# ANNUAL REPORT
# 2003

INTERTAINMENT
Aktiengesellschaft

## Key indicatores

| | 2003 | 2002 |
|---|---|---|
| Sales (million euros) | 6.0 | 19.0 |
| EBIT (million euros) | -8.9 | -16.2 |
| Result of ordinary business activities (million euros) | -28.7 | -13.7 |
| Result before income tax (million euros) | -9.3 | -17.0 |
| Net profit/loss for the period (million euros) | -14.1 | -16.1 |
| Earnings per share (euros) | -1.20 | -1.37 |
| Average number of employees | 23 | 23 |

## Key data for the share

| | | |
|---|---|---|
| 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 31/12/2003 | | 3.39 euros |
| High* for 2003 (11/07/2003) | | 5.25 euros |
| Low* for 2003 (12/03/2003) | | 1.45 euros |
| Shareholder structure 31/12/2003 | Rüdiger Baeres | 52.86 % |
| | Family Baeres | 9.38 % |
| | Management, Supervisory Board | 0.20 % |
| | Free float | 37.56 % |

*Closing price in Xetra electronic trading

## Corporate calendar

| | |
|---|---|
| Publication of 1st Quarterly Report 2004 | September 27, 2004 |
| Publication of 2nd Quarterly Report 2004 | September 27, 2004 |
| Annual General Meeting | October 29, 2004 |
| Publication of 3rd Quarterly Report 2004 | November 30, 2004 |

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## Contents

# Dear Shareholders

**Achim Gerlach,** Chief Financial Officer

**Rüdiger Baeres,** Chief Executive Officer

Three and a half years can be a very long time. This is the time it has taken for the main trial in our lawsuit for fraud filed against American film producer Franchise Pictures, subsidiaries of Franchise and Elie Samaha, the CEO of Franchise, personally, to be heard before a court of law and a judgment handed down. In June 2004, the jury of nine at the Federal District Court in Santa Ana near Los Angeles returned a unanimous verdict in our favor. Overall, Intertainment was granted a total of 121.7 million US dollars at the end of the trial. This represents a substantial step toward drawing the entire fraud case to a successful conclusion. Even if the main trail was marred by personal defamation, we took the right course of action in pursuing the suit consistently against all odds and fighting to the bitter end, despite the high toll it took on Intertainment.

As you know, we filed the lawsuit in December 2000. The subsequent years were marked in particular by the following:

– Our efforts to get the operational business of Intertainment going again despite the extremely detrimental effects of the fraud

– an extremely tough fight with Franchise and all the other companies involved in the fraud

– and hopes associated with the trial that were all too often disappointed – in particular as far as you, our shareholders, were concerned.

The most frustrating aspect of this affair was the fact that the main trial against Franchise Pictures was postponed three times and a decision on the case kept being delayed. This assisted our opponents in the lawsuit, because Intertainment was subject to a very heavy financial burden. After the main trial was unexpectedly postponed for a third time in the summer of 2003, we had to introduce radical measures in order to secure the survival of our company. This action included reorganization of US business – in that connection we terminated our cooperation with film producer Kopelson Entertainment – and the sale of our license rights in "Rudolph the Red-Nosed Reindeer".

Some of the measures were only agreed contractually at the start of 2004, although they impacted on our figures for the business year 2003. And they will also be reflected in our future financial statements. This is because they directly relate to our operating business.

It is extremely important that we finally bring the Franchise Pictures case to a close, leaving us to concentrate on building up our operating business again. We are therefore concentrating on enforcing our rights in the USA granted under the judgment while at the same time preparing for the second major proceeding to be held in the Franchise Pictures case: the arbitration proceeding against the other companies involved in the fraud perpetrated by Franchise Pictures, but which have not yet been declared guilty. The companies mainly involved were Comerica Bank and bond company Film Finances.

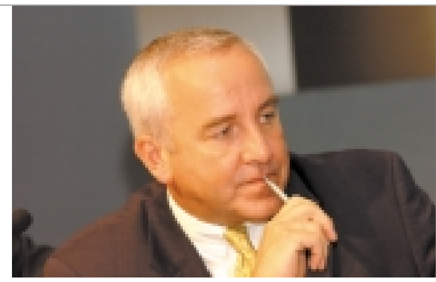
The oral hearing is scheduled to start at the beginning of 2005 and will last around two months. Our goal in the proceeding is to achieve a ruling which allows us to recover from the bank and bond companies the 121.7 million US dollars granted to us in the judgment handed down at the end of the Franchise trial, or at least a substantial portion of the funds.

Considerably more than four years will have elapsed since our lawsuit against Franchise Pictures was filed by the time a decision is reached in the arbitration proceeding. Thanks to the judgment against Franchise Pictures, we have at least created a very sound basis to ensure that these will not have been lost years for Intertainment.

**Rüdiger Baeres**
Chairman of the Board of Management
of Intertainment AG

# Report of the Supervisory Board

**Dr. Matthias Heisse,** Chairman



**Dr. Wilhelm Bahner,** Deputy Chairman

**Wolfgang Blauberger,** Member

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, 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 Supervisory Board held nine sessions during the year 2003. In addition, regular meetings took place with the company's Board of Management, in which important issues were discussed and reviewed. The Supervisory Board devoted continuing attention in the course of several sessions to the adjustment of the company's business strategies and the rationalization 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. Future financing of the company was also a key focus of attention, particularly with respect to the production of the film "Twisted" and the litigation in the US. In its first session on January 29, 2003, the Supervisory Board discussed in detail with the Board of Management the status of the company's lawsuit against the Franchise Group and Comerica Bank, together with strategic issues for the business year 2003. The meeting on February 24, 2003, 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 March 27, 2004, the Board of Management submitted the company's provisional annual financial statements for 2002 to the Supervisory Board. In the course of this session, a detailed discussion took place on the strategic issues and developments in the litigation in the USA. In the session held on April 10, 2003, the Supervisory Board discussed a new draft of the company's consolidated financial statements provided by the Board of Management, together with the provisional annual financial statements for the year 2002. During the same session a detailed discussion took place of various balance-sheet issues raised by the Board of Management of the company and by the auditors KPMG. In the session held on June 23, 2003, the Board of Management reported in detail on the status of the company's annual financial statements and its subsidiaries. During the following days, KPMG completed its audit of the accounting, 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, 2002 while regularly reporting to the Supervisory Board. The Supervisory Board has already reported in detail on these matters in its report for the year 2002 dated July 11, 2003. The Supervisory Board gave its official approval of the results of the auditor's investigations with the resolution dated July 11, 2003.

At the session on September 16, 2003, the Supervisory Board held a detailed discussion on the status of the progress of litigation in the USA, future financing of the company, and various matters relating to the Board of Management. The Supervisory Board then resolved on September 17, 2003 to appoint Mr. Baeres as the Chairman of the Board of Management of the company for a further three years and also to appoint Mr. Gerlach as the Chief Financial Officer of the company for a further three years. At the session held on September 22, 2003, Dr. Bahner was appointed Deputy Chairman of the Supervisory Board after the previous Deputy Chairman of the Supervisory Board, Dr. Ernst Pechtl, stepped down from his office effective September 22, 2003. Mr. Wolfgang Blauberger has been appointed as a new member of the Supervisory Board by resolution of the Local Court, Munich, effective September 22, 2003. The status of the negotiations with HypoVereinsbank was also discussed at the meeting on September 22, 2003. At the session held on December 19, 2003, discussion focused on the status of the negotiations with US film studio Paramount Pictures, with the American film producer Kopelson Entertainment and with HypoVereinsbank, and in addition on the future financing for the company.

The Annual General Meeting of Shareholders on September 22, 2003 chose KPMG Deutsche Treuhandgesellschaft Aktiengesellschaft Wirtschaftsprüfungsgesellschaft, Berlin and Frankfurt/Main, to audit the company's results for the business year 2003.

In the session on August 5, 2004, the Board of Management submitted the company's provisional consolidated financial statements and annual financial statements for 2003 to the Supervisory Board. In the course of this session, a detailed discussion took place on various balance-sheet issues raised by the Board of Management and by KPMG. During the following days, KPMG completed its audit of the accounting, the annual financial statements and management report of Intertainment AG as well as of the consolidated financial statements and group management report for the year ended December 31, 2003, while regularly reporting to the Supervisory Board. It also certified its qualified approval of the accounting, the annual financial statements and the management report of Intertainment AG as well as of the company's consolidated financial statements and group management report for the year ended December 31, 2003.

The written audit report was submitted to the Supervisory Board on September 15, 2003 by the auditors. The Supervisory Board gave its official approval of the results of the auditors investigations – in accordance with the qualified premises stated by KPMG – in the balance-sheet meeting held on September 18, 2004, 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, 2003 and the consolidated financial statements for the year ended December 31, 2003.

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. The outstanding success of the litigation in the USA demonstrated by the favorable outcome of the trial involving compensation for damages against Franchise Pictures and others in the middle of the year bore testimony to the extraordinary degree of dedication shown by members of staff. The Supervisory Board would like to express its thanks for this outstanding commitment to all those involved and also acknowledge their dedication.

Munich, September 18, 2004

The Supervisory Board

**Dr. Matthias Heisse**
Chairman

# Corporate Governance at Intertainment

Corporate Governance entails a management geared to adding value to a company over the long term and maintaining controls within the company. Corporate governance principles include rules for the entire system of management and monitoring of the company, including corporate organization, business principles and guidelines and the internal and external mechanisms for controlling and monitoring the activities of the company. These include efficient cooperation between the Board of Management and the Supervisory Board, transparency in corporate activities, and looking after the interests of the shareholders.
Corporate governance based on international standards and transparency for international investors has traditionally been a top priority at Intertainment AG.

## Increased transparency by changes in the statutes

Intertainment presented numerous changes in the statutes to the Annual General Meeting held on September 22, 2003 for approval. These were intended to contribute to greater transparency in the company or facilitate cooperation between the Board of Management and the Supervisory Board. The amendments to the statutes meant that Intertainment took account of the reform of the share and accounting regulations relating to transparency and publicity (Transparency and Publicity Law, which came into force on July 19, 2002).
For example, the amendment to the statutes allows Intertainment to transmit future Annual General Meetings on the Internet, in full or as extracts. The form of transmission will be announced as appropriate in the invitation to the Annual General Meeting.

## Videoconferencing possible

Meetings of the Supervisory Board may be held as a videoconference in future. Under exceptional circumstances, members of the Supervisory Board who are resident abroad may also take part in the Annual General Meeting by means of video and audio transmission, if transmission is guaranteed in both directions.
In May 2003, the Government Commission on the German Corporate Governance Code ratified a new version of the German Corporate Governance Code. The Board of Management and the Supervisory Board of Intertainment AG last submitted a declaration of compliance on December 19, 2003 pursuant to Article § 161 of the Stock Corporation Law (Aktiengesetz) that took into account the amendments to the new Code.

## Index implementation with a few exceptions

The Board of Management and Supervisory Board have made a commitment to implement the majority of the recommendations of the German Corporate Governance Code, with the following exceptions:

- The recommendation in the Code Section 3.8 sentence 2 provides for a reasonable deductible to be agreed, if the company concludes a D&O insurance for the Board of Management and the Supervisory Board. The Board of Management and the Supervisory Board of Intertainment AG are of the opinion that the executive bodies will discharge their duties in full with a sense of responsibility and with motivation without a deductible. Intertainment will not therefore be concluding D&O insurance cover with a deductible in future.
- The recommendation in Code Section 4.2.4 provides for the remuneration of the members of the Board of Management to be split up in the consolidated financial statements on the basis of fixed remuneration, performance-related components, and elements acting as long-term incentives. The information is supposed to be provided on an individual basis. Intertainment does not intend to publish individual details in this Annual Report.
- Section 7.1.2 of the Code provides for the consolidated financial statements to be published and accessible in the public domain within 90 days of the end of the business year, and the interim reports to be published and accessible in the public domain within 45 days of the end of the reporting period. Intertainment AG will comply with the four-month period for publication of the annual financial statements pursuant to Article § 77 in conjunction with Article § 62 Section 3 p. 1 of the Frankfurt Stock Exchange Rules and Regulations (Prime Standard) and the two-month period for publication of interim reports pursuant to Article § 78 in conjunction with § 63 Section 8 p. 1 of the Frankfurt Stock Exchange Rules and Regulations (Prime Standard) because of sector-specific accounting modalities.

## Valid code can be called up on the Internet

The valid Corporate Governance Code for the company may be found on the Internet site of Intertainment AG under www.intertainment.de in the category “The Share”, “Corporate Governance”, for inspection. This Code provides information on which initiatives Intertainment has implemented voluntarily alongside the mandatory recommendations.

# 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 Group Management Report on page 20.

## The progress of the litigation

| | |
|---|---|
| 12/2000 | ➜ Negotiations with Andrew Stevens, President and COO of Franchise Pictures, concerning an amicable settlement break down.<br>➜ Intertainment takes legal action against Franchise Pictures before the Federal District Court of Los Angeles.<br>➜ Franchise Pictures reacts by taking legal action against Intertainment. |
| 02/2001 | ➜ Intertainment also takes action against Imperial Bank (now Comerica Bank). |
| 04/2001 | ➜ 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). |
| 05/2001 | ➜ Intertainment withdraws the lawsuit against Imperial Bank (now Comerica Bank) in order to further pursue the legal proceedings against Franchise Pictures. |
| 06/2001 | ➜ The Judge rescinds the temporary suspension of the lawsuit against Franchise Pictures. |
| 08/2001 | ➜ Intertainment files the third version (update) of the statement of claim against Franchise Pictures.<br>➜ The date of the hearing is fixed for September 10, 2002. Completion of the discovery stage is scheduled for May 27, 2002. |
| 09/2001 | ➜ The Court orders Franchise Pictures to respond to the interrogatories presented by Intertainment on the budgets of the films in dispute .<br>➜ The Court also grants a petition from Intertainment that obliges the Imperial Bank (now Comperica Bank) to release discovery documents.<br>➜ 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". |
| 10/2001 | ➜ 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. |
| 12/2001 | ➜ 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). |
| 01/2002 | ➜ The court orders that Franchise Pictures has to surrender budget documents and imposes monetary sanctions and that Franchise Pictures cannot assert "confidentiality".<br>➜ The Court orders monetary sanctions against Franchise Pictures again because they did not answer all questions in connection with the film budget. |
| 02/2002 | ➜ The Court orders monetary sanctions against Comerica Bank (formerly Imperial Bank) because it disregarded court orders. |
| 04/2002 | ➜ 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. |
| 05/2002 | ➜ 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. |
| 08/2002 | ➜ Further, the Court upheld the allegation of a criminal enterprise involving Comerica Bank (formerly Imperial Bank) and WorldWide Film Completion, Inc. |
| 11/2002 | ➜ 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.<br>➜ 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.<br>➜ 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 . |
| 12/2002 | ➜ The court accepts the withdrawal of the lawyers representing Franchise Pictures from the case.<br>➜ The court postpones the start of the trial until August 5, 2003.<br>➜ 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. |

## The progress of the litigation

| | |
|---|---|
| **01/2003** | Franchise appoints new lawyers. |
| **02/2003** | Comerica Bank institutes arbitration proceedings against Intertainment relating to payment for the film "Driven". |
| **06/2003** | 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.<br>The United States District 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.<br>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. 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.<br>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. |
| **07/2003** | 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. |
| **10/2003** | The court sets April 20, 2004 as the new date for the start of the main trial. |
| **11/2003** | 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. |
| **03/2004** | 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. |
| **03/2004** | 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. |
| **04/2004** | The presiding judge confirms April 20 as the start of the main trial at a pre-trial conference.<br>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.<br>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.<br>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. |
| **06/2004** | 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.<br>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. |
| **08/2004** | 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.<br>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.<br>Virtually all of the parties involved in the Franchise Pictures case agree to hold settlement negotiations. |
| **09/2004** | First meeting of the committee of creditors of Franchise Pictures. |

# Investor Relations

The most important share markets across the world recovered from three years of bear market in 2003. The German share index (DAX) went up by 37 % in a year-earlier comparison. The Prime Media Performance Index performed even better. The index closed the year with a gain of 79 % compared with the closing value at the end of 2002. After a weak first six months, it experienced an almost unbroken advance during the second half of the year. Media stocks had performed significantly worse than the market as a whole during the previous years. The Prime Media Performance Index includes 23 of the media shares listed on the Frankfurt Stock Exchange. These include Intertainment.

## Performance of the Intertainment share

The Intertainment share did not track the performance of the sector indices. At the end of 2002, the Intertainment share price stood at 2.23 euros, but it fell back during the initial months of 2003 to significantly below 2 euros. However, the share price underwent a sharp increase in advance of the trial for damages against Franchise Pictures and others, before declining significantly again after the renewed postponement of the trial. At the end of the year, Intertainment shares nevertheless closed with a gain of 52 % against the year-end price for the previous year with a year-end price of 3.39 euros. The low for the year was posted at 1.45 euros on March 12, 2003, the high for the year was reached on July 11, 2003 at 5.25 euros. All share prices relate to the relevant daily closing price in Xetra trading.

Trading volume of Intertainment shares was as volatile as the share price. In line with general market sentiment and in connection with the postponement of the trial, it rose strongly to achieve the high for the year on July 15. On this day alone, 1.1 million shares were traded in Xetra trading. The average daily trading volume for the year was over 29,000 shares. This exceeded the daily trading volume for the previous year.

Earnings per share amounted to -1.20 (2002: -1.37) euros in 2003. A dividend was not paid out for the business year 2003.

INDICATED STOCK PRICE DEVELOPMENT*


* 1/1/2003 = 100, in Percent

## Intertainment share listed 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 segment was created for official trading and the General Standard for regulated trading. The segments differ in the level of transparency requirements that are made for 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.

## Investor Relations

In 2003, investor relations work at Intertainment continued to be directed toward near-real time, comprehensive and dependable communication with private investors, investors, analysts and the press. Press releases from the company were made immediately and simultaneously accessible to all interested parties on the internet site of Intertainment AG.

Intertainment was in regular contact with the financial press in 2003 and held individual meetings and telephone conferences with analysts and investors on the current situation of the company.

