Zacks Small-Cap Research

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CYREN Ltd (CYRN-NASDAQ)

CYRN: Zacks Company Report – OUTPERFORM- New Products Gaining Distribution and Generating First Sales

Current Recommendation	**Outperform**
Prior Recommendation	Neutral
Date of Last Change	02/26/2014
Current Price (08/18/14)	$2.38
12 Month Target Price	**$5.75**

OUTLOOK

CYREN is an email and web security software and SaaS vendor. Until recently it has 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. Near term we expect losses, but once cloud products ramp, growth will accelerate and the valuation should expand closer to its much more highly valued peers.

SUMMARY DATA

52-Week High	**$4.09**
52-Week Low	**$2.26**
One-Year Return (%)	**-5.56**
Beta	**0.37**
Average Daily Volume (sh)	**114,702**
Shares Outstanding (mil)	**27**
Market Capitalization ($mil)	**$65**
Short Interest Ratio (days)	**5.25**
Institutional Ownership (%)	**7**
Insider Ownership (%)	**N/A**
Annual Cash Dividend	**$0.00**
Dividend Yield (%)	**0.00**
5-Yr. Historical Growth Rates	
Sales (%)	**19.2**
Earnings Per Share (%)	**-11.2**
Dividend (%)	**N/A**
P/E using TTM EPS	**NM**
P/E using 2014 Estimate	**NM**
P/E using 2015 Estimate	**34**
Zacks Rank	**3**

Risk Level	**High**
Type of Stock	**Small-Blend**
Industry	**Internet-Software**
Zacks Rank in Industry	**42 of 58**

ZACKS ESTIMATES

Revenue
(in millions of $)

	Q1 (Mar)	Q2 (Jun)	Q3 (Sep)	Q4 (Dec)	Year (Dec)
2012	5.9 A	5.7 A	5.6 A	6.8 A	24.1 A
2013	7.9 A	8.1 A	8.0 A	8.4 A	32.8 A
2014	8.1 A	8.3 A	8.6 E	8.9 E	34.2 E
2015					40.0 E

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

	Q1 (Mar)	Q2 (Jun)	Q3 (Sep)	Q4 (Dec)	Year (Dec)
2012	$0.05 A	$0.04 A	$0.01 A	$0.01 A	$0.11 A
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 E	-$0.03 E	-$0.14 E
2015					$0.04 E

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WHAT'S NEW

Q2 Marks First Sale of New Product and Increased Distribution

Q2 continued much the same as Q1, with similar revenues and expenses. 2014 will be a waiting game as the company's strategy to move from an OEM model, to end-user products, takes hold. By moving from an OEM sale to an end-user sale, revenues to CYREN go from $0.50 to $1 per user per year, to $10-30 per user per year. While the core OEM business will not disappear, the incremental sales from this new cloud-based SaaS solution could ratchet up sales and profits for the company in 2015, and beyond.

For the next few quarters, management plans to take all the cash generated from the core business plus a portion of the cash raised in the recent offering, and invest it in sales, marketing and R&D to continue to roll out new products that should show meaningful revenues in 2015. We are lowering earnings numbers slightly to reflect this increased spending. This year we now expect a loss of $0.14 for the year rather than the loss of $0.10 originally expected. Investors in CYRN must be patient short term and benefits will not accrue until next year. In 2015 we look for revenues to grow to $40 million and for the company to return to profitability. We are reducing our $0.07 estimate to $0.04 due primarily to the dilution from the recent financing.

This quarter showed the addition of six new distributors and resellers for the CYREN WebSecurity bringing the total to 18 so far. The new sellers are: imatrix (Tokyo), AvailaSoft, (Asia-Pacific), IMPROVES B.V. (Rotterdam), Hermitage Solutions SARL (France), Komtera (Turkey), and NexTek (India). The company also made its **first sale to an end user of its cloud-based CYREN WebSecurity solution** that was launched in January. UK distributor VCW Security was the seller. It was a small sale but an important milestone.

