

Financial analysis :  
Initial study

**Sector**

Internet service provider

**Internet**

www.artnet.de

**Dates**

Publication of the 2007 annual financial statements 28 March 2008  
 Three-month report 25 April 2008  
 General Meeting 09 July 2008  
 2008 H1 report 25 July 2008  
 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 7.80 (Xetra; 11.02.2008 10:19 am)  
 52-week high EUR 13.90  
 low EUR 6.91

Number of shares 5,631,067 shares (basic)  
 Market capitalization EUR 43.9 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%  
 Treasury Shares 1.4%  
 Free Float 43.6%

2006 dividend none

SIGNUM Research GmbH  
 Postfach 11 07 13  
 40507 Düsseldorf  
 info@SIGNUM-Research.com

**Important:**

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

**Artnet AG, Berlin**

**Analysis Result**

**BUY - Current price target EUR 11.25**

Artnet is the world's leading provider of information on the art market. Artnet's Web-based service provides information to participants in the art market. Its two best known services are its database of auction prices – with illustrations for each work of art – and its gallery network. The price database can be used as a basis to value works of art. The gallery network is a marketing tool for galleries, allowing them to display the works of art they are offering for sale on Artnet's Web site. Artnet's network of galleries provides a representative, market-wide offering of works of art by over 20.000 artists. Art collectors use the network to find work by the artist in whom they are interested, and can value the artwork based on the prices reached at auction for comparable work using Artnet's price database.

The art market is a high-growth market with a long-term horizon, presenting enormous potential for growth for Artnet. Artnet is a prime mover and has created the Internet-based art market. It now leads the market, enjoying double-digit growth rates since mid-2004. Artnet holds a hegemonic position in the market because of the benefits its network offers to Internet-based companies. It continually adds new services to the existing ones. Artnet launched Internet auctions at the end of February. Artnet is organizing these auctions on its own platform. This project has incurred substantial start-up costs in 2007 and 2008. However, we believe that the requisite conditions for success (awareness, market requirements, cost advantage, first mover advantage) have been established.

We believe that earnings will increase dynamically in 2008, and project continued growth at approximately 25% per year based on the existing services, irrespective of the success or failure of the Internet art auctions. EPS are forecast to total EUR 0.45 in 2008, and we have determined that the P/E ratio of 25 is fair. As a result, the current price target for Artnet's shares is EUR 11.25 over a 12-month period.

Analyst: Marcus Sühling (business administration graduate)  
 Date of publication: February 20, 2008  
 Editorial deadline: February 11, 2008

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## Artnet AG, Berlin

**Mark Rothko***White center (Yellow, pink and lavender on rose)*

1950

Oil on canvas

Sotheby's New York:

15 May 2007 [Lot 31]

Contemporary Art Evening

Price: 72,840,000 USD PREMIUM

**1. Financial analysis, forecast and valuation****1.1 Financial analysis**

Our analysis is based on Artnet's 2007 Q3 report. The consolidated accounts are inconspicuous and do not include any extraordinary or unusual items. Equity totaled EUR 3.91 million; the equity ratio is high at 60.0%. There are 5,631 million shares in circulation. In addition, 285,250 share options have been issued, which would dilute the number of shares by up to approx. 5% if exercised in full. Deferred tax assets have only been capitalized in the amount of

EUR 0.63 million, although Artnet has losses carried forward totaling approx. USD 35.9 million which could have been capitalized in the amount of the anticipated tax charges. Artnet has not capitalized any goodwill and does not have any interest-bearing liabilities. Cash and cash equivalents totaled EUR 3.4 million.

**1.2 Forecast**

Artnet grew by 34.7% in euros in the first nine months of 2007. The gross margin is very high at approx. 81%, because the services are provided online. Artnet's product development costs increased at a substantially higher rate than its revenues in 2007 at 59%. These costs include expenses for new products, for example, the online auctions that do not yet make a substantial contribution to revenues. We have adjusted the costs of remuneration from stock options, already included indirectly via the dilution of the number of shares and because this is non-cash. In addition, we have adjusted the capitalization of deferred taxes, since this is non-cash and is not incurred in the relevant period.

The translation of the services settled in US dollars (approx. 81%) to the reporting currency (euros) resulted in a reduction in revenue growth in euros due to the slump in the dollar/euro exchange rate. As a result, we have calculated sales growth in the 4<sup>th</sup> quarter of 2007 to be 20% lower than in the last three years. We forecast that sales in the next two years will be 25% and 20%, respectively. Those rates are lower compared to the last three years.

In addition, we have added a line for the anticipated commission from the Artnet online auctions. This commission comprises of the following parameters: number of weekly auction lots, their acceptance rate, and the hammer price in euros. Commission totals 10% of the hammer price. We have estimated the number of lots at 15 per week with 44 weeks in 2008, the acceptance rate of 70%, with an average price of EUR 7,000. In 2009 (2010), 40 (80) lots are forecast per week, with an acceptance rate of 75% (80%) with unchanged average prices for the lots. The directly allocable marketing costs are estimated at EUR 0.4 million in 2008 and EUR 0.25 million in subsequent years.

▶▶ *Solid, conservative accounts*

▶▶ *Strong gross margin and substantial start-up costs for new offerings*

▶▶ *High currency translation effects*

▶▶ *Forecast with transparent disclosure of the estimated commission from online auctions*

Artnet AG, Berlin

▶▶ Scalable business model means increases in EBT margins can be anticipated

The increase in costs is expected to exceed revenue growth in 2008, however, it is projected to increase at a slower rate than sales starting in 2009. Our forecast is that the cost of sales will continue to grow below average rate. We are projecting an annual increase in administrative expenses of 25%/20%/15% from 2008 to 2010, due to the increase in staffing levels which will be completed in 2008. We are forecasting sales and marketing costs to increase at a rate of 27%/25%/20% in this period, in line with the increase in revenues.

There were strong increases in product development costs in previous years as a result of the expansion of the range of services. We have determined that these costs will increase at a rate of 40%/30%/20%, since the basic structure of the online auctions project will be completed in 2008, and the Website relaunch will have progressed. Correspondingly, the EBIT margin will fall in 2008, as in 2007, then rise again significantly starting in 2009.

Based on an estimated, fully diluted number of shares, this forecast results in 2007 EPS of EUR 0.37 and EUR 0.45 in 2008. The online auctions are projected to break even starting in 2009 to make an increasing contribution to earnings. This dynamic growth is conditional, based on strict cost management coupled with limited staff increases. The downturn in the dollar/euro exchange rate necessitates a review of the price policy for the services invoiced in US dollars.

Table 1

| Artnet AG Forecast (consolidated income statement) |             |             |             |             |             |             |             |             |             |
|--|-------------|-------------|-------------|-------------|-------------|-------------|-------------|-------------|-------------|
| Amounts in EUR thousand                            | 2006        |             | 2007        |             | 2008        |             | 2009        |             | 2010        |
|  | Current     | Change in % | Forecast    | Change in % | Forecast    | Change in % | Forecast    | Change in % | Forecast    |
| Revenues (excl. auctions)                          | 8,416       | +30.6%      | 10,991      | +25.0%      | 13,739      | +25.0%      | 17,174      | +20.0%      | 20,609      |
| Online auction commission                          |             |             |             |             | 323         | +224.7%     | 1,050       | +113.3%     | 2,240       |
| Total sales  |             |             |             |             | 14,063      | +29.6%      | 18,224      | +25.4%      | 22,849      |
| Cost of sales                                      | 1,719       | +23.0%      | 2,114       | +17.0%      | 2,474       | +17.0%      | 2,894       | +15.0%      | 3,329       |
| Gross profit on sales                              | 6,697       | +32.6%      | 8,877       | +30.5%      | 11,589      | +32.3%      | 15,330      | +27.3%      | 19,520      |
| Sales/marketing                                    | 1,296       | +32.0%      | 1,711       | +27.0%      | 2,173       | +25.0%      | 2,716       | +20.0%      | 3,259       |
| General administrative costs                       | 2,960       | +39.0%      | 4,114       | +25.0%      | 5,143       | +20.0%      | 6,172       | +15.0%      | 7,097       |
| Product development                                | 565         | +65.0%      | 932         | +40.0%      | 1,305       | +30.0%      | 1,697       | +20.0%      | 2,036       |
| Marketing costs online auctions                    |             |             |             |             | 400         | -37.5%      | 250         | 0.0%        | 250         |
| Total costs  | 4,821       | +40.2%      | 6,757       | +33.5%      | 9,021       | +20.1%      | 10,834      | +16.7%      | 12,642      |
| Operating result                                   | 1,876       | +13.0%      | 2,120       | +21.2%      | 2,568       | +75.1%      | 4,495       | +53.0%      | 6,878       |
| Net interest                                       | 37          | +170.3%     | 100         | +20.0%      | 120         | +33.3%      | 160         | +25.0%      | 200         |
| Other income                                       | 14          | +80.0%      | 25          | +15.0%      | 29          | +15.0%      | 33          | +15.0%      | 38          |
| EBT  | 1,927       | +16.5%      | 2,245       | +21.0%      | 2,717       | +72.6%      | 4,689       | +51.8%      | 7,116       |
| Taxes (without deferred taxes)                     | 107         |             | 100         |             | 100         |             | 150         |             | 200         |
| Consolidated earnings                              | 1,820       | +17.8%      | 2,145       | +22.0%      | 2,617       | +73.4%      | 4,539       | +52.4%      | 6,916       |
| Number of shares (fully diluted)                   | 5,703       |             | 5,750       |             | 5,800       |             | 5,850       |             | 5,900       |
| EPS  | <b>0.32</b> | +16.9%      | <b>0.37</b> | +21.0%      | <b>0.45</b> | +72.0%      | <b>0.78</b> | +51.1%      | <b>1.17</b> |

