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CyberDefender Corp. (CYDE – 3.73)

An Emerging Player in Internet Security

September 9, 2010

James D. Ragan, CFA

<u>YE 12/31</u>	<u>Gross Rev (mm)</u>	<u>GAAP Rev (mm)</u>	<u>EPS</u>	<u>P/E</u>	Shares Out.(mm): 27.0	Price Target: \$8.00
2011E	103.95	83.71	\$0.18	20.7x	Ent Value (\$mm):\$101	Rating: BUY
2010E	64.24	50.47	(\$0.22)			Dividend: none
2009	28.97	25.97	(\$0.64)			

52-wk Px Range: \$2.00-\$4.90

* Crowell, Weedon estimates..

6/30/10 Bal. Sheet: Cash/Investments: \$6.9mm, Total Assets: \$18.6mm, Total Debt: \$4.2mm

Recommendation: BUY rated, Price Target \$8. **Portfolio Suitability:** Aggressive Growth.

We have initiated coverage of CyberDefender (CYDE) with a Buy rating and \$8.00 target price. CyberDefender is an emerging player in Internet security, a growth industry with a strong component of recurring revenue. CYDE's unique comprehensive security offering delivers cloud computing solutions to consumers and small businesses, combining security software with on-line remote technical support. The Company has built an impressive sales growth record. Gross sales receipts in 2009 were \$28.97 million (mm); we estimate gross sales of \$64.2mm in 2010 and \$104mm in 2011.

We have watched CYDE over the past 15 months and believe the Company is positioned to become a leader in the market for consumer online security and tech support. CYDE's marketing strategy is bolstered by a deep relationship with direct-response powerhouse Guthy-Renker Corp. and a strong customer service operation. Significant investment in 2009 and 2010 has bolstered its in-house call-center and technical support capabilities, and completed key additions to executive management. We estimate that CyberDefender can sustain double-digit sequential quarterly revenue growth through 2011, becoming cash flow positive in Q4 2010 and profitable in 2011.

Market Opportunity. According to International Data Corporation (IDC) the U.S. consumer market for after market computer products is expected to exceed \$28.6B in 2010. In addition, the market for "Digital home tech support services," totaled \$3.2B in 2008 and was estimated to reach \$6.4B by 2013 (Parks Associates).

Multiple Revenue Streams. CYDE is a provider of both software (antivirus, antispyware) and services (on-line technical support). CYDE's services segment (tech on call) has become the largest component of gross revenue. In Q2 Services revenue to new customers was 56% of gross sales, while Software and Renewals comprised 35% (the balance was from ancillary products and renewals).

Subscription Model creates Cash Flow & Recurring Revenue. CYDE sells its software and services typically on a 1 or 2-year license basis. The customer pays the full fee up front and then has use of the product or service for the length of the license. This boosts cash flow at the time of collection, and also creates the potential for renewal revenue upon license expiration. In Q2 renewals comprised 11% of gross revenue.

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Impressive Revenue Growth Potential. In 2009 CYDE reported gross revenue of \$28.9mm and GAAP revenue of \$26.0mm (the difference is deferred revenue and refunds). Due to successful marketing and higher conversion rates, revenue is expected to accelerate in future periods. We estimate 2010 gross revenue of \$64.2mm (+122%) and GAAP revenue of \$50.5mm (+94%). In 2011 we estimate gross revenue growth of 62% to \$104.0mm and GAAP revenue of \$83.7mm (+66%).

Attractive Financial Model. CyberDefender operates three high gross margin revenue segments; software (approximately 90% gross margin), services (50%-55%) and ancillary products (90% gross margin).

Strategic Advantage. In our opinion CyberDefender has established two key competitive advantages. The first is early mover status as a provider of remote tech support/computer repair to consumers. This is possible today through the high penetration of broadband Internet access into U.S. households. The second advantage is CYDE's leadership in marketing computer security and support using direct response consumer marketing. Through radio and television advertising, potential customers are prompted to contact CyberDefender by telephone or Internet (we assume that most consumers who contact the company likely have a computer problem). CYDE's marketing partner, GR Match (wholly owned by Guthy-Renker) is one of the world's pre-eminent direct response marketers, with over 22 years of experience regarding how and when to most effectively sell to consumers.

Estimates. We estimate that CyberDefender can generate 2010 gross sales receipts of \$64.2mm, an increase of 122% from 2009. We also estimate that GAAP revenue (gross receipts less change in deferred revenue and returns) can increase 168% this year to \$50.5mm. In addition, we estimate 2011 gross receipts of \$103.9mm (up 62%) and GAAP revenue of \$83.7mm (66%). We estimate that CYDE can sustain sequential quarterly revenue growth for the next several quarters based upon higher advertising expenditures, improved sales efficiency, and the contribution from sales renewals.

In Q3 (ending September 30, 2010) we estimate gross receipts of \$17.6mm and GAAP revenue \$14.0mm, representing sequential (from Q2) increases of 41% and 44%, respectively. Our Q3 estimate incorporates expectations for stronger second half growth (compared to the first half) as CYDE restructured call center operations in early 2010 to significantly increase its in-house and on-shore customer service representatives and technicians. The in-house call centers are more successful converting potential customers to paying customers, and also generate higher average revenue per user (ARPU).

We estimate that increasing revenue will support higher expenditures for advertising and SG&A expenses, although at a slower rate than sales. In our opinion, this will create significant operating leverage in future quarters. Based upon our Q3 and Q4 estimates for gross receipts operating income, we estimate a Q4 operating profit of \$1.1mm (after a small operating loss in Q3). We also estimate a small profit of \$0.02/share in Q4, although it could be Q1 2010 for EPS profitability. In 2011 we estimate operating profits and net income in each quarter, with full year earnings of \$0.18 per share.

Valuation. Our 12-month valuation range for CYDE is \$7.50 - \$8.70 per share, leading to a price target of \$8.00. As a high growth software and service provider with high gross margins, CYDE has focused on optimizing its revenue model and building its infrastructure to support more growth. Therefore, we believe it is appropriate to value the company based upon Enterprise Value multiples of current and future revenue. We have looked at other high growth software and service providers to compare relative revenue multiples.

