

**Financial analysis:
Follow-up study**

artnet AG, Berlin

Occasion: Presentation of the half-yearly report for the six months ended June 30, 2008

Sector

Internet service provider

Internet www.artnet.com

Dates

Nine-month report 24 October 2008

Master data

Stock exchange symbol

WKN - German Securities Code 690950

ISIN DE0006909500

Bloomberg AYD.ETR

Relevant stock exchanges Xetra and Frankfurt

Trading segment Regulated market/Prime Standard

Share price EUR 5.90 (Xetra; 20.08.2008 14.24 pm)
52-week high EUR 15.00
low EUR 4.95

Number of shares 5,631,067 shares (basic)

Market capitalization EUR 33.2 million

Shareholder structure	Galerie Neuendorf AG, Berlin	26.0%
	Schaeffer Immobilien GmbH, Hamburg	11.3%
	Artis Capital Management LLC, San Francisco	10.4%
	Robert de Rothschild	7.3%
	Oliver Schmidt	5.0%
	Treasury Shares	1.4%
	Free Float	38.6%

2007 dividend none

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Important:

Please read the legal information and the information on possible conflicts of interest at the end of this analysis.

Analysis result

BUY - Current price target EUR 12.00

In the first half of 2008, artnet grew by 25% on a US dollar basis. Translated into euros, the company's reporting currency, the growth rate fell to 8.5%, however. This has prompted us to revise our 2008 forecast for revenue growth measured in euros to 9% excluding revenue from online auctions and 12% including online auctions. artnet online auctions has demonstrated its efficiency. The platform is being well received by the art market, with commission income of EUR 62 thousand generated in the second quarter alone. June and July saw a surge in consignments and revenues. We are therefore maintaining our projection of commission income from online auctions of EUR 323 thousand in 2008. Once the platform is out of Beta, the product will be publicized to a wider audience through a marketing campaign. We expect online auctions to become established as an art auction platform with relevance worldwide and generate substantial revenue growth with high gross margins over the coming years.

artnet's costs continued to rise substantially in Q2/2008, with the four main cost groups, including the cost of sales, rising 58% year-on-year on a dollar basis. The company's workforce also expanded by 33% compared with the end of the same quarter in 2007. These cost increases are attributable to investments in technical enhancements and to new product development led by indices in art market segments as well as the French-language website, artnet.fr. artnet expects its staff costs and other expenses to rise only marginally in the second half of 2008.

The generally muted economic outlook has so far not affected the art market, which continued to achieve new record prices at live auctions. This leads us to maintain our forecast for artnet's revenue growth at 23% in both 2009 and 2010, auction revenues excluded. The negative currency effects have been easing since August 2008 and will boost revenues and earnings on a euro basis as long as the turnaround in the US dollar/euro exchange rate lasts. The planned increase in auction commissions, which now includes a 10% "buyers premium". took effect in late August and will also lift revenues.

In summary, H1/2008 was characterized by the successful kick-off of the artnet online auctions, the accelerated development of new products, and growth of 25% on a dollar basis.

Because we have categorized 2008 as a transition year for artnet – a year in which it was expanded from an information platform into a transaction platform as well – we are conducting our valuation on the basis of 2009. In view of the sustained revenue growth which we are expecting for the coming years and the recent currency movements, we feel that a P/E ratio of 25 or a share price of EUR 12.00 is reasonable. Our DCF model indicates a present day value of EUR 12.39. This leads to a current fair assessment of EUR 12.00 compared with EUR 12.50 in our study on Q1/2008.

