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	Outperform
Date of Last Change	02/26/2014
Current Price (11/20/14)	$1.49
12 Month Target Price	**$4.00**

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	**$1.45**
One-Year Return (%)	**-42.47**
Beta	**0.32**
Average Daily Volume (sh)	**53,578**
Shares Outstanding (mil)	**31**
Market Capitalization ($mil)	**$47**
Short Interest Ratio (days)	**1.35**
Institutional Ownership (%)	**6**
Insider Ownership (%)	**N/A**
Annual Cash Dividend	**$0.00**
Dividend Yield (%)	**0.00**
5-Yr. Historical Growth Rates	
Sales (%)	**19.1**
Earnings Per Share (%)	**-18.0**
Dividend (%)	**N/A**
P/E using TTM EPS	**NM**
P/E using 2014 Estimate	**NM**
P/E using 2015 Estimate	**37.3**
Zacks Rank	**3**

Risk Level	**Average**
Type of Stock	**Small-Value**
Industry	**Internet-Software**
Zacks Rank in Industry	**52 of 65**

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	7.8 E	7.8 E	32.0 E
2015					37.0 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 A	-$0.03 E	-$0.14 E
2015					$0.04 E

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WHAT'S NEW

Still Waiting for New Product Uptake

Q3 revenues fell short of our estimate despite the company's continued progress on new product rollout and distribution partner sign-ups. Revenues were $7.8 million versus $8.1 million last year and our estimate of $8.6 million. As a result revenues were down not only year over year, but sequentially from the $8.3 million reported in Q2. Part of this was due to two customers leaving and part currency translation. Revenues are now expected to be stabilized, especially with the recent addition of a new agreement with MacAfee to use the company's anti-spam SDK engine, from which revenues only started at the beginning of Q4.

Non-GAAP gross margins were also down at 76.7% versus 82.2% last year and 78.1% in Q2 2014. The base business continues under competitive attack as prices come down and more customers move to cloud-based services.

Non-GAAP operating expenses were $6.4 million versus $6.0 million last year, as the company continues to spend on R&D to build new product. Included in one-time expenses was an adjustment for an earn-out of $701,000 that was not included in non-GAAP numbers.

In the quarter the company added six more channel partners who now number 24 total, of which five have completed the on-boarding process and are starting to sell.

The story however continues to be 2015, and given the longer than expected ramp to sales will show in the second half of 2015 a long wait for investors. The new cloud-based products will transform the business model of the company and improve gross margins considerably. By moving from an OEM sale to an end-user sale, revenues to CYREN should 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 the second half 2015, and beyond. Take for example an end user sale to a large bank. Just that one sale could add over $3 million in revenues a year, which is a significant improvement for a company with a base business of $32 million annually.

For the next few quarters, management plans to take all the cash generated from the core business plus a portion of the $10.2 million in cash raised in July in the registered direct offering, and invest it in sales, marketing and R&D to continue to roll out new products that should show meaningful revenues in 2015.

As the roll out has been lengthened due to unexpectedly long sales on-boarding and the completion of certain product features, we are lowering 2015 numbers. Next year, due to a slower ramp we are lowering revenues to $37 million from $40 million. We expect three more quarters of down revenues until the sale of new products kicks in. As an investment, shares of CYRN could be considered dead money for the next few quarters or until at least the company signs a few major end user contracts.

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 so far. It believes its solution will undercut high priced appliance-based solutions from vendors like FireEye, as well as provide better protection for mobile users. It also plans a Data Loss Prevention (DLP) solution that would protect against information leaking out of a system.

The company is working on a database that will aggregate data from all its sources including the 500 million endpoints the company sees per day globally, which it is calling its "Reputation Database". Its will be uniquely able to help customers avoid threats and come close to the concept of zero day protection in

that by having information on an attack elsewhere on the globe, a customer can be protected before it itself has an incident. This database will source feeds with SDKs, URLs, antivirus, phishing and will update automatically giving more real-time protection. As an example where speed is of the essence, spam has gotten so sophisticated that spammers will open a domain, use it for a day, and close it by the end of the day. They can buy data and have out product within 30 minutes of receiving it.

