Zacks Small-Cap Research

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CYREN Ltd (CYRN-NASDAQ)

CYRN: Financing Adds $11.5 Million to Fuel Growth Despite Disappointing Q2

Current Recommendation	**Buy**
Prior Recommendation	Hold
Date of Last Change	02/26/2014
Current Price (08/17/15)	$1.67
12 Month Target Price	**$4.00**

OUTLOOK

CYREN is a cloud-based email and web security SaaS vendor. Until recently, it sold its technology to OEMs as an engine to eliminate spam, phishing etc. in products such as Gmail and Checkpoint appliances, but it has just launched a new inexpensive, simple to deploy cloud-based service to be sold via resellers to small and medium businesses. Its technology more effectively replaces appliance-based solutions. Near term we expect losses, but its recent financing provides cash until its cloud products ramp. Then growth should return and the valuation should expand closer to its much more highly valued peers.

SUMMARY DATA

52-Week High	**$3.43**
52-Week Low	**$1.45**
One-Year Return (%)	**-29.8**
Beta	**-0.05**
Average Daily Volume (sh)	**204,701**
Shares Outstanding (mil)	**31**
Market Capitalization ($mil)	**$52**
Short Interest Ratio (days)	**4.57**
Institutional Ownership (%)	**15**
Insider Ownership (%)	**N/A**
Annual Cash Dividend	**$0.00**
Dividend Yield (%)	**0.00**
5-Yr. Historical Growth Rates	
Sales (%)	**16.2**
Earnings Per Share (%)	**-31.1**
Dividend (%)	**N/A**
P/E using TTM EPS	**NM**
P/E using 2015 Estimate	**NM**
P/E using 2016 Estimate	**52.4**
Zacks Rank	**3**

Risk Level	**Above Average**
Type of Stock	**Small-Blend**
Industry	**Internet-Software**
Zacks Rank in Industry	**57 of 76**

ZACKS ESTIMATES

Revenue
(in millions of $)

	Q1 (Mar)	Q2 (Jun)	Q3 (Sep)	Q4 (Dec)	Year (Dec)
2013	7.9 A	8.1 A	8.0 A	8.4 A	32.8 A
2014	8.1 A	8.3 A	7.8 A	7.9 A	32.1 A
2015	7.0 A	6.8 A	6.6 E	7.5 E	28.0 E
2016					35.0 E

Earnings per Share
(EPS is non-GAAP before non-recurring items)

	Q1 (Mar)	Q2 (Jun)	Q3 (Sep)	Q4 (Dec)	Year (Dec)
2013	-$0.01 A	-$0.01 A	$0.00 A	-$0.07 A	-$0.05 A
2014	-$0.05 A	-$0.04 A	-$0.02 A	-$0.03 A	-$0.14 A
2015	-$0.03 A	-$0.04 A	-$0.04 E	-$0.03 E	-$0.13 E
2016					-$0.06 E

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WHAT'S NEW

…So the Worst Wasn't Over

CYREN revenues declined again sequentially as business weakened further in the core business and new products did not compensate. Non-GAAP revenues were down 18% year over year to $6.8 million from $8.3 million last year and $7.0 million in Q1. The company blamed both the loss of customers as well as currency translation. The revenue decline accelerated from Q1.

On the other hand, the company had positive cash flow of $304,000, but negative free cash flow of $434,000 after taking into account purchase of property and equipment and capitalized software. The company also had a successful capital raise netting $11.5 million, which has not been reflected on the June balance sheet as it happened in August. This leaves the company with $15 million in cash, surely enough to fund current plans.

The other major positive is that bookings went up after declining all last year and Q1. Bookings for the quarter were $6.9 million versus $6.3 in Q1 and are finally headed in the right direction. Hopefully much of these are for the higher margin new businesses such as the contract with Wi-Fi Spark rather than the lower margin contracts such as the renewal with MacAfee. The Wi-Fi Spark deal provides the company with secure browsing for its enterprise customers, hotspot owners and visitors. Wi-Fi SPARK offers over 100,000 access points across Europe. It is using CYREN's DNS-based policy enforcement feature for protection.

Non-GAAP gross margins were down to 71.9% versus 78.1% last year, and down from 73.6% in Q1 2015 due primarily to lower revenues.

Non-GAAP operating expenses were down to $5.8 versus $7.5 million last year and $5.9 in Q1.

Non-GAAP loss was $1.2 million this year versus $1.1 million last year. The company reported non-GAAP loss of $0.04, just shy of our estimate of a loss of $0.03.

