

August 19, 2011

INTERDIGITAL INC. (IDCC-Q)

Rating: Buy
12-Month Target: \$118.00

SAMSUNG DECLINES TO PARTICIPATE IN THE BID PROCESS

MARKET INFO: IDCC-Q			
Closing Price	\$64.69		
Quarterly Dividend	\$0.10		
Annualized Yield	0.62%		
Target Price	\$118.00		
Potential ROI	82.4%		
52 Week Range (\$)	\$22.81 / \$82.50		
Market Cap (\$mm)	\$2,939.77		
Cash (mm)	\$701.11		
Debt (mm)	\$192.60		
Enterprise Value (mm)	\$2,431.26		
Shares o/s (mm)	45.4		
Avg Volume (previous 3 months)	2,131,400		
FYE: Dec 31	FY2010A	FY2011E	FY2012E
Revenue (mm)	394.55	396.86	483.56
EBITDA (mm)	263.80	258.88	344.00
EBITDA margin (%)	66.9%	65.2%	71.1%
EPS	\$3.48	\$3.14	\$4.26
FD EPS	\$3.43	\$3.11	\$4.22
VALUATION	FY2010A	FY2011E	FY2012E
EV/Sales	6.2X	6.1X	5.0X
EV/EBITDA	9.2X	9.4X	7.1X
P/E	18.9X	18.9X	15.3X

Source: Capital IQ, M Partners



...THINKS IDCC IS GETTING TOO EXPENSIVE

- We are getting reports from the Korean media that Samsung has announced that it is not interested in bidding for the InterDigital patents.
- Samsung has said that patent companies have become too costly after the Apple consortium won the Nortel auction.
- Samsung has also stated that it will be watching IDCC closely, as the outcome could have an even bigger impact than Google's offer to acquire Motorola.
- We think that the statements attributed to Samsung suggest that:
 - It believes that the InterDigital patents are pretty important and
 - InterDigital could get expensive

MULTIPLE BIDDERS REMAIN – PROBABLY SIMILAR PARTIES TO NORTEL

- As we have stated multiple times, parties interested in the Nortel patents are likely interested in the InterDigital patents. We believe that there are a large number of potential bidders which could bid individually, or more likely, form into competing consortiums. Potential bidders include Apple, Qualcomm, Intel, Google, Nokia, Microsoft, RIM, Ericsson, Huawei, HTC, ZTE, RPX, Intellectual Ventures and potentially even a network provider such as AT&T. Among bidders, there is a combined cash balance approaching \$300B.
- Samsung did not participate in the Nortel process.
- Reuters reported a "first round" of bidding begins after Labour Day, suggesting more than two interested entities.
- We value IDCC at \$65.50 fundamentally based on its ability to generate cash flow from licensing 50% of the market for 3G and 4G/LTE licenses at around 0.8% FRAND royalty rate. We do not include potential licensing revenue from ZTE, Huawei, Nokia, or Motorola in our estimates.

BIDS WILL COME IN AT A PREMIUM TO CURRENT SHARE PRICE

- We do not believe that the Board of Directors at InterDigital would have made a decision to sell itself for (what it believes to be) fair market value after almost 35 years of operations. During the Nortel process (which they were also participants), they received an unsolicited inquiry, probably at a significant premium to current share price ranges.
- Based on the competitive bidding dynamics underway, we believe that a strategic bidder or consortium of bidders will ultimately be willing to pay a premium to the company's fair value based upon the long-term earnings potential of being able to minimize the cost of IP royalties. We calculate that 1% of gross margin is worth between \$3.0B and \$4.0B per annum. InterDigital is already proving that it can generate close to 1% mostly on 3G patents, most of which do not expire until the early 2020s. Depending upon demand tension created by the process underway, we believe that the company could generate shareholder value ranging between \$118 and \$167 per fully diluted share. Considering that the process is defined and should happen relatively quickly, any time the share price is below the current fundamental value of the stock, we believe is a low risk buy opportunity.
- Stock will remain highly volatile because it is no longer being assessed on a fundamental basis.

We reiterate our BUY recommendation and \$118 target price.

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MOTOROLA COMPARISON IN THE SAMSUNG STATEMENT: BE WARY OF EXHUBERANCE

- The market may misinterpret the “have an even bigger impact than Google’s offer to acquire Motorola” as hint at comparable price value for the IDCC patents, which would infer a \$275.00 share price or \$12.5B. Even in a competitive bid situation, we think this is highly unrealistic. In fact, we think Google paid fair market value for the expected future cash flow potential of the operating business – so in our opinion there is no comparison.

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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 June 30, 2011		
Buy	40	95%
Sell	1	2%
Hold	1	2%
Total	42	100%