

2004

ANNUAL REPORT  
2004



INTERTAINMENT

Aktiengesellschaft

## Key indicators

(million euros)	2004	2003
Sales	17.9	6.0
EBIT	-21.3	-8.9
Result of ordinary business activities	-16.8	-28.7
Net profit for the period	-22.2	-14.1
Earnings per share (euros)	-1.89	-1.20
Average number of employees	13	23

## Key data for the share

ISIN	ISIN: DE0006223605	
Share capital	15,005,155.09 euros	
Number of shares	11,739,013	
Issue price 8/2/1999	36.00 euros	
	after split (1:2)	18.00 euros
Closing price* at 31/12/2004	2.13 euros	
High* for 2004 (18/6/2004)	5.65 euros	
Low* for 2004 (24/8/2004)	1.76 euros	
Shareholder structure at 31/12/2004	Rüdiger Baeres	
	(directly and indirectly)	60.35 %
	Management and Supervisory Board**	0.20 %
	Free float	39.45 %

\*Closing prices in Xetra electronic trading    \*\*excluding Rüdiger Baeres

## Corporate calendar

1 <sup>st</sup> Quarter 2005 Earnings Report	Mai 31, 2005
Annual General Meeting	August 2005
2 <sup>nd</sup> Quarter 2005 Earnings Report	August 31, 2005
3 <sup>rd</sup> Quarter 2005 Earnings Report	November 30, 2005
Analyst Conference	November 2005

## Contact

New Address from 1/7/2005

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## Dear Shareholders,



**Achim Gerlach,**  
Sole Member of the Board of Management  
of the Intertainment AG

During the business year 2004 and the initial months of 2005, Intertainment AG took important steps forward in successfully concluding the legal disputes relating to budget fraud in the USA. In the summer of 2004, the Federal District Court in Santa Ana near Los Angeles found American film producer Franchise Pictures, its former CEO Elie Samaha and 16 production companies liable for having perpetrated fraud on Intertainment. Moreover, all counter-claims against INTERTAINMENT Licensing GmbH and against the incumbent Chairman of the Supervisory Board of Intertainment AG, Rüdiger Baeres, were rejected by the jury, which consisted of nine members. Damages totaling 121.7 million US dollars were granted to Intertainment.

However, the judgment only constitutes one of several steps toward implementing our claims. A direct consequence of the judgment was the bankruptcy of Franchise Pictures and most of the other companies

found liable for the fraud. Intertainment is pursuing the claims against these parties in the corresponding insolvency proceedings. We have also instituted enforcement measures against Mr. Samaha.

Intertainment has also been working toward bringing the litigation with Comerica Bank and the other parties involved in the fraud perpetrated by Franchise Pictures to a positive conclusion and obtaining damages for the fraud.

In December 2004, Intertainment reached a settlement with reinsurance company XL Reinsurance America Inc. And in March 2005, Intertainment arrived at a settlement with the two bond companies Film Finances Inc. and Film Finances (1998) Canada.

The three bond companies were among our opponents in the arbitration proceeding against Comerica Bank, which concerns the claims by Intertainment against

the other parties involved in the fraud. This proceeding is also being held in the USA. We are claiming damages amounting to at least 100 million US dollars, as in the Franchise trial.

The arbitration proceeding was still in the discovery phase when this Annual Report was being prepared. This represented a considerable delay compared with the original schedule. We are directing our efforts toward ensuring that the oral hearing takes place as soon as possible.

This path is particularly pressing in view of the fact that Intertainment continues to feel the negative impact of the fraud. Although Intertainment succeeded in significantly increasing sales through exploitation of the thriller "Twisted" in the business year 2004, we had to carry out comprehensive restructuring measures due to the extended length of the litigation, which significantly affected our business,

notably in North America. It looks likely that consolidated sales will once again be significantly reduced in 2005.

From today's perspective, Intertainment will only be in a position to systematically rebuild its operating activities – film production and sale of film rights – once we have brought litigation to a successful conclusion. However, we are optimistic that we will achieve this goal during the foreseeable future.

**Achim Gerlach,**  
Sole Member of the  
Board of Management  
of the Intertainment AG

# Report of the Supervisory Board

During the period under review, the Supervisory Board fulfilled all the duties required of it by law and by the company's statutes, and continuously consulted with the company's management and monitored its activities. It received regular reports from the Board of Management about the development of the company and about important items of its business, and these were regularly discussed with the Board of Management.

Discussions were held on the general development of the company and important individual items of business, and particular attention was given to decisions concerning company strategy and future financing and restructuring, including the safeguarding of the company's liquidity. Where required by law or the company's statutes, the Supervisory Board gave or withheld its approval of proposals put forward by the Board of Management, following a thorough examination of the issues involved. The Supervisory Board also devoted special attention, together with the Board of Management, to the questions of the risks arising for the company from the lawsuit against the Franchise Group and other parties. The focus of the year under review was the successful outcome in June 2004 to the lawsuit against Franchise Pictures LLC and other parties.

The Supervisory Board held six sessions during the year 2004. In addition, regular meetings took place with the company's Board of Management, in which important issues were discussed and reviewed. The Supervisory Board also regularly requested and received reports from the Board of Management on important individual issues. The Supervisory Board also devoted continuing attention in the course of several sessions to the adjustment of the company's business strategies and the recapitalization of the company. A particular focus was safeguarding the liquidity of the company and instituting a range of measures directed toward reconciling costs and structure, while working closely with the Board of Management to develop appropriate concepts. The discussions also addressed the issue of the future financing of the company, particularly in relation to the lawsuits in the USA.

In its first session on February 18, 2004, the Supervisory Board discussed in detail with the Board of Management the status of the company's lawsuit against the Franchise Group, the Comerica Bank, and other parties, the status of the restructuring measures, together with strategic issues for the business year 2004. The meeting on June 24, 2004, focused primarily on a discussion of the progress in the lawsuit in the USA and the future strategy of the company. In the session on, August 5, 2004, the Board of Management submitted the drafts of the annual financial statements of the Intertainment Group for 2003 to the Supervisory Board. In the course of this session, a detailed discussion took place with the company's auditors on the audit carried out, and the strategic issues and developments in the litigation in the USA were addressed intensively. KPMG subsequently completed its audit of the bookkeeping, the annual financial statements and the management report of Intertainment AG, and of the consolidated financial statements and consolidated management report for the year ended December 31, 2003, while regularly reporting to the Supervisory Board. KPMG gave a limited certification in each case to the bookkeeping, the annual financial statements and the management report of Intertainment AG and the consolidated financial statements and consolidated management report. The written audit report was submitted to the Supervisory Board on September 15, 2003 by the auditors. The Supervisory Board gave its official approval to the result of the audit – in accordance with the restricting premises applied by KPMG – at the balance-sheet meeting held on September 18, 2004, and following detailed discussion of the points raised in connection with the balance sheet, the Supervisory Board approved the annual financial statements of Intertainment AG for the year ended December 31, 2003 and the consolidated financial statements for the year ended December 31, 2003. The Supervisory Board already reported extensively on these matters in its report for the business year 2003 on September 18, 2004.

On October 29, 2004 – in advance of the Annual General Meeting – the progress of the litigation in the USA,



Rüdiger Baeres, Chairman



Dr. Matthias Heisse, Deputy Chairman

Wolfgang Blauburger, Member

the ongoing finance of the company and issues relating to the Board of Management were discussed in detail. At the Annual General Meeting held on the same day, the Chairman of the Board of Management, Rüdiger Baeres, resigned from his position as Chairman of the Board of Management and from his role as member of the Board of Management, after 6 years of service on the Board of Management of Intertainment AG, in order to move to the Supervisory Board. Since that date, Achim Gerlach has been the sole Member of the Board of Management of the company. The Annual General Meeting held on October 29, 2004 also elected the new Supervisory Board on the basis of rotation. The new members of the Supervisory Board were elected for the period until the end of the Annual General Meeting which approves the actions of the Supervisory Board for the business year 2008. They are Rüdiger Baeres, Dr. Matthias Heisse and Wolfgang Blauburger. At the subsequent constituent meeting of the Supervisory Board, Rüdiger Baeres was elected as the new Chairman of the Supervisory Board, while the incumbent Chairman Dr. Matthias Heisse, was elected as Deputy Chairman of the Supervisory Board. Dr. Wilhelm Bahner, who was a Member of the Supervisory Board for three years, did not put himself forward to the Annual General Meeting for election. The Supervisory Board thanks Dr. Bahner for his committed activity during the years he held his position as a Member of the Supervisory Board of the company.

The Annual General Meeting of Shareholders on October 29, 2004 appointed KPMG Deutsche Treuhandgesellschaft Aktiengesellschaft Wirtschaftsprüfungsgesellschaft, Berlin and Frankfurt/Main, to audit the company's results for the business year 2004.

The meeting on February 24, 2005 focused primarily on a discussion with the Board of Management of the progress with the lawsuit in the USA and strategic issues for the business year 2005, and the status of the audit proceedings of KPMG in the context of drawing up the annual financial statements for the business year 2004. KPMG subsequently completed its audit of the book-

keeping, the annual financial statements and the management report of Intertainment AG, and of the consolidated financial statements and consolidated management report for the year ended December 31, 2004 while regularly reporting to the Supervisory Board. KPMG gave a limited certification with qualifications in each case to the bookkeeping, the annual financial statements and the management report of Intertainment AG and the consolidated financial statements and the consolidated management report. On April 28, 2005, the Board of Management submitted the consolidated financial statements of the Intertainment Group prepared for 2004 to the Supervisory Board. Also on April 28, 2005 the draft of the written audit report was submitted to the Supervisory Board by the auditors.

The Supervisory Board gave its official approval of the results of the auditors' investigations – in accordance with the restricted premises stated by KPMG – in the balance-sheet meeting held on May 3, 2005, following detailed discussion of the points raised in connection with the balance sheet and annual financial statements of Intertainment AG for the year ended December 31, 2004 and the consolidated financial statements for the year ended December 31, 2004.

Both the members of the Board of Management and the staff of the company have shown a high degree of commitment during the past year in their endeavors to keep the company progressing despite the challenging conditions. A favorable outcome was achieved in the trial for damages against Franchise Pictures and others in the USA and this bore testimony to the extraordinary degree of dedication shown by members of the staff. The Supervisory Board would like to express its thanks for this outstanding commitment to all those involved and also acknowledge their dedication.

Munich, Mai 3, 2005  
The Supervisory Board

Rüdiger Baeres,  
Chairman



# Chronology of the Franchise Pictures case

Intertainment publishes a chronology of the Franchise Pictures case here to elucidate the processes, interconnections and complexities of the case. Extensive explanations on the relevant events in the case that occurred during the reporting period may be found in the Management Report starting on page 17.



<b>12/2000</b>	→	Negotiations with Andrew Stevens, President and COO of Franchise Pictures, concerning an amicable settlement break down.
	→	Intertainment takes legal action against Franchise Pictures before the Federal District Court of Los Angeles.
	→	Franchise Pictures reacts by taking legal action against Intertainment.
<b>02/2001</b>	→	Intertainment also takes action against Imperial Bank (now Comerica Bank).
<b>04/2001</b>	→	The Judge decides that the general case is to be suspended and that priority should be given to the arbitration proceedings against Imperial Bank (now Comerica Bank).
<b>05/2001</b>	→	Intertainment withdraws the lawsuit against Imperial Bank (now Comerica Bank) in order to further pursue the legal proceedings against Franchise Pictures.
<b>06/2001</b>	→	The Judge rescinds the temporary suspension of the lawsuit against Franchise Pictures.
<b>08/2001</b>	→	Intertainment files the third version (update) of the statement of claim against Franchise Pictures.
	→	The date of the hearing is fixed for September 10, 2002. Completion of the discovery stage is scheduled for May 27, 2002.
<b>09/2001</b>	→	The Court orders Franchise Pictures to respond to the interrogatories presented by Intertainment on the budgets of the films in dispute .
	→	The Court also grants a petition from Intertainment that obliges the Imperial Bank (now Comerica Bank) to release discovery documents.
	→	The Court rejects a petition from Imperial Bank (now Comerica Bank) filed because the bank wanted to refuse to release documents to Intertainment for reasons of "confidentiality".
<b>10/2001</b>	→	The Court orders that Film Finances Canada has to submit documents and answer questions on the budgets.

	→	The case is assigned to a new Judge meaning that there are delays in the court dates.
<b>12/2001</b>	→	The Judge sets June 3, 2002 as the final date for the discovery proceedings and sets November 19, 2002 as the date for proceedings (ten days for a jury trial).
<b>01/2002</b>	→	The court orders that Franchise Pictures has to surrender budget documents and imposes monetary sanctions and that Franchise Pictures cannot assert "confidentiality".
	→	The Court orders monetary sanctions against Franchise Pictures again because they did not answer all questions in connection with the film budget.
<b>02/2002</b>	→	The Court orders monetary sanctions against Comerica Bank (formerly Imperial Bank) because it disregarded court orders.
<b>04/2002</b>	→	Intertainment filed a motion for "writ of attachment" against Franchise amounting to 24 million dollars, in order to secure access to at least a portion of the claims against Franchise.
<b>05/2002</b>	→	The Federal District Court in Los Angeles upheld the pleading of two of three RICO claims against Franchise and its principals, Samaha and Stevens. With this claim, victims of organized crime are entitled to triple compensation and to the refund of attorneys' fees.
<b>08/2002</b>	→	Further, the Court upheld the allegation of a criminal enterprise involving Comerica Bank (formerly Imperial Bank) and WorldWide Film Completion, Inc.
<b>11/2002</b>	→	At a Pretrial Conference, the Franchise lawyer reported on possible problems in representing Franchise in the trial. The judge vacated the trial date set for November 19, 2002. A new trial date is to be set at a new Pretrial Conference on December 16, 2002.
	→	The Magistrate Judge did not uphold the application by Intertainment for a writ of attachment over some of the assets of Franchise. This order will have no effect on the trial.
	→	The protective order applied for by Franchise regarding confidentiality of the trial documents was revoked in part by the Magistrate Judge as applied for at the initiative of Intertainment .
<b>12/2002</b>	→	The court accepts the withdrawal of the lawyers representing Franchise Pictures from the case.
	→	The court postpones the start of the trial until August 5, 2003.
	→	Intertainment reasserts a lawsuit in California State Court against Comerica Bank and extends this suit to WorldWide Film Completion, Film Finances and executives of the three companies.

## Chronology of the Franchise Pictures case



<p><b>01/2003</b> → Franchise appoints new lawyers.</p>	
<p><b>02/2003</b> → Comerica Bank institutes arbitration proceedings against Intertainment relating to payment for the film "Driven".</p>	
<p><b>06/2003</b> → At a pre-trial conference, the United States District Court judge confirmed August 5 as the date for the start of the main hearing for the lawsuit against Franchise.</p> <p>→ The United States State Court judge announced at a hearing that an application by Comerica Bank to have the lawsuit filed by Intertainment postponed had been granted until a decision was reached on the arbitration proceedings.</p> <p>→ By filing replies and counterclaims, Intertainment ensures that the arbitration proceedings instituted by Comerica Bank for the "Driven" case are significantly expanded. As a result, the arbitration case covers all the disputed Franchise films which were financed by the bank and all claims for damages asserted by Intertainment in the lawsuit against the bank and the bond companies in the state court.</p> <p>Comerica Bank extended the claims filed in the arbitration proceedings to all Franchise films for which Intertainment had not paid the second installment to the bank.</p> <p>→ The dummy company International Motion Pictures Corporation based in Hong Kong opens an arbitration case against Intertainment for the Franchise film "Tracker". It demands the sum of 3.3 million US dollars plus interest.</p>	<p><b>04/2004</b> → The presiding judge confirms April 20 as the start of the main trial at a pre-trial conference.</p> <p>→ At the weekend before the start of the main trial, Intertainment reaches a settlement with Andrew Stevens, the former president and COO of Franchise Pictures. Stevens personally was one of the defendants. The settlement includes a payment from Stevens to Intertainment.</p> <p>→ On April 20, the main trial in the lawsuit for damages against Franchise Pictures starts at the Federal District Court in Santa Ana near Los Angeles.</p> <p>→ In order to assert its claims, INTERTAINMENT Licensing GmbH files a lawsuit in the case of the film "Viva las Nowhere" produced by Franchise Pictures against the bank financing the film, the Lewis Horwitz Organization, and against two syndicating banks. Intertainment demands a total of 2 million US dollars.</p>
<p><b>07/2003</b> → The court postpones the start of the main trial and asks the parties involved to agree on a new court date in March, April, May or August 2004.</p>	<p><b>06/2004</b> → Intertainment wins the trial for damages against Franchise Pictures and others. On June 16, 2004, the jury of nine unanimously declares all the defendants in the fraud case against Intertainment to be guilty and grants Intertainment compensation for damages amounting to a total of 77.1 million US dollars. The parties involved are Franchise Pictures, several subsidiaries, and the CEO of Franchise Pictures, Elie Samaha personally. The jury also rejects all countersuits brought by Franchise Pictures against Intertainment.</p> <p>→ The jury grants Intertainment additional punitive damages on June 18 amounting to 29 million US dollars. This brings the damages granted to Intertainment to a total of 106.1 million US dollars.</p>
<p><b>10/2003</b> → The court sets April 20, 2004 as the new date for the start of the main trial.</p>	
<p><b>11/2003</b> → The arbitrator in the "Tracker" case orders that the payments due from INTERTAINMENT Licensing GmbH in the USA should be deposited in a trustee account until the end of the arbitration tribunal.</p>	
<p><b>03/2004</b> → The arbitration tribunal for the "Driven" case decides on the schedule for the proceedings and subsequently schedules the start of the oral hearing for the beginning of 2005.</p>	
<p><b>03/2004</b> → The judge presiding over the main trial in the "Franchise Pictures" case at the Federal District Court releases the assets frozen by the arbitrator in the "Tracker" case.</p>	<p><b>08/2004</b> → The presiding judge publishes the final judgment. In this connection she approves interest payments on the damage sustained by Intertainment amounting to 15.6 million US dollars. This raises the total claim of Intertainment arising from the fraud trial to 121.7 million US dollars. The judge also makes it clear in her ruling that all the parties found guilty are jointly liable for the 77.1 million US dollars, and for the interest of 15.6 million dollars.</p> <p>→ Shortly after publication of the final judgment, Franchise Pictures and most of the subsidiary companies of Franchise Pictures file for insolvency pursuant to "Chapter 11" of the US Insolvency Law.</p> <p>→ Virtually all of the parties involved in the Franchise Pictures case agree to hold settlement negotiations.</p>

## Chronology of the Franchise Pictures case

09/2004	→	All the parties involved in the Franchise case meet in San Francisco for "global mediation" settlement negotiations. Negotiations break down.
12/2004	→	Intertainment concludes a settlement with reinsurer XL Reinsurance America Inc. Intertainment receives 5 million US dollars under the settlement from XL. In a countermove, Intertainment withdraws its claims against XL and Worldwide Film Completion, and specific claims against Worldwide's director Steve Cardone from the lawsuit before the Superior Court and from the arbitration proceeding in connection with the "Driven" case.
	→	International Motion Pictures Corporation succeeds in reinstating the arbitration proceeding in the "Tracker" case.
01/2005	→	First disclosure date relating to the assets of Elie Samaha. Intertainment had already had rights of lien registered over assets held by Samaha.
	→	The discovery phase in the arbitration proceeding against Comerica Bank and others ("Driven" case) takes longer than was originally envisaged. This means that the entire proceeding is delayed.
	→	The deadline of the restructuring manager of Franchise Pictures for submission of a restructuring plan is extended.
02/2005	→	Within the scope of the arbitration proceeding instituted by Intertainment, WestLB submits a counterclaim amounting to approx. 900,000 US dollars for damages relating to non-payment of the second installment for the film "Viva Las Nowhere".
03/2005	→	Intertainment concludes a settlement with the two bond companies Film Finances and Film Finances (1998) Canada. These and others are therefore no longer subject to claims by Intertainment in the arbitration proceeding against Comerica Bank and others.
	→	Intertainment also reaches a settlement with International Motion Pictures Corporation. This company withdraws its claims against Intertainment in the arbitration proceeding relating to the film "Tracker".
04/2005	→	Elie Samaha and Glickson Investment apply to have the trial against them declared null and void in post trial motions and request that a new trial be held. Franchise Pictures and the insolvent Franchise production companies also found liable accede to this application.

## Investor Relations

The most important international share markets on average achieved slight price gains in 2004. Between 31 December 2003 and year-end 2004, the Dow Jones Index in the USA posted a total increase of 3.1 %. At the end of 2004, the German share index (Dax) registered an increase of 7.3 % compared with the closing status of 2003. The Prime Media Performance Index performed better than these blue-chip indexes. The price performances of 23 German media companies listed on the Frankfurt Stock Exchange flow into this index – including Intertainment. The index rose by 13.2 % in a year-on-year comparison.

