

BKN INTERNATIONAL AG

GERMANY / MEDIA & ENTERTAINMENT

Primary Exchange: Frankfurt
Secondary Exchange: London
Symbol: BKQ

General Standard
ISIN: DE0005290704

RATING: Buy

PRICE TARGET: €2.90

RISK RATING: High

CAPITAL INCREASE DILUTES PRICE TARGET

COMPANY PROFILE

BKN International AG and its subsidiaries produce, distribute, license and market children's animated television programmes. The company is headquartered in Cologne, Germany, with offices in New York, London and Barcelona.

KEY POINTS

On 13 July BKN reported the completion of its capital increase first announced on 27 June. The company reported it had issued a total of 3.7m no-par shares at a subscription price of €2.45 per share.

On 23 July BKN announced the early repayment of two convertible bonds worth a total €5.2m including principal and interest. The company also negotiated the waiver of early-redemption penalties worth €1.3m with bondholder Laurus Master Funds Ltd.

On 25 July BKN announced the launch of its digital high-definition (HD) animation studio and the studio's first project, a 26-episode series entitled 'Stone Age'. The company plans to invest around €5.0m in the new studio over the next twelve months. BKN management believe that high-definition production will become increasingly important for animation companies in the future. We will wait to see how much the new studio is likely to contribute to revenues and earnings in the medium term, though we see no reason to alter our projections for FY 06/07.

We have adjusted our discounted-cash-flow (DCF) model to take into account BKN's recently completed capital increase and new investment.

In our valuation of 27 June we valued the company at €3.20 per share. At the time BKN had 15.7m shares outstanding. The dilution effect caused by the new issued shares, the investment in HD technology and maintained revenue forecasts lead to a price-target reduction of €0.30 in our valuation. Using First Berlin methodology, which takes into account company-specific risk factors, our cost of equity is unchanged compared with our previous DCF valuation at 13.5%. Our weighted average cost of capital is also unchanged at 10.5%. Our adjusted valuation places a fair value on the stock of €2.90.

RECOMMENDATION

Despite our reduced price target, we remain positive on BKN. The fundamentals of the company have not changed since we published our comprehensive report on 27 June. Furthermore, by paying off two more of its outstanding convertible bonds, the company has reduced its financial risk. All the other risks highlighted in our 27 June report remain unchanged. Therefore we maintain our Buy recommendation with a reduced price target of €2.90 (€3.20) and a High risk rating.

RISKS

Risks to our price target include but are not limited to: delays in animated series development; a decrease in TV programme budgets; delays in client acquisitions; non-renewals of existing contracts and changing consumer interests.

IMPORTANT DISCLOSURES ARE AT THE BACK OF THIS REPORT

TRADING DATA

Market capitalisation (02.08.07)	€50.05m
Shares outstanding	19.40m
Closing price (02.08.07)	€2.58
52-week range	€2.24 / 3.61
Free float (according to Bloomberg)	50.2%
Average daily share volume (year)	14,348

STOCK OVERVIEW



Source: Bloomberg & First Berlin

FINANCIAL HISTORY & PROJECTIONS

	2004/05	2005/06	2006/07E	2007/08E
Revenue €m	11.97	13.89	17.40	21.50
Yr/Yr growth	44.4%	16.1%	25.2%	23.6%
Operating profit €m	3.20	4.74	6.09	7.46
Operating margin	26.7%	34.1%	35.0%	34.7%
Net income €m	4.29	4.50	4.74	5.60
EPS €	0.28	0.29	0.27	0.29
P/E	9.2	9.0	9.6	8.9

COMPANY DATA (as of 31 March 2007 unless noted)

Liquid assets	€6.23m
Current assets	€9.77m
Intangible assets	€42.32m
Total assets	€55.50m
Current liabilities	€1.21m
Total shareholders' equity	€30.46m

