



**Digital Video Systems, Inc.**

**Moderator: Sean Collins, CCG Investor Relations**  
**Presenter: Thomas Spanier, Chairman & CEO, Digital Video Systems, Inc.**  
**June 15, 2004**  
**12:00 pm CT**

Operator: Good afternoon. My name is Tracy and I will be your conference facilitator today.

At this time I would like to welcome everyone on the Digital Video Systems' strategic overview.

All lines have been placed on mute to prevent any background noise.

After the speakers' remarks there will be a question and answer period. If you would like to ask a question at this time please press 'star,' then the number 1 on your telephone keypad.

If you would like to withdraw your question, press the 'pound' key.

I would now like to turn the conference over to Sean Collins, partner with CCG Investor Relations. Please go ahead, sir.

Sean Collins: Thank you operator. Good morning or good afternoon everyone, depending on where you're located in the country.

Welcome to Digital Video Systems' Strategic Overview Conference Call.

I'm Sean Collins as the operator said, a partner with CCG Investor and Public Relations, the company's [investor relations] counsel.

In a few moments you will hear from and have an opportunity to ask questions of the company's Chairman and CEO, Tom Spanier.

Any statements made in this presentation that are not historical facts contain forward-looking statements that involve risks and uncertainties. These forward-looking statements include, but are not limited to, comments regarding new, higher-margin products for car- and rewrite[able]-DVD markets, and our product strategy.

These forward-looking statements are subject to risks including but not limited to the sufficiency of working capital, the time availability of components, the impact of competitive products and services, the company's ability to manage growth and acquisitions of technology or businesses, the effect of economic and business conditions and other risks detailed from time to time in the company's filings with the SEC.

That said, we can begin.

Allow me to introduce to you the Chairman and CEO of Digital Video Systems, Tom Spanier.

Thomas Spanier: Thank you. I'd like to thank all of you participants for taking time out of your busy days to hear about DVS. I hope it's worth your while.

First, I want to give you a little bit of background about myself and why I thought DVS was a very interesting opportunity.

My background is about 30 years of CEO, CFO and COO experience in a wide range of industries. I've done turnarounds. I've been involved in public companies. I've done early-stage companies, startups, VC-backed companies.

I've got a business education at Berkeley and at Harvard.

I've always focused my experience on special situations. I look for situations where change is needed in companies that have substantial unrealized value.

And I think DVS fits that profile perfectly.

So I hope I can share with you some of what I see in the company's potential here.

I started in April. The first thing we did was to put together a global planning meeting. We took the staff from Korea and from India and spent the better part of a week on presentations and discussions on strategies and opportunities.

And that's basically the core of what we'll discuss today.

There are a few principal takeaways I'd like to leave with you.

First of all, as many of you know, the DVD player and loader business, which has been the core of our business, really does not play a big role in our future.

That business has become commoditized. There are no margins available.

And it really doesn't play to any competitive advantages that we may have available.

On the other hand, we have a very strong foundation for building a company. And we've got some market opportunities that can exploit our real strengths.

First of all, we've got an engineering team that came out of Hyundai that is absolutely expert in DVD technologies.

We've got approximately 70 engineers in Korea. Hyundai spent over \$100 million in developing the DVD technologies.

And that same team is working hard on developing products for our future and then working with customers, developing their products.

We have well-established relationships with vendors and with customers. Our company's reputation is very high with respect to the quality of our product and the role we've played in leading the industry.

We now have products that we believe can sustain margins. We also have an early position in the India market, which is a burgeoning market.

And the transition from a commodity business to a higher-margin, sustainable competitive situation has already begun.

So this isn't the future. This is now.

So let's review the company as it is today and how we're positioned to grow.

First of all, a company overview. We develop technologies that enable the convergence of digital video, audio, data and high-end graphics.

So essentially, DVS has been a leading developer and manufacturer of DVD products, loaders primarily. That's the mechanical and servo guts of the DVD player business.

And it also applies to the DVD recordable business.

The company was founded in 1992 by Doctor Edmund Sun, who is the founder of C-Cube. He's widely known as the father of MPEG.

C-Cube has gone over to LSI and is now sort of the core of their video compression business.

