Cyan

Technology

13 November 2018

The transformation continues

The acquisition of I-New transforms Cyan's scale and growth prospects still further. Recent interim results highlighted a business on track to exceed FY18 pro forma guidance of €20m and expand EBITDA margins significantly. With a largely recurring revenue base, orders with an annualised contract value (ACV) of over €6m already signed and a qualified pipeline of €100m in ACV, the company also appears well positioned to deliver FY19 revenue guidance of €35m (implying 75% y-o-y organic pro forma revenue growth).

I-New deal transforms Cyan

In our initiation note, we highlighted how Cyan's IPO and acquisition of its operating subsidiary was set to transform its profile. The subsequent acquisition of I-New (€17m in July 2018) has accelerated the pace of that transition still further. Aside from providing a significant opportunity to accelerate Cyan's push into the mobile virtual network operator (MVNO) market, it broadens the product portfolio, expands development and sales resources, and creates potential cost synergies.

Growth, visibility and margins

Cyan recently reiterated its guidance to deliver FY19 revenue and EBITDA of more than €35m and €20m, respectively. Implying organic pro forma revenue growth and margins of 75% y-o-y and 57%, respectively, this guidance suggests substantial outperformance vs its nearest cybersecurity peers. Cyan's confidence in future growth is underpinned by a pipeline of €100m ACV. With a largely recurring revenue base and €6m of ACV already signed, it needs to convert c. 10% of this pipeline to meet its FY19 guidance. It is currently in discussions with six customers each capable of adding €5–10m of ACV and classifies €16m of the pipeline as 'close to signing'.

Valuation: Discount to peers despite growth

At €23, Cyan's share price is essentially unchanged since its IPO in March 2018, despite the I-New acquisition. At current levels it implies 10.6x FY19e guided EBITDA, a 37% discount to its nearest cybersecurity peers despite significantly better growth prospects. Ultimately, a DCF approach may be the best way to capture Cyan's potential valuation, but applying a peer group average EV/EBITDA multiple (16.9x) suggests a valuation of €37.5 and 63% upside to the current price.

Headline financials (including FY18-19 guidance and implied multiples)

Year end	Revenue (€m)	EBITDA* (€m)	EV/Revenue (x)	EV/EBITDA (x)
12/16	3.3	1.9	64.0	111.1
12/17	4.1	2.0	52.1	108.2
12/18e**	20.0	7.0	10.6	30.2
12/19e	35.0	20.0	6.0	10.6

Source: Cyan. Note: *Adjusted for exceptionals. **Numbers reflect Cyan's pro forma guidance.

Price	€23
Market cap	€202m

Share price graph

Share details

Code	CYR
Listing	Deutsche Börse Scale
Shares in issue	8.76m
Net debt at October 2018, post equity raise	€8.7m

Business description

Cyan supplies cybersecurity systems for mobile data networks. Following the recent acquisition of I-New, its two major products are: 1) content management software sold as a white-label product to mobile network operators; and 2) a traffic management solution for MVNOs that enables them to reduce network traffic and therefore corresponding costs.

Bull

- Rapid growth in high-margin revenue expected.
- Good visibility on growth: recurring revenue base, €6m of deals signed + €100m pipeline.
- Opportunities to sustain rapid growth through mobile banking initiatives.

Bear

- Integration risk around I-New acquisition.
- FY19 forecasts imply a 57% margin that could attract competition.

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Edison profile page

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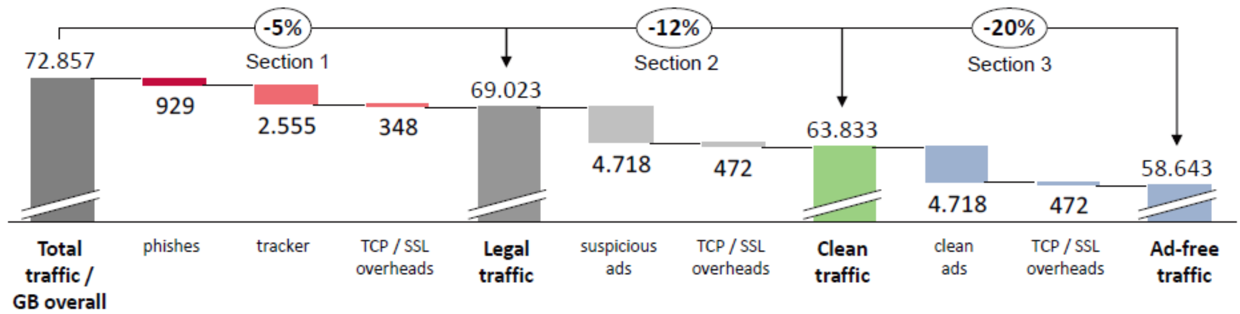
Acquisition of I-New transforms Cyan

In July 2018, Cyan acquired 77% of I-New, an Austria-based provider of technology platforms to MVNOs, for €17.1m. At the time of acquisition I-New had 40 MVNO clients globally with a combined total of 5.5m mobile customers and a particularly strong Latin American presence. The deal represented a deepening of an already established relationship. Cyan first signed a test contract with I-New to supply its traffic optimisation product in Mexico in 2017 – by February 2018, this agreement was extended to cover a further 24 I-New clients. Following completion, Cyan announced its expectations to generate €20m in pro forma revenue in FY18, effectively doubling the market expectations set at IPO.

