Zacks Small-Cap Research

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CYREN Ltd (CYRN-NASDAQ)

CYRN: Zacks Company Report - OUTPERFORM

Current Recommendation	**Outperform**
Prior Recommendation	Neutral
Date of Last Change	02/26/2014
Current Price (05/16/14)	$2.97
12 Month Target Price	**$6.15**

OUTLOOK

CYREN (formerly Commtouch Software) 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 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	**$2.31**
One-Year Return (%)	**1.02**
Beta	**0.53**
Average Daily Volume (sh)	**91,463**
Shares Outstanding (mil)	**26**
Market Capitalization ($mil)	**$78**
Short Interest Ratio (days)	**3.49**
Institutional Ownership (%)	**0**
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	**N/A**
P/E using 2014 Estimate	**-37.1**
P/E using 2015 Estimate	**42.4**
Zacks Rank	**3**

Risk Level	**Above Average**
Type of Stock	**Small-Blend**
Industry	**Internet-Software**
Zacks Rank in Industry	**40 of 55**

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	8.5 E	8.6 E	8.9 E	34.2 E
2015					40.0 E

Earnings per Share
(EPS is operating earnings 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	-$0.03 E	-$0.01 E	$0.01 E	-$0.10 E
2015					$0.07 E

Zacks Projected EPS Growth Rate - Next 5 Years %	**N/A**
N/A	**N/A**

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WHAT'S NEW

Q1 Continues with Investment; Results Are Expected in 2015

2014 will be a transition year as CYREN has embarked on a process to transform the company from low margin OEM business, to higher margin by selling direct to the end-user. It launched of its first cloud-based platform product "CYREN WebSecurity' in January and is building distribution and rolling out supporting data centers now. Other new products are also on their way. This transition should take all of 2014, as resellers and distributors come on board, train staff and sign end-users. Using a SaaS model, revenues will be slow to ramp. CYREN believes that meaningful revenues will not be in evidence until 2015 and expects revenue growth for the company to be in the low single digits this year. Given this, investors may not see near term improvement in the stock until there is some proof that the company has traction in its new product offerings. In addition, investors should be aware that the company might need some form of financing as cash runs low, albeit not much, which could dilute the common stock. While long-term investors could be rewarded, near-term we see less of a catalyst. Ultimately 2015 should show robust growth, higher margins and correspondingly higher company valuation.

CYREN Reports the March Quarter

On May 16, 2014, CYREN Ltd. (formerly Commtouch Software Ltd.), the provider of email security and cloud based services reported financial results for its first quarter.

Non-GAAP revenues grew by only 2% percent to $8.1 million from $8.1 million for the year ago quarter missing our estimates very slightly. This was all organic growth as the acquisitions of FRISK Software International on October 1, 2012 and eleven GmbH on November 16, 2012 have anniversaried.

Non-GAAP gross margin during the quarter on a non-GAAP basis declined once again to 77.7% versus 82.6% a year ago. This was caused by the reclassification of some headcount as well as the addition of data centers in new geographic locations.

Ex-one time charges, non-GAAP operating expenses in the quarter were $7.4 million, compared to $6.4 million in 2013, up 16.3%. This increase was across all categories, but primarily due to increased R&D as the company focuses on new products. Also adding to expenses were increasing sales costs to promote new produces, the rebranding of the company via the name change, and the addition of data centers.

The company reported a non-GAAP net loss of $1.4 million for the first quarter, a decrease from a profit of $72,000 last year. This equated to ($0.05) EPS in 2014 versus breakeven last year.

Net cash declined to $2.3 million and there is now $3.2 million reserve on the credit facility that has recently been extended. The company's current and quick ratio now stands at 0.67X versus 0.75X in December. If the company remains cash flow negative we believe it will take steps to raise capital or at least to look a way to move debt from short term to long term. A possibility is some sort of prepayment arrangement for customers.

CYREN Web Security Cloud Product Looks Encouraging

The key driver to increased stock price is the acceptance or CYREN's new products. So far there has been a lot of interest from the distribution channel. While sellers have a simple dashboard to implementing the security on their networks the user interface and the ease with which the end user can enable it is just as simple. It is a mere click of a link and requires little intervention from the seller. This one factor should make the product a hit all by itself. To see CYREN's pitch to resellers check out this video.

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

Next up will be products that protect from Advanced Persistent Threats (APTs) what will undercut high priced solutions from vendors like FireEye and a Data Loss Prevention (DLP) solution that protect against information leaking out of a system.

INVESTMENT THESIS

- CYREN is rolling out new higher growth products that 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 a very 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 high growth momentum stocks have stalled and crashed back closer to earth. FEYE, was $97 on March 5th and is now $27 (down 72%) with little change in fundamentals. In that same time frame, Checkpoint Software declined from $15 to $12 (20%).

