

**Financial analysis:
Follow-up study**

artnet AG, Berlin

Occasion: Presentation of the annual report for the year ended
December 31, 2008

Sector

Internet service provider

Internet

www.artnet.com

Dates

Q1 interim report April 24, 2009
General Meeting July 15, 2009
H1 report July 31, 2009
Nine-month report October 30, 2009

Master data

Stock exchange symbol
WKN - German Securities Code 690950
ISIN DE0006909500
Bloomberg AYD.ETR

Relevant stock ex- changes Xetra and Frankfurt

Trading segment Regulated market/Prime Stan- dard

Share price EUR 3.49 (Xetra; April 7, 2009 3.37 pm)
52-week high EUR 8.79
low EUR 3.45

Number of shares 5,631,067 shares (basic)
Market capitalization EUR 19.7 million

Shareholder structure
Galerie Neuendorf AG, Berlin 26.0%
Schaeffer Immo- bilien GmbH, Ham- burg 11.3%
Artis Capital Manage- ment LLC, San Fran- cisco 10.4%
Robert de Rothschild 7.3%
Oliver Schmidt 5.0%
Treasury Shares 1.4%
Free Float 38.6%

2008 dividend none

Analysis result

HOLD - Current price target EUR 5.39

artnet continued its growth course in fiscal 2008 with revenue up 12% on a euro basis (in USD: +19%). Accelerated investment in new products and technical improvements, which put a damper on short-term profitability, led to the successful launch of the artnet Online Auctions transaction platform in February 2008. Another result of this investment activity was rolled out a year later in February 2009: the artnet Price Database Decorative Art. This contains international auction results since 2002 for furniture and decorative art ranging from the Middle Ages to Art Nouveau. In spite of the global economic crisis, artnet grew on a dollar basis in Q4/2008 by 7.3% excluding auctions and by 10.5% including auctions compared with the same quarter in 2007. Total revenue was down 1% as against Q3/2008. Measured in euros (artnet's reporting currency), revenue for the quarter under review rose by 14% compared with the previous quarter on the strength of positive exchange rate effects.

October 2008 saw the launch of the artnet.fr website. France is the third -largest art market worldwide after the United States and the United Kingdom. To reach the local clientele, artnet offers an online magazine in French that is updated on a daily basis and whose content is supervised by a French editorial team. Through this investment, artnet aims to expand its competitive position substantially in France in particular.

The types of cost showed varying trends in Q4/2008. While all cost types rose year-on-year measured in US dollars – the most significant increase being the 28% rise in product development costs – a comparison with Q3/2008 reveals a different picture. The highest increases were in the cost of sales and general and administrative expenses, which climbed 16% and 40% respectively on a dollar basis, while selling and marketing expenses declined by around 15%. Consequently, due to both strategic capital expenditures and the increase in tax expense following a tax audit for the years 2001 to 2004, artnet recorded a clear consolidated net loss of USD -718 thousand.

The economic crisis might squeeze out marginal providers from artnet's portfolio of gallery customers and reduce the number of Price Database subscriptions. One of the growth drivers in 2009, on the other hand, will probably be artnet Online Auctions, whose revenue in Q1/2009 – estimated at over USD 200 thousand – grew by around 60% compared with the previous quarter. The new products – Price Database Decorative Art, the artnet.fr website and the planned introduction of new artnet Market Data products, which will facilitate extensive market analyses based on art market data and the new customer indices – are also expected to generate revenue growth, however.

On the whole, we, along with artnet itself, are forecasting a more or less balanced result in 2009 and substantial growth in profits from 2010 onwards. artnet's strategic positioning further improved in 2008 and so far in 2009 on account of the accelerated expansion of the company.

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Important:

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

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HOLD - Current price target EUR 5.39

The valuation of artnet shares is based on the profits estimated from 2010 onwards. These are subject to considerable uncertainty because it is extremely difficult to forecast revenues from the auctions and anticipated revenues from new products. The planned expansion in the headcount of around 10% is likely to push up total costs. In addition, the effects of the recession on the art market and its impact on artnet can only be assessed with greater uncertainty. Our DCF model indicates a fair value of EUR 5.39 for artnet shares at a current price of EUR 3.49. Given the uncertainty, we are revising our recommendation to "hold" for the time being, however.

