

# Studio Babelsberg

**Buy** (unchanged) **Target: Euro 4.00** (old: Euro 4.40)



29 | September | 08

■ **Price (Euro)** **2.30**  
52 weeks range 3.93 / 1.69

■ **Key Data**

Industry	Real Estate (Special Purpose)
Market Segment	Open Market
IPO	04/29/2005
Place of business	Potsdam, (D)
Internet	www.studiobabelsberg.de
Symbol	BG1
ISIN	DE000A0D9UR4
Securities ID-Number	A0D9UR
Reuters	BG1G.DE
Bloomberg	BG1
Reporting Standard	HGB
Fiscal Year	31/12
1 Day Turnover in € / Ø 3M	14.947
Market Cap (EUR million)	38.0
Number of shares (million)	16.5
Free Float	24.5%
Free Float MarketCap (Mio.)	9.3

■ <b>Multiples</b>	<b>2007</b>	<b>2008e</b>	<b>2009e</b>	<b>2010e</b>
MarketCap/ Sales	0.44	0.79	0.61	0.48
<b>PE-Ratio</b>	<b>6.3</b>	<b>12.1</b>	<b>9.9</b>	<b>9.2</b>
Dividend Yield	8.7%	8.7%	8.7%	10.9%

■ <b>Key Data per Share (Euro)</b>	<b>2007</b>	<b>2008e</b>	<b>2009e</b>	<b>2010e</b>
<b>Earnings per Share (EpS)</b>	<b>0.37</b>	<b>0.19</b>	<b>0.23</b>	<b>0.25</b>
Dividends per Share (DpS)	0.20	0.20	0.20	0.25

■ <b>Financial Data (EUR '000 )</b>	<b>2007</b>	<b>2008e</b>	<b>2009e</b>	<b>2010e</b>
<b>Sales revenues</b>	<b>87,055</b>	<b>47,880</b>	<b>62,244</b>	<b>79,050</b>
Purchases	-57,686	-28,728	-38,591	-50,592
<b>Operating Profit (EBIT)</b>	<b>6,428</b>	<b>3,922</b>	<b>5,163</b>	<b>5,626</b>
Pre-tax Profit (EBT)	7,059	4,373	5,313	5,776
<b>Net Profit</b>	<b>6,030</b>	<b>3,136</b>	<b>3,832</b>	<b>4,117</b>

■ <b>Main Shareholders</b>		
FBB-Filmbetrieb Berlin Brandenburg GmbH		75.47%
RMS Unternehmens-Service GmbH		9.09%

■ <b>Analyst</b>	<b>André Hüsemann</b>
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Studio Babelsberg | Xetra | 36 months | Euro



Source: Deutsche Börse, SRC Research

## Second US Blockbuster for 2008 "Inglourious Basterds\*" starts filming in October

Last year was for Studio Babelsberg due to the realisation of 12 motion picture films, thereof 5 Blockbuster productions, the most successful fiscal year since the company was privatised in 1992. For this year we expect a profitable business on a slightly lower level. Currently six productions could be acquired, thereof two Blockbuster productions, which are most profit generating for the studio. About 86% of revenues were generated last year by only three international blockbusters, which shows the importance of those productions for the studio. Big budget productions are the core business of the company. For the whole year 2008 seven to eight thereof two to three blockbuster productions are realistic. From spring to summer the Wachowski brothers shot the Warner Bros production "Ninja Assassin" with a budget of approx. US Dollar 50m. The movie is set for release in January and collected incentives from the DFFF of Euro 5.8m. We guess largest production and most profit generating for this year will be Quentin Tarantino's "Inglourious Basterds\*" starring Brad Pitt. Filming should begin in mid October 2008 at SB and lasts at least until the end of the year while a release is scheduled for June 2009. The movie will be mainly shot on sound stages and applied for incentives of DFFF already. A novelty is the cooperation with the also stock listed German Constantin film for the science fiction movie "Pandorum". The movie collected incentives of Euro 3.7m and is, since DFFF came into force, the German production with the highest incentive granted by DFFF. We estimate a double digit-budget in Euro million. Therefore the production can be rated as big budget production. Good news was also the extension of the on January 1, 2007 initiated German Film Financing Fund (DFFF) from 2009 to now 2012, which enhances competitiveness significantly in the long-run. **We believe affected due to the weak US Dollar, utilization for 2008 will remain below 2007. Therefore we expect significant lower revenues for FY 2008 however combined with a higher profitability EBIT will be according our projection of approx. Euro 4m only moderately lower. Hence we confirm our Buy Rating but lower our target according our DCF to 4.00 Euro.**

