groups. For example, Watchdog has relationships with the Office of Internet Safety in Ireland and the Internet Industry Association in Australia. Due to the time taken to develop relationships (and often the legislative process) the revenue cycle in international markets is very long.

## General Trends

### Security as a Service

Security as a Service (SAAS) refers to delivering security applications as an internet based service to consumers and businesses. For an ISP this means including services security services such as firewalls, antivirus software and even internet filtering systems with their internet connection. Offering a security as a service suite allows ISPs to differentiate a service that would otherwise be commoditised and lower customer churn, since customers must replace these lost services when they move away from the ISP.

### The "Free Internet"

"Free Internet" does not refer to the cost of accessing the internet, rather it refers to whether content is available to all people (regardless of whether they have to pay for it or not). Internet filtering conflicts with the notion of the free internet since access to certain categories of material is blocked. Rohan Meuli describes:

*There is a trend towards establishing boundaries to people's access... We are quite interested just in general terms about how the internet unfolds and the tension between the free internet enthusiasts and the commercial reality which is clamping down on violation of music copyright, peer-to-peer networks, Google fleecing other suppliers of content. So the tension there is of interest to us, because it does affect how people access the internet, how much they'll pay for and the need for filtering.*

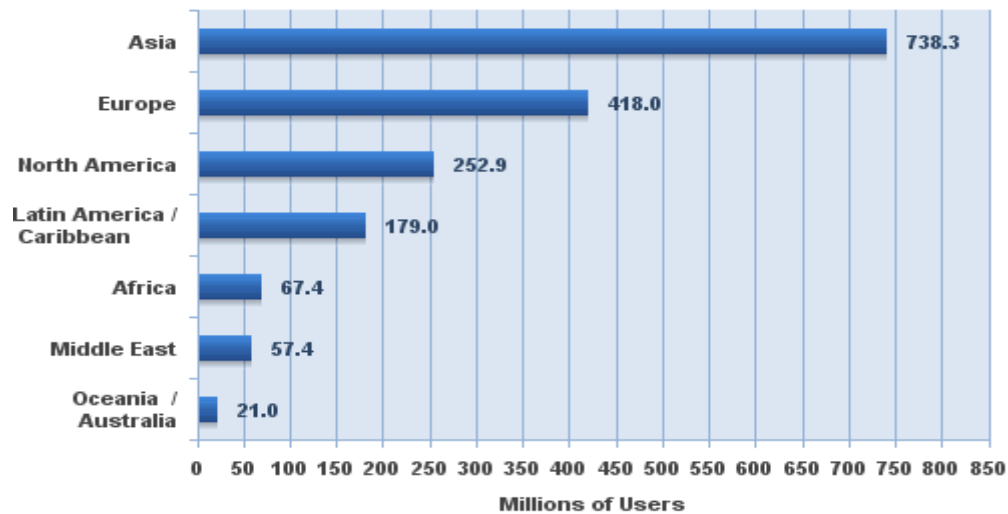
In the context of peer-to-peer networks (where users can upload content to share with other users), Rohan Meuli describes:

*We've tended to treat it [peer-to-peer networks] from a Watchdog perspective as a no-no, because so much of it is providing pornography or illegal software or un-copyrighted music or things like that. But the reality is that peer-to-peer is a very effective way to deliver quite legal material... So how we can better*

handle the filtering of inappropriate peer-to-peer material vs appropriate material is quite a challenge for us.