The company believes its solutions will be an improvement over products provided by FireEye, Proofpoint and ZScaler, as it will be a hybrid of all their methodologies. It will also be a huge cost improvement over appliance-based solutions such as those sold by FireEye. FireEye sells a box for between $200,000 and $350,000 through which everything is routed and gets opened up and scanned. This approach is very expensive to install, monitor, maintain and update and CYREN thinks its solution will be far more cost competitive as well as offering better mobile protection through a cloud service that does not go through a VPN.

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 are at extremely high valuations, and the high profile hackings in the news this year. CYRN currently trades at a price of $1.45 that gives it a fully diluted market cap of $54 million, and an enterprise value of $47 million, or 1.5x estimated 2014 revenues. Its peers trade from a range of 10.5x for FireEye, to 2.4x 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 the 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 7.8 times. At that valuation CYRN would be worth $7.23 per share. At the point when sales growth returns next year, hopefully starting in Q3, we could see the stock move up to half the peer valuation of 4 times sales or $4.00, twelve months from now.

Web Security Companies

Company	Ticker	Revenue 2014E	Revenue LTM	EBIDTA Margin	Enterprise Value / Sales 2014E	Enterprise Value / Sales LTM	Included in Average?	ev
Barracuda Networks	CUDA	$276	$255	3%	6.1x	6.6x	y	1,680
Checkpoint Software	CHKP	$1,490	$1,460	55%	8.8x	9.0x	y	13,120
FireEye	FEYE	$424	$340	-103%	10.5x	13.1x	y	4,460
Imperva	IMPV	$162	$155	-34%	6.3x	6.6x	y	1030
Palo Alto Networks	PANW	$709	$598	-13%	11.8x	14.0x	y	8400
Proofpoint	PFPT	$192	$180	-17%	8.2x	8.8x	y	1580
Qualys	QLYS	$133	$126	13%	7.9x	8.3x	y	1050
Symantec	SYMC	$6,720	$6,680	29%	2.4x	2.4x	y	15890
Average				**-8%**	**7.8x**	**8.6x**		

	Revenue 2014E	Revenue LTM	EBITDA Margin	Enterprise Value / Sales 2014E	Enterprise Value / Sales LTM	Valuation Range Low	Valuation Range High
CYREN	**$32**	**$32**	**-5%**	**7.8x**	**8.6x**	**$248**	**$278**

Conclusion of Enterprise Value	**$263,335,255**
Market Value	**$271,082,255**
Fully Diluted Shares Outstanding	37,500,000
Price per Share	**$7.23**