For CYDE revenues we have used our estimated 2010 gross receipts and also GAAP revenue, as well as our estimated gross receipts and GAAP revenue for the next four quarters (Q3 & Q4 2010 and Q1 & Q2 2011). Our estimate for 2010 gross receipts and GAAP revenue is \$64.2mm and \$50.5, respectively. Our forward four quarter gross receipt and GAAP revenue estimate is \$88.2mm and \$69.9mm, respectively. We have used 40.6mm shares outstanding for valuation purchases, assuming conversion of outstanding warrants that will raise cash theoretically available for share repurchase (modified treasury stock method). In addition, we assume that debt and cash will be equal making Enterprise Value equal to Equity Value.

CYDE Revenue Multiples Valuation Matrix

Shares used for Valuation (mm) 40,570

	2010		Fwd 4 Qtrs	
Estimated Gross Receipts	64,238		88,241	
Multiple	5.0	6.0	4.0	5.0
Equity Valuation (mm)	321,191	385,429	352,962	441,203
Share price Valuation	\$7.92	\$9.50	\$8.70	\$10.88
Estimated GAAP Revenue	50,466		69,867	
Multiple	5.0	6.0	4.0	5.0
Equity Valuation	252,328	302,794	279,466	349,333
Share price Valuation	\$6.22	\$7.46	\$6.89	\$8.61

Discussion of “Comparables.” High growth software and remote service providers can trade at 5x-10x revenue as investors value the potential for sustained high revenue increases. As the companies mature the enterprise value to sales multiples decline, but remain high relative to the market due to high margins inherent in those business models. The table below looks at companies in several technology subsectors that either provide computer security, online services, or deliver software and services remotely (“from the cloud”), similar to CYDE’s delivery model.

Our group of seven security software providers range in valuation (using Enterprise Value to Revenue) from 1.8x for Symantec (SYMC, 14.17, not rated) to 6.7x for Arcsight (ARST, 37.25, not rated), with an average of 4.1x revenue. ARST provides enterprise class threat and fraud detection. Its higher relative valuation to SYMC is a function of much higher growth expectations as ARST is projected to maintain forward growth of 20%, compared to 10% for SYMC.

Cloud computing stocks have been among the market leaders in 2010. We view CYDE’s remote online tech support business as a classic cloud computing service. Customers receive immediate live support from a remote location. While the most successful cloud stocks this year are focused on the enterprise, and large data center customers, cloud solutions for consumers has become important as well. We took a small sample of five companies, which averaged an EV/sales valuation of 8.1x. The range was Rackspace Hosting (RAX, 20.38, not rated) at 3.9x sales, to VMware (VMW, 84.45, not rated) at 13.9x revenue.

Software as a service (SAAS) is another industry buzzword captivating investors. We define SAAS broadly to represent the delivery or use of a software or Internet service delivered remotely to the user’s desktop. We listed nine companies, the largest Salesforce.com (CRM, 119.72, not rated), which provides customer relationship software to businesses, and the smallest, Log me in (LOGM, 33.08, not rated), a provider of remote connectivity software. The average EV/sales multiple was 5.9x, ranging from 3.1x to 11.1x.

Our final grouping was companies providing on-line services to consumers and small businesses, which could include travel reservations through priceline.com (PCLN, 325.64, not rated) or outsourced printing services through Vistaprint (VPRT, 35.44, not rated). Those six stocks traded at an average EV/sales multiple of 3.8x, with a range of 1.4x to 5.9x.

In general the higher revenue multiples are assigned to the higher growth companies, and we listed estimated growth rates in the table. CYDE is a high growth company that started 2010 from a relatively low revenue base. Our estimated growth rate for gross receipts in 2010 is 121%, and 62% in 2011. The growth rate should slow as the revenue rates become larger, but we believe that CYDE can sustain growth of 25%-30% for the next several years. The tables also show P/E ratios for the four subsectors based upon First Call 2010 EPS estimates. The average 2010 P/E for all 26 stocks in the table was 46x. Given our outlook for CYDE to achieve EPS of \$0.18 in 2011, the P/E on that estimate is 20.7x.

CyberDefender Comps

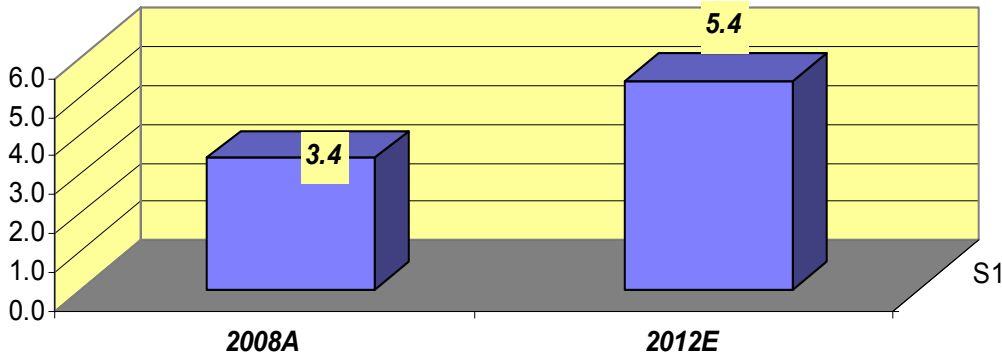
Software Security, Cloud Computing & Software, Consumer Services Over the Internet

