

October 27, 2011

InterDigital, Inc. (IDCC-NASDAQ-US\$45.15)

Core Business Declines While Sale Process Continues

RATING: Neutral **SECTOR:** Intellectual Property
TARGET PRICE: US\$NA **SECTOR RECOMMENDATION:** Market-weight
BASIS OF TARGET: NA

Licensee Weakness, Higher Costs Impact Quarterly Results

Last night, IDCC released 3Q11 results that were well below expectations after backing out a one-time tax related benefit and past sales from resolution of a customer audit. Reported EPS of \$0.57 included a \$0.15 benefit from a lower tax rate (10% versus 36% expectation) and an \$0.11 benefit from past sales of \$7.9 million. Excluding these items, EPS would have been in the \$0.30 range versus consensus expectations of \$0.40. The lower results were due to weak handset shipments at RIMM (13% of total revenues) and higher costs from newly filed litigation and the ongoing process to sell the company. IDCC did not host a conference call.

Sale Process Drags On As Consortiums Are Given Time to Form

IDCC announced it was exploring strategic alternatives for the company in mid-July shortly after the Nortel sale was completed. More than three months have passed with no sale, indicating that no single company is interested in buying IDCC on its own. With the Board continuing to explore a sale, we believe they are gauging interest from consortiums or at least giving them time to form. Given the size of the acquisition, IDCC may be more palatable to a group of companies that want to divvy up the assets.

Changing Competitive Dynamics, Portfolio Encumbrances Limits Upside

Since IDCC put itself up for sale, the competitive dynamics for patent portfolios within the mobile industry have changed mainly with Google buying Motorola Mobility. Now the main competitors in the space, Google and Apple, have expended large sums of capital on patent portfolios making them less interested in the sale process at IDCC. Furthermore, IDCC's portfolio has certain encumbrances that we believe have been overlooked- 1) the patents are heavily licensed to nearly 50% of the market, 2) the patents are declared essential to 3G/LTE standards making them subject to FRAND licensing commitments, and 3) the 3G patents did not fare well the one-time they were battle-tested in litigation with Nokia and the LTE portfolio is unproven.

Estimates Decline; Maintain Neutral Rating On Unattractive Risk-Reward

Our 4Q11 and 2012 estimates decline due to lower handset shipments at RIMM and higher costs from litigation. Our 4Q11 EPS moves to \$0.37 from \$0.45 and our 2012 EPS to \$1.72 from \$2.24. While this is less of an issue due to the ongoing sale process, we do believe it increases the downside risk to the stock in the event that a sale does not happen. In addition, the longer the sale process drags on, the more of an impact it will have on licensing momentum and overall company productivity. Bottom-line, we remain Neutral on the shares with downside risk increasing and interest from potential bidders appearing to wane. We see more attractive risk-reward opportunities in other companies in our patent-focused coverage universe.

RISK PROFILE: Above Average

RISK CONSIDERATIONS: invalidation of IP position, unsuccessful resolution of IP litigation, unfavorable royalty rates, volatility of earnings, competition

Disclosure Code: None

Important disclosures and analyst certifications are in the Disclosure Section.

Valuation Data

FYE Dec	2010A	2011E	2012E
Forecasted Revenue			
Estimates:	\$394.5	\$284.7	\$307.9
Projected			
EPS:			
Q1	\$1.09	\$0.51	--
Q2	\$0.79	\$0.37	--
Q3	\$0.79	\$0.57	--
Q4	\$0.77	\$0.37	--
Total	\$3.43	\$1.81	\$1.72
Basis of Estimate: GAAP Net Income			

Trading & Operating Data

52-Wk Range:	\$22.81-\$82.50
Volume 60-Day Avg (Th):	2,314.07
Avg. Shares O/S- LQ:	45.8
Market Value (\$M):	\$2,147.2
Institutional - % Held:	57.00%
Insider Ownership %:	0.00%
LT Debt /Capital LQtr %:	31.0%
(source: Baseline)	

Company Profile

InterDigital Inc. (IDCC) designs and develops wireless technologies for mobile voice and data communications. IDCC monetizes its technology position by licensing its IP to companies that make, use or sell products that conform to 2G and 3G wireless Standards. IDCC was founded in 1972 and is headquartered in King of Prussia, PA

