

DivX Inc

Outperform (1)

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Analysts

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Lower Expenses And Share Buyback Lift Estimates

Conclusion: Lower expenses and a stock buyback led to Q1 upside and increased EPS estimates. While 2008 is a transition year for DVD (from standard definition to blu-ray devices), and consumer electronics face economic headwinds, DIVX should still benefit from rising penetration and expansion onto additional hardware platforms. Tough EPS compares may limit stock movement in the next few quarters. However, valuation remains low for a high-margin licensing model, with significant cash/share. And, additional content deals with major studios could provide triggers. Maintain Outperform (1).

- **Benefits Of Expense Control, Buyback Lift Estimates.** Cash EPS of 18c (vs. St. 14c) were mainly aided by lower than expected expenses, along with the repurchase of 1.4MM shares. We raised 2008/09E cash EPS to 55c and 57c, respectively (vs. 43c and 53c), on essentially unchanged revenue.
- **Penetration Still A Growth Driver, Despite Slowing DVD.** Worldwide penetration of DivX on DVD players at the end of 2007 grew 27% Y/Y, to 42% on a trailing 12-month basis. Penetration in the U.S. remains an opportunity, at 29%, up 46% Y/Y. All of the major brands (except Sony) offer one or more SKUs with DivX in the U.S. And, new hardware platforms, such as game consoles (PS3), handsets (Samsung and LG) and digital TV (over 80 models certified, LG and HP) are beginning to contribute.
- **Premium Content Should Be A Driver, But Timing Tough To Call.** User generated and independent content continues to proliferate in the DivX format, with over 100 online sites adopting the web player since DIVX shut down the Stage6 site. However, the path to premium content distribution is more complex. Sony Pictures and DIVX announced a deal in January to allow distribution, but work is still ongoing to set up specific online retailers. We believe additional studio deals could follow this year, but perhaps not until Sony-partnered sites establish some traction.

DIVX (05/06)	\$8.76	Revenue \$MM							
Mkt cap	\$309.2MM	FY	2007	2008E	2009E	2010E			
Dil shares out	35.3MM	Dec	Actual	Prior	Current	Prior	Current	Prior	Current
Avg daily vol	664.6K	Q1	20.2	—	25.0A	—	—	—	—
52-wk range	\$6.1-19.4	Q2	18.3	20.8	21.2	—	—	—	—
Dividend	Nil	Q3	21.9	—	24.2	—	—	—	—
Dividend yield	Nil	Q4	24.5	—	27.6	—	—	—	—
BV/sh	\$4.83	Year	84.9	97.1	98.0	—	116.0	—	—
Net cash/sh	\$3.75	EV/S	—	—	1.7x	—	1.4x	—	—
Debt/cap	NA								
ROE (LTM)	12.8%								
5-yr fwd growth (Norm)	30.0%								
S&P 500	1406.9	FY	2007	2008E	2009E	2010E			
		Dec	Actual	Prior	Current	Prior	Current	Prior	Current
		Q1	0.14	—	0.18A	—	—	—	—
		Q2	0.10	0.06	0.09	—	—	—	—
		Q3	0.17	0.10	0.11	—	—	—	—
		Q4	0.16	0.14	0.16	—	—	—	—
		Year	0.54	0.43	0.55	0.53	0.57	—	—
		P/E	—	—	15.9x	—	15.4x	—	—

*Excludes stock-based compensation, intangibles, one-time items and Stage6 expenses.

