

2002

THE ANNUAL REPORT
2002

2002



INTERTAINMENT
Aktiengesellschaft

Key indicators

	2002	2001
Sales (mn euros)	19.0	31.1
EBIT* (mn euros)	-16.2	-100.2
Result from ordinary operations (mn euros)	-13.7	-6.0
Result before Income Tax* (mn euros)	-17.0	-94.9
Net loss (mn euros)	-16.1	-86.8
Earnings per Share (in euros)	-1.37	-7.36
Average number of employees	23	28

*includes extraordinary result

Key data for the share

Securities Identification Number/ISIN	ISIN: DE0006223605	
Share Capital	15,005,155.09 euros	
Number of shares	11,739,013	
Issue Price 08.02.1999	36.00 euros	
	split-adjusted (1:2)	18.00 euros
Closing price* at 30.12.2002	2.23 euros	
Highest Price* (17.12.2002)	4.27 euros	
Lowest Price* (06.05.2002)	1.10 euros	
Shareholder structure at 31.12.2002	Rüdiger Baeres	52.86 %
	Baeres family	9.38 %
	Management, Supervisory board	0.20 %
	Free float	37.56 %

*Closing prices in Xetra electronic trading

Corporate Calender

Publication of 1 st quarterly report	July 11, 2003
Publication of 2 nd quarterly report	August 28, 2003
Annual General Meeting	September 22, 2003
Analysts' Convergence	November 2003
Publication of 3 rd quarterly report	November 28, 2003

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Dear Shareholders,



Stephen Brown, Deputy Chief Executive Officer

Achim Gerlach, Chief Financial Officer

Rüdiger Baeres, Chief Executive Officer

The lawsuit with Franchise Pictures continued to exert a major influence on the performance of Intertainment during fiscal year 2002. Although consolidated earnings improved significantly in line with expectations, Intertainment was again unable to exploit the rights in any new films because of the fraudulent activities of Franchise. This meant that consolidated sales continued to decline, and Intertainment again recorded a loss.

Our efforts during fiscal year 2002 were all the more intensively focused on generating a positive upswing for operating business. We concentrated on the cooperation with successful American producer Arnold

Kopelson. 2002 saw us starting up production of the thriller "Blackout" together with Kopelson and film studio Paramount Pictures. This film has a budget of around 60 million dollars and was filmed in the fall of last year. It is projected to be released in theaters in the U.S. during the fall 2003. This will be the first time we have been in a position to exploit the rights in a major theatrical film internationally following the discovery of fraudulent activities at Franchise.

We are also working together with Kopelson on the development of future film projects. The answer to the question as to how many more new films we will be producing together with Arnold Kopelson during the course of the coming years primarily depends on the outcome of the lawsuit with Franchise Pictures. The fact is that Fran-

chise has fraudulently misappropriated at least 100 million dollars that are due to Intertainment. Naturally, this significantly limits our current financial room to maneuver. The development of Intertainment will therefore be compromised until the lawsuit with Franchise has been brought to a satisfactory conclusion for Intertainment. We believe that we are in a position to present the court with some extremely cogent arguments and convincing evidence. It was therefore particularly regrettable that the start of the trial against Franchise did not commence on November 19, 2002 as originally planned, but was postponed by the court until August 5, 2003. Shortly before the scheduled start of proceedings, the lawyers representing Franchise withdrew from the case.

A positive aspect was that the court accepted two suits for organized criminal activity (RICO) filed by us against Franchise. This would triple the sum for damages if there were a positive outcome to the legal proceedings.

The bottom line for 2002 reflected a turbulent year – undoubtedly not an easy year. It is therefore all the more appropriate for us to thank you for your confidence in our endeavor.

Rüdiger Baeres
Chief Executive Officer
of Intertainment AG

From the idea to exploitation of film rights

Since its stock market debut, Intertainment has progressed from a film distributor to a film producer which is in a position to exploit its own films. This allows Intertainment to monitor the entire value chain from development, through production to exploitation of film rights.

Selective choice and many years of development

As a filmmaker, Intertainment exclusively creates high-quality **US FEATURE FILMS** for the global market. Intertainment is extremely careful in selecting potential film material in order to meet customers' exacting requirements. The company focuses in particular on judicious development of material through to the production stage. This

development phase may last for a number of years, because Intertainment only makes a film once the script has been truly perfected and the film offers opportunities for outstanding sales successes. This entails Intertainment reserving the right to reject production of a film during the development phase or when development has been concluded.

Intertainment also aims to optimize the opportunity-to-risk ratio between the income potential of a film and the necessary investment of in-house financial resources. This is why Intertainment enters into a co-financing arrangement with one of the big US film studios when a film is being developed. Seven-digit financial commitments are incurred during this phase. The film studio is also involved in actual production and normally pays for approximately 35 % of development and production costs in return for North American rights.

During the pre-production phase, Intertainment also actions pre-sales of regional rights in the planned film. During fiscal year 2002, a **JOINT VENTURE** was concluded for this purpose with Summit Entertainment, one of the leading global film distribution companies.

JOINT VENTURE

Cooperation with big US film studios from the start

Pre-sales reduce risk

Pre-sales reduces the in-house risk for Intertainment and safeguards a major proportion of the income for a film at an early stage.

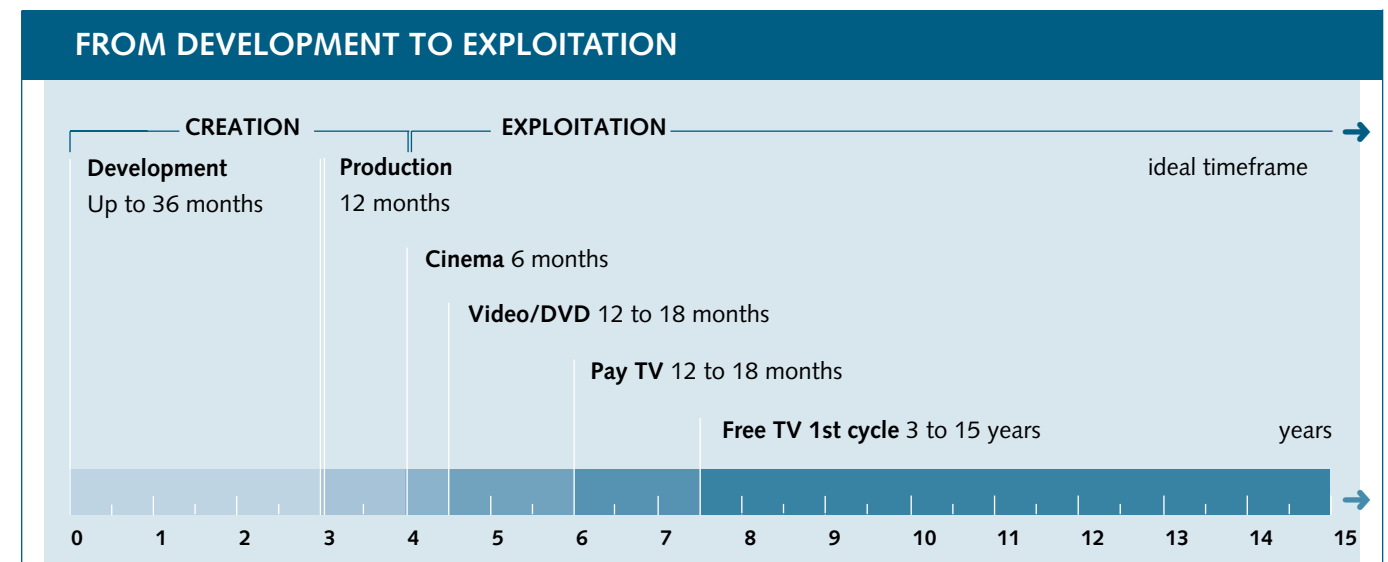
Revenues from pre-sales of this nature flow to Intertainment once the film is delivered. Intertainment itself is responsible for the part of the film budget that is not covered by the film studio and pre-sales. This means that Intertainment retains some **NATIONAL RIGHTS** and exploits these rights in stages through its distribution partners once the film has been launched. Proceeds are then paid to Intertainment successively over a period of many years, as the film goes through the individual stages of exploitation – cinema, video/DVD, pay TV and free TV.

NATIONAL RIGHTS

Intertainment exploits its own national rights

US FEATURE FILMS

Intertainment produces for the global market



Development phase: "Fast Forward" and "Navy Seal"

In spring 2003, Intertainment had several films in the development phase together with its joint venture partner, the successful American filmmaker Arnold Kopelson, or Kopelson Entertainment. The films with the best prospects currently seem to be a thriller and an action comedy, with the working titles "Fast Forward" and "Navy Seal".

Development of the thriller "Fast Forward" has progressed to the most advanced stage. Intertainment is working on this film together with US studio Paramount Pictures. The third version of the film script was completed at the beginning of 2003.

Intertainment and Kopelson have been cooperating with US major DISNEY on "Navy Seal" since the fall of 2002. This was the first time that Intertainment had entered into a joint venture with Disney. Similar to the joint venture agreed by Intertainment with Paramount, the agreement plans for Disney to acquire North American rights in the film for a 35 percent participation in the development and production costs.

DISNEY

First joint venture with Disney agreed

The partners commissioned Jason Filardi to turn the idea into a film script. In spring 2003, he started work on the script. Filardi is one of the big talents among screenwriters in Hollywood. His work on "Bringing Down the House", with Steve Martin and Queen Latifah in the star roles, dominated US cinema charts in the spring of 2003. It earned revenues amounting to around 132 million dollars in US cinemas alone.

Production: "Blackout"

Intertainment is currently scheduled to launch the thriller "Blackout" on cinema screens in the fall of 2003. Starring Ashley Judd, Samuel L. Jackson and Andy Garcia



in the main roles, it was filmed in the fall of 2002 in San Francisco. This makes it the first film to be produced under the joint venture agreed between Intertainment and Arnold Kopelson in 2000. It is also the first film that Intertainment has produced together with Paramount Pictures.

"Blackout" generated a great deal of INTEREST right from the start and Intertainment succeeded in selling numerous regional rights to the film in the course of 2002 and at the beginning of 2003.

BIG INTEREST

Already numerous rights in "Blackout" sold

Cinema exploitation: "Things You Can Tell ..."

The problems with Franchise meant that Intertainment was unable to have any major cinema launches in 2002. In April 2003, Intertainment commenced exploitation of the award-winning film composed of vignettes "Things You Can Tell ..." in around 50 cinemas, together with distributor otffilm. The star roles in the film are played by famous actresses like Glenn



Close, Cameron Diaz, Holly Hunter and Calista Flockhart.

Video and TV exploitation

In fiscal 2002, Intertainment achieved the biggest proportion of its SALES from video and TV proceeds arising from films that had already been acquired in the year 2000. These include the comedy "The Whole Nine Yards" with Bruce Willis. Intertainment concluded an exclusive sales agreement with Beta Film GmbH in October 2002, with the prime aim of launching a marketing drive within Europe for exploitation rights vested in smaller films already owned by Intertainment. This includes eleven films in the first instance. Despite the difficult market environment, Intertainment had prior to this succeeded in selling three film packages with TV licenses within Europe.

SALES

For development of license sales see page 40



The Legal Dispute with Franchise Pictures

TRIAL

Franchise has defrauded Intertainment of at least 100 million dollars

Substantial progress and an unwelcome postponement in the TRIAL schedule dominated the proceedings between Intertainment and US film producer Franchise Pictures during fiscal year 2002. In 1999, Intertainment concluded an output deal with Franchise Pictures. This secured the European rights in films produced by Franchise for Intertainment in return for 47 % of the budget. However, at the end of 2000 Intertainment discovered that Franchise had fraudulently inflated film budgets. This meant that Intertainment had been defrauded by an amount totaling at least 100 million dollars.

Franchise admits inflated budgets

When Intertainment discovered the fraud, Franchise and its CEO Elie Samaha continued to insist that the budgets were correct. Intertainment then provided proof that Franchise had not paid substantial payments reported in the budget at any time. When presented with this evidence, Samaha argued that although Franchise had not yet made the payments, the company was contractually bound to pay these amounts. In this connection, he submitted detailed lists to the court setting out the payment obligations. For example, the sums involved were 18 million dollars for the film entitled "The Pledge", 15.5 million dollars for "Get Carter" and 14.5 million dollars for "3000 Miles to Graceland". However, after Intertainment also provided evidence that these alleged payment obligations had never existed at any time, Sa-

maha changed tack yet again. During the course of 2002, he admitted that the PAYMENTS listed were fictitious and that the budgets were inflated.

The inflated budgets submitted to Intertainment were signed off by Franchise itself and by the relevant film insurer – generally this was Film Finances or WorldWide Film Completion – and in individual cases by Comerica Bank, which was responsible for the film financing (formerly Imperial Bank). The insurers were aware of the actual, much lower budgets. The same applies in part to Comerica Bank. This proved that Intertainment, as alleged, was dealing with a closed cartel.

A special civil action can be brought in the USA for cases like this: RICO CLAIMS. They allow the victims of organized criminality to sue for three times the compensation sum and reimbursement of lawyers' expenses. Actions of this nature are only permitted infrequently because of their implications. It is therefore all the more remarkable that the court declared the admissibility of two out of three of the RICO claims, which Intertainment had filed in addition to the actual action for damages against Franchise. This included a RICO claim against Franchise for the formation of a criminal enterprise that includes Comerica Bank and the insurers.

FICTITIOUS PAYMENTS

Inflated budgets were signed by film insurer

RICO CLAIMS

Two of three RICO claims allowed



Court date postponed to August 5, 2003

Shortly before the planned start of the trial on November 19, the lawyers representing Franchise applied to withdraw from the case. The court cancelled the date for the trial in November 2002 and postponed it until August 5, 2003. The United States District Court judge confirmed the trial date at a pre-trial conference in June 2003. Intertainment itself filed a suit against Comerica Bank, WorldWide Film Completion, Film Finances and against executives in these companies in December 2002. Intertainment thus forestalled expiry of the time limit for filing a lawsuit against these parties. Early in 2003, Comerica Bank commenced arbitration proceedings against Intertainment Licensing GmbH for payment of a second tranche amounting to 13.6 million dollars for the film "Driven".

At the end of June 2003, the United States District Court judge announced at a hearing that the lawsuit filed by Intertainment against Comerica Bank, the two insurance companies and executives of these companies would be postponed until a decision had been reached on the ARBITRATION PROCEEDINGS instituted by Comerica Bank against Intertainment. Intertainment assumes that the arbitration hearing will only be held after the conclusion of the Franchise trial.

Arbitration proceedings instituted against Intertainment by the National Bank of Canada for payment of the second tranche relating to the film "CAVEMAN'S VALENTINE" were finally clarified in 2002. After Intertainment had exhausted all the legal means available in this case without success during the course of the year, the claimed 7 million dollars were transferred to the bank.

ARBITRATION PROCEEDINGS

CAVEMAN'S VALENTINE

Additional information on the film: see item 4.4 in the consolidated management report

THE FRANCHISE CASE IN THE US PRESS

In mid-January 2003, the trade journal "Variety" published a review of the scandals in the entertainment industry during the year 2002. This report highlighted the FBI investigations against Elie Samaha, CEO of Franchise, on account of budget fraud. The American press devoted considerable attention to the fact that not only was Intertainment suing Franchise, but the FBI was also pursuing its own investigations. "Variety" had already published this fact at the beginning of June 2002, and the "Wall Street Journal" and the "Los Angeles Times" also published reports on the case. The trade press also assiduously recorded the fact that two out of three RICO claims filed by Intertainment against Franchise had been allowed, and reported how Franchise had inflated the budgets. "Variety" wrote: Samaha's Franchise pictures will in all probability never win an Oscar, but the "film mogul is undoubtedly a visionary when it comes to expanding budgets".

The progress of the litigation



<p>12/2000 → Negotiations with Andrew Stevens, President and COO of Franchise Pictures, concerning an amicable settlement break down.</p> <p>→ Intertainment takes legal action against Franchise Pictures before the Federal District Court of Los Angeles.</p> <p>→ Franchise Pictures reacts by taking legal action against Intertainment before the California State Court.</p>	<p>4/2002 → 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.</p>
<p>2/2001 → Intertainment also takes action against Imperial Bank (now Comerica Bank).</p>	<p>5/2002 → 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.</p> <p>Further, the Court upheld the allegation of a criminal enterprise involving Comerica Bank and WorldWide Film Completion, Inc.</p>
<p>4/2001 → The Judge decides that the general case is to be suspended and that priority should be given to the arbitration proceedings against Comerica Bank.</p>	<p>8/2002 → Intertainment filed a motion for summary adjudication with respect to some of Franchise defenses.</p>
<p>5/2001 → Intertainment withdraws the lawsuit against Comerica Bank in order to further pursue the legal proceedings against Franchise Pictures.</p>	<p>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.</p> <p>→ 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.</p> <p>→ 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.</p>
<p>6/2001 → The Judge rescinds the temporary suspension of the lawsuit against Franchise Pictures.</p>	<p>12/2002 → The court accepts the withdrawal of the lawyers representing Franchise Pictures from the case.</p> <p>→ The court postpones the start of the trial until August 5, 2003.</p>
<p>8/2001 → Intertainment files the third version (update) of the statement of claim against Franchise Pictures.</p> <p>→ The date of the hearing is fixed for September 10, 2002. Completion of the discovery stage is scheduled for May 27, 2002.</p>	<p>12/2002 → Intertainment files 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.</p>
<p>9/2001 → The Court orders Franchise Pictures to respond to the interrogatories presented by Intertainment on the budgets of the films in dispute.</p> <p>→ The Court also grants a petition from Intertainment that obliges the Comerica Bank to release discovery documents.</p> <p>→ The Court rejects a petition from Comerica Bank filed because the bank wanted to refuse to release documents to Intertainment for reasons of "confidentiality".</p>	<p>1/2003 → Franchise appoints new lawyers.</p>
<p>10/2001 → The Court orders that Film Finances Canada has to submit documents and answer questions on the budgets.</p> <p>→ The case is assigned to a new Judge entailing delays in the court dates.</p>	<p>2/2003 → Comerica Bank institutes arbitration proceedings against Intertainment relating to payment for the film "Driven".</p>
<p>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).</p>	<p>6/2003 → 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.</p> <p>→ 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.</p>
<p>1/2002 → The court orders that Franchise Pictures has to surrender budget documents and imposes monetary sanctions and rules that Franchise Pictures cannot assert "confidentiality".</p> <p>→ The Court orders monetary sanctions against Franchise Pictures again because they did not answer all questions in connection with the film budget.</p>	
<p>2/2002 → The Court orders monetary sanctions against Comerica Bank because it disregarded court orders.</p>	



been screened in the USA during the previous year. This revision adapted the film to meet the requirements of the German market.

Further expansion

The launch of "Rudolph and the Island of Misfit Toys" meant that for the first time, two Rudolph cartoon FILMS were on the market at the same time. The first video "Rudolph, the Red Nosed Reindeer" had generated very high sales figures in previous years. 2002 once again saw the film positioned among the ten videos with the best Christmas sales. "Rudolph and the Island of Misfit Toys" was constantly among the top five videos between the end of October and Christmas. Overall, Intertainment supplied more than 700,000 Rudolph videos. Soft toys from the Rudolph collection were also top sellers.

Intertainment Animation & Merchandising GmbH is planning to progress the breadth and depth of the Rudolph product portfolio during the course of 2003. During 2002, the team at Intertainment Animation & Merchandising GmbH was also working intensively on developing a new product for the children's market.



Promotion campaigns further increase the market value of Rudolph

Success with Rudolph

Performance at Intertainment Animation & Merchandising GmbH for the fiscal year 2002 was extremely gratifying. The company significantly INCREASED SALES over the previous year. Since 1999, the company has held the German-speaking license rights for the Christmas classic "Rudolph the Red Nosed Reindeer" – a cartoon reindeer. During this period, Intertainment has succeeded in establishing Rudolph as a fixed brand in the German, Austrian and Swiss Christmas markets.

Twin-track strategy

The wholly owned subsidiary of Intertainment AG is pursuing a twin-track strategy, by retaining marketing for Rudolph products in-house in areas of core competence and awarding licenses to cover other segments. In conjunction with license partners, the range of merchandising articles focused on Rudolph was increased from 150 to in excess of 200 during the year 2002.

The most important article for Intertainment Animation & Merchandising GmbH was a new video: "Rudolph 2 – Rudolph and the Island of Misfit Toys". Prior to launch on the German market, Intertainment revised the cartoon film that had

INCREASED SALES

For additional information on business figures see page 73 in the consolidated management report

FILMS

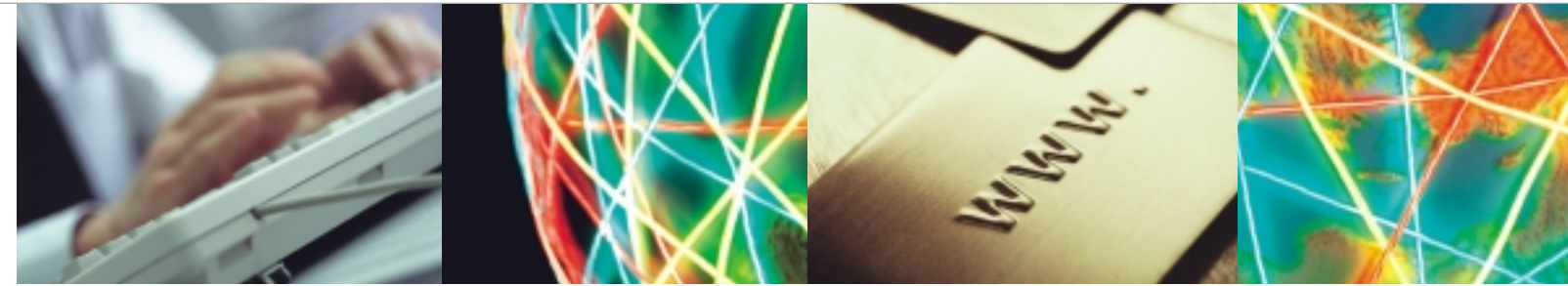
Two Rudolph films are ranked among the top ten in the video charts

INTERNET

Patent also covers downloads from the Internet

LAWSUIT

SightSound sues in order to assert patent rights



SightSound Wins Markman Hearing

2002 was a transition year for the American Intertainment shareholding SightSound Technologies, with an important court decision and entry of a new investor. Intertainment had a 22.8 percent stake in SightSound at the close of 2002.