1. Key events in the first six months of 2008

- Sustained strong revenue growth of 25% on a dollar basis in H1/2008
- Weak dollar dampens revenue growth in euros resulting in growth of just 8.5% on a euro basis
- Successful launch of the artnet online auctions; efficiency confirmed; revenues up considerably in June and July in particular
- Sell-through rate of around 25% of all objects offered at online auctions
- Auction turnover time reduced from 14 to ten days
- Cash flows from operating activities return to negative territory for the first time since 2003 on account of high capital expenditure on online auctions and new product development
- Headcount up 33%, 40% more FTEs, 31 new permanent employees, each compared with the end of Q2/2007; six new permanent FTEs in Q2/2008
- 129 employees and Consultants in total
- Capitalization of staff costs of USD 397 thousand in H1/2008 for new product development
- Sharp rise in all cost types, including cost of sales
- Product development costs up 100% on a dollar basis compared with H1/2007
- Considerable investment in the development of technology, also due to partial capitalization of internal labor
- Decrease in operating income due to the hiring of many new employees for the purpose of evolving Artnet from an information platform to a transaction platform
- Revaluation of deferred taxes increases profit after tax
- Gallery network: 2,125 members (2,017 on March 31, 2008) increase of 9% in H1/2008
- Price database: 12,481 subscribers (11,950 on March 31, 2008) increase of 9% in H1/2008

2. Forecast & Outlook

- Establishment of artnet France S.à.r.l., a wholly owned subsidiary of Artnet Corp., on July 3, 2008; operations due to commence in Q4/2008 artnet France will act as a sales agent for artnet Corp. in France.
- Additional advertising revenue expected in 2009 from the French artnet website artnet.fr
- Acceleration of new product development – price indices for the art market segments
- Record price of USD 130,000 achieved at an online auction in July for a silk-screen print by Andy Warhol (titled \$ 9) shows potential for higher-priced lots at online auctions
- Marketing drives for acquiring new customers for online auctions planned
- Cross-selling synergies for price database subscriptions and gallery network members from the new customer acquisition of online auctions
- Levying of a buyer's commission of 10% for online auctions after August 20, 2008 instituted

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- Sustained rapid growth in the number of member galleries in the gallery network of approximately 20% per year due to the attractiveness of the product and the internationality of artnet expected in the coming years as well
- Plans to increase the prices of the gallery network by 15% were put into effect in June and will continue on a monthly basis
- Rallying of the US dollar in Q3/2008 will lead to faster revenue and earnings growth in euros (artnet's reporting currency)
- Dividends not expected to be paid until after 2010



Andy Warhol
\$ 9
1982

artnet Online Auctions: Wednesday, July 23, 2008
Sale Price: USD 130,000

3. Details

3.1 artnet Online Auctions

The artnet online auctions art-trading platform demonstrated its viability in Q2/2008. Trading on this platform takes place with an acceptable sell-through rate and attractive prices for suppliers and buyers with a wide range of high-quality works of art. The number of lots put up for auction rose to approximately 350 in June. artnet's share of the profits amounting to a 10% seller commission increased each month to reach USD 33 thousand in June. Demand is still strongest for prints by prominent artists. The sell-through rate hovered around 25%, post-auction sales included. The duration of the auctions was reduced from 14 to 10 days as a result of greater customer interest.

On July 23, 2008, after the close of the second quarter, artnet achieved a record sale: Andy Warhol's 1982 silk-screen print "\$ 9" changed hands at a hammer price of USD 130,000. artnet thus succeeded in showing a high-quality range of art at its online auctions and the presence of high end buyers.

The company has introduced a 10% buyer's premium on the hammer price effective August 20. We are leaving our initial revenue estimate of commission income from online auctions unchanged.

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artnet has proven that continuous trading takes place on its platform and that it can draw on an extensive portfolio of consigners and consignments. In addition to making further technical improvements, the company is now seeking to convert existing customers as well as new groups of buyers into auction customers through intensified marketing. Online auctions make it easy for private buyers to buy art conveniently under attractive conditions. Suppliers therefore have a much more efficient sales channel than live auctions with their high costs and long preparation times.

