**INITIATION**

**Equity | Germany |Air Travel**

**23 October 2007**

# Advanced Inflight Alliance AG

VEM Aktienbank AG

## Recommendation

**BUY**

**Risk:**

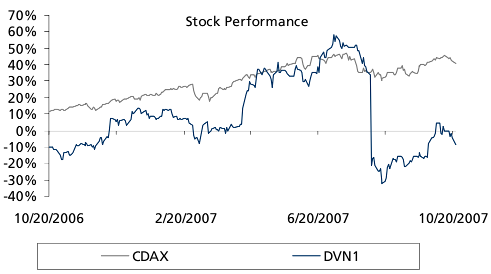
**Medium**

| | |
|---|---|
| Targeted Price: | €2.91 |
| Current Price: | €1.73 |
| **Upside/Downside:** | **68.0%** |

| | |
|---|---|
| Reuters: | **DVNGk.DE** |
| Bloomberg: | **DVN1 GR** |
| ISIN: | **DE0001262186** |
| Sector: | **Air Travel** |
| Segment: | **Inflight Entertainment** |

| | |
|---|---|
| Market Cap.: | **€26.49 m** |
| Enterprise Value: | **€9.91 m** |

| | |
|---|---|
| 52 week high/low: | **€2.99 / 1.28** |
| YTD High: | **€2.99 (July 04, 07)** |
| YTD Low: | **€1.28 (Aug 17, 07)** |




## Shareholder Structure

| | |
|---|---|
| AXXON SA: | 5.59% |
| Universal-Investment-: Gesellschaft mbH | 4.70% |
| Grand Haven Capital AG: | 3.97% |
| KST Beteiligungs AG: | 3.27% |
| Lupus alpha Investment S.A: | 2.93% |
| Marian von Korff: | 1.50% |
| **Free Float:** | **78.03%** |

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Attention is drawn to the disclaimer and other information on Page 23

## Entertaining airline passengers across the world

**Munich, Germany-based Advanced Inflight Alliance AG (AIA) offers inflight entertainment (IFE) services to airlines through its operating subsidiaries. The Company, which has a comprehensive product offering, is expected to benefit from the strong global market for IFE Services. Our target price for AIA is €2.91 per share, a 68% upside over the closing price of €1.73 on the XETRA on 22 October 2007.**

### Key Investment Points

- The strong passenger travel market is expected to increase demand for IFE services. Airlines have woken up to the limitations of pricing as a differentiating factor, and are increasing focus on customer services such as IFE.
- AIA's integrated product offering covers the entire spectrum of IFE services ranging from technical services to content licensing. AIA's subsidiaries deliver comprehensive solutions under the common IFE Alliance umbrella, while retaining their individual brand identities.
- Next generation IFE systems can hold significantly more content, both in terms of quantity and variety. These systems have also become cheaper to install and operate, allowing more airlines to install them. The market base for IFE service providers such as AIA is therefore expected to expand.
- Through its global sales offices, AIA has a presence in nearly every major airline market. The Company's clients include many of the world's largest airlines. Recent acquisitions, especially that of Inflight Productions in FY06, have strengthened AIA's position in the IFE services market.

### Financial Analysis and Forecast

We expect sales to grow at a CAGR of 16% (10.6% after including all revenues from a FY06 acquisition) to €100.1 million in FY09 from €64.1 million in FY06. AIA is expected to earn €1.9 million on sales of €82.6 million in FY07, a net margin of 2.4%. Pricing pressure from large airlines customers would lead to a contraction in gross margins. However, operating and purchasing efficiencies should counteract the negative effect.

### Valuation

Our target price of €2.91 per share was derived through a combination of DCF and peer group analysis. The blended valuation assigned higher weight to the DCF valuation as it comprehensively captures our expectations of AIA's future. The target price represents a 68% upside over the closing price of €1.73 on the XETRA on 22 October 2007.

| (in € million) | FY06 | FY07E | FY08E | FY09E | FY10E |
|---|---|---|---|---|---|
| Revenues | 64.16 | 82.64 | 92.20 | 100.07 | 108.56 |
| *Gross Margin* | 31.6% | 28.0% | 27.7% | 27.4% | 27.2% |
| *EBITDA Margin* | 11.7% | 5.2% | 5.1% | 4.9% | 4.8% |
| Net Income | 3.21 | 1.94 | 2.08 | 2.07 | 3.25 |
| EPS | 0.21 | 0.13 | 0.14 | 0.14 | 0.21 |
| EV/Sales | 0.15 | 0.12 | 0.11 | 0.10 | 0.09 |
| EV/EBITDA | 1.32 | 2.30 | 2.10 | 2.00 | 1.89 |
| P/E | 8.26 | 13.63 | 12.75 | 12.78 | 8.15 |
| Free Cash Flow Yield | -17.0% | 9.5% | 9.5% | 7.9% | 6.9% |

