

# Linus Technologies

## Linus Technologies

### 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

SUBSCRIBE TO OUR RESEARCH AT  
TMT-ANALYTICS.COM.AU/RESEARCH

**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

Analyst: Marc Kennis

marc.kennis@tmt-analytics.com.au

+61 (0)4 3483 8134

Readers should be aware that TMT Analytics has been engaged by the company covered in this report for ongoing research coverage. Please refer to the final page of this report for the General Advice Warning, disclaimer and full disclosures.

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.

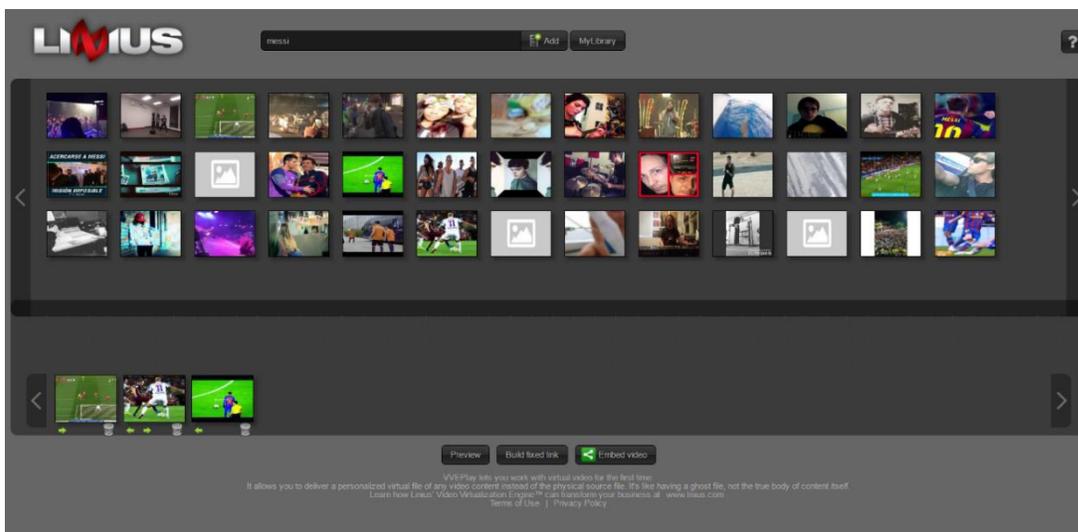
### Industry awareness of LNU’s capabilities is growing

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.

## GENERAL ADVICE WARNING, DISCLAIMER & DISCLOSURES

The information contained herein ("Content") has been prepared and issued by TMT Analytics Pty Ltd ABN 17 611 989 774 ("TMT Analytics"), an Authorised Representative (no: 1242594) of Belmont Securities ABN 47 119 852 890 AFSL 331625. All intellectual property relating to the Content vests with TMT Analytics unless otherwise noted.

### DISCLAIMER

The Content is provided on an as is basis, without warranty (express or implied). Whilst the Content has been prepared with all reasonable care from sources we believe to be reliable, no responsibility or liability shall be accepted by TMT Analytics for any errors or omissions or misstatements howsoever caused. Any opinions, forecasts or recommendations reflect our judgment and assumptions at the date of publication and may change without notice. TMT Analytics will not accept any responsibility for updating any advice, views, opinions or recommendations contained in this document.

No guarantees or warranties regarding accuracy, completeness or fitness for purpose are provided by TMT Analytics, and under no circumstances will any of TMT Analytics, its officers, representatives, associates or agents be liable for any loss or damage, whether direct, incidental or consequential, caused by reliance on or use of the Content.

### GENERAL ADVICE WARNING

The Content has been prepared for general information purposes only and is not (and cannot be construed or relied upon as) personal advice nor as an offer to buy/sell/subscribe to any of the financial products mentioned herein. No investment objectives, financial circumstances or needs of any individual have been taken into consideration in the preparation of the Content.

Financial products are complex, entail risk of loss, may rise and fall, and are impacted by a range of market and economic factors, and you should always obtain professional advice to ensure trading or investing in such products is suitable for your circumstances, and ensure you obtain, read and understand any applicable offer document.

### DISCLOSURES

TMT Analytics has been commissioned to prepare the Content. From time to time, TMT Analytics' representatives or associates may hold interests, transact or hold directorships in, or perform paid services for, companies mentioned herein. TMT Analytics and its associates, officers, directors and employees, may, from time to time hold securities in the companies referred to herein and may trade in those securities as principal, and in a manner which may be contrary to recommendations mentioned in this document.

TMT Analytics may receive fees from a company referred to in this document, for research services and other financial services or advice we may provide to that company. The analyst has received assistance from the company in preparing this document. The company has provided the analyst with communication with senior management and information on the company and industry. As part of due diligence, the analyst has independently and critically reviewed the assistance and information provided by the company to form the opinions expressed in the report. Diligent care has been taken by the analyst to maintain an honest and fair objectivity in writing this report and making the recommendation. Where TMT Analytics has been commissioned to prepare Content and receives fees for its preparation, please note that NO part of the fee, compensation or employee remuneration paid will either directly or indirectly impact the Content provided.

### RECOMMENDATIONS

TMT Analytics' issues a BUY recommendation in case of an expected total shareholder return (TSR, share price appreciation plus dividend yield) in excess of 25% within the next twelve months, an ACCUMULATE recommendation in case of an expected TSR between 5% and 25%, a HOLD recommendation in case of an expected TSR between -5% and +5% within the next twelve months and a SELL recommendation in case of an expected total return lower than -5% within the next twelve months.

---