The primary rationale for the acquisition was the opportunity to accelerate the deployment of Cyan's MVNO product. Cyan's traffic optimisation platform uses a compression tool to monitor and filter network traffic. By removing spam, phishing, tracking and associated overheads, it eliminates c 20% of traffic, thereby saving the MVNO substantial network costs (see Exhibit 1). Cyan was looking for partners with a presence in the MNVO market to accelerate its deployment. In the four months since acquisition, Cyan has already rolled it out to 85% of I-New's existing customers and sold it to new customers (in September it announced a contract with Klik Mobile, a recently launched MVNO in Colombia). Acquiring I-New also substantially improves the economics for Cyan. Under the original partnership arrangement, the 25% of network savings realised by the customer were passed back and split between I-New and Cyan. Following the acquisition, this revenue no longer has to be shared.

Exhibit 1: Cyan's MVNO product can cut network traffic by 20%



Source: Cyan AG

While the most immediate synergies from the deal come from the acceleration of Cyan's MNVO product, the I-New acquisition provides several other important benefits:

- **Broader product portfolio:** I-New provides CRM and billing platforms to both MNVOs and mobile network operators (MNOs) enabling the combined group to offer a more complete solution to these customers.
- **Greater development and sales resources:** I-New adds more than 100 full-time IT experts, trebling Cyan's headcount to 150 at a stroke. This greater scale significantly expands its development and direct sales resource.
- **Cost savings:** Cyan's 'Roadrunner' cost-saving programme aims to merge the operations of the two companies by December 2018. The company hopes to achieve €1m in annualised cost savings including €0.5m from rationalising the number of support centres.
- **€20.8m tax asset:** some of the investment in I-New's technology platform was written down in 2017, leading to the creation of tax losses that Cyan can potentially offset against future combined profits.

Delivering FY19 guidance

Cyan's FY19 guidance of more than €35m in revenue and €20m in EBITDA implies 75% y-o-y growth in pro forma revenues from FY18 guidance and a 22pp margin expansion (effectively implying that more than 85% of incremental revenue drops through to profits).

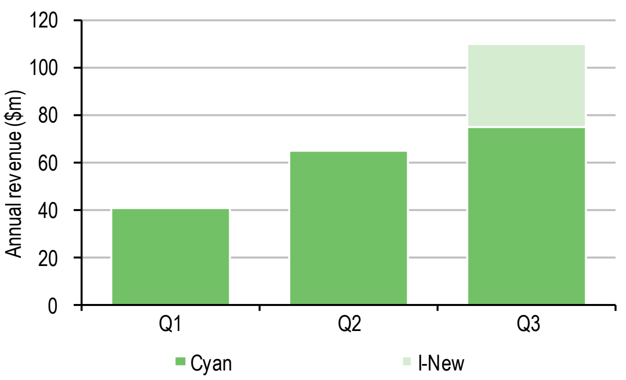
Cyan has clearly set out how it intends to reach these objectives. First of all, it indicated in its recent interim statement that its current revenue run-rate is already above €20m a year (it delivered €10.1m in H118 and H1 is 'usually significantly weaker due to seasonal factors'). The vast majority of this revenue is recurring in nature and generated by high-profile customers such as T-Mobile and Virgin Mobile. Together, these attributes provide high visibility.

Secondly, of the incremental annualised revenue Cyan requires, it has already signed deals that will generate at least €6m of ACV. Revenue from these deals will boost the P&L run-rate before the end of the year. In some cases, it has been prevented from disclosing the details of these wins by non-disclosure agreements (NDAs).

Thirdly, to cover the remaining incremental revenue required to reach guidance the company points to a pipeline of over 100 qualified leads (customers where it is already in exclusive negotiations). It estimates this pipeline is capable of generating over €100m in ACV. Meeting its FY19 guidance requires converting c. 10% of the pipeline. Given this would imply a conversion rate substantially below its historical experience, the company is confident that this is achievable.

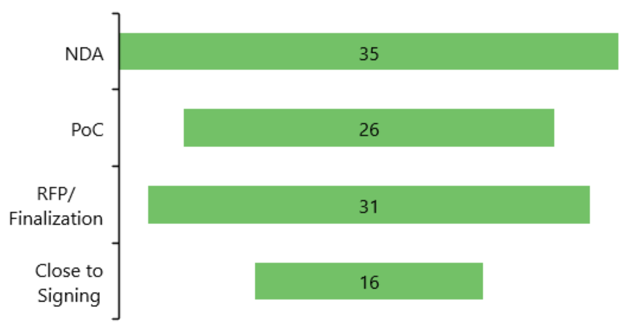
Cyan's additional pipeline disclosure helps assess the likelihood of signing these orders (see Exhibits 2 and 3). Its pipeline has been steadily building all year and has been bolstered by the acquisition of I-New. Breaking it down into stages, €16m of ACV is 'close to signing' and a further €31m of ACV is in the request for proposal (RFP) or finalisation stage. It is currently negotiating with six customers, each of which could add €5–10m of ACV. While there is no guarantee that any of these deals will come to fruition or, even if signed, that they will contribute a full year of annualised revenue in FY19, this analysis helps explain management's confidence in Cyan's growth prospects.