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## Executive Summary

- Advanced Inflight Alliance AG (AIA) provides inflight entertainment (IFE) services to airlines across the globe. The Company, headquartered in Munich, Germany, operates through its numerous subsidiaries, principally Atlas Air Film and Inflight Productions.
- AIA's comprehensive IFE product portfolio comprises technical and content licensing services. The Company's offerings include movies, TV programmes, customized audio content, and technical services such as encoding and data management. AIA offers these services under the IFE Alliance banner. This arrangement allows the Company's subsidiaries to approach the market under one umbrella while retaining their own established brand identities.
- AIA has established itself in the IFE services market through its strong business network. The Company is the preferred content supplier for IFE systems manufactured by Panasonic, one of the three largest IFE system manufacturers. AIA has forged relationships with content owners such as movie studios all over the world; this enables the Company to offer airlines content customized for local markets.
- Growth in the global economy and increasing international trade and tourist links are expected to boost airline travel. Having realized the limitations of pricing as a differentiating factor, airlines are beginning to reinvest in IFE offerings. Next generation IFE systems are cheaper to operate and can hold more content. These factors are expected to drive demand for IFE services globally.
- We expect AIA's revenues to grow at a CAGR of 16% (10.6% after including all revenues in FY06 from the acquisition of Inflight Productions) to €100.1 million in FY09 from €64.2 million in FY06. The CAGR Gross margins, however, would decline due to pricing pressure from large airline customers, leading to a contraction in overall margins. Nevertheless, purchasing and operating efficiencies should minimize the effect on net margin in the medium term. We forecast a net income of €1.9 million for FY07 and €2.1 million for FY08.
- Our target price for AIA is €2.91 per share, representing a 68% upside over the closing price of €1.73 on 22 October, 2007 on the XETRA. We valued AIA using the DCF and peer group valuation methods. In the final blended valuation, we assigned higher weight to the DCF method as it better captures our forecasts of AIA's future operations.

## SWOT Analysis

| Strengths | Weaknesses |
|---|---|
| • Integrated product offering covers entire gamut of IFE services<br>• Strong market position through business networks, global reach and major airline customers<br>• Dominant player in IFE services market | • Weak bargaining position with large airlines exerting pressure on margins<br>• Airline investment in IFE services is subject to factors such as fuel price |

| Opportunities | Threats |
|---|---|
| • Increasing demand for IFE services from airlines, especially in Asia<br>• Technological advanced IFE systems that hold more content boost demand for content licensing<br>• Range of IFE content expanding to include video games, direct programming etc. | • In-flight broadband could facilitate transmission of content directly to aircraft in the future, making AIA's technical services less essential<br>• Increasing use of personal entertainment devices by passengers could lower demand for IFE |

## Short to Medium Term Catalysts

- AIA's margins contracted in H1 FY07. This coupled with the steep downward revision in the earnings guidance has cast some doubt on the Company's ability to sustain profitability in the short term. The publication of Q3 FY07 financial figures mid-November should cast more light on the extent of margin erosion and the efficacy of AIA's corrective measures.
- Singapore Airlines, one of AIA's customers, plans to operate the first Airbus A380 commercial flight in October 2007. Considering Singapore Airlines' stellar reputation for customer service and the A380's technology, we believe IFE offerings on this aircraft would be superior to those in current aircraft. In response, other airlines, especially those in the Asia-Pacific region, might decide to spruce up their own IFE offerings.

## Valuation

We used the Discounted Cash Flow (DCF) and peer group valuation methods to value AIA. Our final blended valuation assigned greater weight to the DCF analysis as it better captures our estimates about the future of the business. Based on our analysis, we are assigning a target price of €2.91 per share. This represents a 68% upside over the closing price of €1.73 on the XETRA on 22 October 2007.

### DCF Valuation

We used Free Cash Flow to Equity (FCFE) to calculate the DCF value of AIA's equity. Towards the end of the forecast period, we applied a terminal growth rate of 2.5% to calculate the terminal value. A beta of 0.9, risk free rate of 4.4%, and risk premium of 7% were used in the CAPM model to calculate the cost of equity of 10.6%. This cost of equity was then used to discount cash flows.