Investment Thesis

DivX provides software technology for digital media content creation, distribution and playback. The DivX codec (compression/decompression algorithm) and the free DivX player application help to attract about 10MM unique visitors per month to the website and 50MM downloads per quarter. The DivX ecosystem enables a wide range of PC and CE hardware platforms and software applications, enjoyed by a large community of online consumers, which also supports advertising and digital media distribution. Licensees include DVD player OEMs, such as Philips, Samsung, LG Electronics, Pioneer, and Toshiba; digital media software vendors, such as Cyberlink, Sonic Solutions, InterVideo and Pinnacle; and digital camera OEMs Pentax and Casio. Sony is a licensee for the PS3, and is the first major studio to support content distribution in the DivX format. Discussions with other studios are underway. Advertising and third-party product distribution revenue is driven mainly via Yahoo. We believe that DivX technology is positioned to become a de facto industry standard, because it provides high-quality video with efficient use of storage, bandwidth and processor resources, and offers an independent alternative to Microsoft and Apple. The acquisition of MainConcept AG adds a leading provider of H.264 and other standard codecs, with major customers including Adobe, Leitch/Harris, Microsoft, mobiTV, Sonic Solutions, Sony, and Panasonic. Projected revenue growth is supported by rising penetration of licensed technology across multiple geographies, new products and platforms, along with advertising and other revenue from digital media distribution. Risks include customer concentration with Yahoo and Philips; competitors with much greater resources, such as Microsoft and Apple; sensitivity of consumer electronics sales to economic cycles; changes in industry standards; and litigation related to on-line content distribution.

DIVX Revenue Buildup (\$MM)

Revenue Buildup	2004	2005	2006	2007	2008E	2009E
Consumer Hardware Licensing	\$9.0	\$23.4	\$42.4	\$56.4	\$72.8	\$94.0
Software Licensing	<u>\$3.3</u>	<u>\$3.6</u>	<u>\$4.9</u>	\$10.0	\$6.9	\$4.5
Total Technology Licensing	<u>\$12.2</u>	<u>\$26.9</u>	<u>\$47.3</u>	<u>\$66.3</u>	<u>\$79.7</u>	<u>\$98.5</u>
Advertising and Third Party Product Distribution	\$2.8	\$5.0	\$10.9	\$17.5	\$16.9	\$16.0
Digital Media Distribution and Services	<u>\$1.3</u>	<u>\$1.2</u>	<u>\$1.1</u>	<u>\$1.1</u>	<u>\$1.4</u>	\$1.5
Total Distribution And Services	<u>\$4.1</u>	<u>\$6.1</u>	<u>\$12.0</u>	<u>\$18.5</u>	<u>\$18.3</u>	<u>\$17.5</u>
Total Revenues	\$16.4	\$33.0	\$59.3	\$84.9	\$98.0	\$116.0
% Of Revenues						
Consumer Hardware Licensing	55%	71%	72%	66%	74%	81%
Software Licensing	<u>20%</u>	<u>11%</u>	<u>8%</u>	<u>12%</u>	<u>7%</u>	<u>4%</u>
Total Technology Licensing	<u>75%</u>	<u>81%</u>	<u>80%</u>	<u>78%</u>	<u>81%</u>	<u>85%</u>
Advertising and Third Party Product Distribution	17%	15%	18%	21%	17%	14%
Digital Media Distribution and Services	<u>8%</u>	<u>4%</u>	<u>2%</u>	<u>1%</u>	<u>1%</u>	<u>1%</u>
Total Distribution And Services	<u>25%</u>	<u>19%</u>	<u>20%</u>	<u>22%</u>	<u>19%</u>	<u>15%</u>
Y/Y Growth						
Consumer Hardware Licensing	425%	161%	82%	33%	29%	29%
Software Licensing	<u>26%</u>	<u>9%</u>	<u>37%</u>	<u>104%</u>	<u>-31%</u>	<u>-34%</u>
Total Technology Licensing	<u>185%</u>	<u>120%</u>	<u>76%</u>	<u>40%</u>	<u>20%</u>	<u>24%</u>
Advertising and Third Party Product Distribution	33%	75%	119%	60%	-3%	-5%
Digital Media Distribution and Services	<u>-2%</u>	<u>-10%</u>	<u>-4%</u>	<u>-5%</u>	<u>35%</u>	<u>4%</u>
Total Distribution And Services	<u>19%</u>	<u>49%</u>	<u>96%</u>	<u>54%</u>	<u>-1%</u>	<u>-5%</u>
Total Revenues	111%	102%	80%	43%	16%	18%