Markman Hearing

SightSound specializes in digital sales of films and music on the Internet. The company holds a patent relating to this activity in the USA for downloading audio and video data along telecommunications lines. It also covers digital downloading of this kind of data from the INTERNET. Since January 1998, SightSound has been pursuing a lawsuit with CD Now, an American Internet music distributor, in connection with enforcement of this patent. The Bertelsmann subsidiary does not recognize the patent rights of SightSound.

The result of the Markman Hearing is potentially of considerable significance in connection with the forthcoming LAWSUIT to enforce the SightSound patent. The presiding judge at the Markman Hearing ruled in February 2002 that the patent of SightSound also covered the digital download of audio and video files via the Inter-

net. This had been contested by CD Now. On the basis of the judgment passed at the Markman Hearing, SightSound is optimistic about winning the actual lawsuit against CD Now. SightSound also anticipates that a positive outcome to the legal dispute will exert a substantial influence on the general worth and enforceability of the patent.

The court date originally scheduled for September 2003 has meanwhile been postponed. A new date for the trial is due to be fixed at a court hearing scheduled for August 4, 2003.

Option not agreed

SightSound also found a NEW INVESTOR in fiscal year 2002 and this ensures that the company will be in a position to bear the substantial financial burdens arising from the legal dispute. Some existing shareholders have also granted the investor the unilateral option of purchasing their shareholdings. In order to keep the full range of strategic possibilities open and not be tied to a particular course of action, Intertainment did not agree to the option.

NEW INVESTOR

A new investor is guaranteeing financial stability at SightSound

A difficult year for the capital markets

The year 2002 once again saw the share prices of all major equity markets falling significantly. The German stock market was particularly hard hit. The DAX dropped 44 % by comparison with the previous year. This is the biggest loss for a year since the DAX was launched in 1987. Shares listed on the New Market fell even more than blue chip stocks. Intertainment was also listed in this segment in 2002. The NEMAX All Share Index plummeted by around 63 % in the course of 2002.

The Intertainment share

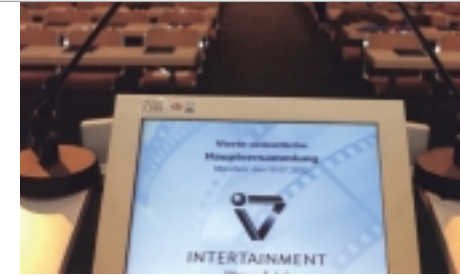
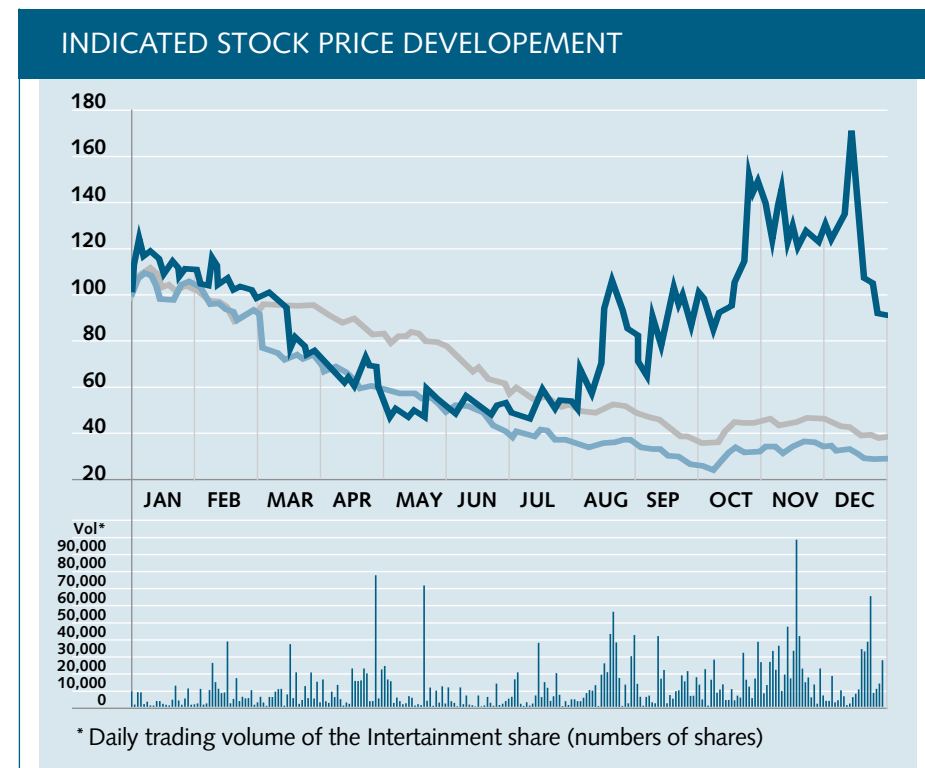
Media stocks posted some of the highest losses on the New Market. The Nemax Media & Entertainment sector index fell by nearly 73 % over the course of the year. The performance of the Intertainment share basically reflected the comparative index, with the share price of Intertainment falling to 1.10 euros on May 6, 2002. This is an all-time low since Intertainment was launched on the stock market. The share succeeded in bucking the general negative **TREND** during the second half of the year and increased in value significantly. On December 17, the share reached a high for the year at 4.27 euros.

BUCKING THE TREND

The Intertainment share performed much better than the market in the second half of the year

CHANGE 1/1/02 - 12/31/02

Intertainment: -10.1 %
 NEMAX All Share: -63 %
 NEMAX Media & Entertainment: -72.7 %



DVFA MEDIA CONFERENCE

Presentation to around 30 analysts and investors

In parallel with the rise in share price, the number of Intertainment shares traded on each day increased during the second half of the year. Around 90,000 shares were being traded in one day when trading peaked. The average number of shares traded over the year was around 20,000 shares per day. Earnings per share is -1.37 (2002: -7.36) euros. A dividend is not being paid out in 2002.

New segmentation

The new structure for market segments on German stock exchanges introduced in January 2003 has two segments with varying listing requirements for transparency. The **PRIME STANDARD** requires maximum transparency criteria for companies. Intertainment has been listed in the Prime Standard of the Frankfurt Stock Exchange since January 15, 2003.

PRIME STANDARD

Intertainment has been quoted in the prime standard since January 15, 2003

Quarterly reporting, application of International Accounting Standards (IFRS), publication of a corporate calendar with key dates, implementation of at least one analysts' conference each year and reporting in German and English are prerequisites for listing in the Prime Standard.

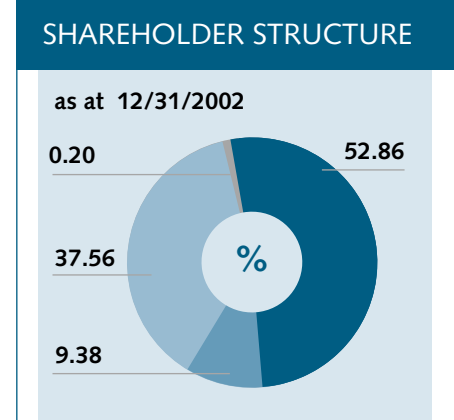
Investor Relations

Intertainment AG is committed to up-to-date, comprehensive and reliable communication between the company and its shareholders, and with financial analysts. The company was therefore also regularly in contact with the press, analysts and in-

vestors in 2002, explaining the current position of the company to analysts and investors at numerous individual meetings. The Intertainment Board of Management also outlined the position of the company during a **DVFA MEDIA FORUM** in Frankfurt to around 30 analysts and investors in October 2002. DZ-BANK AG regularly reported on the Intertainment share among the leading German banks for media shares. News from Intertainment AG was always posted on our corporate website without delay and thus placed in the public domain.

Capital measures

Intertainment was granted the right to purchase its own shares up to 10% of the capital stock at the Annual General Meeting on July 16, 2002, in order to be in a position to react more flexibly in the capital market. To date, Intertainment has not made use of this capital market instrument. The power to purchase its own shares is valid until 1/16/2004.



- Rüdiger Baeres
- Baeres family
- Free float
- Supervisory Board/ other management

Report of the Supervisory Board

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

Aside from the general development of the company and important individual items of business, discussions were held especially with regard to decisions relating to company strategy and the future financing and strategic direction of the company. Where required by law or in accordance with the company's statutes, the Supervisory Board gave or withheld its approval – following a thorough examination of the issues involved – of proposals put forward by the Board of Management. The Supervisory Board also devoted special attention, together with the Board of Management, to the questions of the risks arising for the company out of the lawsuit against the Franchise Group, together with other parties.

The Supervisory Board held six sessions during the year 2002. 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 as a result of fundamental changes in the market, while also working closely with the Board of Management to develop new and more far-reaching options for the future. Discussion of future financing of the company was also a focus of attention, particularly with respect to the Koppelson production "Blackout". In its first session on February 1, 2002 the Supervisory Board discussed in detail with the Board of Management the status of the company's lawsuit against the

Franchise Group and the effects of this on its licensees. In addition, strategic issues for fiscal year 2002 were discussed. In the session of March 26, 2002 the Board of Management submitted the company's preliminary financial statements for the year 2001 to the Supervisory Board. In the course of this session, a detailed discussion took place of the points raised with regard to the company's balance sheet by the auditors of the Entertainment Group, KPMG. The Supervisory Board has already provided detailed information about the results of this session as well as about the further investigations of KPMG in its report on the fiscal year 2001 dated April 29, 2002.

The auditors gave a report on the main findings of their investigations at the balance sheet meeting on April 25, 2002. The Supervisory Board approved the results with the resolution dated April 29, 2002. This was also recorded in the Supervisory Board's report dated April 29, 2002 on the fiscal year 2001.

On July 16/17, 2002 the Board of Management again reported to the Supervisory Board with even more emphasis about the progress of the lawsuit against the Franchise Group and its impact on the company's licensees. Additional detailed discussions also took place on future financing of the company, in particular with respect to financing the Koppelson production "Blackout". In a further joint session of the Board of Management and the Supervisory Board on October 4, 2002 the topics discussed included, aside from the current situation of the Franchise Group lawsuit and the financing of the company (again in particular with respect to financing the Koppelson production "Blackout"), the position with regard to the company's implementation of the new German Corporate Governance Code. In the session held on December 11/17, 2002 the Board of Management reported in detail to the Supervisory Board both about various matters relating to the Board of Management and the financing of the company (in particular implementation of an action plan for cutting



Dr. Matthias Heisse, Chairman

Dr. Ernst Pechtl, Deputy Chairman

Dr. Wilhelm Bahner, Member

costs) and reporting. In the course of this session, the Supervisory Board further concurred with the principle of implementing the German Corporate Governance Code and accordingly together with the Board of Management submitted the declaration of compliance pursuant to Article § 161 Stock Corporation Law (Aktiengesetz, AktG) on December 17, 2002. The Corporate Governance Report by the Board of Management and the Supervisory Board, printed on pages 20/21 of the Annual Report, includes details relating to this matter.

The Annual General Meeting of Shareholders on July 16, 2002 chose KPMG Treuhandgesellschaft Aktiengesellschaft Wirtschaftsprüfungsgesellschaft, Berlin and Frankfurt am Main, to audit the company's results for the fiscal year 2002.

In the session held on April 10, 2003 the Board of Management submitted its preliminary figures for the financial statements of the fiscal year 2002. During the same session a detailed discussion took place of various balance-sheet issues raised by the Board of Management and by KPMG.

Because of new, unforeseeable balance-sheet issues that were still unresolved, the company applied to Deutsche Boerse AG on April 25, 2003 for an extension to publication of the annual financial statements for 2002. A legally binding decision has not yet been handed down on this matter.

KPMG has completed its audit of the accounting, annual financial statements and company status report of Entertainment AG as well as of the company's consolidated financial statements and group management report for the fiscal year ended December 31, 2002 while regularly reporting to the Supervisory Board. It has also certified its unqualified approval of the accounting, annual financial statements and management report of Entertainment AG as well as of the company's consolidated financial statements and group management report with an explanatory note in accordance with

Article § 322 section 2 sentence 2 HGB. The written audit report was submitted to the Supervisory Board on July 10, 2003 by the auditors. The auditor reported on key findings that had emerged in the course of the audit at the balance-sheet meeting on July 11, 2003. The Supervisory Board gave its official approval of the results of the auditors' investigations with the resolution dated July 11, 2003.

In addition, the Supervisory Board examined the financial statements at December 31, 2002, the management report, the consolidated financial statements and the consolidated management report. No objections were raised, with the result that the Supervisory Board has officially adopted the company's financial statements and the consolidated financial statements approved.

Both the members 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 market situation and in their efforts to solve the problems that have arisen. The Supervisory Board would like to express its appreciation and grateful thanks to everyone concerned for their hard work and dedication.

Munich, July 11, 2002

The Supervisory Board,

Dr. Matthias Heisse

- Chairman of the Board -

Corporate Governance at Intertainment

TRANSPARENCY

Improved transparency through corporate governance

Corporate Governance is about responsible management geared to adding long-term value and maintaining controls within the company. This includes efficient cooperation between the Board of Management and the Supervisory Board, **TRANSPARENCY** in corporate communication, and looking after the interests of the shareholders. Alongside balance-sheet data, international institutional investors in particular are increasingly scrutinizing corporate governance in companies when they make investment decisions.

Recommendations and proposals

The German Corporate Governance Code was finally ratified by the Government Commission on the German Corporate Governance Code in 2002. This code contains recommendations that partly reflect legal provisions and are intended to be implemented by companies. It also includes a large number of ideas that are not binding on companies.

When the Transparency and Publicity Law came into force, a new Article § 161 was appended to the Stock Corporation Law (Aktiengesetz). This article obliges the Board of Management and the Supervisory Board of a listed company to declare once a year whether the code has been and is being complied with. Companies are also required to state which recommendations of the code are not being applied.

Traditionally given high priority

The Board of Management reports on corporate governance at Intertainment and also reports in the name of the Supervisory Board pursuant to Article 3.10 of the German Corporate Governance Code:

The principles defined in the Corporate Governance Code for good corporate management have always been highly valued at Intertainment AG. The Board of Management and the Supervisory Board addressed this subject at an early stage, with the Annual General Meeting 2002 already adopting changes to the statutes of Intertainment AG in order to comply with the new statutory requirements. As a result, the agreement on remuneration for Members of the Supervisory Board was amended so that in future Members of the Supervisory Board will also receive an additional performance-related remuneration (dependent on the dividend). An amendment to the statutes also enabled the shareholders to participate in the Annual General Meeting by appointing a **PROXY**. Further changes were made in the rules of procedure for the Board of Management in order to harmonize with the German Corporate Governance Code.

PROXY

Easier to participate in the Annual General Meeting

Declaration of compliance submitted

The Board of Management and the Supervisory Board of Intertainment AG submitted a declaration of compliance for the first time on December 17, 2002 pursuant to Article § 161 of the Stock Corporation Law (Aktiengesetz) to the effect that the recommendations of the German Corporate Governance Code were being implemented to a very large extent with the following **EXCEPTIONS**:

> The recommendation in Code section 3.8 sentence 2 provides for a reasonable deductible being 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 do not believe that this is an appropriate regulation, because contracts for D&O insurance have been concluded for the executive officers of the company over a period of many years now – in accordance with generally accepted practice – without any deductibles.

> The word “price relevant” has been inserted in the sections 6.3 and 6.8 of the Code. This only has an explanatory function and is intended to clarify that only those facts have to be communicated that are likely to exert a significant effect on the share price. The company has therefore taken account of the terms and wording of Articles § 13 and § 15 of the Securities Trading Law (Wertpapierhandelsgesetz, WpHG). This approach is intended to ensure that the capital market is not overwhelmed with communications that in the final analysis do not contain any substantive information.

> The recommendation in Code section 7.1.2. provides for a 90-day period after the close of the fiscal year for publishing the consolidated financial statements and a

EXCEPTIONS

Intertainment is implementing the code apart from a few exceptions



Annual General Meeting: Board of Management and Supervisory Board of Intertainment use the Annual General Meeting to provide shareholders with comprehensive information and have an open discussion with them.

45-day period after the close of the accounting period for publication of interim reports. Intertainment AG will comply with the four-month period pursuant to Article § 77 in conjunction with Article § 62 section 3 sentence 1 of the Frankfurt Stock Exchange Rules and Regulations (Prime Standard) for publication of the consolidated financial statements because of sector-specific accounting modalities. It will also comply with the two-month period pursuant to Article § 78 in conjunction with Article § 63 section 8 sentence 1 of the Frankfurt Stock Exchange Rules and Regulations (Prime Standard) for publication of interim reports.

Own code can also be called up on the Internet

Intertainment AG has prepared its own Code for the company based on the Corporate Governance Code drawn up by the Government Commission. This states which initiatives Intertainment is implementing voluntarily in addition to the mandatory recommendations. This code is available to all shareholders on the Internet pages of Intertainment AG (www.intertainment.de under the category “The Share”/“Corporate Governance”). It can also be requested from the company.

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Intertainment Group: Management Report

for the financial year 2002

A. Development of the financial year 2002

1. Overall economic development: lower growth rates

During 2002, world economic growth was weak. Following sharp falls in stock prices, investment restraint and slack demand, most of the major Western economies reported declining economic growth rates. In addition, in Germany especially, structural problems had a negative impact on economic development. In the entire **EURO ZONE**, which is the most important sales market for Intertainment, the gross domestic product rose in the year under review by only 0.8 percent, after 1.4 percent in the prior year and a growth of 3.5 percent in 2000. Germany developed particularly weakly, with a growth of 0.2 percent. The Federal Republic of Germany was, therefore, at times in recession.

Among the major Western economies, only the USA set itself apart from the negative development. Here the gross domestic product rose 2.4 percent in 2002, after a growth of 0.3 percent the previous year. For 2003, many experts expect at best a slight improvement in the general economic situation over the prior year.

2. Development of the film business: uneven situation

The film sector developed very unevenly in 2002. This is true both for the regional markets and the individual exploitation levels. The cinema and the video/DVD markets were at a high level. The **TELEVISION** sector, on the other hand, again went through a difficult period. In western Europe in particular, many Free TV broadcasters continued to suffer from a persistent advertising slump; the Pay TV broadcasters on the other hand suffered from the effects of excessive investments in the past. The TV stations have in the year under review again responded with cost-saving measures and budget cuts in the purchase of film licenses.

As a company which has specialized in the production and marketing of major US films, the development of the media sector is of supreme importance for Intertainment. The situation on the national markets along the value creation chain made up of cinema, video/DVD, pay TV and free TV is decisive, along with the quality of the films, for the results that Intertainment obtains in exploiting its film license rights.

EURO ZONE

TELEVISION

EUROPEAN CINEMA MARKETS

2.1 Development of the cinema sector: maintaining a high level

All in all, the cinema sector achieved a very good result in 2002, although the development was different in the various territories. Whereas in the USA a record result was achieved with cinema box office sales of 9.27 billion dollar, this representing a plus of 14% over the figures for the prior year, the most important **EUROPEAN CINEMA MARKETS** failed to keep up with this development. Only in the United Kingdom did the cinemas achieve a similarly good development, with ticket sales of 800 million pounds, representing a plus of 13 percent.

In France, the market with the most cinema-goers in Europe, the growth in sales at the cinema box office was insignificant. It was just over 1 billion euro.

In Germany, box office sales fell slightly in comparison with 2001, when the cinemas achieved a record result. In 2002 there were 163.9 million cinema visits, 14 million fewer than in the previous year. The sales made by the cinemas fell by 2.8 percent from 987.2 million euro to 960.1 million euro. Nonetheless, the year under review was by far the second best cinema year in Germany since unification. For 2003, many German film hire companies expect a slightly firmer market since this year will see the arrival in Germany of some of the successful films which boosted the US cinemas in 2002.

MARKET SHARE

The **MARKET SHARE** of US films in Europe rose in 2002 to 71%. The previous year it had been only 65 percent, and, in 2000, 73 percent.

2.2 Development in the video/DVD sector: clear growth thanks to DVD

The video/DVD market has developed very positively. This was exclusively due to the DVD area. In the USA, video and DVD sales rose 11.5 percent to 20.3 billion dollars – and hence these sales were 126 percent higher than the cinema box office receipts.

In Germany, a **RECORD TURNOVER** of 1.4 billion euros was obtained from the sale and rental of videos/DVDs. This represented growth of 22.1% over the prior year. Hence the home entertainment market was the film exploitation area with the highest sales in Germany. Of the total turnover of the sector, 1.04 billion euros (up by 31.7%) was attributable to sales to consumers. Of this amount, 713.3 million euros (up 75%) was spent on DVDs and 327.5 million euros (down by 14.6%) was spent on VHS cassettes. In the film hire market, turnover was 358.6 million euros. This is only a slight increase over 2001 by 0.7%.