During the quarter the company launched a new service, CYREN Zero-Hour URL Phishing Feed that blocks phishing sites before they reach end-users. It identifies thousands of unique phishing URLs using the company's Recurrent Pattern DetectionTM technologies, as well as phishing URL logic, automated crawling, and human analysis.

June 2014 Quarter

For Q2 ending June 30, 2014, Non-GAAP revenues grew by 3% percent to $8.3 million from $8.2 million for the year ago quarter, missing our estimates by $200,000.

Non-GAAP gross margin during the quarter on a non-GAAP basis declined once again to 78.1% versus 81.9% a year ago, but up from 77.7% in Q1.

Non-GAAP operating expenses in the quarter were $7.5 million, compared to $6.4 million in 2013. The company is now managing operations to reinvest in the business through increased R&D and international data center footprint. We expect this to persist for several quarters until the new products have been rolled out. As a result we could expect for the company to lose as much as $1.4 million per quarter in the next few months according to its spending plans. It is now spending $3 million a quarter in R&D and expects that number to remain flat dollar-wise for the foreseeable future until Q3 or Q4 of 2015 when it will be somewhat scaled back. S&M and G&A fluctuated as expenses were reclassified from one category to another. While Q2 had some one-time expenses for the capital raise, this will be offset in future quarters by increase S&M expense.

The company reported a non-GAAP net loss of $1.1 million for the second quarter, slightly less that the $1.4 million in Q1 and resulting in a non-GAAP EPS loss of $0.04, versus our estimate of a loss of $0.03.

Net cash was at the end of the quarter was a negative $2.1 million (using the credit line) but the registered direct offering, done after the quarter closed, added $10.2 million to the coffers and erased that draw down. The company still could raise more cash if the warrants are exercised in the future. This offering added 4.8 million shares to the outstanding or 18%.

INVESTMENT THESIS

- CYREN is moving from OEM sales that have generated $0.50- $1 per user per year, to end-user products that will generate $10-30 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. 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.

- A number of high profile cyber security vendors such as Zscaler and Rapid7 are expecting to go public near term. This is in addition to recent IPOs FireEye and Barracuda Networks. These companies are much more highly valued than CYREN and as a comparable its stock could rise.

VALUATION

Web security vendors were recently at extremely high valuations, fueled in part by the successful IPO of high-flyer FireEye, and the high profile hacking of Target's payment system. However, in recent weeks some high growth momentum stocks stalled and crashed back closer to earth. FEYE was $97 on March 5th and is now $28 (down 70%) with little change in fundamentals.

CYRN currently trades at a price of $2.38 that gives it a fully diluted market cap of $91 million, and an enterprise value of $83 million, or 2.4x estimated 2014 revenues. Its peers trade from a range of 14.8x for FireEye, to 2.2x for Symantec. The difference is primarily that FEYE is expected to grow revenues 262% this year while Symantec's revenues are expected to be virtually flat. Were CYRN to regain revenue growth, we believe its valuation could move up closer to its peers. Taking the average enterprise value to sales of the group (taking out FireEye), we get an average of 6.1-6.6 times. At that valuation CYRN would be worth $5.75 per share.

Company	Ticker	Revenue 2014E	Revenue LTM	EBIDTA Margin	Enterprise Value / Sales 2014E	Enterprise Value / Sales LTM	Included in Average?
Checkpoint Software	CHKP	$1,480	$1,440	55%	7.8x	8.0x	y
FireEye	FEYE	$428	$268	-104%	9.3x	14.8x	n
Imperva	IMPV	$159	$148	-29%	3.9x	4.2x	y
Palo Alto Networks	PANW	$670	$532	-5%	9.2x	11.6x	y
Proofpoint	PFPT	$186	$164	-13%	7.5x	8.5x	y
Qualys	QLYS	$132	$119	12%	7.1x	7.9x	y
Symantec	SYMC	$6,720	$6,700	29%	2.2x	2.2x	y
Average				**21%**	**6.1x**	**6.6x**	

	Revenue 2014E	Revenue LTM	EBITDA Margin	Enterprise Value / Sales 2014E	Enterprise Value / Sales LTM	Valuation Range Low	Valuation Range High
CYREN	**$34**	**$32**	**0.00%**	**6.1x**	**6.6x**	**$210**	**$215**
YoY growth	**6%**						

Conclusion of Enterprise Value	**$212,274,769**
Market Value	**$220,374,769**
Fully Diluted Shares Outstanding	38,358,000
Price per Share	**$5.75**

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.

