

April 28, 2019

Company Name:

InterDigital
IDCC

Marko Stojanovic

Sector: Information Technology

Industry: Communications Equipment

Current Price: \$65.01

Target Price: \$95

InterDigital is a mobile technology research and development company that provides wireless and video technologies for mobile devices, networks, and services worldwide. It provides technology solutions for use in digital cellular and wireless products and networks, including 2G, 3G, 4G and IEEE 802-related products and networks. The company develops cellular technologies, such as technologies related to CDMA, TDMA, OFDM/OFDMA, and MIMO for use in 2G, 3G, and 4G wireless networks, as well as mobile terminal devices; and 3GPP technology portfolio in 5G NR, LTE-Advanced, and cellular Internet of Things (IoT) areas, as well as technologies for automobiles, wearables, smart homes, drones, and other connected consumer electronic products.

BUY

Current Price: \$65.10
Target Price: \$95
Market Cap: \$2.01B
Total Debt: \$317M
ROIC: 6.88%
(LTM)/ 30% (Avg.)
WACC: 9.3%



Thesis: As one of the leader in 5G technology, IDCC will be exposed to the new products that will use 5G platforms. Potential growth of new products is estimated to be 38% CAGR for 2018-2022 and market value of about \$800B. IDCC has 3 different platforms and more than 36,000 patents that could be intergraded in 5G technology. Their reoccurring revenue will stay the same for the next year, but any additional deal would boost revenue that could spike the price up. Management is focusing to bring their operating cost to the same level as of 2017, which will boost their margins up. Market is currently still skeptical about their position in 5G market, but with the good outlook for China and USA trade deal, we should expect new deals on the way.

Short-term outlook:

Interdigital short-term revenue growth depends primarily on executing new deals with 5G technology. Recent acquisition of Technicolor's will allow Interdigital expenditure into video/recording market with approximately 16,000 new patents. Recent launch from Verizon's 5G provides the opportunity to bring products that will run

on Interdigital platforms. With the trading deal between USA and China coming to the end and some kind of positive outlook for both countries, we can expect to see more products shipped in the near future. The deal would also provide easier way of negotiating new deals in China for Interdigital, which is one of the biggest concerns for management at this moment. We can see that Interdigital is expending with new patents and currently holding 36,000 patents. They are leader in the 5G technology that will allow them to expend with new products and open themselves to the new market. Their secondary focus is Internet of things that is growing slower than expected, but with 5G technology, this could be the driver for extra revenue in the near future.

Trade deal problems:

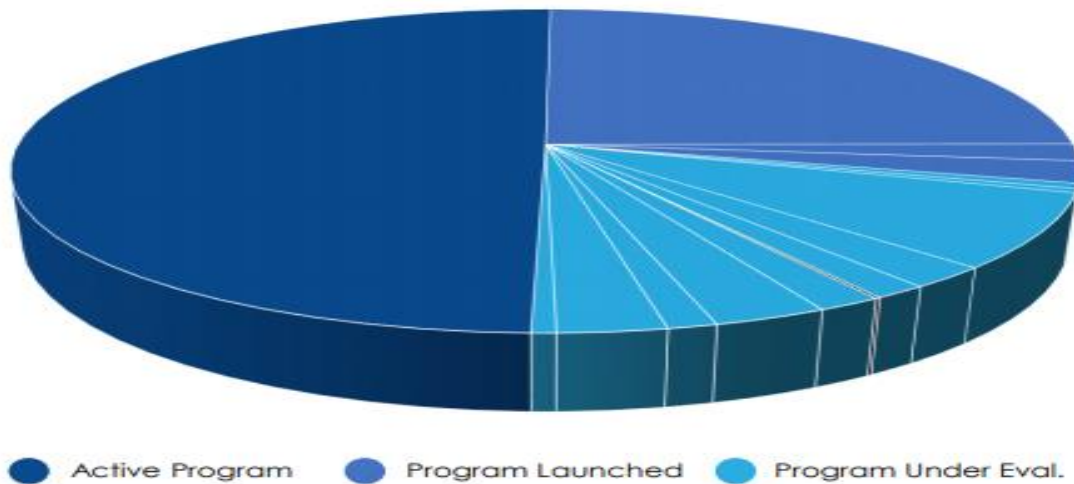
One of the biggest concerns that CEO has expressed himself was negotiation with Chinese companies that are currently using the technology being patented by Interdigital. Due to the limited way of communication and difficulty to approach new companies, Interdigital is hoping that new trade deal will resolve this issue and allow them to bring more of recurring revenues. CEO said that majority of handset companies that are in China are still not under their license. If the trade deal settles down in the near future, this could potentially bring more revenue.

