

Digital Media Technology

May 6, 2008

Closing Price (5/5/08):	\$7.74
12-month Target Price:	\$16
52-Week Range:	\$6.12-\$19.35
Market Cap (MM):	\$269
Shares O/S (MM):	34.7
Float (MM):	34.7
Avg. Vol. (000)	648.0
Book Value/Share:	\$4.83
Dividend/Yield:	\$0.00/0.00%
Risk Profile:	Speculative

Maxim Group FYE: Dec	Quarterly Revenue (\$M)	
	2008E	2009E
1Q	\$25.0A	\$30.2
2Q	\$21.6	\$29.6
3Q	\$23.9	\$30.0
4Q	<u>\$27.4</u>	<u>\$33.3</u>
FY	\$97.9	\$123.0

Maxim Group FYE: Dec	Current EPS	Prior EPS	Current P/E
2007A	\$0.57		13.6
2008E	\$0.56	\$0.46	13.8
2009E	\$0.74		10.5

LT Earnings Growth 25%

Maxim Group FYE: Dec	Quarterly EPS	
	2008E	2009E
1Q	\$0.18A	\$0.18
2Q	\$0.11	\$0.17
3Q	\$0.12	\$0.17
4Q	<u>\$0.16</u>	<u>\$0.22</u>
FY	\$0.56	\$0.74

Consensus-First Call FYE: Dec	Quarterly EPS	
	2008E	2009E
1Q	\$0.14	\$0.18
2Q	\$0.07	\$0.16
3Q	\$0.11	\$0.17
4Q	<u>\$0.15</u>	<u>\$0.22</u>
FY	\$0.47	\$0.55

¹Excludes Stage6 and options expenses

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DivX, Inc.

(DIVX – Nasdaq – \$7.74)

Buy

Inline 1Q revenue, but better than expected 1Q08 EPS and 2Q08-FY08 EPS guidance due to tight expense control; Raising FY08 EPS and target price to \$16 from \$13; Reiterate Buy

- **What should investors do with DIVX stock?** We are encouraged by DIVX's inline revenue results and guidance and likewise view management's tight expense control and upbeat EPS outlook as encouraging, especially in what could prove being a transition year. We reiterate our Buy rating and believe that, at its current valuation, the market has unfairly all but written off DIVX (as was made evident by its 5x EV/2008 EBITDA multiple with \$3.90 per share in cash).
- **DIVX reported inline 1Q08 revenue of \$25.0M (+24% y/y, +2% q/q) versus our forecast \$25.1M, consensus of \$25.0M, and guidance of \$24.5M-\$25.5M.**
- Consumer hardware device revenue of about \$16.8M (+14% y/y and -2% q/q) missed our forecast of \$18.8M. Part of the miss was due to slightly slower than expected share gains in the DVD market (42% of trailing 12-month player sales vs. 41% in Sept), as well as the upfront revenue recognition associated with a new contract signed in 4Q07 (the revenue was recognized in 4Q07 rather split with 1Q08).
- Surprisingly, software licensing revenue was \$2.3M, significantly ahead of our forecast of \$1.3M. We believe that part of the upside was due to increased traction of DIVX's web player with other online video sites, which is a surprisingly positive side-effect of the closure of Stage6.
- Advertising and distribution revenue was \$5.7M (+69% y/y and -3% q/q), above our estimate of \$4.8M. While management stopped short of saying that revenue was linear in the quarter, which would suggest that closing Stage6 had no impact, they stated that linearity exceeded internal expectations. It remains our view that the impact of closing Stage6 on player downloads is being overestimated. We believe that demand for the DIVX player/format was strong before Stage6 and should remain strong due to the adoption of the DIVX web player by other video sites.
- GAAP EPS of \$0.07 was significantly better than our estimate of negative \$0.01, due primarily to aggressive cost controls but also due to slightly lower Stage6 and options expenses. The company's previous guidance was GAAP EPS of (\$0.01)-\$0.01.
- On a proforma basis, excluding Stage6 and options expenses, EPS was \$0.18 versus our forecast of \$0.13, consensus of \$0.14, and management's guidance of \$0.13-\$0.15.
- Stage6 spending was \$3.3M, below our forecast of \$4M for the quarter. 1Q08 represents the last quarter of Stage6 expenses.