COMPANY BACKGROUND

After years of being a small component of email and web security, CYREN is embarking on a new path. It is in the process of build out a full cloud-based product line that can be sold white label to vendors such as telcos and storage providers to protect their customers. Cloud-based security is on the rise according to Gartner who predicts that what was a $2.1B industry in 2013 will grow to $4.1B in 2017. This is an annual compound growth rate of 18.2%. If CYREN can capture even a small portion of this market, it can accelerate its organic growth.

Looking Forward

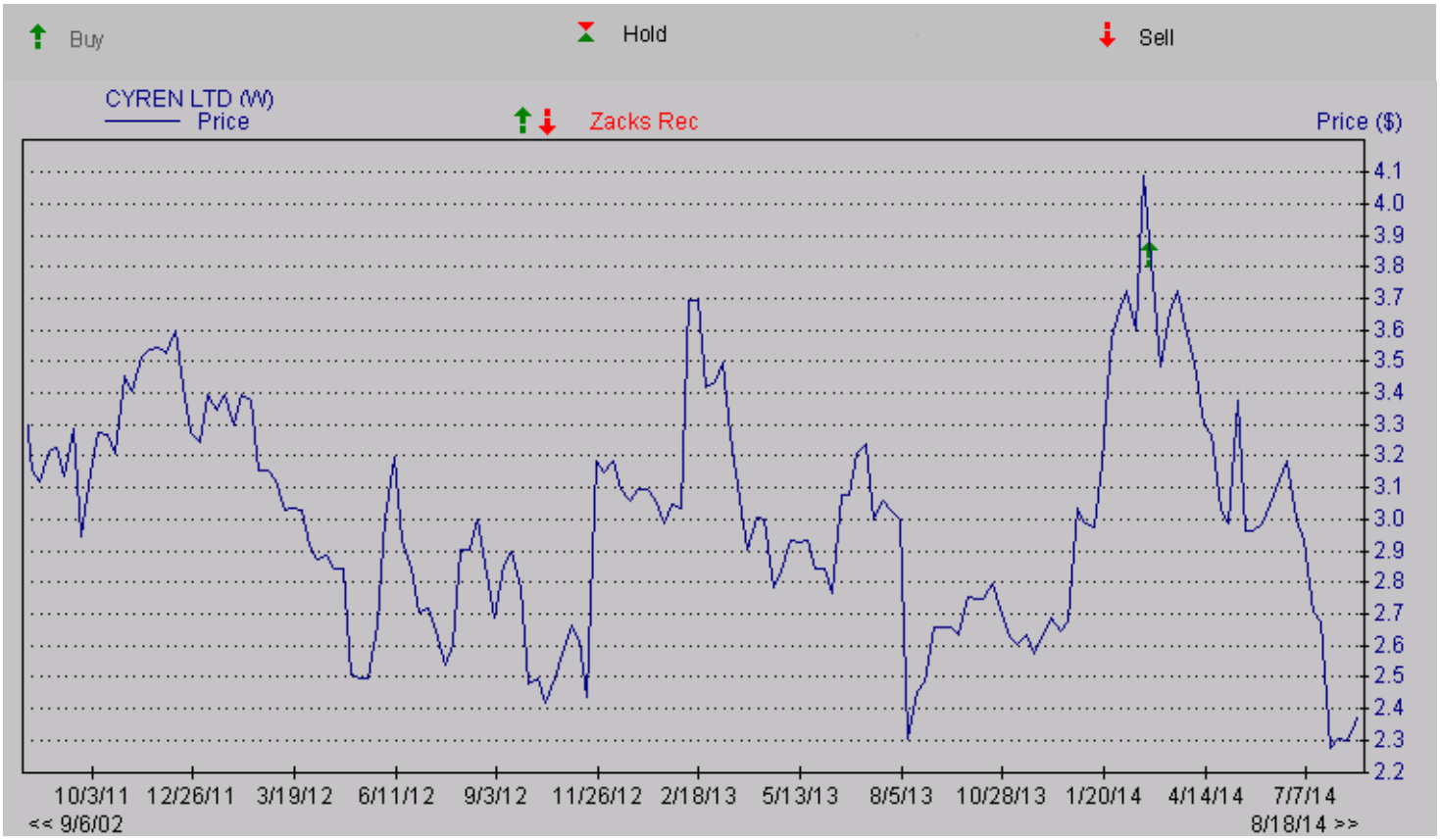
The next major product to be introduced by the company will be a cloud-based Advanced Persistent Threats (APTs) service. It should launch early in 2015. The company is unaware of any cloud-based APT that has been introduced by competitors. It believes its solution will undercut high priced solutions from vendors like FireEye. It also plans a Data Loss Prevention (DLP) solution that protect against information leaking out of a system.