Q3 2015

Next quarter should again be down year over year and perhaps sequentially. The company believe it has a base business that ranges from $6.5 to $7.5 million per quarter and that CyberWeb Security (CWS) revenues will be incremental to that. By next year it expects revenues to be at least half from the new CWS products. In the mean time the company will continue to build its sales force and enhance its new products. In Q3 we are looking for revenue of $6.6 million versus $7.7 million last year, and down slightly sequentially from the $6.8 million in Q1. More importantly we are looking for bookings to grow. We expect losses to continue as the company is now well funded to accelerate its growth plans. They may even accelerate as it races to stake its claim in the cloud cybersecurity market as appliance solutions continue to be usurped. We look for a another non-GAAP loss of $0.04 versus a loss of $0.02 last year

2015

We are once again cutting the annual revenue forecasts and EPS, this time to $28 million and a loss of $0.13, making it another down year for revenues. With a war chest of cash and a cogent strategy we direct investors to look to 2016 when the company should begin to reap the rewards of its investment.

Emerging Business Model

As the company continues rolling out its new products we see a variety of pricing plans emerging all of which should improve revenues and margins considerably versus the legacy OEM business. The products are priced per user and the larger the number of seats that are bought, the less expensive per user. For the lowest tier, with a small number of users, a basic web security plan may cost $28 per year. For a customer with a large number of seats, say over 10,000, that price can go down to $10 per year. There is also a premium plan with a higher price point that has more capabilities and can cost $12 and up. And in the future a third level will be added with cybersecurity that can run as high as $45 per user per year. So the company will eventually track both number of active users, as well as average revenue per user.

2016

By 2016, we hope the company will find its place in the cloud cybersecurity market. As appliances are replaced by cloud service we believe sales should accelerate and margins expand. Additionally perhaps CYREN may be considered a valuable acquisition given its rich patent trove and vast database of threat information. We are looking for revenues of $35 million up 25% and a loss of $0.06.

Market Shifts are in CYREN's Favor

The cloud-based cybersecurity space is exhibiting high growth because of the increase in threats as well as the inability for appliances to protect users outside of the office. As the workforce become more mobile it becomes impractical to protect users by keeping them in corporate locations. Once attached to the Internet outside the workplace, there is no protection. However if the protection function is in the cloud, users are protected everywhere, IT needs to do less work, appliances and other equipment does not need to be bought and economies of scale kick in. While the company considers ZScaler its closest competitor, it believes it has an advantage over that company just by the huge volume of data it already collects from its base business. So while some services can protect you from a threat, at your company, CYREN can protect you from a threat that was receive elsewhere on the globe by someone else. In that way it can provide protection from something that has yet to threaten you.

INVESTMENT THESIS

- CYREN is trying to move from OEM sales that have generated $0.50- $1 per user per year, to end-user products that will generate $10-48 per user per year. If successful, this should accelerate revenues and earnings in 2015 and beyond which should translate to a higher valuation and higher multiples more in line with its public peers.

- Versus public comparable companies in the Internet security business, CYREN is considerably undervalued on an enterprise value to sales basis. This sector is experiencing increased investor attention due to the increasing occurrences of cyber attacks and security breeches in the news. It is believed that companies will commit higher spending to avoid these breeches in the future and the market will grow faster than previously thought.

- ZScaler, its closest competitor, was recently valued at more than $1 billion and could soon go public. We believe it is much more highly valued than CYREN, and as a comparable, CYREN's stock could rise.

- CYREN operates in a large, high growth market. The Global Cloud Security Software market is forecast to grow at 48.46% CAGR over the period 2014-2019 according to Tech Navio. The top three cloud security services that will contribute as the major market in cloud security services market are cloud IAM, email security and web security (WAF).

VALUATION

Web security vendors are at extremely high valuations, and most are growing rapidly and enjoying much publicity as hacking remains a constant threat. Since the last valuation was run, we have added Cyberark and Rapid7 to the comps. CYRN currently trades at a price of $1.67 that gives it a pre-money enterprise value of $52 million, or 1.9 estimated 2015 revenues. Its peers trade from a range of 13.5 for Palo Alto Networks (PANW), to 2.1x for Symantec (SYMC). The difference is primarily that PANW is expected to grow revenues this year while Symantec's revenues are expected to have down revenues and flat earnings. Was CYRN to attain revenue growth of its peers, we believe its valuation could move up closer to its peers. Taking the average enterprise value to sales of the group, we get an average of 8.0 times. At that valuation CYRN would be worth $6.48 per share. Clearly CYRN is trading more like Symantec and less like the growth companies. Were it to again begin to grow, we can see it moving in line with the more highly valued peers and competitors.