\*Spelling by Quentin Tarantino

## SWOT Analysis

### Strengths

- With altogether 16 studios and an indoor area of 25.000m<sup>2</sup>, as well as an outdoor area of 17.000m<sup>2</sup>, Studio Babelsberg is the largest connected studio complex in Europe. By renting further objects in the direct vicinity, it is possible to extend the capacity to more than 30.000m<sup>2</sup>
- The former owner, Vivendi Universal, invested more than Euro 250m during its twelve-year engagement and created an outstanding media infrastructure at Babelsberg. Today, this basis, and in addition SB being debt-free, offers an excellent position to prosper in the market
- By cutting manpower in half to less than 90 employees in 2007, the company decreased personnel expenditure and thus a substantial fixed cost. Nowadays exceeding demand is supplied through freelancers, thus the company is in the position to act more flexible which is required in the cyclic utilization of the film business

### Weaknesses

- Utilization and financial result, as well as the development of Studio Babelsberg in general, strongly depends on the decisions of a few American film-studios (like Paramount, Warner, Universal, New LINE) to produce their films in Germany
- The project-like character of the film production, connected with the uncertainties concerning production start and production duration complicates planning and utilization of the studio. Only two big budget productions can be handled at the same time
- Since each movie requires renewed acquisition, nearly all revenues are non-recurring besides those of TV productions such as series or telenovelas. Therefore the volatility of utilization and earnings is quite high. Long-term TV-productions guarantee a partial utilization and work against the cyclicity of the movie business but are not core business of the company and do not lead into the profit zone

### Chances

- The incentive system for improving the economic conditions for film-production in Germany (Deutscher Filmförderfonds DFFF) is in force since January 2007. The aim to strengthen Germany as media location for film-production could be fulfilled. The price level of production cost thereby is reduced to approximately 20%. Due to past success and increased attractiveness for international productions the maturity of the fund is recently renewed from 2009 to 2012
- World-wide market growth of the entertainment industry and film production leads to increasing numbers of motion picture films, Blockbusters and TV productions and rise the demand for studio capacity and film locations

The management of SB announced serious interest to transform the connected hangars of the closed Airport Berlin Tempelhof into soundstages to shoot movies and is in negotiations with Berlin's senate. The senate has to decide on this issue. In case of a positive agreement the often mentioned argument of limited space and limited growth prospects would disappear.

### Threats

- Due to the fact that all American film-studios calculate their costs in US-dollar the exchange rate of Euro into Dollar is substantial for the cost calculation. An exchange rate above USD 1.60 could deter US majors to produce their movies in Germany. Past two months the exchange rate dropped significantly below USD 1.50 which should help SB to acquire new Blockbuster productions.

**Two types of runaway productions: „Creative“ and „Economic“ ones**

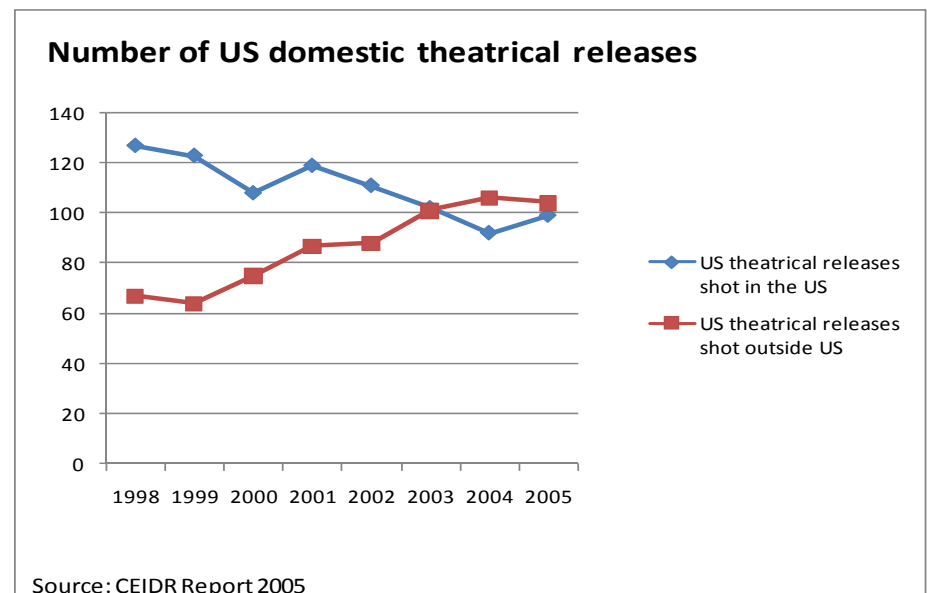
**As crews and infrastructure outside the US improved, it became a leading trend to go abroad**

