

# MEDIA & ENTERTAINMENT

A Research Publication by DZ BANK AG

## Studio Babelsberg<sup>6)</sup>

Reuters: BG1D.DE

Bloomberg: BG1

Year *	Sales		GER GAAP-Earnings p.sh.		Cash flow per share		PER	PCF	Dividend per share
	EUR m		EUR		EUR				
2009	75.6	(75.6)	-0.12	(-0.12)	-0.03	(-0.03)	-	-	0.00
2010	57.5	(104.0)	0.01	(0.14)	0.11	(0.24)	172.6	13.3	0.00
2011e	60.0	(92.0)	0.07	(0.16)	0.16	(0.25)	20.5	8.8	0.00
2012e	63.0	(-)	0.07	(-)	0.16	(-)	19.7	8.7	0.00

\* Fiscal year end December – In brackets: Figures from the last publication

### Back in the black

- » In 2010, sales fell by 23.95% to EUR 57.5m, but total overall performance increased by 25.8% to EUR 55.7m. Accordingly, utilisation rates at the studio and for complementary service units have seen considerable improvements. In 2010, five large international film productions with a total estimated budget of over USD 150m were realised, wholly or partially, with support from Studio Babelsberg AG. Overall, projects realised in 2010 in Babelsberg received subsidies of more than EUR 20.0m from the German Federal Film Fund (DFFF).
- » Higher utilisation rates in the core activities of studio rental and set construction have meant considerably higher earnings. EBIT increased from EUR -2.1m to EUR +0.4m. Taking account of the financial result - which was negative at EUR -0.147m, primarily on account of write-offs of loans (EUR 0.46m) and the depreciation of an investment (EUR 0.264m) - and after the deduction of taxes (EUR 0.286m), the Group surplus stood at EUR 0.23. Studio Babelsberg has a solid balance sheet with a group equity ratio of 86.6% and free liquid funds of EUR 2.6m.

**Sales and earnings performance of Studio Babelsberg is very much dependent on the realisation of individual film projects. Given the project character of activities, there can be large fluctuations in utilisation rates with respect to studio and service capacities and thus also in earnings performance. For 2012, management is cautiously optimistic. Based on available projects, we believe that value added sales and earnings can be further increased. In light of the low visibility, we are leaving our recommendation at HOLD.**

Selected Companies	Price on 7 Jul 2011	PER		EV / EBITDA		EV / Sales 11e	Re-com.
		11e	12e	11e	12e		
Studio Babelsberg	1.36 EUR	20.5	19.7	3.0	2.6	0.14	→
Pinewood Shepperton	2.03 GBP	22.2	20.8	10.4	9.9	3.18	-
Lions Gate Entert Corp	6.79 USD	75.4	17.6	11.8	8.5	0.78	-
Village Roadshow Ltd	3.18 AUD	9.8	9.7	3.3	6.3	0.90	-
Regal Entertainment Group	11.85 USD	21.4	16.5	6.8	6.0	1.19	-
<b>Median for all peer group companies</b>		<b>21.7</b>	<b>17.1</b>	<b>11.1</b>	<b>9.2</b>	<b>2.19</b>	-

↑ = Buy, → = Hold, ↓ = Sell, ● = not rated, n/a = not appropriate  
Source: DZ BANK, I/B/E/S, FactSet

## EQUITIES

Flash  
8 Jul 2011

Hold (prev. Hold)

Closing price 7 Jul 2011

(in EUR): 1.36

Fair value: 1.78 (prev. 2.58)

Risk classification: 5

Financial ratios 2011e:

Book value per share (in EUR):	2.15
Equity ratio (in %):	86.6
Net margin (in %):	1.8
ROE (in %):	3.1
Dividend yield (in %):	0.0
Free cash flow (EUR m):	0.5
Net debt (EUR m):	-13.3

Number of shares

(million units): 15.9

Market cap

(in EUR m): 21.70

Free float (in %): 24.5

SIN: A0D9UR

ISIN: DE000A0D9UR4

Datastream: D:BG1



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**DZ BANK**  
Bank on Germany

## BACK IN THE BLACK

### Sales and earnings performance

In 2010, group sales fell by 23.95% to EUR 57.5m, but total overall performance increased by 25.8% to EUR 55.7m. Accordingly, utilisation rates for studio operations and service companies providing complementary production services have increased considerably. Value added sales generated by Group companies in 2010 - a measure which better reflects operating performance - increased considerably by 59.6% to EUR 30.8m. At the level of Studio Babelsberg AG, sales increased by 22.6% to EUR 6.48m. The EUR 1.27m or 54.5% increase in sales revenues from studio and atelier operations to EUR 3.6m is primarily attributable to income from atelier rentals for the "Anonymous" and "The Three Musketeers" projects. .