Company	Ticker	Price	TTM Sales (mm)	Ent. Val	Ent.Val./ Sales	LT Grwth E	EPS 2010 E	P/E 2010E	
<u>Software</u>									
Symantec	SYMC	14.17	5,986	10,480	1.8	10%	1.31	10.8	
McAfee	MFE	47.00	2,003	6,552	3.3	13%	2.57	18.3	
Check Point	CHKP	34.26	975	6,273	6.4	10%	2.37	14.5	
Arcsight	ARST	37.25	181	1,218	6.7	20%	0.79	47.2	
Websense	WBSN	20.62	320	893	2.8	12%	1.19	17.3	
Source Fire	FIRE	28.20	119	681	5.7	25%	0.54	52.2	
Radiant Systems	RADS	17.87	315	675	2.1	15%	0.90	19.9	
					avg EV/sales	4.1	avg P/E		25.7
<u>Cloud Computing</u>									
VMware	VMW	84.45	2,406	33,333	13.9	20%	1.39	60.8	
Akamai	AKAM	50.76	930	9,230	9.9	15%	1.41	36.0	
Riverbed Tech	RVBD	41.36	453	2,802	6.2	21%	1.02	40.5	
Rackspace Hosting	RAX	20.38	698	2,726	3.9	25%	0.36	56.6	
Aruba Networks	ARUN	19.81	243	1,656	6.8	25%	0.50	39.6	
					avg EV/sales	8.1	avg P/E		46.7
<u>Software as a Service</u>									
SalesForce.com	CRM	119.72	1,378	15,343	11.1	25%	1.18	101.5	
Concur Tech	CTXS	63.84	1,724	11,262	6.5	14%	1.89	33.8	
Concur Tech	CNQR	48.63	280	2,246	8.0	25%	0.76	64.0	
Blackboard Inc	BBBB	34.70	407	1,229	3.0	20%	1.58	22.0	
Net Suite	N	19.90	176	1,165	6.6	25%	0.12	165.8	
Athena Health	ATHN	28.15	216	913	4.2	35%	0.51	55.2	
Logmein	LOGM	33.08	84	668	7.9	21%	0.74	44.7	
Rightnow	RNOW	18.16	166	507	3.1	28%	0.43	42.2	
Constant Contact	CTCT	18.13	152	404	2.7	38%	0.34	53.3	
					avg EV/sales	5.9	avg P/E		64.7
<u>Consumer/SMB-Focused On-line Services</u>									
Priceline.com	PCLN	325.64	2,624	15,405	5.9	18%	12.28	26.5	
WebMD Health	WBMD	50.97	481	2,763	5.7	25%	0.66	77.2	
Vistaprint	VPRT	35.44	641	1,453	2.3	20%	2.16	16.4	
Monster Worldwide	MWW	12.16	858	1,221	1.4	21%	(0.09)	n/a	
Dice Holding	DHX	7.04	110	465	4.2	31%	0.27	26.1	
Travelzoo	TZOO	21.62	104	325	3.1	n/a	0.58	37.3	
					avg EV/sales	3.8	avg P/E		36.7

source: Thomson Baseline, First Call

Market Opportunity - Software. Several independent market research firms have analyzed the cyber security market. According to International Data Corporation (IDC) the Consumer Security market totaled \$3.4B in 2008, and is expected to grow to \$5.4B in 2012 (a CAGR of 12.3%). In addition the 2008 market for Enterprise Security was \$2.9B, Backup and Recovery \$3.2B, and Online Backup \$0.8B. The Gartner Group estimated the total size of the U.S. security software market at \$14.5B (\$3.6B consumer). BCC Research estimated a global market for all forms of secure content management solution of \$58 billion.

“Consumer Security Market” (in \$Bil)

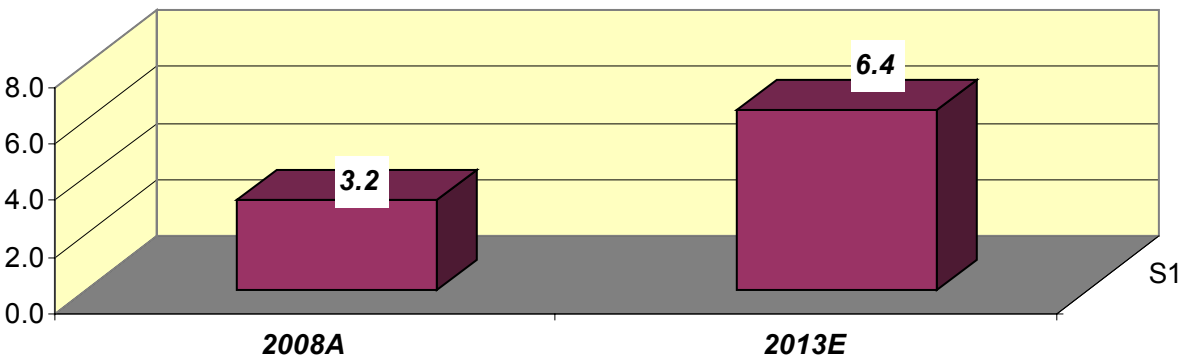


Source: IDC (International Data Corp)

Consumer use of the Internet has expanded the threat of viruses, spyware, and malware; jeopardizing personal privacy and causing reduced system performance. Semiconductor leader Intel (INTC, 17.90, Buy) estimates there are 238mm Internet users in the U.S., and that PCs per household will surpass 1.5 this year and 2.0 in 2013. Social networking site Facebook has 471mm registered users and Twitter has 71mm. Security competitor McAfee (MFE, 47, not rated) recently said that the first half of 2010 was the worst period ever for malware production and identified over 10 million new threats. In the June quarter, MFE posted software revenue of \$191mm in its consumer segment, an annual run rate of \$764mm. Market leader Symantec (SYMC, 14.17, not rated) showed consumer revenue of \$473mm, a \$1.9B annual run rate. On August 19 Intel agreed to acquire MFE for \$48 per share, which was a 60% premium to the current price.

Market Opportunity - Services. Dallas-based Parks Associates has identified a technical support segment it termed, “digital home tech support services.” Parks’ estimate for this digital home tech support market was \$3.2B in 2008, growing to \$6.4B in 2013. Services required by consumers include resolution of operating system problems, software issues, network configuration, and computer tune-ups. According to Parks, more than 28 million U.S. households needed tech support for home computers in 2008. Many of the malicious threats infecting personal computers cause software system changes that slow down computer systems, create hardware conflicts, and lead to other problems in home networks. Increasingly, U.S. consumers are using computer technicians to help solve these problems.

