InterDigital Communications Corporation Annual Report 2003

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For every wireless barrier, there is a breakthrough. Today, when the "send" button is pushed on a digital wireless device, InterDigital's technology makes the connection possible.

Every day, wireless engineers face the same set of challenges. Defy the laws of physics and coax just a little more out of the network, or handheld device. More performance. Greater range. Higher bandwidth. Smaller size. Longer battery life.

Innovations that can give equipment producers a competitive advantage in this fast moving, ever-changing industry.

That's our job. We're InterDigital Communications Corporation, an industry pioneer.

InterDigital helped to shape and influence the standards, and their underlying technologies, for 2G and 3G wireless products. Today, we're a leading architect, designer and provider of advanced wireless technology and product platforms. Advanced inventions, technology and systems developed by InterDigital are embedded in 2G, 2.5G and 3G devices around the world.

Financial Highlights

Year ended December 31, $: in thousands, except per share data	2003	2002	2001
Total revenue	$ 114,574	$ 87,895	$ 52,562
Income (loss) from operations	29,541	9,240	(20,493)
Other income	10,580	—	—
Net income (loss) applicable to common shareholders	34,332	2,375	(19,421)
Net income (loss) per share applicable to common shareholders	.58	.04	(.36)
Total cash, cash equivalents and short-term investments	105,927	87,566	90,363
Total assets	205,165	191,178	148,381
Total shareholders' equity	97,485	78,791	60,274

To Our Shareholders:

Your Company continued its record of strong performance in 2003. In the five years since we changed the Company's emphasis, we have successfully transitioned to a financially stable, premier patent licensing and technology product development company concentrating on the standards-based wireless communications market. With growing success as a pioneer of innovative wireless technologies, we are well positioned to deliver sustainable growth in enterprise value. We are succeeding by pursuing a strategy that, through reinvestments, leverages our cash flows from patent licensing to substantially grow our offerings of wireless technology and product solutions. Our long-term goal, which we are pursuing in stages, is to become a preferred provider of advanced modem solutions for the wireless industry. To accomplish that goal, we are offering to combine intellectual property licensing with technology products that enhance the competitive offerings of our customers.

Highlights of an Outstanding Year – 2003

- Growth in recurring royalties and cash flows
- Addition of new licensees
- Strong market participation by our licensees
- Progress in the development of our technology product offerings
- Growth of our portfolio of patented technologies
- Successful acquisition of patent and technology assets
- Repurchase of two million shares of our Company's common stock

In last year's report, we outlined our objectives for 2003. We're pleased to report significant progress against our goals, including the following highlights:

We strengthened our market position through the acquisition of assets of Windshift Holdings Inc., formerly known as Tantivy Communications, expanding our position in cdma2000® and gaining access to the WLAN market with smart antenna technology that shows early promise as a solution that can improve the performance of WLAN and cellular products.

By continuing our investment in WCDMA technology and product development, we completed a robust Frequency Division Duplex (FDD) protocol stack for use in handsets with our partner, Infineon Technologies. The strength of that product's performance enabled Infineon to secure its first Third Generation (3G) chipset customer in 2003, Chinese equipment producer Huawei Technologies. Early in 2004, Infineon announced a second customer for its advanced chipsets, DBTel, a leading handset brand in China and Taiwan. Under our agreement with Infineon, InterDigital is entitled to royalties as Infineon delivers chipsets incorporating our protocol stack software to their customers.

We completed the development of a fully standards-compliant Time Division Duplex (TDD) technology suite and successfully delivered the technology blocks to Nokia. This is the culmination of five years of pioneering work where we helped to define the worldwide TDD standards and built and successfully demonstrated a complete TDD technology platform that delivers high speed voice and data capability for mobile users.

We accelerated the pace of our Second Generation (2G, 2.5G) and 3G patent licensing program with the addition of five new licensees and the renewal of an important license agreement.

We strengthened our balance sheet while completing both an acquisition and a share repurchase program. At year-end, our cash and short-term investment balance had grown by approximately 20% over the previous year.

Codifying and communicating our corporate governance principles were very important initiatives in 2003. In taking these steps, we have provided the investment community with a clearer statement about our commitment to protect and enhance shareholder value. We also added three new independent directors to our Board. These individuals bring to InterDigital industry experience, rich and diverse management backgrounds, and creative thinking that will benefit the Company for many years.

Strong Financial Performance

We extended our record of strong financial performance in 2003, growing revenues by 30% over 2002, to almost $115 million, and recording positive cash flow of $45.9 million before financing activities and an asset acquisition. Further, our cash position was enhanced in early 2004 after receipts of approximately $35 million from Ericsson, Sony Ericsson and Sharp.

We reported net income of $34.3 million and earnings per share of $0.58 (diluted) for the year. We are particularly proud of these results given our continuing commitment to making significant investment in the development of advanced wireless technologies to enable high performance products.

Recurring royalty revenues from patent licensing increased 58%, to $92.9 million from $58.9 million in 2002. The March 2003 license agreement with Sony Ericsson contributed to our strong performance, generating $32.9 million in revenue and $34.9 million in cash. NEC and Sharp were also important contributors in 2003. NEC established itself as a leading supplier of 3G equipment to NTT DoCoMo and Hutchison. Sharp's continued success as a leading camera phone supplier helped improve its share of the global handset market. These two licensees contributed $61.8 million of our revenues and $77.7 million of our cash flow in 2003. We are optimistic that our licensing royalty revenues will continue to grow as our licensees enjoy success in the market and as 3G products are deployed in key markets around the world in 2004 and beyond.

Harry G. Campagna
Chairman of the Board

Expanding Licensing Revenue Opportunities Worldwide

Our licensing team continues to deliver new agreements that contribute to our financial strength and build the enterprise value of your Company.

In 2003, we established five new agreements with equipment manufacturers — Sony Ericsson, Ericsson, Research in Motion, High Tech Computer, and Nakayo. Some of the most innovative devices in the market are being produced by these new licensees. Additionally, we renewed an important license agreement with Sharp.

In March 2003, we resolved a long-running dispute with Ericsson and established a foundation for positive business relationships with Ericsson and Sony Ericsson, signing 2G GSM/TDMA and 2.5G GSM/GPRS/TDMA patent license agreements with both companies. We believe that the license agreements with Ericsson and Sony Ericsson established the financial terms necessary to define the royalty obligations of Nokia Corporation and Samsung Electronics on 2G GSM/TDMA and 2.5G GSM/GPRS/EDGE/TDMA products under their existing patent license agreements with us. Both Nokia and Samsung have formally requested arbitration as a route to resolve the contract issues associated with their license agreements. We remain very confident in our position with respect to both the Samsung and Nokia license agreements.

While we strive to license the use of our inventions through mutually agreed terms, from time to time, we may find it necessary to institute legal action in order to protect the value of our intellectual property. In March 2004 our subsidiary, Tantivy Communications, filed suit against Lucent Technologies alleging patent infringement. We are dedicated to seeking new ways to leverage our world-class capabilities in licensing through innovative business relationships and agreements that create future revenue opportunities for us and our partners.

Successfully Migrating Technology to 3G Product Solutions

From the beginning of our strategic transformation five years ago, we looked forward to the time when we would introduce standards-compliant, mobile wireless technology products to the industry. That time is here.

At the 3GSM Congress in Cannes, France in February 2004, we demonstrated pre-commercial versions of our expanded suite of advanced wireless solutions. With our partner, Infineon, we demonstrated our jointly developed, fully standards-compliant WCDMA FDD protocol stack embedded in a demonstration handset that streamed video images and accessed the Internet at 384 kilobits per second. Reflecting the intimacy and effectiveness of our partnership, Infineon and Huawei displayed similar demonstration handsets acknowledging InterDigital's contributions. During the show, Infineon announced a second design win with DBTel. DBTel's selection of Infineon's platform provides testimony to the product competitiveness of Infineon's offering.

Howard E. Goldberg
President and Chief Executive Officer

We also showcased planned new solutions, including the evolution of our FDD solution to incorporate key components of High Speed Downlink Packet Access (HSDPA) technology that is targeted to deliver data rates up 14 megabits per second in mobile products. We introduced our subscriber-based smart antenna technology targeted for WLAN and mobile cellular applications, and demonstrated our complete TDD technology platform. Our technology solutions are designed to offer important benefits to semiconductor producers, operators and wireless equipment makers, including improved signal strength to the cell edge, enhanced network capacity, reduced signal interference, lower power requirements which can extend battery life and low cost implementation in finished products.

Plans for 2004

Our agenda for 2004 reflects our intense commitment to build sustainable value in your Company. This year we are focused on:

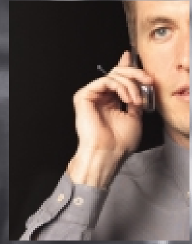
- Strengthening the attractiveness and market relevance of our technology and intellectual property
- Broadening our licensing program
- Establishing new business relationships
- Managing our costs and maintaining the strength of our balance sheet

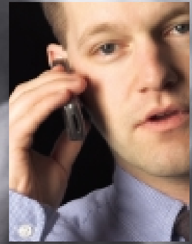
For decades, we have been developing fundamental enabling technology that is now incorporated into wireless products worldwide. From that solid base, we are investing in new technologies and monetizing the value of those investments by growing our base of licensees and technology product customers and partners. Given the depth of talent in our Company, we are very excited about the value we can create in years to come.

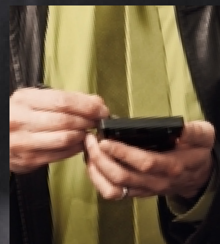
Sincerely,

Harry G. Campagna,
Chairman of the Board

Howard E. Goldberg,
President and Chief Executive Officer







Wireless communications are changing the way people live, work and play. Through our technology contributions and systems embedded in wireless communications devices worldwide, we have enabled break-through technology advances. For more than thirty years, InterDigital Communications Corporation has been recognized as a pioneer in the architecture, design and delivery of advanced wireless technology platforms. Every day, hundreds of millions of consumers and businesses rely on our inventions to move their ideas.

Developing Technology. We create value through our sustained investment in core technology development and the adaptation of that technology for use in a broad array of product applications. Over the course of our history, we have designed and developed a wide range of technologies that form the basis for the vast majority of wireless communications around the world today and in the future. We patent many of our inventions and license those inventions to wireless communications equipment producers and related suppliers. We are constantly working toward the next breakthrough in wireless communications to bring to equipment producers, and ultimately consumers of their products, more wireless communications capability at lower costs.

Conceptualization. Start with a concept. Have a vision of a solution to a problem that does not yet exist. We began developing the constructs for a commercial digital mobile system in the 1980s, years before the products containing those inventions became widely available. In the early 1990s, we envisioned a system that would deliver broadband digital wireless voice and data. That system, incorporating our technology, is now becoming a reality as 3G wireless networks are turned on around the world.

Conceptualization

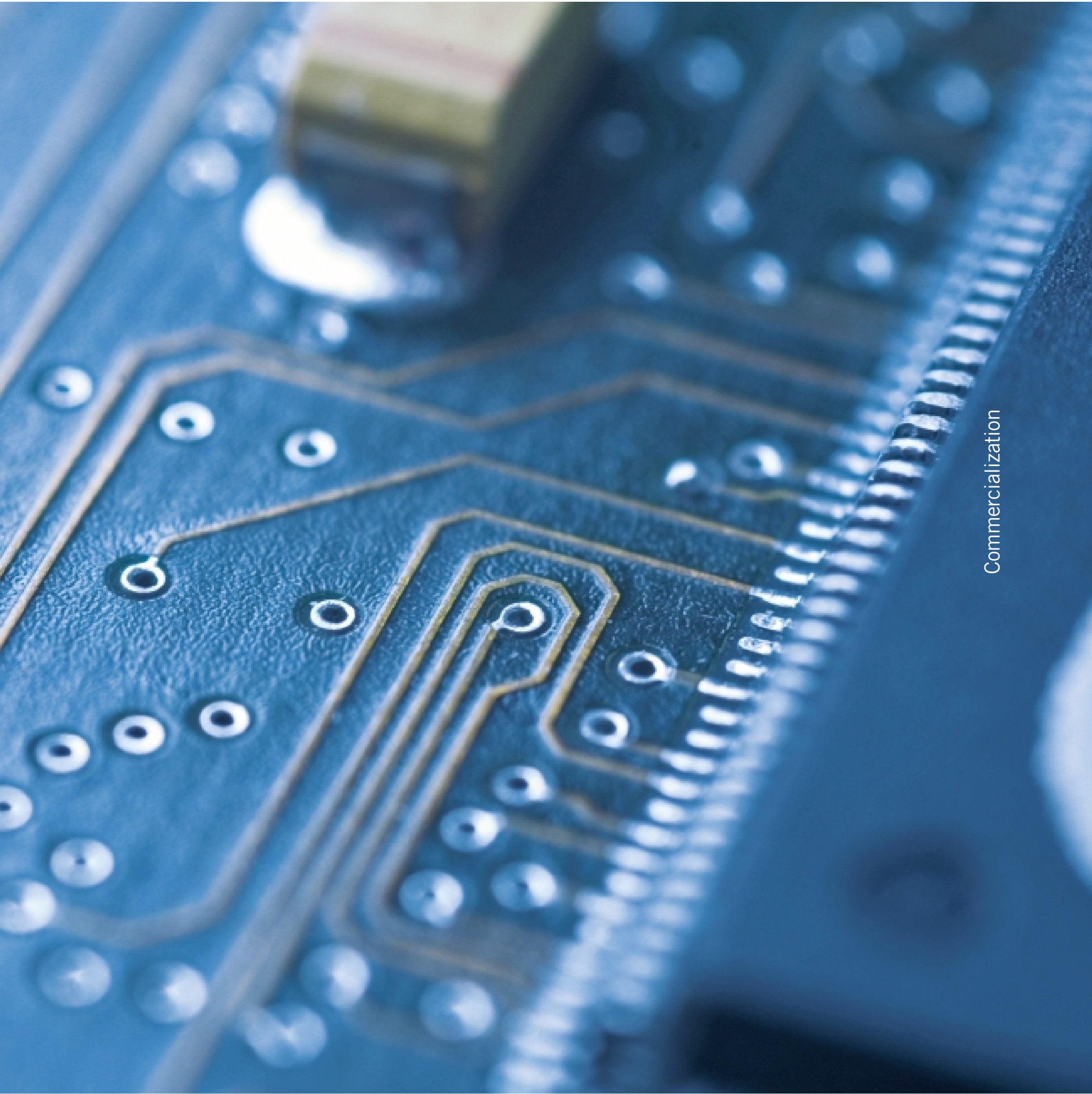
Research. To begin to realize the vision, our engineers outline how an advanced system would work and define and develop the technology to bring it to life. Working within the wireless standards bodies, our people contribute ideas that help to build the owner's manual for a new way of communicating. In this process, new ideas are patented and made available for use in worldwide standards. Our teams continue to evaluate alternate solutions to the challenges presented by a new design construct and develop new technology to support evolving wireless systems and consumer products.

Research

Technology Development. Our technology teams implement concepts into executable code and rigorously test the performance of the software to ensure robust performance in a variety of environments. Through rigorous testing and continuous improvements of the designs to enhance system performance, we bring to fruition the concepts into ready-to-incorporate software and system designs.

SIMAP
IF
MM
GMM
Mobility Management
RRC
BMC
RLC
MAC
MAC-hs
Layer 2/3
Layer 1

Commercialization. Furthering the development effort, we work with our customers to implement the software into their products, customizing the integration to achieve superior performance. In the end, our inventions enable the wireless systems and consumer devices to work better. What began as a breakthrough thought ends inside a finished product.


Commercialization

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Intellectual Property. Our inventions lie at the heart of wireless communications. We have actively contributed hundreds of inventions to the wireless industry. We currently generate revenues and cash flow primarily through royalties from the licensing of our patent portfolio. In recent years, we have dramatically increased our pace of invention. During 2003 we applied for 2,001 new patents, a 156% increase over 2002. In addition, we posted an 89% increase in the number of patents granted, adding 299 new patents worldwide, bringing our current portfolio of U.S. and foreign issued patents and patent applications to approximately 4,000 at the end of 2003. Our success in increasing the pace and breadth of our innovation reflects our fundamental commitment to be an industry leader in the creation of pioneering technologies.

A Sampling of our Essential Inventions Embedded in Wireless Products

Seamless Handover. Increases coverage area, accommodates more users and saves battery life.

Joint Detection and Interference Cancellation. Cancels out extraneous noise for a clearer and crisper reception.

Fundamental System Architecture. InterDigital developed the basic design concepts and methodologies by which most commercial TDMA and CDMA wireless systems are implemented worldwide.

Bandwidth on Demand. Enables systems to allocate bandwidth in an extremely efficient manner, increasing the capacity of a wireless system.

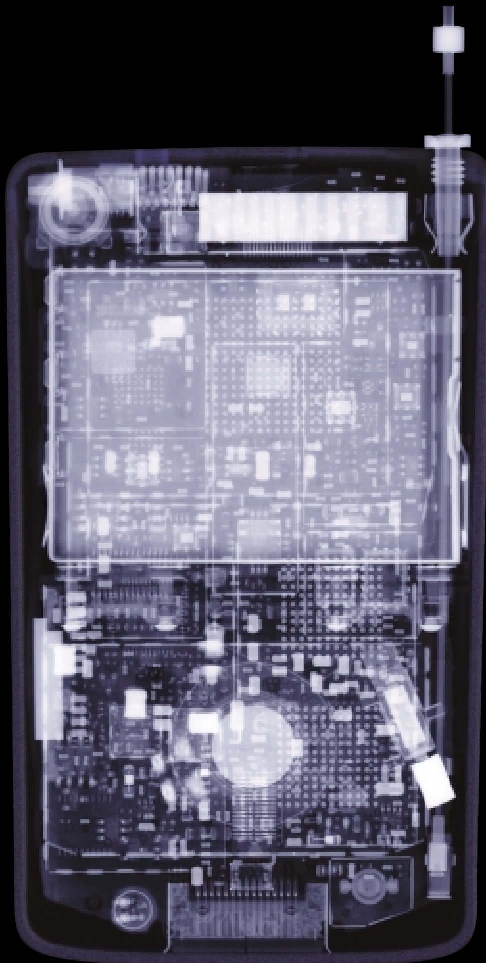
Power Control. Superior power control technology to maximize system capacity and minimize signal interference and degradation.