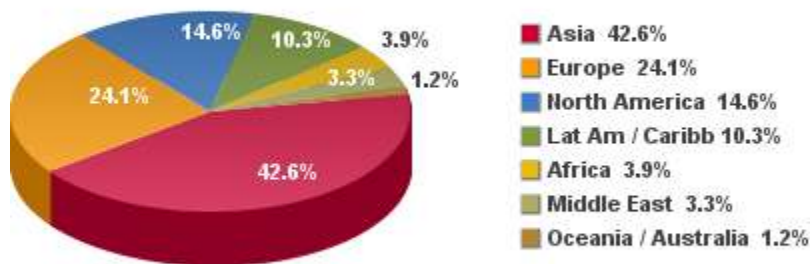
## Statistics

### Internet Users in the World by Geographic Regions



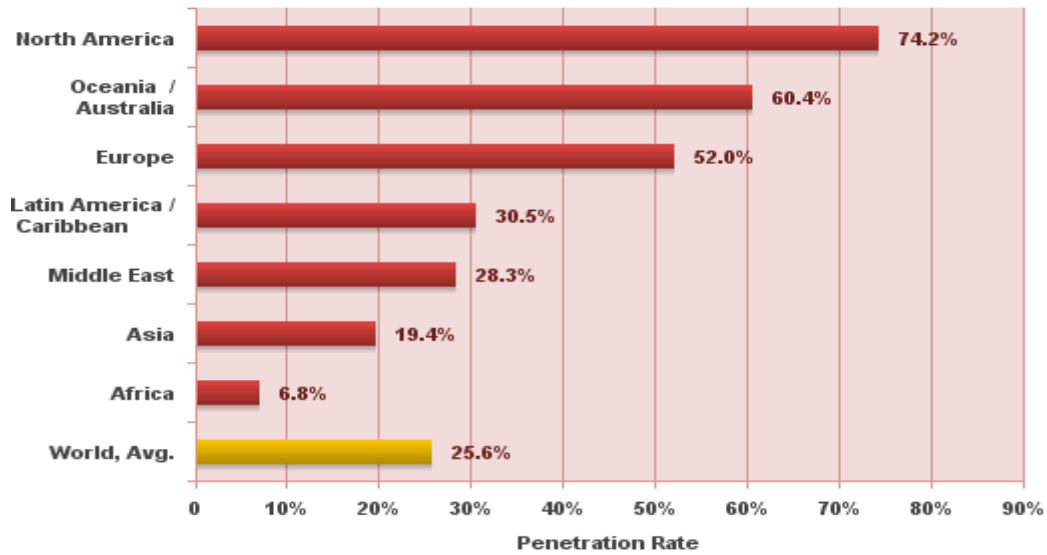
Source: Internet World Stats - [www.internetworldstats.com/stats.htm](http://www.internetworldstats.com/stats.htm)  
Estimated Internet users are 1,733,993,741 for September 30, 2009  
Copyright © 2009, Miniwatts Marketing Group

