

INTERDIGITAL COMMUNICATIONS CORP
Form 10-Q
August 07, 2006

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-Q

X QUARTERLY REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended June 30, 2006

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 1-11152

INTERDIGITAL COMMUNICATIONS CORPORATION

(Exact name of registrant as specified in its charter)

PENNSYLVANIA
(State or other jurisdiction of
incorporation or organization)

781 Third Avenue, King of Prussia, PA 19406-1409

(Address of principal executive offices and zip code)

23-1882087
(I.R.S. Employer

Identification No.)

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(610) 878-7800

(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 is a large accelerated filer , an accelerated filer , or a non-accelerated filer (as defined by Rule 12b-2 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 \$.01 per share
Class

51,720,639
Outstanding at August 1, 2006

INTERDIGITAL COMMUNICATIONS CORPORATION AND SUBSIDIARIES

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INTERDIGITAL COMMUNICATIONS CORPORATION AND SUBSIDIARIES

InterDigital® is a trademark of InterDigital Communications Corporation. All other trademarks, service marks and/or trade names appearing in this Form 10-Q are the property of their respective holders.

GLOSSARY OF TERMS

2G

Second Generation. A generic term usually used in reference to voice-oriented digital wireless products, primarily mobile handsets that provide basic voice services.

2.5G

A generic term usually used in reference to fully integrated voice and data digital wireless devices offering higher data rate services and features compared to 2G.

3G

Third Generation. A generic term usually used in reference to the generation of digital mobile devices and networks after 2G and 2.5G, which provide high speed data communications capability along with voice services.

3GPP

3G Partnership Project. A partnership of worldwide accredited standards organizations the purpose of which is to draft specifications for Third Generation mobile telephony.

Bandwidth

A range of frequencies that can carry a signal on a transmission medium, measured in Hertz and computed by subtracting the lower frequency limit from the upper frequency limit.

CDMA

Code Division Multiple Access. A method of digital spread spectrum technology wireless transmission that allows a large number of users to share access to a single radio channel by assigning unique code sequences to each user.

cdmaOne

A wireless cellular system application based on 2G narrowband CDMA technologies (e.g., TIA/EIA-95).

cdma2000®

A standard which evolved from narrowband CDMA technologies (i.e., TIA/EIA-95 and cdmaOne). The CDMA family includes, without limitation, CDMA2000 1x, CDMA 1xEV-DO, CDMA2000 1xEV-DV and CDMA2000 3x. Although CDMA2000 1x is included under the IMT-2000 family of 3G standards, its functionality is similar to 2.5G technologies. CDMA2000® and cdma2000® are registered trademarks of the Telecommunications Industry Association (TIA USA).

Chip

An electronic circuit that consists of many individual circuit elements integrated onto a single substrate.

Circuit

The connection of channels, conductors and equipment between two given points through which an electric current may be established.

Digital

Information transmission where the data is represented in discrete numerical form.

Digital Cellular

A cellular communications system that uses over-the-air digital transmission.

EDGE

Enhanced Data rates for GSM Evolution. Technology designed to deliver data at rates up to 473.6 Kbps, triple the data rate of GSM wireless services, and built on the existing GSM standard and core network infrastructure. EDGE systems built in Europe are considered a 2.5G technology.

FDMA

Frequency Division Multiple Access. A technique in which the available transmission of bandwidth of a channel is divided by frequencies into narrower bands over fixed time intervals resulting in more efficient voice or data transmissions over a single channel.

Frequency

The rate at which an electrical current or signal alternates, usually measured in Hertz.

GPRS

General Packet Radio Systems. A packet-based wireless communications service that enables high-speed wireless Internet and other data communications via GSM networks.

GSM

Global System for Mobile Communications. A digital cellular standard, based on TDMA technology, specifically developed to provide system compatibility across country boundaries.

Hertz

The unit of measuring radio frequency (one cycle per second).

Internet

A network comprised of numerous interconnected commercial, academic and governmental networks in over 100 countries.

IPR

Intellectual Property Right.

ITC

InterDigital Technology Corporation, one of our wholly-owned Delaware subsidiaries.

Multiple Access

A methodology (e.g., FDMA, TDMA, CDMA) by which multiple users share access to a transmission channel. Most modern systems accomplish this through demand assignment where the specific parameter (frequency, time slot, or code) is automatically assigned when a subscriber requires it.

Standards

Specifications that reflect agreements on products, practices, or operations by nationally or internationally accredited industrial and professional associations or governmental bodies in order to allow for interoperability.

TDMA

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Time Division Multiple Access. A method of digital wireless transmission that allows a multiplicity of users to share access (in a time ordered sequence) to a single channel without interference by assigning unique time segments to each user within the channel.

TIA/EIA-95

A 2G CDMA standard.

TIA

The Telecommunications Industry Association.

UMTS

Universal Mobile Telecommunications System. The European name for 3G mobile telephony. UMTS uses WCDMA standards created by 3GPP.

WCDMA

Wideband Code Division Multiple Access or Wideband CDMA. The next generation of CDMA technology optimized for high speed packet-switched data and high-capacity circuit switched capabilities. A 3G technology.

Wideband

A communications channel with a user data rate higher than a voice-grade channel; usually 64Kbps to 2Mbps.

