Zacks Small-Cap Research

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Finjan Holdings (FNJN-NASDAQ)

FNJN: Zacks Company Report – Earnings Update – $8 Million Websense License Revealed

Current Recommendation	**Buy**
Prior Recommendation	Buy
Date of Last Change	9/15/2014
Current Price (11/11/14)	$2.97
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	**$12.61**
52-Week Low	**$2.20**
One-Year Return (%)	**-48.79**
Beta	**-0.04**
Average Daily Volume (sh)	**14,253**
Shares Outstanding (mil)	**22**
Market Capitalization ($mil)	**$67**
Short Interest Ratio (days)	**0.6**
Institutional Ownership (%)	**9**
Insider Ownership (%)	**29**
Annual Cash Dividend	**$0.00**
Dividend Yield (%)	**0.00**
5-Yr. Historical Growth Rates	
Sales (%)	**-13.9**
Earnings Per Share (%)	**N/M**
Dividend (%)	**N/M**
P/E using TTM EPS	**N/A**
P/E using 2014 Estimate	**N/A**
P/E using 2015 Estimate	**5.1**
Zacks Rank	**3**

Risk Level	**Very High**
Type of Stock	**Small-Blend**
Industry	**Internet-Software**
Zacks Rank in Industry	**26 of 65**

ZACKS ESTIMATES

Revenue
(in millions of $)

	Q1 (Mar)	Q2 (Jun)	Q3 (Sep)	Q4 (Dec)	Year (Dec)
2012	$0.0 R	$0.0 R	$0.00 R	$0.0R	$2.48 R
2013	$0.0 A	$0.2 A	$0.4 A	$0.2 A	$0.7 A
2014	$0.2 A	$0.6 A	$5.4 A	$0.0 E	$6.8 E
2015					$30.0 E

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

	Q1 (Mar)	Q2 (Jun)	Q3 (Sep)	Q4 (Dec)	Year (Dec)
2012	NM	NM	NM	NM	-$0.01 A
2013	-$0.04 A	-$0.06 A	-$0.06 A	$0.0 A	-$0.28 A
2014	-$0.09 A	-$0.15 A	$.02 A	-$0.15 E	-$0.35 E
2015					$0.35 E

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The new Finjan has been operating since last year without any financial rewards for its licensing efforts until this quarter. It reached a licensing agreement with Websense, but until today investors had no idea what the value of that deal was. The license was granted for $8 million, of which $5 million was booked in this quarter. Of that $5 million the company has already received a $3 million cash payment, and will receive another $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.

This license gives investors some confidence that further licensing deals will be forthcoming in future quarters. We are forecasting that there will be no more IP revenues booked for the remainder of 2014, but as always cases can be settled and licenses granted. The company still owns a fertilizer operation that generated $375,000 in revenues in the quarter, but the company has indicated that it is now for sale and will be classified going forward as a discontinued operation. We believe that the company should be able to sell the business in a short time frame, possibly before the end of 2014. At the time of sale, the company plans to issue pro forma financials excluding that business and we will revise our historical and forecasted numbers at that time. This sale should simplify the company operations and provide investors with a pure IP licensing company to evaluate.

Despite booking only $5 million in revenues for the licensing deal, the company took all the expenses associated with Websense litigation this quarter. Therefore when it books the other $3 million in future years, those revenues will be at 100% margins. Despite the expenses for the Websense litigation rolling off, the company is adding on costs for its new suit against Palo Alto Networks, which should keep dollar amounts flattish going forward. The company has structured legal costs to be larger in the early stages of a lawsuit, but eventually hit caps reducing expenses as suits age.

Now that we have a little more insight into legal costs we have adjusted EPS for 2015. For now we are including the fertilizer business until it is sold. Without it, the company should be slightly more profitable. According to the 10Q, year to date that operation lost $274,000.