**Half of US feature film budgets were spent outside the US**

### Core business of SB are “US Runaway Blockbusters“

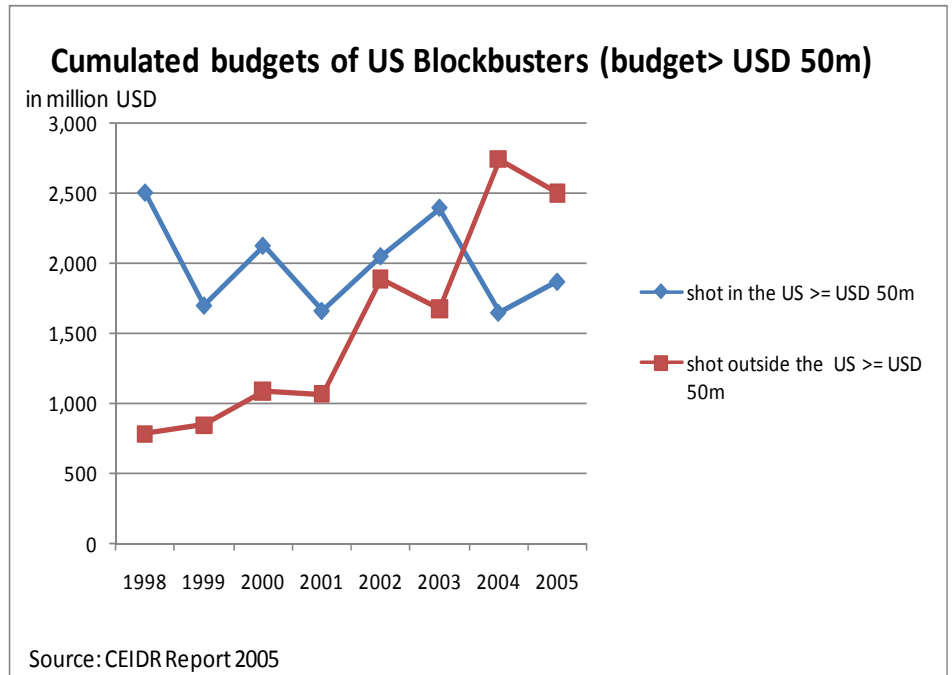
U.S. runaway productions are those which are developed and are intended for initial release/exhibition broadcast in the U.S. but are actually filmed in another country. There are two major types of runaway productions – “creative” runaways, which depart because the story takes place in a setting that cannot be duplicated or for other creative considerations, and “economic” runaways, which depart to achieve lower production costs.

Indeed besides feature films including big budget productions above USD 50m also television (films for TV, TV series, and mini-series) are produced outside the US for mentioned reasons and belong to the term “runaway production”. The most prevalent type of economic runaway television productions are movies for TV. However, SBs prior intention is to acquire Hollywood Blockbusters. Thereof US economic runaways have a larger potential than creative runaways. A general reason for these productions leaving are foreign subsidies offered to American companies ultimately reducing the cost of making the film. Since the infrastructure for larger productions is available abroad and experience and knowledge of non US crews has improved, it became a leading trend, starting in the nineties, to produce even Blockbusters outside the US. According to the last CEIDR Report, 47% of US domestic theatrical releases budgets were spent in the US while 53% of budget expenditures were spent in the rest of the world (numbers of 2005). When focussing only on big budget productions (films with budgets above or equal to USD 50m) production budgets quota spent outside the US is for 2005 with 57% even higher (1998: 24%).