- Management provided inline 2Q08 revenue guidance of \$20.5M-\$21.5M. On a y/y basis, management's guidance implies growth of 12%-18%, significantly below the 39% y/y growth in 2Q07. On a q/q basis, revenue growth of negative -14%-18% is also below past seasonal declines of about negative 5% q/q. However, we believe that management is being conservative because visibility is very unclear as to how much traffic and player downloads can be driven by third-party online video sites.
- Additionally, some of the company's emerging product categories are taking a little longer than expected to achieve traction (e.g. mobile, connected platform, and TVs). The source of the vast majority of DIVX's hardware licensing revenue remains standard definition DVD players, which is a mature market with little growth. Next generation DVD players continue to experience challenges gaining traction with consumers. Apparently, the end of the DVD format war did not release as much pent-up demand for Blu-ray as was expected (at least not YTD and there is concern that a surge in growth could be pushed into 2H09).
- We were modeling 2Q08 revenue of \$21.6M and consensus was \$21.5M.
- Despite inline revenue guidance, management provided upbeat 2Q08 GAAP EPS of \$0.03-\$0.05 and proforma EPS guidance of \$0.09-\$0.11. Our modeling shows that all of the upside is due to tight expense control. However, the one area that we believe will likely increase as a percentage of revenue is R&D as the company expands its technology into emerging product categories (MainConcept's H.264, DIVX Connected, and mobile phones).
- We were modeling 2Q08 GAAP EPS of \$0.02 and proforma EPS of \$0.07, and consensus proforma EPS was \$0.07.
- Management confirmed its previous FY08 revenue guidance of \$95M-\$100M. However, as with its 2Q08 revenue guidance, we believe that management is being somewhat conservative due to limited visibility about downloads driven through other online video sites and its impact on advertising and third-party distribution revenue. We were modeling FY08 revenue of \$97.5M and consensus was \$98.2M.
- As with its 2Q08 EPS guidance, management raised its FY08 GAAP EPS outlook to \$0.24-\$0.30, up from \$0.14-\$0.22, and its proforma EPS (excluding Stage6, options expenses, and acquisition-related amortization) of \$0.52-\$0.58, up from \$0.44-\$0.52. The increase in management's FY08 non-GAAP EPS guidance is slightly more than its 1Q08 beat, suggesting that at least part of the tight expense control policy will remain for the duration of the year.
- Our previous proforma FY08 EPS estimate was \$0.46 and consensus EPS was \$0.47.
- We are maintaining our slightly above guidance 2Q08 revenue of \$21.6M, reflecting our view that management is being somewhat conservative with its advertising and third-party distribution revenue outlook.
- We are raising our 2Q08 and FY08 EPS estimates to reflect impressive cost control, as well as a slightly lower share count.
- During the quarter, the company repurchased 1.4M shares of stock for a total of \$17.5M under its \$20M repurchase plan.
- We are introducing FY09 revenue and EPS forecasts of \$123.0M and \$0.74, respectively.

New Estimates

<i>\$ in thousands, except per share</i>	1Q08A	2Q08E	3Q08E	4Q08E	2008E	1Q09E	2Q09E	3Q09E	4Q09E	2009E
Total net revenues	25.0	21.6	23.9	27.4	97.9	30.2	29.6	30.0	33.3	123.0
GAAP EPS	0.07	0.05	0.06	0.10	0.28	0.13	0.12	0.12	0.17	0.55
Stage6 Impact	0.06	-	-	-	0.06	-	-	-	-	-
Proforma EPS (excluding Stage6, intang. Amort, & options)	0.18	0.11	0.12	0.16	0.56	0.18	0.17	0.17	0.22	0.74

Previous Estimate

<i>\$ in thousands, except per share</i>	1Q08E	2Q08E	3Q08E	4Q08E	2008E	1Q09E	2Q09E	3Q09E	4Q09E	2009E
Total net revenues	25.1	21.6	22.6	28.2	97.5	-	-	-	-	-
GAAP EPS	(0.01)	0.02	0.04	0.12	0.16	-	-	-	-	-
Stage6 Impact	0.07	-	-	-	0.07	-	-	-	-	-
Proforma EPS (excluding Stage6, intang. Amort, & options)	0.13	0.07	0.09	0.17	0.46	-	-	-	-	-

- As a result of: (1) a stable FY08 revenue outlook; (2) tight operating expense control resulting in a higher EPS outlook; and (3) and stable market multiples, we are raising our target price to \$16 from \$13 to reflect our higher FY08 EPS forecasts. Our new target price uses the same 28x P/E multiple.

