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Q4 2023 InterDigital Inc Earnings Call

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PRESENTATION

Operator

Good day and thank you for standing by. Welcome to the InterDigital fourth-quarter 2023 earnings conference call. (Operator Instructions) Please be advised that today's conference is being recorded.

I would now like to turn the conference over today to your speaker, Raiford Garrabrant. Please go ahead.

Raiford Garrabrant *InterDigital Inc - Head of IR*

Good morning to everyone, and welcome to InterDigital's fourth-quarter 2023 earnings conference call. I am Raiford Garrabrant, Head of Investor Relations for InterDigital. With me on today's call are Liren Chen, our President and CEO; and Rich Brezski, our CFO.

Consistent with prior year-end calls, we will offer some highlights about Q4 and fiscal year 2023 before opening up the call for questions. For additional details, you can access our earnings release and slide presentation that accompany this call on our Investor Relations website.

Before we begin our remarks, I need to remind you that, in this call, we will make forward-looking statements regarding our current beliefs, plans, and expectations, which are not guarantees of future performance and are made only as of the date hereof. Forward-looking statements are subject to risks and uncertainties that could cause actual results and events to differ materially from results and events contemplated by such forward-looking statements. These risks and uncertainties include those described in the Risk Factors section of our 2023 annual report on Form 10-K and in our other SEC filings.

In addition, today's presentation may contain references to non-GAAP financial measures. Reconciliations of these non-GAAP financial measures to the most directly comparable GAAP financial measures are included in the supplemental materials posted to the Investor Relations section of our website.

With that taken care of, I will turn the call over to Liren.

Liren Chen *InterDigital Inc - President, Chief Executive Officer, Director*

Thank you, Raiford. Good morning, everyone. Thanks for joining us today. 2023 was another outstanding year for InterDigital. We made excellent progress across our business as we signed new agreements in our smartphone and our consumer electronics and IoT programs, significantly increased our revenue and net income year over year, strengthened our innovation engine with a record number of new patent filings, and returned more capital to shareholders.

Today, we will summarize our progress in Q4, our achievements throughout 2023, and why we feel we are really well positioned for further growth in 2024 and beyond.

Revenue for fourth quarter was \$106 million, including recurring revenue of just over \$103 million, and our adjusted EBITDA was \$53 million. In the quarter, we returned about \$47 million to our shareholders and expanded our existing share repurchase authorization to a total of \$300 million. Our status as a world-class innovator was again underlined in the fourth quarter as one of our senior wireless

engineers was elected to the Board of ETSI, the European Standards Organization which plays a key role in the development of cellular wireless technologies.

Looking across the full year, Q4 capped an outstanding 12 months for the company. Our revenue for 2023 was \$550 million, up 20% year over year. Revenue from our smartphone licensing program increased by 32% year over year. Our recurring revenue increased to a record level of just over \$408 million. As we drive growth in our top line, we see an even greater impact on our bottom line as shown in our more than 80% year-over-year increase for our non-GAAP EPS.

In addition, we returned almost \$380 million to shareholders through dividends and share buybacks. Rich will go through the numbers in more detail in his section. Thus, our excellent financial performance indicates 2023 was full of highlights for the company.

On the licensing side, we entered into eight new license agreements, including cellular and HEVC licenses with Lenovo, a cellular agreement with TCL, and two agreements with Panasonic. 2023 was also an exceptional year for our inventors and patent team, which created a record-setting number of inventions and new patent filings, up more than 70% year over year, taking our total patent portfolio past 30,000 granted patents and applications.

And the quality of our innovation was again recognized as we were named one of the top five patent holders for 5G patents in terms of both quality and quantity by a leading third-party research company.

We take pride in how our engineers lead the evolution of technology globally. In addition to the recent ETSI election I noted above, some of our engineers won the election to senior leadership positions for wireless, video, and AI-standard development organizations. Across our research team, our engineers now hold more than 100 key leadership positions in those organizations.

In 2023, in our disputes with Lenovo, when our patents were tested in litigation, they were repeatedly found to be valid and infringed by courts in both UK and Germany - another clear indicator of quality of our innovation.