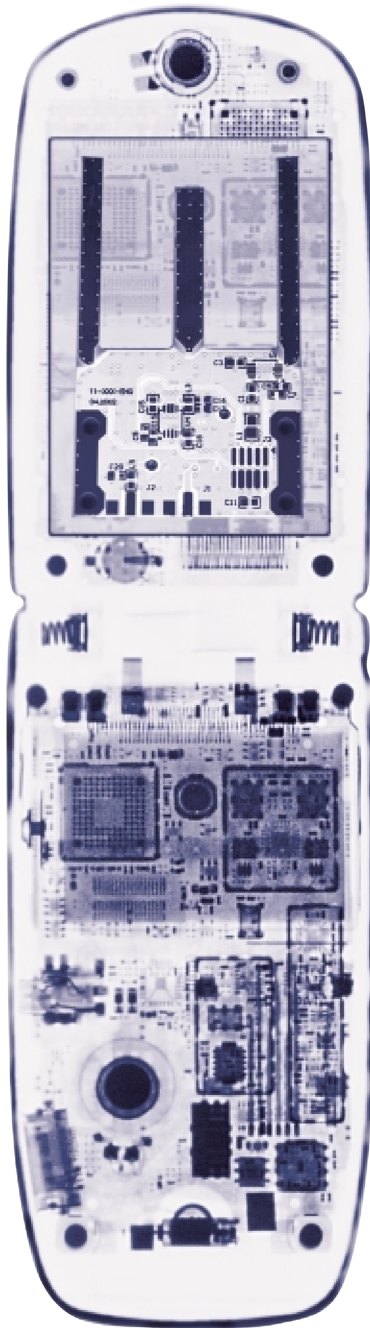
Packet Data. An extremely efficient method of transporting packet data over a radio signal, thereby increasing radio system capacity.

Global Pilot Channel. A reference signal transmitted by the base station that allows reliable and robust communications by all mobile users.

Building Advanced Technology Products. Our products take the form of software and reference designs that producers of components, terminals and infrastructure equipment use to enhance the performance of their products. For our customers, enhanced performance from our technology means their products make more efficient use of finite spectrum resources, employ sophisticated management of signal interference, operate at lower cost and require less power while performing at optimum levels.

Leading equipment producers turn to us for advanced solutions because of our deep knowledge of wireless systems and our experience in successfully implementing complex technologies into finished products. They are attracted by the depth of our intellectual property and our know-how, which is driven by more than 30 years of experience developing advanced technologies and our extensive contributions to the evolving standards for wireless products.





Today our products include a robust 3G software protocol stack, developed jointly by InterDigital and Infineon, now available for use in 3G handsets and other terminals. We are also developing interference management solutions targeted at the cellular and WLAN markets, including smart antenna solutions and radio resource management software.

Strategic Partnerships and Licensees. Our strategic partnerships expand our market access, broaden our technology base, provide manufacturing capability, accelerate innovation and shorten the time-to-market for our technology product development programs. Since 2001, we have been in a partnership with Infineon Technologies to jointly develop the software for inclusion on Infineon's 3G integrated circuit platform for 3G wireless terminals. The demonstration phone shown on this page contains this jointly developed platform and has been used to show the functionality of the software to potential customers.

Over the course of our history we have forged relationships with leading telecommunications manufacturers including Nokia, Siemens and Samsung. In addition to our partnerships, we have established patent license agreements with over 30 manufacturers of wireless equipment.

" Our ongoing partnership with InterDigital is very successful. Our joint team has developed and brought to market a 3G terminal unit protocol stack that, coupled with our multi-media platform, gives our customers a high degree of functionality and speeds their time-to-market. With this strong solution, we are already capturing customers."

Horst Fenske, CTO Secure Mobile Solutions, Infineon Technologies

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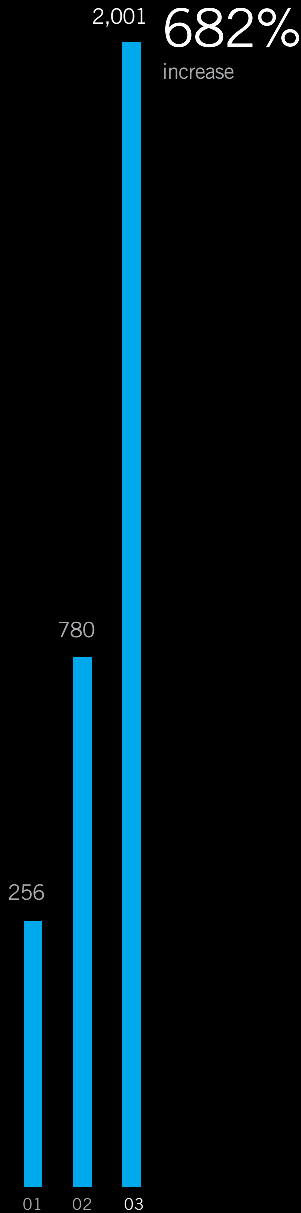
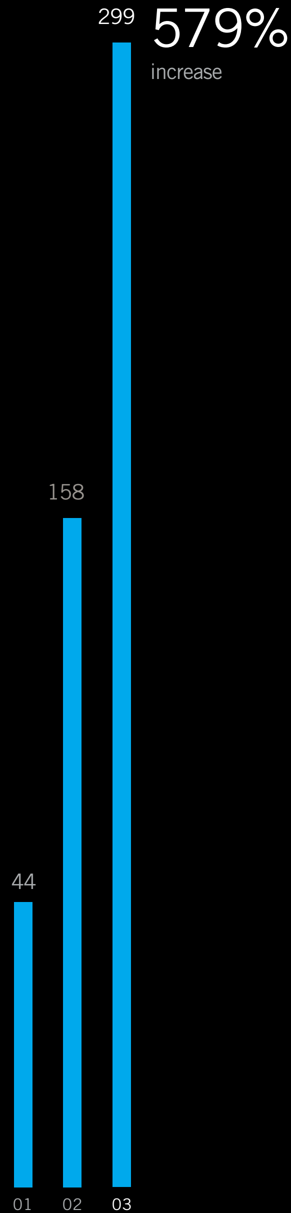
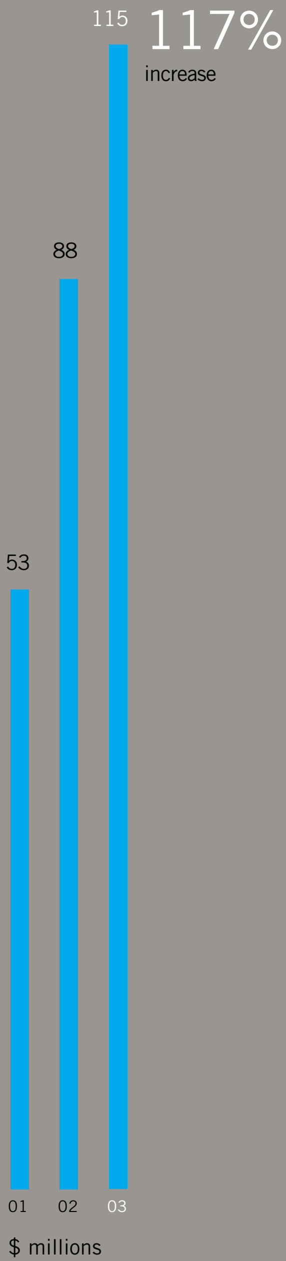
Performance. We are intensely committed to superior performance. And we are delivering it. By a variety of measures, we are building the value of your Company. Our pace of invention, our growth in revenues and recurring royalties have all surged in the last three years. Importantly, we have grown our cash flow before financing and acquisitions significantly during this same period. That performance translates into growth in value.



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88
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03
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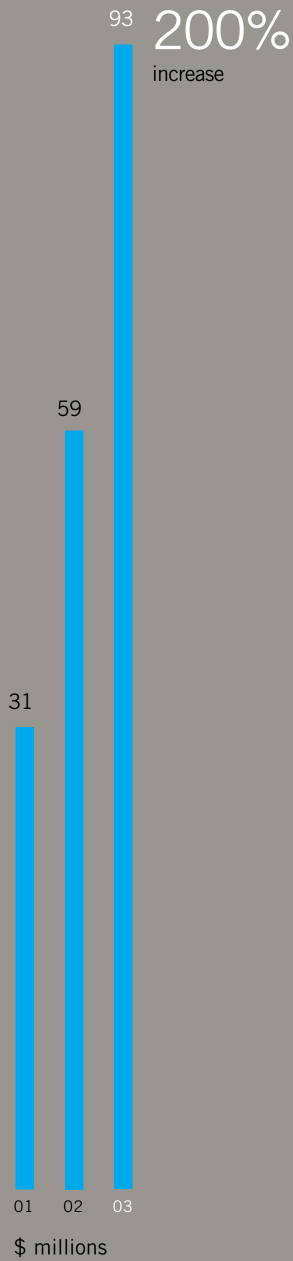
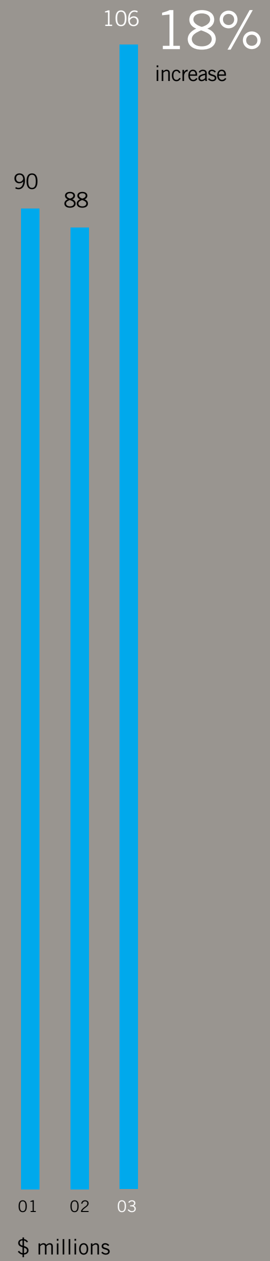

Recurring Royalties
93
200%
increase
59
31
01
02
03
$ millions

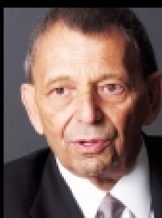

Cash and Short Term Investments
106
18%
increase
90
88
01
02
03
$ millions

Creating Value. InterDigital Communications Corporation's breakthrough inventions continue to forge new advances in wireless technologies. We are building strong momentum as a preferred provider of advanced modem solutions for the wireless industry. We will leverage that momentum in every facet of our business to create new revenue opportunities, grow our cash flow, and build enterprise value. Given our

position in the industry, the high quality and market relevance of our technology and product solutions and our financial strength, we are optimistic about our opportunity to build value in the coming years. We have created a global company of over 300 employees focused on achieving our strategic imperative of sustained, long-term growth in enterprise value. We are breaking through barriers every day.

Corporate Governance. At InterDigital, we are constantly seeking to build an organization that will deliver substantial growth in enterprise value. In doing so, we are committed to a well-defined and broadly communicated governance policy that will protect our shareholders' interests. The oversight functions provided by an experienced and independent Board of Directors are a central element in sound corporate governance. In 2003, we added three new independent directors to our Board. These industry veterans will add to the already diverse and talented set of executives that help guide our organization. Also, last year, we codified our corporate governance guidelines, reflecting the commitment of the Board and management to effective policy and decision-making and to growing long-term shareholder value.

InterDigital Communications Corporation Board of Directors



Harry G. Campagna
Chairman of the Board,
InterDigital
President and
Chief Executive Officer,
Qualitex Co.

Ed Kamins
Chief Information Officer
and Senior Vice President,
Avnet, Inc.

D. Ridgely Bolgiano
Chief Scientist,
InterDigital

Robert S. Roath
Chief Financial Officer
(retired),
RJR Nabisco, Inc.

Steven T. Clontz
President and
Chief Executive Officer,
StarHub Pte. Ltd.

Robert W. Shaner
President (retired),
Cingular Wireless LLC

Howard E. Goldberg
President and
Chief Executive Officer,
InterDigital

Alan P. Zabarsky
Founder and
Chief Executive Officer,
Technology Consulting
Associates, Inc.
Corporate Vice President
(retired), Motorola

2003 Financial Review

Selected Consolidated Financial Data

(in thousands except per share data)	**2003**	2002	2001	2000	1999
Consolidated Statements of Operations Data:					
Revenues:					
Licensing and alliance	$ 114,574	$ 87,895	$ 52,562	$ 51,244	$ 66,171
Products	–	–	–	5,634	4,496
Total revenues	$ 114,574	$ 87,895	$ 52,562	$ 56,878	$ 70,667
Net income (loss) applicable to common shareholders before cumulative effect of change in accounting principle	$ 34,332	$ 2,375	$ (19,421)	$ 5,564	$ 26,451
Net income (loss) per common share before cumulative effect of change in accounting principle - basic	$ 0.62	$ 0.04	$ (0.36)	$ 0.11	$ 0.55
Net income (loss) per common share before cumulative effect of change in accounting principle - diluted	$ 0.58	$ 0.04	$ (0.36)	$ 0.10	$ 0.52
Cumulative effect of change in accounting principle	–	–	–	$ (53,875)	–
Net income (loss) applicable to common shareholders	$ 34,332	$ 2,375	$ (19,421)	$ (48,311)	$ 26,451
Net income (loss) per common share - basic	$ 0.62	$ 0.04	$ (0.36)	$ (0.91)	$ 0.55
Net income (loss) per common share - diluted	$ 0.58	$ 0.04	$ (0.36)	$ (0.91)	$ 0.52
Weighted average number of common shares outstanding - basic	55,271	52,981	53,446	52,855	48,357
Weighted average number of common shares outstanding - diluted	59,691	56,099	53,446	57,306	50,495
Pro forma effect of change in accounting principle:					
Net income applicable to common shareholders before cumulative effect of change in accounting principle	NA	NA	NA	NA	$ 35,488
Net income per share - basic	NA	NA	NA	NA	$ 0.73
Net income per share - diluted	NA	NA	NA	NA	$ 0.70
Consolidated Balance Sheet Data:					
Cash and cash equivalents	$ 20,877	$ 22,337	$ 17,892	$ 12,343	$ 14,592
Short-term investments	85,050	65,229	72,471	76,644	68,550
Working capital	112,325	111,845	87,696	87,390	95,498
Total assets	205,165	191,178	148,381	141,625	126,571
Total debt	1,970	2,159	2,342	2,560	3,005
Total shareholders' equity	$ 97,485	$ 78,791	$ 60,274	$ 73,910	$ 109,507

Overview

The following discussion should be read in conjunction with the Selected Consolidated Financial Data, and the Consolidated Financial Statements and notes thereto, contained in this document.

We are in the business of designing and developing advanced wireless technology solutions which we make available for license or sale to semiconductor companies and equipment producers. Our advanced technology solutions are comprised of inventions, know-how and other technical data (e.g., software, designs and specifications) related to the design and operation of digital wireless products. We patent many of our inventions and license those inventions to wireless communications equipment producers and related suppliers. In addition, we offer for sale or license various portions of the technology (e.g., reference designs, know-how and software) to producers of wireless equipment products and components. Our advanced technology solutions have been developed both independently and in conjunction with certain equipment manufacturers. We also actively participate in the standard setting process, contributing solutions that are incorporated from time to time into Standards. In 2003, we generated substantially all of our revenue from patent license agreements.

Our revenues in 2003 and 2002 included $20.6 million and nearly $8.0 million, respectively, related to our licensees product sales from prior periods. In 2002, our revenues also included $16.5 million of previously received non-refundable prepayments that were recognized upon our receipt of evidence that the licensees had discontinued sales of covered products. These non-recurring items represented 18% and 28% of our total revenues in 2003 and 2002, respectively. We also recorded $14.0 million of other income in 2003 related to the settlement of a patent litigation that was not associated with a pre-existing patent license agreement. Unpredictable amounts like noted above could continue in the future.

In the last three years, we have signed eleven new patent license agreements or amendments with both new and existing customers, including six license agreements covering 3G technologies. Over that period, we increased our recurring patent license royalties by approximately 200%, from $30.8 million in 2001 to $92.9 million in 2003. The increase resulted from both an increase in the number of licensees and higher royalties from existing licensees during the period on covered 2G and 3G products. We expect that our 2G/3G royalty mix will shift to a higher percentage of 3G royalties as the decade unfolds due to the emergence of the 3G market and continued maturation of the 2G market coupled with the expiration of certain of our TDMA patents starting in 2006.

Wireless handset manufacturers, including our licensees, experienced declining average selling prices on mature 2G devices with limited functionality (e.g., voice-only handsets) during 2003. However, these decreases were offset in large part by both increased volumes and higher average selling prices on devices with increased functionality and features, such as 3G devices and camera-enabled 2.5G handsets. Our royalty base differs by licensee. Some royalty obligations are calculated strictly as a percentage of sales. Other agreements provide for fixed royalties per unit sold and others provide for combinations or variations thereof. As such, changes in our royalty revenue from covered handsets may not highly correlate with overall industry changes in average selling prices. That was the case in 2003 when we experienced limited diminution in per unit royalties from licensees due to the mix of royalties and related agreements. We believe our 2G licensing revenue will decline over time as a result of the continued maturation of the 2G market coupled with the expiration of certain of our TDMA patents in coming years.

From time to time, if we believe that a third party is required to license our patents in order to manufacture and sell digital cellular products and that the third party will not enter into a license, we may institute legal action against the third party. These legal actions typically take the form

of a patent infringement lawsuit. In March 2004, we filed a patent infringement lawsuit against Lucent Technologies, Inc. (Lucent) a leading manufacturer of cdma2000 equipment, for infringement of seven United States patents. The complaint seeks damages for past infringement and an injunction against future infringement as well as interest, costs, and attorney's fees. Lucent has not responded to the complaint.

We and our licensees, in the normal course of business, may have disagreements as to the rights and obligations of the parties under the applicable license agreement. For example, we could have a disagreement with a licensee as to the amount of reported sales and royalties. Currently, we are in separate arbitrations regarding our respective license agreements with Nokia Corporation (Nokia) and Samsung Electronics Co. Ltd. (Samsung).

Over the last three years, our cost of development has increased from approximately $44.5 million to approximately $45.9 million and has represented between 54% and 61% of our total operating expenses. Our development efforts are integral to both establishing product offerings and expanding our portfolio of wireless patents and will continue to be a substantial portion of our operating expenses in 2004.

We seek to maintain a strong balance sheet and have increased our cash and short-term investment position over the last three years from approximately $90.0 million at December 31, 2000 to $105.9 million at December 31, 2003 while maintaining less than $2.5 million of long-term debt during that period. We achieved this increase while investing approximately $46.5 million during 2003 to repurchase 2 million shares of our common stock and acquire substantially all of the operating assets of Windshift Holdings, Inc., formerly known as Tantivy Communications, Inc. (Windshift). We plan to continue to maintain a strong cash and short-term investment position. However, we will consider investment opportunities that may require us to reduce our cash and short-term investment position and/or increase our long-term debt. Such opportunities may include, but are not limited to, accelerated investment in our internally developed technology and the acquisition of patents and technology products from third parties.

