

Dearing Lin Cox Ventures

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## Investment Memo: Lingolink

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## **Lingolink**

Lingolink is a new online venture that brings elements of social networking to language tutoring. Powered by an experienced management team that features language instruction and Web technology experts, Lingolink's key value propositions include their platform for facilitating high quality matches between people and their language learning environment. Lingolink is raising their first round of funding and seeks \$2.5M investment for the next four quarters of operations to achieve an estimated 20,000 users and start sales. Breakeven is projected to occur in year 3 with end of year 5 revenues are projected by Lingolink to be \$51.5M with a profit of \$32.3M.

## **The Market**

The general e-learning market is very large (estimated at hundreds of billions of dollars) and is growing due to the pervasiveness of the Internet and its improvement in delivering multimedia to end users. The language instruction sector in particular builds on the ever increasing global aspect that is seen influencing peoples' lives around the world, the availability and penetration of key technologies like broadband Internet and Voice over IP (VoIP). Acquiring conversational or full fluency in another language is now becoming a necessity rather than a luxury for hundreds of millions of people, and a key driver of this sector's growth is due to the growing recognition that English as the language of business and technology.

Fairchild Learning Technologies, developers of the popular Rosetta Stone series, estimates a total market for language learning of \$100B.<sup>1</sup> LiveMocha, an online competitor of Lingolink, claims the language learning market is \$20B.<sup>2</sup> An in-depth 2006 study by Phrasebase.com estimated the total market for Secondary Language Acquisition (SLA) to be \$12B in 2007 but growing at approximately 20% per year.<sup>3</sup> The "live tutoring" segment was estimated at \$6B in 2007 and growing at approximately 16% per year. Lingolink itself claims an annual growth of 50%, with a targeted segment of 20M users who have broadband Internet access, speak at an intermediate level (i.e., ready to try conversations), have VoIP ability, and are seeking a conversation partner.<sup>4</sup> This figure represents about 3% of the total estimated people in the world currently learning a language. Balancing between survey taking concerns and adjusting their strategy to target a broader group of users (see below for recommendations), this number is deemed reasonable at first order. Greater due diligence will be needed to determine the breakdown of the language learning products and services market (especially the live tutoring segment) between business or institutional use and personal use. However, if executed properly Lingolink's service can potentially move beyond the personal language tutor space and address a portion of business or institutional customers as well.

## **Competitive Landscape**

The idea of leveraging the Web for live language tutoring with a social networking angle is not new. There are a number of existing competitors in the online language learning and tutoring space. A summary can found in Table 1.

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<sup>1</sup> <http://www.bgnentrepreneur.net/beta/news/announcements/fairfield-language-technologies.html>

<sup>2</sup> <http://venturebeat.com/2007/09/24/livemocha-uses-social-networks-to-teach-you-new-languages-online/>

<sup>3</sup> <http://www.phrasebase.com/blog/second-language-acquisition-market-forecast.html>

<sup>4</sup> Lingolink Pitch, June 3, 2008, HLC Ventures

Company	Founded	Funding	Business Model	Structured Environment	VoIP	Match Quality	Match Speed
Lingolink	2008	-	Commissions (20%), Subscriptions	●	●	●	●
Myngle	7/2007	Seed	Commissions (18%)		●	●	●
EduFire	2007	\$500k angel, seeking Series A	Commissions (15%)		●	●	
LiveMocha	9/2007	\$6M, Series A (Maveron)	Advertising			●	
MyHappyPlanet	2007	Seed	Advertising?				●
Italki	2006	\$150k, Angel	Advertising?				●
Babbel	8/2007	-	-				●
LingoLoopy	9/2007	-	-				
xLingo	2005	-	Subscriptions		●		●
SharedTalk	2003	-	Referrals		●		●
Mango Languages	2004	-	Premium plans				
Phrasebase	1998	-	Advertising?				
MyLanguage-Exchange	2000	-	-			●	

**Table 1 - Summary of Lingolink Competitors**

Of these competitors, new entrants Myngle and EduFire are the most similar to Lingolink's service and business model and are both sustained currently by a seed round. Both websites offer a platform and exchange service for language learners and takes a commission fee from whatever fee the tutors charge for services. EduFire offers in-browser video chat, while Myngle appears text-only now from an in-browser perspective but indicates a desire to expand multimedia capabilities. Neither company was mentioned in Lingolink's materials. Skype is a widely used vehicle for voice chat, but in-browser VoIP is best for ease-of-use and user acquisition. LiveMocha, which has already obtained a \$6M Series A financing, and newcomer MyHappyPlanet offer a selection of self-paced language courses and materials as well as social networking features where learners can meet and collaborate with each other. However, the live VoIP tutoring that Lingolink, Myngle, and EduFire offer is not a core element of the sites. Other competitors are all motivated by the idea of bring social networking to learning languages online, but do not have the same feature set as the companies mentioned above. A notable competitor is SharedTalk because it is by the same company that produces the Rosetta Stone series. However, the site lacks traction and it is unclear what Rosetta Stone intends for it.

