

InterDigital, Inc.  
Form 10-Q  
November 01, 2018  
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UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, DC 20549  
FORM 10-Q

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended September 30, 2018

OR  
 TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from \_\_\_\_\_ to \_\_\_\_\_  
Commission File Number 1-33579

INTERDIGITAL, INC.

(Exact Name of Registrant as Specified in Its Charter)

PENNSYLVANIA 82-4936666

(State or Other Jurisdiction of (I.R.S. Employer  
Incorporation or Organization) Identification No.)

200 Bellevue Parkway, Suite 300, Wilmington, DE 19809-3727

(Address of Principal Executive Offices and Zip Code)

(302) 281-3600

(Registrant's Telephone Number, Including Area Code)

Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes  No

Indicate by check mark whether the registrant has submitted electronically every Interactive Data File required to be submitted pursuant to Rule 405 of Regulation S-T (Section 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit such files). Yes  No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, a smaller reporting company, or an emerging growth company. See the definitions of "large accelerated filer," "accelerated filer," "smaller reporting company," and "emerging growth company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer  Accelerated filer

Non-accelerated filer  Smaller reporting company

Emerging growth company

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes  No

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date.

Common Stock, par value \$0.01 per share 33,842,244

Title of Class Outstanding at October 30, 2018



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## PART I — FINANCIAL INFORMATION

## Item 1. FINANCIAL STATEMENTS

## INTERDIGITAL, INC. AND SUBSIDIARIES

## CONDENSED CONSOLIDATED BALANCE SHEETS

(in thousands, except per share data)

(unaudited)

|   | SEPTEMBER 30,<br>2018 | DECEMBER 31,<br>2017 |
|---|-----------------------|----------------------|
| ASSETS  |                       |                      |
| CURRENT ASSETS:   |                       |                      |
| Cash and cash equivalents   | \$ 508,829            | \$ 433,014           |
| Short-term investments  | 549,521               | 724,981              |
| Accounts receivable, less allowances of \$456 and \$456   | 29,769                | 216,293              |
| Prepaid and other current assets  | 102,793               | 21,506               |
| Total current assets  | 1,190,912             | 1,395,794            |
| PROPERTY AND EQUIPMENT, NET   | 10,278                | 10,673               |
| PATENTS, NET  | 462,965               | 325,408              |
| DEFERRED TAX ASSETS   | 60,056                | 84,582               |
| OTHER NON-CURRENT ASSETS  | 63,877                | 37,963               |
|   | 597,176               | 458,626              |
| TOTAL ASSETS  | \$ 1,788,088          | \$ 1,854,420         |
| LIABILITIES AND SHAREHOLDERS' EQUITY  |                       |                      |
| CURRENT LIABILITIES:  |                       |                      |
| Accounts payable  | \$ 17,528             | \$ 10,260            |
| Accrued compensation and related expenses   | 19,384                | 24,571               |
| Deferred revenue  | 134,197               | 307,142              |
| Taxes payable   | 98,022                | 14,881               |
| Dividends payable   | 11,996                | 12,156               |
| Other accrued expenses  | 12,425                | 7,431                |
| Total current liabilities   | 293,552               | 376,441              |
| LONG-TERM DEBT  | 313,527               | 285,126              |
| LONG-TERM DEFERRED REVENUE  | 135,465               | 309,671              |
| OTHER LONG-TERM LIABILITIES   | 30,495                | 10,034               |
| TOTAL LIABILITIES   | 773,039               | 981,272              |
| COMMITMENTS AND CONTINGENCIES   |                       |                      |
| SHAREHOLDERS' EQUITY:   |                       |                      |
| Preferred Stock, \$0.10 par value, 14,399 shares authorized, 0 shares issued and outstanding  | —                     | —                    |
| Common Stock, \$0.01 par value, 100,000 shares authorized, 71,117 and 70,749 shares issued and 34,442 and 34,622 shares outstanding | 711                   | 707                  |
| Additional paid-in capital  | 683,140               | 680,040              |
| Retained earnings   | 1,436,171             | 1,249,091            |
| Accumulated other comprehensive loss  | (3,436)               | (2,083)              |
|   | 2,116,586             | 1,927,755            |
| Treasury stock, 36,675 and 36,127 shares of common held at cost   | 1,115,995             | 1,072,488            |
| Total InterDigital, Inc. shareholders' equity   | 1,000,591             | 855,267              |
| Noncontrolling interest   | 14,458                | 17,881               |
| Total equity  | 1,015,049             | 873,148              |

|  |              |              |
|--|--------------|--------------|
| TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY | \$ 1,788,088 | \$ 1,854,420 |
|--|--------------|--------------|

The accompanying notes are an integral part of these statements.

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INTERDIGITAL, INC. AND SUBSIDIARIES  
 CONDENSED CONSOLIDATED STATEMENTS OF INCOME  
 (in thousands, except per share data)  
 (unaudited)

|   | FOR THE THREE MONTHS ENDED<br>SEPTEMBER 30, |          | FOR THE NINE MONTHS ENDED<br>SEPTEMBER 30, |           |
|---|---|----------|--|-----------|
|   | 2018  | 2017     | 2018                                       | 2017      |
| <b>REVENUES:</b>  |   |          |  |           |
| Patent licensing royalties  | \$74,045                                    | \$92,566 | \$230,018                                  | \$314,113 |
| Technology solutions  | 1,034                                       | 4,759    | 2,060                                      | 13,521    |
|   | 75,079                                      | 97,325   | 232,078                                    | 327,634   |
| <b>OPERATING EXPENSES:</b>  |   |          |  |           |
| Patent administration and licensing                               | 32,077                                      | 26,517   | 85,480                                     | 76,629    |
| Development   | 17,276                                      | 17,293   | 49,279                                     | 56,172    |
| Selling, general and administrative                               | 12,806                                      | 12,640   | 38,569                                     | 39,042    |
|   | 62,159                                      | 56,450   | 173,328                                    | 171,843   |
| Income from operations  | 12,920                                      | 40,875   | 58,750                                     | 155,791   |
| OTHER EXPENSE (NET)   | (13,953 )                                   | (2,187 ) | (25,136 )                                  | (7,331 )  |
| Income (loss) before income taxes                                 | (1,033 )                                    | 38,688   | 33,614                                     | 148,460   |
| INCOME TAX BENEFIT (PROVISION)                                    | 21,143                                      | (3,963 ) | 25,001                                     | (29,413 ) |
| NET INCOME  | \$20,110                                    | \$34,725 | \$58,615                                   | \$119,047 |
| Net loss attributable to noncontrolling interest                  | (1,297 )                                    | (811 )   | (3,423 )                                   | (2,744 )  |
| NET INCOME ATTRIBUTABLE TO INTERDIGITAL, INC.                     | \$21,407                                    | \$35,536 | \$62,038                                   | \$121,791 |
| NET INCOME PER COMMON SHARE — BASIC                               | \$0.62                                      | \$1.02   | \$1.79                                     | \$3.52    |
| WEIGHTED AVERAGE NUMBER OF COMMON SHARES<br>OUTSTANDING — BASIC   | 34,651                                      | 34,709   | 34,687                                     | 34,589    |
| NET INCOME PER COMMON SHARE — DILUTED                             | \$0.60                                      | \$1.00   | \$1.74                                     | \$3.40    |
| WEIGHTED AVERAGE NUMBER OF COMMON SHARES<br>OUTSTANDING — DILUTED | 35,607                                      | 35,388   | 35,614                                     | 35,865    |
| CASH DIVIDENDS DECLARED PER COMMON SHARE                          | \$0.35                                      | \$0.35   | \$1.05                                     | \$0.95    |

The accompanying notes are an integral part of these statements.

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INTERDIGITAL, INC. AND SUBSIDIARIES  
 CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME  
 (in thousands)  
 (unaudited)

|   | FOR THE THREE<br>MONTHS ENDED<br>SEPTEMBER 30, |          | FOR THE NINE<br>MONTHS ENDED<br>SEPTEMBER 30, |           |
|---|--|----------|---|-----------|
|   | 2018   | 2017     | 2018  | 2017      |
| Net income  | \$20,110                                       | \$34,725 | \$58,615                                      | \$119,047 |
| Unrealized (loss) gain on investments, net of tax             | 467  | (94 )    | (904 )  | (181 )    |
| Comprehensive income  | \$20,577                                       | \$34,631 | \$57,711                                      | \$118,866 |
| Comprehensive loss attributable to noncontrolling interest    | (1,297 )                                       | (811 )   | (3,423 )                                      | (2,744 )  |
| Total comprehensive income attributable to InterDigital, Inc. | \$21,874                                       | \$35,442 | \$61,134                                      | \$121,610 |

The accompanying notes are an integral part of these statements.

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## INTERDIGITAL, INC. AND SUBSIDIARIES

## CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(in thousands)

(unaudited)

|   | FOR THE NINE<br>MONTHS ENDED<br>SEPTEMBER 30, |                   |
|---|---|-------------------|
|   | 2018  | 2017              |
| <b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>                                      |   |                   |
| Net income  | \$58,615                                      | \$119,047         |
| Adjustments to reconcile net income to net cash provided by operating activities: |   |                   |
| Depreciation and amortization   | 47,024  | 42,809            |
| Non-cash interest expense   | 10,684  | 9,753             |
| Change in deferred revenue  | 9,822   | 90,056            |
| Deferred income taxes   | (27,673 )                                     | (7,853 )          |
| Share-based compensation  | 4,875   | 13,901            |
| Loss on disposal of assets  | 8,176   | —                 |
| Other   | 198   | (4 )              |
| (Increase) decrease in assets:  |   |                   |
| Receivables   | 36,861  | (171,662 )        |
| Deferred charges and other assets   | (63,783 )                                     | (13,316 )         |
| Increase (decrease) in liabilities:   |   |                   |
| Accounts payable  | 5,640   | (3,198 )          |
| Accrued compensation and other expenses   | (5,618 )                                      | (1,798 )          |
| Accrued taxes payable and other tax contingencies                                 | 91,796  | 20,606            |
| Net cash provided by operating activities   | 176,617                                       | 98,341            |
| <b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>                                      |   |                   |
| Purchases of short-term investments   | (142,562 )                                    | (813,267 )        |
| Sales of short-term investments   | 317,447                                       | 678,119           |
| Purchases of property and equipment   | (1,882 )                                      | (942 )            |
| Capitalized patent costs  | (23,845 )                                     | (26,306 )         |
| Acquisition of patents  | (2,250 )                                      | —                 |
| Acquisition of business, net of cash acquired                                     | (142,985 )                                    | —                 |
| Long-term investments   | (6,686 )                                      | (3,201 )          |
| Net cash used in investing activities   | (2,763 )                                      | (165,597 )        |
| <b>CASH FLOWS FROM FINANCING ACTIVITIES:</b>                                      |   |                   |
| Net proceeds from exercise of stock options                                       | 6,362   | 82                |
| Dividends paid  | (36,472 )                                     | (31,107 )         |
| Taxes withheld upon restricted stock unit vestings                                | (8,479 )                                      | (22,236 )         |
| Repurchase of common stock  | (43,508 )                                     | —                 |
| Net cash used in financing activities   | (82,097 )                                     | (53,261 )         |
| <b>NET INCREASE (DECREASE) IN CASH, CASH EQUIVALENTS AND RESTRICTED CASH</b>      | <b>91,757</b>                                 | <b>(120,517 )</b> |
| <b>CASH, CASH EQUIVALENTS AND RESTRICTED CASH, BEGINNING OF PERIOD</b>            | <b>433,014</b>                                | <b>404,074</b>    |
| <b>CASH, CASH EQUIVALENTS AND RESTRICTED CASH, END OF PERIOD</b>                  | <b>\$524,771</b>                              | <b>\$283,557</b>  |
| <b>SUPPLEMENTAL CASH FLOW INFORMATION:</b>  |   |                   |
| Interest paid   | 4,740   | 4,740             |
| Income taxes paid, including foreign withholding taxes                            | 24,459  | 29,173            |



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Non-cash investing and financing activities:

|  |          |        |
|--|----------|--------|
| Dividend payable   | 11,996   | 12,149 |
| Non-cash acquisition of patents  | —        | 12,800 |
| Accrued capitalized patent costs, property and equipment, and acquisition of patents | (1,513 ) | (548 ) |

Refer to Note 1, "Basis of Presentation" for more information regarding the impact of our adoption of ASC 606 and Note 9, "Business Combinations" for a reconciliation of cash, cash equivalents and restricted cash.

The accompanying notes are an integral part of these statements.

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INTERDIGITAL, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

September 30, 2018

(unaudited)

1. BASIS OF PRESENTATION

In the opinion of management, the accompanying unaudited, condensed consolidated financial statements contain all adjustments, consisting only of normal recurring adjustments, necessary for a fair statement of the financial position of InterDigital, Inc. (individually and/or collectively with its subsidiaries referred to as “InterDigital,” the “Company,” “we,” “us” or “our,” unless otherwise indicated) as of September 30, 2018, and the results of our operations for the three and nine months ended September 30, 2018 and 2017 and our cash flows for the nine months ended September 30, 2018 and 2017. The accompanying unaudited, condensed consolidated financial statements have been prepared in accordance with the instructions for Form 10-Q and, accordingly, do not include all of the detailed schedules, information and notes necessary to state fairly the financial condition, results of operations and cash flows in conformity with United States generally accepted accounting principles (“GAAP”). The year-end condensed consolidated balance sheet data was derived from audited financial statements, but does not include all disclosures required by GAAP for year-end financial statements. Therefore, these financial statements should be read in conjunction with the financial statements and notes thereto contained in the Company’s Annual Report on Form 10-K for the fiscal year ended December 31, 2017 (our “2017 Form 10-K”) as filed with the Securities and Exchange Commission (“SEC”) on February 22, 2018. The results of operations for interim periods are not necessarily indicative of the results to be expected for the entire year. We have one reportable segment.

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosures of contingent assets and liabilities as of the date of the financial statements, as well as the reported amounts of revenues and expenses during the reporting period. Actual results could differ from these estimates.

Change in Accounting Policies

There have been no material changes or updates to our existing accounting policies from the disclosures included in our 2017 Form 10-K, except as indicated in the following footnotes:

- Note 1 - Basis of Presentation; and
- Note 9 - Business Combinations.

Reclassifications

Certain reclassifications have been made to prior year amounts to conform to the current year presentation.

New Accounting Guidance

Accounting Standards Update: Revenue Recognition

In May 2014, the Financial Accounting Standards Board (“FASB”) issued ASU No. 2014-09, “Revenue from Contracts with Customers (Topic 606)” (“ASC 606”) which superseded most prior revenue recognition guidance, including industry-specific guidance. The underlying principle is that an entity will recognize revenue to depict the transfer of goods or services to customers at an amount that the entity expects to be entitled to in exchange for those goods or services. The guidance also requires enhanced disclosures regarding the nature, amount, timing and uncertainty of revenue and cash flows arising from an entity’s contracts with customers. We adopted the requirements of the new standard as of January 1, 2018 using the modified retrospective transition method applied to those contracts that were not completed as of January 1, 2018. Accordingly, all periods prior to January 1, 2018 are presented in accordance with ASC Topic 605, “Revenue Recognition” (“ASC 605”).

The adoption of the new guidance affected our recognition of revenue from both our fixed-fee and per-unit license agreements. For accounting purposes under this new guidance, we separate our fixed-fee license agreements into two categories: (i) those agreements that provide rights, over the term of the license, to future technologies that are highly interdependent or highly interrelated to the technologies provided at the inception of the agreement (“Dynamic Fixed-Fee Agreements”) and (ii) those agreements that do not provide for rights to such future technologies (“Static Fixed-Fee Agreements”). Under our previous accounting practices, after the fair value allocation between the past and

future components of the agreement, we recognized the future components of revenue from all fixed-fee license agreements on a straight-line basis over the term of the related license agreement. As a result of our adoption of the new guidance, we will continue to recognize revenue from Dynamic Fixed-Fee Agreements on a straight-line basis over the term of the related license agreement, while we expect to recognize most or all of the revenue from Static Fixed-Fee Agreements in the quarter the license agreement is signed.

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We will not recognize any ongoing revenue from Static Fixed-Fee Agreements already in existence at the time the guidance was adopted. Additionally, in the event a significant financing component is determined to exist in any of our agreements, we will recognize more or less revenue and corresponding interest expense or income, as appropriate. In addition, under our previous accounting practices, we recognized revenue from our per-unit license agreements in the period in which we received the related royalty report, generally one quarter in arrears from the period in which the underlying sales occurred (i.e. on a "quarter-lag"). We are now required to record per-unit royalty revenue in the same period in which the licensee's underlying sales occur. Because we generally do not receive the per-unit licensee royalty reports for sales during a given quarter within the time frame necessary to adequately review the reports and include the actual amounts in our quarterly results for such quarter, we accrue the related revenue based on estimates of our licensees' underlying sales, subject to certain constraints on our ability to estimate such amounts. As a result of accruing revenue for the quarter based on such estimates, adjustments will be required in the following quarter to true-up revenue to the actual amounts reported by our licensees. In addition, to the extent we receive non-refundable prepayments related to per-unit license agreements that do not provide rights over the term of the license to future technologies that are highly interdependent or highly interrelated to the technologies provided at the inception of the agreement, we will recognize such prepayments as revenue in the period in which all remaining revenue recognition criteria have been met.

Finally, under our previous accounting practices, we established a receivable, and any related deferred tax asset for foreign withholding taxes, for payments expected to be received within twelve months from the balance sheet date, based on the terms of the license agreement. Our reporting of such payments resulted in increases to: accounts receivable and deferred revenue; and deferred tax assets and taxes payable. Under ASC 606, we will only recognize those amounts as they become due.

Timing of revenue recognition may differ significantly from the timing of invoicing to customers. Contract assets are included in accounts receivable and represent unbilled amounts expected to be received from customers in future periods, where the revenue recognized to date (or cumulative adjustments to retained earnings in the initial period of adopting ASC 606) exceeds the amount billed, and right to payment is subject to the underlying contractual terms. Contract assets are classified as long-term assets if the payments are expected to be received more than one year from the reporting date.

See below for a summary of adjustments related to our adoption of ASC 606. Amounts are in thousands.

|                     | December<br>31, 2017 | Static<br>Fixed-Fee<br>Agreements | Static<br>Prepayments | Elimination<br>of<br>Quarter-Lag<br>Reporting | Significant<br>Financing<br>Component | Related<br>Tax Effects<br>and Other<br>Balance<br>Sheet<br>Impacts | Total<br>Adjustments | January 1,<br>2018 |
|---------------------|----------------------|-----------------------------------|-----------------------|---|---------------------------------------|--|----------------------|--------------------|
| Accounts Receivable | \$216,293            | \$ 6,000                          | \$ —                  | \$ 10,948                                     | \$ —                                  | \$(171,727)  | \$(154,779 )         | \$ 61,514          |
| Deferred Tax Assets | 84,582               | —                                 | —                     | —   | —                                     | (52,199 )  | (52,199 )            | 32,383             |
| Taxes Payable       | (14,881 )            | —                                 | —                     | —   | —                                     | 8,655  | 8,655                | (6,226 )           |
| Deferred Revenue    | (616,813 )           | 99,466                            | 85,146                | —   | 3,235                                 | 171,727  | 359,574              | (257,239 )         |
| Retained Earnings   | (1,249,091 )         | (105,466 )                        | (85,146)              | (10,948 )                                     | (3,235 )                              | 43,544   | (161,251 )           | (1,410,342 )       |

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## Disaggregated Revenue

The following tables present the disaggregation of our revenue for the three and nine months ended September 30, 2018 under ASC 606. Revenues for the three and nine months ended September 30, 2017 are presented in accordance with ASC 605. Amounts are in thousands.

|   | For the Three<br>Months Ended<br>September 30, |           |                     |       |
|---|--|-----------|---------------------|-------|
|   | 2018   | 2017      | Increase/(Decrease) |       |
| Variable patent royalty revenue                   | \$13,645                                       | \$10,081  | \$3,564             | 35 %  |
| Fixed-fee royalty revenue                         | 60,272   | 73,653    | (13,381)            | (18)% |
| Current patent royalties <sup>a</sup>             | 73,917   | 83,734    | (9,817)             | (12)% |
| Non-current patent royalties <sup>b</sup>         | 128  | 8,832     | (8,704)             | (99)% |
| Total patent royalties                            | 74,045   | 92,566    | (18,521)            | (20)% |
| Current technology solutions revenue <sup>a</sup> | 1,034  | 4,759     | (3,725)             | (78)% |
| Total revenue                                     | \$75,079                                       | \$97,325  | \$(22,246)          | (23)% |
|   | For the Nine<br>Months Ended<br>September 30,  |           |                     |       |
|   | 2018   | 2017      | Increase/(Decrease) |       |
| Variable patent royalty revenue                   | \$26,322                                       | \$37,338  | \$(11,016)          | (30)% |
| Fixed-fee royalty revenue                         | 178,207  | 220,083   | (41,876)            | (19)% |
| Current patent royalties <sup>a</sup>             | 204,529  | 257,421   | (52,892)            | (21)% |
| Non-current patent royalties <sup>b</sup>         | 25,489   | 56,692    | (31,203)            | (55)% |
| Total patent royalties                            | 230,018  | 314,113   | (84,095)            | (27)% |
| Current technology solutions revenue <sup>a</sup> | 2,060  | 13,521    | (11,461)            | (85)% |
| Total revenue                                     | \$232,078                                      | \$327,634 | \$(95,556)          | (29)% |

a. Recurring revenues consist of current patent royalties, inclusive of Dynamic Fixed-Fee Agreement royalties, and current technology solutions revenue.