INTERDIGITAL COMMUNICATIONS CORPORATION AND SUBSIDIARIES

PART I FINANCIAL INFORMATION

Item 1. CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

INTERDIGITAL COMMUNICATIONS CORPORATION AND SUBSIDIARIES

CONDENSED CONSOLIDATED BALANCE SHEETS

(in thousands, except per share data)

(unaudited)

	JUNE 30, 2006	DECEMBER 31, 2005
<u>ASSETS</u>		
CURRENT ASSETS:		
Cash and cash equivalents	\$ 228,899	\$ 27,877
Short-term investments	107,944	77,831
Accounts receivable	115,084	19,534
Deferred tax assets	46,503	42,103
Prepaid and other current assets	14,248	8,370
Total current assets	512,678	175,715
PROPERTY AND EQUIPMENT, NET	12,642	10,660
PATENTS, NET	65,421	59,516
DEFERRED TAX ASSETS	16,469	48,681
OTHER NON-CURRENT ASSETS	11,365	4,965
	105,897	123,822
TOTAL ASSETS	\$ 618,575	\$ 299,537
<u>LIABILITIES AND SHAREHOLDERS' EQUITY</u>		
CURRENT LIABILITIES:		
Current portion of long-term debt	\$ 363	\$ 350
Accounts payable	9,187	7,163
Accrued compensation and related expenses	7,674	17,040
Deferred revenue	104,297	20,055
Taxes payable	7,993	160
Other accrued expenses	8,302	5,766
Total current liabilities	137,816	50,534
LONG-TERM DEBT	1,387	1,572
LONG-TERM DEFERRED REVENUE	172,230	71,193
OTHER LONG-TERM LIABILITIES	3,588	1,924
TOTAL LIABILITIES	315,021	125,223
COMMITMENTS AND CONTINGENCIES		
SHAREHOLDERS' EQUITY:		

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Common Stock, \$.01 par value, 100,000 shares authorized, 63,409 and 60,537 shares issued and 53,521 and 54,032 shares outstanding	634	605
Additional paid-in capital	423,615	377,648
Retained Earnings (Accumulated deficit)	73,463	(109,839)
Accumulated other comprehensive loss	(183)	(192)
	497,529	268,222
Treasury stock, 9,888 and 6,506 shares of common held at cost	193,975	93,908
Total shareholders' equity	303,554	174,314
TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY	\$ 618,575	\$ 299,537

The accompanying notes are an integral part of these statements.

INTERDIGITAL COMMUNICATIONS CORPORATION AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(in thousands, except per share data)

(unaudited)

	FOR THE THREE MONTHS ENDED JUNE 30,		FOR THE SIX MONTHS ENDED JUNE 30,	
	2006	2005	2006	2005
REVENUES	\$ 296,617	\$ 38,601	\$ 348,223	\$ 74,098
OPERATING EXPENSES:				
Sales and marketing	1,561	1,537	3,385	3,817
General and administrative	5,695	5,912	10,716	12,478
Patents administration and licensing	12,804	10,080	22,786	21,327
Development	15,887	14,921	31,897	31,094
	35,947	32,450	68,784	68,716
Income from operations	260,670	6,151	279,439	5,382
OTHER INCOME:				
Interest and investment income, net	3,914	677	5,422	1,467
Income before income taxes	264,584	6,828	284,861	6,849
INCOME TAX PROVISION	(94,221)	(2,817)	(101,559)	(3,720)
NET INCOME APPLICABLE TO COMMON SHAREHOLDERS	\$ 170,363	\$ 4,011	\$ 183,302	\$ 3,129
NET INCOME PER COMMON SHARE - BASIC	\$ 3.13	\$ 0.07	\$ 3.36	\$ 0.06
WEIGHTED AVERAGE NUMBER OF COMMON SHARES OUTSTANDING - BASIC	54,397	53,642	54,590	54,344
NET INCOME PER COMMON SHARE - DILUTED	\$ 2.98	\$ 0.07	\$ 3.20	\$ 0.05
WEIGHTED AVERAGE NUMBER OF COMMON SHARES OUTSTANDING - DILUTED	57,128	56,790	57,358	57,799

The accompanying notes are an integral part of these statements.

INTERDIGITAL COMMUNICATIONS CORPORATION AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS

(in thousands)

(unaudited)

	FOR THE SIX MONTHS ENDED JUNE 30,	
	2006	2005
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income	\$ 183,302	\$ 3,129
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	6,693	5,493
Deferred revenue recognized	(100,936)	(28,795)
Increase in deferred revenue	286,215	35,105
Deferred income taxes	27,812	4,933
Non-cash compensation	2,929	5,233
Increase in deferred charges	(9,870)	(34)
Other	(14)	(89)
(Increase) decrease in assets:		
Receivables	(95,550)	(3,957)
Other current assets	(2,351)	1,042
Increase (decrease) in liabilities:		
Accounts payable	1,889	151
Accrued compensation	(7,133)	(1,984)
Accrued taxes payable	7,670	
Other accrued expenses	2,564	(178)
Net cash provided by operating activities	303,220	20,049
CASH FLOWS FROM INVESTING ACTIVITIES:		
Purchases of short-term investments	(96,128)	(81,620)
Sales of short-term investments	65,992	109,736
Purchases of property and equipment	(4,484)	(3,011)
Capitalized patent costs	(9,972)	(8,607)
Acquisition of patents		(8,050)
Net cash (used) provided by investing activities	(44,592)	8,448
CASH FLOWS FROM FINANCING ACTIVITIES:		
Net proceeds from exercise of stock options and warrants and employee stock purchase plan	28,316	1,910
Payments on long-term debt, including capital lease obligations	(172)	(161)
Repurchase of Common Stock	(100,067)	(34,085)
Tax benefit from stock options	14,317	
Net cash used by financing activities	(57,606)	(32,336)
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	201,022	(3,839)
CASH AND CASH EQUIVALENTS, BEGINNING OF PERIOD	27,877	15,737
CASH AND CASH EQUIVALENTS, END OF PERIOD	\$ 228,899	\$ 11,898

The accompanying notes are an integral part of these statements.

