Zacks Small-Cap Research

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Finjan Holdings (FNJN-NASDAQ)

FNJN: $40 Million Judgment for Finjan is a Big Win and Should Encourage Licensing Deals

UPDATE

This weeks big win against Blue Coat puts the company is a great position to negotiate licensing deals with other is the cybersecurity business and accelerate revenues. While the appeal may take up to another 18 months, discussions and settlements could occur with Blue Coat or any other parties either in the cybersecurity market-- particularly those with which Finjan is currently in litigation. In this particular case patent 6,154,844 was the key.

Current Recommendation	**Buy**
Prior Recommendation	Buy
Date of Last Change	9/15/2014
Current Price (08/10/15)	$2.04
Target Price	**$3.75**

SUMMARY DATA

52-Week High	**$4.46**
52-Week Low	**$1.23**
One-Year Return (%)	**-52.4**
Beta	**-0.04**
Average Daily Volume (sh)	**452,172**
Shares Outstanding (mil)	**23**
Market Capitalization ($mil)	**$46**
Short Interest Ratio (days)	**0.58**
Institutional Ownership (%)	**27**
Insider Ownership (%)	**30**
Annual Cash Dividend	**$0.00**
Dividend Yield (%)	**0.00**
5-Yr. Historical Growth Rates	
Sales (%)	**N/M**
Earnings Per Share (%)	**N/M**
Dividend (%)	**N/M**
P/E using TTM EPS	**N/M**
P/E using 2015 Estimate	**N/M**
P/E using 2016 Estimate	**2.7**
Zacks Rank	**3**

Risk Level	**Above Average**
Type of Stock	**Small-Blend**
Industry	**Internet-Software**
Zacks Rank in Industry	**32 of 76**

ZACKS ESTIMATES

Revenue
(in millions of $- Restated)

	Q1 (Mar)	Q2 (Jun)	Q3 (Sep)	Q4 (Dec)	Year (Dec)
2013	0.0 R	0.0 R	0.0 R	0.0 R	0.0 R
2014	0.0 R	0.0 R	5.0 R	0.0 A	5.0 A
2015	0.0 A	0.7 A	26.3 E	0.3 E	27.3 E
2016					53.0 E

Earnings per Share
(Restated EPS is continuing operating earnings before non-recurring items)

	Q1 (Mar)	Q2 (Jun)	Q3 (Sep)	Q4 (Dec)	Year (Dec)
2013	NA	NA	NA	NA	-$0.26 A
2014	-$0.08 R	-$0.15 R	$0.03 R	-$0.18 A	-$0.38 A
2015	-$0.19 A	-$0.12 A	-$0.13 E	-$0.12 E	-$0.62 E
2016					$0.75 E

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Major Win Against Blue Coat Increases Valuation

The big win for Finjan against Blue Coat has increased the value of Finjan significantly as more of its patents have proven to have value and it has more ammunition with which to convince other entities to license its technology. While all six patents were considered valid, the jury decided one, 822, was not applicable to Blue Coat's products. The award breakdown according to papers filed by the jury was as follows, with 844 being the big contributor.

Patent Number	*$ in Millions*	*Filed*
6,154,844	24.00	1997
7,058,822	0	2001
7,647,633	1.67	2005
7,418,731	6.00	2004
6,965,968	7.75	2003
6,804,780	0.11	2000

System and method for attaching a downloadable security profile to a downloadable
US 6154844 A