2.3 Development of the television branch: advertising crisis in Europe continues

The continuing poor global economic situation affected the German and the European television market in 2002 too, after an already difficult year in 2001. According to the research institute Zenith Optimedia, it is television's biggest advertising crisis ever. In Germany, **ADVERTISING SALES** made by television stations fell in comparison with 2001 by 4.2 percent to 7.25 billion euros. The stations responded with cuts in expenditure and investment. Also, they are concentrating more on own productions.

RECORD TURNOVER

ADVERTISING SALES

The US market set itself apart from the negative development in advertising. After a steep fall in 2001, in 2002 it made a sharp recovery. Overall, advertising expenditure in the USA rose by 5.9 percent, while the advertising sales of the major country-wide television channels rose by 8.3 percent.

3. Development of Intertainment: Change to being a film producer with high quality standards – Franchise fraud continues to represent a burden

In recent years, Intertainment has changed from being a dealer in film licenses to being a film producer that has specialized in the production or co-production of high quality American films. In addition to film production, Intertainment exploits the licenses of its films partly itself, and partly via partners. In addition, Intertainment has for a number of years been successfully engaged in the merchandising business.

In particular, in the area of film development and production, and consequently also in the exploitation of licenses, in 2002 the fraud committed by the American film producer Franchise Pictures, which had come to light two years earlier, again impacted negatively on the Intertainment Group. After Intertainment had recognized the financial charges resulting from the fraud in the financial year 2001 as extraordinary expense, the impact of the pending litigation on the figures of Intertainment in 2002 was for the most part indirect. The 100 million euro loss that management estimates Intertainment suffered as a result of the fraud has considerably curtailed the Group's financial maneuverability, and consequently also its scope for developing and producing new films.

This aspect is all the more decisive since Intertainment makes very high quality demands on the development of new material, that is associated with considerable financial costs up front. Only cinema films whose success is above average can be sold well over the entire exploitation chain. This applies in particular to the television market.

Its demand for high quality demand leads to Intertainment only realizing film projects when they have really matured and offer a good opportunity/risk ratio. This means that

> Intertainment invests a great deal of time in the development of the film material and the film script – mostly between 12 and 36 months.

> During this period, Intertainment has already to bear considerable financial costs for the on-going development.

> Nonetheless, Intertainment sometimes aborts film projects, which at first seemed to have good prospects, in the development phase or even after development. For, on account of the very high investments that are associated with the production of a film, Intertainment re-examines the opportunity/risk ratio regularly for each film project under development. Hence it is only in the case of relatively few submitted film scripts and film ideas that Intertainment acquires an option to develop the material. During the subsequent development phase, Intertainment abandons about half of the projects.

3.1 Film development: five projects

In its film development and production, Intertainment meanwhile relies exclusively on the collaboration agreed in May 2000 with Kopelson Entertainment, the company of the American film producer Arnold Kopelson. USA-Intertainment, Inc. and Kopelson Entertainment share premises in Los Angeles. In the year just completed, the two partners had five film projects in the development phase. Of these, one – the thriller **“BLACKOUT”** – was realized. Intertainment AG started with the worldwide advance sale of licenses for “Blackout” in 2002.

Development work was continued on, among other projects, the science fiction film “Windows to Atlantis” and the thriller “Fast Forward”. They – as too “Blackout” – are part of a first-look and co-financing agreement with the US film studio Paramount Pictures. Paramount is bearing a part of the costs right from the development phase and also during the production phase, and will receive as consideration the North American exploitation rights in the films. All other worldwide rights are held by Intertainment.

Intertainment also pressed ahead during 2002 with the project “Navy Seal” and won the US major **WALT DISNEY** as cooperation partner for this comedy.

3.2 Film production: “Blackout” in postproduction

In the past business year, Intertainment decided for the first time to realize a film-script developed under the collaboration with Kopelson Entertainment. It was the thriller “Blackout”. This was filmed in the third quarter of 2002 and at the end of the year was in postproduction.

Intertainment did not produce any further films in the financial year 2002.

3.3 License trade: successful pre-sales of “Blackout” and sales of packages

Intertainment started with the worldwide **ADVANCE SALE** of licenses for “Blackout” in 2002. For this purpose, Intertainment concluded an agency contract with Summit Entertainment, which is specialized in international distribution. At the time this management report was completed, the rights to “Blackout” had been sold for parts of western and eastern Europe, of the Middle East, Asia and for South Africa. The agreements will influence the turnover of the Intertainment group as from 2003.

In the financial year 2002, Intertainment also succeeded, notwithstanding the difficult situation on the TV market, in selling three film packages with TV rights. The film package with Free TV rights went to a British broadcaster, in Germany Pay and Free TV rights were sold to the Tele München group, while in eastern Europe an all-rights film package was sold.

In addition, Intertainment agreed with a Spanish licensee on the completion of a film deal. This enabled a problem following on from the Franchise litigation to be settled.

Finally, Intertainment concluded in the course of the reporting year with Beta Film GmbH a distribution agreement for three years and, initially, 11 films. Under the contract, Beta is responsible mainly for the overall European TV marketing of these films.

Notwithstanding these successes, the **TURNOVER** in the segment of film production and license trade with feature films declined in 2002 by 49 percent. It was 14.5 million euros, after 28.4 million euros in the prior year. This is mainly because, during 2002, Intertainment was not able to acquire and exploit any new licenses as a result of tie-up of resources resulting from the litigation with Franchise Pictures.

3.4 Cartoon film and merchandising: positive sales development with “Rudolph”

Intertainment’ activities in the segment of trading in rights in cartoon films and merchandising are mainly covered by Intertainment Animation & Merchandising GmbH. In 2002 as in the previous years, this subsidiary marketed in particular the rights in the Christmas character “Rudolph the red-nosed reindeer”. Intertainment Animation & Merchandising GmbH holds the exploitation rights in “Rudolph” for the German-speaking countries.

In the financial year 2002 Intertainment expanded the product assortment of Rudolph merchandising articles by 50 to more than 200. The centre stage of the Christmas business was taken by the new

video “Rudolph and the island of misfit toys”. As expected, the film has sold well. Because of this in particular, in the segment of trade in rights in cartoon films and merchandising, very good sales figures were obtained with the Rudolph products as budgeted. Turnover rose by 60% to 4.4 million euros.

3.5 Financial participations: Option for SightSound rejected

At the Intertainment participation SightSound Technologies, pending litigation continued during the reporting year on the value of its patents for the download of digital data. In 2002 SightSound found a new investor that will ensure through the provision of liquid funds that SightSound can probably conclude the litigation about the patent. Nonetheless, the **BOOK VALUE OF INVESTMENTS** of the participation in SightSound will be subject to uncertainties until the issue of the litigation. The other shareholders offered the new investor a unilateral option to acquire the company. For this, on exercise of the option, the investor would have to pay to the other shareholders a price dependent on the timing and the status of the litigation. For strategic reasons, Intertainment did not agree to this option.

3.6 Staff and management

In 2002 the Intertainment group employed on average 23 staff, compared with 28 staff in the prior year. They work at the headquarters of the company at Ismaning near Munich and at USA-Intertainment, Inc. in Los Angeles, USA. There were no changes in the composition of the management board and the supervisory board during the reporting year.

“BLACKOUT”

WALT DISNEY

TURNOVER

ADVANCE SALE

BOOK VALUE OF INVESTMENTS

**4. The case of Franchise Pictures:
Main hearing to be held on August 5,
2003**

**4.1 Lawsuit against Franchise Pictures:
RICO claims permitted**

In 2002, too, the legal action against the American film producer Franchise Pictures was one of the dominant factors for the business development of Intertainment. It tied up considerable management capacities and made it necessary to make financial commitments up front.

Moreover, Intertainment was unable to invest in the development of new films in the measure desired and planned on account of the financial loss caused by the fraud committed by Franchise Pictures.

The litigation with Franchise Pictures has been pending since December 2000 at the Federal District Court in Los Angeles. According to the information of Intertainment, Franchise damaged the group through fraudulently excessive film budgets by at least 100 million dollars. For this reason, Intertainment has sued Franchise Pictures for damages in this amount.

In the last two management reports and in the quarterly reporting for 2001 and 2002, Intertainment has described the circumstances in detail. The actual main proceedings were originally due to commence on November 19, 2002. Previously, in May 2002, the court had granted leave to pursue two of three RICO suits ("Racketeer Influenced and Corrupt Organizations Act") against Franchise Pictures, and its

CEO Elie Samaha and COO Andrew Stevens. In this connection, the court allowed the suit against Franchise with regard to the formation of a criminal organization, which includes Comerica Bank and the two insurance companies Film Finances and WorldWide Film Completion.

RICO suits are a special feature of US civil law. They grant the victims of organized crime, if the finding goes against the defendants, the threefold sum of damages as well as reimbursement of lawyers' fees. Because of their scope, leave to pursue RICO suits is granted only very rarely.

In November 2002, the court terminated, on application by Intertainment, the confidentiality status for a number of trial documents. However, it did not grant an application for a writ of attachment on parts of the assets of Franchise Partners. By applying for this writ, Intertainment had attempted to secure parts of the receivables which will be claimed in the main proceedings against Franchise Pictures.

Differently to the original time plan, the main hearing of several days did not commence on November 19, 2002. After the lawyers of Franchise suddenly resigned their briefs, the court postponed the **DATE FOR THE COMMENCEMENT** of proceedings by almost 9 months to August 5, 2003.

4.2 Action against Comerica Bank and insurance companies: Intertainment takes the partners of Franchise to court

In December 2002 INTERENTAINMENT Licensing GmbH also filed a suit for damages against **COMERICA BANK** and Comerica employees Morgan Rector and Jared Underwood, that, in the opinion of Intertainment, were substantially involved in the fraud. The lawsuit is directed also against the insurance companies involved in the

**DATE FOR THE
COMMENCEMENT**

UNFOUNDED

COMERICA BANK

fraud and senior employees of these companies – here above all against WorldWide Film Completion and its principal Steve Cardone as well as against Film Finances and its principal Steven Ransohoff. The suit was filed at the State Court in Los Angeles. The counterparties applied to have the suit transferred to the Federal Court, where the suit against Franchise Pictures is pending. Intertainment lodged an objection against this submission, since a transfer of the case to the Federal Court could have the consequence that the proceedings against Franchise Pictures would not be pursued for the time being.

4.3 Countersuit by Franchise Pictures

In a countermove, Intertainment AG, INTERENTAINMENT Licensing GmbH and the chairman of Intertainment AG Rüdiger Baeres personally were sued in the financial year 2000 by Franchise Pictures on the grounds that they had not kept orally given promises and had not made payments in connection with the acquisition of film rights. Intertainment and the legal representatives consider the suit to be entirely **UNFOUNDED**. In 2002 there were no other facts which would justify a different conclusion.

4.4 Arbitration proceeding on account of "Caveman's Valentine": Intertainment pays second installment

In an arbitration case that the National Bank of Canada initiated against INTERENTAINMENT Licensing GmbH, the Bank de-

manded the payment of a second installment of approximately 7 million US dollars to finance the Franchise film "Caveman's Valentine". The film is part of the Franchise court case, but differently to the other films it was not financed by Comerica Bank, but by the National Bank of Canada. In the course of the arbitration proceedings, it was confirmed that the film had been correctly delivered. Thereupon Intertainment lodged an appeal against the arbitration ruling, but the **APPEAL**, too, failed. For this reason, at the beginning of 2003 INTERENTAINMENT Licensing GmbH remitted the due sum.

Nevertheless, "Caveman's Valentine" remains part of the trial against Franchise. No statement as to whether the budget specified by Franchise Pictures was fraudulently excessive – as Intertainment believes – was made during the arbitration proceedings. The subject was, rather, whether the film had been delivered technically as agreed. By this is meant that a specialist laboratory confirms the agreed quality of the film from a technical point of view. Intertainment itself has not had the film available at any time. Since it is part of the proceedings against Franchise, Intertainment assumed that, notwithstanding the payments made, it will not actually receive this film from Franchise for exploitation. In the estimate of Intertainment, the recoverability of the amounts recorded in the **BALANCE SHEET** is given on account of the expectation of the outcome of the Franchise trial.

**APPEAL
FAILED**

BALANCE SHEET

B. Net worth, financial and earnings position

1. Earnings situation: Despite the lower turnover, Intertainment has cut its loss sharply.

Despite the sharp decrease in turnover, the Intertainment Group considerably lowered its **LOSS** in comparison with the prior year. This is exclusively because, as expected, only a relatively low extraordinary expense was incurred for the case of Franchise Pictures.

Overall, Intertainment obtained in 2002 sales revenues of 19.0 (prior year 31.1) million euros. Of this amount, 14.5 (prior year 28.4) million euros is derived from the trade in film rights and 4.5 (prior year 2.7) million euros from the cartoon and merchandising segment covered by Intertainment Animation & Merchandising GmbH. The fall in the turnover in the film license business by 48.8 percent is due mainly to the fact that on account of the fraud by Franchise – and the consequent termination of the business relationship – since autumn 2000 Intertainment has not received any new films for marketing. The sales revenues in the license business come largely from the sale of three film packages for the TV area in three European territories. The main part of the revenues related to the films “The Whole Nine Yards” and “Art of War”.

The very positive development in the merchandising segment, which shows a growth of 66.7%, is connected above all with the introduction of a new video on “Rudolph

the red-nosed reindeer”. The first video on “Rudolph,” which has been on the market for sometime, again sold well.

On the expenses side, Intertainment wrote off as budgeted 5.5 (prior year 5.4) million euros for exploited or sold film licenses. In addition, marketing costs were incurred for these license in the amount of 1.8 (prior year 12.6) million euros. On account of the continuing difficult situation in the area of trading with rights, Intertainment also made unscheduled depreciation on the film assets of 4.7 (prior year 62.2) million euros. The extraordinary expense of 2.3 million euros recorded in 2002 is in its entirety directly connected with the case of Franchise Pictures – and resulted in particular from the increase in the provision for litigation risks, allowances for license sales and retirement of receivables. In comparison with the financial year 2001, the extraordinary charges connected with the Franchise case have, hence, fallen considerably, as expected. In 2001, the extraordinary charges had come to 142.4 million euros. The **EXTRAORDINARY RESULT** was minus 3.3 (prior year minus 88.9) million euros.

On account of the sharp decrease in the extraordinary expense, the Group's deficit for the year fell to 16.1 million euros, after a loss of 86.8 million euros in the previous year. However, the continuing indirect charges relating to Franchise on the operating business of Intertainment led to the result from ordinary business activities deteriorating to minus 13.7 (prior year minus 6.0) million euros. EBIT was roughly minus

SEGMENT OF FILM

16.2 (prior year minus 100.2) million euros. The loss made by the Intertainment Group is exclusively attributable to the **SEGMENT OF FILM** production and trading in film rights. This closed with a loss for the year of 16.4 (prior year loss: 87.4) million euros. The merchandising segment recorded a profit for the year of 0.2 million euros after 0.6 million euros in the prior year. The decline in the annual result is due to write-downs on the license on Rudolph and further license fees as well as marketing costs and high investments in new projects.

2. Net worth: bank debts and film assets lower

In the year under review, both the film assets and the receivables of Intertainment decreased. Bank debts also fell sharply. Overall, film assets declined by 16.9 million euros to 10.8 million euros. This includes scheduled amortization of 5.5 (prior year 5.4) million euros and non-scheduled writedowns of 4.7 (prior year 62.2) million euros.

Trade receivables fell by 17.1 million euros to 37.2 million euros. In this connection, Intertainment has achieved an agreement with licensees which had not been prepared to accept the agreed film rights on account of the problems arising from the litigation against Franchise Pictures. Moreover, in 2002 Intertainment lowered its **BANK LIABILITIES**. They were reduced by 7.1 million euros to 16.2 million euros. Trade liabilities resulting mainly from the purchase of film licenses were 24.2 million euros. Other provisions fell by 4.3 million euros to 7.0 million euros, and payments received on account for film rights fell by 2.9 million euros to 0.4 million euros.

The equity of the Group at the balance sheet date was 73.9 (prior year 90.1) million euros. The equity ratio is 58% (prior year 56%).

3. Financial position: liquid funds of 3.9 million euros

At the end of the year, Intertainment had **LIQUID FUNDS** of 3.9 million euros, which is 10.3 million less than at the balance sheet date of the prior year. The decrease is due mainly to payments of producers' fees, investments in film projects and legal consultancy fees. For the financial year 2003, Intertainment has a detailed financial budget from which the management infers a positive forecast for the continuing existence of the company. The finance plan and the forecast of continued existence are subject to the risks described in the section D. Risks of future development. In particular, we refer at this point to the risks imperiling future existence under item D.1 of this management report.

C. Developments after the end of the financial year and future development of the Group

1. General economic climate and development of the film industry: economy remains weak, positive development expected for video/DVD

In the opinion of many experts, the general economic situation in most industrial countries will improve at best only slightly in 2003. In the media area, most experts expect a continuing relatively stable development in the box office area and long-term a further upturn in the video/DVD area. They attribute the latter expectation

LOSS LOWERED

EXTRAORDINARY RESULT

BANK LIABILITIES

LIQUID FUNDS

TV
BROADCASTERS

to the continuing sharp climb in the number of DVD players in people's homes and the fact that films are being exploited in the cinemas for a shorter time. Their judgment of the television market is muted. Intertainment shares this assessment. In particular, the company does not expect that the difficult situation in the sale of film licenses to television stations in western Europe and especially in Germany will improve. Only when the economic climate picks up noticeably and advertising budgets are increased will the readiness of the **BROADCASTERS** to invest in their programs increase again. There was no sign of this in the first months of 2003. The trend was, rather, negative. In the first two months of 2003, the German television stations booked a decline in advertising revenue of 3.7 percent in comparison with the same period the previous year.

2. Development of Intertainment: concentration on selected projects

2.1 Strategic partnership with OpenPictures AG

On July 4, 2003 Intertainment AG entered a strategic partnership with Open Pictures AG involving collaboration in operating business and in Intertainment's pending lawsuits against, among others, Franchise Pictures. The aim of the collaboration is, firstly, to finance and distribute international feature films in cooperation with major US film studios. Secondly, OpenPictures AG shares the legal position of Intertainment in the current lawsuit against Franchise Pictures, Comerica Bank and the in-

surance companies (among others) and receives the right to participate in the court costs or to assume rights and duties connected with the trial. Moreover, Intertainment and OpenPictures AG will pursue jointly innovative distribution channels for the download of audio and video data from the Internet in the area of film production, using the participation of Intertainment in SightSound Technologies.

2.2 Film development, film production and film license trade: "Blackout" due to start showing at the cinemas in fall 2003, "Things you can tell ..." in the cinemas in April

The financial possibilities of Intertainment – and hence its scope for developing and producing new films – will likely remain very limited until there is a settlement with Franchise Pictures or else a successful issue to the court case against Franchise. At present, Intertainment assumes that it will come to **TRIAL**, and that there will not be any out-of-court settlement. The first day of the proceedings is scheduled for August 5, 2003.

Nonetheless, Intertainment is working intensively on the development of **NEW FILM PROJECTS** under the cooperative agreement with Kopelson Entertainment. Among other things, Intertainment commissioned a further reworking of the film-script to the thriller "Fast Forward" at the beginning of 2003. Paramount Pictures is also participating in this commission. Meanwhile, in March 2003, work was started on a film-script for "Navy Seal". However, the development of the thriller "Decoy" was suspended at the beginning of 2003.

In autumn 2003 Intertainment will probably bring out a major film in the cinemas for the first time in three years with its Thriller "Blackout", which is a product of

GROUP
TURNOVER

the cooperation of Intertainment, Kopelson and Paramount. Since the pre-sales for "Blackout" have been successful, it is already certain that Intertainment will considerably increase its **GROUP TURNOVER** in 2003. At the beginning of 2003 the film was at the post-production phase.

On April 17, 2003, together with the film hire firm ottfilm GmbH, Intertainment brought to the German cinemas "Things you can tell ...", The film, which won an award at the Sundance film festival, started with 50 copies.

In 2003, Intertainment has concluded a distribution agreement with Planet Media home entertainment GmbH. Through this, the independent label is distributing films of the Intertainment film library on the German DVD/video market. The selected titles include "Things you can tell ...", "Camouflage", "Takedown" and "The Third Miracle."

2.3 Merchandising: further concentration on "Rudolph"

Intertainment Animation & Merchandising GmbH will probably concentrate in 2003, too, on expanding its merchandising activities around "Rudolph the red-nosed reindeer". It is also working intensively on the development of new contents in the children's and family sphere.

2.4 Digital distribution – SightSound Technologies: patent dispute goes to court

Intertainment continues to consider SightSound to be a strategic instrument. Its value depends substantially on the outcome

of the patent dispute of SightSound. Intertainment expects that this dispute, following the postponement which was made recently, will be decided at the beginning of 2004.

3. The case of Franchise Pictures

3.1. Suit against Franchise Pictures and Comerica: ruling in the fall

Intertainment expects a result in the trial against Franchise Pictures in the fall. However, it will be more than a year before there is a decision on the lawsuits being prosecuted by Intertainment against, among others, Comerica Bank and the two insurance companies Film Finances and World Wide Film Completion.

