

Tom Carpenter, CFA
Senior Technology Analyst
November 6, 2006

Rating: Neutral
Suitability: 4
Technology

InterDigital Communications Corp

(IDCC-NASDAQ)

	Value	Blend	Growth
Large			
Mid			
Small			

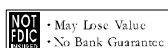
Licensing Activity Remains Stagnant. Upping Rating to Neutral due to Share Price Pullback

		December Fiscal Year	2005A	2006E	2007E
Recent Price	\$30.38	Earnings Per Share	\$0.22	\$1.69	\$0.79
52-Week High Price	\$36.91	P/E Multiple	NM	18.0x	38.5x
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.	\$1.6 B	Insider / Institutional Ownership			2%/45%
Price Target					

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 are raising our rating to Neutral, from Underperform, in response to the recent share price decline.** IDCC reported 3Q06 results on Wednesday, and while the numbers met our expectations, we believe the news regarding Samsung continuing to fight IDCC's \$175 million to \$200 million 2G arbitration award dampened expectations that IDCC and Samsung could craft a combined 2G and 3G licensing agreement (at least in the near-term). As we mentioned in our downgrade report, we believe industry-wide licensing may remain at a standstill until Nokia and Qualcomm resolve their 3G licensing dispute, thus hampering IDCC's 3G licensing efforts.
- **InterDigital generated \$67.2 million of revenue, up 25% y/y. Of that total, IDCC classifies \$54.7 million as recurring revenue and \$12.5 million relating to a Nokia 2G settlement.** With 100% gross margin on licensing revenue, \$21.7 million of the revenue flowed to net income, good for \$0.40 of EPS. Cash from operations was \$12.6 million during the quarter, while free cash flow was \$5.8 million. Large revenue contributors during the quarter include: 1) LG Electronics at 27%, 2) NEC at 17%, and 3) Sharp at 17%. We believe Ericsson/Sony Ericsson were just under the 10% threshold. Note that 2G licensing agreements with Nokia and Ericsson/Sony Ericsson will be "paid up" on December 31, 2006, meaning no further 2G revenue will come from these firms.
- **Samsung is attempting to delay paying InterDigital on its favorable 2G arbitration ruling.** Although we believe the ultimate outcome over the next six months is that Samsung will pay IDCC the \$175 million-\$200 million that it owes for 2G royalties from 2002 through 2006, Samsung is employing several stall tactics. Samsung has: 1) Filed in New York Court

Note Important Disclosures on pages 6-7.
Note Analyst Certification on page 6.



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to vacate the arbitration award (even though Samsung is the one that requested arbitration) and 2) Requested a new arbitration. A legal body needs to tell firms that when you lose **binding** arbitration - that is it. No frivolous appeals or requests for a new arbitration.

- **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 figure could be enhanced by over \$3 per share in cash once IDCC receives its 2G arbitration payment from Samsung. We much 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.
- **Although we are raising our rating to Neutral, we do not see near-term catalysts (next three-to-five months).** 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. However, to do this, IDCC has to license the top 6 manufacturers to agreements that generate recurring revenue, which has proved challenging outside of LG Electronics. Industry-wide, we expect licensing to remain murky until Qualcomm and Nokia resolve their bitter 3G licensing dispute.

INVESTMENT THESIS

We believe InterDigital will sign 3G licensing agreements with all major handset manufacturers over the next three 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.

The fly in the ointment, however, is an increasingly contentious licensing landscape. Lawsuits between: 1) Broadcom and Qualcomm, 2) Nokia 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.

With this as a backdrop, we are content to remain on the sidelines until: 1) IDCC's valuation becomes more compelling, 2) Qualcomm and Nokia appear close to resolving their dispute, or 3) other patent firms successfully license the top 6 handset manufacturers.

RISKS

Risks to our Neutral rating include:

- IDCC signs new 3G licensing agreements.
- IDCC's chipset efforts meet with success.
- IDCC's current licensees gain market share versus unlicensed competitors.

Additional information available upon request.

Prices of other companies mentioned in this report:

Broadcom (BRCM - \$30.21 – not rated)

Ericsson (ERIC - \$37.82 – not rated)

NEC (NIPNY - \$5.07 – not rated)

Nokia (NOK - \$19.34 – Long-term Buy)

Qualcomm (QCOM - \$36.47 – Long-term Buy)

Research in Motion (RIMM - \$116.29 – not rated)

Sharp (SHCAY - \$17.85 – not rated)