InterDigital

Financial Statements

(Dollars in millions, except per share data)

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Income Statement	2008a	2009a	1Q10a	2Q10a	3Q10a	4Q10a	2010a	1Q11a	2Q11a	3Q11a	4Q11e	2011e	2012e
Total revenues	\$ 228.5	\$ 297.4	\$ 116.2	\$ 91.2	\$ 91.9	\$ 95.3	\$ 394.5	\$ 78.5	\$ 69.9	\$ 76.5	\$ 73.8	\$ 284.7	307.9
<i>Growth</i>		30.2%	64.7%	21.7%	21.7%	24.7%	32.7%	-32.5%	-23.3%	-16.8%	-22.6%	-27.8%	8.1%
Operating expenses:													
S,G&A	33.5	24.8	7.5	7.0	7.2	6.6	28.3	7.8	7.5	9.4	8.5	33.2	30.5
Patent administration and licensing expense	63.5	56.1	17.8	14.7	12.8	13.6	58.9	15.9	16.8	17.9	17.7	68.3	69.3
Development expense	98.9	64.0	16.2	16.4	17.5	21.5	71.5	17.4	15.8	17.0	18.1	68.3	69.0
Repositioning expense	-	38.6	-	-	-	-	-	-	-	-	-	-	-
Arbitration and litigation contingencies	(3.9)	-	-	-	-	-	-	-	-	-	-	-	-
Total Expenses	191.9	183.5	41.5	38.1	37.5	41.6	158.7	41.2	40.1	44.3	44.3	169.8	168.7
<i>Growth</i>	-9.1%	-4.4%					-13.5%					7.0%	-0.6%
Operating income	36.5	113.9	74.7	53.1	54.4	53.6	235.9	37.3	29.8	32.2	29.5	114.9	139.2
<i>Growth</i>													
EBITDA	65.4	136.8	80.2	58.4	60.1	59.3	258.0	43.1	35.7	38.1	35.4	138.5	162.7
Net interest and other investment income	3.4	(1.2)	0.6	0.9	0.6	0.5	2.6	(0.9)	(3.4)	(3.1)	(3.1)	(10.6)	(12.4)
Earnings before income taxes	40.0	112.7	75.3	54.0	55.0	54.2	238.4	36.4	26.4	29.0	26.4	118.2	126.8
Income taxes	13.8	25.4	26.5	19.0	19.5	19.9	84.8	13.0	9.3	2.8	9.4	34.5	45.0
Tax Rate	34.4%	22.6%	35.1%	35.2%	35.5%	36.7%	35.6%	35.8%	35.1%	9.6%	35.5%	29.2%	35.5%
Insurance reimbursement (net of tax)	4.0	-	-	-	-	-	-	-	-	-	-	-	-
Net income (GAAP)	26.2	87.3	48.8	35.0	35.5	34.3	153.6	23.3	17.2	26.2	17.0	83.7	81.8
Net income (Non-GAAP)	23.4	97.3	48.8	35.0	35.5	34.3	153.6	23.3	17.2	26.2	17.0	83.7	81.8
EPS (GAAP)	\$ 0.57	\$ 1.97	\$ 1.09	\$ 0.79	\$ 0.79	\$ 0.77	\$ 3.43	\$ 0.51	\$ 0.37	\$ 0.57	\$ 0.37	\$ 1.81	\$ 1.72
EPS (Non-GAAP)	\$ 0.51	\$ 2.20	\$ 1.09	\$ 0.79	\$ 0.79	\$ 0.77	\$ 3.43	\$ 0.51	\$ 0.37	\$ 0.57	\$ 0.37	\$ 1.81	\$ 1.72
<i>Growth</i>													
Shares outstanding	46.0	44.3	44.2	44.5	44.6	44.7	44.8	45.9	45.8	46.3	46.5	46.1	47.5
Margin Analysis													
S,G&A	14.6%	8.3%	6.5%	7.7%	7.9%	6.9%	7.2%	9.9%	10.8%	12.3%	11.5%	9.8%	9.9%
Patent admin & licensing	27.8%	18.9%	15.3%	16.1%	13.9%	14.3%	14.9%	20.3%	24.0%	23.4%	24.0%	19.6%	22.5%
Development	43.3%	21.5%	13.9%	18.0%	19.0%	22.5%	18.1%	22.2%	22.6%	22.3%	24.5%	21.8%	22.4%
Operating margin	16.0%	38.3%	64.3%	58.2%	59.2%	56.3%	59.8%	47.5%	42.7%	42.1%	40.0%	40.4%	45.2%
EBITDA margin	28.6%	46.0%	69.0%	64.1%	65.4%	62.3%	65.4%	55.0%	51.1%	49.8%	48.0%	48.6%	52.9%
Net margin	11.5%	29.3%	42.0%	38.4%	38.6%	36.0%	38.9%	29.7%	24.6%	34.3%	23.0%	29.4%	26.6%
Tax rate	34.4%	22.6%	35.1%	35.2%	35.5%	36.7%	35.6%	35.8%	35.1%	9.6%	35.5%	29.2%	35.5%

