EDISON

Scale research report - Update

Cyan

Technology

14 November 2019

Price	€20.7
Market cap	€203m

Share price graph

Share details

Code	CYR
Listing	Deutsche Börse Scale
Shares in issue	9.8m
Estimated net cash (€m) at 31 October 2019 (H119 net debt of €14m plus estimated net proceeds from capital raising of €23m)	8.6

Business description

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

Bull

- Rapid growth in high-margin revenue expected.
- Good visibility in general with existing recurring revenue base and blue-chip customers.
- Opportunities to sustain rapid growth through mobile banking initiatives.

Bear

- Execution risk and capacity constraints.
- FY19 guidance requires significant sequential growth in H2.
- Additional revenues may be driven by one-off licence sales, offering less visibility.

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Edison profile page

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Focused on delivery

Over the last 12 months Cyan has focused on integrating its I-New acquisition and preparing for its Orange roll-out. Sustaining this focus on delivery over the next few months will be crucial. The company is targeting revenues of €75m by FY21, a significant uplift from the current (€16m) run rate. Investor confidence will be boosted if Cyan can deliver the large sequential jump in revenues implied by FY19 guidance and complete technical integration with Orange on time.

H1 demonstrates integration and investment focus

Cyan reported revenues of €7.9m and EBITDA loss of €1m in H119. Stripping out other income, revenue of €7.0m was broadly flat sequentially but operating costs fell by over €4m. The integration of the I-New team, the closure of its Brno office, merger of Sopron operations and restructuring in Latin America all helped streamline overheads. At the same time, the company began investing to support the upcoming Orange launch, expanding headcount and opening a dedicated office in Paris. In August Cyan lowered its FY19 EBITDA guidance by €6m (from €20m to €14m) predominantly to accelerate R&D and invest in marketing.

H2 delivery key to confidence in FY21 target

This increased investment, backed by a €25m capital raise, enabled Cyan to lift its FY21 revenue target to €75m (previously ‘at least’ €60m). Implying a doubling of revenues from FY19 guidance and accompanied by a 50% EBITDA margin target, Cyan’s medium-term prospects still look very good. However, investors will need reassurance that it can deliver. In our view Orange will be key to this. Cyan expects to complete technical integration by year end and for Orange to add €25m in recurring revenues by FY21. To meet FY19 guidance Cyan has to deliver revenues of €27m in H2 (€19m more than H1). It recently secured a large (€5–10m) deal with ACN/Flash Mobile but needs further big ‘upfront’ software sales to meet guidance.

Valuation: Delivery should see upside

At c €21, Cyan’s share price has fallen 18% since the beginning of 2019. At current levels it implies an enterprise valuation of 10x FY20e consensus EBITDA, a multiple that falls to 6.7x by FY21e. If the company can demonstrate its growth trajectory is on track, in our view there should be upside to both consensus estimates and the share price. Applying a peer group average FY20e EV/EBITDA multiple (12x) suggests a value of €25 per share, 23% upside.

Consensus estimates and implied valuation multiples

Year end	Revenue (€m)	Adj EBITDA** (€m)	Adj. EBIT** (€m)	Adj. EPS** (€m)	EV/revenue (x)	EV/EBITDA (x)
12/18***	8.8	3.4	0.4	NA	21.8	56.9
12/19e	31.1	12.1	8.8	0.8	6.2	16.0
12/20e	45.3	19.3	13.3	1.3	4.3	10.0
12/21e	63.1	28.8	20.3	2.1	3.1	6.7

Source: Cyan and Refinitiv. **Adjusted for exceptionals. ***Cyan previously reported pro forma revenue of €22.9m and (adjusted) EBITDA of €4.8m in FY18. Numbers restated following publication of IFRS statements.

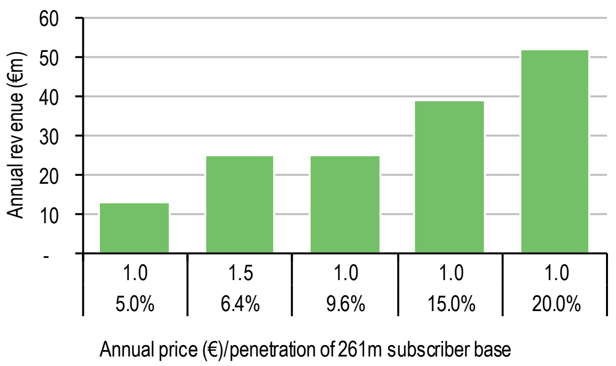
Orange is the new Cyan

In December 2018, Cyan secured a long-term (six-year minimum) global contract to exclusively provide cybersecurity to Orange. The scale of this contract and its significance to Cyan is enormous. Orange's 28 subsidiaries provide services to 264 million mobile, fixed line, consumer and business customers and Cyan's cybersecurity services will be embedded into these networks. Based on its experience with T-Mobile Austria and assuming each customer pays €1.5 per year plus 6.4% penetration of the customer base, Cyan estimates the contract should generate annual recurring revenue of €25m by FY21, ie a third of its FY21 revenue target.

