Zacks Small-Cap Research

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Finjan Holdings (FNJN-NASDAQ)

FNJN: Will Blue Coat's Acquisition Prompt a Licensing Deal?

Current Recommendation	**Outperform**
Prior Recommendation	N/A
Date of Last Change	9/15/2014
Current Price (03/13/14)	$2.05
Target Price	**$5.00**

OUTLOOK

Finjan Holdings, Inc. is an entity that was created last year to enforce the patents of Finjan Inc., a former cybersecurity vendor from Israel founded in 1997. This new company is pursuing licensing arrangements and/or suing current vendors of cybersecurity hardware and software products it believes infringe upon its patents. The former company was a pioneer in a number of foundational attack prevention technologies such as anti-malware and sandboxing. This quarter the new company began to generate IP revenues by licensing to Websense.

SUMMARY DATA

52-Week High	**$7.14**
52-Week Low	**$2.01**
One-Year Return (%)	**-63.59**
Beta	**0.33**
Average Daily Volume (sh)	**108,598**
Shares Outstanding (mil)	**23**
Market Capitalization ($mil)	**$46**
Short Interest Ratio (days)	**0.26**
Institutional Ownership (%)	**28**
Insider Ownership (%)	**29**
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/A**
P/E using 2016 Estimate	**-4.7**
Zacks Rank	**3**

Risk Level	**High**
Type of Stock	**Small-Blend**
Industry	**Internet-Software**
Zacks Rank in Industry	**29 of 67**

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 E	27.3 E	0.0 E	0.0 E	27.3 E
2016					11.0 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	-$0.16 E	-$0.16 E	$0.80 E	-$0.16 E	$0.35 E
2016					-$0.15 E

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As Bain Acquires Blue Coat, Will it Want Litigation off the Books?

On Tuesday, Bain Capital announced its plans to buy Blue Coat Systems at a $2.4 billion valuation from Thoma Bravo. Finjan is in the midst of litigation with Blue Coat and has already had its "Markman" Hearing on August 22, 2014. Blue Coat will have a hearing for a motion for summary judgment on April 16th, which had not been on the schedule. Failing a positive result for Blue Coat, a trial for this action is scheduled for July 20, 2015. As we have seen in the past, often this is an impetus for the acquirer to resolve outstanding litigation rather than taking a reserve and we believe that there is a much better chance that a settlement could occur in this case. This action covers includes, but is not limited to Blue Coat's ProxyAV appliances and software, Blue Coat's ProxySG appliances and software, and Blue Coat's WebPulse service.

Blue Coat is reported to have had $450 million in revenues in 2012 and is targeting $1 billion three years from now. In December, Michael Fey joined Blue Coat as its new president and chief operating officer from MacAfee. MacAfee was a company that settled with Finjan back in 2012, when it was in the midst of its acquisition by Intel, and perhaps Fey will copy that strategy at Blue Coat. Given the timing of this acquisition and the upcoming trial, we would not be surprised to see something transpire near term. The deal is expected to close by the end of June 2015.

2014 Earnings Show New Business Model

Finjan has restructured its business to become a pure play cybersecurity licensing company by selling off the original organic fertilizer company. On December 9, 2014 the fertilizer business was sold for $675,000 and the company wrote off $1.6 million. As a result, past earnings were restated and that business was shown as a discontinued operation. The results for 2014 therefore show revenues of $5 million in 2014 versus no revenues in 2013, and a loss of $0.38 on a continuing operations basis versus a loss of $0.26 in 2013.

The fourth quarter therefore had no revenues and a loss on a continuing operations basis of $0.18 per share, or $4.1 million. We expect the non-revenue quarters in 2015 to show slightly lower losses. Expenses should be somewhat less as the company brings some work in-house despite that fact the has moved to more expensive rental space in Palo Alto, closed the NYC office and plans to hire more people as the year progresses. Given its current cash burn, the company should be able to maintain operations for the next 18 months or so with its $17.5 million in cash as of December 31, 2014, added to the $2 million that was collected in January 2015, for the license agreement booked in Q3 last year. As a recap on that licensing deal: the license was granted for $8 million, of which $5 million was booked in Q3 2014. Of that $5 million the company had already received a $3 million cash payment, and was paid $2 million in January 2015. The remaining payments are for $2 million in January 2016 and $1 million in January 2017. The remaining $3 million in revenue will be booked at the time the cash is received in 2016 and 2017. The company took all the expenses associated with this litigation last year so all future revenues from that license deal will be at 100% margins. The company current practice is to structure legal costs to be larger in the early stages of a lawsuit, but eventually hit caps reducing expenses as suits age.

