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CERTICOM

(CIC.TO C\$2.28) Rating: Buy

Price Target	C\$4.20	Shares Outstanding (MM)	43.7
52 Week Range	C\$0.60 -C\$2.70	Enterprise Value (MM)	C\$41.5
P/E Ratio	NA	Beta	1.6
EV / Sales	1.9	Average Volume	184,000
Cash Per Share	\$0.75	Insider Holdings	8.0%
Book Value	C\$3.00	Institutional Ownership	45.0%

Company description: Certicom provides next generation cryptography solutions for software vendors and device manufacturers to embed security in their products primarily in North America and Asia. The company offers its products and services based on its elliptic curve cryptography (ECC) technology for public key infrastructure implementations, device security, anti-counterfeiting, product authentication, and fixed-mobile convergence. Customers include government agencies, mobile device manufacturers, gambling systems, smart cards, utility meter readers, etc.

Investment Update

Verisign has offered C\$2.10 per share (C\$92 million) for Certicom. The offer represents a 40% premium over RIM's bid.

RIM's bid and the subsequent action by Certicom's board have put the company in play. Shares are currently trading at an 8% premium to Verisign's offer, which leads us to believe that a higher offer will materialize.

Recent acquisitions of companies comparable to Certicom were valued at a median transaction price of 3.0 times the previous 12 months revenue. Verisign's bid is 1.5 times trailing revenues and RIM's bid was just 1.1 times trailing revenues.

Certicom's portfolio of over 400 ECC related patents is highly desirable to numerous technology companies. ECC technology is especially well suited for encrypting mobile communications. Prior to RIM's bid, shares of Certicom had reached a six year low amid the global sell-off in stocks.

EPS		2008A	2009E (old)	2009E (new)
Q1	July	\$(0.08)A	\$(0.08)A	\$(0.08)A
Q2	Oct	(0.06)A	(0.08)E	(0.06)A
Q3	Jan	(0.00)A	(0.04)E	(0.03)E
Q4	April	(0.09)A	(0.08)E	(0.07)E
Year (April)		\$(0.24)A	\$(0.28)E	\$(0.23)E

Revenue \$ MM		2008A	2009E (old)	2009E (new)
Q1	July	\$3.20A	\$4.20A	\$4.20A
Q2	Oct	3.80A	5.10E	6.62A
Q3	Jan	6.08A	6.55E	6.70E
Q4	April	3.53A	3.00E	3.10E
Year (April)		\$16.61A	\$18.85A	\$20.62E



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INVESTMENT OVERVIEW

Certicom's is the leader in elliptical-curve-cryptography (ECC). In addition to the US Government, the company's encryption technology has been licensed by many leading companies, including IBM, Motorola, Oracle, Qualcomm, Research In Motion, and Texas Instruments.

Certicom is a pioneer in researching and developing ECC. The company holds over 400 patents pending and filed. ECC is a computationally efficient form of cryptography that offers equivalent security to other competing public-key technologies but with much smaller key sizes. Because of its efficient size, it is especially well suited for mobile devices that require long battery life. Because of its strength and efficiency, and compliance with government and commercial standards, a growing number of security conscious organizations are implementing ECC.

Incremental verification cost of ECDSA certificates vs. RSA certificates

- RSA: public exponent $e = 2^{16} + 1$
- ECDSA: NIST prime curves
- Platform: HP iPAQ 3950, Intel PXA250 processor 400 MHz)

Security Level (bits)	Certificate size ¹ (bytes)		Ratio ECC/RSA certificates	Verify – incremental cost (ms)			Ratio ECDSA verify vs. RSA verify
	ECDSA	RSA		RSA ²	ECDSA		
					ordinary ²	combined ³	
80	72	256	4x smaller	1.4	4.0	1.7	0.8x smaller
112	84	512	6x smaller	5.2	7.7	3.2	1.6x smaller
128	96	768	8x smaller	11.0	11.8	4.9	2.2x smaller
192	144	1920	13x smaller	65.8	32.9	13.7	4.8x smaller
256	198	3840	19x smaller	285.0	73.2	30.5	9.3x smaller

¹Excluding (fixed) overhead of identification data ²Certicom Security Builder ³Estimate

Despite the great technology, Certicom's licensing revenues have not reached a point where the company attains consistent profitability. Revenues peaked in fiscal 2007.

In July of 2007, the company named Karna Gupta as CEO. He was previously a senior executive with Comverse Technologies and Bell Canada. Gupta quickly moved Certicom's strategy more towards product development with customers which helped the company sign the multi-million dollar license deal with IBM in 2008. Despite traction with the new business model and expansion of verticals markets, shares of Certicom got caught up in the global meltdown in equities.

SHARES ARE NOW IN PLAY

We believe that RIM's bid and subsequent action by Certicom's board have put the company in play. We expect a higher offer than Verisign's to materialize.

Certicom has established a data room to provide confidential information to bona fide interested parties and has signed non-disclosure and standstill agreements with a number of companies, including EMC, IBM, and Qualcomm.