Critical Accounting Policies and Estimates

Our consolidated financial statements are based on the selection and application of accounting principles generally accepted in the United States of America, which require us to make estimates and assumptions that affect the amounts reported in both our consolidated financial statements and the accompanying notes thereto. Future events and their effects cannot be determined with absolute certainty. Therefore, the determination of estimates requires the exercise of judgment. Actual results could differ from these estimates, and any such differences may be material to the financial statements. Our significant accounting policies are described in Note 2 to our consolidated financial statements, and are included in Item 8 of the Form 10-K. We believe the accounting policies that are of particular importance to the portrayal of the Company's financial condition and results, and that may involve a higher degree of complexity and judgment in their application compared to others, are those relating to revenue recognition, income taxes, and long-lived intangible patent assets. If different assumptions were made or different conditions had existed, our financial results could have been materially different.

Revenue Recognition

We derive revenue principally from patent licensing and service agreements. The timing of revenue recognition and the amount of revenue actually recognized from each source depends upon a variety of factors, including the specific terms of each agreement and the nature of the deliverables and obligations. Such agreements are often complex and multi-faceted. These agreements can include, without limitation, elements related to the settlement of past patent infringement liabilities, up-front and non-refundable license fees for the use of patents and/or know-how, patent

and/or know-how licensing royalties on covered products sold by licensees, cross licensing terms between us and other parties, the compensation structure and ownership of intellectual property rights associated with contractual technology development arrangements, and advanced payments and fees for service arrangements. Due to the combined nature of some agreements and the inherent difficulty in establishing reliable, verifiable and objectively determinable evidence of the fair value of the separate elements of these agreements, the total revenue resulting from such agreements may sometimes be recognized over the combined performance period. In other circumstances, such as those agreements involving consideration for past and expected future patent royalty obligations, the determining factors necessary to allocate revenue across past, current, and future years may be difficult to establish. In such instances, the appropriate recording of revenue between periods may require the use of judgment, after consideration of the particular facts and circumstances. Generally, we will not recognize revenue related to payments that are due greater than twelve months from the balance sheet date. In all cases, revenue is only recognized after all of the following criteria are met: (1) written agreements have been executed; (2) delivery of technology or intellectual property rights has occurred or services have been rendered; (3) fees are fixed and determinable; and (4) collectibility of fees is reasonably assured.

Patent License Agreements

Upon signing a patent license agreement, we provide the licensee with permission to use our patented inventions in specific applications. We have no material future obligations associated with such licenses, other than, in some instances, to provide such licensees with notification of future license agreements pursuant to most favored licensee rights. Under our patent license agreements, we typically receive one or a combination of the following forms of payment as consideration for permitting our licensees to use our patented inventions in their applications and products:

- *Consideration for Prior Sales:* Consideration related to a licensee's product sales from prior periods. Such consideration may result from a negotiated agreement with a licensee that utilized our patented inventions prior to signing a patent license agreement with us or from the resolution of a disagreement or arbitration with a licensee over the specific terms of an existing license agreement. In each of these cases, we record the consideration as revenue. We may also receive consideration from the settlement of patent infringement litigation where there was no prior patent license agreement. We record the consideration related to such litigation as other income.

- *Paid-up Amounts:* Up-front, non-refundable royalty payments that fulfill the licensee's obligations to us, under a patent license agreement, for the lifetime of the agreement.

- *Prepayments:* Up-front, non-refundable royalty prepayments towards a licensee's future obligations to us related to its expected product sales in future periods. Our licensees' obligations to pay royalties extend beyond the exhaustion of their prepayment balance. Once a licensee exhausts its prepayment balance, we may provide them with the opportunity to make another Prepayment toward future sales or it will be required to make Current Royalty Payments.

- *Current Royalty Payments:* Royalty payments covering a licensee's obligations to us related to its covered product sales in the current contractual reporting period.

We recognize revenues related to Consideration for Prior Sales when we have obtained a signed agreement, identified a fixed and determinable price and determined that collectibility is reasonably assured. We recognize revenues related to Paid-up Amounts on a straight-line basis over the effective term of the license. We utilize the straight-line method because we have no

future obligations under these licenses and we can not reliably predict in which periods, within the term of a license, the licensee will benefit from the use of our patented inventions. We recognize revenues related to Prepayments as each licensee exhausts its prepayment balance through its sales of covered products. We generally recognize revenue related to Current Royalty Payments in the period in which the sales of each licensee's products occurred.

Licensees that either owe us Current Royalty Payments or have prepayment balances provide us with quarterly or semi-annual royalty reports that summarize their sales of covered products and their related royalty obligations to us. We typically receive these royalty reports subsequent to the period in which our licensees' underlying sales occurred, but prior to the issuance of our financial statements for that period. In such cases, we recognize the related revenue in the period the sales occurred. When we do not receive the royalty reports prior to the issuance of our financial statements, we accrue the related royalty revenue if reasonable estimates of such amounts can be made. These estimates are based on the historical royalty data of the licensees involved, currently available third party forecasts of royalty related product sales in the applicable market and, if available, information provided by the licensee. When our licensees formally report royalties for which we accrued revenues based on estimates, or when they report updates to prior royalty reports, we adjust revenue in the period in which the final reports are received. In cases where we receive objective, verifiable evidence that a licensee has discontinued sales of covered products, we recognize any remaining deferred revenue balance related to unexhausted Prepayments in the period that we receive such evidence.

Service Revenues

We recognize revenues associated with service arrangements on a straight-line basis, unless evidence suggests that the revenue is earned or obligations are fulfilled in a different pattern, over the contractual term of the arrangement or the expected period during which those specified services will be performed, whichever is longer. Recently, our service agreements have been long-term in nature and we have recorded revenue from them based on our proportional performance of services rendered. The terms of these arrangements have provided evidence that this approach better reflects the pattern in which the revenue has been earned or the obligations have been fulfilled. When recognizing revenue based on our proportional performance, we measure the progress of our performance based on the relationship between incurred contract costs and total estimated contract costs. Our most significant costs have been labor hours and we believe these costs provide a measure of the progress of our services. The effect of changes to total estimated contract costs is recognized in the period such changes are determined. Estimated losses, if any, are recorded when the loss first becomes apparent.

Income Taxes

Income taxes are accounted for under the asset and liability method. Under this method, deferred tax assets and liabilities are recognized for the estimated future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases, and operating loss and tax credit carryforwards. Deferred tax assets and liabilities are measured using enacted tax rates in effect for the year in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in the Consolidated Statement of Operations in the period that includes the enactment date. A valuation allowance is recorded to reduce the carrying amounts of deferred tax assets if management has determined that it is more likely than not that such assets will not be realized.

Our accumulated tax losses, which include allowable deductions related to exercised employee stock options, have generated a federal tax net operating loss (NOL) carryforward of approximately $123 million and $137 million as of December 31, 2003 and 2002, respectively. Generally accepted accounting principles require that we establish a net deferred tax asset consisting of estimated future benefits of existing NOLs, offset by a valuation allowance associated with any portion of our NOL carryforward for which management believes it is more likely than not we will be unable to utilize the NOL carryforward to offset future taxes. We believe that the future utilization of our NOL carryforwards is somewhat dependent on our success in three key areas (1) the market acceptance of our technology products, (2) the outcome of significant outstanding patent license arbitrations and (3) our ability to sign additional patent license agreements. We will continue to provide a full valuation allowance on all deferred tax assets, until our success in these or other areas provides evidence that our NOL carryforward will be utilized. We currently provide for income taxes only to the extent that we expect to pay cash taxes (primarily foreign withholding taxes on patent license royalties, state taxes and the federal alternative minimum tax) associated with current taxable income. It is possible, however, that we could generate taxable income in the future at levels which would cause management to conclude that it is more likely than not that we will realize all or a portion of the NOL carryforward benefit. Upon reaching such a conclusion, we would immediately record the estimated realizable value of some or all of the deferred tax asset and, after its utilization, would then provide for income taxes at a rate equal to our combined federal and state effective rates, which would approximate 36% to 39% under current tax laws. If and when recognized, the tax benefit associated with deductions related to the exercise of employee stock options, representing approximately 78% of our NOLs at December 31, 2003, will be accounted for as a credit to shareholders' equity and the remaining portion of the tax benefit will reduce the income tax provision. Subsequent revisions to the estimated realizable value of the deferred tax asset could cause our provision for income taxes to vary significantly from period to period, although our cash tax payments would remain unaffected until our NOL carryforward is fully utilized or has expired.

Patents

We capitalize external costs incurred to obtain patents and patent license rights and amortize these costs on a straight-line basis over the estimated useful lives of the patents. Due to the uncertainty associated with estimating the useful life of any advanced technology at its inception, we assign an estimated useful life of 10 years to patents relating to technology developed directly by the Company. The estimated useful lives of acquired patents and patent rights, however, will be based on analysis related to each acquisition and may differ from the estimated useful lives of patents obtained directly by the Company. We assess the potential impairment to all capitalized net patent costs when there is evidence that events or changes in circumstances indicate that the carrying amount of these patents may not be recovered. Amortization expense was $3.3 million, $2.2 million and $1.8 million in 2003, 2002 and 2001, respectively. Accumulated amortization was $17.1 million and $13.8 million at December 31, 2003 and 2002, respectively.

Contingencies

We recognize contingent liabilities in accordance with SFAS No. 5 "Accounting for Contingencies". We do not record contingent gains.

In first quarter 2003, we accrued a $3.4 million liability under an insurance reimbursement agreement. Our insurance carrier has demanded arbitration, claiming that our obligation under the agreement is approximately $28.0 million. We have since filed an action seeking a declaratory judgement that the insurance reimbursement agreement is void and that we are due damages from

our insurance carrier for their bad faith and breach of obligations under a related insurance policy. At this time, it is impossible to predict the outcome of the litigation and any arbitration, therefore we have not adjusted our original accrual of $3.4 million.

Significant Transactions

Ericsson

In March 2003, we entered into a worldwide license agreement with Telefonaktiebolaget LM Ericsson and Ericsson Inc. (together, Ericsson) for sales of terminal and infrastructure products compliant with 2G GSM/TDMA and 2.5G GSM/GPRS/TDMA standards. Concurrent with this agreement, we resolved a patent infringement lawsuit with Ericsson Inc. that was scheduled for trial in May 2003.

We are due to receive total payments of approximately $14.0 million from Ericsson related to their sales of infrastructure and terminal products through December 31, 2002. In 2003, we received $7.0 million from Ericsson and we expect to receive the remaining payments in first quarter 2004. We recognized the $14.0 million from Ericsson, net of an estimated $3.4 million associated with a claim under an insurance reimbursement agreement with Federal Insurance Company (Federal), as other income in first quarter 2003, as the payments from Ericsson represent the settlement of litigation. The $3.4 million represents a loss contingency and is more fully discussed in Litigation and Legal Proceedings below.

Ericsson is obligated to pay us an annual license fee of $6.0 million per year for sales of covered infrastructure products for each of the years 2003 through 2006. The first payment of $6.0 million was received in February 2004 and the remaining payments are due in quarterly installments of $1.5 million beginning in May 2004. We are recognizing the related revenue on a straight-line basis from first quarter 2003 through fourth quarter 2006.

Sony Ericsson

In March 2003, we entered into a worldwide license agreement with Sony Ericsson Mobile Communications AB (Sony Ericsson) for sales of terminal units compliant with 2G GSM/TDMA and 2.5G GSM/GPRS/TDMA standards.

We are due to receive total payments of approximately $20.3 million from Sony Ericsson related to their sales of terminal products through December 31, 2002. In 2003, we received $8.7 million from Sony Ericsson and we expect to receive the remaining payments in first quarter 2004. Although we reached our agreement with Sony Ericsson at the same time as our resolution of a patent infringement lawsuit with one of its principals, Ericsson Inc., we never engaged in litigation with Sony Ericsson. As such, our agreement with Sony Ericsson represents a new patent license and not a settlement of litigation. We recognized the $20.3 million from Sony Ericsson as revenue in first quarter 2003.

For the period January 1, 2003 through December 31, 2006, Sony Ericsson is obligated to pay us a royalty on each licensed product sold. Through December 31, 2003, we received approximately $26.2 million of advance royalty payments based on Sony Ericsson's projections of sales of covered products for 2003 and 2004. Once this initial prepayment is exhausted, Sony Ericsson will have the option to make additional advance royalty payments or pay royalties on an ongoing basis. In return for making advanced royalty payments, Sony Ericsson has and will receive prepayment discounts and credits as opposed to the undiscounted base royalty rate. We record advance royalty payments as deferred revenue and subsequently recognize the revenue in the periods in which our licensees exhaust such advance royalty payments through the sale of covered products. As of December 31, 2003, Sony Ericsson has exhausted approximately $12.7 million of their advance royalty payments through sales of covered products.

Nokia and Samsung Arbitrations

We believe the license agreements with Ericsson and Sony Ericsson establish the financial terms necessary to define the royalty obligations of Nokia and Samsung on sales of 2G GSM/TDMA and 2.5G GSM/GPRS/TDMA products under their existing patent license agreements with us. Under the most favored licensee (MFL) provisions applicable to their respective patent license agreements, we believe both companies are obligated to pay royalties to us on sales of covered products from January 1, 2002 by reference to the terms of the Ericsson (for infrastructure products) and Sony Ericsson (for terminal unit products) license agreements. The MFL provisions include terms for a period of review, negotiation, and dispute resolution with regard to the determination of the royalty obligations of both Nokia and Samsung. Nokia and Samsung each dispute our position. We are currently in separate arbitration proceedings regarding these disputes as more fully discussed in Litigation and Legal Proceedings below.

We have not recorded revenue associated with the Nokia and Samsung license agreements related to sales of covered products during any period subsequent to January 1, 2002, and will not record any such revenue until all elements required for revenue recognition are met.

Sharp

We are party to a non-exclusive, worldwide, generally nontransferable, royalty-bearing, convenience-based patent license agreement with Sharp Corporation of Japan (Sharp) covering sales of terminal devices compliant with TDMA-based PDC and PHS standards (Sharp PDC/PHS Agreement). In second quarter 2003, we extended the term of the Sharp PDC/PHS Agreement until April 2008. Under the extension, Sharp made a $17.5 million up-front payment consisting of a renewal fee of $2.0 million and a royalty prepayment of $15.5 million. Once the royalty prepayment is exhausted, Sharp will be obligated to make additional royalty payments, at updated rates, on sales of licensed products sold through early 2008. The remaining portion of the upfront payment will be amortized on a straight-line basis over the five-year term of the extension.

We are also party to a separate non-exclusive, worldwide, convenience-based, generally non-transferable, royalty-bearing patent license agreement with Sharp (Sharp NCDMA/GSM 3G Agreement) covering sales of GSM, narrowband CDMA and 3G products that expires upon the last to expire of the patents licensed under the agreement. In 2003, we recorded revenues of $28.5 million from Sharp, of which approximately $19.5 million is attributable to the Sharp PDC/PHS Agreement and approximately $9.0 million is attributable to the NCDMA/GSM/3G Agreement. In 2002 we recorded revenues of $23.5 million and $2.7 million, respectively, from our PDC/PHS and GSM agreements with Sharp. In 2001 we recorded $15.6 million from our PDC/PHS agreement with Sharp. In addition, under an amendment to the Sharp NCDMA/GSM/3G Agreement, Sharp is obligated to make an upfront payment of approximately $17.8 million in second quarter 2004 as an advance against future royalty obligations.

Acquisition

On July 30, 2003, we entered into an Asset Purchase Agreement (the Asset Purchase Agreement) with Windshift, pursuant to which we acquired substantially all the assets of Windshift. Included in the acquisition were patents, patent applications, know-how, and state-of-the art laboratory facilities related to cdma2000, smart antenna, wireless LAN and other wireless communications technologies. The acquisition included patents and patent applications to which we had previously acquired rights under a patent license agreement with Windshift. We acquired these assets to strengthen our existing cdma2000 patent portfolio and competitive position in that marketplace, to broaden our offering to potential licensees and technology partners and to eliminate contingent payment obligations we had to Windshift in connection with the license we entered into with them in 2002 regarding the cdma2000 related patents.

The purchase price for the acquisition was $11.5 million, consisting of approximately $10.0 million in cash and cancellation of approximately $1.5 million in outstanding indebtedness

owed to us by Windshift. In addition, under the terms of the Asset Purchase Agreement, Windshift will be entitled to receive, for a period of approximately five years, 1% and 4%, respectively, of amounts we receive from the licensing or sale of smart antenna and 802.11 intellectual property acquired from Windshift (the Earn-out). In addition to the purchase price, we incurred approximately $0.4 million of acquisition related costs.

In connection with our acquisition, we opened an engineering design center in Melbourne, Florida and hired 10 individuals that were formerly employed by Windshift. Beginning July 31, 2003, we have included the results of the Melbourne design center, amortization of the acquired patents and depreciation of the acquired fixed assets in our results of operations.

Litigation and Legal Proceedings

Nokia

In July 2003, Nokia requested binding arbitration regarding Nokia's royalty payment obligations for its worldwide sales of 2G GSM/TDMA and 2.5G GSM/GPRS/EDGE/TDMA products under the existing patent license agreement with InterDigital Technology Corporation (ITC), a wholly-owned subsidiary of InterDigital Communications Corporation. Pursuant to the dispute resolution provisions of the patent license agreement, the arbitration has been filed in the International Court of Arbitration of the International Chamber of Commerce (ICC).

The binding arbitration relates to ITC's claim that the patent license agreements ITC signed with Ericsson and Sony Ericsson in March 2003 defined the financial terms under which Nokia would be required to pay royalties on its worldwide sales of 2G GSM/TDMA and 2.5G GSM/GPRS/EDGE/TDMA products commencing January 1, 2002. Nokia is seeking a determination that their obligation under our existing patent license agreement is not defined by our license agreements with Ericsson and Sony Ericsson or has been discharged. Alternatively, Nokia is seeking access to various documents related to previous litigations, negotiations, and arbitrations with other parties. Nokia also is seeking a ruling that no royalty rate for its sales after January 1, 2002 can be determined by the panel until certain contractual conditions precedent have been satisfied. Nokia has additionally claimed that, in any event, the panel cannot award money damages.

ITC filed an Answer to Nokia's Request for Arbitration arguing that the patent license agreements signed with Ericsson and Sony Ericsson in March 2003 defined the financial terms under which Nokia would be required to pay royalties on its worldwide sales of 2G GSM/TDMA and 2.5G GSM/GPRS/EDGE/TDMA products commencing January 1, 2002, that Nokia's duty to pay these royalties has not been discharged, and that the documents sought by Nokia are not relevant to the royalty determination. ITC also counterclaimed for an arbitration decision requiring that Nokia pay us royalties on equivalent terms and conditions as those set forth in the Ericsson and Sony Ericsson patent license agreements for the period January 1, 2002 to December 31, 2006, and determining the amount of the royalty and payment terms. During fourth quarter 2003, Nokia filed a Reply contesting our claims and including additional claims and defenses relating to the enforceability, validity, and infringement of certain of ITC's patents. Subsequently Nokia withdrew from the arbitration its claims pertaining to invalidity and non-infringement of those same ITC patents but maintains that the validity and infringement of those patents is a factor the arbitration panel should consider in the arbitration. We do not believe that the issues of patent validity or infringement are relevant to the arbitrable royalty dispute and intend to vigorously contest Nokia's position. The arbitration panel has informed the parties that January 2005 is the month during which the panel will conduct the arbitration evidentiary hearing, and, absent a resolution of this matter or unexpected changes in the arbitration schedule approved by the arbitration panel, we expect a decision to be rendered thereafter.