3.2 Arbitration proceeding on "Driven": Comerica demands second installment

At the beginning of 2003, Comerica opened arbitration proceedings against INTERENTAINMENT Licensing GmbH for payment of the second installment for the film "Driven" in the amount of 13.6 million US dollars, plus lawyers' fees and other costs.

3.3 Arbitration proceeding on account of "Tracker"

In a case which is connected with the allegation of budget fraud against Franchise Pictures, the banks and the insurance companies, International Motion Picture Corporation Ltd., which is based in Hong Kong, opened on June, 18, 2003 a further arbitration case against INTERENTAINMENT Licensing GmbH for payment of damages in the amount of 3,262,500 US dollars in

the case "Tracker". Intertainment will take position against this claim for damages in a comprehensive letter of reply. At no time has Intertainment agreed to arbitration proceedings with International Motion Picture Corporation Ltd. The film "Tracker" is a subject of the budget fraud allegation, so that Intertainment will submit all pleas, crosspetitions and counterclaims in this case, too.

D. Risks of future development

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

The consolidated financial statements for the business year 2002 were prepared on the assumption that Intertainment has still the ability to continue as a going concern. In this connection, the management of Intertainment 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 payments obligations. The positive assumption regarding Intertainment's ability to continue as a going concern is based on an integrated corporate financing plan, from which a detailed financial budget has been derived. This is made up of the financing of future business activity, the planned investments and other financing activities. Overall, the assumption regarding Intertainment's ability to continue as a going concern is qualified by three main **AREAS**

OF UNCERTAINTY, that cannot be judged definitively at the present time. In particular, these are:

- > Cash-Inflows of funds from the litigation against Franchise Pictures
- > Cash-Outflows of funds from arbitration proceedings, as well as
- > Uncertainties about the realization of the other assumptions, on which the financial budget of Intertainment is based.

If the inflows of funds, the outflows of funds or the assumptions on which the financial budget is based fail to materialize as planned, the assumption regarding the ability to continue as a going concern of Intertainment AG, of INTERTAINMENT Licensing GmbH and of Intertainment Animation & Merchandising GmbH will be endangered to a high degree on account of impending inability to pay and the consequent opening of insolvency proceedings, also at short notice.

INFLOWS OF FUNDS FROM THE LITIGATION AGAINST FRANCHISE PICTURES

If INTERTAINMENT Licensing GmbH should fail with its suit against Franchise Pictures in the first instance in August 2003, there is a possibility of appeal. The appeal proceedings would last roughly a further 18 to 24 months. The further financing of the costly trial could also have considerable negative effects on the company. If INTERTAINMENT Licensing GmbH should win the lawsuit against Franchise in the first instance, Franchise too has the possibility of appealing. As with any court case, there is moreover the risk that, even if Intertainment

carries the day, it may not be possible to realize the decision against the parties being sued.

We have discussed further uncertainties relating to the inflows of funds from the Franchise Pictures lawsuit under point C.3 and refer to our comments there.

OUTFLOWS OF FUNDS FROM ARBITRATION PROCEEDINGS

INTERTAINMENT Licensing GmbH is subject to the risk that the banks financing Franchise Pictures will open arbitration proceedings for payment of the second installment for the disputed film rights. Comerica Bank opened such proceedings at the beginning of 2003 against INTERTAINMENT Licensing GmbH in connection with the film "Driven".

If Comerica Bank should have success with the arbitration proceedings that it has initiated regarding the second installment for the film "Driven", INTERTAINMENT Licensing GmbH may face a payment obligation of up to 13.6 million US dollars. In the event that Intertainment does not obtain the budgeted inflows of funds from the Franchise lawsuit, there would be a danger that INTERTAINMENT Licensing GmbH would not be able to meet this payment obligation. A resulting inability to pay and the insolvency proceedings which would have to be initiated against INTERTAINMENT Licensing GmbH would mean for Intertainment AG, among other things, the loss due to the impairment of the inter-company account with INTERTAINMENT Licensing GmbH and the impairment of the shares of INTERTAINMENT Licensing GmbH which are held by Intertainment AG. There would also be a question as to whether Intertainment AG would be able to continue to pursue the lawsuit being prosecuted by INTERTAINMENT Licensing GmbH against Franchise Pictures.

In the event that an arbitration court decides in favor of one of the financing banks, 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. However, in the case of the arbitration court proceedings relating to Caveman's Valentine which were confirmed during the year under review, this did not happen. Intertainment assumes that the income from the exploitation of these film rights will be considerably higher than the obligations to pay the second installment.

In the lawsuit against Comerica and the insurance companies, Intertainment will petition for all claims (including the claims for payment made by Comerica in the arbitration proceedings) connected with any films in which Franchise Pictures is involved to be decided in a consolidated arbitration hearing. Furthermore, Intertainment will apply to have this proceeding scheduled after the main hearing of the lawsuit against Franchise Pictures.

Meanwhile on June 18, 2003 International Motion Picture Corporation Ltd., which is based in Hong Kong, opened a further arbitration case against INTERTAINMENT Licensing GmbH for payment of damages in the amount of 3,262,500 US dollars for the film "Tracker". Here, too, Intertainment will petition to have the claims decided by the consolidated hearing described above. Independently of any arbitration proceedings, the disputed films remain part of the pending lawsuit against Franchise Pictures.

UNCERTAINTIES WITH REGARD TO THE OTHER ASSUMPTIONS IN THE FINANCIAL BUDGET

The other assumptions of the financial budget relate mainly to inflows of funds in the short term from operating activity of the Group and a sale of receivables, which has already been concluded and which is subject to a condition precedent. Moreover, there are financial obligations in connection with the redemption of a **BANK LOAN** which is due in June 2004. The debtor for this loan is INTERTAINMENT Licensing GmbH. Intertainment AG has given a guarantee for these liabilities.

In addition, through the generally poor situation in the sector, there may be delays in incoming payments and bringing forward of outgoing payments from current business activities, which could impair the ability to continue as a going concern of the Group.

The consequences of a possible wrong assessment in relation with the Group's ability to continue as a going concern would be wide-ranging. For instance, it would not, pursuant to § 252 I No. 2 HGB, be possible to use going concern values in the recognition and valuation of assets and debts.

2. Further risks

There are also risks associated with the future development of the company. Intertainment has examined the business processes and has identified and evaluated the risks arising and developed measures in order to minimize risks under an ongoing risk monitoring regime. Building on this, the

risk monitoring system for the **DETECTION OF THREATENING** 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 Producer risk

As the producer of films, Intertainment is subject to the risk that a film production may have to be aborted. This can lead to claims for damages.

2.2 Trading in film licenses

Intertainment trades in film licenses, among other things. There is strong competition in this area. This can lead to changes in the level of prices, falling sales figures, lower profit margins and a deterioration in the market position. The continuing consolidation trends especially in the European cinema and TV area 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.

2.3 Acquisition and exploitation of film rights

When Intertainment acquires license rights prior to the commencement of production, there is a danger of a film being purchased at too high a price. The possible success of a film is difficult to foresee 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 filmscript.

DETECTION OF THREATENING

2.4 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 the financing. Suitable measures for the reduction of this risk are an ongoing control of expenditure and budget 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.

2.5 Dependence on distribution partners

The Europe-wide film distribution by the majors Warner Brothers and 20th Century Fox represents a substantial competitive advantage for Intertainment. If these distribution cooperative agreements should be dissolved, this might have considerable negative effects on the financial situation and the business result of the company.

2.6 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.

2.7 Financing of the future growth

The film production, the purchase of further film license rights and the expansion of the business activities in new distribution

regions require considerable financial resources. Moreover, the liquidity is substantially dependent on the course of the lawsuit between Intertainment and Franchise Pictures.

2.8 Currency risk

Fluctuations in the exchange rate between the US dollar and the euro can 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.

2.9 Risks from the participation in SightSound Technologies, Inc.

The still pending lawsuit with the Bertelsmann subsidiary CDNow is about implementing the patents for the digital download of audio and video files over the Internet in the USA. Following a postponement recently, a decision is to be expected at the beginning of 2004 at the earliest. Considerable opportunities but also significant risks are connected with the decision, relating to the recoverability of the participation book value and the generation of future cash flow.

Ismaning near Munich, July 7, 2003
Intertainment AG

The Management Board

Intertainment Group: Consolidated Balance Sheet

as at December 31, 2002 in accordance with IFRS

ASSETS		in TEuros	
	Note	12/31/2002	12/31/2001
A. FIXED ASSETS			
I. Intangible assets VI.1			
1. Licenses, commercial property rights and similar rights as well as licenses in such rights		631	263
2. Payments made on account		9,513	4,861
		10,144	5,124
II. Property, plant & equipment			
Other plant, business & office equipment		2,206	2,555
III. Financial assets			
Participations		15,036	15,036
		27,386	22,715
B. CURRENT ASSETS			
I. Inventories VI.2			
1. Film rights		10,831	27,700
2. Merchandise		425	177
3. Payments made on account		33,107	24,570
		44,363	52,447
II. Receivables and other assets VI.3			
1. Trade receivables		37,165	54,242
2. Other assets		9,452	12,373
		46,617	66,615
III. Cash in hand, bank balances VI.4			
		3,922	14,231
		94,902	133,293
C. DEFERRED TAXES VI.5			
		5,132	5,214
		127,420	161,222

EQUITY & LIABILITIES		in TEuros	
	Note	12/31/2002	12/31/2001
A. EQUITY VI.6			
I. Subscribed capital VI.6.1			
		15,005	15,005
II. Capital reserve VI.6.2			
		149,426	149,523
III. Revenue reserves VI.6.3			
Statutory reserve		116	116
IV. Retained earnings			
		-74,496	12,311
V. Net deficit for the year			
		-16,124	-86,807
		73,927	90,148
B. PROVISIONS			
1. Tax provisions VI.7.1			
		117	924
2. Other provisions VI.7.2			
		6,966	11,224
		7,083	12,148
C. LIABILITIES VI.8			
1. Liabilities to banks			
		16,172	23,227
2. Payments received on account			
		419	3,266
3. Trade payables			
		24,233	26,301
4. Other liabilities			
		3,782	3,896
		44,606	56,690
D. DEFERRED TAX LIABILITIES VI.9			
		1,804	2,236
		127,420	161,222

Intertainment Group: Consolidated Income Statement

for the period from January 1 to December 31, 2002 in Accordance with IFRS

in TEuros	Note	1/1-12/31/2002	1/1-12/31/2001
1. Sales revenues	VII. 1	18,975	31,145
2. Other operating income	VII. 2	6,729	9,615
		25,704	40,760
3. Cost of material	VII. 3		
a) Expenses for film rights and associated performances		16,311	21,728
b) Expenses for bought-in merchandise		562	440
c) Expenses for bought-in services		412	331
		17,285	22,499
4. Personnel expenses			
a) Wages & salaries		3,481	4,347
b) Social security contributions		134	147
		3,615	4,494
5. Amortization of intangible assets and depreciation of property, plant & equipment	VII. 4	507	399
6. Other operating expenses	VII. 5	17,179	19,616
7. Writedowns on financial assets		0	5,012
8. Net interest	VII. 6	-822	5,265
9. Result of ordinary business activity		-13,704	-5,995
10. Extraordinary income		0	53,494
11. Extraordinary expenses		3,282	142,442
12. Extraordinary result	VII. 7	-3,282	-88,948
13. Taxes in income and earnings	VII. 8	-863	-8,137
14. Other taxes		1	1
15. Net Group deficit for the year		-16,124	-86,807
16. Retained earnings / Accumulated loss		-74,496	12,311
17. GROUP RETAINED EARNINGS		-90,620	-74,496
Basic earnings per share		-1.37	-7.36
Diluted earnings per share		-1.37	-7.36

Intertainment Group: Consolidated Cash Flow Statement

for the period from January 1 to December 31, 2002 in Accordance with IFRS

in TEuros	2002	2001
Period result prior to extraordinary items	-12,842	2,141
Amortization & depreciation on items of fixed assets	507	399
Write-downs on financial assets	0	5,012
Changes in provisions	-5,065	-17,253
Changes to inventories	8,085	18,968
Changes in trade receivables	17,077	31,205
Changes in other assets (prior to write-downs)	3,003	-4,043
Changes in trade payables as well as in other liabilities	-5,462	4,983
	5,303	41,412
Non-cash effects of costs applied to the negative cost budgets	-862	0
Non-cash effects of extraordinary items	-3,282	-141,036
Cash effects of extraordinary items	0	52,088
Outflow of funds from current business activity	1,159	-47,536
Outgoing payments for investments in fixed assets	-4,316	-7,213
Outflow of funds from investment activity	-4,316	-7,213
Changes in liabilities to banks	-7,055	-3,870
Inflow of funds from financing activity	-7,055	-3,870
Changes in cash and cash equivalents	-10,212	-58,619
Changes in cash and cash equivalents resulting from exchange rate and other influences	-97	-1
Cash and cash equivalents at beginning of period	14,231	72,851
CASH AND CASH EQUIVALENTS AT END OF PERIOD	3,922	14,231

Intertainment Group: Schedule of Nominal Capital

as at December 31, 2002 in Accordance with IFRS

in TEuros					
	Nominal capital	Capital reserve	Revenue reserve	Retained earnings	Total
STATUS 12/31/1999	12.394	30.771	116	6,742	50,023
Result 2000				5,569	5,569
Currency difference		44			44
Share swap	246	19,802			20,048
Capital increase	2,365	101,485			103,850
Costs of capital increase		-2,577			-2,577
STATUS 12/31/2000	15,005	149,525	116	12,311	176,957
Balance at 12/31/2001				-86,807	-86,807
Currency difference		-2			-2
STATUS 12/31/2001	15,005	149,523	116	-74,496	90,148
Balance at 12/31/2002				-16,124	-16,124
Currency difference		-97			-97
STATUS 12/31/2002	15,005	149,426	116	-90,620	73,927

Intertainment Group: Notes

for the year 2002 according to IFRS

I. General information

Intertainment AG, which had been listed since February 1999 in the "Neuer Markt", changed on January 15, 2003 to the regulated market, sub-segment "Prime Standard," of the Frankfurt Stock Exchange. The consolidated financial statements of Intertainment Aktiengesellschaft have been prepared, pursuant to § 292a HGB, according to 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.

Intertainment prepared the reconciliation account with IFRS for the first time 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 format for the income statement.

In these Notes, the figures are stated in thousand euro (TEuros). Alongside the figures for the year under review, the corresponding figures for prior year are given. 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:

II.					In TEuros
Company	Subscribed capital (p.y.)	Equity (p.y.)	Annual result 2002 (p.y.)	Share (in %)	Description
Intertainment AG, Ismaning	15,005 (15,005)	153,007 (156,777)	-3,770 (-20,627)		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)	-80,219 (-69,394)	-10,825 (-70,342)	100	The object of the company is the development of media concepts and trade with film rights
Intertainment Animation & Merchandising GmbH, Ismaning	358 (358)	203 (209)	-6 (35)	100	The object of the company is trade with merchandising and cartoon film rights
USA-Intertainment, Inc., Los Angeles	105 (105)	290 (304)	82 (144)	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 statements is December 31, 2002. Both the financial statements of Intertainment AG and those of all the subsidiaries included in the consolidated 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 statements is offset against their equity at the time of their acquisition (IAS 22). Since the financial 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 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 euro of its balance sheet figures at the rate on the closing day and of the figures shown in the income statement at the average rate, **CURRENCY DIFFERENCES** arose in the past financial year of 55 (p.y. 42) TEuros. This was offset against the equity without any effect on results. In addition, under the adjustment of the indivi-

dual financial statements to group-wide accounting and valuation methods, currency differences in the amount of 0 (p.y. 51) TEuros arose, which were taken to income.

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 rights, as often occurs in the case of film rights, Intertainment divides the acquisition costs on the basis of the sales revenues to be expected from each portion of the right. 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
- > film productions which have commenced or which are to commence, as well as
- > fees paid to producers

are shown by Intertainment as payments on account for items of intangible fixed assets. It is decisive for this presentation that the film rights arising are available to Intertainment 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. Intertainment regularly examines the capitalized costs as to their value and, if necessary, writes them down. The writedown is especially necessary when it is not sufficiently probable that a future economic benefit can be generated from the project.

PROPERTY, PLANT & EQUIPMENT

PROPERTY, PLANT & EQUIPMENT are stated at acquisition cost less depreciation. Intertainment depreciates the property, plant & equipment normally on the basis of the normal useful life using the straight-line method. The useful life of the office and business equipment is 4 to 10 years. Low value economic goods of fixed assets up to a value of 410 euro are depreciated in full in the year of acquisition and are shown in the fixed asset schedule as disposals.

FINANCIAL ASSETS

The **FINANCIAL ASSETS** are stated at the lower of acquisition cost and market value. Under a share swap, the acquisition costs were recorded at the value on the day the shares were delivered. Pursuant to IAS 28, participations in which Intertainment possesses less than 100% of the shares or of the voting rights are consolidated only when Intertainment holds more than 20% of the shares or the voting rights and if substantial influence is exercised. In the year under review, no other non-scheduled writedown was made.

2. Current assets

Intertainment records film rights that are acquired for a limited time only under current assets. They are stated at acquisition cost less amortization of the exploited portions of the rights. The cost of financing by outside capital is 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 the breakdown of the acquisition costs and for amortization are the revenues expected, which are analyzed as a proportion of the

total revenues. In the Free-TV area, Intertainment assumes there will be up to three exploitation cycles. Together they cover a period of up to 25 years. If no cinema exploitation is planned for a film, Intertainment breaks down the acquisition costs to the remaining exploitation categories, changing the percentage allocations accordingly.

The film license rights are capitalized when an independent laboratory has approved the technical quality of the film material. The acquisition costs are amortized normally in accordance with economic life or causation.

Intertainment re-examines the exploitability of all film rights regularly (IAS 2). If it is determined that the forecast sales revenues (net sales value) are lower than the capitalized residual book value of a film right, a non-scheduled writedown is made.

The **STOCKS OF MERCHANDISE** were valued at acquisition cost. Merchandise which has already been delivered and for which the distribution partners have a right of return is shown by Intertainment under inventories until the end of the period to which the right of return applies. Only then does Intertainment record the actual sales revenue and the cost of materials.

In cases in which Intertainment makes payments to the film producers prior to the technical acceptance of the film material, these are recorded as payments made on account for film assets. In addition, this item consists of partial payments to Franchise Pictures for film rights which are a subject of the pending litigation. For the case that neither the performance nor a full repayment is expected for these payments made on account, Intertainment forms adjustments.

SHORT-TERM RECEIVABLES and other assets are shown at their nominal value, long-

STOCKS OF MERCHANDISE**SHORT-TERM RECEIVABLES****DEFERRED TAXES**

term receivables and assets are shown at their present value. Intertainment discounts long-term receivables at 5.5% p.a. Receivables in foreign currencies are valued using the euro exchange rate on the balance sheet date.

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. Intertainment forms **DEFERRED TAXES** on the basis of IAS 12 for consolidation bookings with effect on income, that will probably cancel out in subsequent periods ("temporary differences") for valuation differences between IFRS and HGB, 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 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. Intertainment discounts long-term liabilities 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.

OTHER PROVISIONS**LIABILITIES****4. Sales realization**

Intertainment always keeps open the possibility of selling **FILM LICENSE RIGHTS** or exploiting them itself. This has the following effect on the realization of sales:

In the case of a sale of a license a sale is recorded 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
- > the costs for each licensed film right are known, and
- > there is sufficient probability that the economic benefit, i.e. the license fee, will flow to Intertainment when due.

In cases in which Intertainment exploits film rights itself, the sale is recorded in the period of the exploitation of the portion of the right concerned. The exploitation of the video segment begins as a rule six months after the cinema release; the Pay TV exploitation is planned for a further 12 months later.

The sales realization for **MERCHANDISE** occurs when the merchandise is delivered to the retail trade. In the case of goods for which the retail trade has a right of return, the sale is realized only when the return period has expired. Until this time, the goods continue to be shown under inventories.

FILM LICENSE RIGHTS**MERCHANDISE**

V. Explanation of the differences between HGB and IFRS

Pursuant to § 292a II No. 4b HGB, the following differences between HGB and IFRS are to be noted:

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 is applied so that unrealized exchange rate gains are not recorded. A difference of 350 (p.y. 566) TEuros results from this revaluation.

2. General adjustment on receivables

According to IFRS, no general adjustment is formed for trade receivables. According to HGB, a percentage adjustment of 1% (p.y. 1%) is made on receivables on the principle of caution. This corresponds to an amount of 395 (p.y. 556) TEuros.

3. Reversal of the amortization of goodwill

The contribution of INTERTAINMENT Licensing GmbH to Intertainment AG in the financial 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 made pursuant to HGB of 651 (p.y. 651)

TEuros must be eliminated. According to German commercial law, the difference which arises from the capital consolidation and which cannot be distributed among the Group 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 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 2,277 (p.y. 3,209) 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. Under IFRS they must be capitalized. There results an amount to be capitalized of 4,004 (p.y. 4,762) 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%. There is also application of individual tax rates for effects relating to the past. In accordance with the IFRS regulations, Inter-

tainment forms deferred taxes also for loss carry-forwards. The deferred tax earnings in the year under review come to 350 (p.y. 3,344) TEuros.

VI. Explanations to the group 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 comprise mainly cartoon film rights of Intertainment Animation & Merchandising GmbH. They are amortized in accordance with their economic life.