- Over the past few weeks, DIVX has had several positives announced, most notably its increased penetration in the TV market. According to the company, DIVX is currently used in about 80 HDTV SKUs from LG and HP. The majority of these TVs require content to be loaded via a USB drive, but some SKUs connect directly to consumers' home networks. We are most optimistic about DIVX's penetration into TVs that connect directly to the Internet, primarily because it advances the ease-of-use factor and does not require another device to access content either from users home PC or online video service.
- The company's agreements with AMD (ATI), Broadcom, and Trident, which combined represent about 50% of the DTV chipset market, should make it easier for other TV manufacturers to include DIVX playback functionality in their TVs.

\$ in thousands, except per share	1Q07A	2Q07A	3Q07A	4Q07A	2007A	1Q08A	2Q08E	3Q08E	4Q08E	2008E	1Q09E	2Q09E	3Q09E	4Q09E	2009E
Total net revenues	20,218	18,279	21,895	24,470	84,862	25,022	21,611	23,896	27,374	97,903	30,206	29,566	30,006	33,259	123,037
COGS	1,109	1,192	1,008	1,385	4,694	1,208	1,008	1,053	1,207	4,476	1,722	1,675	1,698	1,889	6,984
Gross profit	19,109	17,302	20,887	23,085	80,383	23,814	20,603	22,843	26,166	93,427	28,484	27,892	28,307	31,370	116,053
Operating expenses:															
SG&A	10,796	13,007	15,144	19,368	58,315	15,977	12,905	13,550	14,228	56,659	14,544	14,840	15,137	15,591	60,113
R&D	4,156	4,636	4,299	5,647	18,738	5,425	5,455	6,273	7,214	24,367	7,935	7,539	7,689	7,843	31,006
Amortization of intangibles				750	750	1,000	800	800	800	3,400					-
Total operating expenses	14,952	17,643	19,443	25,765	77,803	22,402	19,160	20,623	22,241	84,426	22,479	22,379	22,827	23,435	91,119
EBIT	4,157	(341)	1,444	(2,680)	2,580	1,412	1,443	2,220	3,925	9,001	6,004	5,512	5,481	7,936	24,933
Interest/other income (expense), net	1,903	2,024	(195)	1,922	5,654	2,174	1,418	1,435	1,512	6,538	1,575	1,606	1,761	1,866	6,809
EBT	6,060	1,683	1,249	(758)	8,234	3,586	2,861	3,655	5,437	15,539	7,580	7,119	7,242	9,801	31,742
Taxes	(2,400)	(680)	(433)	4,487	974	(1,105)	(1,145)	(1,462)	(2,175)	(5,886)	(3,032)	(2,848)	(2,897)	(3,921)	(12,697)
Net income (loss)	3,660	1,003	816	3,729	9,208	2,481	1,717	2,193	3,262	9,653	4,548	4,271	4,345	5,881	19,045
Stage6 expenses	1,038	2,400	3,982	3,483	10,903	3,333				3,333					
EPS															
GAAP EPS	0.10	0.03	0.02	0.11	0.26	0.07	0.05	0.06	0.10	0.28	0.13	0.12	0.12	0.17	0.55
Proforma EPS, (excluding Stage6 & intang. amort)	0.12	0.07	0.13	(0.02)	0.30										
Proforma EPS, (excluding Stage6, amort, & Options)	0.14	0.10	0.17	0.16	0.57	0.18	0.11	0.12	0.16	0.56	0.18	0.17	0.17	0.22	0.74
Diluted shares	35,413	35,401	35,180	35,476	35,368	35,356	33,856	34,006	34,156	34,344	34,406	34,656	34,906	35,156	34,781