Separately, Nokia has filed a motion to intervene in the now-settled Ericsson litigation in the United States District Court for the Northern District of Texas and to gain access to documents previously sealed by the Court in the settled litigation. We filed a response opposing the

request to intervene and opposing the request for access to the documents. While the Court granted Nokia's motion to intervene in the Ericsson litigation, the Court has deferred a ruling on Nokia's request to gain access to sealed documents pending a determination by the arbitration panel in the Nokia arbitration proceeding as to whether any sealed document is relevant to such arbitration proceeding. Nokia subsequently filed a motion to reinstate certain decisions that were vacated in the now-settled Ericsson litigation. We have opposed Nokia's motion to reinstate the decisions and a court decision is pending.

Samsung

In 2002, during an arbitration proceeding, Samsung elected under its 1996 patent license agreement with ITC (1996 Samsung License Agreement) to have Samsung's royalty obligations commencing January 1, 2002 for 2G GSM/TDMA and 2.5G GSM/GPRS/EDGE/TDMA wireless communications products to be determined in accordance with the terms of the Nokia patent license agreement, including its MFL provision. By notice in March 2003, ITC notified Samsung that such Samsung obligations had been defined by the relevant licensing terms of ITC's license agreements with Ericsson and Sony Ericsson as a result of the MFL provision in the Nokia license agreement. In November 2003, Samsung initiated a binding arbitration against InterDigital Communications Corporation (InterDigital) and ITC (collectively with InterDigital, the Company). The arbitration has been filed with the ICC. Samsung is seeking to have an ICC arbitration panel determine that Samsung's obligations under the 1996 Samsung License Agreement are not defined by our license agreements with Ericsson and Sony Ericsson or, in the alternative, to determine the amount of the appropriate royalty due. Samsung also has requested a consolidation of its arbitration matter with the pending ICC arbitration involving Nokia Corporation and the Company and for the arbitration panel to make a determination that Samsung is entitled to seek access to documents previously sealed by the Federal Court related to the now-settled Ericsson litigation. The Company has responded to and contested Samsung's claims and any request for access to the sealed documents. The Company believes that consolidation of the arbitration proceedings is not permitted without the consent of the parties. ITC also has counterclaimed for an arbitration decision requiring that Samsung pay us royalties on equivalent terms and conditions as those set forth in the Ericsson and Sony Ericsson patent license agreements for the period January 1, 2002 to December 31, 2006, and determining the amount of the royalty and payment terms. We also seek a declaration that the parties' rights and obligations are governed by the 1996 Samsung License Agreement, and that the Nokia patent license agreement dictates only Samsung's royalty obligations and most favored rights for those products licensed under the 1996 Samsung License Agreement. Samsung has replied to ITC's answer and counterclaim, maintaining Samsung's position (as set forth in its arbitration demand) and arguing that it has succeeded to all of Nokia's license rights. In the alternative, Samsung asserts that its royalty obligations should be governed by the MFL clause in the 1996 Samsung License Agreement. We expect an arbitration panel will be selected in the near future.

Lucent

In March 2004, Tantivy Communications, Inc., one of our wholly-owned subsidiaries, filed a lawsuit in the United States District Court for the Eastern District of Texas against Lucent, a leading manufacturer of cdma2000 equipment, for infringement of seven United States patents. The complaint seeks damages for past infringement and an injunction against future infringement as well as interest, costs, and attorney's fees. Lucent has not yet responded to the complaint.

Federal

In November 2003, Federal Insurance Company (Federal), the insurance carrier for the settled litigation involving Ericsson Inc., delivered to us a demand for arbitration under the Pennsylvania Uniform Arbitration Act. Federal claims, based on their determination of expected value to the Company

resulting from our settlement involving Ericsson Inc., that an insurance reimbursement agreement requires us to reimburse Federal approximately $28 million for attorneys' fees and expenses it claims were paid by it. On November 4, 2003 the Company filed an action in United States District Court for the Eastern District of Pennsylvania seeking a declaratory judgment that the reimbursement agreement is void and unenforceable, seeking reimbursement of attorneys' fees and expenses which have not been reimbursed by Federal and which were paid directly by the Company in connection with the Ericsson Inc. litigation, and seeking damages for Federal's bad faith and breach of its obligations under the insurance policy. In the alternative, in the event the reimbursement agreement is found to be valid and enforceable, the Company is seeking a declaratory judgment that Federal is entitled to reimbursement based only on certain portions of amounts received by the Company from Ericsson Inc. pursuant to the settlement of the litigation involving Ericsson Inc. Federal has requested the Court to dismiss the action and/or to have the matter referred to arbitration. We have opposed such requests. The Court has held a hearing on Federal's requests, and a decision on such requests is pending. Prior to Federal's demand for arbitration, we had accrued a contingent liability of $3.4 million related to the insurance reimbursement agreement. If this matter results in us paying Federal substantially more than the amount accrued, it could have a material impact on our financial results.

Other

We have filed patent applications in the United States and in numerous foreign countries. In the ordinary course of business, we currently are, and expect from time to time to be, subject to challenges with respect to the validity of our patents and with respect to our patent applications. We intend to continue to vigorously defend the validity of our patents and defend against any such challenges. However, if certain key patents are revoked or patent applications are denied, our patent licensing opportunities could be materially and adversely affected.

In addition to disputes associated with enforcement and licensing activities regarding our intellectual property, including the litigation described above, we are a party to other disputes and legal actions not related to our intellectual property but also arising in the ordinary course of our business. Based upon information presently available to us, we believe that the ultimate outcome of these other disputes and legal actions will not materially affect us.

Financial Position, Liquidity and Capital Requirements

In 2003, we generated net cash of $59.6 million from operating activities. In 2002, we used net cash of $2.2 million in operating activities. The positive operating cash flow in 2003 arose principally from net receipts of approximately $129.5 million from patent licensing agreements. This included $7.0 million from Ericsson and approximately $34.9 million from Sony Ericsson under the above-noted patent license agreements, $48.4 million from NEC Corporation of Japan (NEC) associated with 2G and 3G patent license agreements, $29.3 million from Sharp related to our 2G and 3G patent license agreements and $9.9 million from other licensees related to their respective patent license agreements. These receipts were partially offset by cash operating expenses of $74.0 million (operating expenses less depreciation of fixed assets, amortization of intangible assets and non-cash compensation) and changes in working capital during 2003. The use of cash in 2002 was due, in large part, to outflows related to cash operating expenses of $66.6 million, which outflows were largely offset by the net receipts of approximately $50.4 million from patent license agreements and approximately $10.7 million from our WTDD technology development agreement with Nokia. Our net receipts from patent license agreements in 2002 included $29.5 million from NEC associated with the 2G and 3G patent license agreements, $17.9 million from Sharp associated with their 2G patent license agreement, and $3.0 million from other licensees.

Net cash flows used in investing activities increased to $45.3 million in 2003 from $4.8 million in 2002. We purchased $20.3 million of short-term marketable securities, net of sales, in 2003.

In 2002, we sold $7.2 million of short-term marketable securities, net of purchases. This change resulted from the higher level of cash receipts from patent licensing in 2003. The pace of investments in capital assets decreased from $6.5 million in 2002 to $3.9 million in 2003 due in large part to our decision in mid 2003 to defer investment in field trial demonstration products for our WTDD technology development program. Investment costs associated with patents increased $3.7 million to $9.2 million in 2003 compared to 2002, reflecting higher 3G patenting activity levels during 2003. In July, 2003, we acquired substantially all of the tangible and intangible assets of Windshift for approximately $11.9 million, including acquisition-related costs, as described above. In 2004, we expect patent investments to remain at or near 2003 levels and investments in capital assets to return to pre-2003 levels as we invest in smart antenna and FDD technology product development.

Net cash used in financing activities in 2003 was $15.7 million compared to net cash provided by financing activities of $11.4 million in 2002. The use of cash in 2003 primarily resulted from the repurchase of 2.0 million shares of our common stock for a total of $34.7 million. This repurchase was partially offset by $19.2 million of proceeds from option and warrant exercises and from the Company's employee stock purchase plan.

As of December 31, 2003 we had $105.9 million of cash, cash equivalents and short-term investments, compared to $87.6 million as of December 31, 2002. Our working capital (adjusted to exclude cash, cash equivalents, short-term investments, current maturities of debt and current deferred revenue) decreased to $29.0 million at December 31, 2003 from $41.6 million at December 31, 2002. This decrease was primarily due to the collection of $39.8 million of accounts receivable in 2003 under our 2G agreement with NEC offset partially by increases in accounts receivable from Ericsson and Sony Ericsson associated with their respective 2003 agreements. During 2004, we are due cash from Ericsson of $17.5 million and Sony Ericsson of $11.6 million under their respective license agreements.

Consistent with our strategy to focus our resources on the development and commercialization of technology products, we expect to see modest growth in operating cash needs related to sustaining current staffing levels and continued investments in enabling capital assets in 2004. We are capable of supporting these and other operating cash requirements for the near future through cash and short-term investments on hand, as well as other internally generated funds such as patent license royalty payments. At present, we do not anticipate the need to seek additional financing through either bank facilities or the sale of debt or equity securities.

At December 31, 2003 we did not have any significant purchase obligations outside the course of our ordinary business. Following is a summary of our consolidated debt and lease obligations at December 31, 2003 (in thousands):

Obligation	Total	1-3 Years	4-5 Years	Thereafter
Debt	$ 1,970	$ 560	$ 432	$ 978
Operating leases	6,278	6,084	194	–
Total debt and operating lease obligations	$ 8,248	$ 6,644	$ 626	$ 978

As of December 31, 2003, we had NOL carryforwards of approximately $123 million for which no deferred tax asset has been recorded. We expect that we will continue to pay source withholding taxes to non-U.S. countries related to royalties, local and state income taxes, and U.S. alternative minimum taxes ("AMT") when applicable. We do not expect to pay federal income taxes (other than AMT) until these NOLs are fully utilized.

Property and equipment are currently being utilized in our on-going business activities, and we believe that no write-downs are required at this time due to either lack of use or technological obsolescence. With respect to patent assets, we believe that the fair value of our patents is at least equal to the carrying value reflected on the Company's balance sheet at December 31, 2003.

Results of Operations

2003 Compared With 2002

Revenues

Revenues in 2003 increased 30% to $114.6 million from $87.9 million in 2002. Patent license royalty revenue in 2003 was $113.5 million compared to $83.4 million in 2002. Specialized engineering service revenue was $1.1 million in 2003 compared to $4.5 million in 2002.

Revenues in 2003 included $20.3 million and $0.3 million of royalties from Sony Ericsson and other licensees, respectively, related to sales from periods prior to the effective dates of their respective agreements. Revenues in 2002 included nearly $8.0 million of royalty revenue associated with NEC's pre-2002 3G sales, and the recognition of $16.5 million of deferred revenue associated with non-refundable and non-transferable patent license prepayments previously received from Kyocera Corporation (Kyocera) and Denso Corporation (Denso) that had discontinued sales of covered products.

Recurring patent license royalty revenue increased 58% to $92.9 million from $58.9 million in 2002. Royalties from NEC (36%), Sharp (31%) and Sony Ericsson (14%) collectively contributed to 81% of our recurring patent license royalty revenue in 2003. The increase in recurring patent license royalty revenue from 2002 to 2003 is due to $18.7 million of recurring royalties from our 2003 patent license agreements with Ericsson and Sony Ericsson and increases in recurring royalties from NEC, Sharp and other licensees of $10.6 million, $2.4 million and $2.3 million, respectively. Royalties from NEC increased due to NEC 's higher sales of infrastructure and handsets into the emerging 3G market. Royalties from Sharp reflected increased demand for their 2.5G handsets both in Japan and Europe.

In fourth quarter 2003, we completed the final delivery of our services required under our WTDD technology development agreement with Nokia, collected the final $1.0 million payment due under this agreement and recognized $1.0 million in related service revenue. In 2002, we recognized $4.5 million of revenue for services performed under this agreement.

Operating Expenses

Development expenses decreased less than 1% in 2003 to $45.9 million from $46.1 million in 2002. The decrease was primarily due to an accrued loss of $1.2 million recorded in 2002 related to our WTDD agreement with Nokia offset, in part, by an increase of approximately $0.5 million and $0.4 million, respectively, in costs associated with engineering tools and research and development materials.

Sales and marketing expenses of $4.9 million in 2003 increased 15% from $4.3 million in 2002. This increase was primarily attributable to approximately equal increases in costs related to trade shows and market research activities. In 2003, we participated in an additional trade show and also increased our market research efforts to support strategic planning activities.

General and administrative expenses in 2003 increased 19% to $18.2 million from $15.2 million in 2002. Increases in public entity costs, including a $1.5 million increase in our directors' and officers' liability insurance premiums, were the primary contributors to this increase. We also incurred approximately $0.9 million of costs in second half 2003 related to an update of our strategic plan.

Patents administration and licensing expenses increased 22% in 2003 to $16.0 million from $13.1 million in 2002 due largely to a $1.1 million increase in amortization, resulting from an increase in the number of patents and related prosecution costs over the past couple years, a

$0.8 million increase in legal fees and a $0.8 million increase in commission expense related to higher patent licensing royalty revenue.

Other Income, Interest Income and Interest Expense

We recognized $14.0 million from the settlement of our litigation with Ericsson, net of an estimated $3.4 million associated with a claim under an insurance reimbursement agreement, as other income in 2003. The $3.4 million represents a loss contingency associated with our insurance reimbursement agreement with Federal.

Interest income of $1.8 million in 2003 decreased 20% from $2.3 million in 2002 primarily due to lower yields available in 2003 compared to 2002.

Income Taxes

The income tax provision in both 2003 and 2002 consisted primarily of withholding taxes associated with patent licensing royalties, principally from Japan. Our tax expense decreased $1.4 million in 2003 to $7.3 million from $8.7 million in 2002, due primarily to a decrease in the level of royalty revenue subject to non-US withholding tax.

2002 Compared With 2001

In January 2002, we entered into a worldwide, royalty-bearing license agreement (3G Agreement) with NEC for sales of wireless products compliant with all 3G and narrowband CDMA standards. We also concurrently reached an amicable settlement of a Second Generation (2G) patent licensing dispute (2G Dispute) with NEC in connection with a 1995 2G patent license agreement (2G Agreement).

In connection with the 3G Agreement, we received a non-refundable advance royalty of $19.5 million in April 2002 and recognized revenue of approximately $18.3 million related to that advance royalty in 2002. In connection with the settlement of the 2G Dispute, we received $13.25 million in April 2002, as the first of four equal nonrefundable installments totaling $53 million. The remaining installments were received in 2003. In connection with the $53 million settlement, we are recognizing revenue on a straight-line basis from the January 2002 agreement date until February 2006, which is the expected period of use by NEC. In 2002, we recognized approximately $12.3 million of revenue related to this settlement. At December 31, 2002, our balance sheet included $39.8 million in accounts receivable due under the 1995 Agreement. Our deferred revenue balance contained approximately $40.7 million related to these receivables and the $13.25 million in cash previously collected under this agreement.

Revenues

Revenues in 2002 increased to $87.9 million from $52.6 million in 2001. The increase was due to a significant increase in patent licensing royalty revenues that more than offset an expected decline in revenues from specialized engineering services.

2002 patent licensing royalty revenues increased 170% to $83.3 million from $30.8 million in 2001. The increase in 2002 was due largely to (i) $30.6 million of revenue from NEC related to sales of covered products under the 3G Agreement (nearly $8.0 million of which was attributable to the pre-2002 build-out of 3G systems in Japan by NEC) and the settlement of the 2G Dispute, (ii) an increase of over $10.0 million in royalties from Sharp and (iii) the recognition of $16.5 million of deferred revenue associated with nonrefundable and non-transferable patent license prepayments previously received from Kyocera and Denso that have discontinued sales of covered GSM products. These increases were partially offset by decreased royalties from Samsung and other licensees.

In 2002, specialized engineering services revenues associated with the final stages of the WTDD technology development work for Nokia were $4.5 million compared to peak development related revenues of $21.8 million in 2001. In 2002 and second half 2001, revenues related to the WTDD technology development work were calculated and recorded based on our proportional performance of services under the contract. The final $1.0 million payment associated with this

contract was withheld until final delivery of the remaining technology required under the agreement had been made. The final delivery occurred in second half 2003 and we recognized the final $1.0 million of specialized engineering services revenue associated with the agreement at that time.

Operating Expenses

Development expenses increased 4% to $46.1 million in 2002 from $44.5 million in 2001. This increase was due primarily to increased staff and related support costs primarily devoted to 3G WCDMA technology platform and product development and a provision for an estimated loss of $1.2 million associated with the WTDD development work for Nokia.

Sales and marketing expenses of $4.3 million in 2002 decreased 9% compared to $4.7 million in 2001, mainly due to lower tradeshow costs.

General and administrative expenses for 2002 increased 2% to $15.2 million from $14.9 million in 2001, primarily as a result of increased directors' and officers' liability insurance premiums offset by lower outside legal costs in 2002.

Patents administration and licensing expenses increased 46% to $13.1 million in 2002 compared to $9.0 million in 2001. Approximately $2.0 million of the increase over 2001 resulted from higher commissions related to higher patent licensing royalty revenues. The remainder of the increase versus 2001 was essentially attributable to higher costs associated with patent enforcement, ongoing patent maintenance activities and higher patent cost and acquired license rights amortization.

Other Income and Expense

Interest income for 2002 decreased to $2.3 million from $4.9 million in 2001 due to lower investment yields in 2002 compared to 2001.

Income Taxes

The income tax provision in both 2002 and 2001 consisted primarily of withholding taxes associated with patent licensing royalties, principally from Japan.

Expected Trends

In 2004, we expect to benefit from the continued solid performance of our key licensees and to expand our licensee base. As such, we expect to build upon the solid base of quarterly recurring royalty revenues experienced in the last three quarters of 2003.

Dependent upon market timing, we may also recognize a small level of technology product-related revenue associated with our jointly developed FDD protocol stacks, as products containing this embedded solution are delivered into the emerging 3G markets by Infineon. In addition, we expect that our operating expenses will be higher in 2004 due to the impact of inflation-adjusted expenses, increased directors' and officers' liability insurance premiums, patent prosecution and licensing costs (including legal costs related to arbitration and litigation activities), Sarbanes-Oxley compliance and increased marketing and business development costs.

Our first quarter 2004 revenues are likely to be comprised of royalties from our current base of licensees. Also, we expect that first quarter 2004 expenses could increase 5% - 10% over fourth quarter 2003 levels.