**The value added sales increased by 59.6% in 2010 to EUR 30.8m**

In 2010, five large international film productions with a total estimated budget of over USD 150m were realised, wholly or partially, with support and value creating contributions from Group companies of Studio Babelsberg AG. Overall, projects realised either wholly or partially in Babelsberg in 2010 received more than EUR 20.0m in subsidies from the German Federal Film Fund (DFFF).

**Numerous large projects realised in 2010**

Key projects realised through the course of the year include the two feature films from the production slate of Joel Silver under the Dark Castle company brand:

- "Unknown Identity" with Liam Neeson in the leading role and an estimate production budget of around USD 30m. The film received EUR 4.3m from the DFFF. In the US, the film generated a very considerable USD 61.1m at the box office.
- "The Apparition" with an estimated budget of EUR 17.0m, thereof around EUR 0.9m in finance from the DFFF.

Both projects were produced by Dark Castle in co-production with Studio Babelsberg as executive producer. Both films were shot in Babelsberg, not least because of the financial investment made by Babelsberg Motion Pictures International GmbH in the Dark Castle production slate.

A total of fifteen films are to be produced within the scope of the Dark Castle film slate based on a revolving production budget. Group financial statements will show a loan in the amount of EUR 7.7m to Silver Slate LLC included under financial assets. The loan is to be repaid with the revenue of a 15-title movie package. Up to now, six films from this slate have been released. Only one of these, "Unknown Identity", has generated revenues which will come in considerably above the minimum guarantees paid during the production phase.

Further large film projects in fiscal 2010 were:

- "Anonymous" produced and directed by Roland Emmerich. For this film, Studio Babelsberg received DFFF-subsidies totalling EUR 4.4m as executive producer.
- "Who is Hanna?" with Cate Blanchett and Eric Bana. The film, made by the production company Focus Features, had an estimated production budget of around USD 30m and was subsidised by around EUR 3.7 from the DFFF. Studio Babelsberg was also executive producer here.

<sup>1) - 9)</sup> Important: Please read the references to possible conflicts of interest and disclaimers/disclosures at the end of this report.

- The 3D-feature "The Three Musketeers" by Constantin Film has an estimated budget of over USD 60m. This film received EUR 7.6m in subsidies from the DFFF and will be premiered in autumn 2011. Given the high construction intensity for this project, the value added share of sales is likely to have been relatively high.

Alongside these large film projects, a number of smaller film projects were also realised at Studio Babelsberg. This includes the film "Chicken with Plums" produced by the production company TheManipulators GmbH. This company, which was established as a joint venture in February 2010, holds a 37.4%-stake in Studio Babelsberg.

In addition, Studio Babelsberg or Group subsidiaries have also provided production services for a raft of German films. These include "Yoko" by Blue Eyes Fiction, "In Darkness" by SchmitzKatze Filmkollektiv, "Wunderkinder" by CCC Filmkunst, "Niemandland" by UFA Cinema and "Deckname Annet" by Ziegler Film.

As a result of higher utilisation rates, expenditure for materials increased by 10.4% to EUR 33.9m and personnel expenditure by 67.2% to EUR 15.5m. On the other hand, depreciation fell by 6.4% to EUR 1.47 and other operating expenses by 18.1% to EUR 4.75m. Other operating income remained steady at EUR 1.59m.

Against this background, EBIT increased from EUR -2.1m to EUR +0.4m. Taking account of the financial result (EUR -0.147m) - which was negative primarily on account of write-offs on loans (EUR 0.46m) and the depreciation of an investment (EUR 0.264m) - and after the deduction of taxes (EUR 0.286), the Group surplus stands at EUR 0.23m.