## Insider trading

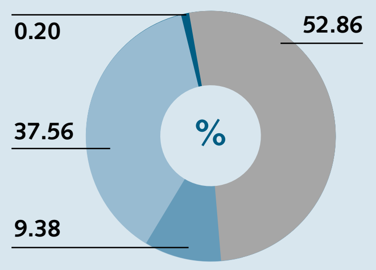
Shortly before the Annual General Meeting on September 22, 2003, Intertainment found out through the press that the German Financial Supervisory Authority (BaFin) was conducting a routine investigation into Intertainment because of a suspicion relating to insider trading. The suspicion was caused by the extraordinarily high level of trading in Intertainment shares prior to the ad hoc press release relating to postponement of the Franchise trial on July 14. Intertainment expressly welcomed these investigations, although the suspicions evidently turned out to be unfounded. In mid-November 2003, it was announced that BaFin had ceased the investigation.

## Capital measures

The Annual General Meeting held on 22 September 2003 authorized Intertainment AG to purchase its own shares amounting to a total of 10 % of the capital stock subject to certain provisos. This authorization is valid until March 22, 2005. To date, the Board of Management of Intertainment AG has not made use of this authorization.

SHAREHOLDER STRUCTURE

as at 31/12/2003




Rüdiger Baeres
Free float
Family Baeres
Supervisory Board / Management

The Annual General Meeting also approved new authorized capital I amounting to 3,202,715.74 euros. The existing authorization to increase the capital stock pursuant to Article § 5 Section 3 of the Statutes valid until January 28, 2004 but not yet used was to be cancelled because of the expiry of the term. The content of the new authorization is otherwise unchanged and remains valid until September 23, 2004. To date, the Board of Management has not made use of this authorization.

The Annual General Meeting on September 22, 2003 created contingent capital IV for a share option program in 2003. This share option program is directed toward providing employees of Intertainment AG with share options and comprises a total of 300,000 option rights. The capital stock of Intertainment AG can be increased to 383,469 euros as a result.

# Financial Section 2003

# Intertainment Group and Intertainment AG: Management Report

## for the Business Year 2003

The Consolidated Management Report and the Management Report for the parent company Intertainment AG are combined in the business year 2003 pursuant to Article § 315 Section 3 HGB ("Handelsgesetzbuch", "German Commercial Code") in connection with Article § 298 Section 3 HGB. 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 2003

**1. Overall economic development: Weak eurozone**

Development within the global economy varied enormously during the business year 2003. While Asia and the USA in part experienced very high growth in gross domestic product, the area of Western and Central Europe, which is extremely important for Intertainment, suffered sustained weak growth. Gross domestic product in the eurozone only rose by 0.4 % in 2003 after the prior-year rise of 0.9 %. Performance in Germany itself was even worse than in the eurozone overall. Despite a slight recovery during the second half of the year, gross domestic product in the Federal Republic throughout the year went down by 0.1 % over the year. Despite the current risks – in particular the risk of international terrorism – experts are predicting an upswing for the economy in the eurozone for 2004.

**2. Development of the film industry: Difficult situation**

2003 was a very difficult year for the media and film industry in general. This affects regional markets and individual exploitation levels. The only exception here was the DVD market. As in previous years, it recorded very high growth rates. The development in the media sector is of outstanding importance for Intertainment, because it exerts substantial influence on how successfully Intertainment markets its films.

**2.1 Development in the cinema section: Much poorer figures in part**

The cinema box-office results showed consistently negative performance in the most important western states during the year under review. Germany had the worst performance in line with the particularly difficult economic situation. Takings at cinemas in the Federal Republic of Germany were down by more than 11 % at 850 million euros in 2003. This compares with sales of 960 million euros in 2002. The number of cinemagoers fell from 163.9 million to 149 million. This means that both figures for sales and the number of visitors to German cinemas declined for the second time in succession. The German Federal Film Board believes that the reduction in 2003 is mainly due to general consumer restraint owing to the poor economic situation, the summer of the century, an increase in pirating of products, and the growing competition coming from the DVD segment. The development in other major European markets was also unsatisfactory. Ticket sales fell by 5.6 % in France, by 4.9 % in Great Britain and by 3 % in Spain. Even cinema box-offices takings in the USA were down for the first time in 11 years.

**2.2 Development of Video & DVD: DVD sales showed strong increase**

The home entertainment market continued to experience strong growth. As a result, the home entertainment industry in the Federal Republic achieved sales totaling 1.6 billion euros through the sale and rental of videos and DVDs during the year under review. This represented an increase of 11 % over the previous year. The market was the film marketing segment with the strongest sales in Germany by far. This development was driven by a very significant increase in DVD sales. A rise of nearly 48 % to 1.1 billion euros was achieved in this market. By contrast, sales of traditional VHS videos fell back by 39.1 % to 200 million euros – and hire sales at video hire shops declined by 15.8 % to 302 million euros. The volume of DVD sales in the USA climbed by 33 % to 11.6 billion US dollars, and DVD hire sales rose by as much as 55 % to 4.5 billion US dollars.

**2.3 Development in the television market: Restrained purchasing continues**

The television market continued to be difficult. Two major players in the German market – Premiere and the ProSiebenSat.1 Group – have regained stability following the insolvency of the Kirch Group, but the market continues to be dominated by restrained purchasing behavior when it comes to feature films. There was no change here, despite the fact that gross advertising revenues generated by the television broadcasters increased slightly by 2.7 % to 7.4 billion euros. Advertising income in the USA at the three big television chains fell by 1 % to 10.5 billion US dollars.

## B. Group's Position

**Development of Business Activity at Intertainment**

The following report will present the developments during the business year 2003 and the developments during the business year 2004, the nature of which reflects value until the point at which the consolidated financial statements were produced, with the aim of fostering transparency. We refer to Section F for information on risks. For the Intertainment Group, the year under review was dominated by the lawsuit against former business partner Franchise Pictures on account of budgetary fraud, by the ongoing proceedings relating to this case that are now pending, and by stringent measures directed toward reorganization and cost-cutting.

**1. The Franchise Pictures case**

This section relates to the lawsuits brought by INTERTAINMENT Licensing GmbH against Franchise Pictures and other parties that have been pending since the business year 2000. During the course of the year under review, the number of proceedings brought against INTERTAINMENT Licensing GmbH as a result of the Franchise lawsuit increased. The management regards these claims as an attempt by the opposing side to delay the main lawsuit against Franchise Pictures and against others and also to delay the lawsuit filed at the end of 2002 against Comerica Bank and the bond companies Film Finances and WorldWide Film, which were also involved in the fraud perpetrated by Franchise Pictures. This did not succeed. INTERTAINMENT Licensing GmbH was successful in winning the lawsuit against Franchise Pictures and others, as described below.

### JURY GRANTS INTERTAINMENT 106.1 MILLION DOLLARS IN JUNE 2004

Three and a half years after the lawsuit was originally filed, the case was decided in favor of INTERTAINMENT Licensing GmbH before the Federal District Court in Santa Ana near Los Angeles in mid-June 2004. A jury unanimously held the defendants to be guilty of the fraud and granted INTERTAINMENT Licensing GmbH damages totaling 106.1 million dollars. The jury also unanimously rejected all the countersuits submitted by Franchise Pictures. In mid-August 2004, the presiding judge also approved interest amounting to 15.6 million US dollars on the damages sustained. This raised the total sum being claimed to 121.7 million US dollars. The final judgment in the trial was handed down by the judge in mid-August. Shortly afterward, a number of the parties involved filed for insolvency under "Chapter 11" of the US Insolvency Law. We refer to item VI.3 in the "Notes to the consolidated financial statements".

INTERTAINMENT Licensing GmbH regards the judgment as an indicator for the prospects of success in the arbitration proceedings against the other parties involved in the fraud perpetrated by Franchise Pictures, in particular Comerica Bank and the bond companies Film Finances and World-Wide Film Completion.

The key facts and events in the Franchise case are presented below for the business year 2003 and the first nine months of 2004 which reflect on value for the business year 2003.

**1.1. Judgment in the legal dispute against Franchise Pictures: Unanimous verdict in favor of Intertainment**

The issue at the center of the legal proceedings during the year under review was the claim against film producer Franchise Pictures relating to fraudulently inflated budgets. INTERTAINMENT Licensing GmbH filed a claim for damages against Franchise Pictures, based in Los Angeles, amounting to at least 100 million US dollars. Until autumn 2000, Franchise was the principal film supplier to INTERTAINMENT Licensing GmbH. The two parties agreed in 1999 that INTERTAINMENT Licensing GmbH 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 – as maintained by INTERTAINMENT Licensing GmbH – had submitted invoices for fraudulently inflated film budgets. In doing so, Franchise Pictures was acting in collaboration with Comerica Bank, and the bond companies securing the film budgets. In December 2000, INTERTAINMENT Licensing GmbH had consequently filed lawsuits relating to budgetary fraud, amongst other things, against Franchise Pictures, against various production companies of Franchise, and personally against the CEO of Franchise, Elie Samaha, and former COO, Andrew Stevens.

After the start of the trial had been postponed several times due to congestion in the court calendar, it commenced on April 20, 2004 and continued with some interruptions for around two months. The trial was heard by a nine-person jury. On June 16, 2004, this jury held Franchise Pictures, Elie Samaha personally and all the production companies also sued to be guilty of having perpetrated fraud on INTERTAINMENT Licensing GmbH – and granted compensation for damages amounting to a total of 77.1 million US dollars. This sum is precisely equivalent to the damages that an expert had determined on the basis of a settlement reached by INTERTAINMENT Licensing GmbH with a German bank in 2001 within the scope of the proceedings.

Two days later, on June 18, 2004, the jury also granted punitive damages to INTERTAINMENT Licensing GmbH amounting to 29 million US dollars. This verdict involved the defendant in payments totaling 106.1 million US 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 1.5 million US dollars to each of the 16 production companies.

Punitive Damages are a special feature of Anglo-Saxon 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. The level of punitive damages granted is determined, amongst other things, on the nature of the act committed.

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 victims of organized crime the threefold sum of damages. In the view of the management, the rejected RICO suits have no effects on the arbitration proceedings against Comerica Bank and others.

On August 18, 2004, the presiding judge handed down a judgment on the outstanding principal claims relating to the trial as part of the final judgment. In this connection, she also approved the claims for 15.6 million US dollars granted by the jury in interest on the damages that had been incurred. This raised the total claim of INTERTAINMENT Licensing GmbH to 121.7 million US dollars. The judge also made it clear in her rulings that all the parties found guilty were jointly liable for the 77.1 million US dollars, including interest of 15.6 million US dollars, awarded by the jury.

Shortly after publication of the final judgment, Franchise Pictures and most of the production companies filed for insolvency pursuant to "Chapter 11" of the US Insolvency Law. INTERTAINMENT Licensing GmbH has therefore registered its claims against these companies under the insolvency proceedings. We refer to item VI.3 of the "Notes to the consolidated financial statements" for the value of these claims for damages. None of the parties involved had appealed against the judgment up to the date at which the consolidated financial statements were drawn up. We refer to item F.1 "Inflows of funds from the litigation against Franchise Pictures and other parties" for additional information on the appeal procedure for the defendants and enforcement.

**1.2 Countersuit by Franchise Pictures: Jury unanimously rejects all countersuits**

INTERTAINMENT Licensing GmbH and the Chairman 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, orally given promises and had not made payments in connection with the acquisition of film rights. The trial jury declared these accusations to be completely unfounded and unanimously rejected all countersuits in their decision on June 16, 2004. All other petitions filed by Franchise Pictures were rejected in the final judgment handed down and the decision of the jury was confirmed.

**1.3 Out-of-court settlement with Andrew Stevens in 2004: Former COO of Franchise Pictures excluded from the lawsuit**

Shortly before the start of the trial against Franchise Pictures and the other defendants, INTERTAINMENT Licensing GmbH came to an out-of-court settlement with Andrew Stevens, former COO of Franchise Pictures. This came about at the initiative of Stevens and included a payment from Stevens personally to INTERTAINMENT Licensing GmbH. The settlement meant that Stevens was no longer one of the defendants in the Franchise lawsuit. The results of the settlement were taken into account in the evaluation of the claims for damages as a fact reflecting value.

**1.4 Lawsuit against Comerica Bank and bond companies: Proceedings suspended until a decision in the arbitration proceedings**

In December 2002, INTERTAINMENT Licensing GmbH filed a lawsuit for damages with the State Court in Los Angeles against Comerica Bank, the bond companies WorldWide Film Completion and Film Finances, and against executive managers of these companies, on account of the fraudulent collaboration that INTERTAINMENT Licensing GmbH believed had taken place with Franchise Pictures. The bank had provided initial finance for many of the disputed Franchise films and in the opinion of the management knew about the inflated budgets while being aware of the actual figures. The bond companies had confirmed the false budgets to INTERTAINMENT Licensing GmbH by providing guarantor's certificates stating the wrong budgets, but they had only secured the actual budgets. Once again, a claim amounting to at least 100 million US dollars is being asserted. The presiding judge at the State Court announced at a hearing held at the end of June 2003 that the action by INTERTAINMENT Licensing GmbH would be suspended until a decision was reached on the arbitration case brought by Comerica Bank for the film "Driven" (see item 1.5).

**1.5 Arbitration proceeding for the film "Driven": INTERTAINMENT Licensing GmbH achieves significant widening of the proceedings**

During the first quarter of 2003, Comerica Bank opened arbitration proceedings against INTERTAINMENT Licensing GmbH for the film "Driven". "Driven" is a film produced by Franchise Pictures in 2000 and was part of the output deal. Comerica Bank provided preliminary finance for the film and INTERTAINMENT Licensing GmbH had paid the first (of two) installments. Comerica Bank was demanding the second installment amounting to 13.6 million US dollars by filing an arbitration suit.
INTERTAINMENT Licensing GmbH believed that the arbitration case was directed exclusively toward undermining the action against Comerica Bank and the bond companies outlined in item 1.4. INTERTAINMENT Licensing GmbH has filed counterclaims and rejoinders and has managed to ensure that the arbitration proceedings no longer simply relate to "Driven", but also cover all the disputed Franchise films financed by Comerica Bank and all claims for damages that INTERTAINMENT Licensing GmbH is filing in the action before the State Court against Comerica Bank, the bond companies and the executive managers of these companies. This means that the scope of the arbitration proceedings has now increased enormously.
Comerica Bank is demanding more than 70 million US dollars from INTERTAINMENT 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 INTERTAINMENT Licensing GmbH. The demands of Comerica Bank relate to the fraudulently inflated budgets and not to the actual budgets of the films, which were in reality proven to be much lower. With the exception of a few films, INTERTAINMENT Licensing GmbH had paid in full before the fraud was discovered, INTERTAINMENT Licensing GmbH had not received any of the disputed films for exploitation. Instead, the films were exploited by the opposing side. They also received all the revenues arising from the films. The executive management of Intertainment is also assuming that these revenues from the exploitation of film rights will exceed the potential claims of the opposing side.
The parties originally involved in the arbitration proceedings agreed in autumn 2003 on a tribunal with three arbitrators. They addressed the different petitions by the parties for the first time at the end of October 2003, relating to the formal procedure for the arbitration proceedings. In this context, Comerica Bank filed an application to negotiate the case of "Driven" separately and bring forward the date in the schedule. The arbitrators rejected this application in the resolution dated November 24, 2003.
The arbitrators scheduled commencement of oral proceedings for January 4, 2005. However, the parties involved agreed on February 2005. The proceedings are expected to last around two months.
INTERTAINMENT Licensing GmbH regards the claims asserted by Comerica Bank as unfounded and by the same token views its own prospects for success as extremely positive. The decision in the trial against Franchise Pictures and the other parties involved also points in this direction – even if, as Comerica Bank and the bond companies contend, this decision is not supposed to exert any prejudicial effect on the arbitration proceedings.
The management of INTERTAINMENT Licensing GmbH assumes that if the outcome of the arbitration proceedings is successful, Comerica Bank will also be liable for the damages sustained by Intertainment which have already been proven in the trial against Franchise Pictures and other parties.

**1.6 Arbitration proceedings for the film "Tracker": Dummy company from Hong Kong**

In mid-June 2003, International Motion Pictures Corporation Ltd. (IMPC), Hong Kong, commenced arbitration proceedings against INTERTAINMENT Licensing GmbH. The company had acquired an alleged payment claim from a bank in connection with the film "Tracker" and was therefore demanding payment of 3.3 million US dollars plus interest.
INTERTAINMENT Licensing GmbH has at no point had business dealings with IMPC and there is a well-founded suspicion that the company is only being used as a dummy company for the interests of Franchise Pictures or the other companies involved in the fraud.
In conjunction with the arbitration claim and in order to secure any potential claims, the lawyers of IMPC attempted in a number of ways through a court of law to obtain a pledge application for assets of INTERTAINMENT Licensing GmbH amounting to around 4 million US dollars. The Superior Court in Los Angeles rejected this application, partly on the grounds that IMPC could not provide verification of the true level of the budget for "Tracker".
Following the rejection by the Superior Court, the company filed the same claim with the Arbitration Tribunal. The arbitrator appointed by the American Film Marketing Association (AFMA) did not feel bound by the court decision and instead ordered on November 12, 2003 that all payments due to INTERTAINMENT Licensing GmbH in the USA be paid into a trustee account until the arbitration proceedings had been concluded. However, the federal judge presiding over the main trial of the suit against Franchise Pictures at the Federal District Court in Santa Ana released these funds at the end of March 2004 and Intertainment was able to dispose over this money again.
In mid-January 2004, shortly before the scheduled start of the arbitration proceedings in the case of "Tracker", the federal judge also invoked a temporary injunction that the arbitration proceedings in the case of "Tracker" should be suspended until the main trial in the Franchise case was deci-

ded. The opposing side appealed against this decision without success. No new date has so far been scheduled for this arbitration proceeding.

**1.7 Arbitration proceeding for the film "Viva Las Nowhere": Claim against the Lewis Horwitz Organization and others in 2004**

In order to protect its claims, INTERTAINMENT Licensing GmbH filed a claim in the case of the film "Viva Las Nowhere" also produced by Franchise Pictures. The claim is against the Lewis Horwitz Organization, which financed the film, and against Westdeutsche Landesbank and Southern Pacific Bank, which acted as syndicating banks. The lawsuit was filed in mid-April 2004 and comprises a claim for damages amounting to around 1.3 million dollars plus interest. It was necessary because the Lewis Horwitz Organization and Westdeutsche Landesbank are not included in the extensive arbitration proceedings relating to "Driven".