Right before end of the year, we won a notable victory in our pursuit of fair compensation for OPPO's use of our patented technologies. A court in Germany ruled that OPPO infringed our IP and that it should be excluded from the German market. The court ruled resoundingly in our favor, agreed that we conducted a licensing negotiation in a fair and reasonable manner, and, as other courts have regularly done, upheld the quality of our patented innovation.

The court's strong criticism of OPPO's behavior throughout our negotiation reflects why, from time to time, we have to enforce our patents in litigation. While we always prefer to sign new agreements through amicable bilateral negotiations, we are firmly committed to defending the value of our IP through enforcement efforts if necessary.

Our progress was recently recognized by Forbes, which ranked us as one of America's top 100 most successful mid-cap companies. While I am particularly pleased by this recognition, we also firmly believe that there is still considerable upside for us in multiple areas.

Our business momentum continues into Q1 of 2024. In January, we announced a landmark agreement with Samsung, which licenses their digital TV and PC monitors to a range of our video and Wi-Fi patents, and to patents that are part of our joint licensing program with Sony. As Rich will explain in more detail, we expect the agreement to have a considerable positive impact on our Q1 results.

Samsung is the largest manufacturer of TV in the world, and this agreement reflects not only the strengths that we see on the CE side, but also, more broadly, the value of our video and wireless innovation. As previously discussed, our video compression technology is important for devices, but it also essentially enables the entire distribution platform of streaming and other cloud services, which we continue to see as an attractive third pillar of growth, along with the significant growth opportunity we have in smartphones and CE IoT programs.

I also want to remind everyone that our new license with Samsung is separate to our license agreement with them for cellular devices, which we announced at the beginning of 2023 and is now being finalized through arbitration. The arbitration hearing is on track to be

held this summer with a final resolution expected by end of this year.

With our recent licensing success, we have signed more than 30 new agreements and renewals with an aggregate contract value of over \$2.5 billion since early 2021. This gives us an incredibly strong platform from which to deliver further success and another very strong result in 2024.

Looking ahead through this year, we have guided that our revenue will be between \$620 million and \$670 million for the full year, which reflects our pipeline for contracted revenue and projected growth through new agreements.

As we continue our journey to grow the company, we announced on Monday that we have appointed Ken Kaskoun as our new Chief Growth Officer. Ken was recently in charge of strategy and business development at a life science company, and before that, led strategy in Qualcomm licensing business. He understands our space very well, and his recruitment underlines our status as a destination for top-level talent.

Later this month, we will once again take part in Mobile World Congress in Barcelona, where we have several demonstrations of our innovation in wireless, video, and AI, and where one of our senior video engineers will give a keynote presentation on the power of haptics to enhance immersive streaming experiences. On the wireless side, our demonstration will focus on integrated sensing and communication, a technology which will be a key pillar of 6G and where we are already a leader. On the video and AI side, we will showcase the latest VVC technology coupled with our energy aware media solutions and AI expertise to stream high-quality video content while lowering energy usage.

I hope to see you at our booth if you are attending Mobile World Congress.

With that, I'll hand you over to Rich to talk you through our numbers in more detail.

Rich Brezski *InterDigital Inc - CFO*

Thanks, Liren.

A year ago at this time, we mentioned that our strong execution throughout 2022 drove excellent financial results and put us in what we believed was the strongest position the company has ever been in. Now, after achieving 20% top-line growth, significant margin expansion, and licensing momentum beyond the smartphone market, we are excited to reiterate our belief that the company has never been better positioned to drive growth.

Our final results for Q4 came in above our preliminary estimates, which we published last month. The improvement was driven primarily by a lower effective tax rate, as well as favorable reward reports we received in the intervening period. Building on Liren's comments, I'll highlight a few noteworthy items from our full-year 2023 results that demonstrate success towards our objective of delivering consistent revenue growth combined with strong margins.

Total revenue accelerated to \$550 million, an increase of 20% year over year, resulting in a compounded annual growth rate of 15% over the past four years. Recurring revenue reached an all-time high of \$408 million. Our 2023 revenue included \$81 million of CE and IoT revenue. This is more than triple our CE and IoT revenue from 2020 and represents a 19% compounded annual growth rate over the past four years. This success demonstrates our ability to grow revenue by capitalizing on the value our fundamental horizontal technologies bring to the markets other than smartphones.

