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Equity Research

**ADD**

**KLASSIK RADIO AG**

GERMANY /  
MEDIA

INITIATING COVERAGE

PRICE TARGET: €8.30  
PREVIOUS CLOSE: €8.03  
RETURN POTENTIAL: 3.4%

19 FEBRUARY 2010





**CONTENTS**

**PAGE**

Klassik Radio - overview .....	1
Investment case .....	2
SWOT analysis.....	3
Valuation.....	4
Risk analysis .....	5
Recent results & forecasts .....	6
Business description .....	8
Management.....	11
Market overview.....	11
Appendix .....	13
Income statement analysis .....	14
Balance sheet analysis.....	15
Cash flow analysis.....	16
First Berlin disclaimer.....	17

## KLASSIK RADIO AG

GERMANY / MEDIA

Primary exchange: Frankfurt Stock Exchange  
 Bloomberg symbol: KA8 GR  
 ISIN: DE0007857476

<b>RATING:</b>	<b>Add</b>
<b>PRICE TARGET:</b>	<b>€8.30</b>
<b>RETURN POTENTIAL:</b>	<b>3.4%</b>
<b>RISK RATING:</b>	<b>High</b>

### INITIATING COVERAGE

**Klassik Radio AG is a media company focussing on the broadcasting of radio shows, sale of advertising space, distribution of merchandising products and entertainment news as well as book publishing. With a daily audience of 1.4m listeners and 3.7m in the past 14 days, Klassik Radio has a greater reach than any other German radio broadcaster. We initiate coverage with a €8.30 price target and an Add rating.**

**Radio broadcaster with the greatest reach / attractive audience** Klassik Radio is one of the very few German radio stations in possession of a national radio license. According to ma Radio 2009 II, the company has a daily audience of 1.4m people and had 3.7m listeners in the past 14 days. It broadcasts its radio shows over 39 FM frequencies, through cable networks, analogue and digital satellites and the internet. The company has a greater reach than any other German radio broadcaster. Moreover, with its audience mostly ranging between 40 and 60 years of age, well-educated, interested in culture and with above-average monthly income, it serves an increasingly attractive and highly interesting target group for advertisers.

**Business segments complement each other very well** Klassik Radio's business segments Radio, Distribution, Merchandising and Publishing complement each other very well. Klassik Radio raises the profile of its brand through the Radio segment, whereas in the other segments it exploits the strength of its brand by selling high-margin merchandising products, such as CDs, DVDs or books.

**Low CAPEX and working capital requirements** A big advantage of Klassik Radio's business model is that it needs very low levels of investment. For example, in fiscal year 2008/09, the company had a working capital/sales ratio of 2.7% and capex/sales of 2.2%. This is a speciality of Klassik Radio and should allow the company to generate high free cash flows as soon as profitability improves.

**Q1 2009/10 results better y-o-y** Klassik Radio's sales in Q1 2009/10 amounted to €4.7m (+0.9% y-o-y). The Radio segment (+17.3% y-o-y) offset the weakness of other segments, which all reported lower sales y-o-y due to weak advertising and consumer spending. EBIT (€0.4m, +29.5% y-o-y, 8% margin) and net income (€0.3m, +32.2% y-o-y) were positively impacted by restructuring measures which reduced the share of personnel (20.9% vs 23.5%) and other expenses (29.6% vs 31.8%) in total sales. Other expenses include marketing, legal and travel costs among others.

### FINANCIAL HISTORY & PROJECTIONS

	FY07/08	FY08/09	FY09/10	FY10/11	FY11/12	FY12/13
Revenue (€m)	14.92	15.57	16.66	18.70	21.51	24.38
Y-o-y growth	na	4.4%	7.0%	12.3%	15.0%	13.4%
EBITDA (€m)	1.16	0.34	1.33	2.10	3.14	4.33
EBITDA margin	7.8%	2.2%	8.0%	11.2%	14.6%	17.8%
EBIT (€m)	-0.03	-0.15	0.85	1.61	2.67	3.85
EBIT margin	-0.2%	-1.0%	5.1%	8.6%	12.4%	15.8%
Net income (€m)	-0.23	-0.59	0.60	1.40	2.55	3.88
EPS (diluted) (€)	-0.05	-0.13	0.13	0.31	0.57	0.86
P/E (x)	na	na	60.0	25.8	14.1	9.3
DPS (€)	0.00	0.00	0.00	0.00	0.00	0.00
Yield	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
FCF (€m)	-1.41	0.23	0.81	1.54	2.66	3.97
Net gearing	92.3%	109.3%	78.1%	36.1%	-8.5%	-39.4%
Liquid assets (€m)	0.98	0.28	0.83	1.63	0.68	4.65

### COMPANY PROFILE

The Klassik Radio Group is a media company which operates in the areas broadcasting of radio shows, sale of radio advertising, distribution of merchandising products and entertainment news as well as book publishing. Klassik Radio is headquartered in Augsburg. At the end of September 2009, the group had 89 employees.

### TRADING DATA

Closing price (18.02.10)	€8.03
Shares outstanding	4.50m
Market capitalisation	€36.14m
52-week range	€3.36 / 9.08
Average volume (12 months)	1,049

### STOCK OVERVIEW



### COMPANY DATA (as of 31 December 2009)

Liquid assets (incl. securities)	€0.05m
Current assets	€4.12m
Intangible assets (incl. goodwill)	€7.07m
Total assets	€12.28m
Current liabilities	€6.16m
Shareholders' equity	€4.22m

### SHAREHOLDERS

Ulrich Kubak	81.2%
Invest Unternehmensbeteiligungs AG	5.4%
von Stauffenberg	4.6%
Free Float	8.8%



## **INVESTMENT CASE**

### **RADIO STATION WITH THE GREATEST REACH / ATTRACTIVE AUDIENCE**

With a footprint covering 250 cities across Germany and also the Austrian city of Innsbruck, Klassik Radio has a greater reach than any other German radio broadcaster. The company broadcasts radio shows over 39 FM frequencies, through cable networks, two Astra satellites (analogue and digital) and the internet. According to the independent advertising research ma Radio 2009 II, Klassik Radio currently has an average daily audience of 1.4m people, which is on average between 40-60 years old, well-educated, interested in culture and has an above-average monthly income (according to ma 2009 Radio II, 13.5% of Klassik Radio's listeners have an average income of €3,000 or more per month compared with 6.4% for the total German population).