Hyundai spun off their digital DVD business in 1998 to DVS. So we currently have operations in Korea, which is where most of our engineering and sales staff is located.

We have manufacturing operations in China. And we have sales, marketing and developing manufacturing operations in India.

And we also have operations in the United States for sales and support.

The company – we have two companies that are public. Digital Video Systems, Inc. is listed on NASDAQ.

And Digital Video Systems Korea is listed on KOSDAQ.

Last year, our revenues were roughly \$89 million. And currently we have approximately 500 employees worldwide.

From a background perspective, this company has a heritage of market leadership. The company was a leading innovator in digital video technology.

And as recently as 2001 the company owned 35% of the worldwide DVD loader market.

That represented about 70% of the China market.

So the company has held absolute market leadership positions in a highly competitive, fast-growing industry, in the past.

Our loaders are highly regarded, as I mentioned. We are found in top-rated products: Meridian, Arcam, Philips, Samsung [and] LG, have all been customers for our loaders.

And at one time we were producing over six million units per year.

So we've got a background of working in a high-growth industry. We have ramped up quickly to meet demands. And we've done so successfully.

Now we have some new opportunities that we're early on.

The company currently has a market cap of less than \$15 million. And I see [the opportunity for] this company, with the foundation that I previously mentioned, as being substantial.

I've seen paper [business] plans that are worth more than \$15 million. And here's a company that's actually been there. We have substance and a real business.

So I really believe that this company has a tremendous opportunity that has not yet been recognized by the investment community.

And we're early on in that transition.

Now the transition has begun to our higher-margin products. So it's not something that we're talking about doing. It's something that we have been doing and we're still in the process of doing.

We have achieved major design wins against world-class competition in the automotive industry with Tier One, highly selective customers.

The company has proven its ability to get customers and win competitively.

This industry that we're approaching has got substantial competitive barriers that I'll talk about a little bit later.

We believe that this industry provides a total available market by 2010 of somewhere in the neighborhood of \$6 billion.

So we have a tremendous opportunity. We've done it before and we've got a team that we believe can do it again.

Now we're shifting our business. In the past, as I mentioned, the company was in the DVD loader, player components business: commoditized, very low margins, no product differentiation to speak of that one could rely upon.

It's a very price-sensitive market.

We're shifting our business out of that into three basic areas. One, the automotive DVD market. The automotive industry has substantial competitive barriers. There are sustainable margins. And that market requires the kind of engineering customer support and partnership that we can provide. So we can really leverage our capabilities – our unique capabilities--- with that industry.

Secondly, we see an opportunity in India as an emerging market where we can, early on, get involved, establish an integration into finished goods where we can establish some branding and enjoy expanded margins in a growing market where we can produce locally and therefore have some advantages on the margins.

Third opportunity, near-term and immediately, is the DVD recordable business. That's an early-stage market that we believe is going to grow very rapidly. And we're well positioned to take advantage of that market as it grows.

We anticipate that that market may face the same kind of product life cycle as the player market. But because we're early on, we have a tremendous profit opportunity that we're going to drive as we transition into the automotive business.

So let's take a look at the car DVD business. The automotive DVD market is broken into two basic components.

One is the audio-visual or the entertainment systems. And the other is the navigation systems.

You're all probably familiar with the on-board navigation systems in the dash.

That market we estimate to grow to roughly 28 million units by 2010, which would be roughly \$6 billion.

Now that market number, 28 million units, is an important number as we move forward, because it plays to the competitive situation.

Unit shipments [in automotive DVDs] overall are going to be growing at roughly an 18% annualized growth rate.

The trends in that marketplace are that, as you're all pretty familiar with, in the dash you've seen your audio-visual system go from audio-only to now becoming audio-video.

There's an aftermarket and a 'before-market.' The aftermarket [products] are those that are available through retail channels and dealer channels, products that are installed after the vehicle has been delivered by the manufacturer to the dealers.

The 'before-market,' or OEM business, is that business which is done by the manufacturer. So when you buy your automobile with the in-dash systems already put in by the manufacturer, that's considered OEM.

Currently the aftermarket is roughly 70% of the overall business. And we see the OEM business growing as the installed base increases.

