



June 3, 2004

Germany
Media & Entertainment

DEAG

Frankfurt Stock Exchange
Prime Standard

Symbol: ERM
ISIN: DE0005513907

Rating: STRONG BUY
12 Month Price Target: €3.75
Risk Rating: High

Initial Report: DEAG returns to profitability

Highlights

- DEAG published its Q1 figures on 14 May. Revenues increased Y-Y by 74% to €25.492m.
- DEAG was able to post a sizable increase in EBIT from €0.088m in Q1 2003 to €0.950m in Q1 2004.
- Net income also saw a large increase, rising from a loss of €0.379m in 2003 to a profit of €1.131m in 2004. This gave a diluted EPS of €0.07 for Q1.
- DEAG has survived the receivership of one of its subsidiaries and has just completed a major consolidation in 2003 reducing its debt load considerably.
- For 2004 we expect DEAG to show exceptional growth. This is due to a large reduction in debts and a onetime tax refund.
- DEAG's move into Classic live events and the Eastern European market is particularly promising for revenue growth in the coming years.

Company Profile

DEAG Deutsche Entertainment AG is one of the leading concert-organiser groups in Europe. The core business of DEAG consists of organising national and international concerts and tours and exclusive management of venues and variety theatres. It provides a full range of services for music tours including producer, agent and promoter. The company is headquartered in Berlin.

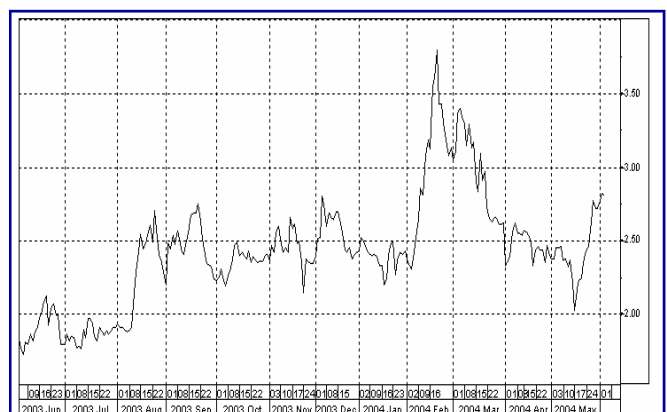
Financial History & Projections

	2002A	2003E	2004E	2005E
Revenue €m	139.991	127.325	136.727	141.835
Yr/Yr Growth		-9.0%	7.4%	3.7%
EBIT €m	-17.739	-7.816	1.271	3.112
Net Income €m	-9.132	-14.678	1.885	2.705
EPS (basic)	-1.08	-1.54	0.14	0.20
EPS (diluted)	-1.08	-1.48	0.10	0.15

Stock Data

Market Capitalisation	€38.50m
Enterprise Value	€21.29m
Shares Outstanding	13,748,820
Liquid Assets	€34.428m
Liquid Assets per Share	€2.50
Total Assets	€112.319m
Total Shareholders' Equity	€30.423m

Stock Overview



Source: Bloomberg	
Closing Price: (2 June 2004)	€2.80.
52-Week Range:	€3.80/€1.58
Free float :	70%
Average Daily Share Volume (year):	121,202

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DEAG Deutsche Entertainment AG published its Q1 figures on 14 May. DEAG has survived the receivership of one of its subsidiaries and has just completed a major consolidation in 2003. It has entered 2004 with the problems of the last 3 years resolved. The Q1 figures were expected to give the first indications of the health of the company and they did not disappoint.

Revenues increased Y-Y by 74% to €25.492m. Management attributes the increase in revenues in Q1 to more performances by Tabaluga and Andre Rieu. The gross margin decreased considerably Y-Y due to a unique profit sharing agreement with one of the artists.

DEAG was still able to post a sizable increase in EBIT from €0.088m in Q1 2003 to €0.950m in Q1 2004. Net income also saw a large increase, rising from a loss of €0.379 in 2003 to a profit of €1.131m in 2004. This gave a diluted EPS of €0.07 for Q1. This positive picture was rounded out by a Y-Y increase in cash flow from a negative €0.921m in 2003 to a positive €0.100m in 2004.