Web Security Companies

Company	Ticker	Revenue 2015E	Revenue LTM	EBITDA Margin	Enterprise Value / Sales 2015E	Enterprise Value / Sales LTM	Included in Average?
Barracuda Networks	CUDA	$326	$289	1%	3.6x	4.1x	y
Checkpoint Software	CHKP	$1,630	$1,560	54%	8.2x	8.6x	y
Cyberark	CYBR	$147	$134	24%	9.9x	10.9x	y
FireEye	FEYE	$641	$530	-75%	9.9x	12.0x	y
Imperva	IMPV	$217	$192	-29%	9.1x	10.3x	y
Palo Alto Networks	PANW	$1,054	$822	-12%	13.5x	17.2x	y
Proofpoint	PFPT	$258	$228	-19%	9.5x	10.8x	y
Qualys	QLYS	$166	$148	21%	5.6x	6.3x	y
Rapid7	RPD	$99	$84	NA	8.2x	9.7x	y
Symantec	SYMC	$6,100	$6,270	29%	2.1x	2.1x	y
Average				**-1%**	**8.0x**	**9.2x**	

	Revenue 2015E	Revenue LTM	EBITDA Margin	Enterprise Value / Sales 2015E	Enterprise Value / Sales LTM	Valuation Range Low	Valuation Range High
CYREN	**$28**	**$29**	**-10%**	**8.0x**	**9.2x**	**$224**	**$271**

Conclusion of Enterprise Value	**$247,482,497**
Market Value	**$250,860,497**
Fully Diluted Shares Outstanding	38,688,000
Price per Share	**$6.48**

The company's closest competitors are OpenDNS and ZScaler. On June 30th Cisco announced its plans to purchase San Francisco-based OpenDNS for $635 million to "boost Cisco's Security Everywhere approach by adding broad visibility and threat intelligence from the OpenDNS cloud delivered platform." The company has over 310 employees. OpenDNS hosts a cloud computing security suite called "Umbrella", which protects enterprise customers from malware, phishing, bots, and targeted online attacks. The company has a free user base of 50 million and more than 10,000 paying customers.

ZScaler of San Jose, CA just raised another round, this time for $100 million led by TPG Growth. According to the press, its valuation was rumored to be more than $1 billion. It is close to cash flow neutral and plans to go public in the next year or two. Enterprise customers are using the platform to protect more than 13 million employees. ZScaler says it secures more than 15 billion Internet requests, and stops more than 100 million cyber-threats, per day. CYREN claims to see 17 billion transactions per day.

RISKS

- The company operates in a highly competitive industry. There are larger well-funded players with greater traction that could be difficult to take market share from.
- Customers may find the new products to be uncompetitive versus other more established offerings.
- The company may have difficulty penetrating new markets and reaching a new group of customers through the reseller channel or direct sales.
- Product rollouts and on-boarding of the new sales channel may take longer than expected and continue to push back financial estimates.
- The stock has doubled since November due in part the increased publicity of cybersecurity threats. This publicity could end or investors could consider the group already fairly valued.