Quantitative and Qualitative Disclosures About Market Risk

Cash Equivalents and Investments

We do not use derivative financial instruments in our investment portfolio. We place our investments in instruments that meet high credit quality standards, as specified in our investment policy guidelines. This policy also limits the amount of credit exposure to any one issue, issuer, and type of instrument. We do not expect any material loss with respect to our investment portfolio.

The following table provides information about our cash and investment portfolio as of December 31, 2003. For investment securities, the table presents principal cash flows and related weighted average contractual interest rates by expected maturity dates. All investment securities are held as available for sale.

(in thousands)	
Cash and demand deposits	$ 6,877
Average interest rate	0.00%
Cash equivalents	$ 14,000
Average interest rate	1.05%
Short-term investments	$ 85,050
Average interest rate	2.38%
Total portfolio	$ 105,927
Average interest rate	2.05%

Long-Term Debt

The table below sets forth information about our long-term debt obligation, by expected maturity dates.

Expected Maturity Date

(In thousands)

December 31,	2004	2005	2006	2007	2008	2009 and Beyond	Total Fair Value
Debt Obligation	$ 193	$ 176	$ 191	$ 207	$ 225	$ 978	$ 1,970
Interest Rate	8.22%	8.28%	8.28%	8.28%	8.28%	8.28%	8.27%

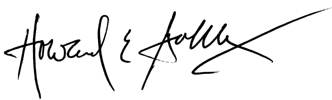
Management is responsible for the consolidated financial statements and the other financial information contained in this Annual Report. The financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America considered appropriate in the circumstances to present fairly the company's financial position, results of operations and cash flows. The financial statements include some amounts that are based on management's best estimates and judgments.

To provide reasonable assurance that assets are safeguarded against loss from unauthorized use or disposition and accounting records are reliable for preparing financial statements, management maintains a system of accounting and other internal controls. Even an effective system of internal controls, no matter how well designed, has inherent limitations, including the possibility of human error and the circumvention or overriding of controls, and therefore can provide only reasonable assurance with respect to financial statement preparation and safeguarding of assets. The system of accounting and other internal controls is continually assessed, modified and improved, where appropriate and cost effective, in response to both changes in business conditions and operations and recommendations made by the independent accountants.

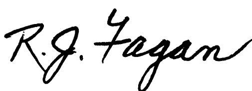
The Audit Committee of the Board of Directors, which is composed of independent directors, meets periodically with management and the independent accountants to review the manner in which these groups are performing their responsibilities and to carry out the Audit Committee's oversight role with respect to corporate accounting, financial reporting practices and integrity of financial reports, as well as legal and regulatory compliance therewith. Both management and the independent accountants periodically meet privately with the Audit Committee and have access to its individual members.

The consolidated balance sheets as of December 31, 2003 and 2002 and the consolidated statements of operations, shareholders' equity and cash flows for each of the two years in the period ended December 31, 2003, have been audited by the company's independent accountants, PricewaterhouseCoopers LLP, in accordance with auditing standards generally accepted in the United States. Their report is presented herein.

The consolidated statements of operations, shareholders' equity and cash flows for the year ended December 31, 2001, have been audited by the company's former independent accountants, Arthur Anderson LLP, in accordance with auditing standards generally accepted in the United States. Their report is presented herein.



Howard E. Goldberg
President and Chief Executive Officer



Richard J. Fagan
Chief Financial Officer

King of Prussia, Pennsylvania
March 15, 2004

Report of Independent Auditors

To Board of Directors and Shareholders of InterDigital Communications Corporation:

In our opinion, the accompanying consolidated balance sheets and the related consolidated statement of operations, cash flow and shareholders' equity present fairly, in all material respects, the financial position of InterDigital Communications Corporation and its subsidiaries at December 31, 2003 and 2002, and the results of their operations and their cash flows for each of the two years in the period ended December 31, 2003 in conformity with accounting principles generally accepted in the United States of America. These financial statements are the responsibility of the Company's management; our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits of these statements in accordance with auditing standards generally accepted in the United States of America, which require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion. The financial statements and financial statement schedule of InterDigital Communications Corporation and its subsidiaries as of December 31, 2001 and for the year ended December 31, 2001, were audited by other independent accountants who have ceased operations. Those independent accountants expressed an unqualified opinion on those financial statements and financial statement schedule in their report dated February 14, 2002.

PricewaterhouseCoopers LLP

Philadelphia, Pennsylvania
March 12, 2004

Report of Independent Public Accountants

THE FOLLOWING IS A COPY OF A REPORT PREVIOUSLY ISSUED BY ARTHUR ANDERSEN LLP (ANDERSEN). THIS REPORT HAS NOT BEEN REISSUED BY ANDERSEN.

To InterDigital Communications Corporation:

We have audited the accompanying consolidated balance sheets of InterDigital Communications Corporation (a Pennsylvania corporation) and subsidiaries as of December 31, 2001 and 2000, and the related consolidated statements of operations, shareholders' equity and cash flows for each of the three years in the period ended December 31, 2001. These financial statements and the schedule referred to below are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements and schedule based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of InterDigital Communications Corporation and subsidiaries as of December 31, 2001 and 2000, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2001, in conformity with accounting principles generally accepted in the United States.

As explained in Note 2 to the consolidated financial statements, effective January 1, 2000, the Company changed its method of recognizing revenue.

Our audit was made for the purpose of forming an opinion on the basic financial statements taken as a whole. The schedule listed in the index of financial statements is presented for purposes of complying with the Securities and Exchange Commission's rules and is not part of the basic financial statements. This schedule has been subjected to the auditing procedures applied in the audit of the basic financial statements and, in our opinion, fairly states in all material aspects the financial data required to be set forth therein in relation to the basic financial statements taken as a whole.

Arthur Andersen LLP

Arthur Andersen LLP

Philadelphia, Pennsylvania
February 14, 2002

THE CONSOLIDATED FINANCIAL STATEMENTS FOR THE YEARS ENDED DECEMBER 31, 1999 AND 2000 ARE NOT REQUIRED TO BE PRESENTED IN THE 2003 ANNUAL REPORT.

Consolidated Balance Sheets

Decemeber 31, (in thousands, except per share data)	2003	2002
Assets		
Current Assets:		
Cash and cash equivalents	$ 20,877	$ 22,337
Short-term investments	85,050	65,229
Accounts receivable	37,839	53,486
Prepaid and other current assets	8,628	7,627
Total current assets	152,394	148,679
Property and Equipment, Net	12,137	14,091
Patents, Net	32,246	15,016
Other Non-Current Assets	8,388	13,392
	52,771	42,499
Total Assets	$ 205,165	$ 191,178
Liabilities and Shareholders' Equity		
Current liabilities:		
Current portion of long-term debt	$ 193	$ 189
Accounts payable	6,435	5,412
Accrued compensation and related expenses	7,569	5,886
Deferred revenue	22,381	17,087
Foreign and domestic taxes payable	1,259	5,434
Other accrued expenses	2,232	2,826
Total current liabilities	40,069	36,834
Long-Term Debt	1,777	1,970
Long-Term Deferred Revenue	64,214	73,583
Other-Long-Term Liabilities	1,620	–
Total Liabilities	107,680	112,387
Commitments and Contingencies (Notes 7 and 8)		
Shareholders' Equity:		
Preferred Stock, $.10 par value, 14,399 shares authorized - $2.50 Convertible Preferred, 53 and 54 shares issued and outstanding, liquidation value of $1,319 and 1,350	5	5
Common Stock, $.01 par value, 100,000 shares authorized, 54,989 shares and 54,767 shares issued and outstanding	585	563
Additional paid-in capital	305,262	285,869
Accumulated deficit	(164,613)	(198,945)
Accumulated other comprehensive (loss) income	(270)	210
Unearned compensation	(722)	(838)
	140,247	86,864
Treasury stock, 3,500 and 1,500 shares of common held at cost	42,762	8,073
Total shareholders' equity	97,485	78,791
Total Liabilities and Shareholders' Equity	$ 205,165	$ 191,178

The accompanying notes are an integral part of these statements.

Consolidated Statements of Operations

For the Year Ended December 31, (In thousands, except per share data)	**2003**	2002	2001
Revenues:			
Licensing and alliance	$ 114,574	$ 87,895	$ 52,562
Operating Expenses:			
Sales and marketing	4,919	4,286	4,698
General and administrative	18,183	15,227	14,898
Patents administration and licensing	15,995	13,074	8,959
Development	45,936	46,068	44,500
	85,033	78,655	73,055
Income (loss) from operations	29,541	9,240	(20,493)
Other Income (Expense):			
Other income	10,580	–	–
Interest income	1,828	2,276	4,885
Interest and financing expenses	(215)	(257)	(258)
Income (loss) before income taxes	41,734	11,259	(15,866)
Income Tax Provision	(7,269)	(8,748)	(3,418)
Net income (loss)	34,465	2,511	(19,284)
Preferred Stock Dividends	(133)	(136)	(137)
Net income (loss) applicable to common shareholders	$ 34,332	$ 2,375	$ (19,421)
Net Income (Loss) Per Common Share – Basic	$ 0.62	$ 0.04	$ (0.36)
Weighted Average Number of Common Shares Outstanding – Basic	55,271	52,981	53,446
Net Income (Loss) Per Common Share – Diluted	$ 0.58	$ 0.04	$ (0.36)
Weighted Average Number of Common Shares Outstanding – Diluted	59,691	56,099	53,446

The accompanying notes are an integral part of these statements.

Consolidated Statements of Shareholders' Equity

(in thousands, except per share data)

Income	$2.50 Convertible Preferred Stock	Common Stock	Additional Paid-In Capital	Accumulated Deficit	Accumulated Other Comprehensive Income (Loss)	Unearned Compensation	Treasury Stock	Total Shareholder's Equity	Total Comprehensive (Loss)
Balance, December 31, 2000	5	538	267,936	(181,899)	–	(4,597)	(8,073)	73,910	
Net loss	–	–	–	(19,284)	–	–	–	(19,284)	$ (19,284)
Net unrealized gain on short-term investments	–	–	–	–	221	–	–	221	221
Total Comprehensive Loss									$ (19,063)
Exercise of Common Stock options	–	2	1,249	–	–	–	–	1,251	
Exercise of Common Stock warrants	–	1	335	–	–	–	–	336	
Dividend of Common Stock and cash to $2.50 Preferred shareholders	–	–	44	(137)	–	–	–	(93)	
Sale of Common Stock under Employee Stock Purchase Plan	–	1	802	–	–	–	–	803	
Issuance of Restricted Common Stock	–	2	1,095	–	–	(930)	–	167	
Amortization of unearned compensation	–	–	–	–	–	2,963	–	2,963	
Balance, December 31, 2001	5	544	271,461	(201,320)	221	(2,564)	(8,073)	60,274	
Net income	–	–	–	2,511	–	–	–	2,511	$ 2,511
Net unrealized loss on short-term investments	–	–	–	–	(11)	–	–	(11)	(11)
Total Comprehensive Income									$ 2,500
Exercise of Common Stock options	–	7	5,865	–	–	–	–	5,872	
Exercise of Common Stock warrants	–	9	4,731	--	–	–	–	4,740	
Dividend of Common Stock and cash to $2.50 Preferred shareholders	–	–	44	(136)	–	–	–	(92)	
Sale of Common Stock under Employee Stock Purchase Plan	–	2	1,253	–	–	–	–	1,255	
Issuance of Common Stock options to a non-employee	–	–	37	–	–	–	–	37	
Issuance of Restricted Common Stock	–	1	1,044	–	–	(635)	–	410	
Tax benefit from exercise of stock options –	–	1,434	–	–	–	–	1,434		
Amortization of unearned compensation	–	–	–	–	–	2,361	–	2,361	
Balance, December 31, 2002	5	563	285,869	(198,945)	210	(838)	(8,073)	78,791	
Net income	–	–	–	34,465	–	–	–	34,465	$ 34,465
Net unrealized loss on short-term investments	–	–	–	–	(480)	–	–	(480)	(480)
Total Comprehensive Income									$ 33,985
Exercise of Common Stock options	–	19	17,490	–	–	–	–	17,509	
Exercise of Common Stock warrants	–	–	19	–	–	–	–	19	
Dividend of Common Stock and cash to $2.50 Preferred shareholders	–	–	56	(133)	–	–	–	(77)	
Sale of Common Stock under Employee Stock Purchase Plan	–	2	1,716	–	–	–	–	1,718	
Issuance of Restricted Common Stock	–	1	1,228	–	–	(840)	–	389	
Reduction of tax benefit from exercise of stock options	–	–	(1,116)	–	–	–	–	(1,116)	
Amortization of unearned compensation	–	–	–	–	–	956	–	956	
Repurchase of Common Stock	–	–	–	–	–	–	(34,689)	(34,689)	
Balance, December 31, 2003	$ 5	$ 585	$ 305,262	$ (164,613)	$ (270)	$ (722)	$ (42,762)	$ 97,485	

The accompanying notes are an integral part of these statements

Consolidated Statements of Cash Flows

For the Year Ended December 31,	**2003**	2002	2001
(in thousands)			
Cash Flows From Operating Activities:			
Net income (loss) before preferred stock dividends	$ 34,465	$ 2,511	$ (19,284)
Adjustments to reconcile net income (loss) to net cash provided (used) by operating activities:			
Depreciation and amortization	9,735	9,268	6,375
Deferred revenue recognized	(61,563)	(54,738)	(9,877)
Increase in deferred revenue	57,488	72,500	30,611
Non-cash compensation	1,345	2,771	2,963
Decrease (increase) in deferred charges	3,401	(805)	(4,240)
Other	325	53	(49)
Decrease (increase) in assets:			
Receivables	15,647	(39,007)	2,449
Other current assets	(839)	(1,030)	743
Increase (decrease) in liabilities:			
Accounts payable	1,023	550	(70)
Accrued compensation	1,683	(99)	2,243
Other accrued expenses	(3,149)	5,800	(2,297)
Net cash provided (used) by operating activities	59,561	(2,226)	9,567
Cash Flows From Investing Activities:			
Purchases of short-term investments	(144,445)	(124,466)	(107,857)
Sales of short-term investments	124,144	131,697	112,251
Purchases of property and equipment	(3,926)	(6,519)	(7,616)
Patent costs	(9,209)	(5,475)	(2,974)
Acquisition of assets	(10,430)	–	–
Increase in notes receivable	(1,446)	–	–
Net cash used by investing activities	(45,312)	(4,763)	(6,196)
Cash Flows From Financing Activities:			
Net proceeds from exercise of stock options and warrants and employee stock purchase plan	19,246	11,904	2,606
Payments on long-term debt, including capital lease obligations	(189)	(378)	(335)
Dividends on preferred stock	(77)	(92)	(93)
Repurchase of common stock	(34,689)	–	–
Net cash (used) provided by financing activities	(15,709)	11,434	2,178
Net (Decrease) Increase In Cash and Cash Equivalents	(1,460)	4,445	5,549
Cash and Cash Equivalents, Beginning of Period	22,337	17,892	12,343
Cash and Cash Equivalents, End of Period	$ 20,877	$ 22,337	$ 17,892
Supplemental Cash Flow Information:			
Issuance of restricted common stock	$ 389	$ 410	$ 167
Accrued purchase of patent rights	–	$ 450	–
Cancellation of note receivable related to acquisition of assets	$ 1,446	–	–
Leased asset additions and related obligation	–	$ 195	$ 117
Interest paid	$ 187	$ 229	$ 201
Income taxes paid, including foreign withholding taxes	$ 9,537	$ 5,592	$ 5,485
Non-cash dividends on preferred stock	$ 56	$ 44	$ 44

The accompanying notes are an integral part of these statements.

Note 1. Background

InterDigital Communications Corporation (collectively with its subsidiaries referred to as InterDigital, the Company, we, us and our) designs and develops advanced wireless technology solutions. We are developing technologies that may be utilized to extend the life of the current generation of products, may be applicable to multiple generational standards such as 2G, 2.5G and 3G cellular standards as well as WLAN standards, and may have applicability across multiple air interfaces. In conjunction with our technology development, we have assembled an extensive body of technical know-how, related intangible products and a broad patent portfolio. We offer our solutions for license or sale to semiconductor companies and producers of wireless equipment and components.

Note 2. Summary of Significant Accounting Policies

Principles of Consolidation

The consolidated financial statements include the accounts of InterDigital and its subsidiaries. All significant intercompany accounts and transactions have been eliminated in consolidation.

Use of Estimates

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities as of the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Cash, Cash Equivalents and Short-Term Investments

We consider all highly liquid investments purchased with initial maturities of three months or less to be cash equivalents. Management determines the appropriate classification of our investments at the time of acquisition and reevaluates such determination at each balance sheet date. At December 31, 2003 and 2002, all of our short-term investments were classified as available-for-sale and carried at amortized cost, which approximates market value. We determine the cost of securities by specific identification and report unrealized gains and losses on our available for sale securities as a separate component of equity, net of any related tax effect. Net unrealized (losses) gains on short-term investments were $(0.3) million and $0.2 million at December 31, 2003 and 2002, respectively. Realized gains and losses for 2003, 2002 and 2001 were as follows (in thousands):

Year	Gains	Losses	Net
2003	$ 64	$ (322)	$ (258)
2002	$ 12	$ (144)	$ (132)
2001	$ 390	$ (32)	$ 358

Cash and cash equivalents consist of the following (in thousands):

December 31,	**2003**	2002
Money market funds and demand accounts	$ 20,868	$ 22,160
Repurchase agreements	9	177
	$ 20,877	$ 22,337

The repurchase agreements are fully collateralized by United States Government securities and are stated at cost, which approximates fair market value. Short-term investments consist of the following (in thousands):

December 31,	**2003**	2002
US Government agency instruments	$ 53,804	$ 37,131
Corporate bonds	31,246	28,098
	$ 85,050	$ 65,229

At December 31, 2003 and 2002, $73.2 million and $54.6 million, respectively, of our short-term investments had contractual maturities within one year. The remaining portions of our short-term investments had contractual maturities within two to five years.

Other Assets

Other assets consist primarily of prepaid foreign withholding taxes and prepaid commissions. We often pay foreign withholding taxes and commissions at the beginning of our patent license relationships in connection with the collection of related up-front payments. We capitalize our prepayment of foreign withholding tax and prepaid commissions and recognize them in the same period as the related revenue.

Property and Equipment

Property and equipment are stated at cost. Depreciation and amortization of property and equipment are provided using the straight-line method. The estimated useful lives for computer equipment, machinery and equipment, and furniture and fixtures are generally three to five years. Leasehold improvements are being amortized over the lesser of their estimated useful lives or their respective lease terms, which are generally five to ten years. Buildings are being depreciated over twenty-five years. Expenditures for major improvements and betterments are capitalized while minor repairs and maintenance are charged to expense as incurred.

Internal-Use Software Costs

Under the provisions of the American Institute of Certified Public Accountants (AICPA) Statement of Position (SOP) 98-1, "Accounting for the Costs of Computer Software Developed or Obtained for Internal-Use," we capitalize costs associated with software for internal-use. Capitalization begins when the preliminary project stage is complete and ceases when the project is substantially complete and ready for its intended purpose. Amortization expense of these costs was $0.5 million in 2003 and $0.6 million in each of 2002 and 2001. Accumulated amortization related to these costs was $1.9 million and $1.4 million at December 31, 2003 and 2002, respectively.