This quarter, the first with IP revenues, the IP business showed an 84% gross margin. Using that for next year's estimate and taking $4 million per quarter for operating expenses, we come up with a fully diluted EPS estimate of $0.35. However keep in mind that revenues could be almost anything given the uncertainty of the timing of any settlements and the results of any trials.

The next scheduled event is a Markman hearing on February 13, 2015 in the Sophos case. Other scheduled events are a Proofpoint Markman in Q2 2015 and a Blue Coat trial in Q3.

Q4 Updates

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, 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.

The products included in the complaint are:

APP-ID

User-ID

Content-ID

Virtualized Firewall

Next-Generation Firewall

URL Filtering Subscription

Advanced EndPoint Protection

Threat Prevention Subscription

Wildfire Platform and Subscription

Next-Generation Security Platform

Targeted Remote Attack Prevention System (TRAPS)



New CFO Announced

On November 12th the company announced the appointment of Mike Noonan as new CFO and Treasurer. Before joining Finjan as VP of Finance, he was CFO at a small oil and gas developer in Dallas, Sky Petroleum (SKPI) from 2005 to September 2013. Before that he was Senior Director in the finance department for Forgent Networks (now called Asure Software Inc.-ASUR), an intellectual property company, from 2002 to 2005, where he also was responsible for IR, human resources and M&A. Mr. Noonan received a BBA in Business Administration and Economics from Simon Fraser University in British Columbia, Canada; an MBA from Athabasca University in Alberta, Canada; and an Executive JD from Concord School of Law in Los Angeles, California. His public company, IR and legal background should allow him to add expertise to many roles at Finjan.

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 $66 million and $20 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 3.7 times sales, the company could be worth $5.80 by next year.

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 **($428 m)**	US District Court for the Northern District of California on July 8, 2013	June 6, 2014, the judge entered an Order Granting Motion to Stay Pending Reexamination of certain Finjan patents.	**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	"Markman" Hearing on August 22, 2014. 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 **($186 m)**	United States District Court for the Northern District of California on December 16, 2013	Hearing on the Motion to Stay on August 21, 2014. "Markman" Hearing on May 8, 2015. Trial for this action is scheduled for January 11, 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" Hearing on February 13, 2015. No trial date yet.	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 **($6.7 billion)**	United States District Court for the Northern District of California on June 1, 2014	Case assigned, SYMC not yet responded	7,756,996; 7,757,289; 7,930,299; 8,015,182; 8,141,154
Palo Alto Networks ($710 m)	United States District Court for the Northern District of California on November 4, 2014		**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 $38 million enterprise value to Interdigital with an enterprise value of $1.3 billion and $409 million in sales expected this year. On average, the companies with revenues trade at an average of 3.3X revenues or an EV/EBITDA of 7.6X. This is a decline from the 3.7 multiple of revenues calculated in September. Since Finjan has just start generating revenues it should be more valuable than when we launched coverage, but it will 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 $30 million in sales in 2015, we could see the market putting a 3.3 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 $5.14 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

	Ticker	Revenue		EV/	EBIDTA	Enterprise Value / Sales		Included	Enterprise
Company		2014E	LTM	EBITDA	Margin	2014E	LTM	in Average?	Value
Interdigital	IDCC	$409	$429	6.0	54%	3.2x	3.1x	y	1,330
Inventergy Global	INVT	NA	$47	-4.28	NM	NM	0.8x	n	38
Neonode	NEON	$4	$4	NM	NM	17.1x	19.0x	n	75
Parkervision	PRKR	$5	$0	NM	NM	20.3x	NM	n	102
Pendrell	PCO	$47	$42	NM	NM	4.6x	5.1x	y	215
Rambus	RMBS	$297	$298	11.0	35%	3.9x	3.9x	y	1,150
RPX	RPXC	$260	$252	2.5	71%	1.7x	1.8x	n	446
Tessera	TSRA	$270	$275	9.3	50%	4.7x	4.6x	y	1,270
Unwired Planet	UPIP	$39	$38	NM	NM	1.8x	1.9x	y	73
VirnetX	VHC	$197	$2	NM	NM	1.4x	114.6x	y	275