### World Internet Users by World Regions

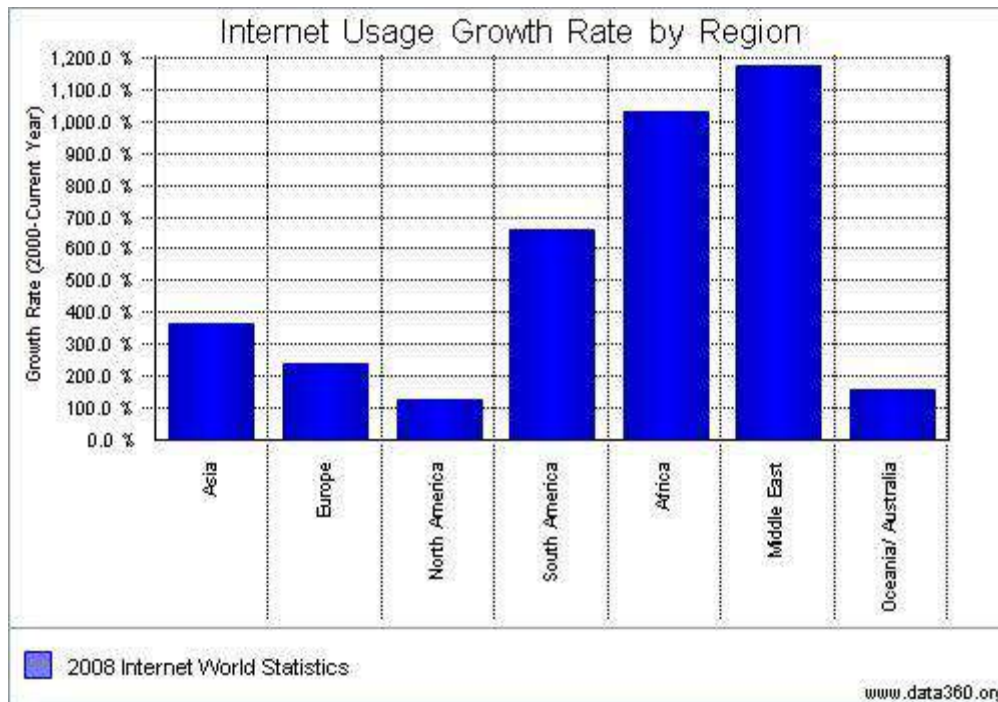


Source: Internet World Stats - [www.internetworldstats.com/stats.htm](http://www.internetworldstats.com/stats.htm)  
1,733,993,741 Internet users for September 30, 2009  
Copyright © 2009, Miniwatts Marketing Group

## World Internet Penetration Rates by Geographic Regions



Source: Internet World Stats - [www.internetworldstats.com/stats.htm](http://www.internetworldstats.com/stats.htm)  
 Penetration Rates are based on a world population of 6,767,805,208 and 1,733,993,741 estimated Internet users for September 30, 2009.





# THE WATCHDOG GROUP

## Strategic Opportunities and Challenges



## Strategic Opportunities and Challenges

### The ISP Business

A possible strategic option for Watchdog would be to discontinue their VISP business by selling the connections with each customer to another ISP. In the past, the VISP business has barely broken even. The function of it was simply to provide an entry point into schools that wanted an internet connection so that Watchdog could then sell the more profitable filtering service. In addition to being less profitable, the trend towards bundled services has made it difficult for Watchdog to compete. Budget constrained schools are moving to ISPs that can offer cheaper services by also providing phone services.

The new high speed fibre network to be constructed in New Zealand also suggests that selling the VISP business may be a sound option, since one of the first to receive access to the network will be New Zealand schools. So large ISPs will be looking to provide the schools with their connection and may be willing to pay for the connections that Watchdog is providing schools with. Rohan Meuli comments about Telstra as a possible buyer, should Watchdog decide to further investigate the option of selling the VISP business:

*We've wondered, in the spirit of co-opetition, whether they [Telstra] might be the right people to sell our internet business to, because if they're keen to get in the [New Zealand schools] market, maybe they're prepared to pay a real premium. Are we bold enough to sell it to them to get a premium price for our ISP business, knowing that they might jeopardise our filtering business? Telstra are also quite a difficult organisation to deal with. We have good relationships with all ISPs, even Telecom...They're [Telstra are] quite closed, quite insular.*

Management believe that it is important to not just evaluate bidders based on the price that they are willing to pay for the ISP business, but also on the impact that their purchase will have on Watchdog's core revenue stream. Should Watchdog sell the VISP business, they would aim to choose a bidder that will agree to form a partnership whereby their ISP customers must subscribe to Watchdog internet filtering. It is also desirable that the partner appeals to the MoE, offers phone services to satisfy the schools desire to access cheaper bundled services, and has a strong presence in the families and businesses segment of the market. This will allow Watchdog to sell the filtering service as add-on to these segments, thus providing their service to more people without having to engage in mass marketing campaigns and offer the bundled services. Neither of which are Watchdog's core competencies.

### Optenet

*So we'd be quite keen to sell the Optenet product. Not because we'd necessarily make a lot of money out of it, I'm not sure we would at all. But because we see it is fulfilling the Watchdog vision to make filtering freely available to families and businesses throughout New Zealand.*

- Rohan Meuli, Managing Director of Watchdog Corporation



Optenet, who Watchdog licence the filtering technology from, have introduced a new PC based product aimed at increasing children's safety on the internet. The product offers multiple services including monitoring conversations on social networking sites to flag risky conversations, time restrictions on children's internet usage, and flagging whenever the user gives their contact details to another user. The product could be sold via download from the internet or as a CD through a retail outlet.