**Figure 1: DCF Valuation**

| ( in € thousands) | 2007E | 2008E | 2009E | 2010E | 2011E |
|---|---|---|---|---|---|
| Net Income | 1,943 | 2,078 | 2,073 | 3,251 | 3,367 |
| (+) Depreciation and Amortization | 2,402 | 2,514 | 2,664 | 1,312 | 1,487 |
| (-) Cash flow from working capital | (274) | (414) | (880) | (854) | (1,218) |
| (-) Capital Expenditure | (1,240) | (1,383) | (1,501) | (1,628) | (1,749) |
| (-) Net Debt repayments | 1,743 | (58) | (58) | (58) | (58) |
| **FCFE** | **4,575** | **2,737** | **2,297** | **2,023** | **1,830** |
| **FCFE adjusted for valuation date** | 1,144 | 2,737 | 2,297 | 2,023 | 1,830 |
| | | | | | |
| **PV of FCFE** | 1,115 | 2,412 | 1,830 | 1,457 | 1,191 |
| | | | | | |
| **Sum of PV of FCFE - First Stage** | 8,004 | | | | |
| **Sum of PV of FCFE - Second Stage** | 5,463 | | | | |
| | | | | | |
| Terminal Value growth rate | 2.5% | | | | |
| Terminal Value | 40,125 | | | | |
| **PV of Terminal Value** | 15,757 | | | | |
| | | | | | |
| **PV of FCFE** | 29,225 | | | | |
| (+) Cash | 16,466 | | | | |
| **Target Value** | **45,691** | | | | |
| | | | | | |
| Number of shares | 15,312 | | | | |
| **Target price** | **2.98** | | | | |
| **Upside / downside** | **72.5%** | | | | |
| | | | | | |
| Current Price | 1.73 | | | | |
| Current Value | 26,489 | | | | |

Source: AIA, VEM Aktienbank AG

The DCF valuation yields an equity value of €45.7 million and a per share price of €2.98.

### Peer Group Valuation

We used the forward P/Earnings and EV/EBITDA multiple to value AIA relative to its peers. The task of choosing comparables for peer group valuation of AIA was not a straightforward one. While many companies operate in the IFE content industry, hardly any of these are publicly listed. A few, such as Spafax and Emphasis Media, are owned by large public conglomerates. Using the multiples of these conglomerates would not be reasonable as they are also active in other businesses.

We, therefore, considered the next best alternative – companies in the movie licensing market. We realize that traditional film licensing does not figure in AIA's future plans. However, we believe the business models of movie licensing companies are broadly similar to those of companies in the

IFE content industry. Also, expenditure on film rights constitutes a major portion of costs for movie licensing companies. Hence, we believe movie licensing companies can be reasonably used as comparables for the peer group valuation of AIA.

### Figure 2: Peer Group Valuation

| Company | Symbol | P/E FY07E | P/E FY08E | P/E FY09E | EV/EBITDA FY07E | EV/EBITDA FY08E | EV/EBITDA FY09E |
|---|---|---|---|---|---|---|---|
| Highlight Communications AG | HLG GR | 20.17x | 17.93x | 15.23x | 13.45x | 12.77x | 5.37x |
| Carrere Group | CAR FP | 10.08x | 7.24x | 6.12x | 2.26x | 2.06x | 1.87x |
| MME Moviement | MME GR | 14.95x | 15.03x | 13.81x | 10.12x | 10.43x | 9.74x |
| RDF Media Group | RDF LN | 12.93x | 10.77x | 9.31x | 6.44x | 5.78x | |
| Eros International Plc | EROS LN | 23.92x | 18.10x | 14.10x | 12.66x | 9.90x | 7.90x |
| | | | | | | | |
| Average | | 16.41x | 13.82x | 11.71x | 8.99x | 8.19x | 6.22x |
| Min | | 10.08x | 7.24x | 6.12x | 2.26x | 2.06x | 1.87x |
| Max | | 23.92x | 18.10x | 15.23x | 13.45x | 12.77x | 9.74x |

