TSRA Wins Ruling, IDCC 4Q Earnings

Tessera *(TSRA, $17.06 -0.26, Rated 'Long—But Upside Incremental' in my latest Chip Investment Ideas)*
Wins $130M Ruling: TSRA announced a favorable arbitration ruling late yesterday regarding its patent dispute against Amkor. TSRA expects to receive $130M although the precise amount and timing is uncertain and apparently subject to limited disclosure per rules of the International Chamber of Commerce (ICC).

I consider this good news for TSRA and its core IP licensing business wholly consistent with renewed licensing deals from Hynix and STATS ChipPAC just since the beginning of the year. My bias on this stock remains positive: relatively attractive fundamental share price valuation compared to its IP business model peers; persistence of its core licensing business as evidenced by this ruling and the other two recent agreements; current restructuring activities to restore profitability that include the disposal of its Silent Air Cooling technology; and the significant potential upside associated with its DigitalOptics mems|cam solid-state auto focus camera initiative.

Separately, two days ago TSRA publically responded to Starboard Value's board proxy fight basically claiming it felt side-swiped amid negotiations to address their concerns. Aren't public companies fun?

IDCC		*InterDigital*			
Qtr:	4Q	**Grade:**	*A*	***Growth****(qtr-qtr)*	
Rev:	87.9	**Rev:**	+++	**Rev:**	-79.7%
GM:	64.4%	**EPS:**	+++	**Fcst:**	-48-47%
EPS:	$0.57	**Fcst:**	+++	**Div:**	$0.10 *reg*

4Q Earnings: 4Q sales exceeded guidance of $62M primarily due to $22.3M in catch-up royalties from a new licensee; the 80% sequential decline followed a one-time patent sale to Intel of $375M; and guidance only reflects on-going royalties exclusive of any potential catch-ups from new licensees. Quarterly royalty sales declined year-to-year on lower shipments from RIMM, HTC and Japanese companies. Nine new, renewed and expanded license deals were signed last year. Deferred revenue of $44.3M was related to arbitration of disputed SlimChip modem royalties. The company paid a one-time dividend of $1.50/share based in its Intel deal and pre-paid its 1Q regular dividend ahead of the tax-cliff on Jan 1. Litigation expense 4Q of $13.6M was spent on an ITC case against Nokia, Huawei, and ZTE; the ITC appeal against Nokia; and a new ITC case against Samsung, Nokia, Huawei and ZTE.

I remain negative on the shares and consider potential downside risk to be significant—mostly with respect to fundamental valuation. IP companies traded for 10-times sales prior to 2008 but these days the number is five-times, in my opinion. IDCC looks inexpensive on a trailing 12-month basis at 2.8-times sales, but its $663M in revenue last year included a one-time patent sale for $375M—and I am not comfortable expecting similar such blue-birds on an annual basis. On-going royalties at the current run-rate approximate $200M in annual sales and I can see this approaching $300M with the addition of potential catch-up royalties from new signatories as well as upside from the company's new business initiatives. This means its forward-looking price-sales ratio is currently in the range of 6.2-9.3 times sales based on yesterday's closing price of $45. A five-times price-sales multiple gets me to a target price of $24-36, so let's just call it $30 for argument sake. This is my potential downside risk.

To be fair, management is claiming a long-term annual revenue run-rate of $800M based on its core licensing business which could justify a $100 share price, although I struggle to see how that is likely over the next couple of years. IDCC has considerable value in its patent portfolio, done an impressive job generating cash and profits for shareholders, and has come up with an admirable multi-faceted business strategy to maximize returns—including licensing, patent sales, patent acquisition and trading, and 'commercializing technologies through key industry partnerships' like its recent Sony deal regarding wireless machine-to-machine communication.

I am probably not the only analyst struggling with details surrounding revenue recognition, deferred revenue, cash flows, and reserves against pending legal actions—never mind trying to scale its various potential market opportunities. The many moving parts at IDCC appear very difficult to model—and hence, to predict.

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