Whilst Watchdog has been dismissive of PC based filtering products in the past, Watchdog are more receptive to the Optenet product for many reasons. The main reason is that it allows Watchdog to extend their reach beyond the families that they provide an internet connection to and families that their potential partner provides with a connection. Also, families can use the product without having to switch ISP, and thus should be more receptive to it.

## **International Opportunities**

### **Australia**

Despite extensive effort in the Australian market, Watchdog continues to await the announcement about whether they will be awarded a contract by the Australian government.

### **The Philippines**

The extent to which Watchdog International is successful in the Philippines is limited by their relationship with NetClean. NetClean are reluctant to let Watchdog use the White Box product beyond the UK and the Pacific (since Watchdog can only distribute to these regions under the licence agreement). Watchdog is continuing to negotiate with NetClean about marketing White Box in the Philippines.

### **ISPs**

Watchdog International intends to shift focus from governments and regulators to selling their filtering product to ISPs. Peter Mancer describes:

*That particular opportunity will be more steady than others. It's not reliant on some political situation... more on commercial terms*



# THE WATCHDOG GROUP

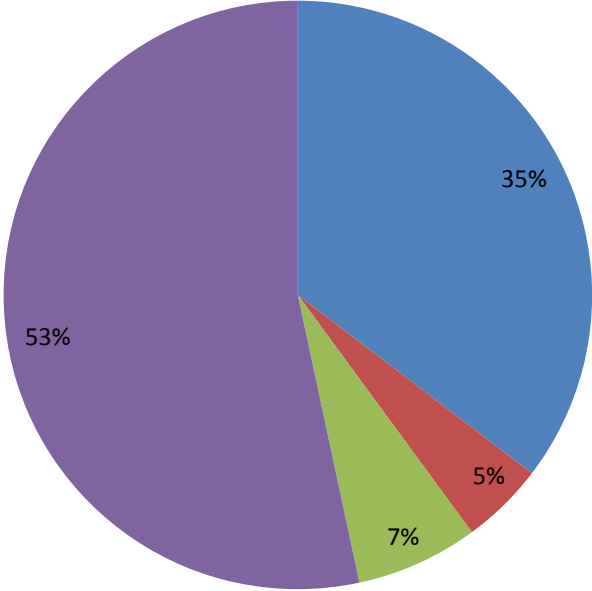
## Financials



# Financials

The following is financial information for Watchdog Corporation Ltd and Watchdog International Ltd.

## Shareholdings in Watchdog Corporation Ltd Shares Outstanding: 2,189



■ Mancer family ■ Rohan Meuli ■ Board of advisors ■ Other

# WATCHDOG CORPORATION LIMITED

## DIVISIONAL ACCOUNTS - OCTOBER 2009

	ISP		Filtering		Applications		Commissions*		Other		Total	
Revenue	81,820	33.7%	153,459	63.2%	5,276	2.2%	796	0.3%	1,312	0.5%	242,663	100.0%
Cost of Sales	68,176	79.2%	12,856	14.9%	3,506	4.1%	0	0.0%	1,555	1.8%	86,093	100.0%
<b>Gross Margin</b>	<b>13,644</b>	<b>8.7%</b>	<b>140,603</b>	<b>89.8%</b>	<b>1,770</b>	<b>1.1%</b>	<b>796</b>	<b>0.5%</b>	<b>-243</b>	<b>-0.2%</b>	<b>156,570</b>	<b>100.0%</b>
Gross Margin %	16.7%		91.6%		33.5%				-18.5%		64.5%	
Expenses	9,329	7.0%	124,029	93.0%	0	0.0%	0	0.0%	0		133,358	100.0%
Operating Profit	4,315	18.6%	16,574	71.4%	1,770	7.6%	796	3.4%	-243	-1.0%	23,212	100.0%
Other Income	0	0.0%	3,545	100.0%	0	0.0%	0	0.0%	0	0.0%	3,545	100.0%
Other Expenses	0	0.0%	0	0.0%	0	0.0%	0	0.0%	0	0.0%	0	0.0%
<b>Net Profit/Loss</b>	<b>4,315</b>	<b>16.1%</b>	<b>20,119</b>	<b>75.2%</b>	<b>1,770</b>	<b>6.6%</b>	<b>796</b>	<b>3.0%</b>	<b>-243</b>	<b>-0.9%</b>	<b>26,757</b>	<b>100.0%</b>