CYREN currently trades at a price of $3.05 that gives it a market cap of $81 million, and an enterprise value of $83 million. EV to sales is at a 2.6xs its trailing 12-month revenues versus its peers that trade from a range of 14.8x for FireEye to for 7.8x Checkpoint Software. The difference is primarily that FEYE is expected to grow revenues 154% this year while Checkpoint is estimated to grow only 3.4%.

CYREN

Web Security Companies

Company	Ticker	Revenue 2014E	Revenue LTM	EBIDTA Margin	Enterprise Value / Sales 2014E	Enterprise Value / Sales LTM	Included in Average?
Checkpoint Software	CHKP	$1,480	$1,410	55%	7.5x	7.9x	y
FireEye	FEYE	$411	$207	-62%	7.5x	14.8x	n
Imperva	IMPV	$154	$141	-24%	2.4x	2.6x	y
Palo Alto Networks	PANW	$665	$483	-4%	5.9x	8.1x	y
Proofpoint	PFPT	$179	$150	-13%	5.2x	6.2x	y
Qualys	QLYS	$130	$113	11%	4.3x	4.9x	y
Symantec	SYMC	$6,500	$6,680	29%	1.9x	1.9x	y
Average				**21%**	**4.7x**	**5.2x**	

	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%**	**4.7x**	**5.2x**	**$162**	**$168**
YoY growth	6%						

Conclusion of Enterprise Value	**$165,106,563**
Market Value	**$163,136,563**
Fully Diluted Shares Outstanding	26,519,000
Price per Share	**$6.15**

On an M&A acquisition basis, we can look to the acquisition of Websense in May 2013 for $906 million or 2.5x times 2012's $361 million in sales or almost 50 times earnings.

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.

- The company may need cash and using equity financing could be dilutive.

PROJECTED INCOME STATEMENT.

Forecast for the June, 2014 Quarter

The June quarter should be much like the March quarter as the company continues to add resellers and distributors and data centers, but not yet start booking revenues for new products due to the long sell cycle. We expect revenues to be somewhat better at $8.5 million in revenues and a loss of $0.03. As it is too early to see sales from new products we believe investors will be more interested in the signing of

new sales help as well as the progress in the introduction of even more new products rather than the performance of the legacy core business as long as it remains somewhat stable.