Artnet AG, Berlin

▶▶ No recognizable direct dependency on the changes in the price of art

▶▶ Share target with moderate valuation leaves room for the imagination

We project that dividends will be disbursed starting in 2009. Artnet was able to pay dividends in fiscal year 2007, however it does not propose a dividend payment in 2008. An initial dividend in 2009 for fiscal year 2008 could total EUR 0.15 per share, paid from the free cash flow.

**1.3 Risks from revenue growth**

The art market and price developments in individual segments of the art market are subject to strong cyclical fluctuations. However, the market segments exhibit very different, sometimes opposing growth. In contrast to the major auctioneers, Artnet is not directly affected by fluctuations in prices for top artwork in the art marketplace. Since Artnet operates in a high-growth segment of the art market, a general market slump would probably slow Artnet's growth, but the impact of the network on demand for Artnet's services could grow stronger. Galleries are continually looking for cost-effective marketing instruments such as the gallery network, while reducing their presence at trade fairs. Demand for Internet art auctions is growing; more offerings are expected; and both the cost and first mover advantages are becoming more appealing.

**1.4 Valuation**

A fair P/E ratio for Artnet is determined by the longer-term revenue growth rates at approximately 25%, the expected success of the online auctions, the growth in employee revenues and the amount of a future dividend or the distribution ratio. In consideration, a P/E ratio of 25 with EPS of EUR 0.45 for the current fiscal year is realistic. This gives a fair value of EUR 11.25.

In 2008, only minor revenues are included from the online auctions, but high costs of over EUR 1.0 million are included. Our analysts project a break-even point being reached in 2009. If, despite our expectations, the online auctions are not a success, this would result in great savings, but also less latitude for growth.

We prepared a discounted cash flow (DCF) valuation using the following parameters (Table 2):

**Table 2**

| Artnet AG valuation using DCF model |              |       |       |         |
|-------------------------------------|--------------|-------|-------|---------|
| Amounts in EUR thousand             | 2008         | 2009  | 2010  | 2011ff. |
| Consolidated net income             | 2,617        | 4,539 | 6,916 | 6,916   |
| Free Cash Flow (FCF)                | 2,617        | 4,539 | 6,916 | 6,916   |
| Terminal value                      |              |       |       | 101,709 |
| Discount factor                     | 1,083        | 1,173 | 1,270 | 1,376   |
| Present values                      | 2,416        | 3,870 | 5,445 | 73,934  |
| Total present values                | 85,665       |       |       |         |
| Number of shares                    | 5,950        |       |       |         |
| <b>DCF / share</b>                  | <b>14.40</b> |       |       |         |

- The free cash flow corresponds to the consolidated net income
- Current bond yield 3.8%
- Market risk premium 4.5%
- Beta for second-tier companies with global operations, market leadership, positive net financial balance and high free cash flow 1.0
- Terminal value growth deduction 1.5%

Based on the results of our forecast through 2010, this gives a fair value of EUR 14.40 per share (fully diluted). In the DCF model, the anticipated growth of profits in 2009 and 2010 has an increased impact compared to a P/E valuation based on the current fiscal year.

Artnet AG, Berlin

In consideration of uncertain success of the online auctions included in our forecast with revenues of EUR 1.05 million in 2009 and EUR 2.24 million in 2010, we conservatively opt for a valuation based on the anticipated profits for 2008 with a P/E ratio in line with the market.

We did not conduct a peer group valuation, since we have determined that only Artprice.com S.A. is a comparable company. This company has a much higher valuation and we think that its market capitalization is excessive. The business model at Sotheby's (auctioneer) is fundamentally different and is not comparable with Artnet.

1.5 Sensitivity analysis

Table 3

| Artnet AG Sensitivity analysis DCF model |       |       |       |  |
|--|-------|-------|-------|--|
| in EUR per share                         | Beta  |       |       |  |
|  | 0.8   | 1.0   | 1.5   |  |
| Growth discount                          |       |       |       |  |
| 1.0%                                     | 15.66 | 13.55 | 10.03 |  |
| 1.5%                                     | 16.82 | 14.40 | 10.48 |  |
| 2.0%                                     | 18.19 | 15.38 | 10.98 |  |

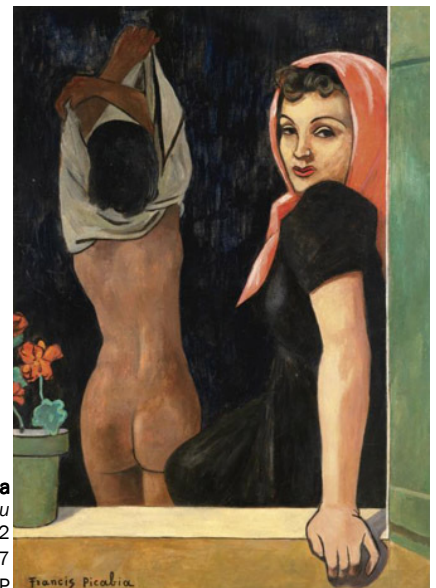
We have conducted a sensitivity analysis which varies the beta in the DCF model at 0.8 and 1.5. We have varied the growth discount for the terminal value at 1.0% and 2.0%. The results of the DCF model have a bandwidth of EUR 10.03 to EUR 18.19.

2. History

▶▶ Artnet has developed the market for art market information

Artnet was formed by Hans Neuendorf and five other business partners in the USA in 1989. The first product was a price database including digital illustrations, which provided auction price information on works of art. This provided collectors and dealers with a rapid overview of price developments on the art market, and allowed them to call up information and images using a modem and software.

Artnet was renamed to become Artnet Worldwide Corp. (Artnet Corp.), New York in 1995. Hans Neuendorf, who previously worked as an art dealer, joined the Managing Board. The Artnet price database, which had until then been a proprietary product, was migrated to the Internet. Artnet launched the English language Artnet Magazine on its Web site, and expanded the range of Internet services it offered by adding the Artnet Galleries network.



**Francis Picabia**  
*Femme à la fenêtre et nu*  
 1941-42

Sotheby's Auction: 6 February 2007  
 Price: 356,000 GBP

Artnet AG, Berlin

Artnet Corp. was added to Artnet.com AG, Berlin in 1998 as a wholly owned subsidiary.

In 1999, Artnet went public on Frankfurt Stock Exchange's Neuer Markt. Artnet launched Internet art auctions for the first time. However, the market was not ready for this concept at that time. It was not possible to implement it on the market and it was discontinued.

The company was renamed to become Artnet AG in 2002. Artnet left the Neuer Markt on October 4, 2002 and since then it has been listed on Frankfurt Stock Exchange's regulated market.

Artnet has been listed in the Frankfurt Stock Exchange's Prime Standard since February 1, 2007.

**3. Corporate structure**

Artnet has global operations as an Internet service provider. The parent company is Artnet AG, Berlin, its sole subsidiary is Artnet Corp., New York. The latter company is responsible for the entire operating business. A subsidiary is being planned in France to establish the French issue of the Artnet Magazine and the French Web site artnet.fr.

**4. Company strategy and market**

▶▶ Artnet's services create a transparent art market

Artnet is the most important information platform on the global art market. Artnet has developed services for the individual groups of participants on this market, allowing them to find transparent online information on prices and art offerings. Artnet's strategy was initially to establish these services as the market standard for professional participants on the art market. In so doing, Artnet has already gained a major lead on the competition, and it aims to increase this lead with new offers and by expanding its existing services. During the second phase of the company's strategy, Artnet aims to develop an additional target group comprising all art fans. Artnet's services were initially exclusively for professional market participants, and now its group of customers is growing to span all art fans.