Source: Cowen and Company, company reports

DIVX Annual P&L Forecast (\$MM)

FY=December	2004	2005	2006	2007	2008E	2009E
Net Sales:						
Technology Licensing	\$12.2	\$26.9	\$47.3	\$66.3	\$79.7	\$98.5
Media and Other Distribution and Services	\$4.1	\$6.1	\$12.0	\$18.5	\$18.3	\$17.5
Total Sales	\$16.4	\$33.0	\$59.3	\$84.9	\$98.0	\$116.0
% Change Y/Y	111%	102%	80%	43%	16%	18%
Cost Of Goods	3.5	3.9	4.0	4.5	5.5	7.0
Gross Profit:						
Technology Licensing	9.8	24.2	44.3	62.6	75.0	92.6
Gross Margin	79.7%	89.7%	93.7%	94.3%	94.1%	94.0%
Media and Other Distribution and Services	3.1	5.2	11.0	17.8	17.5	16.5
Gross Margin	75.1%	85.5%	91.7%	96.2%	95.2%	94.0%
Total Gross Profit	12.8	29.2	55.3	80.4	92.5	109.0
Gross Margin	78.6%	88.3%	93.3%	94.7%	94.3%	94.0%
SG&A Expense	9.8	16.0	26.0	59.1	61.5	65.0
% of Sales	60.0%	48.4%	43.8%	69.6%	62.7%	56.0%
Product Development	7.0	10.3	15.4	18.7	24.7	27.6
% of Sales	42.6%	31.1%	25.9%	22.1%	25.2%	23.8%
Operating Expenses	16.8	26.3	41.3	77.8	86.2	92.6
% of Sales	103%	79%	70%	92%	88%	80%
Operating Income	(3.9)	2.9	14.0	2.6	6.3	16.4
% of Sales	-24%	9%	24%	3%	6%	14%
Interest & Other Income (Expense)	(0.0)	0.2	3.0	7.9	8.1	8.3
Pretax Income	(4.0)	3.1	17.0	10.4	14.3	24.7
% of Sales	-24%	10%	29%	12%	15%	21%
Taxes	0.4	1.1	0.6	0.0	5.4	9.9
Tax Rate	-9.4%	33.8%	3.3%	-0.2%	37.7%	40.0%
Net Income	(4.3)	2.1	16.4	10.5	8.9	14.8
% of Sales	-27%	6%	28%	12%	9%	13%
GAAP EPS*	(\$0.82)	\$0.08	\$0.55	\$0.30	\$0.26	\$0.43
Average Shares	5.315	24.692	29.941	34.841	34.264	34.500
EPS Growth	NM	NM	552%	-45%	-13%	65%
Cash Net Income	(4.3)	2.5	18.8	19.0	18.8	19.8
% of Sales	-26%	7%	32%	22%	19%	17%
Cash EPS**	\$ (0.81)	\$ 0.10	\$ 0.63	\$ 0.54	\$ 0.55	\$ 0.57
*GAAP EPS excludes one-time items			527%	-13%	1%	4%
**Cash EPS excludes stock-based compensation, intangibles, and Stage6 expenses						
Stock-Based Compensation:						
COGS	0	0.001	0.004	0.002	0.015	0.020
SG&A	0.016	0.252	1.528	9.761	6.768	7.000
Product Development	0.01	0.141	0.822	1.995	2.724	2.980
Total Stock-Based Compensation	\$0.026	\$0.394	\$2.354	\$11.758	\$9.507	\$10.000
Tax Adjustment				(\$14.098)	(\$6.431)	(\$5.040)
Stage6 Expenses				\$10.859	\$3.333	\$0.000
Intangibles					\$3.477	\$2.600
Fx impact on intercompany loan					(\$0.465)	

