

CROSSRIDER

SOFTWARE AND COMPUTER SERVICES

CROS.L

66.5p

Market Cap: £93.8m

SHARE PRICE (P)



12m high/low

70.0p/24.5p

Source: LSE Data

KEY INFORMATION

Enterprise value	£38.4m
Index/market	FTSE AIM
Next news	Trading update: Jan '17
Gearing	0
Interest cover	n.a.

CROSSRIDER IS A RESEARCH CLIENT OF PROGRESSIVE

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Solid interims reflect strategic delivery

Good underlying progress

Crossrider's interim results contain revenue and Adjusted EBITDA in line with guidance given in July's trading update. They also reflect Crossrider's ongoing transition towards a SaaS model and its repositioning as a B2C security software and online distribution platform. The results include three months' contribution from CyberGhost and build on the performance in the last financial year with the App Distribution business performing strongly and the group as a whole demonstrating good underlying cash conversion again. We note the revenue and margin metrics of the Company and make small reductions in our revenue and cost estimates while leaving Adjusted EBITDA unchanged, noting that there will be a full six months' contribution from CyberGhost in H2. The outlook remains positive as the Company continues to focus on its growth strategy, and CyberGhost's user acquisition gains momentum.

- The core App Distribution division reported revenues of US\$21.1 million for the first half of Crossrider's current financial year (H1 2016: \$18.2 million). This reflects the expansion of Crossrider's B2C cyber security software business – including the March 2017 acquisition of CyberGhost, a Cyber Security SaaS solution business.
- The Media division's half year revenues were US\$7.3 million versus US\$7.5 million reported in H1 2016. The performance of the Web Apps and License business reflected the decision to cease investment in the division with revenues of US\$1.6 million (H1 2016: US\$3.0 million).
- The acquisition of CyberGhost expanded Crossrider's position in the growing personal privacy and security market. The solution is becoming a key component of personal online security, protecting users' personal information when browsing the internet. We look in more detail at cybersecurity and virtual private networks (VPNs) in more detail in this publication.
- After adjusting for one-off items, cash conversion for the first six months remained good at around 90% of Adjusted EBITDA. Cash of US\$68.7 million as at 30 June 2017 compared to US\$72.1 million six months earlier following US\$5.6 million of investment expenditure during H1 2017. Crossrider has no debt.
- Following the first half results, we reduce revenue estimates for FY 2017E and FY 2018E by 5% and 2% respectively. Offsetting cost reductions mean no change to Adjusted EBITDA or earnings estimates leaving the company trading on an FY 2018E EV/EBITDA multiple of 3.8x on our estimates.

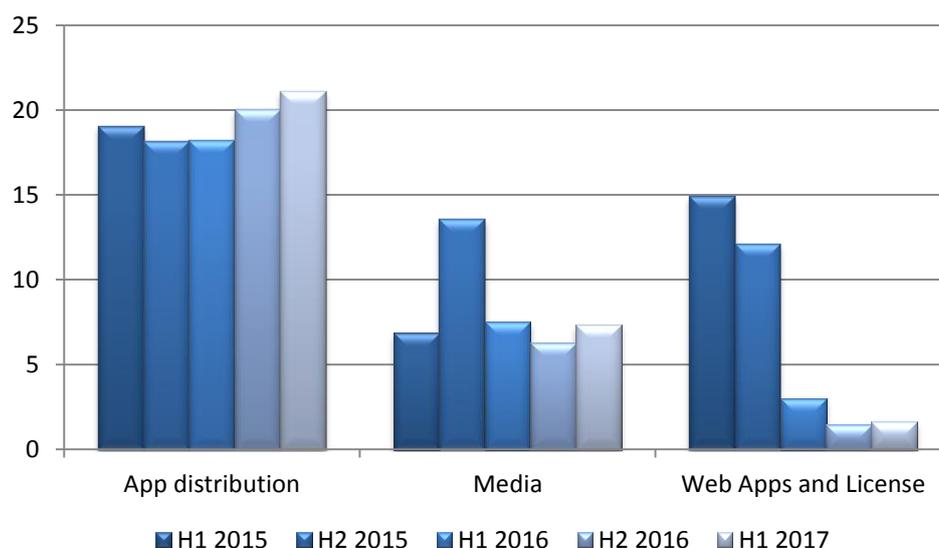
Y/E DEC (US\$M)	FY-14A	FY-15A	FY-16A	FY-17E	FY-18E
Revenue	71.1	84.6	56.5	65.0	79.1
Adjusted EBITDA	13.6	10.1	6.4	8.3	10.1
Adjusted PBT	9.0	8.1	4.8	7.7	9.4
Adjusted EPS (c)	9.1	4.6	2.7	3.8	6.5
EV/Sales	0.5x	0.5x	0.7x	0.6x	0.5x
EV/ Adj. EBITDA	2.8x	3.8x	6.0x	4.6x	3.8x
P/E	9.5x	18.7x	32.0x	22.5x	13.2x