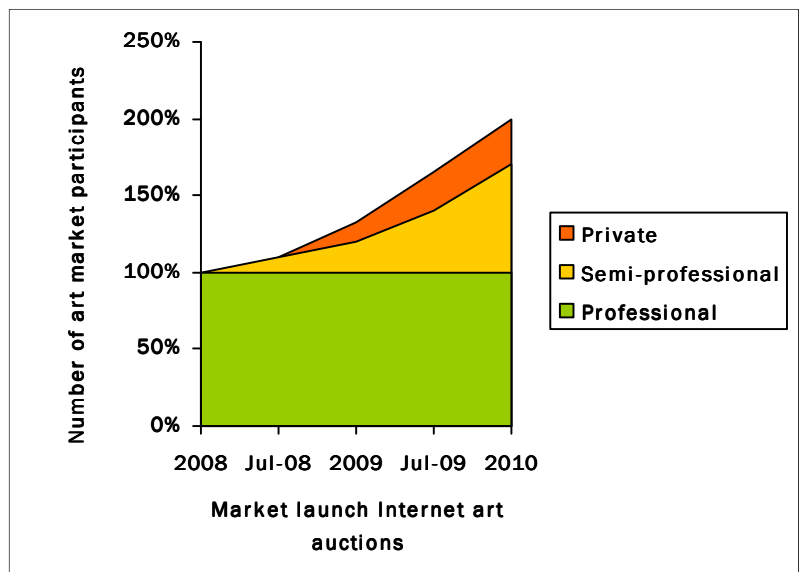


Figure 1: Art market participants

## Artnet AG, Berlin

This is boosted by new offerings and, in the near future, Internet-based art auctions. These will increasingly allow the creation of a mass market – dominated by Artnet. In addition to the need for information on prices and offerings, Artnet's online auctions meet the need for transparent, low-cost transactions on the art market.

#### 4.1 Art market and art market information

Artnet offers Internet-based services for the global art market. Participants on this art market include galleries and artists, collectors, art fans and all of the other professional market participants acting as intermediaries or involved in acquiring, selling, valuing and describing art. Auctions for high-priced works of art at well-known auction houses such as Christie's and Sotheby's enjoy global interest. Art fairs are another reference point – the key art fairs are Art Basel and Art Basel Miami Beach, TEFAF in Maastricht and Frieze Art Fair in London.

As a result of globalization, art market participants gather information from all corners of the world on the artists, artworks and price trends that are relevant to their interests. This information can be found in newspapers, magazines, by visiting exhibitions and galleries and on the Internet. The Internet is clearly the fastest, most cost-effective method, and is also available world-wide. Now that it is possible to present high quality images on the Internet quickly, pictures of artworks can be provided online.

▶▶ *Artnet is the clear market leader*

Artnet is by far the world's most important provider of information on art. Artnet recorded revenues of EUR 2.9 million in the third quarter of 2007 – more than twice the amount recorded by its competitor Artprice at EUR 1.3 million. In addition, auctioneers generate billion-dollar revenues from auctioning works of art. This generates the information on market prices that Artnet uses. EBay is an additional key marketplace for low-price Internet art auctions. Estimates point towards global art sales totaling double-digit billions including galleries' revenues. Decisions to buy and sell are based on information on comparable works of art by an artist as can be taken from the results of auctions and dealers' prices. At the same time, these also form the foundations for Artnet's business.

Art market participants primarily receive information on market prices from auction results. The transaction prices, and thus the market value of a work of art and an artist are identified and published in competition with all interested parties. In contrast, galleries' offerings are much less transparent and are not generally available. Artnet offers price information in its price database. In turn, Sotheby's uses the price database in its information on its auction lots in New York and London. It is the only auctioneer allowed to use the database until the end of 2008. The auction lot is linked to the sale history from the price database under the Artnet brand. This closes the loop for the creation and preparation of price information.

Artnet's strategy is to provide its price database as a standard source of information for all participants on the art market.

#### 4.2 Galleries and Artnet galleries

Galleries that represent artists generally have a large offering from the artist's ongoing production, or they buy works of art on the art market, mostly in auctions.

▶▶ *Artnet Galleries provides galleries a global presence*

## Artnet AG, Berlin

- ▶▶ *Network ensures strong growth in members from galleries*

- ▶▶ *New offering of artists' catalogs of artworks*

Their audience is often highly selective and sensitive regarding prices, comprising collectors and art fans. Galleries are faced with the bottleneck of selling artworks, acquiring new customers and increasing customer loyalty. Artnet offers galleries the opportunity to present their profile world wide with selected works of arts via the Artnet Galleries. This gives the gallery and its offering global visibility and allow it to be reached. The costs for one year of membership are far less than the time-consuming participation at a trade fair.

Art market participants can see the galleries' offerings, including pictures, when looking for a specific artist on Artnet's Web site. At the same time, this also provides an overview of the current global offering for a specific artist in all of the Artnet Galleries. This is far larger than the offering that can be found at the world's leading art fairs. In addition to directly initiating sales – which is possible by e-mail using the Galleries function, and visiting the galleries' showrooms or trade fair stands, participating in Galleries also has a positive effect on the gallery's image. The gallery participates in a global comparison of offerings, which means that the artworks on offer have to be correspondingly attractive.

As more galleries become members, the number of artworks on offer for visitors to the Artnet Web site increases. The network impacts both sides – additional galleries augment the offering, and thus also the customer benefits. The higher the customer benefits, the more interested parties there are on Artnet's Web site, and the higher the demand for the galleries' offerings.

Artnet's strategic goal is to include all of the relevant galleries in its network. In turn, the galleries regard their presence in the network as one of their most important marketing tools.

#### **4.3 Art market participants and Artnet Magazine**

Artnet Magazine includes daily updates on the happenings on the global art market, and ensures an ongoing stream of visits to Artnet's Web site.

This magazine is unique in terms of the scope and quality of the articles. In addition to the English language magazine on artnet.com, there is also a German magazine at artnet.de. The magazine is almost mandatory reading for professional participants on the art market. In addition to the marketing aspect, it ensures a high level of attention in the media and indirectly generates a key proportion of Artnet's online advertising revenues.

Artnet Magazine's strategic objective is to become the preferred, frequently accessed source of information for all participants on the art market, providing end-to-end information. This has the indirect advantages of increasing advertising income and the intended use of Artnet's services as part of the visit to the Artnet Web site.

#### **4.4 Artists and Artnet Monographs**

Artnet Monographs is an illustrated catalog of artists' works. This allows Artnet to develop the artists or their foundations as an independent customer group, in addition to its services such as its price database and gallery network. This service makes it possible to research an artist together with all of his works, as the works can be viewed online – thus boosting the artist's presence on the market.

## Artnet AG, Berlin

- ▶▶ *A transaction platform is to be created in addition to the information platform*

This gives artists a direct marketing tool, irrespective of working with art dealers. In turn, art fans gain an end-to-end overview of the artist's works.

The strategic objective is to use the Monographs to map large swathes of the entire art market, making research possible.

#### 4.5 Internet art auctions and Artnet online auctions

Internet art auctions are the missing link in the range of Internet services Artnet offers for the art market. The price information in the price database will be linked to these online auctions, thus providing interested parties with an overview of the market for each auction lot. Artnet already has the requisite customer base such as galleries and collectors to receive auction offers. The wide audience of people interested in the art market that use the Artnet Web site to find information will ensure that there is sufficient bidder-side demand.

These online auctions will supplement the offerings from the Artnet Galleries.

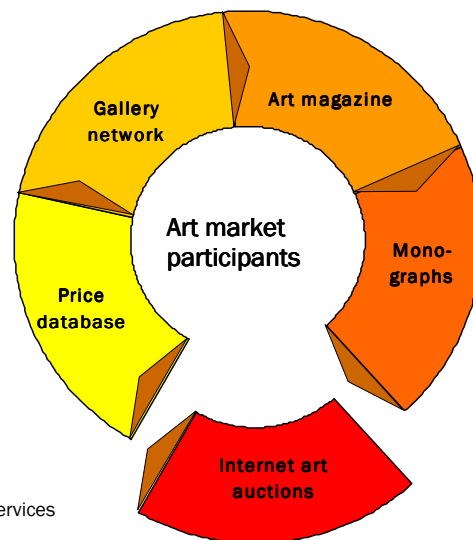


Figure 2: Artnet's services

Online auctions offer the advantage of substantially lower transaction cost, rapid auction processing with only a brief run-up period, transparency during the course of the auction and additional information on the artist and artwork. This is thus an innovative offering, which is not directly comparable with Internet art auctions from smaller auctioneers and on eBay's platform.

The potential sales from Internet art auctions can hardly be quantified due to the lack of past experience prior to the start-up phase. However, the relevant market is huge. Artnet - the leading source of information for the world's art dealers - has corresponding experience and awareness levels, giving it clear competitive advantages compared to all of the other providers. Its job is now to exploit these advantages.