3.2 Growth

Measured in US dollars, revenue rose by 25% in the first half of 2008. However, as the dollar continued its freefall against the euro during this period, revenue growth translated into euros fell to 8% (principal invoicing currency: USD 80%; reporting currency: euro). This trend saw a sharp reversal in early August 2008. A lasting turnaround thus reduced and even reversed the negative currency effects arising from the currency translation. Consequently, we have revised our growth forecast for artnet's revenues excluding auction revenues on a euro basis to 9% for 2008 as a whole.

artnet's workforce was expanded by a total of 32 employees year-on-year. Compared with Q1/2008, six new permanent FTEs were hired; the total headcount rose by 2 to 129. Most of the new employees and consultants were hired for the areas of technology and new product development. New products in planning are artnet.fr and the price indices on art market segments. The website artnet.fr is scheduled to go live in the fourth quarter with a French-language art magazine dedicated to the market in France. The price indices are expected to reflect price trends in a portfolio of selected artists and their works from a given period, e.g. American pop art. Based on the artnet indices, investment banks can create investment products with which investors can participate in the price trends in individual art segments similar to a stock exchange index. artnet receives a marketing fee from the users of its indices. The development of an art index is complicated because the prices of the works of a specific artist are not directly comparable with one another on account of their different characteristics. In this respect, the provider of art indices who can provide this in transparent, consistent quality and variety is likely to prevail. This in turn requires a very extensive database of prices from auctions that only artnet maintains.

The up-front staff costs incurred for new products amounting to USD 397 thousand in H1/2008 were capitalized and will be written down by an annual 20% in the future in accordance with IFRS.

On account of the staffing expenses and the costs of the accelerated development of new and existing products, a much lower profit is now expected in 2008. As of June 30, 2008, artnet changed the recognition of deferred taxes based on a three-year planning period and reported additional deferred tax assets on tax loss carryforwards in the amount of EUR 363 thousand. Two other increases are planned for the remainder of 2008. While these positively influence consolidated earnings, they are not recognized in operations and are therefore not taken into account in our forecast. At the same time, artnet reported negative cash flows from operating activities at the end of Q2/2008 for the first time since 2003.

For 2009 going forward we expect additional advertising revenue from the artnet.fr website as well as much higher revenues in the "Other products" segment, to which the new price indices and the online marketplace for design are allocated.

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We are forecasting revenue growth of around 10% per year for the price database. This also involves the expansion of the price database to include 20th and 21st-century decorative art and design. artnet currently does not have the pricing power to increase prices for the artnet price database due to the free offerings of competing suppliers that are financed through advertising, even though the quality of these suppliers' products is not on a par with that of artnet.

Table 1

artnet AG Forecast (consolidated income statement)									
Amounts in EUR thousand	2006		2007		2008		2009		2010
	Current	Change in %	Current	Change in %	Forecast	Change in %	Forecast	Change in %	Forecast
Revenues (excl. auctions)	8,416	+30.7%	11,000	+9.0%	11,990	+23.0%	14,748	+23.0%	18,140
Online auction commission					323		1,050		2,240
Total sales	8,416		11,000	+11.9%	12,313	+28.3%	15,798	+29.0%	20,380
Cost of sales	1,719	+20.6%	2,073	+131.5%	4,800	+15.0%	5,520	+15.0%	6,348
Gross profit on sales	6,697	+33.3%	8,927	-15.8%	7,513	+36.8%	10,278	+36.5%	14,032
Sales/marketing	1,296	+30.7%	1,694	+29.9%	2,200	+18.0%	2,596	+18.0%	3,063
General administrative costs	2,960	+42.6%	4,220	-38.4%	2,600	+10.0%	2,860	+10.0%	3,146
Product development	565	+88.7%	1,066	+78.2%	1,900	+10.0%	2,090	+10.0%	2,299
Total costs	4,821	+44.8%	6,980	-4.0%	6,700	+12.6%	7,546	+12.7%	8,508
Operating result	1,876	+3.8%	1,947	-58.2%	813	+236.0%	2,732	+102.2%	5,523
Net interest	37		90		50		70		90
Other income	14		75		40		50		60
EBT	1,927	+9.7%	2,112	-57.2%	903	+215.8%	2,852	+98.9%	5,673
Taxes (excl. deferred taxes)	107		0		0		80	+50.0%	120
Consolidated earnings	1,820	+16.0%	2,112	-57.2%	903	+206.9%	2,772	+100.3%	5,553
Number of shares (fully diluted)	5,703		5,741		5,720		5,750		5,800
EPS	0.32	+15.6%	0.37	-57.8%	0.16	+200.0%	0.48	+100.0%	0.96