Sony (SNE - \$40.49 – 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: 2004A –2005A**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	30,797	33,101	44,038	36,200	49,560	54,917	65,975	71,153
Product					2,046	1,700	1,200	1,000
Engineering Development	4,700	5,500	4,500	4,289	-	-	-	-
Other/one-time					-	240,000	-	-
Total Revenue	35,497	38,601	48,538	40,489	51,606	296,617	67,175	72,153
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	72,153
<i>Operating Expenses</i>								
Research and Development	16,173	14,921	15,610	16,391	16,010	15,887	16,805	19,349
Sales & Marketing	2,280	1,537	1,798	2,299	1,824	1,561	1,671	1,939
General & Administrative	6,566	5,912	5,420	6,252	5,021	5,695	5,045	5,563
Patent Admin. & Licensing	11,247	10,080	14,695	13,377	9,982	12,804	13,299	15,150
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>42,002</i>
Operating Income	(769)	6,151	10,166	1,539	18,769	260,670	30,355	30,151
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>34,193</i>
Income Taxes	903	2,817	4,419	1,100	7,338	94,221	12,780	12,583
<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>21,610</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	21,610
EBITDA	4,237	11,151	16,194	7,710	23,440	265,170	34,655	34,451
EBIT	(769)	6,151	10,166	1,539	18,769	260,670	30,355	30,151
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	0.40
Adj. Earnings Per Share	(0.02)	0.07	0.13	0.04	0.23	0.42	0.40	0.40
EBITDA Per Share	0.07	0.20	0.28	0.14	0.41	4.64	0.64	0.64
Margin Analysis								
Gross Profit	100%	100%	100%	100%	100%	100%	100%	100%
Operating	-2%	16%	21%	4%	36%	88%	45%	42%
Net Profit	-2%	10%	13%	3%	25%	57%	32%	30%
EBITDA	12%	29%	33%	19%	45%	89%	52%	48%
EBIT	-2%	16%	21%	4%	36%	88%	45%	42%
Percentage of Revenues								
Research & Development	46%	39%	32%	40%	31%	5%	25%	27%
Selling & Marketing	6%	4%	4%	6%	4%	1%	2%	3%
General & Administrative	18%	15%	11%	15%	10%	2%	8%	8%
Patent Admin. & Licensing	32%	26%	30%	33%	19%	4%	20%	21%
Goodwill & Other Intangibles	0%	0%	0%	0%	0%	0%	0%	0%
Year/Year Growth Rates								
Licensing	-7%	13%	499%	7%	61%	66%	50%	97%
Engineering Development	NM	NM	NM	NM	NM	NM	NM	NM
Total Revenues	8%	31%	560%	19%	45%	668%	38%	78%
Operating Expenses	46%	19%	45%	24%	-9%	11%	-4%	8%
EBITDA	-60%	111%	-207%	15%	453%	2278%	114%	347%
Net Income	-115%	369%	-202%	-927%	-1567%	4147%	232%	1492%
Diluted EPS	-117%	388%	-212%	-1442%	-1520%	495%	205%	911%
Quarter/Quarter Growth Rates								
Total Revenues	5%	9%	26%	-17%	27%	475%	-77%	7%
EBITDA	-37%	163%	45%	-52%	204%	1031%	-87%	-1%
Net Income	NM	NM	63%	-79%	854%	1217%	-87%	0%
Diluted EPS	NM	NM	84%	-69%	469%	85%	-5%	2%