### **BUSINESS SEGMENTS COMPLEMENT EACH OTHER VERY WELL**

Klassik Radio operates in the following areas: broadcasting of radio shows, sale of advertising space, distribution of merchandising goods (e.g. DVDs, CDs, concert tickets, audio and traditional books) and entertainment news, as well as publishing. The company exploits the popularity of its brand/radio channel to sell consumer goods. This is a very attractive business model in our view. Klassik Radio has a very attractive audience, to which it sells goods, especially through its Merchandising and Publishing segments, at high margins (EBITDA margin of up to 30% in the long-term).

### **LOW CAPEX AND WORKING CAPITAL ALLOW FOR HIGH FCF**

With 2008/09 capex/sales and working capital/sales ratios of 1.9% and 2.7% respectively, Klassik Radio demonstrated that its business model does not require high investment expenditures. This, combined with significant operating margins, will in our view allow the company to generate attractive free cash flow yields as soon as the economy and the advertising market start to recover.

### **COMPETENT MANAGEMENT TEAM**

Klassik Radio's CEO and majority shareholder, Ulrich Kubak, a media agent, has been in the radio business for over 20 years. Sabine Reinhard, who is in charge of finance, has extensive international experience, having worked with Deutsche Bank, Morgan Stanley and EMI Music in Paris, London and Sydney.

### **VALUATION SUGGESTS UPSIDE OF 3.8% AT PRESENT**

Since the beginning of April 2009, the Klassik Radio stock has increased from €3.36 to its current level of €8.03. As we strongly believe in Klassik Radio's long-term prospects (mainly due to low investment requirements and high margin distribution and merchandising businesses), we rate the stock an Add. Our DCF model generates a fair value of €8.30 per share. We do not include a peer group analysis due to the difficulty of finding companies of a similar size and with a comparable business model.



## SWOT ANALYSIS

### STRENGTHS

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- Klassik Radio has the highest reach and is the only listed radio broadcaster in Germany
- Due to its attractive audience profile, it is very interesting for advertisers
- Only radio media platform in Germany for decision-makers (self-employed etc.) and only one with a nationwide homogenous advertising radio space for national campaigns on radio
- Between 2005 and 2009, its average daily audience increased by c. 45% from slightly under 1m to 1.4m
- Complementary business segments
- Low working capital and capex requirements
- High entry barriers as a state license is required to operate a radio channel and only a limited number is available
- Experienced and competent management

### WEAKNESSES

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- High net gearing and low equity ratio (105.7% and 34.4% respectively as of 31 December 2009), which is however higher than the median value of the peers (see Appendix)
- Low free float of 8.8%

### OPPORTUNITIES

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- Co-operation with DEAG Deutsche Entertainment will significantly increase sales in the merchandising segment over the coming years and reduce the risks associated with the organisation of concerts
- Increasing share of online sales should improve margins in Distribution and Merchandising
- According to ma Radio 2009 II, 78% of Germans listen to radio every day, for an average of 239 minutes
- Expected growth of the average daily audience to 1.8m–2m from currently 1.4m due to recently received radio licenses (Thüringen, Hannover, Innsbruck) and potential new ones (e.g. in Austria and Switzerland)
- The bigger the audience, the more attractive Klassik Radio becomes for advertisers
- Continuously growing target group of 40-60 year olds
- Management target for incremental EBITDA margins of up to 70% in the longer term in the Radio, Distribution and Merchandising segment
- High margins in combination with low investment requirements should allow the company to pay dividends in the future

### THREATS

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- Weak balance sheet could lead to a strain on liquidity, if the advertising market and consumer spending remain weak
- The Merchandising segment is strongly correlated with the economy
- Shift in advertising budgets from traditional media to digital (especially the internet)



## VALUATION

### DISCOUNTED CASH FLOW MODEL

In order to determine Klassik Radio's WACC, we use our multi-factor risk model, which takes company-specific risk factors into account, such as management strength, balance sheet risk, financial risk, company size and free float.

Our WACC calculation, which generates a value of 11.5%, is based on a risk-free rate equal to 3.8% (yield of German treasury bonds with 10 years to maturity), a market risk premium of 4.0% and a pre-tax cost of debt of 6.5%. In our DCF model, we use an explicit period running until 2020, a terminal sales growth rate of 2% and an effective tax rate of 30%.

Our DCF model derives a fair value of €8.30 for the Klassik Radio share.

	FY09/10	FY10/11	FY11/12	FY12/13	FY 13/14	FY 14/15	FY 15/16	FY 16/17
<b>Net sales</b>	<b>16,660</b>	<b>18,701</b>	<b>21,506</b>	<b>24,382</b>	<b>27,247</b>	<b>30,006</b>	<b>32,556</b>	<b>34,795</b>
Change y-o-y	7%	12%	15%	13%	12%	10%	9%	7%
<b>EBIT</b>	<b>853</b>	<b>1,607</b>	<b>2,674</b>	<b>3,851</b>	<b>5,187</b>	<b>6,738</b>	<b>8,339</b>	<b>10,116</b>
Operating margin	5%	9%	12%	16%	19%	22%	26%	29%
<b>NOPLAT</b>	<b>853</b>	<b>1,607</b>	<b>2,674</b>	<b>3,851</b>	<b>3,631</b>	<b>4,716</b>	<b>5,837</b>	<b>7,081</b>
+ Depreciation	479	488	465	480	495	448	464	395
- CAPEX	-272	-353	-361	-389	-433	-419	-403	-345
Capex	-243	-299	-286	-312	-357	-345	-335	-285
Working capital	-29	-55	-75	-77	-77	-74	-68	-60
Free Cash Flow	1,060	1,742	2,778	3,942	3,693	4,745	5,898	7,131
<b>PV of FCF</b>	<b>991</b>	<b>1,461</b>	<b>2,090</b>	<b>2,661</b>	<b>2,236</b>	<b>2,578</b>	<b>2,876</b>	<b>3,120</b>