**The increase in value added sales is positively reflected in earnings**

#### **Balance sheet**

The balance sheet of the Group as a whole appeared solid on 31 December 2010. The equity ratio of the Group as a whole stands at 86.6% and at 93.8% for Studio Babelsberg AG. The Group has liquid funds of some EUR 5.135m at its disposal. According to management statements, around 50% is for advances for film productions. At the level of the AG, cash and cash equivalents stood at EUR 655,000 as per 31 December 2010. As already mentioned, in order to acquire film projects, Studio Babelsberg has issued a loan for around EUR 7.7m to producer Joel Silver which is to be repaid with the revenues of a 15-title movie package. Given the uncertainties with regard to future cash flow performance from these film projects, Studio Babelsberg will not allocate interest payable by Dark Castle on a pro rata temporis basis but at final maturity. The company currently has over 0.819 million of its own shares at its disposal.

**Studio Babelsberg does not need to take on debt**

#### **Outlook and perspectives**

The future sales and earnings performance of the Studio Babelsberg Group depends on whether management succeeds in convincing enough producers to shoot large film projects at their studios. In doing this, Studio Babelsberg sees competition from a range of international production locations. Aside from consideration given to finding suitable location backdrops, sets (original locations, studios) and infrastructure requirements, the relative costs of production, state subsidy options as well as the local availability of filming, dressing and set construction specialists play a crucial role in choosing the film site. Studio Babelsberg has built up a particularly strong reputation for high-tech film projects

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(3D, Bluescreen). Expertise in the field of 3D technology could prove a particular competitive advantage.

In the current fiscal year, a number of projects have already been realised at Studio Babelsberg. As executive producer and co-producer, Studio Babelsberg completed the feature 3D-production "Hansel & Gretel: Witch Hunters" in the six months to June 2011. The film was a commissioned production for US-major Paramount Pictures with an estimated production budget (according to IMDB) of around USD 60m. The feature was subsidised with EUR 6.7m from the DFFF.

**A larger project could be realised in 2011**

Further production services (studio rental, set construction and/or dressing) could be provided for projects "Rubbeldiekatz" by BojeBuck Film, Berlin "Mitte/Zettl" by Diana Film, "Unsere Mütter/Unsere Väter" by teamWorx and "Am Ende die Hoffnung" by Aspekte Telefilm.

The film "Anleitung zum Unglücklichsein" by Desert Flower Filmproduction is currently in production. The large project "Cloud Atlas" by star producers Andy and Lana Wachowski is also in the pipeline. The film, directed by Tom Tykwer with leading roles played by Tom Hanks, Halle Berry and Susan Sarandon, has an estimated production budget of around USD 140m. Production is to begin in September 2011. The chances are good that this project will be produced at Studio Babelsberg. Management has also reported that the rental situation for Berliner Street is good.

Based on the current utilisation rates for Studio Babelsberg, we expect overall annual performance of around EUR 60.0m and value added sales to stand at around EUR 32.0m. This translates to a slight increase of around 3.9% on value added sales from 2010. At the same time, we expect a below-average increase in operating costs so that the operating result for 2011 could increase by around 100.0% to EUR 1.4m. After adjusting for the financial result and taxes, we have an estimated net result of around EUR 1.1m. This would be considerably above the net result from fiscal 2010, though still notably below results from 2007 and 2008.

**We expect earnings improvement for 2011**

Beyond fiscal 2011, sales and earnings performance is dependent on the acquisition of further projects. Management is currently in negotiations with respect to two further European productions as well as two large international projects. Whether these negotiations will be successful and boost utilisation rates in 2012 cannot be answered today. It can be assumed, however, that at least one further film from the Dark Castle production slate could be produced in fiscal 2012.

Over recent years, the general trend has been for the number of European film productions to increase, climbing from 818 projects in 2006 to more than 880 projects in 2009. The number of German production companies capable of getting finance for large international projects off the ground and subsequently producing the films has also increased. Examples are Constantin Film and Tandem Communications. Subject to further support from the DFFF, the likelihood that Studio Babelsberg will continue to attract projects to Babelsberg is thus increased. Sales and earnings performance depends on how high the value added share of sales will be.

**The number of potential film projects is increasing**

In 2007, value added sales of EUR 32.0m and a net result of EUR 6.0m could be generated. In 2008, the net result stood at EUR 3.0m based on value added sales of EUR 35.0m.

<sup>1) - 9)</sup> Important: Please read the references to possible conflicts of interest and disclaimers/disclosures at the end of this report.