Non-current patent royalties for the three and nine months ended September 30, 2018 consist of past patent royalties and royalties from static agreements. For the three and nine months ended September 30, 2017, non-current patent royalties consist of past patent royalties.

During first nine months 2018, we recognized \$54.1 million of revenue that had been included in deferred revenue as of the beginning of the period. Additionally, upon adoption of ASC 606 on January 1, 2018, we had \$24.7 million of contract assets. As of September 30, 2018, we had contract assets of \$22.0 million and \$5.5 million included within accounts receivable and other non-current assets, respectively.

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## Impact of Adoption of ASC 606

In accordance with the new revenue standard requirements, the disclosure of the impact of adoption on our condensed current period consolidated income statement and balance sheet is presented below. We believe this additional information is vital during the transition year to allow readers of our financial statements to compare financial results from the preceding financial year given the absence of restatement of the prior period. The adoption of ASC 606 did not affect our reported total amounts of cash flows from operating, investing and financing activities. Amounts contained in the tables below are in thousands, except per share data.

|  | For the Three Months Ended September |             |           |           |
|--|--------------------------------------|-------------|-----------|-----------|
|  | 30,                                  |             | 2017      |           |
|  | 2018                                 |             | 2017      |           |
|  | As                                   | Adjustment  | ASC 605   | As        |
|  | Reported                             | ASC 606     | Reported  | Reported  |
|  | ASC 606                              |             | (ASC      | 605)      |
| REVENUES:  |                                      |             |           |           |
| Variable patent royalty revenue                  | \$ 13,645                            | \$ (5,242 ) | \$ 8,403  | \$ 10,081 |
| Fixed-fee royalty revenue                        | 60,272                               | 20,309      | 80,581    | 73,653    |
| Current patent royalties                         | 73,917                               | 15,067      | 88,984    | 83,734    |
| Non-current patent royalties                     | 128                                  | —           | 128       | 8,832     |
| Total patent royalties                           | 74,045                               | 15,067      | 89,112    | 92,566    |
| Current technology solutions revenue             | 1,034                                | 1,197       | 2,231     | 4,759     |
|  | \$ 75,079                            | \$ 16,264   | \$ 91,343 | \$ 97,325 |
| OPERATING EXPENSES:                              | 62,159                               | —           | 62,159    | 56,450    |
| Income from operations                           | 12,920                               | 16,264      | 29,184    | 40,875    |
| OTHER EXPENSE (NET)                              | (13,953 )                            | 3,993       | (9,960 )  | (2,187 )  |
| Income before income taxes                       | (1,033 )                             | 20,257      | 19,224    | 38,688    |
| INCOME TAX BENEFIT (EXPENSE)                     | 21,143                               | (6,676 )    | 14,467    | (3,963 )  |
| NET INCOME                                       | \$ 20,110                            | \$ 13,581   | \$ 33,691 | \$ 34,725 |
| Net loss attributable to noncontrolling interest | (1,297 )                             | —           | (1,297 )  | (811 )    |
| NET INCOME ATTRIBUTABLE TO INTERDIGITAL, INC.    | \$ 21,407                            | \$ 13,581   | \$ 34,988 | \$ 35,536 |
| NET INCOME PER COMMON SHARE — BASIC              | \$ 0.62                              | \$ 0.39     | \$ 1.01   | \$ 1.02   |
| NET INCOME PER COMMON SHARE — DILUTED            | \$ 0.60                              | \$ 0.38     | \$ 0.98   | \$ 1.00   |

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|  | For the Nine Months Ended September 30, |            |           | 2017      |
|--|---|------------|-----------|-----------|
|  | 2018                                    |            |           | As        |
|  | As                                      | Adjustment | ASC 605   | Reported  |
|  | Reported                                |            |           | (ASC      |
|  | ASC 606                                 |            |           | 605)      |
| <b>REVENUES:</b>                                 |   |            |           |           |
| Variable patent royalty revenue                  | \$26,322                                | \$ (466 )  | \$25,856  | \$37,338  |
| Fixed-fee royalty revenue                        | 178,207                                 | 60,081     | 238,288   | 220,083   |
| Current patent royalties                         | 204,529                                 | 59,615     | 264,144   | 257,421   |
| Non-current patent royalties                     | 25,489                                  | (10,000 )  | 15,489    | 56,692    |
| Total patent royalties                           | 230,018                                 | 49,615     | 279,633   | 314,113   |
| Current technology solutions revenue             | 2,060                                   | 5,232      | 7,292     | 13,521    |
|  | \$232,078                               | \$ 54,847  | \$286,925 | \$327,634 |
| <b>OPERATING EXPENSES:</b>                       |   |            |           |           |
| Income from operations                           | 173,328                                 | —          | 173,328   | 171,843   |
| OTHER EXPENSE (NET)                              | 58,750                                  | 54,847     | 113,597   | 155,791   |
| Income before income taxes                       | (25,136 )                               | 13,004     | (12,132 ) | (7,331 )  |
| INCOME TAX BENEFIT (EXPENSE)                     | 33,614                                  | 67,851     | 101,465   | 148,460   |
| NET INCOME                                       | 25,001                                  | (15,607 )  | 9,394     | (29,413 ) |
| Net loss attributable to noncontrolling interest | \$58,615                                | \$ 52,244  | \$110,859 | \$119,047 |
| NET INCOME ATTRIBUTABLE TO INTERDIGITAL, INC.    | (3,423 )                                | —          | (3,423 )  | (2,744 )  |
| NET INCOME PER COMMON SHARE — BASIC              | \$62,038                                | \$ 52,244  | \$114,282 | \$121,791 |
| NET INCOME PER COMMON SHARE — DILUTED            | \$1.79                                  | \$ 1.50    | \$3.29    | \$3.52    |
|  | \$1.74                                  | \$ 1.47    | \$3.21    | \$3.40    |

|                          | September 30, 2018 |            |             | December    |
|--------------------------|--------------------|------------|-------------|-------------|
|                          | As                 |            |             | 31, 2017    |
|                          | As                 | Adjustment | ASC 605     | As          |
|                          | Reported           |            |             | Reported    |
|                          | ASC 606            |            |             | (ASC 605)   |
| Accounts Receivable, net | \$29,769           | \$ 206,079 | \$235,848   | \$216,293   |
| Deferred Tax Assets      | 60,056             | 46,098     | 106,154     | 84,582      |
| Other Non-current Assets | 63,877             | (5,500 )   | 58,377      | 37,963      |
| Taxes Payable            | (98,022 )          | (16,438 )  | (114,460 )  | (14,881 )   |
| Deferred Revenue         | (269,662)          | (341,816 ) | (611,478 )  | (616,813 )  |
| Retained Earnings        | (1,436,171)        | 111,577    | (1,324,594) | (1,249,091) |
| Contracted Revenue       |                    |            |             |             |

Based on contracts signed and committed Dynamic Fixed-Fee Agreement payments as of September 30, 2018, we expect to recognize the following amounts of revenue over the term of such contracts (in thousands):

|                | Revenue  |
|----------------|----------|
| Remainder 2018 | \$60,272 |
| 2019           | 237,339  |
| 2020           | 236,089  |
| 2021           | 169,039  |
| 2022           | 85,228   |

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See below for our revised Revenue Recognition accounting policy upon adoption of the new guidance.

### Revenue Recognition

We derive the vast majority of our revenue from patent licensing. The timing and amount of revenue recognized from each licensee 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 include multiple performance obligations. These agreements can include, without limitation, performance obligations related to the settlement of past patent infringement liabilities, patent and/or know-how licensing royalties on covered products sold by licensees, access to a portfolio of technology as it exists at a point in time, and access to a portfolio of technology at a point in time along with a promises to provide any technology updates to the portfolio during the term.

All agreements have been accounted for under ASC 606. This guidance requires the use of a five-step model to achieve the core underlying principle that an entity should recognize revenue to depict the transfer of goods or services to customers at an amount that the entity expects to be entitled to in exchange for those goods or services. These steps include (1) identifying the contract with the customer, (2) identifying the performance obligations, (3) determining the transaction price, (4) allocating the transaction price to the performance obligations, and (5) recognizing revenue as the entity satisfies the performance obligation(s). Additionally, we have elected to utilize certain practical expedients in the application of ASC 606. In evaluating the presence of a significant financing component in our agreements, we utilize the practical expedient to exclude any contracts wherein the gap between payment by our customers and the delivery of our performance obligation is less than one year. We have also elected to utilize the practical expedient related to costs of obtaining a contract where an entity may recognize the incremental costs of obtaining a contract as an expense when incurred if the amortization period of the asset that the entity otherwise would have recognized is one year or less. Timing of revenue recognition may differ significantly from the timing of invoicing to customers. Contract assets are included in accounts receivable and represent unbilled amounts expected to be received from customers in future periods, where the revenue recognized to date (or cumulative adjustments to retained earnings in the initial period of adopting ASC 606) exceeds the amount billed, and right to payment is subject to the underlying contractual terms. Contract assets are classified as long-term assets if the payments are expected to be received more than one year from the reporting date. Contract assets due within less than twelve months of the balance sheet date are included within accounts receivable in our Condensed Consolidated Balance Sheets. Contract assets due more than twelve months after the balance sheet date are included in Other non-current assets.

### Patent License Agreements

Upon signing a patent license agreement, we provide the licensee permission to use our patented inventions in specific applications. We account for patent license agreements in accordance with the guidance indicated above. 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 Past Patent Royalties

Consideration related to a licensee's product sales from prior periods 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. We may also receive consideration for past patent royalties in connection with the settlement of patent litigation where there was no prior patent license agreement. In each of these cases, we record the consideration as revenue as prescribed by the five-step model.

### Fixed-Fee Agreements

Fixed-fee agreements include fixed, non-refundable royalty payments that fulfill the licensee's obligations to us under a patent license agreement for a specified time period or for the term of the agreement for specified products, under certain patents or patent claims, for sales in certain countries, or a combination thereof - in each case for a specified time period (including for the life of the patents licensed under the agreement).

Dynamic fixed-fee license agreements contain a single performance obligation that represents ongoing access to a portfolio of technology over the license term, since our promise to transfer to the licensee access to the portfolio as it



exists at inception of the license, along with promises to provide any technology updates to the portfolio during the term, are not separately identifiable. Upon entering a new agreement, we allocate the transaction price to the performance obligations delivered at signing (e.g. our existing patent portfolio) and future performance obligations (e.g. the technology updates). We use a time-based input method of progress to determine the timing of revenue recognition, and as such we recognize the future deliverables on a straight-line basis over the term of the agreement. We utilize the straight-line method as we believe that it best depicts efforts expended to develop and transfer updates to the customer evenly throughout the term of the agreement.

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Static fixed-fee license agreements are fixed-price contracts that generally do not include updates to technology we create after the inception of the license agreement or in which the customer does not stand to substantively benefit from those updates during the term. Generally, our performance obligations are satisfied at contract signing, and as such revenue is recognized at that time.

### Variable Agreements

Upon entering a new variable patent license agreement, the licensee typically agrees to pay royalties or license fees on licensed products sold during the term of the agreement. We utilize the sales- or usage- based royalty exception for these agreements and recognize revenues during the contract term when the underlying sale or usage occurs. Our licensees under variable agreements provide us with quarterly 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. As a result, we are required to estimate revenues, subject to the constraint on our ability to estimate such amounts.

### Technology Solutions

Technology solutions revenue consists primarily of revenue from royalty payments. We recognize revenue from royalty payments using the same methods described above under our policy for recognizing revenue from patent license agreements. Technology solutions revenues also consist of revenues from software licenses, engineering services and product sales. The nature of these contracts and timing of payments vary.

### Patent Sales

Our business strategy of monetizing our intellectual property includes the sale of select patent assets. As patent sales executed under this strategy represent a component of our ongoing major or central operations and activities, we will record the related proceeds as revenue. We will recognize the revenue in accordance with the five-step model, generally upon closing of the patent sale transaction.

### Accounting Standards Update: Leases

In February 2016, the FASB issued new guidance related to leases that outlines a comprehensive lease accounting model and supersedes the current lease guidance. The new guidance requires lessees to recognize lease liabilities and corresponding right-of-use assets for all leases with lease terms of greater than 12 months. It also changes the definition of a lease and expands the disclosure requirements of lease arrangements. The new guidance must be adopted using the modified retrospective approach and will be effective for the Company starting in first quarter 2019. Early adoption is permitted. We are in the process of determining the effect the adoption will have on the Company's consolidated financial statements.

### Accounting Standards Update: Financial Instruments

In January 2016, the FASB issued ASU No. 2016-01, "Financial Instruments (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities," which amends certain measurement, presentation, and disclosure requirements for financial instruments. The new guidance must be adopted by means of a cumulative-effect adjustment to the balance sheet in the year of adoption and became effective for the Company starting in first quarter 2018. We adopted this guidance in first quarter 2018, and it did not have a material effect on the Company's consolidated financial results. In conjunction with this adoption, we made an accounting policy election for a measurement alternative for equity investments that do not have readily determinable fair values, specifically related to our strategic investments in other entities. Under the alternative, our strategic investments in other entities without readily determinable fair values are measured at cost, less any impairment, plus or minus changes resulting from observable price changes in orderly transactions for an identical or similar investment of the same issuer, if any. As of September 30, 2018 and December 31, 2017, strategic investments in other entities totaled \$17.4 million and \$19.2 million, respectively.

### Accounting Standards Update: Reclassification of Certain Tax Effects from Accumulated Other Comprehensive Income

In February 2018, the FASB issued ASU No. 2018-02, "Reporting Comprehensive Income (Topic 220): Reclassification of Certain Tax Effects from Accumulated Other Comprehensive Income," which allow a reclassification from accumulated other comprehensive income to retained earnings for stranded tax effects resulting from the Tax Cuts and Jobs Act of 2017 (the "Tax Reform Act"). The guidance is effective for fiscal years beginning

after December 15, 2018, and early adoption is permitted. We early adopted this guidance in first quarter 2018, and reflected a \$0.4 million adjustment to retained earnings during the period.

Accounting Standards Update: Improvements to Nonemployee Share-Based Payment Accounting

In June 2018, the FASB issued ASU No. 2018-07, "Stock Compensation (Topic 718): Improvements to Nonemployee Share-Based Payment Accounting," which is intended to reduce cost and complexity and to improve financial reporting for

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share-based payments issued to nonemployees. The guidance is effective for fiscal years beginning after December 15, 2018 and early adoption is permitted. We do not expect the adoption of this guidance to have a material effect on the Company's consolidated financial statements.

**2. INCOME TAXES**

In first nine months 2018, based on the statutory federal tax rate net of discrete federal and state taxes, our effective tax rate was a benefit of 74.4%. The effective tax rate for first nine months 2018 was favorably impacted by provisions contained within the Tax Reform Act, discussed below. We recorded discrete net benefits of \$18.4 million from excess tax benefits related to share-based compensation, our sale of a commercial initiative and a benefit from the anticipated filing by the Company of amended tax returns in connection with the Competent Authority Proceeding (as defined and discussed below). The effective rate would have been a benefit of 19.7% not including these discrete net benefits. This is compared to an effective tax rate provision of 19.8% based on the statutory federal tax rate net of discrete federal and state taxes during first nine months 2017. The effective tax rate for first nine months 2017 included a \$12.1 million discrete benefit, primarily related to excess tax benefits from share-based compensation, and a \$9.1 million discrete benefit, primarily related to the reversal of uncertain tax positions associated with domestic production activities refund claims. The effective tax rate would have been a provision of 34.2% not including these discrete benefits for first nine months 2017.

During first nine months 2018 and 2017, we paid approximately \$16.5 million and \$11.7 million, respectively, of foreign source withholding tax. Additionally, as of September 30, 2018 and December 31, 2017, we have included \$0.6 million and \$14.9 million, respectively, of foreign source withholding tax within our taxes payable and deferred tax asset balances. These amounts are related to receivables from foreign licensees.

On December 22, 2017, the Tax Reform Act was signed into law. The Tax Reform Act significantly revised the U.S. corporate income tax regime by, among other things: lowering the U.S. corporate tax rate from 35% to 21% effective January 1, 2018; imposing a 13.125% tax rate on income that qualifies as Foreign Derived Intangible Income ("FDII"); repealing the deduction for domestic production activities; implementing a territorial tax system; and imposing a repatriation tax on deemed repatriated earnings of foreign subsidiaries. The first nine months 2018 effective tax rate includes a forecasted \$16.8 million net benefit related to our income qualifying as FDII. As a result of the Tax Reform Act, we recorded a tax charge of approximately \$43.3 million in 2017 due to a re-measurement of deferred tax assets and liabilities, and we do not expect a material repatriation tax liability to be owed. We will continue to monitor as additional guidance is released. The tax charge represents provisional amounts and the Company's current best estimates. Any adjustments recorded to the provisional amounts through fourth quarter 2018 will be included in net income as an adjustment to tax expense. The provisional amounts incorporate assumptions made based upon our current interpretation of the Tax Reform Act and may change as the Company receives additional clarification and implementation guidance.

The effective tax rate reported in any given year will continue to be influenced by a variety of factors, including timing differences between the recognition of book and tax revenue, the level of pre-tax income or loss, the foreign vs. domestic classification of the Company's customers, and any discrete items that may occur. The Company further notes that its tax positions could be altered by pending IRS regulations that could clarify certain provisions of the Tax Reform Act.

As previously disclosed in our 2017 Form 10-K, we have paid foreign taxes, including to those foreign governments that have tax treaties with the U.S., for which we have claimed foreign tax credits against our U.S. tax obligations. On July 24, 2018, the Company received notification that its request for competent authority pertaining to Article 27 (Mutual Agreement

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Procedure) of the United States-Republic of Korea Income Tax Convention had been reviewed by the Internal Revenue Service and an agreement had been reached (the "Competent Authority Proceeding"). As a result of this agreement, we expect to receive a total refund of approximately \$97.4 million, inclusive of interest, a portion of which we have already received. We have recorded in taxes payable as of September 30, 2018 an amount corresponding to the expected total refund. In addition, we have recorded a net tax benefit of \$15.7 million in our third quarter 2018 results related to an anticipated refund the Company expects to receive as a result of amending tax returns for tax years covered by this agreement.

## 3. NET INCOME PER SHARE

Basic Earnings Per Share ("EPS") is calculated by dividing net 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 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 per share computation (in thousands, except for per share data):

|   | For the Three Months Ended          |          |           |           |
|---|-------------------------------------|----------|-----------|-----------|
|   | September 30,                       |          | 2017      |           |
|   | 2018                                | Diluted  | Basic     | Diluted   |
| Numerator:  |                                     |          |           |           |
| Net income applicable to InterDigital, Inc.                                 | \$21,407                            | \$21,407 | \$35,536  | \$35,536  |
| Denominator:  |                                     |          |           |           |
| Weighted-average shares outstanding: Basic                                  | 34,651                              | 34,651   | 34,709    | 34,709    |
| Dilutive effect of stock options, RSUs, convertible securities and warrants |                                     | 956      |           | 679       |
| Weighted-average shares outstanding: Diluted                                |                                     | 35,607   |           | 35,388    |
| Earnings Per Share:   |                                     |          |           |           |
| Net income: Basic   | \$0.62                              | \$0.62   | \$1.02    | \$1.02    |
| Dilutive effect of stock options, RSUs, convertible securities and warrants |                                     | (0.02 )  |           | (0.02 )   |
| Net income: Diluted   |                                     | \$0.60   |           | \$1.00    |
|   | For the Nine Months Ended September |          |           |           |
|   | 30,                                 |          | 2017      |           |
|   | 2018                                | Diluted  | Basic     | Diluted   |
| Numerator:  |                                     |          |           |           |
| Net income applicable to InterDigital, Inc.                                 | \$62,038                            | \$62,038 | \$121,791 | \$121,791 |
| Denominator:  |                                     |          |           |           |
| Weighted-average shares outstanding: Basic                                  | 34,687                              | 34,687   | 34,589    | 34,589    |
| Dilutive effect of stock options, RSUs, convertible securities and warrants |                                     | 927      |           | 1,276     |
| Weighted-average shares outstanding: Diluted                                |                                     | 35,614   |           | 35,865    |
| Earnings Per Share:   |                                     |          |           |           |
| Net income: Basic   | \$1.79                              | \$1.79   | \$3.52    | \$3.52    |
| Dilutive effect of stock options, RSUs, convertible securities and warrants |                                     | (0.05 )  |           | (0.12 )   |
| Net income: Diluted   |                                     | \$1.74   |           | \$3.40    |

Certain shares of common stock issuable upon the exercise or conversion of certain securities have been excluded from our computation of EPS because the strike price or conversion rate, as applicable, of such securities was greater than the average market price of our common stock and, as a result, the effect of such exercise or conversion would have been anti-dilutive. Set forth below are the securities and the weighted average number of shares of common stock underlying such securities that were excluded from our computation of EPS for the periods presented (in thousands):



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|  | For the<br>Three<br>Months<br>Ended<br>September<br>30,<br>2018 |       | For the Nine<br>Months<br>Ended<br>September<br>30,<br>2017 |    |
|--|---|-------|---|----|
| Restricted stock units and stock options | 78  | 25    | 44  | 18 |
| Convertible securities                   | —   | —     | —   | —  |
| Warrants                                 | 4,405   | 4,386 | 4,404   | —  |
| Total                                    | 4,483   | 4,411 | 4,448   | 18 |

## Convertible Notes

During periods in which the average market price of the Company's common stock is above the applicable conversion price of the Company's 1.50% Senior Convertible Notes due 2020 (for purposes of this discussion, the "Convertible Notes") (\$71.74 per share as of September 30, 2018) or above the strike price of our outstanding warrants (\$87.68 per share as of September 30, 2018), the impact of conversion or exercise, as applicable, would be dilutive and such dilutive effect is reflected in diluted EPS. As a result, in periods where the average market price of the Company's common stock is above the conversion price or strike price, as applicable, under the treasury stock method, the Company calculates the number of shares issuable under the terms of the Convertible Notes and the warrants based on the average market price of the stock during the period, and includes that number in the total diluted shares outstanding for the period. See Note 7, "Long-Term Debt," for additional information about the Convertible Notes and warrants.