PV of FCFs in explicit period	25,894
PV of FCFs in terminal period	15,924
<b>Enterprise Value</b>	<b>41,818</b>
+Net cash / -Net debt (30/09/2009)	-4,462
<b>Shareholder Value</b>	<b>37,356</b>

<b>Number of shares outstanding</b>	<b>4,500</b>
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<b>WACC</b>	<b>11.5%</b>
cost of equity	18.4%
pre-tax cost of debt	6.5%
normal tax rate	30.0%
after-tax cost of debt	4.6%
share of equity	50.0%
share of debt	50.0%
<b>Fair value per share</b>	<b>€8.30</b>

WACC	Terminal EBIT margin						
	14.2%	15.2%	16.2%	17.2%	18.2%	19.2%	20.2%
7.5%	13.74	14.26	14.79	15.31	15.84	16.36	16.89
8.5%	11.56	11.97	12.37	12.77	13.17	13.57	13.98
9.5%	9.95	10.26	10.58	10.90	11.21	11.53	11.84
10.5%	8.69	8.94	9.20	9.45	9.70	9.96	10.21
11.5%	7.69	7.89	8.10	8.30	8.51	8.71	8.92
12.5%	6.86	7.03	7.20	7.36	7.53	7.70	7.87
13.5%	6.17	6.31	6.45	6.59	6.73	6.87	7.01
14.5%	5.58	5.69	5.81	5.93	6.05	6.16	6.28

Fair value per share



## **RISK ANALYSIS**

### **STRONG DEPENDENCE ON THE ECONOMIC CYCLE**

Due to its business model, Klassik Radio – although operating in a niche market - is dependent on the development of the advertising market and consumer spending. In the case of a weak economy, Klassik Radio is affected in its Merchandising segment. The company aims to minimise this risk by strengthening its brand, through more accurate audience targeting, as well as long-term audience retention.

### **MARKET SATURATION IN MERCHANDISING AND PUBLISHING**

With regard to its business segments Merchandising and Publishing, there is generally the risk of market saturation. Klassik Radio aims at reducing this risk by focusing on quality in the Publishing segment, as well as active client management, product innovations and by building up additional distribution channels in Merchandising.

### **LOSS OF KEY INDIVIDUALS**

The success of Klassik Radio is highly dependent on the competence and experience of its employees. The loss of key employees could have a material negative effect on its business development.

### **LEGAL RISKS**

As a radio operator, Klassik Radio must hold governmental licenses. The company currently has a license for broadcasting through satellite, which is valid until 2019. Moreover, it owns licenses for terrestrial FM frequencies, which are valid until 2011. An extension is usually granted without delay, however a certain risk remains as licenses are often tied to statutory restrictions.



## RECENT RESULTS & FORECASTS

### SALES AND EARNINGS

For Q1 2009/10, which ended on 31 December 2009, Klassik Radio reported sales of €4.7m (+0.9% y-o-y), an EBIT of €0.4m (+29.5% y-o-y, 8% margin), and net income of €0.3m (+32.2% y-o-y). Sales in Q1 2009/10 improved despite weak advertising markets and consumer spending. The Radio segment increased its sales by 17.3% y-o-y and offset weakness of all other segments. EBIT and net income on the group level were positive especially due to a lower share of personnel costs (20.9% vs 23.5%) and other expenses y-o-y (29.6% vs 31.8% - comprising marketing costs, legal & consulting costs, renting costs, administration costs etc.) resulting from restructuring measures. With regard to profitability of the segments, only Radio and Publishing had a positive EBIT. The Radio segment generated an EBIT of €0.5m (+47.5% y-o-y, 21.2% margin) and the Publishing segment €0.04m (+208.6%, 4.1% margin).

In Q1 2009/10, EBITDA increased by 24.4% y-o-y and amounted to €0.5m. Based on our discussions with management, we believe that a realistic EBITDA estimate for the whole fiscal year 2009/10 is €1.3m. We take into account the fact that in the radio business Q1 and Q4 are the strongest months, whereas during the summer advertising income is usually weak.

### Sales, EBIT and net profit split for Q1 2008/09 and 2009/10

in €'000	Radio		Distribution		Merchandising		Publishing		Others		Total	
	Q1 2008/09	Q1 2009/10	Q1 2008/09	Q1 2009/10	Q1 2008/09	Q1 2009/10	Q1 2008/09	Q1 2009/10	Q1 2008/09	Q1 2009/10	Q1 2008/09	Q1 2009/10
<b>Sales</b>	<b>2,108</b>	<b>2,472</b>	<b>621</b>	<b>609</b>	<b>750</b>	<b>664</b>	<b>1,101</b>	<b>931</b>	<b>97</b>	<b>43</b>	<b>4,677</b>	<b>4,719</b>
<i>change y-o-y</i>		17.3%		-1.9%		-11.5%		-15.4%		-55.7%		0.9%
<b>EBITDA</b>	<b>376</b>	<b>553</b>	<b>-34</b>	<b>-6</b>	<b>2</b>	<b>-101</b>	<b>6</b>	<b>79</b>	<b>54</b>	<b>-20</b>	<b>404</b>	<b>505</b>
<i>EBITDA margin</i>	17.8%	22.4%	-5.5%	-1.0%	0.3%	-15.2%	0.5%	8.5%		-46.5%	8.6%	10.7%
<b>EBIT</b>	<b>356</b>	<b>525</b>	<b>-62</b>	<b>-40</b>	<b>-1</b>	<b>-108</b>	<b>-35</b>	<b>38</b>	<b>33</b>	<b>-37</b>	<b>291</b>	<b>378</b>
<i>EBIT margin</i>	16.9%	21.2%	-10.0%	-6.6%	-0.1%	-16.3%	-3.2%	4.1%		-86.0%	6.2%	8.0%
<b>Net income</b>	<b>403</b>	<b>579</b>	<b>-85</b>	<b>-75</b>	<b>3</b>	<b>-112</b>	<b>-66</b>	<b>-2</b>	<b>-54</b>	<b>-123</b>	<b>201</b>	<b>267</b>
<i>change y-o-y</i>		43.7%		11.8%		n.a.		97.0%		-127.8%		32.8%