ABSTRACT
A system comprises an inspector and a protection engine. The inspector includes a **content inspection engine that uses a set of rules to generate a Downloadable security profile corresponding to a Downloadable**, e.g., Java™ applets, ActiveX™ controls, JavaScript™ scripts, or Visual Basic scripts. The content inspection engine links the Downloadable security profile to the Downloadable. The set of rules may include a list of suspicious operations, or a list of suspicious code patterns. The first content inspection engine may link to the Downloadable a certificate that identifies the content inspection engine, which created the Downloadable security profile. Additional content inspection engines may generate and link additional Downloadable security profiles to the Downloadable. Each additional Downloadable security profile may also include a certificate that identifies its creating content inspection engine. Each content inspection engine preferably creates a Downloadable ID that identifies the Downloadable to which the Downloadable security profile corresponds. The protection includes a Downloadable interceptor for receiving a Downloadable, a file reader coupled to the interceptor for determining whether the Downloadable includes a Downloadable security profile, an engine coupled to the file reader for determining whether to trust the Downloadable security profile, and a security policy analysis engine coupled to the verification engine for comparing the Downloadable security profile against a security policy if the engine determines that the Downloadable security profile is trustworthy. A Downloadable ID verification engine retrieves the Downloadable ID that identifies the Downloadable to which the Downloadable security profile corresponds, generates the Downloadable ID for the Downloadable and compares the generated Downloadable to the linked Downloadable. The protection engine further includes a certificate authenticator for authenticating the certificate that identifies a content inspection engine, which created the Downloadable security profile as from a trusted source. The certificate authenticator can also authenticate a certificate that identifies a developer that created the Downloadable.

At any rate litigation with Blue Coat has not ended. Most likely should Blue Coat not settle, it will appeal, a process that could take another 12-18 months. We have tentative put revenue from this judgment in 2017. In addition there is the new suit against it that encompasses seven patents and addresses new products that have been introduced by Blue Coat since the lawsuit just won was filed in 2013. Specifically the company named certain of Blue Coat's ProxySG Appliances and Software, the ProxyAV Appliances

and Software, and WebPulse Services (some of which Blue Coat recently launched) as products that are infringing.

The patents Finjan believes are being infringed upon in this new suit are: 6,154,844; 6,965,968; 7,418,731; 8,079,086; 8,225,408; 8,566,580 and 8,677,494, the last four of which are being asserted against Blue Coat for the first time. According to its press release “Finjan is seeking a jury trial; entry of judgment of direct and indirect infringement of certain claims of each of the asserted patents by Blue Coat; preliminary and permanent injunction against Blue Coat and its officers, among others, from infringing the asserted patents; and damages to be determined by a jury.”

Q2 2015 Results

Revenues for Q1 were $700,000 generated by the licensing agreement with Websense versus no revenue last year. Gross margin on this revenue was 91%. Operating costs for the quarter were $4.6 million versus $3.3 million last year. Adding to cash was a gain on investment from the sale of a portfolio company from the JVP venture fund of $1.3 million. In total the company burned $3.8 million in cash in this period. The same amount of cash was used in Q1. At this rate the company has another 11 months of cash available without getting any payments from Blue Coat.

The company now has $11.9 million in cash on the balance sheet and is owed another $2.3 million, not including whatever proceeds it might get from the Blue Coat lawsuit win.

NEXT EVENTS

- We await the results of the Markman hearing with Proofpoint that took place on June 24, 2015 and the Markman hearing with Symantec that occurred on June 29, 2015.

2015 Forecast

Although impossible to forecast, we are assuming no additional licensing deals this year. We had thought Blue Coat might negotiate one, but since the judgment we are taking that out of our forecast.

2016 Forecast

We have moved revenues from Blue Coat from 2015 to 2016 and using just the $40 million. If the appeal is upheld, that number will be higher as more Blue Coat product is sold and interest is accrued. We are using a 25% cost of sales for the Blue Coat award, as the lawyers will share in the judgment. We are also assuming over the course of the year other companies will license resulting in total revenues of $53 million. This includes $2 million owed by Websense and $2 million projected for the new cybersecurity consulting business.

Other costs should remain the same except for taxes. We believe the company has a $2 million tax loss carry forward so subtracting that off the taxes using 35% US and 8.86% California tax leaves us at fully diluted EPS of $0.75.

