Zacks Small-Cap Research

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CYREN Ltd (CYRN-NASDAQ)

CYRN: Cloud Products Shows Signs of Life—Bookings and Pipeline Grow

Current Recommendation	**Buy**
Prior Recommendation	Hold
Date of Last Change	02/26/2014
Current Price (11/11/15)	$1.96
12 Month Target Price	**$4.00**

OUTLOOK

CYREN is a cloud-based email and web security SaaS vendor. Until recently, it only 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	**$1.45**
One-Year Return (%)	**25.64**
Beta	**0.31**
Average Daily Volume (sh)	**44,876**
Shares Outstanding (mil)	**39**
Market Capitalization ($mil)	**$77**
Short Interest Ratio (days)	**10.3**
Institutional Ownership (%)	**14**
Insider Ownership (%)	**N/A**
Annual Cash Dividend	**$0.00**
Dividend Yield (%)	**0.00**
5-Yr. Historical Growth Rates	
Sales (%)	**14.1**
Earnings Per Share (%)	**-33.8**
Dividend (%)	**N/A**
P/E using TTM EPS	**NM**
P/E using 2015 Estimate	**NM**
P/E using 2016 Estimate	**NM**
Zacks Rank	**N/A**

Risk Level	**Average**
Type of Stock	**Small-Blend**
Industry	**Internet-Software**
Zacks Rank in Industry	**N/A**

ZACKS ESTIMATES

Non-GAAP 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	7.0 E	7.5 E	28.3 E
2016	7.5 E	8.0 E	9.5 E	10.0 E	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 A	-$0.03 E	-$0.12 E
2016	-$0.04 E	-$0.03 E	$0.00 E	$0.00 E	-$0.06 E

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WHAT'S NEW

Green Shoots Appear in the CWS Product Line

While reported results for CYREN in Q3 showed little sign of traction for its new cloud-based security product CWS, bookings and the sales pipeline continue to grow. As a recurring revenue service with revenues booked ratably, new sales will slowly creep onto the top line, so a better metric to watch is bookings. That number grew for the second quarter in a row to $7.4 million in Q3 from $6.9 million in the June 30, 2015 quarter. Though up only 6% sequentially, the direction is right. CYREN said booking for CWS were up 300% from Q2 2015 to Q3 2015, which gives us little idea of the actual number, but still should be considered a positive. The pipeline is said to be not just growing, but accelerating. The biggest new positive going forward it the company's cash hoard from its capital raise in August to fund growth. Its precarious situation in the past few years has certainly stunted investment as well as scared off potential customers who don't like to embed products from companies with questionable financials. The solid balance sheet should allow to make sales when it might not have been abled to before. We expect from now on we may see greater deficit spending and better top line results.

The company signed seven new CWS customers in the quarter, of which two were major contracts. In one of these major contracts, CYREN beat out another large provider of cloud based security, while for the other it replaced a traditional (non-cloud) vendor. The company also signed its second Wi-Fi hotspot operator Anacapa Holdings that recently deployed CWS across its European network of over 2,300 Wi-Fi hotspots located in 20 countries and supporting 17 million authenticated users. A big selling feature for this win is the company's regional data sovereignty (compliance with EU privacy laws), a unique feature versus the competition.

Cyber Threat Protection Rolls Out in Q1

The new Cyber Threat Protection (CTP) service is expected to be in beta in Q4 and have generally availability in Q1 of 2016. The Cloud Sandbox Array is also expected to be released in Q1. Both are stand-alone products or are able to be used with CWS and will be priced at a discount for multiple products per customer.

Embedded OEM Business Seems to Have Stabilized

Another concern for investors in the company has been its legacy OEM business that had both been losing customers and is experiencing pricing pressure. This quarter management believes it has "turned the corner." It added new customers and believes it can maintain its current revenue for this business in the range of $6.5 to $7.5 million per quarter despite pricing pressure. This quarter saw wins in mobile anti-malware, email SDK and email security SaaS contracts. In the current quarter the company expects renewals at Check Point (CHKP) and Google (GOOG).

Q3 Revenues A Slight Beat While EPS in Line

Non-GAAP revenues for the third quarter were reported at $7.0 million versus $6.8 million in Q2 2015 (down 10%) and $7.8 million in Q3 2014. This included currency headwinds of $500,000 to $600,000 from a 15% change in the Euro/$ exchange.