The strategic goal is to establish online auctions as a cost-effective, high-performance transaction medium for the art market. In addition, Artnet aims to generate synergies with its other services.

Artnet AG, Berlin

## 5. Artnet's services in detail

Artnet's income statement spans four revenue segments. Based on revenues in the third quarter, Artnet records approx. 42% in the gallery network segment and 39% with its price database. In 2007, the strongest growing segment was Internet advertising, which accounted for approx. 16% of revenues. The newly developed services such as Market Alerts, Market Trends and Estimate Reports are carried as other revenues, accounting for approx. 3%.

### 5.1 Price Database

The Artnet price database is a fully searchable, illustrated art archive including price information, which can be accessed online. It includes the results of more than 3.5 million auctions (auction information) since 1985 from more than 500 international auction houses.

Artnet has been negotiating with galleries regarding the inclusion of their selling prices and record sales in galleries and the art trade since 2007. Artnet believes that its art archive is by far the most complete archive in the world. It is also the only fully illustrated Internet price database.

Participants on the art market use the price database to determine a work of art's approximate market value, in particular if they are planning to buy or sell a work of art. It allows independent, discrete research, participants can track developments on the market, compare prices of various groups of artworks in an artist's oeuvre, and to find unknown or rare works of art by artists. The price database thus creates transparent prices.

In the past, the areas of modern and contemporary design have been added to the auction results in the price database, and according to Artnet's information it also contains the most illustrated data of all Internet providers in this segment.

The price database can be augmented by adding all types of assets that can be sold, as the memory capacity is 100% scalable.

Taking Sotheby's as an example, further possible market segments could be: antique art, fashion, furniture, jewelry, musical instruments, silver, coins, clocks and watches, wine and historical cars.

The price database currently exclusively includes auction results. Auction results are defined as being the sales by an auctioneer on the day of the auction, plus the items called up in the auction but not sold, which are then sold privately in the following two to three days. These items are included in the auction results lists published by the auctioneer and are recorded in the price database. Prices for items that the auctioneers sell privately on the market on a later date are not officially announced and are not included in the price database.

Users can research Artnet's price database by subscription only. Prices are based on the maximum number of enquiries desired per month and are between USD 30 per month and USD 2,000 per year. The cost of a few enquiries in the price database to identify the estimated price of a work of art are marginal compared to the estimated values of the corresponding works of art.

▶▶ *Price information is a must-have on the art market*

▶▶ *Additional areas for collectors in the price database could follow after designer objects have been included*

## Artnet AG, Berlin

This thus makes it possible to effectively and cost effectively restrict the bandwidth for a price estimate for a work of art.

Artnet has agreed a marketing alliance with Sotheby's. This alliance is exclusive and runs until the end of 2008. In the past, Sotheby's objected to the use of its auction results in the price database. However, Sotheby's started to rethink its position when it recognized that it could also use Artnet's presence as an advertising and information platform for its own purposes. A strategic alliance resulted. Today, Sotheby's advertises its alliance with Artnet in newspapers, and includes links to the price database and Artnet's Web site from its own Web site. Once they have registered, Sotheby's customers can thus gain information on all relevant works of art and prices from Artnet for the artist they are interested in. They often provide their contact details. This gives Artnet access to information on the major auction companies' customers. The alliance is free of charge. Once the exclusive alliance expires, Artnet plans to enter into comparable alliances with other auctioneers. It has already received enquiries.

- ▶▶ *Artnet is the market and quality leader for price information*

The price database segment has a fixed cost block which currently comprises 27 employees who input the auction results, and its variable costs are low. Professional market participants are expected to continue to prefer to use Artnet's price database rather than competitors' offerings, as Artnet's price data is more complete and completely illustrated. Despite weak speeds, the Web site is more graphically appealing, professionally designed and easier to navigate than other offerings. As a result, we believe that growth in subscriber numbers will continue to be high as a result of the increasing number of participants on the art market with higher information requirements and at least a stable price level. At the end of 2007 Artnet had around 11,500 subscribers world wide. We believe that professional participants on the art market account for a large proportion of this figure, which means that Artnet primarily operates in the business-to-business (BtoB) segment.

The proportion of private customers, i.e., the business-to-consumer (BtoC) segment, will increase hand-in-hand with the increase in subscriber figures. On the whole, it should be possible to further increase the margin from this segment.

## 5.2 Galleries

- ▶▶ *Artnet Galleries are an effective marketing tool for galleries around the globe*

Artnet Galleries is a unique, almost monopolistic offering. Art galleries can present themselves on Artnet's Web site in a structured presentation of galleries together with the works of art they currently have on offer, and it allows users to research the works the galleries have included. Users can research using artist or gallery names. The search results for an artist include Artnet's entire range of services, from auction information through to the list of galleries that offer the artist's works, and the works by this artist that they currently have on offer in the Galleries section. Galleries can be contacted directly by e-mail. Galleries represent approx. 1,950 galleries in 250 cities with more than 100,000 works of art by all well-known international artists. The galleries can use their presence on Artnet's Web site to expand their customer base, thus increasing sales and liquidity. Access and e-mails are free of charge for visitors to the Artnet Web site. The network of galleries has enjoyed constant strong growth since it was formed.

## Artnet AG, Berlin

- ▶▶ *Only approx. 10% of gallery market potential developed*

It had a total of 1,165 members at the end of 2005, 1,476 at the end of 2006 and 1,947 galleries at the end of 2007. Membership prices vary, averaging at EUR 210 per month in 2007.

Artnet has segmented its gallery network into fine arts, decorative arts and antiques as well as 20<sup>th</sup> and 21<sup>st</sup> century design. Architecture and real estate was added recently. Artnet plans to expand the gallery network to span other collectibles over the long term (see also Item 5.1), however this has not been taken into account in this study.

Artnet estimates the number of galleries worldwide at approx 20,000. As a result, only around 10% of the market has been penetrated. As there are currently not any comparable competitors for this service, and as the barriers to market entry are high as a result of the network effect, we believe that it is highly probable that the number of members will grow dynamically over the long term. Artnet operates exclusively in the BtoB sector in this segment, thus securing a professional gallery offering.

The primary cost comprises the 22 employees who work directly for Galleries. In addition, the sales employees are primarily responsible for galleries - four permanent employees and twelve sales consultants. The number of employees and the corresponding costs are expected to increase at a slightly lower rate than the number of member galleries. We believe that the average income per gallery will increase slightly over the longer term. Correspondingly, it should be possible to further increase the margin from this segment.

### 5.3 Magazine

Artnet Magazine is an art magazine, updated daily and provided free of charge. It is published at artnet.com and artnet.de, and edited in New York and Berlin. The English language version includes reports that also cover the UK market.

Artnet maintains that it is the only source of news on the art market with daily updates, and that its magazine is the leading art magazine on the Internet. The authors analyze trends, report on trade fairs and exhibitions, and present the art market from an insider's perspective. The Artnet Magazine has become a key source of information for participants on the art market, and thus makes a major contribution to increasing customer loyalty and increasing the value of Artnet's fee-bearing offerings.

### 5.4 Internet advertising

- ▶▶ *Artnet offers an attractive advertising platform thanks to the Web site audience with money to spend*

Advertising revenues generated from the artnet.com and artnet.de are currently the strongest growing source of revenue. At present, according to its own information, Artnet's sites are called up approx. 17 million times per month, and thus have a great reach compared with other art portals. However, Artnet is keen to ensure that its Web sites are not overloaded with advertising. We believe that the trend to Internet advertising will continue, that prices will tend to rise and that the number of page hits will increase dynamically. As a result, Artnet's advertising revenues should continue to enjoy dynamic growth.

Artnet AG, Berlin

▶▶ *Dynamic increase in catalogs of works expected*

▶▶ *Up-to-date market overview secured thanks to Market Alerts*

### 5.5 Artnet Art Basel (virtual art fair)

Artnet Art Basel is a virtual art fair and an exclusive alliance with the Art Basel fair. An interactive fair plan can be found on Artnet's Web site from the last day of the Art Basel fair, with pictures of the gallery stands and the exhibited works. Visitors and collectors can find information here on the galleries participating in the fair, together with their exhibited works, and refresh and intensify their impressions of the fair. This thus provides a virtual two-month extension to Art Basel, accessible world wide. Access to Artnet Art Basel is free of charge. Art Basel pays Artnet for this service. The cooperation has also been expanded to cover Art Basel Miami Beach, which takes place six months after Art Basel.

More than 50% of the exhibitors at both fairs are members of Artnet's gallery network. The advantages for Artnet are the direct remuneration and also the marketing impact from the visitors' perception as well as a positive effect on Artnet's image.

