

INVESTMENT RESEARCH

Tom Carpenter, CFA
Senior Technology Analyst
December 8, 2006

Rating: Long-term Buy
Suitability: 4
Technology

InterDigital Communications Corp

(IDCC-NASDAQ)

	Value	Blend	Growth
Large			
Mid			
Small			

Share Price Pullback Creates Opportunity.

Raising Rating to Long-term Buy

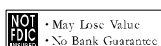
		December Fiscal Year	2006E	2007E	2008E
Recent Price	\$31.69	Earnings Per Share	\$1.69	\$0.78	\$2.02
52-Week High Price	\$36.91	P/E Multiple	18.8x	40.6x	15.7x
52-Week Low Price	\$17.25	Return on Equity ('05)			NM
Indicated Dividend	NA	Long Term Debt/ Total Cap. (09/06)			2%
Annual Yield	NA	Est. 3-Year EPS Growth Rate			25%
Market Cap.	\$1.7 B	Insider / Institutional Ownership			2%/49%
Price Target	\$40				

Company Description: InterDigital designs and develops technology content and systems solutions for advanced digital wireless communications applications. The company licenses 2G and 3G technology to wireless communications firms. Please see p.3 for a Wireless Glossary.

- **We raised our rating to Long-term Buy on Wednesday, December 6, 2006, when IDCC's share price opened under \$29.** At this level, we believe the shares are undervalued, and do not reflect positives that InterDigital can deliver over the next two years (new 3G licenses with major mobile phone manufacturers such as Nokia, Motorola, Samsung, and Sony Ericsson). If InterDigital signs 3G licensing agreements with these manufacturers at a rate between \$0.50 and \$1.25 per phone, we estimate IDCC's earnings power in the \$2.00 to \$3.50 range.
- **Mobile phone industry licensing could be at a standstill until Nokia and Qualcomm resolve their 3G licensing dispute.** Nokia and Qualcomm have a 3G licensing agreement that expires April 2007. There has been a war of words between the two over the past year. However, we believe there is greater likelihood than not of a compromise agreement in the week leading up to license expiration. While this likely impacts the timing of new 3G licensing agreements for InterDigital, once Nokia and Qualcomm resolve their dispute, we believe IDCC could sign 3G licensing agreements with two major manufacturers in 2007. Our take is that Sony Ericsson and Samsung could sign on the dotted line in 2007, with Nokia potentially coming to the table in late 2007 or 1H08 and Motorola in 2008.
- **IDCC is attempting to collect a favorable \$175 million to \$200 million 2G arbitration victory from leading handset manufacturer Samsung.** Although Samsung is attempting to stall paying (similar to Nokia), we believe IDCC will ultimately collect on the money owed (as IDCC did with Nokia). If IDCC's CEO Bill Merritt exercises some of the

Note Important Disclosures on pages 7-8.

Note Analyst Certification on page 8.



J.J.B. Hilliard, W.L. Lyons, Inc. - Member NYSE and SIPC



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creativity he has in past deals, we believe there is an outside chance that IDCC and Samsung can resolve their 2G dispute with a combined 2G/3G deal. That said, we continue to believe the most likely scenario is a 2G settlement, not a combined 2G/3G agreement.

- **IDCC is investing heavily in product solutions that could complement its licensing activity.** We applaud the move, as we believe the efforts, even though costing millions, will aid IDCC's licensing efforts. As licensing talks become more contentious industry-wide, our view is that firms offering solutions (and not just collecting a patent tax), will have an easier time working with handset manufacturers than a pure patent firm. IDCC's product solutions, which focus heavily on high speed data technologies like HSDPA and HSUPA, could meet with success, provided the firm has a working product available in 2H07. By 2008, we believe competitors will have caught up to IDCC's solution.
- **IDCC is in the enviable position of generating more cash than it needs to fund its current business model.** Cash and short-term investments at the end of 3Q06 were \$304 million, or approximately \$5.58 per share in cash. During the quarter, IDCC repurchased 1.8 million shares, utilizing \$50 million. Year-to-date, share repurchases have lowered the share count by 3%. The cash figure could be enhanced by over \$3 per share once IDCC receives its 2G arbitration payment from Samsung. We prefer dividends (which benefit long-term shareholders), special dividends, or patent acquisitions over share buybacks, which are used by many companies to offset option dilution.
- **Longer-term, we like IDCC's prospects, and believe the firm can earn between \$0.50 and \$1.25 per 3G handset sold by licensees.** As such, we are raising our rating to Long-term Buy with a \$40 price target. Although we believe IDCC can sign 3G licensing agreements with the four remaining major manufacturers by the end of 2008, our model is more conservative, and only reflects two of the four (Sony Ericsson and Samsung) inking deals that impact 2008 earnings. Our price target is based on applying a 20x multiple to our 2008 EPS estimate of \$2.02. We believe our target multiple is reasonable given the 22x forward multiple for the Nasdaq Composite and competitor Qualcomm's 22x multiple for 2007 and 20x multiple for 2008.