Source: Cowen and Company, company reports

DIVX Quarterly P&L Forecast (\$MM)

FY=December	Q1:07A	Q2:07A	Q3:07A	Q4:07A	Q1:08E	Q1:08A	Q2:08E	Q3:08E	Q4:08E
Net Sales:									
Technology Licensing	16.7	14.2	17.1	18.3	18.5	19.1	17.2	20.2	23.2
Media and Other Distribution Services	3.5	4.1	4.8	6.1	6.0	5.9	4.0	4.0	4.4
Total Sales	\$20.2	\$18.3	\$21.9	\$24.5	\$24.5	\$25.0	\$21.2	\$24.2	\$27.6
% Change Y/Y	43%	39%	42%	47%	21%	24%	16%	11%	13%
% Change Q/Q	21%	-10%	20%	12%	0%	2%	-15%	14%	14%
Cost Of Goods	1.1	1.0	4.6	1.4	1.5	1.2	1.2	1.5	1.7
Gross Profit:									
Technology Licensing	15.9	13.4	16.2	17.1	17.4	18.0	16.2	19.0	21.8
Gross Margin	94.9%	94.2%	94.9%	93.3%	94.0%	94.6%	94.0%	94.0%	94.0%
Media and Other Distribution Services	3.3	3.9	4.7	6.0	5.6	5.8	3.8	3.8	4.1
Gross Margin	92.6%	96.1%	97.2%	97.6%	94.0%	97.1%	95.0%	94.0%	94.0%
Total Gross Profit	19.1	17.3	20.9	23.1	23.0	23.8	20.0	22.7	25.9
Total Gross Margin	94.5%	94.7%	95.4%	94.3%	94.0%	95.2%	94.2%	94.0%	94.0%
SG&A Expense	10.8	13.0	15.1	20.1	19.0	17.0	14.0	15.0	15.5
% of Sales	53.4%	71.2%	69.2%	82.2%	77.6%	67.8%	66.0%	62.0%	56.2%
Product Development	4.2	4.6	4.3	5.6	6.5	5.4	6.0	6.6	6.7
% of Sales	20.6%	25.4%	19.6%	23.1%	26.5%	21.7%	28.3%	27.3%	24.3%
Operating Expenses	15.0	17.6	19.4	25.8	25.5	22.4	20.0	21.6	22.2
% of Sales	74.0%	96.5%	88.8%	105.3%	104.1%	89.5%	94.3%	89.3%	80.4%
Operating Income	4.2	(0.3)	1.4	(2.7)	(2.5)	1.4	(0.0)	1.1	3.7
% of Sales	20.6%	-1.9%	6.6%	-11.0%	-10.1%	5.6%	-0.2%	4.7%	13.6%
Interest & Other Income (Expense)	1.9	2.0	2.0	1.9	1.9	2.2	1.9	2.0	2.0
Pretax Income	6.1	1.7	3.5	(0.8)	(0.6)	3.6	1.9	3.1	5.7
% of Sales	30.0%	9.2%	15.9%	-3.1%	-2.3%	14.3%	8.8%	13.0%	20.8%
Taxes	2.4	0.7	1.4	(4.5)	(0.2)	1.1	0.7	1.3	2.3
Tax Rate	39.6%	40.6%	40.0%	nm	40.0%	30.8%	40.0%	40.0%	40.0%
Net Income	3.7	1.0	2.1	3.7	(0.3)	2.5	1.1	1.9	3.4
% of Sales	18.1%	5.4%	9.5%	15.2%	-1.4%	9.9%	5.3%	7.8%	12.5%
GAAP EPS*	\$ 0.10	\$ 0.03	\$ 0.06	\$ 0.11	\$ (0.01)	\$ 0.07	\$ 0.03	\$ 0.06	\$ 0.10
Average Shares**	35.413	35.401	34.07	34.476	36.250	35.356	33.800	33.900	34.000
EPS Growth									
Cash Net Income	4.8	3.6	5.9	5.6	4.5	6.2	3.0	3.8	5.3
% of Sales									
Cash EPS***	\$ 0.14	\$ 0.10	\$ 0.17	\$ 0.16	\$ 0.12	\$ 0.18	\$ 0.09	\$ 0.11	\$ 0.16