Corporate Overview

DEAG can look back over 25 years experience in the concert business. DEAG's CEO Peter Schwenkow founded Concert Concept in 1978 in a period when pop & rock concert organisers were motivated by enthusiasm for the music. The typical concert company of that period had 3 employees and their office was the kitchen table.

In the early 90's European concert organisers began to look for ways to increase profit. Regional consolidation began with strong tendencies towards the emergence of national and European groups. Peter Schwenkow founded DEAG to meet the trend for international consolidation. DEAG's IPO, on 14 September 1998, raised over €14m. The subsequent acquisitions of over 26 organisations were on friendly terms with local management being retained.

Today DEAG is one of the largest concert-organiser groups in Europe. Its subsidiaries include organisers not only in Germany, but it also has a strong presence in the UK and Switzerland. DEAG was admitted to the Prime Standard on 1 January 2003.

DEAG Holdings is the administrative head, leading the Group's activities of "Artists & Tours", "Urban Entertainment" and "Theatres". In 2004 the company added a "Classics & Sports" group.

Artists & Tours

This unit organises live music events and concert tours. The music presented is in the rock and pop genres. The company acts as sole organiser, as European agent or to secure individual venues. It can provide a full range of services for music tours including producer, agent and promoter. DEAG organised tours in 2003 with The Rolling Stones, Paul McCartney and Andre Rieu, among others.

Artists & Tours Business Plan: Artists and Tours is the core business of DEAG, having provided 57% of revenues in 2002 and 93% in 2003. The DEAG Group often negotiates contracts to be the sole European agent for international tours, sub-contracting venues in countries where it does not have subsidiaries. Often rights are sold for 50% of the ticket-sale profits of individual shows to local promoters in exchange for a guarantee to cover a breakeven income level. This practise eliminates DEAG's risk exposure. Acting as the agent for international shows DEAG realises margins of 5%-10%. For shows it produces, such as Tabaluga, DEAG's margin is 15%-30%.

Theatres

Theatres represented 37% of revenues in 2002 and only 6% in 2003. The revenues of this unit of the company were significantly reduced due to the de-consolidation of STELLA Entertainment AG and Qivive GmbH in 2002. Remaining are the Variété theatres in Berlin and Stuttgart. The Wintergarten theatre in Berlin is rented (the lease runs to 2011) and the Friedrichbau Variété in Stuttgart is under a tenancy agreement (through to 2008). DEAG Group produces and runs Variété shows in both theatres. In 2003 both revenues and EBIT declined Y-Y in the Theatres unit. The unit showed an EBIT loss for 2003 of -€0.335m. This was primarily due to further consolidation in this unit. The theatres together are expected to produce a margin of between 10%-12%. Management reports that the signs are positive for a return toward these margin levels in 2004.



Urban Entertainment

This unit of DEAG realized 11% of 2002 total revenues, but only 5% of revenues in 2003. These revenues come from bookings for the Waldbühne in Berlin, the Jahrhunderthalle in Frankfurt and revenues from its subsidiary Concert Concept in Berlin. The Frankfurter Jahrhunderthalle is the property of DEAG. This venue hosts concerts and conferences. In addition, this unit has exclusive lease agreements with the Waldbühne in Berlin and the Hallenstadion in Zurich. Activities in this area were reduced in recent months to minimise risk in the period of reorganization after STELLA Entertainment's bankruptcy filing. This unit expects a margin of 10%-15%. In 2003 it produced an EBIT margin of 17%.

DEAG is seeking approval to build 2 shopping centres and a hotel on the property the Jahrhunderthalle occupies in Frankfurt. If approval is given, those building rights will be sold to developers. The sale of those rights is expected to produce additional income in 2004 and annual income from lease agreements. As the building permits have not yet been approved, we have not yet included income from this project in our projections.

Classics & Sports

This new unit organises live music classical events and concert tours. It took over the Andre Rieu concerts from the Artists & Tours division adding other classical tours, operas, operatic concerts and concert orchestras to its list of live events. The sports side of this unit will become active in the next months.

STELLA Entertainment AG's insolvency

DEAG acquired the profitable parts of STELLA Entertainment on 31 March 2000, rescuing it from insolvency proceedings. The acquisition was a major asset to DEAG's theatre unit, more than doubling total company revenues for the year to €259m (€86.9m 1999).