INVESTMENT THESIS

We believe InterDigital will sign 3G licensing agreements with all major handset manufacturers over the next two years. Licensing terms could range from \$0.50 to \$1.25 per 3G handset, potentially bringing in hundreds of millions of dollars of revenue per year. As IDCC generates virtually 100% gross margin on licensing revenue, a large percentage of this revenue will flow to the bottom line, and more importantly, cash flow. Depending on how the agreements are structured (either straight amortization regardless of sales or based on sales), we believe InterDigital's annual earnings per share power is in the \$2.00 to \$3.50 range.

The fly in the ointment, however, is an increasingly contentious licensing landscape. Lawsuits between: 1) Nokia and Qualcomm, 2) Broadcom and Qualcomm, 3) Samsung and Ericsson, 4) Samsung and InterDigital, and 5) Research in Motion and NPD, highlight an industry that is growing MORE, not less, litigious. We believe industry-wide licensing activity may remain at a standstill until Qualcomm and Nokia resolve their increasingly bitter 3G licensing dispute. Their 3G licensing agreement expires in April 2007, and while it is possible the parties resolve their

differences by then, we also believe it is possible that the dispute lingers for months, or possibly even a year if it is tied up in the legal system.

That said, we believe IDCC's share price opening under \$30 was too attractive to pass up. Until Nokia and Qualcomm resolve their dispute, the share price may stay in a trading range. However, once an agreement is achieved, we expect IDCC to sign two major manufacturers in the subsequent six-to-nine months to 3G licensing agreements. These agreements could significantly increase InterDigital's earnings per share and cash flow. We are forecasting that two of the four major mobile phone manufacturers, Sony Ericsson and Samsung, sign 3G licensing agreements with IDCC in 2007, thus contributing to 2008 recurring revenue. We are introducing a 2008 EPS estimate of \$2.02, which includes recurring 3G revenue from most of the Japanese handset manufacturers, LG Electronics, Samsung, several Taiwanese original design manufacturers (ODMs), and several smaller niche manufacturers. Our \$40 price target is derived by applying a 20x multiple to our 2008 EPS estimate.

RISKS

Risks to our Long-term Buy rating include:

- Timing of IDCC signing new 3G licensing agreements.
- IDCC's current 3G licensees losing market share to unlicensed competitors.
- IDCC's chipset efforts do not gain traction.
- Mobile phone industry-wide licensing stalling do to intellectual property rights (patent) disputes.

Additional information available upon request.

Prices of other companies mentioned in this report:

Broadcom (BRCM - \$34.12 – not rated)
Ericsson (ERIC - \$39.65 – not rated)
Motorola (MOT - \$21.09 – Long-term Buy)
Nokia (NOK - \$20.43 – Long-term Buy)
Qualcomm (QCOM - \$39.54 – Long-term Buy)
Research in Motion (RIMM - \$127.69 – not rated)
Sony (SNE - \$40.10 – not rated)

Figure I: Wireless Glossary

GSM – Global Standard for Mobile Communications, a 2G technology.

PDC and PHS – Japanese versions of TDMA. PDC stands for Personal Digital Cellular while PHS is Personal HandyFone System.

CDMA – Code Division Multiple Access.

CDMA2000 1x – a 3G air interface standard for wireless technology

EDGE – Enhanced Data Rates for GSM Evolution.

HSDPA – High Speed Downlink Packet Access. A packet-based data service that features downlink transmission rates up to 8-10 Mbps (megabits per second). It is expected that HSDPA will increase the viability of over-the-air downloads of music, movies, and related media.