Patents

We capitalize external costs incurred to obtain patents and patent license rights and amortize these costs on a straight-line basis over the estimated useful lives of the patents. Due to the uncertainty associated with estimating the useful life of any advanced technology at its inception, we

assign an estimated useful life of 10 years to patents relating to technology developed directly by the Company. The estimated useful lives of acquired patents and patent rights, however, will be based on analysis related to each acquisition and may differ from the estimated useful lives of patents obtained directly by the Company. We assess the potential impairment to all capitalized net patent costs when there is evidence that events or changes in circumstances indicate that the carrying amount of these patents may not be recovered. Amortization expense was $3.3 million, $2.2 million and $1.8 million in 2003, 2002 and 2001, respectively. Accumulated amortization was $17.1 million and $13.8 million at December 31, 2003 and 2002, respectively.

The estimated aggregate amortization expense for patents and patent rights as of December 31, 2003 is as follows (in thousands):

2004	$ 3,897
2005	3,851
2006	3,555
2007	2,973
2008	2,855

Revenue Recognition

We derive revenue principally from patent licensing and service agreements. The timing of revenue recognition and the amount of revenue actually recognized from each source depends upon a variety of factors, including the specific terms of each agreement and the nature of the deliverables and obligations. Such agreements are often complex and multi-faceted. These agreements can include, without limitation, elements related to the settlement of past patent infringement liabilities, up-front and non-refundable license fees for the use of patents and/or know-how, patent and/or know-how licensing royalties on covered products sold by licensees, cross licensing terms between us and other parties, the compensation structure and ownership of intellectual property rights associated with contractual technology development arrangements, and advanced payments and fees for service arrangements. Due to the combined nature of some agreements and the inherent difficulty in establishing reliable, verifiable and objectively determinable evidence of the fair value of the separate elements of these agreements, the total revenue resulting from such agreements may sometimes be recognized over the combined performance period. In other circumstances, such as those agreements involving consideration for past and expected future patent royalty obligations, the determining factors necessary to allocate revenue across past, current, and future years may be difficult to establish. In such instances, the appropriate recording of revenue between periods may require the use of judgment, after consideration of the particular facts and circumstances. Generally, we will not recognize revenue related to payments that are due greater than twelve months from the balance sheet date. In all cases, revenue is only recognized after all of the following criteria are met: (1) written agreements have been executed; (2) delivery of technology or intellectual property rights has occurred or services have been rendered; (3) fees are fixed and determinable; and (4) collectibility of fees is reasonably assured.

Patent License Agreements

Upon signing a patent license agreement, we provide the licensee with permission to use our patented inventions in specific applications. We have no material future obligations associated with such licenses, other than, in some instances, to provide such licensees with notification of future license agreements pursuant to most favored licensee rights. Under our patent license agreements, we typically receive one or a combination of the following forms of payment as consideration for permitting our licensees to use our patented inventions in their applications and products:

- *Consideration for Prior Sales:* Consideration related to a licensee's product sales from prior periods. Such consideration may result from a negotiated agreement with a licensee that

utilized our patented inventions prior to signing a patent license agreement with us or from the resolution of a disagreement or arbitration with a licensee over the specific terms of an existing license agreement. In each of these cases, we record the consideration as revenue. We may also receive consideration from the settlement of patent infringement litigation where there was no prior patent license agreement. We record the consideration related to such litigation as other income.

- *Paid-up Amounts:* Up-front, non-refundable royalty payments that fulfill the licensee's obligations to us, under a patent license agreement, for the lifetime of the agreement.

- *Prepayments:* Up-front, non-refundable royalty prepayments towards a licensee's future obligations to us related to its expected product sales in future periods. Our licensees' obligations to pay royalties extend beyond the exhaustion of their prepayment balance. Once a licensee exhausts its prepayment balance, we may provide them with the opportunity to make another Prepayment toward future sales or it will be required to make Current Royalty Payments.

- *Current Royalty Payments:* Royalty payments covering a licensee's obligations to us related to its covered product sales in the current contractual reporting period.

We recognize revenues related to Consideration for Prior Sales when we have obtained a signed agreement, identified a fixed and determinable price and determined that collectibility is reasonably assured. We recognize revenues related to Paid-up Amounts on a straight-line basis over the effective term of the license. We utilize the straight-line method because we have no future obligations under these licenses and we can not reliably predict in which periods, within the term of a license, the licensee will benefit from the use of our patented inventions. We recognize revenues related to Prepayments as each licensee exhausts its prepayment balance through its sales of covered products. We generally recognize revenue related to Current Royalty Payments in the period in which the sales of each licensee's products occurred.

Licensees that either owe us Current Royalty Payments or have prepayment balances provide us with quarterly or semi-annual royalty reports that summarize their sales of covered products and their related royalty obligations to us. We typically receive these royalty reports subsequent to the period in which our licensees' underlying sales occurred, but prior to the issuance of our financial statements for that period. In such cases, we recognize the related revenue in the period the sales occurred. When we do not receive the royalty reports prior to the issuance of our financial statements, we accrue the related royalty revenue if reasonable estimates of such amounts can be made. These estimates are based on the historical royalty data of the licensees involved, currently available third party forecasts of royalty related product sales in the applicable market and, if available, information provided by the licensee. When our licensees formally report royalties for which we accrued revenues based on estimates, or when they report updates to prior royalty reports, we adjust revenue in the period in which the final reports are received. In cases where we receive objective, verifiable evidence that a licensee has discontinued sales of covered products, we recognize any remaining deferred revenue balance related to unexhausted Prepayments in the period that we receive such evidence.

Service Revenues

We recognize revenues associated with service arrangements on a straight-line basis, unless evidence suggests that the revenue is earned or obligations are fulfilled in a different pattern, over the contractual term of the arrangement or the expected period during which those specified services will be performed, whichever is longer. Recently, our service agreements have been long-term in nature and we have recorded revenue from them based on our proportional performance of services rendered. The terms of these arrangements have provided evidence that this approach

better reflects the pattern in which the revenue has been earned or the obligations have been fulfilled. When recognizing revenue based on our proportional performance, we measure the progress of our performance based on the relationship between incurred contract costs and total estimated contract costs. Our most significant costs have been labor hours and we believe these costs provide a measure of the progress of our services. The effect of changes to total estimated contract costs is recognized in the period such changes are determined. Estimated losses, if any, are recorded when the loss first becomes apparent.

Development

All engineering development expenditures are charged to expense in the period incurred.

Stock-Based Compensation

We account for stock-based employee compensation using the intrinsic value method and provide pro forma disclosures related to our stock-based compensation under the provisions of Statement No. 148, "Accounting for Stock-Based Compensation — Transition and Disclosure an amendment of FASB Statement No. 123." Equity instruments issued to non-employees for services are accounted for at fair value and are marked to market until service is complete.

At December 31, 2003, the Company had three stock-based employee compensation plans, which are described more fully in Note 11. The Company accounts for these plans under the recognition and measurement principles of APB Opinion No. 25, "Accounting for Stock Issued to Employees," and related interpretations. No stock-based employee compensation cost is reflected in net income, as all options granted under those plans have an exercise price equal to the market value of the underlying common stock on the date of grant. The following table illustrates the effect on net income and earnings per share if the Company had applied the fair value recognition provisions of FASB Statement No. 123, "Accounting for Stock-Based Compensation," to stock-based employee compensation (in thousands, except per share data):

For the Year Ended December 31,	**2003**	2002	2001
Net income (loss) applicable to Common Shareholders – as reported	$ 34,332	$ 2,375	$ (19,421)
Add: Stock-based employee compensation expense included in reported net income (loss)	1,345	2,771	3,130
Deduct: Total stock-based employee compensation expense determined under fair value based method for all awards [(a)]	(13,472)	(21,764)	(30,817)
Net income (loss) applicable to Common Shareholders – pro forma	$ 22,205	$ (16,618)	$ (47,108)
Net income (loss) per share - as reported – basic	0.62	0.04	(0.36)
Net income (loss) per share - as reported – diluted	0.58	0.04	(0.36)
Net income (loss) per share - pro forma – basic	0.40	(0.31)	(0.88)
Net income (loss) per share - pro forma – diluted	0.37	(0.31)	(0.88)

(a) No tax benefit has been recognized for the stock-based employee compensation expense since the Company is in an NOL carryforward position and the realization of such benefit cannot be assured.

The fair value of each option grant is estimated on the date of grant using the Black-Scholes option pricing model with the following weighted-average assumptions used for grants in 2003, 2002 and 2001; no dividend yield; expected volatility of 104% for 2003, 72% for 2002 and 97% for 2001, risk-free interest rates of 2.9%, 3.83% and 4.59% for 2003, 2002 and 2001, respectively, and an expected option life of 4.65 years for 2003, 4.32 years for 2002 and 4.21 years for 2001. The weighted-average fair value at the date of grant for options granted during 2003, 2002 and 2001 is estimated as $15.99, $8.51 and $8.16, respectively.

Concentration of Credit Risk and Fair Value of Financial Instruments

Financial instruments that potentially subject us to concentration of credit risk consist primarily of cash equivalents, short-term investments, and accounts receivable. We place our cash equivalents and short-term investments only in highly rated financial instruments and in United States Government instruments.

Our accounts receivable are derived principally from patent license agreements and engineering services. At December 31, 2003, three customers represented 46%, 31% and 14%, respectively, of our accounts receivable balance. At December 31, 2002, two customers collectively represented 95% of our accounts receivable balance. We perform ongoing credit evaluations of our customers who generally include large multi-national wireless telecommunications equipment manufacturers. We believe that the book value of our financial instruments, which include cash and cash equivalents, short-term investments and debt, approximate their fair values.

Impairment of Long-Lived Assets

Pursuant to Statement of Financial Accounting Standards (SFAS) No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets," we evaluate long-lived assets and intangible assets for impairment when factors indicate that the carrying amount of an asset may not be recoverable. When factors indicate that such assets should be evaluated for possible impairment, we review the realizability of our long-lived assets by analyzing the projected undiscounted cash flows in measuring whether the asset is recoverable. No such adjustments were needed in 2003, 2002 or 2001.

Income Taxes

Income taxes are accounted for under the asset and liability method. Under this method, deferred tax assets and liabilities are recognized for the estimated future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases, and operating loss and tax credit carryforwards. Deferred tax assets and liabilities are measured using enacted tax rates in effect for the year in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in the Consolidated Statement of Operations in the period that includes the enactment date. A valuation allowance is recorded to reduce the carrying amounts of deferred tax assets if it is more likely than not that such assets will not be realized.

Net Income (Loss) Per Common Share

Basic earnings per share (EPS) are calculated by dividing income available to common shareholders by the weighted-average number of common shares outstanding for the period. Diluted EPS reflects the potential dilution that could occur if options, warrants or other securities with features that could result in the issuance of Common Stock were exercised or converted to Common Stock.

The following tables reconcile the numerator and the denominator of the basic and diluted net income (loss) per share computation (in thousands, except for per share data):

For the Year Ended December 31, 2003	Income (Numerator)	Shares (Denominator)	Per-Share Amount
Income per Share – Basic:			
Income available to common shareholders	$ 34,332	55,271	$ 0.62
Dilutive effect of options, warrants and convertible preferred stock	–	4,420	0.04
Income per Share – Diluted:			
Income available to common shareholders + dilutive effects of options, warrants and convertible preferred stock	$ 34,332	59,691	$ 0.58

For the Year Ended December 31, 2002	Income (Numerator)	Shares (Denominator)	Per-Share Amount
Income per Share – Basic:			
Income available to common shareholders	$ 2,375	52,981	$ 0.04
Dilutive effect of options, warrants and convertible preferred stock	–	3,118	–
Income per Share – Diluted:			
Income available to common shareholders + dilutive effects of options, warrants and convertible preferred stock	$ 2,375	56,099	$ 0.04

For the Year Ended December 31, 2001	Income (Numerator)	Shares (Denominator)	Per-Share Amount
Loss per Share - Basic:			
Loss available to common shareholders	$ (19,421)	53,446	$ (0.36)
Dilutive effect of options, warrants and convertible preferred stock	–	–	–
Loss per Share - Diluted:			
Loss available to common shareholders + dilutive effects of options, warrants and convertible preferred stock	$ (19,421)	53,446	$ (0.36)

For the years ended December 31, 2003 and 2002, options and warrants to purchase approximately 1.1 million and 3.6 million shares, respectively, of Common Stock were excluded from the computation of diluted EPS because the exercise prices of the options were greater than the weighted average market price of our common stock during the respective periods and, therefore, their effect would have been anti-dilutive. For the year ended December 31, 2001, the effects of all options, warrants, and convertible preferred stock to purchase approximately 12.1 shares of Common Stock were excluded from the computation of diluted earnings per share (EPS) as a result of a net loss reported in the period.

Reclassification

Certain prior period amounts have been reclassified to conform to the current year presentation.

Note 3. Geographic/Customer Concentration

We have one operating segment. Substantially all of our revenue is derived from a limited number of customers based outside of the United States (primarily Japan and Europe). These revenues are paid in U.S. dollars and are not subject to any substantial foreign exchange transaction risk. During 2003, 2002, and 2001, revenue from our Japan-based licensees comprised 64%, 94%, and 50% of total revenues, respectively. Revenue from a customer based in Finland, represented 1%, 5%, and 42% of total revenues in 2003, 2002 and 2001, respectively.

During 2003, 2002, and 2001, the following customers accounted for 10% or more of revenues:

	2003	2002	2001
Sony Ericsson	29%	–	–
NEC	29%	35%	–
Sharp	25%	30%	30%
Denso	–%	11%	2%
Nokia	1%	5%	42%

Note 4. Significant Agreements

Ericsson

In March 2003, we entered into a worldwide license agreement with Telefonaktiebolaget LM Ericsson and Ericsson Inc. (together, Ericsson) for sales of terminal and infrastructure products compliant with 2G GSM/TDMA and 2.5G GSM/GPRS/TDMA standards. Concurrent with this agreement, we resolved a patent infringement lawsuit with Ericsson Inc. that was scheduled for trial in May 2003.

We are due to receive total payments of approximately $14.0 million from Ericsson related to their sales of infrastructure and terminal products through December 31, 2002. In 2003, we received $7.0 million from Ericsson and we expect to receive the remaining payments in first quarter 2004. We recognized the $14.0 million from Ericsson, net of an estimated $3.4 million associated with a claim under an insurance reimbursement agreement with Federal Insurance Company (Federal), as other income in first quarter 2003, as the payments from Ericsson represent the settlement of litigation. The $3.4 million represents a loss contingency and is more fully discussed in Note 8.

Ericsson is obligated to pay us an annual license fee of $6.0 million per year for sales of covered infrastructure products for each of the years 2003 through 2006. The first payment of $6.0 million was received in February 2004 and the remaining payments are due in quarterly installments of $1.5 million beginning in May 2004. We are recognizing the related revenue on a straight-line basis from first quarter 2003 through fourth quarter 2006.

Sony Ericsson

In March 2003, we entered into a worldwide license agreement with Sony Ericsson Mobile Communications AB (Sony Ericsson) for sales of terminal units compliant with 2G GSM/TDMA and 2.5G GSM/GPRS/TDMA standards.

We are due to receive total payments of approximately $20.3 million from Sony Ericsson related to their sales of terminal products through December 31, 2002. In 2003, we received $8.7 million from Sony Ericsson and we expect to receive the remaining payments in first quarter 2004. Although we reached our agreement with Sony Ericsson at the same time as our resolution of a patent infringement lawsuit with one of its principals, Ericsson Inc., we never engaged in litigation with Sony Ericsson. As such, our agreement with Sony Ericsson represents a new patent

license and not a settlement of litigation. We recognized the $20.3 million from Sony Ericsson as revenue in first quarter 2003.

For the period January 1, 2003 through December 31, 2006, Sony Ericsson is obligated to pay us a royalty on each licensed product sold. Through December 31, 2003, we received approximately $26.2 million of advance royalty payments based on Sony Ericsson's projections of sales of covered products for 2003 and 2004. Once this initial prepayment is exhausted, Sony Ericsson will have the option to make additional advance royalty payments or pay royalties on an ongoing basis. In return for making advanced royalty payments, Sony Ericsson has and will receive prepayment discounts and credits as opposed to the undiscounted base royalty rate. We record advance royalty payments as deferred revenue and subsequently recognize the revenue in the periods in which our licensees exhaust such advance royalty payments through the sale of covered products. As of December 31, 2003, Sony Ericsson has exhausted approximately $12.7 million of their advance royalty payments through sales of covered products.

Nokia and Samsung Arbitrations

We believe the license agreements with Ericsson and Sony Ericsson establish the financial terms necessary to define the royalty obligations of Nokia Corporation (Nokia) and Samsung Electronics Co. Ltd. (Samsung) on sales of 2G GSM/TDMA and 2.5G GSM/GPRS/TDMA products under their existing patent license agreements with us. Under the most favored licensee (MFL) provisions applicable to their respective patent license agreements, we believe both companies are obligated to pay royalties to us on sales of covered products from January 1, 2002 by reference to the terms of the Ericsson (for infrastructure products) and Sony Ericsson (for terminal unit products) license agreements. The MFL provisions include terms for a period of review, negotiation, and dispute resolution with regard to the determination of the royalty obligations of both Nokia and Samsung. Nokia and Samsung each dispute our position. We are currently in separate arbitration proceedings regarding these disputes as more fully discussed in Note 8.

We have not recorded revenue associated with the Nokia and Samsung license agreements related to sales of covered products during any period subsequent to January 1, 2002, and will not record any such revenue until all elements required for revenue recognition are met.

NEC

In 2002, we entered into a worldwide royalty-bearing license agreement (3G Agreement) with NEC Corporation (NEC) for sales of wireless products compliant with all 3G and narrowband CDMA standards. We also concurrently reached an amicable settlement of a Second Generation (2G) patent licensing dispute (2G Dispute) with NEC in connection with a 1995 2G patent license agreement (2G Agreement).

In connection with the 3G Agreement, we received a non-refundable advance royalty of $19.5 million in April 2002. We recognized revenue of approximately $18.3 million related to that advance in 2002 and the balance in the first quarter of 2003. NEC has not made an additional prepayment under their 3G agreement and therefore submits quarterly royalty payments based on its current period sales of licensed products. In connection with the settlement of the 2G Dispute, we received $13.25 million in April 2002, as the first of four equal nonrefundable installments totaling $53 million. We received the remaining three installments in 2003. In connection with the $53 million settlement, we are recognizing revenue on a straight-line basis from the January 2002 agreement date through February 2006, which is the expected period of use by NEC. In 2003 and 2002, we recognized approximately $12.9 million and $12.3 million of revenue, respectively, related to this settlement. At December 31, 2003 and 2002, our deferred revenue balance contained approximately $27.8 million and $40.7 million related to cash previously collected under these agreements.

