RPX Corporation: Huge Growth Potential And Competitive Advantages At A Discounted Price

Feb. 10, 2015 7:47 PM ET14 comments
by: Michael Liu

Summary

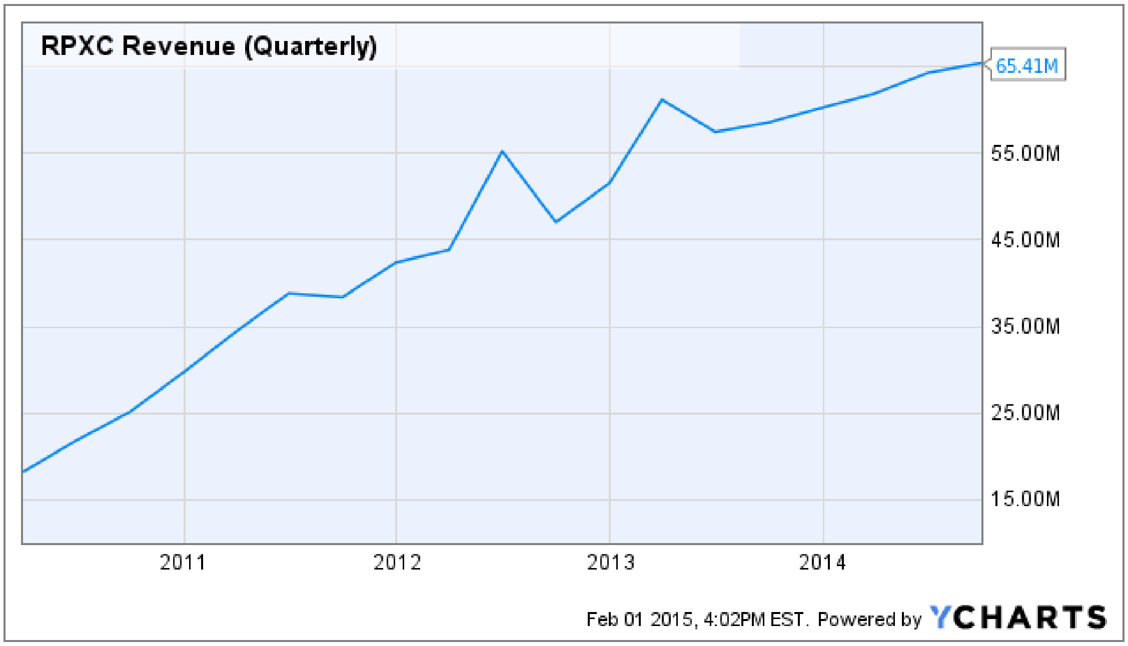
- RPX's business revolves around buying patents from businesses and then licensing them out to companies that desire to use the technology protected by those patents.
- It is one of the only players in this patent-licensing industry, and has two distinctive competitive advantages, namely its alignment with customer desires and the network effect.
- The company has demonstrated an impressive ability to grow over the past few years by growing revenues at a CAGR of over 20%.
- RPX's industry is massively under-served, and the company could easily capture a large portion of the market before competitors.
- The share price is also currently being discounted due to short-term worries over drops in subscription revenues amplified by end-year tax-loss selling.

What is RPX?

RPX Corporation (NASDAQ:RPXC) specializes in helping companies avoid patent-related lawsuits. Over 2500 companies are sued for over $13 billion a year in patent infringement lawsuits. The initiators of these lawsuits are often non-practicing entities (NPEs). NPEs acquire patents for the sole purpose of suing other companies when they attempt to develop products based on those patents. They do not make any products based on the patents that they own.

RPX helps to lessen the amount of these patent infringement lawsuits by buying patents from NPEs and then licensing them out to companies that desire to use the technologies guarded by the patents. RPX makes money off of the annual subscription fees that companies pay it in order to use its patented technologies. This subscription fee can range from anywhere between $85,000 and $7 million a year.

RPX is a relatively small company with a market cap of ~$650 million. RPX IPOed in 2011 at a price of $19 per share. To-date, it is down 30% to $12 a share, far from a stellar performance. What is impressive about the company is its revenue growth. This is shown in the chart below:



RPXC Revenue (Quarterly) data by YCharts

RPX has achieved a consistent 3-year CAGR of 20%, and is showing no signs of stopping. This CAGR is not including RPX's first public year, whose 100% revenue growth is near impossible to replicate.