## 4. LITIGATION AND LEGAL PROCEEDINGS

## ARBITRATIONS AND COURT PROCEEDINGS (OTHER THAN DE DISTRICT COURT ACTIONS RELATED TO USITC PROCEEDINGS)

## Huawei China Proceedings

On February 21, 2012, InterDigital was served with two complaints filed by Huawei Technologies Co., Ltd. in the Shenzhen Intermediate People's Court in China on December 5, 2011. The first complaint named as defendants InterDigital, Inc. and its wholly owned subsidiaries InterDigital Technology Corporation and InterDigital Communications, LLC (now InterDigital Communications, Inc.), and alleged that InterDigital had abused its dominant market position in the market for the licensing of essential patents owned by InterDigital by engaging in allegedly unlawful practices, including differentiated pricing, tying and refusal to deal. The second complaint named as defendants the Company's wholly owned subsidiaries InterDigital Technology Corporation, InterDigital Communications, LLC (now InterDigital Communications, Inc.), InterDigital Patent Holdings, Inc. and IPR Licensing, Inc. and alleged that InterDigital had failed to negotiate on FRAND terms with Huawei. Huawei asked the court to determine the FRAND rate for licensing essential Chinese patents to Huawei and also sought compensation for its costs associated with this matter.

On February 4, 2013, the Shenzhen Intermediate People's Court issued rulings in the two proceedings. With respect to the first complaint, the court decided that InterDigital had violated the Chinese Anti-Monopoly Law by (i) making proposals for royalties from Huawei that the court believed were excessive, (ii) tying the licensing of essential patents to the licensing of non-essential patents, (iii) requesting as part of its licensing proposals that Huawei provide a grant-back of certain patent rights to InterDigital and (iv) commencing a USITC action against Huawei while still in discussions with Huawei for a license. Based on these findings, the court ordered InterDigital to cease the alleged excessive pricing and alleged improper bundling of InterDigital's Chinese essential and non-essential patents, and to pay Huawei 20.0 million RMB (approximately \$3.2 million) in damages related to attorneys' fees and other charges, without disclosing a factual basis for its determination of damages. The court dismissed Huawei's remaining allegations, including Huawei's claim that InterDigital improperly sought a worldwide license and improperly sought to bundle the licensing of essential patents on multiple generations of technologies. With respect to the second complaint, the court determined that, despite the fact that the FRAND requirement originates from ETSI's Intellectual

Property Rights policy, which refers to French law, InterDigital's license offers to Huawei should be evaluated under Chinese law. Under Chinese law, the court concluded that the offers did not comply with FRAND. The court further ruled that the royalties to be paid by Huawei for InterDigital's 2G, 3G and 4G essential Chinese patents under Chinese law should not exceed 0.019% of the actual sales price of each Huawei product.

On March 11, 2013, InterDigital filed notices of appeal with respect to the judgments in both proceedings, seeking reversal of the court's February 4, 2013 rulings. On October 16, 2013, the Guangdong Province High Court issued a ruling affirming the ruling of the Shenzhen Intermediate People's Court in the second proceeding, and on October 21, 2013, issued a ruling affirming the ruling of the Shenzhen Intermediate People's Court in the first proceeding.



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InterDigital believes that the decisions are seriously flawed both legally and factually. For instance, in determining a purported FRAND rate, the Chinese courts applied an incorrect economic analysis by evaluating InterDigital's lump-sum 2007 patent license agreement with Apple (the "2007 Apple PLA") in hindsight to posit a running royalty rate. Indeed, the ALJ in USITC Inv. No. 337-TA-800 rejected that type of improper analysis. Moreover, the Chinese courts had an incomplete record and applied incorrect facts, including with respect to the now-expired and superseded 2007 Apple PLA, which had been found in an arbitration between InterDigital and Apple to be limited in scope.

On April 14, 2014, InterDigital filed a petition for retrial of the second proceeding with the Chinese Supreme People's Court ("SPC"), seeking dismissal of the judgment or at least a higher, market-based royalty rate for a license to InterDigital's Chinese standards-essential patents ("SEPs"). The petition for retrial argues, for example, that (1) the lower court improperly determined a Chinese FRAND running royalty rate by using as a benchmark the 2007 Apple lump sum fixed payment license agreement, and looking in hindsight at the unexpectedly successful sales of Apple iPhones to construct an artificial running royalty rate that neither InterDigital nor Apple could have intended and that would have varied significantly depending on the relative success or failure in hindsight of Apple iPhone sales; (2) the 2007 Apple PLA was also an inappropriate benchmark because its scope of product coverage was significantly limited as compared to the license that the court was considering for Huawei, particularly when there are other more comparable license agreements; and (3) if the appropriate benchmarks had been used, and the court had considered the range of royalties offered by other similarly situated SEP holders in the wireless telecommunications industry, the court would have determined a FRAND royalty that was substantially higher than 0.019%, and would have found, consistent with findings of the ALJ's initial determination in the USITC 337-TA-800 proceeding, that there was no proof that InterDigital's offers to Huawei violated its FRAND commitments.

The SPC held a hearing on October 31, 2014, regarding whether to grant a retrial and requested that both parties provide additional information regarding the facts and legal theories underlying the case. The SPC convened a second hearing on April 1, 2015 regarding whether to grant a retrial. If the retrial is granted, the SPC will likely schedule one or more additional hearings before it issues a decision on the merits of the case. The SPC retrial proceeding was excluded from the dismissal provisions of the August 2016 patent license agreement between Huawei and InterDigital, and a decision in this proceeding is still pending.

### ZTE China Proceedings

On July 10 and 11, 2014, InterDigital was served with two complaints filed by ZTE Corporation in the Shenzhen Intermediate People's Court in China on April 3, 2014. The first complaint names as defendants the Company's wholly owned subsidiaries InterDigital Technology Corporation, InterDigital Communications, Inc., InterDigital Patent Holdings, Inc. and IPR Licensing, Inc. This complaint alleges that InterDigital has failed to comply with its FRAND obligations for the licensing of its Chinese standards-essential patents. ZTE is asking the court to determine the FRAND rate for licensing InterDigital's standards-essential Chinese patents to ZTE and also seeks compensation for its litigation costs associated with this matter. The second complaint names as defendants InterDigital, Inc. and its wholly owned subsidiaries InterDigital Technology Corporation and InterDigital Communications, Inc. This complaint alleges that InterDigital has a dominant market position in China and the United States in the market for the licensing of essential patents owned by InterDigital, and abused its dominant market position in violation of the Chinese Anti-Monopoly Law by engaging in allegedly unlawful practices, including excessively high pricing, tying, discriminatory treatment, and imposing unreasonable trading conditions. ZTE originally sought relief in the amount of 20.0 million RMB (approximately \$2.9 million based on the exchange rate as of September 30, 2018), an order requiring InterDigital to cease the allegedly unlawful conduct and compensation for its litigation costs associated with this matter.

On August 7, 2014, InterDigital filed petitions challenging the jurisdiction of the Shenzhen Intermediate People's Court to hear the actions. On August 28, 2014, the court denied InterDigital's jurisdictional challenge with respect to the anti-monopoly law case. InterDigital filed an appeal of this decision on September 26, 2014. On September 28, 2014, the court denied InterDigital's jurisdictional challenge with respect to the FRAND case, and InterDigital filed an appeal of that decision on October 27, 2014. On December 18, 2014, the Guangdong High Court issued decisions on both appeals upholding the Shenzhen Intermediate Court's decisions that it had jurisdiction to hear these cases. On February 10, 2015, InterDigital filed a petition for retrial with the Supreme People's Court regarding its jurisdictional

challenges to both cases.

The Shenzhen Court held hearings on the anti-monopoly law case on May 11, 13, 15 and 18, 2015. At the May hearings, ZTE withdrew its claims alleging discriminatory treatment and the imposition of unfair trading conditions and increased its damages claim to 99.8 million RMB (approximately \$14.5 million based on the exchange rate as of September 30, 2018). The Shenzhen Court held hearings in the FRAND case on July 29-31, 2015 and held a second hearing on the anti-monopoly law case on October 12, 2015.

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On September 18, 2018, ZTE independently filed a petition with the Shenzhen Court to withdraw the complaint in its FRAND case against InterDigital, and on September 28, 2018, the Shenzhen Court granted ZTE's petition and dismissed the FRAND case without prejudice. On October 25, 2018, ZTE independently filed a petition with the Shenzhen Court to withdraw the complaint in its anti-monopoly law case against InterDigital, and on October 26, 2018, the Shenzhen Court granted ZTE's petition and dismissed the anti-monopoly law case without prejudice.

**Asustek Actions**

On April 15, 2015, Asustek Computer Incorporated ("Asus") filed a complaint in the CA Northern District Court against InterDigital, Inc., and its subsidiaries InterDigital Communications, Inc., InterDigital Technology Corporation, IPR Licensing, Inc., and InterDigital Patent Holdings, Inc. The complaint asserted the following causes of action: violation of Section Two of the Sherman Act, violation of Section 17200 of the California Business and Professions Code, breach of contract resulting from ongoing negotiations, breach of contract leading to and resulting in the parties' April 2008 patent license agreement (the "2008 Asus PLA"), promissory estoppel, waiver, and fraudulent inducement to contract. Among other allegations, Asus alleged that InterDigital breached its FRAND commitment. As relief, Asus sought a judgment that the 2008 Asus PLA is void or unenforceable, damages in the amount of excess royalties Asus paid under the 2008 Asus PLA plus interest, a judgment setting the proper FRAND terms and conditions for InterDigital's patent portfolio, an order requiring InterDigital to grant Asus a license on FRAND terms and conditions, and punitive damages and other relief.

In response, on May 30, 2015, InterDigital filed an Arbitration Demand with the ICDR. InterDigital claimed that Asus breached the 2008 Asus PLA's dispute resolution provision by filing its CA Northern District Court lawsuit and sought declaratory relief that it is not liable for any of the claims in Asus's complaint. On June 2, 2015, InterDigital filed in the CA Northern District Court a motion to compel arbitration on each of Asus's claims. On August 25, 2015, the court granted InterDigital's motion for all of Asus's claims except its claim for breach of contract resulting from ongoing negotiations. Aside from this claim, the court ruled that the issue of arbitrability should be decided by an arbitrator, and stayed the proceedings pending that determination.

Asus asserted counterclaims in the arbitration that mirrored its CA Northern District Court claims, except that it did not assert the breach of contract claim that the court determined was not arbitrable and it added a claim of violation of the Delaware Consumer Fraud Act. Asus also contended that its counterclaims were not arbitrable. InterDigital added a claim for breach of the 2008 Asus PLA's confidentiality provision.

On July 14, 2016, Asus filed a motion to lift the stay in the CA Northern District Court proceeding along with a notice of the arbitral tribunal's decision on arbitrability, informing the court of the arbitrators' decision that, other than InterDigital's breach of contract claims and Asus's fraudulent inducement claim, no other claim or counterclaim is arbitrable. Asus then filed in the CA Northern District Court an amended complaint on August 18, 2016. This amended complaint includes all of the claims in Asus's first CA Northern District Court complaint except fraudulent inducement and adds a claim of violation of the Delaware Consumer Fraud Act. It seeks the same relief as its first CA Northern District Court complaint, but also seeks a ruling that each of InterDigital's patents "declared [to standards-setting organizations] to be essential or potentially essential" is unenforceable and any contracts InterDigital entered into in furtherance of its unlawful conduct are void. On September 8, 2016, InterDigital filed its answer and counterclaims to Asus's amended complaint. It denied Asus's claims and filed a counterclaim for declaratory judgment that Asus's tort claims are invalid or preempted as applied under the First Amendment to the U.S. Constitution, the Patent Clause of the U.S. Constitution, and Title 35 of the U.S. Code. On September 28, 2016, Asus answered and denied InterDigital's counterclaims. On December 16, 2016, the court set a case schedule that includes a May 2019 trial date.

With respect to its arbitration counterclaim for fraudulent inducement, Asus stated in its pleadings that it was seeking return of excess royalties (which totaled close to \$63 million as of the August 2016 date referenced in the pleadings and had increased with additional royalty payments made by Asus since such time), plus interest, costs and attorneys' fees. The evidentiary hearing in the arbitration was held in January 2017, and the parties presented oral closing arguments on March 22, 2017. On August 2, 2017, the arbitral tribunal issued its Final Award. The tribunal fully rejected Asus's counterclaim, finding that InterDigital did not fraudulently induce Asus to enter into the 2008 Asus PLA. Accordingly, the tribunal dismissed Asus's fraudulent inducement counterclaim in its entirety. The tribunal also

dismissed InterDigital's claims that Asus breached the confidentiality provisions and the dispute resolution provisions of the 2008 Asus PLA. On October 20, 2017, InterDigital and Asus jointly moved to confirm both the tribunal's Final Award and the Interim Award on Jurisdiction in the CA Northern District. The court confirmed both awards on October 25, 2017.

On April 16, 2018, InterDigital filed a motion in the CA Northern District Court proceeding for leave to amend its counterclaims to include a claim of intentional interference with contract. On June 12, 2018, the court denied this motion.

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On April 17, 2018, the parties served opening expert reports in the CA Northern District Court proceeding. Asus's damages expert contends that Asus is currently owed damages in the amount of \$75.9 million based on its claims that InterDigital charged royalties inconsistent with its FRAND commitments. Those damages, which represent a substantial portion of the royalties paid by Asus through third quarter 2017, do not reflect Asus's most recent royalty payments. Asus also seeks interest, costs and attorneys' fees, as well as, in connection with its Sherman Act claim, treble damages.

On August 16, 2018, the parties filed motions for summary judgment. InterDigital contends that (1) Asus is judicially estopped from arguing that the 2008 Asus PLA is "non-FRAND" due to Asus's prior inconsistent positions; (2) issue preclusion prevents Asus from re-litigating issues decided in the arbitration; (3) as a matter of law, Asus cannot void the binding and enforceable 2008 Asus PLA; and (4) Asus's Sherman Act, promissory estoppel, and California UCL claims fail as a matter of law. For its part, Asus contends that, as a matter of law, InterDigital breached its contractual obligation to license its essential patents on FRAND terms and conditions by engaging in discriminatory licensing practices. The parties filed oppositions on September 13, 2018 and replies on September 27, 2018, and the court held an oral argument on October 11, 2018. These motions remain pending.

The Company has not recorded any accrual at September 30, 2018, for contingent losses associated with the CA Northern District Court Proceeding. While a material loss is reasonably possible, the Company cannot estimate the potential range of loss given the range of possible outcomes, as this matter is not at a sufficiently advanced stage to allow for such an estimate.

### REGULATORY PROCEEDINGS

Investigation by National Development and Reform Commission of China

On September 23, 2013, counsel for InterDigital was informed by China's National Development and Reform Commission ("NDRC") that the NDRC had initiated a formal investigation into whether InterDigital has violated China's Anti-Monopoly Law ("AML") with respect to practices related to the licensing of InterDigital's standards-essential patents to Chinese companies. Companies found to violate the AML may be subject to a cease and desist order, fines and disgorgement of any illegal gains. On March 3, 2014, the Company submitted to NDRC, pursuant to a procedure set out in the AML, a formal application for suspension of the investigation that included proposed commitments by the Company. On May 22, 2014, NDRC formally suspended its investigation of the Company based on the commitments proposed by the Company. The Company's commitments with respect to the licensing of its patent portfolio for wireless mobile standards to Chinese manufacturers of cellular terminal units ("Chinese Manufacturers") are as follows:

1. Whenever InterDigital engages with a Chinese Manufacturer to license InterDigital's patent portfolio for 2G, 3G and 4G wireless mobile standards, InterDigital will offer such Chinese Manufacturer the option of taking a worldwide portfolio license of only its standards-essential wireless patents, and comply with F/RAND principles when negotiating and entering into such licensing agreements with Chinese Manufacturers.
2. As part of its licensing offer, InterDigital will not require that a Chinese Manufacturer agree to a royalty-free, reciprocal cross-license of such Chinese Manufacturer's similarly categorized standards-essential wireless patents. Prior to commencing any action against a Chinese Manufacturer in which InterDigital may seek exclusionary or injunctive relief for the infringement of any of its wireless standards-essential patents, InterDigital will offer such Chinese Manufacturer the option to enter into expedited binding arbitration under fair and reasonable procedures to resolve the royalty rate and other terms of a worldwide license under InterDigital's wireless standards-essential patents.
3. If the Chinese Manufacturer accepts InterDigital's binding arbitration offer or otherwise enters into an agreement with InterDigital on a binding arbitration mechanism, InterDigital will, in accordance with the terms of the arbitration agreement and patent license agreement, refrain from seeking exclusionary or injunctive relief against such company.

The commitments contained in item 3 above will expire five years from the effective date of the suspension of the investigation, or May 22, 2019.

### USITC PROCEEDINGS AND RELATED DELAWARE DISTRICT COURT PROCEEDINGS

2013 USITC Proceeding (337-TA-868) and Related ZTE Delaware District Court Proceeding

USITC Proceeding (337-TA-868)



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On January 2, 2013, the Company's wholly owned subsidiaries InterDigital Communications, Inc., InterDigital Technology Corporation, IPR Licensing, Inc. and InterDigital Holdings, Inc. filed a complaint with the United States International Trade Commission (the "USITC" or "Commission") against Samsung Electronics Co., Ltd., Samsung Electronics America, Inc. and Samsung Telecommunications America, LLC, Nokia Corporation and Nokia Inc., Huawei Technologies Co., Ltd., Huawei Device USA, Inc. and FutureWei Technologies, Inc. d/b/a Huawei Technologies (USA) and ZTE Corporation and ZTE (USA) Inc. (collectively, the "337-TA-868 Respondents"), alleging violations of Section 337 of the Tariff Act of 1930 in that they engaged in unfair trade practices by selling for importation into the United States, importing into the United States and/or selling after importation into the United States certain 3G and 4G wireless devices (including WCDMA-, cdma2000- and LTE-capable mobile phones, USB sticks, mobile hotspots, laptop computers and tablets and components of such devices) that infringe one or more of up to seven of InterDigital's U.S. patents. The complaint also extended to certain WCDMA and cdma2000 devices incorporating Wi-Fi functionality. InterDigital's complaint with the USITC sought an exclusion order that would bar from entry into the United States infringing 3G or 4G wireless devices (and components), including LTE devices, that are imported by or on behalf of the 337-TA-868 Respondents, and also sought a cease-and-desist order to bar further sales of infringing products that have already been imported into the United States. Certain of the asserted patents were also asserted against Nokia, Huawei and ZTE in earlier pending USITC proceedings (including the Nokia, Huawei and ZTE 2011 USITC Proceeding (337-TA-800) and the Nokia 2007 USITC Proceeding (337-TA-613), as set forth below) and therefore were not asserted against those 337-TA-868 Respondents in this investigation. On December 23, 2013, InterDigital and Huawei reached a settlement agreement to enter into binding arbitration to resolve their global patent licensing disputes. Pursuant to the settlement agreement, InterDigital and Huawei moved to dismiss all litigation matters pending between the parties except the action filed by Huawei in China to set a fair, reasonable and non-discriminatory ("FRAND") rate for the licensing of InterDigital's Chinese standards-essential patents (discussed above under "Huawei China Proceedings"), the decision in which InterDigital is permitted to further appeal. As a result, effective February 12, 2014, the Huawei Respondents were terminated from the 337-TA-868 investigation.

From February 10 to February 20, 2014, ALJ Essex presided over the evidentiary hearing in this investigation. The patents in issue in this investigation as of the hearing were U.S. Patent Nos. 7,190,966 (the "'966 patent") and 7,286,847 (the "'847 patent") asserted against ZTE and Samsung, and U.S. Patent No. 7,941,151 (the "'151 patent") asserted against ZTE, Samsung and Nokia.