INTERDIGITAL COMMUNICATIONS CORPORATION AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

June 30, 2006

(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 Communications Corporation (collectively with its subsidiaries referred to as InterDigital, the Company, we, us and our) as of June 30, 2006, and the results of our operations and cash flows for the three and six months ended June 30, 2006 and 2005. 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 present fairly the financial condition, results of operations and cash flows in conformity with generally accepted accounting principles. Therefore, these financial statements should be read in conjunction with the financial statements and notes thereto contained in the Company's latest Annual Report on Form 10-K for the fiscal year ended December 31, 2005 (2005 Form 10-K) as filed with the Securities and Exchange Commission (SEC) on March 14, 2006. 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 generally accepted accounting principles 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.

The classification of certain prior period amounts has been changed to conform to the current period presentation.

There have been no material changes in our existing accounting policies from the disclosures included in our 2005 Form 10-K, except as follows:

Share-Based Compensation

In December 2004, the Financial Accounting Standards Board, or FASB, issued Statement of Financial Accounting Standards (SFAS) No. 123(R), *Share-Based Payment*. SFAS No. 123(R) requires that compensation cost relating to share-based payment transactions be recognized in financial statements. The Company adopted the accounting provisions of SFAS No. 123(R) effective January 1, 2006. SFAS No. 123(R) replaces SFAS No. 123, *Accounting for Stock - Based Compensation*, and supersedes Accounting Principles Board (APB) Opinion No. 25, *Accounting for Stock Issued to Employees*. As originally issued in 1995, SFAS No. 123 established as preferable the fair-value-based method of accounting for share-based payment transactions with employees. However, that Statement permitted entities the option of continuing to apply the guidance in APB Opinion No. 25, as long as the footnotes to financial statements disclosed what net income would have been had the preferable fair-value-based method been used. We have elected to adopt the new rules using the modified-prospective method. Under the modified prospective method, prior periods are not revised for comparative purposes. The adoption of SFAS No. 123(R) did not have a material impact on our statement of operations. As a result of the application of this standard, in our consolidated statement of cash flows for the six months ended June 30, 2006, we classified a \$14.3 million tax benefit associated with the exercise of stock options within cash flows from financing activities. Prior to the adoption of SFAS No. 123(R) we classified such tax benefits, if any, within cash flows from operating activities.

SFAS No. 123(R) requires that compensation cost relating to share-based payment transactions be measured based on the fair value of the instruments issued. SFAS No. 123(R) covers a wide range of share-based compensation arrangements including share options, restricted share plans, performance-based awards, share appreciation rights and employee share purchase plans. SFAS No. 123(R) further requires that share-based compensation expense be based on the awards ultimately expected to vest. This is accomplished by reducing the compensation expense for estimated forfeitures. Forfeitures must be estimated at the time of grant and revised, if necessary, in subsequent periods if actual forfeitures differ from those estimates. Prior to the adoption of SFAS No. 123(R), we recorded forfeitures in the period in which they occurred.

On November 10, 2005, the FASB issued FASB Staff Position No. SFAS No. 123(R), *Transition Election Related to Accounting for the Tax Effects of Share-Based Payment Awards*. Under this pronouncement, we have until December 2006 to elect, as provided in this pronouncement, an alternative transition method for calculating the tax effects of share-based compensation pursuant to SFAS No. 123(R). The alternative method provides a simplified computation to establish the beginning balance of the additional paid-in-capital pool (APIC pool) related to the tax effects of employee share-based compensation. Any positive balance in the APIC pool would be available to absorb tax shortfalls (which occur

when tax

deductions resulting from share-based compensation are less than the related book expense) recognized subsequent to the adoption of SFAS No. 123(R). We did not incur any net tax shortfalls in the six months ended June 30, 2006.

During the three and six months ended June 30, 2006, we issued the following share-based awards (units/shares in thousands):

	Three months	Six months
Restricted Stock Units (RSUs)	25	194
Restricted Stock		17
Common Stock		24
Total share-based awards	25	235

During first half 2006, we granted RSUs to all non-management personnel and newly hired or promoted members of management under our Long-Term Compensation Program (LTCP). RSUs vest either incrementally or in-full over three years subject to applicable plan and program terms. During first half 2006, we also issued shares of Restricted Stock to our executive officers and other key management personnel as part of their 2005 annual bonus. These shares were fully vested when granted but may not be transferred for two years. We issued Common Stock in first half 2006 primarily for our 2005 profit sharing contribution to eligible employees under our Savings and Protection Plan (Savings Plan). We also issued Common Stock as part of the Company's employer match under the Savings Plan. Shares issued into employee accounts under the Savings Plan vest in accordance with the terms of the Savings Plan, are transferable into other investment electives under the Savings Plan, and cannot be redeemed until employment with the Company terminates. We valued each of the above share-based awards at the fair market value of our Common Stock on the date of grant.

We have estimated forfeiture rates for RSUs currently granted at between 0% and 5%, depending upon the group receiving the grant and the specific terms of the award issued. We recorded a reduction in operating expenses for the cumulative effect of a change in accounting principle of less than \$0.2 million upon adoption. This cumulative effect adjustment was recorded to apply an estimated forfeiture rate of 3% to the unvested RSUs which had been issued under the 2005-2007 cycle of our LTCP and which remained unvested and outstanding at December 31, 2005.

In second quarter 2006 and 2005, we recorded share-based compensation expense of \$1.6 million and \$2.4 million, respectively. In first half 2006 and 2005, we recorded share-based compensation expense of \$2.9 million and \$5.2 million, respectively. The majority of this expense, for all time periods in both years, related to RSU awards granted to managers under our LTCP.

