

Financial analysis:
Follow-up study

artnet AG, Berlin

Occasion: Presentation of the quarterly report for the period ended March 31, 2008

Sector

Internet service provider

Internet

www.artnet.com

Dates

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 8.00 (Xetra; 19.05.2008 3.35 pm)
52-week high EUR 13.90
low EUR 6.91

Number of shares 5,631,067 shares (basic)
Market capitalization EUR 45.0 million

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

2006 dividend none

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Important:

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

Analysis result

BUY - Current price target EUR 12.50

In the first quarter of 2008, artnet posted growth of 29% in its three existing divisions on a US dollar basis. Translated into euros, the growth rate fell to 13%, though adjusted for currency effects it still managed to top 25%. This has prompted us to revise our 2008 forecast for revenue growth in the existing divisions measured in euros to 17%.

On the whole, the artnet online auctions got off to a promising start, with the first auctions concluding in March. Revenues were generated from the outset—EUR 17 thousand in March—and artnet expects them to remain on an upward curve. Initial adjustments to the empirical data collected have already been integrated into the auction process. We are sticking to our revenue projection of EUR 323 thousand for 2008 in spite of the exchange rate movements. While it is impossible to make a clear forecast on the basis of this data, current data has made the negative scenario of a failure much less likely. The proper launch of the full version with an advertising campaign—once the auction process in the beta version has ended—could thus give a further boost to the artnet online auctions.

Costs are continuing to develop at a high level in an attempt to intensify new product development and press ahead with the establishment of existing products on the market as well as their enhancement. This is being impeded by the subprime crisis and the struggling US economy, which are putting a certain damper on revenue growth. So far, however, these factors have not had a significant impact on the art market. We have consequently lowered our forecast for revenue growth excluding auctions from 25% to 23% for 2009 and raised it from 20% to 23% for 2010. We no longer anticipate major negative currency effects after Q4/2008.

Summing up, Q1/2008 was characterized by the promising kick-off of the online auctions, the accelerated development of new products, a huge negative currency effect, and a slowdown of growth to 29% on a dollar basis.

Following 2008, which was a transition year, we are now conducting our valuation on the basis of 2009 and feel that a P/E ratio of 20 or a share price of EUR 12.60 is at least reasonable. Our DCF model indicates a present value of EUR 12.49. This results in a current fair assessment of EUR 12.50, compared with EUR 11.25 in our initial study.

Analyst: Marcus Sühling (business administration graduate)
Date of publication: May 26, 2008
Editorial deadline: May 19, 2008

artnet AG, Berlin

1. Key Events in Q1/2008

- Promising start to the artnet online auctions on February 25, 2008
- Strong sell-through rate of around 30% of all auction objects at online auctions
- Cash flow remains positive in spite of high capital expenditure on online auctions and development of new products
- Consolidated revenue growth adjusted for currency effects continues to top 25%
- 13 new employees hired, 127 employees in total, development of employee revenue still negative
- First-time capitalization of staff costs of EUR 108 thousand for new product development
- New cost breakdown, reclassification of general administrative expenses as cost of sales
- Gallery network: 2,017 members (1,947 on December 31, 2007)
- Price database: 11,950 subscribers (11,500 on December 31, 2007)
- Expansion of gallery network and price database in the 20th and 21st-century handcrafts and design segments

2. Forecast & Outlook

- Continued improvement process of artnet online auctions initiated
- Auctions expected to generate higher income through the reduction of turnover time to 10 and later to 7 days and the levying of an additional buyer commission of 10% (up to now, seller commission of 10%)
- Expansion of sales will be driven forward in China and Russia, especially for the gallery network and price information
- Online marketplace for design (modern and contemporary furniture and design objects from over 150 galleries from 75 countries) will be introduced along the same lines as that for art
- Development of new products in the field of price database products



Beatriz Milhazes

O mágico
2001 -

oil, acrylic and gold leaf on canvas

Sotheby's New York: Thursday, May 15, 2008

[Lot 460] Contemporary Art Day Auction

Sale price: 1,049,000 US\$ PREMIUM

3. Details

3.1 artnet Online Auctions

Since February 25, suppliers have put works of art up for sale on the artnet online auctions art trading platform. Demand is particularly strong for graphic arts, which make up the largest segment. Photographs, works on paper, sculptures, and paintings are also offered. The top sellers so far have been works by Warhol and Murakami, two of the best-known names worldwide in modern/contemporary art. The platform is still in the ramp-up phase, termed "beta mode" at artnet. Improvements are continuously being made to bidder information, contract implementation, and the layout of the platform based on the empirical data already collected. For example, the bidding process has been made more straightforward and easier to understand, now enabling bidders to continue bidding automatically until their individual price limits are reached.

Deliveries are solicited by Sales, particularly in the gallery network. The marketplace is advertised in the media, through advertisements in the New York Times for example. Expenses for this have been planned in the marketing budget, though mainly after the full version of the online auctions goes live. The low slotting fee of USD 25 per object also enables the sellers to put their objects up for auction on multiple occasions provided they were not sold the first time round. In the five weeks of the first quarter, artnet reported around 200 deliveries. According to information provided by the company, the sell-through rate was approximately 30% and thus lies within the upper range of the expected 20%-30%. Sales after close of auction (post-auction sales) account for around 10% of all sales. artnet is planning to levy a buyer commission of 10% in the future in addition to the 10% seller commission. This would double artnet's income as long as auction revenues remain largely unaffected, as artnet expects. We are initially leaving our revenue estimate of commission income from online auctions unchanged in view of negative currency effects and possibly a theoretical doubling of income from the introduction of a 10% buyer commission.