The payments made on account for intangible assets include 5,509 (p.y. 0) TEuros for the acquisition of film rights and 4,004 (p.y. 4,762) TEuros for further film productions.

The amounts shown under this item in the prior year continue in the year under review to be part of the payments made on account. In comparison with the prior year, in the financial year 2002 the administrative costs of a producer were classified as acquisition costs for film rights, since they are part of the film budget.

PROPERTY, PLANT & EQUIPMENT consists of office and business equipment. It is depreciated according to its useful economic life.

The **FINANCIAL ASSETS** of the Intertainment group consist of a 22.8% participation in SightSound Technologies Inc. The participation ratio has therefore declined by roughly two percentage points in comparison with the balance sheet date 2001. Intertainment had then held 24.84% in SightSound Technologies. The decline in the share is wholly attributable to a capital

increase of SightSound Technologies during the year under review in which Intertainment did not participate.

In 2001, Intertainment had written off 5,012 TEuros on the participation in SightSound Technologies. This corresponds to 25% of the acquisition costs. The reason for the writedown was the lower earning capacity value of SightSound Technologies. It resulted from higher risk discounts. With these discounts, Intertainment had taken account of higher sector and company risks as well as the increased level of uncertainty in the media markets. Intertainment is convinced that in the period under review, notwithstanding the existing uncertainties about the outcome of the lawsuit being pursued by SightSound Technologies, no further writedown is necessary.

2. Inventories

At the balance sheet date, the Intertainment Group was in possession of film rights with a value of 10,831 (p.y. 27,701) TEuros. They developed as follows:

VI.2 FILMRIGHTS		in TEuros	
Item	2002	2001	
Balance at January 1	27,701	64,008	
Writeups	1,856	0	
Additions	0	42,692	
Normal depreciation/amortization	-5,481	-5,393	
Non-scheduled writedowns	-4,708	-62,221	
Reclassifications (p.y. disposals/reductions)	-8,537	-11,385	
Balance at December 31	10,831	27,701	

The writeups relate to various film rights which had been the subject of non-scheduled amortization in the prior year. 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 year under review.

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

The reclassification of film assets results solely from the change in presentation of the film rights for "Caveman's Valentine". The acquisition costs of this film are no longer included under film assets. Despite an arbitration court ruling and the fact that Intertainment thereupon paid an outstanding residual amount for the film rights to Caveman's Valentine, the film has not been delivered. Since Caveman's Valentine is a subject of the lawsuit against Franchise Pictures, we assume that delivery will not take place. For this reason, Intertainment shows in the reporting year the payments made for this film right to Franchise Pictures within current assets under the item "Payments made on account".

The merchandise comprises merchandising articles and video and DVD stocks. The value is 425 (p.y. 177) TEuros.

The payments made on account for film rights in the amount of 33,107 (p.y. 24,570) TEuros consist mainly of payments

of the first installment for film rights of Franchise Pictures that are directly connected with the pending litigation. Intertainment has paid the first of two installments for these films. We show the entire amount for the first installments, less risk allowance, as payments made on account for film rights. The payments made developed as follows:

VI.2 PAYMENTS MADE		
	in TEuros	
Item	2002	2001
Balance at January 1	24,570	6,904
+ Reclassifications from film assets	8,537	0
+ Additions from payments on account to Franchise Pictures	0	87,576
- Disposals from payments on account to Franchise Pictures	0	-5,925
- Writedowns (risk allowance)	0	-63,985
Balance at December 31	33,107	24,570

The reclassifications relate to the film "Caveman's Valentine" and correspond to the "Reclassifications of film assets" described under Point VI.2. Although the delivery was not made, Intertainment assumes that the payments made for Caveman's Valentine represent a recoverable asset since, in the estimate of Intertainment, there is a recourse claim in this amount against Franchise.

At the present time, Intertainment assumes that there is nothing further to indicate any non-scheduled writedown of the payments made on account.

LONG-TERM RECEIVABLES

3. Receivables and other assets

Of the trade receivables 19,214 (p.y. 47,075) TEuros have a residual term of more than one year. The **LONG-TERM RECEIVABLES** relate to the sale of Free-TV rights. Here the payment dates are linked directly to the commencement of the relevant license cycle of the films. The discount amount on the long-term receivables fell by 932 (p.y. 2,466) TEuros. It is included under interest and other earnings. The other assets are composed mainly of receivables from Blackout Productions Inc. in the amount of 6,820 (p.y. 0) TEuros as well as Paramount Pictures in the amount of 506 (p.y. 2,260) TEuros and of input VAT which is not yet due in the amount of 1,337 (p.y. 1,371) TEuros.

4. Cash on hand, bank balances

Liquid funds totaling 3,922 (p.y. 14,231) TEuros result in the amount of 900 (p.y. 10,459) TEuros from fixed term deposits and in the amount of 3,022 (p.y. 3,772) TEuros from current accounts as well as from cash in hand. The fixed term deposits all have remaining terms of less than one year. Because of a surety and a letter of credit, which are connected with the rent obligations for the office premises, 717 (p.y. 1,039) TEuros of the liquidity is not freely available.

5. Deferred tax assets

Deferred taxes have been formed on consolidation measures which affect income (these measures will probably cancel out in the subsequent periods); on valuation differences between HGB and IFRS; and on loss carry-forwards in the amount that realization may be expected. The amount recognized is determined by applying an estimated tax rate of 38% for municipal

trade earnings and corporation tax, and on the basis of individual tax rates in the case of effects related to the past. We refer to our comments under Point VII.8.

6. Equity

6.1 Subscribed capital

In the financial year 2002 the **NOMINAL CAPITAL** was unchanged at 15,005 TEuros. It is held in the form of 11,739,013 issued no-par shares. In comparison with the prior year, no change was made during the financial year 2002 in the subscribed capital.

APPROVED CAPITAL

The board is authorized until January 28, 2004, with the consent of the supervisory board, to increase the nominal capital by issuing, once or more than once, new bearer no-par shares against cash contribution or contribution in kind by **AUTHORIZED CAPITAL** in the amount of 3,203 TEuros, and until June 26, 2006 by authorized capital in the amount of a further 4,300 TEuros (authorized capital II). If the authorized capital is used, the board will determine, with the consent of the supervisory board, the conditions of the share issue.

The board is authorized furthermore, with the consent of the supervisory board, on exercise of the authorized capital and of the authorized capital II, to exclude partially or wholly the subscription right of the shareholders in the following cases:

- > to compensate for fractional amounts
- > to obtain contributions in kind
- > when the capital increase against cash contributions does not exceed 1,500 TEuros of the nominal capital and the issue price

of the shares is not substantially lower than the stock exchange price

> if this is necessary, in order to be able to grant a subscription right to bearers of options and convertible bonds issued by the company in the scope to which they would be entitled on exercise of the options.

CONTINGENT CAPITAL

The contingent capital I at December 31, 2002 is 511 TEuros. An increase in the contingent capital is only made if the holders of subscription rights which are issued by Intertainment AG on the strength of the authorization of the shareholders' meeting of January 18, 1999 as well as on the strength of the amended authorization of the shareholders' meeting of July 9, 1999 make use of their subscription rights. The new shares participate in profit from the commencement of the financial year in which they arise through the exercise of subscription rights.

There is also a contingent capital II of 383 TEuros. According to the resolution of the shareholders' meeting of June 27, 2001 (share option program 2001), it serves the granting of option rights to employees, members of the board and of management of the company or of affiliated enterprises. The new shares participate in profit from the commencement of the financial year in which they arise through the exercise of option rights.

The nominal capital of the company is contingently increased by a further 6,002 TEuros (contingent capital III). The contingent capital increase is in order to grant rights to the bearers or creditors of option and convertible bonds, which are issued by the company before June 26, 2006 inclusive or by an enterprise in which the company holds a direct or an indirect participation. The new shares participate in profit from the commencement of the financial year in which they arise through the exercise of conversion or option rights or through the fulfillment of conversion obligations.

6.2 Capital reserve

At the balance sheet date the capital reserve was 149,426 (p.y. 149,523) TEuros. The change arises from the offsetting of currency differences.

6.3 Revenue reserve

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

7. Provisions

7.1 Tax provisions

The tax provisions developed in the reporting year as follows:

VI. 7.1 TAX PROVISIONS					in TEuros
Type of provision	Status 1/1/2002	Utilization	Release	Allocation	Status 12/31/2002
Municipal trade tax	854	0	-854	37	37
Corporation tax	70	-70	0	75	75
Solidarity surcharge	0	0	0	5	5
Total	924	-70	-854	117	117

The tax provisions cover taxes which have still to be paid for the financial years 1998 to 2000, which have arisen following a tax audit.

7.2 Other provisions

The other provisions developed in 2002 as follows:

VI. 7.2 OTHER PROVISIONS					in TEuros
Type of provision	Status 1/1/2002	Utilization	Release	Allocation	Status 12/31/2002
Litigation risks	3,068	-2,690	0	2,622	3,000
Outstanding invoices	2,788	-950	-18	803	2,623
Allowance for license sales	4,250	-4,250	0	765	765
Personnel	520	-496	-25	373	372
License fees	249	-239	-10	127	127
Miscellaneous	349	-270	0	0	79
Total	11,224	-8,895	-53	3,690	6,966

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 litigation risks comprises the estimated costs which may still be incurred of the pending litigation with Franchise Pictures.

The provision for allowances from license sales results from disputes in the contract implementation of sales of films. In 2002 Intertainment adjusted existing contracts with licensees because of, among other reasons, the litigation with Franchise Pictures. This is reflected in the utilization in the amount of 4,250 TEuros.

The provision for personnel relates to vacation not taken and severance pay.

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 1,250 (p.y. 787) TEuros have a residual term of more than one year.

8. Liabilities

The liabilities to financial institutions relate exclusively to loans.

Liabilities exist of 15,185 (p.y. 16,359) TEuros to HypoVereinsbank AG and 987 (p.y. 6,637) TEuros to BHF Bank. Both loans are being repaid and are due for repayment at the latest on June 30, 2004. The rates of interest are variable and are linked to base interest rates. In the current financial year,

5,881 TEuros were repaid of the BHF loan and 1,358 TEuros of the HVB loan.

With the loans, Intertainment has financed the purchase of film licenses and agreed in this connection with the banks the assignment of these exploitation rights, the assignment of the material as security as well as the assignment of receivables from sales contracts. We refer moreover to our comments on contingent liabilities under Point VIII 5.

The trade liabilities result mainly from the purchase of film rights. The long-term liabilities of 18,206 (p.y. 20,441) TEuros included here are discounted with 2,277 (p.y. 3,209) TEuros. They include 3,770 TEuros for the film Caveman's Valentine, which have been paid in the financial year 2003.

The other liabilities include mainly repayment obligations of 2,088 (p.y. 0) TEuros to Paramount Pictures.

9. Deferred tax liabilities

Deferred tax has been formed on consolidation measures with effect on income that will probably cancel out in subsequent periods, and also 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 corporation tax, and on the basis of individual tax rates for effects related to the past. We refer to our comments under Point VII.8.

VII. Explanations to the Group income statement

1. Sales revenues

Sales revenues were 18,975 TEuros, following 31,145 TEuros in the prior year. They are made up as follows:

VII. 1 SALES REVENUES		
	in TEuros	
Type of provision	2002	2001
Sale of film rights	14,527	28,365
Sale of visual media	3,727	1,709
Other sales revenues	822	1,118
Sales deductions	-101	-47
Total	18,975	31,145

The sales deductions relate mainly to rebates and discounts.

2. Other operating income

Other operating income includes 2,049 (p.y. 0) TEuros in costs for film projects which are applied to the production budget of the film. The item also includes currency gains of 2,162 (p.y. 4,935) TEuros, writeups on film rights of 1,856 (p.y. 0) TEuros, and remuneration received for producer services of 528 (p.y. 3,712) TEuros.

3. Cost of materials

The cost of materials is made up mainly of write-downs on exploited or sold film rights of 5,481 (p.y. 5,393) TEuros, **NON-SCHEDULED WRITEDOWNS** of film rights of 4,708 (p.y. 2,575) TEuros, marketing costs of 3,025 (p.y. 12,618) TEuros, sales input for visual media and merchandising articles of 563 (p.y. 390) TEuros, synchronization

NON-SCHEDULED WRITEDOWNS

costs of 190 (p.y. 0) TEuros and licensor shares of 127 (p.y. 350) TEuros. The non-scheduled writedowns refer to various films whose expected selling prices, in the present marketing situation, were below the book values.

4. Depreciation & amortization

In the year under review, Intertainment performed amortization and depreciation on fixed assets in the amount of 507 (p.y. 399) TEuros.

5. Other operating expenses

The other operating expenses also cover: expenses for currency losses of 5,178 (p.y. 4,269) TEuros, **LEGAL AND CONSULTANCY FEES** of 2,305 (p.y. 6,401) TEuros, and allowances for license sales of 1,055 (p.y. 0) TEuros.

6. Interest result

The interest result is made up of interest income of 1,341 (p.y. 7,336) TEuros and interest expenses of 2,163 (p.y. 2,071) TEuros.

7. Extraordinary result

Since Intertainment was compelled to initiate litigation for fraud against Franchise, we have presented all the items connected with this with effect on income in the extraordinary result.

The extraordinary expenses incurred by Intertainment in connection with the case of Franchise Pictures totaled 3,282 TEuros. They consist of the allocation to the provision for litigation risks of 2,623 (p.y. 3,465) TEuros, the adjustment on receivables of 198 (p.y. 0) TEuros and further allowances in connection with Franchise Pictures in an amount of 461 (p.y. 0) TEuros. In compari-

son with the financial year 2001, the **EXTRAORDINARY CHARGES** connected with the Franchise case have, hence, fallen considerably, as expected. In 2001, the extraordinary charges had come to 142,442 TEuros.

8. Taxes

Intertainment records overall tax income of 863 (p.y. 8,137) TEuros. It is made up as follows:

VII. 8 TAXES		
	in TEuros	
	2002	2001
Taxes on income and earnings	+513	+4,793
Deferred tax income	+350	+3,344
Total	+863	+8,137

The current taxes on income and earnings result in particular from the release of **TAX PROVISIONS** for 1998 to 2000, the period examined by the tax audit. Apart from some minor deviations, there was an additional tax payment for 2000 on account of the timing of an expense item. Deferred taxes are formed on temporary differences between the commercial and the tax accounts and on the differences arising from uniform Group valuation and consolidation. The deferred taxes are calculated at the relevant country tax rates, which in 2002 ranged between 38% and

EXTRAORDINARY CHARGES

TAX PROVISIONS

43%. Tax rate changed applicable after the balance sheet date have been taken into account. The higher tax rate of 26.5% which applies to corporation 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 in Germany. The Group tax rate corresponds to the average domestic tax rate, since more than 95% of the Group's pre-tax result is generated domestically. Taking into consideration the deductibility of the municipal trade tax as well as corporation 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. At the balance sheet date, there were unused corporation tax losses of 102,783 TEuros and municipal tax **LOSS CARRY-FORWARDS** of 114,371 TEuros. The losses can be carried forward without limitation. A deferred tax asset has been recorded on losses of 13,158 TEuros. In the valuation of an asset for future tax reliefs, the probability of the realization of the expected tax advantage is taken into consideration. The following deferred tax assets and liabilities relate to recognition and valuation differences for the individual items in the balance sheet:

LOSS CARRY-FORWARDS

VII. 8 DEFERRED TAX ASSETS				
in TEuros				
	12/31/2002		12/31/2001	
	Assets	Liabilities	Assets	Liabilities
Loss carry-forwards	5,000		5,039	
Intangible assets	132		175	
Payments made on account		1,522		1,810
Trade receivables		150		426
Trade payables		132		0
Total	5,132	1,804	5,214	2,236

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

VII. 8 DEFERRED TAX ASSETS ON LOSS CARRY-FORWARDS		
in TEuros		
	12/31/2002	12/31/2001
Corporation tax	3,026	3,065
Municipal trade tax	1,974	1,974
Total	5,000	5,039

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

VII. 8 EARNINGS TAX EXPENSE: RECONCILIATION		
in TEuros		
	12/31/2002	12/31/2001
Result before taxes on earnings	-16,986	-94,943
Group tax rate	38 %	38 %
Expected income tax expense	-6,455	-36,079
Tax effects as a consequence of		
Differences in tax rates	7	-22
Non-capitalized loss carry-forwards	5,831	27,780
Effects on account of tax rate changes	0	-543
Taxes for prior years on account of tax audit	-575	0
Corporation tax reduction on account of intra-Group distribution	0	-1,211
Other additions and deductions	329	1,938
Taxes on income and earnings	-863	-8,137

The effect from non-capitalized taxes on loss carry-forwards includes an adjustment of taxes which have previously been capitalized on losses in the amount of 39 TEuros.

The other additions and deductions result from deductible taxes (324 TEuros) and other non-deductible expenses (5 TEuros).

VIII. Other information

1. Segment reporting

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

- > Film production and trading in feature film rights; and
- > Trading in rights to cartoon films, their exploitation and the merchandising associated therewith.

The situation in the individual business fields is as follows:

The acquisition costs of intangible and tangible assets are 11,498 (p.y. 6,773) TEuros in the segment of film production and trade in rights to feature films, and 2,042 (p.y. 1,614) TEuros in the segment of trade in rights to cartoon films and merchandising.

Under the segment reporting, Intertainment has resolved not to break down the business figures by region. On account of the relatively low sales of the Group, there is a danger that a publication of these fig-

VIII. 1 SEGMENT REPORTING								in TEuros	
Item	Film production and trading in rights to feature films		Trading in rights to cartoon films and merchandising		Consolidation		Total		
	2002	2001	2002	2001	2002	2001	2002	2001	
External sales revenues	14,527	28,365	4,448	2,780	0	0	18,975	31,145	
Write-downs	-414	-363	-204	-186	111	150	-507	-399	
Non-cash expenses	-14,333	-149,004	0	0	0	0	-14,333	-149,004	
Net interest	-675	5,460	-147	-195	0	0	-822	5,265	
Extraordinary result	-3,282	-88,948	0	0	0	0	-3,282	-88,948	
Annual result	-16,367	-87,383	243	576	0	0	-16,124	-86,807	
Assets	124,483	158,076	2,937	3,147	0	0	127,420	161,223	
Tangible assets	2,186	2,552	20	3	0	0	2,206	2,555	
Receivables	46,201	66,171	1,245	1,273	0	-829	46,617	66,615	
Liabilities	44,370	56,573	2,126	2,628	-1,890	-2,511	44,606	56,690	

ures would lead to considerable competitive disadvantages for Intertainment, in particular in negotiating contracts with customers.

2. Result per share

According to IAS 33, the result per share is calculated by dividing the period result by the weighted average number of the shares in circulation.

The number of Intertainment shares is 11,739,013. In 2002 the Group recorded a deficit of 16,124 TEuros, following a deficit of 86,807 TEuros in the previous year. Hence the result per share improved in 2002 to minus 1.37 euros, after minus 7.36 euros in 2001. The diluted result per share in the year under review and in the prior year corresponds to the undiluted result.

3. Employee share program

The **SHARE OPTION PROGRAMS** of 1999 and 2001 authorize Intertainment AG to offer to employees or members of the board, 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 is determined for the members of the management board by the supervisory board alone, and in other cases by the management board 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, relative to the option rights granted, 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 subscription 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 the further price development, in a later exercise period. 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 be purchased by those with entitlement. Under the share option program 2001, the offer to subscribe the option rights may only be made within two weeks of publication of an annual, semi-annual 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 blocking 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.

**NO SHARE
OPTIONS ISSUED**

NO SHARE OPTIONS were issued in the financial year 2002. The number of issued shareoptions, 338,000, at December 31, 2002 was therefore the same as at the balance sheet date of the previous year. The number of options still available is also unchanged at 62,000 for employees arising from the share option program of 1999 as well as 50,000 options for employees from the share option program of 2001. For the board, the available options from the share

option program 2001 is unchanged at 210,000. No expense has been recorded for the share options issued, since under IAS 19 there is at present no explicit ruling on this. A "fair value" at the balance sheet date has not been calculated.

4. Other financial commitments

At December 31, 2002, Intertainment records the following future payment obligations:

VIII. 4 OTHER FINANCIAL COMMITMENTS			in TEuros
	Remaining term less than 1 year	Remaining term more than 1 year	Total
Obligations arising from film productions	32,699 (p.y. 8,475)	7,659 (p.y. 32,204)	40,358 (p.y. 40,679)
Obligations arising from lease and rental contracts	1,640 (p.y. 1,457)	3,245 (p.y. 4,616)	4,885 (p.y. 6,073)
Total	34,339 (p.y. 9,932)	10,904 (p.y. 36,820)	45,243 (p.y. 46,752)

**OBLIGATIONS ARISING FROM FILM
PRODUCTIONS**

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

**OTHER OBLIGATIONS FROM LEASING
AND RENTAL CONTRACTS**

The Intertainment Group leases motor vehicles and various items of office equipment, all of which are classified under operating leases. 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.

**PAYMENTS OBLIGATIONS FOR FRAN-
CHISE FILM RIGHTS**

In the estimate of Intertainment, the financial obligations shown at December 31, 2000 for film rights of 176,618 TEuros no longer exist since, firstly, Intertainment has in part made payments and, secondly, has resolved on account of the lawsuit against Franchise Pictures not to pay the second installment for the films affected by the litigation. In an arbitration case in the year under review, the National Bank of Canada successfully obliged Intertainment to pay the second installment for the film Caveman's Valentine. For the case that the financing banks of Franchise Pictures initiate further arbitration proceedings for payments of second installments for disputed film rights, as has happened for the film "Driven," Intertainment assumes that, in the case that there is a ruling in their favor, the banks would be obliged to offset the income from the exploitation of these film rights against the payments obligation of Intertainment. However, in the case of "Caveman's Valentine" no offsetting took place. Basically Intertainment assumes that the income from the exploitation will be considerably higher than the payment obligation for the outstanding second installment.