## The Product

Lingolink provides a platform for live language tutoring with the following key features:

- Intelligently matches tutors and tutee's for an optimal experience
- Provides structured conversation content to facilitate lessons
- Enables text and voice conversations without 3<sup>rd</sup> party software
- Provides an exchange for people to exchange credits (i.e., currency) for compensation
- Uses social networking features for community experiences and empowering individuals to provide services that are more cost-effective than current professional offerings.

Lingolink's central distinguishing feature is its structured environment for facilitating conversations and lessons between tutors and tutees. Most competitors offer a barebones chat window for conversations, or rely on the tutor to create from scratch lessons. Though some components are present, no competitor has put together a comprehensive and compelling conversational environment like Lingolink has done. Additionally, Lingolink's use of an in-browser VoIP solution (that it will license) makes it easy for people to use their site and not rely on 3<sup>rd</sup> party programs. This is critical in helping achieve a growth in users.

Lingolink's business model includes a few possible revenue channels that include: subscription fees for premium services like greater account and matching control, collecting a 20% commission fee for facilitating payments between tutors and tutees, as well as advertising and referrals. Lingolink also intends to rely on the IMTranslator property for split revenues and serving users to them. As for the revenue projections for the suggested business model, at first order the formulation appears reasonable. There has been thought put into developing a viable and sustainable business model. Suspect drivers include the percentage breakdown of heavy, average, and casual users of Lingolink, and more importantly the high percentage of those users (50%, 30%, 1%, respectively) who become premium service subscribers, especially when so many competing services are free.

## **The Company**

Lingolink features a diverse management team with experience both consumer web and language instruction spaces. Domain expertise is clearly evident. Two notable aspects regarding the company's background: 1) the CTO, Sonya Zak, founded the widely used (by even competitors) IMTranslator for machine language translation and several million monthly uniques and 2) their advisory board includes the Director of Spanish Language Studies and the Director of Foreign Language Studies at Stanford, along with Dr. Noam Chomsky. In addition to the the management team's backgrounds at Google and Yahoo!, they can pitch strong credentials and establish credibility on both technology and language quality fronts. Lingolink was founded this year and hopes to launch a beta website by the end of 2008.

Lingolink has not received any funding yet. IMTranslator is owned by the CTO.

## **Growth Strategy**

As a consumer web property, rapid growth and affordable acquisition of users is paramount for Lingolink. The financial projections of Lingolink across all revenue channels is heavily reliant on the number of users. Lingolink plans to leverage the connection to IMTranslator by encouraging users of IMTranslator to the Lingolink platform in order to seed a community. Social networking applications and games, along with some free services and Internet ads will be deployed in Q2-Q4 to spur growth, with revenue generating actions starting in Q4 with targeting businesses, offline teachers, etc.

From a strategic perspective, the content rollout seems misguided. While social networking applications and games might create a viral marketing campaign, such a move would undermine attempts to appeal to more serious users who would be willing to spend money for live tutoring such as committed individuals or students, or business users. Competitors also offer language-centric games, and italki already has a strong presence in Facebook. Lingolink should instead focus on its structured conversation environment because a) low barriers to switching website can enable popular tutors on other sites to move their clientele to Lingolink if it can provide higher quality teaching and b) positions the company better to secure future revenue-generating partnerships with business users, governmental institutions, and education organizations. With a strong teaching platform, Lingolink can target business and professional

segments that need to practice a foreign language but offer such tutoring at lower rates than traditional professional language tutoring programs.

From a financial standpoint, the projected headcount is of great concern. The current plan is to scale from 5 employees to 14 employees in just 3 quarters, with sizable engineering and sales/marketing staffs. The second year of operations shows a tripling sales/marketing staff which results in payroll constituting 92% of year 2 revenues, the same year that revenue channels will finally open for Lingolink. Additionally, payroll comprises 45% of total costs for the first two years then drops to 38% of total costs. Meanwhile, budget allocation for advertising and direct sales efforts lag behind payroll. With high levels of uncertainty that surround such revenue projections, operating at such large headcount does not lend itself to a sustainable growth rate. Competitive analysis shows that launching a similar website can be done in a much more lean way at much reduced burn rate. The management team is expected to use their networks at Google and Yahoo! to attract top multitasking talent.