**Valuation**

We expect Studio Babelsberg will be in a position to generate sales of between EUR 60m and EUR 70m with value added sales of between EUR 30m and EUR 40m. On this basis, we expect the net result to come in between EUR 1.1m and EUR 1.9 over the next few years. Based on our adjusted sales and earnings forecasts, our DCF model yields a new Fair Value of EUR 1.78, previously EUR 2.58. The contraction is attributable, on the one hand, to a reduction in future anticipated earnings and, on the other hand, from an increased risk discount reflecting the extreme project character of the business model and the lack of long-term visibility. For these reasons, we confirm our HOLD recommendation.

**Given the project character of business, sales and earnings performance difficult to plan for the medium-term**

<sup>1) - 9)</sup> Important: Please read the references to possible conflicts of interest and disclaimers/disclosures at the end of this report.

## AT A GLANCE

### Company profile

Studio Babelsberg operates one of the largest European large-atelier film studios. Revenues are generated from studio rentals and complementary production services. The business model is subject to strong fluctuations in utilisation rates on account of the project-driven nature of activities.

### Basis for investment recommendation

Studio Babelsberg is one of the largest film production studios outside the USA. In addition to attractive film subsidies in Germany, Studio Babelsberg offers comprehensive studio capacities as well as complementary production services for the production of international cinema films. However, the lack of visibility in the area of film financing is making the business model less reliable.

### Price sensitive current issues

- » Trends in film subsidy in Germany and in competing studio locations in Europe
- » Effects from the development of the global film production market
- » The introduction of new technologies such as HDTV and 3D demands special production expertise
- » The development of co-production activities
- » Trends in film financing

### Opportunities and risks

Opportunities	Risks
Increasing number of european big budget movie productions	Increasing subsidies with competing studio locations
Production know how with respect to 3D-projects	Weak US-Dollar makes production in Germany relatively more expensive
Hidden reserves with the real estate assets	Project character of the business is hampering sales and earnings forecasts

<sup>1)–9)</sup> Important: Please read the references to possible conflicts of interest and disclaimers/disclosures at the end of this report.

## PROFIT AND LOSS ACCOUNT

Euro m	2009	2010	2011e	2012e	2013e	2014e
<b>Sales</b>	<b>75.6</b>	<b>57.5</b>	<b>60.0</b>	<b>63.0</b>	<b>65.0</b>	<b>67.0</b>
Change in inventory/Own work	-31.3	-1.8	-0.7	-0.5	0.0	0.0
<b>Total output</b>	<b>44.3</b>	<b>55.7</b>	<b>59.3</b>	<b>62.5</b>	<b>65.0</b>	<b>67.0</b>
% against prev. year	-53%	26%	6%	5%	4%	3%
Cost of materials	-30.8	-33.9	-36.1	-38.2	-39.7	-41.0
Personnel expenses	-9.9	-16.5	-16.8	-17.3	-17.6	-18.1
Other operating expenses/income	-4.2	-3.2	-3.6	-4.3	-4.1	-4.2
<b>EBITDA</b>	<b>-0.6</b>	<b>2.1</b>	<b>2.8</b>	<b>2.8</b>	<b>3.6</b>	<b>3.7</b>
Depreciation/Amortisation	-1.6	-1.5	-1.4	-1.4	-1.4	-1.4
Amortisation	0.0	0.0	0.0	0.0	0.0	0.0
<b>Operating profit (EBIT)</b>	<b>-2.1</b>	<b>0.7</b>	<b>1.4</b>	<b>1.4</b>	<b>2.2</b>	<b>2.3</b>
% against prev. year	-194%		107%	4%	54%	5%
Net interest income	0.5	0.5	0.1	0.1	0.1	0.1
Net other financial income	-0.3	-0.7	0.1	0.1	0.1	0.1
<b>Profit before extraordinary items</b>	<b>-1.9</b>	<b>0.5</b>	<b>1.5</b>	<b>1.5</b>	<b>2.3</b>	<b>2.4</b>
% against prev. year	-161%		187%	4%	51%	5%
Extraordinary profit/loss	0.0	0.0	0.0	0.0	0.0	0.0
<b>Profit before tax</b>	<b>-1.9</b>	<b>0.5</b>	<b>1.5</b>	<b>1.5</b>	<b>2.3</b>	<b>2.4</b>
% against prev. year	-161%		187%	4%	51%	5%
Tax	-0.4	-0.3	-0.4	-0.4	-0.7	-0.7
Tax rate	-21%	56%	28%	28%	28%	28%
<b>Profit after tax</b>	<b>-2.4</b>	<b>0.2</b>	<b>1.1</b>	<b>1.1</b>	<b>1.7</b>	<b>1.8</b>
% against prev. year	-180%		367%	4%	51%	5%
Minority interest	0.0	0.0	0.0	0.0	0.0	0.0
<b>Profit after minorities</b>	<b>-2.4</b>	<b>0.2</b>	<b>1.1</b>	<b>1.1</b>	<b>1.7</b>	<b>1.8</b>
Adjusted profit after minorities	-2.0	0.1	1.1	1.1	1.7	1.8
Average number of shares, fully diluted (m)	15.911	15.911	15.911	15.911	15.911	15.911
<b>Fully diluted earnings per share</b>	<b>-0.12</b>	<b>0.01</b>	<b>0.07</b>	<b>0.07</b>	<b>0.10</b>	<b>0.11</b>
<b>Fully diluted EpS before goodwill amort.</b>	<b>-0.12</b>	<b>0.01</b>	<b>0.07</b>	<b>0.07</b>	<b>0.10</b>	<b>0.11</b>

