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# MORNING NOTE

**November 15, 2010**

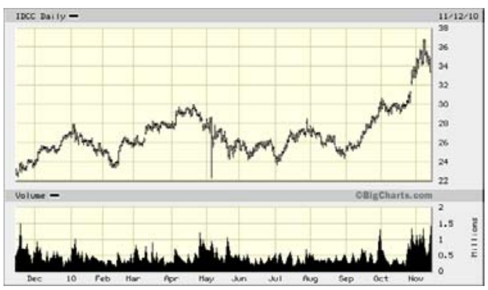
# INTERDIGITAL INC. (IDCC-Q)

**Rating: Buy**
**12-Month Target: $48.00**

## Q4'10 GUIDANCE AND INSIGHT FROM TWO DAYS OF MARKETING

| MARKET INFO: IDCC-Q | | | |
|---|---|---|---|
| Closing Price | | | $33.46 |
| Target Price | | | $48.00 |
| Potential ROI | | | 43.5% |
| 52 Week Range ($) | | | $22.30 / $36.81 |
| Market Cap ($mm) | | | $1,482.91 |
| Cash (mm) | | | $563.58 |
| Debt (mm) | | | $0.54 |
| Enterprise Value (mm) | | | $919.87 |
| Shares o/s (mm) | | | 44.3 |
| Avg Volume (previous 3 months) | | | 509,770 |
| **FYE: Dec 31** | **FY2009A** | **FY2010E** | **FY2011E** |
| Revenue (mm) | 297.40 | 395.30 | 397.43 |
| EBITDA (mm) | 185.16 | 266.76 | 281.03 |
| EBITDA margin (%) | 62.3% | 67.5% | 70.7% |
| EPS | $1.95 | $3.49 | $3.59 |
| **VALUATION** | **FY2009A** | **FY2010E** | **FY2011E** |
| EV/Sales | 3.1X | 2.3X | 2.3X |
| EV/EBITDA | 5.0X | 3.4X | 3.3X |
| P/E | 17.2X | 9.6X | 9.3X |

Source: Capital IQ, M Partners




## Q4'10 GUIDANCE AHEAD OF CONSENSUS

- On Friday, Nov 12, InterDigital released Q4'10 revenue guidance of between $92M and $94M representing Y/Y growth of ~21%. This was ahead of consensus expectations of $91.0M and also sequentially ahead of Q3'10 performance of $91.9M.
- Guidance included a $4.3M final payment from Beceem for technology solutions whose agreement is expected to terminate due to its acquisition by Broadcom (BRCM-Q). Guidance does not include "past infringement" revenue that often results from regular licensing audits on per unit device sales, nor does guidance include revenue from new licensees.
- Considering the recent pace of on-boarding new licensees over the past four quarters, and the rate of new OEMs manufacturing Android-based mobile devices, there is a strong possibility of new licensee signings during the quarter. Moreover, during the Q3'10 conference call, management highlighted that their licensing team has never been bigger and has been very active.
- We have refined our Q4'10 and FY'10 forecast to reflect the company's guidance. For Q4'10, we are forecasting revenue of $96.0M and adj. EBITDA of $64.1M.

| | Historical | | M Partners | Change | |
|---|---|---|---|---|---|
| **($mm)** | **Q3'10A** | **Q4'09A** | **Q4'10E** | **Q/Q** | **Y/Y** |
| Revenue | $91.9 | $76.4 | $96.0 | 4.5% | 25.7% |
| Adj. EBITDA | $61.4 | $47.5 | $64.1 | 4.4% | 35.1% |
| EBITDA (%) | 66.8% | 62.1% | 66.8% | - | +469 bps |
| EPS | $0.79 | $0.88 | $0.81 | 2.9% | -7.6% |

Source: M Partners, Capital IQ

## MARKETING MEETINGS – WHAT WE LEARNED

- On November 2nd and 3rd, we accompanied management for two days of marketing where they met with 18 institutional investors. Here is what we learned:
  - **LG must and will renew its 3G licenses**. However, IDCC is intent on including 4G/LTE license agreements into negotiations. The inclusion of 4G/LTE licenses may result in a small delay in renewal, which would be made up in past infringement payments.
  - **There is no dispute that Nokia is in violation of IDCC patents**. The current litigation track is intended to establish timelines and scope of infringement for independent negotiations towards closing a gap in price. We believe that 4G/LTE licenses may also be part of the discussion. With IDCC's current balance sheet strength, it now has the patience to terms that are broadly favourable.
  - **M2M patent licensing should become a larger contributor to revenue on a percentage basis over time.** Although per unit contribution should be less, sheer volume will drive high revenue contribution over time. IDCC currently has 60% of the M2M market under license.
  - **IDCC expects to get to 100% of all 3G devices under license, although 2G licensing topped out at 85%**. Currently, it has approximately 50% under license. Its expanded licensing group is currently engaged in negotiations with all or most unlicensed infringers.
  - **In conjunction with a consortium of interested parties, IDCC has submitted a bid for certain Nortel LTE patents**. The company expects the process to conclude sometime in mid-2011.

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- **The company currently has new 4G/LTE inventions deployed with a major converged network in AsiaPac**. These inventions are network-centric and are focused on solving congestion management challenges in real time. Investors should expect a broader range of licensing methodologies in the future to include network patents and IP licensing.
- **The typical dividend range for technology companies is between 2% and 3% per annum with the mean at 2.7%**. The company reiterated to all investors that when the dividend is established, it will fall within the typical range of technology stock dividends.

## VALUATION AND RECOMMENDATION

| Sum of Parts | Value (In MM) | Per Share |
|---|---|---|
| Cash and Equivalents | $563.6 | $12.79 |
| Existing Per-Unit Agreements | $709.1 | $16.10 |
| LG and Samsung Renewal | $371.0 | $8.42 |
| 4G/LTE Opportunity | $694.3 | $15.76 |
| **Less:** LT Debt | $0.6 | $0.01 |
| **TOTAL** | **$2,338.6** | **$53.09** |
| **Add: Nokia** | **???** | **???** |

Source: M Partners

- Our refined Q4'10 forecast is inconsequential to our sum-of-parts target price. IDCC currently trades at 3.1x and 2.9x our FY'10 and FY'11 EBITDA estimates compared to its peer set which trades at 14.2x and 13.0x respectively.
- Despite the recent run-up in its share price, we believe that IDCC continues to be undervalued on an absolute and relative basis and maintain our BUY recommendation with a $48.00 target price based on a 10% discount to our sum-of-parts analysis. We have discounted the sum-of-the-parts per share value from $53.09 to $48.00 due to its jurisdiction of incorporation in Pennsylvania.
- We are pleased with Q4'10 guidance, and we believe that statements made during the marketing tour de-risk our model assumptions. Most importantly, we believe that it is almost a certainty that Nokia and InterDigital will come to an agreement on 3G, and possibly some 4G licensing. We do not contemplate a licensing agreement with Nokia in our forecast. We reiterate our BUY recommendation.



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|---|---|
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**Rating System**

Buy: price expected to rise
Sell: price is inflated and expected to decrease
Hold: properly priced
Speculative Buy: price expected to rise; material risk to the investment exists
Under review: not currently rated

| Summary of Recommendations as of September 30, 2010 | | |
|---|---|---|
| Buy | 28 | 88% |
| Sell | 1 | 3% |
| Hold | 2 | 6% |
| Under Review | 1 | 3% |
| Total | 32 | 100% |

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