On June 3, 2014, InterDigital and Samsung filed a joint motion to terminate the investigation as to Samsung on the basis of settlement. The ALJ granted the joint motion by initial determination issued on June 9, 2014, and the USITC determined not to review the initial determination on June 30, 2014.

On June 13, 2014, the ALJ issued an Initial Determination ("ID") in the 337-TA-868 investigation. In the ID, the ALJ found that no violation of Section 337 had occurred in connection with the importation of 3G/4G devices by ZTE or Nokia, on the basis that the accused devices do not infringe asserted claims 1-6, 8-9, 16-21 or 23-24 of the '151 patent, claims 1, 3, 6, 8, 9, or 11 of the '966 patent, or claims 3 or 5 of the '847 patent. The ALJ also found that claim 16 of the '151 patent was invalid as indefinite. Among other determinations, the ALJ further determined that InterDigital did not violate any FRAND obligations, a conclusion also reached by the ALJ in the 337-TA-800 investigation, and that Respondents have engaged in patent "hold out."

On June 30, 2014, InterDigital filed a Petition for Review with the USITC seeking review and reversal of certain of the ALJ's conclusions in the ID. On the same day, Respondents filed a Conditional Petition for Review urging alternative grounds for affirmance of the ID's finding that Section 337 was not violated and a Conditional Petition for Review with respect to FRAND issues.

In June 2014, Microsoft Mobile Oy ("MMO") was added as a respondent in the investigation.

On August 14, 2014, the Commission determined to review in part the June 13, 2014 ID but terminated the investigation with a finding of no violation.

On October 10, 2014, InterDigital filed a petition for review with the U.S. Court of Appeals for the Federal Circuit (the "Federal Circuit"), appealing certain of the adverse determinations in the Commission's August 8, 2014 final determination including those related to the '966 and '847 patents. On June 2, 2015, InterDigital moved to voluntarily

dismiss the Federal Circuit appeal, because, even if it were to prevail, it did not believe there would be sufficient time following the court's decision and mandate for the USITC to complete its proceedings on remand such that the accused products would be excluded before the '966 and '847 patents expire in June 2016. The court granted the motion and dismissed the appeal on June 18, 2015.

Related Delaware District Court Proceeding



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On January 2, 2013, the Company's wholly owned subsidiaries InterDigital Communications, Inc., InterDigital Technology Corporation, IPR Licensing, Inc. and InterDigital Holdings, Inc. filed four related district court actions in the Delaware District Court against the 337-TA-868 Respondents. The proceedings against Huawei, Samsung and Nokia were subsequently dismissed, as discussed below. The remaining complaint alleges that ZTE infringes the same patents with respect to the same products alleged in the complaint filed by InterDigital in USITC Proceeding (337-TA-868). The complaint seeks a permanent injunction and compensatory damages in an amount to be determined, as well as enhanced damages based on willful infringement, and recovery of reasonable attorneys' fees and costs.

On January 31, 2013, ZTE filed its answer and counterclaims to InterDigital's Delaware District Court complaint; ZTE asserted counterclaims for breach of contract, equitable estoppel, waiver of right to enjoin and declarations that InterDigital has not offered ZTE licenses on FRAND terms, declarations seeking the determination of FRAND terms and declarations of noninfringement, invalidity and unenforceability. In addition to the declaratory relief specified in its counterclaims, ZTE seeks specific performance of InterDigital's purported contracts with ZTE and standards-setting organizations, appropriate damages in an amount to be determined at trial, reasonable attorneys' fees and such other relief as the court may deem appropriate.

On March 21, 2013, pursuant to stipulation, the Delaware District Court granted InterDigital leave to file an amended complaint against ZTE to assert allegations of infringement of the '244 patent. On March 22, 2013, ZTE filed its answer and counterclaims to InterDigital's amended Delaware District Court complaint. On April 9, 2013, InterDigital filed a motion to dismiss ZTE's counterclaims relating to its FRAND allegations. On July 12, 2013, the Delaware District Court held a hearing on InterDigital's motion to dismiss. By order issued the same day, the Delaware District Court granted InterDigital's motion, dismissing ZTE's counterclaims for equitable estoppel and waiver of the right to injunction or exclusionary relief with prejudice. It further dismissed the counterclaims for breach of contract and declaratory relief related to InterDigital's FRAND commitments with leave to amend.

On August 6, 2013, ZTE filed its answer and amended counterclaims for breach of contract and for declaratory judgment seeking determination of FRAND terms. The counterclaims also continue to seek declarations of noninfringement, invalidity, and unenforceability. On August 30, 2013, InterDigital filed a motion to dismiss the declaratory judgment counterclaim relating to the request for determination of FRAND terms. On May 28, 2014, the court granted InterDigital's motion and dismissed ZTE's FRAND-related declaratory judgment counterclaim, ruling that such declaratory judgment would serve no useful purpose.

On December 30, 2013, InterDigital and Huawei filed a stipulation of dismissal on account of the confidential settlement agreement and agreement to arbitrate their disputes in this action. On the same day, the Delaware District Court granted the stipulation of dismissal and dismissed the action against Huawei.

On February 11, 2014, the Delaware District Court judge entered an InterDigital, Nokia, and ZTE stipulated Amended Scheduling Order that bifurcated issues relating to damages, FRAND-related affirmative defenses, and any FRAND-related counterclaims.

On August 28, 2014, the court granted in part a motion by InterDigital for summary judgment that the asserted '151 patent is not unenforceable by reason of inequitable conduct, holding that only one of the references forming the basis of defendants' allegations would remain in issue, and granted a motion by InterDigital for summary judgment that the asserted claims of the '966 and '847 patents are not invalid for lack of enablement.

On August 5, 2014, InterDigital and Samsung filed a stipulation of dismissal in light of the parties' settlement agreement. On the same day, the court granted the stipulation of dismissal and dismissed the action against Samsung with prejudice.

By order dated August 28, 2014, MMO was joined in the case against Nokia as a defendant.

The ZTE trial addressing infringement and validity of the '966, '847, '244 and '151 patents was held from October 20 to October 27, 2014. During the trial, the judge determined that further construction of certain claim language of the '151 patent was required, and the judge decided to hold another trial as to ZTE's infringement of the '151 patent at a later date. On October 28, 2014, the jury returned a unanimous verdict in favor of InterDigital, finding that the '966, '847 and '244 patents are all valid and infringed by ZTE 3G and 4G cellular devices. The court issued formal judgment to this effect on October 29, 2014.

On November 26, 2014, ZTE filed a motion for judgment as a matter of law that the asserted claims of the '966, '847 and '244 patents are not infringed and, in the alternative, for a new trial. InterDigital filed an opposition on December 15, 2014, and ZTE filed a reply on January 7, 2015.

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The ZTE trial addressing infringement of the '151 patent was held from April 20 to April 22, 2015. On April 22, 2015, the jury returned a verdict in favor of ZTE, finding that the '151 patent is not infringed by ZTE 3G and 4G cellular devices.

On May 29, 2015, the court entered a new scheduling order for damages and FRAND-related issues, scheduling the ZTE trial related to damages and FRAND-related issues for October 2016.

On September 14, 2015, a panel of Administrative Law Judges of the United States Patent and Trademark Office Patent Trial and Appeal Board (the "PTAB") issued a final written decision in two Inter Partes Review ("IPR") cases concerning the '244 patent. These IPR proceedings were commenced on petitions filed by ZTE Corporation and ZTE (USA) Inc. and by Microsoft Corporation, respectively. Specifically, the panel determined that a number of claims of the '244 patent are unpatentable as obvious. IPR Licensing, Inc. appealed to the Federal Circuit seeking review of the PTAB's decision. Oral argument in the appeal was heard on April 7, 2017. On April 20, 2017, the Federal Circuit affirmed the PTAB's decision that most of the challenged claims of the '244 patent are unpatentable as obvious. However, the court vacated and remanded the PTAB's obviousness finding as to claim 8, which returned the matter to the PTAB for further proceedings as to that claim. On July 28, 2017, IPR Licensing, Inc., filed a petition for a writ of certiorari with the U.S. Supreme Court seeking to appeal the Federal Circuit decision, arguing that the petition should be held pending the Supreme Court's decision in *Oil States Energy Services, LLC v. Greene's Energy Group, LLC*, which will determine whether the IPR process as a whole is unconstitutional. On October 2, 2017, ZTE filed a response to the petition for a writ of certiorari in which ZTE agreed that the petition should be held pending the Court's decision in *Oil States* and then disposed of as appropriate in light of that decision. On April 24, 2018, the Supreme Court rejected the petitioner's constitutional challenge to the IPR process in the *Oil States* case. Accordingly, InterDigital expects that the Supreme Court will deny IPR Licensing, Inc.'s July 28, 2017 petition for a writ of certiorari. On March 6, 2018, in the PTAB remand proceeding, the PTAB again found claim 8 to be invalid. On April 10, 2018, IPR Licensing, Inc. appealed to the Federal Circuit seeking review of the PTAB's decision. That appeal (the "'244 patent PTAB remand appeal") remains pending.

On December 21, 2015, the district court entered another scheduling order that vacated the October 2016 date for the ZTE trial related to damages and FRAND-related issues as set forth in the May 2015 scheduling order.

On March 18, 2016, the court denied ZTE's motion for judgment as a matter of law, or in the alternative for a new trial, with respect to the '966 and '847 patents. The court postponed its ruling on ZTE's motion as to the '244 patent pending the Federal Circuit's decision on InterDigital's appeal of the September 14, 2015 PTAB ruling and administratively closed that portion of the motion.

On April 18, 2016, ZTE filed a stipulated request for dismissal with prejudice of its counterclaims for breach of contract and patent unenforceability based on FRAND and withdrew its corresponding FRAND-related affirmative defenses. The court granted this request the same day. Also on April 18, 2016, ZTE filed a motion under Federal Rule of Civil Procedure 54(b) seeking certification of partial final judgment on the claims for infringement of the '966 and '847 patents to allow ZTE to file an immediate appeal as to those patents. The motion was granted on June 7, 2016, and a partial final judgment was entered on June 20, 2016. On July 18, 2016, ZTE filed its notice of appeal with the Federal Circuit regarding the Delaware District Court's judgment against ZTE with respect to the '966 and '847 patents. Oral argument on ZTE's appeal was heard on October 4, 2017. On November 3, 2017, the Federal Circuit issued its decision affirming the Delaware District Court judgment finding that the '966 and '847 patents are not invalid and are infringed by ZTE 3G and 4G cellular devices. On December 4, 2017, ZTE filed a petition for panel rehearing of the Federal Circuit's decision. The Federal Circuit denied ZTE's petition on December 20, 2017, and the court's mandate issued on December 27, 2017.

On May 15, 2017, InterDigital and Nokia/MMO filed a stipulation of dismissal of the case against MMO, Nokia Corporation and Nokia, Inc. pursuant to a Settlement Agreement and Release of Claims among InterDigital, Microsoft Corporation, Microsoft Mobile, Inc., and MMO, dated May 9, 2017, (the "Microsoft Settlement Agreement"). On May 16, 2017, the Delaware District Court granted the stipulation and dismissed the case against MMO, Nokia Corporation and Nokia, Inc. with prejudice.

The case against ZTE remains pending. On January 16, 2018, InterDigital and ZTE filed a joint status report that informed the court of the Federal Circuit's decision regarding the '966 and '847 patents and that the PTAB proceedings

regarding the '244 patent remained pending. The parties jointly requested that the case remain stayed so that the portion of the case related to damages potentially owed by ZTE as to the three patents-in-suit may be coordinated. The court granted this request on January 17, 2018. The case remains stayed through at least January 23, 2019.

2011 USITC Proceeding (337-TA-800) and Related ZTE Delaware District Court Proceeding  
USITC Proceeding (337-TA-800)

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On July 26, 2011, InterDigital's wholly owned subsidiaries InterDigital Communications, LLC (now InterDigital Communications, Inc.), InterDigital Technology Corporation and IPR Licensing, Inc. filed a complaint with the USITC against Nokia Corporation and Nokia Inc., Huawei Technologies Co., Ltd. and FutureWei Technologies, Inc. d/b/a Huawei Technologies (USA) and ZTE Corporation and ZTE (USA) Inc. (collectively, the "337-TA-800 Respondents"), alleging violations of Section 337 of the Tariff Act of 1930 in that they engaged in unfair trade practices by selling for importation into the United States, importing into the United States and/or selling after importation into the United States certain 3G wireless devices (including WCDMA- and cdma2000-capable mobile phones, USB sticks, mobile hotspots and tablets and components of such devices) that infringe several of InterDigital's U.S. patents. The action also extended to certain WCDMA and cdma2000 devices incorporating WiFi functionality. InterDigital's complaint with the USITC sought an exclusion order that would bar from entry into the United States any infringing 3G wireless devices (and components) that are imported by or on behalf of the 337-TA-800 Respondents, and also sought a cease-and-desist order to bar further sales of infringing products that have already been imported into the United States. In May 2012, Huawei Device USA, Inc. was added as a 337-TA-800 Respondent.

The ALJ held an evidentiary hearing from February 12-21, 2013. The patents in issue as of the hearing were U.S. Patent Nos. 8,009,636 (the "636 patent"), 7,706, 830 (the "830 patent"), 7,502,406 (the "406 patent"), 7,616,970 (the "970 patent"), 7,706,332 (the "332 patent"), 7,536,013 (the "013 patent") and 7,970,127 (the "127 patent"). The ALJ's Initial Determination ("ID") issued on June 28, 2013, finding no violation because the asserted patents were not infringed and/or invalid. Among other determinations, with respect to the 337-TA-800 Respondents' FRAND and other equitable defenses, the ALJ found that Respondents had failed to prove either that InterDigital violated any FRAND obligations, that InterDigital failed to negotiate in good faith, or that InterDigital's licensing offers were discriminatory. The ALJ also found that InterDigital is not precluded from seeking injunctive relief based on any alleged FRAND commitments.

Petitions for review of the ID to the Commission were filed by InterDigital and the 337-TA-800 Respondents on July 15, 2013. On September 4, 2013, the Commission determined to review the ID in its entirety.

On December 19, 2013, the Commission issued its final determination. The Commission adopted, with some modification, the ALJ's finding of no violation of Section 337 as to Nokia, Huawei, and ZTE. The Commission did not rule on any other issue, including FRAND and domestic industry, and stated that all other issues remain under review.

On December 20, 2013, InterDigital filed in the Federal Circuit a petition for review seeking reversal of the Commission's final determination. On February 18, 2015, the Federal Circuit issued a decision affirming the USITC's determinations that the claims of the '830, '636, '406 and '332 patents were not infringed, that the claims of the '970 patent are invalid, and that the Respondents did not violate Section 337. On April 6, 2015, InterDigital filed a combined petition for panel rehearing and rehearing en banc as to the '830 and '636 patents. The petition was denied on May 12, 2015, and the court's mandate issued on May 19, 2015.

Related Delaware District Court Proceeding

On July 26, 2011, the same date that InterDigital filed USITC Proceeding (337-TA-800), it filed a parallel action in the United States District Court for the District of Delaware against the 337-TA-800 Respondents alleging infringement of the same asserted patents identified in USITC Proceeding (337-TA-800). The Delaware District Court complaint seeks a permanent injunction and compensatory damages in an amount to be determined, as well as enhanced damages based on willful infringement, and recovery of reasonable attorneys' fees and costs. On September 23, 2011, the defendants in the Delaware District Court complaint filed a motion to stay the Delaware District Court action pending the parallel proceedings in the USITC. Because the USITC has instituted USITC Proceeding (337-TA-800), the defendants have a statutory right to a mandatory stay of the Delaware District Court proceeding pending a final determination in the USITC. On October 3, 2011, InterDigital amended the Delaware District Court complaint, adding LG as a defendant and adding the same additional patent that InterDigital requested be added to USITC Proceeding (337-TA-800). On October 11, 2011, the Delaware District Court granted the defendants' motion to stay. The case is currently stayed through December 10, 2018.

On January 14, 2014, InterDigital and Huawei filed a stipulation of dismissal of their disputes in this action on account of the confidential settlement agreement mentioned above. On the same day, the Delaware District Court

granted the stipulation of dismissal.

On May 15, 2017, InterDigital and Nokia filed a stipulation of dismissal of their dispute pursuant to the Microsoft Settlement Agreement discussed above. On May 16, 2017, the Delaware District Court granted the stipulation and dismissed the case with prejudice with respect to Nokia Corporation and Nokia Inc.

In December 2017, InterDigital entered into a patent license agreement with LG, pursuant to which the parties agreed to terms for dismissal by InterDigital of the outstanding litigation among the parties and their affiliates. Accordingly, on

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December 5, 2017, InterDigital and LG filed a stipulation of dismissal of the case against LG. On the same day, the Delaware District Court granted the stipulation and dismissed the case against LG with prejudice.

The case remains pending with respect to ZTE.

**OTHER**

We are party to certain other disputes and legal actions in the ordinary course of business, including arbitrations and legal proceedings with licensees regarding the terms of their agreements and the negotiation thereof. We do not currently believe that these matters, even if adversely adjudicated or settled, would have a material adverse effect on our financial condition, results of operations or cash flows. None of the preceding matters have met the requirements for accrual or disclosure of a potential range as of September 30, 2018.

**5. EQUITY TRANSACTIONS**

Changes in shareholders' equity for the nine months ended September 30, 2018 and September 30, 2017 were as follows (in thousands):

|  | For the Nine Months<br>Ended September 30, |             |
|--|--|-------------|
|  | 2018                                       | 2017        |
| Balance beginning of period, December 31                         | \$855,267                                  | \$739,709   |
| Cumulative effect of change in accounting principle              | 161,251                                    | —           |
| Net income attributable to InterDigital, Inc.                    | 62,038                                     | 121,791     |
| Unrealized (loss) gain on investments, net                       | (904                                       | ) (181 )    |
| Cash dividends declared  | (36,312                                    | ) (32,966 ) |
| Repurchase of common stock                                       | (43,508                                    | ) —         |
| Exercise of common stock options                                 | 6,362                                      | 82          |
| Taxes withheld upon vesting of restricted stock units            | (8,478                                     | ) (22,235 ) |
| Share-based compensation   | 4,875                                      | 13,901      |
| Total InterDigital, Inc. shareholders' equity end of period      | \$1,000,591                                | \$820,101   |
| Noncontrolling Interest Balance beginning of period, December 31 | 17,881                                     | 14,659      |
| Net loss attributable to noncontrolling interest                 | (3,423                                     | ) (2,744 )  |
| Noncontrolling interest  | 14,458                                     | 11,915      |
| Total Equity end of period                                       | \$1,015,049                                | \$832,016   |

**Repurchase of Common Stock**

In June 2014, our Board of Directors authorized a \$300 million share repurchase program (the "2014 Repurchase Program"). In June 2015, our Board of Directors authorized a \$100 million increase to the program, and in September 2017, our Board of Directors authorized another \$100 million increase to the program, bringing the total amount of the 2014 Repurchase Program to \$500 million. The Company may repurchase shares under the 2014 Repurchase Program through open market purchases, pre-arranged trading plans or privately negotiated purchases.

The table below sets forth the number of shares repurchased and the dollar value of shares repurchased under the 2014 Repurchase Program from inception of the program through third quarter 2018 (in thousands).

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|             |           |  |
|-------------|-----------|--|
| 2014        |           |  |
| Repurchase  |           |  |
| Program     |           |  |
| # of        | Value     |  |
| Shares      |           |  |
| 2018 549    | \$43,508  |  |
| 2017 107    | 7,693     |  |
| 2016 1,304  | 64,685    |  |
| 2015 1,836  | 96,410    |  |
| 2014 3,554  | 152,625   |  |
| Total 7,350 | \$364,921 |  |

## Dividends

Cash dividends on outstanding common stock declared in 2018 and 2017 were as follows (in thousands, except per share data):

| 2018           | Per Share | Total    | Cumulative by Fiscal Year |
|----------------|-----------|----------|---------------------------|
| First quarter  | \$0.35    | \$12,124 | \$12,124                  |
| Second quarter | \$0.35    | \$12,192 | \$24,316                  |
| Third quarter  | 0.35      | 11,996   | 36,312                    |
|                | \$1.05    | \$36,312 |                           |

| 2017           | Per Share | Total    | Cumulative by Fiscal Year |
|----------------|-----------|----------|---------------------------|
| First quarter  | \$0.30    | \$10,404 | \$10,404                  |
| Second quarter | 0.30      | 10,413   | 20,817                    |
| Third quarter  | 0.35      | 12,149   | 32,966                    |
| Fourth quarter | 0.35      | 12,156   | 45,122                    |
|                | \$1.30    | \$45,122 |                           |

In September 2017, we announced that our Board of Directors had approved an increase in the Company's quarterly cash dividend to \$0.35 per share. We currently expect to continue to pay dividends comparable to our quarterly \$0.35 per share cash dividend in the future; however, continued payment of cash dividends and changes in the Company's dividend policy will depend on the Company's earnings, financial condition, capital resources and capital requirements, alternative uses of capital, restrictions imposed by any existing debt, economic conditions and other factors considered relevant by our Board of Directors.