HSUPA – High Speed Uplink Packet Access. A packet-based data service that enables communication from a terminal to host (uplink) at transmission rates up to 5.75 Mbps. It is expected that HSUPA will find early success with PC card manufacturers and PC manufacturers looking to embed their devices with technology that enables users to send large files quickly.

WCDMA – a 3G air interface standard for wireless technology, Wideband Code Division Multiple Access.

WCDMA FDD – Frequency Duplex Division, an initial stage of WCDMA that enables voice, video and data.

1G – First Generation. A circuit-switched, analog wireless technology that is not widely used today, except in rural or less developed areas. 1G only carries voice traffic.

2G – Second Generation. A digital wireless technology that enables voice and limited amounts of data. TDMA, GSM, and CDMA are examples of 2G air interface standards.

2.5G – Second and a Half Generation wireless technology that utilizes packet-switching, which facilitates increased data speeds. GPRS is an example of 2.5G.

3G - Third Generation wireless technology that uses packet-based wireless networks to deliver voice and advanced data services. WCDMA and CDMA 2000 1x are examples of 3G air interface standards.

Exhibit I: InterDigital Quarterly Earnings: 2005A –2006E**InterDigital (IDCC)****Earnings Model** in thousands, except per share data

Fiscal Year (ends Dec)	Q1-05A	Q2-05A	Q3-05A	Q4-05A	Q1-06A	Q2-06A	Q3-06A	Q4-06E
Calendar Year	Mar-05	Jun-05	Sep-05	Dec-05	Mar-06	Jun-06	Sep-06	Dec-06
Revenue								
Recurring Licensing & Royalty Product	30,797	33,101	44,038	36,200	49,560	54,917	65,975	61,000
Engineering Development	4,700	5,500	4,500	4,289	2,046	1,700	1,200	1,700
Other/one-time	-	-	-	-	-	-	-	-
Total Revenue	35,497	38,601	48,538	40,489	51,606	296,617	67,175	62,700
EXPENSES								
<i>Cost of Revenues</i>								
<i>Total Cost of Revenues</i>	-	-	-	-	-	-	-	-
Gross Profit	35,497	38,601	48,538	40,489	51,606	296,617	67,175	62,700
<i>Operating Expenses</i>								
Research and Development	16,173	14,921	15,610	16,391	16,010	15,887	16,805	18,068
Sales & Marketing	2,280	1,537	1,798	2,299	1,824	1,561	1,671	1,810
General & Administrative	6,566	5,912	5,420	6,252	5,021	5,695	5,045	5,399
Patent Admin. & Licensing	11,247	10,080	14,695	13,377	9,982	12,804	13,299	14,921
Other	-	-	849	631	-	-	-	-
<i>Total Operating Expenses</i>	<i>36,266</i>	<i>32,450</i>	<i>38,372</i>	<i>38,950</i>	<i>32,837</i>	<i>35,947</i>	<i>36,820</i>	<i>40,198</i>