### Performance of the Intertainment share

As in the previous year, the Intertainment share diverged from the performance of the Prime Media Performance Index. Its value fluctuated very strongly over the course of the year. In June, immediately after the successful outcome of the trial against Franchise Pictures, the share price climbed to the highest levels for the year. Trading in the security in Xetra trading closed at an annual high of 5.65 euros on June 18. The Intertainment share registered the lowest levels of the year around two months later, after

### INDICATED STOCK PRICE DEVELOPMENT\*



\* 1/1/2004 = 100, in Percent



most of the parties found liable in the trial filed for insolvency. On August 24, the shares closed at an annual low of 1.76 euros. At the end of the year, the Intertainment share was being quoted at 2.13 euros, having lost 37.2 % of its value compared with the closing price for 2003.

The trading volume of Intertainment shares also fluctuated very significantly. The highest daily sales were posted immediately after the judgment in the trial for damages was handed down. On June 17, 2004 alone, nearly 660,000 shares were traded in Xetra. On average over the year, the trading volume on all German stock exchanges totaled around 40,000 shares a day.

Earnings per share for 2004 amount to -1.89 (p.y. -1.20) euros. A dividend is not being paid out for the business year 2003.

### Intertainment share quoted in the "Prime Standard"

In January 2003, equity markets on the Frankfurt Stock Exchange were classified into new segments. In this connection, the Prime Standard was created for official trading and the General Standard for regulated trading. The segments differ in the level of transparency requirements that apply to the listed companies. Companies in the General Standard meet the legal requirements, while the companies listed in the Prime Standard meet additional reporting obligations.

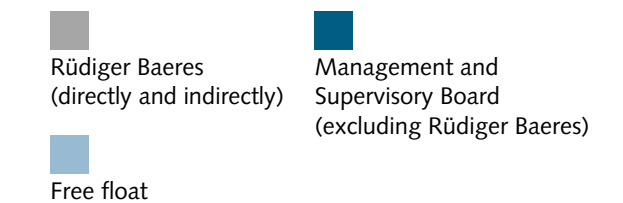
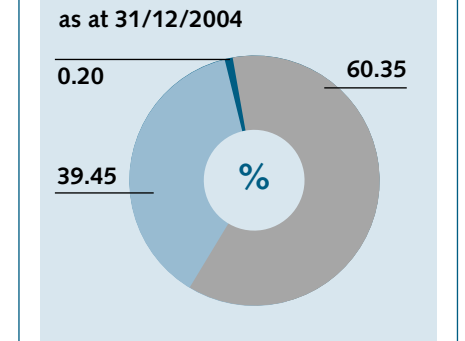
The Intertainment share has been quoted in the Prime Standard on the Frankfurt Stock Exchange since January 15, 2003 and is therefore subject to the maximum transparency requirements.

### Regular contacts

In 2004, Intertainment once again focused on immediate and comprehensive communication concerning events affecting Intertainment for all target groups in Investor Relations work. Press releases from the company were made immediately and simultaneously accessible to all interested parties on the Internet site of Intertainment AG. Intertainment was also in regular personal contact with the financial press, analysts, numerous private investors and other investors. Particularly during the weeks before, during, and after the trial against Franchise Pictures, Intertainment experienced interest in the company from these parties that was significantly above the normal level of interest.

Intertainment also provided comprehensive information on the position of the company at the Annual General Meeting on October 29, 2004 in Munich and at an analysts' conference that was also transmitted live over the Internet on November 23, 2004 within the scope of the Deutsches Eigenkapitalforum in Frankfurt.

## SHAREHOLDER STRUCTURE



The Annual General Meeting elected the former Chairman of the Board of Management, Rüdiger Baeres, who had previously resigned as a Member of the Board of Management, to the Supervisory Board of the company. At a meeting of the Supervisory Board after the Annual General Meeting, Mr. Baeres was also elected to the post of Chairman of the Supervisory Board of the Company. The previous Chairman of the Supervisory Board, Dr. Matthias Heise, was elected Deputy Chairman. The Annual General Meeting confirmed Wolfgang Blauburger in the office of third Member of the Supervisory Board

At the Annual General Meeting, the previous Deputy Chairman of the Supervisory Board, Dr. Wilhelm Bahner, resigned from the Supervisory Board. Intertainment would like to take this opportunity to thank Mr. Bahner for the great commitment he has shown in his position on the Supervisory Board.

### Capital measures

The Annual General Meeting held on October 29, 2004 authorized Intertainment AG to purchase its own shares amounting to a total of 10 % of the capital stock subject to certain provisos. The authorization is valid until April 28, 2006, and replaced the authorization granted by the Annual General Meeting on September 22, 2003 for the purchase of the company's own shares. To date, the Board of Management of Intertainment AG has not made use of this authorization.

### Corporate Governance

The Board of Management and the Supervisory Board of Intertainment AG have committed themselves to implementing the recommendations of the German Corporate Governance Code as far as possible. Any deviations relate solely to the publication of the salaries of the Members of the Board of Management, to the conclusion of a D&O insurance without deductible, and to the deadline for publishing the consolidated financial statements and the interim reports. An extensive explanation of the reasons for the deviations was given in the Annual Report for the year 2003. The Corporate Governance Code valid for the company is posted on the Internet site of Intertainment AG under [www.intertainment.de](http://www.intertainment.de), "The Share", "Corporate Governance", for purposes of inspection. This code provides information on the initiatives Intertainment has implemented voluntarily alongside the mandatory recommendations.



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# Intertainment Group and Intertainment AG: Management Report for the Business Year 2004

The Consolidated Management Report and the Management Report for the parent company Intertainment AG for the business year 2004 are combined pursuant to Article § 315 Section 3 HGB ("Handelsgesetzbuch", "German Commercial Code") in conjunction with Article § 298 Section 3. For this reason, information will be differentiated according to individual Group companies in the individual sections, insofar as this enhances transparency.

## A. Development of the markets in the year 2004

### 1. Overall economic development

#### Global upswing

The global economy underwent extremely gratifying development in the fiscal year 2004. In particular in Asia and the USA, gross domestic product experienced very strong growth. Growth in Western and Central Europe came out much lower by comparison. This was applicable in particular to Germany.

### 2. Development of the film industry

The film and media industry benefited to varying degrees from growth in the global economy during the year under review. While box-offices at cinemas tended to undergo moderate growth, sales in the DVD market continued their significant

upward trend and achieved a new record, although actual growth rates lagged substantially behind the percentage rise of the previous year. Business with television broadcasters continued to be difficult. Although they were pursuing a consistent policy of making savings in the film sector, the situation in Germany relaxed somewhat, because gross advertising revenues generated in the television industry went up by 3.7 % and the broadcasters therefore generated higher revenues than in previous years.

## B. Group's Position

### Development of Business Activity

The following report presents the development of the Intertainment Group during the business year 2004. The report will focus on the legal disputes pursued by INTERTAINMENT Licensing GmbH in the USA relating to the budgetary fraud and to the fundamental reorganization and restructuring measures implemented by Intertainment. Key events which occurred between the end of the business year and the preparation of this management report will be presented in section E. We refer to sections F and G for the risks.

### 1. Legal Disputes in the USA

Intertainment concentrated on the compensation proceedings for budgetary fraud and breach of contract pending in the USA during the business year. All proceedings related to INTERTAINMENT Licensing GmbH, with Intertainment AG involved in some proceedings. Although the opposing side had long pursued the strategy of imposing a financial burden on Intertainment by filing additional claims, deploying an extensive legal team, investing substantial financial resources and delaying proceedings as much as possible, INTERTAINMENT Licensing GmbH made significant progress during the course of the business year and achieved substantial success. In the main trial against American film producer Franchise Pictures, a jury of nine granted a total of 106.1 million US dollars in June 2004. The jury also unanimously rejected all the counterclaims by film producer Franchise Pictures against INTERTAINMENT Licensing GmbH, Intertainment AG and the (former) Chairman of the Board of Management Rüdiger Baeres. We also refer to the Annual Report for 2003 in which we have already reported extensively on the proceedings and the legal decision. When the judgment was entered, the presiding judge granted INTERTAINMENT Licensing GmbH, in addition to compensation, interest amounting to 15.6 million US dollars. The total claims arising from the proceedings amount to 121.7 million dollars. Shortly after publication of the final judgment, most of the parties found liable filed for insolvency under chapter 11 of the US Bankruptcy Code. Intertainment thereupon began to institute measures directly

after the judgment in order to pursue the disputed claims.

After the final judgment in the Franchise trial was entered, the arbitration proceeding was continued against Comerica Bank, the bond company Film Finances and against other parties involved. In the opinion of INTERTAINMENT Licensing GmbH, the opposing parties had been actively involved in the fraud perpetrated by Franchise Pictures. INTERTAINMENT Licensing GmbH demanded from them damages amounting to at least 100 million US dollars. At the end of the business year, the arbitration proceeding was in the discovery phase.

At the end of 2004, arbitration proceedings relating to the films "Tracker" and "Viva las Nowhere" meant that two further proceedings were pending in connection with the entire fraud case.

During the business year, two out-of-court settlements were also concluded with defending parties. Negotiations relating to a comprehensive settlement covering all parties came to nothing.

The following report gives a detailed presentation of the complexities of the entire case divided into the individual proceedings.

#### 1.1 Judgment in the Legal Dispute against Franchise Pictures

The fraud trial pursued by INTERTAINMENT Licensing GmbH against US film producer Franchise Pictures was at the center of legal proceedings pursued by Intertainment in the USA against US film producer Franchise Pictures for around three and a half years. In this connection, INTERTAINMENT Licensing GmbH had asserted claims for damages relating to fraudulently inflated budgets against Franchise

Pictures amounting to at least 100 million US dollars. Franchise Pictures is a film-producing company based in Los Angeles. This company was the main film supplier for Intertainment until autumn 2000. INTERTAINMENT Licensing GmbH and Franchise Pictures had agreed in 1999 that Intertainment would acquire the European exploitation rights in 60 films produced by Franchise within the space of five years.

During the course of 2000, it was discovered that Franchise had submitted invoices for fraudulently inflated budgets to INTERTAINMENT Licensing GmbH. In December 2000, Intertainment consequently filed a lawsuit relating to budgetary fraud in Los Angeles against Franchise Pictures, 15 production companies of Franchise, and personally against former CEO Elie Samaha and former COO Andrew Stevens. Intertainment also filed a suit against Glickson Investment LLC. This company is partly owned by Samaha and Stevens, and others.

After the trial was postponed several times, the main trial started on April 20, 2004 before the Federal District Court in Santa Ana near Los Angeles and continued with some interruptions for around two months. The nine-person jury held all the defendants to be liable and granted INTERTAINMENT Licensing GmbH total damages amounting to 77.1 million dollars.

Two days later, on June 18, 2004, the jury also granted punitive damages to INTERTAINMENT Licensing GmbH amounting to 29 million dollars. This verdict brought the total amount of the judgment to 106.1 million dollars. The decision by the jury to grant punitive damages allocated payment

as follows: 4 million US dollars were attributed personally to Elie Samaha, one million dollars to Franchise Pictures, and a further 1.5 million dollars to each of the other 16 companies involved. Punitive damages are a special feature of American law. They are additional payments on account of the reprehensible nature of the deed and are intended to punish the defendant additionally for their behavior, as well as acting as a deterrent to third parties. The level of punitive damages granted is determined, amongst other things, by the nature of the act committed.

When the judgment was entered in mid-August 2004, the presiding judge also approved claims for interest amounting to 15.6 million US dollars. This raised the total amount of the judgment to 121.7 million US dollars.

The jury did not uphold the RICO claims filed against Franchise Pictures and Elie Samaha by INTERTAINMENT Licensing GmbH. RICO claims are a special feature of American law, enacted in conjunction with anti-Mafia legislation. They grant the RICO plaintiffs the threefold sum of damages.

#### 1.2 Countersuit by Franchise Pictures

##### Jury rejects all countersuits

In December 2000, Intertainment AG, INTERTAINMENT Licensing GmbH and the former Chairman of the Board of Management and incumbent Chairman of the Supervisory Board of Intertainment AG Rüdiger Baeres personally were sued by Franchise Pictures, in a countermove to the suit filed by INTERTAINMENT Licensing GmbH, on the grounds that they had not kept, among other things, allegedly oral promises and had not made payments in

connection with the acquisition of film rights. The trial jury rejected these allegations in their decision on June 16, 2004.

### 1.3 Post Trial Motions and Appeal

When this management report was being prepared, post trial motions were pending before the court in connection with the successful trial against Franchise Pictures. These related to petitions that were filed after the entry of a legally enforceable judgment. A decision on the post trial motions was originally scheduled for mid-November. However, this date was postponed with the consent of INTERTAINMENT Licensing GmbH in the first instance to mid-December 2004 and then to 2005. In the context of the Post Trial Motions, Intertainment submitted a petition for reimbursement of costs and a petition to place joint liability on a firm legal basis. Franchise Pictures and its subsidiary companies, in turn, filed a petition requesting a retrial and a petition asking the court to restrict liability solely to the parent company Franchise Pictures, LLC.

Assuming that the post-trial motions were properly filed, the appeal period only begins once the judge has handed down a decision on these petitions. It lasts 30 days. This deadline is automatically extended for at least 60 days pursuant to the United States Bankruptcy Code. An appeal would not prevent enforcement of the judgment. This could only be prevented by a separate resolution by the court or if the defendants pay a bond as security.

### 1.4 Insolvency of Franchise Pictures and the Production Companies

A few days after the judgment was entered, Franchise Pictures and the majority of the other companies filed for insolvency pursuant to Chapter 11 of the US Insolvency Law. INTERTAINMENT Licensing GmbH therefore asserted its claims against Franchise Pictures and the insolvent companies in the insolvency proceedings. The Franchise creditors also include Comerica Bank. Other entities owned or controlled by the former Franchise investor David Bergstein also claim to be creditors in the case.

Within the scope of the insolvency proceedings, the companies R2D2, LLC and Mobius International Inc., which INTERTAINMENT Licensing GmbH understands to be owned or controlled by Bergstein, granted Franchise Pictures a debtor in possession financing. R2D2, LLC and Mobius also acquired various film rights from Franchise Pictures. INTERTAINMENT Licensing GmbH has received a commitment that transactions from earlier periods by means of which Franchise received additional cash inflows will be investigated. John Brincko, the Chief Restructuring Officer for Franchise Pictures has stated that he intends to examine whether legal transactions prejudicial to the creditors of Franchise Pictures have taken place in the past, which can be contested. However, at the close of the business year there was still no conclusive information available on this matter. The Chief Restructuring Officer was also unable to provide a reliable asset and debt status of Franchise Pictures to the creditors' committee by the close of the year.

Under American Law a company has the exclusive right to submit a restructuring

plan to the court for 120 days after opening insolvency proceedings pursuant to Chapter 11. It is possible to extend this period. In the case of the insolvency of Franchise Pictures, this exclusivity period was to expire by the end of the year. However, the Chief Restructuring Officer applied for and received an extension of the deadline to May 1, 2005. A further extension of the exclusivity period is likely.

### 1.5 Proceedings against Elie Samaha

Elie Samaha himself, the former CEO of Franchise Pictures, in office until the shortly before commencement of insolvency proceedings, had not filed for insolvency by the end of the business year. After the judgment was entered, INTERTAINMENT Licensing GmbH instituted measures directed toward enforcement and securing the existing claims against Elie Samaha. INTERTAINMENT Licensing GmbH therefore obtained a lien on property owned by Samaha in several counties in the State of California. Appropriate court orders enabling them to be seized were also obtained in relation to shareholdings owned by Elie Samaha. The date originally scheduled for the disclosure of the assets of Samaha in December 2004 was postponed with the consent of INTERTAINMENT Licensing GmbH to the beginning of 2005.

### 1.6 Lawsuit against Comerica Bank and the Bond Companies

#### In the discovery phase

INTERTAINMENT Licensing GmbH is of the opinion that apart from the defeated Franchise parties, other parties played a significant role in the budget fraud. These parties included in particular Comerica Bank, the bond companies Film Finances Inc., executive managers of these companies, and Film Finances (1998) Canada, XL Reinsurance and World Wide Film Completion. INTERTAINMENT Licensing GmbH therefore filed a lawsuit against these companies in December 2002 because of fraudulent cooperation with Franchise Pictures for damages before the State Court in Los Angeles. The bank had pre-financed many of the Franchise films provided with a fraudulent budget and had been aware of the inflated and the actual budgets. The bond companies had confirmed the fraudulent budgets with completion bonds to INTERTAINMENT Licensing GmbH, but had secured the actual budgets. Damages amounting to at least 100 million US dollars were also asserted in this lawsuit.

At the end of June 2003, the presiding judge decided during a hearing that the lawsuit should be suspended until a decision was reached on the arbitration proceeding instituted by Comerica Bank against INTERTAINMENT Licensing GmbH for the film "Driven" during the first quarter of 2003.

"Driven" is a film produced by Franchise Pictures in the year 2000. The film was part of the output deal with INTERTAINMENT Licensing GmbH. Comerica Bank had pre-financed the film. INTERTAINMENT Licensing GmbH had paid Comerica Bank two the first (of two) installments for the film.

Comerica Bank filed an arbitration suit for the second installment amounting to 13.6 million US dollars.

In the opinion of INTERENTAINMENT Licensing GmbH, the arbitration case was directed exclusively toward undermining the action commenced by INTERENTAINMENT Licensing GmbH against Comerica Bank and the bond companies. INTERENTAINMENT Licensing GmbH countered this attempt by significantly expanding the scope of the arbitration proceeding. It now encompasses all the claims arising from the lawsuit against all parties which were asserted before the State Court.

Comerica Bank reacted to the expansion by demanding more than 70 million US dollars from INTERENTAINMENT Licensing GmbH in the arbitration case. This amount corresponds to all the outstanding installments for all films it had financed under the output deal between Franchise Pictures and INTERENTAINMENT Licensing GmbH. The demands of Comerica Bank relate without exception to the fraudulently inflated budgets. Although the first installment was paid in each case, INTERENTAINMENT Licensing GmbH never received any of the disputed films for exploitation. Instead, the films were exploited by the opposing side. In addition to receiving the payments already made by INTERENTAINMENT Licensing GmbH on the basis of fraudulently inflated budgets, it had also received all the revenues arising from the films. The management of Intertainment is assuming that these revenues from the exploitation of film rights exceeded all the claims asserted by the opposing side.

Three arbitrators have been appointed to the tribunal in the arbitration proceeding. The oral proceedings were initially schedu-

led for November 2004. However, due to the scope and duration of the preceding Franchise case and discovery issues, they were postponed in mid-2004. A new arbitration date has not yet been set.

INTERENTAINMENT Licensing GmbH is assuming that the claims asserted by Comerica Bank are unfounded and by the same token views its own prospects for success as extremely positive. The decision in the trial against Franchise Pictures, the 16 other parties involved and Elie Samaha also points in this direction – even if was not intended to exert any prejudicial effect on the arbitration proceedings. If the outcome of the arbitration proceedings is in favor of INTERENTAINMENT Licensing GmbH, it is to be assumed that the resulting damages will form part of the claims arising from the Franchise trial. Intertainment believes that the claims arising from the arbitration proceedings against the Bank and the bond companies will in parts be founded on a joint liability with the claims successfully asserted in the Franchise case.

#### **1.7 Arbitration Proceeding for the Film "Tracker"**

In mid-June 2003, International Motion Picture Corporation Ltd. (IMPC), Hong Kong, commenced arbitration proceedings against INTERENTAINMENT Licensing GmbH. The company had acquired an alleged payment claim from Kredietbank Luxembourg

against INTERENTAINMENT Licensing GmbH in connection with the film "Tracker" and was asserting a claim amounting to 3.3 million US dollars plus interest. IMPC is a letter-box company based in Hong Kong. IMPC has at no point had any business dealings with INTERENTAINMENT Licensing GmbH.

"Tracker" was licensed to Intertainment by a company in the Franchise Group that has meanwhile become insolvent – without Intertainment ever having received the film.

After the arbitration claim was submitted, IMPC attempted in a number of ways through a court of law to obtain a pledge application for assets of INTERENTAINMENT Licensing GmbH amounting to around 4 million US dollars but failed to obtain the right of lien. However, the arbitrator appointed by the American Film Marketing Association (AFMA) – today known as the Independent Film & Television Alliance (IFTA) – ordered on November 12, 2003 that all payments due to INTERENTAINMENT Licensing GmbH be paid into a trustee account. However, the judge presiding over the main trial in the Franchise case released these funds at the end of March 2004 on application by INTERENTAINMENT Licensing GmbH.

In mid-January 2004, the judge also invoked a temporary injunction that the arbitration proceedings in the case of "Tracker" should be suspended until the Franchise case was concluded.

In December 2004, IMPC succeeded in restarting the arbitration proceedings.

Under the settlement agreement concluded with International Motion Pictures Corporation Ltd. on March 15, 2005, see item B.1.9 and item E.1.1, IMPC was obliged to withdraw the arbitration proceedings relating to the film "Tracker" against Intertainment.

#### **1.8 Arbitration Proceeding for the Film "Viva Las Nowhere"**

##### **Claim against WestLB and others**

Franchise subsidiary VLN Productions Inc. was found liable for budget fraud during the Franchise trial. This company had produced the film "Viva Las Nowhere". INTERENTAINMENT Licensing GmbH had already filed a claim in April 2004 in the USA against Westdeutsche Landesbank (WestLB), the Lewis Horwitz Organization and Federal Deposit Insurance Corp. in connection with this film. The parties were involved in financing the film. INTERENTAINMENT Licensing GmbH asserted a claim for repayment of an advance payment amounting to around 1.3 million dollars plus interest for the film. This advance payment was made on the basis of fraudulent budgets submitted. After the lawsuit was filed, the parties agreed to have the claim heard before an IFTA arbitration tribunal.



