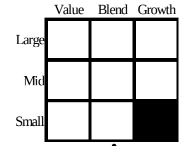
Tom Carpenter, CFA
Senior Technology Analyst
July 29, 2009

Rating: Buy
Suitability: 4
Technology

InterDigital, Inc.

(IDCC-NASDAQ)



Raising Target to $38. Strong 2Q09 Highlights Operating Leverage in Business Model. Possible Settlement of 3G Patent Infringement Case Against Nokia Could mean $300 mm plus. Reiterate Buy Rating.

Recent Price	$27.82	**December Fiscal Year**	**2008A**	**2009E**	**2010E**
52-Week High Price	$33.69	Earnings Per Share	$0.54	$2.38	$4.23
52-Week Low Price	$16.20	P/E Multiple	51.5x	11.7x	6.6x
Indicated Dividend	NA	Weighted Return on Equity ('08)			40%
Annual Yield	NA	Long Term Debt/ Total Cap. (03/09)			12%
Market Cap.	$1.2 billion	Est. 3-Year EPS Growth Rate			25%
Price Target	**$38**	Insider / Institutional Ownership			3%/50%

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. 4 for a Wireless Glossary.

- **We are raising our target price to $38, up from $35**. We derive our target price by applying a 16x multiple to our 2009 EPS estimate of $2.38. This compares to a 17x multiple for the Nasdaq Composite. Given that InterDigital grew its revenue by 28% y/y and its EPS by 352% y/y, we believe our multiple reflects both IDCC's growth, and the risk in its patent licensing business model.
- **InterDigital reported strong growth y/y for 2Q09.** 2Q09 revenue of $74.9 million grew 28% y/y, while EPS of $0.60 surpassed 2Q08's $0.13**.** This was InterDigital's second quarter with contributions from 2G and 3G licensee Samsung, who signed a four-year, $400 million licensing agreement last November. IDCC recognized $25.7 million from Samsung during the quarter. Also benefitting results this quarter was a repositioning during 1Q09, whereby InterDigital ceased further development of its SlimChip modem. This resulted in a significant decline in development expenses to $13.2 million, a 49% q/q drop. Licensing revenue accounted for $72.7 million of total revenue; the remaining $2.3 million was product revenue. Earnings could improve further in 2009 as revenue grows, while legal expenses could drop significantly if IDCC and Nokia settle their dispute.
- **InterDigital's 3G patent infringement case against Nokia is moving towards a ruling on August 14, 2009.** The administrative law judge (ALJ) is scheduled to rule by August 14, 2009, with a final ruling by the ITC on December 14, 2009. If the Nokia case mirrors Samsung's, Nokia and InterDigital could settle before the ALJ's ruling. We believe it will be an uphill battle for Nokia to claim it does not use InterDigital's patents when manufacturers such as Samsung (#2 market share), LG Electronics (#4 manufacturer), Apple, Research in Motion, Sharp, NEC, Panasonic, Kyocera, Toshiba, and HTC have licensed InterDigital's 3G patents. We estimate that a 3G license with Nokia could add over $300 million in revenue over five years. This would bolster IDCC's already strong

Note Important Disclosures on pages 8-9.
Note Analyst Certification on page 8.

$317 million cash position (includes a July 2009 $100 million payment from Samsung) with another $200 million due from Samsung over the next twelve months.