% of Revenue						263.16									
Consumer hardware devices	73%	68%	71%	70%	71%	67%	77%	76%	77%	74%	77%	77%	77%	78%	77%
Software	10%	10%	7%	5%	8%	9%	7%	8%	9%	8%	9%	9%	9%	9%	9%
Technology licensing	83%	78%	78%	75%	78%	76%	84%	84%	86%	82%	86%	86%	86%	87%	86%
Advertising and third-party distribution	17%	21%	21%	23%	21%	23%	15%	15%	13%	17%	13%	13%	13%	12%	13%
Digital media distribution services	1%	1%	1%	2%	1%	1%	1%	1%	1%	1%	1%	1%	1%	1%	1%
Other revenue	17%	22%	22%	25%	22%	24%	16%	16%	14%	18%	14%	14%	14%	13%	14%
Gross Margin	95%	95%	95%	94%	95%	95%	95%	96%	96%	95%	94%	94%	94%	94%	94%
SG&A	53%	71%	69%	79%	69%	64%	60%	57%	52%	58%	48%	50%	50%	47%	49%
R&D	21%	25%	20%	23%	22%	22%	25%	26%	26%	25%	26%	25%	26%	24%	25%
Operating Margin	21%	(2%)	7%	(11%)	3%	6%	7%	9%	14%	9%	20%	19%	18%	24%	20%
Tax Rate	40%	40%	35%	59%	(12%)	31%	40%	40%	40%	38%	40%	40%	40%	40%	40%
Net Margin	18%	5%	4%	15%	11%	10%	8%	9%	12%	10%	15%	14%	14%	18%	15%
Y/Y Growth															
Consumer hardware devices	49%	34.2%	44.1%	37%	41%	14%	34%	16%	22%	21%	39.4%	37.5%	27.7%	23.1%	31%
Software	66%	63.9%	(7.8%)	29%	33%	18.9%	(17%)	27%	104%	27%	18.1%	72.0%	41.4%	22.0%	35%
Technology licensing	51%	37.1%	37.2%	37%	40%	14%	27%	17%	28%	22%	36.8%	40.4%	29.1%	23.0%	32%
Advertising and third-party distribution	22%	48.2%	63.4%	114%	62%	68%	(15%)	(21%)	(37%)	(8%)	(34.1%)	17.3%	6.9%	13.6%	(4%)
Digital media distribution services	(278%)	—	(460.0%)	28%	(7%)	—	—	11%	(38%)	142%	—	—	—	(0.1%)	27%
Other revenue	16%	44.8%	63.6%	90%	54%	69%	(14%)	(19%)	(36%)	(7%)	(30.9%)	18.0%	7.6%	12.4%	(2%)
Total Revenue	43%	38.8%	42.2%	47%	43%	24%	18%	9%	12%	15%	20.7%	36.8%	25.6%	21.5%	26%
SG&A	82%	125.3%	126.9%	155%	125%	48%	(1%)	(11%)	(27%)	(3%)	(9.0%)	15.0%	11.7%	9.6%	6%
R&D	29%	25.3%	4.7%	31%	22%	31%	18%	46%	28%	30%	46.3%	38.2%	22.6%	8.7%	27%
Operating Income	4%	(113%)	(60%)	(173%)	NM	—	—	—	—	NM	—	—	—	102%	NM
Net Income	12%	(62.4%)	(73.7%)	(50%)	(44%)	(32%)	71%	169%	(13%)	5%	—	148.8%	98.1%	80.3%	97%
Q/Q Growth															
Consumer hardware devices	18%	(16%)	25%	10%		(2%)	(1%)	9%	16%		11%	(2%)	1%	12%	
Software	107%	(6%)	(16%)	(21%)		90%	(34%)	28%	28%		10%	(4%)	5%	10%	
Technology licensing	24%	(15%)	20%	7%		4%	(5%)	10%	17%		11%	(2%)	1%	12%	
Advertising and third-party distribution	27%	13%	20%	24%		1%	(43%)	12%	(1%)		5%	1%	2%	5%	
Digital media distribution services	(78%)	51%	24%	88%		(50%)	10%	10%	25%		3%	(10%)	1%	6%	
Other revenue	9%	15%	19%	27%		(3%)	(41%)	12%	1%		5%	0%	2%	5%	
Total Revenue	21%	(10%)	20%	12%		2%	(14%)	11%	15%		10%	(2%)	1%	11%	
SG&A	42%	20%	16%	28%		(18%)	(19%)	5%	5%		2%	2%	2%	3%	
R&D	(4%)	12%	(7%)	31%		(4%)	1%	15%	15%		10%	(5%)	2%	2%	
Operating Income	13%	(108%)	(523%)	(286%)		(153%)	2%	54%	77%		53%	(8%)	(1%)	45%	
Net Income	(51%)	(73%)	(19%)	357%		(33%)	(31%)	28%	49%		39%	(6%)	2%	35%	