### 1.9 Out-of-court Settlements

#### Former COO of Franchise Pictures excluded from the lawsuit

Shortly before the start of the trial against Franchise Pictures and the other defendants, INTERENTAINMENT Licensing GmbH agreed an out-of-court settlement with Andrew Stevens, the former COO of Franchise Pictures. A confidentiality agreement was agreed on the content of the settlement. The settlement meant that Stevens was no longer included among the defendants in the Franchise case.

#### Settlement with XL Reinsurance – payment amounting to five million US dollars

At the beginning of December 2004, INTERENTAINMENT Licensing GmbH reached a settlement with XL Reinsurance America Inc. This company was involved as a bond company for Worldwide Film Completion, meanwhile insolvent, in the fraud case. Under the settlement, the company paid the sum of 5 million US dollars. In return, INTERENTAINMENT Licensing GmbH withdrew its claims against XL and against Worldwide Film Completion, as well as certain of its claims against Worldwide's sales director Steve Cardone arising from the lawsuit before the Superior Court and the arbitration proceedings. INTERENTAINMENT Licensing GmbH also agreed to waive contractual claims arising from the films "Battlefield Earth" and "Driven." Worldwide Film Completion had provided the completion bonds for these films. The parties agreed a confidentiality agreement relating to other details.

#### Settlement with Film Finances, Inc., Film Finances (1998) Canada and International Motion Pictures Corporation Ltd.

After the close of the business year, INTERENTAINMENT Licensing GmbH and Intertainment AG concluded a settlement agreement on the pending legal proceedings with the bond companies Film Finances, Inc. and Film Finances (1998) Canada, as well as with International Motion Pictures Corporation Ltd on March 15, 2005 International Motion Pictures Corporation Ltd. (IMPC). Explanations of the settlement are provided under item E 1.1 "Future Development of the Intertainment Group".

### 1.10 Negotiations about a Comprehensive Settlement

#### Discussions ended without result

Following the successful lawsuit against Franchise Pictures, all the parties involved in the fraud case agreed to start negotiations. The goal was to achieve a comprehensive settlement at the end of the negotiations. The talks were carried out within the scope of "Global Mediation" at the beginning of September 2004 in San Francisco. The didn't lead to any results.

## 2. Operating area

#### Extensive reorganization measures implemented

In spite of the very substantial burdens arising from the fraud perpetrated by Franchise Pictures, Intertainment attempted in the past to strengthen operating business. These efforts were focused on cooperation with the American film producer Kopelson Entertainment. The results of this coopera-

tion included the thriller "Twisted". Intertainment AG produced this film in collaboration with Paramount Pictures and Kopelson Entertainment. "Twisted" is the first major cinema film to be supplied by Intertainment AG to its customers since the discovery of the fraud perpetrated by Franchise Pictures. The film was delivered in the second quarter of 2004.

Although this was a positive development, the operating business of Intertainment suffered more than ever from the fraud perpetrated by Franchise Pictures and the other parties involved during the year under review. This is due to the fact that following postponement of the main hearing against Franchise Pictures in July 2003, Intertainment was compelled to implement extensive reorganization measures, in order to secure the continuing existence of the company as a going concern and finance the very expensive litigation in the USA. In this connection, Intertainment agreed with Paramount Pictures and Kopelson Entertainment to terminate and restructure contracts respectively at the start of 2004. These facts impacted positively on value in the financial statements and these measures were therefore already reflected in the figures for the year 2003. On the following pages, we present the key measures and events from the operating area in the business year 2004.

### 2.1 Development in the segments of film production and licensing

#### Termination of contract with Kopelson Entertainment

Intertainment AG had agreed comprehensive cooperation with the American film producer Kopelson Entertainment in mid-2000. The thriller "Twisted" was produced in the context of this cooperation. Since the reorganization and cost-cutting measures introduced by Intertainment AG could not be reconciled with the production requirements of Kopelson Entertainment, the two parties agreed to terminate their cooperation on February 11, 2004 after several months of negotiations. Terminating the contract released Intertainment AG from substantial financial obligations in the year 2004. The same applies to the coming years. Terminating the contract meant that Intertainment AG relinquished all the rights in the – originally joint – film projects still being developed by Intertainment and Kopelson Entertainment.

#### Contract with Paramount Pictures for the film "Twisted"

With a view to further restricting financial commitments and minimizing the risks associated with exploitation, Intertainment furthermore concluded a contract for the film "Twisted" with Paramount Pictures. On the basis of this contract, the two parties agreed on the distribution of the territories and the exploitation risks, with Intertainment AG acquiring fewer territories than originally projected.

#### "Twisted" launched in cinemas

"Twisted" was launched in American cinemas at the end of February 2004. Inter-

tainment had already used presales to market the film successfully. Licenses for large parts of Western and Eastern Europe, the Middle East, and Asia were sold. These license sales impacted on revenues during the first half of 2004.

**2.2 Development in the segment cartoon film and merchandising**

**Sale of the license rights in “Rudolph the Red-Nosed Reindeer”**

In the context of restructuring measures, Intertainment Animation & Merchandising GmbH, a subsidiary of Intertainment AG, sold its German-language rights in the Christmas figure “Rudolph the Red-Nosed Reindeer” to a subsidiary of Splendid Medien AG, Cologne. The company also sold its rights in “Ben & Bella’s World of Language” to the Splendid subsidiary. At that point, this was a learning toy for small children that was still at the development stage. Intertainment Animation & Merchandising GmbH had developed this product during the course of 2003 with the aim of expanding its product range. Development to market maturity and the planned marketing costs through to production launch would have involved substantial additional investments.

**3. Participation in SightSound Technologies Inc.**

**Agreement with Bertelsmann subsidiaries**

The American Intertainment-AG holding SightSound Technologies holds the US patent rights for downloading audio and video files from the Internet. During the past years, it has concentrated in particular on asserting its patent rights in the fast-growing market. In this connection, SightSound had filed a lawsuit against the two Bertelsmann subsidiaries CDNow and N2K on account of an infringement of its patent rights.

Shortly before the start of the main trial, the parties agreed a settlement at the end of February 2004. Under the settlement agreed, the defendants made a payment of 3.3 million US dollars in total to SightSound while at the same time acknowledging the validity of the patent rights. Up to the date of the settlement, the defendants had achieved sales of less than 0.1 million US dollars with downloads.

**Writedown of the book value**

Despite these positive developments, Intertainment wrote down the full book value of SightSound in the balance sheet for the business year 2004. This is due to the fact that the management of Intertainment is currently not in a position to assess with adequate certainty the extent of the value of the patent rights and whether SightSound is in a position to continue to finance the assertion and marketing of the patents. The negotiations between SightSound and a potential licensee from the area of digital music and film downloads failed to reach a successful conclusion at the

beginning of 2005. A risk has arisen in conjunction with the consequences of the failed negotiations that the patents of SightSound may be subject to renewed investigation by the US Patent Office. An investigation of this nature may last up to two years.

**4. Staff, management & Supervisory Board**

**Change in the Board of Management and Supervisory Board**

The Intertainment Group significantly reduced the number of staff employed in the business year 2004. The Group employed an average of 13 employees in the business year 2004, after an average of 23 employees in the prior year. The personnel adjustments are a direct result of the reorganization and restructuring measures undertaken in 2004. Intertainment AG also further reduced the size of the Board of Management. The previous Chairman of the Board of Management, Rüdiger Baeres resigned from the Board of Management at the Annual General Meeting on October 29, 2004 and was elected to the Supervisory Board. The former Chief Financial Officer, Achim Gerlach, became the only Member of the Board of Management of the company. At the end of the Annual General Meeting, Rüdiger Baeres was unanimously elected as the new Chairman of the Supervisory Board. The previous Chairman of the Supervisory Board, Dr. Matthias Heisse, was appointed Deputy Chairman of the Supervisory Board. The previous Deputy Chairman of the Supervisory Board, Dr. Wilhelm Bahner, stepped down from the Supervisory Board.

**C. Net worth, financial and earnings position of the Intertainment AG Group for the business year 2004 in accordance with IFRS**

**1. Net worth**

The key changes for net worth on the ASSETS SIDE were as follows:

C.1 GROUP: KEY CHANGES ON THE ASSETS SIDE	in mn Euros		
	31/12/2004	31/12/2003	Change
<b>Financial assets</b>	0	15.0	-15.0
<b>Other assets</b>	59.3	69.3	-10.0
<b>Film rights</b>	4.4	7.1	-2.7

The reduction in financial assets relates to the writedown in full of the shareholding in SightSound Technologies Inc. The management of Intertainment decided to take this measure due to the failed contractual negotiations with a licensee and the high level of uncertainty about ongoing finance for the assertion and marketing of the patents.

As in the prior year, the damages claims against Franchise Pictures and other parties constitute the major item of other assets. In the prior year, receivables amounting to 67.7 million euros were reported in the financial statements but the value recorded in the year under review has fallen to 59.1 million euros. The reduction is due to payments made following out-of-court settle-

ments and changes in the exchange rate between the euro and the US dollar. The management of Intertainment continues to regard the claims for damages as valuable, despite the proceedings for insolvency instituted by Franchise Pictures and other parties. The value derives from the fact that part of the claims can be met by the insolvency settlement and the management of Intertainment regards the prospects for success in the impending arbitration proceedings against Comerica Bank as extremely positive. If Intertainment succeeds in asserting its claims against Comerica Bank, the management of Intertainment believes that Comerica Bank would also be liable for the damages sustained by Intertainment which were already successfully asserted in the trial against Franchise Pictures and other parties. The value of the film rights fell back by 2.7 million euros compared with the previous year and currently amounts to 4.4 million euros. This drop is particularly attributable to non-normal depreciation due to a reduction in anticipated sale prices.

The key items on the **EQUITY AND LIABILITIES** side developed as follows:

C.1 GROUP: KEY ITEMS ON THE EQUITY AND LIABILITIES SIDE			
	in mn Euros		
	31/12/2004	31/12/2003	Change
<b>Other provisions</b>	27.2	33.1	-5.9
<b>Liabilities</b>	1.0	2.8	-1.8
<b>Equity</b>	37.9	59.8	-21.9

The reduction in other provisions is in particular due to lower values in provisions for participation in trial proceeds, trial costs and reorganization. The provision for participation in trial proceeds is reduced by 1.9 million euros to 17.8 million euros. This is based in particular on the reduced balance sheet value of claims for damages against Franchise Pictures etc., which form the measurement base for the underlying claims. The lower value by 3.3 million euros reported under the provision for legal and consultancy costs (3.2 million euros) by comparison with the prior year is mainly due to a correspondingly lower requirement during the business year 2004. The same is applicable to the provisions for reorganization reduced by 1.2 million euros to 0.9 million euros. Liabilities amounted to 1.0 million euros on the balance sheet date. The reduction by 1.8 million euros resulted in particular from netting the payments on film rights received with license receivables.

Equity amounted to 37.9 (prior year 59.8) million euros on the balance sheet date. The capital reserve went down by 23.1 (prior year 79.4) million euros, mainly due to the utilization carried out in accordance with Article § 150 Sections 3 and 4 AktG ("Aktengesetz", "Stock Corporation Law") in the context of preparing the financial statements of Intertainment AG to balance the consolidated net loss for the year and loss carry-forward. The equity ratio deteriorated by 8.3 percentage points and amounts to 45.0 (prior year 53.3) %.

## 2. Financial position

At the close of 2004, the Intertainment Group had liquid funds amounting to 1.7 million euros, compared with 2.1 million euros on December 31, 2003. The decrease is due in particular to legal consultancy fees and regular outgoings for personnel expenses and rents. A detailed financial plan from Intertainment AG is available for the business year 2005, from which the management infers a positive forecast for the continuing existence of the company as a going concern. However, despite the measures that have been instituted and implemented, the liquidity situation of Intertainment is difficult. We therefore refer expressly to the fact that the financial plans and the forecast of continued existence are subject to the risks described in Section "F. Risks of future development of the Intertainment AG Group". In particular, we refer at this point to the risks imperiling future existence under item F.1. of this Management Report.

## 3. Earnings situation

The Intertainment Group has a consolidated deficit of -22.2 (prior year -14.1) million euros for the business year 2004. The EBIT amounts to -21.3 million euros compared with -8.9 million euros in the previous year. Earnings from ordinary activities amounted to -16.8 (prior year -28.8) million euros.

The significant deterioration in the result during the year under review is due in particular to the writedown of the participation in SightSound Technologies Inc. amounting to 15.0 (prior year 0) million euros (compare item C.1).

Sales revenues increased by 11.9 million euros to 17.9 million euros compared with 6.0 million euros in the previous year. This significant increase resulted in particular from the sale of license rights in the thriller "Twisted". In this context, the cost of materials rose by 10.0 million euros to 17.1 million euros. The cost of materials essentially comprises amortization of these sold rights. Other operating expenses went down by 9.9 million euros to 2.3 million euros. This development reflects the intensive cost-reduction measures undertaken by Intertainment – and in particular restructuring of American business activities. Extraordinary earnings amounted to -4.5 (prior year +19.4) million euros. Extraordinary income amounted to 2.4 (prior year 48.2) million euros and includes in particular an adjustment in the provision for participation in trial proceeds. Extraordinary expenses totaled 7.0 (prior year 28.8) million euros and essentially include exchange-rate effects arising from the valuation of claims for damages against Franchise Pictures and adjustment of the provision for legal and consultancy costs.

The earnings of the Intertainment Group were also burdened by the tax expense to be reported in the year under review in the sum of 0.8 (prior year 4.7) million euros. This mainly resulted from reporting deferred taxes arising from valuation differences between IFRS and HGB.

### D. Net worth, financial and earnings positions of Intertainment AG for the business year 2004 in accordance with HGB

#### 1. Net worth

The assets of Intertainment AG are affected on the **ASSETS SIDE** by the following key changes:

D.1 AG: KEY CHANGES ON THE ASSETS SIDE		in mn Euros	
	31/12/2004	31/12/2003	Change
<b>Financial assets</b>	9.0	24.4	-15.4
<b>Receivables from affiliated companies</b>	58.2	65.1	-6.9
<b>Equity</b>	4.3	6.3	-2.0

The reduction in financial assets relates in particular to the writedown in full of the shareholding in SightSound Technologies Inc. The management of Intertainment decided to take this measure due to the failed contractual negotiations with a licensee and the high level of uncertainty about on-

going finance for the assertion and marketing of the patents. Intertainment AG has decided to carry out a further revaluation amounting to 5.0 (prior year 44.3) million euros on the intercompany account on the basis of the future cash flows expected by INTERENTAINMENT Licensing GmbH. Receivables from affiliated companies decreased by 6.9 million euros primarily on the basis of this revaluation and amount to 58.2 million euros at the balance sheet date. The value of the film rights decreased by 2.0 million euros compared with the previous year and amounts to 4.3 million euros. This drop is particularly attributable to non-scheduled depreciation due to a reduction in anticipated sale prices.

The key items on the **EQUITY AND LIABILITIES SIDE** developed as follows:

D.1 AG: KEY ITEMS ON THE EQUITY AND LIABILITIES SIDE		in mn Euros	
	31/12/2004	31/12/2003	Change
<b>Other provisions</b>	1.3	2.3	-1.0
<b>Equity</b>	74.2	97.5	-23.3

The decline in other provisions is due in particular to utilization of the provision for reorganization amounting to 1.1 million euros. Equity amounted to 74.2 (prior year 97.5) million euros on the balance sheet date. The capital reserve went down by 23.3 (prior year 79.4) million euros due to withdrawals carried out in accordance with

Clause § 150 Sections 3 and 4 AktG ("Aktiengesetz" "Stock Corporation Law") in the context of preparing the financial statements of Intertainment AG to balance the consolidated net loss for the year. The equity ratio improved by 1.8 percentage points and amounts to 98.0 (prior year 96.2) %.

#### 2. Financial position

At the close of 2004, Intertainment AG had liquid funds amounting to 1.6 million euros, compared with 1.4 million euros on December 31, 2003. The increase is due to a number of factors including cash inflows from out-of-court settlements in connection with the Franchise Pictures case. These inflows are offset with payments for personnel and rents, and payments to INTERENTAINMENT Licensing GmbH to finance litigation. A detailed financial plan from Intertainment AG is available for the business year 2005, from which the management infers a positive forecast for the continuing existence of the company as a going concern. However, despite the measures that have been instituted and implemented, the liquidity situation of Intertainment is difficult. We therefore refer expressly to the fact that the financial plans

and the forecast of continued existence are subject to the risks described in Section "G. Risks of future development of the Intertainment AG Group". In particular, we refer at this point to the risks imperiling future existence under item G.1. of this Management Report.

#### 3. Earnings situation

The earnings situation is dominated by an improvement in earnings. The consolidated deficit for the year fell by 32.2 million euros to 23.3 million euros, and earnings from ordinary activities amounted to -22.2 million euros compared with -55.5 million euros in the previous year. The basis for this change in earnings by comparison with the prior year is a significantly lower extraordinary effect resulting from the revaluation on intercompany accounts for subsidiary companies. The revaluation amount under the item "Depreciation of current assets" was 52.2 million euros for the prior year, while a further revaluation of 5.4 million euros was reported in the year under review. However, the writedown on the shareholding in SightSound Technologies Inc. amounting to 15.0 (prior year 0) million euros (see item C.1.). Sales revenues amounted to 17.8 (prior year 4.0) million euros in the business year 2004. The increase by 13.8 million euros is attributable in particular to license sales of the thriller "Twisted". In this context, the cost of materials rose by 10.9 million euros to 16.9 million euros. In particular, this amount included normal amortization of the sold rights. Interest income fell by 10.1 million euros compared to the prior year. Intertainment AG waived interest on the intercompany accounts during the business year 2004.



## E. Future Development of the Intertainment AG Group

This section presents key events that occurred in the period between the close of the business year and preparation of this management report. We also outline the future strategy of Intertainment.

### 1. The Franchise Pictures case, Comerica Bank and Film Finances

#### 1.1 Settlement with Film Finances Inc., Film Finances (1998) Canada and International Motion Pictures Corporation Ltd.

On March 15, 2005 INTERTAINMENT Licensing GmbH and Intertainment AG reached a settlement with bond companies Film Finances Inc. and Film Finances (1998) Canada Ltd. in conjunction with the pending lawsuits in the USA. Under the terms of the settlement, Intertainment has received a payment from Film Finances Inc. and Film Finances (1998) Canada.

A confidentiality agreement was reached not to disclose specific terms of the settlement. Film Finances Inc. and Film Finances (1998) Canada also assign their claims against the insolvent film producer Franchise Pictures and against subsidiaries of Franchise to the estate, hence withdrawing from the list of creditors. INTERTAINMENT Licensing GmbH is the biggest unsecured creditor in the Franchise insolvency proceedings. Until the settlement was concluded, Film Finances and Film Finances Canada (1998) Ltd., together with Comerica Bank, and executive managers of the bank, numbered among the opposing parties involving claims asserted by Intertainment in an arbitration proceeding pending in the USA (see item B.1.6 and E.1.5).

Under the settlement, it was further agreed that International Motion Pictures Corporation Ltd. (IMPC), Hong Kong, withdraw its arbitration suit against Intertainment in connection with the film "Tracker" (see item B. 1.7).

#### 1.2 Insolvency proceeding of Franchise Pictures

At the time when this management report was concluded, the Chief Restructuring Officer had not yet submitted a restructuring plan for Franchise Pictures.

#### 1.3 Enforcement against the former CEO of Franchise Pictures

The first hearing relating to the assets of Elie Samaha was held on January 24, 2005. Samaha disclosed documents at the hearing and a date for another hearing was agreed. After the disclosure, Intertainment started to examine the documents submitted and started to institute concrete enforcement measures.

#### 1.4 Post Trial Motions

At the time when this management report was prepared, the presiding judge had still not reached a decision on the post trial motions. The hearing for the outstanding points originally planned on January 24, was initially postponed with the consent of INTERTAINMENT Licensing GmbH to February 28, 2005 and then again until May 2005.

In the context of the post trial motions, Elie Samaha and Glickson Investment LLC., also found liable, submitted a petition shortly before this Management Report was prepared, that the court should declare the judgment to be null and void and order a complete retrial. The Franchise companies currently subject to insolvency proceedings also acceded to this petition.

#### 1.5 Arbitration Proceedings against Comerica Bank, Film Finances etc.

The arbitration proceedings against Comerica Bank, Film Finances Inc., and executive managers of these companies, as well as Film Finances (1998) Canada were still in the discovery phase at the start of 2005. The first witness testimony was also taken under oath. The settlement between INTERTAINMENT Licensing GmbH and Intertainment AG with the two bond companies Film Finances Inc., and Film Finances (1998) Canada in March 2005 means that Comerica Bank and executive managers of the bank are now the only opposing parties within the scope of the proceedings. However, Comerica Bank has asserted cross-claims for indemnity against XL Reinsurance and has indicated it may assert such claims against Film Finances as well.