- **InterDigital may expand its business model over the next 12 months.** We expect InterDigital to acquire patent families in wireless and related areas to add to its licensing business**.** In the past, InterDigital has only licensed its entire patent portfolio, never in pieces. Going forward, we believe the firm may segment its licensing (offering a license for a certain segment vs. the entire portfolio) if it adds patent families that are outside its core technology. We are in favor of this strategy, because licensing rates for InterDigital's and Qualcomm's patent portfolios appear to be declining as 3G technology matures. Our view is that 4G patents are more widely dispersed than 3G patents, which could lead to further erosion in royalty rates for 4G handsets. That said, if InterDigital can add to the $0.60 to $0.75 royalty that we estimate it averages for 3G handsets, it could mean significant incremental revenue if the firm adds another $0.10 to $0.25 per phone (one billion 3G handsets in 2012) or a similar amount if the firm expands its patents into related electronic devices (tens of millions or possibly hundreds of millions of devices). Possibilities include wireless security, machine to machine (M2M – see recent Qualcomm and Verizon partnership), mobile payments, batteries, displays, and Wi-Fi.
- **InterDigital could generate over $500 million in new revenue from 3G licenses with Nokia and Sony Ericsson**. If InterDigital licenses Nokia for its 3G patents, we believe the rate will be between $0.35 per handset and $0.50 per handset. This translates into a potential $360 million to $514 million revenue contribution for InterDigital for the years 2010-2014. A 3G license with Sony Ericsson (at $0.50 to $0.75 per handset), which has approximately 7% market share, could generate $200 million over five years, in our view. Given healthy dialogue (and no legal actions between the firms over the past five years), we believe InterDigital and Sony Ericsson will sign a 3G agreement soon after InterDigital and Nokia finalize an agreement.
- **InterDigital stopped funding its SlimChip product during 1Q09.** This translates into a significant drop in research and development spending, beginning in 2Q09. R&D spending dropped by 49% q/q. We believe 2H09 R&D spending will mirror 2Q09's spending, leading to IDCC delivering favorable y/y earnings comparisons. Even though InterDigital is ceasing new development for its SlimChip product, existing licensees for the product – Infineon, NXP, and Spreadtrum are expected to help the product unit generate revenue of over $2 million per quarter in 2009.
- **We expect InterDigital's $317 million cash position ($7.15 per share) to grow.** The $317 million counts the first two of Samsung's four $100 million payments, which IDCC received in 1Q09 and July 2009. We believe the two subsequent $100 million payments will be in early 2010 and mid-2010. Samsung's $400 million in payments represents $9 per share to InterDigital (pre-tax). Combined with our estimated $550 million in potential license payments from Nokia and Sony Ericsson, InterDigital could have a mid to high teens per share cash balance, assuming it doesn't use the cash in the interim for patent acquisitions, going private, dividends, share repurchases, etc. We are in favor of the firm implementing a modest dividend, acquiring 4G patents, acquiring media independent handover technology, acquiring patent families that enable the firm to segment its licensing efforts, going private, or tactically repurchasing shares. InterDigital announced a $100 million share repurchase program on March 11, 2009, which if done at current prices, would retire 8% of outstanding shares. The firm repurchased 600,000 shares for $14.7 million during 2Q09. Given InterDigital's potential for a high cash position relative to its market capitalization, we believe the firm could attract interest from private equity firms. Our view is that InterDigital's management prefers to use cash on share repurchases and ancillary non-cellular patent acquisitions, attempting to increase either the: 1) Dollar amount of its future licenses or 2) Number of licensees.
- **We believe Nokia and Qualcomm's 3G and 4G settlement and InterDigital's 3G agreement with Samsung provide a framework for InterDigital and Nokia to agree upon a 3G royalty rate.** There are many confidential terms in the Nokia/Qualcomm settlement, but it appears that the blended

3G royalty rate that Nokia is paying Qualcomm is approximately 2%, or a little over $4 per phone at today's average selling price per 3G handset. We believe InterDigital will receive between $0.35 to $0.50 per phone from Nokia once the firms finalize a 3G agreement. Our forward estimates have always modeled $0.35 per 3G phone from Nokia. Although a modest rate, it would mean hundreds of millions of dollars of royalty revenue to InterDigital over a five-year period, which is a common length of InterDigital licenses. The licenses then renew for another five years, and so on. Please see Exhibits I, II, and III for the impact of potential licensing agreements with Nokia, Samsung, and Sony Ericsson on IDCC's financials.

- **Investors may ask about InterDigital's patents in 4G and its ability to license handset manufacturers for the next generation of wireless technology**. We believe InterDigital has a large number of patents in 4G and 802.xx technology, as well as a greater number of patent applications. The firm has licensed a few small manufacturers to its 802.xx patents, but has not licensed any manufacturers to Long Term Evolution (LTE), which appears to be the main air interface standard to 4G. Over the next two years, we expect InterDigital to begin licensing its 4G patents to manufacturers. A key issue, in our view, will be the firm's success in licensing manufacturers to 4G without legal means. Given that the firm licensed all the main Japanese handset manufacturers, along with Apple, LG Electronics, and Research in Motion to its 3G technology through negotiations, we believe the firm can license a majority of the 4G handset providers without using the court system. Another key issue will be the royalty rate. We believe 4G rates will be lower due to a greater dispersion of patents among patent holders than in 3G technology. However, it appears many more devices than just handsets could use 4G and 802.xx technology, possibly increasing the number of potential licensees and revenue base.
- **We reiterate our Buy rating.** We are positive on InterDigital's ability to sign 3G licensing agreements with Nokia, Sony Ericsson, and Motorola (if it remains a viable handset manufacturer). We believe InterDigital's case against Nokia at the ITC, with its infringement ruling date, provide the parties a time frame to settle. 3G agreements with Nokia, Sony Ericsson, and Motorola could add hundreds of millions of dollars of licensing revenue to InterDigital over a five year period, and this leads us to project InterDigital's earnings power at over $3.50 per share if it signs Nokia and Sony Ericsson, and if the licensing terms are structured as fixed payment/ratable deals. We derive our $38 price target by applying a 16x multiple to our adjusted 2009 EPS estimate of $2.38. Our target multiple is in line with the 17x multiple for the Nasdaq Composite. Note: our 2009 adjusted EPS of $2.38 includes revenue from Samsung, but not from Nokia or Sony Ericsson. It also excludes the nonrecurring 1Q09 charge. Our 2010 EPS estimate of $4.23 includes revenue from Samsung, Nokia, and Sony Ericsson. If one chooses to exclude from our 2010 EPS estimate the $37.5 million of 2010 revenue that we account for as past money for Samsung's 2G obligation, the adjusted EPS estimate is $3.67.