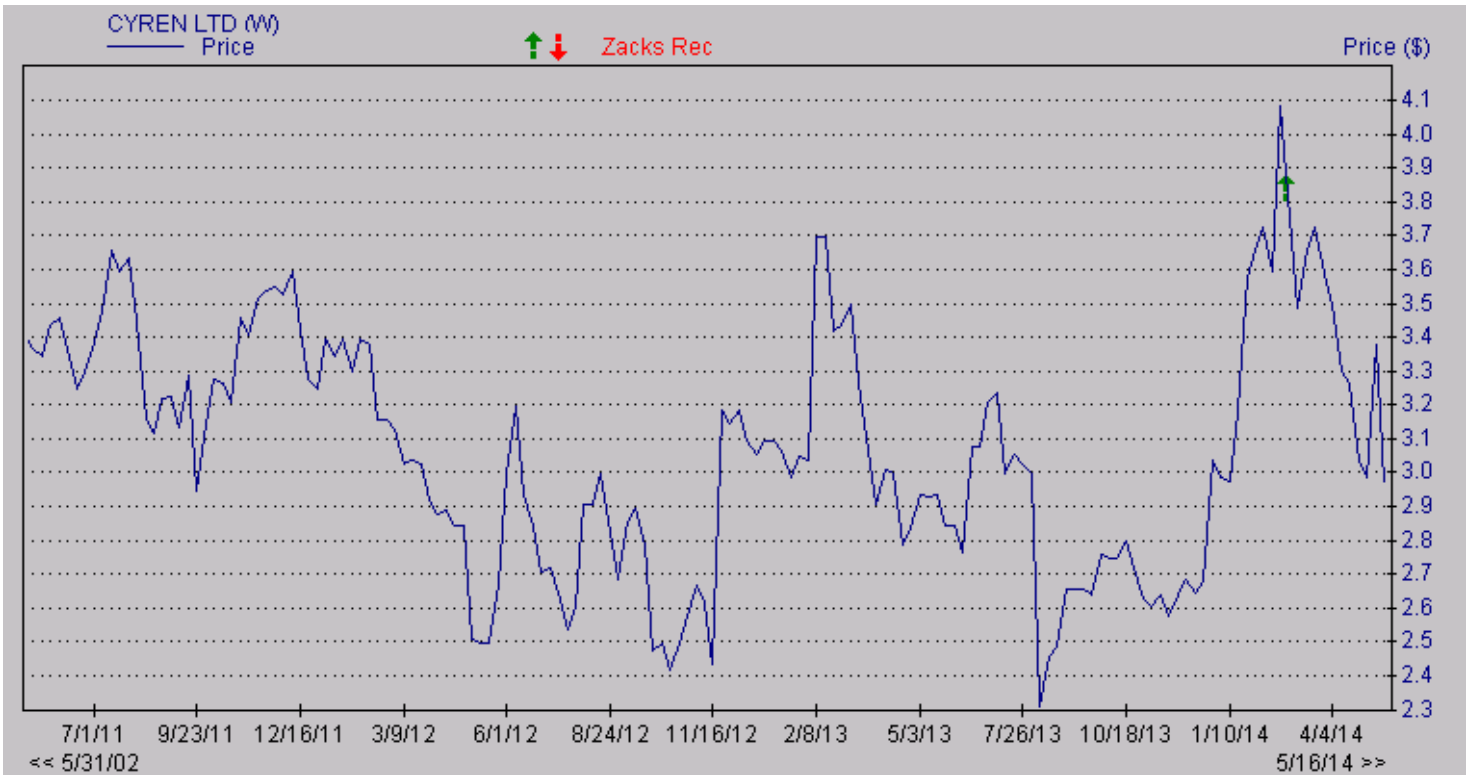
Forecast for 2014

We hope to see customers start to nibble at the new products in the September quarter but as a SaaS offering sales will be ratable and build slowly. As such we believe that 2014 will be a wait and see year with the real growth coming in 2015. Cautiously we are predicting that most of the company's growth will come in the later half of the year resulting in non-GAAP revenue growth of only 4% to $34 million. 2014 will be a year of building and could result slight losses as the company invests in marketing and R&D with the corresponding lags in sales. Investors should look forward to 2015 when the company truly hits its stride and revenues should accelerate. We are conservatively forecasting revenues of $40 million in 2015 and EPS of $0.07 until we see traction in the new products to convince us higher numbers are possible.

INCOME STATEMENT

	Non-GAAP Dec Q4 12	Non-GAAP Dec Q4 13	Non-GAAP March Q1 14	Non-GAAP June Q2 14	Non-GAAP Sept Q3 14	Non-GAAP Dec Q4 14	Non-GAAP 2012	Non-GAAP 2013	Non-GAAP 2014
REVENUE									
Non-GAAP Rev	$7.01	$8.12	$8.37	$8.62	$9.12	$9.62	$24.14	$32.8	$35.71
GAAP Revenue	$6.8	$8.0	$8.2	$8.5	$9.0	$9.5	$23.9	$32.2	$35.25
Yr-to-yr Gr.								35%	9%
OPERATING EXPENSES									
Cost of goods sold	1.2	1.7	1.8	1.8	1.9	2.2	4.0	6.4	$7.78
Gross Margin	5.8	6.4	6.6	6.8	7.2	7.4	19.9	26.4	27.9
% of Sales	85.5%	78.8%	78.5%	78.6%	78.7%	77.1%	82.4%	80.5%	78.2%
R&D	2.2	2.6	2.4	2.4	2.4	2.4	6.0	8.9	$9.60
S&M	1.8	2.7	2.3	2.3	2.3	2.3	5.3	9.6	$9.20
G&A	3.1	3.4	2.0	2.0	2.0	2.0	8.3	9.2	$8.00
Adjustment of Earnout								0.0	$0.00
Tot Operating Exp.	7.0	8.7	6.7	6.7	6.7	6.7	19.7	27.8	26.8
Operating Income	(1.2)	(2.3)	(0.1)	0.1	0.5	0.7	0.2	(1.4)	1.1
Yr-to-yr Gr.									
Net Interest	(0.1)	(0.4)	(0.4)	(0.4)	(0.4)	(0.4)	0.1	(1.3)	(1.3)
Impairment of Investment								0.0	0.0
Pretax Income	(1.3)	(2.7)	(0.5)	(0.3)	0.1	0.3	0.3	(2.6)	(0.1)
Taxes	(0.5)	0.0	0.0	0.0	0.0	0.0	(0.6)	0.0	0.0
Tax Rate	40.2%	0.0%	0.0%	0.0%	0.0%	0.0%	-217.0%	0.0%	0.0%
Net Income	(0.8)	(2.7)	(0.5)	(0.3)	0.1	0.3	0.9	(2.6)	(0.1)
EPS-Basic	($0.03)	(0.10)	(0.02)	(0.01)	0.00	0.01	0.04	(0.10)	(0.00)
EPS-Fully dil.	($0.03)	(0.10)	(0.02)	(0.01)	0.00	0.01	0.04	(0.10)	(0.00)
Yr-to-yr Gr.									
Non-GAAP EPS	$0.01	($0.07)	($0.02)	($0.01)	$0.00	$0.01	$0.04	($0.10)	($0.00)
Share Out	25.6	26.5	26.7	26.9	27.1	27.3	24.6	26.2	26.2
Fully diluted shares	25.6	26.5	26.7	26.9	27.1	27.3	25.1	26.2	26.2

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