Source: Company Information and Progressive Equity Research estimates

Interim results

Crossrider has reported half year revenue of U\$30.1 million (H1 2016: U\$28.7 million) reflecting a 16% increase in App Distribution revenue to U\$21.1 million (H1 2016: U\$18.2 million) while the Media division produced stable revenue of U\$7.3 million in H1 2017 (H1 2016: U\$7.5 million). The decision to cease investment in the legacy web apps platform is reflected in Adjusted EBITDA of U\$2.9 million (H1 2016: U\$3.5 million). Excluding the Web Apps and License segment, underlying growth in Adjusted EBITDA was 131% versus H1 2016.

Revenue reflects business transition (U\$m)



Source: Crossrider data

Segment margins (reflecting revenues and direct segment costs)

	H1 2015	H2 2015	H1 2016	H2 2016	H1 2017
App distribution	21.5%	29.2%	32.3%	26.9%	31.7%
Media	21.7%	14.9%	23.2%	27.7%	23.0%
Web App and Licensing	49.4%	51.6%	100.0%	100.0%	100.0%
	31.7%	31.0%	37.0%	31.0%	33.3%

Source: Crossrider data

After cash conversion from Adjusted EBITDA of 90% (H1 2016: 119%) – and despite U\$5.6 million of investment during the first half - Crossrider retained a strong balance sheet with U\$68.7 million cash as at the end of June 2017 compared to U\$72.1 million six months earlier. Adjusted cash from operations of U\$2.6 million (H1 2016: U\$4.1 million) represented 95% underlying growth after excluding cash generated from the Web Apps and License businesses.

Acquisitions

Crossrider bought CyberGhost during the first half of 2017 for a maximum consideration of €9.2 million out of which €3.2 was in cash at closing, €3.0 million in nominal value share options and a deferred earn-out consideration capped at €3.0 million. It also increased its holding in Clearvelvet Trading Ltd, a programmatic video advertising company, from 16.67% to 50.01% for an initial consideration of US\$1.7 million. The sellers will also be entitled to receive up to a total of US\$1.4 million earn-out consideration contingent on achieving specific EBITDA goals.

The interim announcement confirms that the integration of CyberGhost is now complete and fully integrated to Crossrider's user acquisition platform. Importantly, CyberGhost is performing ahead of expectations. Crossrider has also launched Reimage for MAC, embodying its PC repair technology in a Mac repair product.

KPIs and business model transition

In terms of KPIs, Crossrider now has US\$8.0 million of revenues from existing customers – reflecting its ongoing transition to a pure SaaS based model - and reported a subscription retention rate in H1 2017 of 69% from the second half which bodes well for future revenues. Currently, Crossrider has four digital products: Reimage, Reimage for MAC, CyberGhost and DriverAgent. It has 800,000 paying, active users in 164 countries on its digital marketing platform.

In addition to the move towards a SaaS model, the first half of 2017 reflects Crossrider's repositioning as a B2C security software and online distribution platform. The acquisition of CyberGhost brought Crossrider more strongly into the cyber security market. There are clear potential synergy benefits through additional sales, a lower cost structure and the application of Crossrider's skill in low-cost online marketing of the CyberGhost product. This represents a template for what it is possible to achieve from further acquisitions over time.