*GAAP EPS excludes one-time items

**Cash EPS excludes stock-based compensation, intangibles, and Stage6 expenses

Source: Cowen and Company, company reports

DIVX Annual Cash Flow Forecast (\$MM)

	2004	2005	2006	2007	2008E	2009E
Net Income	(4.3)	2.3	16.4	9.2	8.9	14.8
Depreciation & Amortization	0.6	1.0	1.4	2.4	1.8	2.4
Stock-Based Compensation	0.1	0.4	2.4	11.8	9.5	10.0
Other Non-Cash Expenses	0.0	0.0	0.0	(5.7)	0.6	0.0
Working Capital Changes:						
Accounts Receivable	(1.0)	(2.0)	(2.7)	(2.9)	(0.3)	(1.2)
Other Current Assets	(1.1)	0.4	(4.0)	(3.4)	3.9	(0.2)
Accounts Payable	1.3	(0.8)	0.2	0.8	0.9	0.4
Accrued Liabilities & Other	2.7	0.3	0.1	1.8	(5.2)	0.9
Deferred Revenue	<u>0.7</u>	<u>0.5</u>	<u>1.5</u>	<u>2.8</u>	<u>(1.2)</u>	0.0
Total Working Capital Changes	2.6	(1.5)	(4.9)	(0.8)	(1.9)	(0.1)
Cash Flow From Operations	(1.0)	2.2	15.3	16.9	19.0	27.2
Net Capital Expenditures	(2.3)	(0.9)	(1.7)	(3.5)	(3.0)	(3.0)
Restricted Cash	(0.3)	0.0	0.0	0.3	0.0	0.0
Other Investments	0.0	0.0	(0.4)	(23.9)	(18.0)	2.6
Cash Flow From Investing	(2.5)	(0.9)	(2.1)	(27.1)	(21.0)	(0.4)
Change In Debt	9.7	0.7	(0.8)	(0.7)	0.0	0.0
Change In Equity	0.2	16.1	111.6	3.3	(9.1)	(0.0)
Other	0.0	0.0	(0.4)	0.0	0.0	0.0
Cash Flow From Financing	9.9	16.8	110.4	2.6	(9.1)	(0.0)
Change In Cash Position	6.3	18.1	123.6	(7.6)	(11.2)	26.8
Beginning Cash	0.6	6.9	25.0	148.6	141.0	129.8
Ending Cash	6.9	25.0	148.6	141.0	129.8	156.6

Cowen Summary:

Cash Flow From Operations (a)	(1.0)	2.2	15.3	22.6	18.4	27.2
Capital Spending	<u>(2.3)</u>	<u>(0.9)</u>	<u>(1.7)</u>	<u>(3.5)</u>	<u>(3.0)</u>	<u>(3.0)</u>
Owner's Cash Flow	(3.3)	1.3	13.6	19.2	15.4	24.2
Financing	9.9	16.8	110.4	2.6	(9.1)	(0.0)
Non-Recurring Items	(0.3)	0.0	(0.4)	(29.3)	(17.5)	2.6
Beginning Cash & Equivalent	0.6	6.9	25.0	148.6	141.0	129.8
Ending Cash & Equivalent	6.9	25.0	148.6	141.0	129.8	156.6

(a) Excludes non-recurring items

Source: Cowen and Company, company reports

DIVX Annual Balance Sheet Forecast (\$MM)