KEY POINTS

- Finjan holds a number of pioneering patents for cybersecurity hardware and software that is relevant to dozens of companies in this space.
- The company's non-compete with Trustwave has ended and they are pursuing new product launches.
- While its patents have already generated > $150M in its licensing and enforcement track record, the company has the potential to continue to reap large licensing revenues from the $20 billion market for cybersecurity software, services and appliance market.
- The technology licensing market in the U.S., once an afterthought, has grown from $33 billion in 1994 to $68 billion in 2002 and is likely over $100 billion today.
- The company's win against Blue Coat proves its patents are still valued and able to be successfully defended and therefore monetized.
- The company's has a market cap of $xx million and approximately $15 million in cash but could be worth considerably more if it is successful in its licensing pursuits. Estimating revenues of $23 million in 2015 and an industry multiple of 3.7 times sales, the company could be worth $115 million by next year if it succeeds in reaching successful licensing arrangements.

OVERVIEW

Finjan Holdings is a patent licensing and enforcement firm based in NYC that owns the patents of its predecessor company Finjan Inc., a cybersecurity company that was founded in Israel in 1997. It invented several technologies that are used in current cybersecurity products today. Its three main patent areas:

- Behavior-based methods to detect and prevent threats from the Internet, including email and Web malware
- "Sandboxing" or stripping applications and running potentially malicious code in a safe environment
- Mobile code replacement where the malicious code is stripped and replaced by safe code

CYBERSECURITY MARKET

The market for cyber security products that may use technology covered by Finjan patents is expected to total $20 billion in sales in 2014, according to estimates by Gartner. These types of products include: endpoint and cloud, web gateway and next generation firewall software and hardware products as shown on the following chart.

Relevant Security Markets	2013	2014	2015	2016	2017
Endpoint & Cloud	$11.2 BN	$11.8 BN	$12.5 BN	$13.2 BN	$13.8 BN
Web Gateway	$4.1 BN	$4.4 BN	$4.7 BN	$5.0 BN	$5.3 BN
Next Gen. Firewall	$4.0 BN	$4.0 BN	$4.0 BN	$3.7 BN	$3.4 BN
Total Finjan Technology related Sales	$19.3 BN	$20.2 BN	$21.2 BN	$21.9 BN	$22.5 BN

Source: Gartner, IDC and Finjan estimates

Cybersecurity Consulting Business

According to Gartner, the market for information security consulting grew by 8.1% to $15.3 billion in 2014, from $14.2 billion in 2013. Combined, the top 10 providers grew by 12.7%. Three quarters of revenue comes from North America and Western Europe. Deloitte was ranked number one in this market.
Other players, and competitors for Finjan in the cybersecurity consulting business include FireEye's Mandiant division, Hacknetics, a division of Ernst & Young, and root9B (RTNB) as well as IBM and Symantec.

THE PRESENT COMPANY ENFORCEMENT

Litigation Update

Company	Date and Location	Status	Patent numbers
FireEye **($426 m)**	US District Court for the Northern District of California on July 8, 2013	Stayed	**6,804,780**, 8,079,086, 7,975,305, 8,225,408, **7,058,822**, 7,647,633 and 6,154,844
Blue Coat **(est. >$500m)**	US District Court for the Northern District of California on August 28, 2013 US District Court for the Northern District of California on July 16, 2015	**Won $40m judgment. All patents upheld. Only 7,058,822 did not infringe.** Just filed	6,154,844, **6,804,780**, 6,965,968, **7,058,822**, 7,418,731, and 7,647,633 6,154,844; 6,965,968; 7,418,731; 8,079,086; 8,225,408; 8,566,580; 8,677,494
Proofpoint **($196 m)**	United States District Court for the Northern District of California on December 16, 2013	"Markman" occurred **June 24, 2015**. Awaiting results. Trial date for March 7, 2016.	6,154,844, **7,058,822**, 7,613,918, 7,647,633, 7,975,305, 8,079,086, 8,141,154, and 8,225,408
Sophos **(est. $420 m)**	United States District Court for the Northern District of California on March 14, 2014	Markman concluded	6,154,844, **6,804,780**, 7,613,918, 7,613,926, 7,757,289, 8,141,154, 8,566,580, and 8,677,494
Symantec **($6.6 billion)**	United States District Court for the Northern District of California on June 1, 2014	"Markman" occurred **June 29, 2015**. Awaiting results. A trial date has not been scheduled	6,154,844; 7,613,926; 7,756,996; 7,757,289; 7,930,299; 8,015,182; 8,141,154; and 8,677,494
Palo Alto Networks ($739 m)	United States District Court for the Northern District of California on November 4, 2014	"Markman" tentatively scheduled for **November 2, 2015**.	**6,804,780**; 6,965,968; **7,058,822**; 7,418,731; 7,613,918; 7,613,926; 7,647,633; 8,141,154; 8,225,408; and 8,677,494

Highlighted patent numbers have been successfully defended in court.