Because of the financial leverage inherent in our model, adjusted EBITDA grew 36%, almost twice the rate of revenue growth, to \$345 million. As a result, our adjusted EBITDA margin continued to improve and rose by 7 points to an exceptional 63%. This represents a 22-point improvement over the past four years.

We ended the year with roughly \$1 billion in cash and \$400 million of net cash. Cash flow continued to be robust, with \$214 million of cash from operations and \$169 million of free cash flow for the year. These strong cash flows enabled us to return a record \$379 million

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to shareholders in 2023. Most of this was through buybacks of nearly \$340 million, and we also increased our dividend by 14%.

After the increase to the share repurchase authorization in December 2023, and our repurchases through the first half of Q1 '24, we have room to buy back another \$285 million. Since we announced our first dividend in December 2010, we have returned nearly \$1.8 billion to shareholders through buybacks and dividends. In that time, we have reduced our outstanding share count by more than 40%, from more than 45 million shares to fewer than 26 million shares.

With all that we accomplished in 2023, the most important thing is that we built on our strong foundation and have carried that momentum into 2024. The Samsung TV agreement Liren discussed is a significant step toward reaching our goals in CE and IoT. On the strength of the Samsung TV deal, we expect Q1 revenue will be in the range of \$245 million to \$255 million. This includes \$152 million to \$160 million of catch-up sales, and almost \$22 million of recurring revenue, or more than \$85 million on an annualized basis from CE and IoT.

Our Q1 quarterly guidance does not include any new agreements or renewals we may sign between now and the end of the quarter. We expect Q1 operating expenses will be \$149 million to \$154 million, including revenue share expense from existing agreements of \$66 million to \$69 million, an adjusted EBITDA margin of about 50%, and non-GAAP diluted earnings per shares of roughly \$3.00 to \$3.60.

Given the momentum in the business and the strong pipeline of opportunities, we feel it's an appropriate time to introduce full-year guidance in addition to our typical quarterly outlook.

For fiscal year 2024, we have guided to total revenue in the range of \$620 million to \$670 million. We expect an adjusted even on margin of roughly 50% due to the revenue share associated with large catch-up revenue from recent CE licenses. With that, we expect non-GAAP diluted earnings per share of \$7.45 to \$8.76.

Longer term, our goal remains to achieve and sustain a 60% adjusted EBITDA margin on \$650 million of annual recurring revenue from device licenses with upside from the greenfield opportunity in video streaming and cloud services.

Before I conclude, I'd like to mention that we'll be attending three upcoming conferences, the Susquehanna Tech Conference in New York City on February 29, Sidoti's Virtual Small-Cap Conference on March 13 and 14, and the 36th Annual Roth Conference in Southern California on March 18. Please check with the representatives at those firms, if you would like to schedule a meeting.

With that, I'll turn it back to Raiford.

Raiford Garrabrant *InterDigital Inc - Head of IR*

Thanks, Rich. At this point, Lisa, we are ready to take questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Scott Searle, ROTH MKM.

Scott Searle *ROTH Capital Partners, LLC - Analyst*

Hey, good morning. Thanks for taking the questions. Hey, congrats, guys, on, I guess, the improving visibility to be able to give 2024 guidance well above what we were looking for?

Liren Chen *InterDigital Inc - President, Chief Executive Officer, Director*

Thanks, Scott.

Scott Searle ROTH Capital Partners, LLC - Analyst

Maybe to start. Liren, to dive in on the first quarter, implying your guidance is recurring revenue takes a little bit of a step down related to, I believe, some expirations with Huawei and Lenovo. Yet, for the year, you're looking for a relatively big number of \$620 million to \$670 million. I'm wondering if you could calibrate us through the course of the second to fourth quarters.

It sounds like you're clearly expecting some other either renewals or new contract wins to come in there that presumably will have some catch-up payments along with it. It seems like you're very comfortable that the Samsung arbitration is maybe going to be part of that. So I'm wondering if you could calibrate us with your early thoughts in terms of what's in the first quarter and how we should be thinking about the remainder of 2024.