“Digital Home Tech Support Services” (in \$Bil)

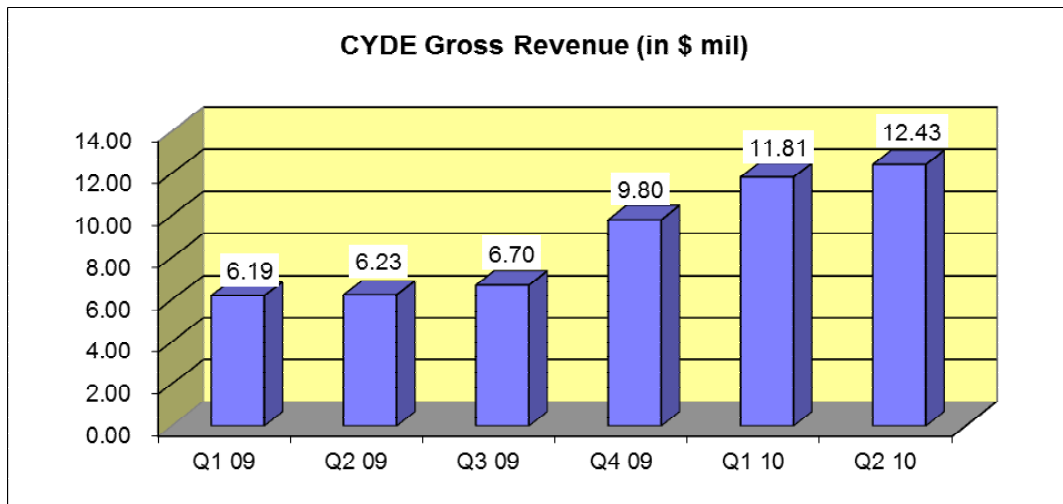


Source: Parks Associates

Service departments within retail stores or local shops, and/or technicians who make house calls, often provide tech support services. One of the most successful technical support companies to our knowledge is the Geek Squad, a wholly owned subsidiary of Best Buy (BBY, \$33.50, not rated). Best Buy does not report segment revenue for Geek Squad, but the 2008 book *Mavericks at Work*, estimated that Geek Squad posted at least \$1.0B in revenue in 2007. In news articles since then, Geek Squad revenue estimates have reached \$1.5B. Best Buy employs nearly 24,000 Geek Squad “agents” across its 1,200 U.S. stores. These technical service agents have met an important consumer need, as home-based electronics systems have become more complex and interconnected. We believe that many of these tech services are movable to the cloud, eliminating the need for a technician to be physically present.

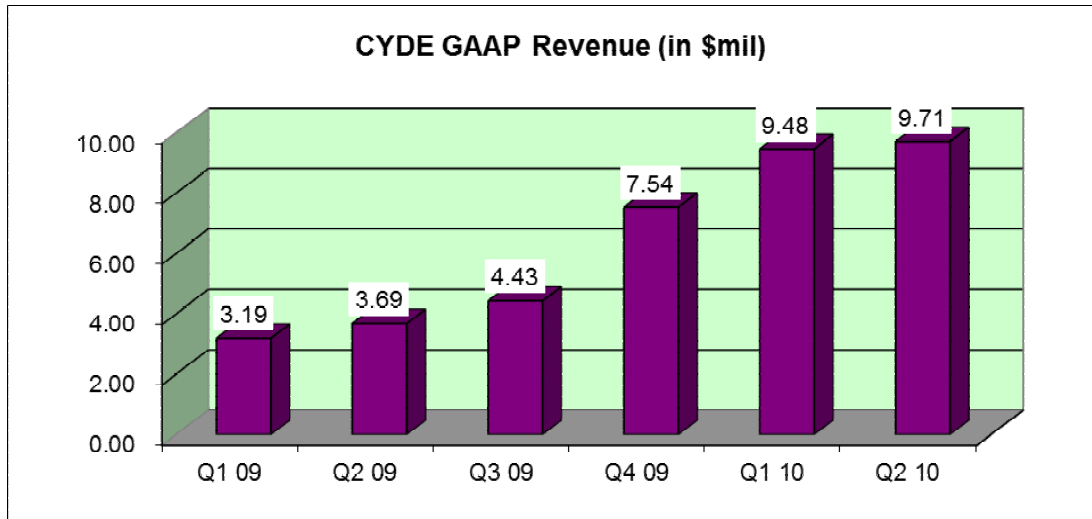
With the growth of high speed Internet access (broadband) many tech services can be delivered remotely, often with better results. In fact, many consumer services such as music and software downloads, bill pay, legal services, etc., are currently delivered on-line, as consumers are attracted to the immediate satisfaction made possible by broadband communications. Computer tech services can be delivered often in minutes compared to days or weeks when leaving one’s computer at a tech center or scheduling an appointment is required. We believe that CyberDefender is one of the first providers offering ongoing (subscription) tech support services directly to consumers on a 24/7 basis.

Recent Results. CYDE has reported a sequential increase in gross sales receipts for ten consecutive quarters. The past six quarters are shown in the chart below. In Q1 and Q2 2009 gross sales receipts totaled \$6.2mm, a \$24.8mm annual run rate. In the most recent quarter, Q2 2010, gross receipts were \$12.43mm, an annual run rate of \$49.7mm, a 100% increase over an 18 month period. Marketing efforts have led to more than 30,000 new subscribers monthly, and sales efficiencies and product improvements have led to average revenue per user of \$120, from \$80 one year ago.



Source: company SEC filings

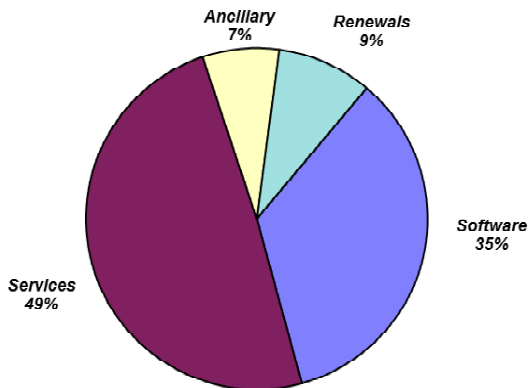
GAAP Revenue, which is Gross Sales Receipts less deferred revenue and refunds, also increased every quarter, reaching \$9.7mm in Q2 2010 (\$38.8mm run rate) vs. \$3.2mm (\$12.8mm run rate) in Q1 2009. In mid-2009 and 2010, quarterly revenue increased modestly for a couple of quarters, before resuming a stronger trajectory after significant corporate events. In late 2009, the growth rate accelerated due to expanded marketing programs under the partnership with Guthy-Renker. The growth spike in Q1 2010 was related to a more focused effort to introduce potential customers to the tech-on-call service. We believe that another round of accelerated growth is building in the second half of 2010, as efficiencies and restructuring in CYDE’s call centers have led to higher rates of customer conversion and sales of premium products.