### 5.6 Monographs (catalogs of works)

Artnet's "artist works catalogs" or "Monographs" are illustrated lists of works by key modern and contemporary artists, together with their biographies. Artnet currently has 60 monographs in its database. The contents are provided by the artists themselves or by galleries and foundations. Artists present themselves in their monographs - serving as advertising and an ongoing Internet presence. The artist is generally charged a set-up fee and ongoing fees of around USD 50 per month for their presence on Artnet. The offering was launched in 2007 and is to undergo continued strong expansion in order to provide participants on the art market with a reliable source for their research. Art Monographs offers artists an ideal opportunity to increase their market presence. The information included in the monographs can be accessed free of charge.

Revenues are currently still low, however they are set to grow dynamically over the long term as a result of the increasing number of artists. As is the case in its Galleries segment, Artnet operates exclusively in the BtoB sector with its Monographs. The costs are still comparatively high compared to the number of lists of work with a current total of three employees, however growth will be similar to Galleries over the longer term, allowing excellent margins.

### 5.7 Market alerts (news service)

Artnet Market Alerts is a news service. It provides automatic e-mail alerts as soon as a work by a specific artist or field of collection is offered in Artnet's galleries or by auctioneers. Users of the alert service thus receive ongoing information on current happenings on the market, and can move faster than non-users. The alert service is available to subscribers at a fee. Of the current total of 4,500 users, 1,000 users have already become regular subscribers. The other users have trial subscriptions for six months. These subscribers are approached and acquired via the newsletter mailing list.

As a result of the high benefits of up-to-date information for those interested in making sales and purchases lead us to forecast long-term dynamic growth rates. In line with the price database, the offering is increasingly being geared to private customers, and thus in the BtoC sector.

## Artnet AG, Berlin

- ▶▶ *Changes in USD/EUR exchange rate demand price adjustments*

- ▶▶ *Launch of Artnet Online Auctions fills a gap in the market*

Margins in this area are expected to be very high due to the automated workflows. Only marketing costs are directly allocable. These are used to rapidly increase the number of subscribers.

### 5.8 Invoicing currency

All of the company's products detailed above are invoiced by the subsidiary Artnet Corp., New York. 81% are invoiced in dollars, 13% are invoiced in euros, and 6% are invoiced in British pounds. In terms of their geographical location, 61% of invoice recipients were in the USA, 33% were in Europe, and 6% were in the rest of the world. Artnet invoices advertisers on its Web sites in the local currency at the advertiser's registered offices.

As a result, the downturn in the USD/EUR exchange rate has had an unfavorable impact on the revenues and results reported in euros. Artnet should adjust its USD prices and increasingly invoice services in euros in order to compensate for these currency effects.

## 6. Artnet Online Auctions project

### 6.1 Description of online auctions

Artnet Online Auctions is the Internet-based auction platform for works of art being planned by Artnet. The first trial auctions are scheduled to be launched at the end of February. Artnet already held Internet art auctions in 1999. However, the market was not ready for this business at that time, and it was not possible to implement it on the market. Other auctioneers such as Sotheby's also did not succeed in establishing Internet art auctions at that time either.

The lack of acceptance for Artnet's auctions in 1999 was due to the low availability of broadband networks at that time to be able to offer corresponding high-quality images, the fact that the Internet was still a very young medium at that time, and the substantially lower awareness of Artnet.

In contrast, Artnet now expects that participants on the art market will generally be prepared to buy art on the basis of digital images now that broadband networks have become the Internet standard. The fields of photography, printed graphics and contemporary art would appear particularly suitable for online auctions.

Artnet is forecasting an average estimated price for the works of art to be auctioned at around USD 10,000. Large auctioneers tend not to be as active in this price segment as a result of the high fixed advance costs per item for the supplier and the auctioneer. Medium-sized and smaller auction houses are represented in this price segment, however they only generate limited demand with high return rates for unsold lots.

Online auctions also include information from Artnet's own price database together with the lots. Bidders can use this information to gain a better picture of the auction lots, and they thus also have a verifiable reference for the estimated price. Only Sotheby's provides comparable information for auction lots via its alliance with Artnet.

Artnet AG, Berlin

▶▶ *Online auction concept creates clear competitive advantages*

▶▶ *Limited cost framework for online auctions*

The potential group of customers for online auctions includes art dealers as well as private customers, a group of buyers that sometimes feels uncomfortable in auction houses, prefers to buy lots from a distance, has preference for the comfort and efficiency of the Internet or is price-conscious when acquiring art. Artnet also expects to develop new groups of buyers among participants on the art market with its online auctions. As a result, this project is currently in the BtoB sector, but is increasingly migrating into the BtoC sector in terms of the bidders. This demands a differentiated marketing strategy.

One of the major advantages of Artnet's Online Auctions is their speed. They can be processed in a much shorter timeframe than comparable live auctions, which involve an expert opinion, preparation of a catalog, and the lots being exhibited for viewing prior to the auction. In the case of the online auctions, consignors upload a photo and complete a questionnaire on the work of art, at which point the bidding process can start. Approx. four to six weeks should be scheduled in until the proceeds from the sale are transferred, instead of four to six months for live auctions.

The lower transaction costs are another competitive advantage. The standard commission for buyers and sellers is between approx. 23% through to more than 40% of the auction result. Artnet is planning to charge commission of 10% of the auction result. According to Artnet's plans, the commission will be deducted from the hammer price and thus charged to the seller. As a result, the bidder does not have to pay any premium for the auctioneer on top of the auction price.

The largest objection to Internet art auctions is that it is not possible to view and assess the work of art in advance. Artnet counters this with a cancellation guarantee.

The buyer can return the item to the seller within five working days. As a result, the buyer is not at any risk. However, in the event of a return, the buyer must bear the transport and insurance costs for the acquired item.

The budgeted costs for the online auctions total EUR 1.4 million in 2008, of which EUR 0.4 million are for marketing and EUR 1.0 million are for personnel expenses and material costs. Planned marketing activities include advertising campaigns, for example in the New York Times, letters to galleries, mail shots to Artnet's customers from its stock of addresses and advertising banners on Web sites.

Artnet currently has a total of 227,715 registered customers in its database. The stock of customer addresses is broken down as follows:

**Table 4**

| <b>Artnet Customer Contacts</b>     |                |
|-------------------------------------|----------------|
| Promotion contacts                  | 92.180         |
| Artnet newsletter distribution list | 88.999         |
| Price database subscribers          | 10.783         |
| Galleries                           | 23.772         |
| Marketing contacts from Sotheby's   | 11.981         |
|                                     | <u>227.715</u> |

Artnet AG, Berlin

▶▶ Auction lots are described in detail

▶▶ Low transaction costs boost offers and demand for auction lots

The ratio of the registered customer contacts to the number of customers that use the paid services already shows major potential for the sale of existing offerings as well as for the planned online auctions.

The marketing campaigns are expected to continue in the years from 2009 – however without the costly introductory advertising. The auctions are scheduled to start at the end of February with around 100 auction lots.

**6.2 Workflow for online auctions**

All of the auctions are supported from a dedicated department in New York, which also executes and settles the auctions in US dollars. Artnet does not subject the items being auctioned to a visual check. It is much rather the case that Artnet relies on the offering dealers – who are known to the company as being reliable and whom Artnet can check up on. The seller enters the measurements, description, a description in their own words of the merits of the item and a report on its condition online in an input form. The report on the item's condition is highly detailed and covers a large number of questions.

The offer is supplemented by supporting information, such as extracts from the price database, price indices, comparable items and the development of their prices in the past few years or a link to the list of works, so that interested parties receive the most comprehensive overview possible. The seller enters the offer on the Web site. The auctions are scheduled to run for seven days. The starting price of the auction can be between the lower and upper estimate, however it will normally be lower than the lower estimate in order to provide potential bidders with an incentive to place bids.

Once potential purchasers have registered, Artnet checks their creditworthiness. Bidders then receive a bidder number. The auction ends when the time expires. In order to prevent competition for the item being auctioned just before the end of the auction, all of the bidders have the opportunity to increase their bids one more time in a five minute period after the auction has ended. If bidders increase their bids, the extension period extends by a further five-minute period. If several bidders are active, the auction ends when five minutes have passed since the last highest bid and the auction has been won.

**Table 5**

| Artnet online auctions - sample calculation |          |
|---|----------|
|   | Beispiel |
| Hammer price                                | 100      |
| Less Artnet's commission 10%                | 10       |
| Proceeds for consignor                      | 90       |
| <br>  |          |
| Bidder's purchase price                     | 100      |
| Plus escrow 1%                              | 1        |
| Plus insurance approx. 1%                   | 1        |
| Plus transport approx. 0.5%                 | 0        |
| Total expense for bidder                    | 102      |

The buyer then arranges for the total amount to be transferred (hammer price plus transaction costs) to an external trustee's escrow account. The trustee charges 1% of the hammer price as the processing fee. The item is shipped once the trustee has received the full amount.

