

*This article is authored by MOI Global instructor Rodrigo Lopez Buenrostro, Investment Principal at KUE Capital. The article previews Rodrigo's in-depth idea presentation on BlackBerry (NYSE: BB) at Wide-Moat Investing Summit 2018.*

"John Chen has completed the transition of BlackBerry from a smartphone company to a software company with about \$1 billion in revenue and growing. BlackBerry's reputation for security for mobile devices, its focus on an integrated internet of things system and its very large patent portfolio stand it in good stead for the future. Its QNX platform has had much success with building autonomous car systems for the major automobile companies, and its Radar for the trucking industry continues to excel." -Prem Watsa, 2017 Letter to Shareholders of Fairfax Financial Holdings

"Wait, I thought Blackberry didn't exist anymore..." is a phrase I have heard quite often the past few months. I don't blame these people as BB isn't the smartphone manufacturer that many people in the world used to know. Today, BB's largest clients are government, banks, insurance companies, hospitals and large automotive OEMs. In fact, many of these clients have remained Blackberry clients since the company's start back in the 1990s thanks to the company's strong legacy on secure communications.

Blackberry is a software security company. It focuses on mobile, security, and automotive software, catering to the enterprise. Blackberry's value add includes securing and managing endpoints in the Internet of Things. At the beginning of 2017, new CEO John Chen announced their withdrawal from the hardware business which he claims to be "commoditized and saturated".

As of the latest filing, more than 80% of revenues are software and services and this is expected to be 100% in the next couple of quarters as they continue to exit the hardware market. 75% of this revenue is recurring and requires limited CAPEX/WC to continue to grow. Current gross margins stand at 72% and are expected to increase toward the 80-85% range in the next couple of years.

As with any software business, R&D is BB's most important expense. The company spends 20-25% of revenues on R&D or \$230-250M per year. Although this investment is dwarfed by the large tech firms who spend billions on developing new products, BB has been able to win market share in the cybersecurity segment. Why? Because BB has a unique patent portfolio that allows it to compete despite smaller investment in R&D. These patents have positioned BB as the to-go cybersecurity company in the world for high-profile clients such as 9/10 of the largest commercial banks and insurance companies, 8/10 of the largest healthcare and aerospace/defense companies, and all of the G7 governments. Blackberry is the only company that has the ISO 26262 certification, which is the international standard for functional safety in electronic systems in automobiles, as well as the patents that allow Blackberry to be the sole user of Elliptic Curve Cryptography (ECC), essentially the most secure and efficient cryptography for the near future.

Given that the patents provide the wide moat for BB, we can get a sense of their market value with previous software acquisitions and the bid to buy the whole company from a renowned value investor. First, previous acquisitions provide a reference value of \$116K EV/patent. Assuming no premium for BlackBerry's unique patents, this values BB at \$10.9 per share or a downside of ~9%. Second, Prem Watsa from Fairfax Financial offered to buy the whole company for \$9 per share back in 2013. If I bring Watsa's offer to 2018 numbers after adding invested capital and current net cash, he would be willing to buy BB for \$11-12 per share, like the current market price.

That covers the downside as is tradition at Kue Capital. What about the upside? The two main drivers for BlackBerry's business going forward are QNX (secure automotive software platform) and EMM (enterprise communications security service). Assuming conservatively that BB grows parallel to the overall cybersecurity industry and takes advantage of the operating leverage inherent in this great business this company could be valued at \$25-27 in 5 years or \$15 per share today providing an attractive risk-reward relative to the value of its patents.

BlackBerry is an opportunity to invest in a tarnished yet legacy brand, in a formerly mismanaged company that boasts the right team today, in a company that used to manufacture smartphones but today sells cybersecurity solutions to large-ticket clients, and finally, in a portfolio of solid patents that provide the foundation for growth in the enterprise of things.