After 2007, the trend of video [and audio as] separate systems will see some convergence. We're talking about entertainment systems that begin to penetrate -- at the higher range you're probably seeing the beginnings of that.

But you'll see the combination of communications, internet, broadcast, navigation and entertainment systems all inside the vehicle.

[The] car DVD business is currently broken into in-dash segments and rear-seat entertainment and portable systems, with the in-dash obviously being the greatest component.

The car navigation market is a smaller quantity of devices. And DVDs are a little over half of that market. CDs are still common and hard disk drives are also a common medium of use.

I'd like to talk briefly about why we see the automotive business as being a prime opportunity relative to our historical home DVD products, or consumer entertainment systems.

The two products are very different. The way one does business is very different. The dynamics are different. And the profitability is very different.

I mean, if you take the automotive DVD products, we're very early in the market space. Whereas, the home DVD business is very mature.

But generally speaking, earlier on, you get greater profit opportunities.

Competitively the automotive industry is driven, at least in this sector, by quality, reliability and engineering support.

The Tier One companies have to work with companies such as DVS to develop a product to satisfy their customers' needs. The automotive industry has been trying to narrow their supply chain. And they have spun off their parts companies into a Tier-One group of competitors who now compete with each other for the business of all the manufacturers.

So, for example, Visteon is competing with Delphi for GM business.

Johnson Controls is competing with Visteon for Ford business.

So in this way the automotive manufacturers have been able to simplify their supply chain. And these other companies are now in a competitive environment where they can seek business from those beyond their captive owner.

So it's made for an interesting business opportunity.

These companies are very large. They're systems integrators and they deal with us at the first level.

They are dealing with us on the basis of being able to respond to specific design requirements and providing substantial engineering support to come up with a solution.

And we've done that.

Our competition in the automotive side is primarily from Japan. Whereas, in the home entertainment business, China has been a major player.

Manufacturing is in smaller quantities, batches. Whereas, mass production of the consumer entertainment products – that's all mass production that fits well with China.

Prices are higher on the automotive side. The profits and margins are substantially greater. And the barriers to entry are very high.

The automotive product is very different from the consumer electronics product. [The] consumer electronics product is basically price-driven.

You get very low-cost components [in consumer home DVDs]. They don't have an extreme environment that you'll find in the automotive side.

A vehicle has substantial vibration and temperature extremes. So it requires a much more robust mechanical system.

And if you can imagine the fine precision required of a DVD player in a difficult high-vibration environment, you can imagine it's a difficult problem.

So they therefore use more heavy-duty parts, industrial-grade parts instead of commercial-grade parts. And the quality of programs required to support the automotive industry is substantially greater.

So the R&D time and sales cycle are different, as well. The amount of time necessary to develop an automotive product for OEM is several years.

You start out with a RFP (or a “request for proposal”) or request for quotation, and you begin a cycle. For example, starting today, you would be working on 2006, 2007 models.

You have to be in that process early and once you’re in the process, you’re in good position. If you’re not in the process early on, you have a very difficult time playing.

So, our company has been involved in the process since 2002 so we’re early on in that stage.

Another important factor in the automotive business and in the consumer electronics business is the support that you get from the integrated circuit companies.

I mentioned there are approximately 28 million units per year ultimately in the automotive business. This compares to substantially greater volumes in the consumer entertainment business.

Chip companies who develop the chipsets to drive the video and the servo requirements of the [home] product will develop chips and engineer solutions for manufacturers if they know the volume exceeds a million units a month potentially, while the automotive business isn’t going to do that.

So there’s less chance of the IC companies driving new competition into the automotive field.

Secondly, the companies that have relied on the IC companies do not have the engineering organization required to provide the overall support to the customer in the development of products.

What they do is get a solution from an IC company and go ahead and produce mass volumes of low-cost product. That's not what works in the automotive field.

Lastly, I mentioned quality. Manufacturing requirement TS16949 is an automotive Tier-One manufacturers' requirement. And DVS is the only company that makes DVDs in Korea that meets that standard.

There are companies in Japan that meet that standard, and to our knowledge nobody in China currently is satisfying that requirement.