RISKS

Risks to our Buy rating include:

- InterDigital loses its 3G patent infringement case at the ITC against Nokia.
- Nokia delays the proceedings at the ITC.
- Nokia pays InterDigital less than $0.35 per 3G phone.

Additional information available upon request.

Prices of other companies mentioned in this report:

Apple (AAPL - $159.07 – not rated)
Ericsson (ERIC - $8.32 – not rated)
HTC (HTCCF - $21.84 – not rated)
Infineon (IFX - $3.79 – not rated)

Kyocera (KYO - $79.34 - not rated)
Motorola (MOT - $6.82 – Long-term Buy)
NEC (NIPNF - $3.25 – not rated)
Nokia (NOK - $13.15– Long-term Buy)
Panasonic (PC - $14.69 – not rated)
Qualcomm (QCOM - $46.36 – Long-term Buy)
Research in Motion (RIMM - $76.90 – not rated)
Sharp (SHCAY - $10.24 – not rated)
Spreadtrum Communications (SPRD - $3.15 – not rated)
Sony (SNE - $24.55 – not rated)
Toshiba (TOSBF - $4.32 – not rated)
Verizon (VZ - $31.4- - Buy)

Figure I: Wireless Glossary
802.xx – specification for various wireless local area networks. The xx after the period is representational. 802.11b and 802.11g are examples of real wireless local area networks.
GSM – Global Standard for Mobile Communications, a 2G technology.
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.
LTE – Long Term Evolution. A 4G air interface standard.
TD-SCDMA – Time Division-Synchronous Code Division Multiple Access. A 3G air interface standard that will likely only find widespread use in China.
UMTS – Universal Mobile Telecommunications System, basically the European name for WCDMA.
WCDMA – a 3G air interface standard, Wideband Code Division Multiple Access.
WiBro – Wireless broadband technology designed to offer 30 Mbs to 50 Mbs theoretical data speeds in a one-half to three mile radius of a wireless base station.
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 date services. WCDMA and CDMA 2000 1x are examples of 3G air interface standards.
4G – Fourth Generation wireless technology based on internet-protocol with theoretical data rates up to between 100 Mbit/s to 1Gbit/s. LTE is an example of a 4G technology.

Exhibit I: Nokia, Samsung, and Sony Ericsson Estimated Sales and Royalties to IDCC

Nokia ← Pay as you go model →

Year		2008	2009	2010	2011	2012	2013	2014	5-Yr. Total
Industry Shipments		1,213	1,100	1,183	1,260	1,335	1,415	1,486	
Nokia Market Share		38%	38%	36%	36%	35%	35%	35%	
Nokia 3G phone %		20%	26%	37%	48%	65%	70%	75%	
Nokia 3G Phones		92	107	159	218	304	347	390	
Rate/phone	0.35	32	38	56	76	106	121	137	360
Rate/phone	0.5	46	54	80	109	152	173	195	514
Rate/phone	0.75	69	80	119	163	228	260	293	771
Rate/phone	1.00	92	107	159	218	304	347	390	1027

Samsung ← Pay as you go model →

Year		2008	2009	2010	2011	2012	2013	2014	5-Yr. Total
Industry Shipments		1,213	1,100	1,183	1,260	1,335	1,415	1,486	
Samsung Market Share		16.5%	17.5%	17.5%	17.5%	17.5%	17.5%	17.5%	
Samsung 3G phone %		36%	43%	52%	64%	75%	75%	75%	
Samsung 3G phones		72	83	108	141	175	186	195	579
Rate/phone	0.35	25	29	38	49	61	65	68	203
Rate/phone	0.5	36	41	54	71	88	93	98	289
Rate/phone	0.75	54	62	81	106	131	139	146	434
Rate/phone	1.00	72	83	108	141	175	186	195	579

