Zacks Small-Cap Research

May 27, 2015

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CYREN Ltd (CYRN-NASDAQ)

CYRN: Waiting for…2016?

Current Recommendation	**Buy**
Prior Recommendation	Hold
Date of Last Change	02/26/2014
Current Price (05/26/15)	$2.62
12 Month Target Price	**$4.00**

OUTLOOK

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

SUMMARY DATA

52-Week High	**$3.43**
52-Week Low	**$1.45**
One-Year Return (%)	**-9.97**
Beta	**0.17**
Average Daily Volume (sh)	**155,496**
Shares Outstanding (mil)	**35**
Market Capitalization ($mil)	**$91**
Short Interest Ratio (days)	**4.31**
Institutional Ownership (%)	**15**
Insider Ownership (%)	**N/A**
Annual Cash Dividend	**$0.00**
Dividend Yield (%)	**0.00**
5-Yr. Historical Growth Rates	
Sales (%)	**17.6**
Earnings Per Share (%)	**-28.6**
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	**46 of 67**

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	7.3 E	8.1 E	9.7 E	32.0 E
2016					40.0 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	-$0.03 E	-$0.02 E	$0.01 E	-$0.11 E
2016					$0.05 E

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WHAT'S NEW

IS THE WORST OVER…OR NOT?

CYRN revenues came in $1 million short of our estimates exhibiting an extremely weak Q1 not seen before. Q4 non-GAAP revenues were $7 million versus $8.1 million down 14% from last year, and down 11% sequentially. The company continues to be hurt by the Euro and the shekel and said revenues were hurt $300,000 due to the change in exchange rates. Last year on March 31, the Euro was $1.38 and this year was $1.08, a decline of 22%.



Additionally there has been weakness in Germany where the company lost customers in the second half of last year. Also a number of previously large customers are seeing email spam volumes down, hurting revenues; these revenues have been replaced in some part by more sophisticated schemes such as malware, but revenues from this product take time to build. Two large customers have suffered disruption, which will reduce future revenue streams further. One was bought and is transitioning to the acquirer's product; the other one lost its large customer and thus plans to cancel CYREN. These losses will impact the company later this year.

Non-GAAP gross margins were down to 73.6% versus 77.7% last year, and down from 77.4% in Q4 2014 as renewed customer contracts bring with them lower prices per user.

Non-GAAP operating expenses were down to $5.9 versus $7.4 million last year due primarily to the same currency forces that impacted revenues.

Non-GAAP loss was $1.1 million this year versus $1.4 million last year, a clear improvement despite down revenues. The company reported non-GAAP loss of $0.03, just shy of our estimate of a loss of $0.02.

Q2 2015

On the earnings call, management stated that **Q2 would be similar to Q1 revenues**, and that year over year revenue growth would be challenging due in no small part to the continued weakness of

the Euro, the currency of a typical 40% of revenues for the company. Short term there is a not a lot to look forward to. We do not expect any improvement until much later in the year, or perhaps next, as new product is added and the recent loss of customers is fully felt. For Q2 we believe revenues may be only slightly better than Q1 and are cutting both revenue expectation and earnings.

2015

After this weak first quarter, revenues should increase sequentially through out 2015 as new product sales ramp, but we now expect they would be much weaker than originally thought due to the base business deterioration. There is a tough balance fighting currency, customer disruptions and ramping sales of new product. Investors may best set their sights on 2016. We are cutting revenue forecasts and EPS to $32 million and a loss of $0.11, and even these may be aggressive.

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 market and have a few success stories given the market growth of 50% and the huge global market in the billions. As the market evolves we expect more M&A activity in cybersecurity could disrupt business as customers are acquired and providers merge. Perhaps in this ecosystem, CYREN may be considered a valuable acquisition given its rich patent trove and vast database of threat information. 2016 will be make or break for the company. It needs to prove itself by then or else it will be passed by as innovation accelerates.

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.