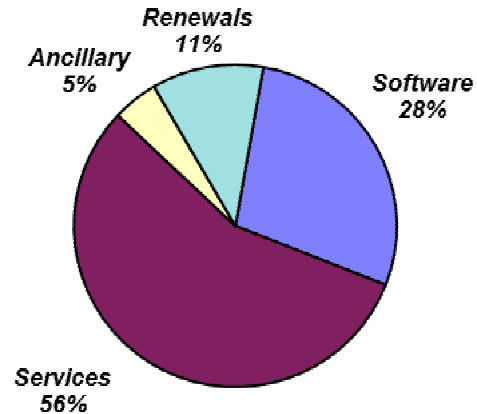
Over the same 18 month period deferred revenue increased to \$12.1mm from \$6.7mm, as new sales sold as a subscription are recognized over the length of the contract (typically 12-36 months). Most of the \$12.1mm of deferred revenue as of 6/30/10 will be recognized in GAAP revenue over the next four quarters.

Q2 2010 gross margin was 58.7%, down from 66.7% in Q1 and 77% in Q4 2009. This was a result of the growth in the services segment, which has a lower gross margin. While software sales carry a higher gross margin than services, the tech-on-call business typically generates more gross profit dollars because the revenue contribution per license is much greater. We estimate some gross margin improvement from levels of Q2 2010, but the range should remain below 70%.

Components of Gross Sales – Q1 2010



Components of Gross Sales – Q2 2010



Also in Q2 2010 CYDE reported an operating loss of \$2.45 million, and interest expense of \$2.4mm, leading to a net loss of \$4.9mm or $-\$0.19$ per share. CYDE has not been profitable, although Q4 2009 showed an operating profit. In 2010 the Company has made several investments to support its call center infrastructure, product development, and senior management team. The Company has put in place, we believe, the necessary infrastructure to sustain revenue growth in excess of 25% going forward (our growth projections are substantially above that rate in 2010 and 2011).

Marketing Model. CyberDefender markets its products using television and radio advertising (offline), and paid Internet search (online). In a typical commercial a character discusses a computer problem, such as a system that runs slower than expected or has become sluggish. The ad prompts the potential customer to a web address (URL) that takes them to CyberDefender. CYDE and Guthy-Renker have used several different URLs to test market demand. The most successful URLs to-date are MyCleanPC.com, DoubleMySpeed.com, and MaxMySpeed.com.

Once on the CyberDefender site, the consumer is offered a range of options including, 1) running a free diagnostic program that analyzes viruses, spam, and malware, 2) downloading CyberDefender's software solutions (such as anti-spyware and anti-virus protection), and 3) talking to a live person. Once the potential customer asks for a live discussion the CYDE sales rep will market the Company's service offerings, 24/7 live technical support. CYDE's services generally receive a high degree of satisfaction, as customers typically purchase the tech-on-call package to fix an existing computer problem. The CYDE solution permits an immediate solution and ongoing future protection.

Converting Media Dollars into Revenue. CYDE runs commercials on radio and television on several networks/stations at all times of the day. Internet advertising is based upon paid-search, where a user searches for certain key words and Cyber has paid to have its information displayed near the top of the list. CYDE then pays the search provider a fee for the display and more if the consumer clicks through to a CYDE website. The consumer then is offered CYDE's products once they are on the site. In addition, CyberDefender is paid to link to other services as well. For instance, Microsoft (MSFT, 23.93, Buy) pays CYDE a fee if a customer on the CYDE site agrees to download the Bing search toolbar to their desktop.

CYDE's most successful advertising however, has been the radio and television commercials, which is a key advantage of the company's relationship with Guthy-Renker. The use of different URLs enables CYDE to track the effectiveness of different ads, networks and airing times. This is a skill; an ongoing process refined and optimized by Guthy-Renker, and is critical to maximize the success of radio and television advertising. In August this year, CYDE began running some commercials using the CyberDefender brand name.

Guthy-Renker LLC Relationship. GR Match (GRM), a subsidiary of Guthy-Renker, has been a partner and investor of CYDE since 2008, when GRM signed a letter of intent to create and test direct response radio advertisements for CyberDefender's products. GRM has made several investments since that time, paying a higher price at each round. By our calculations, on a fully diluted basis GRM could own 12.6mm shares of CYDE, approximately 27% of the shares outstanding.

Initially GRM received a warrant to purchase 1.0mm shares of CYDE at \$1.25/share. In March 2009, GRM signed an agreement to provide direct response radio and television commercials, and purchase media time for CYDE. The consideration included an additional 9.0mm warrants at \$1.25, with 8.0mm earned by providing media time (each \$2 in media time earns 1 warrant). In June 2009 GRM invested \$2.0mm for 1.14mm common shares (\$1.75/share), and in March 2010 CYDE issued GRM a \$5.3mm private placement in the form of a 9% convertible note. The shares are convertible to common stock at \$3.50 (approximately 1.5mm shares).

In April 2010 CYDE and GRM entered into a license agreement giving GRM an exclusive royalty-bearing license to market and distribute CYDE products through retail outlets and television shopping channels in the U.S. and through most distribution channels in 28 international countries. GRM will pay royalties to CYDE based upon gross revenue. This agreement will allow CYDE to faster penetrate international markets without raising substantial capital, and leverages Guthy-Renker's international experience and strong marketing presence. Our model assumes no contribution from the international license, although operations are expected to commence in early 2011. We will wait for data points from that business prior to adding it to our model.

Guthy-Renker is privately owned and based in Santa Monica, California. We believe that Guthy-Renker is the #1 U.S. provider of direct response marketing (infomercials, radio and television ads), with annual revenue above \$1.5B. As part of its business, GR pre-buys millions of dollars of television and radio advertising spots each year, inventory that is made available to CYDE. The CYDE-GRM agreement includes one GRM appointed CYDE Board Member, currently held by Guthy-Renker's CEO, Ben Van de Bunt.

Products. Software. CyberDefender's two most popular software titles are, Early Detection Center Anti-Malware (anti-virus/anti-spyware) software (\$29.99 for an annual license), and Registry Cleaner/PC Optimization (also \$29.99). In 2010 CYDE offered a new product, SafeCentral Secure Browser for \$29.99 annually. CYDE also markets "Anti-Spyware for Dummies" (\$29.99) under license from Wiley Publishing. The For Dummies product is being upgraded to include a full range of Malware protection and Registry Cleaner solutions. The new For Dummies product is expected in early 2011.