Net R&D expense was up $400,000 sequentially from a lower offset credit from the Office of Chief Scientist in Israel, as well as the capitalization of some R&D.

Non-GAAP operating expenses were $6.3 million versus $6.0 million in Q2 2015 and $6.4 million a year ago. The non-GAAP net loss was $1.3 million or a loss of $0.04, in line with our estimate, compared to a non- GAAP net loss of $0.7 million or $0.02 per diluted share in the third quarter of 2014.

The company increased its positive cash flow to $600,000, up from $304,000, but had negative free cash flow of $132,000 after taking into account purchase of property and equipment and capitalized software. The cash balance $18.7 million includes the new $11.5 million from an equity raise of 7.7 million on August 17, 2015.

Q4 2015

Next quarter should again be down year over year but up sequentially as the embedded business stabilizes and CWS ramps. We are keeping our estimates the same. In Q4 we are looking for revenue of non-GAAP revenue of $7.5 million versus $7.9 million last year, and up sequentially from the $7.0 million in Q3. More importantly we are looking for bookings to continue 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 non-GAAP loss of $0.03 flat with last year.

2015

We are tweaking our annual revenue forecasts upward because of Q3 results and EPS, this time to $28.3 million and a loss of $0.12, 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, the company should be reaping the rewards of its sales pipeline and grab more market share in cloud cybersecurity. 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. For now we are maintaining our current forecast of $35 million in revenues 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 received 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. CYRN currently trades at a price of $1.96 per share that gives it an enterprise value of $62 million, or 2.2xs estimated 2015 revenues. Its peers trade from a range of 11.6x for Palo Alto Networks (PANW), to 1.9x for Symantec (SYMC). The difference is primarily that PANW is expected to grow revenues this year while Symantec's revenues are expected to have flattish revenues and earnings. Taking the average enterprise value to sales of the group, we get an average of

6.9 times. At that valuation CYRN would be worth $5.66 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	Cal. Revenue 2015E	Cal. Revenue LTM	EBIDTA Margin	Enterprise Value / Sales 2015E	Enterprise Value / Sales LTM	Included in Average?
Barracuda Networks	CUDA	$321	$299	-1%	2.5x	2.7x	y
Checkpoint Software	CHKP	$1,630	$1,590	53%	8.1x	8.4x	y
Cyberark	CYBR	$153	$146	24%	6.2x	6.4x	y
FireEye	FEYE	$625	$581	-67%	4.9x	5.2x	y
Imperva	IMPV	$230	$213	-29%	8.5x	9.2x	y
Palo Alto Networks	PANW	$1,112	$928	-11%	11.6x	13.9x	y
Proofpoint	PFPT	$264	$247	-24%	10.8x	11.5x	y
Qualys	QLYS	$165	$156	21%	6.6x	6.9x	y
Rapid7	RPD	$104	$92	NA	7.9x	8.9x	y
Symantec	SYMC	$6,200	$6,150	28%	1.9x	1.9x	y
Average				**-1%**	**6.9x**	**7.5x**	

	Revenue 2015E	Revenue LTM	EBITDA Margin	Enterprise Value / Sales 2015E	Enterprise Value / Sales LTM	Valuation Range Low	Valuation Range High
CYREN- 11/12/15	**$28**	**$29**	**-10%**	**6.9x**	**7.5x**	**$195**	**$216**