Matsushita

In 2001, we entered into a worldwide royalty-bearing license agreement with Matsushita Communications Industrial Co., Ltd. (Matsushita) of Japan under our patent portfolio for Matsushita to manufacture, sell, and distribute 3G products. We received a non-refundable advance royalty payment of $19.5 million related to this agreement. The agreement with Matsushita provides for royalty payments for products when the make, sell or use of the Matsushita 3G product infringes one or more claims of the licensed patents. As of December 31, 2003, Matsushita manufacturing and sales activities for 3G products have currently occurred in Japan and, in its royalty reports to the Company, Matsushita has not included any royalties owed. We have not recognized any revenue to date.

Sharp

We are party to a non-exclusive, worldwide, generally nontransferable, royalty-bearing, convenience-based patent license agreement with Sharp Corporation of Japan (Sharp) covering sales of terminal devices compliant with TDMA-based PDC and PHS standards (Sharp PDC/PHS Agreement). In second quarter 2003, we extended the term of the Sharp PDC/PHS Agreement until April 2008. Under the extension, Sharp made a $17.5 million up-front payment consisting of a renewal fee of $2.0 million and a royalty prepayment of $15.5 million. Once the royalty prepayment is exhausted, Sharp will be obligated to make additional royalty payments, at updated rates, on sales of licensed products sold through early 2008. The remaining portion of the upfront payment will be amortized on a straight-line basis over the five-year term of the extension.

We are also party to a separate non-exclusive, worldwide, convenience-based, generally non-transferable, royalty-bearing patent license agreement with Sharp (Sharp NCDMA/GSM/3G Agreement) covering sales of GSM narrowband CDMA and 3G products that expires upon the last to expire of the patents licensed under the agreement. In 2003, we recorded revenues of $28.5 million from Sharp, of which approximately $19.5 million is attributable to the Sharp PDC/PHS Agreement and approximately $9.0 million is attributable to the NCDMA/GSM/3G Agreement. In 2002 we recorded revenues of $23.5 million and $2.7 million, respectively, from our PDC/PHS and GSM agreements with Sharp. In 2001 we recorded $15.6 million from our PDC/PHS agreement with Sharp. In addition, under an amendment to the Sharp NCDMA/GSM/3G Agreement, Sharp is obligated to make an upfront payment of approximately $17.8 million in second quarter 2004 as an advance against future royalty obligations.

Acquisition

In July 2003, we entered into an Asset Purchase Agreement (the Asset Purchase Agreement) with Windshift Holdings, Inc., formerly known as Tantivy Communications, Inc. (Windshift), pursuant to which we acquired substantially all the assets of Windshift. Included in the acquisition were patents, patent applications, know-how, and state-of-the-art laboratory facilities related to cdma2000, smart antenna, wireless LAN and other wireless communications technologies. The acquisition included patents and patent applications to which we had previously acquired rights under a patent license agreement with Windshift. We acquired these assets to strengthen our existing cdma2000 patent portfolio and competitive position in that marketplace, to broaden our offering to potential licensees and technology partners and to eliminate contingent payment obligations we had to Windshift in connection with the license we entered into with them in 2002 regarding the cdma2000-related patents.

The purchase price for the acquisition was $11.5 million, consisting of approximately $10.0 million in cash and cancellation of approximately $1.5 million in outstanding indebtedness owed to us by Windshift. In addition, under the terms of the Asset Purchase Agreement, Windshift will be entitled to receive, for a period of approximately five years, 1% and 4%, respectively, of amounts we receive from the licensing or sale of smart antenna and 802.11 intellectual property acquired from

Windshift ("the Earn-out"). In addition to the purchase price, we incurred approximately $0.4 million of acquisition related costs.

We accounted for this asset acquisition under FAS 141 "Business Combinations." The following table summarizes the estimated fair values of the assets acquired. Additional payments to Windshift under the Earn-out may result in the recognition of goodwill, which would be subject to impairment testing in accordance with SFAS 142 "Goodwill and Other Intangible Assets."

(In thousands)

Property and Equipment	$ 552
Patents	11,324
Total assets acquired	$ 11,876

As indicated in the table above, the majority of the purchase price has been allocated to patents with the remainder allocated to fixed assets. We have estimated the useful life of the acquired patents to be 15 years. We have estimated the useful lives of the acquired fixed assets to be between 3 and 10 years.

In connection with our acquisition, we opened an engineering design center in Melbourne, Florida and hired 10 individuals that were formerly employed by Windshift. Beginning July 31, 2003, we have included the results of the Melbourne design center, amortization of the acquired patents, and depreciation of the acquired fixed assets in our results of operations.

The following unaudited pro forma combined results of operations is provided for illustrative purposes only and assumes this acquisition of assets occurred as of the beginning of each of the periods presented. The unaudited pro forma combined financial results do not purport to be indicative of the results of operations for future periods or the results that actually would have been realized had the entities been a single entity during these periods.

Year Ended December 31,	**2003**	2002
(In thousands except per share data)		
Pro forma revenue	$ 114,574	$ 88,220
Pro forma net income	$ 31,651	$ (8,290)
Diluted net income per share, as reported	$ 0.58	$ 0.04
Diluted net income per share, pro forma	$ 0.56	$ (0.16)

Nokia Development Agreement

In February 1999, we entered into a multi-year arrangement with Nokia for development of new technology for 3G wireless telecommunications products. Under the multi-year arrangement, we provided specialized engineering services and technology and know-how development and we retain ownership rights of all of the technology we developed thereunder. In third quarter 2001, Nokia and the Company amended the agreement by refining the pace and scope of the development arrangement and Nokia committed to increase funding to a maximum of approximately $58 million, up from the original estimate of $40 million. Under the amendment, we became responsible for costs not covered by the maximum funding amount. This modification was treated as a new contract for accounting purposes and as a result, we reported revenue for the remainder of the program based on our proportional performance of service. Prior to the change, revenue had been reported on a time and materials basis and we had billed Nokia approximately $46 million under the contract, leaving approximately $12 million of revenue to be recognized based on our proportional performance under the contract. During 2002, we accrued a loss of $1.2 million on the modified contract based on our estimates of cost to complete the contract. In 2003, we received the final $1.0 million payment associated with this contract upon our final delivery of the remaining technology required under the agreement. For the years ended December 31, 2003,

2002 and 2001, we recognized specialized engineering service revenue related to this development arrangement of $1.0 million, $4.6 million and $21.8 million, respectively.

Note 5. Property and Equipment

December 31, (In thousands)	**2003**	2002
Land	$ 695	$ 695
Building and improvements	5,941	5,608
Machinery and equipment	10,544	10,080
Computer equipment and software	25,832	22,730
Furniture and fixtures	3,829	3,702
Leasehold improvements	2,301	1,849
	49,142	44,664
Less: Accumulated depreciation	(37,005)	(30,573)
	$ 12,137	$ 14,091

Depreciation expense was $6.4 million, $7.0 million and $5.0 million in 2003, 2002 and 2001, respectively.

Note 6. Long-Term Debt Obligations

December 31, (In thousands)	**2003**	2002
Mortgage debt	$ 1,939	$ 2,088
Capitalized leases	31	71
Total long-term debt obligations	1,970	2,159
Less: Current portion	(193)	(189)
	$ 1,777	$ 1,970

During 1996, we purchased our King of Prussia, Pennsylvania facility for $3.7 million, including cash of $0.9 million and a 16-year mortgage of $2.8 million with interest payable at a rate of 8.28% per annum.

Capitalized lease obligations are payable in monthly installments at an average rate of 4.6%, through 2004. The net book value of equipment under capitalized lease obligations was less than $0.1 million at December 31, 2003 and $0.1 million at December 31, 2002.

Maturities of principal of the long-term debt obligations as of December 31, 2003 are as follows (in thousands):

2004	$ 193
2005	176
2006	191
2007	207
2008	225
Thereafter	978
	$ 1,970

Note 7. Commitments and Contingencies

Leases

We have entered into various operating lease agreements. Total rent expense primarily for office space, was $2.6 million, $2.4 million and $2.4 million in 2003, 2002 and 2001, respectively. Minimum future rental payments for operating leases as of December 31, 2003 are as follows (in thousands):

2004	$ 2,537
2005	2,046
2006	1,501
2007	194
2008	–
Thereafter	–

Note 8. Litigation and Legal Proceedings

Nokia

In July 2003, Nokia requested binding arbitration regarding Nokia's royalty payment obligations for its worldwide sales of 2G GSM/TDMA and 2.5G GSM/GPRS/EDGE/TDMA products under the existing patent license agreement with InterDigital Technology Corporation (ITC), a wholly-owned subsidiary of InterDigital Communications Corporation. Pursuant to the dispute resolution provisions of the patent license agreement, the arbitration has been filed in the International Court of Arbitration of the International Chamber of Commerce (ICC).

The binding arbitration relates to ITC's claim that the patent license agreements ITC signed with Ericsson and Sony Ericsson in March 2003 defined the financial terms under which Nokia would be required to pay royalties on its worldwide sales of 2G GSM/TDMA and 2.5G GSM/GPRS/EDGE/TDMA Products commencing January 1, 2002. Nokia is seeking a determination that their obligation under our existing patent license agreement is not defined by our license agreements with Ericsson and Sony Ericsson or has been discharged. Alternatively, Nokia is seeking access to various documents related to previous litigations, negotiations, and arbitrations with other parties. Nokia also is seeking a ruling that no royalty rate for its sales after January 1, 2002 can be determined by the panel until certain contractual conditions precedent have been satisfied. Nokia has additionally claimed that, in any event, the panel cannot award money damages.

ITC filed an Answer to Nokia's Request for Arbitration arguing that the patent license agreements signed with Ericsson and Sony Ericsson in March 2003 defined the financial terms under which Nokia would be required to pay royalties on its worldwide sales of 2G GSM/TDMA and 2.5G GSM/GPRS/EDGE/TDMA Products commencing January 1, 2002, that Nokia's duty to pay these royalties has not been discharged, and that the documents sought by Nokia are not relevant to the royalty determination. ITC also counterclaimed for an arbitration decision requiring that Nokia pay us royalties on equivalent terms and conditions as those set forth in the Ericsson and Sony Ericsson patent license agreements for the period January 1, 2002 to December 31, 2006, and determining the amount of the royalty and payment terms. During fourth quarter 2003, Nokia filed a Reply contesting our claims and including additional claims and defenses relating to the enforceability, validity, and infringement of certain of ITC's patents. Subsequently Nokia withdrew from the arbitration its claims pertaining to invalidity and non-infringement of those same ITC patents but maintains that the validity and infringement of those patents is a factor the arbitration panel should consider in the arbitration. We do not believe that the issues of patent validity or infringement are relevant to the arbitrable royalty dispute and intend to vigorously contest Nokia's position. The arbitration panel has informed the parties that January 2005 is the month during which the panel will conduct the arbitration evidentiary hearing, and, absent a resolution of this

matter or unexpected changes in the arbitration schedule approved by the arbitration panel, we expect a decision to be rendered thereafter.

Separately, Nokia has filed a motion to intervene in the now-settled Ericsson litigation in the United States District Court for the Northern District of Texas and to gain access to documents previously sealed by the Court in the settled litigation. We filed a response opposing the request to intervene and opposing the request for access to the documents. While the Court granted Nokia's motion to intervene in the Ericsson litigation, the Court has deferred a ruling on Nokia's request to gain access to sealed documents pending a determination by the arbitration panel in the Nokia arbitration proceeding as to whether any sealed document is relevant to such arbitration proceeding. Nokia subsequently filed a motion to reinstate certain decisions that were vacated in the now-settled Ericsson litigation. We have opposed Nokia's motion to reinstate the decisions and a court decision is pending.

Samsung

In 2002, during an arbitration proceeding, Samsung elected under its 1996 patent license agreement with ITC (1996 Samsung License Agreement) to have Samsung's royalty obligations commencing January 1, 2002 for 2G GSM/TDMA and 2.5G GSM/GPRS/EDGE/TDMA wireless communications products to be determined in accordance with the terms of the Nokia patent license agreement, including its MFL provision. By notice in March 2003, ITC notified Samsung that such Samsung obligations had been defined by the relevant licensing terms of ITC's license agreements with Ericsson and Sony Ericsson as a result of the MFL provision in the Nokia license agreement. In November 2003 Samsung initiated a binding arbitration against InterDigital Communications Corporation (InterDigital) and ITC (collectively with InterDigital, the Company). The arbitration has been filed with the ICC. Samsung is seeking to have an ICC arbitration panel determine that Samsung's obligations under the 1996 Samsung License Agreement are not defined by our license agreements with Ericsson and Sony Ericsson or, in the alternative, to determine the amount of the appropriate royalty due. Samsung also has requested a consolidation of its arbitration matter with the pending ICC arbitration involving Nokia Corporation and the Company and for the arbitration panel to make a determination that Samsung is entitled to seek access to documents previously sealed by the Federal Court related to the now-settled Ericsson litigation. The Company has responded to and contested Samsung's claims and any request for access to the sealed documents. The Company believes that consolidation of the arbitration proceedings is not permitted without the consent of the parties. ITC also has counterclaimed for an arbitration decision requiring that Samsung pay us royalties on equivalent terms and conditions as those set forth in the Ericsson and Sony Ericsson patent license agreements for the period January 1, 2002 to December 31, 2006, and determining the amount of the royalty and payment terms. We also seek a declaration that the parties' rights and obligations are governed by the 1996 Samsung License Agreement, and that the Nokia patent license agreement dictates only Samsung's royalty obligations and most favored rights for those products licensed under the 1996 Samsung License Agreement. Samsung has replied to ITC's answer and counterclaim, maintaining Samsung's position (as set forth in its arbitration demand) and arguing that it has succeeded to all of Nokia's license rights. In the alternative, Samsung asserts that its royalty obligations should be governed by the MFL clause in the 1996 Samsung License Agreement. We expect an arbitration panel will be selected in the near future.

Lucent

In March 2004, Tantivy Communications, Inc., one of our wholly-owned subsidiaries, filed a lawsuit in the United States District Court for the Eastern District of Texas against Lucent Technologies, Inc. (Lucent), a leading manufacturer of cdma2000 equipment, for infringement of seven United States patents. The complaint seeks damages for past infringement and an

injunction against future infringement as well as interest, costs, and attorneys' fees. Lucent has not yet responded to the complaint.

Federal

In November 2003, Federal, the insurance carrier for the settled litigation involving Ericsson Inc., delivered to us a demand for arbitration under the Pennsylvania Uniform Arbitration Act. Federal claims, based on their determination of expected value to the Company resulting from our settlement involving Ericsson Inc., that an insurance reimbursement agreement requires us to reimburse Federal approximately $28 million for attorneys' fees and expenses it claims were paid by it. On November 4, 2003, the Company filed an action in United States District Court for the Eastern District of Pennsylvania seeking a declaratory judgment that the reimbursement agreement is void and unenforceable, seeking reimbursement of attorneys' fees and expenses which have not been reimbursed by Federal and which were paid directly by the Company in connection with the Ericsson Inc. litigation, and seeking damages for Federal's bad faith and breach of its obligations under the insurance policy. In the alternative, in the event the reimbursement agreement is found to be valid and enforceable, the Company is seeking a declaratory judgment that Federal is entitled to reimbursement based only on certain portions of amounts received by the Company from Ericsson Inc. pursuant to the settlement of the litigation involving Ericsson Inc. Federal has requested the Court to dismiss the action and/or to have the matter referred to arbitration. We have opposed such requests. The Court has held a hearing on Federal's requests, and a decision on such requests is pending. Prior to Federal's demand for arbitration, we had accrued a contingent liability of $3.4 million related to the insurance reimbursement agreement. If this matter results in us paying Federal substantially more than the amount accrued, it could have a material impact on our financial results.

Other

We have filed patent applications in the United States and in numerous foreign countries. In the ordinary course of business, we currently are, and expect from time to time to be, subject to challenges with respect to the validity of our patents and with respect to our patent applications. We intend to continue to vigorously defend the validity of our patents and defend against any such challenges. However, if certain key patents are revoked or patent applications are denied, our patent licensing opportunities could be materially and adversely affected.

In addition to disputes associated with enforcement and licensing activities regarding our intellectual property, including the litigation described above, we are a party to other disputes and legal actions not related to our intellectual property but also arising in the ordinary course of our business. Based upon information presently available to us, we believe that the ultimate outcome of these other disputes and legal actions will not materially affect us.

Note 9. Related Party Transactions

In 2003, we engaged a consulting firm and paid approximately $0.7 million for their services. One of our outside directors is Chairman of the Advisory Board to the consulting firm. Our board member did not receive any direct compensation or commissions related to the engagement.

We paid $27,000 to a consultant for services in 2003 prior to his appointment to our Board of Directors in December, 2003.

Note 10. Preferred Stock

The holders of the $2.50 Convertible Preferred Stock are entitled to receive, when and as declared by our Board of Directors, cumulative annual dividends of $2.50 per share payable in cash or Common Stock at the Company's election (subject to a cash election right of the holder), if legally available.

Such dividends are payable semi-annually on June 1 and December 1. In the event we fail to pay two consecutive semi-annual dividends within the required time period, penalties, such as adjusted conversion rates, may be imposed. The $2.50 Convertible Preferred Stock is convertible into Common Stock at any time prior to redemption at a conversion rate of 2.08 shares of Common Stock for each share of preferred. In 2003, 2002 and 2001, InterDigital declared and paid dividends on the $2.50 Preferred Convertible Stock of $133,000, $136,000 and $137,000, respectively. These dividends were paid with both cash of $77,000, $92,000 and $93,000 and shares of the Company's Common Stock of 2,593, 3,113 and 3,260 in 2003, 2002 and 2001, respectively.

Upon any liquidations, dissolution or winding up of the Company, the holders of the $2.50 Convertible Preferred Stock will be entitled to receive, from the Company's assets available for distribution to shareholders, $25 per share plus all dividends accrued, before any distribution is made to shareholders of common stock. After such payments, the holders of the $2.50 Convertible Preferred Stock would not be entitled to any other payments. The redemption price for each share of the $2.50 Convertible Preferred Stock is $25 per share. The $2.50 Convertible Preferred Stock is redeemable at our option.

The holders of the $2.50 Convertible Preferred Stock do not have any voting rights except on those amendments to the Company's Articles of Incorporation which would adversely affect their rights, create any class or series of stock ranking senior to or not at parity with the $2.50 Convertible Preferred Stock, as to either dividend or liquidation rights, or increase the authorized number of shares of any senior stock. In addition, if two or more consecutive semi-annual dividends on the $2.50 Convertible Preferred Stock are not paid by the Company, the holders of the $2.50 Convertible Preferred Stock, separately voting as a class, will be entitled to elect one additional director of the Company.