Proposing 400% annual user growth for the first two years, reaching 500,000 at end of year 3 is simply too optimistic and competitor growth trends do not support such a claim. More than one competitor, after one year of operation, claims over 200,000 users. Finally, some project costs need to be revisited, such as rent expenses. \$1200 and \$2500 in monthly rent for 14 and 30 employees, respectively, is suspiciously low, even if some employees are working overseas.

## **Exit Strategies**

The most likely exit strategy for Lingolink is an acquisition. There is no real precedent in the language learning space for IPOs, despite the large market size. There are numerous reasons for this including customer segmentation, technological adoption, and the required number of users on such a business model to make a public offering viable. Nonetheless, Lingolink's product offering and projected clientele and user base could make it an attractive acquisition bid for an existing language learning company in the vein of Berlitz or RosettaStone to strengthen their web offering or alternative digital distribution model.

A five-year IRR is approximately 136% for the project cashflows as presented in the pitch, with revenues totaling \$51.5M in year 5. More conservative five-year IRR estimate, in which losses are doubled and profits reduced by 66%, is estimated at 25%. Realistic IRRs could fit well into our above-average performing portfolio of firms.

## **Risk Analysis**

Though there are many risks, three primary risks are chosen and explained below:

**Competitors** – The online language learning space is crowded, with more than a dozen companies in the space, with 2 or 3 companies competing directly with Lingolink. The barriers of entry are low, but there is little to suggest that websites have reached lasting stickiness amongst users. Technologically, only one site offers in-browser video chat (which has privacy and security concerns). While competitors could implement structured learning environments, it would lack the integration and quality of Lingolink's offering.

**Time-to-market** - Lingolink does not enjoy any entry advantage. Five of the competition companies were founded in 2007 and already have launched websites. The roll-out plan that has revenue channels opening up after Q4 must be sped up. The duration of time that its competitors have spent in the market presents difficulties in drawing users and growth from them.

**Customer Acquisition** – The current rate and pricing structure for Lingolink could slow their user growth. Competitor’s commission on tutor compensation is at 18% and 15%, below the 20% that Lingolink intends to charge. Also, when compared to other sites it is unclear what Lingolink’s \$5/month premium subscription will provide to the customer, and the estimation that 50% and 30% of heavy users and average users, respectively, will pay the subscription fee is not convincingly supported. This risk can be mitigated by experimenting with pricing models during a beta phase and from user feedback.

## **Funding Decision**

With no website launched or users yet, the requested \$2.5M in funding is too risky and inappropriate for this stage of the company. Lingolink is entering this space lacking the 1 year headstart that a number of its close competitors currently enjoy. Its business model is not novel, but: 1) Its product does have a value proposition not seen in the current competition, 2) it features a competent management team and well credentialed advisory board, 3) it owns the highly trafficked and popular IMTranslator property. Furthermore, this space is still nascent and existing competitors have not locked up their users. Customers in the professional and institutional segments remain fairly untapped for a service such as Lingolink.

Success relies on proper execution. The time-to-market should be reduced and Lingolink should focus on its target segment before expanding too rapidly. Taking steps to position the company to acquire business, professional, and institutional customers is a path towards less uncertain financial sustainability, rather than attempting to compete directly with the dozen other language learning websites, most of which offer services for free. It is entirely possible for Lingolink, in its current stage, to execute these changes.

## **Terms**

I propose investing a \$500,000 seed amount for an equity stake in Lingolink. This seed amount is intended to launch the beta website, drive customer acquisition, and to start determining immediately the needs of more lucrative customer segments. Typically, this amount would be raised by an angel investor, but in this case our firm would gain right of first offer for a Series A round. Continued funding after 2 or 3 quarters would be determined by milestones reached, which would be the number of users acquired and sufficient proof of interest and willingness to pay in key customer segments.

- \$500,000, Seed amount
- 5% equity stake in Lingolink, negotiated to a higher percentage if Series A commences.
- Preferred stock, non-participating for seed round. Do not want to reduce attractiveness of the company to additional investors for later rounds.
- Right of first offer for Series A .
- Decline board seat position for seed amount. Board seats negotiated if Series A commences.
- Milestones-driven decision for Series A, based on customers acquired and interest from lucrative customer segments

## **Summary**

Lingolink has a unique element to their approach in this crowded but young space. The market for language learning is sufficiently large with great upside, and there is no clear market leader. Lingolink needs to move quickly and use its personnel and technology assets to gain users and differentiate itself. A seed round will give our firm a foot in this rapidly growing space while limiting our risk of potential downside.