Share-based compensation prior to January 1, 2006

Prior to the adoption of SFAS No. 123(R), we accounted for share-based employee compensation under the recognition and measurement principles of APB Opinion No. 25, and related interpretations. No stock-option-based employee compensation cost was reflected in net income, as all effected options had an exercise price equal to the market value of the underlying Common Stock on the date of grant. However, compensation expense was recognized related to Restricted Stock and RSU grants. The following table illustrates the effect on net income and earnings per share if we had applied the fair value recognition provisions of SFAS No. 123, to stock-option-based employee compensation for the three and six months ended June 30, 2005 (in thousands, except per share data):

	Three months	Six Months
Net income applicable to common shareholders as reported	\$ 4,011	\$ 3,129
Add: Stock-based employee compensation expense included in reported net income	2,307	4,975
Deduct: Total stock-based employee compensation expense determined under fair value based method for all awards	(3,459)	(7,102)
Net Tax Effect	392	724
Net income applicable to common shareholders pro forma	\$ 3,251	\$ 1,726
Net income per share as reported basic	0.07	0.06
Net income per share as reported diluted	0.07	0.05
Net income per share pro forma basic	0.06	0.03

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Net income per share	pro forma	diluted	0.06	0.03
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The fair value of each option grant in 2005 was estimated on the date of grant using the Black-Scholes option pricing model with the following weighted-average assumptions:

	Three months	Six months
Expected option life (in years)	4.9	4.9
Risk-free interest rate	3.9%	3.9%
Volatility	80%	80%
Dividend yield		
Weighted average fair value	\$ 12.36	\$ 12.52

New Accounting Pronouncements

In May 2005, the FASB issued SFAS No. 154, *Accounting Changes and Error Corrections*, which replaces APB Opinion No. 20, *Accounting Changes*, and SFAS No. 3, *Reporting Accounting Changes in Interim Financial Statements-An Amendment of APB Opinion No. 28*. SFAS No. 154 provides guidance on the accounting for and reporting of accounting changes and error corrections. It establishes retrospective application, or the latest practicable date, as the required method of accounting for and reporting a change in accounting principle or the correction of an error. SFAS No. 154 is effective for accounting changes and corrections of errors made in fiscal years beginning after December 15, 2005 and was adopted by the Company effective January 1, 2006. The adoption of SFAS No. 154 did not have a material impact on our consolidated financial position, results of operations or cash flows.

In July 2006, the FASB issued Interpretation No. 48, *Accounting for Uncertainty in Income Taxes, an interpretation of FASB Statement No. 109* (FIN 48). FIN 48 clarifies the accounting for uncertainty in income taxes recognized in an entity's financial statements in accordance with SFAS No. 109, *Accounting for Income Taxes*, by prescribing the minimum recognition threshold and measurement attribute a tax position taken or expected to be taken on a tax return is required to meet before being recognized in the financial statements. FIN 48 also provides guidance on derecognition, measurement, classification, interest and penalties, accounting in interim periods, disclosure and transition. We are currently evaluating the impact of FIN 48, which must be implemented effective January 1, 2007.

2. SIGNIFICANT AGREEMENTS AND EVENTS:

Nokia Litigation and Legal Proceedings

In April 2006, InterDigital Communications Corporation (IDCC) and InterDigital Technology Corporation (ITC) entered into agreements with Nokia Corporation (Nokia) which resolved certain legal proceedings between them. Specifically, in an Arbitration Settlement Agreement, the parties resolved their disputes arising out of the June 2005 International Court of Arbitration of the International Chamber of Commerce (ICC) Arbitration Tribunal Award, which related to the January 1999 Patent License Agreement (the Nokia License Agreement) between the parties. Pursuant to the UK Settlement Agreement, Nokia dismissed its claims under Claim No. HC04 C01952, a proceeding that Nokia instituted in June 2004 against ITC in the High Court of Justice of England and Wales, Chancery Division, Patents Court, seeking to challenge three of our TDMA-related patents.

Pursuant to the Arbitration Settlement Agreement, on April 28, 2006, Nokia paid InterDigital \$253 million. Nokia is deemed to have a fully paid-up license covering worldwide sales of 2G TDMA-based products, consisting primarily of GSM/GPRS/EDGE terminal units and infrastructure. Nokia is also released from infringement liability for worldwide sales of 3G terminal units and infrastructure through April 26, 2006. Under the Arbitration Settlement Agreement, the Nokia License Agreement was terminated.

We recognized \$228 million of revenue related to the Arbitration Settlement Agreement in second quarter 2006 and will recognize \$12.5 million in each of the third and fourth quarters of this year.

LG Electronics Inc.

In January 2006, IDCC's patent holding subsidiaries entered into a worldwide, non-transferable, non-exclusive, patent license agreement with LG Electronics Inc. (LG). The five-year patent license agreement, effective January 1, 2006, covers the sale, both prior to January 1, 2006 and during the five-year term, of terminal units compliant with all TDMA-based 2G standards (including TIA-136, GSM, GPRS, and EDGE) and all 3G standards (including WCDMA, TD-SCDMA and cdma2000® technology and its extensions), and infrastructure products compliant with cdma2000® technology and its extensions up to a limited threshold amount, under all patents owned by us prior to and during the term of the license. At the end of the five-year term, LG will receive a paid-up license to sell single-mode GSM/GPRS/EDGE terminal units under the patents included under the patent license agreement.