ANALYST INFORMATION

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VALUATION

All figures in €T	2005/06	2006/07E	2007/08E	2008/09E	2009/10E	2010/11E	2011/12E	2012/13E
Net sales	13,893	17,400	21,500	25,800	31,012	37,015	43,308	50,704
(y-o-y change)	16.1%	25.2%	23.6%	20.0%	20.2%	19.4%	17.0%	17.1%
Operating profit	4,743	6,090	7,461	8,772	10,544	11,845	12,992	14,197
(operating margin)	34.1%	35.0%	34.7%	34.0%	34.0%	32.0%	30.0%	28.0%
Net income / loss	4,495	4,743	5,602	6,233	7,786	9,029	10,184	11,411
+ depreciation & amortis.	1,430	3,352	5,504	6,889	8,294	9,694	11,337	12,788
= net operating cash flow	5,925	8,095	11,106	13,122	16,080	18,723	21,521	24,199
- total investments (Capex and WC)	-12,479	-16,627	-18,281	-10,927	-11,856	-12,776	-13,927	-19,022
Capital expenditure	-14,477	-16,611	-18,240	-10,884	-11,804	-12,716	-13,865	-18,948
working capital	1,998	-16	-41	-43	-52	-60	-63	-74
+/- others (incl. adj. on net interest, etc.)	-876	-377	-524	-816	-638	-347	-10	438
= Free cash flow (FCF)	-7,430	-8,909	-7,699	1,379	3,587	5,600	7,584	5,615
PV of FCF's	0	-8,749	-6,842	1,109	2,611	3,689	4,522	3,030

All figures in €T	
PV of FCFs in explicit period	24,680
Residual free cash flow	11,827
FV residual period CFs in last year explicit period	139,243
PV of FCFs in terminal period	33,818
Enterprise value (EV)	58,498
+ Net cash / - net debt (31/03/07)	-2,250
Shareholder value	56,248
shares outstanding (m)	19,400
Fair value per share in €	2.90

Sensitivity analysis

		WACC						
		7.5%	8.5%	9.5%	10.5%	11.5%	12.5%	13.5%
Terminal growth rate	0.5%	4.86	3.93	3.22	2.67	2.23	1.87	1.57
	1.0%	5.09	4.08	3.32	2.74	2.28	1.90	1.60
	1.5%	5.34	4.24	3.43	2.81	2.33	1.94	1.62
	2.0%	5.65	4.43	3.56	2.90	2.39	1.98	1.65
	2.5%	6.02	4.66	3.70	3.00	2.45	2.03	1.69
	3.0%	6.47	4.92	3.87	3.10	2.53	2.08	1.72
	3.5%	7.03	5.24	4.06	3.23	2.61	2.14	1.77

Fair value per share in €

WACC	10.5%
cost of equity	13.5%
pre-tax cost of debt	7.2%
normal tax rate	30.0%
after-tax cost of debt	5.0%
share of equity	65.3%
share of debt	33.0%
Terminal sales growth	2.0%
Terminal EBIT margin	18.0%

		2007 P/E exit multiples						
		7.5%	8.5%	9.5%	10.5%	11.5%	12.5%	13.5%
Terminal growth rate	0.5%	19.9x	16.1x	13.2x	10.9x	9.1x	7.6x	6.4x
	1.0%	20.8x	16.7x	13.6x	11.2x	9.3x	7.8x	6.5x
	1.5%	21.9x	17.4x	14.0x	11.5x	9.5x	7.9x	6.6x
	2.0%	23.1x	18.1x	14.6x	11.9x	9.8x	8.1x	6.8x
	2.5%	24.6x	19.1x	15.1x	12.3x	10.0x	8.3x	6.9x
	3.0%	26.5x	20.1x	15.8x	12.7x	10.3x	8.5x	7.1x
	3.5%	28.8x	21.4x	16.6x	13.2x	10.7x	8.7x	7.2x



