Interdigital Inc. (IDCC)

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Disclaimers

- I am not a registered investment advisor and I do not offer any investment advise
- No parts of this talk are suggestions to invest, not invest, buy or sell any kind of securities or other financial instruments
Interdigital - business
Interdigital - Misc thoughts

• What can go wrong?
  • Patent/royalty collection / legal expenses - what is a “pipeline” of patents, what are agreements, when they expire, etc.
  • Patent troll business model - deplorable?
Strategic considerations

• Moat (*switching costs, habit, low cost*):
  • What are the moats? Patents / legal system
  • What does it take to sustain the moats? R&D/legal system
  • Bargaining power of suppliers/customers? Lawsuit length, standard committees, etc.
• Is it a low risk business? Low risk in existing revenues, high risk long term
• Is there high uncertainty? Yes, in R&D
• How capital intensive is the business? Moderate to low.
• Future growth - unknown
• Are the revenues and cash flows of the business sustainable or overstated / understated due to boom or bust conditions? Not clear
Management

- I don’t usually do management analysis. Included for template completeness
- No dilution - share buybacks
- Can I trust management?
- Management shareholding (> 10%)
- Management incentives?
- Are the salaries too high?
- Is there heavy insider buying?
- Is there heavy insider selling?
- Do I like the management? (Operators, capital allocators, integrity)
- Profitable reinvestment
- What has management done with the cash?
- Where is Free Cash Flow invested? Share buybacks, dividends, reinvested, ROE & ROCE, incremental BV
Is it a good business?

- 5 year history of profits
- ROE:
  - 31.4  81.8  14.6  29.9  2009:51.5  2010q1: 86.04
- Margins
  - 2008: 11  2009:29  2010:42
- Growing earnings
- No dilution - share buyback
- Very strong balance sheet
  - Cash+short term investments >> debt
- ROIC = Earnings / (Equity + Debt - Cash) = Earnings / (Assets - non-debt liabilities - Cash)
  - Cannot be computed since cash > equity!
Is it a good business? Cash flow

• Strong cash flow
  • Q1 72.7M operating cash flow, 72M FCF (FCF = OCF - capital expenditures)
  • Operating cash flow higher than earnings per share
  • Free Cash Flow/Share higher than dividends paid - no dividends
Is business cheap? - Buffettology calculations

- ROE 50% - assume 20%
- Earnings in 10 years = ROE*Equity*(1+ROE)^9 = $234M
- Equity in 10 years = Equity*(1+ROE)^9 = 1.2B
- Market cap = 234M x P/E (15) = $3.5B
- Rate of return = ~10% after tax (calculations omitted)
- If we assume 25% ROE: 16.7%
Is business cheap? DCF

- Discounted cash flow
  - Current earnings of ~195M
  - 10% growth for 5 years, leveling after that
    - 10% discount -> $2.9B current valuation (if you buy company at < $69B, you will get 10% return or higher)
    - 15% discount -> $1.9B current valuation
  - 5% growth for 10 years, leveling after that
    - 15% discount -> $1.7B current valuation
  - 100M earnings 10% growth for 5 years, leveling after that
    - 15% discount -> $972M current valuation
- Owner’s yield = earnings / (market cap + debt - cash) = earnings/EV
  - 195M / (1.1B-.48B) = 30%
- What makes up the margin of safety? High ROE, high expected earnings
- Is there a sufficient margin of safety? Maybe
Is business cheap? - Graham investment considerations

- N/A for Interdigital - included for completeness
- >5 P/Book - not a net net
- Altman Z score (http://en.wikipedia.org/wiki/Altman_Z-score)