Under the terms of the patent license agreement, LG paid us the first of three equal installments of \$95 million in first quarter 2006. The remaining two installments are due in first quarter 2007 and 2008, respectively. We have recorded the second installment of \$95 million in both accounts receivable and deferred revenue at June 30, 2006, in accordance with our policy to recognize receivables that are due within twelve months. We are recognizing the revenue associated with this agreement on a straight-line basis from its inception through December 31, 2010.

Technology Solution Agreements

In August 2005, we entered into an agreement with Philips Semiconductors B.V. (Philips) to deliver our HSDPA technology solution to Philips for integration into Philips family of Nexperia cellular system solutions. Under the agreement, we will also assist Philips with chip design and development, software modification and system integration and testing to implement our HSDPA technology solution into the Philips chipset. Subsequent to the delivery of portions of our HSDPA technology solution, we agreed to provide Philips with support and maintenance over an aggregate estimated period of approximately 2 years.

In December 2004, we entered into an agreement with General Dynamics C4 Systems (formerly known as, General Dynamics Decision Systems, Inc.) (General Dynamics), to serve as a subcontractor on the Mobile User Objective System (MUOS) program for the U.S. military. MUOS is an advanced tactical terrestrial and satellite communications system utilizing 3G commercial cellular technology to provide significantly improved high data rate and assured communications for U.S. warfighters. The Software License Agreement (SLA) required us to deliver to General Dynamics standards-compliant WCDMA modem technology, originating from the technology we developed under our agreement with Infineon Technologies AG, for incorporation into handheld terminals. We have also provided product training under the SLA and will provide maintenance for a period of three years, beginning January 1, 2006.

We are accounting for portions of these and other technology solution agreements using the percentage-of-completion method. From the inception of these agreements through June 30, 2006, we recognized related revenue of approximately \$22.0 million using the percentage-of-completion method, including \$1.2 million and \$3.0 million in the three and six months ended June 30, 2006, respectively. Our accounts receivable at June 30, 2006 and December 31, 2005 included unbilled amounts of \$6.3 million and \$4.1 million, respectively. We expect to bill and collect such amounts within twelve months of each respective balance sheet date.

Acquisition of Patents

In first half 2005, we acquired, for a purchase price of approximately \$8.1 million, selected patents, intellectual property blocks and related assets from an unrelated third party. These assets are designed to improve the range, throughput and reliability of wireless LAN and other wireless technology systems. The purchase price was allocated almost entirely to patent assets with a nominal amount being allocated to other assets. Based on our assessment in connection with the asset acquisition, we are amortizing these patents over their expected useful lives of approximately 15 years.

3. INCOME TAXES:

During first half 2006, our effective tax rate of 35.7% consisted of the statutory federal tax rate and the recognition of \$1.8 million of foreign tax expense related to foreign source withholding tax payments made in prior years. During first half 2006, we paid \$28.5 million and accrued \$15.7 million of foreign source withholding taxes and established corresponding deferred tax assets related to foreign tax credits that we expect to utilize to offset future U.S. federal income taxes.

Excluding any prospective recognition of additional tax credits, we expect to provide for income taxes over the balance of 2006 at a rate equal to our combined federal and state effective rates, which would approximate 35% to 37% under current tax laws, plus an amount for deferred foreign source withholding tax expense, which is dependent, in part, upon licensee royalty reports. Our future book tax expense may also be affected by charges associated with any share-based tax shortfalls that may occur under SFAS No. 123(R). However, we cannot predict if, when, or to what extent this will affect our future tax expense. If, in the course of future tax planning, we identify tax saving opportunities that entail amending prior year returns in order to fully avail ourselves of credits that we previously considered unavailable to us, we will recognize the benefit of the credits in the period in which they are both identified and quantified. Due to the incremental contributions to taxable income from a first quarter 2006 license agreement with LG and second quarter 2006 dispute resolution with Nokia, we expect to utilize the majority of our NOLs and make cash tax payments associated with our projected 2006 taxable income. As a result, in second quarter 2006, we made an estimated payment of \$23.0 million toward our 2006 federal income taxes.

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

A more-than-50% cumulative change in ownership occurred in 1992. As a result of such change, approximately \$14 million of our NOL carryforwards were limited as of December 31, 2005. As a result of these limitations, we will not be able to utilize all of our NOL carryforwards to offset our U.S. federal tax liability in 2006. If we experience an additional more-than-50% cumulative ownership change, the full amount of the NOL carryforward may become subject to annual limitation under IRC Section 382.

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Based on judgments associated with determining the annual limitation applicable to us under Internal Revenue Code Section 382, we did not include all NOL carryforwards in the computation of our gross deferred tax assets. We also excluded from this computation a portion of the federal research and experimental credits that may be available to us based upon estimates of the final credit that may be realized. Had we included all federal NOL carryforwards and research and

experimental credits in the computation of gross deferred tax assets, our gross deferred tax assets at June 30, 2006 and December 31, 2005 would have been approximately \$10 million greater.