Although it saved STELLA, DEAG was not able to find long term resolutions for the deficiencies in STELLA's business plan. Due to high overhead costs, it is very difficult to make a profit in the musical theatre business. There are high royalty fees and high personnel costs including a

large number of orchestra members, cast, stagehands and sales/administrative staff. The 5 STELLA Theatres, spread throughout Germany, were dependent on 90% of their audiences travelling over 150 KM to each performance. Marketing costs consumed 12% of revenue. In addition only 20% of tickets were sold directly. 80% of ticket sales were executed by travel agents, usually in connection with travel and hotel packages. Those retail agents retained 15% of the ticket price. It was a complicated mix that had to be optimally balanced to show a profit. In addition, with the advent of low-fare airlines, package tours with theatre tickets to London became cheaper than going to Stuttgart or Hamburg.

The buy-out was complicated and partially contested. DEAG had resolved the lawsuit and almost completed the consolidation of STELLA, when 11 September 2001 hit the US. DEAG cancelled performances that evening, but for months afterward the German public was not willing to travel and ticket sales fell dramatically. The Neue Flora in Hamburg premiered STELLA's new musical "Mozart" on 16 September. Mainly due to 11 September, the show flopped and that theatre showed a €10m loss in 2001. The long term effects of 9/11 tipped STELLA into insolvency and threatened to pull DEAG down. STELLA declared insolvency in April 2002. To protect DEAG, STELLA was de-consolidated from the company as of 1 April 2002. STELLA was turned over to the insolvency court on 2 May 2002.

Looking back, DEAG's CEO Peter Schwenkow admits he made mistakes that contributed to the situation. It is, however, to his credit that he believed enough in DEAG to battle for its survival. He held his sizable number of shares (2.499m 18.2%) in DEAG as he watched the price fall and used his own assets to back loans so DEAG could survive. Due to STELLA's insolvency, DEAG incurred debts of €29m. Roland Berger Strategy Consultants were engaged to give advice on the re-organization.

The retirement of debt was achieved through re-negotiations and the sale of 4.583m new shares. The shares were offered from 8 to 11 December 2003 at the price of €2.33. The placement was successful and all debts associated with the insolvency have been paid off.



Competition

CTS Eventim

CTS Eventim is DEAG's main competitor. Eventim (EVD) is a consolidation of German Concert organizers and ticketing agents. In 2003, 84% of its revenues came from its live entertainment unit and 16% from ticketing activities. Although Eventim has a concert subsidiary in Austria, in 2003 94% of its revenues were realised in Germany.

DEAG's 2003 revenues were derived mainly in Germany with 65% and 35% coming from other countries (UK and Switzerland).

Eventim's Business Plan

Eventim's ticketing unit has probably given it an edge in signing international shows as a concert organiser in the past. Eventim's monopoly in ticketing has been based on significant investments in a nationwide advance booking infrastructure. Eventim's ticketing was still growing in terms of both revenues and earnings in 2003.

However, ticketing is moving online. Online ticketing enjoys low overhead and high margins. Eventim is expanding into online ticketing and has set the goal of becoming Europe's biggest eCommerce ticketing provider. In doing so, however, it is competing with its own sizable investments in non-electronic ticketing infrastructure. We expect the competition to increase in the ticketing industry. Eventim's ticketing activities could possibly lose their edge in the coming years due to strong competition. As a result, it could even lose contract signings in its live entertainment segment.

DEAG has contracted Intelli Mark's "print-at-home" ticketing system which is operated in cooperation with Ticket online. This system is counterfeit proof as it carries a bar code identifier that is read at the gate to prevent duplications. Because of the low over-heads of the system, DEAG retains 10% of the price of each ticket sold through this channel.

CTS Eventim acts as a local or national promoter for international shows. Promoting only produces a margin of 5%-10%. In addition to promoting, DEAG produces shows and has fixed contracts with attractive venues; these two activities produce margins between 10%-30%.

DEAG – EVENTIM Numbers comparison

Eventim's stock price rose from €4 in July 2002 to a high of €16.24 in March 2004. Had it not been for the insolvency of STELLA, DEAG's stock price might have had a similar price climb.