Exhibit 2: Pipeline evolution in 2018



Source: Edison Investment Research

Exhibit 3: Pipeline breakdown at Q318



Source: Edison Investment Research

The 22pp boost to EBITDA profitability implied by the FY19 guidance also looks feasible. Cyan reported pro forma direct margin (revenues minus COGS) of 78% in H118 and expects incremental revenue to have an 80% direct margin. Achieving the €35m FY19 revenue target (€15m incremental), therefore, should generate €12m of additional EBITDA assuming no other costs. Reaching the €20m+ therefore requires only a further €1m from cost synergies, which should be attainable given the cost-saving measures currently underway.

Other mobile cybersecurity opportunities

Cyan's rapid growth at least partially reflects its focus on mobile, as opposed to PC-based cybersecurity. As the dominant and fastest-growing internet access platform, mobile cybersecurity represents a fundamentally more attractive market, in our view. Yet traditional consumer cybersecurity firms focusing on providing labelled solutions direct to customer devices have struggled to gain traction. Cyan's white-label approach (or B2B2C as it describes it) enables operators to provide cybersecurity at a network level, generating 'value-added' revenue for them and reducing the hassle for consumers. The value of its traffic management solution for MVNOs is particularly obvious and it appears to face little direct competition at present. Over 80% of Cyan's revenue run-rate is generated from its MNO and MVNO products currently.

The company hopes to expand its presence by providing enhanced security for mobile commerce. In May 2017, it launched a software development (SDK) enabling financial service providers to add extensive customised security features to their mobile applications. It has signed agreements with MyBucks and Sberbank so far. In July 2019, the regulatory technical standard (RTS) of the EU's Payment Services Directive II (PSD2) comes into force, demanding that banks strengthen customer authentication for online transactions. Cyan provides a 'risk management' module that enables the optimal authentication mechanism to be selected based on the individual threat level and is partnering with AliasLab to commercialise it. These initiatives are small today, but should enhance Cyan's competitive position in mobile cybersecurity further and help sustain its long-term growth.

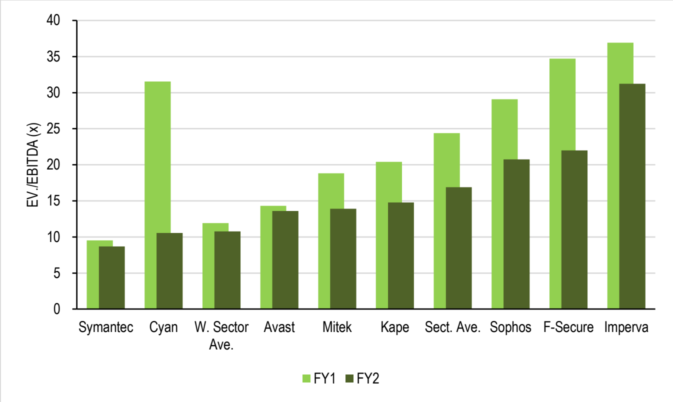
Forecasts and valuation

Cyan's recently published interim numbers (six months to June 2018) on a pro forma basis (ie assuming the consolidation of I-New from the beginning of the year) down to the EBITDA level in English. Given the large changes in consolidation boundary over the last nine months and that guidance is given on a pro-forma basis, we focus our analysis on these numbers.

Cyan expects to substantially outperform its nearest cybersecurity peer group over the next 18 months. Guidance implies organic revenue growth of 75% (based on pro forma FY18 taking into account acquisitions) and EBITDA margins rising to over 57%, both metrics substantially greater than its peers (20% and 30%, respectively). This guidance is underpinned by its pipeline of €100m in ACV, direct margins of 80% on new revenue and cost savings. Cyan delivered 28% EBITDA margin in H118 and expects this to rise to over 40% in H218e.

At €23, Cyan's share price is essentially unchanged since its IPO in March 2018. Its sharp rise after the acquisition of I-New in July (+38% in three weeks) was reversed in October's market-wide sell-off, only partially recovering when the company reaffirmed guidance in its interim release. At current levels, it implies 10.6x FY19e guided EBITDA, a 37% discount to wider cybersecurity peers despite growth prospects significantly better than its peer group. Ultimately, we believe that a DCF model is probably the best way to value Cyan's long-term growth prospects. However, applying a peer group average multiple (16.9x) suggests a valuation of €37.5, 63% upside to the current price.

Exhibit 4: EV/EBITDA valuation multiples



Source: Thompson Reuters, Edison Investment Research