Applying Crossrider's strategy



Source: Crossrider

The Company continues to follow a combined organic and acquisitive approach to growth and we expect to see further acquisitions in line with its previously-announced criteria. In particular, acquisitions are likely to focus on the cybersecurity market and, as we note above, we expect management to apply the same strategy to other businesses that it has successfully applied to CyberGhost by integrating Crossrider's technology and leveraging its digital marketing expertise. CEO, Ido Erlichman comments that in the second half of the current financial year, Crossrider's growth strategy will continue to focus on those points.

Estimate changes

Following the first half results, we reduce revenue estimates for FY 2017E and FY 2018E by 5% and 2% respectively. Noting the progression of margins and the continuing shift in mix, offsetting cost reductions mean no change to Adjusted EBITDA or earnings estimates.

Estimate changes

U\$m unless stated	FY17E			FY18E		
	Old	New	Change (%)	Old	New	Change (%)
Revenue	68.6	65.0	-5%	80.7	79.1	-2%
Adj EBITDA	8.3	8.3	0%	10.1	10.1	0%
Fully adj PBT	7.6	7.7	0%	9.4	9.4	0%
Fully adj EPS (c)	3.8	3.8	0%	6.5	6.5	0%

Source: Progressive Equity Research estimates

The Virtual Private Network (VPN) market

The rise in cybercrime is driving up risk

In August 2016, Cybersecurity Ventures published a market report which looked at cybercrime and its likely growth by 2021. The type of crime involved includes damage to, and destruction of, data, theft of intellectual property, theft of personal and financial data, fraud, post-attack disruption to the normal course of business, forensic investigation, restoration and deletion of hacked data and systems, and reputational harm. It predicted that global annual cybercrime costs will grow from U\$3 trillion in 2015 to U\$6 trillion annually by 2021. It also observed that global spending on cybersecurity products and services for defending against cybercrime is projected to exceed U\$1 trillion cumulatively from 2017 to 2021.

Many more devices will exist by 2021 with Cisco estimating that the number of connected devices worldwide will rise from 15 billion today to 50 billion by 2020. Intel suggests that the total could be greater than 200 billion devices.

Cybersecurity Ventures' Q2 2017 market update noted that it expected the global cybersecurity market to be worth more than U\$120 billion in 2017. This is being driven by massive cybercriminal activity as evidenced by the huge increase in ransomware attacks, malware on mobile devices and the raft of unprotected Internet of Things (IoT) devices. This latter point, in particular, leaves myriad data sources under-protected. Hackers are able to target individuals, government agencies and businesses through cars, smartphones, retail payment systems, fuel pumps, video game consoles, cables boxes, GPS devices, digital cameras, and other electronically connected devices. Stolen datasets are used to provide the most profitable outcome for hackers through methods such as identity theft or ransom, for instance.

Cybersecurity Ventures says in its reports that over half of cyber-attacks are made against small businesses. Many are subject to ransomware attacks where U\$1,000 or less may be demanded in exchange for releasing data - a level which is perceived to encourage victims to pay quickly rather than trying to fix the issue on their own.

Governments' concerns

There are some specific examples of how the cost of cybersecurity is rising with President Trump's first federal budget blueprint in March 2017 proposing U\$1.5 billion for the Department of Homeland Security to protect federal networks and critical infrastructure from cyberattacks. The fiscal 2018 budget proposal also asked for a sharp increase in funding for the Defense Department - in part aimed at improving the military's cyber operations and defences.

The UK Government published its National Cyber Security Strategy 2016-2021 document in 2016 which said that it would invest £1.9 billion over the five-year period in "defending systems and infrastructure, deterring our adversaries, and developing a whole-society capability – from the biggest companies to the individual citizen".

Individuals' concerns

It is worth remembering that individuals spend a great deal of money on protecting themselves and this is less easy to track. It is a market which is not just about anti-virus and malware defence apps and includes such solutions as personal identity theft protection services, computer and mobile phone repair services specific to malware and virus removal post-breach services including data recovery. Identity theft is a constant source of (growing) concern.