InterDigital, Inc.

IDCC

1) 03/30/09	2) 05/08/09	3) 10/30/09
Buy \$30	Buy \$36	Neutral NA



Disclosure Section

As of 10/03/11, Davenport's ratings of covered companies were distributed as follows: 67.18% Buy, 37.82% Neutral, 0.0% Sell
As of 10/03/11, Davenport's percentages of covered companies that were investment banking clients within the past 12 months by rating were: 10.31% Buy, 8.47% Neutral, 0.0% Sell

Companies Mentioned in this Report and Associated Disclosures

InterDigital, Inc. (IDCC - NASDAQ): None; Research in Motion (RIMM - NASDAQ): NA; Nortel (NTRLQ.PK) NA; Google (GOOG - NASDAQ): NA; Motorola Mobility (MMI - NYSE): NA; Apple (AAPL - NASDAQ): NA; Nokia (NOK - NYSE): NA

Description of Rating System

- Buy** These shares offer attractive long-term appreciation potential from current prices. We would expect these shares to outperform the market over a longer-term horizon and long-term investors can buy at current prices.
- Neutral** These shares should perform roughly in-line with the current market. We neither encourage the purchase nor the sale of these securities at current prices.
- Reduce/Sell** These shares have more downside risk than upside potential at current prices. We expect these shares to underperform the market at current prices.

Risk Profile Considerations

This risk classification has been determined primarily from considering the level and predictability of earnings, the volatility of the stock relative to the market, applicable debt ratings, the composition and level of the company's capital structure, the dependence on key customers, and other relevant risk considerations.

Description of Possible Disclosure Codes

- A1** The Research Analyst or a member of the Analyst's household owns common stock of the subject company.
- A2** The Research Analyst or a member of the Analyst's household owns preferred stock of the subject company.
- A3** The Research Analyst or a member of the Analyst's household has options on the common stock of the subject company.
- A4** The Research Analyst or a member of the Analyst's household owns rights for the securities of the subject company.
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- A8** The Research Analyst or a member of the Analyst's household owns a debt security issued by the subject company.
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- I2** Davenport or its affiliates expects to receive or intends to seek compensation for investment banking services from the subject company in the next 3 months.
- I/F** Davenport or its affiliates received fixed income investment banking fees from this company within the past 12 months.
- S/C** The subject company was a non-investment banking - securities related services client of Davenport or its affiliates for which compensation was received during the past 12-months.
- N/C** The subject company was a non-securities services client of Davenport or its affiliates for which compensation was received during the past 12-months.
- O** As of the end of the month immediately preceding the date of this report (or the end of the second most recent month if the report date is less than 10 calendar days after the end of the most recent month), Davenport or its affiliates beneficially

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- SCC** The Research Analyst received non-investment banking related compensation from the subject company in the past 12 months.
- U** Davenport or its affiliates managed or co-managed a public offering of securities for the subject company in the past 12 months.
- C** Any other actual, material conflict of interest of the Research Analyst or Davenport and its affiliates, of which Davenport and its affiliates or the Research Analyst knows, or has reason to know, at the time of this report.

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Certification

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