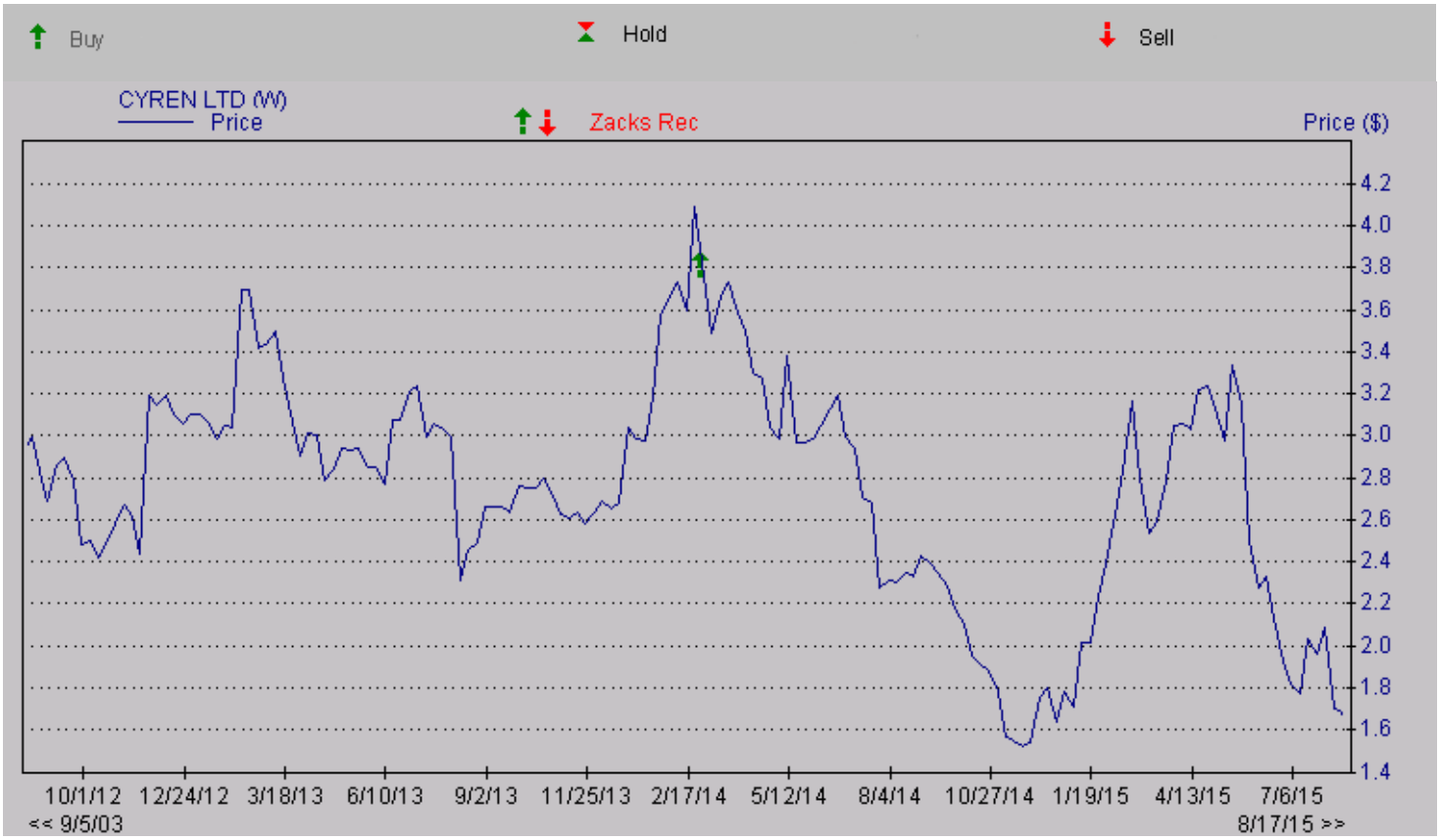
INCOME STATEMENT

	Non-GAAP March Q1 14	Non-GAAP June Q2 14	Non-GAAP Sept Q3 14	Non-GAAP Dec Q4 14	Non-GAAP March Q1 15	Non-GAAP June Q2 15	Non-GAAP Sept Q3 15E	Non-GAAP Dec Q4 15E	Non-GAAP 2013	Non-GAAP 2014	Non-GAAP 2015E	Non-GAAP 2016E
REVENUE												
Non-GAAP Rev	$8.1	$8.3	$7.8	$7.9	$7.0	$6.8	$6.6	$7.5	$32.8	$32.1	$28.0	$35.0
Yr-to-yr Gr.	5.7%	2.6%	-1.5%	-6.1%	-13.6%	-18.6%	-14.6%	-4.4%	35.8%	-2.0%	-12.9%	25.0%
GAAP Revenue	$8.1	$8.3	$7.7	$7.8	$7.0	$6.7	$6.6	$7.5	$32.2	$31.9	$27.8	$34.8
	2.1%	2.6%	-3.6%	-4.9%	-13.6%	-18.6%	-14.6%	-4.4%	34.9%	-2.0%	-12.9%	25.0%
OPERATING EXPENSES												
Cost of goods sold	1.813	1.8	1.8	1.8	1.9	1.9	1.9	2.0	6.4	7.2	7.7	9.8
Gross Margin	6.3	6.5	6.0	6.1	5.2	4.9	4.7	5.5	26.4	24.9	20.3	25.2
% of Sales	77.7%	78.1%	76.7%	77.4%	73.6%	71.9%	71.4%	73.5%	80.5%	77.5%	72.6%	72.0%
R&D	2.8	3.0	2.3	2.8	2.6	2.2	2.3	2.4	8.9	10.9	9.6	10.1
S&M	2.7	2.8	2.5	2.6	2.0	1.9	2.2	2.5	9.6	10.6	8.6	10.3
G&A	1.9	1.6	2.2	1.5	1.3	1.7	1.8	2.0	9.2	7.2	6.8	7.2
Adjustment of Earnout	0.0	0.0	(0.7)	0.6	(0.0)	(0.1)	0.0	0.0	0.0	(0.7)	(0.1)	0.0
Tot Operating Exp.	7.4	7.5	6.4	7.4	5.9	5.8	6.3	6.9	27.8	28.0	25.0	27.6
Operating Income	(1.1)	(1.0)	(0.4)	(1.3)	(0.7)	(1.0)	(1.6)	(1.4)	(1.4)	(3.1)	(4.6)	(2.4)
Yr-to-yr Gr.					-32%	0%	302%	8%				
Net Interest	(0.2)	(0.1)	(0.2)	0.0	(0.2)	(0.1)	0.0	0.1	(1.3)	(0.4)	(0.2)	0.0
Pretax Income	(1.3)	(1.0)	(0.6)	(1.2)	(0.9)	(1.1)	(1.6)	(1.3)	(2.6)	(3.6)	(4.8)	(2.4)
Taxes	0.1	0.0	0.1	0.2	0.2	0.0	0.0	0.0	0.0	0.4	0.2	0.1
Tax Rate	-4.3%	-3.7%	-19.2%	-14.5%	-18.4%	-0.6%	0.0%	0.0%	0.0%	-10.7%	-3.7%	-4.2%
Net Income	(1.4)	(1.1)	(0.684)	(1.4)	(1.1)	(1.2)	(1.6)	(1.3)	(2.6)	(3.9)	(5.0)	(2.5)
Yr-to-yr Gr.	-1983.3%	-946.8%	-214.4%	-47.4%	-19.7%	9.2%	127.8%	-10.4%				
GAAP EPS-Basic	(0.05)	(0.04)	(0.02)	(0.04)	(0.03)	(0.02)	(0.04)	(0.03)	(0.10)	(0.14)	(0.15)	(0.06)
EPS-Fully dil.	(0.05)	(0.04)	(0.02)	(0.04)	(0.03)	(0.02)	(0.04)	(0.03)	(0.10)	(0.12)	(0.13)	(0.06)