4. INCOME PER SHARE:

The following table sets forth a reconciliation of the shares used in the basic and diluted net income per share computations:

	(In thousands, except per share data)					
	Three Months Ended June 30, 2006			Three Months Ended June 30, 2005		
	Income	Shares	Per-Share	Income	Shares	Per-Share
	(Numerator)	(Denominator)	Amount	(Numerator)	(Denominator)	Amount
Income per share - basic:						
Income available to Common Shareholders	\$ 170,363	54,397	\$ 3.13	\$ 4,011	53,642	\$ 0.07
Effect of dilutive options, warrants and restricted stock units		2,731	(0.15)		3,148	
Income per share - diluted:						
Income available to Common Shareholders + dilutive effects of options, warrants and restricted stock units	\$ 170,363	57,128	\$ 2.98	\$ 4,011	56,790	\$ 0.07

	Six Months Ended June 30, 2006			Six Months Ended June 30, 2005		
	Income	Shares	Per-Share	Income	Shares	Per-Share
	(Numerator)	(Denominator)	Amount	(Numerator)	(Denominator)	Amount
Income per share - basic:						
Income available to Common Shareholders	\$ 183,302	54,590	\$ 3.36	\$ 3,129	54,344	\$ 0.06
Effect of dilutive options, warrants and restricted stock units		2,768	(0.16)		3,455	(0.01)
Income per share - diluted:						
Income available to Common Shareholders + dilutive effects of options, warrants and restricted stock units	\$ 183,302	57,358	\$ 3.20	\$ 3,129	57,799	\$ 0.05

For the three and six months ended June 30, 2006, options to purchase approximately 0.6 million and 0.7 million shares of Common Stock, respectively, were excluded from the computation of diluted earnings per share because the exercise prices of these options were greater than the weighted-average market price of our Common Stock during this period and, therefore, their effect would have been anti-dilutive.

For the three and six months ended June 30, 2005, options to purchase approximately 2.1 million and 1.9 million shares of Common Stock, respectively were excluded from the computation of diluted earnings per share because the exercise

prices of these options were greater than the weighted-average market price of our Common Stock during this period and, therefore, their effect would have been anti-dilutive.

5. LITIGATION AND LEGAL PROCEEDINGS:

Nokia

In April 2006, InterDigital Communications Corporation (IDCC) and ITC entered into agreements with Nokia Corporation (Nokia) which resolved certain legal proceedings between them. Specifically, in an Arbitration Settlement Agreement, the parties resolved their disputes arising out of the June 2005 International Court of Arbitration of the International Chamber of Commerce (ICC) Arbitration Tribunal Award, which related to the January 1999 Patent License Agreement between the parties (the Nokia License Agreement). Pursuant to the UK Settlement Agreement, Nokia dismissed its claims under Claim No. HC04 C01952, a proceeding that Nokia instituted in June 2004 against ITC in the High Court of Justice of England and Wales, Chancery Division, Patents Court (High Court), seeking to challenge three of our TDMA-related patents (UK 2G Proceeding).

Pursuant to the Arbitration Settlement Agreement, on April 28, 2006, Nokia paid InterDigital \$253 million. Nokia is deemed to have a fully paid-up license covering worldwide sales of 2G TDMA-based products, consisting primarily of GSM/GPRS/EDGE terminal units and infrastructure. Nokia is also released from infringement liability for worldwide sales of 3G terminal units and infrastructure through April 26, 2006. Under the Arbitration Settlement Agreement, the Nokia License Agreement was terminated.

Pursuant to the UK Settlement Agreement, Nokia has withdrawn its challenge before the High Court in the UK 2G Proceeding. In consideration for the discontinuance of the UK 2G Proceeding, InterDigital agreed (i) not to assert against Nokia the three patents (and related non-UK counterparts) involved in that proceeding, and (ii) Nokia will have a paid-up license for single-mode IS-95 products. The paid-up license and the covenant not to assert became effective upon the discontinuance of the UK 2G Proceeding and Nokia's withdrawal of its opposition to a related UK amendment application in the UK 2G Proceeding, both of which have occurred.

Nokia UK Proceeding

In July 2005, Nokia filed a claim in the High Court against ITC. Nokia's claim seeks a declaration that 29 of ITC's UMTS European patents registered in the UK are not essential IPR for the 3GPP standard using a definition of "essentiality" asserted by Nokia. ITC contends that 24 of these patents are essential under a definition of "essentiality" asserted by ITC. In April 2006, a hearing was held to contest the jurisdiction of the High Court to hear the case. Subsequently, the High Court denied ITC's claim as to jurisdiction. ITC has appealed the decision as to jurisdiction to the English Court of Appeal which has scheduled a hearing for November 2006. We intend to vigorously defend the claim as to essentiality and are continuing to contest Nokia's claim for declarations in the High Court. A trial date for the action has been set for a date not before October 15, 2007, at which time the High Court will rule on the definition of "essentiality".

Nokia Delaware Proceeding

In January 2005, Nokia and Nokia, Inc. filed a complaint in the United States District Court for the District of Delaware against IDCC and ITC for declaratory judgments of patent invalidity and non-infringement of certain claims of certain patents, and violations of the Lanham Act. In December 2005, as a result of our motion to dismiss all of Nokia's claims, the Delaware District Court entered an order to grant our motion to dismiss all of Nokia's declaratory judgment claims due to lack of jurisdiction. The Delaware District Court did not dismiss Nokia's claims relating to violations of the Lanham Act. Under the Lanham Act claim, Nokia alleges that we have used false or misleading descriptions or representations regarding our patents' scope, validity, and applicability to products built to comply with 3G wireless phone standards, and that such statements have caused Nokia harm. A scheduling order was entered by the Delaware District Court which contemplates trial in 2008, but no specific trial date has been set.

Samsung

In 2002, Samsung Electronics Co. Ltd. (Samsung) elected, pursuant to the Most Favored Licensee (MFL) clause in its 1996 patent license agreement with ITC (Samsung Agreement), to have its royalty obligations commencing January 1, 2002 for 2G GSM/TDMA and 2.5G GSM/GPRS/EDGE wireless communications products be determined in accordance with the terms of the Nokia License Agreement, including its MFL provision. In March 2003, ITC notified Samsung that such Samsung obligations had been defined by the relevant licensing terms of the Ericsson Agreement (for infrastructure products) and the Sony Ericsson Agreement (for terminal unit products) as a result of the MFL provision in the Nokia License Agreement.