Table I

Source: Klassik Radio, First Berlin

We believe that as the economy continues to improve, Klassik Radio will be able to strongly benefit from its business model, which allows the company to improve sales and profits without high investments. We believe the main drivers in the coming years will be Radio, Distribution and Merchandising, as these, according to management, are able to generate an incremental EBITDA margin (EBITDA margin for every additional sales unit above fixed costs) of up to 70% over the longer term. In the Radio segment, we expect sales to increase from €6.4m in 2008/09 to €10m by 2011/12, due to recently received licenses (Thüringen, Hannover and Innsbruck) and potential new licenses (for example in Austria and Switzerland) and as a result, a larger audience. For fiscal year 2011/12, we assume total sales of €21.5m, EBIT of €2.7m (margin of 12.4%) and a net profit of €2.6m. Between 2009/10 and 2013/14, we forecast that the company will pay no taxes due to corporate tax loss carry forwards of €9.3m and trade tax carry forwards of €14.5m.



## Breakdown of Sales 2008/09-2011/12E

in € '000	FY 08/09	Share	FY 09/10E	Share	FY 10/11E	Share	FY 11/12E	Share
Radio	6,421	41.2%	7,030	42.2%	8,247	44.1%	9,979	46.4%
Distribution	2,136	13.7%	2,349	14.1%	2,656	14.2%	3,097	14.4%
Merchandising	2,746	17.6%	2,965	17.8%	3,347	17.9%	3,871	18.0%
Publishing	4,039	25.9%	4,065	24.4%	4,189	22.4%	4,280	19.9%
Others (FIRST NEWS + FM Radio Network)	228	1.5%	250	1.5%	262	1.4%	280	1.3%
<b>Total sales</b>	<b>15,570</b>	<b>100.0%</b>	<b>16,660</b>	<b>100.0%</b>	<b>18,701</b>	<b>100.0%</b>	<b>21,506</b>	<b>100.0%</b>

Table 2

Source: Klassik Radio, First Berlin

## Breakdown of EBITDA 2008/09-2011/12E

in € '000	FY 08/09	FY 09/10E	FY 10/11E	FY 11/12E
Radio	771	963	1,460	2,165
% margin	12.0%	13.7%	17.7%	21.7%
Distribution	-588	141	220	328
% margin	-27.5%	6.0%	8.3%	10.6%
Merchandising	-354	59	189	360
% margin	-12.9%	2.0%	5.7%	9.3%
Publishing	-103	163	220	278
% margin	-2.6%	4.0%	5.3%	6.5%
Others (FIRST NEWS + FM Radio Network)	612	6	7	7
% margin	268.4%	2.5%	2.5%	2.5%
<b>Total EBITDA</b>	<b>338</b>	<b>1,332</b>	<b>2,096</b>	<b>3,139</b>

Table 3

Source: First Berlin

## BALANCE SHEET AND CASH FLOW

At the end of December 2009, Klassik Radio had a relatively high intangible assets position on its balance sheet. This consisted on the one hand of other intangible assets of €0.8m, which comprised hidden reserves from acquisitions (client relationships, client lists, order backlog etc.), software and licenses and goodwill on the other. The goodwill position of €6.3m mainly stemmed from the acquisitions of the Protone Promotion Werbeagentur GmbH and Hirmer Verlag GmbH in fiscal years 2006/07 and 2007/08 respectively (100% shareholdings, total purchase price for both was €2.1m). Klassik Radio depreciates hidden reserves over a period of one to ten years and software/licenses over three to ten years. In accordance with IFRS, goodwill is written-down only if a yearly impairment test suggests a lower fair value.

As of 31 December 2009, Klassik Radio had an equity ratio of 34% (Q1 2008/09: 32%). The short-term financial debt increased from €1.1m to €2.7m y-o-y due to a convertible bond (€1.5m nominal value, interest rate of 6.5%), which was originally due in March 2010 but which Klassik Radio managed to prolong by 12 months. The convertible bond was shifted in accordance with IFRS to short-term financial debt from long-term financial debt. Long-term financial debt went down from €3.8m to €1.8m y-o-y.

Net debt amounted to €4.5m (€4.2m) resulting in net gearing of 105.7% (105.3%). In Q1 2009/10, Klassik Radio generated a positive operating cash flow of €0.3m (€0.3m), the same as in Q1 2008/09. The company should be able to generate future significant free cash flows due to its low capex and working capital requirements. With higher free cash flow generation in the coming months and years, Klassik Radio will be able to significantly increase its equity ratio and decrease its gearing. For 2011/12, we forecast an equity ratio of 60.7% and a net gearing of -8.5%, with a free cash flow will of €2.7m.