VALUATION

Valuation of an IP company, even with a track record is very difficult and even more so with a company like Finjan that has only one court victory and one recent licensing arrangement. We can however look at other IP companies to see how the market values them to make some comparisons. There seems to be two different types of companies in this space, the older stable revenue generating companies like Rambus, and the upstarts that trade on events and potential. We can see from the table below, these range from Unwired Planet with a $7 million enterprise value, to Interdigital with an enterprise value of $1.6 billion and $401 million in sales expected this year. On average, the companies with revenues trade at an average of 3.5X 2015 estimated calendar revenues.

Using a valuation based on enterprise value to sales is easier for unprofitable companies. If Finjan were to generate $53 million in sales in 2016, we could see the market putting a 3.5 times sales multiple on it as shown in the industry average below. Using that and working back to enterprise value per share, we see that given those revenues, Finjan could be worth $8.13 per share by the end of next year, assuming it still has the same amount of cash on the balance sheet as today and achieves those revenue levels in 2016 by licensing in addition to whatever settlement is received from Blue Coat.

IP Companies

	Ticker	Revenue		EV/	EBIDTA	Enterprise Value / Sales		Included	Enterprise
Company		2015E	LTM	EBITDA	Margin	2015E	LTM	in Average?	Value
Interdigital	IDCC	$401	$468	6.5	57%	4.0x	3.4x	y	1,600
Inventergy Globa	INVT	NA	$1	-2.5	-166%	NM	0.0x	n	0
Neonode	NEON	$15	$6	-11.9	-200%	8.0x	19.4x	n	116
Parkervision	PRKR	$33	$0	-2.9	NM	0.9x	NM	y	31
Pendrell	PCO	$29	$30	-28.9	-19%	6.4x	6.1x	y	181
Rambus	RMBS	$306	$288	15.6	35%	4.4x	4.6x	y	1,330
RPX	RPXC	$292	$281	2.5	73.10%	1.7x	1.8x	y	498
Tessera	TSRA	$270	$270	8.1	72%	5.1x	5.1x	y	1,390
Unwired Planet	UPIP	$5	$40	6.2	-13%	1.4x	0.2x	n	7
VirnetX	VHC	$20	$1	-6.1	NM	9.8x	142.8x	n	196
Vringo	VRNG	NA	$1	-1.1	NM	NM	21.7x	n	29
Wi-Lan	WILN	$100	$93	3.6	67%	1.7x	1.8x	y	168
Average				**7.6**	**41%**	**3.5x**	**3.3x**		**$742**

	Revenue		EBITDA	Enterprise Value / Sales		Valuation Range	
	2016E	LTM	Margin	2016E	LTM	Low	High
Finjan	**$53**	**$6**	**-243.00%**	**3.5x**	**3.3x**	**$19**	**$183**

Conclusion of Enterprise Value	**$182,850,834**
Market Value	**$197,855,834**
Shares Outstanding	24,324,000
Price per Share	**$8.13**

Another way to look at possible revenues from current activity is to compare the relevant revenues of the various companies involved. We are taking a general guess that 20% of Websense's revenues were affected by Finjan patents which resulted in a licensing fee of $8 million at this stage in the litigation. This was settled before the Markman Hearing. Blue Coat went through the full trial and was awarded $40 million. If this is appealed and the company wins on appeal, the sum will be higher as interest and

royalties for additional products sold during the litigation process is added on. Looking at the rest of the companies we can derive revenues over $224 million for similar licensing at the same stage as Websense. Judgments, of course, may be all over the place.