| **Advanced Inflight Alliance** | | | | |
|---|---|---|---|---|
| | FY07E | FY08E | FY09E | |
| Earnings | 1,943 | 2,078 | 2,073 | |
| EBITDA | 4,306 | 4,708 | 4,943 | |
| | | | | |
| Equity Value based on multiples | Equity Vl. | Per share | Disc/Premium | **Weight In Peer Group Value** |
| Value based on P/E | | | | |
| FY07E | 31,887 | 2.08 | 0.0% | 10.0% |
| FY08E | 28,706 | 1.87 | 0.0% | 20.0% |
| FY09E | 24,280 | 1.59 | 0.0% | 20.0% |
| | | | | |
| Value based on EV/EBITDA | | | | |
| FY07E | 55,280 | 3.61 | 0.0% | 10.0% |
| FY08E | 55,126 | 3.60 | 0.0% | 20.0% |
| FY09E | 47,330 | 3.09 | 0.0% | 20.0% |
| | | | | |
| **Peer Group Valuation Value** | | | | |
| | | | | |
| **Equity Value** | **39,805** | | | |
| **Per Share Price** | **2.60** | | | |
| **Upside / downside from current price** | **50.3%** | | | |

Source: Bloomberg, Reuters, VEM Aktienbank AG

While applying these multiples to AIA, we assigned greater weight to FY08 and FY09 multiples to reflect the Company's growth potential. Based on these multiples, the peer group valuation of AIA works out to €39.8 million, or €2.60 per share.

## Blended Valuation

We determined the final target price through a blended valuation that incorporates the DCF and peer group valuations. Our final target price for the Company is €44.6 million, or €2.91 per share.

### Figure 3: Blended Valuation

| **Blended Valuation** | Equity Value | Per Share | Weight |
|---|---|---|---|
| Value through DCF | 45,691 | 2.98 | 80.0% |
| Value through Peer Group | 39,805 | 2.60 | 20.0% |
| | | | |
| **Target Price** | **44,514** | **2.91** | |
| Current Price | 26,489 | 1.73 | |
| | | | |
| **Upside / downside** | **68.0%** | | |

Source: VEM AKtienbank AG

Peer group valuation lacks the comprehensiveness of the DCF model. In addition, while the comparables used have broadly similar business models, they are from a different industry. Hence, we assigned lower weight to the peer group valuation in the final blended valuation.

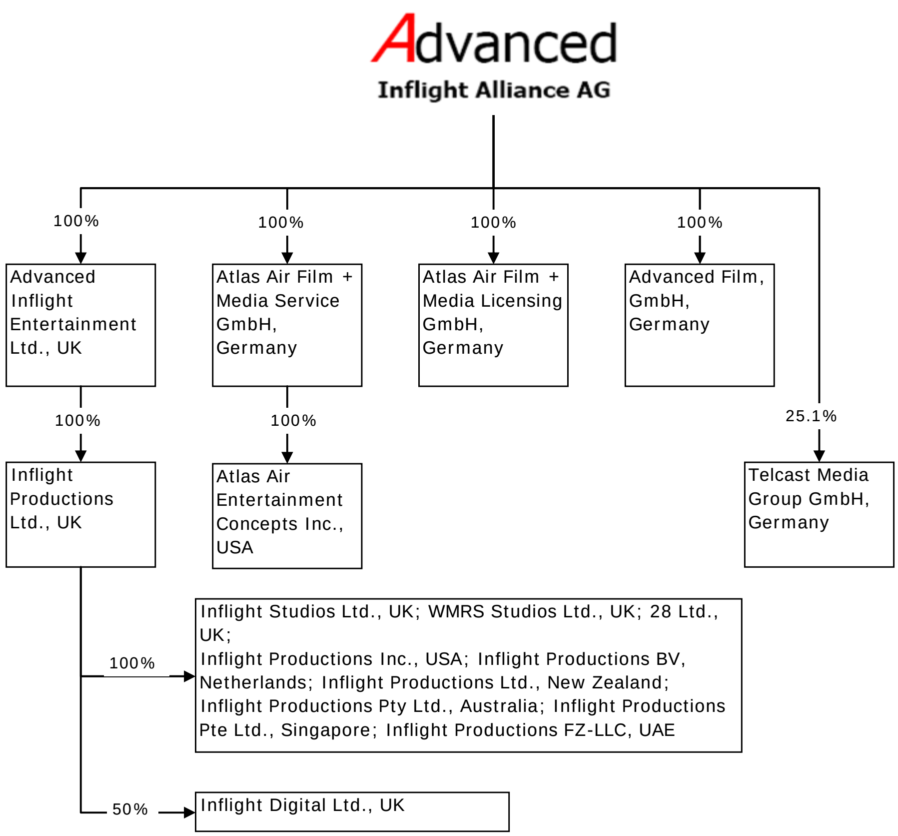
## Profile – Comprehensive IFE Service Offering

Advanced Inflight Alliance (AIA) was founded in 1998 as Advanced Medien, a film licensing and distribution company. The Company entered the capital market in the middle of 1999. However, by then the original business model had lost momentum. The resulting profit erosion saw AIA teetering on the brink of a cash flow crisis. It was then that AIA, under the leadership of its current management, reduced focus on traditional film licensing and entered the IFE content delivery business through a number of acquisitions.