After the lawsuit was filed, the parties agreed that the suit filed should be suspended until an arbitration tribunal has reached a decision on this dispute.

**1.8 Arbitration proceeding on account of the film "Caveman's Valentine": INTERTAINMENT Licensing GmbH pays second installment**

In an arbitration case that the National Bank of Canada filed against INTERTAINMENT Licensing GmbH, the Bank demanded payment of the second installment of approximately 7 million US dollars to finance the franchise film "Caveman's Valentine". The film was also part of the Franchise trial due to a fraudulently inflated budget. However, it was not financed by Comerica Bank but by the National Bank of Canada.

In the course of the arbitration proceedings, it was already confirmed in 2002 that the film had been correctly delivered. Thereupon INTERTAINMENT Licensing GmbH lodged an appeal against the arbitration ruling, but the appeal failed and this meant that the relevant sum had to be paid. A statement about the fraudulently inflated budgets was not part of the arbitration proceedings. The budget fraud was much more the subject of the Franchise trial which was decided in favor of Intertainment.

**2. Operating area: Extensive reorganization measures at Intertainment AG**

Particularly during the first half of the business year 2003, Intertainment AG worked intensively on revitalizing operating business despite the burdens originating from the fraud perpetrated by Franchise Pictures. The positive trends achieved through these efforts by summer 2003 were negated from the end of July 2003 by the further postponement of the main trial in the proceedings for damages filed by INTERTAINMENT Licensing GmbH against Franchise Pictures. The management of Intertainment AG reacted to the new situation by radically revising and intensifying the measures directed toward restructuring, reorganization and savings. The additional measures involved all areas of the Group and all business partners. They were primarily directed toward relieving the burden on finances and hence ensuring that Intertainment is in a position to provide the finance for the trial relating to the Franchise case. It was necessary to take into account that existing strategic initiatives would suffer as a result. This affected – and continues to affect – the schedule for transforming the company from a film-license dealer into a film producer. The measures included terminating cooperation with American film producer Kopelson Entertainment and the Thriller "Twisted" which Intertainment AG produced under the working title "Blackout" together with Paramount Pictures and Kopelson Entertainment.

Some of the agreements sought within the scope of the reorganization only came into effect during the first weeks or months of the business year 2004. Nevertheless, the agreements on reorganizing American activities in particular, exerted substantial effects on the figures for 2003 because these matters reflected value.

On the following pages, we present the key measures and events from the operating area in the business year 2003 and the first half of 2004.

**2.1 Development in the areas of film production and licensing: Termination of contract with Kopelson Entertainment in 2004**

Intertainment AG continued development work on a number of film projects with Kopelson Entertainment during the first half of 2003. This included the thriller "Fast Forward", and it was an element in a first-look and co-financing agreement with US film studio Paramount Pictures. A further revision of the script for the film was commissioned at the start of 2003. In March, 2003, work was also started with Kopelson Entertainment on a film for the comedy "Navy Seal".

However, after the Franchise trial was postponed again, Intertainment AG was compelled to make cooperation with Kopelson Entertainment the focus of reorganization and cost-cutting measures. Since cost reductions in particular, could not be harmonized with the production requirements of Kopelson Entertainment, the two parties finally ended the cooperation they had agreed in mid-2000 on February 11, 2004 after several months of negotiations.

Terminating the contract has released Intertainment AG from substantial financial obligations. This matter impacted positively on value in the financial statements for 2003. It was reported under amortization of intangible assets and depreciation of property, plant & equipment in the sum of 7.4 million euros, and in the sum of 1.6 million euros under tangible assets of USA-Intertainment, Inc. All the projects still being developed were abandoned when the contract was terminated.

### CONTRACT WITH PARAMOUNT PICTURES FOR THE FILM "TWISTED" IN 2004

With a view to further restricting financial commitments and minimizing the risks associated with exploitation, Intertainment AG concluded a contract for the film "Twisted" with Paramount Pictures in February 2004. This contract regulates the distribution of the territories and the exploitation risks between Intertainment AG and Paramount, with Intertainment AG acquiring fewer territories than originally projected. In this connection, we refer to the supplementary information provided under item C.3 and item F.2.1.

### "TWISTED" LAUNCHED IN CINEMAS

Activities in film production and sales of film rights during the year under review focused on production, post-production and marketing of "Twisted". Intertainment AG produced the thriller with the working title "Blackout" in collaboration with US studio Paramount Pictures and Kopelson Entertainment. It was completed during the first half of 2003. Paramount subsequently decided not to release the film on cinema screens as originally planned in autumn 2003, but to wait until the end of February 2004. The major studio hoped that this postponement would achieve better box-office results. This action meant that delivery of the film to the business partners of Intertainment was also delayed.

### LICENSE SALES OF "TWISTED"

Marketing the global first exploitation rights in "Twisted" was at the center of license sales activities during the year under review. Intertainment AG had already started marketing in 2002 and continued successfully in 2003. Licenses were sold for large parts of Western and Eastern Europe, the Middle East and Asia. However, postponement of the cinema launch by Paramount meant that sales during the year under review were no longer relevant to the financial statements in contrast with projections. Figures for sales will be reported in the second quarter of 2004. We refer to the other financial commitments in the "Notes to the consolidated financial statements" item VIII.5.

### CINEMA LAUNCH OF "THINGS YOU CAN TELL ..."

Other activities in the area of film license sales during the year under review included the cinema launch of "Things you can tell ..." in 50 selected German cinemas. This film was launched in April 2003 in collaboration with distributor Ottfilm. Intertainment AG also concluded a sales agreement for the German DVD and video market with Planet Media home entertainment GmbH. This agreement covers selected titles from the Intertainment film library, including "Things you can tell ...", "Camouflage" and "The third miracle". However, the fraud perpetrated by Franchise Pictures impacted even more significantly on license sales than in previous years. In particular, this was due to the fact that – with the exception of "Twisted" – it had not been possible to market any major new cinema films since autumn 2000.

### 2.2 Development in the segment cartoon film and merchandising: Fall in sales for "Rudolph the red-nosed reindeer"

Intertainment focused its business activities in the segment film rights sales with cartoon films and merchandising in Intertainment Animation & Merchandising GmbH. This company also owned the German-language marketing rights to the Christmas classic "Rudolph the red-nosed reindeer".

Once again, more than 200 products associated with Rudolph were marketed during the Christmas period in 2003. The two Rudolph videos were again established among the VHS videos with the highest sales over Christmas. However, in line with expectations, their sales revenues were significantly below the figures achieved for the previous year. This led to sales of Intertainment Animation & Merchandising GmbH falling back by 61 % to 1.6 million euros. In 2002, sales were 4.2 million euros. Earnings at Intertainment Animation & Merchandising GmbH deteriorated from -6,000 to -203,000 euros.

### ASSET SALES OF INTERTAINMENT ANIMATION & MERCHANDISING GMBH

The restructuring measures involved the sale of its business for "Rudolph the red-nosed reindeer" to a subsidiary of Splendid Medien AG, Cologne. In this connection, Intertainment Animation & Merchandising GmbH also sold its rights in a learning game for small children, which is currently being developed, to the Splendid subsidiary. Intertainment developed this game in 2003 with the aim of expanding the product range. Substantial investments would have been required to develop the product as far as the ready-to-market stage and finance the planned marketing costs up to product launch in autumn 2004.

### 3. Participation in SightSound Technologies: Positive development through association with Bertelsmann subsidiaries

The American Intertainment AG holding SightSound Technologies mainly focused on asserting its US patent rights for downloading audio and video files from the Internet during the business year 2003. 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 US patent rights held by SightSound for the digital download of audio and video files from the Internet. Given that the defendant has only achieved sales amounting to less than 0.1 million US dollars with downloads to date, the settlement sum of 3.3 million US dollars appears to be extremely significant. Intertainment AG believes that the settlement will have far-reaching effects on the entire sector for downloading music and films. It substantially improves the prospects of SightSound for also asserting its patent rights in the USA against other commercial providers of film and music downloads from the Internet – if necessary through legal channels. In addition, it allows SightSound to promote its license business and significantly increases the appeal of SightSound patents. Accor-

dingly, SightSound does not exclude the possibility of selling the patents to another company.
The stake in SightSound fell during the course of 2003 from 22.8 % to 12.4 %. SightSound had found a new financier in 2002 who guaranteed the financing of the lawsuit in exchange for a stake in the company and options. During the course of 2003, SightSound carried out a number of capital increases to finance the legal dispute. A review is currently being carried out to examine whether the capital increases brought about a legally valid dilution of the shareholding held by Intertainment in view of the contractually agreed protection against dilution. However, the management continued to value the shareholding in SightSound unchanged at approximately 15 million euros on the balance sheet date for 2003, since the Board of Management is of the view that the value of SightSound increased substantially as a result of the events described.

**4. Strategic partnership with OpenPictures: Medium and long-term reinforcement of the operating business planned**

Film production and license sales are an element in a comprehensive strategic partnership which Intertainment AG entered into with OpenPictures AG, Munich, at the start of July 2003. The partnership is directed toward strengthening the operating business of Intertainment over the medium to long-term. The main goal is the joint development and production of films. Intertainment AG has additionally granted OpenPictures the right to market films from the Intertainment film library in the German-language area. Over the medium term, the option of OpenPictures taking a stake in Intertainment is not excluded.

**5. Staff, management & Supervisory Board: Change in the Board of Management and Supervisory Board**

An average of 23 employees was employed in the Intertainment Group in the business year 2003. This means there was no change in the number of employees but personnel expenses were reduced from 3.6 million to 3.0 million euros – particularly due to members of the Board of Management waiving part of their salary. Staff were actively employed at Group Head Office in Ismaning and at USA-Intertainment, Inc. in Los Angeles.
Intertainment rationalized its management structure in connection with the reorganization measures. For this reason, Stephen Brown, deputy chairman of the Board of Management, left the Board on August 13, 2003. However, he continues to work for the Group as President of USA-Intertaiment, Inc. Brown had been a member of the Board of Management since October 31, 2000.
There were also changes in the Supervisory Board. The deputy Chairman of the Supervisory Board of Intertainment AG, Dr. Ernst Pechtl, resigned from his post at the Annual General Meeting on September 22, 2003. Auditor and tax consultant Wolfgang Blauberger was appointed as his successor. Dr. Pechtl has been a member of the Intertainment Supervisory Board since December 23, 2000.

**6. Share trading & suspicion of insider trading: Federal Financial Services Regulatory Authority closes preliminary investigations**

Shortly before the Annual General Meeting on September 22, 2003, Intertainment found out from the press that the Federal Financial Services Regulatory Authority (BaFin) had carried out a routine investigation into Intertainment on account of suspicion of insider trading. The suspicion was prompted by unusually high trading in Intertainment shares in advance of the ad-hoc press release relating to the postponement of the Franchise case on July 14. Intertainment expressly welcomed these investigations. However, the grounds for suspicion were clearly not confirmed. In mid-November, it was announced that BaFin had closed the investigation.

## C. Net worth, financial and earnings position of the Intertainment AG Group for the business year 2003 in accordance with IFRS

**1. Net worth**

The Franchise Pictures case and the implemented reorganization measures impacted substantially on the financial statements of the Intertainment Group for the business year 2003. The key changes on the assets side were as follows:

**C. 1 GROUP: KEY CHANGES ON THE ASSETS SIDE** — mn euros

| | 31/12/2003 | 31/12/2002 | Change |
|---|---|---|---|
| Other assets | 69.3 | 9.4 | 59.9 |
| Payments made on account for film rights (current assets) | 0.2 | 33.1 | -32.9 |
| Trade receivables | 0.8 | 37.2 | -36.4 |
| Intangible assets | 2.1 | 10.1 | -8.0 |
| Tangible assets | 0.2 | 2.2 | -2.0 |
| Film rights | 7.1 | 10.8 | -3.7 |

The positive development in the legal dispute with Franchise Pictures resulted in a revaluation of the claims of Intertainment. Payments made on account for film rights were written up by 34.6 million to 67.7

million euros. 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. Despite the fact that Franchise Pictures and other parties recently instituted insolvency proceedings, the management of Intertainment still regards this asset as valuable.

The value derives on the one hand from the fact that part of the claims of Intertainment can be met by the insolvency settlement. On the other hand, the management also regards the prospects for success of the impending arbitration proceedings against Comerica Bank as extremely positive (see item B.1.5 of the Management Report). If Intertainment succeeds in asserting its claims against Comerica Bank, 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. Because the judgment states that the case simply relates to claims for damages, the reclassification was made to other assets on the balance sheet date.

Trade receivables fell by 36.4 million euros on account of offsets and the settlement of outstanding items. In this context, trade liabilities also went down by 23.1 million euros. Implementation of the reorganization measures for American business activities and unscheduled depreciation reduced the payments made on account for film projects reported under intangible assets by 7.4 million euros. Tangible assets amounting to 2.0 million euros were also written down and a receivable amounting to 7.6 million euros from Blackout Productions Inc. and Paramount Pictures and reported in the previous year under other assets was largely written off.

The value of film rights fell back by 3.7 million euros and currently amounts to 7.1 million euros. The drop is particularly attributable to unscheduled depreciation amounting to 5 million euros due to a reduction in anticipated sales prices. These are partly a consequence of the market developments described under item A. Inclusion of the additions and writeups amounting to 1.3 million euros results in the overall change.

The key items on the equity and liabilities side developed as follows:

**C. 1 GROUP: KEY CHANGES ON THE EQUITY AND LIABILITIES SIDE** — mn euros

| | 31/12/2003 | 31/12/2002 | Change |
|---|---|---|---|
| Trade liabilities | 1.1 | 24.2 | -23.1 |
| Liabilities to banks | 0 | 16.2 | -16.2 |
| Other provisions | 33.1 | 7.0 | +26.1 |
| Equity | 59.8 | 73.9 | -14.0 |

Liabilities to banks decreased by 16.2 million euros and they were almost 0 euros on the balance sheet date. A loan from the previous year amounting to 1.0 million euros was settled in full. In the view of the management of Intertainment, it proved possible to reschedule an additional loan with the bank. Accordingly, the bank issued a debt waiver with an undertaking to repay amounting to the entire residual debt. In this context, we refer to the risks endangering continuation as a going concern listed under item F.1 of the Management Report.

Other provisions increased by 26.1 million euros. The major share is attributable to contractually agreed participation in trial proceeds amounting to 19.8 million euros, trial risks totaling 6.5 million euros and contractual disputes valued at 3.5 million euros. Equity amounted to 59.8 (prior year 73.9) million euros on the balance sheet date. The capital reserve went down by 79.4 million euros due to the transfer carried out in accordance with Article § 150 Section 3 & 4 AktG ("Aktiengesetz", "Stock Corporation Law") in the context of preparing the financial statements of Intertainment AG by offsetting the net loss for the year. The equity ratio deteriorated by 4.7 percentage points and amounts to 53.3 (prior year 58) %.

### 2. Financial position

At the close of 2003, the Intertainment Group had liquid funds amounting to 2.1 million euros, compared with 3.9 million euros on December 31, 2002. The decrease is due in part to regular outgoings for personnel expenses, rents and loan settlements, but mainly to payments for legal consultancy fees and producers' fees. A detailed financial plan from Intertainment is available for the business year 2004, 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". In particular, we refer at this point to the risks imperiling future existence under item F.1. of this Management Report.

### 3. Earnings position

The Franchise Pictures case impacts on the earnings position to the same extent as on the net worth. Losses continued to fall compared with the prior year despite declining revenues. The consolidated deficit for the business year 2003 amounts to 14.1 (prior year 16.1) million euros and this came down by 2.0 million euros compared with the previous year. The EBIT of the Group amounted to -8.9 (prior year -16.2) million euros. Intertainment posted earnings from ordinary activities of -28.7 (prior year -13.7) million euros.

The reduced consolidated deficit for the year is mainly due to extraordinary earnings of 19.4 (prior year -3.3) million euros. On the one hand, this was the result of extraordinary income amounting to 48.2 (prior year 0) million euros, which was booked for writeups on payments on account to Franchise Pictures and income arising from a debt waiver with an undertaking to repay. On the other hand, it derives from extraordinary expenses amounting to 28.8 (prior year 3.3) million euros including participation in trial proceeds, future trial costs and provisions for contractual disputes.

The positive earnings performance is offset by a negative change in sales. Sales amount to 6.0 million euros compared with 19.0 million euros in the previous year. This is partly due to the fact that Intertainment was not in a position to exploit any major new cinema films during the business year 2003. Exploitation of "Twisted" was postponed until the business year 2004, with the result that no sales were generated from this source in the business year 2003.
In addition, reorganization measures for US activities have increased depreciation on fixed assets and current assets to 16.6 (prior year 0.5) million euros. The reorganization measures therefore resulted in revaluation of a loan totaling 7.3 million euros reported in the prior year under other assets. They also involved payments on account for film projects amounting to 7.4 million euros reported under intangible assets being written down as an unscheduled item. These measures enabled future financial commitments to be reduced significantly.
The earnings of the Intertainment Group were also burdened by the increased tax expense to be reported in the year under review in the sum of 4.7 (prior year tax earnings of 0.9) million euros. This mainly resulted from reporting deferred taxes arising from valuation differences between HGB and IFRS.

## D. Net worth, financial and earnings positions of Intertainment AG for the business year 2003 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** — mn euros

| | 31/12/2003 | 31/12/2002 | Change |
|---|---|---|---|
| **Receivables from affiliated enterprises** | 65.1 | 109.4 | -44.3 |
| **Trade receivables** | 0.6 | 9.5 | -8.9 |
| **Payments made on account for film rights (current assets)** | 0 | 8.5 | -8.5 |
| **Other assets** | 1.3 | 9.3 | -8.0 |
| **Intangible assets** | 2.1 | 5.5 | -3.4 |
| **Film rights** | 6.3 | 7.4 | 1.1 |

Intertainment AG carried out revaluations on the relevant intercompany accounts on the basis of the future cash flows expected by INTERTAINMENT Licensing GmbH and Intertainment Animation & Merchandising GmbH. Receivables from affiliated companies decreased by 44.3 million euros for this and other reasons and amount to 65.1 million euros at the balance sheet date. Trade receivables were reduced to 0.6 million euros, due to the settlement of outstanding items and offsets with trade liabilities. Payments on account for film rights amounting to 8.5 million euros were reclassified to the intercompany account with respect to INTERTAINMENT Licensing GmbH. This measure was necessary because the judgment against Franchise Pictures and other parties stated that claims for damages related exclusively to INTERTAINMENT Licensing GmbH.