Analyst: Marcus Sühling (business administration graduate)

Date of publication: April 16, 2009

Editorial deadline: April 8, 2009



Eileen Gray

Fauteuil aux dragons
1917–1919

Christie's Paris: February 23, 2009

Selling Price: EUR 21,905,000

artnet AG, Berlin

1. Key events

- Revenue up 7.3% year-on-year on a dollar basis in Q4/2008 excluding revenue from Online Auctions, 10.5% including Online Auctions
- Auction revenue up 3% compared with Q3/2008 on a dollar basis in spite of global economic crisis
- Gallery Network expanded 13.5% year-on-year on a dollar basis
- Advertising revenue in Q4 almost flat year-on-year on a dollar basis
- artnet.fr website launched with French online magazine updated daily, own artnet French editorial team, advertising revenue from this still low
- Operating expenses up again by 11% year-on-year
- Performance-based Board of Directors compensation increased to EUR 272 thousand in 2008 from EUR 86 thousand in the previous year
- Three more FTEs hired in Q4/2008, 137 employees at year-end
- artnet is planning to increase its headcount to around 150 by the end of 2009 (+12% year-on-year)
- Adjusted consolidated loss of EUR -65 thousand due to high strategic capital expenditures as well as non-recurring factors such as prior-period tax expense of EUR 286 thousand and default interest of EUR 43 thousand on this
- Cash and cash equivalents of EUR 2.9 million at year-end, down from EUR 3.6 million in the previous year
- Net cash provided by operating activities of EUR 437 thousand in 2008 (2007: EUR 2,394 thousand); after deduction of capitalized development costs of EUR 614 thousand, net cash used in operating activities of EUR -177 thousand remains
- Free cash flow clearly in negative territory at EUR -770 thousand for 2008 as a whole
- Gallery Network: 2,256 members, +38 in Q4/2008
- Price database: 12,309 subscribers, -613 in Q4/2008
- Launch of the artnet Price Database Decorative Art in February 2009
- Launch of the artnet Market Data art indices and market reports planned in the course of 2009



2. Details

2.1 artnet Online Auctions

In Q4/2008 artnet Online Auctions continued to build on the level it had achieved in Q3. The number of lots put up for auction grew by around 20% to an average of almost 500 per month (approximately 400 per month in Q3). Conversely, the number of lots sold declined from around 22% to approximately 18% in Q4 as a consequence of the weak economic environment. On the whole, however, Online Auctions revenues rose by 2% on a dollar basis in the fourth quarter of 2008 compared with the previous quarter. This translates into growth of 14% in euros. Since its launch in February, Online Auctions has therefore contributed USD 373 thousand to total revenue. A silk-screen print by Andy Warhol generated record revenue in 2008 with an auction price of USD 130 thousand (July 2008). The main revenue drivers are still prints and photographs.

Graham Robert
 Elizabeth
 1992
 artnet Online Auctions: March 31, 2009
 Selling Price: USD 32,000

The product benefits of Online Auctions, such as turnover of 4-5 weeks instead of six months for live auctions and a buyer's premium of 10% instead of around 25% to 40%, remain a unique selling point. Other providers of Internet auctions do not nearly generate the same revenues and interest worldwide as Online Auctions.

While auction revenues in July reached a monthly record of around USD 450 thousand, they fell steadily until December/January to below USD 150 thousand. The buyer's premium of 10% was introduced in August on top of the seller's fee of 10%. In February and March 2009, auction revenues nevertheless rose once again to well in excess of USD 300 thousand due to a higher-priced range of lots. artnet is optimistic about its prospects. We have estimated Online Auctions revenues cautiously on the basis of an average of USD 350 thousand per month from April onwards and assume that auction revenues will increase only marginally compared with February and March. On the whole, our revenue estimate for artnet's revenues from the auctions including listing fees is USD 975 thousand or EUR 722 thousand. If the positive trend from Q1/2009 continues throughout the year, revenues could be much higher. Online Auctions could then become a fast-seller that generates increasing, higher-priced supply and demand on account of the product benefits mentioned above.

2.2 Development of the company

In Q4/2008, artnet's revenue rose by 7.3% year-on-year on a dollar basis excluding auction revenues and by 10.5% including auction revenues in what was a difficult economic environment. The company thus successfully continued its growth trend in the last quarter of the year as well. The largest revenue driver in absolute figures was the Gallery Network, which recorded growth of 13% in US dollars. Price data subscriptions rose by 2%, while advertising revenue slipped slightly. Compared with Q3/2008, total revenue edged down 0.5%, with all product groups affected except for advertising revenue, which increased on account of the season in question. The decline in quarterly revenue leads us to expect specific valuation allowances on receivables in the Gallery Network and further cancellations by price database subscribers in 2009. This trend could intensify in the course of 2009.