- A number of high profile cyber security vendors such as Zscaler and Rapid7 are expecting to go public perhaps as soon as late 2015. ZScaler, its closest competitor, is believed to be growing rapidly and CYREN could start to show growth like that should it gain traction. These companies are 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. CYRN currently trades at a price of $2.85 that gives it a fully diluted market cap of $110 million, and an enterprise value of $106 million, or 3.1x estimated 2015 revenues. Its peers trade from a range of 12x for Palo Alto Networks (PANW), to 2.2x for Symantec (SYMC). The difference is primarily that PANW is expected to grow revenues 47% this year while Symantec's revenues are expected to have down revenues and flat earnings. Given CYRN's Were 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 7.5 times. At that valuation CYRN would be worth $7.09 per share. Despite the disappointing Q1, long term we could see the stock move up to half the peer valuation of 4 times sales or $4.00 perhaps by year end.

Web Security Companies

Company	Ticker	Revenue 2015E	Revenue LTM	EBIDTA Margin	Enterprise Value / Sales 2015E	Enterprise Value / Sales LTM
Barracuda Networks	CUDA	$328	$277	2%	5.7x	6.7x
Checkpoint Software	CHKP	$1,620	$1,530	54%	9.0x	9.5x
FireEye	FEYE	$630	$477	-84%	9.8x	12.9x
Imperva	IMPV	$206	$177	-31%	6.0x	6.9x
Palo Alto Networks	PANW	$1,024	$739	-12%	12.0x	16.6x
Proofpoint	PFPT	$252	$211	-19%	8.4x	10.0x
Qualys	QLYS	$166	$141	19%	6.8x	7.9x
Symantec	SYMC	$7,200	$6,620	28%	2.2x	2.4x
Average				**-5%**	**7.5x**	**9.1x**

	Revenue 2015E	Revenue LTM	EBITDA Margin	Enterprise Value / Sales 2015E	Enterprise Value / Sales LTM
CYREN	**$34**	**$31**	**-10%**	**7.5x**	**9.1x**

Conclusion of Enterprise Value	**$269,050,775**
Market Value	**$272,996,775**
Fully Diluted Shares Outstanding	38,513,000
Price per Share	**$7.09**

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.