Implementation of the reorganization measures for American business activities reduced the payments on account for film projects reported under intangible assets by 3.4 million euros. A receivable amounting to 7.6 million euros from Blackout Productions Inc. and Paramount Pictures reported in the previous year under other assets was largely written off. The value of film rights fell back by 1.1 million euros and currently amounts to 6.3 million euros. The drop is particularly attributable to unscheduled depreciation due to a reduction in anticipated sales prices amounting to 4.6 million euros that are also a consequence of the market developments described under item A. Inclusion of additions and writeups amounting to 3.5 million euros result in the overall change.

The key items on the equity and liabilities side developed as follows:

**D. 1 AG: KEY CHANGES ON THE PASSIVE SIDE** — mn euros

| | 31/12/2003 | 31/12/2002 | Change |
|---|---|---|---|
| **Trade liabilities** | 0.1 | 20.7 | -20.6 |
| **Other provisions** | 2.3 | 1.2 | +1.1 |
| **Equity** | 97.5 | 153.0 | -55.5 |

Equity amounted to 97.5 (prior year 153.0) million euros on the balance-sheet date. The capital reserve went down by 79.4 million euros due to the transfer in accordance with Article § 150 Section 3 & 4 AktG undertaken in the course of preparing the financial statements by offsetting the accumulated loss. The equity ratio improved by 10.1 percentage points and is 96.2 (prior year 86.1) %. Trade liabilities were reduced by 20.6 million euros, due to offsets with trade liabilities and the settlement of outstanding items, and they amount to 0.1 million euros on the balance sheet date. Other provisions total 2.3 million euros. The major share is attributable to the provision for reorganization measures amounting to 2.1 million euros.

**2. Financial position**

At the close of 2003, Intertainment AG had liquid funds amounting to 1.4 million euros, compared with 3.5 million euros on December 31, 2002. Apart from regular outgoings for personnel expenses, rents and loan settlements, the decrease is mainly due to payments to INTERTAINMENT Licensing GmbH. A detailed finance plan from Intertainment AG is available for the business year 2004, from which the Board of 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". 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 earnings situation is dominated by a significant deterioration in earnings. The consolidated deficit for the year increased by 51.7 million euros to 55.5 million euros, earnings from ordinary activities amounted to -55.5 million euros after -4.6 million euros in the previous year. This development is mainly due to the depreciation of current assets undertaken during the year under review amounting to 52.2 (prior year 0) million euros. These mainly include revaluations and waivers on intercompany accounts for INTERTAINMENT Licensing GmbH, Intertainment Animation & Merchandising GmbH and USA-Intertainment, Inc. A receivable amounting to 7.3 (prior year 0) million euros from Blackout Productions Inc. was written off as a result of the restructuring measures.

Sales revenues fell by 5.3 million euros to 4.0 million euros during the year under review. This is mainly due to the fact that Intertainment AG did not exploit any major new cinema films during the business year 2003. Exploitation of "Twisted" was postponed until the business year 2004, with the result that no sales could be generated from this source in the business year 2003.

## E. Future development of the Intertainment AG Group

**1. The Franchise Pictures case**

The development of proceedings in the Franchise Pictures case has already been reported in detail. We refer to Section B.1 of this Management Report. We also refer to the risks listed under item F.1.

**1.1 Option of alternative settlement to the dispute**

It is possible that alternative solutions could be found for the pending disputes in the Franchise case. The parties involved have reached a basic agreement that an attempt should be made to reach a solution in this way. The parties agreed that mediation should take place in the near future with this approach in mind. It is not possible to provide any information on the chances of success for this procedure from the current perspective.

**1.2 Realization of the claims arising from the judgment against Franchise Pictures**

INTERTAINMENT Licensing GmbH had originally intended to launch enforcement proceedings against Franchise Pictures and the other parties convicted immediately after the executed judgment was handed down. US law allows enforcement proceedings to be commenced ten days after the final judgment has been announced. INTERTAINMENT Licensing GmbH will also pursue its claims through insolvency proceedings of Franchise and the other parties involved. Up to the point at which the financial statements were drawn up, all the defendants apart from Elie Samaha and one production company had filed for insolvency. The insolvency proceedings instituted have meant that claims against these parties must be asserted in the insolvency proceedings.

As far as Elie Samaha and the other production company are concerned, INTERTAINMENT Licensing GmbH will implement the measures required for enforcement. If it emerges that the convicted parties disposed of assets before the court proceedings to the disadvantage of INTERTAINMENT Licensing GmbH, the necessary steps will be implemented to secure such assets.

**1.3 Arbitration proceedings**

The arbitration case with Comerica Bank and the bond companies includes a discovery phase in the period leading up to the start of the hearing. In this phase, the lawyers of both sides have the right to call witnesses under oath. The witness statements can be used during the course of the arbitration proceedings. The arbitrators scheduled commencement of oral proceedings for January 4, 2005. The parties have reached mutual agreement that the proceedings should start at the beginning of February. The proceedings are expected to last around two months. The management of INTERTAINMENT Licensing GmbH regards the prospects for success very positively and assumes that if there is a positive outcome to these arbitration proceedings, joint and several liability for the claims which have already been proven in the trial against Franchise Pictures and others will be confirmed.

There was still lack of clarity when this Management Report was produced on the issue of whether and how the arbitration proceedings would continue in the "Tracker" case. The intention is to file a petition in the context of the proceedings for the arbitration suit of IMPC to be rejected in full as unfounded on the grounds that a decision has already been reached on "Tracker" in the Franchise case.

**2. Setting up and expanding the new business model**

As soon as the cash-inflows of funds arising from the Franchise Pictures case are received, Intertainment will start implementing the new business strategy. The intention is to use new 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 is to reduce risks significantly with a maximally broad choice of films and film exploitation.

## 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 2003 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 regarding the Intertainment AG Group'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 three 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 of funds from the legal disputes with Franchise Pictures, Comerica Bank and others parties referred to above
- Positive outcome of current arbitration proceedings
- Cash-inflow from the disposal of financial assets
- Fulfillment of the other assumptions of the finance plan including the incoming payments planned for the near future, in particular the transfer of equity capital or outside capital envisaged in the finance plan amounting to a total of 4 million euros in September and October 2004.

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, Intertainment Animation & Merchandising GmbH and USA-Intertainment, Inc. is highly endangered because of being unable to fulfill their payment obligations and the associated risk of filing for insolvency proceedings – also a very short notice under certain circumstances.

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

In the context of the settlement of the residual debt for a bank loan to INTERTAINMENT Licensing GmbH, the management assumes that rescheduling was negotiated with the affected bank which includes a debt waiver with an undertaking to pay. In order to assess this matter, an expert report was drawn up by a law firm that forms the basis for this appraisal. If it emerges in 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-INFLOW FROM THE LEGAL DISPUTES WITH FRANCHISE PICTURES, COMERICA BANK AND OTHER PARTIES

INTERTAINMENT Licensing GmbH expects to receive the cash-inflows reported in the balance sheet as damages receivable following the judgment in the legal dispute with Franchise Pictures 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 the convicted parties may appeal against the judgment; this had not happened up to the point at which the financial statements were prepared. It is possible to lodge an appeal within 30 days of announcement of the final judgment. The appeal would not affect enforcement of the judgment. However, two exceptions are a possibility. It is possible that the convicted parties may go to appeal and at the same time make a payment of a bond as security. This should be about 1.5 to two times the sum defined in the judgment. In this case, the judgment could not be enforced during the period of the appeal procedure.

It is also conceivable that the convicted parties could go to appeal and the court would decide that the judgment cannot be enforced during the appeal phase, although no bond has been paid as security. However, a court decision of this nature can only be made on the basis of special circumstances. An appeal procedure may last for 18 to 24 months. Irrespective of whether the judgment from the first instance can be enforced during the appeal phase, there is a risk in the case of an appeal procedure that continuing to finance the expensive litigation will exert substantial negative effects on Intertainment.

An alternative approach to going down the appeal route is for one of the parties involved to challenge the result of this trial by submitting petitions to the responsible judge. One of the consequences of such an approach could be that the judgment would be declared null and void and a new main trial ordered. A result of this nature could be justified by providing evidence of gross procedural regularities or infringements of the law.

### POSITIVE OUTCOME TO THE CURRENT ARBITRATION PROCEEDINGS

INTERTAINMENT Licensing GmbH is subject to the risk that the second installments for the disputed films will be claimed in the context of judgments in the arbitration proceedings. Comerica Bank opened such proceedings at the beginning of 2003 against INTERTAINMENT Licensing GmbH in relation to the film "Driven". The arbitration proceedings have meanwhile been expanded and now include all the disputed Franchise films that were financed by Comerica Bank, and also all claims for damages made by Intertainment in the lawsuit before the State Court against

Comerica Bank, the bond companies and the executive managers of these companies.

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 court 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 an additional risk that the arbitration proceedings will be further delayed by petitions from the parties involved and hence the cash-inflows arising from a positive outcome to the arbitration proceedings will not commence as planned.

Arbitration proceedings in relation to the film "Tracker" are an additional issue in this context. International Motion Pictures Corporation Ltd. is demanding payment from Intertainment in the amount of 3.3 million US dollars plus interest. The management of INTERTAINMENT Licensing GmbH assumes that a decision has already been reached in the Franchise Pictures case on this matter that is in favor of INTERTAINMENT Licensing GmbH. A petition will therefore be submitted for the arbitration claim to be rejected outright as unfounded. However, there is still the risk that INTERTAINMENT Licensing GmbH will lose the arbitration case.

#### CASH-INFLOWS FROM THE DISPOSAL OF FINANCIAL INVESTMENTS

SightSound is performing very satisfactorily, as a result of the settlement in the patent infringement proceedings between SightSound Technologies Inc. and Bertelsmann subsidiaries CDNow and N2K. The residual book value from the prior year could therefore be retained on the basis of the diluted participation ratio. However, there is the risk that no cash-inflows can be generated from this participation through a disposal.

#### REALIZATION OF THE OTHER ASSUMPTIONS IN THE FINANCE PLAN

The other assumptions in the finance plan mainly relate to short-term cash-inflows from equity and outside-capital measures taken by Intertainment AG amounting to 4 million euros. If these cash-inflows fail to materialize for Intertainment AG or do not materialize within the projected period, the ability of the Group to continue as a going concern is endangered.

#### 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 and also 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 Article § 252 I No. 2 HGB.

### 2. Further risks

There are other risks associated with the future development of the company. 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, see item B.2.1, entails the risk on the basis of exploitation of the film title "Twisted" that other financial obligations may arise in the future for Intertainment AG. Securities amounting to maximally 7 million US dollars were granted to Paramount Pictures in order to cover these obligations.

#### 2.2 Risk of diluting the shares in SightSound Technologies Inc.

During the year under review, the participation ratio fell by 10.4 percentage points to 12.4 % on the balance sheet date. The cause of this decrease is dilution of the Intertainment AG participation due to the capital increases undertaken at SightSound Technologies Inc. There is therefore a risk that the participation ratio becomes further diluted as a result of future capital measures undertaken by SightSound and the cash-inflows from the disposal of the participation are correspondingly lower. There is also the risk that the contractually agreed antidilutive provisions for these capital increases are not applied (see item B.3).

#### 2.3 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 also the risk that payment for damages has to be made for existing future obligations.

#### 2.4 Trading in film licences

Intertainment trades in film licenses, among other things. There is a 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, 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.

**2.5 Acquisition and exploitation of film rights**

When 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 this risk on the strength of the expertise of the staff, the actors in the main roles and by analysis of the film script.

**2.6 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.

**2.7 Dependence on distribution partners**

The Europe-wide distribution by the majors Warner Brothers and 20th Century Fox represents a substantial competitive advantage for Intertainment. If these cooperative distribution agreements should expire because they are not renewed or if they are dissolved, this might have considerable effects on the financial situation and the business result of the company.

**2.8 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.

**2.9 Currency risk**

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

## G. Risks or 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 2003 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 INTERTAINMENT 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 from the legal disputes with Franchise Pictures, Comerica Bank and others parties referred to above

• Positive outcome of current arbitration proceedings.

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 additionally form the basis for the financial plan submitted by Intertainment AG*

• Cash-inflow of funds from the disposal of financial assets

• Fulfillment of the other assumptions of the finance plan of Intertainment AG including the incoming payments planned for the near future, in particular the transfer of equity capital or outside capital envisaged in the finance plan to a total of 4.0 million euros in September and October 2004.

We refer to our statements on the Intertainment Group under item F.1. for an explanation of the risks imperiling future existence.

### 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 and also 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 Article § 252 I No. 2 HGB.

**2. Other risks**

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

Ismaning, September 16, 2004
Intertainment AG

**Ernst Rüdiger Baeres**
Chairman of the Board of Management

**Hans Joachim Gerlach**
Chief Financial Officer

# Intertainment Group: Consolidated Balance Sheet

as at December 31, 2003 in Accordance with the IFRS

| ASSETS | TZ. | 31/12/2003 | 31/12/2002 |
|---|---|---|---|
| in TEuros | | | |
| **A. FIXED ASSETS** | | | |
| **I. Intangible assets** | VI.1 | | |
| **1.** Licenses, commercial property rights and similar rights as well as licences to such rights | | 3 | 631 |
| **2.** Payments made on account | | 2,147 | 9,513 |
| | | **2,150** | **10,144** |
| **II. Property, plant & equipment** | | | |
| Other plant, business and office equipment | | 194 | 2,206 |
| **III. Financial assets** | | | |
| Participations | | 15,036 | 15,036 |
| | | **17,380** | **27,386** |
| **B. CURRENT ASSETS** | | | |
| **I. Inventories** | VI.2 | | |
| **1.** Film rights | | 7,100 | 10,831 |
| **2.** Merchandise | | 305 | 425 |
| **3.** Payments made on account | | 235 | 33,107 |
| | | **7,640** | **44,363** |
| **II. Receivables and other assets** | VI.3 | | |
| **1.** Trade receivables | | 755 | 37,165 |
| **2.** Other assets | | 69,304 | 9,452 |
| | | **70,059** | **46,617** |
| **III. Cash on hand, bank balances** | VI.4 | 2,138 | 3,922 |
| | | **79,837** | **94,902** |
| **C. DEFERRED TAXES** | VI.5 | 14,977 | 5,132 |
| | | **112,194** | **127,420** |

| EQUITY & LIABILITIES | TZ. | 31/12/2003 | 31/12/2002 |
|---|---|---|---|
| in TEuros | | | |
| **A. EQUITY** | VI.6 | | |
| **I. Subscribed capital** | VI.6.1 | 15,005 | 15,005 |
| **II. Capital reserve** | VI.6.2 | 70,045 | 149,481 |
| **III. Earnings reserves** | VI.6.3 | | |
| Statutory reserve | | 116 | 116 |
| **IV. Group retained earnings** | VI.6.4 | -25,249 | -90,620 |
| **V. Currency differences** | | -81 | -55 |
| | | **59,836** | **73,927** |
| **B. PROVISIONS** | | | |
| **1.** Tax provisions | VI.7.1 | 0 | 117 |
| **2.** Other provisions | VI.7.2 | 33,099 | 6,966 |
| | | **33,099** | **7,083** |
| **C. LIABILITIES** | VI.8 | | |
| **1.** Liabilities due to banks | | 7 | 16,172 |
| **2.** Payments received on account | | 1,318 | 419 |
| **3.** Trade accounts payables | | 1,142 | 24,233 |
| **4.** Other liabilities | | 358 | 3,782 |
| | | **2,825** | **44,606** |
| **D. DEFERRED TAXES** | VI. 9 | **16,434** | **1,804** |
| | | **112,194** | **127,420** |

# Intertainment Group: Income Statement

for the period from January 1, 2003 to December 31, 2003
in Accordance with the IFRS

| in TEuros | | Tz. | 1/1/-31/12/2003 | 1/1/-31/12/2002 |
|---|---|---|---|---|
| **1.** | **Sales revenues** | VII. 1 | 6,028 | 18,975 |
| **2.** | **Other operating income** | VII. 2 | 4,676 | 6,729 |
| | | | **10,704** | **25,704** |
| **3.** | **Cost of materials** | VII. 3 | | |
| | **a)** Cost of film rights and associated performances | | -6,714 | 16,311 |
| | **c)** Expenses for bought-in merchandise and services | | -384 | -974 |
| | | | **-7,098** | **-17,285** |
| **4.** | **Personnel expenses** | | | |
| | **a)** Salaries | | -2,832 | -3,481 |
| | **b)** Social security contributions | | -159 | -134 |
| | | | **-2,991** | **-3,615** |
| **5.** | **Depreciation on property, plant & equipment and amortization on intangible fixed assets** | VII. 4 | -9,332 | -507 |
| **6.** | **Depreciation of current assets** | VII. 4 | -7,261 | 0 |
| **7.** | **Other operating expenses** | VII. 5 | -12,276 | -17,179 |
| **8.** | **Net interest** | VII. 6 | -458 | -822 |
| **9.** | **Result of ordinary business activities** | | **-28,712** | **-13,704** |
| **10.** | **Extraordinary income** | | 48,176 | 0 |
| **11.** | **Extraordinary expenses** | | -28,801 | -3,282 |
| **12.** | **Extraordinary result** | VII. 7 | **19,375** | **-3,282** |
| **13.** | **Taxes on income and earnings** | VII. 8 | -4,727 | -863 |
| **14.** | **Other taxes** | | -1 | -1 |
| **15.** | **Net loss** | | **-14,065** | **-16,124** |
| **16.** | **Accumulated loss** | | -90,620 | -74,496 |
| **17.** | **Release of capital reserve** | | 79,436 | 0 |
| **18.** | **GROUP RETAINED EARNINGS** | | **-25,249** | **-90,620** |
| | **Basic earnings per share** | | **-1.20** | **-1.37** |
| | **Diluted earnings per share** | | **-1.20** | **-1.37** |