Operating Income	(769)	6,151	10,166	1,539	18,769	260,670	30,355	22,502
Interest, net	790	677	779	918	1,508	3,914	4,082	4,041
Extraordinary Income (Expense)	-	-	-	-	-	-	-	-
<i>Net Income Before Taxes</i>	<i>21</i>	<i>6,828</i>	<i>10,945</i>	<i>2,457</i>	<i>20,277</i>	<i>264,584</i>	<i>34,437</i>	<i>26,543</i>
Income Taxes	903	2,817	4,419	1,100	7,338	94,221	12,780	9,768
<i>Income Tax Rate</i>	<i>NM</i>	<i>41%</i>	<i>40%</i>	<i>45%</i>	<i>36%</i>	<i>36%</i>	<i>37%</i>	<i>37%</i>
<i>Net Income</i>	<i>(882)</i>	<i>4,011</i>	<i>6,526</i>	<i>1,357</i>	<i>12,939</i>	<i>170,363</i>	<i>21,657</i>	<i>16,775</i>
<i>Preferred stock Dividends</i>	<i>-</i>	<i>-</i>	<i>-</i>	<i>-</i>	<i>-</i>	<i>-</i>	<i>-</i>	<i>-</i>
Net Income	(882)	4,011	6,526	1,357	12,939	170,363	21,657	16,775
EBITDA	4,237	11,151	16,194	7,710	23,440	265,170	34,655	26,802
EBIT	(769)	6,151	10,166	1,539	18,769	260,670	30,355	22,502
Average Shares Outstanding	55,053	53,642	53,611	53,943	54,340	54,397	52,209	51,165
Fully Diluted Shares Outst.	58,700	56,790	57,089	56,370	56,884	57,128	54,543	53,452
Earnings Per Share	(0.02)	0.07	0.11	0.02	0.23	2.98	0.40	0.31
Adj. Earnings Per Share	(0.02)	0.07	0.13	0.04	0.23	0.42	0.40	0.31
EBITDA Per Share	0.07	0.20	0.28	0.14	0.41	4.64	0.64	0.50
Margin Analysis								
Gross Profit	100%	100%	100%	100%	100%	100%	100%	100%
Operating	-2%	16%	21%	4%	36%	88%	45%	36%
Net Profit	-2%	10%	13%	3%	25%	57%	32%	27%
EBITDA	12%	29%	33%	19%	45%	89%	52%	43%
EBIT	-2%	16%	21%	4%	36%	88%	45%	36%
Percentage of Revenues								
Research & Development	46%	39%	32%	40%	31%	5%	25%	29%
Selling & Marketing	6%	4%	4%	6%	4%	1%	2%	3%
General & Administrative	18%	15%	11%	15%	10%	2%	8%	9%
Patent Admin. & Licensing	32%	26%	30%	33%	19%	4%	20%	24%
Goodwill & Other Intangibles	0%	0%	0%	0%	0%	0%	0%	0%
Year/Year Growth Rates								
Licensing	-7%	13%	499%	7%	61%	66%	50%	69%
Engineering Development	NM	NM	NM	NM	NM	NM	NM	NM
Total Revenues	8%	31%	560%	19%	45%	668%	38%	55%
Operating Expenses	46%	19%	45%	24%	-9%	11%	-4%	3%
EBITDA	-60%	111%	-207%	15%	453%	2278%	114%	248%
Net Income	-115%	369%	-202%	-927%	-1567%	4147%	232%	1136%
Diluted EPS	-117%	388%	-212%	-1442%	-1520%	495%	205%	685%
Quarter/Quarter Growth Rates								
Total Revenues	5%	9%	26%	-17%	27%	475%	-77%	-7%
EBITDA	-37%	163%	45%	-52%	204%	1031%	-87%	-23%
Net Income	NM	NM	63%	-79%	854%	1217%	-87%	-23%
Diluted EPS	NM	NM	84%	-69%	469%	85%	-5%	-21%