As we highlighted in our last note, The future is bright, the future is …, precisely how Cyan's cybersecurity service is provided to Orange's customer base will be driven by Orange on a market-by-market basis. It is expected that in some countries, consumers will need to opt-in but in others it could be included as a default option or even mandated. Offering the product as a default across large swathes of Orange's customer base could result in penetration rates much higher than 6.4%, In this scenario, revenues could be significantly larger than €25m (see Exhibit 1).

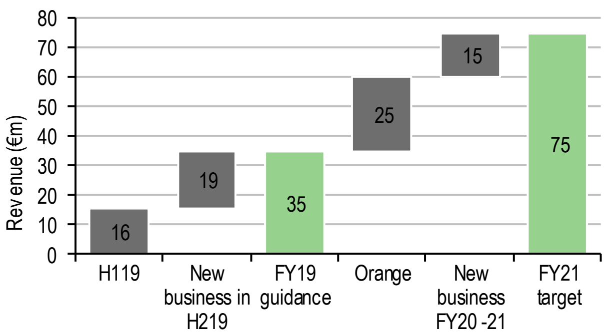
The pace of the roll out is also not yet clear. Cyan expects to complete final technical integration in France in Q419 (ie in the next two months) before deploying it across Orange's other European assets and African subsidiaries. It is still on track to deliver this but how quickly Orange will be able to roll out the service across all its subsidiaries, tariff plans and customer bases within each market remains to be seen. In countries where Cyan is not a default option, the pace of customer adoption is also uncertain.

Exhibit 1: Annual revenue impact from Orange contract with different pricing and penetration assumptions



Source: Cyan, Edison Investment Research

Exhibit 2: The additional business Cyan needs to generate to reach its FY21 target



Source: Cyan, Edison Investment Research. Note: FY21 target €75m comprises FY19 guidance + Orange + New Business FY20/21. H119 = run rate

Cyan has considerable experience integrating its security products at mobile providers but a deployment of this scale poses challenges. In June it highlighted how it is focusing a substantial proportion of its internal resources to ensuring seamless delivery and in August it announced that it is increasing headcount to expand capacity across the group. In our view, there are both downside and upside risks to Cyan's revenues from Orange. Completing technical integration and recognising the first revenues in the next two months, followed by a smooth commercial launch in early FY20, will reassure investors that Cyan is on track to deliver at least €25m in extra revenues in FY21.

H2 delivery key to confidence in FY21 target

Assuming Cyan generates incremental revenues from Orange of €25m in FY21, it still needs to boost its H119 annualised run rate (c €16m) by €34m to reach its FY21 target (see Exhibit 2). Its

FY21 EBITDA margin target of 50%+ also implies a 65%+ margin on incremental sales. The market appears sceptical at this point. Consensus FY21e EBITDA of €29m is 23% below guidance and the current valuation implies a relatively modest FY20e EV/EBITDA multiple of 10x.

The company has plenty of growth opportunities outside Orange. In July it signed a potentially significant deal with Telecom Argentina to provide network security and optimisation to up to 20 million customers and a strategic partnership with Wirecard in the financial services sector (on top of its deal with Aon last year). At the end of Q3 it disclosed five additional large contracts close to signing and announced a large deal in November to provide security to up to 60m ACN/Flash Mobile customers. The company indicated that the ACN/Flash Mobile deal could generate licence revenues in FY19 of €5–10m, but no financial terms were provided on the other wins and there is no guarantee the remaining Q3 pipeline will be converted to orders. However, the recent investment in headcount should remove resource constraints and help accelerate the rate of customer acquisition and implementation.

In our view, financial performance in H2 will be a big opportunity to reassure investors the company is on track to meet its FY21 target. FY19 revenue guidance of €35m implies €27m in H2, c €19m above the H1 run rate. If achieved, the company would be well on the way to reaching its FY21 target. However, the mix of incremental sales will be as important as the amount, in our view. To date Cyan's revenues have been largely subscription based, a model that offers good visibility on revenue recurring in future years. The company expects most incremental revenues in H2 will be 'one-off' licence sales similar to the ACN/Flash Mobile deal. Such deals can generate large upfront payments but typically offer less long-term visibility because they are not recurring. Revenue recognition from Orange in H219 will be welcome but will not count against the €34m it needs to find from other customers.

Aside from the size and mix of any revenue uplift in H219, profitability and cashflow generation will also be important. Reaching FY19 EBITDA guidance of €14m requires a 50%+ margin on incremental sales and its FY21 EBITDA margin target of 50%+ requires a 65%+ incremental margin. The company will need to demonstrate that, despite increasing operating costs to drive long-term growth, profits from sequential growth are reaching the bottom line.

Valuation

At c €21, Cyan's share price implies enterprise valuation multiple of 10x FY20e consensus EBITDA, a 20% discount to its nearest cybersecurity peers. This multiple falls to 6.7x by FY21e and is just 5.2x its FY21 EBITDA target of €37.5m. This note has discussed forecast risks – both positive (Orange) and negative (H219). Nevertheless, as we highlighted in The future is bright, the future is… and The transformation continues, Cyan does have a significant growth opportunity and, if it can hit its targets, there should be upside to consensus and the share price. Applying a peer group average multiple (12x) to FY20 consensus estimates generates a valuation of €25 per share (23% upside). Applying the same multiple (12x) to Cyan's FY21e EBITDA target suggests a €47 per share valuation.

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