

# Linus Technologies

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### Added-value based revenue model taking shape

ASX:LNU

Software & IT Services

Australia

Risk: High

In its discussions with potential licensees of its Video Virtualization Engine (VVE) technology in the last few months, we believe LNU has not only been able to further demonstrate the commercial value of the VVE to potential licensees, but has also been able to further develop its revenue model; i.e. a revenue model based on the value LNU can add for clients.

Linus Technologies Ltd. (LNU) provides a patented enterprise grade software technology that virtualizes video files. It transforms cumbersome, static video files into agile, dynamic files that can be easily manipulated on the fly, in order to deliver an enhanced, custom experience for both broadcasters and end-users. One of the application areas of the technology is the valuable personalized TV advertising market.

The company's thinking around its future revenue models for personalized advertising and anti-piracy applications is best illustrated using a few examples:

1. Say a major cable operator generates \$500M in generic TV advertising revenues annually. Applying LNU's VVE to the operator's advertising streams to subscribers would enable the cable operator to personalize most of its advertising to these subscribers. Personalized ads on the internet are worth approximately 2.7x more than generic ads. Applying that same ratio to personalized TV advertising increases the value of the operator's TV advertising spots very substantially, i.e. potentially increasing advertising revenues by 2.7x over the course of the implementation time frame of, say, three to four years. In other words, the cable operator's revenues would grow from \$500M to \$1.35BN in that time frame.

LNU aims for part of its revenue stream to be a function of the additional value it generates for its clients, e.g. 15% of the additional advertising revenue LNU generates for the cable operator (the industry norm is 15% to 20%). This would translate into \$127.5M (15%\*\$850M) over the course of a number of years. This 15% fee is just an example and may be lower or higher.

Additionally, LNU aims to charge an annual license fee per subscriber of \$1. So, a cable operator with 5M subscribers would pay an annual license fee of \$5M in addition to the variable fee based on higher ads revenues.

2. In another example, assume a movie studio generates an average \$1BN in box office, Video On Demand (VOD) and DVD/Blu-ray revenues from a new movie title. The average loss of revenues at the box office alone, due to content piracy, amounts to 15% (Carnegie Mellon University, 2016). Assuming the box office share of total revenues from a movie title is 40%, with 60% of revenues generated through VOD and DVD sales, this movie studio misses out on \$60M (40%\*\$1BN\*15%) in revenues due to piracy, just at the box office. We believe revenue losses from piracy in the VOD and DVD segments are actually a lot higher than revenue loss at the box office. In any case, LNU's VVE will enable movie studios to largely regain control over their pirated content available on the internet, e.g. on

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**BUY**

Share price: A\$ 0.052

7 March 2017

	A\$ M		FY16A	FY17E	FY18E	FY19E
Number of shares (m)	679.2	Revenues	0.0	0.1	5.7	12.6
Number of shares FD (m)	752.2	EBITDA	-3.4	-2.3	2.2	7.8
Market capitalisation (A\$ m)	35.3	NPAT	-5.4	-2.8	1.0	4.9
Market cap fully dil (A\$ m)	39.1	EPS FD	-0.01	-0.004	0.001	0.01
12 month high/low A\$	0,094 / 0,036	EV/EBITDA	N/A	N/M	15.9	3.9
Average daily volume (k)	737	EV/Sales	N/M	246.9	6.0	2.4

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torrent sites, thereby opening up new revenues streams from content that was initially pirated. It should also drive existing revenue streams at the box office as well as from DVD and VOD sales as there will be fewer opportunities for consumers to “consume” pirated content without being flagged and remotely locked out of this content. LNU might charge 10% of the additional content revenues the movie studio has been able to generate from implementing the VVE technology for this particular movie, i.e. \$6M, plus a fixed fee each time the studio gets a warning signal when pirated content is played out on a device. Again, the 10% is just an example and may differ substantially.

These are just two examples of value creation from the VVE technology, but similar value can be added in LNU’s other initial target markets, e.g. Search and Defense & Security.

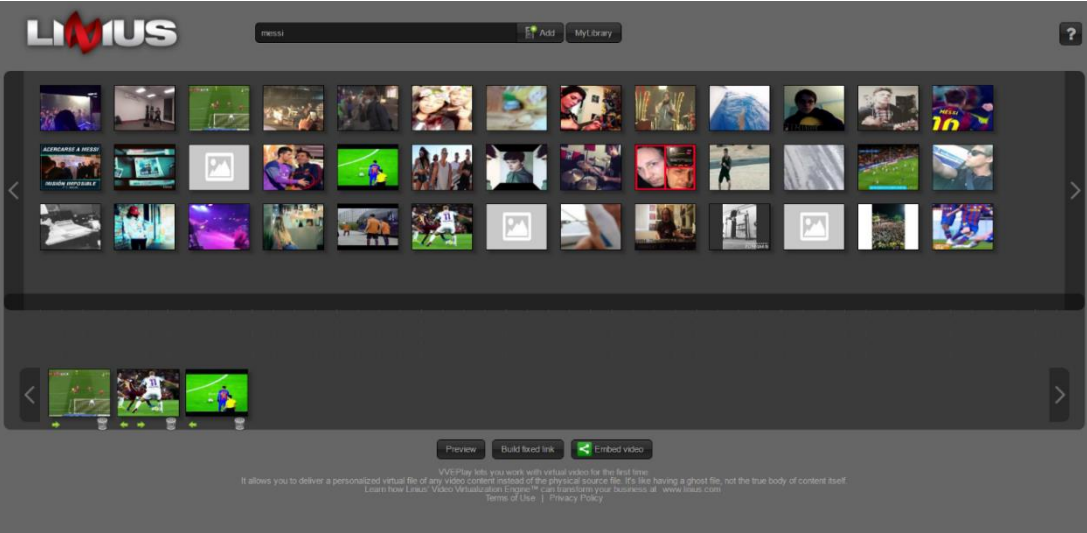
Industry awareness of LNU’s capabilities is growing

We believe these sorts of revenue models are currently being discussed with potential licensees of the VVE technology, and illustrate the enormous revenue potential for LNU. While proof of the pudding will be in the eating, i.e. signed contracts with actual revenues to LNU, we believe awareness of LNU’s capabilities among industry players is growing rapidly.

Instagram videos indexed as further demonstration of VVE’s commercial potential

This awareness has been further increased on the back of LNU’s recent announcement that it has used its VVE technology to virtualize millions of Instagram and Ted Talk videos. The company has launched a trial website (Figure 1) where users can search this virtual video library and generate their own virtual video by combining search results into one video stream. The resulting video can subsequently be shared, sent and uploaded, e.g. on social media.

FIGURE 1: SCREENSHOT VVE PLAY



Source: Linus Technologies, TMT Analytics

Building commercial momentum, BUY rating reiterated

We believe commercial momentum for LNU is building, driven by its recently launched commercial plan for the initial four addressable verticals (see our Flash Note dated 2 February 2017) and the demonstration of capabilities through the Instagram virtualization. Furthermore, the revenue model is crystalizing further and will form the basis for commercial discussions with prospects, in our view, providing an indication of LNU’s revenue potential. Our DCF model suggests a fair value per LNU share of A\$ 0.28. We reiterate our Buy recommendation for LNU.



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