Fiscal year end December

Source: Studio Babelsberg and DZ BANK estimates

1) - 9) Important: Please read the references to possible conflicts of interest and disclaimers/disclosures at the end of this report.

**RATIOS**

Euro	2009	2010	2011e	2012e	2013e
<b>Profit and loss ratios</b>					
Total output (m)	44.3	55.7	59.3	62.5	65.0
EBITDA margin	-1.3%	3.8%	4.7%	4.5%	5.5%
EBIT margin	-4.8%	1.2%	2.3%	2.3%	3.4%
Net margin	-4.4%	0.2%	1.8%	1.8%	2.6%
Investment ratio	1.1%	0.5%	1.3%	1.6%	1.8%
Net other operating costs as % of total output	9.5%	5.7%	6.1%	6.8%	6.3%
Net financial income as % of total output	0.5%	-0.3%	0.2%	0.2%	0.2%
Average sales growth next five years	8.6%	4.7%			
Average earnings growth next five years		73.1%			

<b>Profitability ratios</b>					
ROE	-6.0%	0.4%	3.1%	3.1%	4.5%
ROCE	-11.3%	3.2%	6.5%	6.7%	10.1%

<b>Productivity ratios</b>					
Sales per employee ('000)	520.76	633.09	658.89	694.44	714.29
EBIT per employee ('000)	-25.24	7.53	15.27	15.85	24.17

<b>Balance sheet ratios</b>					
Equity ratio	77.1%	86.7%	86.6%	86.4%	86.3%
Long term debt and equity / Fixed assets	121.8%	113.6%	120.0%	126.0%	132.8%
Liquidity (quick ratio)	200.3%	166.8%	185.7%	211.4%	240.6%
Receivables as % of total output	1.6%	1.1%	1.2%	1.3%	1.4%
Investment (net of GW) / Depreciation	32.5%	18.7%	53.8%	70.7%	87.3%
Working capital as % of total output	-1.1%	-2.9%	-1.6%	-1.1%	-1.0%

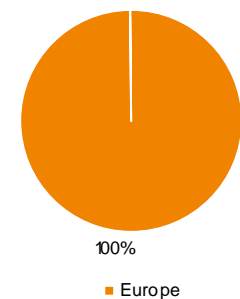
<b>Figures per share</b>					
EpS after goodwill amortisation	-0.12	0.01	0.07	0.07	0.10
Fully diluted EpS before goodwill amort.	-0.12	0.01	0.07	0.07	0.10
Diluted cash earnings per share	-0.03	0.11	0.16	0.16	0.19
Dividend per common share	0.00	0.00	0.00	0.00	0.00
Cash per share, diluted	0.52	0.32	0.36	0.42	0.51
Net debt per share, diluted	-0.55	-0.81	-0.84	-0.90	-0.99

<b>Valuation ratios</b>					
Enterprise value / Sales	0.5	0.2	0.1	0.1	0.1
Enterprise value / EBITDA		4.6	3.0	2.6	1.6
Enterprise value / EBIT		14.7	6.1	5.2	2.7
EV/Sales to sales growth	-0.07	0.02	0.03	0.03	0.02
PEG ratio - common shares			0.28		