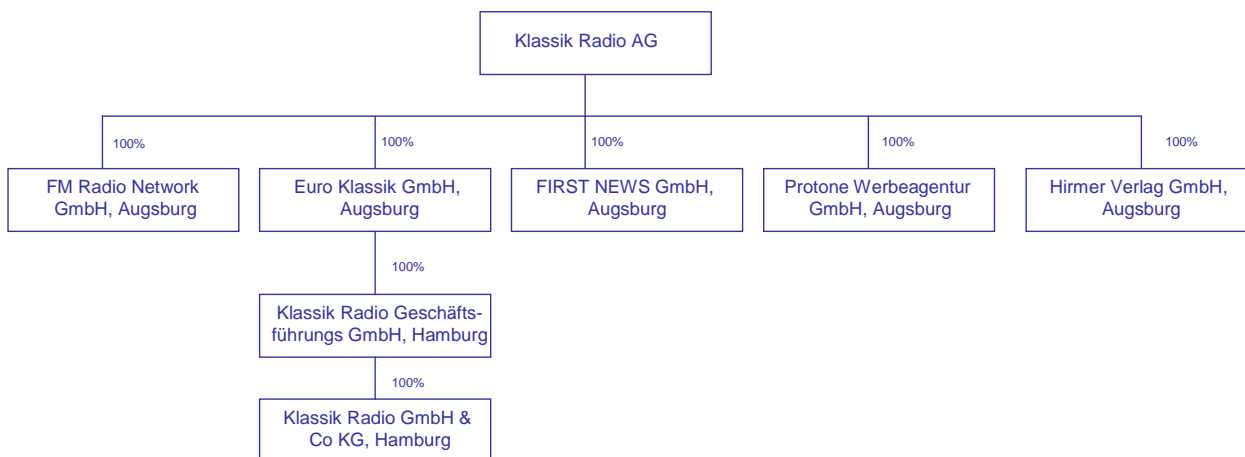


## BUSINESS DESCRIPTION

### BUSINESS SUMMARY

Klassik Radio AG is headquartered in Augsburg/Bavaria and had 89 employees on average in the fiscal year 2008/09 (2007/08: 83.6 employees). Apart from Augsburg, the company also has offices in Hamburg (radio station and sales office), Munich (publishing company), Kiel, Berlin, Innsbruck and Dresden (all sales offices). Since December 2004, the company has been listed on the General Standard of the Frankfurt Stock Exchange as well as on the unregulated markets of the stock exchanges in Berlin-Bremen, München and Stuttgart.

Klassik Radio has been in existence since 1989 when Klassik Radio & Co. KG was founded and began operating the Klassik Radio channel. In 2001, the newly founded Klassik Radio AG took over the shares in Klassik Radio & Co. KG, Euro Klassik GmbH and FM Radio Network GmbH. Euro Klassik, the 100%-owned sales unit, has been responsible for the marketing of the Klassik Radio channel as well as the FM Radio Network GmbH, Germany's first radio syndication house.



Graphic 1

Source: Klassik Radio

The following paragraph includes a description of Klassik Radio's business divisions.

### RADIO

This is the most important business division accounting for 52.4% of total sales in Q1 2009/10. In the same period, it had EBIT of €0.5m and net income of €0.6m.

This segment comprises the operations of the radio channel Klassik Radio, which owns a state licenses for 250 German cities and the Austrian city of Innsbruck.

Klassik Radio is Germany's radio station with the highest reach and an average daily audience of 1.4m listeners (in 2005 it had only 1m). It offers classical music, film music, "new classics" and lounge music. With 39 terrestrial FM frequencies throughout Germany and in Innsbruck,



an Austrian city with above-average income, availability through the cable network in Germany and two Astra satellites (analogue and digital) in Europe, Klassik Radio has access to the whole population in Europe. In addition, it has a global presence through the internet. According to management, more than 40% of the 700k people, who currently listen to Klassik Radio's internet live stream, are based outside Germany.

As its main audience are people, who are between 40 and 60 years old and have on average higher education and incomes, Klassik Radio is particularly attractive for the advertising industry. Because of that, we expect that the Klassik Radio channel will be able to significantly increase its revenues (comprising income from selling advertising spots on the radio) as the advertising market continues to recover over the coming years. Klassik Radio's management believe that the segment will generate an incremental EBITDA margin of 70% in the long term.

## **DISTRIBUTION**

This segment summarises the activities of the subsidiaries Euro Klassik GmbH and Protone Promotion Werbeagentur GmbH. In Q1 2009/10, it contributed 12.9% to total sales. With -€0.04m its EBIT was however negative, the reason being the weak advertising market.

Euro Klassik sells advertising space of Klassik Radio's own radio channel on the national as well as regional level. On the website [www.euroklassik.com](http://www.euroklassik.com), the customers can book advertising space, get information about prices and get in touch with responsible persons. Protone is Germany's biggest supplier of co-op radio advertising and targets mainly small companies whom it offers co-op advertising space on Klassik Radio, but also on other radio channels.

Protone Promotion Werbeagentur was acquired by Klassik Radio in February 2007. Euro Klassik has been part of the Klassik Radio group since the takeover in 2001.

## **MERCHANDISING**

Through its Merchandising segment, Klassik Radio distributes CDs, mp3s, DVDs and concert tickets for its own events. Sales are conducted through call centres and the Klassik Radio online shop. With over 10,000 customers so far and an average amount spent by every customer of >€40 according to the company, the online shop today accounts for 72% of all orders. Management expect the share of the sales generated from the online shop to increase further in coming years, correlating with general market trends. In Q1 2009/10, the Merchandising segment contributed 14.1% to total sales and generated an EBIT and net income of -€0.1m.



The events, which Klassik Radio organises under the brand “Klassik Radio Live in Concert”, include “Die grosse Welt der Filmmusik” and “Klassik Hits”. Klassik Radio is the only private radio broadcaster in Germany with its own orchestra, “Das Klassik Radio Pops Orchestra”. According to the company, the average ticket price for its events is currently >€60.

In October 2009, Klassik Radio started a co-operation with Berlin-based DEAG Deutsche Entertainment AG, the biggest organiser of classical concerts in Europe. Due to this cooperation, the company can double the number of venues where it can organise concerts. The cooperation agreement, which has a duration of three years, includes a yearly fixed fee and a profit sharing on every ticket sold. In addition, it has significantly reduced the risk which Klassik Radio has to bear in relation to the organisation of concerts e.g. Klassik Radio will now not have any rental costs relating to concert halls. In our model, we assume that the co-operation with DEAG will already have an impact on revenues from merchandising in the current fiscal year.

According to management, due to the cooperation with DEAG the incremental EBITDA margin of concert sales will be 100% in the future. In the case of CD, DVD and book sales, the incremental EBITDA margin is between 20% and 30%. With regard to Euro Klassik, management told us that they target an incremental EBITDA margin of 30% in Business-to-Customer part.