Furthermore, the company was able to add an average of 8.8 licensing customers every quarter since its IPO (investor presentation, slide 27). This number is also expanding at a consistent rate, and should continue into the future as RPX continues to acquire patents that are needed by more and more companies.

Undervalued Opportunity

RPX's share price has been steadily declining for the past half-year. This downtrend was due to investor worries about the company's first-ever drop in subscription revenue. This was predicted in Q2 2014 guidance, and came true in Q3 results. Management attributed this drop to a unprecedented concentrated drop in mobile customers. However, on Tuesday, February 10th, RPX reported Q4 2014 earnings. Subscription revenue rose from the 3rd quarter, and was above guidance. Management also projected subscription revenues to increase again next quarter. This shows that the drop in Q3 was a one-time event that will likely not have any meaningful impact on the company in the long term.

The drop caused by this subscription revenue decline is a major overreaction and a buying opportunity. RPX's market cap has declined over 30% because of this one-time issue that has already been corrected. Management also seems to think the company is undervalued, as they just approved a $75 million buyback program, good for 11% of current shares outstanding.

The most likely reason for this overreaction could be that the company's IPO investors always begin to sell once the company nears its IPO price. As shown by the below chart, RPX's stock has found major long-term resistance at $18 levels, just shy of its $19 IPO price, showing that investors are still feeling burnt from the disappointing IPO and want to get out of the company.

RPXC data by YCharts

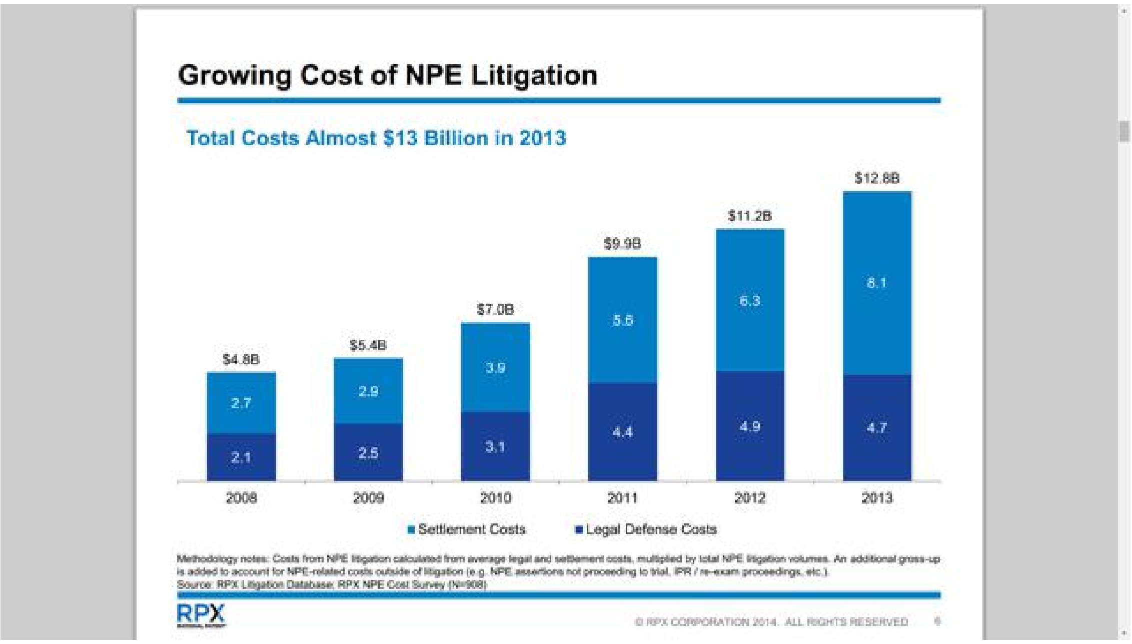
The overreaction could have also been amplified by year-end tax-loss selling.

Neither of these reasons are legitimate justifications for the company's decline, especially as the problem of dropping subscription revenues has already been shown as a one-time event.