What is a VPN and how does it work?

A VPN (or Virtual Private Network) works by creating a “private network” (effectively a closed tunnel) between a user and a remote server, normally in a different country. The server then accesses the internet, free from restriction or monitoring, and downloads web pages or interacts with the world as if it were a “real” user, but all the time relaying the information through the tunnel to the actual user who wishes to keep his or her activity private.

VPN technology effectively creates a safe and encrypted connection over a less secure network, such as the internet. Data travels through the secure, encrypted tunnels and VPN users must use authentication methods, including unique identification criteria, to gain access to a specific VPN. VPNs can be accessed remotely via wifi, on a site-to-site basis or a VPN can be defined between specific computers.

Benefits of VPN

VPNs allow users’ personal data (passwords, credit card details etc.) to be encrypted and kept safe. They also prevent the collection of personal information so that users can retain their privacy, keeping information secure while using public wifi. They can bypass local (geographic) restrictions on internet activity. For example, during the Arab Spring uprisings, local regimes’ attempts to block social media sites were often thwarted as users bypassed local blocks, using VPNs to access the websites they then used to share information.

The growing use of VPNs

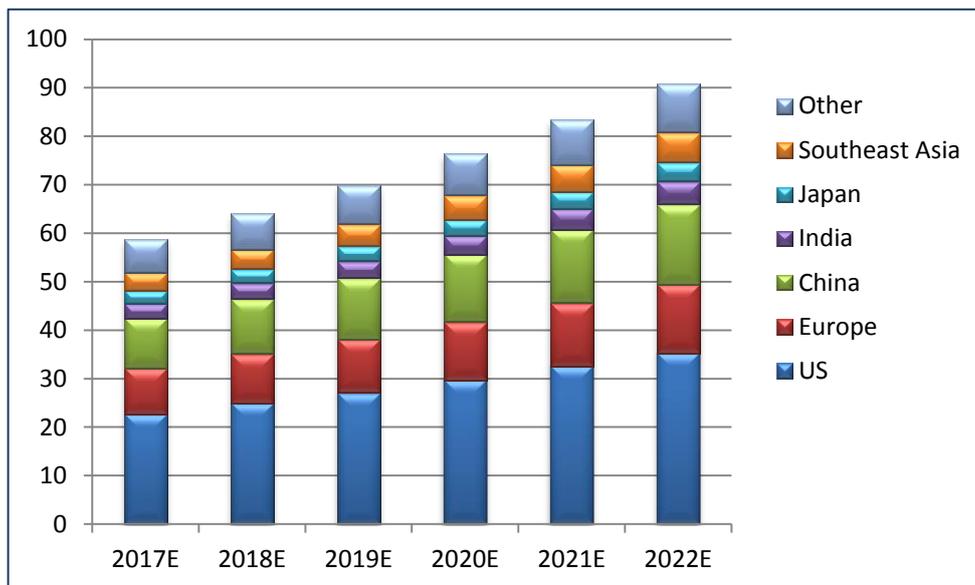
There is a growing population of law abiding, honest web users who choose to keep their online activities private, and are prepared to pay a monthly fee for access to a range of VPN servers. VPNs are popular because, as well encrypting internet traffic, they render users anonymous. Hackers are unable to access a VPN and cannot tell who the user is, offering protection against identity theft. It can also prevent the collection of personal information by commercial or government entities. It is worth remembering, for instance, that the Trump administration signed legislation earlier this year getting rid of proposed privacy rules that would have required internet service providers to get explicit consent before sharing or selling web browsing histories and other sensitive information.

VPNs are becoming a key component of personal online security and an increasing requirement from businesses to provide secure communication with remote locations or employees. They protect users’ personal information when browsing the internet. They prevent external parties from monitoring activity and personal or business data and allow users to keep their online activity confined to their mobile and desktop devices.