Fully dil Non-GAAP EPS Ex- One time	($0.05)	($0.04)	($0.02)	($0.03)	($0.03)	($0.04)	($0.04)	($0.03)	($0.10)	($0.14)	($0.13)	($0.06)
Yr-to-yr Growth	-1941.8%	-932.5%	-285.9%	-73.7%	-45%	-8%	116%	21%				
Primary Share Out	26.5	26.6	29.8	31.4	31.4	31.4	35.3	39.2	26.2	28.6	34.3	39.3
Yr-to-yr Growth	2.3%	1.7%	14.1%	18.5%	18%	18%	18%	25%	7%	9%	20%	15%
Fully diluted shares	26.5	26.6	36.8	38.3	38.5	38.7	38.9	39.0	26.2	32.1	38.8	39.5
Yr-to-yr Growth	2.3%	1.7%	40.9%	44.8%	45%	46%	6%	2%	4%	22%	21%	2%
Bookings	$8.3	$7.7	$7.7	$7.4	$6.3	$6.9						

BALANCE SHEET

$ In Thousands	June 30, 2015	March 31, 2015	Yr-to-Yr Growth
CURRENT ASSETS:			
Cash and cash equivalents	$7,870	$8,489	-7%
Trade receivables, net	3,595	3,792	-5%
Prepaid expenses and other receivables	2,084	1,763	18%
Total current assets	13,549	14,044	-4%
LONG-TERM ASSETS:			
Lease deposits	76	69	10%
Deferred tax assets	0	13	-100%
Deferred issuance costs	153	0	NA
Severance pay fund	575	550	5%
Property and equipment, net	2,151	2,279	-6%
Goodwill and intangible assets, net	30,000	29,110	3%
Total long-term assets	32,955	32,021	3%
Total assets	46,504	46,065	1%
CURRENT LIABILITIES:			
Credit line	4,492	4,543	-1%
Trade payables	755	873	-14%
Employees and payroll accruals	2,082	2,064	1%
Deferred tax liability	117	119	-2%
Accrued expenses and other liabilities	912	865	5%
Earn-out consideration	2,868	2,058	39%
Deferred revenues	**3,187**	**3,123**	2%
Total current liabilities	14,413	13,645	6%
LONG-TERM LIABILITIES:			
Deferred revenues	**1,365**	**1,264**	8%
Deferred tax liability	1,688	1,693	0%
Earn-out consideration	0	762	-100%
Accrued severance pay	690	640	8%
Other liabilities	92	88	5%
Total long-term liabilities	3,835	4,447	-14%
SHAREHOLDERS' EQUITY:			
Shareholders' equity	28,256	27,960	1%
Total liabilities and shareholders' equity	$46,504	$46,052	1%
Current ratio	0.9	1.0	-9%
Net cash	$3,378	$3,946	-14%

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