Details of the precise schedule for the proceedings were not yet available when this management report was prepared. A hearing before the arbitrators on March 18, 2005 did not result in any decision on this matter. During the course of the hearing, the opposing parties applied to have all claims by Intertainment rejected. The arbitrators had not yet reached a decision at the point when this management report was prepared.

#### 1.6 Arbitration Proceeding for the Film "Viva Las Nowhere"

Intertainment filed an arbitration claim against Westdeutsche Landesbank (WestLB), the Lewis Horwitz Organization and Federal Deposit Insurance Corp. in connection with the film "Viva Las Nowhere" at the beginning of January 2005. In a countermove, WestLB on its part filed a claim against Intertainment relating to an advance payment amounting to around 900,000 dollars plus interest.

### 2. Setting up and Expanding the New Business Model

As soon as the necessary cash-flows of funds arising from the Franchise Pictures case are received, Intertainment will start implementing the new business strategy. The intention is to use refined financing structures and other finance partners to build up film production again. Another goal is to exploit film rights using existing sales structures and resume sales of film rights across Europe. The portfolio approach remains a key element for Intertainment. The aim of Intertainment is to attempt to reduce risks significantly with a maximally broad choice of films.

## F. Risks of Future Development of the Intertainment AG Group

### 1. Risks relating to the Ability to Continue as a Going Concern

The consolidated financial statements for the business year 2004 were prepared on the assumption that the Intertainment AG Group still has the ability to continue as a going concern. The management of Intertainment has a positive assumption regarding its ability to continue as a going concern, so that the Group will in all probability be able to continue its business activities in the current and the subsequent business years and meet its payment obligations. The positive assumption of the Intertainment AG Group's ability to continue as a going concern is based on an integrated corporate plan, from which the detailed finance plan was derived. This is made up of the financing of future business activity, the planned investments and other financing activities. Overall, the assumption regarding Intertainment's ability to continue as a going concern is qualified by four main areas of uncertainty that cannot be judged definitively at the present time. In particular, these are:

- Settlement of the bank loan which has been called in on the basis of the assumptions by the legal representatives
- Cash-inflows arising from the settlement of the legal disputes with Franchise Pictures, Comerica Bank and other parties
- No cash-outflows from current arbitration proceedings for the payment of the second installments of the disputed films

- Fulfillment of the other assumptions of the finance plan including cash-inflows planned over the short term.

If the inflows of funds, the outflows of funds or the assumptions on which the financial plan is based fail to materialize as planned, the ability to continue as a going concern of Intertainment AG, INTERTAINMENT Licensing GmbH and Intertainment Animation & Merchandising GmbH is highly endangered because of being unable to fulfill their payment obligations and the associated risk of filing for insolvency proceedings.

#### HANDLING OF THE BANK LOAN WHICH HAS BEEN CALLED IN ON THE BASIS OF THE ASSUMPTIONS BY THE LEGAL REPRESENTATIVES

In the context of the processing of the residual debt for a bank loan to INTERTAINMENT Licensing GmbH, the management of Intertainment is assuming that Intertainment received an agreement with the affected bank containing a debt waiver on a deferred debt basis. In order to assess this matter, an expert report was drawn up by a law firm that forms the basis for the appraisal by the management. If it emerges in the future that this legal opinion is flawed, there is a risk of substantial cash-outflows for the settlement of the original residual debt. In this connection, there is also the risk that the original guarantee

given by Intertainment AG for the settlement of the loan has not been extinguished and significant cash-outflows will arise for Intertainment AG amounting to the original residual debt.

#### CASH-INFLOWS FROM THE SETTLEMENT OF THE LEGAL DISPUTES WITH FRANCHISE PICTURES, COMERICA BANK AND OTHER PARTIES

INTERTAINMENT Licensing GmbH expects to receive at least the cash-outflows reported in the balance sheet as damages receivable following the judgment in the legal dispute with Franchise Pictures and other parties and from the arbitration proceedings against Comerica Bank and other parties. At the same time – as in other proceedings – there is also the risk that it may not be possible to enforce a title despite having won the trial or that the expected level of damages may not be obtained. There is also the risk that Franchise Pictures may appeal against the judgment. If Franchise Pictures appeals, the appeal would not affect enforcement of the judgment. However, two exceptions are a possibility. There is, on the one hand, the very unlikely possibility that Franchise Pictures goes to appeal and at the same time makes a payment of a bond as security. This should be about one-and-a-half to two times the sum defined in the judgment. In this case, no claims could be enforced against Franchise during the period of the appeal procedure. Any potential appeal procedure may last for 18 up to 24 months. On the other hand, there is also the possibility that Franchise Pictures may go to appeal and the court would decide that the judgment

cannot be enforced during the appeal phase. However, such a resolution by the court of this nature can only be made on the basis of special circumstances. Irrespective of whether the judgment from the first instance can be implemented during the appeal phase, there is a risk that continuing to finance the expensive litigation will exert substantial negative effects on Intertainment.

There is also the risk that the liability claim existing in the opinion of the management of Intertainment against Comerica Bank is not successful in the arbitration tribunal.

#### NO CASH-OUTFLOWS FROM CURRENT ARBITRATION PROCEEDINGS FOR THE PAYMENT OF TWO INSTALLMENTS OF THE DISPUTED FILMS

INTERTAINMENT Licensing GmbH is subject to the risk that payment of the second installments for the disputed films will be claimed in the context of awards in the arbitration proceedings. This applies to the arbitration proceedings that Comerica Bank opened at the beginning of 2003 against INTERTAINMENT Licensing GmbH in relation to the film "Driven" and which were subsequently expanded to include all the disputed Franchise films financed by Comerica Bank.

If **Comerica Bank** were to be successful with the arbitration proceedings that it has instigated, INTERTAINMENT Licensing

GmbH may face a payment obligation of more than 70 million US dollars. In the event that the arbitration tribunal decides in favor of the bank, the bank would in the view of Intertainment, be obliged to offset the income from the exploitation of the disputed film rights against the payment obligation of Intertainment. The management of Intertainment assumes that this income will be higher than the sum of the second installment.

There is also an arbitration proceeding in the case "Viva Las Nowhere". If Intertainment is unsuccessful in this proceeding with its claim for repayment and WestLB were successful with a counterclaim, there is a threat of cash-outflow amounting to approximately 1 million US dollars.

The two arbitration tribunals entail substantial cash-outflows for Intertainment due to legal fees.

#### CONSEQUENCES OF A POSSIBLE MISCALCULATION

The consequences of a possible wrong assessment in relation to the risks endangering the company's ability to continue as a going concern would be far-reaching in their effect on the continuation of business activity. Insolvency proceedings could be instituted – under certain circumstances at very short notice – because of impending inability to fulfill payment obligations and it would then not be possible to use going concern values in the valuation of assets and debts pursuant to IFRS Framework Articles § 23.

## 2. Further risks

There are other risks associated with the development of the Group. Intertainment has examined the business processes and has identified, analyzed, and evaluated the risks arising. It has also developed measures under an ongoing risk monitoring regime which are designed to minimize these risks. Building on this, the risk monitoring system for the detection of dangerous influences is being further developed and supplemented. Below is a description of the principal risks which arise, firstly, from the company's own operating activity in the areas of trading with film rights and film production and, secondly, from the participations.

### 2.1 Risk of further cash-outflows to Paramount Pictures

The contract with Paramount Pictures entails the risk on the basis of exploitation of the film title "Twisted" that depending on exploitation proceeds assigned other financial obligations may arise in the future for Intertainment AG. Securities amounting to maximally 7.0 million US dollars were granted to Paramount Pictures in order to cover these obligations.

### 2.2 Producer risk

As the producer of films, Intertainment is subject to the risk that a film production may have to be aborted. This may result in the loss of development costs that have already been invested. There is additionally the risk that payment for damages has to be made for existing future obligations.

### 2.3 Trading in film licenses

Intertainment trades in film licenses, among other things. There is strong competition in this area. This can lead to changes in the level of prices, falling sales figures, lower profit margins and a deterioration in the market position. The continuing consolidation trends, especially in European cinema and TV sector, may lead to a concentration in the European sales market and so make it more difficult to sell license rights. The sale of TV licenses is closely connected with the development of advertising income by the television stations.

### 2.4 Acquisition and exploitation of film rights

Where Intertainment acquires license rights prior to the commencement of production, there is a risk of a film being purchased at too high a price. The possible success of a film is difficult to forecast at this point in time. An attempt is made to minimize the risk on the strength of the expertise of the staff, the actors in the main roles and by analysis of the film script.

### 2.5 Fraud through collaboration with several partners

In cases in which Intertainment is the co-financier of a film, there is a danger of fraud arising through cooperation with a number of partners. As a result, it is possible that Intertainment is informed of fraudulently excessive budgets for financing. Suitable measures for the reduction of this risk are ongoing control of expenditure and budget control with weekly reports,

the control and monitoring of the completion bond company securing the film financing, and a continuous examination of the ongoing film production by the company's own staff on the spot.

### 2.6 Dependence on distribution partners

The Europe-wide distribution by the majors represents a substantial competitive advantage for Intertainment. If these cooperative distribution agreements are dissolved, this might have considerable effects on the financial situation and the business result of the company.

### 2.7 Planning risk

Intertainment acquires and awards film licenses at irregular intervals. It is very difficult to plan the timing of acquisition and the award of licenses. Through the irregular intervals of the transactions, the result of Intertainment can fluctuate sharply from period to period. Furthermore, a financing risk can arise through the changes in the incoming and outgoing payments involved.

## 2.8 Currency risk

Fluctuations in the exchange rate between the US dollar and the euro may have effects on business activity, the financial and earnings situation and in particular on profit margins as a result of exchange rate gains or losses.

## G. Risks of future development of Intertainment AG

### 1. Risks relating to the ability to continue as a going concern

The annual financial statements for the business year 2004 were prepared on the basis that Intertainment AG still has the ability to continue as a going concern. The Board of Management of Intertainment AG has a positive assumption regarding its ability to continue as a going concern, so that the company will in all probability be able to continue its business activities in the current and the subsequent business years and meet its payment obligations. The positive assumption regarding the company's ability to continue as a going concern is based on a detailed finance plan. This is made up of the financing of future business activity, the planned investments, and other financing activities.

Overall, the assumption regarding Intertainment's ability to continue as a going concern is qualified by substantial uncertainties that cannot be judged definitively at the present time. In particular these are:

#### • Fulfillment of the assumptions on which the finance plan of the subsidiary INTER-TAINMENT Licensing GmbH is based:

- Settlement of the bank loan which has been called in on the basis of the assumptions by the legal representatives
- Cash-inflow of funds arising from the settlement of the legal disputes with Franchise Pictures, Comerica Bank and other parties
- No cash-outflow of funds arising from the current arbitration proceedings for payment of the second installments for the disputed film rights

If these assumptions fail to materialize and the subsidiary becomes insolvent, Intertainment AG would be faced with a claim arising from the guarantee it had given to the bank.

#### • Fulfillment of the assumptions which additionally form the basis for the financial plan submitted by Intertainment AG

We refer to our statements under "F.1. Risks relating to the ability to continue as a going concern" in the Intertainment Group.

#### CONSEQUENCES OF A POSSIBLE MISCALCULATION

The consequences of a possible wrong assessment in relation to the risks endangering the company's ability to continue as

a going concern are far-reaching in their effect on the continuation of business activity. Insolvency proceedings could be instituted – under certain circumstances at very short notice – because of impending inability to fulfill payment obligations and it would not be possible to use going concern values in the valuation of assets and debts pursuant to Articles § 252 Section I No. 2 HGB ("Handelsgesetzbuch", "German Commercial Code")

### 2. Other risks

We refer to our statements on the Intertainment Group under item F.2. for an explanation of other risks.

Ismaning near Munich, April 29, 2005

Intertainment AG  
Board of Management



## Intertainment Group: Consolidated Balance Sheet

as at December 31, 2004 in Accordance with the IFRS

ASSETS		in TEuros	
	Note	31/12/2004	31/12/2003
<b>A. FIXED ASSETS</b>			
<b>I. Intangible assets</b>			
VI.1			
1. Licenses, commercial property rights and similar rights as well as licences to such rights		1	3
2. Payments made on account		2,147	2,147
		<b>2,148</b>	<b>2,150</b>
<b>II. Property, plant &amp; equipment</b>			
Other plant, business and office equipment			
		122	194
<b>III. Financial assets</b>			
Participations			
		0	15,036
		<b>2,270</b>	<b>17,380</b>
<b>B. CURRENT ASSETS</b>			
<b>I. Inventories</b>			
VI.2			
1. Film rights		4,408	7,100
2. Merchandise		0	305
3. Payments made on account		0	235
		<b>4,408</b>	<b>7,640</b>
<b>II. Receivables and other assets</b>			
VI.3			
1. Trade receivables		661	755
2. Other assets		59,264	69,304
		<b>59,925</b>	<b>70,059</b>
<b>III. Cash on hand, bank balances</b>			
VI.4			
		1,694	2,138
		<b>66,027</b>	<b>79,837</b>
<b>C. DEFERRED TAXES</b>			
VI.5			
		15,924	14,977
		<b>84,221</b>	<b>112,194</b>

EQUITY & LIABILITIES		in TEuros	
	Note	31/12/2004	31/12/2003
<b>A. EQUITY</b>			
VI.6			
I. Subscribed capital	VI.6.1	15,005	15,005
II. Capital reserve	VI.6.2	46,989	70,106
III. Earnings reserves	VI.6.3		
Statutory reserve		116	116
IV. Group retained earnings	VI.6.4	-24,158	-25,310
V. Currency differences		-85	-81
		<b>37,867</b>	<b>59,836</b>
<b>B. PROVISIONS</b>			
VI.7			
Other provisions		27,187	33,099
		<b>27,187</b>	<b>33,099</b>
<b>C. LIABILITIES</b>			
VI.8			
1. Liabilities due to banks		0	7
2. Payments received on account		0	1,318
3. Trade accounts payables		911	1,142
4. Other liabilities		54	358
		<b>965</b>	<b>2,825</b>
<b>D. DEFERRED TAXES</b>			
VI.9			
		18,202	16,434
		<b>84,221</b>	<b>112,194</b>

## Intertainment Group: Income Statement

for the period from January 1, 2004 to December 31, 2004  
in Accordance with the IFRS

in TEuros	Note	1/1/-31/12/2004	1/1/-31/12/2003
1. Sales revenues	VII. 1	17,854	6,028
2. Other operating income	VII. 2	1,989	4,676
		<b>19,843</b>	<b>10,704</b>
3. Cost of materials	VII. 3		
a) Cost of film rights and associated performances		-17,033	-6,714
c) Expenses for bought-in merchandise and services		-26	-384
		<b>-17,059</b>	<b>-7,098</b>
4. Personnel expenses			
a) Salaries		-2,052	-2,893
b) Social security contributions		-100	-159
		<b>-2,152</b>	<b>-3,052</b>
5. Depreciation and amortization	VII. 4		
a) Amortization on intangible fixed assets depreciation on property, plant & equipment		-55	-9,332
b) Depreciation of current assets insofar as this exceeds other depreciation normal in the company		0	-7,261
		<b>-55</b>	<b>-16,593</b>
6. Other operating expenses	VII. 5	-2,340	-12,276
7. Writedowns on financial assets	VII. 6	-15,036	0
8. Net interest	VII. 7	5	-458
9. Result of ordinary business activities		<b>-16,794</b>	<b>-28,773</b>
10. Extraordinary income		2,419	48,176
11. Extraordinary expenses		-6,953	-28,801
12. Extraordinary result	VII. 8	<b>-4,534</b>	<b>19,375</b>
13. Taxes on income and earnings	VII. 9	-822	-4,727
14. Other taxes		-1	-1
15. Net loss		<b>-22,151</b>	<b>-14,126</b>
16. Accumulated loss		-25,310	-90,620
17. Release of capital reserve		23,303	79,436
18. GROUP RETAINED EARNINGS		<b>-24,158</b>	<b>-25,310</b>
Basic loss per hare		<b>-1.89</b>	<b>-1.20</b>
Diluted loss per share		<b>-1.89</b>	<b>-1.20</b>

## Intertainment Group: Consolidated Cash Flow Statement

for the period from January 1, 2004 to December 31, 2004  
in Accordance with the IFRS

in TEuros	2004	2003
Period result prior to extraordinary items, interest and taxes	-16,800	-26,356
Personnel expenses share options for Board of Management and employees	186	61
Amortization & depreciation of fixed assets	55	9,332
Writedowns on financial assets	15,036	0
Decrease in provisions	-5,427	-2,785
Decrease in inventories	3,232	4,290
Decrease in trade receivables	94	15,969
Decrease in other assets	6,025	7,861
Decrease in trade payables as well as in other liabilities	-1,740	-6,975
Interest received	5	48
Interest paid	0	-498
Taxes paid	0	-123
<b>Outflow/inflow of funds from current business activities</b>	<b>666</b>	<b>824</b>
<b>Cash items from the extraordinary result</b>	<b>-1,118</b>	<b>0</b>
Incoming payments on the disposal of fixed assets	23	0
Outgoing payments for investments in fixed assets	-4	0
<b>Inflow of funds from investment activities</b>	<b>19</b>	<b>0</b>
Decrease in liabilities to banks	-7	-2,582
<b>Outflow of funds from financing activities</b>	<b>-7</b>	<b>-2,582</b>
<b>Changes in cash and cash equivalents</b>	<b>-440</b>	<b>-1,758</b>
Changes in cash and cash equivalents resulting from exchange rate and other influences	-4	-26
Cash and cash equivalents at beginning of period	2,138	3,922
<b>CASH AND CASH EQUIVALENTS AT END OF PERIOD</b>	<b>1,694</b>	<b>2,138</b>

## Entertainment Group: Schedule of Nominal Capital

in Accordance with the IFRS

in TEuros						
	Share capital	Capital reserve	Revenue reserve	Retained earnings	Currency differences	Total
AS AT 31/12/2001	15,005	149,481	116	-74,496	42	90,148
Result 2002				-16,124		-16,124
Currency difference					-97	-97
AS AT 31/12/2002	15,005	149,481	116	-90,620	-55	73,927
Result 2003				-14,126		-14,126
Withdrawals from cap. res.		-79,436		79,436		0
Share options		61				61
Currency difference					-26	-26
AS AT 31/12/2003	15,005	70,106	116	-25,310	-81	59,836
Result 2004				-22,151		-22,151
Withdrawals from cap. res.		-23,303		23,303		0
Share options		186				186
Currency difference					-4	-4
AS AT 31/12/2004	15,005	46,989	116	-24,158	-85	37,867

## Entertainment Group: Notes

for the Business Year 2004 in Accordance with the IFRS

## I. General Information

Intertainment Aktiengesellschaft (referred to as "Intertainment" below) has been listed since February 1999 in the "Neuer Markt" changed on January 15, 2003 to the regulated market, "Prime Standard" sub-segment, of the Frankfurt Stock Exchange. The consolidated financial statements of Intertainment Aktiengesellschaft have been prepared, pursuant to § 292a HGB, according to the International Financial Reporting Standards (IFRS). The company is consequently exempt from the requirement to prepare consolidated financial statements according to the provisions of § 290 ff. HGB.

The accounting and valuation methods used by the companies included in the consolidated financial statements are uniform. On the basis of the individual financial statements of the enterprises to be consolidated, Intertainment prepares consolidated financial statements according to the German commercial code (HGB) and reconciles these with the consolidated financial statements according to IFRS.

For the first time, share options issued to the Board of Management and staff were capitalized under assets in accordance with IFRS 2. An equivalent adjustment was made for the prior year for purposes of easier comparison.

For the business year 1998, Intertainment prepared the reconciliation account with IFRS. On the grounds that the contribution

of INTERENTAINMENT Licensing GmbH represented a "legal reorganization", there was a change in the result in comparison with the commercial code regulations in the amount of 1,618 TEuros in 1998.

Intertainment uses the type of expenditure method for the income statement.

In these Notes, the figures are stated in thousand euros (TEuros). Alongside the figures for the business year 2004, the corresponding figures for the prior year are given for purposes of comparison. Generally they are in brackets. The abbreviation "p.y." stands for "prior year".

## II. Details of the scope of consolidation and the balance sheet date

The scope of consolidation includes Intertainment AG and its subsidiaries INTERENTAINMENT Licensing GmbH, Intertainment Animation & Merchandising GmbH and USA-Intertainment, Inc.

The Intertainment Group consists of the following companies, with Intertainment AG directly holding 100 % of the other enterprises. The individual financial statements were prepared in accordance with HGB, and the relevant national regulations.

