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)