In line with its strategy of establishing itself as a top IFE content provider, the Company rechristened itself Advanced Inflight Alliance AG in July 2007. While the Company is based in Munich, Germany, it has sales offices all over the world.

AIA operates through subsidiaries, most of which are wholly owned. The corporate office is primarily used for strategic planning and group-wide functions.

**Figure 4: Principal Subsidiary Structure**




Source: AIA

Atlas Air, Atlas Air Film + Media Service, Atlas Air Entertainment and Inflight Productions are all active in the IFE market and are the Company's main operating subsidiaries. Inflight Productions is AIA's largest operations subsidiary.

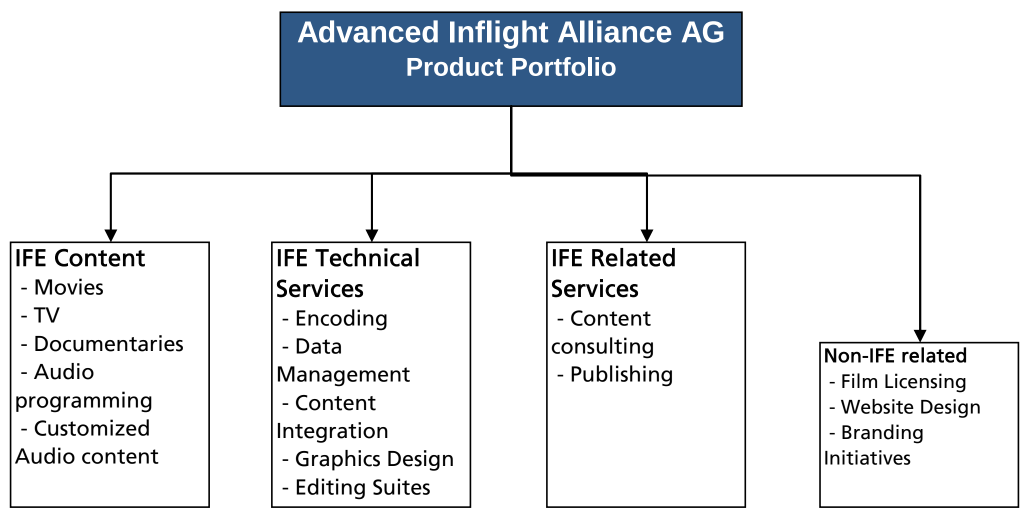
Advanced Film manages AIA's legacy film licensing business and its legacy film portfolio. Telcast Media operates in the TV programming market. These two subsidiaries are not involved in the Company's core operations. AIA is open to selling its stake in Telcast.

As part of its branding strategy, AIA formed the IFE Alliance. The Company's subsidiaries market themselves to customers under the IFE Alliance umbrella, while retaining their individual brand identities.

## IFE Services Constitute Core Product Portfolio

AIA's core product portfolio comprises IFE services that allow airlines to manage their IFE offerings. The Company's IFE solutions can be broadly classified into content, technical and other services. AIA also has some non-core product offerings such as traditional film licensing.

**Figure 5: Product Portfolio**




Source: AIA, VEM Aktienbank

- IFE Content – AIA licenses content such as movies, TV and audio programmes from content owners such as movie studios. The Company then offers this content to airlines for use in their IFE systems. The Company's audio programming facilities can create customized audio programmes.
- IFE Technical Services - AIA offers a host of technical services that are used to integrate and manage IFE content aboard aircraft. Encoding, duplication, database management and graphic design are a few among the range of technical services offered.
- Other IFE Services – AIA helps airlines choose the right mix of IFE content for their flights. The Company analyzes market trends and cultural preferences before advising an airline on what its IFE content mix should be. AIA also helps airlines designing the graphic interface for their IFE offerings.
- Other Services – AIA licenses out movies from its own legacy portfolio; the Company's old business entailed buying movies and then licensing

them out. AIA also offer miscellaneous services such as website design through its subsidiaries.