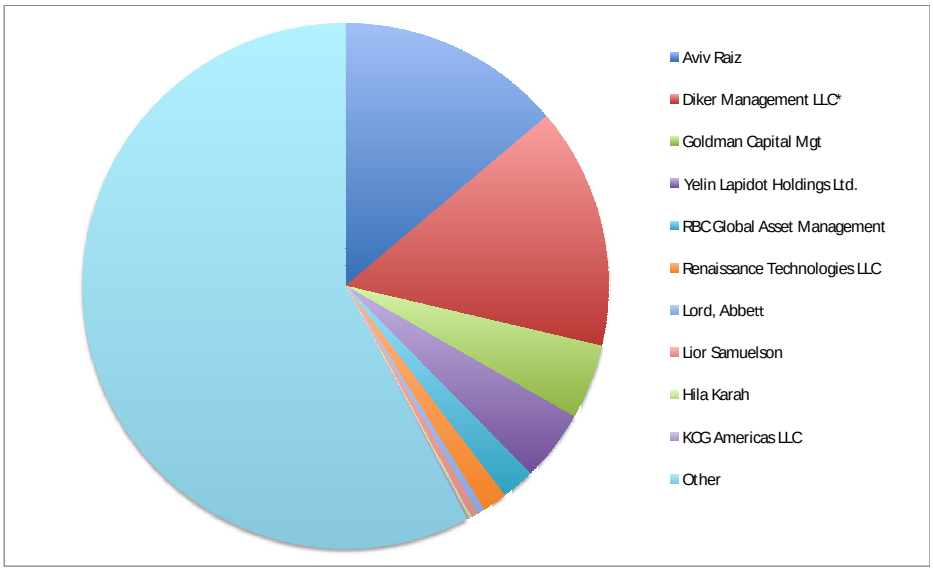
Conclusion of Enterprise Value	**$205,524,064**
Market Value	**$220,023,064**
Fully Diluted Shares Outstanding	38,863,000
Price per Share	**$5.66**

Private Company and M&A Valuations

The company's closest competitors are OpenDNS and ZScaler. On August 27th, Cisco acquired 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 had over 310 employees and 25 data centers. 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 $110 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 15 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.

OWNERSHIP



Mr. Aviv Raiz founded and serves as the President at Eurotrust Ltd., a well-known foreign exchange company that has some of Israel's foremost companies as its clients. He has invested in several high tech, biotech and real estate companies, vastly diversifying his investment interests. He has been a Director of CYREN Ltd, since December 2005.

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.