In comparison to numbers of 1998 the quota of US theatrical releases and budget expenditures outside the US strongly increased in the past decade. In 1998 only about 29% of total US film budgets were spent outside the US. Since then the volume of budget expenditures spent outside the US more than doubled and rose from USD 1.6bn to USD 3.8bn in 2005. Following chart shows this leading trend for the segment of big budget productions:

**Cumulated budget volume of Blockbusters produced outside US is already above those produced within the US**



**Europe is most relevant for US producers before Canada and Mexico**

### Where do US majors go to produce their movies ?

When looking at figures for 2007, US feature films with a budget above USD 10m where shot most frequently in Europe (142 in number), Canada (76) and Mexico (39). While other locations worldwide (without US) count 104 movies in number. For this reason Europe is today an essential film location for US majors. Focussing US filming activities in Europe, UK is with 52 productions of capital importance before France (25) and Italy (15). As Studio Babelsberg is on the A-list of European film studios together with Pinewood Shepperton in London and Barrandov Studios in Prague and operates the largest studio complex in Europe, it is, as the excellent track record shows, a well-known player in the branch today.

**The combined result of exchange rate, lower overall costs and government incentives reduce production costs**

Besides a professional working environment and an experienced filmcrew, which is existent at Studio Babelsberg, cost-considerations have besides script-considerations, as described, a major effect where US majors shoot their movies. Hence, the combined result of the exchange rate, lower overall costs and government incentives are the general three factors to reduce production costs. Germany's capital Berlin as production location is famous for its low price level in connection with a cosmopolitan atmosphere. Indeed level of prices is below London or Los Angeles but above Prague or Bucarest. Therefore we would rate the overall price level as the middle range. Another significant reason to produce at SB is Germany's incentive system for film production (DFFF), which is in force since January 2007 and was recently extended until 2012. It is beyond dispute one of the most attractive ones when compared to other countries.

As the DFFF has an annual budget of Euro 60m which caused economical effects in its first year 2007 of approx. Euro 364m in Germany, the recent limitation until 2009 is for this reason extended until 2012. In average 10% to 20% of production costs are refunded by the fund. The DFFF proofed its success and will further on support competitiveness of film production in

Germany. Following chart gives a short overview about the DFFF, conditions for incentives and size of subsidies:

Conditions for incentives of DFFF - Short overview	
■ Length of movie	running time of at least 79 minutes at least 59 minutes for children's films
■ What films qualify for grants?	at least Euro 1m for feature films at least Euro 200k for documentaries at least Euro 3m for animated films
■ How large are the grants ?	at least 25% of the production costs must be spent in Germany at least 20% if the production costs are higher than Euro 20m no minimum percentage for German production costs of Euro 15m and above
■ Who may submit an application ?	normal grant ceiling per film is Euro 4m in case of special requests by producers this grant ceiling can be extended to max. Euro 10m the advisory council decides on such requests for extra funding.
■ Who may submit an application ?	applicants must have a legal residence or registered place of business in Germany applicants must have produced, either as a company or a person, at least one full-length film

Source: Deutscher Filmförderfonds (DFFF)

**Due to the weak US Dollar nearly all relevant studios abroad suffer the loss of economic advantage**

**In particular the low-cost studios in Prague and Bucarest are the European losers**

Third basic variable is the exchange rate of USD into the specific currency of the country of the film-studio as US majors plan their production costs solely in USD. In general, it is a matter of fact, that the weak US dollar in the past five years showed significant negative impact to all currencies relevant for studios worldwide, besides the Mexican Peso which is connected to the USD.

USD exchange rates in past 5 years & change in percent to today					
rates as of 09/26/2008	1Y	3Y	5Y	Affected countries with relevant studios	
USD/EUR	<b>0.68</b>	0.70 -3%	0.83 -22%	0.85 -25%	Germany, France, Italy, Spain
USD/GBP	<b>0.54</b>	0.49 9%	0.57 -6%	0.60 -11%	UK
USD/CZK	<b>16.68</b>	20.00 -20%	24.00 -44%	28.00 -68%	Czech Republic
USD/RON (new)	<b>2.52</b>	2.37 6%	2.90 -15%	3.30 -31%	Romania
USD/CAD	<b>1.03</b>	0.99 4%	1.16 -13%	1.35 -31%	Canada
USD/MXN	<b>10.78</b>	10.90 -1%	10.80 0%	11.00 -2%	Mexico
USD/AUD	<b>1.20</b>	1.13 6%	1.31 -9%	1.46 -22%	Australia

Source: SRC Research

In particular, the exchange rate of US dollar into Czech Koruna lost exorbitant about 68% in the past five years, which means considerable higher costs for US producers here. Furthermore the exchange rate for US Dollar into the Romanian LEU and the Canadian Dollar developed quite disadvantageous for US producers with losses about 31% in the past five years.