II. GROUP OF COMPANIES CONSOLIDATED					in TEuros
Company	Subscribed capital (p. y.)	Equity 2004 (p. y.)	Annual result 2004 (p. y.)	Share (in %)	Description
Intertainment AG, Ismaning	15,005 (15,005)	74,203 (97,506)	-23,303 (-55,501)		The object of the company is the acquisition and exploitation of film rights, trade with film rights, production and co-production of films, merchandising, distribution and transfer of media contents in the audio and video area via communications channels of all kinds as well as the execution of similar business. The company also acts as finance holding.
INTERTAINMENT Licensing GmbH, Ismaning	946 (946)	-73,381 (-69,749)	-3,586 (10,424)	100	The object of the company is the development of media concepts and trade with film rights.
Intertainment Animation & Merchandising GmbH, Ismaning	358 (358)	0 (0)	0 (-203)	100	The object of the company is trade with merchandising and cartoon film rights.
USA-Intertainment, Inc., Los Angeles, USA	105 (105)	48 (10)	42 (-254)	100	The object of the company is to oversee contracts of enterprises belonging to the Intertainment Group with American corporations and to identify and evaluate new film projects as well as potential license and production agreements.

The closing date for the consolidated financial statements is December 31, 2004. Both the financial statements of Intertainment AG and those of all the subsidiaries included in the consolidated financial statements refer to this closing date.

### III. Consolidation methods

#### 1. Capital consolidation – first consolidation

For the capital consolidation, Intertainment applies the book value method. The book value of the shares of the subsidiaries included in the consolidated financial statements is offset against their equity at the time of their acquisition. Since the business year 1999, the inclusion of INTERTAINMENT Licensing GmbH in the consolidated financial statements has been treated as a legal reorganization. This means that the goodwill from the capital consolidation is directly offset with the capital reserve. Goodwill is not shown.

#### 2. Debt and expense and earnings consolidation

Receivables and liabilities, and income and expenses between the companies included in the consolidated financial statements have been eliminated.

#### 3. Elimination of intercompany results

The intercompany results from transactions within the Intertainment group have been eliminated.

#### 4. Currency translation (IAS 21)

USA-Intertainment, Inc. draws up its balance sheet in US dollars. Through the translation to the euro of the balance sheet figures at the rate on the closing date and of the figures shown in the income statement at the average rate, currency differences arose in the past business year of -85 (p.y. -81) TEuros. These were offset against the equity without any effect on

results. In addition, under the adjustment of the individual financial statements to group-wide accounting and valuation methods, as in the prior year, there were no currency differences to be taken into account as affecting results.

### IV. Accounting and valuation methods

#### 1. Fixed assets

**INTANGIBLE ASSETS** are shown at their acquisition cost less amortization. Where the acquisition costs of an asset relate to different portions of the rights, as often occurs in the case of film rights, the acquisition costs are divided on the basis of the forecast revenues. The acquisition costs are amortized normally in accordance with economic life or causation. The useful life for software is 3 to 5 years, and for license rights 4 to 7 years.

Payments for the acquisition of film rights which are available for an indefinite period of time and have not yet been delivered and the technical quality accepted are reported as payments under intangible assets.

The capitalized costs are regularly examined as to their value and, if necessary, recorded as a non-scheduled writedown. This writedown is especially necessary when it is not sufficiently probable that a future economic benefit can be generated from the assets.

Intangible assets that are no longer appropriate for serving the business over the long term are re-classified under current assets.



**PROPERTY, PLANT & EQUIPMENT** are stated at acquisition costs less scheduled linear depreciation. The scheduled linear depreciation is based on the normal useful life for the business. The useful life of other plant, business and office equipment is 4 to 10 years. Non-scheduled depreciation is also carried out at the market or current value. Low value economic goods of fixed assets up are depreciated in full in the year of acquisition and are shown in the fixed asset schedule as disposals.

The **FINANCIAL ASSETS** are stated at the lower of acquisition costs and fair value. In the case of a share swap, the acquisition costs are stated at the value on the day the shares were delivered. Pursuant to IAS 28, participations in which less than 100 % of the shares or voting rights are held are consolidated only if more than 20 % of the shares or voting rights are held and if substantial influence is exercised on the company in which the participation is held.

## 2. Current assets

**FILM RIGHTS AND LICENSES** that are acquired for a limited period of time are recorded under current assets. The valuation is based on the acquisition costs less amortization of the exploited portions of the rights. The costs of financing by outside capital are treated as expense in accordance with IAS 23. The acquisition costs are broken down according to the rights portions cinema, video & DVD, as well as Pay TV and Free TV. The measurement base for this breakdown relates to the revenues forecast for the defined subsegments. The Free TV rights portions are broken down into up to three exploitation cycles. Often they will cover a period of up to 25 years. If

individual subsegments for film rights are not exploited, the acquisition costs are broken down into the remaining exploitations stages with modified allocation percentages. The film license rights are capitalized when an independent laboratory has accepted the technical quality of the film material supplied.

The normal amortization of film rights is based on economic life or exploitation of the film rights. In addition, non-scheduled writedowns are made in accordance with IAS 2, if it is determined that the forecast revenues from disposal (net disposal value) are less than the residual book value.

The **STOCKS OF MERCHANDISE** are valued at acquisition costs. Merchandise which has already been delivered and for which the distribution partners have a right of return is partly shown under inventories until the end of the period to which the right of return applies.

The **PAYMENTS MADE ON ACCOUNT FOR FILM RIGHTS** comprise payments made to film distributors prior to technical acceptance of the film material.

**RECEIVABLES AND OTHER ASSETS**, which have a residual term of less than one year are capitalized at their nominal value. Receivables in foreign currencies are valued using the euro exchange rate on the balance sheet date. Adjustments are formed to take account of the risk of the receivable not being paid.

**CASH IN HAND AND BANK BALANCES** are stated at their nominal values. The valuation of bank balances in foreign currency is on the basis of the euro exchange rate on the balance sheet date.

In accordance with IAS 12, **DEFERRED TAXES** are formed for consolidation bookings

with effect on income, that will probably cancel out in subsequent periods ("temporary differences"), and for valuation differences between IFRS and HBG, as well as for loss carry-forwards, which will reduce the profit to be taxed in the future, as long as their realization is expected ("tax credits").

## 3. Equity

The **CAPITAL RESERVE** includes the amount that is achieved by the issue of shares above the nominal value. The proportionate fair value of share options issued is additionally recorded under this item for the relevant business year.

## 4. Outside capital

**OTHER PROVISIONS** are formed when on account of an event in the past a present legal or practical obligation exists, the outflow of economic resources to fulfill this obligation is probable and it is possible to reliably estimate the amount of the obligation.

**LIABILITIES**, which have a residual term of less than one year are capitalized at their nominal value. Receivables in foreign currencies are valued in accordance with IAS 21 using the euro exchange rate on the balance sheet date.

## 5. Sales realization

The sale and exploitation of licenses for film rights should always be differentiated when they are reported.

In the case of a **SALE OF A LICENSE** revenues are realized when a binding contractual relationship has arisen with the licensee. This is the case in particular when the licensed film rights have been accepted, the license fee for each licensed film right is known, and there is sufficient probability that the economic benefit, i.e. the license fee, will flow as income when due.

In cases of **EXPLOITATION OF FILM RIGHTS**, the sale is recorded when the actual box-office results during the period of exploitation of the relevant portion of the rights concerned are known. As a rule, exploitation of the video segment begins six months after the cinema release, Pay TV exploitation takes place twelve months later and the Free-TV segment starts a further twelve months later.

The sales realization for **MERCHANDISE** occurs with delivery to the retail trade. In the case of goods for which the retail trade has a right of return, the sales are only realized taking into account return rates. Until this time, the value of the goods for the expected return rate is shown under inventories. The final sales are realized when the return period has expired.

## V. Explanation of the differences between HGB and IFRS

According to § 292a II No. 4b HGB, the following differences exist between HGB and IFRS:

### 1. Valuation of the foreign currency items

According to IAS 21, foreign currency items, in particular receivables and liabilities, are valued at the rate on the balance sheet date. According to HGB, the principle of caution should be observed according to which unrealized exchange rate gains are not recorded. A difference of 0 (p.y. 12) TEuros results from this revaluation.

### 2. Valuation of share options

According to IFRS 2, remuneration by way of granting share options to the Board of Management and staff members of the company is recorded proportionately over the waiting period under personnel expenses and the capital reserve from the point in time of the issue. To this end, the share options were therefore valued at the point of issue on the basis of an option price model. A difference amounting to 186 (p.y. 61) TEuros arises from reporting share options under income in accordance with IFRS.

### 3. Reversal of the amortization of goodwill

The contribution of INTERTAINMENT Licensing GmbH to Intertainment AG in the business year 1998 does not come within the scope of IAS 22 (2003). According to IAS 22, it is economically not a "Business Combination" but a legal reorganization of

the Intertainment Group. This has the consequence that this contribution does not give rise to any goodwill and that the amortization of goodwill amounting to 651 (p.y. 651) TEuros reported in the HGB financial statements must be eliminated. According to German commercial law, the difference which arises from the capital consolidation and which cannot be distributed among the consolidated balance sheet items must be recorded under intangible assets. The goodwill arises from the difference between the acquisition costs of the shares in the subsidiary included in the consolidated financial statements and the equity of the subsidiary at the time of initial consolidation. The goodwill is amortized from the commencement of the initial consolidation over the probable useful life of 10 years pursuant to § 309 (1) sentence 2 HGB in combination with § 255 (4) sentence 3 HGB.

### 4. Deferred taxes

According to IAS 12 and taking into consideration the Tax Relief Law 1999/2000/2002, the tax effect from the revaluation according to the International Financial Reporting Standards has been accounted for using a tax rate of approximately 38 %. In accordance with the IFRS regulations, deferred taxes are also formed for loss carry-forwards. The deferred tax expenses amount to 822 TEuros, compared with 4,772 TEuros in the prior year.

## VI. Explanations to the consolidated balance sheet

### 1. Fixed assets

With regard to the presentation of the development of **FIXED ASSETS** we refer to the schedule of fixed assets.

Payments on account for intangible fixed assets include payments for the acquisition of secondary rights in the thriller "Twisted" for various territories amounting to 2,147 (p.y. 2,147) TEuros.

Property, plant and equipment essentially consists of office and business equipment from Intertainment AG and INTERTAINMENT Licensing GmbH.

The financial assets consist of the participation in the US company SightSound Technologies Inc. amounting to 0 (p.y. 15,036) TEuros. The participation ratio was 12.4 % in the prior year. According to the most recent financial statements available to Intertainment, prepared by the company dated April 30, 2003 (prepared in accordance with US GAAP), subscribed capital was 56 TEuros, equity was -1,515 TEuros and net earnings for the year were -1.925 TEuros. The management of Intertainment is assuming that there will be no further dilution of the shareholding than occurred in the business year 2003. However, the management decided to write down this shareholding in full. This is because the negotiations on the sale of the patents by SightSound to a licensee have failed temporarily to reach a successful conclusion. There is also a risk that the validity of the patents will be subject to a new investigation by the Patent Office. An investigation of this nature may last up to two years. The Patent Office has not yet agreed to a further review of the patents.

The management of Intertainment is currently not therefore in a position to assess with adequate certainty the extent of the value of the patents and whether SightSound is in a position to finance the assertion and marketing of the patents. Due to this substantial element of uncertainty, the management has therefore decided to write this shareholding off in full.

### 2. Inventories

The **FILM RIGHTS AND LICENSES** are valued at 4,408 (p.y. 7,100) TEuros:

VI.2 FILM RIGHTS AND LICENSES		in TEuros
Position	2004	2003
Balance at January 1	7,100	10,831
Additions	13,603	0
Normal amortization	-14,233	0
Non-scheduled amortization	-1,552	-4,951
Writeups	0	710
Reclassifications	0	510
Disposals	-510	0
<b>Balance at December 31</b>	<b>4,408</b>	<b>7,100</b>

The writeups related to various film rights in the prior year which had been the subject of non-scheduled amortization in previous accounting periods. The valuation of these film rights led to improved net sales values during the business year 2003. Normal amortization will be carried out for license sales of film rights. Non-scheduled writedowns on film rights were incurred as a result of writing down at the lower fair

value. The expected net sales revenues for the relevant films rights were below the amounts capitalized under assets to date. The disposals amounting to 510 TEuros relate to the sale of the license rights in "Rudolph the Red-Nosed Reindeer". The **MERCHANDISE** in the prior year comprised merchandising articles and video and DVD stocks amounting to 305 TEuros. The **PAYMENTS ON ACCOUNT** for film rights amounted in the prior year to 235 TEuros and comprised payments for the development and production of a film project. The project was sold during the course of the business year 2004.

### 3. Receivables and other assets

The **TRADE RECEIVABLES** amount to 661 (p.y. 755) TEuros and have a residual term of less than one year.

The **OTHER ASSETS** amounting to 59,264 (p.y. 69,304) TEuros are comprised as follows:

VI.3 OTHER ASSETS	in TEuros	
	2004	2003
Damages receivable from legal disputes	59,110	67,700
Deposited securities	0	1,096
Tax rebates	0	72
Miscellaneous	154	436
<b>Total</b>	<b>59,264</b>	<b>69,304</b>

The **DAMAGES RECEIVABLE** from legal disputes relate to the claims of Intertainment

against Franchise Pictures and other parties. The valuation is based on the claims of Intertainment arising from the successful legal dispute amounting to the sum cited in the judgment less the risk reduction. The change by comparison with the prior year results from the partial settlements and exchange rate effects.

The management still regards as valuable the asset reported as damages, despite the fact that Franchise Pictures and other parties have instituted insolvency proceedings. The value derives on the one hand from the fact that part of the claims can be met by the insolvency settlement. On the other hand, the management also regards the prospects for success in the impending arbitration proceedings against Comerica Bank as extremely positive, see item B.1.6 of the Management Report. If Intertainment succeeds in asserting its claims against Comerica Bank, Comerica Bank would also, in the view of the management, be liable for the damages sustained by Intertainment which were already successfully asserted in the trial against Franchise Pictures and other companies. All items relate to a residual term of less than one year.

### 4. Cash on hand, bank balances

Liquid funds totaling 1,694 (p.y. 2,138) TEuros are made up of current accounts and cash in hand amounting to 1,694 (p.y. 1,874) TEuros. In the prior year, fixed term deposits with short remaining terms amounted to 264 TEuros.

### 5. Deferred tax assets

The deferred tax assets include an amount of 15,924 (p.y. 14,977) TEuros. They relate in particular to the capitalization of

deferred taxes and loss carry-forwards in the amount expected from realization. The amount recognized is based on an estimated tax rate of 38 % for municipal trade earnings and corporate income tax. The change compared with the prior year is based on the recognition of deferred tax assets on loss carry-forwards derived from the adjustments for intercompany accounts of Intertainment AG described under item VI.9 and the consequences of debt consolidation. The statutory regulations governing the offset of loss carry-forwards allow 60 % of the underlying losses to be recognized. We refer to our comments under item VII.9 of the notes to the consolidated financial statements for further information.

### 6. Equity

We refer in particular to the statement on changes in consolidated equity for details of the development of equity capital.

#### 6.1 Subscribed capital

The nominal capital remained unchanged at 15,005 TEuros on the balance sheet date. It is held in the form of 11,739,013 issued no-par shares.

#### AUTHORIZED CAPITAL

The Board of Management is authorized until September 23, 2008 to increase the nominal capital by issuing, once or more than once, new bearer no-par shares against cash contribution and/or contribution in kind by a total of up to 3,203 TEuros with the consent of the Supervisory Board (*authorized capital 2003/1*). The approved capital dated January 18, 1999 (*authorized capital 1999/1*) was cancelled.

The Board of Management is authorized furthermore until June 26, 2006, to increase the nominal capital, once or more than once, against cash contribution and/or contribution in kind by a total of up to 4,300 TEuros with the consent of the Supervisory Board (*authorized capital /11*). The Board of Management is authorized, with the consent of the Supervisory Board, on exercise of the authorized capital 2003/I and the authorized capital II to exclude partially or wholly the subscription right of the shareholders under certain conditions.

#### CONTINGENT CAPITAL

The nominal capital may be raised contingently by up to 511 TEuros (*contingent capital I*) and a further 383 TEuros (*contingent capital II*). It serves for the exercise of option rights by employees, members of the management and members of the Board of Management of the company and affiliated enterprises according to the share option program adopted by the Annual General Meeting. The nominal capital is furthermore contingently increased by 6,002 TEuros (*contingent capital III*). The contingent capital increase is only carried out insofar as the creditors make use of their convertible and option bonds by June 26, 2006.

In order to grant option rights to employees, members of the management and members of the Board of Management of the company and affiliated enterprises, the nominal capital was increased contingently by a further 383 TEuros (*contingent capital IV*) according to the resolution adopted by the shareholders' meeting on September 22, 2003 for the share option program 2003.

**6.2 Capital reserve**

At the balance sheet date, the capital reserve was 46,989 (p.y. 70,106) TEuros. The change compared with the prior year resulted from utilization to balance the annual deficit of Intertainment AG amounting to 23,303 (p.y. 55,501) TEuros and the loss carry-forward amounting to 0 (p.y. 23,935) TEuros in accordance with § 150 (3) and (4) of the AktG ("Aktengesetz", "Stock Corporation Act"). For the first time, share options issued to the Board of Management and staff were capitalized under expenses. This resulted in an increase

in capital reserve amounting to 186 (p.y. 61) TEuros. An equivalent adjustment was made for the prior year.

**6.3 Revenue reserve**

The revenue reserve in the amount of 116 (p.y. 116) TEuros relates exclusively to the legal reserve.

**6.4 Accumulated loss**

At December 31, 2004 an accumulated loss amounting to -24,158 (p.y. -25,310) TEuros is reported. The consolidated annual deficit amounts to -22,151 (p.y. -14,126) TEuros. We refer to our statements under item VI.6.2 on the utilization of the annual deficit of Intertainment AG.

**7. Provisions**

The other provisions developed as follows:

VI.7 OTHER PROVISIONS					in TEuros
Type of provision	Balance 1/1/2004	Utilization	Release	Allocation	Balance 31/12/2004
Litigation revenue participations	19,800	187	1,863	185	17,935
Contractual disputes	3,500	0	0	1,250	4,750
Legal/consultancy fees	6,500	3,870	0	570	3,200
Reorganization	2,100	1,072	93	0	935
Outstanding invoices	938	233	474	100	331
Personnel	63	61	2	34	34
License fees	119	113	6	0	0
Other	79	0	77	0	2
<b>Total</b>	<b>33,099</b>	<b>5,536</b>	<b>2,515</b>	<b>2,139</b>	<b>27,187</b>

The provision for **LITIGATION REVENUE PARTICIPATIONS** relates to the participation of third parties in the litigation revenues flowing to Intertainment. This provision is directly connected with the damages receivable under item VI.3. The amount of the participations is defined by the contractually agreed percentages based on the expected inflows of funds. The litigation revenue participations are only due at the point in time when the inflows of funds are received. The release amounting to 1,863 TEuros is reported in the income statement under extraordinary earnings.

The provision for **CONTRACTUAL DISPUTES** is for risks arising in the settlement of agreements which in the opinion of the management are binding and concluded. The provision for **LEGAL AND CONSULTANCY COSTS** (p.y. litigation risks) comprises the estimated costs still due for all the pending legal disputes. Apart from the provision for trial costs, no provisions were made for any payment obligations arising from the arbitration proceedings because the management is not assuming any further outflows of funds.

The provision for **REORGANIZATION** includes obligations to contractual partners for the settlement and termination of existing contracts.

The provision for **OUTSTANDING INVOICES** consists of payment obligations for supplies and services obtained during the reporting year that have not yet been invoiced.

The provision for **PERSONNEL** relates to meeting vacation entitlements for employees who had not yet taken holiday owing to them on the balance sheet date. Overall, provisions of 0 (p.y. 2,030) TEuros have a residual term of more than one year.

**8. Liabilities**

There are no **LIABILITIES TO BANKS**. In the prior year, liabilities to banks amounted to 7 TEuros excluding current accounts.

A loan due on June 30, 2004 was written off in the business year 2003 in the amount of 13,583 TEuros since the management believed that the residual debt called in by the bank on June 30, 2004 was rescheduled. For this reason, the management believed that the loan could no longer be called in already on June 30, 2004. The re-scheduling provides for the bank issuing a debt waiver on a deferred debt basis. Within the context of this deferred debt, receivables are reinstated when the conditions come into force. The total sum of the receivables reinstated through the deferred debt is limited to 115 % of the original loan debt. In order to secure the claims of the bank, the assets and claims described under liabilities in item VIII.6 were assigned. We refer to item F.1 of the Management Report for the risks entailed in connection with the settlement of the residual debt.

The **PAYMENTS ON ACCOUNT** received on film rights amounted to 1,318 TEuros in the previous year and comprised payments from licenses for film titles not yet supplied and not yet technically accepted. These were netted in full during the business year 2004.



The **TRADE LIABILITIES** amount to 911 (p.y. 1,142) TEuros and result in particular from repayment obligations for related services. The **OTHER LIABILITIES** amounting to 54 (p.y. 358) TEuros include liabilities to the tax authorities for wages and church tax amounting to 20 (p.y. 45) TEuros and liabilities for social security amounting to 11 (p.y. 20) TEuros. The liabilities have overall a residual term of less than one year.

#### 9. Deferred tax liabilities

Deferred tax liabilities amount to a value of 18,202 (p.y. 16,434) TEuros and were formed for consolidation measures with effect on income that will probably be cancelled out in the subsequent periods and also valuation differences between HGB and IFRS. The amount recognized is determined by applying an estimated tax rate of 38 % for municipal trade earnings tax and corporate income tax.