Liren Chen InterDigital Inc - President, Chief Executive Officer, Director

Hey, Scott. Good morning. So basically, if you look at how we exit 2023, we were at record high recurring revenue platform. As you pointed out, we had a couple contracts expiring, but the main one is really the Huawei agreement, which we are currently in renegotiation, so it's not baked in our Q1 number yet.

Aside from Huawei, Scott, as you know, we have quite a few larger opportunities we are pursuing. The top of this is being OPPO and vivo. Based on our deal momentum, based on, frankly, some of the enforcement effort here, including what you mentioned, the Samsung mobile arbitration, we feel very strong about 2024 revenue opportunity.

It's difficult, as always, to pinpoint the exact timing of the deals. And frankly, we are also at this moment not breaking down the catch-up payment versus recurring portion. Needless to say, we are pursuing fair value for both catch-up and going forward rates in every negotiation. So in combination, we feel very strong regarding where we are, and we are comfortable providing the annual guidance.

One thing I do want to mention is our Q1 number does not include any new agreements we may sign, and then we will provide quarterly updates going forward as we make progress on the next quarter as well as the annual numbers.

Scott Searle ROTH Capital Partners, LLC - Analyst

Got you. Helpful. Maybe just then is the follow-up, and I don't know if you'll be able to answer this, but is there a number that you're comfortable with exiting 2024, what that annualized recurring revenue will look like versus the \$408 million that you posted in 2024? And I guess some of the newer opportunities, I'm kind of curious where guys like HONOR and Transsion kind of fit into the equation. Thanks.

Liren Chen InterDigital Inc - President, Chief Executive Officer, Director

Yes. So Scott, as I said earlier, we currently do not provide the breakdown of the recurring versus catch-up. And I hope by another year as we progress, we'll give you more insight.

Regarding HONOR and Transsion, if you look at the mobile side, the largest opportunity for us is OPPO, the next is vivo, then the HONOR, Huawei, and Lenovo are frankly in the next category.

Transsion, as you are aware, currently is one of those vendors that a lot of focus from multiple licensors are on them. Primarily historically, because of their business model, they were sort of below the radar. Now there's a lot of volume gains, so we are frankly together with some other major licensors are negotiating with them, and we hope over time to be able to add them as our valued licensee.

Operator

Jonathan Eisensohn, Bank of America.

Jonathan Eisensohn Bank of America - Analyst

Hey, thanks guys. So my first question is for Liren. How should we think about potential impacts or growth opportunities from AI on edge devices, on obviously handsets, and then also on some of the other devices that you guys also cover?

Liren Chen *InterDigital Inc - President, Chief Executive Officer, Director*

Hey, John. Good morning. We believe AI will be a very significant boost to our business. And the way we look at it here, there's actually multiple aspects for it. Number one, we believe AI will increase the value of our IP on a per unit base, but more adoption of AI technology onto the device side, so we will have a higher value of IP on the per device side.

Second thing's really quite a few market reports that say AI will drive an increase of device sales in the next 12 months and going forward. So obviously, with increasing volume and increasing value, we think that's a very good dynamic for our renewal as well as signing up new customers. So that's the second piece.

And the last piece of AI growth of our story is we have demonstrated our technology for AI in combination with video is very valuable. If you notice, we have a press announcement this Monday regarding our collaboration with a leading streaming company where we are combining our video codec with AI for the streaming delivery service. So we believe over time, this will strengthen the third leg of our growth story, which I refer to as online streaming as well as cloud services.

So having said all these business opportunities but fundamentally though, it always translates into our strengths in the AI technology, and we believe we have some of the best engineers in the industry and we frankly have quite a few leadership roles already in the AI standard space. So I'm quite bullish of that impact to us.

Jonathan Eisenson *Bank of America - Analyst*

Got it. That's very helpful. And then my follow-up is for Rich. So I mean it kind of goes off one of the last questions, but diluted EPS guidance obviously suggests a pretty strong first quarter. And then if you look at kind of the full year, you may see a little bit weaker EPS growth throughout the year. Can you kind of just give some color there? And obviously, there is potential upside as you talked about from other deals, but that's not baked into the guidance right now. So kind of just how should we think about the EPS growth throughout the year?