3.2 Growth

Adjusted for currency effects, revenue growth in Q1/2008 continued to hover above the 25% figure that artnet anticipates for the coming years. On account of the extremely weak development of the exchange rate of the US dollar (principal invoicing currency/80%) to the euro (reporting currency) in this quarter, artnet recorded growth of 13% after adjustment for currency effects. The subprime crisis has so far had few repercussions, though they are putting a damper on growth. The competitor Artprice.com also recorded a slowdown in growth to 11% in Q1/2008. Consequently, we are revising our growth forecast for artnet's existing divisions to 17% for 2008.

artnet has reclassified a number of the cost items reported under general administrative expenses as cost of sales. These relate to information technology and online auction costs, as well as to other costs directly allocable to the products.

The primary cost drivers are the much larger workforce and the internal and external costs for the development of new products such as online auctions and derivative price database products. The headcount grew by 53% compared with the same quarter in the previous year. Correspondingly, revenue per employee will continue to plummet until the new products start to lift revenues. This was reflected in SIGNUM's lower profit forecast for 2008. On the other hand, the company's competitive edge is likely to expand as a result.

artnet AG, Berlin

Ed Ruscha

I don't want no retro spective
1979 -
Pastel

Sotheby's New York: Thursday, May 15, 2008
[Lot 248] Contemporary Art Day Auction
Sale Price: 3,961,000 US\$ PREMIUM



We have assumed only minor currency factors in 2009 and are now forecasting slightly higher growth for 2010 excluding the auction commissions. At present, several weeks before kick-off, it is still difficult to estimate the auction commissions, which is why we are leaving our planning unchanged.

3.3 Valuation

We are now changing our valuation to 2009. In general, valuations of small caps worldwide have initially fallen substantially. We are making allowance for this by cutting the fair P/E ratio for artnet from 25 to 20. As soon as the slide in the US dollar levels off and revenue growth exceeds 25% again (adjusted for currency effects) and the rise in staff and other costs eases, a higher P/E valuation will seem reasonable once more. The online auctions could trigger additional upside if they exceed our expectations. Then, with total sales growing faster than the current estimates of 20%, 28%, and 29% for 2008, 2009, and 2010, it would be easy to justify raising the P/E ratio further to 30.

Table 1

artnet AG Forecast (consolidated income statement)									
	2006		2007		2008		2009		2010
	Current	Change in %	Current	Change in %	Forecast	Change in %	Forecast	Change in %	Forecast
Amounts in EUR thousand									
Revenues (excl. auctions)	8,416	+30.6%	11,000	+17.0%	12,870	+23.0%	15,830	+23.0%	19,471
Online auction commission					323		1,050		2,240
Total sales	8,416		11,000	+19.9%	13,193	+27.9%	16,880	+28.6%	21,711
Cost of sales	1,719	+23.0%	2,073	+126.7%	4,700	+15.0%	5,405	+15.0%	6,216
Gross profit on sales	6,697	+33.3%	8,927	-4.9%	8,493	+35.1%	11,475	+35.0%	15,495
Sales/marketing	1,296	+32.0%	1,694	+21.0%	2,050	+20.0%	2,460	+20.0%	2,952
General administrative costs	2,960	+39.0%	4,220	-36.0%	2,700	+15.0%	3,105	+15.0%	3,571
Product development	565	+65.0%	1,066	+50.0%	1,599	+30.0%	2,079	+20.0%	2,494
Marketing costs online auctions					400		250		250
Total costs	4,821	+44.8%	6,980	-3.3%	6,749	+17.0%	7,894	+17.4%	9,267
Operating result	1,876	+3.8%	1,947	-10.4%	1,744	+105.4%	3,581	+73.9%	6,228
Net interest	37		91		100		150		200
Other income	14		75		29		33		38
EBT	1,927	+9.7%	2,113	-11.4%	1,873	+101.0%	3,765	+71.8%	6,446
Taxes (excl. deferred taxes)	107	+22.4%	131		80		120		150
Consolidated earnings	1,820	+8.9%	1,982	-9.5%	1,793	+103.3%	3,645	+73.3%	6,316
Number of shares (fully diluted)	5,703		5,741		5,750		5,800		5,850
EPS	0.32	+8.2%	0.35	-9.7%	0.31	+101.5%	0.63	+71.8%	1.08

artnet AG, Berlin

Table 2

Calculation of enterprise value				
Discounted cash flow model in EUR thousand	2008	2009	2010	2011 ff.
Consolidated net income	1,793	3,645	6,316	6,316
Change in working capital	200	300	300	300
Less net investments	-700	-500	-300	-200
Free cash flow (FCF)	1,293	3,445	6,316	6,416
Discount factor	1.088	1.184	1.288	1.401
Terminal value				88,017
Present values FCF	1,189	2,911	4,906	62,836
Total present values (fair value)	71,841			
Number of shares	5,750,000			
Fair value per share	12,49			

Assumptions for calculation of enterprise value

Basic interest rate (current yield)	4,29%
Market risk premium	4,50%
Beta factor	1,00
CAPM interest rate	8,79%
Terminal value growth discount	1,50%

The DCF model was adjusted to take account of the higher current bond yield and the revised expectations for the cash flow components. The parameters of the sensitivity analysis remained unchanged.

Table 3

artnet AG Sensitivity analysis DCF model			
in EUR per share	Beta		
	0.8	1.0	1.5
Growth discount			
1.0%	13.55	11.79	8.80
1.5%	14.49	12.49	9.18
2.0%	15.58	13.30	9.61

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Main sources of information

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

Analysis prepared by:

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Investment recommendation

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

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

First analysis on February 25, 2008, Analysis Result: BUY EUR 11.25
Follow-up study on May 26, 2008, Analysis Result: BUY EUR 12.50

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Company: artnet AG

Numbers concerned: 3, 7

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