INCOME STATEMENT ANALYSIS

All figures in €T	2003/04	2004/05	2005/06	2006/07E	2007/08E	2008/09E	2009/10E
Revenues	8,290	11,967	13,893	17,400	21,500	25,800	31,012
Cost of goods sold	0	0	0	0	0	0	0
Gross profit	8,290	11,967	13,893	17,400	21,500	25,800	31,012
HR expenses	-1,110	-2,099	-2,993	-3,400	-3,940	-4,561	-5,272
Operating expenses	-171	-232	-985	-708	-360	-919	-1,009
Goodwill amortisation + depreciation	-3,245	-2,679	-1,430	-3,352	-5,504	-6,889	-8,294
General and administrative expenses	-1,914	-3,761	-3,742	-3,850	-4,235	-4,659	-5,892
Operating income	1,850	3,196	4,743	6,090	7,461	8,772	10,544
Net financial result	-158	-225	-625	-838	-1,152	-1,633	-1,468
Other financial income and expenses	0	0	0	17	22	26	31
Income before income taxes and minority interests	1,692	2,971	4,118	5,270	6,330	7,164	9,107
Income taxes	-2	1,318	377	-527	-728	-931	-1,320
Net income / loss	1,690	4,289	4,495	4,743	5,602	6,233	7,786
EPS	0.14	0.28	0.29	0.27	0.29	0.32	0.40
EBITDA	5,095	5,875	6,173	9,442	12,965	15,661	18,838
Y-o-y growth							
EBIT margin	22.3%	26.7%	34.1%	35.0%	34.7%	34.0%	34.0%
EBITDA margin	61.5%	49.1%	44.4%	54.3%	60.3%	60.7%	60.7%
Net income margin	20.4%	35.8%	32.4%	27.3%	26.1%	24.2%	25.1%
Effective tax rate	0.1%	-44.4%	-9.2%	10.0%	11.5%	13.0%	14.5%
Expenses as % of total output							
Human resources	13.4%	17.5%	21.5%	19.5%	18.3%	17.7%	17.0%
Goodwill amortisation + depreciation	39.1%	22.4%	10.3%	19.3%	25.6%	26.7%	26.7%
Other operating income / expenses	23.1%	31.4%	26.9%	22.1%	19.7%	18.1%	19.0%
Y-o-y growth							
Total revenues	84.6%	44.4%	16.1%	25.2%	23.6%	20.0%	20.2%
Operating income	-221.2%	72.8%	48.4%	28.4%	22.5%	17.6%	20.2%
Net income / loss	-233.9%	153.8%	4.8%	5.5%	18.1%	11.3%	24.9%



BALANCE SHEET ANALYSIS

All figures in €T	2003/04	2004/05	2005/06	2006/07E	2007/08E	2008/09E	2009/10E
Assets							
Current assets, total	5,827	3,704	3,933	4,721	6,020	7,482	8,993
Cash and cash equivalents	2,220	384	1,648	1,241	1,720	2,322	2,791
Trade accounts and notes receivable	1,870	2,048	1,496	2,436	3,010	3,612	4,342
Other current assets and prepaid expenses	1,737	1,272	789	1,044	1,290	1,548	1,861
Non-current assets, total	16,686	25,581	39,888	53,184	65,465	69,066	71,947
Property, plant and equipment	70	69	127	2,100	5,150	5,176	5,202
Goodwill and intangible assets	16,056	23,602	36,591	47,821	57,441	61,341	64,741
Deferred financing costs	342	188	738	900	600	400	0
Deferred tax assets	0	1,502	2,209	2,084	1,929	1,735	1,507
Others	218	220	223	279	345	414	498
Total assets	22,513	29,285	43,821	57,905	71,485	76,548	80,941
Shareholders' equity & debt							
Current liabilities, total	1,213	1,164	2,127	3,306	4,085	4,902	5,892
Trade payables	201	261	1,166	1,740	2,150	2,580	3,101
Other current liabilities	1,012	903	961	1,566	1,935	2,322	2,791
Long-term liabilities, total	5,025	4,045	13,059	17,539	24,738	22,751	18,367
Long-term debt	5,000	3,851	12,604	17,000	24,072	21,951	17,406
Long-term provisions	25	22	14	17	22	26	31
Deferred taxes	0	172	441	522	645	774	930
Shareholders equity, total	16,275	24,076	28,635	37,060	42,662	48,895	56,681
Share capital	15,012	15,718	15,718	19,400	19,400	19,400	19,400
Capital reserve	70,148	8,161	8,286	8,286	8,286	8,286	8,286
Other comprehensive income	121	197	136	136	136	136	136
Loss carryforward / retained earnings	-69,006	0	4,495	9,238	14,840	21,073	28,859
Total consolidated equity and debt	22,513	29,285	43,821	57,905	71,485	76,548	80,941
RATIOS							
Current ratio	4.80	3.18	1.85	1.43	1.47	1.53	1.53
Quick ratio	3.37	2.09	1.48	1.11	1.16	1.21	1.21
Equity ratio (as%)	72.3%	82.2%	65.3%	64.0%	59.7%	63.9%	70.0%
Debt to equity ratio (gearing as %)	30.7%	16.0%	44.0%	45.9%	56.4%	44.9%	30.7%
Equity per share	1.34	1.57	1.82	2.11	2.20	2.52	2.92
Net debt	2,780	3,467	10,956	15,759	22,352	19,629	14,615
Interest coverage ratio	9	12	32	7	6	5	7
Capital employed (CE)	18,520	25,827	36,876	50,095	62,806	66,775	70,253
Return on equity (ROE)	15.9%	21.3%	17.1%	14.4%	14.1%	13.6%	14.8%
Return on capital employed (ROCE)	13.3%	14.4%	15.1%	14.0%	13.2%	13.5%	15.4%
Return on net assets (RONA)	12.1%	19.3%	14.3%	10.9%	9.9%	9.6%	11.4%