## Artnet AG, Berlin

- ▶▶ *Buyers have the right to return the artwork*

The bidder has the opportunity to review the item for five working days after its receipt. If the bidder is not pleased with the work of art, or if it does not have the assured characteristics, the artwork can be returned without comment and the purchaser only has to bear the transport, insurance and escrow costs. The second highest bidder then wins the auction. If the buyer is satisfied with the item, they send an e-mail to the seller and the trustee, and the purchase price is credited to the seller.

### 6.3 Anticipated results of online auctions

Artnet is, at least in part, developing a new market with its online auctions, and it is thus not exclusively contesting a share of a market that has already been segmented. Artnet is expecting a wide range of art to be offered by art dealers, and a large number of participants on the art market as bidders. The comparatively low transaction costs will make it easier to enter the market and bidders become less inhibited about using a new offer. The professional presence on the market and the trust in Artnet's reliability and seriousness generated as a result of use of its existing services, as well as its market relevance create a suitable environment for launching this type of innovative product.

It thus appears rather improbable that the project will fail completely, even though a start-up phase certainly has to be factored in. If the project is not a success, Artnet would be able to re-deploy or reduce its staff, discontinue its marketing costs and write-off the capitalized costs. This would only depress earnings temporarily by an estimable amount.

It is much more likely that the auctions will be increasingly successful, and the contribution margin that could be recorded together with the increased volume of auctions is expected to be greater than the costs allocable to the auctions after just a few years. The larger the online auctions are, and the faster they become established on the market, the lower the marketing costs required to boosting their awareness. As a result, Artnet must try to hold successful auctions from the very outset, with a large number of attractive offerings, broad demand and hammer prices that are in line with the market. This would be the best advertising for the auction platform.

We have included scenario that we believe is cautious as a separate line of revenues and costs in the forecast. The revenues are the commission on the hammer prices, costs include the directly allocable marketing costs.

## 7. Competition

Artnet reviews its competitors with regard to their key products and offerings. These are the price database, the gallery network, Internet advertising and the planned Internet art auctions.

### 7.1 Artnet Price Database

Various competitors offer art price databases. The magazine artinfo24 ([www.artinfo24.com](http://www.artinfo24.com)) has identified 15 providers, each with a different focus. Their focus could be, for example, styles of art, artists or periods. Data are researched and provided via the Internet, as a printout, or on CD ROM. Some price databases can be used by non-subscribers.

- ▶▶ *Artnet's price database should lead to more relevant results than the other providers*

## Artnet AG, Berlin

In contrast to Artnet, many price databases do not include a fully illustrated catalog or offer only a limited number of hits. Artnet has been concentrating on providing fully illustrated auction results since 1985. Artnet is convinced that the auction results of a short to medium-term period offer users the greatest benefits in their research with regard to price developments in the area in which they collect, or on an artist's body of work.

A statement can only be made on a price database's quality and contents in a direct comparison. Artnet has checked four price databases for their number of hits for 80 artists. Artnet had more hits in 99% of cases compared to its competitor Artprice, and more hits in 100% of cases compared to two other relevant competitors. This leads us to believe that Artnet's price database is almost always more complete than its competitors' databases. As a result, it is expected that competitors' databases lag Artnet's database in terms of their information, and possibly also in terms of their technology. Despite the free access to auction results, new competitors entering the market are faced with technology and marketing barriers, with the result that it would not be cost-effective for new players to enter the market – making this seem fairly improbable.

#### 7.1.1 Artprice.com, France

Artnet's best-known competitor for price databases is artprice.com (Artprice) in Saint Romain au Mont d'Or, by Lyon, France.

This company was formed by the lawyer and artist Thierry Ehrmann. It has been listed on the Euronext stock exchange in Paris since 2000 (ISIN FR0000074783, stock exchange symbol PRC) and had a closing price of EUR 11.40 on February 8, 2008. It has 6,267,935 shares, resulting in a market capitalization of EUR 71.5 million. Its market capitalization is thus approx. 60% higher than Artnet's.

According to the information on its Web site, Artprice runs and maintains the most important illustrated database in the world with 290,000 Internet catalogs, 25 million auction results as well as prices and indices for 405,000 artists. The price database also includes a large number of historical works. If Artprice's information can be verified at all, it appears to have little relevance, as shown by Artnet's analysis. In this analysis, Artnet reviewed the quality of auction results for 80 famous artists. This review led to 128,504 hits in Artprice's database, and 215,289 in Artnet's database.

Artprice also has an art market shop system, which is discussed under the gallery network below. Artprice recorded like-for-like Internet revenues of EUR 5.2 million in 2007, and its earnings are expected to be positive.

#### 7.1.2 Askart.com, USA (Askart)

Askart (www.askart.com) is a US Internet price database, and according to its own information it has added more than 100,000 artists to its database since the mid 1980s. Its historic focus has been on Americans from the early 16<sup>th</sup> century to the present time. It has also constantly added auction results on international artists to its price database since January 2007.

## Artnet AG, Berlin

In Artnet's review of auction results for 80 well-known artists, Askart had 17,257 hits, and Artnet had 215,289. Askart's price database appears to be negligible in this comparison.

#### 7.1.3 Artvalue.com, Luxembourg (Artvalue)

Together with ADAGP, Paris, France, a French administrative organization for copyrights, Artvalue (www.artvalue.com) offers free access to 160,000 artists and 1.5 million auction results. The price database includes global auction results starting in 1987, in particular Le Guide Mayer, an international art auction reference work for the fine arts. Le Guide Mayer has been recording auction results since 1962 and was published annually until the end of 2005. Artvalue bought Le Guide Mayer in 2001, and transferred this and other information to the Internet, adding additional offers for collectors and luxury goods. The site is updated daily. Artvalue plans to launch other free offers, such as an Artvalue gallery on the Internet.

The gallery will include limited editions of lithographs by Dali, Matisse, Magritte and Braque. According to its own statements, Artvalue was the first free Internet offering.

In Artnet's review of auction results for 80 well-known artists, Artvalue had 61,371 hits, and Artnet had 215,289. Artvalue's price database appears to be negligible in this comparison.

#### 7.1.4 Artifact, Newton, MA, USA. (Artifact)

Artifact (www.artifact.com) states that it is the world's largest, most complete price database with results from more than 1,000 auction houses. The price database includes 100,000 unabridged catalogs with more than 20 million price results. It bears a fee. Artnet has not yet compared its database with this competitor's.

In summary, we can ascertain that the prices for all of the providers' fee-bearing offerings do not differ greatly. Market differentiation is clearly not sought via the price.

## **7.2 Artnet Galleries**

Artnet attracts art market participants to its Web site with a multi-faceted offering. Visitors can gather information and research galleries' offerings. The high number of visitors and the quality of its offering makes Artnet Galleries an attractive proposition for galleries.

Artprice offers an art market shop system on its Web site. Anyone can rent a shop on Artprice's Web site and offer works of art for sale. The offering is highly diversified, often low priced, and not a particularly attractive environment for professional galleries to use as a sales platform. Accordingly, the platform is scarcely established among galleries outside France, and it does not appear to be developing to become a relevant competitor for Artnet Galleries. The offering is comparable to eBay. In turn, as a platform eBay is generally comparable with Online Auctions, however the quality of the offerings and the information available varies too greatly to provide a professional environment.

▶▶ *Artnet Galleries has no real competition*

## Artnet AG, Berlin

- ▶▶ *Established auction houses are no real competition for Online Auctions ...*
- ... and neither are small Internet art auctioneers*

### 7.3 Internet advertising

All Internet service providers on the art market record revenues from Internet advertising and compete indirectly with each other. Revenues are governed by the number of page hits per month and their fee paid for these. With its well focused range of services, Artnet reaches a broad, highly attractive audience. As a result it is also an interesting advertising platform for larger companies. The other providers do not have a comparable media reach.

### 7.4 Artnet Online Auctions

Competition on the market for Internet art auctions is broken down by providers of

- Live auctions such as Sotheby's and Christie's
- Internet art auctions such as eBay, Ketterer, Dorotheum and (soon to come) Artnet

Large auction houses hold auctions on specific areas of collectors' interest twice to four times per year. In addition, some providers such as Ketterer Kunst offer ongoing Internet art auctions. Live auctions have the following stages:

1. Work of art is delivered and valued
2. Categorization for shipment of printed auction catalogs and online catalogs
3. Advance viewings
4. Auction day and possibly winning bid for the work of art

If the auction lot is not sold at auction, it may be sold after the auction. If the work of art is sold in the auction, the auction house receives consignment commission from the seller and commission on the sale from the buyer. Taken together, this commission totals approx. 23% to more than 40% of the auction price. In many cases the commission can be negotiated and can be reduced by up to 50% with regard to the consignment commission. Further costs result for insurance, transport, illustrations and the transfer of resale rights. If the property is not sold, the consignor incurs costs for insurance, transportation and the illustrations in the catalogs. Around five to seven weeks after the successful auction the seller receives a listing of the hammer price and the payment. Items that are not sold in the auction are offered in a subsequent sale for approximately four weeks at their reserve price. The entire process takes several months from the initial contact until the customer receives payment.