## **PUBLISHING**

At the beginning of April 2008, Klassik Radio bought Hirmer Verlag GmbH, an art book publishing house with a long history of over 60 years. Through this publishing house, the company sells art books on different European and international topics. The books are being developed and produced by the Hirmer Verlag and also published in foreign languages.

In Q1 2009/10, the Publishing segment generated 19.7% of total sales, an EBIT of €0.04m and a net loss of €2,000. In the longer term, Klassik Radio targets an incremental EBITDA margin in this segment of 15%. Management believe that Hirmer will be a success as its products fit very well to Klassik Radio’s audience.

## **OTHERS**

The subsidiaries FM Radio Network GmbH and FIRST NEWS Nachrichtenagentur GmbH have been summoned under the segment Others due to their little importance for Klassik Radio. In Q1 2009/10, both had together a share of 0.9% in total sales, an operating loss of €0.04m and net loss of €0.1m.



## MANAGEMENT

**Ulrich R. J. Kubak** is the Chief Executive Officer of Klassik Radio AG. A media agent, Mr Kubak has been dealing with radio for over 20 years. In 1985, he was founding shareholder of the media corporation Donau-Lech. He owned 100% of the shares in the Augsburg-based Radio Fantasy, which went online in 1987. In 1989 and 1993, he founded FM Radio Network GmbH and the entertainment news agency FIRST NEWS, which are today part of Klassik Radio. In 1999, Mr Kubak took over the majority of the shares in Klassik Radio, in 2002 100%. As CEO, he brought the company in 2004 on the stock market and has remained in this position until today. In his function, Mr Kubak is also in charge of the whole sales organisation of Klassik Radio.

**Sabine Reinhard** has been member of the management board since April 2008 and with the company since it went public in 2004. As such, she is in charge of finances and the subsidiaries Protone Promotion Werbeagentur GmbH and Hirmer Verlag GmbH. Before, she worked with Deutsche Bank, Morgan Stanley and EMI Music in Paris, London and Sydney. Mrs Reinhard studied business administration in Augsburg.

## MARKET OVERVIEW

### GLOBAL RADIO MARKET TO RECOVER ONLY IN 2011

Due to weak economic conditions, the volume of the global radio market fell by 2.2% in 2008 according to consultancy PriceWaterhouseCoopers (PwC). With -5.2%, the decline was worst in North America. The recession has been expected to affect the radio market in 2009 even stronger. For that year, PwC forecast a decrease of 6.7% worldwide. With the economy recovering, growth in the radio market will be reported only from 2011.

For the period 2009 to 2013, PwC expects the global radio market to grow with a CAGR of 0.9% and in the EMEA region (Europe, Middle East and Africa) by 0.8% y-o-y on average. The growth of the radio market is expected to be relatively low as expenditures will be shifted to the internet (which is forecast to grow with a CAGR 09-13 of 10.6%).

in USDm	2008	2009	2010	2011	2012	2013	CAGR 09-13
North America	21,941	19,703	18,889	18,837	19,395	20,134	
% change y-o-y	-5.2%	-10.2%	-4.1%	-0.3%	3.0%	3.8%	0.5%
EMEA	18,378	17,678	17,483	17,525	17,719	18,255	
% change y-o-y	-0.9%	-3.8%	-1.1%	0.2%	1.1%	3.0%	0.8%
Asia Pacific	7,235	6,990	6,963	7,075	7,279	7,560	
% change y-o-y	2.8%	-3.4%	-0.4%	1.6%	2.9%	3.9%	2.0%
Latin America	1,170	1,084	1,041	1,051	1,102	1,188	
% change y-o-y	7.4%	-7.4%	-4.0%	1.0%	4.9%	7.8%	2.3%
<b>Total</b>	<b>48,724</b>	<b>45,455</b>	<b>44,376</b>	<b>44,488</b>	<b>45,495</b>	<b>47,137</b>	
% change y-o-y	-2.2%	-6.7%	-2.4%	0.3%	2.3%	3.6%	0.9%

Table 4

Source: PwC Global Entertainment and Media Outlook 2009-13



## GROWTH TO BE IMPACTED BY STRONG SATELLITE RADIO SUBSCRIPTIONS

In the period 2009 to 2013, PwC forecast the growth in the radio market to be mainly impacted by satellite radio subscriptions (worldwide CAGR 09-13 of 9.1%). This is positive for Klassik Radio as the company's radio channel is also available through two Astra satellites. However, the volume of radio advertising, which is an important revenue source for every radio broadcasting company, is forecast to decline on average between 2009 and 2013 (CAGR 09-13 of -0.5%) as the weak economy will continue to negatively affect the advertising sector by 2011 and more and more advertising budgets will be shifted to the internet.

in USDm	2008	2009	2010	2011	2012	2013	CAGR 09-13
Radio advertising	32,546	28,661	26,997	26,592	27,109	28,070	
% change y-o-y	-5.8%	-11.9%	-5.8%	-1.5%	1.9%	3.5%	-0.5%
Public radio license fee	12,923	13,188	13,439	13,575	13,671	13,957	
% change y-o-y	1.4%	2.1%	1.9%	1.0%	0.7%	2.1%	1.4%
Satellite radio subscriptions	3,255	3,606	3,940	4,321	4,715	5,110	
% change y-o-y	28.8%	10.8%	9.3%	9.7%	9.1%	8.4%	9.1%
<b>Total</b>	<b>48,724</b>	<b>45,455</b>	<b>44,376</b>	<b>44,488</b>	<b>45,495</b>	<b>47,137</b>	
% change y-o-y	-2.2%	-6.7%	-2.4%	0.3%	2.3%	3.6%	0.9%

Table 5

Source: PwC Global Entertainment and Media Outlook 2009-13

## DEVELOPMENT OF RETAIL SPENDING

According to different sources, e.g. Hamburger Welt Wirtschafts Institut, Börsenverein des Deutschen Buchhandels, retail sales in 2009 decreased in Germany by 2% y-o-y. In contrast to that, the volume of goods in the same year which customers acquired online went up by 15% y-o-y to €15.4bn. This trend is expected to continue in the coming years whereby the highest sales are forecast for CDs, books and DVDs. After flat sales y-o-y in 2009, total book sales are expected to increase by 0.5%-1% y-o-y between 2009 and 2013.