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

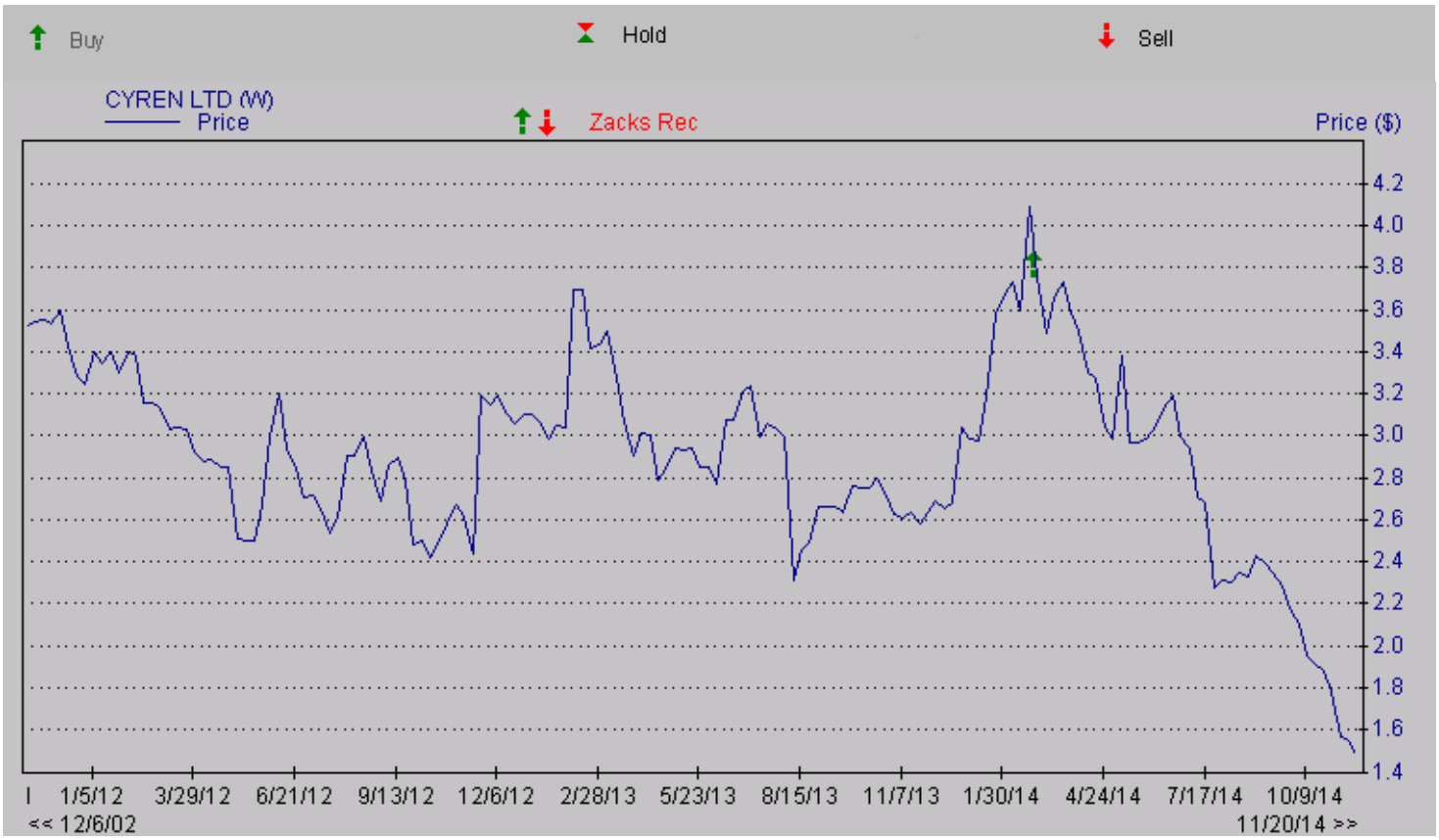
Non-GAAP

	Non-GAAP March Q13 A	Non-GAAP June Q13 A	Non-GAAP September Q13 A	Non-GAAP Dec Q13	Non-GAAP March Q14 A	Non-GAAP June Q14 A	Non-GAAP Sept Q14 A	Non-GAAP Dec Q14 E		Non-GAAP 2012	Non-GAAP 2013	Non-GAAP 2014E	Non-GAAP 2015E
REVENUE													
Non-GAAP Rev	$8.1	$8.2	$8.1	$8.1	$8.1	$8.3	$7.8	$7.8		$24.1	$32.8	$32.0	$37.0
Yr-to-yr Gr.	*	*	**		6%	3%	-2%	-8%	*		36%	-2%	16%
GAAP Revenue	$7.9	$8.1	$8.1	$8.0	$8.1	$8.3	$7.7	$7.7		$23.9	$32.2	$31.8	$39.0
	*	*	**		2%	3%	-4%	-7%	*		35%	-2%	23%
OPERATING EXPENSES													
Cost of goods sold	1.6	1.6	1.5	1.7	1.813	1.8	1.8	1.8		4.0	6.4	7.2	6.9
Gross Margin	6.5	6.6	6.6	6.4	6.3	6.5	6.0	6.0		19.9	26.4	24.7	30.1
% of Sales	82.6%	81.9%	82.2%	78.8%	77.7%	78.1%	76.7%	76.8%		82.4%	80.5%	77.4%	81.4%
R&D	2.2	2.1	2.0	2.6	2.8	3.0	2.3	2.6		6.0	8.9	10.8	10.0
S&M	2.5	2.3	2.2	2.7	2.7	2.8	2.5	2.5		5.3	9.6	10.6	9.8
G&A	1.7	2.0	1.8	3.4	1.9	1.6	2.2	1.6		8.3	9.2	7.3	8.8
Adjustment of Earnout	0.0	0.0	0.0	0.0	0.0	0.0	(0.7)	0.0		0.0	0.0	(0.7)	0.0
Tot Operating Exp.	6.4	6.4	6.0	8.7	7.4	7.5	6.4	6.7		19.7	27.8	27.9	28.6
									*	*	*	*	
Operating Income	0.2	0.2	0.6	(2.3)	(1.097)	(0.958)	(0.388)	(0.7)		0.2	(1.4)	(3.2)	1.5
Yr-to-yr Gr.													
Net Interest	0.0	(0.1)	(0.1)	(0.4)	(0.2)	(0.1)	(0.2)	0.0		0.1	(1.3)	(0.4)	0.0
Pretax Income	0.2	0.1	0.6	(2.7)	(1.3)	(1.029)	(0.574)	(0.7)		0.3	(2.6)	(3.6)	1.5
Taxes	0.1	(0.0)	(0.0)	0.0	0.1	0.0	0.1	0.1		(0.6)	0.0	0.3	0.1
Tax Rate	61.5%	-15.6%	-8.3%	0.0%	-4.3%	-3.7%	-19.2%	-13.7%		-217.0%	0.0%	-8.4%	6.6%
Net Income	0.1	0.1	0.6	(2.7)	(1.4)	(1.1)	(0.684)	(0.8)		0.9	(2.6)	(3.9)	1.4
EPS-Basic	0.00	0.00	0.09	(0.10)	(0.05)	(0.04)	(0.02)	(0.03)		0.04	(0.10)	(0.14)	0.05
EPS-Fully dil.	0.00	0.00	0.02	(0.10)	(0.05)	(0.04)	(0.02)	(0.02)		0.04	(0.10)	(0.12)	0.04