The EPS chart below shows DEAG moving solidly toward profitability in 1999 and 2000 ahead of Eventim. The Stella insolvency resulted in an EPS loss in 2001 of €2.12.

DEAG's and Eventim's EPS on an Annual Basis

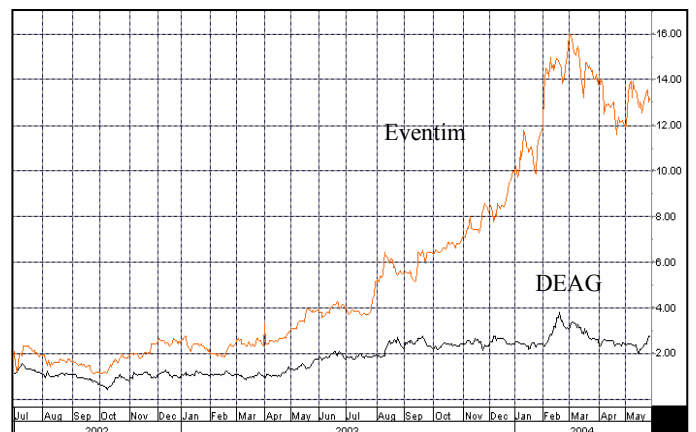
	1999	2000	2001	2002	2003
DEAG	0.13	0.37	-2.12	-1.08	-1.48
EVENTIM	-0.24	0.17	-0.12	0.03	0.39

Source: Bloomberg

The Stock price comparison chart below begins in July of 2002 as DEAG's and Eventim's stock prices were both in the €1.50 to €2.00 range. They both moved down, due to the effects of the 9/11 attacks. From that point both companies' stock prices began a slow rise.

Looking at DEAG's EPS figures above, it seems understandable that its stock price did not keep pace with Eventim's. However, considering Eventim's EPS figures, its price seems somewhat high. Based on the 2003 figures, Eventim's price high of €16.24 gives a P/E ratio of 42X and based on 2004 projections its P/E is 30X. Eventim's current price of €13.70 gives a P/E of 25X based on 2004 projections. This is somewhat high in the current market environment, but is acceptable if projected growth is factored in.

Stock price comparison DEAG – EVENTIM



Source: Bloomberg



Having completed the re-organisation and retired all debt associated with the STELLA insolvency, both the DEAG CEO Peter Schwenkow and Supervisory Board Member Wolf-Dieter Gramatke are optimistic that DEAG's stock will perform well in the future. They view Eventim's stock price rise during the past 12 months as an indication of what DEAG's stock could do over the coming quarters.

OUTLOOK

After the dramatic Q1 revenue rise, our revenue projections for the remainder of 2004 and 2005 are conservative. We are keeping our revenue projections very low due to current uncertainties about the strength of the German economic recovery and the effects it might have on the entertainment industry.