RPX's current price puts it at a forward P/E ratio of just 12. This is an absurd valuation for the growth potential of the company, which will now be discussed.

Growth Potential

As was stated in the beginning of the article, almost $13 billion was spent on NPE litigation issues in 2013.



Source: RPX Investor Presentation, Slide 5

This litigation cost has also been rapidly expanding over the past few years. RPX has the prime potential to capture the growth of this multi-billion dollar industry, as it is the largest player in the industry.

The company is taking many initiatives to secure market share in the industry. One of these is amassing a huge patent portfolio. Just recently, the company announced the purchase of $900 million worth of 4000 patents from Rockstar Consortium. These patents cover a wide range of products in the smartphone industry, and their licensing by RPX should both give the company a huge new revenue stream and help to alleviate the huge amount of lawsuits in the mobile industry between industry giants such as Apple (NASDAQ:AAPL) and Samsung (OTC:SSNLF).

RPX currently has 195 clients, and is adding close to 30 new clients every year. Many of the company's clients are huge multi-billion dollar corporations that develop dozens of new products yearly and require hundreds of patents. And as RPX's customer base continues to grow, revenues should follow.

Competitive Advantage

RPX has two competitive advantages that put it leaps and bounds ahead of competitors. The first is its alignment with clients' desires. RPX's main competitor, Acacia (NASDAQ:ACTG), acts as an NPE, in that its earnings are derived from lawsuits against other companies for the violation of the patents that it owns. Acacia also licenses its patents out to other companies, like RPX. However, Acacia's suing gives it a bad name in its industry, which causes companies to avoid the company, and also makes earnings very volatile. This is nothing like RPX, whose earnings grow steadily in accordance to its licensing deals, and which is widely respected in the patent protection industry.

RPX is also a prime beneficiary of the "network effect." This network effect basically works by fueling growth by growth. In RPX's case, this means that as the company acquires more customers and earns more money, it can buy more patents and acquire even more customers from those patents, which gives it more money to buy more patents, and so on... So, as the company grows larger and earns more money, its growth potential increases as well. This competitive advantage allows RPX to continuously grow as long as it has a customer base, and is inherent to the investment thesis.

Going Forward

Going forward, I believe that RPX should continue to occupy the leading position in the patent licensing industry. This industry is immensely under-served, and RPX could easily take advantage of that by building up its patent portfolio and issuing licensing deals quickly, thus further strengthening its industry position and growing its valuation for shareholders.

This, however, would be a long-term move, and requires patience from shareholders. If RPX is able to hold the dominant industry position when the patent licensing industry matures, the company could be multiples of its current value. However, it may also take 5-10 years for this to occur. The short term for RPX is incredibly unpredictable, especially since it's a small cap stock with very little analyst coverage. Investors must look no further than the recent 25% decline due to investor worries about one quarter of bad earnings to see this short-term volatility in play.

Conclusion

DOCKET ALARM

Explore Litigation Insights

Docket Alarm provides insights to develop a more informed litigation strategy and the peace of mind of knowing you're on top of things.

Real-Time Litigation Alerts

Keep your litigation team up-to-date with **real-time alerts** and advanced team management tools built for the enterprise, all while greatly reducing PACER spend.

Our comprehensive service means we can handle Federal, State, and Administrative courts across the country.

Advanced Docket Research

With over 230 million records, Docket Alarm's cloud-native docket research platform finds what other services can't. Coverage includes Federal, State, plus PTAB, TTAB, ITC and NLRB decisions, all in one place.

Identify arguments that have been successful in the past with full text, pinpoint searching. Link to case law cited within any court document via Fastcase.

Analytics At Your Fingertips

Learn what happened the last time a particular judge, opposing counsel or company faced cases similar to yours.

Advanced out-of-the-box PTAB and TTAB analytics are always at your fingertips.

API

Docket Alarm offers a powerful API (application programming interface) to developers that want to integrate case filings into their apps.

LAW FIRMS

Build custom dashboards for your attorneys and clients with live data direct from the court.

Automate many repetitive legal tasks like conflict checks, document management, and marketing.

FINANCIAL INSTITUTIONS

Litigation and bankruptcy checks for companies and debtors.

E-DISCOVERY AND LEGAL VENDORS

Sync your system to PACER to automate legal marketing.