On December 3rd, Research In Motion offered C\$1.50 per share (C\$66 million) for Certicom. Certicom's board recommended against the offer to shareholders, saying the figure undervalued the company's technology assets.

In response to RIM's offer, Certicom formed a special Board committee and hired a financial advisor (Toronto Dominion) to evaluate RIM's offer, solicit other proposals and make a recommendation to the full Board of Directors.

On December 22nd, Certicom requested an injunction to block RIM's offer on grounds that it breached non-disclosure agreements by using confidential and proprietary information supplied by Certicom to RIM during previous deal talks between the two companies. On January 21st, the Ontario Superior Court of Justice granted Certicom an injunction and RIM withdrew its offer.

Last Friday, January 23rd, Certicom agreed to a C\$2.10 per share offer, (C\$92 million) from VeriSign. When you take out Certicom's existing cash, VeriSign will be paying only \$40 million. The offer represents a 40% premium over RIM's bid. As a diversified provider of Internet infrastructure services and secure SSL certificates, we see VeriSign as a better fit for Certicom than RIM is.

RIM could make a higher offer. The two companies have been in deal discussions since 2007. As a Canadian company, RIM is better suited to use Certicom's tax losses than Verisign is.

VALUATION

Certicom Board's financial advisor, TD Securities, reviewed recent acquisitions of companies comparable to Certicom and found the median transaction price was 3.0 times the previous 12 months revenue. Verisign's bid is just over 1.5 times trailing revenues and RIM's bid was 1.1 times the prior 12 months' revenue.

Our revised price target of C\$4.20 is equal to 3.0 times the previous four quarters revenues.

As a profitable Canadian company, RIM is better suited to use Certicom's tax losses than Verisign is. We estimate these tax losses to be about C\$.80 per share in value.

2Q OVERVIEW

Certicom reported better than expected FQ2/09 results. Revenue was \$6.6 million, up 74.3% year over year. This includes \$0.5 million from new licensee IBM. Consensus estimates were \$4.5 million. EPS of \$0.00 (-\$0.06 GAPP) was above consensus of (\$0.06)

Operating expenses were \$5.9 million excluding cost of sales and legal. Additional expenses from Sony litigation were \$1.8 million.

Cash flow continues to be negative. Free cash flow for the quarter was (\$4.2 million). Total cash at the end of the quarter was \$33.3 million versus \$37.6 million at the end of FQ1/09.

LITIGATION UPDATE

In June of 2007, Certicom sued Sony for patent infringement of content protection technologies. The allegedly infringing products include Sony's PlayStation 3 game console, Vaio computer and Blu-Ray DVD technologies, as well as some of the company's TV models and audio systems.

In its suit, Certicom alleged that Sony's use of the Advanced Access Content System (AACs) and Digital Transmission Content Protection (DTCP) technologies violated two patents related to the use of digital signatures on smart cards and a strengthened public-key protocol.

In 2003, the National Security Agency, paid Certicom \$25 million for nonexclusive worldwide license rights to 26 of Certicom's elliptic curve cryptography (ECC) patents, including the two named in the lawsuit against Sony.

Certicom has not disclosed specific financial damages that it is seeking in its lawsuit against Sony. More information on this should be available during the Markman hearing, which is scheduled for June 11th. The trial is scheduled to begin September 8th in the U.S. District Court in Marshall, Texas. We expect Certicom to spend approximately \$10 million in legal expenses over the course of the lawsuit.

Certicom's law firm in the Sony litigation is Ropes & Gray. Transmeta employed Ropes & Gray when it sued Intel for patent infringement. In October of 2007, the two companies settled for \$250 million before the trial started.

Certicom

Income Statement, \$US (millions)

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Product and Intellectual Property

Service

Revenue

Cost of Revenue

Gross Profit

Gross Profit Margin

Operating Expenses

Research and Development

Sales and Marketing

General and Administrative

Amortization of Patents

Other, Net

Operating Income

Operating Margin

Interest Income (Expense)

Earnings Before Tax

Income Tax (Benefit)