Services. CyberDefender's core service offering is Live Help Desk (24/7 Tech Support), sold for \$229.99 for one year of protection on one computer that includes live remote tech support for any PC problem. That price generally includes the Anti-Malware software and will include the PC Optimization software for an additional \$10. CYDE also sells an Identity Theft Protection service for \$19.99 per month. For \$299.99 the Live Tech Support product is extended to up to 5 home computers and discounts are offered for licenses covering 2, 3, or 5 years. Typical 24/7 services provided are malware removal, speed optimization, software updates, file back-up, and hardware troubleshooting.

Occasionally CYDE technicians identify a severe computer problem beyond the limits of a remote solution. In that case the customer is fully refunded. Typically, customers are protected by a 30-day rescission period for refunds.



Software Technology. CYDE's anti-malware solution utilizes proprietary technology named the Argus Network. The Network functions as a peer-to-peer collaborative security platform. Customer computers become part of the network and function as both client and server. When a threat is detected on any computer the threat is sent to CYDE's Early Alert center, where it is analyzed and neutralized and sent to an Alert Server. The Alert Server then sends the information to network computers, which then also notifies additional computers on the network. This process enables rapid distribution of threat protection, and requires much less bandwidth than would be necessary for a central server-based distribution system. In addition, the collaborative network makes the system extremely scalable, supporting growth in subscribers and software.

Tech-on-Call. The threat of spyware, viruses, phishing scams, and other intrusions has intensified as consumers use multiple devices connected to broadband networks. Many consumers subscribe to more than one security software program to increase protection. In addition to the threat of viruses and spyware, other, user approved computer changes, (such as software downloads, hardware additions, and social networking sites) can alter computer registry files, and hurt computer performance (reduced speed, high frequency of error messages). CyberDefender offers consumers a unique comprehensive solution of combining passive threat detection software with active live tech support that can optimize system performance on-line, from a remote location. Cyber markets the combined package as its optimal solution, but software and services can also be purchased separately under single year and multi-year licenses.

Call Center Operations. CYDE uses more than 430 trained agents in the U.S. and overseas, some are in-house Cyber employees and some are outsourced through third parties. The company-owned call center in Los Angeles is the largest operation, employing 225 agents. Another 125 agents are provided by a third party in Syracuse, New York, and CYDE uses outsourced customer service reps in India and Singapore. Call centers provide a range of services including sales, technical support, and customer service, with trained agents dedicated to each function. State of the art technology is used to manage the call centers, maximizing service levels and labor efficiency. CYDE believes that all of the functions are more effectively managed from a dedicated call center, as opposed to some competitors who use remote technical support people working from their homes.

In late 2009 CYDE determined that sales and service representatives working from in-house and/or on-shore call center operations were more effective than the external, outsourced counterparts. The Company decided to transition to an in-house dominated model in 2010. The transition involved expanding the company-owned call center in Los Angeles, finding a reliable domestic call-center partner (ultimately located in New York), expanding its call center management team, and upgrading software and systems (upgraded CRM and call routing software) to make the in-house operations state of the art. Each of these initiatives was largely completed in the first half of the year (although ongoing improvement continues) and early results are promising. When reporting Q2 results Company management indicated the migration to on-shore call centers delivered improved customer service, leading to higher conversion rates and shorter talk times, driving higher sales and higher sales dollars per customer.

As noted above, Q2 ended with approximately 430 call center agents, compared to approximately 600 at the end of Q1. The improved efficiency was evident in reported revenue as Q2 gross receipts totaled \$12.4mm, up from \$11.8mm in Q1. We estimate continued efficiencies in Q3, as our gross receipts estimate is \$17.6mm.

Balance Sheet and Finances. As of August 11, 2010 CYDE had 27.0mm common shares outstanding. However, an additional 18mm shares were reserved for warrants attached to prior financings and the media services agreement with Guthy-Renker Corp. If all warrants were exercised CYDE would raise more than \$22.5mm in cash. For valuation purposes we have used 40.6mm shares.

As of 6/10/10 CYDE held cash balances of \$6.9mm and had long-term debt of \$4.2mm (in the form of a 9% convertible note, convertible to common equity at \$3.50/share). Total Assets of \$18.6mm included the cash and \$9.3mm of Deferred Charges, comprised most of media expenditures already made, that will be recognized in future periods. Total Liabilities were \$24.5mm, including \$12.1mm of Deferred Revenue, to be recognized in future periods. CYDE has been making investments in marketing and call center infrastructure, creating a platform for growth that is expected to generate positive cash flow and profitability in 2011.

Background and Management. Current CEO Gary Guseinov founded CYDE in August 2003. The Company began selling one product, CyberDefender Anti-spyware, which was expanded to a suite of security products, CyberDefender Early Detection Center and CyberDefender FREE in 2006. In 2007 CyberDefender went public through an S2 filing, and on June 9, 2010 CYDE commenced trading on the NASDAQ Global Market.

In February 2009, current Chief Financial Officer, Kevin Harris joined the Company. Mr. Harris is a licensed CPA and a former accountant with KPMG, and has extensive experience as an operations and accounting executive with several operating companies.

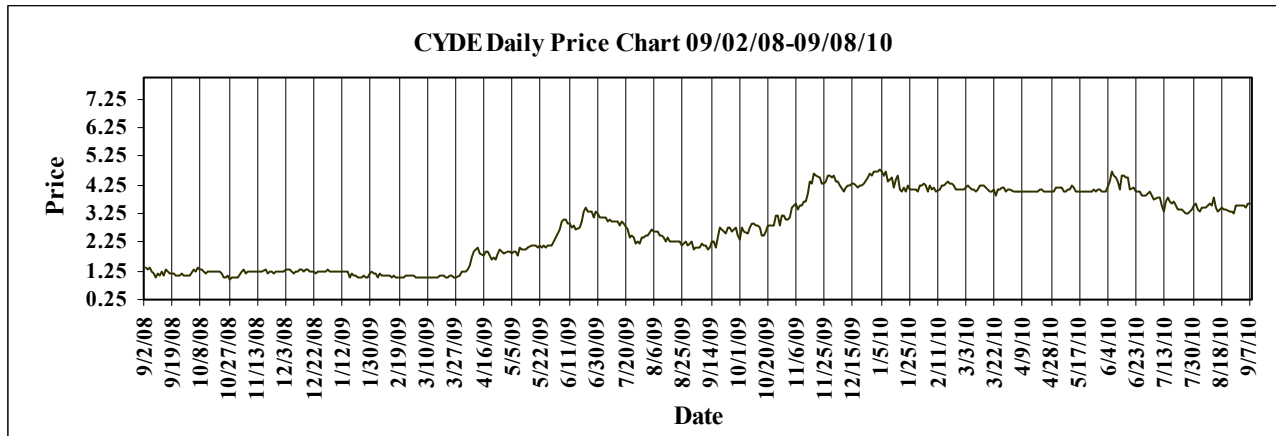
In early 2010, the Company made several key executive appointments, including Vice Presidents of Product Development, Operations, and Call Center Operations. In addition, the Board of Directors was expanded to increase independence and expand industry expertise. New Board members include a former VP of program development with Nutrisystems, a former IBM eCommerce Chief Strategist, a former CEO of iLIANT Corp, a healthcare IT firm, and a former CFO of five publicly traded silicon valley companies.