On November 5, 2014, in the fourth quarter, Finjan filed a suit against Palo Alto Networks, the leader in firewall protection according to Gartner. The complaint (3:14-cv-04908, docket No. 1) was filed in the U.S. District Court for the Northern District of California and alleges that Palo Alto Networks' products and services infringe U.S. Patent Nos. 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. For the first time the company has announced a dollar amount of one of its lawsuits. In this specific suit it is asking for "**damages of no less than $60 million** to the extent proven at trial; enhanced damages, up to three times the amount of the damages, for willful disregard of our patent rights; and reasonable attorneys' fees and costs." Palo Alto Networks sells

products that more than any other company are most compatible with Finjan's main technology of sandboxing and email protection.

Recent News

Since the end of 2014, the company had a Markman hearing on February 13, 2015 in the Sophos case. In March the company reported that the judge adopted Finjan's constructions for each of the five claim terms reviewed.

Next Events

In the March quarter, case management conferences have been scheduled for both Proofpoint and Sophos.

In addition on March 31, 2015 there will be Inter Parte Reexamination proceedings with FireEye. It may be a few weeks before the results of this proceeding are issued. So results will (most likely) fall into Q2.

To review:

U.S. Patent No. 7,647,633

- FireEye filed a third party request for *ex parte* reexamination of claims 1-7 and 28-33 of Finjan's U.S. Patent No. 7,647,633 on October 7, 2013.
- The request for reexamination was granted and a non-final Office Action was mailed November 19, 2013. The non-final Office Action included rejections of claims 1-7 and 28-33 under various prior art.
- An in-person Examiner interview was conducted at the USPTO on February 4, 2014, and a timely response to non-final Office Action was filed on February 19, 2014. Additionally, a petition to accept an unintentionally delayed priority claim was also submitted.

U.S. Patent No. 7,058,822

- FireEye filed a third party request for *ex parte* reexamination of claims 1-8 and 16-27 of Finjan's U.S. Patent No. 7,058,822 on October 7, 2013.
- The request for reexamination was granted and a non-final Office Action was mailed December 6, 2013. The non-final Office Action included rejections of claims 1-8 and 16-27 under various prior art.
- An in-person Examiner interview was conducted at the USPTO on February 4, 2014, and a timely response to non-final Office Action was filed on March 6, 2014. Additionally, a petition to accept an unintentionally delayed priority claim was also submitted.

On April 16, 2015 there will be a hearing for a motion for summary judgment in the Blue Coat case.

The next major event scheduled it the Markman Hearing with Symantec tentatively set for June 11, 2015 because of the assignment of a new judge. Given the size of Symantec and its long history what happens at Symantec dwarfs all the other activity combined.

2015 Model

Although anything could happen, we have modeled at licensing arrangement with Blue Coat into our 2015 estimate and no other settlements. Given that Blue Coat is further along in the process we expect a higher royalty rate. Given the large size of the company and its long history we are using revenues of $27 million for the year which would yield EPS of $0.35 given our estimate of the companies cost structure and its efforts to reduce expenses.

2016 Model

In 2016, the company will book another $2 million from Websense at 100% margins and could have a resolution with Proofpoint as a trial date is set on March 7, 2016. Since Proofpoint is much smaller, with $196 million forecasted in revenues for 2015, we are tentatively using $9 million in licensing. The total revenues of $11 million at 92% gross margins resulting in a loss per share of $0.15.