Pleasant for US producers was the exchange rate into British Pound. UK is of major importance for the industry as most runaway productions in Europe were realized here. Losses of 11% (5Y horizon) are quite moderate.

Other relevant European countries like Germany, France, Italy, Spain belong to the EWWU. The US Dollar into Euro developed moderately weak with losses of 25% (past 5Y). The more common view for Europeans of EUR into USD shows a strengthen of the USD in the past two to three months to currently 1.44 (EUR/USD) (as of September, 29 2008). Maxima

**As the Dollar gained back strength and we see today exchange rates below 1.50 (EUR/USD) acquisition should become easier.**

**Nevertheless, average for the record year 2007 was an exchange rate of 1.35 to 1.40, which can be seen as comfortable level.**

above 1.55 (EUR/USD) within the summer months of 2008 are history now. CEO Woebcken named an exchange rate above 1.60 (EUR/USD) as critical for SB.



We believe already the high exchange rate scratching 1.60 USD/EUR as seen from March to July deterred at least hesitate US majors to produce in countries of EWWU. Therefore utilization of SB could be on a more satisfying level if currency fluctuations would not hamper business.

We adjusted our projection which results in a new fair value of Euro 4.00. Therefore we reduce our target from Euro 4.40 to 4.00 and confirm our Buy-rating. With a current share price of some Euro 2.30 there is an upside potential for the share price of almost 74%.

### DCF-Model for Studio Babelsberg AG (Entity WACC method)

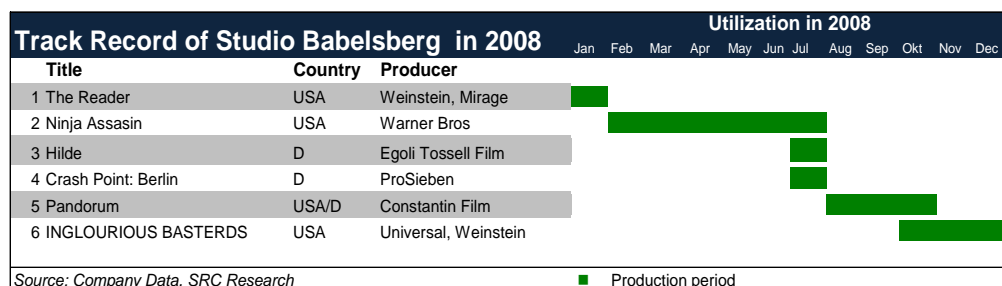
<b>Weighted Average Cost of Capital (WACC)</b>	<b>11.8%</b>	<b>CoE</b>	<b>12.0%</b>
years until first pay-out	0.32	<b>CoL</b>	<b>7.0%</b>
Terminal value growth rate	1.0%		

Euro m	2008e	2009e	2010e	2011e	2012e	Perpetuity
<b>Sales revenues</b>	<b>47.9</b>	<b>62.2</b>	<b>79.1</b>	<b>79.8</b>	<b>80.6</b>	<b>81.4</b>
Sales growth	0.0%	30.0%	27.0%	1.0%	1.0%	1.0%
EBIT margin	8.2%	8.3%	7.1%	7.5%	7.6%	7.5%
<b>EBIT</b>	<b>3.9</b>	<b>5.2</b>	<b>5.6</b>	<b>6.0</b>	<b>6.1</b>	<b>6.1</b>
Tax on EBIT	28.3%	27.9%	28.7%	28.0%	28.0%	30.0%
<b>Net operating profit after tax (NOPAT)</b>	<b>2.8</b>	<b>3.7</b>	<b>4.0</b>	<b>4.3</b>	<b>4.4</b>	<b>4.3</b>
+ Depreciation SAV/ immat. AV	2.0	2.1	2.1	2.1	2.1	2.1
+/- Changes in working capital	1.1	1.1	1.2	1.2	1.2	1.2
+/- Changes in current assets	0.0	0.0	0.0	0.0	0.0	0.0
- net investments in tangible assets	-1.4	-1.6	-1.7	-1.8	-1.8	-1.9
<b>Free Cash Flow</b>	<b>4.5</b>	<b>5.3</b>	<b>5.6</b>	<b>5.8</b>	<b>5.9</b>	<b>5.7</b>
<b>Present value of free cash flows</b>	<b>3.4</b>	<b>3.6</b>	<b>3.4</b>	<b>3.5</b>	<b>3.6</b>	<b>29.1</b>
<b>Sum of free Cash Flows</b>	<b>46.6</b>					
+ Market value of assets that are not necessary for operating business	0					
+ Cash / cash equivalents	19.9					
Financial debt	0.0					
<b>Enterprise value</b>	<b>66.5</b>					
- interest bearing liabilities / long-term provisions	-1.3					
<b>Market value of equity</b>	<b>65.2</b>					
Number of shares (million)	16.5					
<b>Fair market value per share</b>	<b>3.95 €</b>					

