6 April 2017

Corero Network Security plc (AIM: CNS)

("Corero" or the "Company")

Full year results

Corero Network Security plc, the AIM listed network security company, announces its audited results for the year ended 31 December 2016.

Highlights:

- Strong performance of flagship SmartWall product
  - Revenue up 62%
  - Customer numbers up to 64 at 31 December 2016 (up from 29 at 31 December 2015)
  - 100% support renewal rate
- Total revenue up 5% to $8.8 million (2015: $8.3 million)
- Reduced EBITDA loss* $5.1 million (2015: $6.4 million)
- Loss per share 9.0 cents (2015: 8.5 cents)
- Net cash $2.9 million at 31 December 2016 (2015: $2.7 million)
- Launched SmartProtect DDoS protection as-a-service offering
- "Recommended" rating from NSS Labs, the world's leading independent product test laboratory

** before depreciation, amortisation, impairment of goodwill and financing*

Post period highlights:

- $1.0 million new contract
- Strengthened management team
  - Appointed Andrew Lloyd, President and Executive Vice President Sales & Marketing
- Juniper Networks technology alliance partnership (NASDAQ:JNPR)

Ashley Stephenson, CEO of Corero, commented:

"With the DDoS threat landscape continuing to move in our favour, independent third party validation from one of the world's leading product test laboratories, and a growing SmartWall install base, the Board is increasingly confident in Corero's ability to become the leading player in the real-time DDoS mitigation market.

"Corero has continued to invest in its technology in the period, and with the new as-a-service sales model and focus on go-to-market partnerships such as the alliance with Juniper that expand our addressable market, is now focused on delivering revenue growth.

"We have started the new financial year well, having signed our largest SmartWall deal to date, and look forward to reporting further commercial progress in the coming months."

The Annual Report and Accounts for the year ended 31 December 2016 are available on the Company's website www.corero.com/investors.

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About Corero Network Security

Corero Network Security is the leader in real-time, high-performance DDoS defense solutions. Service providers, hosting providers and online enterprises rely on Corero's award winning technology to eliminate the DDoS threat to their environment through automatic attack detection and mitigation, coupled with complete network visibility, analytics and reporting. This next-generation technology provides a First Line of Defense® against DDoS attacks in the most complex environments while enabling a more cost effective economic model than previously available. For more information, visit www.corero.com

Review of business

Corero revenue for the year ended 31 December 2016 was $8.8 million (2015: $8.3 million) with SmartWall revenue up 62% over the prior year whilst legacy product revenues declined as expected.

The 2016 revenue was lower than expected, impacted by extended sales cycles for the large Tier 1 service provider customer segment and the new as-a-service customers signed in the fourth quarter of 2016, where the revenue is recognised monthly over the term of the contract.

Review of performance

For the year ended 31 December 2016, the Group reported an EBITDA loss before depreciation, amortisation, impairment of goodwill and financing of $5.1 million (2015: EBITDA loss $6.4 million).

The loss for the year after taxation amounted to $17.2 million (2015: $11.2 million) and includes:

- Unrealised exchange gain of $1.2 million (2015: gain $0.4 million) arising on an intercompany loan;
- An impairment to goodwill acquired of $9.0 million (2015: $nil) relating to the 2011 acquisition of Top Layer Networks, Inc;
- Finance costs of $0.006 million (2015: $0.02 million).

The loss per share was 9.0 cents (2015: loss per share 8.5 cents).

The Group's net assets at 31 December 2016 were $18.2 million (2014: $26.3 million).

The key financial metrics for the business are as follows:

- Order intake: $7.1 million for the year ended 31 December 2016 (2015: $7.9 million);
- Gross margin: 76% for the year ended 31 December 2016 (2015: 75%);
- Operating expenses (gross of research and development costs capitalised and before depreciation and amortisation of intangibles): $14.4 million for the year ended 31 December 2016 (2015: $15.0 million); and
- Net cash: $2.9 million at 31 December 2016 (2015: $2.7 million)

The order intake in 2016 included $6.7 million of SmartWall orders, an increase of 58% over the prior year (2015: $4.3 million), to 35 service providers, hosting providers and enterprises, providing real-time DDoS and cyber threat protection. As expected the order intake for the previous generation products declined to $0.4 million (2015: $3.6 million) with Corero having announced the end of life of the previous generation products in 2015.