Note: Samsung 3G percentage is higher due to Samsung's high market share in CDMA 2000 1X phones

Sony Ericsson ← Pay as you go model →

		2008	2009	2010	2011	2012	2013	2014	5-Yr. Total
Industry Shipments		1,200	1,296	1,387	1,484	1,588	1,699	1,818	
Sony Ericsson Market Share		8.0%	7.5%	7.0%	7.0%	7.0%	7.0%	7.0%	
Sony Ericsson 3G phone %		27%	33%	44%	53%	70%	70%	70%	
Sony Ericsson 3G Phones		26	32	43	55	78	83	89	
Rate/phone	0.35	9	11	15	19	27	29	31	122
Rate/phone	0.5	13	16	21	28	39	42	45	174
Rate/phone	0.75	19	24	32	41	58	62	67	261
Rate/phone	1.00	26	32	43	55	78	83	89	348

Notes:

1) Rates per phone are estimates. Actual dollars can vary due to prepayment discounts and caps per phone. Companies can also use a royalty rate % instead of dollar amount per phone. Dollar amount per phone is easier to explain.

2) Pay as you go model entails a phone manufacturer paying InterDigital every time it sells a 3G phone. As 3G phones represented approximately 15% of units shipped in 2007, initial payments are lower while 3G shipment represent a smaller part of overall market shipments.

3) Ratable involves taking the total over five years and dividing it by five. It gives a manufacturer a fixed payment, giving it certainty if its market share increases.

4) Numbers in millions

5) Nokia and Sony Ericsson 5-year totals are for 2010-2014

6) Samsung signed a $400 million agreement covering 2009-2012. The table with Samsung's numbers is for comparative purposes only. InterDigital will recognize $100 million per year from Samsung.

Source: Hilliard Lyons estimates

Exhibit II: InterDigital Quarterly Earnings: 2008A – 2009E

InterDigital (IDCC)
Earnings Model *in thousands, except per share data*

Fiscal Year (ends Dec)	Q1-09A	Q2-09A	Q3-09E	Q4-09E
Calender Year	Mar-09	Jun-09	Sep-09	Dec-09
Revenue				
Recurring Licensing & Royalty	69,300	72,728	75,900	77,900
Product	1,261	2,200	2,000	2,000
Engineering Development	-	-	-	-
Other/one-time	-	-	-	-
Total Revenue	**70,561**	**74,928**	**77,900**	**79,900**
EXPENSES				
Cost of Revenues				
Total Cost of Revenues				
Gross Profit	**70,561**	**74,928**	**77,900**	**79,900**
Operating Expenses				
Research and Development	26,870	13,226	13,205	13,265
Selling, General, and Adminstrative	8,254	5,987	6,147	6,304
Patent Admin. & Licensing	12,137	15,580	14,991	11,141
Other	37,063	(93)		
Total Operating Expenses	*84,324*	*34,700*	*34,342*	*30,710*
Operating Income	**(13,763)**	**40,228**	**43,558**	**49,190**
Interest, net	829	625	850	1,000
Extraordinary Income (Expense)				
Net Income Before Taxes	*(12,934)*	*40,853*	*44,408*	*50,190*
Income Taxes	(4,248)	14,408	15,543	16,563
Income Tax Rate	33%	35%	35%	33%
Net Income	(8,686)	26,445	28,865	33,627
Preferred stock Dividends				
Net Income	**(8,686)**	**26,445**	**28,865**	**33,627**
EBITDA	27,723	47,409	49,258	54,890
EBIT	(13,763)	40,228	43,558	49,190
Average Shares Outstanding	**43,501**	**43,479**	**42,936**	**42,291**
Fully Diluted Shares Outst.	**44,460**	**44,313**	**43,759**	**43,103**
Earnings Per Share	**(0.20)**	**0.60**	**0.66**	**0.78**
Adj. Earnings Per Share	**0.34**	**0.60**	**0.66**	**0.78**
EBITDA Per Share	**0.62**	**1.07**	**1.13**	**1.27**
Margin Analysis				
Gross Profit	100%	100%	100%	100%
Operating	-20%	54%	56%	62%
Net Profit	-12%	35%	37%	42%
EBITDA	39%	63%	63%	69%
EBIT	-20%	54%	56%	62%
Percentage of Revenues				
Research & Development	38%	18%	17%	17%
Selling & Marketing	12%	8%	8%	8%
General & Adminstrative	0%	0%	-1%	-1%
Patent Admin. & Licensing	17%	21%	19%	14%
Goodwill & Other Intangibles	0%	0%	0%	0%
Year/Year Growth Rates				
Licensing Revenue	30%	30%	47%	68%
Product Revenue	-43%	-12%	-9%	-61%
Total Revenues	26%	28%	41%	36%
Operating Expenses	87%	-32%	-18%	-43%
EBITDA	44%	195%	132%	312%
Net Income	NM	352%	213%	778%
Diluted EPS	162%	374%	371%	457%
Quarter/Quarter Growth Rates				
Total Revenues	20%	6%	4%	3%
EBITDA	108%	71%	4%	11%
Net Income	NM	352%	213%	778%
Diluted EPS	143%	76%	11%	18%