If we only consider services provided, licensing of IFE and other content is the largest source of revenues, accounting for about 60% in FY06. While revenues from technical services contributed 30%, fixed fees from airlines contributed the remaining 10%.

## Strong Management Team

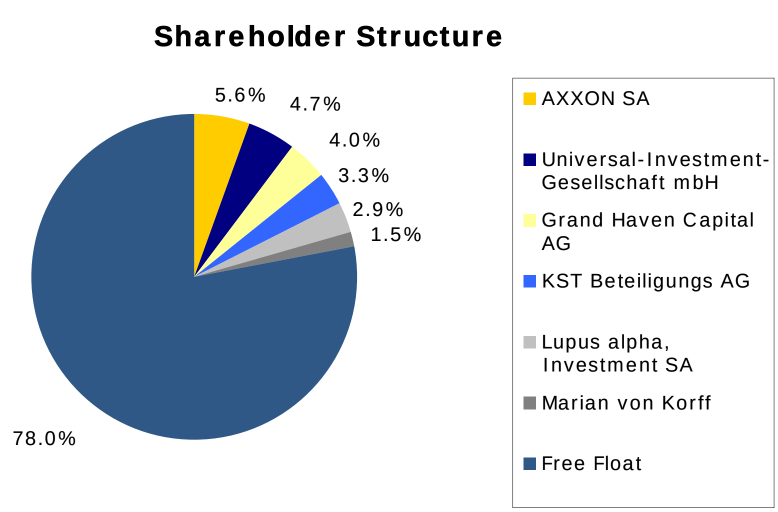
AIA has a formidable management team led by the CEO, Mr. Otto Dauer. The current team was instrumental in helping the Company make a turnaround following the failure of its traditional film licensing business. Under the leadership of the current management, AIA entered the IFE content market by adopting an acquisition-led growth strategy. The Company absorbs the managements of acquired companies, thereby strengthening its core team.

Mr. Otto Dauer, who is credited with AIA's turnaround, joined the Company as CFO at the beginning of 2001 and became its CEO soon after. He led AIA through a difficult phase—its traditional film licensing business was floundering and the Company faced delisting from Deutsche Börse's Neuer Markt. Prior to joining AIA, Mr. Otto Dauer helped establish Dolce Media, a TV marketing agency.

## Large Institutional Holdings Strengthen Capital Structure

AIA has approximately 15.32 million outstanding shares following the completion of a share repurchase programme in March 2007. Thereafter, the Company launched another share buyback programme. However, AIA has not yet repurchased any shares under the new programme. The tally of the individual holdings of the Company's Supervisory Board and senior officers towards the end of H1 FY07 was 0.45 million shares.

**Figure 6: Shareholder Structure**




Source: AIA

## Drivers – Growing market base; Strong Position

### Globalization, Competition Fuelling Demand for IFE Services

A robust global air travel market combined with increased competition is expected to boost demand for IFE services. Frost and Sullivan, a research firm, expects the IFE systems and solutions market to grow at a CAGR of 21.2% to $7.74 billion in 2012 from $2.01 billion in 2005.

Globalization has led to stronger trade links and increased tourist travel among countries. Domestic markets in developing countries are beginning to benefit from deregulation and economic growth. Boeing forecasts passenger kilometres flown to grow at an average of 4.5% from 2006 to 2026. Growth in the Asia-Pacific region and other developing regions is expected to be stronger than that in mature markets such as North America and Europe.

The rediscovery of IFE as a differentiating factor can be credited to the intense competition among airlines. Traditional airlines are using IFE as a means to differentiate themselves from low cost carriers (LCCs). IFE offerings are especially important on long-haul international routes and the lucrative business class market. Realizing the limited effect of price as a differentiating factor, even LCCs, such as US-based JetBlue and Maxjet, are offering IFE. According to Inflight Management Development Center (IMDC), a specialized market research firm, 45% of the current global aviation fleet has IFE systems installed. IMDC expects more than 70% of new aircraft deliveries to have IFE systems installed.

Asian and Middle-Eastern carriers tend to focus the most on IFE offerings, followed by European carriers. Increased competition in these carriers' core markets and their expansion plans imply that this set of airlines should continue to focus on IFE. A positive development is that North American carriers are also beginning to consider IFE as a competitive factor. Large American airlines are slowly beginning to recover from a series of bankruptcies. With their home markets saturating, North American carriers are beginning to target international routes, where IFE offerings are more important. North American carriers, which include five of the world's ten biggest airlines (both in terms of passengers carried and kilometres flown), represent a major market for IFE systems and offerings.