In fourth quarter of 2016, Corero introduced an as-a-service sales model , an offering introduced in response to increasing customer interest in subscription-based contracts in contrast to the purchase of equipment under a traditional perpetual license model. The as-a-service offering is expected to expand Corero's addressable market with fast-growing Cloud hosting providers and regional service providers who can enter the market more rapidly by offsetting the costs of operating a DDoS protection solution with the monthly revenues derived from selling these high margin security services to their customers. Under the as-a-service offering, recognised revenue at the time of the initial customer order is reduced but the contract value and recurring revenues increase over the life of the customer relationship.

The average perpetual license order value in 2016 was in excess of $200,000, in line with the prior year, and the average as-a-service year one contract value was $40,000.

Operating expenses, gross of research and development costs capitalised of $2.5 million (2015: $2.3 million), of $14.4 million were below the prior year (2015: $15.0 million).

The 2016 operating loss of $17.3 million (2015: $11.6 million) includes amortisation of capitalised development expenditure of $2.3 million (2015: $2.4 million) and an impairment to goodwill of $9.0 million (2015: $nil). The goodwill arose on the 2011 acquisition of Top Layer Networks, Inc. ("Top Layer"). Since the acquisition of Top Layer, Corero has made significant investment in its products with the launch of SmartWall in 2014 and the end of life of the previous generation products acquired as part of the Top Layer acquisition announced in 2015. The Corero go-to-market is now exclusively focused on products and services developed by Corero since the Top Layer acquisition. In addition, the ability to accurately forecast revenue growth for the business has resulted in prior year forecasts not being achieved by the Company. As a result, a more conservative approach has been adopted in the forecasts which underpin the intangible assets impairment review as required by IFRS. The Board have therefore assessed that an impairment of the goodwill of $7.1 million is appropriate.

Cash and treasury

The closing cash balance was $2.9 million (2015: $2.7 million). Corero had no debt at 31 December 2016 (2015: $0).

The net reduction in cash from operating activities in the year ended 31 December 2016 was $5.5 million (2015: $7.7 million). In the year ending 31 December 2016, the Company raised $12.0 million (before expenses), of which the Chairman contributed $1.2 million, to fund the further development of the SmartWall product and sales and marketing activities.

The Directors are satisfied, in view of the cash reserves of $2.9 million (2015: $2.7 million) held on the balance sheet at 31 December 2016 and the cash of £5.6 million ($7.0 million) to be raised by the proposed fund raise to be announced by the Company on 6 April 2017 ("Equity Fund Raise"), that the Company and the Group have adequate resources to continue operating for the foreseeable future.

Fund raise

The proposed equity fund raise to be announced on 6 April 2017 will provide Corero with the funding required to execute the Company's strategy and get to the position of being cash generating.

A circular containing a notice of General Meeting will be sent to shareholders on 6 April 2017. In the notice of General Meeting Independent Shareholders will be asked to consider and vote on the Whitewash resolution for Jens Montanana's proposed participation in the Equity Fund Raise, and the Shareholders as a whole will be asked to approve the Placing. In the event that a Rule 9 Waiver is not obtained or the authorities necessary to authorise the Directors to complete the Placing are not approved by the requisite majorities, the Placing will not proceed and the Company will be required to seek further working capital funding in short order.

Market dynamics

2016 marked a turning point for DDoS, as attacks reached new heights in terms of both size and complexity. The Mirai botnet showed us just how powerful an Internet of Things (IoT) powered DDoS attack could really be, with the unprecedented onslaught against DNS provider Dyn in September 2016. Overnight, the security considerations around connected devices went from being something that security consultants have long warned about, into a hot button issue that could no longer be ignored. This will only increase with the first Terabit-scale DDoS attack likely to occur in the year ahead, with far-reaching implications and the potential to impact the Internet backbone itself.

With DDoS attacks costing large enterprises an average of US$500,000 per incident in lost business and IT spending, these increased threats will mean that defending against DDoS attacks will become a top security priority for any organisation that relies on the Internet to conduct business. Our entire digital economy depends upon access to the internet, and so organisations will need to think carefully about business continuity in the wake of such events.

In preparing a robust defence against botnets like Mirai, it is important to consider how they work. Effectively acting like a giant cloud computer, botnet-driven attacks are launched and then disappear without leaving enough information for victims to trace its origins. This leaves organisations really no choice but to defend themselves at the edges of the network. Legacy out-of-band scrubbing solutions, which require human intervention and reactive countermeasures to remove the attack, will not be successful, and using such systems will also allow hackers to experiment on networks undetected, finding vulnerabilities and testing new methods through smaller, hidden attacks that don't meet the threshold for scrubbing.