Note 11. Common Stock Compensation Plans

Stock Compensation Plans

We have stock-based compensation plans under which, depending on the plan, directors, employees, consultants and advisors can receive stock options, stock appreciation rights, restricted stock awards and other stock unit awards.

Common Stock Option Plans

We have granted options under two incentive stock option plans, three non-qualified stock option plans and two plans which provide for grants of both incentive and non-qualified stock options (Pre-existing Plans) to non-employee directors, officers and employees of the Company and other specified groups, depending on the plan. No further grants are allowed under the Pre-existing Plans. In 2000, the shareholders approved the 2000 Stock Award and Incentive Plan (2000 Plan) that allows for the granting of incentive and non-qualified options, as well as other securities. The 2000 Plan authorizes the offer and sale of up to approximately 7.4 million shares of common stock. The Board of Directors or the Compensation Committee of the Board determines the number of options to be granted. Under the terms of the 2000 Plan, the option price cannot be less than 100% of fair market value of the Common Stock at the date of grant.

In 2002, the Board of Directors approved the 2002 Stock Award and Incentive Plan (2002 Plan) that allows for the granting of incentive and non-qualified options, as well as other securities to Company employees who are not subject to the reporting requirements of Section 16 of the Securities Act of 1934 or an "affiliate" for purposes of Rule 144 of the Securities Act of 1933. The 2002 Plan authorizes the offer and sale of up to 1.5 million shares of common stock. The Board of Directors or the Compensation Committee of the Board determines the number of options to be granted.

Under the terms of the 2002 Plan, the option price cannot be less than 100% of fair market value of the Common Stock at the date of grant. In addition, unless otherwise modified, no awards may be granted under the 2002 Plan after the close of business on March 21, 2012.

Under all of these plans, options are generally exercisable for a period of 10 years from the date of grant and may vest on the grant date, another specified date or over a period of time. However, under plans that provide for both incentive and non-qualified stock options, grants most commonly vest in six semi-annual installments.

Information with respect to stock options under the above plans is summarized as follows (in thousands, except per share amounts):

	Available For Grant	Outstanding Options		Weighted Average Exercise Price
		Number	Price Range	
Balance at December 31, 2000	5,800	5,919	$ 0.01-39.00	$ 12.90
Granted	(5,109)	5,109	$ 5.38-15.10	$ 10.47
Canceled	280	(280)	$ 5.38-39.00	$ 17.30
Exercised	–	(184)	$ 6.80-15.38	$ 11.61
Balance at December 31, 2001	971	10,564	$ 0.01-39.00	$ 11.67
Granted	(1,056)	1,056	$ 6.32-19.10	$ 12.46
Canceled	463	(463)	$ 0.01-39.00	$ 13.80
Exercised	–	(695)	$ 0.01-17.13	$ 8.45
2002 Plan Authorization	1,500	–		
Balance at December 31, 2002	1,878	10,462	$ 0.01-39.00	$ 11.86
Granted	(999)	999	$13.20-25.85	$ 19.05
Canceled	151	(151)	$ 6.50-39.00	$ 19.34
Exercised	–	(1,952)	$ 0.01-19.10	$ 8.97
Balance at December 31, 2003	1,030	9,358	$ 0.01-39.00	$ 13.11

The following table summarizes information regarding the stock options outstanding at December 31, 2003 (in thousands, except for per share amounts):

Range of Exercise Prices	Number Outstanding	Weighted Average Remaining Contractual Life	Weighted Average Exercise Price	Number Exercisable	Weighted Average Exercise Price
$ 0.01 - 5.44	1,454	4.56	$ 5.16	1,454	$ 5.16
$ 5.50 - 8.81	1,223	7.94	7.21	1,149	7.17
$ 8.83 - 9.60	1,459	8.01	9.56	1,105	9.57
$ 9.63 - 11.13	1,058	7.62	10.50	939	10.54
$11.15 - 12.40	993	12.32	12.02	746	12.04
$12.43 - 15.88	946	8.15	14.25	615	13.79
$15.90 - 19.77	1,102	8.43	17.88	592	17.52
$19.81 - 33.50	528	7.56	24.75	391	25.17
$34.13 - 34.13	13	6.18	34.13	13	34.13
$39.00 - 39.00	582	6.04	39.00	582	39.00
$ 0.01 - 39.00	9,358	7.79	$ 13.11	7,586	$ 12.79

Common Stock Warrants

As of December 31, 2003 and 2002, we had warrants outstanding to purchase 192,000 and 222,000 shares of Common Stock at exercise prices ranging from $2.50 to $7.63 per share, with a weighted average exercise price of $6.22 per share. As of December 31, 2003, all of these warrants were currently exercisable. Unless exercised, 112,000 warrants will expire in 2004 and the remaining warrants will expire in 2006. The exercise price and number of shares of Common Stock to be obtained upon exercise of these warrants are subject to adjustment under conditions specified in the respective agreements.

Restricted Stock

Under our 1999 Restricted Stock Plan, as amended, we can issue up to 3,500,000 shares of restricted common stock and restricted stock units to directors, employees, consultants and advisors. The restrictions on issued shares lapse over periods generally ranging from 1 to 5 years from the date of the grant. As of December 31, 2003 and 2002, we had 1,006,491 and 915,064 shares of restricted stock and restricted stock units, respectively, issued under the plan. The related compensation expense will be, or has been, amortized over vesting periods that are generally from one to five years. The balance of unearned compensation at December 31, 2003 and 2002 was $0.7 million and $0.8 million, respectively.

Note 12. Shareholder Rights Plan

In December 1996, our Board of Directors declared a distribution under its Shareholder Rights Plan (Rights Plan) of one Right (as described below) for each outstanding common share of the Company to shareholders of record as of the close of business on January 3, 1997. In addition, any new common shares issued after January 3, 1997 will receive one Right for each common share. The Rights Plan was amended in a number of respects with the latest amendment in March 2000. As amended, each Right entitles shareholders to buy one-thousandth of a share of Series B Junior Participating Preferred Stock at a purchase price of $250 per share, subject to adjustment. Ordinarily, the Rights will not be exercisable until 10 business days after any of the following events (each, a Triggering Event): (i) a non-exempt person or group owns or acquires 10% or more of the Company's outstanding Common Stock, or (ii) a non-exempt person or group publicly commences

an offer for 10% or more of the Company's outstanding Common Stock, or (iii) a non-exempt person or group publicly announces an intention to acquire control over the Company and proposes in a proxy or consent solicitation to elect such a number of directors, who if elected, would represent a majority of the directors when compared with the Independent Directors (as defined in the Rights Plan) on the Board. If the Company's Board of Directors has consented to the occurrence of a particular Triggering Event, then the occurrence of such Triggering Event will not give rise to the exercisability of the Rights. In general, upon the occurrence of a Triggering Event without Board approval, each holder of a Right will have the right to receive, upon exercise, Units of Preferred Stock (or, in certain circumstances, Company Common Stock, cash, property, or other securities of the Company) having a value equal to twice the exercise price of the Right, or if the Company is acquired in a merger or other business combination, each holder of a Right will have the right to receive stock of the acquiring person with a value equal to twice the exercise price of the Right.

Note 13. Taxes

Income tax expense/(benefit) consists of the following components for 2003, 2002, and 2001:

Year Ended December 31, (In thousands)	**2003**	2002	2001
Current			
Federal	$ (755)	$ 1,834	$ 200
State	–	–	–
Alternative Minimum Tax Receivable (AMT)	(793)	–	–
Foreign	7,383	8,348	3,218
	5,835	10,182	3,418
Deferred			
Federal	3,418	(165)	(6,621)
State	(410)	(4,095)	(3,363)
Foreign	–	–	–
Increase/(decrease) in valuation allowance	(1,574)	2,826	9,984
	1,434	(1,434)	–
Total	$ 7,269	$ 8,748	$ 3,418

The deferred tax assets and liabilities are comprised of the following at December 31, 2003 and 2002:

(In thousands)	**2003**	2002
Depreciation	$ 1,143	$ 1,141
Patent amortization	2,093	1,762
Other employee benefits	561	564
Other accrued liabilities	72	542
Other	1,279	34
Restricted stock compensation	786	417
Deferred revenue	28,922	28,966
AMT credit carryforward	1,711	1,434
R&E credits	2,657	2,657
Net operating losses	42,119	46,834
Less: valuation allowance	(81,343)	(82,917)
Net deferred tax asset	–	$ 1,434

The following is a reconciliation of income taxes at the federal statutory rate with income taxes recorded by the Company for the years ended December 31, 2003, 2002 and 2001:

(In thousands)	**2003**	2002	2001
Tax at U.S. Statutory Rate	$ 14,190	$ 3,828	$ (5,394)
Foreign withholding tax, with no US foreign tax credit	4,861	5,502	2,124
State tax provision	(410)	–	–
Change in federal and state valuation allowance	(9,814)	(1,269)	6,621
AMT refund receivable	(793)	–	–
Other	(765)	687	67
Total tax provision	$ 7,269	$ 8,748	$ 3,418

At December 31, 2003, the Company had a federal net operating loss carryforward of approximately $123 million, which will expire, if unused, in the years 2005 through 2021. At December 31, 2003 and 2002, we have provided a full valuation allowance on all deferred tax assets. Our assessment did not take into consideration the potential realization of any gain contingencies and it is possible that the full valuation allowance, or a portion of it, could be reversed in 2004. In 2003 we increased the valuation allowance by $8.2 million related to the exercise of non-qualified stock options. At December 31, 2003, approximately $96 million of benefits associated with the exercise of non-qualified stock options are included in the net operating loss carryforward. However, these benefits have been deferred because the Company is in a net operating loss position. Such benefits will be credited to additional paid-in capital in the year in which the benefits are realized.

Under the Internal Revenue Code Section 382, the utilization of a corporation's net operating loss carryforwards is limited following a change in ownership (as defined by the Internal Revenue Code) of greater than 50% within a three-year period. If it is determined that prior equity transactions limit the Company's net operating loss carryforwards, the annual limitation will be determined by multiplying the market value on the date of ownership by the federal long-term tax-exempt rate. Any amount exceeding the annual limitation may be carried forward to future years for the balance of the net operating loss carryforward period.

A more-than-50% cumulative change in ownership occurred in 1992. As a result of such change, approximately $26 million of the Company's NOL carryforwards were limited as of December 31, 2003. If the Company experiences an additional more-than-50% cumulative ownership change, the full amount of the NOL carryforward may become subject to annual limitation under Section 382. There can be no assurance that the Company will realize the benefit of any carryforward.

Note 14. Selected Quarterly Results (Unaudited)

The table below presents quarterly data for the years ended December 31, 2003 and 2002:

Selected Quarterly Results (in thousands, except per share amounts, unaudited)	First	Second	Third	Fourth	Full Year
2003					
Revenues	$ 37,324	$ 25,777	$ 26,790	$ 24,683	$ 114,574
Net income applicable to common shareholders	$ 26,693	$ 3,125	$ 3,431	$ 1,083	$ 34,332
Net income per common share – diluted	$ 0.45	$ 0.05	$ 0.06	$ 0.02	$ 0.58
2002					
Revenues	$ 20,949	$ 25,149	$ 14,706	$ 27,091	$ 87,895
Net income (loss) applicable to common shareholders	$ 16	$ 2,444	$ (5,833)	$ 5,748	$ 2,375
Net income (loss) per common share – diluted	$ 0.00	$ 0.04	$ (0.11)	$ 0.10	$ 0.04

Market for Company's Common Equity and Related Stockholder Matters

The following table sets forth the range of the high and low sales prices of InterDigital's Common Stock as reported by The Nasdaq Stock Market.

	High	Low
2002		
First Quarter	$ 12.40	$ 8.29
Second Quarter	13.64	8.58
Third Quarter	9.51	6.32
Fourth Quarter	19.10	8.83

	High	Low
2003		
First Quarter	$ 24.14	$ 11.50
Second Quarter	28.85	18.21
Third Quarter	26.25	13.90
Fourth Quarter	21.13	15.00

As of March 7, 2004, there were approximately 1,796 holders of record of our Common Stock.

We have not paid cash dividends on our Common Stock since inception. It is anticipated that, in the foreseeable future, no cash dividends will be paid on our Common Stock and any cash otherwise available for such dividends will be reinvested in our business. The payment of cash dividends will depend on our earnings, the prior dividend requirements on our remaining series of Preferred Stock and other Preferred Stock which may be issued in the future, our capital requirements and other factors considered relevant by our Board of Directors.

Risk Factors

This Annual Report contains forward-looking statements reflecting, among other things, the Company's beliefs and expectations as to: (i) the deployment, pace, and growth of the 3G market and the wireless data services market; (ii) our current strategic objectives to (a) strengthen the attractiveness and market relevance of our technology and intellectual property, (b) broaden our licensing program and find new ways to leverage our licensing capabilities, (c) establish new business relationships, (d) manage our costs and maintain the strength of our balance sheet, (e) continue to invest in new technologies; (iii) our plans to expand our HSDPA solution and seek potential customers for our smart antenna technology in WLAN and mobile cellular applications; (iv) the capabilities of our technology solutions; (v) our future revenues, cash flow, short-term investment position, operating expenses, and capital expenditures, and the sources and timing thereof, and

our near term operating requirements and lack of need to seek additional financing; (vi) our ability to monetize our investment in technology development primarily through patent licensing or sale of all or a portion of our technologies; (vii) our ability to enter into new customer, partner and licensing relationships, secure patent protection for our inventions; (viii) our beliefs as to the royalty obligations of Nokia and Samsung under their respective patent license agreements with us and the timing of the respective arbitration proceedings; and (ix) our ability to collect royalties under existing license agreements and settlement agreements and derive revenues from our patents. Forward-looking statements are subject to risks and uncertainties.

In addition to those factors identified in this Annual Report, the following factors, among others, could cause actual outcomes to differ materially from those expressed in such forward-looking statements: (i) Our technologies may not be widely deployed. (ii) We may experience technical, financial or other difficulties or delays related to the development of our technologies and products; moreover, our technologies have not been fully tested in commercial use and may not perform as expected. (iii) The 3G market and the market for smart antenna solutions may fail to materialize at the pace or size we expect. For example, the potential exists for 3G market preemption or reduction in scope by the success of current or future 2.5G solutions and of WLAN. (iv) Investments designed to keep pace with technology and product market targets, and other strategic investments, could adversely impact near-term operating results. (v) We may not be able to enter into additional or expanded strategic partnerships or license agreements, either at all or on acceptable terms. (vi) The strength of our patent portfolio could be weakened through patents being declared invalid, our claims being narrowed, changes to the standards, and adverse court decisions. (vii) Our 2G licensing revenue is expected to be impacted negatively over time by the decline of the 2G market coupled with the expiration of certain of our TDMA patents starting in 2006. (viii) Licensees, individually and collectively, are increasingly demanding that the royalty rates for 3G patents be lower than historic royalty rates, and in some cases, that the aggregate royalty rates for their 3G products be capped at a maximum amount. (ix) We face substantial competition from companies with greater resources. (x) Failure to anticipate or keep pace with changes in industry standards, technological developments, and varying customer requirements. (xi) A failure of one of our three primary licensees to meet their payment obligations or negative economic conditions in Japan could adversely impact our revenues and cash flow. (xii) If any of our products are found to infringe the intellectual property rights of a third party, we could be required to redesign such products, take a license from such third party, and/or pay damages to the third party. (xiii) A negative resolution to Nokia and Samsung arbitrations could (a) reduce or eliminate amounts that we believe Nokia and/or Samsung owe and/or are required to pay in the future, and (b) impact negotiating leverage in patent licensing activities. (xiv) Challenges to existing license agreements and failure to extend expiring license agreements or enter new license agreements will impact revenues and cash flow. (xv) Challenges to the validity of our patents may result in certain of our patent claims declared invalid or substantially narrowed which could result in the loss of patent licensing revenue from existing licensees and substantially impair our ability to secure new patent licenses. (xvi) The cost of defending our intellectual property has been and may continue to be significant. (xvii) Certain of our licenses contain provisions that could cause the licensee's obligation to pay royalties to be reduced or suspended for an indefinite period, with or without the accrual of the royalty obligation. (xviii) Our ability to attract and retain qualified personnel required for our strategic objectives could be affected by any adverse decisions in any litigation or arbitration and by our ability to offer competitive cash and equity compensation and work environment conditions.

Officers and Directors

Board of Directors

Harry G. Campagna
Chairman of the Board,
InterDigital
President and Chief Executive Officer,
Qualitex Co.

D. Ridgely Bolgiano
Chief Scientist,
InterDigital

Steven T. Clontz
President and Chief Executive Officer,
StarHub Pte. Ltd.

Howard E. Goldberg
President and Chief Executive Officer,
InterDigital

Ed Kamins
Chief Information Officer and
Senior Vice President,
Avnet, Inc.

Robert S. Roath
Chief Financial Officer (retired),
RJR Nabisco, Inc.

Robert W. Shaner
President (retired),
Cingular Wireless LLC

Alan P. Zabarsky
Founder and CEO,
Technology Consulting Associates, Inc.
Corporate Vice President (retired),
Motorola

Executive Management

Howard E. Goldberg
President, Chief Executive Officer and Director

Dr. Alain C. Briançon
Chief Technology Officer

Richard J. Fagan
Chief Financial Officer

Gary D. Isaacs
Senior Human Resources Officer

Brian G. Kiernan
Chief Strategic Standards Officer

Mark A. Lemmo
Senior Business Development Officer

William J. Merritt
General Patent Counsel and President of
InterDigital Technology Corporation

William C. Miller
Senior Programs and Engineering Officer

Lawrence F. Shay
General Counsel and Corporate Secretary

Charles “Rip” Tilden
Chief Operating Officer

Annual Meeting of Shareholders

Thursday, June 3, 2004
2:00 p.m. EDT
Sheraton Park Ridge Hotel
King of Prussia, Pennsylvania USA

Common Stock Information

The primary market for InterDigital's common stock is the Nasdaq National Market. InterDigital trades under the ticker symbol "IDCC."

Registrar and Transfer Agent

Shareholders with questions concerning stock certificates, shareholder records, account information, dividends, or stock transfer should contact InterDigital's transfer agent:
American Stock Transfer and Trust Co.
Customer Service
59 Maiden Lane
New York, New York 10038 USA
+1 800.937.5449
http://www.amstock.com

Independent Auditors

PricewaterhouseCoopers
Philadelphia, Pennsylvania USA

Investor Relations

Janet Meenehan Point
Senior Director, Investor Relations
+1 610.878.7866
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Melbourne, Florida 32901 USA

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Corporate Ombudsman

To report concerns anonymously or confidentially about InterDigital accounting, internal accounting controls or auditing matters, please write:
Office of the Ombudsman
PO Box 60814
King of Prussia, PA 19406 USA

Contact the InterDigital Board of Directors

To report concerns of a non-audit or non-accounting nature to InterDigital's Board of Directors, please email:
Directors@InterDigital.com
or write
InterDigital Board of Directors
781 Third Avenue
King of Prussia, PA 19406 USA

Web Site

http://www.interdigital.com

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