# Intertainment Group: Consolidated Cash Flow Statement

for the period from January 1, 2003 to December 31, 2003
in Accordance with the IFRS

| in TEuros | 2003 | 2002 |
|---|---|---|
| Period result prior to extraordinary items, interest and taxes | -26,295 | -19,973 |
| Amortization & depreciation of fixed assets | 9,332 | 507 |
| Changes in provisions | -2,785 | -8,149 |
| Changes to inventories | 4,290 | 8,085 |
| Changes in trade receivables | 15,969 | 16,879 |
| Changes in other assets | 7,861 | 3,003 |
| Changes in trade payables as well as in other liabilities | -6,975 | -5,462 |
| Interest received | 48 | 251 |
| Interest paid | -498 | -1,231 |
| Taxes received | 0 | 7,319 |
| Taxes paid | -123 | -70 |
| **Inflow of funds from current business activities** | **824** | **1,159** |
| Outgoing payments for investments in fixed assets | 0 | -4,316 |
| **Outflow of funds from investment activities** | **0** | **-4,316** |
| Changes in liabilities to banks | -2,582 | -7,055 |
| **Outflow of funds from financing activities** | **-2,582** | **-7,055** |
| **Changes in cash and cash equivalents** | -1,758 | -10,212 |
| Changes in cash and cash equivalents resulting from exchange rate and other influences | -26 | -97 |
| Cash and cash equivalents at beginning of period | 3,922 | 14,231 |
| **CASH AND CASH EQUIVALENTS AT END OF PERIOD** | **2,138** | **3,922** |

# Intertainment Group: Schedule of Nominal Capital

in Accordance with the IFRS

| in TEuros | Share capital | Capital reserve | Revenue reserve | Retained earnings | Currency differences | Total |
|---|---|---|---|---|---|---|
| **BALANCE AT 31/12/2000** | **15,005** | **149,481** | **116** | **12,311** | **44** | **176,957** |
| **Result 2001** | | | | -86,807 | | -86,807 |
| **Currency difference** | | 0 | | | -2 | -2 |
| **BALANCE AT 31/12/2001** | **15,005** | **149,481** | **116** | **-74,496** | **42** | **90,148** |
| **Result 31/12/2002** | | | | -16,124 | | -16,124 |
| **Currency difference** | | 0 | | | -97 | -97 |
| **BALANCE AT 31/12/2002** | **15,005** | **149,481** | **116** | **-90,620** | **-55** | **73,927** |
| **Result 31/12/2003** | | | | -14,065 | | -14,065 |
| **Withdrawals from cap. res.** | | -79,436 | | 79,436 | | 0 |
| **Currency difference** | | 0 | | | -26 | -26 |
| **BALANCE AT 31/12/2003** | **15,005** | **70,045** | **116** | **-25,249** | **-81** | **59,836** |



# Intertainment Group: Notes

for the Business Year 2003 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, Intertainment prepared the reconciliation account with IFRS for the business year 1998. On the grounds that the contribution of INTERTAINMENT 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 year under review, 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 (IAS 22)

The scope of consolidation includes Intertainment AG and its subsidiaries INTERTAINMENT Licensing GmbH, Intertainment Animation & Merchandising GmbH and USA-Intertainment, Inc.
The Intertainment Group consists of the following companies, with Intertainment AG holding directly 100 % of the other enterprises. The individual financial statements were prepared in accordance with HGB.

| II. GROUP OF COMPANIES CONSOLIDATED | | | | | in TEuros |
|---|---|---|---|---|---|
| Company | Subscribed capital (p. y.) | Equity 2003 (p. y.) | Annual result 2003 (p. y.) | Share (in %) | Description |
| **Intertainment AG, Ismaning** | 15,005 (15,005) | 97,506 (153,007) | -55,501 (-3,770) | | 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 and contractual partner with the producer Arnold Kopelson. |
| **INTERTAINMENT Licensing GmbH, Ismaning** | 946 (946) | -69,794 (-80,218) | 10,424 (-10,824) | 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 (203) | -203 (-6) | 100 | The object of the company is trade with merchandising and cartoon film rights. |
| **USA-Intertainment, Inc., Los Angeles, USA** | 105 (105) | 10 (290) | -254 (82) | 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, 2003. 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 (IAS 22). 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 81 (p.y. 55) 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, for film productions which have commenced or which are to commence, and for fees paid to producers are shown as payments on account for items of intangible fixed assets. Furthermore, payments for the acquisition of film rights which have not yet been delivered and the technical quality accepted are reported under this item. It is decisive for this presentation that the film rights arising or acquired are available for an indefinite period of time. The producer fees made prior to project commencement are added to the total production costs for a film project. 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 project.

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 office and business 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 that 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, 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 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 scheduled amortization of film rights is based on economic life or causation of the film rights. In addition, nonscheduled 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. Adjustments are formed for the payments made on account if there is a significant risk that neither the performance nor a full repayment of the amount is expected. The adjustments formed are regularly subject to further risk assessment. If a change in the risk assessment means that the reasons for adjustments no longer exist, the rights are written up at the newly determined fair value.

Short-term **RECEIVABLES AND OTHER ASSETS** are capitalized at their nominal value, long-term receivables and assets are shown at their present value. Long-term receivables are discounted at 5.5 % p.a. 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. Outside capital**

The **TAX PROVISIONS** (IAS 12/37) comprise the probable tax debts of the Group calculated according to the valid tax rates.

The **OTHER PROVISIONS** are to be 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.

The short-term **LIABILITIES** are shown at their nominal values, and long-term liabilities are shown at their present values. Long-term liabilities are discounted at 5.5 % p.a. In accordance with IAS 21, liabilities in foreign currencies are valued using the euro exchange rate on the balance sheet date.

**4. Sales realization**

The sale and exploitation of film rights should always be differentiated when they are reported. This has the following effect on the realization of sales:

In the case of a **SALE OF A LICENSE** sales 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 **FILM EXPLOITATION**, 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 12 months later and the Free-TV segment starts a further 12 months later.

The sales realization for **MERCHANDISE** always 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 12 (p.y. 350) TEuros results from this revaluation.

**2. General adjustment on receivables**

According to IFRS, no general adjustment should be formed for trade receivables. According to HGB, a percentage adjustment of 1 % was made for trade receivables on the principle of caution in the prior year. This corresponds to an amount of 395 TEuros.

**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. 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 good-will 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. Discounting of long-term liabilities**

According to HGB, long-term liabilities must be recorded with their repayment amount. In contrast, according to IFRS this item is to be recognized at its present value, using a discount rate of 5.5 % p.a. The difference is 0 (p.y. 2,277) TEuros.

**5. Capitalization of fees paid to producers and of film project costs**

According to German commercial code regulations, internally generated intangible fixed assets must be recorded as expense. According to IFRS, these must be capitalized if it is extremely likely that a future economic benefit can be generated. There results an amount to be capitalized of 0 (p.y. 4,004) TEuros.

**6. 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 Accounting 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 in the year under review amount to 4,727 TEuros. Deferred tax earnings of 350 TEuros were reported 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.

Acceptance of the licenses reported under intangible assets amounting to 628 TEuros is principally based on the reclassification of the cartoon film rights of Intertainment Animation & Merchandising GmbH to current assets. The change in reporting results from the disposal of the business of Intertainment Animation & Merchandising GmbH including the German-language license rights in "Rudolph the red-nosed reindeer" which was carried out after end of the period under review.

The payments on account for intangible fixed assets include, in particular, payments for the acquisition of a film right amounting to 2,147 (p.y. 0) TEuros. The payments on account for current and pending film productions amounting to 9,513 TEuros reported in the prior year were reclassified in the amount of 2,147 TEuros to payments on account for film rights and the residual amount of 7,366 (p.y. 0) was written off as a non-scheduled writedown. This writedown is solely attributable to the termination of the cooperation agreement with Kopelson Entertainment carried out in conjunction with the reorganization of the American business activities.

Property plant and equipment consists of office and business equipment. The tenant fixtures and fittings of USA-Intertainment, Inc. were written off as a non-scheduled writedown amounting to 1,574 (p.y. 0) TEuros during the year under review.

The financial assets consist of the participation in the US company SightSound Technologies Inc. During the year under review, the participation ratio has therefore declined by 10.4 percentage points to 12.4 %. The cause of this decline is attributable to a dilution effect caused by capital increases at SightSound Technologies Inc.

In the opinion of Intertainment, the positive development in the patent-infringement dispute between SightSound Technologies Inc. and CDNow and N2K and the out-of-court agreement reached by the parties in February 2004 (see item B.3 of the management report) confirms the value of the patent rights of SightSound and substantially reduces the corporate risks. The management of Intertainment values SightSound at an unchanged residual book value compared with the prior year amounting to 15,036 TEuros on the basis of the substantially increased participation value on account of the results described above.

**2. Inventories**

The film rights and licenses are valued at 7,100 (p.y. 10,831) TEuros. They developed as follows:

| VI. 2 FILM RIGHTS AND LICENSES | | in TEuros |
|---|---|---|
| **Position** | **2003** | **2002** |
| **Balance at January 1** | 10,831 | 27,701 |
| **Writeups** | 710 | 1,856 |
| **Normal amortization** | 0 | -5,481 |
| **Non-scheduled amortization** | -4,951 | -4,708 |
| **Reclassifications** | 510 | -8,537 |
| **Balance at December 31** | 7,100 | 10,831 |

The writeups relate to various film rights which had been the subject of non-scheduled amortization in prior years. The present valuation of these film rights led at the balance sheet date to improved net sales values in comparison with the prior year.

The normal amortization occurred on account of exploitation and license sales of film rights in the prior year.

The non-scheduled writedowns on film rights were incurred under the loss-free valuation for film rights. At the balance sheet date, the expected sales revenues are below the capitalized costs of the film rights concerned.

The reclassifications amounting to 510 TEuros result from the changes in presentation of the German-language license rights in “Rudolph the red-nosed reindeer”. These were disposed of after the business year had finished.

The **MERCHANDISE** comprises merchandising articles or video and DVD stocks. Their value amounts to 305 (p.y. 425) TEuros after loss-free valuation.

The **PAYMENTS ON ACCOUNT** for film rights amount to 235 (p.y. 33,107) TEuros and comprise payments for the development and production of film projects. The payments on account reported under this item during the prior year associated with the legal dispute in the Franchise Pictures case were reclassified under other assets during the year under review. This reclassification was necessary since the judgment against Franchise Pictures means that there is now no longer any legal basis for the payments on account. The issue now relates exclusively to claims for damages against Franchise Pictures and other parties.

The payments to Franchise Pictures are shown below in TEuros:

| VI. 2 PAYMENTS TO FRANCHISE PICTURES | in TEuros |
|---|---|
| **Origin of payments on account** | 97,092 |
| **Adjustments** | -63,985 |
| **Book value 01/01/2003** | 33,107 |
| **Writeups** | 34,593 |
| **Reclassification to other assets** | -67,700 |
| **Book value 31/12/2003** | 0 |

The “original payments on account” amounting to 97,092 (p.y. 97,092) TEuros relate exclusively to film rights which were the subject of the damages trial against Franchise Pictures and the arbitration proceedings against Comerica Bank and the bond companies. Adjustments were formed during the business year 2001 because there was a significant risk that neither the performance nor the full repayment of the amount would be carried out.

**3. Receivables and other assets**

The trade receivables amount to 755 (p.y. 37,165) TEuros. The reduction compared to the prior year essentially results from offsetting the trade liabilities and payment of outstanding items. In offsetting the trade receivables and liabilities, the Board of Management takes the view that there is no longer a security link between trade receivables and liabilities to banks on account of an agreement with a bank. We also refer in this connection to item VI.8 of these notes.

The receivables refer exclusively to a residual term of less than one year. In the prior year, there were receivables with a residual term of more than one year amounting to 19,214 TEuros which were discounted with 932 TEuros.

The **OTHER ASSETS** amounting to 69,304 (p.y. 9,452) TEuros are comprised as follows:

| VI. 3 OTHER ASSETS | | in TEuros |
|---|---|---|
| | **2003** | **2002** |
| **Damages receivable from legal disputes** | 67,700 | 0 |
| **Deposited securities** | 1,096 | 0 |
| **Input tax not yet due** | 0 | 1,337 |
| **Tax rebates** | 72 | 70 |
| **Receivables from Blackout Productions Inc. and Paramount Pictures** | 0 | 7,571 |
| **Loan to SightSound Technologies Inc.** | 0 | 309 |
| **Miscellaneous** | 436 | 165 |
| **Total** | **69,304** | **9,452** |

The **DAMAGES RECEIVABLE** from legal disputes relate to the claims of Intertainment against Franchise Pictures and other parties. Reclassifications from payments on account for film rights (see item VI.2.) were made on the balance sheet date to other assets on account of winning the legal dispute and the associated collapse of the legal basis.

The valuation is based on the claims of Intertainment arising from the successful legal dispute against Franchise Pictures and other parties amounting to the sum cited in the judgment less the risk reduction. Despite the fact that Franchise Pictures and other parties have recently instituted insolvency proceedings, the management still regards this asset as valuable. 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.1.5) of the management report. If Intertainment succeeds in asserting its claims against Comerica Bank, 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 companies.

The **DEPOSITED SECURITIES** relate to the money paid to the American court and which are directly connected with the arbitration proceedings concerning "Tracker" described under item B.1.6 of the management report. We also refer to the provision for reorganization under item VI.7.2 of the notes to the consolidated financial statements.

The **RECEIVABLES** from Blackout Productions Inc. and Paramount Pictures were written off in the sum of 7,065 TEuros and offset in the sum of 506 TEuros against existing obligations.

The **LOAN** to SightSound Technologies was repaid in full to Intertainment AG during the business year 2003.

All items relate to a residual term of less than one year.

**4. Cash on hand, bank balances**

Liquid funds totaling 2,138 (p.y. 3,922) TEuros are made up of fixed term deposits amounting to 264 (p.y. 900) TEuros and current accounts and cash in hand amounting to 1,874 (p.y. 3,022) TEuros. The fixed term deposits have short remaining terms of less than one year and fall due in the business year 2004. Because of a surety and a letter of credit, which are connected with the rent obligations for office premises, 340 (p.y. 717) TEuros of the liquidity is not freely available.

**5. Deferred tax assets**

The deferred tax assets include an amount of 14,977 (p.y. 5,132) TEuros. Apart from valuation differences between HGB and IFRS 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 amounting to 9,857 (p.y. 0) TEuros derived from the adjustments for inter-company accounts of Intertainment AG described under item VI.9 and the consequences of debt consolidation. The statutory regulations governing offsetting loss carry-forwards allow 60 % of the underlying losses to be recognized. We refer to our comments under item VII.8 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 /1I)*.

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 shareholders' meetings

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 70,045 (p.y. 149,481) TEuros. The change compared with the prior year resulted from utilization to balance the loss carry-forward and annual deficit of Intertainment AG in accordance with § 150 (3) and (4) of the AktG ("Aktiengesetz", "Stock Corporation Act"). Currency differences were not reported in the capital reserve during the year under review for the first time. They are reported separately under equity. The value for the prior year has been adjusted appropriately.

**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, 2003 a reduced accumulated loss of -25,249 (p.y. -90,620) TEuros is reported because of the consolidated annual deficit of -14,065 (p.y. -16,124) TEuros and application of the capital reserve amounting to 79,436 (p.y. 0) TEuros.

## 7. Provisions

### 7.1 Tax provisions

The TAX PROVISION amounting to 117 TEuros was used in full during the year under review to settle taxes due to be paid resulting from a tax audit.

### 7.2 Other provisions

The other provisions developed as follows:

VI. 7.2 OTHER PROVISIONS — in TEuros

| Type of provision | Balance 1/1/2003 | Utilization | Release | Allocation | Balance 31/12/2003 |
|---|---|---|---|---|---|
| Litig. revenue participations | 0 | 0 | 0 | 19,800 | 19,800 |
| Litigation risks | 3,000 | 1,577 | 0 | 5,077 | 6,500 |
| Contractual disputes | 0 | 0 | 0 | 3,500 | 3,500 |
| Reorganization | 0 | 0 | 0 | 2,100 | 2,100 |
| Outstanding invoices | 2,623 | 1,032 | 1,353 | 700 | 938 |
| Allowance for license sales | 765 | 264 | 501 | 0 | 0 |
| Personnel | 372 | 371 | 1 | 63 | 63 |
| License fees | 127 | 161 | 19 | 172 | 119 |
| Miscellaneous | 79 | 0 | 0 | 0 | 79 |
| **Total** | **6,966** | **3,405** | **1,874** | **31,412** | **33,099** |

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 provision for LITIGATION RISKS comprises the estimated costs still due for all the pending legal disputes within the context of the Franchise Pictures case. The transfer amounting to 5,077 TEuros was required amongst other things on account of the postponement of the main trial of the lawsuit against Franchise Pictures from August 2003 to April 2004, the arbitration suit filed by Comerica Bank in the "Driven" case and on account of the arbitration proceeding brought by International Motion Pictures Corporation in the "Tracker" case. 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 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 REORGANIZATION includes obligations to contractual partners for the settlement and termination of existing contracts. This relates in particular to inflows of funds arising from the security deposits assigned to contractual parties reported under other assets. We also refer to item VI.3 of these notes.

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 ALLOWANCES FROM LICENSE SALES resulted from disputes – on account of the litigation with Franchise Pictures – in the contract implementation of sales of films.

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. In the prior year, this item also included obligations relating to severance payments.

The provision for LICENSE FEES includes exploited license rights for which the corresponding fees must be paid to the seller of the license.

Overall, provisions of 2,030 (p.y. 1,250) TEuros have a residual term of more than one year.

## 8. Liabilities

The LIABILITIES TO BANKS amount to 7 (p.y. 16,172) TEuros. This item relates exclusively to current accounts.

A loan reported in the prior year was settled in full during the year under review. Another loan amounting to 15,185 TEuros reported in the prior year and due on June 30, 2004 was written off in the business year 2003 since the management believed that the residual debt called in by the bank on June 30, 2004 was rescheduled. For this reason, the management believes that the loan can no longer be called in on June 30, 2004. The rescheduling provides for the bank issuing a debt waiver with an undertaking to repay. Within the context of this undertaking to repay, receivables are reinstated when the conditions come into force. The total sum of the receivables reinstated through the undertaking to repay is limited to 115 % of the original loan debt. In order to secure the claims of the bank, the assets and claims described under item VIII.6 (other liabilities) 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 amounting to 1,318 (p.y. 419) TEuros comprise payments from licensees for film titles not yet supplied and not yet technically accepted.