## 6. CONCENTRATION OF CREDIT RISK AND FAIR VALUE OF FINANCIAL ASSETS AND FINANCIAL LIABILITIES

### 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 and contract assets are derived principally from patent license and technology solutions agreements. As of September 30, 2018 and December 31, 2017, four and three licensees comprised 64% and 96% of our net accounts receivable balance, respectively. We perform ongoing credit evaluations of our licensees, who generally include large, multinational, wireless telecommunications equipment manufacturers. We believe that the book values of our financial instruments approximate their fair values.

### Fair Value Measurements



We use various valuation techniques and assumptions when measuring the fair value of our assets and liabilities. We utilize market data or assumptions that market participants would use in pricing the asset or liability, including assumptions about risk and the risks inherent in the inputs to the valuation technique. This guidance established a hierarchy that prioritizes

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fair value measurements based on the types of input used for the various valuation techniques (market approach, income approach and cost approach). The levels of the hierarchy are described below:

Level 1 Inputs — Level 1 includes financial instruments for which quoted market prices for identical instruments are available in active markets.

Level 2 Inputs — Level 2 includes financial instruments for which there are inputs other than quoted prices included within Level 1 that are observable for the instrument such as quoted prices for similar instruments in active markets, quoted prices for identical or similar instruments in markets with insufficient volume or infrequent transactions (less active markets) or model-driven valuations in which significant inputs are observable or can be derived principally from, or corroborated by, observable market data, including market interest rate curves, referenced credit spreads and pre-payment rates.

Level 3 Inputs — Level 3 includes financial instruments for which fair value is derived from valuation techniques including pricing models and discounted cash flow models in which one or more significant inputs are unobservable, including the Company's own assumptions. The pricing models incorporate transaction details such as contractual terms, maturity and, in certain instances, timing and amount of future cash flows, as well as assumptions related to liquidity and credit valuation adjustments of marketplace participants.

Our assessment of the significance of a particular input to the fair value measurement requires judgment and may affect the valuation of financial assets and financial liabilities and their placement within the fair value hierarchy. We use quoted market prices for similar assets to estimate the fair value of our Level 2 investments.

Recurring Fair Value Measurements

Our financial assets are generally included within short-term investments on our condensed consolidated balance sheets, unless otherwise indicated. Our financial assets and liabilities that are accounted for at fair value on a recurring basis are presented in the tables below as of September 30, 2018 and December 31, 2017 (in thousands):

|   | Fair Value as of September 30, 2018 |           |          |             |
|---|-------------------------------------|-----------|----------|-------------|
|   | Level 1                             | Level 2   | Level 3  | Total       |
| Assets:   |                                     |           |          |             |
| Money market and demand accounts (a)                                | \$415,614                           | \$—       | \$—      | \$415,614   |
| Commercial paper (b)  | —                                   | 131,987   | —        | 131,987     |
| U.S. government securities  | —                                   | 328,440   | —        | 328,440     |
| Corporate bonds, asset backed and other securities                  | —                                   | 198,251   | —        | 198,251     |
| Total   | \$415,614                           | \$658,678 | \$—      | \$1,074,292 |
| Liabilities:  |                                     |           |          |             |
| Contingent consideration resulting from the Technicolor Acquisition | —                                   | —         | 18,616   | \$18,616    |
| Long-term debt resulting from the Technicolor Acquisition           | —                                   | —         | 18,107   | \$18,107    |
|   | \$—                                 | \$—       | \$36,723 | \$36,723    |

|  | Fair Value as of December 31, 2017 |           |         |              |
|--|------------------------------------|-----------|---------|--------------|
|  | Level 1                            | Level 2   | Level 3 | Total        |
| Assets:  |                                    |           |         |              |
| Money market and demand accounts (a)               | \$417,348                          | \$—       | \$—     | —\$417,348   |
| Commercial paper (b)                               | —                                  | 66,132    | —       | 66,132       |
| U.S. government securities                         | —                                  | 511,032   | —       | 511,032      |
| Corporate bonds, asset backed and other securities | —                                  | 163,483   | —       | 163,483      |
| Total  | \$417,348                          | \$740,647 | \$—     | —\$1,157,995 |

(a) Primarily included within cash and cash equivalents.

(b) Includes \$109.2 million and \$15.7 million of commercial paper that is included within cash and cash equivalents as of September 30, 2018 and December 31, 2017, respectively.



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## Level 3 Fair Value Measurements

## Contingent consideration

As discussed further in Note 9, we completed our acquisition of the patent licensing business of Technicolor (the “Technicolor Acquisition”) during third quarter 2018. In conjunction with the Technicolor Acquisition, we recognized a contingent consideration liability which is measured at fair value on a recurring basis using significant unobservable inputs classified as Level 3 measurements within the fair value hierarchy. We utilized a Monte Carlo simulation model to determine the estimated fair value of the contingent consideration liability. A Monte Carlo simulation uses random numbers together with volatility assumptions to generate individual paths, or trials, for variables of interest governed by a Geometric Brownian Motion in a risk-neutral framework. Level 3 significant unobservable inputs include the following:

| Significant Unobservable Input          | Ranges        |
|---|---------------|
| Risk-adjusted discount rate for revenue | 13.5% - 14.5% |
| Credit risk discount rate               | 3.9% - 6.7%   |
| Revenue volatility                      | 35.0%         |
| Projected years of earn out             | 2018 - 2030   |

Significant increases or decreases in any of those inputs in isolation could result in a significantly lower or higher fair value measurement. Adjustments to the fair value of contingent consideration are reflected within our condensed consolidated statements of income.

## Technicolor Acquisition long-term debt

We also recognized long-term debt in conjunction with the Technicolor Acquisition as more fully disclosed in Note 9. This long-term debt is measured at fair value on a recurring basis based on the discounted expected future cash flows over the life of the arrangement. Estimating the future cash flows under this arrangement requires several Level 3 significant unobservable inputs, including the following:

| Significant Unobservable Input | Ranges      |
|--------------------------------|-------------|
| Discount rate for revenue      | 14.5%       |
| Projected term of arrangement  | 2018 - 2030 |

Significant increases or decreases in any of those inputs in isolation could result in a significantly lower or higher fair value measurement, and estimates may change which would result in future adjustments to the accretion of the interest expense and the principal amortization of the debt. Adjustments to the fair value of the long-term debt are reflected as interest expense within “Other Expense (Net)” in the condensed consolidated statements of income.

The following table provides a reconciliation of the beginning and ending balances of our two Level 3 fair value measurements from December 31, 2017 to September 30, 2018, both of which relate to the Technicolor Acquisition and are discussed further above and within Note 9. As of September 30, 2018, the Level 3 contingent consideration liability is included within "Other long-term liabilities" and the Level 3 long-term debt is included within "Long-term debt" in the condensed consolidated balance sheet.

## Level 3 Fair Value Measurements

|   | Contingent<br>Consideration<br>Liability | Technicolor<br>Acquisition<br>Long-term<br>Debt |
|---|--|---|
| Balance as of December 31, 2017   | \$—                                      | \$—   |
| Technicolor Acquisition - July 30, 2018   | 18,616                                   | 17,717  |
| Reduction for payments  | —  | —   |
| Interest expense accretion  | —  | 390   |
| Changes in fair value recognized in the condensed consolidated statements of income | —  | —   |
| Balance as of September 30, 2018  | \$18,616                                 | \$18,107  |



Table of Contents**Non-Recurring Fair Value Measurements**

As discussed in Note 1, in conjunction with the adoption of ASU 2016-01 in the first quarter of 2018, we made an accounting policy election to utilize a measurement alternative for equity investments that do not have readily determinable fair values, which applies to our strategic investments in other entities. Under the alternative, our strategic investments in other entities that do not have readily determinable fair values are measured at cost, less any impairment, plus or minus changes resulting from observable price changes in orderly transactions for an identical or similar investment of the same issuer. Any adjustments to the carrying value of those investments are considered non-recurring fair value measurements.

During third quarter 2018, we recognized an aggregate \$8.4 million loss resulting from the sale of our entire ownership interest in one of our strategic investments and the impairment of a separate strategic investment.

**Fair Value of Senior Convertible Long-Term Debt**

The principal amount, carrying value and related estimated fair value of the Company's senior convertible debt reported in the condensed consolidated balance sheets as of September 30, 2018 and December 31, 2017 are as follows (in thousands). The table below does not include the Technicolor Acquisition long-term debt that is classified as a Level 3 fair value measurement and is discussed above.

|   | September 30, 2018 |                |            | December 31, 2017 |                |            |
|---|--------------------|----------------|------------|-------------------|----------------|------------|
|   | Principal Amount   | Carrying Value | Fair Value | Principal Amount  | Carrying Value | Fair Value |
| Total Senior Convertible Long-Term Debt | \$316,000          | \$295,420      | \$371,300  | \$316,000         | \$285,126      | \$377,029  |

The aggregate fair value of the principal amount of the senior convertible long-term debt (Level 2 Notes as defined in Note 7 "Long-Term Debt") was calculated using inputs such as actual trade data, benchmark yields, broker/dealer quotes and other similar data, which were obtained from independent pricing vendors, quoted market prices or other sources.

**7. LONG-TERM DEBT****Technicolor Acquisition Long-Term Debt**

Refer to Note 9 for information regarding the long-term debt recognized during third quarter 2018 resulting from the Technicolor Acquisition.

**2020 Senior Convertible Notes, and related Note Hedge and Warrant Transactions**

On March 11, 2015, we issued \$316.0 million in aggregate principal amount of 1.50% Senior Convertible Notes due 2020 (the "2020 Notes"). The 2020 Notes bear interest at a rate of 1.50% per year, payable in cash on March 1 and September 1 of each year, commencing September 1, 2015, and mature on March 1, 2020, unless earlier converted or repurchased.

The 2020 Notes will be convertible into cash, shares of our common stock or a combination thereof, at our election, at a current conversion rate of 13.9392 shares of common stock per \$1,000 principal amount of 2020 Notes (which is equivalent to a conversion price of approximately \$71.74 per share), as adjusted pursuant to the terms of the indenture for the 2020 Notes (the "Indenture"). The conversion rate, and thus the conversion price, may be adjusted under certain circumstances, including in connection with conversions made following certain fundamental changes and under other circumstances set forth in the Indenture. It is our current intent and policy to settle all conversions through combination settlement of cash and shares of common stock, with a specified dollar amount of \$1,000 per \$1,000 principal amount of the 2020 Notes and any remaining amounts in shares.

Prior to 5:00 p.m., New York City time, on the business day immediately preceding December 1, 2019, the 2020 Notes will be convertible only under certain circumstances as set forth in the Indenture, including on any date during any calendar quarter (and only during such calendar quarter) if the closing sale price of our common stock was more than 130% of the applicable conversion price (approximately \$93.26 based on the current conversion price) on each applicable trading day for at least 20 trading days in the period of the 30 consecutive trading days ending on the last trading day of the immediately preceding calendar quarter.



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Commencing on December 1, 2019, the 2020 Notes will be convertible in multiples of \$1,000 principal amount, at any time prior to 5:00 p.m., New York City time, on the second scheduled trading day immediately preceding the maturity date of the 2020 Notes.

The Company may not redeem the 2020 Notes prior to their maturity date.

On March 5 and March 9, 2015, in connection with the offering of the 2020 Notes, we entered into convertible note hedge transactions that cover approximately 3.8 million and approximately 0.6 million shares of our common stock, respectively, at a strike price that corresponds initially to the initial conversion price of the 2020 Notes and are exercisable upon conversion of the 2020 Notes.

The cost of the March 5 and March 9, 2015 convertible note hedge transactions was approximately \$51.7 million and approximately \$7.7 million, respectively.

On March 5 and March 9, 2015, we sold warrants to acquire approximately 3.8 million and approximately 0.6 million, respectively, of common stock, subject to customary anti-dilution adjustments. As of September 30, 2018, the warrants had a strike price of approximately \$87.68 per share, as adjusted. The warrants become exercisable and expire in daily tranches over a three and a half month period starting in June 2020. As consideration for the warrants issued on March 5 and March 9, 2015, we received approximately \$37.3 million and approximately \$5.6 million, respectively.

On April 3, 2018, in connection with the reorganization of the Company's holding company structure, the predecessor company (now known as InterDigital Wireless, Inc., the "Predecessor Company") and the successor company (now known as InterDigital, Inc., the "Successor Company") entered into a First Supplemental Indenture (the "Supplemental Indenture") to the Indenture with the trustee. The Supplemental Indenture effected certain amendments to the Indenture in connection with the Reorganization, which, among other things, amended the conversion right of the 2020 Notes so that at the effective time of the Reorganization, the holder of each Note outstanding as of the effective time of the Reorganization will have the right to convert, subject to the terms of the Indenture, each \$1,000 principal amount of such 2020 Note into the number of shares of the Successor Company's common stock that a holder of a number of shares of the Predecessor Company's common stock equal to the conversion rate immediately prior to the effective time of the Reorganization would have been entitled to receive upon the Reorganization. In addition, pursuant to the Supplemental Indenture, the Successor Company guaranteed the Predecessor Company's obligations under the 2020 Notes and the Indenture.

### Accounting Treatment of the 2020 Notes and related Convertible Note Hedge and Warrant Transactions

The offering of the 2020 Notes on March 5, 2015 was for \$275.0 million and included an overallotment option that allowed the initial purchasers to purchase up to an additional \$41.0 million aggregate principal amount of 2020 Notes. The initial purchasers exercised their overallotment option on March 9, 2015, bringing the total amount of 2020 Notes issued on March 11, 2015 to \$316.0 million.

In connection with the offering of the 2020 Notes, as discussed above, InterDigital entered into convertible note hedge transactions with respect to its common stock. The \$59.4 million cost of the convertible note hedge transactions was partially offset by the proceeds from the sale of the warrants described above, resulting in a net cost of \$16.5 million. Both the convertible note hedge and warrants were classified as equity.

The Company bifurcated the proceeds from the offering of the 2020 Notes between liability and equity components. On the date of issuance, the liability and equity components were calculated to be approximately \$256.7 million and \$59.3 million, respectively. The initial \$256.7 million liability component was determined based on the fair value of similar debt instruments excluding the conversion feature. The initial \$59.3 million (\$38.6 million net of tax) equity component represents the difference between the fair value of the initial \$256.7 million in debt and the \$316.0 million of gross proceeds. The related initial debt discount of \$59.3 million is being amortized using the effective interest method over the life of the 2020 Notes. An effective interest rate of 5.89% was used to calculate the debt discount on the 2020 Notes.

In connection with the above-noted transactions, the Company incurred \$9.3 million of directly related costs. The initial purchasers' transaction fees and related offering expenses were allocated to the liability and equity components in proportion to the allocation of proceeds and accounted for as debt and equity issuance costs, respectively. We allocated \$7.0 million of debt issuance costs to the liability component, which were capitalized as deferred financing



costs. These costs are being amortized to interest expense over the term of the debt using the effective interest method. The remaining \$2.4 million of costs allocated to the equity component were recorded as a reduction of the equity component.

The following table reflects the carrying value of the 2020 Notes as of September 30, 2018 and December 31, 2017 (in thousands):

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|                                   | September 30, December 31, |            |
|-----------------------------------|----------------------------|------------|
|                                   | 2018                       | 2017       |
| Principal                         | \$ 316,000                 | \$ 316,000 |
| Less:                             |                            |            |
| Unamortized interest discount     | (18,611 )                  | (27,863 )  |
| Deferred financing costs          | (1,969 )                   | (3,011 )   |
| Net carrying amount of 2020 Notes | \$ 295,420                 | \$ 285,126 |

The following table presents the amount of interest cost recognized, which is included within "Other Expense" in our condensed consolidated statements of income, for the three and nine months ended September 30, 2018 and September 30, 2017 relating to the contractual interest coupon, accretion of the debt discount, and the amortization of financing costs (in thousands):

|  | For the Three<br>Months Ended<br>September 30, |          |
|--|--|----------|
|  | 2018   | 2017     |
| Contractual coupon interest              | \$1,185  | \$1,185  |
| Accretion of debt discount               | 3,124  | 2,947    |
| Amortization of deferred financing costs | 347  | 348      |
| Total                                    | \$4,656  | \$4,480  |
|  | For the Nine<br>Months Ended<br>September 30,  |          |
|  | 2018   | 2017     |
| Contractual coupon interest              | \$3,555  | \$3,555  |
| Accretion of debt discount               | 9,252  | 8,710    |
| Amortization of deferred financing costs | 1,042  | 1,043    |
| Total                                    | \$13,849                                       | \$13,308 |

**8. VARIABLE INTEREST ENTITIES**

As further discussed below, we are the primary beneficiary of two variable interest entities. As of September 30, 2018, the combined book values of the assets and liabilities associated with these variable interest entities included in our condensed consolidated balance sheet were \$29.4 million and \$3.0 million, respectively. Assets included \$12.1 million of cash and cash equivalents, \$1.3 million of accounts receivable, \$13.4 million of patents, net, and \$2.5 million of other non-current assets. As of December 31, 2017, the combined book values of the assets and liabilities associated with these variable interest entities included in our condensed consolidated balance sheet were \$34.4 million and \$0.2 million, respectively. Assets included \$23.3 million of cash and cash equivalents and \$11.1 million of patents, net. We recognized \$10.0 million of non-current patent royalties during the nine months ended September 30, 2018 related to a patent license agreement signed by the Signal Trust for Wireless Innovation (the "Signal Trust").

**Convida Wireless**

In September 2015, we renewed and expanded our joint venture with Sony, Convida Wireless, to include 5G technologies. Convida Wireless was launched in 2013 to combine Sony's consumer electronics expertise with our pioneering Internet of Things ("IoT") expertise to drive IoT communications and connectivity. Based on the terms of the agreement, the parties will contribute funding and resources for additional research and platform development, which we will perform. SCP IP Investment LLC, an affiliate of Stephens Inc., is a minority investor in Convida Wireless.

Convida Wireless is a variable interest entity. Based on our provision of research and platform development services to Convida Wireless, we have determined that we remain the primary beneficiary for accounting purposes and will continue to consolidate Convida Wireless. For the three months ended September 30, 2018 and 2017, we have allocated approximately \$1.3 million and \$0.8 million, respectively, of Convida Wireless's net loss to noncontrolling

interests held by other parties. For the nine months ended September 30, 2018 and 2017, we have allocated approximately \$3.4 million and \$2.7 million, respectively, of Convida Wireless's net loss to noncontrolling interests held by other parties.

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### Signal Trust for Wireless Innovation

During 2013, we announced the establishment of the Signal Trust, the goal of which is to monetize a large InterDigital patent portfolio related to cellular infrastructure.

The more than 500 patents and patent applications transferred from InterDigital to the Signal Trust focus primarily on 3G and LTE technologies, and were developed by InterDigital's engineers and researchers over more than a decade, with a number of the innovations contributing to the worldwide standards process.

InterDigital is the primary beneficiary of the Signal Trust. The distributions from the Signal Trust will support continued research related to cellular wireless technologies. A small portion of the proceeds from the Signal Trust will be used to fund, through the Signal Foundation for Wireless Innovation, scholarly analysis of intellectual property rights and the technological, commercial and creative innovations they facilitate.

The Signal Trust is a variable interest entity. Based on the terms of the trust agreement, we have determined that we are the primary beneficiary for accounting purposes and must consolidate the Signal Trust.

## 9. BUSINESS COMBINATIONS

### Technicolor Acquisition

On July 30, 2018, we completed our acquisition of the patent licensing business of Technicolor, a worldwide technology leader in the media and entertainment sector, which we refer to as the Technicolor Acquisition. The final transaction includes the acquisition by InterDigital of approximately 18,000 patents and applications, across a broad range of technologies, including approximately 3,000 worldwide video coding patents and applications. The acquisition of Technicolor's portfolio greatly expands InterDigital's technology footprint in the mobile industry, and opens new markets in consumer home electronics, display technology and video. The portfolio will also be supplemented by jointly funded R&D collaboration, which will bring together the efforts of hundreds of engineers in InterDigital Labs and Technicolor Research and Innovation ("R&I"). Members of Technicolor's licensing, legal and other support teams in offices in Rennes and Issy-les-Moulineaux, France; Princeton, New Jersey, and other locations joined InterDigital's team of more than 300 R&D and other staff in locations around the world. In addition, we have assumed Technicolor's rights and obligations under a joint licensing program with Sony Corporation ("Sony") relating to digital televisions and standalone computer display monitors (the "Madison Arrangement"), including Technicolor's role as sole licensing agent for the Madison Arrangement. As part of this transaction, we also granted back to Technicolor a perpetual license for patents acquired in the transaction. With respect to patents generated through the jointly funded R&D efforts, we will own the patents, and Technicolor will receive a license back to the patents resulting from the targeted research conducted by its R&I team.

The Technicolor Acquisition meets the definition of a business combination, and as such was accounted for using the acquisition method of accounting. Under the terms of the agreement, in third quarter 2018, we paid Technicolor \$158.9 million in cash, inclusive of \$15.9 million of cash acquired, yielding net cash consideration of \$143.0 million. We funded this payment with cash on hand. Technicolor will receive 42.5% of all of InterDigital's future cash receipts (net of estimated operating expenses) from InterDigital's new licensing efforts in the consumer electronics field; there will be no revenue sharing associated with InterDigital's mobile industry licensing efforts. We account for the portion of the future cash receipts owed to Technicolor relating to patents existing as of the date of the acquisition as a contingent consideration liability, which was valued at \$18.6 million as of the acquisition date. See below for further discussion of the contingent consideration liability. Additionally, we estimate we will receive payments totaling \$20.2 million relating to the transaction from Technicolor, of which \$8.5 million is included within "Prepaid and other current assets" and the remaining balance is included within "Other non-current assets" in the condensed consolidated balance sheet. We account for our assumption of Technicolor's rights and obligations under the Madison Arrangement as a collaborative arrangement.