So there are high hurdles to get into this business. We have already passed those hurdles, and we are well on our way to working in that business.

From a competitive positioning point of view, our technology is much stronger than the Taiwanese or the Chinese. There are certain standards you have to achieve all across the board in order to compete in the OE ["Original Equipment"] or the high-end aftermarket business.

Mechanical capabilities, servo firmware, MPEG and product reliability are all critical issues. And if you miss out on one you miss out on everything. So really, only Japan and DVSK are currently satisfying the requirements across the board for mechanical, servo, firmware, MPEG and reliability.

And because of our QA program and because the IC (integrated circuit), manufacturers won't really be able to bring new players into the market, we believe that we're well positioned to grow in the original equipment aftermarket segment.

And we are targeting Tier-One automotive vendors and systems integrators in that part of the business.

Currently we have 10 products in the automotive line that are 'sets.' What we've done is gone from a pure components and loader business to finished products.

So we have developed four portable players that can be installed in vehicles.

We have two rear-seat entertainment items.

We have three head units. Those are the devices that are installed in the dash.

And we have an automotive PC, which is a touch-screen system, for introduction later this year.

These are all initially going into the aftermarket where the sales cycle is slower [than the consumer business, but faster than the OEM segment], but they have great potential for being modified and introduced into the original equipment market.

Now, many of you have probably heard that we achieved a contract with Visteon. I would welcome you to take a look when you get a chance at Visteon's website, that's "V I S T E O N," and look at their aftermarket mobile entertainment systems, and there you will see displayed a dockable family entertainment system.

This is a product that we developed for them in competition with a wide range of people. Our final competition was with Samsung and we were awarded that contract in January.

So we've already initiated deliveries. This is a dealer-installed aftermarket option.

We're also selling to Visteon portable players for delivery in South America.

Quick background on Visteon: Visteon, as I mentioned, is a Tier-One systems integrator. They're a Ford Motor spin-off. They have 72,000 employees and almost \$18 billion in revenues.

They have 137 production facilities in 25 countries. So this is a major company. We have roughly six projects that we've been involved with them on.

So starting back in 2002, the company was involved, competing against 12 others including Philips, Panasonic, and Pioneer. And we won that program in 2003.

So when I say that we're working with major design wins with major companies against world-class competition, that's a prime example.

We are working not only with Visteon but we're also working with the other Tier One companies.

Tier One is generally considered Delphi, which came out of General Motors, Johnson Controls, and Blaupunkt. We have programs directly and indirectly with all of them.

So the company has made its initial spearhead into that market with its success with Visteon. But it's been able to leverage that in developing relationships with these other customers.

We're broadening our scope and we are making successful inroads into that marketplace.

So that's the automotive business.

Next is the India business. That's an emerging market, as I mentioned. It's hard to get good numbers on the Indian market [but] everyone agrees that it is explosive.

It's estimated that there should be in the neighborhood of 10 million units of DVD players there in the next year or so. They are just now shifting over from video CDs, and the content is moving over to DVDs, which means that the player market will be expanding.

We have established a branding program there. Last year, DVS established the start of that on a regional basis, so that we're not faced with a \$25 million branding program.

We can do this rather inexpensively and make some good headway on a regional basis. That market tends to be pretty geographically focused, with the urban areas having the TVs, and we're able to do a good marketing job over there.

We've got dealer channels established. We've got finished products that are available, and this is an opportunity for us to move up the value chain. And with local assembly we can improve our margins.

We have some special export and import tax benefits by providing local assembly. So there's a substantial margin opportunity relative to what we've experienced in the past with the player business.

And because it's an emerging market, we can take advantage of what we currently have to sell through into India.

In the recordable business, we see this as our primary near term opportunity. New chipsets have become available that are building that market rapidly.

Last year it was anticipated that that market would grow faster, but because [of] some of the problems with the chipsets, the market didn't grow as fast.

But now that problem seems to be taken care of. So we anticipate that that market will grow very quickly.

The expectation is [a] roughly 90% annual growth rate through 2008. Currently Europe is in full swing in that market.

We see a big Christmas season in recordables in the United States this year. And we have been selected by major-volume producers for these markets. So we're looking forward to that business.