The VPN market

ICRWorld has published research on the VPN market which provides industry data and views on growth trends. It said that global VPN revenue reached U\$53.4 billion in 2016 and is expected to reach over U\$90 billion in 2022. It expects the evolution of worldwide demand to take the form shown in the chart below.

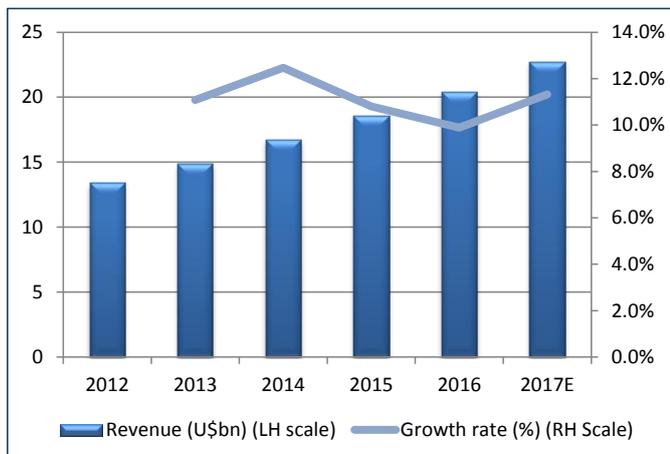
VPN demand by regions (U\$bn)



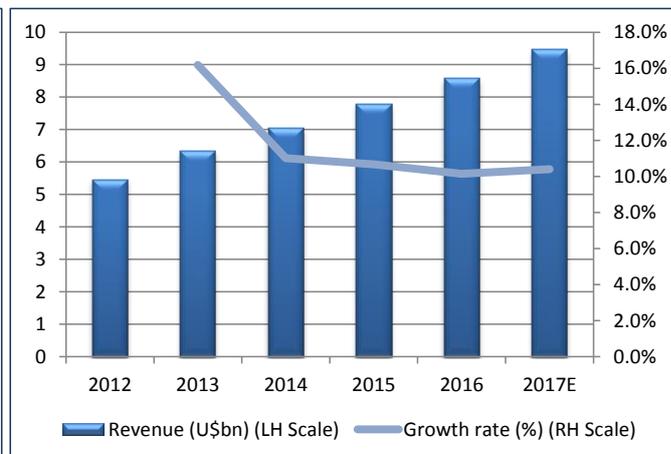
Source: ICRWorld

Currently, the main VPN business of Crossrider’s CyberGhost is conducted with users in the United States and Europe. Both markets have shown steady growth in recent years with revenue in 2017 expected to total U\$22.7 billion and U\$9.5 billion respectively. The charts below show the revenue progression and growth rates in those two markets since 2012.

VPN revenue (U\$bn) and growth (%): United States



VPN revenue (U\$bn) and growth (%): Europe



Source: ICRWorld

ICRWorld’s findings suggest that the VPN market is highly fragmented with the largest player highlighted in its research, CISCO, having a share of only 0.7%.

Crossrider's opportunity

Crossrider owns, develops and acquires software products solutions for consumers in the cyber security space targeting users globally. Crossrider has noted that the VPN market is becoming more mainstream with a wider market developing from the original group of 18-30 year-old tech-savvy users. Wombat Security Technologies' 2017 *User Risk Report* found that in its survey, 65% of US respondents and 44% of UK respondents used a VPN on a corporate and/or personal device.

The market has also spread from predominantly PC/Mac users to encompass a growing requirement for iOS solutions. This reflects the fact that the need to protect personal and business information and data from hackers is an ever more key requirement for internet users. The opportunities for suppliers of VPN solutions such as Crossrider are driven by those concerns about cyberattacks, consumers' requirement for improved quality of solutions, the general level of worldwide economic development and growth and the associated burgeoning demand for remote accessibility of data in business organisations noted above – although Crossrider's focus is currently on consumers.

This may mean that economic volatility is a risk to growth of the VPN market. However, Crossrider has said that it will look to diversify in the VPN market to cover the demand for, for instance, parental controls and anti-bullying solutions. It is also likely to consider other cybersecurity or privacy solutions such as anti-virus/active protection products or password keepers. Crossrider has significant balance sheet strength to support this strategy.