We allocated the fair value of consideration transferred to identifiable assets acquired and liabilities assumed based on their estimated fair values as of the acquisition date. We recorded the excess of the fair value of consideration transferred over the net values of these assets and liabilities as goodwill. We estimated the fair value of the intangible assets in this transaction through a combination of a discounted cash flow analysis (the income approach) and an analysis of comparable market transactions (the market approach). For the income approach, we based the inputs and assumptions used to develop these estimates on a market participant perspective and included estimates of projected

revenues, discount rates, economic lives and income tax rates, among others, and all of these estimates require significant management judgment. For the market approach, we applied judgment to identify the most comparable market transactions to this transaction. Refer to Note 6 for discussion regarding the valuation methodologies used for the contingent consideration liability.

The following table summarizes the fair value of consideration transferred and our preliminary allocation of that consideration based on the estimated fair values of the assets acquired and liabilities assumed as of the date of acquisition:

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|   |                           |
|---|---------------------------|
|   | As of<br>July 30,<br>2018 |
| Cash  | \$158,898                 |
| Contingent consideration liability          | 18,616                    |
|   | \$177,514                 |
| Less: Transaction-related receivable        | (20,200 )                 |
| Net fair value of consideration transferred | \$157,314                 |

|   |                               |
|---|-------------------------------|
| Allocation:                               | Estimated useful life (Years) |
| Net tangible assets and liabilities:      |                               |
| Restricted cash                           | \$15,913                      |
| Other current assets                      | 5,600                         |
| Other non-current assets                  | 3,116                         |
| Current liabilities                       | (6,219 )                      |
| Long-term debt                            | (17,717 )                     |
| Other long-term liabilities               | (3,767 )                      |
| Total net tangible assets and liabilities | \$(3,074 )                    |

|                                    |                  |
|------------------------------------|------------------|
| Identified intangible assets:      |                  |
| Patents <sup>(1)</sup>             | \$154,000 9 - 10 |
| Goodwill <sup>(2)</sup>            | 6,388            |
| Total identified intangible assets | \$160,388        |

Total fair value of consideration transferred \$157,314

(1) We expect \$16.4 million of additional annualized amortization expense from patents acquired in the Technicolor Acquisition.

(2) Goodwill consists of expected synergies resulting from the combination of our and Technicolor's patent licensing businesses in the increasingly complementary areas of mobile and video technology. We expect that the majority of the goodwill resulting from the Technicolor Acquisition will be deductible for income tax purposes.

The following table shows the change in the carrying amount of our goodwill balance from December 31, 2017 to September 30, 2018, all of which is allocated to our one reportable segment:

|   |          |
|---|----------|
| Goodwill balance as of December 31, 2017  | \$16,033 |
| Technicolor Acquisition                   | 6,388    |
| Goodwill balance as of September 30, 2018 | \$22,421 |

Since the date of closing, the Technicolor Acquisition resulted in \$1.9 million of revenue and \$4.6 million of pre-tax losses that were included in our condensed consolidated statements of income for the three and nine months ended September 30, 2018. Transaction-related one-time costs for the three and nine months ended September 30, 2018 were \$5.4 million and \$9.2 million, respectively, the majority of which were recorded within "Selling, general and administrative" expenses in the condensed consolidated statements of income.

The amount of revenue and earnings that would have been included in the Company's condensed consolidated statement of income for the three and nine months ended September 30, 2018 and 2017 had the acquisition date been January 1, 2017 are reflected in the table below. These amounts have been calculated after applying the Company's accounting policies and adjusting the results to reflect additional interest expense as well as amortization that would have been charged assuming the fair value adjustments to amortizable intangible assets had been recorded as of January 1, 2017. In addition, pro forma adjustments have been made to reflect the impact of the transaction-related costs discussed above. These unaudited pro forma combined results of operations have been prepared for comparative purposes only, and they do not purport to be indicative of



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the results of operations that actually would have resulted had the acquisition occurred on the date indicated, or that may result in the future. The amounts in the table are unaudited (in thousands):

|   | Three Months<br>Ended<br>September 30,<br>2018 |           | Nine Months<br>Ended<br>September 30,<br>2017 |           |
|---|--|-----------|---|-----------|
| Actual revenue                                    | \$75,079                                       | \$97,325  | \$232,078                                     | \$327,634 |
| Supplemental pro forma revenue                    | \$76,034                                       | \$100,391 | \$238,761                                     | \$335,229 |
| Actual earnings                                   | \$21,407                                       | \$35,536  | \$62,038                                      | \$121,791 |
| Supplemental pro forma earnings                   | \$22,539                                       | \$29,621  | \$54,404                                      | \$97,303  |
| Actual diluted earnings per share                 | \$0.60   | \$1.00    | \$1.74  | \$3.40    |
| Supplemental pro forma diluted earnings per share | \$0.63   | \$0.84    | \$1.53  | \$2.71    |

**Contingent Consideration**

As discussed above, in conjunction with the Technicolor Acquisition, Technicolor will receive 42.5% of all of InterDigital's future cash receipts (net of estimated operating expenses) from InterDigital's new licensing efforts in the consumer electronics field; there will be no revenue sharing associated with InterDigital's mobile industry licensing efforts. The portion of the future cash receipts relating to patents existing as of the date of the acquisition will be accounted for as a contingent consideration liability in accordance with ASC 805-30-25, Business Combinations - Contingent Consideration. The revenue sharing arrangement continues through December 31, 2038, and there are no minimum or maximum payments under the arrangement.

The estimated acquisition date fair value of the contingent consideration liability of \$18.6 million was determined utilizing a Monte Carlo simulation model. This initial fair value measurement is based on the perspective of a market participant and includes significant unobservable inputs that are classified as Level 3 inputs within the fair value hierarchy and are discussed further within Note 6. The contingent consideration is subject to re-measurement each reporting period until it has been fully paid, and any adjustments to the fair value of the contingent consideration are reflected within the condensed consolidated statements of income.

**Madison Arrangement**

As discussed above, in conjunction with the Technicolor Acquisition, effective July 30, 2018, we have assumed Technicolor's rights and obligations under the Madison Arrangement, which commenced in 2015. The Madison Arrangement falls under the scope of ASC 808, Collaborative Arrangements ("ASC 808").

**Significant Accounting Policy - Collaborative Arrangements**

We record the elements of our collaboration agreements that represent joint operating activities in accordance with ASC 808. Accordingly, the elements of our collaboration agreements that represent activities in which both parties are active participants, and to which both parties are exposed to the significant risks and rewards that are dependent on the commercial success of the activities, are recorded as collaborative arrangements. Generally, the classification of a transaction under a collaborative arrangement is determined based on the nature and contractual terms of the arrangement along with the nature of the operations of the participants. For transactions that are deemed to be a collaborative arrangement under ASC 808, costs incurred and revenues generated on sales to third parties will be reported in our condensed consolidated statement of operations on a gross basis if the Company is deemed to be the principal in the transaction, or on a net basis if the Company is instead deemed to be the agent in the transaction, consistent with the guidance in ASC 606-10-55-36, Revenue From Contracts with Customers - Principal Agent Considerations.

Under the Madison Arrangement, Technicolor and Sony combined portions of their respective digital TV ("DTV") and computer display monitor ("CDM") patent portfolios and created a combined licensing opportunity to DTV and CDM manufacturers. Per an Agency and Management Services Agreement ("AMSA") entered into upon the creation of the Madison Arrangement, Technicolor was initially appointed as sole licensing agent of the arrangement, and InterDigital has now assumed that role. As licensing agent, we are responsible for making decisions regarding the



prosecution and maintenance of the combined patent portfolio and the licensing and enforcement of the combined patent portfolio in the field of use of DTVs and CDMs on an exclusive basis during the term of the AMSA in exchange for an agent fee.

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We were deemed to be the principal in this collaborative arrangement under ASC 808, and, as such, in accordance with ASC 606-10-55-36 Revenue From Contracts with Customers - Principal Agent Considerations, we record revenues generated on sales to third parties and costs incurred on a gross basis in the condensed consolidated statements of income. Therefore, we recognize all royalties from customers as revenue and payments to Sony for its royalty share as operating expenses within the condensed consolidated statements of income. Cost reimbursements for expenses incurred resulting from fulfilling the duties of the licensing agent are recorded as contra expenses. Amounts attributable to transactions arising from the Madison Arrangement between participants were not material during the three and nine months ended September 30, 2018.

Long-term debt

An affiliate of CPPIB Credit Investments Inc. ("CPPIB Credit"), a wholly owned subsidiary of Canada Pension Plan Investment Board, is a third-party investor in the Madison Arrangement. CPPIB Credit has made certain payments to Technicolor and Sony and has agreed to contribute cash to fund certain capital reserve obligations under the arrangement in exchange for a percentage of future revenues, specifically through September 11, 2030 in regard to the Technicolor patents.

Upon our assumption of Technicolor's rights and obligations under the Madison Arrangement, our relationship with CPPIB Credit meets the criteria in ASC 470-10-25 - Sales of Future Revenues or Various Other Measures of Income ("ASC 470"), which relates to cash received from an investor in exchange for a specified percentage or amount of revenue or other measure of income of a particular product line, business segment, trademark, patent, or contractual right for a defined period. Under this guidance, we recognized the fair value of our contingent obligation to CPPIB Credit, as of the acquisition date, as long-term debt in our condensed consolidated balance sheet. This initial fair value measurement is based on the perspective of a market participant and includes significant unobservable inputs which are classified as Level 3 inputs within the fair value hierarchy and are discussed further within Note 6. At each subsequent reporting period, we will measure the long-term debt at fair value based on the discounted expected future cash flows over the life of the obligation. Our repayment obligations are contingent upon future royalty revenues generated from the Madison Arrangement.

Under ASC 470, amounts recorded as debt shall be amortized under the interest method. The Company made an accounting policy election to utilize the catch-up method when there is a change in the estimated future cash flows, whereby we will adjust the carrying amount of the debt to the present value of the revised estimated future cash flows, discounted at the original effective interest rate, with a corresponding adjustment recognized as interest expense within "Other Expense (Net)" in the condensed consolidated statements of income. As of September 30, 2018, the effective interest rate was approximately 12%. This rate represents the discount rate that equates the estimated future cash flows with the fair value of the debt, and is used to compute the amount of interest to be recognized each period. Any future payments made to CPPIB Credit, or additional proceeds received from CPPIB Credit, will decrease or increase the long-term debt balance accordingly.

Restricted cash

Under the Madison Arrangement, the parties reserve cash in bank accounts to fund our activities to manage the portfolios. These accounts are custodial accounts for which the funds are restricted for this purpose. As of September 30, 2018, the Company had \$15.9 million of restricted cash included within the condensed consolidated balance sheet attributable to the Madison Arrangement.

The following table provides a reconciliation of cash, cash equivalents and restricted cash as of September 30, 2018 and 2017 and December 31, 2017 and 2016:

|  | September 30, |           | December 31, |           |
|--|---------------|-----------|--------------|-----------|
|  | 2018          | 2017      | 2017         | 2016      |
| Cash and cash equivalents  | \$508,829     | \$283,557 | \$433,014    | \$404,074 |
| Restricted cash included within prepaid and other current assets | 15,942        | —         | —            | —         |
| Total cash, cash equivalents and restricted cash                 | \$524,771     | \$283,557 | \$433,014    | \$404,074 |

Commitments

To receive consent from both Sony and CPPIB Credit to assume the rights and responsibilities of Technicolor under the Madison Arrangement, we committed to contributing cash to fund shortfalls in the Madison Arrangement, up to a

maximum of \$25.0 million, through 2020. A shortfall funding is only required in the scenario in which the restricted cash is not sufficient to fund current obligations. In the event that we fund a shortfall, any surplus cash resulting from subsequent royalty receipts would be used to repay our shortfall funding plus 25% interest in advance of distributions of royalties to either Sony or CPPIB

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Credit, assuming they have not participated in the funding of the shortfall. As of September 30, 2018, we have not contributed any shortfall funding.

Item 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS.

OVERVIEW

The following discussion should be read in conjunction with the unaudited, condensed consolidated financial statements and notes thereto contained in Part I, Item 1 of this Quarterly Report on Form 10-Q, in addition to our 2017 Form 10-K, other reports filed with the SEC and the Statement Pursuant to the Private Securities Litigation Reform Act of 1995 — Forward-Looking Statements below.

Throughout the following discussion and elsewhere in this Form 10-Q, we refer to “recurring revenues” and “non-current patent royalties.” Recurring revenues are comprised of “current patent royalties” and “current technology solutions revenue.” Non-current patent royalties are comprised of “past patent royalties” and “static fixed-fee revenue.”

New Accounting Guidance

In first quarter 2018, we adopted ASU No. 2014-09, "Revenue from Contracts with Customers (Topic 606)" ("ASC 606"). We adopted the requirements of the new standard as of January 1, 2018 using the modified retrospective method. This resulted in a cumulative adjustment of \$161.3 million to retained earnings.

The adoption of the new guidance affected our recognition of revenue from both our fixed-fee and per-unit license agreements. For accounting purposes under this new guidance, we separate our fixed-fee license agreements into two categories: (i) those agreements that provide rights, over the term of the license, to future technologies that are highly interdependent or highly interrelated to the technologies provided at the inception of the agreement (“Dynamic Fixed-Fee Agreements”) and (ii) those agreements that do not provide for rights to such future technologies (“Static Fixed-Fee Agreements”). As a result of our adoption of the new guidance, we will continue to recognize revenue from Dynamic Fixed-Fee Agreements on a straight-line basis over the term of the related license agreement, while we expect to recognize most or all of the revenue from Static Fixed-Fee Agreements in the quarter the license agreement is signed. We will not recognize any ongoing revenue from Static Fixed-Fee Agreements already in existence at the time the guidance was adopted. Additionally, in the event a significant financing component is determined to exist in any of our agreements, we will recognize more or less revenue and corresponding interest expense or income, as appropriate.

Absent the adoption of ASC 606, we would have recognized \$16.3 million of additional revenue and \$4.0 million less interest expense in third quarter 2018, which after taxes would have resulted in \$13.6 million of additional net income for the three months ended September 30, 2018. Similarly, had we remained under ASC 605, for the nine months ended September 30, 2018, we would have recognized \$54.8 million of additional revenue and \$13.0 million less interest expense, which after taxes would have resulted in \$52.2 million of additional net income for the period. See Note 1, “Basis of Presentation,” in the Notes to Condensed Consolidated Financial Statements included in Part I, Item 1 of this Quarterly Report on Form 10-Q for further discussion on the adoption of ASC 606.

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### Recurring Revenue

Third quarter 2018 recurring revenue was \$75.0 million. Under ASC 605, recurring revenue for third quarter 2018 would have been \$91.2 million, compared to \$88.5 million in third quarter 2017, with the increase primarily driven by an increase in fixed-fee royalty revenues as a result of new license agreements signed in 2017 and 2018, partially offset by a decrease in variable patent royalty revenue primarily related to expired contracts and decreased shipments. Refer to "Results of Operations -- Third Quarter 2018 Compared to Third Quarter 2017" and "Results of Operations -- First Nine Months 2018 Compared to First Nine Months 2017" for further discussion of our 2018 revenue.

### Technicolor Acquisition

On July 30, 2018, we completed the acquisition of the patent licensing business of Technicolor, a worldwide technology leader in the media and entertainment sector (the "Technicolor Acquisition"). The final transaction includes the acquisition by InterDigital of approximately 18,000 patents and applications, across a broad range of technologies, including approximately 3,000 worldwide video coding patents and applications. Refer to Note 9, "Business Combinations," in the Notes to Condensed Consolidated Financial Statements included in Part I, Item 1 of this Quarterly Report on Form 10-Q for more information on this transaction.

### Share Repurchase Program

During the nine months ended September 30, 2018, we repurchased 0.5 million shares for \$43.5 million under the 2014 Repurchase Program. As of September 30, 2018, there was approximately \$135.1 million remaining under the stock repurchase authorization.

### Comparability of Financial Results

When comparing third quarter 2018 financial results against other periods, the following items should be taken into consideration:

discrete net benefits of \$14.7 million primarily related to an anticipated refund that the Company expects to receive from amending tax returns for tax years covered by the Competent Authority Proceeding discussed in Note 2, "Income Taxes," in the Notes to Condensed Consolidated Financial Statements included in Part I, Item 1 of this Quarterly Report on Form 10-Q;

an aggregate \$8.4 million loss recognized during third quarter 2018 related to the sale of our entire ownership interest in one of our strategic investments and the impairment of a separate strategic investment;

\$5.4 million of transaction and integration costs related to the Technicolor Acquisition; and

as discussed above, assuming we had not adopted ASC 606, we would have recognized \$16.3 million of additional revenue and \$4.0 million less interest expense in third quarter 2018, which after taxes would have resulted in \$13.6 million of additional net income for the three months ended September 30, 2018. For the nine months ended September 30, 2018, we would have recognized \$54.8 million of additional revenue and \$13.0 million less interest expense, which after taxes would have resulted in \$52.2 million of additional net income.

### CRITICAL ACCOUNTING POLICIES AND ESTIMATES

Our significant accounting policies are described in Note 1 of the Notes to Consolidated Financial Statements included in our 2017 Form 10-K. A discussion of our critical accounting policies, and the estimates related to them, are included in Management's Discussion and Analysis of Financial Condition and Results of Operations in our 2017 Form 10-K. With the exception of our adoption of ASC 606 as discussed below, there have been no material changes to our existing critical accounting policies from the disclosures included in our 2017 Form 10-K. Refer to Note 1, "Basis of Presentation," in the Notes to Condensed Consolidated Financial Statements included in Part I, Item 1 of this Quarterly Report on Form 10-Q for updates related to new accounting pronouncements and changes in accounting policies. See below for critical accounting estimates from the current year period.

### Revenue Recognition

Beginning January 1, 2018, we adopted ASC 606. See Note 1, "Basis of Presentation," to the Notes to Condensed Consolidated Financial Statements included in Part I, Item 1 of this Quarterly Report on Form 10-Q for discussion regarding this new accounting policy.

### FINANCIAL POSITION, LIQUIDITY AND CAPITAL RESOURCES



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Our primary sources of liquidity are cash, cash equivalents and short-term investments, as well as cash generated from operations. We believe we have the ability to obtain additional liquidity through debt and equity financings. Based on our past performance and current expectations, we believe our available sources of funds, including cash, cash equivalents and short-term investments and cash generated from our operations, will be sufficient to finance our operations, capital requirements, debt obligations, existing stock repurchase program and dividend program for the next twelve months.

Cash, cash equivalents, restricted cash and short-term investments

As of September 30, 2018, and December 31, 2017, we had the following amounts of cash, cash equivalents, restricted cash and short-term investments (in thousands):

|  | September 30,<br>2018 | December 31,<br>2017 | Increase /<br>(Decrease) |
|--|-----------------------|----------------------|--------------------------|
| Cash and cash equivalents  | \$ 508,829            | \$ 433,014           | \$ 75,815                |
| Restricted cash included within prepaid and other current assets         | 15,942                | —                    | 15,942                   |
| Short-term investments   | 549,521               | 724,981              | (175,460 )               |
| Total cash, cash equivalents, restricted cash and short-term investments | \$ 1,074,292          | \$ 1,157,995         | \$(83,703 )              |

The net decrease in cash, cash equivalents, restricted cash and short-term investments was primarily attributable to cash used in investing activities of \$177.6 million, primarily related to the Technicolor Acquisition, as well as capital investments for patents and fixed assets and additional long-term strategic investments. Cash used in financing activities of \$82.1 million for dividend payments, share repurchases and cash payments for payroll taxes upon vesting of restricted stock units, slightly offset by proceeds received from the exercise of stock options, further contributed to the decrease. These decreases were partially offset by \$176.6 million of cash provided by operating activities. Please see below for further discussion of these items.

Cash flows from operations

We generated the following cash flows from our operating activities in first nine months 2018 and 2017 (in thousands):

|   | For the Nine Months Ended<br>September 30, |           |                          |
|---|--|-----------|--------------------------|
|   | 2018                                       | 2017      | Increase /<br>(Decrease) |
| Net cash provided by operating activities | \$ 176,617                                 | \$ 98,341 | \$ 78,276                |

Our cash flows provided by operating activities are principally derived from cash receipts from patent license and technology solutions agreements offset by cash operating expenses and income tax payments. The increase in cash flows provided by operating activities of \$78.3 million was primarily attributable to a timing difference within our working capital accounts related to the Competent Authority Proceeding discussed in Note 2, "Income Taxes." Additionally, an increase in cash receipts of \$18.0 million driven by new license agreements in 2018 contributed to the increase in cash provided by operating activities. The table below sets forth the significant items comprising our cash flows provided by (used in) operating activities during the nine months ended September 30, 2018 and 2017 (in thousands).