## DIVISIONAL ACCOUNTS - 1 JANUARY 2009 to 1 OCTOBER 2009

	ISP		Filtering		Applications		Commissions*		Other		Total	
Revenue	571,683	34.9%	1,034,493	63.2%	20,320	1.2%	3,061	0.2%	7,072	0.4%	1,636,629	100.0%
Cost of Sales	525,943	80.7%	103,144	15.8%	15,559	2.4%	0	0.0%	7,008	1.1%	651,654	100.0%
<b>Gross Margin</b>	<b>45,740</b>	<b>4.6%</b>	<b>931,349</b>	<b>94.6%</b>	<b>4,761</b>	<b>0.5%</b>	<b>3,061</b>	<b>0.3%</b>	<b>64</b>	<b>0.0%</b>	<b>984,975</b>	<b>100.0%</b>
Gross Margin %	8.0%		90.0%		23.4%		100.0%		0.9%		59.4%	
Expenses	65,303	8.1%	740,686	91.9%	0	0.0%	0	0.0%	0	0.0%	805,989	100.0%
Operating Profit	<b>-19,563</b>	<b>-10.9%</b>	190,663	106.5%	4,761	2.7%	3,061	1.7%	64	0.0%	178,986	100.0%
Other Income	0	0.0%	64,923	100.0%	0	0.0%	0	0.0%	0	0.0%	64,923	100.0%
Other Expenses	0	0.0%	9,155	100.0%	0	0.0%	0	0.0%	0	0.0%	9,155	100.0%
<b>Net Profit/Loss</b>	<b>-19,563</b>	<b>-8.3%</b>	<b>246,431</b>	<b>105.0%</b>	<b>4,761</b>	<b>2.0%</b>	<b>3,061</b>	<b>1.3%</b>	<b>64</b>	<b>0.0%</b>	<b>234,754</b>	<b>100.0%</b>

\*Commissions are received from selling ISP clients to CallPlus. Watchdog continues the filtering services for these schools.

# Watchdog Corporation Limited

PO Box 313  
Whangaparaoa  
Auckland

## Balance Sheet

As of October 2009

15/12/20  
12:31:28 p.m.

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Assets	
Current Assets	
Cash On Hand	
Cheque Account	\$11,433.51
Business Saver Bank Acct	\$135,434.40
ASB Bank - USD	\$76,393.00
90 Day Term Deposit	\$220,000.00
Petty Cash	\$640.00
Total Cash On Hand	<u>\$443,900.91</u>
Trade Debtors	\$108,282.97
Other Assets	
Payments in Advance	\$28,410.85
Other Receivables	\$5,343.00
WDI recharge account	<u>\$2,383.00</u>
Total Current Assets	\$588,320.73
Fixed Assets	
Property, Plant & Equipment	
ISP Equipment - Cost	\$372,633.63
ISP Equip - Accum Depr'n	-\$320,396.00
Software - Cost	\$216,939.94
Software - Accum Depr'n	-\$160,474.00
CPE - Cost	\$510,560.41
CPE - Accum Depr'n	-\$416,112.00
Furn & Fixtures - Cost	\$16,540.48
Furn & Fixtures- Accum Dep'n	-\$5,176.00
Office Equip - Cost	\$64,419.75
Office Equip - Accum Depr'n	-\$43,926.00
Total Property, Plant & Equipment	<u>\$235,010.21</u>
Investments	
Dataview Shareholding	<u>\$52,700.00</u>
Total Investments	\$52,700.00
Intangibles	
Intellectual Property Rights	<u>\$78,600.00</u>
Total Intangibles	\$78,600.00
Loans	
Watchdog International	<u>\$139,479.48</u>
Total Loans	\$139,479.48
Total Fixed Assets	<u>\$505,789.69</u>
Total Assets	<u>\$1,094,110.42</u>