### Strong Market Position Boosts Revenues, Deters Competitors

AIA has leveraged its strong relationships with its customers and suppliers to strengthen its position in the market. The Company's strong relationships with major studios across the world facilitate access to the latest movies and content in each region. By negotiating with major studios on a companywide basis, AIA would be able to bargain for lower licensing costs.

Since IFE content and the accompanying software need to closely integrate with the IFE hardware, IFE content providers must enjoy strong working relationships with IFE system manufacturers. AIA's technical services teams are familiar with systems designed by the three main in-seat IFE system manufacturers – Rockwell Collins, Panasonic, and Thales. The Company's status as the Preferred Content Supplier for Panasonic Avionics gives it an edge over its competitors. Through this relationship, AIA is the recommended and preferred supplier of technical services for IFE systems installed by Panasonic.

AIA's global sales network covers every major airline market in the world. In regions such as South America, where AIA currently does not have an office, the Company uses sales agents to reach its customers. Local offices help the Company to not only market its services to new airlines but also factor in region-specific preferences while recommending IFE content to clients.

Apart from driving growth, the Company's global operations also make it immune to a slowdown in any one market. While about half of total revenues came from Europe in FY05, no region contributed more than 40% of total revenues in FY06. AIA's customers include some of the largest airlines in the world such as Air France, Cathay Pacific, Lufthansa, and Northwest Airlines. In fact, four of the five airlines to have received the Skytrax 2006 World Airline Awards for best IFE offerings are customers of AIA. While most of the Company's customers are from Europe, the Middle East and Asia, AIA also caters to airlines in North America.

**Figure 7: Major Customers**

| Europe | Middle East | North America |
|---|---|---|
| Air France | El Al | Continental Airlines |
| Austrian Airlines Group | Emirates | Northwest Airlines |
| Brussels Airlines | Eithad Airways | United Airlines |
| KLM | Saudi Arabian Airlines | |
| Lufthansa | | |
| Swiss | | |
| Virgin Atlantic | | |

| Asia | Africa | Latin America |
|---|---|---|
| Jet Airways | Air Seychelles | Air Jamaica |
| Cathay Pacific | | |
| China Airlines | | |
| Dragon Air | | |
| Malaysia Airlines | | |
| Phillipines Airlines | | |
| All Nippon Airways | | |
| Singapore Airlines | | |

Source: AIA

AIA has strengthened its operations in the IFE services industry through an acquisition-led growth strategy. The purchase of Inflight Productions in March 2006 for €12.7 million is the Company's most significant acquisition to date. The acquisition gave AIA access to Inflight Productions' technical expertise and global offices, strengthening its foothold in the IFE content market. The Company is benefiting from the long-standing relationships these subsidiaries have with content owners and IFE hardware manufacturers. Apart from driving growth, AIA's comprehensive business relationships also act as entry barriers for new players.

## Technological Advances in IFE Systems Enhance Demand

The increasing content capacity of advanced IFE systems should boost demand for the IFE services of companies such as AIA. First generation AVOD systems were usually available only to business and first class passengers, and had just a handful of choices. The latest AVOD systems offer unprecedented choice to both premium and economy class passengers. On some of its newer aircraft, Emirates Airlines offers more than 600 movie channels, TV shows and music. AVOD systems can now hold video games and could even allow multiplayer gaming in the future, further expanding the IFE Services market.

While IFE systems have become more sophisticated, they have also become lighter and cheaper. This makes them preferable for installation on more aircraft, further expanding the market base for IFE technical and content services. Airlines often pay a lot of attention to the weight of an IFE system, as it can directly affect fuel consumption and profitability. The manufacturers of IFE systems are beginning to consolidate different hardware components to reduce weight. The installation and operational costs are also decreasing.

IFE systems are becoming more flexible. AVOD systems were previously installed only on twin-aisle aircraft. Single-aisle aircraft had to settle for basic systems that consisted of a few television displays in the cabin. However, the latest lighter and flexible AVOD systems are suited for single-aisle aircraft as well. Many airlines are also installing these systems in their older aircraft.

Newer generation aircraft are better equipped to handle advanced IFE systems, making installation and operation easier. Many airlines prefer to to install their newest IFE offerings on the latest variants of the Airbus A340 and Boeing 777 series. The soon-to-be-launched Airbus A380 and Boeing 787 will take this trend forward. Growth in the commercial aviation fleet, combined with an increase in the percentage of aircraft having IFE systems, should give a double boost to the IFE solutions and IFE content market.