The TRADE LIABILITIES amount to 1,142 (p.y. 24,233) TEuros and result in particular from payment obligations for returned goods and related services. The reduction compared to the prior year is primarily due to offsetting trade receivables amounting to 19,418 (p.y. 0) TEuros and payment of outstanding items. We also refer in this connection to item VI.3 of these notes.

There are **OTHER LIABILITIES** amounting to 358 (p.y. 3,782) TEuros and mainly included in the prior year value added tax not due amounting to 1,337 TEuros.

The liabilities have overall a residual term of less than one year. In the prior year, there were long-term liabilities with a residual term of more than one year amounting to 18,206 TEuros which were discounted with 2,277 TEuros.

**9. Deferred tax liabilities**

Deferred tax liabilities amount to a value of 16,434 (p.y. 1,804) TEuros and were formed for consolidation measures with effect on income that will probably be cancelled out in the subsequent periods and are also based on 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 change compared with the prior year is based on an effect related to debt consolidation. During the year under review, Intertainment AG carried out adjustments amounting to 43,233 (p.y. 0) TEuros in individual financial statements on intercompany accounts to its subsidiaries. In the context of debt consolidation, the difference led to a deferred tax asset amounting to 16,428 TEuros. We refer to our comments under item VII.8 for further information.

## VII. Explanations to the Group income statement

**1. Sales revenues**

Sales revenues amount 6,028 TEuros following 18,975 TEuros in the prior year. They are made up as follows:

| VII. 1 SALES REVENUES in TEuros | 2003 | 2002 |
|---|---|---|
| Sale of film rights | 4,288 | 14,527 |
| Sale of visual media | 1,508 | 3,727 |
| Other sales revenues | 283 | 822 |
| Sales deductions | -51 | -101 |
| Total | 6,028 | 18,975 |

The sales deductions relate mainly to rebates and discounts.

**2. Other operating income**

Other operating income amounts to 4,676 (p.y. 6,729) TEuros and comprises:

| VII. 2 OTHER OPERATING INCOME in TEuros | 2003 | 2002 |
|---|---|---|
| Release of provisions | 1,874 | 53 |
| Currency gains | 1,112 | 2,162 |
| Writeups on film rights | 710 | 1,856 |
| Miscellaneous | 980 | 2,658 |
| Total | 4,676 | 6,729 |

**3. Cost of materials**

The cost of materials amounts to 7,098 (p.y. 17,285) TEuros and includes expenses for film rights and associated services amounting to 6,714 (p.y. 16,311) TEuros and expenses for related goods and services amounting to 384 (p.y. 974) TEuros. Overall the cost of materials is made up as follows:

| VII. 3 COST OF MATERIALS in TEuros | 2003 | 2002 |
|---|---|---|
| Non-scheduled writedowns of film rights | 4,951 | 4,708 |
| Marketing costs | 1,492 | 3,025 |
| Synchronization and copying costs | 350 | 286 |
| Licensor shares | 172 | 127 |
| Sales inputs for visual media and merchandising articles | 99 | 563 |
| Normal writedowns on film rights | 0 | 5,481 |
| Miscellaneous | 34 | 3,095 |
| Total | 7,098 | 17,285 |

**4. Depreciation & amortization**

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

Amortization and depreciation on intangible assets and fixed assets amount to 9,332 (p.y. 507) TEuros and are made up as follows:

| VII. 4.1 DEPRECIATION AND AMORTIZATION ON INTANGIBLE ASSETS AND FIXED ASSETS in TEuros | 2003 | 2002 |
|---|---|---|
| Normal depreciation and amortization | 392 | 507 |
| Non-scheduled depreciation on fixed assets | 1,574 | 0 |
| Non-scheduled amortization on intangible assets | 7,366 | 0 |
| Total | 9,332 | 507 |

Non-scheduled depreciation is exclusively due to the reorganization of the Intertainment Group – and in particular restructuring of the American business activities. The fixed assets and in particular the tenant fixtures and fittings of USA Intertainment, Inc. also had to be written off as a non-scheduled writedown in the amount of 1,574 TEuros. Film projects paid on account also had to be written down as a non-scheduled writedown in the amount of 7,366 (p.y. 0) TEuros. There is no longer any value attached to these assets as a result of the measures instituted.

**4.2 Depreciation of current assets, insofar as this exceeds other depreciation normal in the company**
As a result of the restructuring measures, the reported receivables from Blackout Productions Inc. amounting to 7,261 TEuros (p.y. 0) were written off as a result of the restructuring measures. This amount is comprised of the receivables from Blackout Productions Inc. amounting to 7,065 (p.y. 0) reported in the prior year and the payments on account in the amount of 196 TEuros made during the business year 2003.

**5. Other operating expenses**
The other operating expenses also amount to 12,276 (p.y. 17,179) TEuros and comprise:

| VII. 5 OTHER OPERATING EXPENSES | | in TEuros |
|---|---|---|
| | **2003** | **2002** |
| **Legal and consultancy costs** | 1,737 | 2,305 |
| **Administrative costs of producers** | 2,887 | 1,190 |
| **Currency losses** | 2,682 | 5,178 |
| **Costs of reorganization** | 1,300 | 0 |
| **Rents and accommodation costs** | 1,245 | 1,247 |
| **Miscellaneous** | 2,425 | 7,259 |
| **Total** | **12,276** | **17,179** |

**6. Interest result**
The interest result amounting to -458 (p.y. -822) TEuros is made up of interest income in the sum of 2,494 (p.y. 1,341) TEuros and interest expenses in the sum of 2,952 (p.y. 2,163) TEuros. These amounts include the discount effects of long-term receivables and liabilities.

**7. 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 was confirmed with the decision by the jury on June 16, 2004.

**7.1 7.1 Extraordinary income**
Extraordinary income amounts to 48,176 (p.y. 0) TEuros. This item includes writing off the liability to a bank on account of the debt waiver described under item VI.8 in the sum of 13,583 (p.y. 0) TEuros and the writeup of the payments on account (see item VI.2) for the Franchise Pictures case in the sum of 34,593 (p.y. 0) TEuros.

**7.2. Extraordinary expenses**
Extraordinary expenses amount to 28,801 (p.y. 3,282) TEuros and comprise in particular the participation of third parties in the litigation revenues from the Franchise Pictures case in the sum of 19,800 (p.y. 0) TEuros, allowances for disputes in contract processing in the sum of 3,523 TEuros and the transfer to provision for litigation risks in the sum of 5,077 (p.y. 2,623) TEuros.





**8. Taxes**
Overall tax expenses amounting to 4,727 (p.y. tax income 863) TEuros were recorded. They are made up as follows:

| VII. 8 TAX EXPENSES | | in TEuros |
|---|---|---|
| | **2003** | **2002** |
| **Current taxes on income and earnings** | +45 | +513 |
| **Deferred tax income** | -4,772 | +350 |
| **Total** | **-4,727** | **+863** |

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 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 150,687 TEuros and municipal tax loss carry-forwards of 161,575 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 43,233 TEuros were consolidated as a deferred tax asset in the current year. 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.
Furthermore, in the past a deferred tax asset was recorded on losses amounting to 13,158 TEuros. 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 liabi-

lities reported are attributable to differences in recognition and valuation in the individual balance sheet items:

| VII. 8 DEFERRED TAXES | | | | in TEuros |
|---|---|---|---|---|
| | 31/12/2003 | | 31/12/2002 | |
| | assets | liabilities | assets | liabilities |
| **Loss carry-forwards** | 14,857 | 0 | 5,000 | 0 |
| **Debt consolidation** | 0 | 16,429 | 0 | 0 |
| **Intangible assets** | 120 | 0 | 132 | 0 |
| **Payments on account** | 0 | 0 | 0 | 1,522 |
| **Trade receivables** | 0 | 0 | 0 | 150 |
| **Trade liabilities** | 0 | 5 | 0 | 132 |
| **Total** | **14,977** | **16,434** | **5,132** | **1,804** |

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

| VII. 8 DEFERRED TAX ASSETS ON LOSS CARRY-FORWARDS | | in TEuros |
|---|---|---|
| | 31/12/2003 | 31/12/2002 |
| **Corporate income tax** | 8,991 | 3,026 |
| **Municipal trade tax** | 5,866 | 1,974 |
| **Total** | **14,857** | **5,000** |

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

| VII. 8 EARNINGS TAX EXPENSE: RECONCILIATION | | in TEuros |
|---|---|---|
| | 31/12/2003 | 31/12/2002 |
| **Result before taxes on earnings** | -9,338 | -16,986 |
| **Group tax rate** | 38 % | 38 % |
| **Expected income tax expense** | -3,548 | -6,455 |
| **Tax effects as a consequence of:** | | |
| Differences in tax rates | -16 | 7 |
| Non-capitalized loss carry-forw. | 11,959 | 5,831 |
| Utilization of loss carry-forwards | - 3,960 | 0 |
| Taxes for prior years on account of tax audit | 2 | -575 |
| Loss carryback | 78 | 0 |
| Other additions and deductions | 212 | 329 |
| **Taxes on income and earnings** | **4,727** | **-863** |

The other additions and deductions result from deductible taxes and other non-deductible expenses (4 TEuros).

## 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**

The business activities of Intertainment can be divided into two segments:

• Film production and trading in feature film rights

• Trading in rights to cartoon films, their exploitation and the merchandising associated therewith.

The situation in the individual business fields is as follows:

| VIII. 2 SEGMENT REPORTING | | | | | | | | in TEuros |
|---|---|---|---|---|---|---|---|---|
| Position | Film production and trading in rights to feature films | | Trading in rights to cartoon films and merchandising | | Consolidation | | Total | |
| | 2003 | 2002 | 2003 | 2002 | 2003 | 2002 | 2003 | 2002 |
| **External sales revenues** | 4,322 | 14,527 | 1,706 | 4,448 | 0 | 0 | 6,028 | 18,975 |
| **Write-downs** | -16,472 | -414 | -154 | -204 | 33 | 111 | -16,593 | -507 |
| **Non-cash expenses** | -53,380 | -14,333 | 0 | 0 | 0 | 0 | -53,380 | -14,333 |
| **Net interest** | -447 | -675 | -11 | -147 | 0 | 0 | -458 | -822 |
| **Extraordinary result** | 19,375 | -3,282 | 0 | 0 | 0 | 0 | 19,375 | -3,282 |
| **Annual result** | -13,942 | -16,367 | -143 | 243 | 20 | 0 | -14,065 | -16,124 |
| **Assets** | 111,434 | 124,483 | 2,145 | 2,937 | -1,385 | 0 | 112,194 | 127,420 |
| **Tangible assets** | 179 | 2,186 | 15 | 20 | 0 | 0 | 194 | 2,206 |
| **Receivables** | 71,129 | 46,201 | 120 | 1,245 | -1,190 | 0 | 70,059 | 46,617 |
| **Liabilities** | 2,080 | 44,370 | 1,935 | 2,126 | -1,190 | -1,890 | 2,825 | 44,606 |

The acquisition costs of intangible and tangible assets are 2,848 (p.y. 11,498) TEuros in the segment of film production and trade in rights to feature films are 30 (p.y. 2,042).
The figures are not broken down by region in segment reporting. On account of the relatively low sales of the Group, there is a danger that publication of these figures would lead to considerable competitive disadvantages in negotiating contracts with customers.

**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 2003, the Group recorded a deficit of 14,065 TEuros, following a deficit of 16,124 TEuros in the prior year. Hence the earnings per share improved in 2003 to -1,20 euros, after -1.37 euros in the year 2002. The diluted earnings per share amount to -1.20 (p.y. -1.37) euros.

**4. Employee share program**

The share option programs of 1991 and 2001 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 Supervisory 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 (Xetra Intraday Auction) on the first five stockmarket days after the ordinary shareholders' meeting has increased by at least 30 % in comparison with the average spot rate or the 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 the 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 SHARE OPTIONS | numbers of shares | |
|---|---|---|
| | **2003** | **2002** |
| **Options issues at January 1** | 338,000 | 338,000 |
| **New options allocated to employees** | 120,000 | 0 |
| **Issued options at December 31** | 458,000 | 338,000 |
| **Options still available** | 452,000 | 322,000 |

No expense has been recorded for the share options issued, since under IAS 19 there is no explicit obligation relating to this for this balance sheet date. The "fair value" at the balance sheet date has not been calculated.

**5. Other financial commitments**

At December 31, 2003, the following future payment obligations were recorded:

| VIII. 5 OTHER FINANCIAL COMMITMENTS | | | in TEuros |
|---|---|---|---|
| | **Remaining term less than 1 year** | **Remaining term more than 1 year** | **Total** |
| **Obligations arising from film productions** | 29,680 (p.y. 32,699) | 3,180 (p.y. 7,659) | 32,860 (p.y. 40,358) |
| **Obligations arising from lease and rental contracts** | 1,137 (p.y. 1,640) | 1,655 (p.y. 3,245) | 2,792 (p.y. 4,885) |
| **Total** | **30,817 (p.y. 34,339)** | **4,835 (p.y. 10,904)** | **35,652 (p.y. 45,243)** |

### 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.

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. We refer to item 14.8 and 14.9 of the notes to the consolidated financial statements and to item B.2.1 of the management report for further information.

### 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.

### PAYMENT OBLIGATIONS ARISING FROM THE ARBITRATION PROCEEDING FOR THE FILM "TRACKER"

In mid-June 2003, International Motion Pictures Ltd. commenced arbitration proceedings for the film "Tracker". The company demanded payment of 3.3 million US dollars plus interest for the film "Tracker". We refer to item B.1.6 of the management report for further information.

### OBLIGATIONS ARISING FROM THE ARBITRATION PROCEEDING AGAINST COMERICA BANK AND THE BOND COMPANIES

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 and the bond companies. 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.1.5 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 67,700 TEuros reported under other assets, other contractual obligations for litigation revenue participations arise on the basis of contractual agreements for which no provisions were formed during the year under review.



## 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, insofar as these exceed the amount reported.

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. There is also a letter of credit from Intertainment AG amounting to 333 (p.y. 666) TUS dollars for the rental obligations arising from the offices leased by USA-Intertainment, Inc. in Los Angeles.

## 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 2003 and 2002.

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

The presentation of the cash flow statement has been changed compared with the prior year. 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. The values for the prior year were adjusted. During the year under review, income tax amounting the 123 TEuros (p.y. 70) TEuros was paid. Intertainment booked tax rebates amounting to 0 (p.y. 7,319) TEuros, paid interest in the sum of 498 (p.y. 1,231) TEuros, and received interest in the sum of 48 (p.y 251) TEuros. In the year under review 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)
- Stephen Joel Brown, Los Angeles (Deputy Chairman); until August 13, 2003
- Hans-Joachim Gerlach, businessman, Berlin (Chief Financial Officer)

Ernst Rüdiger Baeres has sole power of attorney. Stephen Joel Brown (until August 13, 2003) and Hans-Joachim Gerlach each has power of attorney jointly with a further board member. Stephen Joel Brown stepped down from the Board of Management of Intertainment AG with effect from August 13, 2003.

The fixed remuneration package of the Board of Management amounted to 1,274 (p.y. 2,129) TEuros in the calendar year 2003. In addition, the Board of Management of Intertainment AG receives a contractually defined bonus amounting to 2,880 (p.y. 0) TEuros. This is dependent on the cash-inflows of funds arising from the successful legal dispute against Franchise Pictures and other parties and during the year under review is, amongst other things, based on the damages claims reported under other assets. During the year under review, this bonus is reported under the provisions for litigation revenue participations and is recognized in ordinary expenses.

SUPERVISORY BOARD

- Dr. Matthias Heisse, lawyer, Munich (Chairman)
- Dr. Ernst Pechtl, businessman, Berg (Deputy Chairman); until September 21, 2003
- Dr. Wilhelm Bahner, businessman, Munich; (member, from September 21, 2003 Deputy Chairman)
- Wolfgang Blauberger, businessman, Munich; from September 21, 2003

During the year under review, Dr. Matthias Heisse was also a member of the Supervisory Board of Firestorm AG, Munich. Dr. Ernst Pechtl was also a member of the Supervisory Board of Wegold Edelmetalle AG, Wendelstein, PointS International AG, Darmstadt, and InfoMiner AG, Weilheim. Dr. Wilhelm Bahner and Wolfgang Blauberger did not hold any further Supervisory Board offices during the business year 2003.
For the business year 2003, Supervisory Board compensation in the amount of 23 (p.y. 23) TEuros was paid.

**10. Related companies and persons**

According to IAS 24, INTERTAINMENT 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 INTERTAINMENT 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 year under review, Intertainment AG and INTERTAINMENT Licensing GmbH assumed expenses of USA-Intertainment, Inc. in the amount of 2,110 (p.y. 2,714) TEuros. Of this amount, Intertainment AG paid 1,308 (p.y. 1,683) TEuros and INTERTAINMENT Licensing GmbH 802 (p.y. 1,031) TEuros. In addition, Intertainment AG declared a debt waiver in respect of USA-Intertainment, Inc. amounting to 1,535 (p.y. 0) TEuros and with respect to Intertainment Animation & Merchandising GmbH amounting to 279 (p.y. 0) TEuros. Furthermore, the following amounts were offset for services between the individual Group companies:

**VIII. 10 OFFSETS** in TEuros

| | 2003 | 2002 |
|---|---|---|
| **Intertainment AG** | -45 | 101 |
| **INTERTAINMENT Licensing GmbH** | 192 | 48 |
| **Intertainment Animation & Merchandising GmbH** | -147 | -149 |

The liquidity of Group companies is ensured through intercompany accounts of Intertainment AG as is usual in the market. At December 31, 2003 Intertainment AG posted the following receivable from subsidiaries:

**VIII. 10 RECEIVABLES FROM SUBSIDIARIES** in TEuros

| | 2003 | 2002 |
|---|---|---|
| **INTERTAINMENT Licensing GmbH (after adjustment)** | 64,500 | 105,884 |
| **Intertainment Animation & Merchandising GmbH (after adjustment)** | 647 | 1,746 |
| **USA-Intertainment, Inc.** | 0 | 1,749 |
| **Total** | 65,147 | 109,379 |

On the balance sheet date, Intertainment AG carried out an adjustment on the intercompany account for INTERTAINMENT Licensing GmbH amounting to 42,913 (p.y. 0) TEuros and for Intertainment Animation & Merchandising GmbH amounting to 320 (p.y. 0) TEuros. This was undertaken on account of the changed liquidity planning of INTERTAINMENT Licensing GmbH and Intertainment Animation & Merchandising GmbH.
Ernst Rüdiger Baeres should be regarded as a naturally related person. On the balance sheet date, he held 52.9 % of the voting rights in Intertainment AG. Other related

family members of Mr. Baeres hold more than 9.3 % of the voting rights. An apartment in Los Angeles was placed at the disposal of Mr. Baeres during the year under review, which Intertainment AG leased from Alkmäon Vermögensverwaltungsgesellschaft mbH, whose shares are held by Mr. Baeres. The rent amounts to 171 (p.y. 145) TEuros. Rental payments amounting to 29 (p.y 0) 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 year under review, fees of 534 (p.y. 311) 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 a separate consultancy contract (pursuant to §114 AktG) fees amounting to 16 (p.y. 64) TEuros were also paid to Pechtl Gmbh, in which Dr. Pechtl is managing shareholder, and fees of 107 (p.y. 151) TEuros were paid to the auditing firm Wolfgang Blauberger, in which Wolfgang Blauberger is managing partner.