KEY POINTS

- Finjan holds a number of pioneering patents for cybersecurity hardware and software that is relevant to dozens of companies in this space.
- While its patents have a limited licensing and enforcement track record, the company has the potential 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 recent settlement with Websense shows its patents are still valued and able to be monetized.
- The company's has a market cap of $46 million and $19 million in cash but could be worth considerably more if it is successful in its licensing pursuits. Estimating revenues of $30 million in 2015 and an industry multiple of 4.1 times sales, the company could be worth more than $5.00 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

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	Inter Parte Review scheduled on **March 31, 2015.**	**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	Motion for Summary Judgment being held **April 16, 2105.** **Trial for this action is scheduled for July 20, 2015.**	6,154,844, **6,804,780**, 6,965,968, **7,058,822**, 7,418,731, and 7,647,633
Proofpoint **($196 m)**	United States District Court for the Northern District of California on December 16, 2013	Case Management Conference before new judge has been set for **March 19, 2015**. Pretrial conference was scheduled for February 23, 2016, and a trial date for March 7, 2016. These will be rescheduled.	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	Case Management Conference is set for **March 24, 2015**. A trial date has not yet been set.	6,154,844, **6,804,780**, 7,613,918, 7,613,926, 7,757,289, 8,141,154, 8,566,580, 8,677,494
Symantec **($6.6 billion)**	United States District Court for the Northern District of California on June 1, 2014	Case Management Conference has not yet been scheduled. "Markman" Hearing is tentatively scheduled for **June 11, 2015**, and a trial date has not been scheduled	7,756,996; 7,757,289; 7,930,299; 8,015,182; 8,141,154
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

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 values Inventergy Global with a $28 million enterprise value to Tessera with an enterprise value of $1.6 billion and $263 million in sales expected this year. On average, the companies with revenues trade at an average of 4.1X revenues. Since Finjan has generated revenues it should be more valuable than when we launched coverage, but it may be years before it reaches its maximum potential.

Using a valuation based on enterprise value to sales is easier for pre-revenue companies. If Finjan were to generate $27 million in sales in 2015, we could see the market putting a 4.1 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 $5.45 per share by next year, assuming it still has the same amount of cash on the balance sheet as today.

IP Industry Comparable Public Companies

IP Companies

Company	Ticker	Revenue 2015E	Revenue LTM	EV/ EBITDA	EBIDTA Margin	Enterprise Value / Sales 2015E	Enterprise Value / Sales LTM	Included in Average?	Enterprise Value
Interdigital	IDCC	$371	$416	7.2	48%	4.0x	3.6x	y	1,500
Inventergy Globa	INVT	NA	$0	-2.9	-70%	NM	78.7x	n	28
Neonode	NEON	$16	$0	-345.0	NM	6.9x	1098.0x	n	110
Parkervision	PRKR	$5	$0	-2.9	NM	14.5x	NM	n	72
Pendrell	PCO	$20	$43	-28.9	-19%	6.0x	2.9x	y	122
Rambus	RMBS	$306	$297	11.6	37%	4.2x	4.3x	y	1,280
RPX	RPXC	$293	$259	2.6	71.90%	1.7x	1.9x	y	484
Tessera	TSRA	$263	$279	8.2	70%	6.2x	5.9x	y	1,640
Unwired Planet	UPIP	$5	$39	5.7	-11%	13.9x	1.9x	n	73
VirnetX	VHC	$20	$1	-8.5	NM	14.9x	239.0x	n	299
Vringo	VRNG	$29	$1	-1.1	NM	1.6x	39.6x	n	48
Wi-Lan	WILN	$90	$98	3.4	68%	2.5x	2.3x	y	225
Average				**7.6**	**46%**	**4.1x**	**3.5x**		**$875**

	Revenue 2015E	Revenue LTM	EBITDA Margin	Enterprise Value / Sales 2015E	Enterprise Value / Sales LTM	Valuation Range Low	Valuation Range High
FinJan	**$28**	**$5**	**-132.00%**	**4.1x**	**3.5x**	**$17**	**$113**

Conclusion of Enterprise Value	**$112,780,426**
Market Value	**$132,280,426**
Shares Outstanding	24,255,000
Price per Share	**$5.45**

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. Looking at the rest of the companies we can derive revenues over $200 million for similar licensing at the same stage as Websense.

Blue Coat is much further along in the process and had a Markman Hearing last August. There is a trial date set for July. Because of this we know that Finjan would be seeking higher licensing rates than Websense.

	Revenues	% Relevant		License
FireEye	$428	30%	$128	$13
Blue Coat	500	10%	$50	27
Websense	400	20%	$80	8
Proofpoint	186	50%	$93	9
Sophos	420	25%	$105	11
Symantec (2 seg)	4,200	30%	$1,260	126
Palo Alto Networks	710	42%	$300	30
TOTAL				224

RISKS

- The company has a limited track record with which to set expectations.
- Finjan's patents have only prevailed in court once, in 2010, and only two patents in the portfolio, **7,058,822** and **6,804,780** have been upheld thus far.
- 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.