This process is costly and time consuming. Relatively high fixed processing costs are incurred for each auction lot. As a result, cost advantages have their full impact in the around to USD 10,000 market segment Artnet is initially targeting. At the same time, as a result of its Web site's global reach and the starts from New York, Artnet is able to attract substantially more potential bidders that pay adequate auction prices and ensure high hammer ratios. A large number of auction lots are expected to be offered from the stocks of art dealers in the gallery network.

**Artnet AG, Berlin**

- ▶▶ *Low 10% commission creates strong incentive to transition to online auctions*

- ▶▶ *User benefits from synergies in services offered*

- ▶▶ *Artnet expects growth in the past few years to continue*

As a result, competition is not as important for the success of the online auctions, but rather how the online auctions are implemented in practice. Individual Internet art auction providers such as Ketterer Kunst in Germany or Dorotheum in Austria mostly use their Internet art auctions for auction lots of up to EUR 1,000, as these can scarcely be sold in live auctions at reasonable costs. However, the charges and consignment commission are substantially higher than Artnet's 10% commission. As a result, we do not believe that the existing providers of Internet art auctions are relevant competition for Artnet's Online Auctions.

Artnet or other Internet art service providers could copy Artnet's Online Auctions. However there do not appear to be any such preparations or announcements. There would be significant technical and organizational effort and expense involved. In addition, the importance of the market to gain a sufficient number of buyers and sellers is key. In this regard Artnet is by far the largest provider with a natural advantage that would be further amplified by the effect of the network in the event that the Internet auctions are successfully launched.

## **8. Competitive advantages**

Artnet's end-to-end product offering always adds value for art market participants. For example, visitors to the Internet site want to research auction results for an artist in the price database, and view price growth. Then they can look for offers for this artist in Artnet Galleries, look for monographs for the artist, read corresponding reports in the Magazine, look for current auction offers and use the Alert service to be informed of offers for this artist. Buying and selling via Artnet's Online Auctions will soon be added to the product range. This will allow interested parties to check the market context for their artist or a work of art at any time. This end-to-end range of services is Artnet's key competitive advantage (see Figure 2), and more and more art market participants are availing of these services every year.

Artnet's end-to-end offering of services and information is unique. Artnet Galleries is a monopoly-like network, which provides Artnet with a sustained competitive advantage, including for its other offers.

## **9. Growth**

### **9.1 Growth drivers**

Artnet grew 28.5% in 2005, 29.3% in 2006 and approx. 30% in 2007. It is thus a high-growth company. Artnet was profitable in 2005. Artnet has been a the resource to consult for art market participants. This can be seen, in particular, in the subscribers to the price database, the number of galleries represented in the network, and the number of Internet page views. The Internet advertising segment enjoyed the greatest growth in 2007, as the number of visitors to the Web site grew strongly and banner advertising on Artnet's site is now also of interest to larger companies. Benefits for art market participants increase hand-in-hand with the expansion of the services offered. The offering is becoming broader and deeper, and is attracting an increasing number of visitors. This results in a snowball effect, which in turn makes advertising more valuable. Artnet believes that it will be able to record similarly high growth rates in the coming years.

**Artnet AG, Berlin**

- ▶▶ *Risks in technological restructuring will be avoided*

These growth rates could increase once again if the launch of the Internet art auctions is a success. The commission income from Artnet's Online Auctions could surpass revenues from the previous divisions in a few years' time.

**9.2 Web site relaunch project**

Artnet's price database and Internet presence have grown over the years. Both are constantly adapted to the current requirements of the Internet. Artnet restructured its data storage in 2007 and transformed existing content in its data store. In addition, the Web site's starting page was re-designed and improved. The Web site's speed and reliability are to be improved in a re-launch. Artnet has elected not to fully restructure its Web site from the ground up, and has decided instead to engage in a constant improvement process, which will be continued in 2008.

**9.3 Internationality**

The most urgent project is to process the world's third largest art market – France – in greater detail with the company's own French Web site [www.artnet.fr](http://www.artnet.fr), and an Internet art magazine designed specially for the French Art market. However the bottleneck is identifying an editor-in-chief who is well versed in the French art market. It will only be possible to start developing the market once this editor has been found. This can then be implemented over the short-term from Berlin or Paris. The other international markets are being developed on an ongoing basis, in particular including expanding the network of galleries, together with freelance sales employees.

**10. Employees**

The number of employees, including the Managing Board, freelance employees and temporary employees has increased at a faster rate than sales in each of the past few years. The revenues per employee have thus fallen each fiscal year since 2005. Annual revenues per employee have fallen from EUR 112 thousand in 2005 to EUR 105 thousand in 2006 and approx. EUR 90 thousand in 2007, based on the year-end number of employees in each year. After adjustment for the 9 Online Auctions employees in 2007, revenues per employee still fall to EUR 97 thousand.

106 employees work in New York, including sales, and 16 employees work in Berlin. As a rule, the employees and Managing Board members fall into three categories: Administration, products and sales. 15 people were employed in administration at the end of 2007, with 16 in sales and 91 in products. In particular in the products area, not all of the employees contribute to revenues as their work is focused on new products. Slower employee growth is seen in 2008 and the coming years after the rapid growth in recent years, to allow the revenues per employee to lift significantly again.

**11. Managing Board**Hans Neuendorf

Hans Neuendorf is Artnet AG's CEO and CEO of Artnet Worldwide Corp.

- ▶▶ *Higher employee productivity anticipated in future*

**Artnet AG, Berlin**

- ▶▶ *Management anchored in the global art market*

He studied philosophy and art history in Munich. He has been an art dealer on the market since the 1960s, and had his own galleries in Hamburg, Cologne and Frankfurt.

He was one of the early promoters of key art movements, and represented at an early stage modern masters such as Andy Warhol and Cy Twombly, the UK artists David Hockney and Richard Hamilton, the US West Coast artists Robert Graham and Billy Al Bengston, the German artists Georg Baselitz, Bernd Koberling and Georg-Kahl Pfahler or the Italian artists Lucio Fontana and Emilio Vedova. He was one of the founders of Art Cologne, the first international art fair, in Cologne in 1967. This fair aimed to break down the geographic barriers between dealers and galleries – bringing them together and providing an overview of the offering on the art market for the first time.

Mr. Neuendorf joined Artnet's Supervisory Board in 1990. He became the controlling shareholder in 1992 and Chairman of the Supervisory Board. He then discontinued his galleries and in January 1995 he became CEO in New York and the sole member of the Managing Board of Artnet AG in 1999.

The National Arts Club in New York awarded Mr. Neuendorf the Medal of Honor for Visual Arts in December 2006. He was honored with this award in recognition of his services to the art market.

Mr. Neuendorf receives a fixed salary of EUR 250 thousand, has a company car and a variable capped annual bonus of 3.375% of the consolidated profits. The variable bonus totals at least EUR 30 thousand. A new remuneration plan was agreed for the Managing Board in the third quarter of 2007. In addition to variable remuneration, this also includes a new remuneration component based on Artnet's share price. A provision of EUR 300 thousand was formed on September 30, 2007 for commitments from this new remuneration regulation. This remuneration component will be paid starting in 2008 in three equal annual installments, with the payments in 2009 and 2010 being subject to sustained positive share price performance.

**12. Supervisory Bodies****12.1 Artnet AG's Supervisory Board**John D. Hushon, Naples/Florida, Chairman

Mr. Hushon is a business lawyer and an art collector. He has been a member of Artnet AG's Supervisory Board since it was formed in 1999. He has been closely linked with Artnet since 1991 and previously held an office on the Board of Artnet Corp. Mr. Hushon is CEO of North Oak Consultants Inc., Washington D.C.

Dr. Christian Dohm, Munich, Deputy Chairman

Dr. Dohm is an attorney focusing on business and corporate law. He has been a member of the Supervisory Board for four years and chairs the General Meetings.

Klaus-Jochen Schaeffer, Hamburg

Mr. Schaeffer is a business man and investor in Artnet AG. He has been a member of the Supervisory Board since it was formed.

Artnet AG, Berlin

Mr. Schaeffer is the managing partner of Schaeffer Immobilien GmbH, Hamburg.