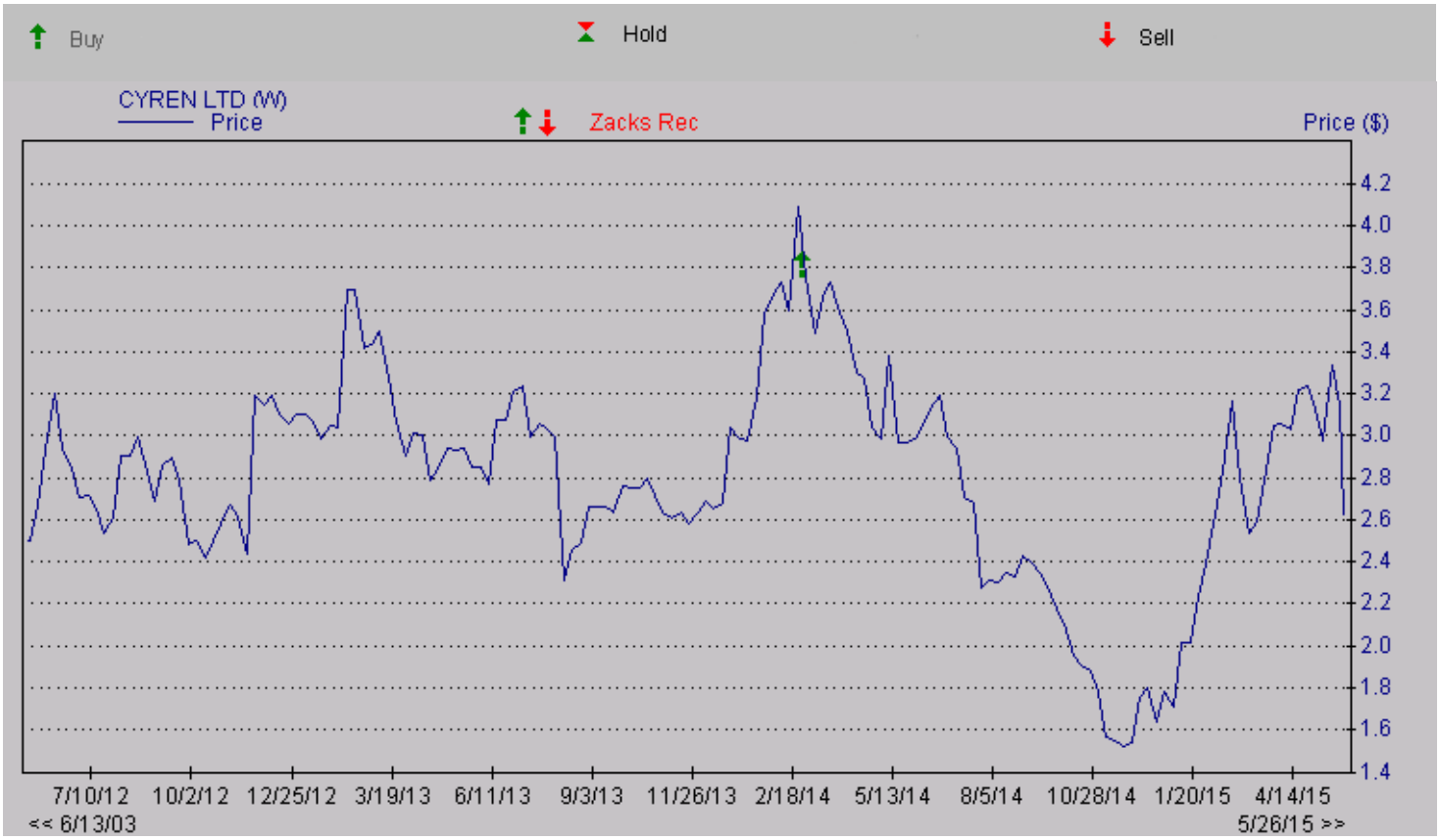
INCOME STATEMENT

	Non-GAAP March Q1 13A	Non-GAAP June Q2 13A	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 15E	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	$8.2	$8.1	$8.3	$7.8	$7.9	$7.0	$7.3	$8.1	$9.7	$32.8	$32.1	$32.0	$40.0
Yr-to-yr Gr.			5.7%	2.6%	-1.5%	-6.1%	-13.6%	-12.8%	3.5%	22.4%	35.8%	-2.0%	-0.4%	25.0%
GAAP Revenue	$7.9	$8.1	$8.1	$8.3	$7.7	$7.8	$7.0	$7.2	$8.0	$10.8	$32.2	$31.9	$33.0	$41.3
			2.1%	2.6%	-3.6%	-4.9%	-13.6%	-12.9%	3.5%	37.8%	34.9%	-2.0%	3.4%	25.0%
OPERATING EXPENSES														
Cost of goods sold	1.6	1.6	1.813	1.8	1.8	1.8	1.9	1.8	2.1	2.2	6.4	7.2	8.0	9.8
Gross Margin	6.5	6.6	6.3	6.5	6.0	6.1	5.2	5.4	6.0	7.4	26.4	24.9	24.0	30.2
%of Sales	82.6%	81.9%	77.7%	78.1%	76.7%	77.4%	73.6%	74.9%	73.9%	77.0%	80.5%	77.5%	75.0%	75.5%
R&D	2.2	2.1	2.8	3.0	2.3	2.8	2.6	2.6	2.7	2.7	8.9	10.9	10.7	11.2
S&M	2.5	2.3	2.7	2.8	2.5	2.6	2.0	2.2	2.4	2.6	9.6	10.6	9.2	11.0
G&A	1.7	2.0	1.9	1.6	2.2	1.5	1.3	1.3	1.4	1.5	9.2	7.2	5.5	5.8
Adjustment of Earnout	0.0	0.0	0.0	0.0	(0.7)	0.6	(0.0)	0.0	0.0	0.0	0.0	(0.7)	0.0	0.0
Tot Operating Exp.	6.4	6.4	7.4	7.5	6.4	7.4	5.9	6.2	6.5	6.8	27.8	28.0	27.0	28.1
Operating Income	0.2	0.2	(1.1)	(1.0)	(0.4)	(1.3)	(0.7)	(0.7)	(0.5)	0.6	(1.4)	(3.1)	(3.0)	2.2
Yr-to-yr Gr.							-32%	-25%	41%	-148%				
Net Interest	0.0	(0.1)	(0.2)	(0.1)	(0.2)	0.0	(0.2)	(0.2)	(0.2)	(0.1)	(1.3)	(0.4)	(0.6)	0.0
Pretax Income	0.2	0.1	(1.3)	(1.0)	(0.6)	(1.2)	(0.9)	(0.9)	(0.7)	0.5	(2.6)	(3.6)	(3.6)	2.2
Taxes	0.1	(0.0)	0.1	0.0	0.1	0.2	0.2	0.1	0.1	0.1	0.0	0.4	0.5	0.1
Tax Rate	61.5%	-15.6%	-4.3%	-3.7%	-19.2%	-14.5%	-18.4%	-11.2%	-15.2%	22.5%	0.0%	-10.7%	-13.9%	4.6%
Net Income	0.1	0.1	(1.4)	(1.1)	(0.684)	(1.4)	(1.1)	(1.0)	(0.834)	0.4	(2.6)	(3.9)	(4.1)	2.1
Yr-to-yr Gr.	-98.8%	-97.9%	-1983.3%	-946.8%	-214.4%	-47.4%	-19.7%	-7.0%	21.9%	-129.7%				
GAAP EPS-Basic	0.00	0.00	(0.05)	(0.04)	(0.02)	(0.04)	(0.03)	(0.03)	(0.03)	0.01	(0.10)	(0.14)	(0.13)	0.06
EPS-Fully dil.	0.00	0.00	(0.05)	(0.04)	(0.02)	(0.04)	(0.03)	(0.03)	(0.02)	0.01	(0.10)	(0.12)	(0.11)	0.05
Fully dil Non-GAAP EPS Ex- One time	$0.00	$0.00	($0.05)	($0.04)	($0.02)	($0.03)	($0.03)	($0.03)	($0.02)	$0.01	($0.10)	($0.14)	($0.11)	$0.05
Yr-to-yr Growth			-1941.8%	-932.5%	-285.9%	-73.7%	-45%	-36%	15%	-150%				
Primary Share Out	25.9	26.1	26.5	26.6	29.8	31.4	31.4	31.5	31.6	31.7	26.2	28.6	31.5	32.0
Yr-to-yr Growth			2.3%	1.7%	14.1%	18.5%	18%	19%	6%	1%	7%	9%	10%	1%
Fully diluted shares	25.9	26.1	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	4.2%	0.0	2.3%	1.7%	40.9%	44.8%	45%	46%	6%	2%	4%	22%	21%	2%