	Q109	Q209	Q309	Q409	Year 09	Q110	Q210	Q310	Q410	Year 10	Q111	Q211	Q311	Q411	Year 11
	Mar	Jun	Sep	Dec		Mar	Jun	Sep	Dec		Mar	Jun	Sep	Dec	
Revenue Detail															
Gross Sales	6,191	6,231	6,742	9,808	28,972	11,813	12,429	17,580	22,417	64,238	23,366	24,878	26,828	28,872	103,945
Refunds/Chargebacks	(865)	(1,119)				(1,495)	(2,255)	(2,122)	(2,613)	(8,485)	(2,699)	(2,875)	(2,978)	(3,210)	(11,762)
Change in Deferred Rev (incr)	(2,134)	(1,428)				(841)	(462)	(1,473)	(2,512)	(5,287)	(2,084)	(1,995)	(2,153)	(2,240)	(8,472)
GAAP Revenue	3,192	3,686	4,427	7,536	18,841	9,477	9,713	13,984	17,292	50,466	18,583	20,008	21,698	23,422	83,710
Income Statement															
Net Sales (GAAP Rev)	3,191.6	3,686.6	4,427.4	7,536.2	18,841.9	9,477.3	9,712.6	13,984.4	17,291.6	50,465.9	18,582.9	20,007.7	21,698.0	23,421.7	83,710.3
Cost of Sales	679.7	753.3	1,018.4	1,731.1	4,182.5	3,155.1	4,013.8	4,221.5	5,168.8	16,559.1	5,534.9	5,978.0	6,525.8	6,968.0	25,006.8
Gross Profit	2,511.9	2,933.3	3,409.0	5,805.2	14,659.4	6,322.3	5,698.8	9,762.9	12,122.7	33,906.7	13,048.0	14,029.7	15,172.2	16,453.7	58,703.5
Advertising	3,743.7	3,408.3	3,545.1	2,384.4	13,081.5	3,067.9	3,407.2	4,640.0	5,675.0	16,790.1	6,338.0	7,081.4	7,674.5	8,147.2	29,241.1
Product Development	299.7	365.5	464.8	721.9	1,851.9	752.1	963.4	839.1	812.7	3,367.3	799.1	780.3	770.3	749.5	3,099.1
SG&A Expense	1,251.6	1,566.0	1,612.3	2,136.8	6,566.7	2,877.2	3,722.4	4,265.2	4,495.8	15,360.6	4,552.8	4,621.8	4,665.1	4,684.3	18,524.0
Investor Relations/consult	1,220.0	1,346.2	490.3	147.3	3,203.8	165.1	0.0	0.0	0.0	165.1	0.0	0.0	0.0	0.0	0.0
Dep/Amort	10.3	9.8	9.0	8.0	37.1	20.2	54.9	42.0	51.9	169.0	55.7	58.0	60.8	63.2	237.8
Other Op Expense															
Total Operating Exp.	6,525.3	6,695.8	6,121.5	5,398.4	24,741.0	6,882.5	8,147.9	9,786.3	11,035.4	35,852.1	11,745.6	12,541.5	13,170.6	13,644.3	51,102.0
Operating Income	(4,013.4)	(3,762.5)	(2,712.5)	406.7	(10,081.6)	(560.2)	(2,449.1)	(23.3)	1,087.4	(1,945.3)	1,302.4	1,488.1	2,001.6	2,809.4	7,601.5
Derivative Sec Valuation	109.1														
Loss on Registr. Rights															
Interest Expense	(912.5)	(1,052.9)	(843.2)	(921.3)	(3,729.9)	(1,320.5)	(2,447)	(1,743)	(403)	(5,913.3)	(119)	(119)	(119)	(119)	(477.0)
Interest Income		0.0	0.1												
Pretax Income	(4,816.9)	(4,815.4)	(3,555.6)	(514.6)	(13,811.5)	(1,880.7)	(4,895.7)	(1,766.6)	684.4	(7,858.7)	1,183.1	1,368.9	1,882.3	2,690.1	7,124.5
Income Taxes (credit)	(0.2)	(0.2)	(0.2)	(0.2)	(0.2)	(0.2)	(0.2)	(0.2)	(0.2)	(0.2)	(0.2)	(0.2)	(0.2)	(0.2)	(0.2)
Net Income	(4,817.1)	(4,815.6)	(3,555.8)	(514.8)	(13,811.7)	(1,880.9)	(4,895.9)	(1,766.8)	684.2	(7,858.9)	1,182.9	1,368.7	1,882.1	2,689.9	7,124.3
Diluted EPS	(\$0.27)	(\$0.24)	(\$0.15)	(\$0.02)	(\$0.64)	(\$0.07)	(\$0.19)	(\$0.07)	\$0.02	(\$0.30)	\$0.03	\$0.03	\$0.05	\$0.07	\$0.18
WA Shares	17,991	20,392	23,620	24,459	21,616	25,758	26,427	26,927	27,427	26,635	38,327	39,260	39,760	40,570	39,479
Components of GAAP Revenue															
Rev from Prod Sales	1,700	2,000			3,700	4,400	3,600	6,192	7,615	21,807	7,579	8,121	8,717	9,658	34,074
Rev from Services	900	1,100			2,000	4,000	4,900	7,192	9,037	25,129	10,130	10,971	12,044	12,806	45,951
Rev from Other Sources	592	300			892	1,077	1,000	600	640	3,317	874	916	937	958	3,685
Components of Gross Receipts															
Software Revenue	6,191	6,231	6,742	9,808	28,972	11,813	12,429	17,580	22,417	64,238	23,366	24,878	26,828	28,872	103,945
Services Revenue	2,475	2,501	2,666	4,402		4,092	3,504	4,615	5,520	17,731	5,962	6,379	6,698	7,033	26,071
Ancillary Revenue	2,646	2,679	2,916	3,706		5,802	6,967	10,529	13,600	36,898	14,688	15,716	17,113	17,969	65,486
Renewals Revenue	606	584	461	983		856	569	600	640		874	916	937	958	
Expense and Revenue %															
Gross Profit % of GAAP Rev	78.7%	79.6%	77.0%	77.0%	77.8%	66.7%	58.7%	69.8%	70.1%	67.2%	70.2%	70.1%	69.9%	70.2%	70.1%
Advertising as % Rev	117.3%	92.5%	80.1%	31.6%	69.4%	32.4%	35.1%	33.2%	32.8%	33.3%	34.1%	35.4%	35.4%	34.8%	34.9%
Product Development % Rev	9.4%	9.9%	10.5%	9.6%	9.8%	7.9%	9.9%	6.0%	4.7%	6.7%	4.3%	3.9%	3.6%	3.2%	3.7%
SG&A Expense % Rev	39.2%	42.5%	36.4%	28.4%	34.9%	30.4%	38.3%	30.5%	26.0%	30.4%	24.5%	23.1%	21.5%	20.0%	22.1%
Investor Relations % Rev	38.2%	36.5%	11.1%	2.0%	17.0%	1.7%	0.0%	0.0%	0.0%	0.3%	0.0%	0.0%	0.0%	0.0%	0.0%
Dep/Amort as % Rev	0.3%	0.3%	0.2%	0.1%	0.2%	0.2%	0.6%	0.3%	0.3%	0.3%	0.3%	0.3%	0.3%	0.3%	0.3%
Other Op Expense															
Total Oper Exp. As % Rev	204.5%	181.6%	138.3%	71.6%	131.3%	72.6%	83.9%	70.0%	63.8%	71.0%	63.2%	62.7%	60.7%	58.3%	61.0%
Operating Margin	-125.7%	-102.1%	-61.3%	5.4%	-53.5%	-5.9%	-25.2%	-0.2%	6.3%	-3.9%	7.0%	7.4%	9.2%	12.0%	9.1%
Interest Exp. As % of Rev	-28.6%	-28.6%	-19.0%	-12.2%	-19.8%	-13.9%	-25.2%	-12.5%	-2.3%	-11.7%	-0.6%	-0.6%	-0.5%	-0.5%	-0.6%
Pretax Income as % Rev.	-150.9%	-130.6%	-80.3%	-6.8%	-73.3%	-19.8%	-50.4%	-12.6%	4.0%	-15.6%	6.4%	6.8%	8.7%	11.5%	8.5%
Ad Exp as % of Gross Receipts															
Prod Develop as % GR	4.8%	5.9%	6.9%	7.4%	6.4%	6.4%	7.8%	4.8%	3.6%	5.2%	3.4%	3.1%	2.9%	2.6%	3.0%
SG&A Exp as % GR	20.2%	25.1%	23.9%	21.8%	22.7%	24.4%	29.9%	24.3%	20.1%	23.9%	19.5%	18.6%	17.4%	16.2%	17.8%
Cash Flow-EBITDA															
Operating Income						(560.2)	(2,449.1)	(23.3)	1,087.4	(1,945)	1,302.4	1,488.1	2,001.6	2,809.4	7,602
Dep/Amort						20.2	54.9	42.0	51.9	169	55.7	58.0	60.8	63.2	238
Stock Comp						91.4	298.9	174.8	216.1	781	232.3	250.1	271.2	292.8	1,046
Add Change in Def Rev						841.0	461.4	1,473.0	2,511.8	5,287	2,084.2	1,994.9	2,152.9	2,240.2	8,472
less Change in Def Charges						(1,715.5)	(1,341.9)	(1,360.0)	(1,225.0)	(5,642)	(1,114.0)	(892.2)	(697.8)	(643.7)	(3,348)
Other															
Adjusted EBITDA						(1,323.1)	(2,975.8)	306.5	2,642.2	(1,350)	2,560.6	2,898.9	3,788.7	4,761.9	14,010