The calculation is essentially based on an effect related to debt consolidation. During the business years 2003 and 2004, Inter-tainment AG carried out adjustments in individual financial statements on inter-company accounts to its subsidiaries. In the context of debt consolidation, the difference led to a deferred tax asset.

## VII. Explanations to the Group income statement

### 1. Sales revenues

Sales revenues amount to 17,854 TEuros following 6,028 TEuros in the prior year. They are made up license revenues from the sale of film rights amounting to 17,819 (p.y. 4,288) TEuros. These mainly result from the sale of rights in the thriller "Twisted".

### 2. Other operating income

Other operating income amounts to 1,989 (p.y. 4,676) TEuros and comprises:

VII.2 OTHER OPERATING INCOME		
	in TEuros	
	2004	2003
Tax rebates (not related to the accounting period)	939	0
Release of provisions (not related to the accounting period)	210	1,874
Currency gains	388	1,112
Writeups on film rights	0	710
Miscellaneous	452	980
<b>Total</b>	<b>1,989</b>	<b>4,676</b>

### 3. Cost of materials

The cost of materials amounts to 17,059 (p.y. 7,098) TEuros and includes expenses for film rights and associated services amounting to 17,033 (p.y. 6,714) TEuros and expenses for related goods and servi-

ces amounting to 26 (p.y. 384) TEuros. Overall the cost of materials is made up as follows:

VII.3 COST OF MATERIALS		
	in TEuros	
	2004	2003
Normal writedowns on film rights	14,233	0
Non-scheduled writedowns of film rights	1,552	4,951
Marketing costs	1,219	1,492
Miscellaneous	55	655
<b>Total</b>	<b>17,059</b>	<b>7,098</b>

### 4. Depreciation and amortization

#### 4.1 Depreciation and amortization on intangible assets and fixed assets

Amortization and depreciation on intangible assets and fixed assets amount to 55 (p.y. 9,332) TEuros and comprise normal depreciation and amortization in the business year 2004.

In the prior year, non-scheduled depreciation on fixed assets amounted to 1,574 TEuros and non-scheduled amortization depreciation on intangible assets amounted to 7,366 due to the reorganization of the Inter-tainment Group and restructuring of American business activities.

#### 4.2 Depreciation of current assets, insofar as this exceeds other depreciation normal in the company

As a result of the restructuring measures, the receivables reported in the prior year from Blackout Productions Inc. amounting to 7,261 TEuros were written off as a result of the restructuring measures.

### 5. Other operating expenses

The other operating expenses comprise 2,340 (p.y. 12,276) TEuros and comprise:

VII.5 OTHER OPERATING EXPENSES		
	in TEuros	
	2004	2003
Legal and consultancy costs	497	1,737
Rents and accommodation costs	280	1,245
Currency losses	185	2,682
Administrative costs of producers	0	2,887
Costs of reorganization	0	1,300
Miscellaneous	1,378	2,425
<b>Total</b>	<b>2,340</b>	<b>12,276</b>

### 6. Writedowns on financial assets

Writedowns on financial assets include the diminution in value of shares in SightSound Technologies Inc. amounting to 15,036 (p.y. 0) TEuros. We refer to statements under item VI.1 for further information.

**7. Interest result**

The interest result amounts to 5 (p.y. -458) TEuros and includes interest in the sum of 5 (p.y. 2,494) TEuros and interest expenses in the sum of 0 (p.y. 2,952) TEuros. In the prior year, these amounts included the discount effects of long-term receivables and liabilities.

**8. Extraordinary result**

Intertainment presents all the items directly connected with litigation associated with the Franchise Pictures case relating to the fraud scenario in the extraordinary result. The fraud alleged by Intertainment against Franchise Pictures and other parties was confirmed in the first instance with the decision by the jury on June 16, 2004. We refer to statements made under item B.1. of the Management Report for further information.

**8.1 Extraordinary income**

Extraordinary income amounts to 2,419 (p.y. 48,176) TEuros and results in particular from release of the provision for litigation revenue participations amounting to 1,863 (p.y. 0) TEuros.

**8.2 Extraordinary expenses**

Extraordinary expenses amount to 6,953 (p.y. 28,801) TEuros and comprise expenses arising from the claims for damages in the sum of 4,015 (p.y. 0) TEuros, expenses for disputes in contract processing in the sum of 2,368 (p.y. 3,523) TEuros and the transfer to provision for litigation risks and consultancy expenses amounting to 570 (p.y. 5,077) TEuros.

**9. Taxes**

Overall tax expenses amounting to 822 (p.y. 4,727) TEuros were recorded. They are made up as follows:

VII.9 TAXES		
	in TEuros	
	2004	2003
<b>Current taxes on income and earnings</b>	0	+45
<b>Deferred tax income</b>	-822	-4,772
<b>Total</b>	<b>-822</b>	<b>-4,727</b>

Deferred taxes are formed on temporary differences between the commercial and tax accounts and on the differences arising from uniform Group valuation and consolidation. The deferred taxes are calculated at the relevant country rates, which in 2003 ranged between 38 % and 43 %. The Tax-rate changes applicable after the balance sheet date have been taken into account. The higher tax rate of 26.5 % which applies to corporate income tax for 2003 only pursuant to the law on solidarity with flood victims has not been applied, this is in view of low materiality involved and the present situation of a tax loss or option of offsetting with loss carry-forwards prevailing in Germany. The Group tax rate corresponds to the average domestic tax rate, since more than 95 % of the Group's pre-tax result is generated domestically. Taking into consideration the deductibility of the municipal trade tax as

well as corporate income tax including the solidarity surcharge, it comes to 38 %. Expected tax savings from the use of loss carry-forwards which are estimated to be realizable are capitalized. There were unused corporate income tax losses of 161,811 TEuros and municipal tax loss carry-forwards of 173,198 TEuros at the balance sheet date. The accrued losses can be carried forward without limitation in accordance with the applicable legislation. However, a change in the legislation effective from 1/1/2004 means that current profits from a period can only be offset up to 60 % on loss carry-forwards. (so-called minimum taxation). This is applicable to amounts above 1,000 TEuros. Losses amounting to 61,071 TEuros were consolidated as a deferred tax asset on the

balance sheet date. However, on account of minimum taxation, capitalized deferred taxes are only formed on 60 % of these losses. Capitalization of the deferred taxes is justified by the surplus of deferred tax liabilities resulting from the capitalization of the deferred tax assets described under item VI. 9. The management is of the view that earnings from future business activity will probably generate sufficient taxable profits in order to realize this tax asset. In valuing a tax asset for purposes of future tax relief, the probability of realizing the expected tax benefit is taken into account. The following deferred tax assets and liabilities reported are attributable to differences in recognition and valuation in the individual balance sheet items:

VII.9 DEFERRED TAXES				
	31/12/2004		31/12/2003	
	assets	liabilities	assets	liabilities
<b>Loss carry-forwards</b>	15,924	0	14,857	0
<b>Debt consolidation</b>	0	18,207	0	16,429
<b>Intangible assets</b>	0	0	120	0
<b>Trade receivables</b>	0	-5	0	5
<b>Total</b>	<b>15,924</b>	<b>18,202</b>	<b>14,977</b>	<b>16,434</b>

The deferred tax assets on loss carry-forwards consist of:

VII.9 DEFERRED TAX ASSETS ON LOSS CARRY-FORWARDS		
	in TEuros	
	31/12/2004	31/12/2003
Corporate income tax	9,637	8,991
Municipal trade tax	6,287	5,866
<b>Total</b>	<b>15,924</b>	<b>14,857</b>

Reconciliation of expected to actual earnings tax expense (IAS 12.81c.ii)

VII.9 EARNINGS TAX EXPENSE: RECONCILIATION		
	in TEuros	
	31/12/2004	31/12/2003
Result before taxes on earnings	-21,329	-9,338
Group tax rate	38 %	38 %
Expected income tax expense	-8,105	-3,572
<b>Tax effects as a consequence of</b>		
Differences in tax rates	2	-16
Non-capitalized loss carry-forwards	3,164	11,959
Utilization of loss carry-forwards	-18	-3,960
Taxes for prior years on account of tax audit	0	2
Loss carryback	0	78
Writedowns on financial assets	5,714	0
Other additions and deductions	65	236
<b>Taxes on income and earnings</b>	<b>822</b>	<b>4,727</b>

## VIII. Other information

### 1. The Franchise Pictures case and other arbitration proceedings

We refer to item B.1 of the Management Report.

### 2. Segment reporting

Due to the sale of license rights in "Rudolph the Red-Nosed Reindeer", Intertainment no longer has any segments subject to reporting obligations under IAS 14. The segment trading in film rights to cartoon films and merchandising reported in the prior year is no longer subject to reporting obligations due to the minimum requirements for a segment. All information relates to the segment film production and trading in film rights to feature films.

### 3. Earnings per share

According to IAS 33, the earnings per share are calculated by dividing the earnings for the period by the weighted average number of the shares in circulation. The number of shares is 11,739,013. In 2004, the Group recorded a deficit of 22,151 TEuros, following a deficit of 14,126 TEuros in the prior year. Hence the earnings per share deteriorated in 2004 to -1.89 euros, after -1.20 euros in the year 2003. The diluted earnings per share amount to -1.89 (p.y. -1.20) euros.

### 4. Employee share program

The share option programs of 1991, 2001 and 2003 authorize Intertainment AG to offer to employees or members of the Board of Management, or employees and members of the management of affiliated enterprises, with the consent of the Super-

visory Board, rights to subscribe to no-par bearer shares. The entitlement to subscribe and the number of subscription rights are determined for the members of the Board of Management by the Supervisory Board alone, and in other cases by the Board of Management together with the Supervisory Board. Shareholders do not have a legal entitlement to subscription.

The prerequisite for the exercise of option rights is that the options have not expired and that the average rate of the Xetra midday auction on the first five stockmarket days after the ordinary shareholders' meeting has increased by at least 30 % in comparison with the average rate of the Xetra midday auction of the Intertainment share which was used as the basis for the exercise price when the subscriptions rights concerned were issued. This income target must be reached for those subscription rights which can be exercised for the first time in this exercise period. If the earnings target for these subscription rights is reached, they may also be exercised, independently of further price development, at a later point in time.

The offer to subscribe the option rights under the share option program 1999 may be made in each case within six weeks of the ordinary shareholders' meeting of the company or after publication of the result of the third quarter and may be purchased by those with entitlement. Under the share option programs 2001 and 2003, the offer to subscribe the option rights may only be made within two weeks of publication of an annual, half-yearly or quarterly report of the company. The offer can be subscribed only within four weeks after issue of the offer. The subscription rights may be

exercised, on observance of the corresponding waiting periods and exercise prerequisites, annually during the fourth quarter and the following 15 stockmarket days after the ordinary shareholders' meeting and after publication of the result for the third quarter. Up to 25 % of the subscription rights may be exercised for the first time two years from the time of issue of the subscription rights. In the following three years, a further 25 % per annum may be exercised. If subscription rights are not exercised at this last point in time, they lapse.

The development of share options is as follows:

### VIII.4 DEVELOPMENT OF SHARE OPTIONS

	2004	2003
Options issued at January 1	458,000	338,000
New options issued	230,000	120,000
Options issued at December 31	688,000	458,000
of which lapsed options	4,000	0
Options still available	312,000	452,000

No share options have been exercised by the Board of Management or employees during the year under review. The lapsed share options relate to items for which the exercise period has expired. The issued share options have been charged to expenditure for the first time in the business

year 2004 based on IFRS 2. In this connection, an appropriate adjustment was made to the business year 2003.

For purposes of valuation, the fair current value of the share options was calculated on the basis of the Black Scholes option price model. The measurement date is the grant date of the share options. The current fair value determined in this way is allocated uniformly over the vesting period under personnel expenses to the capital reserve. The vesting period entails that 25 % of the share options can be exercised after two years and a further 25 % each year during each of the following three years from this point in time. The vesting conditions are defined in the introductory section to this item. In accordance with the transitional regulations under IFRS 2, only the share options granted after November 7, 2002 are included in the valuation.

The valuation parameters for the Black Scholes option price model are as follows:

VIII.4 VALUATION PARAMETERS		in TEuros	
	2004	2003	
<b>Risk-free interest rate</b>	5.0 %	5.0 %	
<b>Expected duration to exercise (in years)</b>	5	5	
<b>Expected volatility</b>	120 %	120 %	

The expected volatility is based on the historical development of the share price of Intertainment AG. It is based on the period of the last 250 days.

Valuation criteria for issued and issuable share options:

VIII.4 SHARE OPTIONS		in TEuros	
	2004	2003	
<b>Options granted (no-par shares)</b>	230,000	120,000	
<b>Exercise price (weighted average) in euros</b>	2.00	1.85	

In the business year 2004, 186 (p.y. 61) TEuros are included under personnel expenses for the valuation of share options.

#### 5. Other financial commitments

At December 31, 2004, the following future payment obligations were recorded:

VIII.4 OTHER FINANCIAL COMMITMENTS		in TEuros	
	Remaining term less than 1 year	Remaining term more than 1 year	Total
<b>Obligations arising from film productions</b>	0 (p. y. 29,680)	0 (p. y. 3,180)	0 (p. y. 32,860)
<b>Obligations arising from lease and rental contracts</b>	928 (p. y. 1,137)	534 (p. y. 1,655)	1,462 (p. y. 2,792)
<b>Total</b>	<b>928</b> <b>(p. y. 30,817)</b>	<b>534</b> <b>(p. y. 4,835)</b>	<b>1,462</b> <b>(p. y. 35,652)</b>

#### OBLIGATIONS ARISING FROM FILM PRODUCTIONS

The obligations arising from film productions related in the prior year to payments to production companies and remuneration to be paid to the co-producers of Intertainment.

Current contracts were restructured as a result of the reorganization measures carried out at the start of the business year 2004. In this connection, it was possible to significantly reduce the obligations for film productions reported in the prior year effective from the first quarter of 2004. The claims arising from the license sales of the film "Twisted" were assigned in order to settle other ongoing obligations. It is possible that other financial obligations will arise in the future from this restructuring depending on the proceeds from exploitation.

#### OTHER OBLIGATIONS ARISING FROM LEASING AND RENTAL CONTRACTS

Within the framework of operating leases, the Intertainment Group leases motor vehicles and various items of office equipment. The obligations from the rental contracts relate to the business premises in Ismaning and in Los Angeles. Both contracts have a fixed term of 5 years, with the rental contract for the offices in Ismaning expiring on June 14, 2005 and that in Los Angeles on April 30, 2006.



#### OBLIGATIONS ARISING FROM ARBITRATION PROCEEDINGS

The arbitration proceeding that originally related to the film "Driven" was extended to all the disputed films financed by Comerica Bank and all claims for damages being asserted by Intertainment against Comerica Bank. Comerica Bank is demanding in this arbitration proceeding all outstanding installments for the films it financed. The total amount is more than 70 million US dollars. We refer to item B.1.6 of the Management Report for further information.

In addition, the arbitration proceeding against International Motion Pictures (IMPC) for the film title "Tracker" was pending on the balance sheet date. IMPC is demanding a payment in the sum of 3.3 million US dollars from Intertainment plus interest from Intertainment. The settlement concluded in the business year 2005 means that Intertainment no longer has any obligations at this point in time. We refer to statements in item B.1.9 of the Management Report for further information.

#### OTHER OBLIGATIONS ARISING FROM LITIGATION REVENUE PARTICIPATIONS

Insofar as cash-inflows of funds from the legal dispute with Franchise Pictures and other parties exceed the damages receivable amounting to 59,110 TEuros reported under other assets, other contractual obligations for litigation revenue participations arise on the basis of contractual agreements for which no provisions have been formed during the business year 2004.

#### 6. Other contingent obligations

Under liabilities to banks, Intertainment reports rescheduling for the settlement of the residual debt arising from a loan to INTERTAINMENT Licensing GmbH, which the management assumes will come into force. In the opinion of the management, the bank issued a debt waiver with an under-taking to pay in December 2003. In this connection, the film rights already assigned but not yet sold and the resulting exploitation revenues remain assigned as security. The financing bank is also being assigned 15 % of the future net income for the business years 2004 to 2006 and a further 15 % of the litigation revenues arising from the litigation against Franchise Pictures as security.

In the business year 2001, Intertainment AG took over a guarantee to the bank for this loan. In the view of the management, this guarantee has been extinguished within the framework of the new negotiations with the bank. We refer to item F.1 of the Management Report for the risks associated with this assessment.

In the year 2000, Intertainment AG provided an unchanged, ongoing surety amounting to 76 (p.y. 76) TEuros for the rental of the offices in Ismaning

#### 7. Financial instruments

In order to hedge currency risks – they relate in particular to the price performance of the US dollar – Intertainment always concludes forward currency transactions. These derivative financial instruments are used only to secure the underlying transactions; they are therefore not to be considered speculative transactions, since there is a close relationship in terms of the amount

and the timing between the underlying and the securing transaction. No forward currency transactions were concluded in the business years 2004 and 2003.

#### 8. Supplementary information on the cash flow statement according to IAS 7

Intertainment no longer reports non-cash extraordinary items separately, but offsets them with the corresponding changes in balance sheet items. This procedure provides a more transparent presentation of changes in financial flows. During the business year 2004, income tax amounting to 0 (p.y. 123) TEuros was paid. Intertainment booked no tax rebates, paid no interest (p.y. 498 TEuros), and received interest in the sum of 5 (p.y. 48) TEuros. In the business year 2004 and in the prior year, there were no "non-cash transactions" affecting exclusively equity.

#### 9. Executive bodies

##### BOARD OF MANAGEMENT

- Ernst Rüdiger Baeres, lawyer, Munich (Chairman to October 29, 2004)
- Hans Joachim Gerlach, businessman, Berlin (Sole Member of the board of Management from October 29, 2004)

Ernst Rüdiger Baeres had sole power of attorney until the change. Hans Joachim Gerlach represented the company together with the Chairman of the Board of Management. Rüdiger Baeres was elected as the new Chairman of the Supervisory Board at the constituent meeting of the Supervisory Board of Intertainment AG. The meeting was held immediately after the Annual General Meeting of the company.

The fixed remuneration package of the Board of Management amounted to 679 (p.y. 1,274) TEuros in the calendar year 2004. In addition, the Board of Management of Intertainment AG receives a contractually defined bonus amounting to 2,488 TEuros. This is dependent on the cash-inflows of funds arising from the successful legal dispute against Franchise Pictures and other parties and is, amongst other things, based on the claims for damages reported under other assets. This bonus is reported under the provisions for litigation revenue participations. Changes to this bonus affecting earnings are recognized in the extraordinary result.

##### SUPERVISORY BOARD

- Ernst Rüdiger Baeres, lawyer, Munich (Chairman from October 29, 2004)
- Dr. Matthias Heisse, lawyer, Munich (Deputy Chairman from October 29, 2004)
- Dr. Wilhelm Bahner, businessman, Munich; (Deputy Chairman to October 29, 2004)
- Wolfgang Blauburger, businessman, Munich

During the business year 2004, Dr. Matthias Heisse was also a member of the Supervisory Board of Firestorm AG, Munich. Rüdiger Baeres, Dr. Wilhelm Bahner and Wolfgang Blauburger did not hold any further Supervisory Board offices during the business year 2004.

For the business year 2004, Supervisory Board compensation in the amount of 23 (p.y. 23) TEuros was paid.

### 10. Related companies and persons

According to IAS 24, INTERENTAINMENT Licensing GmbH, Intertainment Animation & Merchandising GmbH and USA-Intertainment, Inc. are related parties of Intertainment AG. It holds 100 % of the voting rights and shares in these three companies. The nature of the relationships between the enterprises is, among other things, that USA-Intertainment, Inc. performs services in Los Angeles for Intertainment AG and INTERENTAINMENT Licensing GmbH. Under a cost allocation arrangement on the cost-plus method, the recipient of the performances bears the costs resulting from the performance.

In the business year 2004, Intertainment AG and INTERENTAINMENT Licensing GmbH assumed expenses of USA-Intertainment, Inc. in the amount of 801 (p.y. 2,110) TEuros. Of this amount, Intertainment AG paid 496 (p.y. 1,308) TEuros and INTERENTAINMENT Licensing GmbH 305 (p.y. 802) TEuros. In addition, Intertainment AG declared a debt waiver in respect of USA-Intertainment Inc. amounting to 0 (p.y. 1,535) TEuros and with respect to Intertainment Animation & Merchandising GmbH amounting to 56 (p.y. 279) TEuros.

Furthermore, the following amounts were offset for services between the individual Group companies:

VIII.10 OFFSETS	in TEuros	
	2004	2003
Intertainment AG	-41	-45
INTERENTAINMENT Licensing GmbH	111	192
Intertainment Animation & Merchandising GmbH	-170	-147

At December 31, 2004 Intertainment AG posted the following receivables after adjustments and liabilities from subsidiaries:

VIII.10 RECEIVABLES FROM SUBSIDIARIES	in TEuros	
	2004	2003
INTERENTAINMENT Licensing GmbH	64,500	105,884
Intertainment Animation & Merchandising GmbH	647	1,746
USA-Intertainment, Inc.	0	1,749
<b>Total</b>	<b>65,147</b>	<b>109,379</b>

On the balance sheet date, Intertainment AG carried out an adjustment on the inter-company account for INTERENTAINMENT Licensing GmbH amounting to 5,000 (p.y.