	2004	2005	2006	2007	2008E	2009E
Assets:						
Cash & Cash Equivalents	6.9	25.0	148.6	141.0	129.8	156.6
Restricted Cash	0.3	0.3	0.3	0.0	0.0	0.0
Accounts Receivable	2.2	4.2	6.9	10.4	10.7	11.9
Prepaid Expenses and Other	0.2	0.7	1.4	5.3	1.4	1.5
Deferred Tax Asset	<u>1.0</u>	<u>0.1</u>	<u>1.6</u>	<u>2.7</u>	<u>2.7</u>	2.7
Current Assets	10.6	30.3	158.8	159.4	144.7	172.8
Fixed Assets	3.0	2.9	3.5	5.4	6.0	6.6
Long-Term Investments					19.2	19.2
Other Assets	<u>0.1</u>	<u>0.0</u>	<u>2.1</u>	<u>37.2</u>	<u>36.0</u>	33.4
Total Assets	13.7	33.2	164.4	202.0	205.9	232.0
Liabilities & Stockholder Equity:						
Payables	1.7	1.0	2.7	2.8	3.7	4.1
Accrued Liabilities and Compensation	1.6	1.9	3.3	15.3	7.7	8.5
Accrued Patent Royalties	1.1	1.2	0.7	0.0	0.0	0.0
Deferred Revenue	2.7	3.1	4.7	7.2	5.0	5.0
Short-term Debt	<u>1.3</u>	<u>0.8</u>	<u>0.4</u>	<u>0.0</u>	<u>0.0</u>	<u>0.0</u>
Current Liabilities	8.5	7.9	11.8	25.3	16.3	17.6
LT Debt	0.7	0.5	0.1	0.0	0.0	0.0
Deferred Revenue	<u>0.7</u>	0.8	0.8	0.0	1.0	1.0
Other	<u>1.0</u>	0.9	0.8	1.3	3.8	3.8
Preferred Stock	<u>0.0</u>	<u>16.8</u>	<u>0.0</u>	<u>0.0</u>	<u>0.0</u>	<u>0.0</u>
Total Liabilities	10.8	27.0	13.5	26.6	21.1	22.4
Equity	2.9	6.2	150.9	175.4	184.8	209.6
Total Liabilities & Stockholder Equity	13.7	33.2	164.4	202.0	205.9	232.0
Turnover:						
Assets	1.2	1.0	0.4	0.4	0.5	0.5
Non-Cash Assets	2.5	4.2	3.8	1.4	1.3	1.5
Days Receivables		35.7	37.5	38.2	35.0	35.0
Days Payables		8.7	14.5	10.3	12.0	12.5
Leverage:						
LT Debt/Equity	23%	8%	0%	0%	0%	0%
Total Debt/Capital	41%	17%	0%	0%	0%	0%
Debt-Cash/Equity	nm	nm	nm	nm	nm	nm
Cash/Assets	53%	76%	91%	70%	63%	68%
Returns:						
ROA	nm	10.6%	19.0%	10.4%	9.2%	9.0%
ROE	nm	54.5%	23.9%	11.6%	10.5%	10.0%
Per Share						
Operating Cash Flow	\$ (0.19)	\$ 0.09	\$ 0.51	\$ 0.48	\$ 0.55	\$ 0.79
Depreciation	\$ (0.38)	\$ -	\$ 0.04	\$ 0.03	\$ 0.05	\$ -
Cash	\$ 1.36	\$ 1.02	\$ 4.97	\$ 4.05	\$ 3.79	\$ 4.54
Working Capital	\$ 0.40	\$ 0.91	\$ 4.91	\$ 3.85	\$ 3.74	\$ 4.50
Book Value	\$ 0.54	\$ 0.25	\$ 5.04	\$ 5.04	\$ 5.39	\$ 6.08

Source: Cowen and Company, company reports

Addendum

STOCKS MENTIONED IN IMPORTANT DISCLOSURES

Ticker	Company Name
DIVX	DivX Inc

ANALYST CERTIFICATION

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Rating	Definition
Outperform (1)	Stock expected to outperform the S&P 500
Neutral (2)	Stock expected to perform in line with the S&P 500
Underperform (3)	Stock expected to underperform the S&P 500

(a) Assumptions: Time horizon is 12 months; S&P 500 is flat over forecast period.