In November 2003, Samsung filed a Request for Arbitration with the International Chamber of Commerce against IDCC and ITC regarding Samsung's royalty obligations to ITC for its worldwide sales of 2G GSM/TDMA and 2.5G GSM/GPRS/EDGE products (Samsung Arbitration). In this arbitration proceeding, IDCC and ITC claim that the Ericsson Agreement and the Sony Ericsson Agreement define the financial terms under which Samsung is required to pay royalties on its worldwide sales of 2G GSM/TDMA and 2.5G GSM/GPRS/EDGE products commencing January 1, 2002 through December 31, 2006. IDCC and ITC also seek a declaration that the parties' rights and obligations are governed by the Samsung Agreement, and that the Nokia License Agreement dictates only Samsung's royalty obligations and most favored licensee rights for those TDMA products licensed under the Samsung Agreement. In the arbitration, Samsung has claimed that its obligations are not defined by the Ericsson Agreement, the Sony Ericsson Agreement, or the Final Award in the Nokia arbitration. Samsung seeks a determination of the amounts owed to InterDigital by Samsung, which Samsung claims to be substantially less than the amount that IDCC and ITC believe is owed. Samsung also claims that there was a novation of the Samsung Agreement such that Samsung is now licensed to IDCC's CDMA patents, including its 3G patents. If the arbitration panel were to agree with Samsung's position on Samsung's alleged CDMA rights, Samsung would be licensed to sell 3G products on the terms set forth in the Nokia License Agreement.

In January 2006, the final evidentiary hearing was held. Post-hearing briefings have been completed and we are awaiting a decision from the ICC Arbitral Tribunal.

Samsung also has asserted that depending on how the arbitration panel decides the arbitration matters, Samsung can: (i) pursuant to a purported conditional election made by Samsung in June 2006, substitute the royalty rates under the Nokia License Agreement for a royalty rate that Samsung purports to derive from the Nokia Arbitration Settlement Agreement or, alternatively (ii) elect a subsequent MFL event via the terms of the Samsung Agreement. We disagree with Samsung's position.

Federal

In October 2003, Federal Insurance Company (Federal), the insurance carrier which provided partial reimbursement to the Company of certain legal fees and expenses for the now-settled litigation involving the Company and Ericsson Inc., delivered to us a demand for arbitration under the Pennsylvania Uniform Arbitration Act. Federal claims, based on its determination of expected value to the Company resulting from our settlement involving Ericsson Inc., that an insurance reimbursement agreement (Agreement) requires us to reimburse Federal approximately \$28.0 million for attorneys' fees and expenses it claims were paid by it. Additionally, under certain circumstances, Federal may seek to recover interest on its claim. In November 2003, the Company filed an action in United States District Court for the Eastern District of Pennsylvania (the Court) seeking a declaratory judgment that the reimbursement agreement is void and unenforceable, seeking reimbursement of attorneys' fees and expenses which have not been reimbursed by Federal and which were paid directly by the Company in connection with the Ericsson Inc. litigation, and seeking damages for Federal's bad faith and breach of its obligations under the insurance policy. In the alternative, in the event the reimbursement agreement was found to be valid and enforceable, the Company sought a declaratory judgment that Federal is entitled to reimbursement based only on certain portions of amounts received by the Company from Ericsson Inc. pursuant to the settlement of the litigation involving Ericsson Inc. Federal requested the Court dismiss the action and/or have the matter referred to arbitration.

In October 2005, the Court filed an order granting in part and denying in part Federal's motion to dismiss the Company's complaint. As part of its decision, the Court determined that the Agreement between Federal and the Company (which Agreement served as a basis for Federal's demand to recover any legal fees and expenses) is enforceable, but did not address whether Federal is entitled to recover any legal fees and expenses. Also, the Court reserved to a later time consideration of whether any arbitration award would be binding on the parties. Additionally, in October 2005, the Company filed a motion to reconsider the Court's order which subsequently was denied. An arbitrator has been selected and the parties are currently in the process of preparing for arbitration. A hearing date has not been scheduled.

Prior to Federal's demand for arbitration, we had accrued a contingent liability of \$3.4 million related to the Agreement. We continue to evaluate this contingent liability and have maintained this accrual at June 30, 2006. While we continue to contest this matter, any adverse decision or settlement obligating us to pay amounts materially in excess of the accrued contingent liability could have a material negative effect on our consolidated financial position, results of operations or cash flows.

Other

We have filed patent applications in the United States and in numerous foreign countries. In the ordinary course of business, we currently are, and expect from time-to-time to be, subject to challenges with respect to the validity of our patents

and with respect to our patent applications. We intend to continue to vigorously defend the validity of our patents and defend against any such challenges. However, if certain key patents are revoked or patent applications are denied, our patent licensing opportunities could be materially and adversely affected.

We and our licensees, in the normal course of business, have disagreements as to the rights and obligations of the parties under the applicable patent license agreement. For example, we could have a disagreement with a licensee as to the amount of reported sales of covered products and royalties owed. Our patent license agreements typically provide for arbitration as the mechanism for resolving disputes. Arbitration proceedings can be resolved through an award rendered by an arbitration panel or through private settlement between the parties.

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

6. REPURCHASE OF COMMON STOCK:

In first half 2006, our Board of Directors (Board) authorized the repurchase of up to \$200 million of our outstanding common stock through open market purchases, pre-arranged trading plans or privately negotiated purchases. The amount and timing of purchases will be based on a variety of factors including potential share repurchase price, cash requirements, acquisition opportunities, strategic investments and other market and economic factors. During second quarter 2006, we repurchased approximately 3.4 million shares at a cost of \$100 million. To date in third quarter 2006, we repurchased approximately 1.8 million additional shares at a cost of \$50 million.