Disclosure Section

References to Past Performance Are Not An Indicator Of Future Potential Returns

I, James Ragan certify that the views expressed in this note/report accurately reflect my personal views and that no part of my compensation was or will be directly or indirectly related to any recommendations.



Ratings History: 9/9/10 (\$3.73) Initiate Buy.Price target \$8.

Risks to Achieving Target Price

1. CYDE should be considered a high-risk, emerging growth investment. Prior to 6/9/10 the shares traded on the OTCBB.
2. CYDE has not been profitable in its history. The company will likely access the capital markets to support its growth outlook.
3. CYDE operates in a highly competitive industry against several well-capitalized competitors. Its products and services could be duplicated, leading to price competition and/or loss of market share.

Crowell, Weedon & Co. makes a market in CYDE

Ratings Key: **Buy/Add:** Buy new positions or Add to existing portfolio positions. We believe the security's 12-18 month reward-to-risk profile is **attractive**. Security appears **under valued** based on our analysis. **Hold/Neutral:** We believe that the security has strong attributes, but **concerns exist** that offset the conviction of a Buy/Add and Sell/Reduce opinion. Security appears **fairly valued** based on our analysis. **Sell/Reduce:** Sell positions or Reduce exposure to portfolio positions. We believe the security's 12-18 month reward-to-risk profile is **unattractive**. Security appears **over valued** based on our analysis.

Department	#	%	Growth	%	Income	%
Total Buys	43	83%	35	85%	8	73%
Total Holds	8	15%	5	12%	3	27%
Total Sells	1	2%	1	2%	0	0%
Total Companies	52	100%	41	100%	11	100%
As of:	9/9/2010					

Distribution of recommendations

Partners of and/or the firm of Crowell, Weedon & Co. in the normal course of business have a position in all of the securities mentioned in this report

The analyst who prepared this report owns CYDE, INTC and MSFT shares.