Source: SRC Research

## Appendix



### Studio Babelsberg

31/12 HGB (TEUR)	2004	2005	2006	2007	2008e	2009e	2010e	CAGR '07 - '10e
<b>Revenues</b>	<b>17,265</b>	<b>43,214</b>	<b>16,370</b>	<b>87,055</b>	<b>47,880</b>	<b>62,244</b>	<b>79,050</b>	<b>-3%</b>
Change in inventories	83	-510	-99	6,493	0	0	0	
Own work capitalized	0	762	225	109	350	350	350	
Cost of sales	-8,416	-32,729	-8,248	-57,686	-28,728	-38,591	-50,592	
in % of revenues	49%	76%	50%	66%	60%	62%	64%	
<b>Gross profit</b>	<b>8,932</b>	<b>10,737</b>	<b>8,248</b>	<b>35,971</b>	<b>19,502</b>	<b>24,003</b>	<b>28,808</b>	<b>-7%</b>
Other income	1,597	2,347	921	2,624	2,800	2,800	2,900	
Personnel expenses	-8,756	-8,597	-7,909	-24,794	-10,534	-13,694	-17,391	
Other operating expenses	-6,381	-4,602	-4,555	-5,479	-5,806	-5,856	-6,201	
<b>EBITDA</b>	<b>-4,608</b>	<b>-115</b>	<b>-3,295</b>	<b>8,322</b>	<b>5,962</b>	<b>7,253</b>	<b>8,116</b>	<b>-1%</b>
Depreciation	-1,534	-2,336	-1,923	-1,894	-2,040	-2,090	-2,490	
<b>EBIT</b>	<b>-6,142</b>	<b>-2,451</b>	<b>-5,218</b>	<b>6,428</b>	<b>3,922</b>	<b>5,163</b>	<b>5,626</b>	<b>-4%</b>
<b>EBIT margin</b>	<b>neg.</b>	<b>neg.</b>	<b>neg.</b>	<b>7.4%</b>	<b>8.2%</b>	<b>8.3%</b>	<b>7.1%</b>	
Financial result	1,011	358	150	631	450	150	150	
<b>Earnings before taxes (EBT)</b>	<b>-5,131</b>	<b>-2,093</b>	<b>-5,068</b>	<b>7,059</b>	<b>4,373</b>	<b>5,313</b>	<b>5,776</b>	<b>-6%</b>
Extraordinary income	4,276	5,961	5,937	80	0	0	0	
Extraordinary expenses	-11,418	-870	-3,491	-80	0	0	0	
Income tax	-1,634	-94	-35	-779	-1,137	-1,381	-1,560	
other tax	169	-255	-90	-250	-100	-100	-100	
Tax rate	29%	17%	2%	15%	28%	28%	29%	
<b>Net profit</b>	<b>-13,738</b>	<b>2,649</b>	<b>-2,747</b>	<b>6,030</b>	<b>3,136</b>	<b>3,832</b>	<b>4,117</b>	<b>-12%</b>
Number of shares (million)	-	15.3	16.5	16.5	16.5	16.5	16.5	
Earnings per Share (EpS)	-	0.17	-0.17	0.37	0.19	0.23	0.25	
Dividends per Share (DpS)	-	0.10	0.10	0.20	0.20	0.20	0.25	
Book Value per Share (BVpS)								
Shareholders' Equity		38,748	34,350	38,783	40,269	42,450	43,267	
RoE after tax		3.4%	neg.	4.1%	2.0%	2.3%	2.4%	

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Rating Chronicle	Date	Rating	Former Price	Former Target
Studio Babelsberg	May 14, 2008	Buy	2.97 €	4.40 €
Studio Babelsberg	October 8, 2007	Buy	3.01 €	4.00 €

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Source: SRC Research

**Please note:**

The Studio Babelsberg share price mentioned in this report is from closing of September, 26 2008. Studio Babelsberg mandated SRC Research for mentoring the Studio Babelsberg share.

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