	Revenues	% Relevant		License	Judgment
FireEye	$428	30%	$128	$13	
Blue Coat	500	10%	$50	27	$40
Websense	400	20%	$80	8	
Proofpoint	186	50%	$93	9	
Sophos	420	25%	$105	11	
Symantec	4,200	30%	$1,260	126	
Palo Alto Networks	710	42%	$300	30	
TOTAL				**224**	

Cybersecurity companies

The new consulting venture will have different peer comparables where valuations are much higher. For example, FireEye bought Madiant for $1 billion or approximately 7 times sales. Another comparable would be root9b, a company with $141 million enterprise value and a run rate of $38 million, or 3.7 times.

RISKS

- The company has a limited track record with which to set expectations.
- There is no way to predict the timing of lawsuit settlements or licensing agreements, or even the length of a lawsuit.
- As the current company burns cash and has little licensing revenue, it may not generate enough revenues to cover costs and continue operations in the future unless it generates greater income or receives further financing.
- The stock is high risk and is expected to have wide swings in stock price depending on unpredictable events.
- Government is expected to legislate new laws on patent enforcement that could affect the company's ability to monetize its patents as it currently expects.

INCOME STATEMENT

	2014				2015							
In Thousands	**Q1R**	**Q2R**	**Q3R**	**Q4**	**Q1**	**Q2**	**Q3E**	**Q4E**	**2013R**	**2014**	**2015E**	**2016E**
Websense	$0	$0	$4,998	$0	$0	$0	$0	$0	$0	$4,998	$0	$2,000
Other licenses					0	700	0	0	0	0	700	9,000
Consulting & Products					0	0	0	300	0	0	300	2,000
Blue Coat												40,000
Total Revenues	**0**	**0**	**4,998**	**0**	**0**	**700**	**0**	**300**	**0**	**4,998**	**1,000**	**53,000**
Cost of revenues	0	0	800	0	0	60	0	20	0	800	80	10,900
Gross profit	0	0	4,198	0	0	640	0	280	0	4,198	920	42,100
Gross Margin			84%			91%		93%		84%	92%	79%
Operating Expenses:												
SG&A	1,792	3,332	3,535	5,157	4,205	4,559	3,000	3,000	6,225	13,813	14,764	12,000
R&D						0	100	100	0	0	200	500
Transaction costs	0	0	0	0	0	0	0	0	790	0	0	0
Total operating expenses	1,792	3,332	3,535	5,157	4,205	4,559	3,100	3,100	7,015	13,813	14,964	12,500
Operating Income	(1,792)	(3,331)	663	(5,157)	(4,205)	(3,919)	(3,000)	(2,820)	(7,015)	(9,615)	(14,044)	29,600
Other Income												
Gain on settlements	1,000	0	0	0	0	0	0	0	1,000	1,000	0	0
Other income	0	5	0	(5)	(1)	1,271	0	0	9	0	0	0
Interest income	68	6	8	8	9	7	6	5	153	90	27	100
Total other income		11	8	3	8	1,278	6	5	1,162	1,090	27	100
Loss before taxes	(724)	(3,320)	671	(5,154)	(4,196)	(2,634)	(2,994)	(2,815)	(5,853)	(8,525)	(14,017)	29,700
Income taxes	1	(2)	(2)	8	5	0	0	(5)	(260)	5	0	11,020
Tax rate												37%
Net Income	(725)	(3,322)	673	(5,146)	(4,201)	(2,634)	(2,994)	(2,810)	(5,593)	(8,520)	(14,017)	18,680
Net Income Per Share:												
Basic EPS from Cont.	**($0.03)**	**($0.15)**	**$0.03**	**($0.23)**	**($0.19)**	**($0.12)**	**($0.13)**	**($0.12)**	**($0.26)**	**($0.38)**	**($0.62)**	$0.81
Diluted EPS	($0.03)	($0.15)	$0.03	($0.21)	($0.19)	($0.12)	($0.12)	($0.12)	($0.26)	($0.38)	($0.57)	**$0.75**
Basic Shares	22,368	22,379	22,422	22,445	22,409	22,519	22,793	23,066	21,602	22,404	22,697	23,200
Diluted Shares	22,368	22,379	23,036	24,250	24,315	24,324	24,598	24,871	23,227	24,209	24,527	24,827
Stock-based Comp	338	618	971	-479	355	355	355	355	1189	1448	1420	1500
Non-GAAP Income	(387)	(2,704)	1,644	(5,625)	(3,846)	(2,279)	(2,639)	(2,455)	(4,404)	(7,072)	(12,597)	20,180
Non-GAAP EPS	**($0.02)**	**($0.12)**	**$0.07**	**($0.25)**	**($0.17)**	**($0.10)**	**($0.12)**	**($0.11)**	**($0.20)**	**($0.32)**	**($0.56)**	**$0.87**