Liabilities

Current Liabilities

Trade Creditors	\$130,518.80
GST	
GST Outputs	\$1,705,581.03
GST Output Adjustments	\$2,728.38
GST Inputs	-\$1,174,370.67
GST Input Adjustments	-\$498.50
GST Payments/Refunds	-\$521,290.39
Total GST	<u>\$12,149.85</u>
Taxation	
Provisional Tax (2010)	-\$6,248.00
RWT Paid	-\$730.16
Total Taxation	<u>-\$6,978.16</u>
Income Received in Advance	\$53,690.62
Other Creditors	\$74,513.04
Holiday Pay Liability	\$34,700.34
Total Current Liabilities	<u>\$298,594.49</u>

Long Term Liabilities

Lease - Equico 8330	
8330 - O/balance	\$45,871.79
8330 - Payments	-\$15,378.80
8330 - Interest	\$4,319.29
Total Lease - Equico 8330	<u>\$34,812.28</u>
Lease - Equico 7282	
7282 - O/balance	\$9,817.50
7282 - Payments	-\$5,863.13
7282 - Interest	\$1,804.43
Total Lease - Equico 7282	<u>\$5,758.80</u>
Lease - Equico 7174	
7174 - O/balance	\$10,331.50
7174 - Payments	-\$6,400.80
7174 - Interest	\$1,791.57
Total Lease - Equico 7174	<u>\$5,722.27</u>
Lease - Equico 6856	
6856 - O/balance	\$9,513.47
6856 - Payments	-\$6,479.00
6856 - Interest	\$1,631.05
Total Lease - Equico 6856	<u>\$4,665.52</u>
Lease - Equico 6712	
6712 - O/balance	\$19,170.06
6712 - Payments	-\$13,490.76
6712 - Interest	\$2,899.71
Total Lease - Equico 6712	<u>\$8,579.01</u>
Lease - Equico 6279	
6279 - O/balance	\$21,121.58
6279 - Payments	-\$17,566.45
6279 - Interest	\$3,448.18
Total Lease - Equico 6279	<u>\$7,003.31</u>
Lease - Equico 6030	
6030 - O/balance	\$5,909.79
6030 - Payments	-\$5,362.56
6030 - Interest	\$1,065.59
Total Lease - Equico 6030	<u>\$1,612.82</u>

Lease - Equico 5480		
5480 - O/balance	\$10,231.97	
5480 - Payments	-\$9,287.39	
5480 - Interest	\$970.61	
Total Lease - Equico 5480		<u>\$1,915.19</u>
Lease - Equico A010112		
A010112 - O/balance	\$14,832.00	
A010112 - Payments	-\$988.82	
A010112 - Interest	\$300.08	
Total Lease - Equico A010112		<u>\$14,143.26</u>
Lease - Equico A010609		
A010609 - O/balance	\$14,384.00	
A010609 - Payments	-\$479.47	
A010609 - Interest	\$144.90	
Total Lease - Equico A010609		<u>\$14,049.43</u>
Cisco Loan - 116		
116 - O/balance	\$72,830.00	
116 - Payments	-\$6,838.98	
116 - Interest	\$1,416.90	
Total Cisco Loan - 116		<u>\$67,407.92</u>
Total Long Term Liabilities		<u>\$165,669.81</u>
Total Liabilities		<u>\$464,264.30</u>
Net Assets		<u>\$629,846.12</u>
Equity		
Shareholder's Equity		
Contributed Equity	\$306,674.99	
Total Shareholder's Equity		<u>\$306,674.99</u>
Retained Earnings		\$88,417.47
Current Year Earnings		\$234,753.66
Total Equity		<u>\$629,846.12</u>