We've got some real advantages. We've got an established quality reputation. We've got, again, a stable mechanism, [a] highly reliable product. We are ready to market. We're early on in the product life cycle. Customers are responsive, so we will work that market until it is no longer interesting.

So that is, generally speaking, the core of our opportunity as we see it. In the long run, from a strategic point of view, we are located here in Silicon Valley at a crossroads of a lot of new technology.

So we anticipate being able to stay on top of new developments and being able to integrate them into our engineering team to develop. So we're moving forward.

Thank you. Questions?

Sean Collins: Operator, we're ready for questions.

Operator: At this time I would like to remind everyone. In order to ask a question please press star then the number one on your telephone keypad.

We will pause for just a moment to compile the Q&A roster.

Thomas Spanier: Hello.

Operator: Your first question comes from the line of Bert Siebrand.

Bert Siebrand: Yes, hi. Good evening. Couple of questions. Your numbers for this year: first of all, when can we expect first – Q1 numbers?

Is it possible to give us some feeling what of those numbers are going to look like compared to the fourth quarter, and then, considering the Visteon contract, I suppose these numbers are going to filter through in revenues as of second quarter? Is that correct? And what sort of impact will those have?

Thomas Spanier: Well, first, we have filed the Q1. That was done [on] May 15. So Q1 is available. It's all been 'EDGARized.'

Q2 we anticipate filing within the schedule provided, in August.

With respect to actual numbers and forward-looking estimates and revenues, we're reluctant to provide much guidance in that because, frankly, we are right in the midst of transitioning and it's pretty hard to give estimates. I don't want to give anybody numbers that aren't absolutely reliable. So...

Bert Siebrand: Would it then be possible to give any sort of long-term business model to guidance of what sort of margins would you be looking for?

Thomas Spanier: We look at – it depends on the product. Within the automotive side, margins can range from 10[%] to 25%. So it depends on the product. It depends on who the customer is.

That market can be very dramatic. For example, it would not be unusual for a product that is successful in the OEM side to achieve 250,000 units. And with the average price anywhere from \$300 to \$600, you can do the math.

That [is], a product could achieve \$100 million, for example, in that industry.

So it depends upon, obviously, the penetration of the OEM side, the success of individual products, and the like. But it's definitely a large business that's got certainly better margins than the loader business.

Bert Siebrand: Okay. May I ask a few more questions, perhaps? First of all, what's the situation with the managerial problems in Korea? Has [it] now been finally solved?

Then another question is will there be any impact in India from the elections? Could this be anywhere negative maybe because your relationships have changed in India? Just a little bit of insight into this would be helpful. And...

Thomas Spanier: Sure. I'll take the second part of the question first. In India, we don't anticipate the political situation to really impact this initial business. Our opportunity there is driven by an early-stage market where we can get some initial advantages on the tax holidays and on the export credits and so on.

If that changes later on, by that time we believe we'll be pretty well established. So we don't see much problem on that side.

With respect to the management issues, I'm not sure what you're talking about in Korea.

Bert Siebrand: I believe in the past I have – where some problems with – for a previous top management I think, where some issues in sort of changing that management. I

think that these issues were still there in the first quarter. But perhaps they have been solved now.

Thomas Spanier: Well, the company did have a change of management and currently, Song Sim, who had been running the R&D department, is CEO of the company and we've been moving along on that without a hitch.

So we don't really – I really don't see any significant problems at all. I mean, obviously, any organization has to be on top of its staffing and make sure that we've got the strongest people in every position.

We don't really have any issues that I'm aware of, really just past management at this time.

Bert Siebrand: Okay. Thanks very much and I think the reason that I may have missed the Q1 report [is] I don't think it's on your website. So perhaps that's something you could also correct.

Thomas Spanier: Sure we'll take a look at updating that. That's definitely on our checklist to do.

Bert Siebrand: Thanks very much.

Thomas Spanier: Sure.

Operator: Again to ask a question, press 'star, one' on your telephone keypad.

You have no further questions.

Thomas Spanier: Well, thank you very, very much for your time. And [we] look forward to the opportunity to chat with you again.

Operator: This concludes today's conference call. You may now disconnect.

END

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