DISCLOSURES



Source: Investars .com

Maxim Group LLC Stock Rating System		As of:	5/6/2008
Expected Performance*		% of Coverage Universe with Rating	% of Ratings that Firm received Banking fees
Buy	Expected total return of 15% or more over next 12 months	73.0%	9.2%
Hold	Expected total return of plus or minus 14% over next 12 months	27.0%	0.0%
Sell	Expected total negative return of at least 15% over next 12 months	0.0%	0.0%

* Relative to Nasdaq Composite.
An Under Review (UR) rating represents a stock that the Firm has temporarily placed under review due to a material change.

Maxim Group makes a market in DivX Inc.**Maxim Group expects to receive or intends to seek compensation for investment banking services from DivX Inc. in the next 3 months.**

I, **Mark Harding**, attest that the views expressed in this research report accurately reflect my personal views about the subject security and issuer. Furthermore, no part of my compensation was, is, or will be directly or indirectly related to the specific recommendation or views expressed in this research report.

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Valuation Methods: One or more of the following valuation methods are used by Maxim Group analysts in making a ratings or price projection: Analysis of companies' P/E ratio, price/book ratio, earnings expectations or sales growth as they relate within an industry group or to the broader market, enterprise value/sales, Individual sector analysis, sum of the parts analysis and discounted cash flow.

Price Target Risks: Investment risks associated with the achievement of the price target include, but are not limited to, the company's failure to achieve our earnings and revenue estimates, unforeseen macroeconomic and/or industry events that adversely impact demand for the company's products and services, product obsolescence, the company's ability to recruit and retain competent personnel, changes in investor sentiment regarding the specific company or industry, changing competitive pressures, and adverse market conditions. For a complete discussion of the risk factors that could affect the market price of the company's shares, refer to the most recent form 10-Q or 10-K that the company has filed with the SEC.

Investment Risks. Aside from general market and economic risks, other risks particular to our investment rating include: 1) fierce competition from industry behemoths; 2) securing a content agreement, which is critical in our view, may be more challenging than we expect; and 3) most current revenue is from DVD player sales, which is starting to slow, and the ramp in digital camera related revenue may take longer than we anticipate.

Risk Ratings

Risk ratings take into account both fundamental criteria and price volatility.

Speculative –

Fundamental Criteria: This is a risk rating assigned to early-stage companies with minimal to no revenues, lack of earnings, balance sheet concerns, and/or a short operating history. Accordingly, fundamental risk is expected to be significantly above the industry.

Price Volatility: Because of the inherent fundamental criteria of the companies falling within this risk category, the price volatility is expected to be significant with the possibility that the investment could eventually be worthless.

Speculative stocks may not be suitable for a significant class of individual investors.

High –

Fundamental Criteria: This is a risk rating assigned to companies having below-average revenue and earnings visibility, negative cash flow, and low market cap or public float. Accordingly, fundamental risk is expected to be above the industry.

Price volatility: The price volatility of companies falling within this category is expected to be above the industry.

High-risk stocks may not be suitable for a significant class of individual investors.

Medium –

Fundamental Criteria: This is a risk rating assigned to companies that may have average revenue and earnings visibility, positive cash flow, and is fairly liquid.

Accordingly, both price volatility and fundamental risk are expected to approximate the industry average.

Low –

Fundamental Criteria: This is a risk rating assigned to companies that may have above-average revenue and earnings visibility, positive cash flow, and is fairly liquid.

Accordingly, both price volatility and fundamental risk are expected to be below the industry.

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