42,913) TEuros and for Intertainment Animation & Merchandising GmbH amounting to 363 (p.y. 320) TEuros. This has been undertaken on account of the changed liquidity planning of INTERENTAINMENT Licensing GmbH and Intertainment Animation & Merchandising GmbH. Intertainment AG also waived interest from the inter-company account of INTERENTAINMENT Licensing GmbH in the business year 2004. Ernst Rüdiger Baeres should be regarded as a naturally related person. On the balance sheet date, he held 60.4 % of the voting rights in Intertainment AG. An apartment in Los Angeles was placed at the disposal of Mr. Baeres, which Intertainment AG leased from Alkmäon Vermögensverwaltungsgesellschaft mbH, whose shares are held by Mr. Baeres. The rent amounts to 146 (p.y. 171) TEuros. Rental payments amounting to 29 TEuros were also paid by

Intertainment AG to Mr. Baeres, which relate to a further apartment leased to the company for a short period of time.

During the business year 2004, fees of 224 (p.y. 534) TEuros were paid to the law firm ARCON in which Dr. Heisse is a partner, under the framework of a separate consultancy contract (pursuant to §114 AktG). Under separate consultancy contracts (pursuant to §114 AktG) fees amounting to 35 TEuros were paid to Mr Rüdiger Baeres from October 29 2004 and fees of 47 (p.y. 107) TEuros were paid to the auditing firm Wolfgang Blauburger, in which Wolfgang Blauburger is managing partner.

### 11. Shares and options held by members of the executive bodies

On December 31, 2004, the figures on shares and options rights held by members of the executive bodies were as follows:

VIII.11 SHARE OWNERSHIP AND OPTIONS		
BOARD OF MANAGEMENT	Shares	Options
Rüdiger Baeres (to 29/10/2004)	7,085,031	0
Achim Gerlach	10,000	200,000
SUPERVISORY BOARD		
Rüdiger Baeres (from 29/10/2004)	7,085,031	0
Dr. Matthias Heisse	12,980	0
Dr. Wilhelm Bahner (to 29/10/2004)	0	0
Wolfgang Blauburger	670	0

At December 31, 2004 the company did not hold any own shares.

#### 12. Employees

On average during the business year 2004, the Group employed 13 (p.y. 23) staff.

#### 13. Company headquarters

Intertainment AG is located at Osterfeldstraße 84, 85737 Ismaning, in the district of Munich.

#### 14. Events occurring after the balance sheet date

After December 31, 2004, the following significant events occurred as described below. Other events that exert influence in terms of reflecting value on the annual financial statements for the year ended December 31, 2004, did not occur after the balance sheet date.

##### 14.1 Settlement with Film Finances, Inc., Film Finances Canada and International Motion Pictures Corporation Ltd.

On March 15, 2005 INTERTAINMENT Licensing GmbH and Intertainment AG reached a settlement with the bond companies Film Finances, Inc. and Film Finances (1998) Canada Ltd, in conjunction with the pending legal disputes in the USA. Under the terms of the settlement, Intertainment will receive a payment from Film Finances and Film Finances (1998) Canada. It has been agreed not to disclose the amount of the payment. Film Finances, Inc. and Film Finances (1998) Canada will also assign their claims against the insolvent film producer Franchise Pictures and against subsidiaries of Franchise to the estate, hence withdrawing from the list of

creditors. Intertainment is the biggest unsecured creditor in the Franchise insolvency proceedings.

It has further been agreed that International Motion Pictures Corporation Ltd. (IMPC), Hong Kong, will withdraw its arbitration claim against Intertainment in connection with the film "Tracker".

##### 14.2 Insolvency proceeding of Franchise Pictures

At the point in time when this Management Report was prepared, the presiding court had not yet reached a decision on the petition by the restructuring manager of Franchise Pictures to extend the period to submission of the restructuring plan by 120 days. A decision had also not been reached on the protest filed by Intertainment against this petition.

##### 14.3 Enforcement against the former CEO of Franchise Pictures

The first court hearing about the assets of Elie Samaha was held on 24 January 2005. Samaha disclosed documents and a date for another meeting was set. After the disclosure, Intertainment began to analyze the documents submitted and made preparations for concrete enforcement measures.

##### 14.4 Post Trial Motions

At the point in time when this Management Report was prepared, the presiding judge had not yet reached a decision on the post trial motions. The hearing on the outstanding issues, originally scheduled for January 24, was postponed with the consent of INTERTAINMENT Licensing GmbH initially to February 28, 2005 and then to May 2005.

##### 14.5 Arbitration proceeding in the case "Viva Las Nowhere"

Intertainment filed a claim at the beginning of January 2005 against Westdeutsche Landesbank (WestLB), the Lewis Horwitz Organization and Federal Deposit Insurance Corp. in connection with the film "Viva Las Nowhere". WestLB on its part then filed a counterclaim against Intertainment in the context of the proceeding for an outstanding installment payment in the sum of some 0.9 million US dollars.

##### 15. Statement on the German Corporate Governance Code

The Board of Management and Supervisory Board of Intertainment AG have made the declaration of compliance required by § 161 AktG on the German Corporate Governance Code and made it available to shareholders permanently on the website of the company ([www.intertainment.de](http://www.intertainment.de)).

Ismaning near Munich, April 29, 2005  
Intertainment AG

##### Hans Joachim Gerlach

Chairman of the Board of Management

Intertainment Group: Schedule of Fixed Assets

Gross

in TEuros	ACQUISITION COSTS					ACCUMULATED AMORTIZATION				CARRYING VALUE	
	1/1/2004	Additions	Disposals	Currency	31/12/2004	1/1/2004	Amortization and depreciation in the business year	Disposals	31/12/2004	31/12/2004	31/12/2003
<b>I. Intangible assets</b>											
1. Licenses, commercial property rights and similar rights as well as licenses in such rights	131	0	0	0	131	128	2	0	130	1	3
2. Payments made on account	2,147	0	0	0	2,147	0	0	0	0	2,147	2,147
	2,278	0	0	0	2,278	128	2	0	130	2,148	2,150
<b>II. Tangible assets</b>											
Other plant, business and office equipment	600	1	-64	3	540	406	53	-41	418	122	194
<b>III. Financial assets</b>											
Participations	20,048	0	0	0	20,048	5,012	15,036	0	20,048	0	15,036
	<b>22,926</b>	<b>1</b>	<b>-64</b>	<b>3</b>	<b>22,866</b>	<b>5,546</b>	<b>15,091</b>	<b>-41</b>	<b>20,596</b>	<b>2,270</b>	<b>17,380</b>



## Intertainment Group: Audit Opinion

We have audited the consolidated financial statements comprising the balance sheet, the income statement, notes, the statement of changes in shareholders' equity and cash flows prepared by Intertainment Aktiengesellschaft, Ismaning, district of Munich, for the business year from January 1 to December 31, 2004. The preparation and the content of the consolidated financial statements in accordance with the International Financial Reporting Standards (IFRS) are the responsibility of the company's Board of Management. Our responsibility is to express an opinion on the consolidated financial statements, based on our audit.

With the exception of the matters presented in the section below, we conducted our audit of the consolidated financial statements in accordance with the German auditing regulations and the generally accepted German standards for the audit of financial statements promulgated by the Institut der Wirtschaftsprüfer (IDW). Those standards require that we plan and perform the audit such that misstatements materially affecting the presentation of the consolidated financial statements are detected with reasonable assurance. Knowledge of the business activities and the economic and legal environment of the Group and evaluations of possible misstatements are taken into account in the determination of the audit procedures. The effectiveness of the accounting-related internal control systems and the evidence supporting the amounts and disclosures in the consolidated financial statements are examined primarily on a test basis within the framework of the audit. The audit includes assessing the annual financial statements of the companies included in consolidation, the determination of the companies to be included in consolidation, the accounting and consolidation principles

used and significant estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements. We believe that with the exception stated in the paragraph below, our audit provides a reasonable basis for our opinion.

With the exception of the following qualifications, our audit has not led to any reservations:

- We draw attention to the comments made in the notes to the consolidated financial statements in section "VI.7 Other provisions" and in section "VI.8 Liabilities". It is stated that the Board of Management assumes that the settlement of a residual debt with a bank in the fiscal year 2003 that has been called in was rescheduled. The liability was therefore written off in the previous year and provisions were made in the form of reserves. It was not possible to obtain reasonable certainty as to the existence of this agreement with the bank relating to a debt waiver on a deferred debt basis at December 31, 2004, even by means of alternative auditing procedures. It is therefore not possible to exclude the possibility that the liability still exists at the balance-sheet date and a receivable from a third party which is linked with this liability as security should not have been netted with the liabilities in respect of this third party in the previous year.

- We further draw attention to the comments in the notes to the consolidated financial statements in section "VI.3 Receivables and other assets". It is stated that the damages receivable arising from the disputes represent a valuable asset in the amount capitalized. The Board of Management assumes in this connection that the claims confirmed by the court judgment against Franchise Pictures can be met partly out of their settlement. In the opinion of the Board of Management, there should

also be alternative liability claims against Comerica Bank and these claims should be enforceable. A decision on the existence of joint and several liability is likely to be made in the course of an ongoing arbitration proceeding in the USA, which is currently in the discovery phase. It was not possible to obtain reasonable certainty on the value of the claims for damages against Franchise Pictures and the other parties found liable and concerning the existence of a relationship of liability through Comerica Bank, even by means of alternative auditing procedures.

It is therefore not possible to exclude the possibility that the consolidated financial statements should have been changed because of the two audit obstacles referred to above.

In our opinion, subject to these qualifications, the consolidated financial statements give a true and fair view of the net assets, financial position and results of operations in the Intertainment AG Group as of December 31, 2004 and the results of their operations and their cash flows for the year then ended in accordance with the International Financial Reporting Standards, and on the whole the consolidated management report provides an accurate understanding of the Group's position and suitably presents the risks of future development. Our audit, which also extends to the Group management report prepared by the Company's management for the business year from January 1 to December 31, 2004, summarized with the management report of the parent company, has not led to any reservations with the exception of the qualifications stated above. In addition, we confirm that the consolidated financial statements and the Group management report for the business year from January 1 to December 31, 2004 satisfy the conditions required for the Company's

exemption from its duty to prepare consolidated financial statements and a Group management report in accordance with German law.

Without further qualifying this opinion, we draw attention to the statements made in the Group management report concerning the risks relating to the ability to continue as a going concern. It is stated that there are substantial uncertainties with respect to the assumptions on which the financial budget is based. If these assumptions fail to materialize as planned, the Group will not be able to fulfill its current payment obligations – also at very short notice. We refer to the statements in the consolidated annual report in the section "F. Risks of future development of the Intertainment AG Group". If the events referred to below fail to materialize as planned, the ability of the Group to continue as a going concern is endangered – also at very short notice:

- Settlement of the bank loan referred to above which has already been called in on the basis of the assumptions made by the legal representatives
- Cash-inflow of funds from the legal disputes referred to above with Franchise Pictures, Comerica Bank and other parties
- No cash-outflow of funds from the current arbitration proceedings for the payment of the second installment for the disputed films rights
- Fulfillment of the other assumptions of the financial plan including further incoming payments planned for the near future.

Munich, May 3, 2005

KPMG Deutsche Treuhand-Gesellschaft  
Aktiengesellschaft  
Wirtschaftsprüfungsgesellschaft

Curtis                      Querfurth  
Wirtschaftsprüfer      Wirtschaftsprüfer

## Intertainment AG: Consolidated Balance Sheet

as at December 31, 2004 in Accordance with the IFRS

ASSETS		in TEuros	
	Note	31/12/2004	31/12/2003
<b>A. FIXED ASSETS</b>			
<b>I. Intangible assets</b>			
1. Licenses, commercial property rights and similar rights as well as licences to such rights	III.1	0	1
2. Payments made on account	III.1	2,147	2,147
<b>II. Property, plant &amp; equipment</b>			
Other plant, business and office equipment	III.1	2	7
<b>II. Financial assets</b>			
1. Shares in affiliated enterprises	III.1	9,001	9,359
2. Participations	III.1	0	15,036
		<b>11,150</b>	<b>26,550</b>
<b>B. CURRENT ASSETS</b>			
<b>I. Inventories</b>			
1. Film rights	III.2	4,250	6,308
2. Merchandise	III.2	0	17
<b>II. Receivables and other assets</b>			
1. Trade receivables	III.3	461	631
2. Receivables from affiliated enterprises	III.3	58,165	65,147
3. Other assets	III.3	97	1,258
<b>III. Cash on hand, bank balances</b>			
	III.4	1,613	1,387
		<b>64,586</b>	<b>74,748</b>
<b>C. DEFERRED TAXES</b>			
		0	99
		<b>75,736</b>	<b>101,397</b>

EQUITY & LIABILITIES		in TEuros	
	Note	31/12/2004	31/12/2003
<b>A. EQUITY</b>			
I. Subscribed capital	III.5.1	15,005	15,005
II. Capital reserve	III.5.2	59,082	82,385
<b>III. Earnings reserves</b>			
Statutory reserve	III.5.3	116	116
		<b>74,203</b>	<b>97,506</b>
<b>B. PROVISIONS</b>			
Other provisions	III.6	1,268	2,322
		<b>1,268</b>	<b>2,322</b>
<b>C. LIABILITIES</b>			
1. Payments received on account	III.7	0	1,318
2. Trade accounts payables	III.7	106	79
3. Liabilities from affiliated enterprises	III.7	114	0
4. Other liabilities	III.7	45	172
		<b>265</b>	<b>1,569</b>
		<b>75,736</b>	<b>101,397</b>

## Intertainment AG: Income Statement

for the period from January 1, 2004 to December 31, 2004  
in Accordance with the IFRS

		in TEuros	
	Note	2004	2003
1. Sales revenues	IV.1	17,829	4,021
2. Other operating income	IV.2	822	2,903
3. Cost of materials			
Cost of raw materials, consumables and supplies, and of purchased materials	IV.3	-16,883	-6,017
4. Personnel expenses			
a) Salaries		-991	-1,309
b) Social security contributions and other pension costs – of which for pension provision TEUR 7 (p.y. TEUR 6) –		-52	-70
5. Depreciation and amortization			
a) Amortization on intangible fixed assets and depreciation on property, plant & equipment	IV.4	-6	-3,367
b) Depreciation of current assets, insofar as this exceeds other depreciation normal in the company	IV.5	-5,363	-52,243
6. Other operating expenses	IV.6	-2,157	-9,504
7. Other interest and similar income	IV.8	10	10,143
8. Writedowns on financial assets	IV.7	-15,394	0
9. Interest and similar expenses	IV.8	0	-57
10. Result of ordinary business activities		<b>-22,185</b>	<b>-55,500</b>
11. Extraordinary expenses	IV.9	-1,118	0
12. Other taxes		0	-1
13. Net loss		<b>-23,303</b>	<b>-55,501</b>
14. Loss carry-forward from prior year		0	-23,935
15. Withdrawal from capital reserves		23,303	79,436
16. GROUP RETAINED EARNINGS		<b>0</b>	<b>0</b>

## Intertainment AG: Notes

for the Business Year 2003 in Accordance with the IFRS

## I. General information

Since February 18, 1999, Intertainment AG (hereinafter also referred to as Intertainment) has been quoted on the Frankfurt Stock Exchange – until January 15, 2003 in the “Neuer Markt” and since then in the “Prime Standard segment”. The company is a large company pursuant to § 267 (3) sentence 2 HGB (“Handelsgesetzbuch”, “German Commercial Code”). The annual financial statements of Intertainment AG have been prepared according to the regulations of the Commercial Code and the Stock Corporation Act. The type of expenditure method has been chosen for the income statement.

Intertainment presents the figures in these Notes in thousand euros (TEuros). Alongside the figures for the business year 2004, the corresponding figures for the prior year are given for purposes of comparison. Generally they are in brackets. The abbreviation “p.y.” stands for “prior year”.

## II. Accounting and valuation methods

## 1. Fixed assets

**INTANGIBLE ASSETS** are shown at their acquisition cost less amortization. Where the acquisition costs of an asset relate to different portions of the rights, as often occurs in the case of film rights, the acquisition costs are divided on the basis of the forecast revenues of each rights portion. The acquisition costs are amortized normally in accordance with economic life or causation.

Payments for the acquisition of film rights which are available for an indefinite period of time and have not yet been delivered and the technical quality accepted are reported as payments under intangible assets.

The capitalized costs are regularly examined as to their value and, if necessary, recorded as a non-scheduled writedown. This writedown at a lower fair value is necessary when it is not sufficiently probable that an adequate future economic benefit can be generated from the assets.

**PROPERTY, PLANT AND EQUIPMENT** are stated at acquisition costs less scheduled linear depreciation. The scheduled linear depreciation is based on the normal useful life for the business. Low value economic goods of fixed assets with acquisition costs up to 410 euros are depreciated in full

during the year of acquisition and are shown in the fixed asset schedule as disposals. The **FINANCIAL ASSETS** are stated at the lower of acquisition costs and fair value. In the case of a share swap, the acquisition costs are stated at the value on the day the shares were delivered.

## 2. Current assets

**FILM RIGHTS** that are acquired for a limited period of time are recorded under current assets. The valuation is based on the acquisition costs less amortization of the exploited portions of the rights. The acquisition costs are broken down according to the rights portions cinema, video/DVD, Pay TV and Free TV. The measurement base for this breakdown relates to the revenues forecast for the defined subsegments. The Free TV rights portions are broken down into up to three exploitation cycles. Together they will cover a period of up to 25 years. If individual subsegments for film rights are not exploited, the acquisition costs are broken down into the remaining exploitation stages with modified allocation percentages.

The film license rights are capitalized when an independent laboratory has accepted the technical quality of the film material supplied.

The normal amortization of film rights is based on economic life or exploitation of the film rights. In addition, non-scheduled writedowns are made in the context of loss-free valuation, if it is determined that the forecast revenues from disposal are less than the residual book value of a film right.

The **STOCKS OF MERCHANDISE** were valued at acquisition costs less depreciation.

**RECEIVABLES AND OTHER ASSETS** were stated at nominal value. Foreign currency receivables are valued at the exchange rate in force at the time when the receivable arises or, if lower at the rate on the balance sheet date. Adjustments are formed to take account of the risk of the receivable not being paid.

**CASH IN HAND AND BANK BALANCES** are stated at their nominal values. For current accounts, bank balances in foreign currency are valued at the euro exchange rate on the balance sheet date, while deposits in fixed term accounts are recorded at the lower of the exchange rate on the closing date and the rate when the booking entry is made.

## 3. Outside capital

**OTHER PROVISIONS** include all risks identifiable and uncertain obligations on the balance sheet date and should be valued on the basis of a reasonable commercial assessment.

**LIABILITIES** are recognized at the repayment amount. Foreign-currency liabilities are valued at the exchange rate in force at the time when the invoice is received or the higher rate on the balance sheet date.

## III. Explanations to the balance sheet

### 1. Fixed assets

With regard to the presentation of the development of **FIXED ASSETS** we refer to the schedule of fixed assets.

Payments on account for intangible fixed

assets include payments for the acquisition of secondary rights in the thriller "Twisted" for various territories amounting to 2,147 (p.y. 2,147) TEuros.

Property, plant and equipment essentially consist of office and business equipment, and other assets. The financial assets amount to 9,001 (p.y. 9,359) TEuros and include the following participations:

III.1 FINANCIAL ASSETS				in TEuros
Participation	Share (in %)	Subscribed capital 2004 (p.y.)	Equity 2004 (p.y.)	Annual result 2004 (p.y.)
<b>INTERTAINMENT Licensing GmbH, Ismaning</b>	100	946 (946)	-73,381 (-69,794)	-3,586 (10,424)
<b>Intertainment Animation &amp; Merchandising GmbH, Ismaning</b>	100	358 (358)	0 (0)	0 (-203)
<b>USA-Intertainment, Inc., Los Angeles, USA</b>	100	105 (105)	48 (10)	42 (-254)

The financial assets also consist of the participation in the US company SightSound Technologies Inc. amounting to 0 (p.y. 15,036) TEuros. The participation ratio was 12.4 % in the prior year. According to the most recent financial statements available to Intertainment, prepared by the company dated April 30, 2003 (prepared in accordance with US GAAP), subscribed capital was 56 TEuros, equity was -1,515 TEuros and net earnings for the year were -1,925 TEuros. The manage-



ment of Intertainment is assuming that there will be no further dilution of the shareholding than occurred in the business year 2003. However, the management decided to write down this shareholding in full. This is because the negotiations on the sale of the patents by SightSound to a licensee have failed temporarily to reach a successful conclusion. There is also a risk that the validity of the patents will be subject to a new investigation by the Patent Office. An investigation of this nature may last up to two years. The Patent Office has not yet agreed to a further review of the patents. The management of Intertainment is currently not therefore in a position to assess with adequate certainty the extent of the value of the patents and whether SightSound is in a position to finance the assertion and marketing of the patents. Due to this substantial element of uncertainty, the management has therefore decided to write this shareholding off in full.