Non-GAAP EPS	$0.00	$0.00	$0.01	($0.07)	($0.05)	($0.04)	($0.02)	($0.03)	*	$0.04	($0.10)	($0.14)	$0.04
Yr-to-yr Growth			*		-1941.8%	-932.5%	-285.9%	-62.2%					
Shares Out	25.9	26.1	26.1	26.5	26.5	26.6	29.8	31.3		24.6	26.2	28.6	31.4
					2.3%	1.7%	14.1%	18.2%			7%	9%	10%
Fully diluted shares	25.9	26.1	26.1	26.5	26.5	26.6	36.8	37.5		25.1	26.2	31.8	38.3
*	4.2%	0.0	0.0		2.3%	1.7%	40.9%	41.7%	*		4%	21%	20%

BALANCE SHEET

$ In Thousands	Sept. 30, 2014	Jun. 30, 2014	Dec. 31, 2013	Sept. to Dec % Change
CURRENT ASSETS:				
Cash and cash equivalents	$13,094	$3,104	$3,757	249%
Trade receivables, net	4,085	4,831	5,178	-21%
Deferred tax assets	0	16	48	-100%
Prepaid expenses and other receivables	1,417	1,446	1,988	-29%
Total current assets	18,596	9,397	10,971	70%
LONG-TERM ASSETS:				
Lease deposits	75	80	74	1%
Severance pay fund	635	706	819	-22%
Property and equipment, net	2,546	2,622	2,674	-5%
Goodwill and intangible assets, net	33,009	35,287	36,395	-9%
Total long-term assets	36,265	38,695	39,962	-9%
Total assets	54,861	48,092	50,933	8%
CURRENT LIABILITIES:				
Credit line	5,347	5,301	3,245	65%
Trade payables	638	661	859	-26%
Employees and payroll accruals	2,366	2,772	3,102	-24%
Deferred tax liability	149	56	0	
Accrued expenses and other liabilities	1,233	1,180	1,366	-10%
Earn-out consideration	2,294	2,704	1,428	61%
Deferred revenues	4,407	4,319	4,499	-2%
Total current liabilities	16,434	16,993	14,499	13%
LONG-TERM LIABILITIES:				
Deferred revenues	1,238	1,420	1,646	-25%
Deferred tax liability	2,150	2,517	2,749	-22%
Earn-out consideration	903	1,387	2,857	-68%
Accrued severance pay	706	787	873	-19%
Total long-term liabilities	4,997	6,111	8,125	-38%
SHAREHOLDERS' EQUITY:				
Shareholders' equity	33,430	24,988	28,309	18%
Total liabilities and shareholders' equity	$54,861	$48,092	$50,933	8%
Current ratio	1.1	0.6	0.8	50%
Net cash	$7,747	($2,197)	$512	

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