Tax %

Net Income

Net Income Margin

Diluted Shares

EPS

	FY2007		1Q-2008		2Q-2008		3Q-2008		4Q-2008		FY2008		1Q-2009		2Q-2009		3Q-2009E		4Q-2009E		FY2009E		
			July	Oct	Jan	April	July	Oct	Jan	April	July	Oct	Jan	April	July	Oct	Jan	April	July	Oct	Jan	April	
	14.63		2.02	1.64	4.13	2.04	9.83				2.35	4.97	5.00	2.10	2.35	4.97	5.00	2.10	2.35	4.97	5.00	2.10	14.42
	6.72		1.19	2.16	1.95	1.49	6.78				1.85	1.65	1.70	1.00	1.85	1.65	1.70	1.00	1.85	1.65	1.70	1.00	6.20
	\$ 21.35		\$ 3.21	\$ 3.80	\$ 6.08	\$ 3.53	\$ 16.62				\$ 4.20	\$ 6.62	\$ 6.70	\$ 3.10	\$ 4.20	\$ 6.62	\$ 6.70	\$ 3.10	\$ 4.20	\$ 6.62	\$ 6.70	\$ 3.10	\$ 20.61
	2.82		0.62	1.00	0.83	0.88	3.32				0.79	0.94	0.94	0.45	0.79	0.94	0.94	0.45	0.79	0.94	0.94	0.45	3.12
	18.53		2.59	2.80	5.25	2.65	13.30				3.41	5.68	5.76	2.65	3.41	5.68	5.76	2.65	3.41	5.68	5.76	2.65	17.49
	86.8%		80.7%	73.7%	86.4%	75.2%	80.0%				81.2%	85.8%	86.0%	85.5%	81.2%	85.8%	86.0%	85.5%	81.2%	85.8%	86.0%	85.5%	84.9%
	6.21		1.85	1.56	1.75	1.80	6.96				2.00	2.07	1.80	1.90	2.00	2.07	1.80	1.90	2.00	2.07	1.80	1.90	7.77
	9.21		2.20	1.80	1.96	1.74	7.69				2.12	2.77	2.20	1.80	2.12	2.77	2.20	1.80	2.12	2.77	2.20	1.80	8.89
	4.69		1.62	1.69	1.38	2.61	7.29				2.13	2.94	2.54	2.60	2.13	2.94	2.54	2.60	2.13	2.94	2.54	2.60	10.20
	1.13		0.31	0.33	0.36	0.22	1.22				0.29	0.31	0.27	0.25	0.29	0.31	0.27	0.25	0.29	0.31	0.27	0.25	1.12
	1.74		0.53	0.68	0.48	0.61	2.29				0.60	0.55	0.51	0.43	0.60	0.55	0.51	0.43	0.60	0.55	0.51	0.43	2.09
	\$ (4.45)		\$ (3.92)	\$ (3.25)	\$ (0.67)	\$ (4.33)	\$ (12.16)				\$ (3.73)	\$ (2.96)	\$ (1.56)	\$ (4.33)	\$ (3.73)	\$ (2.96)	\$ (1.56)	\$ (4.33)	\$ (3.73)	\$ (2.96)	\$ (1.56)	\$ (4.33)	\$ (12.58)
	N/A		N/A	N/A	N/A	N/A	N/A				N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A
	1.79		0.56	0.43	0.49	0.43	1.90				0.36	0.40	0.39	0.38	0.36	0.40	0.39	0.38	0.36	0.40	0.39	0.38	1.53
	(2.66)		(3.36)	(2.82)	(0.17)	(3.90)	(10.26)				(3.37)	(2.56)	(1.17)	(3.95)	(3.37)	(2.56)	(1.17)	(3.95)	(3.37)	(2.56)	(1.17)	(3.95)	(11.05)
	0.47		0.02	0.00	0.00	0.23	0.24				0.01	0.00	0.00	(0.79)	0.01	0.00	0.00	(0.79)	0.01	0.00	0.00	(0.79)	(0.78)
	N/A		N/A	N/A	N/A	N/A	N/A				N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A
	\$ (3.13)		\$ (3.38)	\$ (2.83)	\$ (0.17)	\$ (4.13)	\$ (10.50)				\$ (3.38)	\$ (2.56)	\$ (1.17)	\$ (3.16)	\$ (3.38)	\$ (2.56)	\$ (1.17)	\$ (3.16)	\$ (3.38)	\$ (2.56)	\$ (1.17)	\$ (3.16)	\$ (10.27)
	N/A		N/A	N/A	N/A	N/A	N/A				N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A
	41.45		43.20	43.64	43.67	43.67	43.54				43.70	43.70	43.70	43.70	43.70	43.70	43.70	43.70	43.70	43.70	43.70	43.70	43.70
	\$ (0.08)		\$ (0.08)	\$ (0.06)	\$ (0.00)	\$ (0.09)	\$ (0.24)				(0.08)	(0.06)	(0.03)	(0.07)	(0.08)	(0.06)	(0.03)	(0.07)	(0.08)	(0.06)	(0.03)	(0.07)	(\$0.23)

Companies Mentioned in this Report

Motorola	(NYSE: MOT - \$4.92, NOT RATED)
Nokia	(NYSE: NOK - \$12.98, NOT RATED)
Qualcomm	(NASDAQ: QCOM - \$36.81, NOT RATED)
RIM	(NASDAQ: RIMM - \$56.40, NOT RATED)
Samsung	(KOREA: SSNLF - \$626, NOT RATED)
Sony	(NYSE: SNE - \$20.94, NOT RATED)
Transmeta	(NASDAQ: TMTA - \$18.70, RATED BUY)
Texas Instruments	(NYSE: TXN - \$15.52, NOT RATED)

RECOMMENDATION HISTORY

Date	Closing Price	Rating	Price Target
5/30/2008	\$ 2.23	Buy	\$ 5.40

GENERAL DISCLOSURES

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