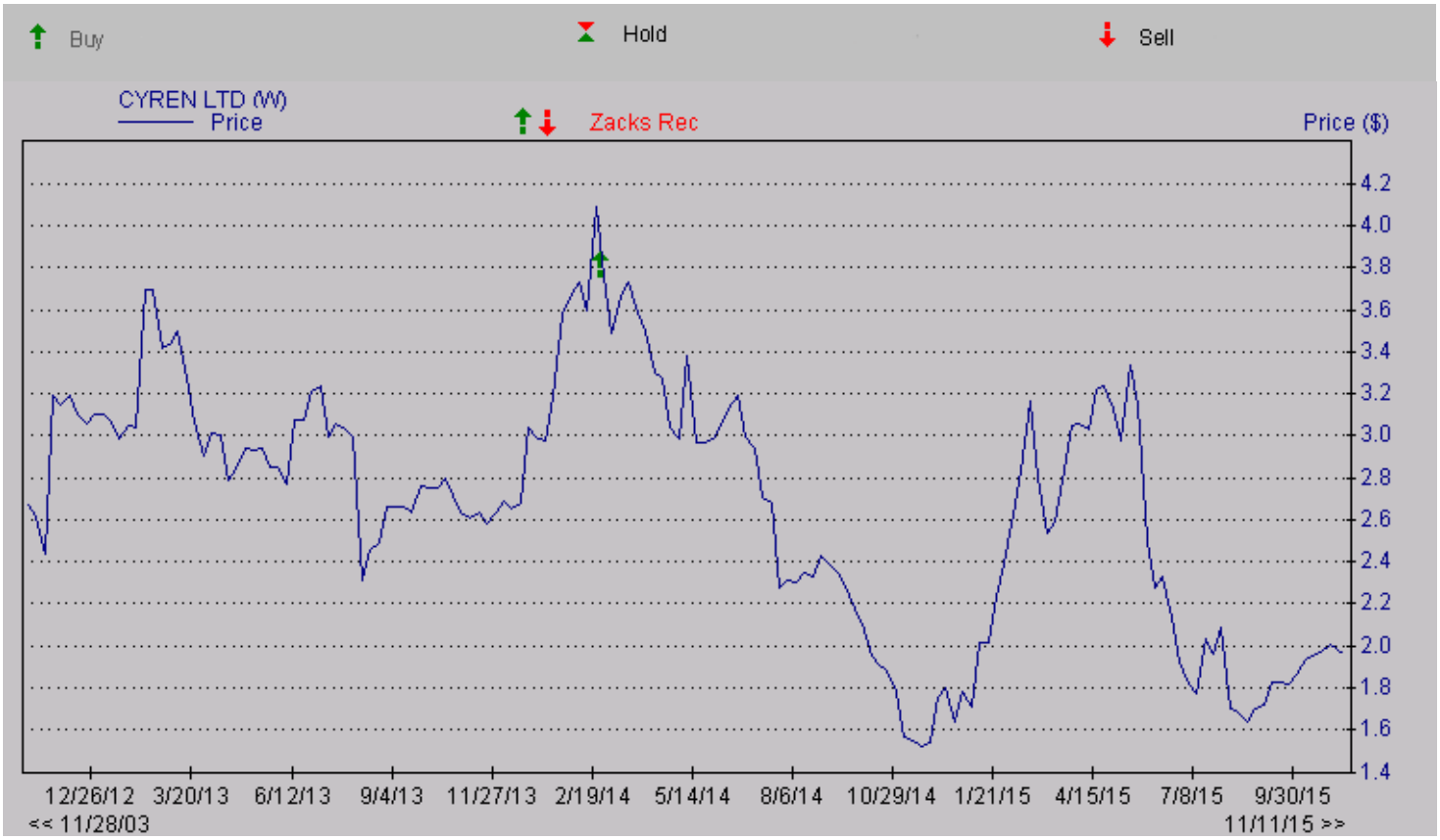
INCOME STATEMENT

	Non-GAAP March Q1 15	Non-GAAP June Q2 15	Non-GAAP Sept Q3 15	Non-GAAP Dec Q4 15E	Non-GAAP March Q1 16E	Non-GAAP June Q2 16E	Non-GAAP Sept Q3 16E	Non-GAAP Dec Q4 16E	Non-GAAP 2013	Non-GAAP 2014	Non-GAAP 2015E	Non-GAAP 2016E
REVENUE												
Non-GAAP Rev	$7.0	$6.8	$7.0	$7.5	$7.5	$8.0	$9.5	$10.0	$32.8	$32.1	$28.3	$35.0
Yr-to-yr Gr.	-13.6%	-18.6%	-10.3%	-4.4%	-3.8%	1.3%	5.6%	-16.7%	35.8%	-2.0%	-11.8%	23.6%
GAAP Revenue	$7.0	$6.7	$6.9	$7.5	$7.5	$8.0	$9.5	$10.0	$32.2	$31.9	$28.2	$34.8
	-13.6%	-18.6%	-10.3%	-4.4%	-7.9%	-3.8%	22.2%	29.2%	34.9%	-2.0%	-11.8%	23.6%
OPERATING EXPENSES												
Cost of goods sold	1.9	1.9	1.9	2.1	2.1	2.1	2.5	2.6	6.4	7.2	7.7	9.3
Gross Margin	5.2	4.9	5.0	5.5	5.4	5.9	7.0	7.5	26.4	24.9	20.6	25.8
%of Sales	73.6%	71.9%	72.3%	72.8%	72.0%	73.8%	73.7%	74.5%	80.5%	77.5%	72.7%	73.6%
R&D	2.6	2.2	2.6	2.8	2.8	2.9	3.0	3.1	8.9	10.9	10.4	11.8
S&M	2.0	1.9	1.8	2.0	2.0	2.1	2.2	2.3	9.6	10.6	7.8	8.6
G&A	1.3	1.7	1.8	2.0	2.0	2.1	2.1	2.2	9.2	7.2	6.9	8.4
Adjustment of Earnout	(0.0)	(0.1)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	(0.7)	(0.1)	0.0
Tot Operating Exp.	5.9	5.8	6.3	6.9	6.9	7.1	7.3	7.6	27.8	28.0	24.9	28.8
Operating Income	(0.7)	(1.0)	(1.2)	(1.4)	(1.5)	(1.2)	(0.3)	(0.2)	(1.4)	(3.1)	(4.4)	(3.1)
Yr-to-yr Gr.	-32%	0%	217%	13%	10%	-21%	-174%	-107%				
Net Interest	(0.2)	(0.1)	(0.1)	0.1	0.1	0.1	0.1	0.1	(1.3)	(0.4)	(0.2)	0.6
Pretax Income	(0.9)	(1.1)	(1.3)	(1.3)	(1.4)	(1.0)	(0.1)	(0.0)	(2.6)	(3.6)	(4.6)	(2.5)
Taxes	0.2	0.0	(0.0)	(0.0)	0.0	0.0	0.0	0.0	0.0	0.4	0.1	0.0
Tax Rate	-18.4%	-0.6%	3.3%	0.8%	0.0%	0.0%	0.0%	0.0%	0.0%	-10.7%	-2.7%	0.0%
Net Income	(1.1)	(1.2)	(1.3)	(1.3)	(1.4)	(1.0)	(0.1)	(0.0)	(2.6)	(3.9)	(4.7)	(2.5)
Yr-to-yr Gr.	-19.7%	9.2%	85.7%	-9.0%	-6.9%	-32.0%	-147.8%	-100.5%				
GAAP EPS-Basic	(0.03)	(0.02)	(0.04)	(0.03)	(0.04)	(0.02)	(0.00)	(0.00)	(0.10)	(0.14)	(0.14)	(0.06)
EPS-Fully dil.	(0.03)	(0.02)	(0.04)	(0.03)	(0.04)	(0.02)	(0.00)	(0.00)	(0.10)	(0.12)	(0.12)	(0.06)
Fully dil Non-GAAP EPS Ex- One time	($0.03)	($0.04)	($0.04)	($0.03)	($0.04)	($0.03)	($0.00)	($0.00)	($0.10)	($0.14)	($0.12)	($0.06)
Yr-to-yr Growth	-45%	-8%	94%	23%	-9%	-33%	-146%	-100%				
Primary Share Out	31.4	31.4	35.2	39.2	39.2	39.2	39.2	39.2	26.2	28.6	34.3	39.2
Yr-to-yr Growth	18%	18%	18%	25%	25%	25%	25%	25%	7%	9%	20%	14%
Fully diluted shares	38.5	38.7	38.9	39.1	39.1	39.3	39.5	39.6	26.2	32.1	38.8	39.4
Yr-to-yr Growth	45%	46%	6%	2%	2%	2%	3%	6%	4%	22%	21%	1%