In the business year 2004, the participation book value of Intertainment Animation & Merchandising GmbH amounting to 358 (p.y. 0) TEuros was written off in full.

## 2. Inventories

The film rights and licenses are valued at 4,250 (p.y. 6,308) TEuros. They developed as follows:

III.2	FILM RIGHTS AND LICENSES	in TEuros	
Position	2004	2003	
Balance at January 1	6,308	7,419	
Additions	13,603	2,980	
Normal depreciation	-14,233	0	
Non-scheduled depreciation	-1,428	-4,639	
Writeups	0	548	
Balance at December 31	4,250	6,308	

Normal amortization will be carried out for license sales of film rights effected in the business year 2004. Non-scheduled write-downs on film rights were incurred as a result of the loss-free valuation of film rights. The expected sales revenues were below the capitalized costs of the relevant film rights on the balance sheet date.

The **MERCHANDISE** in the prior year comprised merchandising articles and video and DVD stocks amounting to 17 TEuros.

## 3. Receivables and other assets

The **TRADE RECEIVABLES** amount to 461 (p.y. 631) TEuros. The reduction compared to the prior year results from payment of outstanding items.

The **RECEIVABLES FROM AFFILIATED ENTERPRISES** amount to 58,528 (p.y. 65,147) TEuros and comprise:

III.3	RECEIVABLES FROM SUBSIDIARIES	in TEuros	
Subsidiary	2004	2003	
INTERTAINMENT Licensing GmbH	58,165	64,500	
Intertainment Animation & Merchandising GmbH	0	647	
Total	58,165	65,147	

Additional adjustments amounting to 5,000 (p.y. 42,913) TEuros were carried on the receivables from INTERTAINMENT Licensing GmbH in the business year 2004. Intertainment AG also waived interest on the receivables from the intercompany account of INTERTAINMENT Licensing GmbH amounting to 85,000 TEuros. Intertainment AG also waived receivables from Intertainment Animation & Merchandising GmbH amounting to 56 (p.y. 279) TEuros and carried out an adjustment amounting to 363 (p.y. 320) TEuros.

The **OTHER ASSETS** amount to 97 (p.y. 1,258) TEuros and are essentially comprised of tax rebate claims amounting to 69 (p.y. 72) TEuros.

As in the prior year, all receivables have a residual term of less than one year.

## 4. Bank balances

Liquid funds totaling 1,613 (p.y. 1,387) TEuros are made up of current accounts and cash in hand.

## 5. Equity

### 5.1 Subscribed capital

The subscribed capital of Intertainment AG remained unchanged at 15,005 TEuros on the balance sheet date and it is held in the form of 11,739,013 issued no-par shares.

### AUTHORIZED CAPITAL

The Board of Management is authorized until September 23, 2008 to increase the nominal capital, once or more than once, shares against cash contribution and/or contribution in kind by a total of up to 3,203 TEuros with the consent of the Supervisory Board. (*authorized capital 2003/1*).

The approved capital dated January 18, 1999 (*authorized capital 1999/1*) was cancelled.

The Board of Management is authorized furthermore until June 26, 2006, to increase the nominal capital, once or more than once, against cash contribution and/or contribution in kind by a total of up to 4,300 TEuros with the consent of the Supervisory Board (*authorized capital /1*).

The Board of Management is authorized, with the consent of the Supervisory Board, on exercise of the authorized capital 2003/I and the authorized capital II to exclude partially or wholly the subscription right of the shareholders under certain conditions.

**CONTINGENT CAPITAL**

The nominal capital may be raised contingently by up to 511 TEuros (*contingent capital I*) and a further 383 TEuros (*contingent capital II*). It serves for the exercise of option rights by employees, members of the management and members of the Board of Management of the company and affiliated enterprises according to the share option programs adopted by the Annual General Meeting.

The nominal capital is furthermore contingently increased by 6,002 TEuros (*contingent capital III*). The contingent capital increase is only carried out insofar as the creditors of convertible and option bonds make use of their convertible and option rights by June 26, 2006.

In order to grant option rights to employees members of the management and members of the Board of Management of the company and affiliated enterprises, the nominal capital was increased contingently by a further 383 TEuros (*contingent capi-*

*tal IV*) according to the resolution adopted by the Annual General Meeting on September 22, 2003 for the share option program 2003.

**5.2 Capital reserve**

At the balance sheet date, the capital reserve was 59,082 (p.y. 82,385) TEuros. The change of -23,303 TEuros compared with the previous year resulted from utilization of the capital reserve to balance the annual deficit (§150 (4) No. 1 AktG). At December 31, 2004, as in the previous year, Intertainment AG did not show an accumulated loss due to withdrawals from the capital reserve.

**5.3 Revenue reserve**

The revenue reserve continues at 116 (p.y. 116) TEuros and relates exclusively to the legal reserve.

**6. Provisions****Other provisions**

The other provisions developed as follows:

III.6 OTHER PROVISIONS					in TEuros
Type of provision	Balance at 1/1/2004	Utilization	Release	Allocation	Balance at 31/12/2004
Reorganization	2,100	1,072	93	0	935
Year-end closing costs	134	134	0	70	70
Miscellaneous	88	38	0	213	263
<b>Total</b>	<b>2,322</b>	<b>1,244</b>	<b>93</b>	<b>283</b>	<b>1,268</b>

The provision for **REORGANIZATION** relates to obligations to contractual partners for the settlement and termination of contracts.

The provision for **YEAR-END CLOSING** costs relates to the preparation and audit of the annual financial statements for the business year 2004.

Overall, provisions, as in the prior year, have a residual term of less than one year.

**7. Liabilities**

The **PAYMENTS ON ACCOUNT RECEIVED** on film rights amounted to 1,318 TEuros in the previous year and comprised payments from licensees for film titles not yet supplied and not yet technically accepted. These were netted in full during the business year 2004.

The **TRADE LIABILITIES** amount to 106 (p.y. 79) TEuros and result in particular from repayment obligations for related services.

The **LIABILITIES FROM AFFILIATED ENTERPRISES** amount to 114 (p.y. 0) TEuros from USA-Intertainment, Inc.

The **OTHER LIABILITIES** amounting to 45 (p.y. 172) TEuros and include liabilities to the tax authorities for wages and church tax of 17 (p.y. 32) TEuros and liabilities relating to social security amounting to 6 (p.y. 8) TEuros.

The liabilities have overall a residual term of less than one year.

**IV. Explanations to the income statement****1. Sales revenues**

The sales revenues amount to 17,829 (p.y. 4,021) TEuros. They result in particular from the sale of film rights in the thriller "Twisted" and other proceeds from the ongoing exploitation of film rights.

**2. Other operating income**

The other operating income amounts to 822 (p.y. 2,903) TEuros and is comprised as follows:

IV.2 OTHER OPERATING INCOME	in TEuros	
	2004	2003
Income from currency differences	387	493
Release of adjustments on receivables (not related to the accounting period)	320	0
Release of provisions (not related to the accounting period)	93	939
Miscellaneous	22	1,471
<b>Total</b>	<b>822</b>	<b>2,903</b>

**3. Cost of materials**

The cost of materials amounting to 16,883 (p.y. 6,017) TEuros includes expenses for film rights and associated services amounting to 16,880 (p.y. 5,991) TEuros and expenses for related goods and services amounting to 3 (p.y. 26) TEuros.

The expenses for film rights and associated services are comprised as follows:

IV.3 EXPENSES FOR FILM RIGHTS		in TEuros	
	2004	2003	
Normal amortization on film rights	14,233	0	
Non-scheduled amortization on film rights	1,428	4,639	
Marketing costs of film exploitation	1,219	1,334	
Miscellaneous	0	18	
<b>Total</b>	<b>16,880</b>	<b>5,991</b>	

**4. Amortization on intangible fixed assets and depreciation on property, plant and equipment**

Amortization and depreciation on intangible assets and property, plant and equipment amount to 6 (p.y. 3,367) TEuros and comprise exclusively normal amortization and depreciation.

In the previous year, payments on account for a current film production were written off as non-scheduled depreciation in the amount of 3,362 TEuros.

**5. Depreciation of current assets, insofar as this exceeds other depreciation normal in the company**

Depreciation on current assets, insofar as this exceeds other depreciation normal in the company, amounts to 5,363 (p.y. 52,243) TEuros and includes the adjustment on the intercompany account to INTERTAINMENT Licensing GmbH.

**6. Other operating expenses**

Other operating expenses amount to 2,157 (p.y. 9,504) TEuros and include:

IV.6 OTHER OPERATING EXPENSES		in TEuros	
	2004	2003	
Expenses for exchange rate losses	171	1,328	
Services for USA-Intertainment, Inc.	496	1,308	
Legal and consultancy costs	455	1,520	
Miscellaneous	1,035	5,348	
<b>Total</b>	<b>2,157</b>	<b>9,504</b>	

**7. Writedowns on financial assets**

Writedowns on financial assets include the diminution in value of shares in SightSound Technologies Inc. amounting to 15,036 (p.y. 0) TEuros. We refer to statements under item III.1 for further information. The participation book value of Intertainment Animation & Merchandising GmbH amounting to 358 (p.y. 0) TEuros was also written down.

**8. Interest result**

The interest result in the sum of 10 (p.y. 10,086) TEuros includes interest income amounting to 10 (p.y. 10,143) TEuros and interest expenses amounting to 0 (p.y. 57) TEuros. The decrease in interest income during the business year 2004 resulted from the waiver on interest on the intercompany accounts.

**9. Extraordinary expenses**

Extraordinary expenses amount to 1,118 (p.y. 0) TEuros and comprise in particular expenses arising from the premature settlement of long-term contracts.

**V. Other information****1. Other financial commitments**

Other financial commitments comprise:

V.1 OTHER FINANCIAL COMMITMENTS		in TEuros	
	2004	2003	
Obligations arising from film productions	0	32,860	
Leasing obligations	17	23	
<b>Total</b>	<b>17</b>	<b>32,883</b>	

**OBLIGATIONS ARISING FROM FILM PRODUCTIONS**

The obligations arising from film productions relate on the balance sheet date to payments to production companies and remuneration to be paid to the co-producers of Intertainment AG.

Current contracts were restructured as a result of the reorganization measures carried out at the start of the business year 2004. In this connection, it was possible to significantly reduce the obligations for film productions reported on the balance sheet date effective from the first quarter of 2004. The claims arising from the license sales of the film "Twisted" were assigned in order to settle other ongoing obligations. It is possible that other financial obligations will arise in the future from this restructuring.

**OBLIGATIONS ARISING FROM LEASING CONTRACTS**

Within the framework of an operating lease, Intertainment AG leases motor vehicles. The obligations amount to a total of 17 (p.y. 23) TEuros.

The financial obligations amount to 10 (p.y. 16) TEuros and have a residual term of more than one year.

**2. Other contingent obligations****SETTLEMENT OF A RESIDUAL DEBT TO A BANK**

During the financial year 2001, Intertainment AG assumed a guarantee to a bank. This served as security for a loan taken out by INTERTAINMENT Licensing GmbH. In the view of the management, this

guarantee has been extinguished within the framework of the new negotiations with the bank. The rescheduling of the residual debt of INTERENTAINMENT Licensing GmbH provides for the bank issuing a debt waiver on a deferred debt basis. In this connection the residual loan was written off in the business year 2003 in the amount of 13,583 TEuros.

The film rights already assigned but not yet sold and the resulting exploitation revenues remain assigned as security. The financing bank is also being assigned 15 % of the future net income for the business years 2004 to 2006 and a further 15 % of the litigation revenues arising from the litigation against Franchise Pictures as security.

In the view of the management, the security link between the receivables originally assigned and the residual debt to the bank as security no longer exists. As a result the trade receivables were assigned by INTERENTAINMENT Licensing GmbH to Intertainment AG during the business year. Netting with trade receivables was therefore carried out at Intertainment AG.

If it emerges in future that this legal opinion is flawed, there is a risk that the guarantee of Intertainment AG originally provided for the settlement of the loan (13,583 TEuros) is not extinguished and significant outflows of funds will result from take-up of the guarantee. There is also the risk that the security link to the receivables originally assigned has not lapsed. We refer to item F.1. of the Management Report for further information.

#### RENTAL PAYMENT GUARANTEE FOR OFFICE PREMISES

A rental payment guarantee for office premises in Ismaning amounting to 76 TEuros remains unchanged compared with the prior year.

#### ASSIGNMENTS AS SECURITY

Within the scope of the reorganization measures described under item V.1 and the restructuring of contracts, there are comprehensive assignments of existing assets as security to contractual partners. They serve to hedge against possible financial obligations arising in the future.

#### SUBORDINATION TO INTERENTAINMENT LICENSING GMBH

Intertainment AG gave a subordination declaration in the amount of 85,000 (p.y. 85,000) TEuros on receivables from the intercompany account in order to avert the material over-indebtedness of INTERENTAINMENT Licensing GmbH.

#### 3. Employees

On average during the business year 2004, the company employed six (p.y. seven) staff at its headquarters in Ismaning near Munich.

#### 4. Composition of the executive bodies

##### DURING THE BUSINESS YEAR 2004, THE MEMBERS OF THE BOARD OF MANAGEMENT WERE:

- Ernst Rüdiger Baeres, lawyer, Munich (Chairman until October 29, 2004)
- Hans Joachim Gerlach, businessman, Berlin (Sole Member of the Board of Management from October 29, 2004)

The fixed remuneration package of the Board of Management amounted to 679 (p.y. 953) TEuros for the business year 2004. There is also an agreement by which the Board of Management receive an additional performance-related remuneration element which is likely to be 2,488 TEuros at the balance sheet date. This is dependent on the cash-inflows of funds arising from the successful legal dispute against Franchise Pictures and others parties. The payment of this remuneration is only made when the cash-inflows on which it is based are received.

##### DURING THE BUSINESS YEAR 2004, THE MEMBERS OF THE SUPERVISORY BOARD WERE:

- Ernst Rüdiger Baeres, lawyer, Munich (Chairman from October 29, 2004)
- Dr. Matthias Heisse, lawyer, Munich (Deputy Chairman from October 29, 2004)
- Dr. Wilhelm Bahner, businessman, Munich (Deputy Chairman to October 29, 2004)
- Wolfgang Blauburger, businessman, Munich

During the business year 2004, Dr. Matthias Heisse was also a member of the

Supervisory Board of Firestorm AG, Munich. Rüdiger Baeres, Dr. Wilhelm Bahner and Wolfgang Blauburger did not hold any further Supervisory Board offices during the business year 2004.

For the business year 2004, Supervisory Board compensation in the amount of 23 (p.y. 23) TEuros was paid.

#### 5. Consolidated financial statements

Intertainment Aktiengesellschaft prepares consolidated financial statements in accordance with IFRS including its subsidiaries.

#### 6. Statement on the German Corporate Governance Code

The Board of Management and Supervisory Board of Intertainment AG have made the declaration of compliance required by § 161 AktG on the German Corporate Governance Code and made it available to shareholders permanently on the web-site of the company ([www.intertainment.de](http://www.intertainment.de)).

Intertainment AG  
Ismaning near Munich, April 29, 2005

#### Hans Joachim Gerlach

Chairman of the Board of Management



Intertainment AG: Schedule of Fixed Assets

Gross

in TEuros	ACQUISITION COSTS			ACCUMULATED AMORTIZATION & DEPRECIATION				CARRYING VALUE	
	1/1/2004	Disposals	31/12/2004	1/1/2004	Amortization and depreciation in the business year	Disposals	31/12/2004	31/12/2004	31/12/2003
<b>I. Intangible assets</b>									
1. Licenses, commercial property rights and similar rights as well as licenses in such rights	117	0	117	116	1	0	117	0	1
2. Payments made on account	5,509	-3,362	2,147	3,362	0	-3,362	0	2,147	2,147
	<b>5,626</b>	<b>-3,362</b>	<b>2,264</b>	<b>3,478</b>	<b>1</b>	<b>-3,362</b>	<b>117</b>	<b>2,147</b>	<b>2,148</b>
<b>II. Property, plant and equipment</b>									
Other plant, business and office equipment	20	0	20	13	5	0	18	2	7
<b>III. Financial assets</b>									
1. Shares in affiliated enterprises	9,359	0	9,359	0	358	0	358	9,001	9,359
2. Participations	20,048	0	20,048	5,012	15,036	0	20,048	0	15,036
	29,407	0	29,407	5,012	15,394	0	20,406	9,001	24,395
	<b>35,053</b>	<b>-3,362</b>	<b>31,691</b>	<b>8,503</b>	<b>15,400</b>	<b>-3,362</b>	<b>20,541</b>	<b>11,150</b>	<b>26,550</b>

# Intertainment AG: Audit Opinion

We have audited the annual financial statements, together with the bookkeeping system of Intertainment Aktiengesellschaft, Ismaning, district of Munich, and the management report of the Company and the Group, for the business year from January 1 to December 31, 2003. The maintenance of the books and records and the preparation of the annual financial statements and management report in accordance with German commercial law (and supplementary provisions in the articles of incorporation) are the responsibility of the Company's management. Our responsibility is to express an opinion on the annual financial statements, together with the bookkeeping system, and the management report, based on our audit.

With the exception of the matters presented in the section below, we conducted our audit of the annual financial statements in accordance with §317 HGB ["Handelsgesetzbuch" – "German Commercial Code"] and the generally accepted German standards for the audit of financial statements promulgated by the Institut der Wirtschaftsprüfer in Deutschland (IDW). Those standards require that we plan and perform the audit such that misstatements materially affecting the presentation of the net assets, financial position and results of operations in the annual financial statements in accordance with German principles of proper accounting and in the management report are detected with reasonable assurance. Knowledge of the business activities and the economic and legal environment of the Company and evaluations of possible misstatements are taken into account in the determination of auditing procedures. The effectiveness of the accounting-related internal control system and the evidence supporting the dis-

closures in the books and records, the annual financial statements and the management report are examined primarily on a test basis within the framework of the audit. The audit includes assessing the accounting principles used and significant estimates made by the management, as well as evaluating the overall presentation of the financial statements and the management report. We believe that with the exceptions stated in the paragraph below, our audit provides a reasonable basis for our opinion.

With the exception of the following qualifications, our audit has not led to any reservations:

- We draw attention to the comments made by the Company in the notes to the financial statements in section "V.2. Other contingent obligations". It is stated that in the fiscal year 2003 trade receivables and liabilities are netted. The corresponding trade receivables were transferred from the subsidiary INTERENTAINMENT Licensing GmbH to Intertainment AG in the previous year. It was not possible to obtain reasonable certainty, even by means of alternative auditing procedures, that the receivables transferred in the previous year were no longer linked with liabilities of the subsidiary as security with respect to a bank as at the balance-sheet date and hence would not be permitted to be transferred.

- We further draw attention to the comments in the notes to the financial statements in section "III. 3 Receivables and other assets". It is stated that further revaluations were undertaken on the intercompany account of INTERENTAINMENT Licensing GmbH. It was not possible to obtain reasonable certainty concerning the participation book value of INTERENTAINMENT Licensing GmbH, even by means of alter-

native auditing procedures. The value is mainly dependent on the anticipated cash-inflow of funds from the legal disputes of the subsidiary with Franchise Pictures, Comerica Bank and others, and the realization of the other assumptions in the financial plan of the subsidiary.

It is therefore not possible to exclude the possibility that the consolidated financial statements should have been changed because of the two audit obstacles referred to above.

In our opinion, subject to these qualifications, the annual financial statements give a true and fair view of the net assets, financial position and results of operations of the Company in accordance with German principles of proper accounting. On the whole, the management report provides a suitable understanding of the Company's position and suitably presents the risks of future development.

Without further qualifying this opinion, we draw attention to the statements in the management report concerning the risks relating to the ability to continue as a going concern. It is stated that there are substantial uncertainties relating to the assumptions on which the financial budget is based. If these assumptions fail to materialize as planned, Intertainment AG will not be able to fulfill its current payment obligations and also possible payment obligations arising from a guarantee it has given for repayment of a loan taken out by INTERENTAINMENT Licensing GmbH – also at very short notice. For further details, we refer to the comments in section "G. Risks of future development of Intertainment AG" in the management report. If the events referred to below fail to materialize as planned, the ability of the Company to

continue as a going concern is endangered – also at very short notice:

- Fulfillment of the assumptions on which the financial plan of the subsidiary INTERENTAINMENT Licensing GmbH is based:

- Settlement of the bank loan referred to above which has already been called in, on the basis of the assumptions made by the legal representatives

- Cash-inflow of funds from the settlement of legal disputes with Franchise Pictures, Comerica Bank and other parties

- No cash-outflow of funds from the current arbitration proceedings for the payment of the second installment for the disputed films rights

If these assumptions fail to materialize and the subsidiary becomes insolvent, Intertainment AG would be faced with a claim arising from the guarantee it had given to the bank.

- Realization of the assumptions which form the basis for the financial plan of INTERENTAINMENT AG.

Munich, May 3, 2005

KPMG Deutsche Treuhand-Gesellschaft  
Aktiengesellschaft  
Wirtschaftsprüfungsgesellschaft

Curtis	Querfurth
Wirtschaftsprüfer	Wirtschaftsprüfer



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