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

On December 31, 2003, 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 | 6,205,635 | 0 |
| Hans-Joachim Gerlach | 10,000 | 25,000 |
| Stephen Brown (until Aug. 13, 2003) | 0 | 50,000 |
| SUPERVISORY BOARD | | |
| Dr. Matthias Heisse | 12,980 | 0 |
| Dr. Ernst Pechtl (until Sep. 21, 2003) | 0 | 0 |
| Dr. Wilhelm Bahner | 0 | 0 |
| Wolfgang Blauberger (from Sep. 21, 2003) | 670 | 0 |

At December 31, 2003 the company did not hold any own shares.

**12. Employees**

On average during the business year 2003, the Group employed 23 (p.y. 23) staff.

**13. Company headquarters**

Intertainment AG is located at Osterfeldstraße 84, 85737 Ismaning.

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

After December 31, 2003, 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, 2003, did not occur after the balance sheet date.

**14.1 The legal dispute with Franchise Pictures**

Three and a half years after the lawsuit was filed against Franchise Pictures and others, the case was decided in favor of Intertainment before the Federal District Court in Santa Ana near Los Angeles in mid-June 2004. A jury unanimously held the defendants to be guilty of the fraud and granted Intertainment damages totaling 106.1 million dollars. The jury also unanimously rejected all the countersuits submitted by the opposing side against Intertainment.

On August 18, 2004 the presiding judge also handed down a decision on the remaining outstanding claims when she executed the final judgment. In this connection, she also approved the claims for 15.6 million US dollars in interest on the damages granted by the jury. This raised the total claim of Intertainment to 121.7 million US dollars. The judge also made it clear in her rulings that all the parties found guilty were jointly liable for the 77.1 million US dollars, including interest of 15.6 million US dollars, awarded by the jury. We refer to item B.1 ff of the management report for further information.

**14.2 Insolvency of Franchise Pictures**

Shortly after publication of the final judgment, Franchise Pictures and the majority of the Franchise subsidiaries involved filed for insolvency under “Chapter 11” of the US Insolvency Law. Intertainment registered its claims against these companies within the framework of the insolvency proceedings. We refer to item VI.3 of the notes to the consolidated financial statements for the value of the claims for damages.

**14.3 Lawsuit and arbitration proceeding against Comerica Bank and the bond companies**

We refer to item B.1.4 ff of the management report.

**14.4 Arbitration proceeding on damages for the film "Tracker"**

We refer to item B.1.6 of the management report.

**14.5 Arbitration proceeding for the film "Viva Las Nowhere"**

We refer to item B.1.7 of the management report for further information.

**14.6 Option of alternative settlement to the dispute**

It is possible that alternative solutions could be found for settling the pending disputes in the Franchise case. The parties involved have reached a basic agreement that an attempt should be made to reach a solution in this way. The parties agreed that mediation should take place in the near future with this approach in mind. It is not possible to provide any information on the chances of success for this procedure from the current perspective.

**14.7 Settlement between SightSound Technologies Inc. and CDNow & N2K**

On February 23, 2004, a settlement was reached between SightSound Technologies Inc. and Bertelsmann subsidiary CD-Now and N2K. In this settlement, CDNow and N2K confirm that the patents of SightSound for digital download of audio and video files are valid and enforceable. CDNow and N2K also made a payment to SightSound Technologies Inc. amounting to 3.3 million US dollars without recognizing any infringements of law or obligations arising from previous activities in the area of music downloads. SightSound Technologies Inc. is now able to focus on marketing its patents in the music and film industry. We refer to item B.3 of the management report.

**14.8 Contract with Paramount Pictures for the Film "Twisted"**

With a view to reducing financial commitments and minimizing the risks associated with exploitation, Intertainment concluded a contract with Paramount Pictures for the film "Twisted". This contract regulates distribution to the territories and the exploitation risks between Intertainment and Paramount. In this connection, Intertainment acquires fewer territories than originally projected. Intertainment also assigned the claims on the sublicensees arising from the sales of the film "Twisted" to Paramount. We refer to item B.2.1 of the management report for further information. Securities amounting to maximally 7 million US dollars were granted to Paramount in order to hedge possible future obligations.

**14.9 Termination of the business relationship with Kopelson Entertainment**

In February 2004, cooperation between the film production company Kopelson Entertainment based in Los Angeles and Intertainment AG and INTERTAINMENT Licensing GmbH was also terminated by mutual agreement. We refer to item B.2.1 of the management report for further in-formation.

**14.10 Disposal of the license "Rudolph the red-nosed reindeer" and another project**

In January 2004, Intertainment Animation & Merchandising GmbH sold the business with "Rudolph the red-nosed reindeer" and another project. We refer to item B.2.2 of the management report for further information.

**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).

Ismaning, September 16, 2004
Intertainment AG

**Rüdiger Baeres**
Chairman of the Board of Management

**Hans Joachim Gerlach**
Chief Financial Officer

# Intertainment Group: Schedule of Fixed Assets

Gross

| in TEuros | ACQUSITION COSTS | | | | | ACCUMULATED AMORTIZATION | | | | CARRYING VALUE | |
|---|---|---|---|---|---|---|---|---|---|---|---|
| | 1/1/2003 | Additions | Disposals | Currency | 31/12/2003 | 1/1/2003 | Amortization and depreciation in the business year | Disposals | 31/12/2003 | 31/12/2003 | 31/12/2002 |
| **I. Intangible assets** | | | | | | | | | | | |
| **1.** Licenses, commercial property rights and similar rights as well as licenses in such rights | 973 | 0 | -842 | 0 | 131 | 342 | 121 | -335 | 128 | 3 | 631 |
| **2.** Payments made on account | 9,513 | 0 | -7,366 | 0 | 2,147 | 0 | 7,366 | -7,366 | 0 | 2,147 | 9,513 |
| | 10,486 | 0 | -8,208 | 0 | 2,278 | 342 | 7,487 | -7,701 | 128 | 2,150 | 10,144 |
| **II. Tangible assets** | | | | | | | | | | | |
| Other plant, business and office equipment | 3,054 | 0 | -2,287 | -167 | 600 | 848 | 1,845 | -2,287 | 406 | 194 | 2,206 |
| **III. Financial assets** | | | | | | | | | | | |
| Participations | 20,048 | 0 | 0 | 0 | 20,048 | 5,012 | 0 | 0 | 5,012 | 15,036 | 15,036 |
| | **33,588** | **0** | **-10,495** | **-167** | **22,926** | **6,202** | **9,332** | **-9,988** | **5,546** | **17,380** | **27,386** |

# 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, rural district of Munich, for the business year from January 1 to December 31, 2003. The preparation and the content of the consolidated financial statements are the responsibility of the company's Board of Management. Our responsibility is to express an opinion on whether the consolidated financial statements are in accordance with the International Financial Reporting Standards (IFRS), 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 let to any reservations:

• We draw attention to the comments made in the notes to the consolidated financial statements in section "VI.7.2 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 that has been called in was rescheduled. The liability has therefore been written off and provisions have been 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 with an undertaking to repay, 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.

• 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 and the other convicted parties as well as against Comerica Bank can be enforced in the amount reported in the financial statements. It was not possible to obtain reasonable certainty concerning the existence of a relationship of liability through Comerica Bank, even by means of alternative auditing procedures. A decision on the existence of joint and several liability will be reached in the arbitration proceedings scheduled for February 2005.

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 of the Intertainment AG Group as of December 31, 2003 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, 2003, 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, 2003 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 comments made in the notes to the consolidated financial statements in section "VI.1. Fixed assets". It is stated that the management's valuation of the participation in SightSound remains unchanged compared with the previous year at EUR 15.00 million despite the dilution of the participation ratio during the business year. The value of this item is substantially dependent on the successful marketing of the patents by SightSound.

We further refer to the statements 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". 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 with Franchise Pictures, Comerica Bank and others referred to above
– Cash-inflow of funds from the disposal of financial assets
– Positive outcome of current arbitration proceedings relating to payment of the second installment for the disputed films rights
– Fulfillment of the other assumptions of the financial plan including the incoming payments planned for the near future, in particular the transfer of equity capital or outside capital envisaged in the financial plan amounting to a total of EUR 4.0 million in September and October 2004.

Munich, September 16, 2004

KPMG Deutsche Treuhand-Gesellschaft
Aktiengesellschaft
Wirtschaftsprüfungsgesellschaft

**Dr. Bartels-Hetzler**
Wirtschaftsprüfer

**Dr. Kreher**
Wirtschaftsprüfer

# Intertainment AG: Consolidated Balance Sheet

as at December 31, 2003 in Accordance with the IFRS

| ASSETS | Tz. | 31/12/2003 | 31/12/2002 |
|---|---|---|---|
| | | | in TEuros |
| **A. FIXED ASSETS** | | | |
| **I. Intangible assets** | | | |
| **1.** Licenses, commercial property rights and similar rights as well as licences to such rights | III.1 | 1 | 1 |
| **2.** Payments made on account | III.1 | 2,147 | 5,509 |
| **II. Property, plant & equipment** | | | |
| Other plant, business and office equipment | III.1 | 7 | 11 |
| **II. Financial assets** | | | |
| **1.** Shares in affiliated enterprises | III.1 | 9,359 | 9,359 |
| **2.** Participations | III.1 | 15,036 | 15,036 |
| | | **26,550** | **29,916** |
| **B. CURRENT ASSETS** | | | |
| **I. Inventories** | | | |
| **1.** Film rights | III.2 | 6,308 | 7,419 |
| **2.** Merchandise | III.2 | 17 | 58 |
| **3.** Payments made on account | III.2 | 0 | 8,537 |
| | | **6,325** | **16,014** |
| **II. Receivables and other assets** | | | |
| **1.** Trade receivables | III.3 | 631 | 9,511 |
| **2.** Receivables from affiliated enterprises | III.3 | 65,147 | 109,379 |
| **3.** Other assets | III.3 | 1,258 | 9,318 |
| **III. Cash on hand, bank balances** | | 1,387 | 3,520 |
| | | **74,748** | **147,742** |
| **C. DEFERRED TAXES** | | 99 | 24 |
| | | **101,397** | **177,682** |

| EQUITY & LIABILITIES | Tz. | 31/12/2003 | 31/12/2002 |
|---|---|---|---|
| | | | in TEuros |
| **A. EQUITY** | | | |
| **I. Subscribed capital** | III.5.1 | 15,005 | 15,005 |
| **II. Capital reserve** | III.5.2 | 82,385 | 161,821 |
| **III. Earnings reserves** | | | |
| Statutory reserve | III.5.3 | 116 | 116 |
| **IV. Group retained earnings** | III.5.4 | 0 | -23,935 |
| | | **97,506** | **153,007** |
| **B. PROVISIONS** | | | |
| **1.** Tax provisions | III.6.1 | 0 | 37 |
| **2.** Other provisions | III.6.2 | 2,322 | 1,171 |
| | | **2,322** | **1,208** |
| **C. PAYMENTS RECEIVED ON ACCOUNT** | III.7 | 1,318 | 419 |
| **D. LIABILITIES** | | | |
| **1.** Trade accounts payables | III.7 | 79 | 20,670 |
| **2.** Other liabilities | III.7 | 172 | 2,378 |
| | | **251** | **23,048** |
| | | **101,397** | **177,682** |

## Intertainment AG: Income Statement

for the period from January 1, 2003 to December 31, 2003
in Accordance with the IFRS

| | | Tz. | 2003 | 2002 |
|---|---|---|---|---|
| | | | | in TEuros |
| 1. | Sales revenues | IV.1 | 4,021 | 9,287 |
| 2. | Other operating income | IV.2 | 2,903 | 10,725 |
| 3. | Cost of materials | IV.3 | -6,017 | -11,973 |
| 4. | Personnel expenses | | | |
| | a) Salaries | | -1,309 | -1,643 |
| | b) Social security contributions | | -70 | -40 |
| | | | **-1,379** | **-1,683** |
| 5. | Depreciation on property, plant & equipment and amortization on intangible fixed assets | IV.4 | -3,367 | -41 |
| 6. | Depreciation of current assets, insofar as this exceeds other depreciation normal in the company | IV.5 | -52,243 | 0 |
| 7. | Other operating expenses | IV.6 | -9,504 | -11,257 |
| 8. | Other interest and similar expenses | IV.7 | 10,143 | 386 |
| 9. | Net interest | IV.7 | -57 | -67 |
| 10. | Result of ordinary business activities | | **-55,500** | **-4,623** |
| 11. | Taxes on income and earnings | | 0 | 0 |
| 12. | Other taxes | | 1 | 853 |
| 13. | Net loss | | **-55,501** | **-3,770** |
| 14. | Loss carry-forward from prior year | | -23,935 | -20,165 |
| 15. | Withdrawal from capital reserves | | 79,436 | |
| 16. | GROUP RETAINED EARNINGS | | **0** | **-23,935** |





# 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 Section 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 year under review, 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.

In cases in which Intertainment does not count as the manufacturer pursuant to the media directive for manufacturer attributes, payments for film productions are shown under intangible fixed assets as **PAYMENTS ON ACCOUNT OR FILM RIGHTS**. Furthermore, payments for the acquisition of licenses for film rights which have not yet been delivered and the technical quality accepted are reported under this item. It is a prerequisite for this presentation that the film rights arising or acquired are available for an indefinite period of time. 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 project.

**PROPERTY, PLANT AND EQUIPMENT** is 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 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. If the reason for an adjustment in prior business years no longer applies, a writeup to maximally the original acquisition cost is undertaken.

### 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 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 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 scheduled amortization of film rights is based on economic life or causation of the film rights. In addition, nonscheduled writedowns are made by 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 **PAYMENTS MADE ON ACCOUNT FOR FILM RIGHTS** comprise payments made to film distributors prior to technical acceptance of the film material.

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.

The **INTANGIBLE FIXED ASSETS** include, in particular, payments for the acquisition of a film right amounting to 2,147 (p.y. 0) TEuros. The payments on account for current film productions amounting to 5,509 TEuros reported in the prior year were reclassified to payments on account for film rights amounting to 2,147 TEuros and the residual amount of 3,362 (p.y. 0) TEuros was written off as a non-scheduled writedown. This writedown is solely attributable to termination of the cooperation agreement with Kopelson Entertainment carried out in conjunction with the reorganization of American business activities.

**PROPERTY, PLANT AND EQUIPMENT** consists exclusively of office and business equipment.

The **FINANCIAL ASSETS** include the following shares in affiliated enterprises and participations:

**III. 1 FINANCIAL ASSETS** — in TEuros

| Participation | Share (in %) | Subscribed capital 2003 (p.y.) | Equity 2003 (p.y.) | Annual result 2003 (p.y.) |
|---|---|---|---|---|
| **INTERTAINMENT Licensing GmbH, Ismaning** | 100 | 946<br>(946) | -69,794<br>(-80,218) | 10,424<br>(-10,824) |
| **Intertainment Animation & Merchandising GmbH, Ismaning** | 100 | 358<br>(358) | 0<br>(203) | -203<br>(-6) |
| **USA-Intertainment, Inc., Los Angeles, USA** | 100 | 105<br>(105) | 10<br>(290) | -254<br>(82) |
| **SightSound Technologies Inc. (*), Pitsburg, USA** | 12.4 | 56<br>(49) | -1,511<br>(-4,416) | -1,925<br>(-3,673) |

(*) The equity shown here and the annual deficit of SightSound Technologies Inc. relate to the financial statements of the company for the year ended April 30, 2003. This includes 7 months of the business year. It was prepared according to the regulations of the Generally Accepted Accounting Principles (US-GAAP). September 30, 2002 in the prior year is presented as an equivalent year-earlier point in time or period.

During the year under review, the participation ratio in SightSound Technologies Inc. has therefore declined by 10.4 percentage points to 12.4 %. The cause of this decline is attributable to a dilution effect caused by capital increases at SightSound Technologies Inc.
In the opinion of Intertainment, the positive development in the patent-infringement dispute between SightSound Technologies Inc. and CDNow and N2K and the out-of-court agreement reached by the parties in February 2004 (see item B.3 of the management report) confirms the value of the patent rights of SightSound and substantially reduces the corporate risks. The management of Intertainment values SightSound at an unchanged residual book value compared with the prior year amounting to 15,036 TEuros on the basis of the substantially increased income value of the participation despite the dilution carried out.