New acquisition of Technicolor:

The recent acquisition of Technicolor's video/recording division provided additional 16,000 patents that will provide new market for Interdigital. Recent conference in Barcelona on February 12th promoted some of the new products that Interdigital and Technicolor's have been working on which includes 360 degree picture model and feedbacks were very positives. There has been renewal deal with LG that announced their cooperation on new technology for the Hillcrest Lab that will focused on television remotes.

New market is coming:

There is tremendous talk about 5G platform and what it will bring to customers. IDCC has shown ability to adopt quickly in 2014 when 4G was released and their revenue was doubled since then. With this said, we can expect their approach towards new technology in the same matter and try to stay one of the leader with wireless connections. In their recent report they said that their patents are used by 9 out of 20 phone leaders companies. They also showed the chart of their programs that is under review still, which is almost 50%. Taking into consideration that they already have more than 34,000 patents we can expect more to come.



Average
2017-2022 CAGR
 of all cellular IoT
 markets outside
 mobile devices:



New Accounting rule ASC606:

On January 1st 2018, InterDigital was required to adopt to new accounting revenue recognition called ASC606. This ruling cause their revenue to drop drastically and it was reflected in the price of the stock. However, if we look closely into their reported revenue for past 3 years, we can see that their reoccurring

revenue kept constant of approximately \$300M and we can see some surprises in non-current patent royalties. These numbers are very interesting, because they usually move the stock price up in the short run. With new potential market, IDCC is expecting to bring their reoccurring revenue to approximately 500M by 2022, and if we take into consideration of some non-current patent royalties to be announced throughout the year, we can expect this number to be much higher. Looking into their past 3 years, they have never missed reoccurring revenue; however, ASC606 caused them to push some of the revenue into future. Looking into 2016 and 2017, they had recurring revenue around \$350M and they were able to bring additional 200M in both years. With 5G coming to the market in 2019, we can expect similar outcome for InterDigital.

	2016					2017					2018					YTD Adjustment	ASC 605 YTD ⁵
	Q1	Q2	Q3	Q4	YTD	Q1	Q2	Q3	Q4	YTD	Q1	Q2	Q3	Q4	YTD		
Revenues:																	
Variable patent royalty revenue	\$ 73.7	\$ 44.5	\$ 35.8	\$ 14.0	\$ 168.0	\$ 15.9	\$ 11.4	\$ 10.1	\$ 10.5	\$ 47.8	\$ 6.1	\$ 6.6	\$ 13.6	\$ 10.1	\$ 36.4	\$ 0.4	\$ 36.8
Fixed-fee royalty revenue	29.1	29.1	45.7	73.7	177.6	73.4	73.1	73.7	81.5	301.6	57.7	60.3	60.3	61.1	239.4	79.3	318.7
Current patent royalties ⁴	102.8	73.6	81.5	87.7	345.6	89.2	84.5	83.7	92.0	349.5	63.8	66.9	73.9	71.2	275.8	79.7	355.5
Non-current patent royalties	4.2	1.3	124.0	180.3	309.8	—	47.9	8.8	106.2	162.9	23.3	2.0	0.1	0.8	26.3	(9.9)	16.3
Total patent licensing royalties	107.0	74.9	205.5	268.0	655.4	89.2	132.3	92.6	198.2	512.4	87.1	68.9	74.0	72.0	302.0	69.8	371.8
Patent Sales	—	—	—	—	—	—	—	—	—	—	—	—	—	0.8	0.8	—	0.8
Current technology solutions revenue ⁴	0.8	1.0	2.8	5.9	10.5	5.3	3.5	4.8	7.1	20.6	0.3	0.7	1.0	2.5	4.5	5.0	9.5
Total revenue	\$ 107.8	\$ 75.9	\$ 208.3	\$ 273.9	\$ 665.9	\$ 94.5	\$ 135.8	\$ 97.3	\$ 205.3	\$ 532.9	\$ 87.4	\$ 69.6	\$ 75.1	\$ 75.3	\$ 307.4	\$ 74.8	\$ 382.1
Recurring Revenue (E a)	\$ 103.6	\$ 74.6	\$ 84.3	\$ 93.6	\$ 356.1	\$ 94.5	\$ 87.9	\$ 88.5	\$ 99.1	\$ 370.0	\$ 64.1	\$ 67.5	\$ 75.0	\$ 73.7	\$ 280.3	\$ 84.7	\$ 365.0

Operating costs:

One of their strong side is keeping their operating cost same no matter how much revenue they bring. This is very important for the future revenue, if we consider that they are going to double their revenue. With that said, their margins are growing with revenue and companies value is based on the thought to keep their expenses same. In the last conference call, CEO announced that at the end of the year we should see expenses to drop down to the same level as of 2017. This will boost margins even more, and bring free cash flows up that will pay of well for investors.