In spite of the unfavorable environment in its sector, artnet added 38 galleries to its Gallery Network in Q4/2008, bringing the total up to 2,256, an increase of 1.7%. Average monthly revenue per member gallery decreased slightly from USD 303 in Q3/2008 to USD 292 in Q4/2008, mainly due to currency translation effects. Nevertheless, it was obvious that the price increase envisaged could not be implemented in the market. The number of price database subscribers fell quarter-on-quarter by 613 to 12,309, a decline of around 5%. By contrast, subscription revenue increased from USD 43 to USD 44. As prices were not increased, it was mostly small subscriptions that were lost. The trends show sustained growth in the Gallery Network, but also increased sensitivity to economic conditions among price database subscribers.

artnet launched the artnet.fr website in October. France is the third-largest art market worldwide after the United States and the United Kingdom. This website will significantly increase awareness of artnet in France, achieved through a French-language version of artnet Magazine that is updated daily and reports on the art market with the spotlight on France. artnet created its own French editorial team for this purpose.

artnet AG, Berlin

All cost types on a dollar basis rose by 42% year-on-year after adjusting for the non-cash costs of the stock options (USD 142 thousand). The cost of sales increased by 16% from Q3 to Q4. Following the partial reclassification from operating expenses at the start of the year, the cost of sales therefore rose by 52% over the year as a whole, while operating expenses increased by 36% compared with the previous year.

Operating expenses rose by 8% from Q3 to Q4. The highest increase in operating expenses was in product development costs, which were up 28% year-on-year. Compared with the previous quarter, general and administrative expenses climbed 40% on a dollar basis, while selling and marketing expenses fell by around 15%. Here, the company continues to rely on personal recommendations by customers instead of initiating an expensive marketing program. The increase in general and administrative expenses was due in particular to the commitment to performance-based compensation for the Board of Directors in the amount of EUR 272 thousand (previous year: EUR 85.5 thousand). Compensation of the Board rose to EUR 583 thousand for 2008 as a whole (previous year: EUR 406 thousand). artnet recorded a clear consolidated net loss of EUR -490 thousand in comparison.

In addition to the burden of strategic capital expenditures, especially additional personnel expenses of EUR 1,384 thousand, artnet posted non-recurring factors such as prior-period tax expense of EUR 286 thousand resulting from an external tax audit for the years 2001 to 2004 plus default interest of EUR 43 thousand. After adjusting for these non-recurring factors and the costs of the non-cash stock options (EUR 97 thousand), artnet recorded a net loss of EUR 65 thousand for the year. artnet is now retracting its earnings forecast of a break-even result for 2009 and only expects its earnings to rise again in 2010.

In 2008, artnet capitalized development costs of EUR 614 thousand for product development as work performed by the entity and capitalized. Of this figure, EUR 291 thousand is attributable to the development of the artnet Market Data art indices, EUR 135 thousand to Online Auctions and EUR 131 thousand to the Decorative Art database. On the whole, we believe that these capitalizations are acceptable in view of the anticipated revenues. artnet writes down work performed by the entity and capitalized over three years.

Table 1

artnet AG Forecast (consolidated income statement)									
Amounts in EUR thousand	2007		2008		2009		2010		2011
	Current (adjusted)	Change in %	Current (adjusted)	Change in %	Forecast	Change in %	Forecast	Change in %	Forecast
Revenues (excl. auctions)	11,000	+9.5%	12,048	+11.1%	13,385	+8.9%	14,578	+14.5%	16,690
Online auction commission			255		722		1,074		1,800
Total sales	11,000	+11.9%	12,303	+14.7%	14,107	+11.0%	15,652	+18.1%	18,490
Cost of sales	2,073	+141.5%	5,007	+12.4%	5,630	+5.0%	5,911	+10.0%	6,502
Gross profit on sales	8,927	-18.3%	7,296	+16.2%	8,477	+14.9%	9,741	+23.1%	11,988
Operating expenses	6,980	+1.0%	7,052	+18.7%	8,377	+4.4%	8,741	+8.3%	9,463
Operating result	1,947	-87.5%	244	-56.2%	107	+836.0%	1,000	+152.4%	2,525
Net interest	90		4		0		0		0
Other income	75		-183		0		0		0
EBT	2,112	-96.9%	65	+63.7%	107	+836.0%	1,000	+152.4%	2,525
Taxes (excl. deferred taxes)	0		130		50		80		120
Consolidated earnings	2,112		-65		57	+1518.2%	920	+161.3%	2,405
Number of shares (fully diluted)	5,741		5,687		5,690		5,690		5,700
EPS	0.37		-0.01		0.01		0.16		0.42

Net cash provided by operating activities fell significantly to EUR 437 thousand; after deduction of payments for investments containing work performed by the entity and capitalized, a cash outflow of EUR 770 thousand remains.

artnet's headcount rose by 20% in 2008 as a whole, from 114 to 137. Monthly revenue per employee fell from USD 11.3 thousand in Q3/2008 to USD 11.0 thousand in Q4/2008. In 2009, the company plans to hire 13 more staff, which means that employee revenue is likely to decrease further.