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|   | For the Nine Months Ended |           |                          |
|---|---------------------------|-----------|--------------------------|
|   | September 30,             |           |                          |
|   | 2018                      | 2017      | Increase /<br>(Decrease) |
| <b>Cash Receipts:</b>                                 |                           |           |                          |
| Patent royalties                                      | \$252,783                 | \$229,785 | \$ 22,998                |
| Technology solutions                                  | 9,306                     | 14,325    | (5,019 )                 |
| Total cash receipts                                   | \$262,089                 | \$244,110 | \$ 17,979                |
| <b>Cash Outflows:</b>                                 |                           |           |                          |
| Cash operating expenses <sup>a</sup>                  | 121,429                   | 115,133   | 6,296                    |
| Income taxes paid <sup>b</sup>                        | 24,459                    | 29,173    | (4,714 )                 |
| Total cash outflows                                   | 145,888                   | 144,306   | 1,582                    |
| Other working capital adjustments                     | 60,416                    | (1,463 )  | 61,879                   |
| Cash flows provided by (used in) operating activities | \$ 176,617                | \$98,341  | \$ 78,276                |

(a) Cash operating expenses include operating expenses less depreciation of fixed assets, amortization of patents and non-cash compensation.

(b) Income taxes paid include foreign withholding taxes.

**Working capital**

We believe that working capital adjusted to exclude cash, cash equivalents and short-term investments and to include current deferred revenue provides additional information about non-cash assets and liabilities that might affect our near-term liquidity. While we believe cash and short-term investments are important measures of our liquidity, the remaining components of our current assets and current liabilities, with the exception of deferred revenue, could affect our near-term liquidity and/or cash flow. We have no material obligations associated with our deferred revenue, and the amortization of deferred revenue has no impact on our future liquidity and/or cash flow. Our adjusted working capital, a non-GAAP financial measure, reconciles to working capital, the most directly comparable GAAP financial measure, as of September 30, 2018, and December 31, 2017 (in thousands), as follows:

|                           | September 30, | December 31, | Increase /  |
|---------------------------|---------------|--------------|-------------|
|                           | 2018          | 2017         | (Decrease)  |
| Current assets            | \$ 1,190,912  | \$ 1,395,794 | \$(204,882) |
| Less: current liabilities | 293,552       | 376,441      | (82,889 )   |
| Working capital           | 897,360       | 1,019,353    | (121,993 )  |
| <b>Subtract:</b>          |               |              |             |
| Cash and cash equivalents | 508,829       | 433,014      | 75,815      |
| Short-term investments    | 549,521       | 724,981      | (175,460 )  |
| <b>Add:</b>               |               |              |             |
| Current deferred revenue  | 134,197       | 307,142      | (172,945 )  |
| Adjusted working capital  | \$(26,793 )   | \$ 168,500   | \$(195,293) |

The \$195.3 million net decrease in adjusted working capital is primarily attributable to a decrease in accounts receivable with an offset to deferred revenue as a result of our adoption of ASC 606. Refer to Note 1, "Basis of Presentation," for more information on this adoption. Additionally, an increase in taxes payable, partially offset by an increase in other assets, is related to the Competent Authority Proceeding discussed in Note 2, "Income Taxes."





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## Cash flows from investing and financing activities

Net cash used in investing activities for first nine months 2018 was \$2.8 million, a \$162.8 million decrease from \$165.6 million net cash used in first nine months 2017. We sold \$174.9 million, net of purchases, of short-term marketable securities in first nine months 2018, as compared to purchases of \$135.1 million, net of sales, in first nine months 2017. We applied a substantial portion of the proceeds from our sale of short-term marketable securities toward the \$143.0 million, net of cash acquired, paid for the Technicolor Acquisition in first nine months 2018.

Long-term investments increased by \$3.5 million due to an increase in strategic investment activity.

Net cash used in financing activities for first nine months 2018 was \$82.1 million, a \$28.8 million increase from \$53.3 million in first nine months 2017. This change was primarily attributable to a \$43.5 million increase in repurchases of common stock and a \$5.4 million increase in dividends paid. These increases in cash used in financing activities were partially offset by a \$13.8 million decrease in payroll taxes upon the vesting of restricted stock units and a \$6.3 million increase in net proceeds from the exercise of stock options. The decrease in payroll taxes was driven by both a greater number of restricted stock units vested and a higher share price on their vesting date in first nine months 2017 as compared to restricted stock unit vestings in first nine months 2018. The increase in dividend payments was attributable to the September 2017 increase in the Company's regular quarterly cash dividend, from \$0.30 per share to \$0.35 per share.

## Other

Our combined short-term and long-term deferred revenue balance as of September 30, 2018 was approximately \$269.7 million, a decrease of \$347.2 million from December 31, 2017. The decrease was primarily due to our adoption of ASC 606. Refer to Note 1, "Basis of Presentation," for more information.

Based on current license agreements, we expect the amortization of dynamic fixed-fee royalty payments to reduce the September 30, 2018 deferred revenue balance of \$269.7 million by \$134.2 million over the next twelve months.

## Convertible Notes

Our 1.50% Senior Convertible Notes due 2020 (for purposes of this discussion, the "Convertible Notes") are included in the dilutive earnings per share calculation using the treasury stock method. Under the treasury stock method, we must calculate the number of shares of common stock issuable under the terms of the Convertible Notes based on the average market price of our common stock during the applicable reporting period, and include that number in the total diluted shares figure for the period. At the time we issued the Convertible Notes, we entered into convertible note hedge and warrant agreements that together were designed to have the economic effect of reducing the net number of shares that will be issued in the event of conversion of the Convertible Notes by, in effect, increasing the conversion price of the Convertible Notes from our economic standpoint. However, under GAAP, since the impact of the convertible note hedge agreements is anti-dilutive, we exclude from the calculation of fully diluted shares the number of shares of our common stock that we would receive from the counterparties to these agreements upon settlement. During periods in which the average market price of the Company's common stock is above the applicable conversion price of the Convertible Notes (\$71.74 per share as of September 30, 2018) or above the strike price of the warrants (\$87.68 per share as of September 30, 2018), the impact of conversion or exercise, as applicable, would be dilutive and such dilutive effect is reflected in diluted earnings per share. As a result, in periods where the average market price of the Company's common stock is above the conversion price or strike price, as applicable, under the treasury stock method, the Company calculates the number of shares issuable under the terms of the Convertible Notes and the warrants based on the average market price of the stock during the period, and includes that number in the total diluted shares outstanding for the period.

Under the treasury stock method, changes in the price per share of our common stock can have a significant impact on the number of shares that we must include in the fully diluted earnings per share calculation. As described in Note 7, "Long-Term Debt," it is our current intent and policy to settle all conversions of the Convertible Notes through a combination settlement of cash and shares of common stock, with a specified dollar amount of \$1,000 per \$1,000 principal amount of the Convertible Notes and any remaining amounts in shares ("net share settlement"). Assuming net share settlement upon conversion, the following table illustrates how, based on the \$316.0 million aggregate principal amount of Convertible Notes outstanding as of September 30, 2018 and the approximately 4.4 million warrants outstanding as of the same date, changes in our stock price would affect (i) the number of shares issuable

upon conversion of the Convertible Notes, (ii) the number of shares issuable upon exercise of the warrants subject to the warrant agreements, (iii) the number of additional shares deemed outstanding with respect to the Convertible Notes, after applying the treasury stock method, for purposes of calculating diluted earnings per share ("Total Treasury Stock Method Incremental Shares"), (iv) the number of shares of common stock deliverable to us upon settlement of the hedge agreements and (v) the number of shares issuable upon concurrent conversion of the Convertible Notes, exercise of the warrants and settlement of the convertible note hedge agreements:

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| Market Price Per Share | Shares Issuable Upon Conversion of Convertible Notes | Shares Issuable Upon Exercise of Warrants | Total Treasury Stock Method Incremental Shares | Shares Deliverable to InterDigital upon Settlement of the Hedge Agreements | Incremental Shares Issuable (a) |
|------------------------|--|---|--|--|---------------------------------|
|                        | (Shares in thousands)                                |   |  |  |                                 |
| \$75                   | 191  | —   | 191  | (191)  | —                               |
| \$80                   | 455  | —   | 455  | (455)  | —                               |
| \$85                   | 687  | —   | 687  | (687)  | —                               |
| \$90                   | 894  | 114                                       | 1,008  | (894)  | 114                             |
| \$95                   | 1,078  | 339                                       | 1,417  | (1,078)  | 339                             |
| \$100                  | 1,245  | 543                                       | 1,788  | (1,245)  | 543                             |
| \$105                  | 1,395  | 727                                       | 2,122  | (1,395)  | 727                             |
| \$110                  | 1,532  | 894                                       | 2,426  | (1,532)  | 894                             |
| \$115                  | 1,657  | 1,046                                     | 2,703  | (1,657)  | 1,046                           |
| \$120                  | 1,771  | 1,186                                     | 2,957  | (1,771)  | 1,186                           |

(a) Represents incremental shares issuable upon concurrent conversion of convertible notes, exercise of warrants and settlement of the hedge agreements.

**RESULTS OF OPERATIONS**

Third Quarter 2018 Compared to Third Quarter 2017

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## Revenues

The following table compares third quarter 2018 revenues to third quarter 2017 revenues (in thousands):

|  | For the Three<br>Months Ended<br>September 30, |          | Total<br>Increase/(Decrease) |       | Components of<br>Increase/(Decrease) |             |            |
|--|--|----------|------------------------------|-------|--------------------------------------|-------------|------------|
|  | 2018   | 2017     |                              |       | Due to<br>ASC 606                    | Operational | Total      |
| Variable patent royalty revenue          | \$13,645                                       | \$10,081 | \$3,564                      | 35 %  | \$5,242                              | \$(1,678)   | \$3,564    |
| Fixed-fee royalty revenue                | 60,272   | 73,653   | (13,381)                     | (18)% | (20,309)                             | 6,928       | (13,381)   |
| Current patent royalties (a)             | 73,917   | 83,734   | (9,817)                      | (12)% | (15,067)                             | 5,250       | (9,817)    |
| Non-current patent royalties (b)         | 128  | 8,832    | (8,704)                      | (99)% | —                                    | (8,704)     | (8,704)    |
| Total patent royalties                   | 74,045   | 92,566   | (18,521)                     | (20)% | (15,067)                             | (3,454)     | (18,521)   |
| Current technology solutions revenue (a) | 1,034  | 4,759    | (3,725)                      | (78)% | (1,197)                              | (2,528)     | (3,725)    |
| Total revenue                            | \$75,079                                       | \$97,325 | \$(22,246)                   | (23)% | \$(16,264)                           | \$(5,982)   | \$(22,246) |

(a) Recurring revenues consist of current patent royalties, inclusive of Dynamic Fixed-Fee Agreement royalties, and current technology solutions revenue.

(b) Non-current patent royalties for the three months ended September 30, 2018 consist of past patent royalties and royalties from static agreements. For the three months ended September 30, 2017, non-current patent royalties consist of past patent royalties.

As discussed above, we adopted new revenue guidance, ASC 606, effective January 1, 2018. Consistent with the modified retrospective adoption method, our results of operations for periods prior to our adoption of ASC 606 remain unchanged. As a result, the difference in accounting principles resulting from the adoption of ASC 606 accounted for \$16.3 million of the decrease in net revenue. This decrease was primarily related to pre-existing static fixed-fee license agreements.

The \$6.0 million "Operational" decrease in total revenue was primarily driven by a decrease in non-current patent royalties, as in third quarter 2017 we recognized \$8.8 million in such royalties primarily related to the transfer of the remaining patents pursuant to our patent license agreement with Huawei. The decreases in current technology solutions revenue and variable patent royalties primarily related to the expiration of certain fixed-fee and technology solutions agreements at the end of 2017 and decreased shipments by certain of our variable licensees, respectively. These decreases were partially offset by the LG Electronics ("LG") dynamic fixed-fee agreement signed in fourth quarter 2017 and new dynamic fixed-fee agreements signed during 2018.

In third quarter 2018 and third quarter 2017, 84% and 73% of our total revenue, respectively, was attributable to companies that individually accounted for 10% or more of our total revenue. In third quarter 2018 and third quarter 2017, the following companies accounted for 10% or more of our total revenue:

|                    | For the<br>Three<br>Months<br>Ended<br>September<br>30,<br>2018 |      | 2017 |  |
|--------------------|---|------|------|--|
| Apple              | 37%   | 29%  |      |  |
| Samsung            | 26%   | 18%  |      |  |
| LG                 | 11%   | —%   |      |  |
| Asustek            | 10%   | <10% |      |  |
| Huawei             | —%  | 26%  |      |  |
| Operating Expenses |   |      |      |  |

The following table summarizes the changes in operating expenses between third quarter 2018 and third quarter 2017 by category (in thousands):

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|                                     | For the Three<br>Months Ended<br>September 30, |          | Increase/(Decrease) |      |
|-------------------------------------|--|----------|---------------------|------|
|                                     | 2018   | 2017     |                     |      |
| Patent administration and licensing | \$32,077                                       | \$26,517 | \$ 5,560            | 21 % |
| Development                         | 17,276   | 17,293   | (17 )               | — %  |
| Selling, general and administrative | 12,806   | 12,640   | 166                 | 1 %  |
| Total operating expenses            | \$62,159                                       | \$56,450 | \$ 5,709            | 10 % |

Operating expenses increased to \$62.2 million in third quarter 2018 from \$56.5 million in third quarter 2017. The \$5.7 million increase in total operating expenses was primarily due to changes in the following items (in thousands):

|  | Increase/<br>(Decrease) |
|--|-------------------------|
| Technicolor Acquisition-related costs    | \$ 11,540               |
| Other                                    | (1,204 )                |
| Consulting services                      | (1,852 )                |
| Performance-based incentive compensation | (1,484 )                |
| Personnel-related costs                  | (1,291 )                |
| Total increase in operating expenses     | \$ 5,709                |

The \$5.7 million increase in operating expenses was primarily driven by the Technicolor Acquisition, which contributed \$11.5 million to our third quarter 2018 operating expenses. The \$11.5 million of costs is comprised of \$5.4 million of one-time transaction-related costs incurred during the quarter, as well as \$6.1 million for two months of operating expenses for the acquired Technicolor business, of which \$2.7 million relates to patent amortization. The \$1.9 million decrease in consulting services was primarily related to spending on corporate initiatives, including the implementation of a new enterprise resource planning system in third quarter 2017. The decrease in performance-based incentive compensation was primarily related to higher accrual rates in third quarter 2017 as compared to third quarter 2018. The \$1.3 million decrease in personnel-related costs was primarily due to a reduction in headcount in an ongoing effort to optimize our cost structure.

**Patent Administration and Licensing Expense:** The increase in patent administration and licensing expense primarily resulted from the above-noted increases related to the Technicolor Acquisition. These increases were partially offset by the above-noted decrease in performance-based compensation.

**Development Expense:** The decrease in development expense primarily related to the above-noted decrease in personnel-related costs, as well as reduced spending on the development of commercial solutions in an ongoing effort to optimize our cost structure. These decreases were partially offset by costs associated with the jointly funded R&D collaboration with Technicolor R&I.

**Selling, General and Administrative Expense:** The increase in selling, general and administrative expense primarily resulted from the above-noted increases related to the Technicolor Acquisition. These increases were partially offset by the above-noted decreases in performance-based compensation and consulting services.

#### Other (Expense) Income

The following table compares third quarter 2018 other (expense) income to third quarter 2017 other (expense) income (in thousands):

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|                                | For the Three<br>Months Ended<br>September 30, |            |            |         |
|--------------------------------|--|------------|------------|---------|
|                                | 2018   | 2017       | Change     |         |
| Interest expense               | \$(9,039 )                                     | \$(4,480 ) | \$(4,559 ) | (102 )% |
| Other                          | (8,654 )                                       | 130        | (8,784 )   | 6,757 % |
| Interest and investment income | 3,740  | 2,163      | 1,577      | 73 %    |
|                                | \$(13,953)                                     | \$(2,187)  | \$(11,766) | (538 )% |

Third quarter 2018 other expense includes an aggregate \$8.4 million loss related to the sale of one of our strategic long-term investments and the impairment of a separate strategic long-term investment during the period. Related to the adoption of ASC 606, as discussed above, third quarter 2018 includes \$4.0 million of interest expense related to significant financing components of patent license agreements. Interest expense also increased by \$0.4 million due to interest incurred on long-term debt resulting from the Technicolor Acquisition. The remaining change between periods was primarily due to the increase in interest and investment income of \$1.6 million primarily due to higher average investment balances and higher returns during third quarter 2018 as compared to third quarter 2017.

**Income tax provision**

Third quarter 2018 includes a tax benefit of \$21.1 million, including discrete net benefits of \$14.7 million. The effective rate would have been a benefit of 620.0% not including these discrete net benefits. The effective tax rate for third quarter 2018 was favorably impacted by provisions contained within the Tax Cuts and Jobs Act of 2017 (the "Tax Reform Act"), discussed below. Additionally, our third quarter 2018 effective tax rate includes discrete net benefits of \$15.7 million primarily related to an anticipated refund that the Company expects to receive from amending tax returns for tax years covered by the Competent Authority Proceeding discussed in Note 2, "Income Taxes.". This is compared to an effective tax rate of 10.2% based on the statutory federal tax rate net of discrete federal and state taxes during third quarter 2017. The third quarter 2017 effective tax rate included a \$9.1 million discrete net benefit primarily related to the reversal of uncertain tax positions associated with domestic production activities refund claims.

On December 22, 2017, the Tax Reform Act was signed into law. The Tax Reform Act significantly revised the U.S. corporate income tax regime by, among other things: lowering the U.S. corporate tax rate from 35% to 21% effective January 1, 2018; imposing a 13.125% tax rate on income that qualifies as FDII; repealing the deduction for domestic production activities; implementing a territorial tax system; and imposing a repatriation tax on deemed repatriated earnings of foreign subsidiaries. The third quarter 2018 effective tax rate includes a forecasted \$16.8 million net benefit related to our income qualifying as FDII.

**First Nine Months 2018 Compared to First Nine Months 2017****Revenues**

The following table compares first nine months 2018 revenues to first nine months 2017 revenues (in thousands):

|  | For the Nine<br>Months Ended<br>September 30, |           |                              | Components of<br>Increase/(Decrease) |             |             |             |
|--|---|-----------|------------------------------|--------------------------------------|-------------|-------------|-------------|
|  | 2018  | 2017      | Total<br>Increase/(Decrease) | Due to<br>ASC 606                    | Operational | Total       |             |
| Variable patent royalty revenue          | \$26,322                                      | \$37,338  | \$(11,016 )                  | (\$30 )%                             | \$466       | \$(11,482 ) | \$(11,016 ) |
| Fixed-fee royalty revenue                | 178,207                                       | 220,083   | (41,876 )                    | (19 )%                               | (60,081 )   | 18,205      | (41,876 )   |
| Current patent royalties (a)             | 204,529                                       | 257,421   | (52,892 )                    | (21 )%                               | (59,615 )   | 6,723       | (52,892 )   |
| Non-current patent royalties (b)         | 25,489  | 56,692    | (31,203 )                    | (55 )%                               | 10,000      | (41,203 )   | (31,203 )   |
| Total patent royalties                   | 230,018                                       | 314,113   | (84,095 )                    | (27 )%                               | (49,615 )   | (34,480 )   | (84,095 )   |
| Current technology solutions revenue (a) | 2,060   | 13,521    | (11,461 )                    | (85 )%                               | (5,232 )    | (6,229 )    | (11,461 )   |
| Total revenue                            | \$232,078                                     | \$327,634 | \$(95,556 )                  | (29 )%                               | \$(54,847)  | \$(40,709 ) | \$(95,556)  |

(a)



Recurring revenues consist of current patent royalties, inclusive of Dynamic Fixed-Fee Agreement royalties, and current technology solutions revenue.

Non-current patent royalties for the nine months ended September 30, 2018 consist of past patent royalties and (b) royalties from static agreements. For the nine months ended September 30, 2017, non-current patent royalties consist of past patent royalties.

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As discussed above, we adopted new revenue guidance, ASC 606, effective January 1, 2018. Consistent with the modified retrospective adoption method, our results of operations for periods prior to our adoption of ASC 606 remain unchanged. As a result, the difference in accounting principles resulting from the adoption of ASC 606 accounted for \$54.8 million of the decrease in net revenue. This decrease was primarily related to pre-existing static fixed-fee license agreements and prepayment agreements, as well as the elimination of quarter-lag reporting for our per-unit license agreements.

Total "Operational" revenues decreased by \$40.7 million compared to first nine months 2017, primarily driven by non-current patent royalties related to the Microsoft settlement agreement signed in second quarter 2017 and the transfer of the remaining patents pursuant to our Huawei patent license agreement in third quarter 2017. The decreases in variable patent royalties and current technology solutions revenue primarily related to decreased licensee shipments and the expiration of agreements with certain of our variable licensees, and the expiration of certain fixed-fee and technology solutions agreements at the end of 2017, respectively. These decreases were partially offset by the LG dynamic fixed-fee agreement signed in fourth quarter 2017 and new dynamic fixed-fee agreements signed during 2018.