Meanwhile, International Motion Picture Corporation Ltd., which is based in Hong Kong, opened on June 18, 2003 a further arbitration case against INTERTAINMENT Licensing GmbH on account of payment of damages in the amount of 3,262,500 US dollars in the case "Tracker".

Any arbitration proceedings are independent of – and are without affect on – the lawsuit against Franchise Pictures. Only in the proceedings before the Federal District Court in Los Angeles will there be a definitive decision about the fraud committed by Franchise Pictures against Intertainment.

5. Other contingent obligations

Intertainment has financed part of its film rights with **LOANS** from financial institutions. In return, Intertainment has assigned to the banks film rights and receivables arising from the exploitation of the rights. Overall, in this connection, receivables of 16,002 (p.y. 16,052) TEuros have been assigned to HypoVereinsbank AG and receivables of 16,522 (p.y. 14,811) TEuros to BHF Bank.

During the financial year 2001 Intertainment AG assumed a guarantee to HypoVereinsbank AG of 16,361 (p.y. 16,361) TEuros. This serves as security for a loan taken out by INTERTAINMENT Licensing GmbH. This loan is repayable on June 30, 2004. At December 31, 2002, the amount of the loan was 15,185 (p.y. 16,358) TEuros.

For the tenancy of the office premises in Ismaning, in 2000 Intertainment AG gave a surety of 76 (p.y. 76) TEuros, which is unchanged. There is furthermore a letter of credit from Intertainment AG for 666 (p.y. 1,000) thousand US dollars for the rental obligations relating to the tenancy of office premises of USA-Intertainment, Inc. in Los Angeles.

6. Financial instruments

In order to hedge currency risks, especially against 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. At the balance sheet date, and also in the prior year, there were no forward currency transactions.

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

In the year under review, taxes on income amounting to 70 (p.y. 7,865) TEuros were paid. Intertainment received **TAX REFUNDS** of 7,319 (p.y. 10,093) TEuros, paid interest of 1,231 (p.y. 2,071) TEuros and received interest of 251 (p.y. 1,661) TEuros. In the year under review and in the prior year, there were no "non-cash transactions" affecting exclusively equity.

8. Executive bodies

MANAGEMENT BOARD

> Ernst Rüdiger Baeres, Munich (chairman)
> Stephen Joel Brown, Los Angeles (deputy chairman)
> Hans-Joachim Gerlach, Berlin (chief financial officer)
Ernst Rüdiger Baeres has sole power of attorney. Stephen Joel Brown and Hans-Joachim Gerlach each have power of attorney jointly with a further board member. The **COMPENSATION OF THE BOARD** for the calendar year 2002 was 2,129 (p.y. 2,213) TEuros. This sum also includes importantly

severance payments for a member of the board who left in the financial year 2001.

SUPERVISORY BOARD

> Dr. Matthias Heisse, lawyer, Munich (chairman)
> Dr. Ernst Pechtl, German MBA, Berg (deputy chairman)
> Dr. Wilhelm Bahner, German MBA, Munich

During the reporting year, Dr. Matthias Heisse was also a member in the supervisory board of Firestorm AG, Munich. During the financial year 2002, Dr. Ernst Pechtl was also a member of the supervisory boards of Wegold Edelmetalle AG, Wendelstein, PointS International AG, Darmstadt, and InfoMiner AG, Weilheim. Dr. Wilhelm Bahner did not hold any further supervisory board offices during the financial year 2002. For the financial year 2002, **SUPERVISORY BOARD COMPENSATION** in the amount of 23 (p.y. 25) TEuros was paid.

9. Related companies and persons

In the meaning of 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 2,714 (p.y. 2,929) TEuros. Of this amount Intertainment AG paid 1,683 (p.y. 0) TEuros and INTERTAINMENT Licensing GmbH 1,031 (p.y. 2,929) TEuros. In addition, the following amounts were offset between the individual Group companies for services:

VIII.9 OFFSETS	in TEuros	
	2002	2001
Intertainment AG	101	-29
INTERTAINMENT Licensing GmbH	48	168
Intertainment Animation & Merchandising GmbH	-149	-139

The liquidity of the Group companies is assured by means of intercompany accounts with Intertainment AG, which bear interest at the normal market rates. At December 31, 2002, Intertainment AG had the following receivables from its subsidiaries:

VIII.9 RECEIVABLES FROM SUBSIDIARIES	in TEuros	
	2002	2001
INTERTAINMENT Licensing GmbH	105,884	98,552
Intertainment Animation & Merchandising GmbH	1,746	2,511
USA-Intertainment, Inc.	1,749	2,721

Rüdiger Baeres is to be considered a natural related person. At the balance sheet date he held 52.9% of the voting rights in Intertainment AG. Close family members of Rüdiger Baeres hold a further 9.38% voting rights.

During the year under review, fees of 311 (p.y. 650) 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, stock corporation act).

Fees of 64 (p.y. 83) TEuros were paid to Pechtl GmbH under a further separate consultancy contract (pursuant to §114 AktG). Dr. Ernst Pechtl is the managing shareholder of this enterprise.

10. Shares and options held by members of the executive bodies

The figures on shares and option rights held by members of the executive bodies have not changed in comparison with the prior year. At December 31, 2002 they were as follows:

VIII.10 SHARE OWNERSHIP AND OPTIONS

MANAGEMENT BOARD	Shares	Options
Rüdiger Baeres	6,205,635	0
Achim Gerlach	10,000	100,000
Stephen Brown	0	50,000
SUPERVISORY BOARD	Shares	Options
Dr. Matthias Heisse	12,980	0
Dr. Ernst Pechtl	0	0
Dr. Wilhelm Bahner	0	0

At December 31, 2002 the company did not hold any own shares.

11. Lawsuit against Franchise Pictures

In connection with the lawsuit against Franchise Pictures we refer to Point A/4 of the management report.

TAX REFUNDS

COMPENSATION OF THE BOARD

COMPENSATION OF THE SUPERVISORY BOARD

12. Employees

On average during the financial year 2002, the Group employed 23 (p.y. 28) staff.

13. Company headquarters

Intertainment AG is located at Osterfeldstrasse 84, 85737 Ismaning.

14. Events occurring after the balance sheet date**STRATEGIC PARTNERSHIP WITH OPENPICTURES AG**

On July 4, 2003 Intertainment AG entered a strategic partnership with OpenPictures AG involving collaboration in operating business and in Intertainment's pending lawsuits against, among others, Franchise Pictures. The aim of the collaboration is, firstly, to finance and distribute international feature films in cooperation with major US film studios. Secondly, OpenPictures AG shares the legal position of Intertainment in the current lawsuit against Franchise Pictures, Comerica Bank and the insurance companies (among others) and receives the **RIGHT TO PARTICIPATE IN THE COURT COSTS** or to assume rights and duties connected with the trial. Moreover, Intertainment and OpenPictures AG will pursue jointly innovative distribution channels for the download of audio and video data from the Internet in the area of film production, using the participation of Intertainment in SightSound Technologies.

LAWSUIT AGAINST COMERICA BANK AND THE INSURANCE COMPANIES

Comerica Bank and the insurance companies that are co-defendants submitted a petition for suspension of the action until

there has been a ruling in the arbitration case for the film "Driven"; they also entered an application for enforcement of arbitration proceedings.

On June 27, 2003 a hearing was held on these matters before the State Court of the State of California. The judge allowed the application of the defendants for suspension of the action until a decision has been made in the arbitration proceedings.

ARBITRATION PROCEEDING FOR THE FILM "DRIVEN"

In February 2003, Comerica Bank opened arbitration proceedings against INTER-TAINMENT Licensing GmbH for payment of the second installment of the guaranteed license fee for the film "Driven" in the amount of 13.6 million US dollars. In its rejoinder, Intertainment stated its position comprehensively, asserting defenses, counterclaims and crosspetitions.

The Board assumes that the decision will go to a consolidated arbitration proceeding for all films of Franchise Pictures that are subject to the allegation of fraud with regard to all claims asserted in this connection. Furthermore, the Board expects that the date laid down for this **PROCEEDING** will be subsequent to the main hearing of the lawsuit against Franchise Pictures. Intertainment will initiate the necessary petitions and procedural steps.

ARBITRATION PROCEEDINGS FOR DAMAGES FOR THE FILM "TRACKER"

In a case which is connected with the allegation of budget fraud against Franchise Pictures, the banks and the insurance companies, International Motion Picture Corporation Ltd., which is based in Hong Kong, opened on June 18, 2003 a further **ARBITRATION CASE** against INTER-TAINMENT Licensing GmbH for payment of damages

in the amount of 3,262,500 US dollars for the film "Tracker". Intertainment will take position against this claim for damages in a comprehensive letter of reply. At no time has Intertainment agreed to arbitration proceedings with International Motion Picture Corporation Ltd. The film "Tracker" is a subject of the budget fraud allegation, so that Intertainment will submit all pleas, crosspetitions and counterclaims in this case, too. Here, too, Intertainment will petition for the claims submitted to be decided in the consolidated hearing described above after the main proceedings of the lawsuit against Franchise Pictures.

RESULTS OF THE PRE-TRIAL CONFERENCE ON THE LAWSUIT AGAINST FRANCHISE PICTURES

On June 16 and 18, 2003 the pre-trial conference was held on the lawsuit against Franchise Pictures. During this conference, the competent judge of the United States District Court confirmed the date of the main hearing in the lawsuit of Intertainment against Franchise Pictures. The main hearing will hence, as planned, begin on August 5, 2003. The judge has set **16 DAYS FOR THE HEARING** spread over a period of four weeks. The judge has distributed the time available for presentation of the legal positions evenly. For July 28, 2003 the court has set a hearing to decide on certain procedural petitions of the parties.

CONTRACTUAL ARRANGEMENTS FOR THE FILM "BLACKOUT"

In May 2003, for the film project "Blackout" a supplementary agreement was concluded with Blackout Productions in addition to the existing framework contract with Paramount Pictures. This agreement governs the details on production, financing and exploitation of the rights to the film.

POSTPONEMENT OF THE LAWSUIT OF SIGHTSOUND TECHNOLOGIES INC.

The hearing for the case SightSound Technologies Inc. against the Bertelsmann subsidiary CDNow will not, as originally planned, take place on September 8, 2003. A hearing will be held in court on August 4, 2003 in which the new court date is to be specified.

No other events have occurred since the balance sheet date which could lead to the financial statements for the year ended December 31, 2002 presenting a false impression of its circumstances.

15. Statement on the German Corporate Governance Code

The board and the 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 near Munich, July 7, 2003
Intertainment AG

Rüdiger Baeres
Chairman of the Board

Stephen Brown
Deputy Chairman

Achim Gerlach
Financial Officer

RIGHT TO PARTICIPATE IN THE COURT COSTS

PROCEEDING SUBSEQUENT TO THE MAIN HEARING

16 DAYS FOR THE HEARING

ARBITRATION CASE

Intertainment Group: Schedule of Fixed Assets

In TEuros	ACQUISITION COSTS					ACCUMULATED AMORTIZATION				CARRYING VALUE	
	1/1/2002	Additions	Disposals	Reclassification	12/31/2002	1/1/2002	Amortization & depreciation in the financial year	Disposals	12/31/2002	12/31/2002	12/31/2001
I. Intangible assets											
1. Licenses, commercial property rights and similar rights as well as licenses in such rights	480	394	0	99	973	217	125	0	342	631	263
2. Payments made on account	4,861	4,751	0	-99	9,513	0	0	0	0	9,513	4,861
II. Tangible assets											
Other plant, business and office equipment	3,047	33	-26	0	3,054	492	382	-26	848	2,206	2,555
III. Financial assets											
Participations	20,048	0	0	0	20,048	5,012	0	0	5,012	15,036	15,036
	28,436	5,178	-26	0	33,588	5,721	507	-26	6,202	27,386	22,715

Intertainment Group: Audit opinion

We have audited the consolidated financial statements prepared by Intertainment Aktiengesellschaft, Ismaning, rural district of Munich, comprising the balance sheet, the income statement, the statement of changes in shareholders' equity, the cash flow statement as well as the notes to the financial statements for the financial year from January 1 to December 31, 2002. The preparation and the content of the consolidated financial statements in accordance with the International Financial Reporting Standards (IFRS) are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements and the Group management report based on our audit.

We conducted our audit of the consolidated financial statements in accordance with German auditing regulations and the generally accepted 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 it can be assessed with reasonable assurance whether the consolidated financial statements are free

of material misstatements. 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 evidence supporting the amounts and disclosures in the consolidated financial statements is examined 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. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the consolidated financial statements in compliance with the International Financial Reporting Standards give a true and fair view of the net assets, financial position and results of operations of the Group as well as of the cash flows of the financial year.

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,

2002, has not led to any reservations. In our opinion on the whole, the Group management report provides a suitable understanding of the Group's position and suitably presents the risks of future development. In addition, we confirm that the consolidated financial statements and the Group management report for the business year from January 1 until December 31, 2002 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 qualifying this opinion, we draw attention to the comments made in the Group management report. It is stated that there are considerable uncertainties in the assumptions on which the budget is based. If these assumptions should fail to materialize as planned, the Group will not be able to meet its current payments obligations and the payment obligation to redeem a bank loan which is due in June 2004. For further details, we refer to the comments in Section "D. Risks of future development" in the Group management report. If only one of the events described below fai-

ls to materialize as planned, the ability of the company to continue as a going concern is threatened.

- > Cash-Inflow of funds from the lawsuit against Franchise Pictures in the amount budgeted by the legal representatives.
- > Positive outcome of current arbitration proceedings. Moreover, there are additional circumstances threatening the Group's ability to continue as a going concern, since third parties could open and win further arbitration court proceedings against Intertainment for payment of the second installments for the disputed film rights.
- > Realization of the other assumptions of the financial plan including the incoming payments planned for the near future.

Munich, July 7, 2003

KPMG

Deutsche Treuhand-Gesellschaft
Aktiengesellschaft
Wirtschaftsprüfungsgesellschaft

Dr. Bartels-Hetzler
Wirtschaftsprüfer

Dr. Kreher
Wirtschaftsprüfer

Intertainment AG: Management Report

for the financial year 2002

A. Development of the financial year 2002

1. Overall economic development and development of the mass media industry

During 2002, world economic growth was weak. This had a negative effect on the European media industry and in particular on the **VOLUME OF ADVERTISING** in the mass media. As a result, many TV broadcasters that are financed by advertising suffered from falling revenues. They reacted by, among other things, reducing their investments in new film rights. The other sales markets of the film sector developed better. Hence the turnover of the cinema sector in the USA was at a record level. In the most important European markets – for example in Germany – they were only slightly below a new record. The video/DVD area in turn showed high growth rates worldwide. This was exclusively due to the high demand for DVD.

2. Development of Intertainment AG: fraud by Franchise continues to be a burden

Intertainment AG (also referred to below as Intertainment) functions as financial holding within the Intertainment Group. It is also engaged in the areas of film production and trading in film licenses.

In particular in the area of film production – and consequently also in the exploitation of licenses – the fraud which came to light two years previously of the American film producer Franchise Pictures continued to impact negatively on Intertainment; in 2002 this impact took the form of limiting the financial scope of Intertainment to engage in further film projects. This is all the more decisive since the development of new film material is associated with considerable financial input up front.

In its film development and production, Intertainment meanwhile relies exclusively on the collaboration agreed in May 2000 with Kopelson Entertainment, the company of the American film producer Arnold Kopelson. In the year just completed, the two partners had **FIVE FILM PROJECTS IN THE DEVELOPMENT PHASE**. Of these, one – the thriller "Blackout" – was realized. Intertainment started with the worldwide advance sale of licenses for "Blackout" in 2002. For this purpose, Intertainment concluded an agency contract with Summit Entertainment, which is specialized in international distribution. At the time this management report was completed, the rights to "Blackout" had been sold for large parts of western and eastern Europe, of the Middle East, Asia and for South Africa. The agreements will probably have an impact on turnover in 2003.

DIRECT CONSEQUENCE OF THE LITIGATION

FIVE FILM PROJECTS IN THE DEVELOPMENT PHASE

3. Subsidiaries

3.1 INTERTAINMENT Licensing GmbH:

3.1.1 Three package sales to TV stations
 INTERTAINMENT Licensing GmbH is specialized in trading in film licenses. In 2002 the operative business continued to be in decline. This is a **DIRECT CONSEQUENCE OF THE LITIGATION** with Franchise Pictures. The litigation has had the consequence that since the fall of 2000 Intertainment has not received any new film rights for exploitation. In 2002, it obtained sales revenues of 5.5 (p.y. 28.3) million euros. Its result from ordinary business activity was minus 7.3 (minus 2.4) million euros, and there was a net deficit for the year of 10.8 (70.3) million euros.

In the financial year 2002, INTERTAINMENT Licensing GmbH succeeded, notwithstanding the difficult situation on the TV market, in selling three film packages with TV rights. The film package with Free TV rights went to a British broadcaster, in Germany Pay and Free TV rights were sold to the Tele München group, while in eastern Europe an all-rights film package was sold.

3.1.2 The case of Franchise Pictures: Main hearing to be held on August 5, 2003

3.1.2.1 Lawsuit against Franchise Pictures: RICO claims permitted

In 2002, too, the legal action against the American film producer Franchise Pictures was one of the dominant factors for the business development of Intertainment. It tied up considerable management capacities and made it necessary to make financial commitments up front.

Moreover, on account of the financial loss caused by the fraud committed by Franchise Pictures, Intertainment was unable to invest in the development of new films in the measure desired and planned.

The litigation with Franchise Pictures has been pending since December 2000 at the Federal District Court in Los Angeles. According to the information of Intertainment, Franchise damaged the group through fraudulently excessive film budgets by at least 100 million dollars. For this reason, INTERTAINMENT Licensing GmbH has sued Franchise Pictures for damages in this amount.

The actual main proceedings were originally due to commence on November 19, 2002. Previously, in May 2002, the court had granted leave to pursue two of three RICO suits ("Racketeer Influenced and Corrupt Organizations Act") against Franchise Pictures, its CEO Elie Samaha and COO Andrew Stevens. In this connection, the court allowed the suit against Franchise with regard to the formation of a criminal organization, which includes Comerica Bank and the two insurance companies Film Finances and World Wide Film Completion.

RICO suits are a special feature of US civil law. They grant the victims of organized crime, if the finding goes against the defendants, the threefold sum of damages as well as reimbursement of lawyers' fees. Because of their scope, leave to pursue RICO suits is granted only very rarely.

In November, the court terminated, on application by Intertainment, the confidentiality status for a number of trial documents.

COMMENCEMENT OF PROCEEDINGS

However, it did not grant an application for a writ of attachment on parts of the assets of Franchise Partners. By applying for this writ, Intertainment had attempted to secure parts of the receivables which will be claimed in the main proceedings against Franchise Pictures.

Differently to the original time plan, the main hearing of several days did not commence on November 19, 2002. After the lawyers of Franchise suddenly resigned their briefs, the court postponed the date for the **COMMENCEMENT OF PROCEEDINGS** by almost 9 months to August 5, 2003. In January 2003, Franchise appointed new lawyers to represent it at the trial.

3.1.2.2 Action against Comerica Bank and insurance companies: Intertainment takes the partners of Franchise to court

In December 2002 INTERTAINMENT Licensing GmbH also filed a suit for damages against Comerica Bank and Comerica employees Morgan Rector and Jared Underwood, that, in the opinion of Intertainment, were substantially involved in the fraud. The lawsuit is directed also against the insurance companies involved in the fraud and senior employees of these companies – here above all against WorldWide Film Completion and its principal Steve Cardone as well as against Film Finances and its principal Steven Ransohoff. The suit was filed at the State Court in Los Angeles. The counterparties applied to have the suit transferred to the Federal Court, where the suit against Franchise Pictures is pending. Intertainment lodged an objection against

this submission, since a transfer of the case to the Federal Court could have the consequence that the proceedings against Franchise Pictures would not be pursued for the time being.

3.1.2.3 Countersuit by Franchise Pictures

In a countermove, Intertainment AG, INTERTAINMENT Licensing GmbH and the chairman of Intertainment AG Rüdiger Bares personally were sued by Franchise Pictures on the grounds that they had not kept orally given promises and had not made payments in connection with the acquisition of film rights. Intertainment and the legal representatives consider the suit to be entirely unfounded. In 2002 there were no other facts which would justify a different conclusion.

3.1.2.4 Arbitration proceeding on account of "Caveman's Valentine": Intertainment pays second installment

In an arbitration case that the National Bank of Canada initiated against INTERTAINMENT Licensing GmbH, the Bank demanded the payment of a second installment of approximately 7 million US dollars to finance the Franchise film "Caveman's Valentine". The film is part of the Franchise court case, but, unlike the other films, it was not financed by Comerica Bank, but by the National Bank of Canada.

In the course of the arbitration proceedings, it was confirmed that that film had been correctly delivered. Thereupon Intertainment lodged an appeal against the arbitration ruling, but the appeal, too, failed. For this reason, at the beginning of 2003 INTERTAINMENT Licensing GmbH paid the due sum.