## APPENDIX

Financial data at the end of fiscal year 2008					
	Sales	EBIT margin	Net margin	Equity ratio	Net gearing
DEAG AG	€109.5m	1.6%	-10.1%	24.9%	-39.7%
RTL Group SA	€5.8bn	15.1%	3.4%	59.0%	-6.0%
ProSiebenSat.1 Media AG	€3.1bn	13.7%	-4.2%	7.8%	765.9%
NRJ SA	€338.9m	13.1%	-1.4%	64.5%	-19.0%
GMA Network, Inc.	PHP 10549.7m	32.1%	22.5%	78.3%	-17.3%
Grupo Televisa SA	MXN 47972.3m	31.5%	16.3%	34.2%	-3.9%
UTV Media Plc	GBP 120.3m	23.1%	7.5%	37.7%	84.1%
CTS Eventim AG	€404.3m	11.9%	7.2%	29.5%	-173.7%
Radio One Inc.	\$316.4m	23.5%	-95.7%	27.9%	208.3%
CBS Corporation	\$14bn	15.5%	-83.7%	32.0%	76.5%
<b>Median</b>		<b>15.3%</b>	<b>1.0%</b>	<b>33.1%</b>	<b>-5.0%</b>



## INCOME STATEMENT ANALYSIS

All figures in €'000	FY07/08	FY08/09	FY09/10	FY10/11	FY11/12	FY12/13	FY 13/14
<b>Sales</b>	<b>14,917</b>	<b>15,570</b>	<b>16,660</b>	<b>18,701</b>	<b>21,506</b>	<b>24,382</b>	<b>27,247</b>
Change in inventory	234	134	143	161	185	210	234
Other operating income	490	695	666	748	860	975	1,090
Cost of goods sold	-6,876	-7,761	-8,163	-8,976	-10,108	-11,338	-12,615
<b>Gross profit</b>	<b>8,765</b>	<b>8,638</b>	<b>9,306</b>	<b>10,633</b>	<b>12,443</b>	<b>14,230</b>	<b>15,956</b>
Personnel expenses	-3,748	-3,861	-3,998	-4,114	-4,301	-4,389	-4,360
Depreciation and amortisation	-1,190	-490	-479	-488	-465	-480	-495
Other operating expenses	-3,855	-4,439	-3,976	-4,423	-5,003	-5,510	-5,914
<b>Operating income (EBIT)</b>	<b>-28</b>	<b>-152</b>	<b>853</b>	<b>1,607</b>	<b>2,674</b>	<b>3,851</b>	<b>5,187</b>
Net financial result	-287	-360	-251	-207	-120	30	207
<b>Income before taxes &amp; minority interests</b>	<b>-315</b>	<b>-512</b>	<b>602</b>	<b>1,400</b>	<b>2,554</b>	<b>3,880</b>	<b>5,394</b>
Taxes	86	-76	0	0	0	0	-1,618
<b>Net income / loss</b>	<b>-229</b>	<b>-588</b>	<b>602</b>	<b>1,400</b>	<b>2,554</b>	<b>3,880</b>	<b>3,776</b>
<b>EPS</b>	<b>-0.05</b>	<b>-0.13</b>	<b>0.13</b>	<b>0.31</b>	<b>0.57</b>	<b>0.86</b>	<b>0.84</b>
<b>Ratios</b>							
Gross margin	58.8%	55.5%	55.9%	56.9%	57.9%	58.4%	58.6%
EBIT margin	-0.2%	-1.0%	5.1%	8.6%	12.4%	15.8%	19.0%
EBITDA margin	7.8%	2.2%	8.0%	11.2%	14.6%	17.8%	20.9%
Net income margin	-1.5%	-3.8%	3.6%	7.5%	11.9%	15.9%	13.9%
Tax rate	27.3%	-14.8%	0.0%	0.0%	0.0%	0.0%	30.0%
<b>Expenses as % of sales</b>							
Cost of goods sold	46.1%	49.8%	49.0%	48.0%	47.0%	46.5%	46.3%
Personnel expenses	25.1%	24.8%	24.0%	22.0%	20.0%	18.0%	16.0%
Depreciation and amortisation	8.0%	3.1%	2.9%	2.6%	2.2%	2.0%	1.8%
Other operating expenses	25.8%	28.5%	23.9%	23.7%	23.3%	22.6%	21.7%
<b>Y-o-y growth</b>							
Total revenues	n.a	4.4%	7.0%	12.3%	15.0%	13.4%	11.8%
Operating income	n.a	-442.9%	661.2%	88.4%	66.4%	44.0%	34.7%
Net income / loss	n.a	-156.8%	202.3%	132.7%	82.4%	51.9%	-2.7%