Rich Brezski *InterDigital Inc - CFO*

Yeah, so our first-quarter outlook is aided by new agreements including the Samsung TV agreement that we signed in January, and included in that number is quite a bit of catch-up sales. So therefore that's a Q1 impact that doesn't repeat in Q2 through Q4. In the Q2 to Q4 time period, we did factor in the potential for new growth into our outlook.

Operator

Anja Soderstrom, Sidoti.

Anja Soderstrom *Sidoti & Company, LLC - Analyst*

Hi, and thank you for taking my question and congrats on the nice progress here. First of all, I just want to clarify the full-year revenue guidance. It includes the catch-up payments for the first quarter, but does it include any potential catch-up payments in the coming quarters as well or is it just pure recurring revenue?

Rich Brezski *InterDigital Inc - CFO*

Yeah. So Anja, it does include the catch-up payments that I just referenced for Q1, and then it also includes our expectations for new business over the balance of the year. As Liren indicated, we're not detailing catch-up versus recurring revenue on that new business growth, because there's a number of different opportunities that it could come from, and they each present a different mix.

Anja Soderstrom *Sidoti & Company, LLC - Analyst*

Okay. Thank you. That was helpful. And then you benefited from a lower tax rate this quarter, and how should we think about that going forward? Should that continue decreasing or stay steady?

Rich Brezski *InterDigital Inc - CFO*

Yeah. So good question. In this quarter in particular, we had a positive tax adjustment related to a reversal of a valuation allowance, and that drove our rate for the year down to about 10%. If you look over the last three years, it's gone from like 27% to 22% to 10%.

Over that entire period, it's about 16%, which is pretty well in line with what we've been talking about for some time as the way we think of our long-term tax rate as being in the mid, growing to high teens. There's a step up in FDII in two years, which is one of the tax benefits we enjoy.

But overall, we think that as the business becomes more profitable, the tax rate actually gets better because we're able to leverage some of the fixed elements of our tax base that don't grow with new revenue growth.

Anja Soderstrom Sidoti & Company, LLC - Analyst

Okay. Thank you. And in terms of the new hire, Ken Kaskoun, what can we expect from him? What are you hoping he will accomplish? And why are you hiring a revenue growth officer now?

Liren Chen InterDigital Inc - President, Chief Executive Officer, Director

Yeah. We hired Ken from a life science company where he was responsible for business development as well as strategy work. But before that, he was at Qualcomm for extended period of time, where he was an engineer, he was an inventor. But his last job was really, he was in charge of strategy for Qualcomm technology licensing business.

And so the reason we bring him in is we are building for the long-term growth for the company. We really want to add more strength to our leadership team. And I think this hire, timing wise, it's very, very good. And also, it demonstrates we as a company are able to attract some of the best talents in our industry to further add to our leadership team.

Operator

(Operator Instructions) Chris Madison, William Blair.

Chris Madison William Blair - Analyst

Hi, thank you. This is Chris on for Arjun . Just one quickly for me. Just wanted to touch on, given the strong position the business is in today, how does this change the philosophy or approach to investments and capital allocation going forward in 2024? Thanks.

Rich Brezski InterDigital Inc - CFO

Yeah. So as far as the approach, it really doesn't change it at all. I mean, our approach has always been, we feel it's important to keep a strong balance sheet, but we want to make investments where we see substantial opportunity for return. And then beyond that, we tend to, given our cash generation, have excess cash, and we want to return that to shareholders. And that's exactly what we've been executing on for the last -- well, for many years, but certainly over the last year or so.

Operator

Thank you. There are no more questions in the queue, and I would like to turn the call back over to Liren Chen, CEO for closing remarks. Please go ahead.

Liren Chen InterDigital Inc - President, Chief Executive Officer, Director

Yeah. Thank you, Lisa. Before we close, I'd like to thank our employees for their dedication and contribution to InterDigital, as well as our many partners and licenses for outstanding year in 2023. Thank you to everyone who joined the call today, and we look forward to updating you on our progress next quarter.

Operator

Thank you for joining. Everyone may disconnect.

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