Source: company data, Hilliard Lyons estimates

Exhibit III: InterDigital Yearly Income Statement

InterDigital (IDCC)
Earnings Model *in thousands, except per share data*

Fiscal Year (ends Dec) Calender Year	FY F2009E	FY F2010E	FY 2010E V2
Revenue			
Recurring Licensing & Royalty	295,828	400,000	362,500
Product	7,461	10,000	10,000
Engineering Development	-	-	-
Other/one-time			
Total Revenue	**303,289**	**410,000**	**372,500**
EXPENSES			
Cost of Revenues			
Total Cost of Revenues			
Gross Profit	**303,289**	**410,000**	**372,500**
Operating Expenses			
Research and Development	66,566	62,811	62,811
Selling, General, and Adminstrati\	26,692	26,179	26,179
Patent Admin. & Licensing	53,848	39,008	39,008
Other	-	-	-
Total Operating Expenses	*147,106*	*127,998*	*127,998*
Operating Income	**156,183**	**282,002**	**244,502**
Interest, net	3,304	4,800	4,800
Extraordinary Income (Expense)	-	-	-
Net Income Before Taxes	*159,487*	*286,802*	*249,302*
Income Taxes	42,265	103,249	89,749
Income Tax Rate	35%	36%	36%
Net Income	117,221	183,553	159,553
Preferred stock Dividends	-	-	-
Net Income	**80,251**	**183,553**	**159,553**
EBITDA	179,280	307,002	269,502
EBIT	119,213	282,002	244,502
Average Shares Outstanding	**43,052**	**42,621**	**42,621**
Fully Diluted Shares Outst.	**43,909**	**43,470**	**43,470**
Earnings Per Share	**1.84**	**4.23**	**3.67**
Adj. Earnings Per Share	**2.38**	**4.23**	**3.67**
EBITDA Per Share	**4.09**	**7.06**	**6.20**
Margin Analysis			
Gross Profit	100%	100%	100%
Operating	51%	69%	66%
Net Profit	26%	45%	43%
EBITDA	59%	75%	72%
EBIT	39%	69%	66%
Percentage of Revenues			
Research & Development	32%	15%	17%
Selling & Marketing	6%	6%	7%
General & Adminstrative	8%	4%	0%
Patent Admin. & Licensing	12%	10%	10%
Goodwill & Other Intangibles	0%	0%	0%
Year/Year Growth Rates			
Licensing Revenue	43%	35%	-9%
Product Revenue	-38%	NM	NM
Total Revenues	33%	35%	-9%
Operating Expenses	-25%	-13%	0%
EBITDA	178%	71%	-12%
Net Income	240%	129%	-13%
Diluted EPS	218%	130%	-13%

Source: company data, Hilliard Lyons estimates

Note: Our model for 2009 incorporates payments from Samsung.

Our 2010 estimate incorporates payments from Nokia, Samsung, and Sony Ericsson under fixed/ratable terms.
Our 2010E V2 estimates exclude $37.7 million of revenue from Samsung.

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.

The author of this report or members of his household have a long position in the common stock of InterDigital Communications, but may not engage in buying or selling contrary to the recommendation.

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 Recommended Issues		Investment Banking Provided in Past 12 Mo.	
Rating	**# of Stocks Covered**	**% of Stocks Covered**	**Banking**	**No Banking**
Buy	47	27%	4%	96%
Long-term Buy	44	25%	2%	98%
Neutral	71	41%	3%	97%
Underperform	9	5%	11%	89%
Suspended	2	1%	0%	100%

As of 10 July 2009