BALANCE SHEET

$ in Thousands	12/31/14	12/31/2013 Restated	% Change
Current assets:			
Cash and cash equivalents	$17,505	$24,580	-16%
Accounts receivable, net	2,016	13	1854%
Prepaid expenses and other current assets	112	99	141%
Curr. Assets related to disc. oper.	0	140	
Total current assets	19,633	24,832	-15%
Property and equipment, net	66	60	1337%
Investments	1000	500	100%
Non-current assets related to disc. oper.	0	2,555	-99%
Total Assets	20,699	27,947	-18%
Current Liabilities:			
Accounts payable	1,675	416	148%
Accounts payable - related parties	100	15	-13%
Accrued expenses	800	282	239%
Accrued income taxes	0	4	0%
Other current liabilities related to disc. oper.	0	168	-91%
Total current liabilities	2,575	885	128%
Deferred tax liabilities related to disc. oper.	0	39	-10%
Total Liabilities	2,575	924	122%
Commitments and contingencies			
Stockholders' Equity			
Common stock	2	2	0%
Additional paid-in capital	23,126	21,546	4%
Retained earnings	(5,004)	5,475	-96%
Total Stockholders' Equity	18,124	27,023	-17%
Total Liabilities & Stockholders' Equity	$20,699	$27,947	-12%

INCOME STATEMENT

	2014				2015							
In Thousands	**Q1R**	**Q2R**	**Q3R**	**Q4**	**Q1E**	**Q2E**	**Q3E**	**Q4E**	**2013R**	**2014**	**2015E**	**2016E**
Websense	$0	$0	$4,998	$0	$0	$0	$0	$0	$0	$4,998	$0	$2,000
Other licenses							27,300				27,300	9,000
Total Revenues	**0**	**0**	**4,998**	**0**	**0**	**0**	**27,300**	**0**	**0**	**4,998**	**27,300**	**11,000**
Cost of revenues	0	0	800	0	0	0	4,485	0	0	800	4,485	900
Gross profit	0	0	4,198	0	0	0	22,815	0	0	4,198	22,815	10,100
Gross Margin			84%							84%	84%	92%
Operating Expenses:												
SG&A	2,791	3,331	3,535	4,090	3,700	3,550	3,500	3,500	6,225	13,813	14,250	13,500
Transaction costs	0	0	0	0	0	0	0	0	790	0	0	0
Total operating expenses	2,791	3,331	3,535	4,090	3,700	3,550	3,500	3,500	7,015	13,813	14,250	13,500
Operating Income	(2,791)	(3,331)	663	(4,090)	(3,700)	(3,550)	19,315	(3,500)	(7,015)	(9,615)	8,565	(3,400)
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)	0	0	0	0	9	0	0	0
Interest income	68	6	8	8	8	7	6	5	153	90	26	100
Total other income		11	8	3	8	7	6	5	1,162	1,090	26	100
Loss before taxes	(1,791)	(3,320)	671	(4,087)	(3,692)	(3,543)	19,321	(3,495)	(5,853)	(8,525)	8,591	(3,300)
Income taxes	1	(2)	(2)	8	0	0	0	0	(260)	5	0	0
Net Income	(1,792)	(3,322)	673	(4,079)	(3,692)	(3,543)	19,321	(3,495)	(5,593)	(8,520)	8,591	(3,300)
Net Income Per Share:												
Basic EPS from Cont.	**($0.08)**	**($0.15)**	**$0.03**	**($0.18)**	**($0.16)**	**($0.16)**	**$0.86**	**($0.16)**	**($0.26)**	**($0.38)**	**$0.38**	**($0.15)**
Diluted EPS	($0.08)	($0.15)	$0.03	($0.17)	($0.16)	($0.16)	$0.80	($0.16)	($0.26)	($0.38)	$0.35	($0.13)
Basic Shares	22,368	22,379	22,422	22,445	22,450	22,450	22,450	22,450	21,602	22,404	22,450	22,500
Diluted Shares	22,368	22,379	23,036	24,250	24,255	24,255	24,255	24,255	23,227	24,209	24,255	24,555

STOCK PRICE CHART

Source: E*TRADE Securities



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