

WEEKDAY TRADER

InterDigital Has a Patent on Profits

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[InterDigital Communications](#), which holds hundreds of patents on wireless technology, finally ended a decade-long legal wrangle with [LM Ericsson](#) last month before it was slated to go to trial.

The suit with Ericsson, the fifth-largest handset maker (in partnership with Sony), was over past patent infringements, prepaid license agreements and future infrastructure sales. Ericsson agreed to pay InterDigital almost \$58 million.

"Before then, [InterDigital] was hope and prayer, and now the license dominoes are falling," says Eric Miller, co-manager of the Heartland Value Fund.

A day after the verdict was announced, investors sent the shares skyrocketing by 43%, as the company moved from just breaking even to rolling in dough.

From its 52-week low in August, the stock has more than tripled to 19.94 Wednesday. The shares are down 17% from their 52-week high late last month (see *At a Glance*), however, and more than 75% off their 1999 all-time high of 82.

InterDigital's big run-up may make some investors wary, but new customers and the growth of next-generation networks could make earnings estimates for the company seem conservative (See *At a Glance*).

InterDigital holds patents on technology used to transmit and receive wireless phone calls. Handset makers buy those licenses to use the technology in their phones.

Its technology enhances handsets' power control, allocation of bandwidth and data transmission, among other purposes.

InterDigital focuses on the GSM (Global System for Mobile Communications) standard, which is mainly used in Europe, though it has patents on technology used in U.S. and Asia as well.

InterDigital should really get a boost as providers phase in next-generation, or 3G, technology.

Its niche is in managing data sent through wireless networks, whether it's text messaging, sending digital photos of the grandkids or downloading the new Britney Spears ring tone.

"The market's moving toward data and that's [InterDigital's] specialty," says analyst Tom Carpenter of Hilliard Lyons.

Right now, voice remains the principal use for wireless, and the jury is still out on whether consumers will really use data features heavily. But 3G should make data transmission much easier.

"We think there's more upside [for InterDigital] from 3G," says Miller, whose fund owns about 1.4 million InterDigital shares.

More than six million wireless customers in Japan already have 3G phones capable of handling data-heavy features.

The U.S. and some Latin American, European and Asian countries are all building 3G networks, says Bryan Prohm, analyst at Gartner Dataquest.

"There are certainly 3G success stories, but it will take time for data to replicate [voice's growth]," he says.

The settlement with Ericsson came just in time for InterDigital to benefit from the new technology. The terms Ericsson agreed to will likely become the template for [Nokia](#) and Samsung, as well.

Carpenter expects the two big handset makers to sign similar deals in the next 12 months, although they are not in litigation with InterDigital.

In fact, Nokia has already booked a patent infringement charge to 2002 earnings of \$100 million to pay royalties to InterDigital. And InterDigital estimates that Samsung, which chose the same licensing agreement as Nokia did last year, may pay from \$22 million to \$27 million.

InterDigital also has license agreements with Sharp, [NEC](#) and [Matsushita](#) that could provide it with extra cash while it waits for the Nokia and Samsung deals to close.

And the Ericsson settlement doesn't even deal with 3G licenses, and neither does Samsung's agreement. That could mean additional royalties that are not now being factored in to the stock price.

We're in discussions [with Ericsson and Samsung] with 3G agreements," says Charles Tilden, InterDigital's chief operating officer, but it's unclear when those deals may be signed.

Even before the Ericsson settlement, things were clicking at InterDigital.

For its fourth quarter, the company earned seven cents a share on sales of \$25 million, as recurring royalty revenue grew 12% over the

third quarter, to \$15.5 million. In the previous year, InterDigital lost 18 cents a share.

And as InterDigital merely licenses its patents on technology, gross profits were an astonishing 100%, while operating margins were a healthy 25%, up from negative margins a year ago, according to Carpenter.

Financially, InterDigital seems healthy, too.

The company has very little debt and about \$87 million in cash. Carpenter estimates that including Ericsson's royalty prepayments for this year and next will give InterDigital almost \$3.00 a share in cash. He expects Nokia and Samsung to pay another \$2.00 a share in royalties when those two deals are completed.

That's why his projected annual earnings growth rate of 25% for the next three years could be conservative.

And even with that conservative valuation, shares seem cheap, trading below that rate.

As settlement and royalty payments flow in just in time for 3G technology to begin taking off, more investors may wind up dialing InterDigital for profits.

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