BALANCE SHEET

$ In Thousands	Sept. 30, 2015	June 30, 2015	Yr-to-Yr Growth
CURRENT ASSETS:			
Cash and cash equivalents	$18,665	$7,870	137%
Trade receivables, net	3,525	3,595	-2%
Deferred tax assets	0	0	
Prepaid expenses and other receivables	1,464	2,084	-30%
Total current assets	23,654	13,549	75%
LONG-TERM ASSETS:			
Lease deposits	76	76	0%
Deferred tax assets	0	0	
Deferred issuance costs	0	153	-100%
Severance pay fund	593	575	3%
Property and equipment, net	2,206	2,151	3%
Goodwill and intangible assets, net	30,218	30,000	1%
Total long-term assets	33,093	32,955	0%
Total assets	56,747	46,504	22%
CURRENT LIABILITIES:			
Credit line	4,166	4,492	-7%
Trade payables	706	755	-6%
Employees and payroll accruals	2,257	2,082	8%
Deferred tax liability	106	117	-9%
Accrued expenses and other liabilities	951	912	4%
Earn-out consideration	2,418	2,868	-16%
Deferred revenues	**3,288**	**3,187**	3%
Total current liabilities	13,892	14,413	-4%
LONG-TERM LIABILITIES:			
Deferred revenues	**1,653**	**1,365**	21%
Deferred tax liability	1,639	1,688	-3%
Earn-out consideration	0	0	
Accrued severance pay	714	690	3%
Other liabilities	92	92	0%
Total long-term liabilities	4,098	3,835	7%
SHAREHOLDERS' EQUITY:			
Shareholders' equity	38,757	28,256	37%
Total liabilities and shareholders' equity	$56,747	$46,504	22%
Post offering Current ratio	1.7	1.7	-2%
Post offering Net cash	$14,499	$14,878	-3%
Deferred revenues	4,941	4,552	9%
Change in deferred revenues	389	165	136%

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Sell/Underperform: The analyst expects the company will underperform the broader U.S. Equity market over the next one to two quarters.

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