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What have I missed?

Last Friday, some of the World's most prestigious organisations such as the NHS and Telefonica were brought to their knees by a malicious cyber-ransom known as WannaCry. The type of malware used was Ransomware which restricts access to a computer's data in return for a ransom. The virus then spreads like wild fire, predominantly through the sharing of Word documents and emails.

What went wrong?

Fingers quickly pointed across the pond to the US's GCHQ equivalent, the NSA. Their secret squirrel antics are consistently penetrating the latest exploits in a bid to always be one step ahead in cyber attack methods. However, this information is worthless unless it is acted upon. I.e. The NSA telling the likes of Microsoft how to fix a potential threat if it should so occur. For the NSA, the best form of defence is attack and as President Trump builds his cyber war chest, they were busy behind the scenes developing their cyber arsenal.

Reports then started to emerge that the NSA's exploits were being leaked which means their secret tactics on how to launch a cyber attack were no longer not so secret. The likes of Microsoft were then scrambling to close the proverbial software gate after the cyber horse had bolted. Once software upgrades were in place to tackle these new cyber threats, it is then the end user's responsibility to install the necessary upgrades. However, many organisations such as the NHS did not get round to installing the software in time before WannaCry hit.

We all know upgrades cost companies huge amounts of time and money and resource strapped organisations such as the NHS are less enthused to jump towards the latest Microsoft upgrade.

The complexity of this attack is quite astounding. Hackers now have the power to infiltrate and use Government cyber techniques that were primarily in place to prevent them from such a threat. The hunter has now become the hunted.

Where are the investment opportunities? Innovation, Innovation, Innovation!

We last covered the sector in June 2016 commenting on the infamous Talk Talk cyber attack of October 2015 whereby 150,000 customer details went missing. Followed on by Apple's co-founder Steve "Woz" Wozniak claiming Cybersecurity is the greatest threat the World has faced since the atom bomb. Seemed far fetched last year but with the recent WannaCry incident does not seem so unrealistic.

The sentiment is quite fickle in this sector, coverage of cyber security only really rears its head after a media frenzy reporting the attack. The Sunday Paper Tip Sheets are cranked up offering investors with their latest pick on which company has the silver bullet to rid the world of cyber security (a futile and impossible undertaking). With many companies singing from the same hymn sheet, it's a minefield for investors to try and navigate successfully. We've included a sample below to get you started with a couple of thoughts:

- 1) Throw your valuation rule book out the window** (Your usual 10x PE max rule is not valid here). Many companies in the space command dizzy valuations based on high year on year revenue growth and attracting SaaS like valuations on a revenue model underpinned by subscription based annual licenses.
- 2) Look at the management team.** How many industry heavyweights are on board? Have they been in the sector for a long time? The landscape is incredibly competitive and you need the right people to open the right doors. Customers and investors highly rate the benefits of having experienced management on board that are capable of generating business.
- 3) Getting the right product/service mix.** One hit product wonders will fail in this market. WannaCry has shown us the ever changing nature of cyber attacks will consistently test the most sophisticated of technology barriers. Innovation is paramount here as companies need to be one step ahead of the hackers. Does the company have a consulting arm? Cybersecurity is a deeply cultural issue for organisations and they need help implementing and using certain products and techniques to defend against a potential threat.
- 4) Routes to market.** A company could have the best technology in the world, but if nobody knows about it, it is a futile and costly exercise. R&D heavy companies will burn through cash like you wouldn't believe. There is a fine balance between commercialisation and innovation.

A select few worth a closer look...

Osirium Technologies (OSI.L) 102.5p £10.6m

Osirium IPO'd on AIM in April 2016 at 156p. The Company recently reported 2016 numbers with £477,577 in revenues (£440k was SaaS revenue) with an operating loss of £1.8m reflecting increased R&D spend. SaaS revenues are going in the right direction. The Company is focused on being the "dominant" cyber-security brand in the UK by 2018. The Company secured a significant contract win with a leading global asset management company in August 2016 as they look to deliver on their strategy of seeking mainstream "mid-market" adoption through channel partners.

ECSC Group (ECSC.L) 542.5p £48.8mm

ECSC has had a fantastic performance since their AIM IPO in Dec 2016. Raising £5.9m at 167p, IPO investors are sitting on gains of currently 224%. The Company was founded in 2000 by a former adviser to GCHQ. Last reported results for 15 months ending 31st Dec 2016 showed revenues of £4.51m with a loss of £517k. ECSC has a solid mix of product and consulting revenues with some 200 customers representing 10% of the FTSE 100. The Company needs to meet some impressive growth targets to help justify their current market cap.

Falanx (FLX.L) 8.75p £13.6m

The Company made a wise move to refocus on cybersecurity from its grass roots as a private security business. Shares have responded well, up over 100% over the past 12 months demonstrating the progress they have made in the field. The group's Trading update in May stated FY revenues to show 50% growth to £2.7m. Their cyber defence division grew to 29 clients deploying a range of services including consulting. Their "Security-As-A-Service" platform went live in March 2017 which has the potential of generating significant recurring revenues going forward.

Crossword Cybersecurity* (NEX:CCS) 195p £6m

Crossword are at the forefront of cybersecurity innovation as they look to commercialise world class IP coming out of Universities. This approach lends well to the ever evolving threats cyber security poses. Revenues in 2016 grew 1,542% to £345k reflecting a year of transition from R&D to commercial activity. Sir Richard Dearlove (former Chief of Mi6) is Non-Exec Chairman and one of their products, CyberOwl was selected to join GCHQ's new Cyber Accelerator programme.

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