In first nine months 2018 and first nine months 2017, 71% and 74% of our total revenue, respectively, was attributable to companies that individually accounted for 10% or more of our total revenue. In first nine months 2018 and first nine months 2017, the following companies accounted for 10% or more of our total revenue:

|           | For the<br>Nine<br>Months<br>Ended<br>September<br>30,<br>2018 2017 |     |
|-----------|---|-----|
| Apple     | 36%   | 26% |
| Samsung   | 25%   | 16% |
| LG        | 10%   | —%  |
| Microsoft | —%  | 14% |
| Huawei    | —%  | 18% |

## Operating Expenses

The following table summarizes the changes in operating expenses between first nine months 2018 and first nine months 2017 by category (in thousands):

|                                     | For the Nine<br>Months Ended<br>September 30, |           |                     |        |
|-------------------------------------|---|-----------|---------------------|--------|
|                                     | 2018  | 2017      | Increase/(Decrease) |        |
| Patent administration and licensing | \$85,480                                      | \$76,629  | \$ 8,851            | 12 %   |
| Development                         | 49,279  | 56,172    | (6,893 )            | (12 )% |
| Selling, general and administrative | 38,569  | 39,042    | (473 )              | (1 )%  |
| Total operating expenses            | \$173,328                                     | \$171,843 | \$ 1,485            | 1 %    |

Operating expenses increased 1% to \$173.3 million in first nine months 2018 from \$171.8 million in first nine months 2017. The \$1.5 million increase in total operating expenses was primarily due to changes in the following items (in thousands):

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|   | Increase/(Decrease) |
|---|---------------------|
| Technicolor Acquisition-related costs                       | \$ 15,261           |
| Intellectual property enforcement and non-patent litigation | 4,227               |
| Depreciation and amortization                               | 1,598               |
| Performance-based incentive compensation                    | (6,781 )            |
| Consulting services   | (4,789 )            |
| Personnel-related costs                                     | (3,817 )            |
| Commercial initiatives                                      | (1,701 )            |
| Patent maintenance  | (1,438 )            |
| Other   | (1,075 )            |
| Total increase in operating expenses                        | \$ 1,485            |

The \$1.5 million increase in operating expenses was primarily driven by the Technicolor Acquisition, which contributed \$15.3 million to our first nine months 2018 operating expenses. The \$15.3 million of costs is comprised of \$9.2 million of one-time transaction-related costs incurred during first nine months 2018, as well as \$6.1 million for two months of operating expenses for the acquired Technicolor business, of which \$2.7 million relates to patent amortization. The \$4.2 million increase in intellectual property enforcement was primarily due to increased activity related to existing licensee disputes. The \$1.6 million increase in depreciation and amortization, which does not include the previously mentioned amortization from the Technicolor Acquisition, was primarily related to the growth in our patent portfolio driven by both internal patent generation and patent acquisition. The \$6.8 million decrease in performance-based incentive compensation was primarily related to higher accrual rates in first nine months 2017, as well as a greater number of active long-term compensation cycles in first nine months of 2017. The \$4.8 million decrease in consulting services was primarily related to spending on corporate initiatives, including the implementation of a new enterprise resource planning system in first nine months 2017. The \$3.8 million decrease in personnel-related costs was due to a reduction in headcount in an ongoing effort to optimize our cost structure. The \$1.7 million decrease in commercial initiatives was primarily attributable to reduced spending on the development of commercial solutions and on-going efforts to optimize our cost structure. The \$1.4 million decrease in patent maintenance costs was a result of our initiatives to more efficiently prosecute and maintain our patent portfolio. Patent Administration and Licensing Expense: The increase in patent administration and licensing expense primarily resulted from the above-noted increases related to the Technicolor acquisition, intellectual property enforcement costs and patent amortization expense. These increases were partially offset by decreased performance-based incentive compensation and patent maintenance costs as discussed above.

Development Expense: The decrease in development expense primarily resulted from the above-noted decreases in performance-based incentive compensation, commercial initiatives and personnel-related costs. Additionally, lower consulting services related to development projects contributed to this decrease.

Selling, General and Administrative Expense: The slight decrease in selling, general and administrative expense primarily resulted from the above-noted decreases in performance-based incentive compensation, personnel-related costs and consulting services expense. These decreases were partially offset by the above-noted increases related to the Technicolor Acquisition.

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## Other (Expense) Income

The following table compares first nine months 2018 other (expense) income to first nine months 2017 other (expense) income (in thousands):

|                                | For the Nine Months<br>Ended September 30, |            |            |          |   |
|--------------------------------|--|------------|------------|----------|---|
|                                | 2018                                       | 2017       | Change     |          |   |
| Interest expense               | \$(27,242)                                 | \$(13,308) | \$(13,934) | (105)    | % |
| Other                          | (8,907)                                    | 26         | (8,933)    | (34,358) | % |
| Interest and investment income | 11,013                                     | 5,951      | 5,062      | 85       | % |
|                                | \$(25,136)                                 | \$(7,331)  | \$(17,805) | (243)    | % |

First nine months 2018 other expense includes an aggregate \$8.4 million loss related to the sale of one of our strategic long-term investments and the impairment of a separate strategic long-term investment during the period. Related to the adoption of ASC 606, as discussed above, first nine months 2018 includes \$13.0 million of interest expense related to significant financing components of patent license agreements. Interest expense also increased by \$0.4 million due to interest incurred on long-term debt resulting from the Technicolor Acquisition. The remaining change between periods was primarily due to the increase in interest and investment income of \$5.1 million primarily due to higher average investment balances and higher returns during first nine months 2018 as compared to first nine months 2017.

## Income tax provision

In first nine months 2018, based on the statutory federal tax rate net of discrete federal and state taxes, our effective tax rate was a benefit of 74.4%. The effective tax rate for first nine months 2018 was favorably impacted by provisions contained within the Tax Reform Act. Additionally, we recorded discrete net benefits of \$18.4 million from excess tax benefits related to share-based compensation, our sale of a commercial initiative and a net benefit from anticipated amended tax returns that the Company will file in connection with the Competent Authority Proceeding discussed further in Note 2, "Income Taxes." The effective rate would have been a benefit of 19.7% not including these discrete benefits. This is compared to an effective tax rate provision of 19.8% based on the statutory federal tax rate net of discrete federal and state taxes during first nine months 2017. The effective tax rate for first nine months 2017 included a \$12.1 million discrete benefit, primarily related to excess tax benefits from share-based compensation, and a \$9.1 million discrete benefit, primarily related to the reversal of uncertain tax positions associated with domestic production activities refund claims. The effective tax rate would have been a provision of 34.2% not including these discrete benefits for first nine months 2017.

STATEMENT PURSUANT TO THE PRIVATE SECURITIES LITIGATION REFORM ACT OF 1995 —  
FORWARD-LOOKING STATEMENTS

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This Quarterly Report on Form 10-Q contains forward-looking statements within the meaning of Section 21E of the Securities Exchange Act of 1934, as amended. Such statements include certain information under the heading “Item 2. Management’s Discussion and Analysis of Financial Condition and Results of Operations” and other information regarding our current beliefs, plans and expectations, including without limitation the matters set forth below. Words such as “anticipate,” “estimate,” “expect,” “project,” “intend,” “plan,” “forecast,” “goal,” variations of any such words or similar expressions are intended to identify such forward-looking statements. Forward-looking statements in this Quarterly Report on Form 10-Q include, without limitation, statements regarding:

- Our expectations regarding the potential effects of new accounting standards, including the new revenue recognition guidance, on our financial position, results of operations or cash flows;
- Our expectation that the amortization of dynamic fixed-fee royalty payments will reduce our September 30, 2018 deferred revenue balance over the next twelve months;
- Our expectations with respect to revenue to be recognized based on contracts signed and committed Dynamic Fixed-Fee Agreement payments as of September 30, 2018;
- Our expectations and estimations regarding the income tax effects, and the impact on the Company, of the Tax Reform Act, including our forecasted net benefit related to our income qualifying as FDII;
- Our expectations with respect to anticipated tax refunds to be received from amending certain tax returns;
- The timing, outcome and impact of, and plans, expectations and beliefs with respect to, our various litigation, arbitration, regulatory and administrative matters;
- Our belief that we have the ability to obtain additional liquidity through debt and equity financings;
- Our expectations with respect to the impact of the Technicolor Acquisition on our financial statements and our business;
- Our belief that our available sources of funds will be sufficient to finance our operations, capital requirements, debt obligations, existing stock repurchase program and dividend program for the next twelve months; and
- Our expectation that we will continue to pay dividends comparable to our quarterly \$0.35 per share cash dividend in the future.

Forward-looking statements concerning our business, results of operations and financial condition are inherently subject to risks and uncertainties that could cause actual results, and actual events that occur, to differ materially from results contemplated by the forward-looking statements. These risks and uncertainties include, but are not limited to, the risks and uncertainties outlined in greater detail in Part I, Item 1A of our 2017 Form 10-K, Part II, Item 1A of our Quarterly Report on Form 10-Q for the quarter ended March 31, 2018, and Part II, Item 1A Risk Factors in this Quarterly Report on Form 10-Q. We undertake no obligation to revise or update publicly any forward-looking statement for any reason, except as otherwise required by law.

### Item 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK.

There have been no material changes in quantitative and qualitative market risk from the disclosures included in our 2017 Form 10-K.

### Item 4. CONTROLS AND PROCEDURES.

The Company’s principal executive officer and principal financial officer, with the assistance of other members of management, have evaluated the effectiveness of our disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended) as of the end of the period covered by this report. Based on that evaluation, the Chief Executive Officer and Chief Financial Officer have concluded that our disclosure controls and procedures were effective to ensure that the information required to be disclosed by us in the reports that we file or submit under the Securities Exchange Act of 1934, as amended, is recorded, processed, summarized and reported within the time periods specified in the SEC’s rules and forms and to ensure that the information required to be disclosed by us in the reports that we file or submit under the Securities Exchange Act of 1934, as amended, is accumulated and communicated to our management, including our principal executive officer and principal financial officer, as appropriate, to allow timely decisions regarding required

disclosure. As permitted pursuant to guidance from the staff of the SEC with respect to newly acquired businesses, this evaluation did not include an assessment of those disclosure controls and procedures that are subsumed by internal control over financial reporting as it relates to the Technicolor Acquisition, which closed on July 30, 2018.

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Aside from the Technicolor Acquisition discussed above, there were no additional changes in our internal control over financial reporting that occurred during the quarter ended September 30, 2018, that materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

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PART II — OTHER INFORMATION

Item 1. LEGAL PROCEEDINGS.

ZTE China Proceedings

Reference is made to the ZTE China proceedings previously disclosed in our Annual Report on Form 10-K for the year ended December 31, 2017 (the “2017 Form 10-K”). On September 18, 2018, ZTE independently filed a petition with the Shenzhen Court to withdraw the complaint in its FRAND case against InterDigital, and on September 28, 2018, the Shenzhen Court granted ZTE’s petition and dismissed the FRAND case without prejudice. On October 25, 2018, ZTE independently filed a petition with the Shenzhen Court to withdraw the complaint in its anti-monopoly law case against InterDigital, and on October 26, 2018, the Shenzhen Court granted ZTE’s petition and dismissed the anti-monopoly law case without prejudice.

Asustek Actions

Reference is made to the Asustek actions previously disclosed in the 2017 Form 10-K, our Quarterly Report on Form 10-Q for the quarter ended March 31, 2018 (the “First Quarter 2018 Form 10-Q”) and our Quarterly Report on Form 10-Q for the quarter ended June 30, 2018 (the “Second Quarter 2018 Form 10-Q”). On August 16, 2018, the parties filed motions for summary judgment in the CA Northern District Court proceeding. InterDigital contends that (1) Asus is judicially estopped from arguing that the parties’ April 2008 patent license agreement (the “2008 Asus PLA”) is “non-FRAND” due to Asus’s prior inconsistent positions; (2) issue preclusion prevents Asus from re-litigating issues decided in the parties’ 2017 arbitration; (3) as a matter of law, Asus cannot void the binding and enforceable 2008 Asus PLA; and (4) Asus’s Sherman Act, promissory estoppel, and California UCL claims fail as a matter of law. For its part, Asus contends that, as a matter of law, InterDigital breached its contractual obligation to license its essential patents on FRAND terms and conditions by engaging in discriminatory licensing practices. The parties filed oppositions on September 13, 2018 and replies on September 27, 2018, and the court held an oral argument on October 11, 2018. These motions remain pending.

2013 USITC Proceeding (337-TA-868) and Related ZTE Delaware District Court Proceeding

Reference is made to the USITC proceeding and related Delaware District Court proceeding initiated in January 2013 involving InterDigital and ZTE previously disclosed in the 2017 Form 10-K, the First Quarter 2018 Form 10-Q and the Second Quarter 2018 Form 10-Q. The Delaware District Court proceeding remains stayed through at least January 23, 2019.

2011 USITC Proceeding (337-TA-800) and Related ZTE Delaware District Court Proceeding

Reference is made to the USITC proceeding and related Delaware District Court proceeding initiated in July 2011 involving InterDigital and ZTE previously disclosed in the 2017 Form 10-K, the First Quarter 2018 Form 10-Q and the Second Quarter 2018 Form 10-Q. The Delaware District Court proceeding is now stayed through December 10, 2018.

See Note 4, “Litigation and Legal Proceedings,” to the Notes to Condensed Consolidated Financial Statements included in Part I, Item 1 of this Quarterly Report on Form 10-Q for further discussion regarding these and other proceedings.

Item 1A. RISK FACTORS.

Reference is made to Part I, Item 1A, “Risk Factors” included in the 2017 Form 10-K for information concerning risk factors. We are updating the risk factors contained in the 2017 Form 10-K and the First Quarter 2018 Form 10-Q to include the risk factor set forth below.

The following risk factor should be read in conjunction with the risk factors discussed in Part I, Item 1A of the Form 10-K and in Part II, Item 1A of the First Quarter 2018 Form 10-Q, in addition to the factors set forth in the Statement Pursuant to the Private Securities Litigation Reform Act of 1995 -- Forward-Looking Statements in Part I, Item 2 of this Quarterly Report on Form 10-Q. You should carefully consider such factors, which could materially affect our business, financial condition or future results. The risks described in this Quarterly Report on Form 10-Q and in the



2017 Form 10-K and the First Quarter 2018 Form 10-Q are not the only risks facing our company. Additional risks and uncertainties not currently known to us or that we currently deem to be immaterial also may materially and adversely affect our business, financial condition and/or operating results.

We may experience difficulties or delays integrating, and may not be able to realize all of the anticipated benefits from the integration of, the Technicolor patent licensing business (the “Technicolor business”).

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We may experience difficulties integrating the Technicolor business, or may fail to realize the anticipated benefits from our integration of the Technicolor business on a timely basis, or at all, for a variety of reasons, including the following:

- failure of the acquisition to materially increase the value of our core handset licensing business by not increasing the royalty amount we would otherwise derive on each handset, not accelerating the pace of licensing, or not allowing us to avoid litigation to protect our intellectual property;
  - unexpected costs and strain on our resources and potential distraction of management arising from our attempts at integrating the businesses;
  - difficulties integrating the patent portfolios and related portfolio management systems of the businesses, or migrating the portfolios to a new patent management system, and the risk that the patent assets could be negatively impacted;
  - failure to continue to develop and expand our portfolio of video technology patent assets;
  - failure to develop a successful business plan and licensing program related to consumer electronics;
  - difficulties integrating the personnel of the Technicolor business into our operations, organization, and human resources programs, and the risk that we could lose key employees;
  - challenges associated with managing a geographically remote business;
  - failure to accurately forecast the long-term value and costs of the Technicolor business or of certain assets acquired in the transaction;
    - liabilities that are not covered by, or exceed the coverage under, the indemnification or other provisions of the acquisition-related agreements; and
  - patent validity, infringement or enforcement issues not uncovered during our diligence process.
- In the event that we experience significant integration difficulties or delays, or fail to realize the anticipated benefits from the integration, our business and results of operations, and our stock price, may be adversely affected.

## Item 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS.

## Issuer Purchases of Equity Securities

The following table provides information regarding Company purchases of its common stock during third quarter 2018.

| Period                                 | Total Number of Shares (or Units) Purchased (1) | Average Price Paid Per Share (or Unit) | Total Number of Shares (or Units) Purchased as Part of Publicly Announced Plans or Programs (2) | Maximum Number (or Approximate Dollar Value) of Shares (or Units) That May Yet Be Purchased Under the Plans or Programs (3) |
|--|---|--|---|---|
| July 1, 2018 - July 31, 2018           | 83,900  | \$ 81.54                               | 83,900  | \$ 162,562,816  |
| August 1, 2018 - August 31, 2018       | 153,799   | \$ 81.37                               | 153,799   | \$ 150,044,482  |
| September 1, 2018 - September 30, 2018 | 186,517   | \$ 80.26                               | 186,517   | \$ 135,070,343  |
| Total                                  | 424,216   | \$ 80.92                               | 424,216   | \$ 135,070,343  |

(1) Total number of shares purchased during each period reflects share purchase transactions that were completed (i.e. settled) during the period indicated.

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(2) Shares were purchased pursuant to the Company's \$500 million share repurchase program (the "2014 Repurchase Program"), \$300 million of which was authorized by the Company's Board of Directors on June 11, 2014 and announced on June 12, 2014, \$100 million of which was authorized by the Company's Board of Directors and announced on June 11, 2015, and \$100 million of which was authorized by the Company's Board of Directors and announced on September 14, 2017. The 2014 Repurchase Program has no expiration date. The Company may repurchase shares under the 2014 Repurchase Program through open market purchases, pre-arranged trading plans or privately negotiated purchases.

(3) Amounts shown in this column reflect the amounts remaining under the 2014 Repurchase Program.

Item 4. MINE SAFETY DISCLOSURES.

Not applicable.

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Item 6. EXHIBITS.

The following is a list of exhibits filed with this Quarterly Report on Form 10-Q:

| Exhibit Number | Exhibit Description   |
|----------------|---|
| 10.1*          | <u>2017 Equity Incentive Plan, Form of Term Sheet for 2018 Performance-Based Restricted Stock Unit Awards (Exhibit 10.1 to InterDigital, Inc.'s Current Report on Form 8-K dated July 9, 2018).</u> †   |
| 10.2*          | <u>2017 Equity Incentive Plan, Form of Term Sheet for 2018 Performance-Based Stock Option Awards (Exhibit 10.2 to InterDigital, Inc.'s Current Report on Form 8-K dated July 9, 2018).</u> †  |
| 10.3           | <u>2017 Equity Incentive Plan, Form of Agreement for Time-Based Restricted Stock Unit Awards (revised October 2018).</u> †  |
| 10.4           | <u>2017 Equity Incentive Plan, Form of Agreement for Performance-Based Restricted Stock Unit Awards (revised October 2018).</u> †   |
| 10.5           | <u>2017 Equity Incentive Plan, Form of Agreement for Stock Option Awards (revised October 2018).</u> †  |
| 10.6           | <u>InterDigital, Inc. Executive Severance and Change in Control Policy.</u> †   |
| 10.7           | <u>Offer letter, dated October 10, 2018, between InterDigital, Inc. and Kai O. Oistamo.</u> †   |
| 31.1           | <u>Certification of Principal Executive Officer pursuant to Rule 13a-14(a) of the Securities Exchange Act of 1934, as amended.</u>  |
| 31.2           | <u>Certification of Principal Financial Officer pursuant to Rule 13a-14(a) of the Securities Exchange Act of 1934, as amended.</u>  |
| 32.1           | <u>Certification of Principal Executive Officer pursuant to 18 U.S.C. Section 1350.</u> **  |
| 32.2           | <u>Certification of Principal Financial Officer pursuant to 18 U.S.C. Section 1350.</u> **  |
| 101            | The following financial information from InterDigital, Inc.'s Quarterly Report on Form 10-Q for the quarter ended September 30, 2018, filed with the Securities and Exchange Commission on November 1, 2018, formatted in eXtensible Business Reporting Language:<br><br>(i) Condensed Consolidated Balance Sheets at September 30, 2018 and December 31, 2017, (ii) Condensed Consolidated Statements of Income for the three and nine months ended September 30, 2018 and 2017, (iii) Condensed Consolidated Statements of Comprehensive Income for the three and nine months ended September 30, 2018 and 2017, (iv) Condensed Consolidated Statements of Cash Flows for the nine months ended September 30, 2018 and 2017 and (v) Notes to Condensed Consolidated Financial Statements. |

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\* Incorporated by reference to the filing indicated.

† Management contract or compensatory plan or arrangement.

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This exhibit will not be deemed “filed” for purposes of Section 18 of the Securities Exchange Act of 1934, as amended (15 U.S.C. 78r), or otherwise subject to the liability of that section. Such exhibit will not be deemed to be incorporated by reference into any filing under the Securities Act or Securities Exchange Act, except to the extent that InterDigital, Inc. specifically incorporates it by reference.

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SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

INTERDIGITAL, INC.

Date: November 1, 2018 /s/ WILLIAM J. MERRITT

William J. Merritt

President and Chief Executive Officer

Date: November 1, 2018 /s/ RICHARD J. BREZSKI

Richard J. Brezski

Chief Financial Officer