On the strength of the price increases in the gallery network of 15% which took effect in June, and a market potential of over 20,000 galleries worldwide with relevance for artnet, we anticipate sustained strong growth of between 20% and 30% per year in this product group. In the future, positive price effects are also likely to arise from the change in the pricing model for the gallery network, which will be increasingly based on the value of the gallery offerings shown and consequently on the performance of the galleries.

By expanding its end-to-end art offering, artnet is reinforcing its competitive lead. The competitor artprice, which invoices exclusively in euros, grew by 11% in Q2/2008 to EUR 1.225 million (equivalent to 40.0% of artnet's Q2 revenues) and anticipates revenues in excess of EUR 5 million for 2008 as a whole.

3.3 Valuation

The growth in online auctions and the complete turnaround in the dollar/euro exchange rate up to now have led us to raise the fair P/E ratio for artnet from 20 to 25 for 2009.

The DCF model was adjusted to take account of the lower current bond yield, the lower expected number of shares at the end of 2008 (including exercise of stock options) of 5.72 million, and the expected cash flows from the revised profit forecast.

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We are now forecasting a free cash flow in the amount of the profit (cash flows from operating activities – investments = profit). For the calculation of the terminal value, similar to the unchanged profit in 2011 and in 2010, we have also ignored the discounting in 2011.

The model with our assumptions concerning the company valuation indicates a current fair assessment of EUR 12.39 per share. The parameters of the sensitivity analysis were unchanged.

Table 2

Calculation of enterprise value				
Discounted cash flow model in EUR thousand	2008	2009	2010	2011 ff.
Consolidated net income	903	2,772	5,553	5,553
Free cash flow (FCF)	903	2,772	5,553	5,553
Terminal value				77,670
Discount factor	1.0433	1.1335	1.2315	1.2315
Present values FCF	866	2,445	4,509	63,067
Total present values (fair value)	70,887			
Number of shares	5,720,000			
Fair value per share	12,39			

Assumptions for calculation of enterprise value

Basic interest rate (current yield)	4,15%
Market risk premium	4.50%
Beta factor	1.00
CAPM interest rate	8.65%
Terminal value growth discount	1.50%

Table 3

artnet AG Sensitivity analysis DCF model			
in EUR per share	Beta		
	0.8	1.0	1.5
Growth discount			
1.0%	13.32	11.67	8.87
1.5%	14.27	12.39	9.28
2.0%	15.39	13.22	9.72

Analyst: Marcus Sühling (business administration graduate)

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Francis Bacon

Study for head of George Dyer

Medium: oil on canvas

Sotheby's London: Tuesday, July 1, 2008 [Lot 11]

Sale Price: GBP 13,761,250

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Main sources of information

The main sources of information for the preparation of this analysis are publications in German and foreign media, such as information services, the business press, professional literature, published statistics, ratings agencies and publications by the analyzed companies/issuers.

Analysis prepared by:

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Investment recommendation

Buy: We expect the price of these shares to increase by 15% or more in the coming 12 months
Hold: We expect the price of these shares to fluctuate but only to change slightly in the coming 12 months
Sell: We expect the price of these shares to fall by 15% or more in the coming 12 months
N/A: We have not made a recommendation for these shares

Overview of our analysis results for these shares in the past 12 months

First analysis on February 25, 2008, Analysis Result: BUY EUR 11.25

Follow-up study on May 26, 2008, Analysis Result: BUY EUR 12.50

Follow-up study on August 28, 2008, Analysis Result: BUY EUR 12.00

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Company: artnet AG

Numbers concerned: 3, 7

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