BALANCE SHEET

$ In Thousands	March 31, 2015	Dec. 31, 2014	Yr.-to-Yr. Growth
CURRENT ASSETS:			
Cash and cash equivalents	$8,489	$11,063	-23%
Trade receivables, net	3,792	4,444	-15%
Prepaid expenses and other receivables	1,763	1,019	73%
Total current assets	14,044	16,526	-15%
LONG-TERM ASSETS:			
Lease deposits	69	70	-1%
Deferred tax assets	0	13	-100%
Severance pay fund	550	594	-7%
Property and equipment, net	2,279	2,401	-5%
Goodwill and intangible assets, net	29,110	31,869	-9%
Total long-term assets	32,008	34,947	-8%
Total assets	46,052	51,473	-11%
CURRENT LIABILITIES:			
Credit line	4,543	4,900	-7%
Trade payables	873	646	35%
Employees and payroll accruals	2,064	2,359	-13%
Deferred tax liability	119	120	-1%
Accrued expenses and other liabilities	865	1,394	-38%
Earn-out consideration	2,058	2,269	-9%
Deferred revenues	3,123	4,097	-24%
Total current liabilities	13,645	15,785	-14%
LONG-TERM LIABILITIES:			
Deferred revenues	1,264	1,042	21%
Deferred tax liability	1,693	1,984	-15%
Earn-out consideration	762	837	-9%
Accrued severance pay	640	666	-4%
Other liabilities	88	100	-12%
Total long-term liabilities	4,447	4,629	-4%
SHAREHOLDERS' EQUITY:			
Shareholders' equity	27,960	31,059	-10%
Total liabilities and shareholders' equity	$46,052	$51,473	-11%
Current ratio	1.0	1.0	-2%
Net cash	$3,946	$6,163	-36%

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