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

	Revenues	% Relevant		License
FireEye	$428	30%	$128	$13
Blue Coat	500	10%	$50	5
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				**202**

RISKS

- The company has a limited track record with which to set expectations.
- Finjan's patents have only prevailed in court once and only two patents in the portfolio 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 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	9/30/14	6/30/14	% Change Sept-June	3/31/14	12/31/13	% Change June-Dec
Current assets:						
Cash and cash equivalents	$20,390	$20,559	-1%	$23,549	$24,598	-16%
Accounts receivable, net	2,134	254	740%	51	50	408%
Inventories	138	80	73%	61	34	135%
Prepaid expenses and other current assets	195	239	-18%	214	150	59%
Total current assets	22,857	21,132	8%	23,875	24,832	-15%
Property and equipment, net	806	862	-6%	958	953	-10%
Intangible assets, net	1,132	1,192	-5%	1,253	1,333	-11%
Goodwill	306	306	0%	306	306	0%
Investments	1000	1000	0%	500	500	100%
Other non-current assets	23	23	0%	23	23	0%
Total Assets	26,124	24,515	7%	26,915	27,947	-12%
Current Liabilities:						
Accounts payable	1,733	1,030	68%	873	495	108%
Accounts payable - related parties	13	13	0%	19	15	-13%
Accrued expenses	908	957	-5%	591	336	185%
Accrued income taxes	4	4	0%	5	4	0%
Other current liabilities	13	15	-13%	32	35	-57%
Total current liabilities	2,671	2,019	32%	1,520	885	128%
Deferred tax liabilities	33	35	-6%	37	39	-10%
Total Liabilities	2,704	2,054	32%	1,557	924	122%
Commitments and contingencies						
Stockholders' Equity						
Common stock	2	2	0%	2	2	0%
Additional paid-in capital	22,641	22,461	1%	21,884	21,546	4%
Retained earnings	777	222	250%	3,472	5,475	-96%
Total Stockholders' Equity	23,420	22,461	4%	25,358	27,023	-17%
Total Liabilities & Stockholders' Equity	$26,124	$24,515	7%	$26,915	$27,947	-12%

INCOME STATEMENT

	2013				2014						
In Thousands	Q1A	Q2R	Q3R	Q4A	Q1A	Q2A	Q3A	Q4E	2013	2014E	2015E
Licensing	$0	$0	$0	$0	$0	$0	$4,998	$0	$0	$4,998	$27,300
Fertilizer	0	198	394	152	175	636	377	600	744	1,788	2,700
Total Revenues	**0**	**198**	**394**	**152**	**175**	**636**	**5,375**	**600**	**744**	**6,786**	**30,000**
Cost of revenues	0	148	324	290	134	332	1,037	250	762	1,753	5,988
Gross profit	0	50	70	(138)	41	304	4,338	350	(18)	5,033	24,012
Gross Margin		25%	18%	-91%	23%	48%	81%	58%	-2%	74%	80%
Operating Expenses:											
SG&A	847	1,493	1,449	$2,900	3,123	3,564	3,794	3,800	6,689	14,281	16,000
Transaction costs	0	790	0	$0		0	0	0	790	0	0
Total operating expenses	847	2,283	1,449	$2,900	3,123	3,564	3,794	3,800	7,479	14,281	16,000
Loss from operations	(847)	(2,233)	(1,379)	(3,038)	(3,082)	(3,260)	544	(3,260)	(7,497)	(9,058)	8,012
Other Income											
Gain on settlements		1,000			1,000	-	-	-	1,000	1,000	-
Other income		17	(4)		12	5	(1)	-	9	16	-
Interest income	90	21	7	25	68	6	8	5	153	87	100

STOCK PRICE CHART



Source: E*TRADE

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