PART OF THE TRIAL

Nevertheless, "Caveman's Valentine" remains **PART OF THE TRIAL** against Franchise. No statement as to whether the budget specified by Franchise Pictures was fraudulently excessive – as Intertainment believes – was made during the arbitration proceedings. The subject was, rather, whether the film had been delivered technically as agreed. By this is meant, among other things, that a specialist laboratory confirms the agreed quality of the film from a technical point of view. Intertainment itself has not had the film available at any time. Since it is part of the proceedings against Franchise, Intertainment assumed that, notwithstanding the payments made, it will not actually receive this film from Franchise for exploitation. In the estimate of Intertainment, the recoverability of the amounts recorded in the balance sheet is given on account of the expectation of the outcome of the Franchise trial.

3.2 USA-Intertainment, Inc.: "Blackout" in postproduction

USA-Intertainment, Inc., Los Angeles, performs **SERVICES** on behalf of Intertainment AG and INTERTAINMENT Licensing GmbH. These include in particular overseeing the co-production and co-financing contract with Kopelson Entertainment and the perusal of new film material. In the financial year 2002, it worked together with Kopelson Entertainment and Paramount Pictures especially on the production of the thriller "Blackout". At the end of the year, this was at the postproduction phase. In 2002, USA-Intertainment, Inc. obtained an annual result of 82 (p.y. 144) TEuros.

3.3 Intertainment Animation & Merchandising GmbH: Increasing turnover with "Rudolph"

Intertainment' activities in the segment of cartoon films and merchandising are mainly covered by Intertainment Animation & Merchandising GmbH. In 2002 as in the previous years, this subsidiary marketed in particular the rights in the Christmas character "Rudolph the red-nosed reindeer". Intertainment Animation & Merchandising GmbH holds the exploitation rights in "Rudolph" for the German-speaking countries. In 2002 it expanded the product assortment of Rudolph merchandising articles by 50 to more than 200.

The focus of the Christmas season 2002 was on the **NEW VIDEO** "Rudolph and the island of misfit toys". As expected, the film has sold well. Because of this in particular, Intertainment Animation & Merchandising GmbH achieved, as budgeted, very good sales figures with the Rudolph products. Its turnover rose by 87% to 4.2 million euros. The company had a deficit for the year of 6 TEuros, after a surplus of 35 TEuros in the previous year. The decline in the annual result is due to writedowns on the license on Rudolph, further license fees as well as marketing costs and high investments in new projects.

3.4 Financial participations: Option for SightSound rejected

At the end of the year, Intertainment held 22.8% in the US company SightSound Technologies, Inc. The participation ratio has therefore declined by roughly two percentage points in comparison with the balance sheet date 2001. Intertainment had then held 24.8% in SightSound Technologies. The decline in the share is wholly at-

NEW VIDEO

FINANCIAL INVESTMENT

tributable to a capital increase of Sight-Sound Technologies during the year under review in which Intertainment did not participate.

The engagement in SightSound Technologies is a purely **FINANCIAL INVESTMENT** for Intertainment. SightSound Technologies supplies download technologies for the media industry for the commercial exploitation of feature films and music via the internet. The company has several patents in this area. In the year under review, it continued to be involved in litigation about the value of its patents for the download of digital data. In 2002 the company found a new investor that will ensure that Sight-Sound will probably be able to bring the patent lawsuit to a conclusion. The other shareholders offered the new investor a unilateral option to acquire the company. For this, on exercise of the option, the investor would have to pay to the other shareholders a price dependent on the timing and the status of the litigation. For strategic reasons, Intertainment did not agree to this option.

B. Net worth, financial and earnings position

1. Earnings situation: Rise in sales

In the year under review, Intertainment AG increased its **SALES REVENUES** sharply over the prior year. The background was that it was engaged for the first time operatively in trading in film rights and it succeeded in selling film packages. In all, during the fi-

ancial year 2002 Intertainment AG achieved sales of 9.3 (p.y. 0.6) million euros. In addition, Intertainment AG recorded other income of 10.7 million euros, after 3.9 million euros the previous year. The increase is in particular attributable to costs for film projects of 6.5 (p.y. 0) million euros which were applied to the production budget of a film. Expenses also increased sharply. Cost of materials rose to 11.9 (p.y. 4.8) million euros. **COST OF MATERIALS** includes producer fees of 5.3 (p.y. 4.5) million euros, and scheduled amortization of film rights of 3.7 (p.y. 0.1) million euros. Intertainment AG also recorded non-scheduled writedowns on film rights of 0.6 (p.y. 0) million euros. The **OTHER OPERATING EXPENSES** climbed during the reporting year to 11.3 (p.y. 5.7) million euros. The reasons for the increase over the prior year figure are exchange losses of 3.6 (p.y. 0) million euros, the first time take-up of services of USA-Intertainment Inc. (1.7 million euros, p.y. 0 euros) and repayment obligations to Paramount Pictures of 2.3 (p.y. 0) million euros.

The **RESULT FROM ORDINARY BUSINESS ACTIVITY** is minus 4.6 (p.y. 0.2) million euros. In the prior year, Intertainment AG had benefited here from the distribution by INTERTAINMENT Licensing GmbH of 11.5 million euros. In the financial year 2002, on the other hand, there was no dividend distribution by INTERTAINMENT Licensing GmbH.

After in 2001 the case of Franchise Pictures has led to Intertainment AG making an extraordinary loss of 20.8 million euros, in the year under review it caused, as expected, no extraordinary expense. Consequently, the **LOSS FOR THE YEAR** fell to 3.8 million euros, after 20.6 million euros in the prior year.

COST OF MATERIALS

OTHER OPERATING EXPENSES

RESULT FROM ORDINARY BUSINESS ACTIVITY

LOSS FOR THE YEAR

FILM RIGHTS

SUBORDINATION

2. Net worth situation: subordination letter to INTERTAINMENT Licensing GmbH

On the assets side of the balance sheet, the net assets situation of Intertainment AG is marked by an increase in intangible assets of 5.5 million euros. In the financial year 2002, for the first time payments on account were made for film productions which do not count as manufactured items in the meaning of the commercial code and the media decree.

The **FILM RIGHTS** decreased by 11.0 million euros to 7.4 (p.y. 18.4) million euros. This is in part due to a reclassification of the balance sheet recognition for "Caveman's Valentine" in the amount of 8.5 million euros to payments on account for film rights. Through scheduled amortization, the film assets decreased by a further 3.7 (p.y. 0.1) million euros, and through non-scheduled writedowns by 0.6 (p.y. 0) million euros. On the other hand, there were writeups of 1.9 (p.y. 0) million euros.

Trade receivables fell by 4.3 million euros to 9.5 (p.y. 13.8) million euros, mainly on account of the payment of outstanding items. Receivables from affiliated enterprises increased by 5.6 million euros to 109.4 (p.y. 103.8) million euros. At December 31, 2002, Intertainment AG declared to INTERTAINMENT Licensing GmbH a **SUBORDINATION** for an amount of 85 million euros on the intercompany account. This enabled the material over-indebtedness of INTERTAINMENT Licensing GmbH to be averted.

On the equity & liabilities side of the balance sheet, the provisions for taxes decreased by 0.8 million euros to 37,000 euros. Trade payables fell by 1.0 million

euros to 20.7 (p.y. 21.7) million euros. Payments received on account for film rights at the balance sheet date were to 0.4 (p.y. 0) million euros. Other liabilities rose from 0.3 million euros to 2.4 million euros, since repayment obligations to Paramount Pictures were shown for the first time.

At December 31, 2002, the equity of Intertainment AG was 153.0 (p.y. 156.8) million euros. The **EQUITY RATIO** was 86% (p.y. 87%).

3. Financial position: liquid funds of 3.5 million euros

At the end of the year, Intertainment AG had liquid funds of 3.5 (p.y. 11.3) million euros, which is 7.8 million less than at the balance sheet date of the prior year. The decrease is due mainly to payments of producers' fees, investments in film projects and legal consultancy fees. For the financial year 2003, Intertainment AG has a detailed financial budget from which the management board infers a positive forecast for the continuing existence of the company. The finance plan and the forecast of continued existence are subject to the risks described in section D. Risks of future development. In particular, we refer at this point to the risks imperiling future existence under item D.1 of this management report.

EQUITY RATIO

C. Developments after the ending of the financial year and future development of Intertainment AG

1. Strategic partnership with OpenPictures AG

On July 4, 2003 Intertainment AG entered a strategic partnership with OpenPictures AG involving collaboration in operating business and in Intertainment's pending lawsuits against, among others, Franchise Pictures. The aim of the collaboration is, firstly, to finance and distribute international **FEATURE FILMS IN COOPERATION WITH MAJOR US FILM STUDIOS**. Secondly, OpenPictures AG shares the legal position of Intertainment in the current lawsuit against Franchise Pictures, Comerica Bank and the insurance companies (among others) and receives the right to participate in the court costs or to assume rights and duties connected with the trial. Moreover, Intertainment and OpenPictures AG will pursue jointly innovative distribution channels for the download of audio and video data from the Internet in the area of film production, using the participation of Intertainment in SightSound Technologies.

2. Film development, film production and film license trade: "Blackout" and "Things you can tell" come to the cinemas

The financial possibilities of Intertainment – and hence its scope for developing and producing new films – will likely remain very limited until there is a settlement with

Franchise Pictures or else a successful issue to the court case against Franchise. At present, Intertainment assumes that it will come to trial, and that there will not be any out-of-court settlement. The first day of the proceedings is scheduled for August 5, 2003.

Nonetheless, Intertainment is working intensively on the development of new film projects under the cooperative agreement with Kopelson Entertainment. Among other things, Intertainment commissioned a **FURTHER REWORKING OF THE FILMSCRIPT** to the thriller "Fast Forward" at the beginning of 2003. Paramount Pictures is also participating in this commission. Meanwhile, in March 2003, work was started on a filmscript for "Navy Seal". However, the development of the thriller "Decoy" was suspended at the beginning of 2003.

In autumn 2003 Intertainment will probably bring out a major film in the cinemas for the first time in three years with its Thriller "Blackout", which is a product of the cooperation of Intertainment, Kopelson and Paramount. Since the pre-sales for "Blackout" have been successful, it is already certain that Intertainment AG will considerably increase its turnover in 2003. At the beginning of 2003 the film was at the post-production phase.

On April 17, 2003, together with the film hire firm Ottfilm GmbH, Intertainment brought to the German cinemas "Things you can tell". The film, which won an award at the Sundance film festival, started with 50 copies.

FURTHER REWORKING OF THE FILMSCRIPT

In 2003, Intertainment has concluded a distribution agreement with Planet Media home entertainment GmbH. Through this, the independent label is distributing films of the Intertainment film library on the German DVD/video market. The selected titles include "Things you can tell" "Camouflage" "Takedown" and "The Third Miracle".

3. Investments: decision on patent dispute expected

Intertainment continues to consider the participation in SightSound Technologies Inc. as a financial investment. Its value depends substantially on the outcome of the patent dispute of SightSound Technologies. Intertainment expects that this dispute, following the postponement which was made recently, will be decided at the beginning of 2004.

4. Subsidiaries

4.1 Intertainment

Animation & Merchandising GmbH: Concentration on "Rudolph"

Intertainment Animation & Merchandising GmbH will probably concentrate in 2003, too, on expanding its merchandising activities around "Rudolph the red-nosed reindeer". It is also working intensively on the development of new contents in the children's and family sphere.

4.2 INTERTAINMENT Licensing GmbH: The case of Franchise Pictures

4.2.1 Suit against Franchise Pictures and Comerica: ruling in the autumn

We also expect in the fall a result in the trial against Franchise Pictures. However, it will be more than a year before there is a

decision on the lawsuits being prosecuted by Intertainment against, among others, Comerica Bank and the two insurance companies Film Finances and World Wide Film Completion.

4.2.2 Arbitration proceeding on "Driven": Comerica demands second installment

In this connection, Comerica Bank has opened **ARBITRATION PROCEEDINGS** against INTERTAINMENT Licensing GmbH for payment of the second installment for the film "Driven" in the amount of 13.6 million US dollars, plus lawyers' fees and other costs.

4.2.3 Arbitration proceeding on account of "Tracker"

In a case which is connected with the allegation of budget fraud against Franchise Pictures, the banks and the insurance companies, International Motion Picture Corporation Ltd., which is based in Hong Kong, opened on June 18, 2003 a further arbitration case against INTERTAINMENT Licensing GmbH for payment of damages in the amount of 3,262,500 US dollars in the case "Tracker". Intertainment will take position against this claim for damages in a comprehensive **LETTER OF REPLY**. At no time has Intertainment agreed to arbitration proceedings with International Motion Picture Corporation Ltd. The film "Tracker" is a subject of the budget fraud allegation, so that Intertainment will submit all pleas, crosspetitions and counterclaims in this case, too.

FEATURE FILMS IN COOPERATION WITH MAJOR US FILM STUDIOS

ARBITRATION PROCEEDINGS

LETTER OF REPLY

D. Risks of future development

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

The financial statements of Intertainment AG for the business year 2002 were prepared on the assumption that the company has still the ability to continue as a going concern. In this connection, the board 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 payments obligations. The positive assumption regarding Intertainment AG's ability to continue as a going concern is based on an integrated corporate financing plan, from which a detailed financial budget has been derived. This is made up of the financing of future business activity, the planned investments and other financing activities. Overall, the assumption regarding Intertainment AG'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:

- > Economic development of INTERTAINMENT Licensing GmbH combined with:
- > Cash-Inflows of funds from the litigation against Franchise Pictures;
- > Cash-Outflows of funds from arbitration proceedings, as well as
- > Uncertainties about the realization of the other assumptions on which the finan-

cial budget of Intertainment AG and INTERTAINMENT Licensing GmbH is based.

If the inflows of funds, the outflows of funds or the assumptions on which the financial budget is based fail to materialize as planned, the assumption regarding the ability to continue as a going concern of Intertainment AG and its subsidiaries is endangered to a high degree on account of impending inability to pay and the consequent opening of insolvency proceedings, also at short notice.

INFLOWS OF FUNDS FROM THE LITIGATION AGAINST FRANCHISE PICTURES

If INTERTAINMENT Licensing GmbH should fail with its suit against Franchise Pictures in the first instance in August 2003, there is a possibility of appeal. The appeal proceedings would last a further 18 to 24 months. The further financing of the costly trial could also have considerable negative effects on the company. If INTERTAINMENT Licensing GmbH should win the lawsuit against Franchise in the first instance, Franchise too has the possibility of appealing. As with any court case, here there is moreover the risk that, even if Intertainment carries the day, it may not be possible to realize the decision against the parties being sued.

We have discussed further uncertainties relating to the inflows of funds to INTERTAINMENT Licensing GmbH from the Franchise Pictures lawsuit under point C.3.2. and refer to our comments there.

OUTFLOWS OF FUNDS FROM ARBITRATION PROCEEDINGS

Intertainment Licensing GmbH is subject to the risk that banks financing Franchise Pictures will open arbitration proceedings for payment of the second installment for the disputed film rights. Comerica Bank opened such proceedings at the beginning of 2003 against Intertainment Licensing GmbH in connection with the film "Driven".

If Comerica Bank should have success with the arbitration proceedings that it has initiated for the second installment for the film "Driven", INTERTAINMENT Licensing GmbH may face a payment obligation of up to 13.6 million US dollars, plus lawyers fees and other costs. In the event that Intertainment does not obtain the budgeted inflows of funds from the Franchise lawsuit, there would then be a danger that INTERTAINMENT Licensing GmbH would not be able to meet this payment obligation. A resulting inability to pay and the insolvency proceedings which would have initiated against INTERTAINMENT Licensing GmbH would mean for Intertainment AG, among other things, the loss due to the impairment of the intercompany account with INTERTAINMENT Licensing GmbH and the impairment of the shares of INTERTAINMENT Licensing GmbH which are held by Intertainment AG. There would also be a question as to whether Intertainment AG would be able to continue to pursue the lawsuit being prosecuted by INTERTAINMENT Licensing GmbH against Franchise Pictures.

In the event that an arbitration court decides in favor of one of the financing banks, the bank would, in the view of Intertain-

ment, be obliged to offset the income from the exploitation of the disputed film rights against the payment obligation of Intertainment. However, in the case of the arbitration court proceedings relating to Caveman's Valentine which were confirmed during the year under review, this did not happen. Intertainment assumes that the income from the exploitation of these film rights will be considerably higher than the obligations to pay the second installment.

In the framework of the lawsuit against Comerica and the insurance companies, Intertainment will petition for all claims (including the claims for payment made by Comerica in the arbitration proceedings) that are connected with any films in which Franchise Pictures is involved to be decided in a consolidated arbitration case. Furthermore, Intertainment will petition to time this proceeding after the main hearing of the lawsuit against Franchise Pictures.

Meanwhile, International Motion Picture Corporation Ltd., which is based in Hong Kong, opened on June 18, 2003 a further arbitration case against INTERTAINMENT Licensing GmbH on account of payment of damages in the amount of 3,262,500 US dollars in the case "Tracker". In this case, too, Intertainment will petition to decide the claims submitted in the consolidated hearing described above.

Independently of any arbitration proceedings, the disputed films remain part of the pending lawsuit against Franchise Pictures.

BANK LOAN**UNCERTAINTIES WITH REGARD TO THE OTHER ASSUMPTIONS IN THE FINANCIAL BUDGET**

The other assumptions of the financial budget relate to inflows of funds mainly in the near future from the operating activity of Intertainment AG and a sale of receivables, which has already been concluded, with is subject to a condition precedent. Moreover, there are financial obligations in connection with the redemption of a **BANK LOAN** which is due in June 2004. The debtor for this loan is INTERTAINMENT Licensing GmbH. Intertainment AG has given a guarantee for these liabilities. In addition, through the generally poor situation in the sector, there may be delays in incoming payments and bringing forward of outgoing payments from current business activities, which could impair the ability to continue as a going concern. The consequences of a possible wrong assessment in relation with the company's ability to continue as a going concern would be wide-ranging. For instance, it would not, pursuant to § 252 I No. 2 HGB, be possible to use going concern values in the recognition and valuation of assets and debts.

2. Further risks

There are also risks associated with the future development of the company. Intertainment AG has examined the business processes and has identified and evaluated the risks arising and has developed measures under an ongoing risk monitoring

regime which are designed to minimize 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 Producer risk

As the producer of films, Intertainment AG is particularly exposed to the risk that a film production may have to be aborted. This can lead to claims for damages.

2.2 Trading in film licenses

Intertainment AG trades in film licenses, among other things. There is strong competition in this area. This can lead to changes in the level of prices, falling sales figures, lower profit margins and a deterioration in the market position. The continuing consolidation trends especially in the European cinema and TV area 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.

2.3 Acquisition and exploitation of film rights

If Intertainment AG acquires license rights prior to the commencement of production, there is a danger of a film being purchased at too high a price. The possible success of a film is difficult to foresee 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 filmscript.

2.4 Fraud through collaboration with several partners

In cases in which Intertainment AG 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 the financing. Suitable measures for the reduction of this risk are an ongoing control of expenditure and budget 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.

2.5 Dependence on distribution partners

The Europe-wide film distribution by the majors Warner Brothers and 20th Century Fox represents a substantial competitive advantage for Intertainment. If these distribution cooperative agreements should be dissolved, this might have considerable negative effects on the financial situation and the business result of the company.

2.6 Planning risk

Intertainment AG 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 AG can fluctuate sharply from period to period. Furthermore, a financing risk can arise through the changes in the incoming and outgoing payments involved.

2.7 Financing of the future growth

The film production, the purchase of further film license rights and the expansion of the business activities in new distribution regions require considerable financial re-

sources. Moreover, the liquidity is substantially dependent on the development of the lawsuit between INTERTAINMENT Licensing GmbH and Franchise Pictures.

2.8 Currency risk

Fluctuations in the exchange rate between the US dollar and the euro can 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.

2.9 Risks arising from the participation in SightSound Technologies, Inc.

The still pending lawsuit with the Bertelsmann subsidiary CDNow is about implementing the patents for the digital download of audio and video files over the Internet in the USA. Following a postponement recently, a decision is to be expected at the beginning of 2004 at the earliest. Considerable opportunities but also significant risks are connected with the decision, relating to the recoverability of the participation book value and the generation of future cash flow.