Overall, fiscal year 2008 was dominated by high strategic capital expenditures and successful launches of new products with Online Auctions and artnet.fr. In 2008, artnet grew by 17% on a dollar basis excluding Online Auctions, while its competitor arprice.com gained 8% on a euro basis. artnet was therefore able to expand its market position in the price database area. The Gallery Network cemented its monopoly-like market position. In addition, Online Auctions is also expected to establish itself as the world's only relevant Internet platform for art auctions. Thanks to the labor-intensive development of an innovative methodology for calculating art indices which artnet will make available in market reports and a new price database, artnet looks set to rapidly become the market leader in this new product category as well.

2.3 Outlook

Due to the fact that sales in the art market will probably fall sharply, artnet anticipates only minor growth in US dollar-denominated revenue excluding auctions in 2009 in spite of new product launches. We are correspondingly forecasting growth of 2%. Growth rates should pick up again in 2010 and 2011 on a dollar basis on the back of the new products. We have accordingly assumed growth of 9% and 14% and are projecting a USD/EUR exchange rate of 1.35 as the annual average exchange rate, also for 2010 and 2011. Please refer to point 2.1 for information on the growth of artnet Online Auctions.

On February 26, 2009, artnet activated the artnet Price Database Decorative Art. This contains the results of international auctions from 2002 for furniture and decorative arts from the Middle Ages to Art Nouveau. The database comprises the results of auctions for furniture, silver, ceramics, porcelain, glass, clocks and rugs and constitutes an extension of the Price Database Fine Art.

During 2009, artnet plans to launch new art indices and therefore provide indices for the development of art market segments and artists. Price indices enable professional art market players to track price trends quantitatively. artnet thus provides the financial market with the framework for developing investment products based on these indices. Here, artnet believes that the quality of its products is far superior to that of the products already marketed by its competitors.

We expect the cost of sales and operating expenses, which we combined in our forecast, to increase only moderately on a dollar basis. Firstly, the new product developments are expected to be ready for marketing in 2009 and, secondly, artnet is planning to complete the modification of the network infrastructure and the transfer of database codes by the end of the year. Following this, marketing and selling expenses will probably increase substantially. We are forecasting that the cost of sales will rise on a dollar basis by 4%, 5% and 10% in 2009, 2010 and 2011. Similarly, we predict that operating expenses measured in US dollars will increase by 10%, 4% and 8%.

artnet AG, Berlin

In general, we expect to see a surge in profitability starting in 2010 following the expansion of business and the data cleansing between 2007 and 2009. Tapping rationalization potential and much faster revenue growth in relation to the number of employees should enable artnet to boost employee revenue in the long term. The revenue drivers will most likely be Online Auctions, the Gallery Network, as well as new products such as the art indices. artnet therefore has an outstanding strategic starting position as an Internet platform in the art market and should be able to further expand its market lead and also offer its products and services on other markets such as the financial market.

3. Valuation

The DCF model was adjusted to take account of the lower current bond yield of 3.03% as well as the revised forecast and expected cash flows. We have now also expanded the forecasting period to 2011. When calculating expected cash flows, we now take net cash provided by operating activities as a basis, which we estimate as moderately higher than the expected profit, and reduce the disbursements for investments.

Table 2

Calculation of enterprise value				
Discounted cash flow model in EUR thousand	2008	2009	2010	from 2011.
Cash inflow from operating activities	437	400	1,000	2,600
Net Investment/working capital	-1,177	-800	-600	-500
Free Cashflow (FCF)	-740	-400	400	2,100
Terminal value				34,826
Discount factor	1.000	1.045	1.108	1.108
Present values FCF	-740	-383	361	31,424
Total present values (fair value)	30,662			
Number of shares	5,690,000			
Fair Value per share	5.39			

Assumptions for calculation of enterprise value

Basic interest rate (current yield)	3.03%
Market risk premium	4.50%
Beta factor	1.00
CAPM interest rate	7.53%
Terminal value growth discount	1.50%

The model with our assumptions concerning the company valuation indicates a current fair assessment of EUR 5.39 per share.

The parameters of the sensitivity analysis were unchanged.

Table 3

artnet AG Sensitivity analysis DCF model			
in EUR per share	Beta		
	0.8	1.0	1.5
Growth discount			
1.0%	5.63	4.92	3.49
1.5%	6.46	5.39	3.74
2.0%	7.23	5.94	4.02

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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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Responsible company: SIGNUM Research GmbH, Düsseldorf.

Layout: Michele Anne Zeh, CH-Windisch

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
Follow-up study on November 14, 2008, Analysis Result: BUY EUR 9.50
Follow-up study on April 16, 2009, Analysis Result: HOLD EUR 5.39

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Company: artnet AG

Numbers concerned: 3, 7

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