CASH FLOW ANALYSIS

All figures in €T	2003/04	2004/05	2005/06	2006/07E	2007/08E	2008/09E	2009/10E
Net income	1,690	4,289	4,495	4,743	5,602	6,233	7,786
Depreciation and amortisation	3,245	2,679	1,430	3,352	5,504	6,889	8,294
Investment in working capital	-4,484	464	1,376	-16	-41	-43	-52
Others	0	-1,330	-438	209	282	327	390
Operating cash flow	451	6,102	6,863	8,288	11,347	13,407	16,418
CAPEX	-8,295	-10,299	-14,477	-16,611	-18,240	-10,884	-11,804
Free cash flow	-7,844	-4,197	-7,614	-8,323	-6,893	2,523	4,614
Change in cash	2,194	-1,836	1,264	-407	479	602	469
Cash, start of the year	26	2,220	384	1,648	1,241	1,720	2,322
Cash, end of the year	2,220	384	1,648	1,241	1,720	2,322	2,791
Cash flow per share in €	0.04	0.40	0.44	0.47	0.58	0.69	0.85
Y-o-y growth							
Operating cash flow	-70.3%	1253.0%	12.5%	20.8%	36.9%	18.1%	22.5%
Free cash flow	-1411.4%	46.5%	-81.4%	-9.3%	17.2%	136.6%	82.9%
Cash flow per share	-79.2%	970.7%	9.9%	8.1%	23.9%	18.1%	22.5%



FIRST BERLIN RECOMMENDATION & PRICE TARGET HISTORY

Report No.:	Date of publication	Previous day closing price	Recommendation	Price target	Interim high	% change to high
Initial Report	3 February 2006	€1.87	Strong Buy	€2.75	-	-
2...10	↓	↓	↓	↓	↓	↓
11	23 January 2007	€3.00	Buy	€3.75	€3.25	8.0%
12	27 June 2007	€2.78	Buy	€3.20	€2.72	-2.2%
13	29 June 2007	€2.51	Buy	€3.20	€2.76	10.0%
14	Today	€2.58	Buy	€2.90	-	-

Source: Bloomberg & First Berlin

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First Berlin's investment rating system 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:

BUY: Expected return greater than 15%
HOLD: Expected return between 0% and 15%
SELL: Expected negative return

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 and political uncertainty, company size, free float and other company specific risks. These risk factors are incorporated into our valuation models and are therefore reflected in our price targets. Our models are available upon request to First Berlin clients.

Up until 30 June 2005, First Berlin's investment rating system was five 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: STRONG BUY: expected return greater than 20%, BUY: expected return greater than 10%, HOLD: fairly valued, REDUCE: expected return between -10% and 0%, SELL: expected return to depreciate by more than 15%. In addition, we had a SPECULATIVE BUY recommendation for stocks which we projected had the potential to give a return of 50% or more but which we also expected to be exceptionally volatile (movement up or down of 50% or more). Our risk ratings were Low, Medium, High and Speculative and were a reflection of expected price volatility, the strength of the balance sheet and the predictability of earnings.

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