In first half 2005, we repurchased 2 million shares of our outstanding common stock at a cost of \$34.1 million under repurchase programs authorized by our Board in October 2004 and March 2005.

7. COMMON STOCK COMPENSATION PLANS

Stock Compensation Plans

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

Common Stock Option Plans

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

In 2002, the Board approved the 2002 Plan that allows for the granting of incentive and non-qualified options, as well as other securities to Company employees who are not subject to the reporting requirements of Section 16 of the Securities Act of 1934 or an affiliate for purposes of Rule 144 of the Securities Act of 1933. The 2002 Plan authorizes the offer and sale of up to 1.5 million shares of common stock. The Board or the Compensation and Stock Option Committee of the Board determine the number of options to be granted. Under the terms of the 2002 Plan, the option price cannot be less than 100% of fair market value of the Common Stock at the date of grant. In addition, unless otherwise modified, no awards may be granted under the 2002 Plan after the close of business on March 31, 2012.

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

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

	Available For Grant	Outstanding Options Number	Price Range	Weighted Average Exercise Price
BALANCE AT DECEMBER 31, 2005	913	7,926	\$ 0.01-39.00	\$ 13.93
Granted			\$ 0.00-0.00	\$
Canceled			\$ 15.72-	
	7	(7)	39.00	\$ 26.61
Exercised			\$	
		(2,475)	4.38-31.25	\$ 11.44
BALANCE AT JUNE 30, 2006			\$	
	920	5,444	0.01-39.00	\$ 15.05

The following table summarizes information regarding the stock options outstanding at June 30, 2006 (in thousands, except for per share amounts):

Range of Exercise Prices	Number Outstanding	Weighted Average Remaining Contractual Life*	Weighted Average Exercise Price	Number Exercisable	Weighted Average Exercise Price
\$ 0.01 - 5.44	809	2.48	\$ 5.09	809	\$ 5.09
\$ 5.50 - 9.00	562	8.55	7.28	562	7.28
\$ 9.03 - 9.60	609	5.49	9.59	609	9.59
\$ 9.76 - 11.63	666	11.30	10.78	666	10.78
\$ 11.64 - 13.19	729	5.04	12.48	729	12.48
\$ 13.25 - 17.13	592	5.50	15.82	592	15.82
\$ 17.26 - 24.30	545	6.80	20.03	545	20.03
\$ 24.36 - 31.81	380	5.33	25.87	380	25.87
\$ 34.13 - 39.00	552	3.54	38.89	552	38.89
\$ 0.01 - 39.00	5,444	5.93	\$ 15.05	5,444	\$ 15.05

* We currently have approximately 232,000 options outstanding that have an indefinite contractual life. These options were granted between 1983 and 1986 under Pre-existing Plans. For purposes of this table, these options were assigned an original life in excess of 50 years. The majority of these options have an exercise price of between \$5.75 and \$11.63.

At June 30, 2006, we had 4.9 million options outstanding which had exercise prices less than the fair market value of the Company's Common Stock at that date. These options had an aggregate intrinsic value of approximately \$110 million based on the Company's June 30, 2006 closing stock price and would have generated \$60.9 million of cash proceeds to the Company if they had been fully exercised.

Common Stock Warrants

As of June 30, 2006, we had warrants outstanding to purchase 80,000 of Common Stock at an exercise price of \$7.63 per share. These warrants are exercisable and will expire in September 2006. The exercise price and number of shares of Common Stock to be obtained upon exercise of these warrants are subject to adjustment under conditions specified in the warrant certificate.

Restricted Stock

Under our 1999 Restricted Stock Plan, as amended (1999 Plan), we may issue up to 3.5 million shares of restricted common stock and restricted stock units to directors, employees, consultants and advisors. The restrictions on issued shares lapse over periods generally ranging from 1 to 5 years from the date of the grant. As of June 30, 2006 and December 31, 2005 we had issued 2.2 million and 2.0 million shares, respectively, of

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Restricted Stock and RSUs under the 1999 Plan. The related compensation expense has been, and will continue to be, amortized over vesting periods that are generally from 1 to 5 years. At June 30, 2006 and December 31, 2005, we had unrecognized compensation cost related to

share-based awards of \$7.1 million and \$5.8 million, respectively. We expect to amortize the unrecognized compensation cost at June 30, 2006 over a weighted average period of 3.4 years using an accelerated method.

We grant RSUs as an element of compensation to all of our employees. These awards vest over three years, depending upon job level, according to the following schedules:

	Year 1	Year 2	Year 3
Employees below manager level	33%	33%	34%
Managers and technical equivalents	25%	25%	50%
Senior officers	0%	0%	100%

Information with respect to unvested RSUs under the above plan is summarized as follows (in thousands, except per share amounts):

	Number of Unvested RSUs	Weighted Average Grant Date Fair Value
Balance at December 31, 2005	814	\$ 21.67
Granted	195	19.70
Forfeited	(18)	20.08
Vested	(335)	19.42
Balance at June 30, 2006	656	\$ 22.43

8. COMPREHENSIVE INCOME:

The following table summarizes comprehensive income for the periods presented (in thousands):

	For the Three Months Ended June 30,	
	2006	2005
Net income	\$ 170,363	\$ 4,011
Unrealized (loss) gain on investments	(25)	97
Total comprehensive income	\$ 170,338	\$ 4,108

	For the Six Months Ended June 30,	
	2006	2005
Net income	\$ 183,302	\$ 3,129