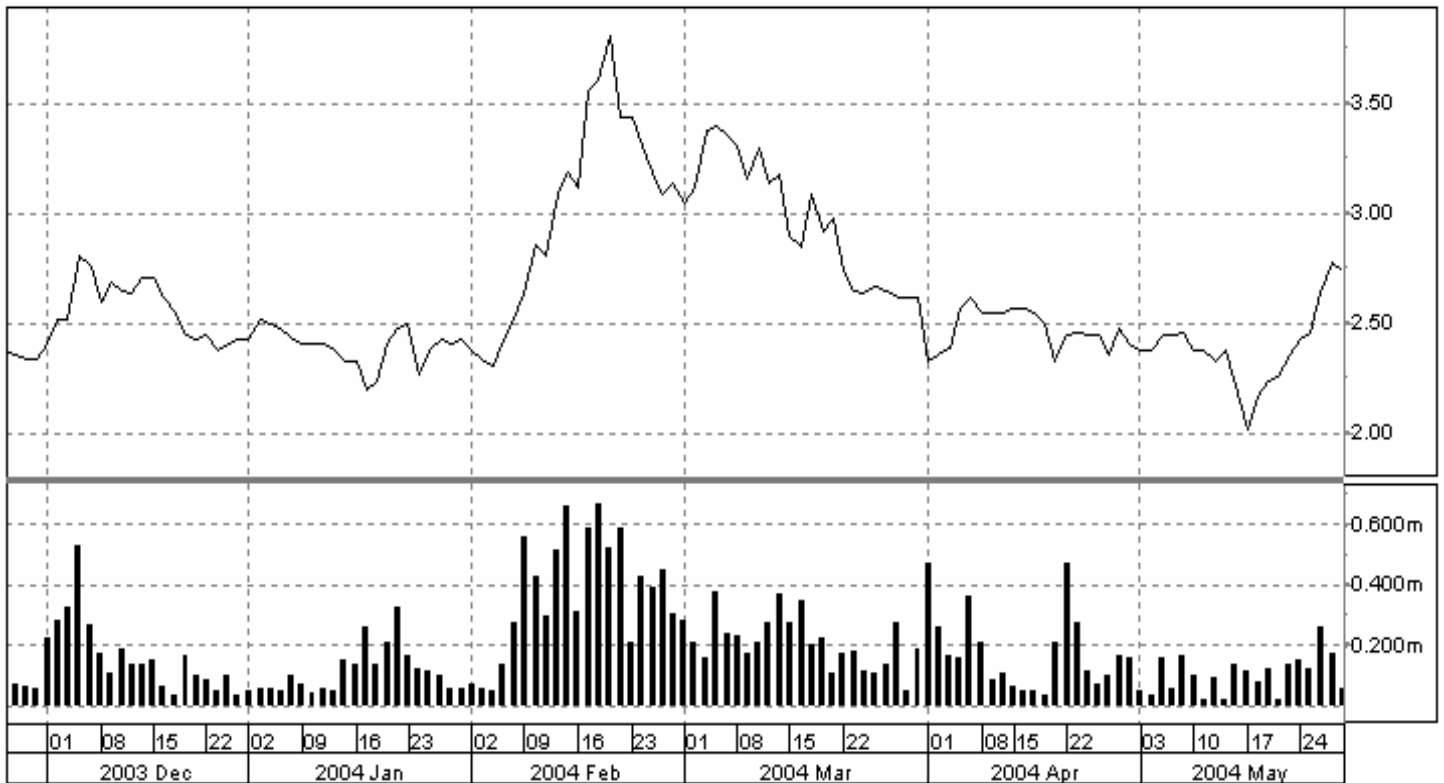
At the end of Q1 DEAG was holding €18.895m in advanced ticket sales. This figure supports our revenues projection for Q2 of €63m, traditionally its strongest quarter.

We project DEAG to show a large increase in earnings in 2004. We expect the company to move from a net loss of €14.678m in 2003 to a net profit of €1.885m in 2004 with a diluted EPS of €0.10. This increase is due to the company resolving the problems and debts associated with the insolvency of STELLA. Several costs have fallen away in 2004, such as the line item, "Interest Income and Expenses". The 2004 results will be particularly helped by a one-time tax refund of €1.2m. The amount will be booked in this year allowing the company to show extraordinary growth in earnings despite low revenue growth. We expect a strong organic revenue growth to €141.835m in 2005 and a net income of €2.705m. This results in a diluted EPS of €0.15.

The company has expanded its number of classical music concerts, establishing a Classic business unit. This new unit is expected to drive company growth in the next few years. DEAG announced it has opened an office in Moscow and is looking to become active in Eastern Europe live entertainment industry and the presentation of East European artists. The first Eastern European artists have been signed and tours are booked.



Share Price and Volume Chart



Source: Bloomberg

In the past 6 months, DEAG's stock has had a weak but persistent support level of €2.50. In December 2003 the company announced the possibility of eliminating much of its large debt commitment in 2003. The rise in February could have been caused by management presentations of their expected turnaround to the financial community. But as the Q1 numbers were not yet available to substantiate the turnaround, the stock could not yet maintain that level.

A Q1 ad-hoc was released on 30 April, with the full report issued on 14 May. The stock saw a €0.70 rise after that date.

Daily average volume has been 121,202 over the past 12 months. Both volume and price are highly volatile. The volatility and price moves do not always appear to be motivated by company news. This makes a technical assessment of future moves difficult.