## **12.2 Board Artnet Worldwide Corp., New York, USA**

### Bill Fine

Bill Fine is the President of the operating subsidiary Artnet Corp. He heads Artnet's sales organization. Mr. Fine has more than twenty years' experience in marketing high-end artwork and in the advertising industry. He was previously the Journalist Executive Vice President and Group Publisher at Brant Publications, Inc. (The Magazine Antiques, Art in America, Interview) and published the magazines Interior Design and Connoisseur.

### Brian McConville

Brian McConville is Executive Vice President of Artnet Worldwide Corp. and heads the global sales team. He joined the company in 2003. He previously spent 10 years as a trader in the treasury division with the Bank of New Zealand and National Australia Bank in New York in fixed income securities. He held executive positions in the technology sector, including Chief Financial Officer with Group Intelligence, Inc.

### Jacob Pabst

Jacob Pabst studied macroeconomics and manages the Technology and Product Development departments. He joined the company in 2002. He has been Vice President since 2005 and is responsible for development, launching new products and technical improvements to the Web site. Mr. Pabst is Mr. Neuendorf's son.

### Amy King

Amy King runs the sales and production team for the Artnet price database. She has been working for Artnet since 2004. She was previously an expert for 19<sup>th</sup> century art with Sotheby's for four years. She holds a Master of Art History (MA) and is a certified art expert.

### Walter Robinson

Walter Robinson is a journalist, art critic and Artnet Magazine's editor-in-chief. He has more than 20 years' experience in newspaper journalism. According to Artnet, he is known as one of the best art critics in the USA. He worked as a journalist and news editor for Art magazine in the USA for 18 years.

## **13. Financial reporting and investor relations**

The company's IFRS financial reporting is meaningful as a result of its listing in Deutsche Börse AG's Prime Standard. We believe that the investor relations work is excellent.

## **14. Audit**

The 2006 consolidated financial statements were audited by Ebner, Stolz, Mönning GmbH Wirtschaftsprüfungsgesellschaft und Steuerberatungsgesellschaft, Hamburg. The audit did not lead to any objections.

## Artnet AG, Berlin

- ▶▶ *Dividend payments expected to start in 2009, with increasing distribution rates thereafter*

### 15. Dividend

Artnet became able to pay a dividend for the first time in 2007. It is not yet planned to make a dividend payment. As a result of its subscription business, Artnet's cash flow is easy to forecast. Investments in property, plant and equipment are low, interest-bearing liabilities are not included in the accounts. The cash and cash equivalents disclosed as of the end of the third quarter appear sufficient to cover all recognizable risks and to finance starting up possible additional new projects. No corporate acquisitions are planned, and do not appear pertinent given Artnet's positioning. The market capitalization of the only relevant competitor, Artprice, is substantially higher than Artnet's, although Artnet records double the amount of revenues. An acquisition would thus not be financially viable, nor would it increase Artnet's value.

Artnet could demonstrate its trust in profitable future growth by commencing dividend payments, allowing the shareholders to participate in the high free cash flow, and also engaging in strict financial management. It would be recommended to start paying dividends from fiscal year 2008.

### 16. Licenses

The illustrations in the price database necessitate payments to the *Verwertungsgesellschaft BILD-KUNST r.V.*, Bonn (VG BILD-KUNST) as a result of the copyright act. VG BILD-KUNST is an association formed by copyrighted parties (artists, photographers and film-makers) to uphold their rights. It upholds all of the visual copyrights for 60 image rights companies worldwide that the individual copyrighted parties cannot uphold themselves for practical or legal reasons. Artnet has concluded a preliminary three-year agreement with VG BILD-KUNST for the period from 2007 to 2009 in order to combat the risk of expensive license claims and to cap the amount of future license claims. This agreement stipulates that Artnet would not have to make license payments according to the current regulations of the copyright act. However, Artnet pays a mid-range five-digit amount to VG BILD-KUNST as license fees.

### 17. Litigation

According to the company, it is not aware of any major litigation.

### 18. SWOT - Analysis

#### Strengths

- Market innovator and first mover
- Professional management team with industry experience
- High level of awareness among participants on the art market
- Substantial size advantage compared to competitors such as Artprice and other smaller providers of price information and gallery Web sites
- Sole provider of a fully illustrated price database from 1985
- Price database could be expanded, including the addition of new segments

## Artnet AG, Berlin

- Artnet's Web site is user-friendly, tidy and appealing to the eye, and is much better quality than all of the other providers
- Artnet clearly gears its offerings to customer requirements
- Artnet Magazine with daily updates as USP is practically mandatory reading for professional participants on the art market
- Synergies between price database, gallery network, magazine, monographs and (soon to come) Internet art auctions creates network effects with high barriers to market entry
- Globalization trend on the art market ensures increasing demand for Artnet's services
- Art market is a long-term growth market with prices tending to increase, rapidly increasing numbers of artists and museums and the entire stock of art
- Attractive advertising platform for luxury goods
- High proportion of costs incurred in USD – natural hedging
- Exclusive marketing alliance agreement with Sotheby's and Art Basel

**Weaknesses**

- High proportion of revenues in the USA (>60%) with corresponding dependency on USD/EUR exchange rate
- Many services are also invoiced in USD outside the USA (total of 81%) – revenues highly dependent on USD/EUR exchange rate
- Price information from auction houses are generally freely accessible for existing and new competitors
- Prices in the gallery network are lump sums and not measured according to the value of the individual art works that are included
- To date little experience in direct marketing of Artnet services to supplement word-of-mouth advertising, in particular for BtoC
- Price information from auction houses do not include any information on items sold outside the auctions
- Complex/heterogeneous stock of data as price database has been stocked since 1985 – making stocks of data technically uniform would be costly and time-consuming
- Results diluted by stock options program
- French market, the third largest art market in the world, has not yet been sustainably penetrated
- Several delays in launching Internet art auctions on the market and Web site relaunch

**Opportunities**

- Internet art auctions could bring Artnet into a new sphere of revenues and earnings, and open up a further growth area with high technical and organizational barriers to market entry
- Latitude for price increases in the gallery network is also possible by changing the price model
- Expansion of offering to cover other items, such as luxury real estate, historic cars, collectible clocks and watches, etc. appears realistic
- Artnet's directories of works could grow to become a key revenue segment

## Artnet AG, Berlin

- Intensifying marketing could substantially bolster the Artnet brand and further spread acceptance in the BtoC segment
- Acquisition offer or establishment of a minority interest by a strategic investor is conceivable in view of Artnet's stock market valuation, which appears favorable and low in absolute figures, as well as prestige purchase for a non-strategic investor, in particular if the Internet art auctions are successfully launched

**Risks**

- Internet art auctions may not be a success and prove to be an expensive mistake
- If Internet art auctions fail, reduction in fixed costs will be delayed
- It may not be possible to cover the ongoing costs for infrastructure and staff from commission from Internet art auctions if market acceptance is not high enough
- Auction houses could restrict cooperation with Artnet if the launch of the Internet art auctions is successful
- The market launch of the Internet art auctions could be further delayed
- In general, the management could attach too great an importance to developing the market compared to cost growth, with the effect that margins would continue to fall
- The bear market on key sections of the art market could reduce new customer growth and existing customers could exit the market as most of the customers and subscribers only have month-long contracts
- Fraud, data theft and other organizational problems could have a negative impact on the number of customers or give rise to claims for damages
- A disruption in the availability of the Web site would reduce Artnet's ongoing revenues and profits and could also impact the future revenues and profits
- As exchange rates can fluctuate, the figures may not reach the forecast after currency translation
- Dependency on a few executives, split between the two offices in New York and Berlin
- The loss of a key employee could have a negative impact on business
- A delay in acquiring key employees could have a negative impact on market entry (France), revenues and results
- Increased price competition possible for illustrated price information, for example with Artprice
- Change in price model for gallery network (price increase) could lead to key customers being lost
- It may not be possible to cover the costs of additional country-specific offerings (magazine and representation), such as for artnet.fr in France with additional revenues

**Legal note**

**This legal note is part of this financial analysis and should certainly be taken into account when making decisions based on this analysis or initiated by it.**

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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:

Marcus Sühling (business administration graduate), Analyst  
Responsible company: SIGNUM Research GmbH, Düsseldorf.

Layout: Hans-Peter Zeh, Tettngang

## 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

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**Company: Artnet AG**

**Numbers concerned: 3, 7**

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#### Responsible supervisory authority

Bundesanstalt für  
Finanzdienstleistungsaufsicht (BaFin)  
Lurgiallee 12  
60439 Frankfurt

#### Credits

SIGNUM Research GmbH  
PO Box 11 07 13  
40507 Düsseldorf

#### Email

info@SIGNUM-Research.com

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