## BALANCE SHEET ANALYSIS

All figures in €'000	FY07/08	FY08/09	FY09/10	FY10/11	FY11/12	FY12/13	FY 13/14
<b>Current Assets</b>	<b>5,529</b>	<b>4,146</b>	<b>4,971</b>	<b>6,272</b>	<b>6,023</b>	<b>10,709</b>	<b>15,258</b>
Inventories	1,721	1,873	2,004	2,250	2,587	2,933	3,278
Trade receivables	2,336	1,500	1,605	1,802	2,072	2,349	2,625
Other receivables and assets	433	473	506	568	653	741	828
Tax receivables	59	21	22	25	29	33	37
Liquid funds	980	279	833	1,627	682	4,653	8,491
<b>Non-Current Assets</b>	<b>8,553</b>	<b>8,287</b>	<b>7,870</b>	<b>7,296</b>	<b>7,117</b>	<b>6,949</b>	<b>6,811</b>
Goodwill	6,276	6,276	6,276	6,276	6,276	6,276	6,276
Other intangible assets	1,063	859	618	397	196	15	-146
PP&E	526	587	591	623	645	658	681
Deferred tax assets	688	565	384	0	0	0	0
<b>Total Assets</b>	<b>14,082</b>	<b>12,433</b>	<b>12,841</b>	<b>13,567</b>	<b>13,140</b>	<b>17,658</b>	<b>22,069</b>
<b>Current Liabilities</b>	<b>5,356</b>	<b>6,317</b>	<b>6,320</b>	<b>7,561</b>	<b>5,088</b>	<b>5,769</b>	<b>6,447</b>
Short-term financial debt	1,300	2,633	2,378	3,136	0	0	0
Trade payables	3,437	3,073	3,288	3,691	4,245	4,812	5,378
Provisions	251	286	306	344	395	448	500
Other liabilities	360	299	320	359	413	468	523
Tax liabilities	8	26	28	31	36	41	45
<b>Long-term liabilities</b>	<b>4,183</b>	<b>2,161</b>	<b>2,024</b>	<b>531</b>	<b>73</b>	<b>83</b>	<b>93</b>
Long-term financial debt	3,875	1,967	1,967	467	0	0	0
Other liabilities	123	53	57	64	73	83	93
Deferred tax liabilities	185	141	0	0	0	0	0
<b>Shareholders Equity</b>	<b>4,543</b>	<b>3,955</b>	<b>4,497</b>	<b>5,475</b>	<b>7,978</b>	<b>11,806</b>	<b>15,529</b>
<b>Total Shareholders Equity &amp; Debt</b>	<b>14,082</b>	<b>12,433</b>	<b>12,841</b>	<b>13,567</b>	<b>13,140</b>	<b>17,658</b>	<b>22,069</b>
<b>Ratios</b>							
Current ratio	1.03	0.66	0.79	0.83	1.18	1.86	2.37
Quick ratio	0.62	0.28	0.39	0.45	0.54	1.21	1.72
Equity ratio (as %)	32.3%	31.8%	35.0%	40.4%	60.7%	66.9%	70.4%
Net gearing	92.3%	109.3%	78.1%	36.1%	-8.5%	-39.4%	-54.7%
Equity per share	1.01	0.88	1.00	1.22	1.77	2.62	3.45
Net debt	4,195	4,321	3,512	1,976	-682	-4,653	-8,491
Capital employed (CE)	8,726	6,116	6,521	6,006	8,051	11,889	15,622
Return on equity (ROE)	-10.1%	-13.8%	14.2%	28.1%	38.0%	39.2%	27.6%
Return on capital employed (ROCE)	-0.4%	-2.1%	13.1%	26.8%	33.2%	32.4%	23.2%
Days of inventory turnover	46	85	87	86	87	89	90
Days of sales outstanding (DSO)	29	45	34	33	33	33	33
Days of payables outstanding	91	153	142	142	143	146	147



## CASH FLOW ANALYSIS

All figures in €'000	FY07/08	FY08/09	FY09/10	FY10/11	FY11/12	FY12/13	FY 13/14
<b>Net income</b>	-229	-588	602	1,400	2,554	3,880	3,776
Depreciation	1,190	490	479	488	465	480	495
Change in working capital	105	519	-29	-55	-75	-77	-77
Others	61	114	0	0	0	0	0
<b>Operating Cash Flow</b>	<b>1,127</b>	<b>535</b>	<b>1,052</b>	<b>1,834</b>	<b>2,944</b>	<b>4,283</b>	<b>4,195</b>
<b>CAPEX</b>	<b>-2,538</b>	<b>-306</b>	<b>-243</b>	<b>-299</b>	<b>-286</b>	<b>-312</b>	<b>-357</b>
<b>Free Cash Flow</b>	<b>-1,411</b>	<b>229</b>	<b>809</b>	<b>1,535</b>	<b>2,658</b>	<b>3,971</b>	<b>3,838</b>
Financial Cash Flow	1,328	-970	-255	-741	-3,603	0	0
<b>Change in cash</b>	<b>-83</b>	<b>-741</b>	<b>554</b>	<b>794</b>	<b>-945</b>	<b>3,971</b>	<b>3,838</b>
<b>Cash at the beginning of the period</b>	<b>793</b>	<b>710</b>	<b>279</b>	<b>833</b>	<b>1,627</b>	<b>682</b>	<b>4,653</b>
<b>Cash at the end of the period</b>	<b>710</b>	<b>-31</b>	<b>833</b>	<b>1,627</b>	<b>682</b>	<b>4,653</b>	<b>8,491</b>
Free Cash Flow per share (€)	-0.55	0.05	0.18	0.34	0.59	0.88	0.85
Free Cash Flow yield	-6.6%	0.6%	2.2%	4.1%	7.1%	10.6%	10.3%
<b>Y-o-y growth</b>							
Operating Cash Flow	n.a	-52.5%	96.6%	74.4%	60.5%	45.5%	-2.1%
CAPEX	n.a	87.9%	20.7%	-23.1%	4.3%	-9.1%	-14.4%
Free Cash Flow per share	n.a	109.2%	-253.4%	89.7%	73.1%	49.4%	-3.4%



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First Berlin's investment rating system is five tiered and includes an investment recommendation and a risk rating. Our recommendations, which are a function of our expectation of total return (forecast price appreciation and dividend yield) in the year specified, are as follows:

**STRONG BUY:** Expected return greater than 50% and a high level of confidence in management's financial guidance

**BUY:** Expected return greater than 25%

**ADD:** Expected return between 0% and 25%

**REDUCE:** Expected negative return between 0% and -15%

**SELL:** Expected negative return greater than -15%

Our risk ratings are Low, Medium, High and Speculative and are determined by ten factors: corporate governance, quality of earnings, management strength, balance sheet and financing risk, competitive position, standard of financial disclosure, regulatory an

Up until 16 May 2008, First Berlin's investment rating system was three tiered and was a function of our expectation of return (forecast price appreciation and dividend yield) over the specified year. Our investment ratings were as follows: **BUY:** expected than 15%; **HOLD:** expected return between 0% and 15%; and **SELL:** expected negative return.

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