While the cost of development of VPN has been cited as something of a barrier to entry, Crossrider already owns CyberGhost and is therefore well-placed to advance its sales potential. It seems likely that certain technical and brand supply barriers could emerge where new projects could obtain a certain market share with excellent new technology and strong marketing. Consequently, there is a risk that keen international competition may emerge coupled with rising demand for product quality from consumers. Key to Crossrider's prospects in this context, CyberGhost already exists, has established itself in the market and is growing.

SUMMARY FINANCIALS

PROFIT & LOSS (U\$m)	FY-14A	FY-15A	FY-16	FY-17E	FY-18E
Revenue	71.1	84.6	56.5	65.0	79.1
Adj EBITDA	13.6	10.1	6.4	8.3	10.1
Adj EBIT	4.7	0.7	(3.5)	4.9	6.9
Reported PBT	(11.7)	(14.7)	(10.0)	4.8	6.8
Fully adj PBT	9.0	8.1	4.8	7.7	9.4
NOPAT	13.2	6.5	3.6	5.2	9.0
Reported EPS (c)	(10.5)	(11.9)	(7.6)	2.5	3.6
Fully adj EPS (c)	9.1	4.6	2.7	3.8	6.5
Dividend per share (c)	0.0	0.0	0.0	0.0	0.0
CASH FLOW & BALANCE SHEET (U\$m)	FY-14A	FY-15A	FY-16	FY-17E	FY-18E
Operating cash flow	9.3	5.9	5.9	7.8	9.4
Free Cash flow (U\$m)	6.8	1.8	3.0	5.6	6.6
FCF per share (c)	5.8	1.2	2.1	3.9	4.5
Acquisitions	(9.8)	(0.9)	(1.1)	(5.6)	(1.8)
Disposals	0.0	0.0	0.0	0.0	0.0
Shares issued	71.4	(5.1)	(1.0)	2.9	0.0
Net cash flow	67.3	(4.7)	0.7	2.9	4.8
Overdrafts / borrowings	0.0	0.0	0.0	0.0	0.0
Cash & equivalents	76.0	71.3	72.1	75.0	79.8
Net (Debt)/Cash	76.0	71.3	72.1	75.0	79.8
NAV AND RETURNS	FY-14A	FY-15A	FY-16	FY-17E	FY-18E
Net asset value	110.8	91.5	80.6	87.1	92.2
NAV/share (c)	74.6	64.8	57.1	61.7	65.4
Net Tangible Asset Value	75.0	72.3	73.4	81.9	88.2
NTAV/share (c)	50.5	51.1	52.1	58.0	62.5
Average equity	54.4	101.2	86.0	83.8	89.7
Post-tax ROE (%)	-21.6%	-17.4%	-12.4%	4.3%	5.7%
METRICS	FY-14A	FY-15A	FY-16	FY-17E	FY-18E
Revenue growth	379.0%	19.0%	-33.2%	14.9%	21.8%
Adj EBITDA growth	620.8%	-26.2%	-36.3%	29.2%	22.3%
Adj EBIT growth	-177.7%	-85.3%	n.a.	n.a.	40.6%
Adj PBT growth	-959.9%	-10.2%	-41.5%	61.2%	23.0%
Adj EPS growth	574.4%	-49.1%	-41.7%	42.5%	69.9%
Adj EBIT margins	6.6%	0.8%	-6.1%	7.5%	8.7%
VALUATION	FY-14A	FY-15A	FY-16	FY-17E	FY-18E
EV/Sales	0.5	0.5	0.7	0.6	0.5
EV/EBITDA	2.8	3.8	6.0	4.6	3.8
EV/NOPAT	2.9	5.9	10.6	7.3	4.2
PER	9.5	18.7	32.0	22.5	13.2
Dividend yield	0.0%	0.0%	0.0%	0.0%	0.0%
FCF yield	6.7%	1.3%	2.4%	4.5%	5.3%

Source: Company information, Progressive Equity Research estimates

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