The only proper defence is to use an automatic, always-on, in-line DDoS mitigation system, which can monitor all traffic in real-time, negate the flood of attack traffic at the internet edge, eliminate service outages and allow security personnel to focus on uncovering any subsequent malicious activity, such as data breaches or malware deposits. This type of in-line, always-on protection can come in various forms – either on-premises, or purchased as a security service from an upstream provider. It is only through deploying these real-time solutions that organisations will be able to identify and mitigate the most serious botnet-driven DDoS attacks on their networks in the years ahead.

Operating performance against strategy

Customer wins in the last year have validated the Corero target market for real-time, automatic DDoS mitigation solutions - namely service providers, hosting providers and on-line enterprises. We have also expanded our addressable market with the as-a-service pricing model targeting emerging companies in this target market who wish to acquire our technology on the more modern pay-as-you-grow model rather than larger up-front capital expenditures.

Corero has an increasing number of satisfied customers who are willing to be industry references for the breakthrough levels of automation, security and service that Corero delivers.

The Company has delivered on its strategic goals of adding new DDoS attack defences to the SmartWall product and additional forensics and analytics capability. In addition, Corero announced at the RSA security show in San Francisco in February 2017 the availability of a 100G SmartWall product and has plans to launch a Cloud enabled product in 2017.

Corero's strategy is to work with leading IT and network technology vendors to make DDoS mitigation an integral component of any well-engineered Internet facing network design thereby increasing our go-to-market opportunities. The recently announced technology alliance partnership with Juniper Networks, a US based multinational corporation that develops and markets networking and security products is the first of such partnerships, and will enable Corero to expand its market reach by leveraging Juniper Networks' global footprint.

Outlook

With the DDoS threat landscape continuing to move in Corero's favour, independent third party validation from one of the world's leading product test laboratories, and a growing SmartWall install base, the Board is increasingly confident in Corero's ability to become the leading player in the real-time DDoS mitigation market.

Corero has continued to invest in its technology in the period, and with the new as-a-service sales model and focus on go-to-market partnerships such as the alliance with Juniper that expand Corero's addressable market, is now focused on delivering revenue growth.

The new financial year is off to a good start, having signed Corero's largest SmartWall deal to date.

The Board has confidence Corero will deliver strong revenue growth in 2017.

Consolidated Statement of Comprehensive Income
for the year ended 31 December 2016

	Total 2016 $'000	Total 2015 $'000
Revenue	8,772	8,340
Cost of sales	(2,071)	(2,073)
Gross profit	6,701	6,267
Operating expenses before highlighted items	(11,847)	(12,699)
Depreciation and amortisation of intangible assets	(3,128)	(5,174)
Impairment of goodwill	(8,992)	-
Operating expenses	(23,967)	(17,873)
Operating loss	(17,266)	(11,606)
Finance income	9	11
Finance costs	(6)	(20)
Loss before taxation	(17,263)	(11,615)
Taxation	85	382
Loss for the year	(17,178)	(11,233)
Other comprehensive expense		
Difference on translation of UK functional currency entities	(2,355)	(482)
Total comprehensive expense for the year	(19,533)	(11,715)
Total loss for the year attributable to:		
Equity holders of the parent	(17,178)	(11,233)
Total	(17,178)	(11,233)
Total comprehensive expense for the year attributable to:		
Equity holders of the parent	(19,533)	(11,715)
Total	(19,533)	(11,715)

Consolidated Statement of Financial Position
as at 31 December 2016

	2016 $'000	2015 $'000
Assets		
Non-current assets		
Goodwill	8,991	17,983
Acquired intangible assets	82	375
Capitalised development expenditure	7,901	7,620
Property, plant and equipment	970	893
Trade and other receivables	80	228
	18,024	27,099
Current assets		
Inventories	65	661
Trade and other receivables	2,227	3,738
Cash and cash equivalents	2,940	2,706
	5,232	7,105
Liabilities		
Current Liabilities		
Trade and other payables	(1,728)	(2,551)
Deferred income	(2,457)	(3,791)
	(4,185)	(6,342)
Net current assets	1,047	763
Non-current liabilities		
Deferred income	(855)	(1,439)
Deferred taxation	-	(85)
	(855)	(1,524)
Net assets	18,216	26,338
Total equity attributable to owners of the parent		
Ordinary share capital	3,119	2,573
Capital redemption reserve	7,051	7,051
Share premium	67,681	56,835
Share options reserve	301	282
Translation reserve	(2,123)	232
Retained earnings	(57,813)	(40,635)
Total equity	18,216	26,338