**2. Inventories**

The film rights and licenses are valued at 6,308 (p.y. 7,419) TEuros. They developed as follows:

**III. 2 FILM RIGHTS AND LICENSES** in TEuros

| Position | 2003 | 2002 |
|---|---|---|
| Balance at January 1 | 7,419 | 18,362 |
| Writeups | 548 | 1,854 |
| Additions | 2,980 | 0 |
| Normal depreciation | 0 | -3,673 |
| Non-scheduled depreciation | -4,639 | -587 |
| Disposals / impairments | 0 | -8,537 |
| **Balance at December 31** | **6,308** | **7,419** |

The writeups relate to various film rights which had been the subject of non-scheduled amortization in prior years. The present valuation of these film rights led at the balance sheet date to improved net sales values in comparison with the prior year.
The additions to film assets result from the transfer of film rights of INTERTAINMENT Licensing GmbH.
The normal amortization occurred on account of exploitation and license sales of film rights in the prior year.
The non-scheduled writedowns on film rights were incurred under the loss-free valuation for film rights. At the balance sheet date, the expected sales revenues were below the capitalized costs of the film rights concerned.
The MERCHANDISE comprises merchandising articles or video and DVD stocks. Their value amounts to 17 (p.y. 58) TEuros.
The PAYMENTS ON ACCOUNT for film rights amount to 0 (p.y. 8,537) TEuros. The payments on account reported under this item during the prior year associated with the legal dispute in the Franchise Pictures case were reclassified under receivables from INTERTAINMENT Licensing GmbH. This reclassification was necessary since the judgment against Franchise Pictures means that there is now no longer any legal basis for the payments on account. The issue now relates exclusively to claims for damages which are asserted by INTERTAINMENT Licensing GmbH against Franchise Pictures and other parties.

**3. Receivables and other assets**

The TRADE RECEIVABLES amount to 631 (p.y. 9,511) TEuros. The reduction compared to the prior year essentially results from offsetting and payment of outstanding items. The receivables relate exclusively to a residual term of less than one year. In the prior year, there were receivables with a residual term of more than one year amounting to 905 TEuros.
RECEIVABLES FROM AFFILIATED ENTERPRISES amount to 65,147 (p.y. 109,379) TEuros and comprise:

**III. 3 RECEIVABLES FROM SUBSIDIARIES** in TEuros

| | 2003 | 2002 |
|---|---|---|
| INTERTAINMENT Licensing GmbH | 64,500 | 105,884 |
| Intertainment Animation & Merchandising GmbH | 647 | 1,746 |
| USA-Intertainment, Inc. | 0 | 1,749 |
| **Total** | **65,147** | **109,379** |

These are exclusively intercompany accounts that have a residual term of less than one year as in the prior year.

During the year under review, Intertainment AG waived receivables from USA-Intertainment, Inc. amounting to 1,535 (p.y. 0) TEuros and from Intertainment Animation & Merchandising GmbH totaling 279 (p.y. 0) TEuros.
Furthermore, adjustments were carried out on receivables from INTERTAINMENT Licensing GmbH amounting to 42,913 (p.y. 0) TEuros and Intertainment Animation & Merchandising GmbH amounting to 320 (p.y. 0) TEuros. In addition, the issue of a subordination letter by Intertainment AG on the receivables from the intercompany account to INTERTAINMENT Licensing GmbH amounting to 85,000 TEuros continued unchanged over the prior year.
The OTHER ASSETS are comprised as follows:

**III. 3 OTHER ASSETS** in TEuros

| | 2003 | 2002 |
|---|---|---|
| Deposited securities | 1,096 | 0 |
| Input tax not yet due | 0 | 1,337 |
| Tax rebates | 72 | 70 |
| Receivables from Blackout Productions Inc. and Paramount Pictures | 0 | 7,571 |
| Loan to SightSound Technologies | 0 | 309 |
| Miscellaneous | 90 | 31 |
| **Total** | **1,258** | **9,318** |

The DEPOSITED SECURITIES relate to the money paid to the American court which are directly connected with the arbitration proceedings concerning “Tracker” described under item B.1.6 of the management report. We also refer to the provision for reorganization under item III.

The **RECEIVABLES** from Blackout Productions Inc. and Paramount Pictures were written off in the sum of 7,065 TEuros and offset in the sum of 506 TEuros against existing obligations.

The **LOAN** to SightSound Technologies was repaid in full to Intertainment AG during the business year 2003.

As in the prior year, all items relate to a residual term of less than one year.

### 4. Bank balances

Liquid funds totaling 1,387 (p.y. 3,520) TEuros are made up of fixed term deposits amounting to 264 (p.y. 900) TEuros and current accounts and cash in hand amounting to 1,123 (p.y. 2,620) TEuros. The fixed term deposits have short remaining terms and fall due in the business year 2004. Because of a surety and a letter of credit, which are connected with the rent obligations for office premises, 340 (p.y. 717) TEuros of the liquidity is not freely available.

### 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 /1I)*.

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 shareholders' meetings

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 capital IV)* according to the resolution adopted by the shareholders' meeting on September 22, 2003 for the share option program 2003.

#### 5.2 Capital reserve

At the balance sheet date, the capital reserve was 82,385 (p.y. 161,821) TEuros. The change of 79,436 TEuros compared with the previous year resulted from utilization to balance the loss carry-forward (§150 (4) No. 2 AktG) amounting to 23,935 TEuros and annual deficit (§150 (4) No. 1 AktG) with 55,501 TEuros.

#### 5.3 Revenue reserve

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

#### 5.4 Accumulated loss

At December 31, 2003, Intertainment AG did not show an accumulated loss (p.y. 23,935 TEuros) as a result of withdrawal from the capital reserve. The annual deficit amounts to 55,501 (p.y. 3.770) TEuros during the year under review.

In summary, the equity developed in the year under review as follows:

**III. 5.4 SCHEDULE OF EQUITY CAPITAL** in TEuros

| | Balance at 1/1/2003 | Annual deficit 2003 | Release of capital reserve | Balance at 31/12/2003 |
|---|---|---|---|---|
| **Subscribed capital** | 15,005 | 0 | 0 | 15,005 |
| **Capital reserve** | 161,821 | 0 | -79,436 | 82,385 |
| **Revenue reserve** | 116 | 0 | 0 | 116 |
| **Accumulated loss** | -23,935 | -55,501 | +79,436 | 0 |
| **Equity** | **153,007** | **-55,501** | **0** | **97,506** |

### 6. Provisions

**6.1 Tax provisions**
The TAX PROVISION amounting to 37 TEuros was used in full during the year under review to settle taxes due to be paid resulting from a tax audit.

**6.2 Other provisions**
The other provisions developed as follows:

| III. 6.2 OTHER PROVISIONS | | | | | | in TEuros |
|---|---|---|---|---|---|---|
| Type of provision | Balance at 1/1/2003 | Transfer | Utilization | Release | Allocation | Balance at 31/12/2003 |
| Reorganization | 0 | 0 | 0 | 0 | 2,100 | 2,100 |
| Year-end closing costs | 104 | 0 | -104 | 0 | 134 | 134 |
| Personnel costs | 350 | 0 | -350 | 0 | 35 | 35 |
| Outstanding invoices | 717 | 0 | -279 | -438 | 53 | 53 |
| Miscellaneous | 0 | 765 | -264 | -501 | 0 | 0 |
| **Total** | **1,171** | **765** | **-997** | **-939** | **2,322** | **2,322** |

The provision for REORGANIZATION includes obligations to contractual partners for the settlement and termination of existing contracts. This relates in particular to inflows of funds from the funds deposited as security assigned to contractual parties. We also refer to the explanation for other assets under item VI.3 of these notes.
The provision for year-end closing costs relates to the preparation and audit of the annual financial statements for the business year 2003.
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.
The provision for outstanding invoices consists of payment obligations for supplies and services obtained during the reporting year that have not yet been invoiced.
Overall, provisions, as in the prior year, exclusively have a residual term of less than one year.

**7. Liabilities**
The PAYMENTS ON ACCOUNT RECEIVED on film rights amounting to 1,318 (p.y. 419) TEuros comprise payments from licensees for film titles not yet supplied and not yet technically accepted.
The TRADE LIABILITIES amount to 79 (p.y. 20,670) TEuros and result in particular from payment obligations for related services. The reduction compared to the prior year is primarily due to offsetting and payment of outstanding items.
The OTHER LIABILITIES amounting to 172 (p.y. 2,378) TEuros and including liabilities to the tax authorities for wages and church tax amounting to 32 (p.y. 51) TEuros and liabilities for value added tax amounting to 125 (p.y. 232) TEuros and liabilities relating to social security amounting to 8 (p.y. 3) TEuros.
The liabilities have overall a residual term of less than one year. In the prior year, there were long-term trade liabilities with a residual term of more than one year amounting to 18,206 TEuros.

## IV. Explanations to the income statement

**1. Sales revenues**
The sales revenues come to 4,021 (p.y. 9,287) TEuros. They result from the disposal or exploitation of film rights and from commissions.

**2. Other operating income**
Other operating income is comprised as follows:

| IV. 2 OTHER OPERATING INCOME | | in TEuros |
|---|---|---|
| | 2003 | 2002 |
| Release of provisions | 939 | 25 |
| Writeups on film rights | 548 | 1,854 |
| Income from currency differences | 493 | 1,608 |
| Production costs attributable to film projects | 0 | 6,540 |
| Miscellaneous | 923 | 698 |
| **Total** | **2,903** | **10,725** |

**3. Material costs**
The cost of materials amounting to 6,017 (p.y. 11,973) TEuros includes expenses for film rights and associated services amounting to 5,991 (p.y. 11,973) TEuros and expenses for related goods and services amounting to 26 (p.y. 0) TEuros.
The expenses for film rights and associated services are comprised as follows:

| IV. 3 EXPENSES FOR FILM RIGHTS | | in TEuros |
|---|---|---|
| | 2003 | 2002 |
| Non-scheduled amortization on film rights | 4,639 | 587 |
| Marketing costs of film exploitation | 1,334 | 1,671 |
| Producer services | 0 | 5,343 |
| Normal amortization on film rights | 0 | 3,673 |
| Miscellaneous | 18 | 699 |
| **Total** | **5,991** | **11,973** |

**4. Amortization on intangible fixed assets and depreciation on property, plant and equipment**
Depreciation and amortization relates to planned depreciation on property, plant and equipment and amortization on intangible assets amounting 5 (p.y. 41) TEuros. Furthermore, payments on account for a current film production were written off as non-scheduled depreciation in the amount of 3,362 (p.y. 0) 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 52,243 (p.y. 0) TEuros and includes adjustments and waivers for the intercompany accounts to INTERTAINMENT Licensing GmbH, Intertainment Animation & Merchandising GmbH and USA-Intertainment, Inc. amounting to 44,982 (p.y. 0) TEuros. Furthermore, as a result of the restructuring measures, the reported receivables from Blackout Productions Inc. amounting to 7,261 TEuros (p.y. 0) were written off. This amount is comprised of the receivables from Blackout Pictures Inc. reported in the prior year amounting to 7,065 (p.y. 0) TEuros and the payments on account amounting to 196 TEuros made in the business year 2003.



**6. Other operating expenses**
Other operating expenses comprise:

| IV. 6 OTHER OPERATING EXPENSES | | in TEuros |
|---|---|---|
| | 2003 | 2002 |
| Administrative costs of producers | 2,887 | 1,191 |
| Legal and consultancy costs | 1,520 | 779 |
| Expenses for exchange rate losses | 1,328 | 3,601 |
| Services for USA-Intertainment, Inc. | 1,308 | 1,683 |
| Costs of reorganization | 1,300 | 0 |
| Miscellaneous | 1,161 | 4,003 |
| **Total** | **9,504** | **11,257** |

**7. Interest result**
The interest result amounting to 10,086 (p.y. 319) TEuros includes interest income amounting to 10,143 (p.y. 386) TEuros and interest expenses amounting to 57 (p.y. 68) TEuros. Interest income results in particular from the interest on intercompany accounts amounting to 9,016 (p.y. 137) TEuros.
The increase in interest income compared with the prior year results from the fact that Intertainment AG had declared a waiver relating to INTERTAINMENT Licensing GmbH on interest for the business year 2002.

## V. Other information

**1. Other financial commitments**
Other financial commitments comprise:

| V. 1 OTHER FINANCIAL COMMITMENTS | | in TEuros |
|---|---|---|
| | 2003 | 2002 |
| Obligations arising from film productions and producers | 32,860 | 40,358 |
| Leasing obligations | 23 | 0 |
| **Total** | **32,883** | **40,358** |

### 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.
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. We refer to item B.2.1 of the management report for further information.

OBLIGATIONS ARISING FROM LEASING CONTRACTS

Within the framework of an operating lease, Intertainment AG leases motor vehicles. The obligations amount to a total of 23 (p.y. 0) TEuros.

The financial obligations amount to 16 (p.y. 7,659) TEuros and have a residual term of more than one year.

**2. Other contingent obligations**

GUARANTEE TO A BANK

During the financial year 2001, Intertainment AG assumed a guarantee to a bank. This serves 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. 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 is not extinguished and significant outflows of funds will result from take-up of the guarantee. We refer to item F.1. of the management report for further information.

SURETY FOR OFFICE PREMISES

For the tenancy of office premises in Ismaning in 2000, Intertainment AG gave a surety amounting to 76 (p.y. 76) TEuros, which is unchanged. There is also a letter of credit amounting to 333 (p.y. 666) TUS dollars for the rental obligations relating to the tenancy of office premises of USA-Intertainment, Inc. in Los Angeles.

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 INTERTAINMENT LICENSING GMBH

At December 31, 2003, Intertainment AG declared a subordination in the amount of 85,000 (p.y. 85,000) TEuros on receivables from the intercompany account in order to avert the material overindebtedness of INTERTAINMENT Licensing GmbH.

**3. Employees**

On average during the business year 2003, the company employed seven (p.y. six) staff at its headquarters in Ismaning near Munich.

**4. Composition of the executive bodies**

DURING THE BUSINESS YEAR 2003, THE MEMBERS OF THE BOARD OF MANAGEMENT WERE:

- Ernst Rüdiger Baeres, lawyer, Munich (Chairman)
- Stephen Brown, Los Angeles (Deputy Chairman), until August 13, 2003
- Hans-Joachim Gerlach, businessman, Berlin (Chief Financial Officer)

The fixed remuneration package of the Board of Management amounted to 953 (p.y. 2,129) TEuros during the business year 2003. The reduction compared with the previous year is mainly due to severance payments included during the business year 2002.

DURING THE BUSINESS YEAR 2003, THE MEMBERS OF THE SUPERVISORY BOARD WERE:

- Dr. Matthias Heisse, lawyer in Munich (Chairman)
- Dr. Ernst Pechtl, businessman, Berg (Deputy Chairman), until September 21, 2003
- Dr. Wilhelm Bahner, businessman, Munich (member, Deputy Chairman from September 21, 2003)
- Wolfgang Blauberger, businessman, Munich, from September 21, 2003

During the year under review, Dr. Matthias Heisse was also a member of the Supervisory Board of Firestorm AG, Munich. Dr. Ernst Pechtl was also a member of the Supervisory Board of Wegold Edelmetalle AG, Wendelstein, PointS International AG, Darmstadt, and InfoMiner AG, Weilheim during the business year 2003. Dr. Wilhelm Bahner and Wolfgang Blauberger did not hold any further Supervisory Board offices during the business year 2003.

For the business year 2003, 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 website of the company (www.intertainment.de).

Ismaning, September 16, 2004
Intertainment AG

**Ernst Rüdiger Baeres**
Chairman of the Board of Management

**Hans Joachim Gerlach**
Chief Financial Officer

# Intertainment AG: Schedule of Fixed Assets

Gross

| in TEuros | ACQUISITION COSTS | ACCUMULATED AMORTIZATION & DEPRECIATION | | | CARRYING VALUE | |
|---|---|---|---|---|---|---|
| | 1/1/2003/ 31/12/2003 | 1/1/2003 | Amortization and depreciation in the business year | 31/12/2003 | 31/12/2003 | 31/12/2002 |
| **I. Intangible assets** | | | | | | |
| **1.** Licenses, commercial property rights and similar rights as well as licenses in such rights | 117 | 116 | 0 | 116 | 1 | 1 |
| **2.** Payments made on account | 5,509 | 0 | 3,362 | 3,362 | 2,147 | 5,509 |
| | **5,626** | **116** | **3,362** | **3,478** | **2,148** | **5,510** |
| **II. Property, plant and equipment** | | | | | | |
| Other plant, business and office equipment | 20 | 8 | 5 | 13 | 7 | 11 |
| **III. Financial assets** | | | | | | |
| **1.** Shares in affiliated enterprises | 9,359 | 0 | 0 | 0 | 9,359 | 9,359 |
| **2.** Participations | 20,048 | 5,012 | 0 | 5,012 | 15,036 | 15,036 |
| | 29,407 | 5,012 | 0 | 5,012 | 24,395 | 24,395 |
| | **35,053** | **5,136** | **3,367** | **8,503** | **26,550** | **29,916** |

# Audit Opinion: Intertainment AG

We have audited the annual financial statements, together with the bookkeeping system, and the management report of the Company and the Group Intertainment Aktiengesellschaft, Ismaning, rural district of Munich, 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 disclosures 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 "III.3 Receivables and other assets" and in section "III.7 Liabilities". It is stated that trade receivables and liabilities are netted. The corresponding trade receivables were transferred from the subsidiary INTERTAINMENT Licensing GmbH to Intertainment AG. It was not possible to obtain reasonable certainty, even by means of alternative auditing procedures, that the transferred receivables 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 revaluations were undertaken on the intercompany account of INTERTAINMENT Licensing GmbH. It was not possible to obtain reasonable certainty concerning the participation book value of INTERTAINMENT Licensing GmbH, even by means of alternative 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 comments made in the notes to the financial statements in section "III.1 Fixed assets". It is stated that the Board of Management's valuation of the participation in SightSound remains unchanged compared with the previous year at EUR 15.00 million despite the dilution of the participation ratio during the business year. The value of this item is substantially dependent on the successful marketing of the patents by SightSound.

We further refer 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 INTERTAINMENT Licensing GmbH – also at very short notice. For further details, we refer to the comments in section "G. Risks of future development" 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 INTERTAINMENT 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 legal disputes with Franchise Pictures, Comerica Bank and others

– Positive outcome of current arbitration proceedings relating to payment of the second installment of 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.

• Realization of the assumptions which additionally form the basis for the financial plan submitted by Intertainment AG:

– Cash-inflow of funds from the disposal of financial assets

– Fulfillment of the other assumptions of the financial plan of Intertainment AG including the incoming payments planned for the near future, in particular the transfer of equity capital or outside capital envisaged in the financial plan amounting to a total of EUR 4.0 million in September and October 2004.

Munich, September 16, 2004

KPMG Deutsche Treuhand-Gesellschaft
Aktiengesellschaft
Wirtschaftsprüfungsgesellschaft

**Dr. Bartels-Hetzler**
Wirtschaftsprüfer

**Dr. Kreher**
Wirtschaftsprüfer

# Notice

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