Recommendation

DEAG had produced a strong EPS of €0.37 in 2000. As a result of the terrorists attacks in September 2001, the live concert business contracted and DEAG's subsidiary STELLA Entertainment AG went into insolvency. The insolvency and the debts it produced have preoccupied the company both financially and managerially for the past 3 years. Now that DEAG has resolved all problems and debts associated with the insolvency, it can focus all its resources on returning to the EPS level it enjoyed in 2000.

The Q1 2004 figures showed revenues increased by 74% Y-Y and net income from a loss of €0.379 in 2003 to a profit of €1.131m in 2004. One quarter does not create a trend. However, we expect DEAG's FY 2004 to show strong profit growth even with no Y-Y revenue increase for the remaining quarters. This is due to a large reduction in debt payments and a windfall tax rebate.

Management's move into Classic live events and the Eastern European market is particularly promising for revenue growth in the coming years.

DEAG is definitely in the upward side of a turnaround and we view its stock as undervalued at current levels. We are using a P/E ratio of 25X due to the company's growth potential and the fact that the market sustains that multiple for its competitor.

We recommend DEAG as a STRONG BUY and set our 12 month price target to €3.75, with a high risk rating.

Detailed Financial History & Projections IAS

	2002A	2003A					2004E					2005E
in t €	TotalA	Q1A	Q2A	Q3A	Q4A	TotalA	Q1A	Q2E	Q3E	Q4E	TotalE	TotalE
Revenue	139991	14680	63791	11043	37811	127325	25492	63150	10650	37435	136727	141835
Cost of revenues	-104455	-9755	-49824	-8013	-33399	-100991	-20419	-47994	-7775	-29948	-106136	-108504
Gross profit	35536	4925	13967	3030	4412	26334	5073	15156	2876	7487	30592	33331
Selling and marketing expenses	-19863	-1940	-5557	-2950	-2767	-13214	-1995	-5684	-1278	-2995	-11951	-12765
General and administrative expenses	-17199	-2804	-5466	-2056	1741	-8585	-2243	-6315	-1065	-3744	-13367	-14184
Other operating income and expenses	9740	868	1528	1226	12793	16415	284	442	75	262	1063	1262
Amortisation of goodwill	-5598	-816	-1134	-1572	-8824	-12346	0	-227	-129	-240	-596	-633
Depreciation and amortisation	-8929	-145	-298	-151	-3698	-4292	-169	-600	-100	-3600	-4469	-3900
Operating income / loss (EBIT)	-17739	88	3040	-2939	-8005	-7816	950	2772	378	-2829	1271	3112
Interest income and expenses	-2532	-384	-1653	-1491	-825	-4353	-355	-200	-200	-200	-955	-800
Result from investments and participations	5213	0	61	359	-1488	-1068	0	63	320	-1497	-1115	-1418
Income/expenses from associated companies	44	0	0	20	-13	7	0	0	213	-11	202	284
Foreign currency exchange gains / losses	-213	-36	-243	16	107	-156	13	-253	11	112	-117	-217
Other expenses and income	54	-37	0	66	37	66	1200	0	0	0	1200	0
Result before taxes (and minority interest)	-15173	-369	1205	-3969	-10187	-13320	1808	2383	721	-4425	486	960
Income tax	4111	-136	-927	790	-14	-287	-576	-350	375	375	1500	1745
Result before minority interest	-11062	-505	278	-3179	-10201	-13607	1232	2033	1096	-4050	1986	2705
Minority interest	1930	126	-196	-267	-734	-1071	-101	0	0	0	-101	0
Net income / loss	-9132	-379	451	-3446	-11304	-14678	1131	2033	1096	-4050	1885	2705
Earnings per share (basic)	-1.08	-0.04	0.01	-0.41	-1.10	-1.54	0.08	0.15	0.08	-0.29	0.14	0.20
Earnings per share (diluted)	-1.08	-0.04	0.01	-0.41	-1.04	-1.48	0.07	0.11	0.06	-0.22	0.10	0.15

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Risk Rating

Risk ratings which are a reflection of expected price volatility and other fundamental risk factors are: Low, Medium, High and Speculative.

Rating system

STRONG BUY (outperform the market by 15% or more)

BUY (outperform the market by 15% or less)

HOLD (perform at market level)

REDUCE (underperform the market by up to 15%)

SELL (under perform the market by 15% or greater)

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