Ismaning near Munich, July 7, 2003
Intertainment AG

The Management Board

Intertainment AG: Balance Sheet

as at December 31, 2002

ASSETS		in TEuros	
	Note	12/31/2002	12/31/2001
A. FIXED ASSETS			
I. Intangible assets			
1. Licenses, commercial property rights and similar rights as well as licenses to such rights	III.1	1	36
2. Payments made on account	III.1	5,509	0
II. Property, plant & equipment			
Other plant, business and office equipment	III.1	11	3
II. Financial assets			
1. Shares in affiliated enterprises	III.1	9,359	9,359
2. Participations	III.1	15,036	15,036
		29,916	24,434
B. CURRENT ASSETS			
I. Inventories			
1. Film rights	III.2.1	7,419	18,362
2. Merchandise	III.2.1	58	0
3. Payments made on account	III.2.1	8,537	0
		16,014	18,362
II. Receivables and other assets			
1. Trade receivables	III.2.2	9,511	13,795
2. Receivables from affiliated enterprises	III.2.2	109,379	103,784
3. Other assets	III.2.2	9,318	9,508
III. Bank balances			
		3,520	11,267
		147,742	156,716
C. PREPAID EXPENSES			
	III.2.2	24	0
		177,682	181,150

EQUITY & LIABILITIES		in TEuros	
	Note	12/31/2002	12/31/2001
A. EQUITY			
I. Subscribed capital	III.3	15,005	15,005
II. Capital reserve	III.3	161,821	161,821
III. Revenue reserves			
Statutory reserve	III.3	116	116
IV. Retained earnings	III.3	-23,935	-20,165
		153,007	156,777
B. PROVISIONS			
1. Tax provisions	III.4	37	854
2. Other provisions	III.4	1,171	1,503
		1,208	2,357
C. LIABILITIES			
1. Payments received on account	III.4	419	0
2. Trade payables	III.4	20,670	21,682
3. Other liabilities	III.4	2,378	334
--of which tax liabilities TEuros 283			
--of which related to social security TEuros 3			
		23,467	22,016
		177,682	181,150

Intertainment AG: Income Statement

for the period from January 1 to December 31, 2002

			in TEuros	
	Note	2002	2001	
1. Sales revenues	IV.1	9,287	614	
2. Other operating income	IV.2	10,725	3,902	
3. Cost of materials	IV.3	11,973	4,811	
4. Personnel expenses				
a) Wages & salaries		1,643	2,105	
b) Social security contributions and expenses for retirement pensions and similar support – of which for retirement pensions 5 (p. Y. 3) TEuros –		40	26	
		1,683	2,131	
5. Depreciation on property, plant & equipment amortization on items of intangible fixed assets	IV.4	41	41	
6. Other operating expenses	IV.5	11,257	5,690	
7. Income from participations	IV.6	0	11,483	
8. Writedowns on financial assets		0	5,012	
9. Other interest and similar income	IV.7	386	1,893	
10. Interest and similar expenses	IV.7	67	16	
11. Result of ordinary business activity		-4,623	191	
12. Extraordinary expenses		0	20,780	
13. Taxes on income and earnings	IV.8	853	36	
14. Net deficit for the year		-3,770	-20,625	
15. Loss carry-forward from prior year		-20,165	460	
16. Accumulated loss		-23,935	-20,165	

Intertainment AG: Notes

to the financial statements for 2002

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 in the meaning of § 267 (3) sentence 2 HGB (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. In these Notes, the figures are stated in thousand euro (TEuros). Alongside the figures for the year under review, the corresponding figures for prior year are given. 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. In the case of software, amortization is on the straight-line method over an estimated useful life of three to five years.

In cases in which Intertainment does not count as the manufacturer in the meaning of commercial law and the media decree, payments for film productions are shown under intangible fixed assets as payments on account for film rights. For this presentation, the film rights arising must be available to Intertainment for an unlimited time.

PROPERTY, PLANT & EQUIPMENT are stated at acquisition cost less depreciation. Intertainment depreciates the property, plant & equipment normally on the basis of the normal useful life using the straight-line method. The useful life of the office and business equipment is 4 to 10 years. Low-value items of fixed assets up to a value of 410 euros 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 cost and market value. Un-

INTANGIBLE
ASSETSPROPERTY, PLANT
& EQUIPMENT

FINANCIAL ASSETS

FILM RIGHTS

der a share swap, the acquisition costs are composed of the value of the shares on the day they were delivered.

2. Current assets

FILM RIGHTS that are acquired for a limited time only are shown under current assets. They are stated at acquisition cost 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 the breakdown are the proportionate receipts expected in the segments. In the Free-TV area, Intertainment assumes there will be up to three exploitation cycles. Together they cover a period of up to 25 years. If no cinema exploitation is planned for a film, Intertainment breaks down the acquisition costs to the remaining exploitation categories, changing the percentage allocations accordingly.

The film rights are capitalized once the technical quality of the film material delivered has been accepted by an independent laboratory. The acquisition costs are amortized normally in accordance with the economic life or causation.

Intertainment re-examines the exploitability of all film rights regularly. If it is deter-

mined that the forecast sales revenues (net sales value) are lower than the capitalized residual book value of a film right, a non-scheduled writedown is made.

The **PAYMENTS ON ACCOUNT** consist of part payments made to Franchise Pictures for a film right which is a subject of the pending litigation.

The stocks of merchandise were valued at acquisition cost.

RECEIVABLES and other assets are stated at nominal value. The general credit risk on trade receivables is covered by a general adjustment of 1%. Long-term receivables which do not bear interest are discounted at 5.5% p.a.

Foreign currency receivables are recognized at the exchange rate in force at the time when the receivable arises or, if lower, at the rate on the balance sheet date.

Cash in hand and bank balances are stated at their nominal values. For current accounts, bank balances in foreign currency are valued at the exchange rate on the closing 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

Provisions are measured on the basis of reasonable business judgment and take account of all detectable risks arising from uncertain liabilities.

Liabilities are stated at their repayment value. Liabilities in foreign currency are valued at the higher of the exchange rate on the day the invoice is received and the rate on the closing date (i.e. at December 31, 2002).

PAYMENTS ON ACCOUNT

RECEIVABLES

III. Explanations to the balance sheet

1. Fixed assets

With regard to the presentation of the development of fixed assets we refer to the attached schedule of fixed assets.

For the reporting year, we show under intangible assets for the first time in the amount of 5,509 (p.y. 0) TEuros the item "Payments on account for film rights," which relates to current film productions.

Under financial assets the following participations and shares in affiliated enterprises are recorded.

III.1 FINANCIAL ASSETS				in TEuros
Company	Share (in %)	Subscribed capital (p.y.)	Equity (p.y.)	Annual result 2002 (p.y.)
INTERENTAINMENT Licensing GmbH, Ismaning	100	946 (946)	-80,219 (-69,394)	-10,825 (-70,342)
Intertainment Animation & Merchandising GmbH, Ismaning	100	358 (358)	203 (209)	-6 (35)
USA-Intertainment, Inc., Los Angeles / USA	100	105 (105)	290 (304)	82 (144)
SightSound Technologies Inc. (*), Pittsburg/USA	22.8	49 (39)	4,416 (2,584)	-3,673 (-9,555)

(*) The equity shown here and the annual deficit of SightSound Technologies Inc. relate to the financial statements of the company for the year ended September 30, 2002, which have not been equipped with an audit opinion. It was drawn up according to General Accepted Accounting Principles (US-GAAP).

2. Current assets

2.1 Film rights and merchandise

At the balance sheet date, Intertainment possessed film rights with a value of 7,419 (p.y. 18,362) TEuros, that developed as follows:

III. 2.1 FILM RIGHTS		in TEuros	
Item	2002	2001	
Balance at Januar 1	18,362	0	
Writeups	1,854	0	
Additions	0	35,955	
Normal depreciation/ amortization	-3,673	-49	
Non-scheduled writedowns	-587	-17,544	
Reclassifications (p.y.) disposals/reductions	-8,537	0	
Balance at Dezember 31	7,419	18,362	

The writeups relate to film rights which had been subject to non-scheduled write-down in the prior year. 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 year under review.

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

The reclassifications of film assets results solely from the change in presentation of the film rights for "Caveman's Valentine". The acquisition costs of this film are no longer included under film assets. Despite an arbitration court ruling and the fact that Intertainment thereupon paid the disputed second installment for the film rights to Caveman's Valentine, the film has not been delivered. Since Caveman's Valentine is a subject of the lawsuit against Franchise Pictures, we assume that delivery will not now take place. For this reason, Intertainment shows the payments made in the reporting year for this film right to Franchise Pictures within current assets under the item "Payments made on account": 8,537 (p.y. 0) TEuros. Nonetheless, Intertainment continues to assume that the payments made for the film represent a recoverable asset since, in the estimate of Intertainment, there is a recourse claim in this amount against Franchise. At the present time, Intertainment assumes that there are no grounds for a non-scheduled writedown of the payments made on account.

The merchandise comprises merchandising articles and video and DVD stocks. The value is 58 (p.y. 0) TEuros.

2.2 Receivables, other assets and bank balances

The trade receivables of 9,511 (p.y. 13,795) TEuros include long-term receivables with a residual term of more than one year in the amount of 905 (p.y. 3,028) TEuros. For the general credit risk, a general adjustment of 100 (p.y. 141) TEuros has been made.

The receivables from affiliated enterprises comprise the following items:

III.2.2 RECEIVABLES FROM AFFILIATED ENTERPRISES in TEuros

Subsidiary	2002	2001
INTERTAINMENT Licensing GmbH	105,884	98,552
Intertainment Animation & Merchandising GmbH	1,746	2,511
USA-Intertainment, Inc.	1,749	2,721

INTERCOMPANY ACCOUNTS

These are exclusively **INTERCOMPANY ACCOUNTS**, that bear interest at 8% p.a., although in the year under review, as in the prior year, Intertainment AG has waived the annual interest on the intercompany account of INTERTAINMENT Licensing GmbH. All receivables are due in less than one year. To avert the material over-indebtedness of INTERTAINMENT Licensing GmbH, on December 31, 2002 Intertainment AG issued a **LETTER OF SUBORDINATION** for the amount of 85,000 (p.y. 71,000) TEuros on its receivables from the intercom-

LETTER OF SUBORDINATION

pany account. The recoverability of these receivables is in part dependent on the outcome of the litigation between INTERTAINMENT Licensing GmbH and Franchise Pictures. The recoverability of the receivable is reasonable also in the light of the long-term contributions to earnings from INTERTAINMENT Licensing. We refer also to the comments in the management report.

The **OTHER ASSETS** include receivables from Blackout Productions Inc. 6.820 (p.y. 0) TEuros, Paramount Pictures of 506 (p.y. 2,260) TEuros, loans to SightSound Technologies of 309 (p.y. 0) TEuros and input tax not yet due of 1,337 (p.y. 1,371) TEuros. Of the other assets, 0 (p.y. 26) TEuros have a remaining term of more than one year.

The **BANK BALANCES** were made up of time deposits of 900 (p.y. 10,459) TEuros and current accounts of 2,620 (p.y. 808) TEuros. The time deposits are all due during the financial year 2003. Because of a surety and a letter of credit, which are connected with the rent obligations for the office premises, 717 (p.y. 1,039) TEuros of the liquidity is not freely available.

OTHER ASSETS

BANK BALANCES

3. Equity

The subscribed capital of Intertainment AG at the closing date was 15,005 (p.y. 15,005) TEuros. It takes the form of 11,739,013 no-par shares and has not changed since the balance sheet date of the prior year. The capital reserve of 161,821 (p.y. 161,821) TEuros and the statutory reserve of 116 (p.y. 116) TEuros are also unchanged. At December 31, 2002 Intertainment AG shows an **ACCUMULATED LOSS** of 23,935 (p.y. 20,165) TEuros.

The authorized and contingent capital as well as the number of share options have not changed since the prior year.

At December 31, 2002, the authorized capital was 3,203 (p.y. 3,203) TEuros, the authorized capital II was 4,300 (p.y. 4,300) TEuros, the contingent capital was 511 (p.y. 511) TEuros, the contingent capital II was 383 (p.y. 383) TEuros and the contingent capital III was 6,002 (p.y. 6002) TEuros.

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

III.3 SCHEDULE OF EQUITY CAPITAL			
in TEuros			
	Status 1/1/2002	Annual result	Status 12/31/2002
Subscribed capital	15,005	0	15,005
Capital reserve	161,821	0	161,821
Revenue reserve	116	0	116
Accumulated deficit	-20,165	-3,770	-23,935
Equity	156,777	-3,770	153,007

4. Outside capital

The **TAX PROVISIONS** of 37 (p.y. 854) TEuros cover taxes which have still to be paid for the financial years 1998 to 2000, which have arisen following a tax audit.

The **OTHER PROVISIONS** relate mainly to provisions for outstanding invoices of 717 (p.y. 670) TEuros and for personnel for 350 (p.y. 511) TEuros.

The **PAYMENTS RECEIVED** on account for film rights of 419 (p.y. 0) TEuros comprise payments by licensees for films that Intertainment has not yet delivered. All items are due in less than one year.

The **TRADE LIABILITIES** result largely from the purchase of licenses and, at the closing date, amounted to 20,670 (p.y. 21,682) TEuros; of this amount 18,206 (p.y. 20,441) TEuros is due in more than one year.

TAX PROVISIONS**OTHER PROVISIONS****PAYMENTS RECEIVED****TRADE LIABILITIES****OTHER LIABILITIES**

The **OTHER LIABILITIES** in the amount of 2,378 (p.y. 334) TEuros include repayment obligations to Paramount Pictures of 2,088 (p.y. 0) TEuros, liabilities to the tax authorities for wages and church tax of 51 (p.y. 65) TEuros as well as value added tax of 232 (p.y. 251) TEuros and liabilities relating to social security of 3 (p.y. 3) TEuros. All items are due in less than one year.

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

The sales revenues came to 9,287 (p.y. 614) TEuros. They result from the sale or the exploitation of film rights and from commissions.

2. Other operating income

Other operating income includes 6,540 (p.y. 0) TEuros in **COSTS FOR FILM PROJECTS** which are applied to the production budget of the film. In addition, the item includes remuneration for producer services of 528 (p.y. 3,712) TEuros and exchange gains of 1,608 (p.y. 158) TEuros.

3. Cost of materials

The cost of materials consists mainly of bought-in services for **PRODUCER ACTIVITIES** in the amount of 5,343 (p.y. 4,491) TEuros, normal amortization of 3,673 (p.y. 49) TEuros as well as non-scheduled writedowns on film rights of 587 (p.y. 0) TEuros and marketing costs of 1,671 (p.y. 0) TEuros.

4. Depreciation & amortization

The depreciation and amortization on the fixed assets was 41 (prior year 41) TEuros.

5. Other operating expenses

The other operating expenses include 3,601 (p.y. 28) TEuros expenses for currency losses, repayment obligations to Paramount Pictures of 2,260 (p.y. 0) TEuros, 1,191 (p.y. 2,049) TEuros for the reimbursement of administrative costs of producers, an amount of 1,683 (p.y. 0) TEuros for services performed by USA-Intertainment, Inc., 779 (p.y. 1,369) TEuros for legal and consultancy fees, allowances for license sales 290 (p.y. 0) TEuros and 215 (p.y. 400) TEuros for the shareholders' meeting.

ACCUMULATED LOSS

6. Result on participatory investments

The income from participatory investments came in the prior year entirely from affiliated enterprises and related to a distribution for the financial year 2000 from INTER-TAINMENT Licensing GmbH on December 17, 2001 in the amount of 11,483 TEuros.

7. Writedown on financial assets

In the prior year, non-scheduled writedown of 5,012 TEuros was made on the participation in the company SightSound Technologies Inc.

8. Interest result

The interest income results from 249 (p.y. 1,484) TEuros bank interest and 137 (p.y. 408) TEuros from the interest on intercompany accounts that Intertainment AG maintains with its subsidiaries. These accounts bear interest at 8% p.a. At December 31, 2002, Intertainment AG waived the interest for the financial year 2002 from INTER-TAINMENT Licensing GmbH. The interest expense of 67 TEuros relates to bank interest.

9. Taxes on income and earnings

The taxes on income and earnings relate to the release of the tax provision of 853 (p.y. 0) TEuros in the financial year 2002.

V. Other information

1. Other financial commitments

Intertainment has future payment obligations for producer fees of 11,489 (p.y. 40,678) TEuros and obligations to Paramount Pictures for the film project "Black-out" of 28,869 (p.y. 0) TEuros. Of the other financial obligations, 32,698 (p.y. 8,475) TEuros is due less than one year.

2. Other contingent obligations

During the financial year 2001 Intertainment AG assumed a **GUARANTEE TO HYPO-VEREINSBANK** AG of 16,361 (p.y. 16,361) TEuros. This serves as security for a loan taken out by INTER-TAINMENT Licensing GmbH. This loan is repayable on June 30, 2004. At December 31, 2002, the amount of the loan was 15,185 (p.y. 16,358) TEuros.

For the tenancy of the office premises in Ismaning, in 2000 Intertainment AG gave a surety of 76 (p.y. 76) TEuros, which is unchanged. There is also a letter of credit from Intertainment AG for 666 (p.y. 1,000) thousand US dollars for the rental obligations relating to the tenancy of office premises of USA-Intertainment, Inc. in Los Angeles.

To avert the material over-indebtedness of INTER-TAINMENT Licensing GmbH, on December 31, 2002 Intertainment AG issued a letter of subordination for the amount of 85,000 (p.y. 71,000) TEuros on receivables from the intercompany account.

3. Employees

On average during the financial year 2002, the company employed six (p.y. five) staff at its headquarters in Ismaning near Munich.

GUARANTEE TO HYPOVEREINSBANK

4. Composition of the executive bodies

DURING THE FINANCIAL YEAR, THE MEMBERS OF THE MANAGEMENT BOARD WERE:

> Ernst Rüdiger Baeres, Munich (chairman)

> Stephen Brown, Los Angeles (deputy chairman)

> Hans-Joachim Gerlach, Berlin (chief financial officer)

The remuneration of the board for the financial year 2002 amounted to 2,129 (p.y. 1,273) TEuros. This sum also includes importantly severance payments for a member of the board who left in the financial year 2001.

DURING THE FINANCIAL YEAR 2002 THE MEMBERS OF THE SUPERVISORY BOARD WERE:

> Dr. Matthias Heisse, lawyer, Munich (chairman)

> Dr. Ernst Pechtl, German MBA, Berg (deputy chairman)

> Dr. Wilhelm Bahner, German MBA, Munich

During the reporting year, Dr. Matthias Heisse was also a member in the supervisory board of Firestorm AG, Munich. During the financial year 2002, Dr. Ernst Pechtl was also a member of the supervisory boards of Wegold Edelmetalle AG, Wendelstein, PointS International AG, Darmstadt,

and InfoMiner AG, Weilheim. Dr. Wilhelm Bahner did not hold any further supervisory board offices during the financial year 2002.

During the financial year, supervisory board remuneration of 23 (p.y. 25) TEuros was paid.

5. Consolidated financial statements

Intertainment Aktiengesellschaft prepares consolidated financial statements including its subsidiaries.

6. Statement on the German Corporate Governance Code

The board and the 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 near Munich, July 7, 2003
Intertainment AG

Ernst Rüdiger Baeres
Chairman of the Board

Stephen Brown
Deputy Financial Officer

Achim Gerlach
Chairman

Intertainment AG: Schedule of Fixed Assets

In TEuros	ACQUISITION COSTS			ACCUMULATED AMORTIZATION & DEPRECIATION			CARRYING VALUE	
	1/1/2002	Additions	12/31/2002	1/1/2002	Amortization & depreciation of the financial year	12/31/2002	12/31/2002	12/31/2001
I. Intangible assets								
1. Licenses, commercial property rights and similar rights as well as licenses in such rights	117	0	117	81	36	117	0	36
2. Payments made on account	0	5,509	5,509	0	0	0	5,509	0
	117	5,509	5,626	81	36	117	5,509	36
II. Property, plant & equipment								
Other plant, business & office equipment	6	14	20	3	5	8	12	3
III. Financial assets								
1. Shares in affiliated enterprises	9,359	0	9,359	0	0	0	9,359	9,359
2. Participations	20,048	0	20,048	5,012	0	5,012	15,036	15,036
	29,407	0	29,407	5,012	0	5,012	24,395	24,395
	29,530	5,523	35,053	5,096	41	5,137	29,916	24,434

Audit opinion: Intertainment AG

We have audited the annual financial statements, together with the bookkeeping system, and the management report of the Company Intertainment AG, Ismaning, rural district of Munich, for the business year from January 1 until December 31, 2002. The maintenance of the books and records and the preparation of the annual financial statements and of the management report in accordance with German commercial law 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.

We conducted our audit of the annual financial statements in accordance with § 317 HGB and the generally accepted 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 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 audit 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 of the management report. We believe that our audit provides a reasonable basis for our opinion.

Our audit has not led to any reservations.

In our opinion, 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 account-

ing. On the whole the management report provides a suitable understanding of the Company's position and suitably presents the risks of future development.

Without qualifying this opinion, we draw attention to the comments made in the management report. It is stated that there are considerable uncertainties in the assumptions on which the budget is based. If these assumptions should fail to materialize as planned, Intertainment AG will no longer be able to meet its current payment commitments and possible payment obligations to a bank arising from a guarantee it has given for repayment of a loan taken out by INTERTAINMENT Licensing GmbH. For further details, we refer to the comments in Section "D. Risks of future development" in the Group management report. If only one of the events described below fails to materialize as planned, the ability of the company to continue as a going concern is threatened.

> Fulfillment of the assumptions on which the financial plan of the subsidiary INTERTAINMENT Licensing GmbH is based on. The financial plan of this subsidiary is

based on key assumptions, namely that there will be a cash-inflow of funds from the lawsuit against Franchise Pictures and that there will not be any cash-outflows of funds arising from current or future arbitration proceedings for payment of the second installments for the film rights in dispute. If these assumptions fail to materialize and the subsidiary becomes insolvent, Intertainment AG would be faced with a claim arising from the guarantee it has given to a bank.

> Realization of the other assumptions of the financial plan of Intertainment AG and of the subsidiary INTERTAINMENT Licensing GmbH, including the incoming payments which budgeted for in the near future.

Munich, July 7, 2003

KPMG

Deutsche Treuhand-Gesellschaft
Aktiengesellschaft
Wirtschaftsprüfungsgesellschaft

Dr. Bartels-Hetzler
Wirtschaftsprüfer

Dr. Kreher
Wirtschaftsprüfer



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