Consolidated Statement of Cash Flow
for the year ended 31 December 2016

	2016 $'000	2015 $'000
Loss for the year	(17,178)	(11,233)
Adjustments for non-cash movements:		
Amortisation of acquired intangible assets	325	1,210
Impairment loss on intangible assets	8,992	-
Amortisation and impairment of capitalised development expenditure	2,252	3,289
Depreciation	551	675
Loss on sale of property, plant and equipment	9	-
Finance income	(9)	(11)
Finance expense	6	20
Taxation	(85)	(382)
Share-based payment charge/(credit)	19	(3)
Decrease in inventories	596	88
Decrease/(increase) in trade and other receivables	1,605	(1,167)
Decrease in payables	(2,623)	(168)
Net cash used in operating activities	(5,540)	(7,682)
Cash flows from investing activities		
Purchase of intangible assets	(32)	(37)
Capitalised development expenditure	(2,533)	(2,285)
Purchase of property, plant and equipment	(644)	(392)
Net cash used in investing activities	(3,209)	(2,714)
Cash flows from financing activities		
Net proceeds from issue of ordinary share capital	11,392	7,604
Finance income	9	11
Finance expense	(6)	(20)
Repayment of credit facility	-	(20)
Net cash from financing activities	11,395	7,575
Effects of exchange rates on cash and cash equivalents	(2,412)	(509)
Net increase/(decrease) in cash and cash equivalents	234	(3,330)
Cash and cash equivalents at 1 January	2,706	6,036
Cash and cash equivalents at 31 December	2,940	2,706

Consolidated Statement of Changes in Equity
for the year ended 31 December 2016

	Share capital $'000	Capital redemption reserve $'000	Share premium account $'000	Share options reserve $'000	Translation reserve $'000	Retained earnings $'000	Total attributable to equity holders of the parent $'000
1 January 2015	8,855	–	50,000	285	714	(29,402)	30,452
Loss for the year	–	–	–	–	–	(11,233)	(11,233)
Other comprehensive income	–	–	–	–	(482)	–	(482)
Total comprehensive expense for the year	–	–	–	–	(482)	(11,233)	(11,715)
Contributions by and distributions to owners							
Share-based payments	–	–	–	(3)	–	–	(3)
Issue of share capital	769	–	6,835	–	–	–	7,604
Shares purchased for cancellation	(7,051)	7,051	–	–	–	–	–
Total contributions by and distributions to owners	(6,282)	7,051	6,835	(3)	–	–	7,601
31 December 2015	2,573	7,051	56,835	282	232	(40,635)	26,338
Loss for the year	–	–	–	–	–	(17,178)	(17,178)
Other comprehensive income	–	–	–	–	(2,355)	–	(2,355)
Total comprehensive expense for the year	–	–	–	–	(2,355)	(17,178)	(19,533)
Contributions by and distributions to owners							
Share-based payments	–	–	–	19	–	–	19
Issue of share capital	546	–	10,846	–	–	–	11,392
Total contributions by and distributions to owners	546	–	10,846	19	–	–	11,411
31 December 2016	3,119	7,051	67,681	301	(2,123)	(57,813)	18,216

1. General information

These consolidated financial statements are presented in US Dollars (“$”) which represents the presentation currency of the Group. The average $-GBP sterling (“GBP”) exchange rate, used for the conversion of the statement of comprehensive income, for the 12 months ended 31 December 2016 was 1.36 (2015: 1.53). The closing $-GBP exchange rate, used for the conversion of the Group’s assets and liabilities, at 31 December 2016 was 1.23 (2015: 1.48).

The principal accounting policies adopted in the preparation of the financial information in this preliminary announcement are unchanged from those used in the company’s financial statements for the year ended 31 December 2015 and are consistent with those that the company has applied in its financial statements for the year ended 31 December 2016. The financial information set out above does not constitute the Company's Annual Report and Accounts for the year ended 31 December 2016. The Annual Report and Accounts for 2015 have been delivered to the Registrar of Companies and those for 2016 will be delivered shortly. The auditor's report for the Company’s 2016 Annual Report and Accounts was unqualified, did not draw attention to any matters by way of emphasis without qualifying their report and did not contain statements under s498(2) or (3) of the Companies Act 2006. Whilst the financial information included in this preliminary announcement has been computed in accordance with International Financial Reporting Standards (IFRSs) this announcement does not itself contain sufficient information to comply with IFRSs.

The Annual Report and Accounts for the year ended 31 December 2016 are available on the Company’s website www.corero.com/investors.

The information in this preliminary announcement was approved by the board on 5 April 2017.