INCOME STATEMENT

Non-GAAP

	March Q1 14A	June Q2 14A	Sept Q3 14E	Dec Q4 14E	2012	2013	2014E	2015E
REVENUE								
Non-GAAP Rev	$8.1	$8.3	$8.6	$8.9	$24.1	$32.8	$33.9	$40.0
GAAP Revenue	$8.1	$8.3	$8.5	$8.8	$23.9	$32.2	$33.6	$39.0
Yr-to-yr Gr.	2%	3%	5%	7%		35%	4%	16%
OPERATING EXPENSES								
Cost of goods sold	1.813	1.8	1.9	2.2	4.0	6.4	7.8	7.8
Gross Margin	6.3	6.5	6.6	6.7	19.9	26.4	26.2	32.3
% of Sales	77.7%	78.1%	77.4%	75.3%	82.4%	80.5%	77.1%	80.6%
R&D	2.8	3.0	3.0	3.0	6.0	8.9	11.8	11.8
S&M	2.7	2.8	2.8	2.9	5.3	9.6	11.3	11.8
G&A	1.906	1.6	1.7	1.8	8.3	9.2	7.0	7.0
Adjustment of Earnout							0.0	
Tot Operating Exp.	7.4	7.5	7.5	7.7	19.7	27.8	30.1	30.6
Operating Income	(1.097)	(0.958)	(0.9)	(1.0)	0.2	(1.4)	(4.0)	1.7
Yr-to-yr Gr.								
Net Interest	(0.2)	(0.1)	0.0	0.0	0.1	(1.3)	(0.3)	0.1
Pretax Income	(1.3)	(1.029)	(0.9)	(1.0)	0.3	(2.6)	(4.2)	1.8
Taxes	0.1	0.0	0.0	0.0	(0.6)	0.0	0.1	0.1
Tax Rate	-4.3%	-3.7%	0.0%	0.0%	-217.0%	0.0%	-2.2%	5.7%
Net Income	(1.4)	(1.1)	(0.9)	(1.0)	0.9	(2.6)	(4.3)	1.7
EPS-Basic	(0.05)	(0.04)	(0.03)	(0.03)	0.04	(0.10)	(0.15)	0.05
EPS-Fully dil.	(0.05)	(0.04)	(0.02)	(0.03)	0.04	(0.10)	(0.13)	0.04
Yr-to-yr Gr.								
Non-GAAP EPS	($0.05)	($0.04)	($0.02)	($0.03)	$0.04	($0.10)	($0.14)	$0.04
Share Out	26.5	26.6	31.4	31.4	24.6	26.2	29.0	31.4
Fully diluted shares	26.5	26.6	38.4	38.4	25.1	26.2	32.5	38.4

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