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	241,605	202,250
Engineering Development	21,627	4,498	1,177	-	18,989	5,946	5,250
Other/one-time	-	-	20,324	-	-	240,000	-
Total Revenue	52,562	85,498	114,574	103,685	163,125	487,551	207,500
EXPENSES							
<i>Cost of Revenues</i>							
<i>Total Cost of Revenues</i>	-	-	-	-	-	2,973	-
Gross Profit	52,562	85,498	114,574	103,685	163,125	484,578	207,500
<i>Operating Expenses</i>							
Research and Development	44,500	46,686	45,936	51,218	63,095	68,051	72,537
Sales & Marketing	4,698	4,331	4,919	6,201	7,914	6,995	8,165
General & Administrative	14,898	14,477	18,183	21,622	24,150	21,324	23,600
Patent Admin. & Licensing	8,959	13,141	15,995	30,340	49,399	51,235	52,931
Other	-	-	-	595	-	-	-
<i>Total Operating Expenses</i>	<i>73,055</i>	<i>78,635</i>	<i>85,033</i>	<i>109,977</i>	<i>144,558</i>	<i>147,606</i>	<i>157,233</i>
Operating Income	(20,493)	6,863	29,541	(6,292)	18,567	336,972	50,267
Interest, net	4,627	2,019	1,613	1,743	3,164	13,545	18,286
Extraordinary Income (Expense)	-	-	10,580	-	-	-	-
<i>Net Income Before Taxes</i>	<i>(15,866)</i>	<i>8,882</i>	<i>41,734</i>	<i>(4,549)</i>	<i>20,251</i>	<i>350,518</i>	<i>68,553</i>
Income Taxes	3,418	8,555	7,269	(2,806)	9,239	126,922	25,365
<i>Income Tax Rate</i>	<i>-22%</i>	<i>96%</i>	<i>17%</i>	<i>40%</i>	<i>40%</i>	<i>36%</i>	<i>37%</i>
<i>Net Income</i>	<i>(19,284)</i>	<i>327</i>	<i>34,465</i>	<i>(1,743)</i>	<i>11,012</i>	<i>223,596</i>	<i>43,188</i>
<i>Preferred stock Dividends</i>	<i>137</i>	<i>136</i>	<i>133</i>	<i>66</i>	<i>-</i>	<i>-</i>	<i>-</i>
Net Income	(19,421)	191	34,332	(1,809)	11,012	223,596	43,188
EBITDA	(14,093)	14,863	39,541	2,303	39,292	345,472	59,267
EBIT	(20,493)	6,863	29,541	(6,292)	18,567	336,972	50,267
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	4.01	0.79
Adj. Earnings Per Share	(0.36)	(0.11)	0.24	(0.01)	0.22	1.69	0.79
EBITDA Per Share	(0.25)	0.26	0.66	0.12	0.69	6.22	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%	29%
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%	68%	-16%
Engineering Development	26%	-79%	NM	NM	NM	NM	NM
Total Revenues	-8%	63%	34%	-10%	57%	199%	-57%
Operating Expenses	51%	8%	8%	29%	31%	2%	7%
EBITDA	-282%	205%	166%	-94%	NM	779%	-83%
Net Income	-60%	101%	NM	-105%	NM	1930%	-81%
Diluted EPS	-60%	98%	NM	-101%	NM	1980%	-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

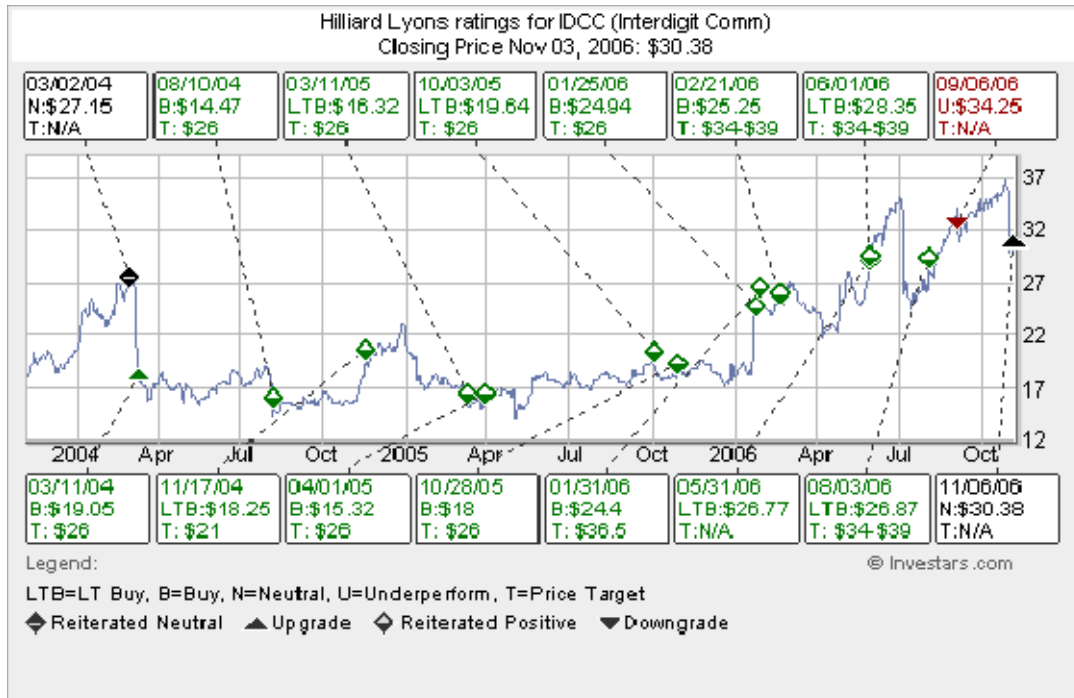
2 - A historically secure company which could be cyclical, has a shorter history than a "1" or is subject to event driven setbacks

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.

Rating	Hilliard Lyons Recommended Issues		Investment Banking Provided in Past 12 Mo.	
	# of Stocks Covered	% of Stocks Covered	Banking	No Banking
Buy	15	13%	20%	80%
Long-term Buy	33	29%	12%	88%
Neutral	64	56%	2%	98%
Underperform	3	3%	0%	100%

As of 10/9/06



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	\$34.00 - \$39.00
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