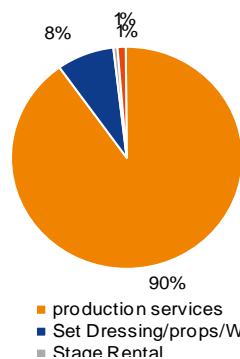
Fiscal year end December

Source: Studio Babelsberg, DZ BANK estimates

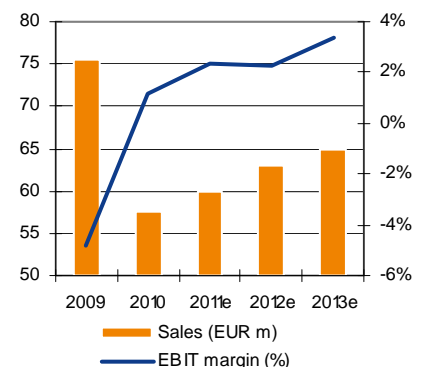
**SALES BY REGION 2009**



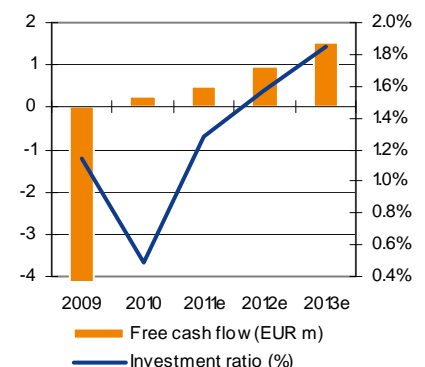
**SALES BY BUSINESS SEGMENT 2009**



**SALES AND MARGIN DEVELOPMENT**



**FREE CASH FLOW AND INVESTMENT RATIO**



<sup>1) - 9)</sup> Important: Please read the references to possible conflicts of interest and disclaimers/disclosures at the end of this report.

## DISCOUNTED CASH FLOW VALUATION

## Cost of capital

Weighted average cost of capital (WACC)	12.18%
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Euro m	2011e	2012e	2013e	2014e	2015e
<b>EBIT</b>	<b>1.4</b>	<b>1.4</b>	<b>2.2</b>	<b>2.3</b>	<b>2.4</b>
Interest expenditure on pensions provisions	0.0	0.0	0.0	0.0	0.0
Extraordinary result	0.0	0.0	0.0	0.0	0.0
<b>Adjusted EBIT</b>	<b>1.4</b>	<b>1.4</b>	<b>2.2</b>	<b>2.3</b>	<b>2.4</b>
Adjusted taxes on earnings of the company	-0.4	-0.4	-0.6	-0.7	-0.7
<b>Net Operating Profit After Tax (NOPAT)</b>	<b>1.0</b>	<b>1.0</b>	<b>1.6</b>	<b>1.7</b>	<b>1.7</b>
Depreciation/Amortisation of tangible/intangible assets	1.4	1.4	1.4	1.4	1.4
Investments in tangible/intangible assets	-0.8	-1.0	-1.2	-1.3	-1.4
Change in provisions/special items	-0.1	0.1	0.1	0.0	0.1
Change in working capital	-0.7	-0.3	0.0	-0.2	-0.1
Change in other current assets	-0.5	-0.4	-0.5	-0.3	-0.2
<b>Free cash flow</b>	<b>0.4</b>	<b>0.9</b>	<b>1.3</b>	<b>1.2</b>	<b>1.5</b>
Cash values of free cash flows on the valuation date	0.4	0.8	1.0	0.9	0.9
<b>Total cash value of free cash flow</b>	<b>12.8</b>				
Market value of non-operating assets	2.5				
Liquid assets/Securities/Interest-bearing financial assets	12.8				
<b>Entity value</b>	<b>28.2</b>				
Financial debt/Pension provisions	0.0				
<b>Equity value (incl. minority interest)</b>	<b>28.2</b>				
Value of minority interest	0.0				
<b>Equity value (excl. minority interest)</b>	<b>28.2</b>				
<b>Equity value per share, diluted (EUR)</b>	<b>1.78</b>				

Fiscal year end December

Source: Studio Babelsberg and DZ BANK estimates

**IMPRINT**

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**RATING HISTORY**

Recommendation	Date	Price
Hold	22 Apr 2010	1.84 EUR
Buy	16 Jul 2009	2.05 EUR

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