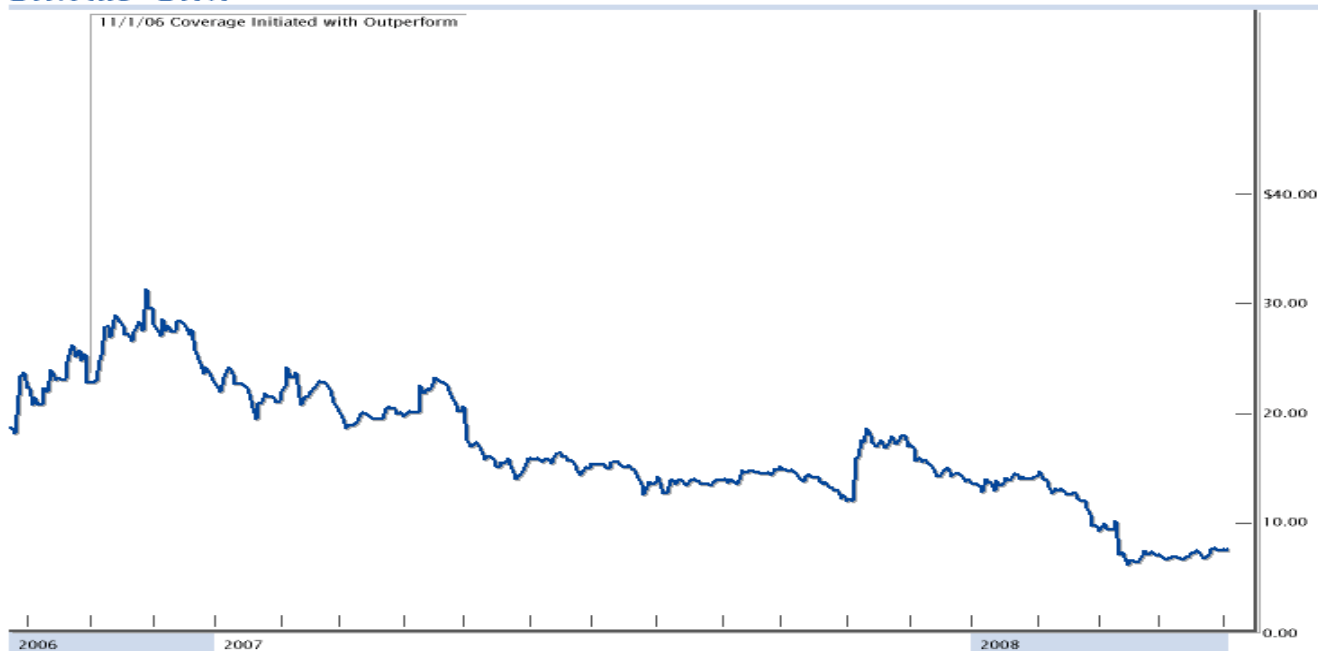
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(a) As of 03/31/2008. (b) Corresponds to "Outperform" rated stocks as defined in Cowen and Company, LLC's rating definitions (see above). (c) Corresponds to "Neutral" as defined in Cowen and Company, LLC's ratings definitions (see above). (d) Corresponds to "Underperform" as defined in Cowen and Company, LLC's ratings definitions (see above). Note: "Buy," "Hold" and "Sell" are not terms that Cowen and Company, LLC uses in its ratings system and should not be construed as investment options. Rather, these ratings terms are used illustratively to comply with NASD and NYSE regulations.

Cowen and Company Price and Ratings History

DivX Inc - DIVX



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