Source: company data, Hilliard Lyons estimates

Exhibit II: InterDigital Yearly Income Statement**InterDigital (IDCC)****Earnings Model** in thousands, except per share data

Fiscal Year (ends Dec) Calendar Year	FY F2001A	FY F2002A	FY F2003A	FY F2004A	FY F2005A	FY F2006E	FY F2007E
Revenue							
Recurring Licensing & Royalty Product	30,935	81,000	93,073	103,685	144,136	231,452	202,250
Engineering Development	21,627	4,498	1,177	-	18,989	-	5,250
Other/one-time	-	-	20,324	-	-	240,000	-
Total Revenue	52,562	85,498	114,574	103,685	163,125	478,098	207,500
EXPENSES							
<i>Cost of Revenues</i>							
Total Cost of Revenues	-	-	-	-	-	3,323	-
Gross Profit	52,562	85,498	114,574	103,685	163,125	474,775	207,500
<i>Operating Expenses</i>							
Research and Development	44,500	46,686	45,936	51,218	63,095	66,770	72,554
Sales & Marketing	4,698	4,331	4,919	6,201	7,914	6,866	8,168
General & Administrative	14,898	14,477	18,183	21,622	24,150	21,160	23,709
Patent Admin. & Licensing	8,959	13,141	15,995	30,340	49,399	51,006	53,262
Other	-	-	-	595	-	-	-
Total Operating Expenses	73,055	78,635	85,033	109,977	144,558	145,802	157,692
Operating Income	(20,493)	6,863	29,541	(6,292)	18,567	328,973	49,808
Interest, net	4,627	2,019	1,613	1,743	3,164	13,545	18,286
Extraordinary Income (Expense)	-	-	10,580	-	-	-	-
Net Income Before Taxes	(15,866)	8,882	41,734	(4,549)	20,251	342,518	68,094
Income Taxes	3,418	8,555	7,269	(2,806)	9,239	124,107	25,195
Income Tax Rate	-22%	96%	17%	40%	40%	36%	37%
Net Income	(19,284)	327	34,465	(1,743)	11,012	218,411	42,899
Preferred stock Dividends	137	136	133	66	-	-	-
Net Income	(19,421)	191	34,332	(1,809)	11,012	218,411	42,899
EBITDA	(14,093)	14,863	39,541	2,303	39,292	337,473	58,808
EBIT	(20,493)	6,863	29,541	(6,292)	18,567	328,973	49,808
Average Shares Outstanding	53,306	53,700	55,269	55,333	54,062	53,028	52,232
Fully Diluted Shares Outst.	56,951	57,603	59,714	59,076	57,237	55,502	54,669
Earnings Per Share	(0.36)	(0.01)	0.58	(0.01)	0.19	3.92	0.78
Adj. Earnings Per Share	(0.36)	(0.11)	0.24	(0.01)	0.22	1.69	0.78
EBITDA Per Share	(0.25)	0.26	0.66	0.12	0.69	6.08	1.08
Margin Analysis							
Gross Profit	100%	100%	100%	100%	100%	99%	100%
Operating	-39%	8%	26%	-6%	11%	69%	24%
Net Profit	-37%	0%	30%	-2%	7%	46%	21%
EBITDA	-27%	17%	35%	2%	24%	71%	28%
EBIT	-39%	8%	26%	-6%	11%	69%	24%
Percentage of Revenues							
Research & Development	85%	55%	40%	49%	39%	14%	35%
Selling & Marketing	9%	5%	4%	6%	5%	1%	4%
General & Administrative	28%	17%	16%	21%	15%	4%	11%
Patent Admin. & Licensing	17%	15%	14%	29%	30%	11%	26%
Goodwill & Other Intangibles	0%	0%	0%	0%	0%	0%	0%
Year/Year Growth Rates							
Licensing	-9%	162%	15%	11%	39%	61%	-13%
Engineering Development	26%	-79%	NM	NM	NM	NM	NM
Total Revenues	-8%	63%	34%	-10%	57%	193%	-57%
Operating Expenses	51%	8%	8%	29%	31%	1%	8%
EBITDA	-282%	205%	166%	-94%	NM	759%	-83%
Net Income	-60%	101%	NM	-105%	NM	1883%	-80%

Source: company data, Hilliard Lyons estimates

Analyst Certification

I, Tom Carpenter, hereby certify that the views expressed in this research report accurately reflect my personal views about the subject company(ies) and its (their) securities. I also certify that I have not been, am not, and will not be receiving direct or indirect compensation in exchange for expressing the specific recommendation(s) in this report.

Important Disclosures

Hilliard Lyons' analysts receive bonus compensation based on Hilliard Lyons' profitability. They do not receive direct payments from investment banking activity.

Investment Ratings

Buy - We believe the stock has significant total return potential in the coming 12 months.

Long-term Buy - We believe the stock is an above average holding in its sector, and expect solid returns to be realized over a longer time frame than our Buy rated issues.

Neutral - We believe the stock is an average holding in its sector, is currently fully valued, and may be used as a source of funds if better opportunities arise.

Underperform - We believe the stock is vulnerable to a price set back in the next 12 months.