BALANCE SHEET

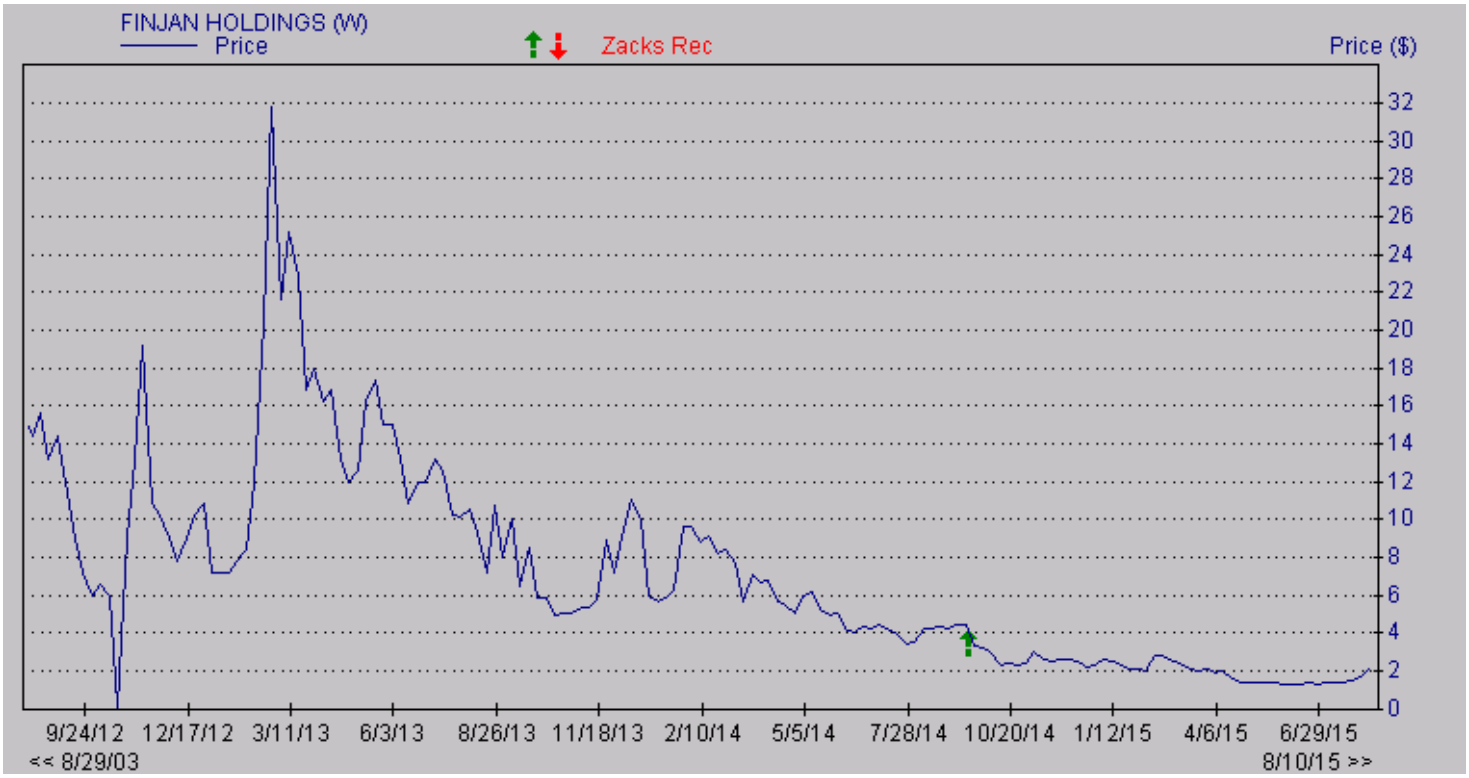
$ in Thousands	June 30, 2015	March 31, 2015	% Change
Current assets:			
Cash and cash equivalents	$11,905	$15,005	-21%
Accounts receivable, net	-	55	-100%
Prepaid expenses and other current assets	218	65	235%
Total current assets	12,123	15,125	-20%
Property and equipment, net	250	136	84%
Investments	1445	1000	45%
Other long term assets	231	231	0%
Total Assets	14,049	16,492	-15%
Current Liabilities:			
Accounts payable	1,479	1,327	11%
Accounts payable - related parties	8	18	-56%
Accrued expenses	798	842	-5%
Accrued income taxes	8	8	0%
Total current liabilities	2,293	2,195	4%
Total Liabilities	2,293	2,195	4%
Stockholders' Equity			
Common stock	2	2	0%
Additional paid-in capital	23,601	23,501	0%
Retained earnings	(11,847)	(9,206)	29%
Total Stockholders' Equity	11,756	14,297	-18%
Total Liabilities & Stockholders' Equity	$14,049	$16,492	-15%
Cash per fully diluted share	$0.49	$0.62	