	2016					2017					2018				
	Q1	Q2	Q3	Q4	YTD	Q1	Q2	Q3	Q4	YTD	Q1	Q2	Q3	Q4	YTD
Operating Expenses:															
Patent administration and licensing ¹	\$ 25.0	\$ 26.3	\$ 24.7	\$ 27.4	\$ 113.5	\$ 26.9	\$ 23.2	\$ 26.5	\$ 26.0	\$ 102.6	\$ 26.9	\$ 26.5	\$ 32.1	\$ 38.6	\$ 124.1
Development ¹	20.6	14.9	16.0	21.6	68.8	19.8	19.1	17.3	19.6	75.8	16.2	15.8	17.3	20.4	69.7
Selling, general and administrative ¹	13.8	11.7	10.9	15.7	46.3	13.9	12.5	12.6	14.0	53.0	14.2	11.6	12.8	12.5	51.1
Total Operating Expenses	\$ 59.5	\$ 52.8	\$ 51.6	\$ 64.7	\$ 228.6	\$ 60.6	\$ 54.8	\$ 56.4	\$ 59.6	\$ 231.4	\$ 57.3	\$ 53.9	\$ 62.2	\$ 71.5	\$ 244.9

Concerns about their future:

Their business model is very dependent on making deals with companies that are potentially using their patents. In the last conference calls, CEO explained that it is hard to find companies that will willingly agree to pay them royalties for the patents. Many cases end up in the court and this could be costly for them if the result of the court is not in their favor. Other concerns are how long their patents and licenses could sustain same revenue and if their technology is going to be used for long or short time.

Valuation:

InterDigital remains an attractive platform to participate in the expansion of wireless connectivity. Adding a multimedia licensing platform at nearly no incremental cost augments the potential revenue platform and leverage. The view that 2018-2019 numbers are clouded by the implementation of a new revenue standard and the sizable Technicolor acquisition, but capture of revenue towards the platform potential would generate earnings growth and outperformance. Capture of the platform is likely over time given IDCC's strong record of accomplishment. The price target of \$95 comes from a 23x multiple on 2019 Non-GAAP EPS estimate of \$4.19.

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idcc

Monday, April 29, 2019

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InterDigital, Inc.	Symbol: idcc
Analyst	Marko Stojanovic
Buy below	\$73.29
Sell above	\$105.64
Probability of Price Increase	100%
Last Price	\$65.44
Intrinsic Value	\$84.51
Target Dividends	\$0.00
Target Price	\$91.62

Quarterly Earning Surprises (Actual Vs. Median Estimates)

Revenue

12/31/2017	5.31%
3/31/2018	24.92%
6/30/2018	7.21%
9/30/2018	2.83%
12/31/2018	1.65%
Mean (Standard Error)	8.38% (1.05%)

EBITDA

12/31/2017	-86.85%
3/31/2018	-112.57%
6/30/2018	92.92%
9/30/2018	223.44%
12/31/2018	-64.87%
Mean (Standard Error)	8.38% (3.67%)

Financials

Profitability	idcc (LTM)	idcc Historical	Peers' Median (LTM)
Return on Capital	2.6%	191.10%	-1.58%
Adjusted EBITDA Margin	38.9%	55.05%	-0.39%
Return on Equity	3.9%	12.8%	22.2%
Adjusted Net margin	21.2%	27.3%	2789.6%
Invested Funds	idcc (LTM)	idcc Historical	Peers' Median (LTM)
Cash/Capital	94.4%	95.5%	19.1%
NWC/Capital	-12.9%	-19.8%	-1.4%
Operating Assets/Capital	16.8%	19.4%	57.5%
Goodwill/Capital	1.7%	0.0%	11.4%
Capital Structure	idcc (LTM)	idcc Historical	Peers' Median (LTM)
Total Debt/Market Cap.	0.15	0.12	0.10
Reported Cost of Borrowing	11.9%		10.1%
Cash Interest/Total Debt			6.7%
CGFS Credit Rating	CCC		CC
Credit Model Rating	bb-		b- to b
Probability of Default	0.06%		0.10%
Cost of Capital	CGFS Credit Rating	Credit Model Rating	Probability of Default
Implied Cost of Borrowing (idcc)	6.1%	6.6%	5.2%
Implied Cost of Borrowing (Peers)	6.6%	7.3%	6.8%
Cost of New Debt Estimate	10.0%		
Market Risk Premium Estimate	2.3%		
Cost of Equity Estimate	12.3%		
WACC Estimate	12.0%		