Suitability Ratings

1 - A large cap, core holding with a solid history

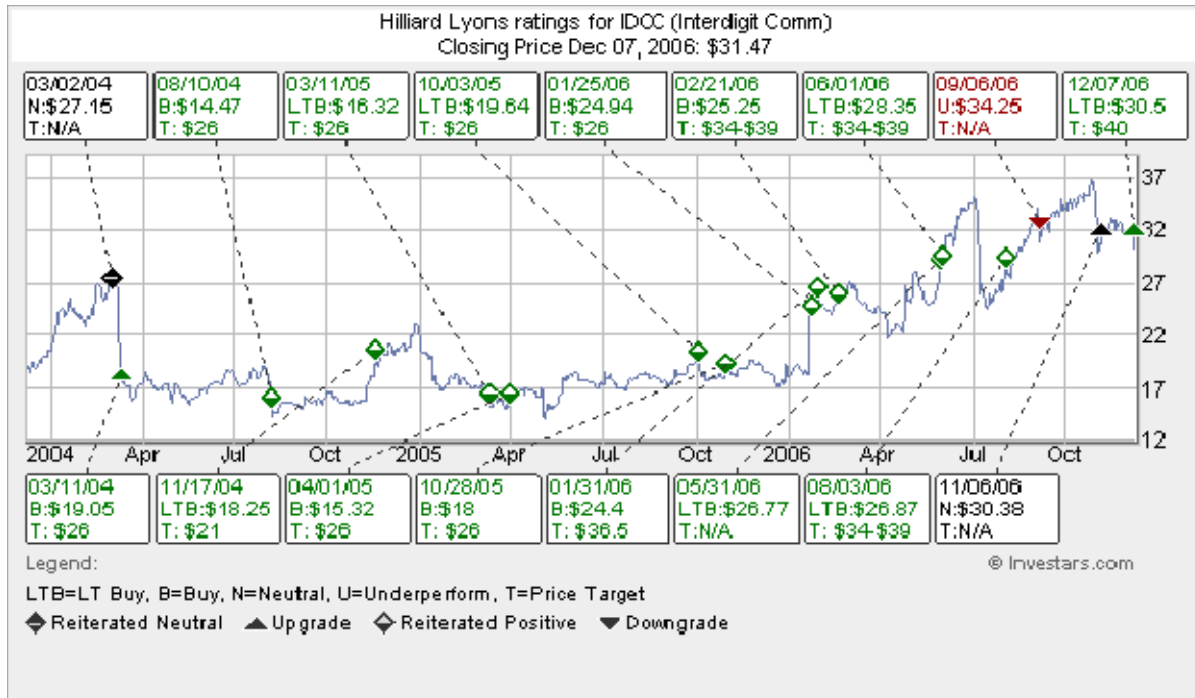
2 - A historically secure company which could be cyclical, has a shorter history than a "1" or is subject to event driven setbacks

3 - An above average risk/reward ratio could be due to small size, lack of product diversity, sporadic earnings or high leverage

4 - Speculative, due to small size, inconsistent profitability, erratic revenue, volatility, low trading volume or a narrow customer or product base.

	Hilliard Lyons		Investment Banking	
	Recommended Issues		Provided in Past 12 Mo.	
Rating	# of Stocks Covered	% of Stocks Covered	Banking	No Banking
Buy	12	10%	25%	75%
Long-term Buy	34	30%	6%	94%
Neutral	66	57%	3%	97%
Underperform	3	3%	0%	100%

As of 6 November 2006



Date	Action	Rating	Closing Price	Price Target
9/8/2003	carry over	Neutral	\$18.22	n/a
3/2/2004	reiterated	Neutral	\$27.15	n/a
3/11/2004	upgraded	Buy	\$19.05	\$26.00
8/10/2004	reiterated	Buy	\$14.47	\$26.00
11/17/2004	reiterated	LT Buy	\$18.25	\$21.00
3/11/2005	reiterated	LT Buy	\$16.32	\$26.00
4/1/2005	reiterated	Buy	\$15.32	\$26.00
10/3/2005	reiterated	LT Buy	\$19.64	\$26.00
10/28/2005	reiterated	Buy	\$18.00	\$26.00
1/25/2006	reiterated	Buy	\$24.94	\$26.00
1/31/2006	reiterated	Buy	\$24.40	\$36.50
2/21/2006	reiterated	Buy	\$25.25	\$34.00 - \$39.00
5/31/2006	reiterated	LT Buy	\$26.77	n/a
6/1/2006	reiterated	LT Buy	\$28.35	\$34.00 - \$39.00
8/3/2006	reiterated	LT Buy	\$26.87	\$34.00 - \$39.00
9/6/2006	downgraded	Underperform	\$34.25	n/a
11/6/2006	upgraded	Neutral	\$30.38	n/a
12/7/2006	upgraded	LT Buy	\$30.50	\$40.00