CASH FLOW

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(Unaudited) - USD ($) $ in Thousands

	Jun. 30, 2015	March 31, 2015
Cash flows from operating activities:		
Net loss	$ (2,641)	$ (4,202)
Adjustments to reconcile net loss to net cash used in operating activities:		
Loss on discontinued operations	$ 0	$ 0
Gain on Investment	$ (1,271)	$ 0
Depreciation and amortization	$ 19	$ 7
Stock-based compensation	$ 100	$ 355
Deferred tax liability	$ 0	$ 0
Changes in operating assets and liabilities:	$ 0	
Accounts receivable	$ 55	$ 1,961
Inventories	$ 0	$ 0
Prepaid expenses and other current assets	$ (153)	$ 47
Other long-term assets	$ (231)	$ 0
Accrued expenses	$ (44)	$ 42
Accounts payable	$ 152	$ (348)
Accounts payable - related parties	$ (10)	$ (82)
Other long term assets	$ 231	$ (231)
Other current liabilities	$ 0	$ 0
Accrued income taxes	$ 0	$ 8
Total Adjustments	$ (1,397)	$ 1,397
Net cash used in operating activities	$ (3,793)	$ (2,443)
Cash flows from investing activities:	$ 0	
Purchases of property and equipment	$ (133)	$ (77)
Proceeds from investment	$ 826	$ 0
Purchase of additional investment	$ 0	$ 0
Net cash provided by (used in) investing activities	$ 693	$ (77)
Proceeds from exercise of stock options	$ 0	
Proceeds from exercise of stock options	$ 0	$ 20
Net cash provided by financing activities	$ 0	$ 20
Net decrease in cash and cash equivalents	$ (3,100)	$ (2,500)
Cash and cash equivalents - beginning	$ 0	$ 17,505
Cash and cash equivalents - ending	$ (3,100)	$ 15,005
Non-cash investing and financing activities	$ 0	
Additional investment held by investee	$ 445	$ 0
Purchase of property and equipment in exchange for finance agreement	$ 0	$ 0
Cash Flow	$ (3,793)	$ (3,840)

STOCK PRICE CHART



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Buy/Outperform: The analyst expects that the subject company will outperform the broader U.S. equity market over the next one to two quarters.
Hold/Neutral: The analyst expects that the company will perform in line with the broader U.S. equity market over the next one to two quarters.
Sell/Underperform: The analyst expects the company will underperform the broader U.S. Equity market over the next one to two quarters.

The current distribution is as follows: Buy/Outperform- 15.4%, Hold/Neutral- 74.9%, Sell/Underperform – 8.9%. Data is as of midnight on the business day immediately prior to this publication.