## Integrated Product Offering under One Banner

Through its subsidiaries, AIA delivers a comprehensive IFE product offering that encompasses the entire spectrum of services from content licensing to technical services. The Company leverages its knowledge of local markets to recommend various programmes to airlines. AIA is leveraging Inflight Production’s experience in audio programming to offer customized audio content. The Company has an equally strong presence in technical services. AIA has experience in dealing with IFE systems from the three main in-seat IFE system manufacturers. The Company offers a host of technical services such as encoding, data storage, and AVOD management.

Under the IFE Alliance banner, AIA can offer airlines this entire product offering in an integrated format. One of the Company’s key selling points is its ability to seamlessly handle the entire IFE content process from content delivery and management to technical integration.

We view the IFE Alliance as an innovative brand integration solution. AIA had to counter near-zero brand recognition when it entered the IFE content delivery market. On the other hand, acquired companies, such as Atlas Air Film and Inflight Productions, had established brand names and long histories in the IFE content market. The IFE Alliance allows individual subsidiaries to tap the market under one integrated banner. At the same time, it lets them preserve their well established brand names in the market. The IFE Alliance also enables AIA to steadily build a large product portfolio under a single brand name. In our opinion, the IFE Alliance branding strategy is a reflection of the management's innovative and successful efforts to compete in the IFE content industry.

## Financials – Revenues Seen Growing, But Margins May Contract

### Acquisition powers growth in FY06

AIA's revenues grew 148.1% to €64.2 million in FY06 from €25.9 million in FY05. The acquisition of Inflight Productions contributed €41.5 million to revenues in FY06, with the remaining €22.7 million coming from Atlas Air Film and from the traditional film licensing business. Since the acquisition of Inflight Productions was completed in March 2006, only nine months of the acquired entity's revenues and earnings were included in the consolidated statement for FY06. We estimate Inflight Productions' revenues for the entire year at around €51 million.

After accounting for a restatement in FY06 concerning impairment of film assets, AIA's net income increased to €3.2 million in FY06 from €1.53 million in FY05. FY06 margins should be analyzed with regard to some significant extraordinary items. EBITDA margin decreases to 8.5% from 11.7% once the effect of an exceptional gain from a loan waiver is excluded. There is no significant impact on other margins as the waiver and an exceptional impairment loss counteract each other. Gross margin expanded to 31.6% in FY06 from 30.3% in FY05. After accounting for the FY06 restatement, net margin decreased from 5.9% in FY05 to 5.0% in FY06.

H1 FY07 results showed a fall in margins, mainly due to pricing pressure from large airline clients. The Company recorded a net income of €0.9 million on sales of €42.2 million, representing a net margin of 2.2%. EBITDA and gross margin were about 5.9% and 27.8%, respectively. The inclusion of Inflight Productions in H1 FY07 figures means that these results cannot be compared with H1 FY06.

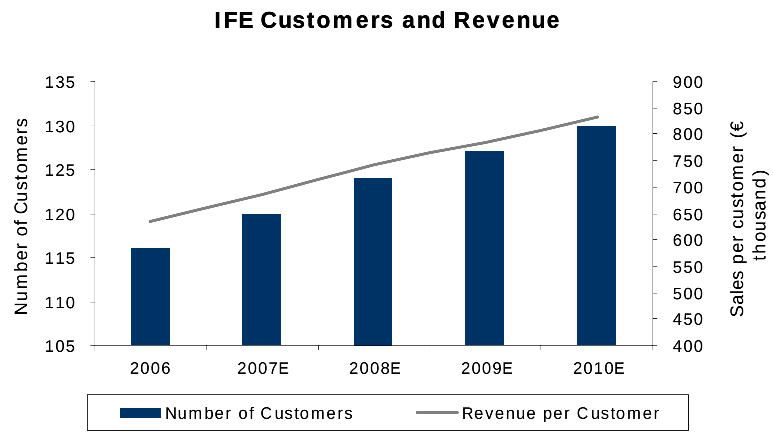
The acquisition of Inflight Productions tripled the size of the balance sheet, taking it to €75.9 million in FY06 from €22.53 million in FY05. The full cash effect of the acquisition was not felt in FY06, as the Company will be making the majority of the payment to Inflight Production's former shareholders in FY07. AIA raised €13.57 million through a round of equity financing at the beginning of FY06. The Company issued 7 million shares at an average price of about €1.9 per share. This round of financing was mainly used to fund the acquisition of Inflight Productions. The Company also closed a round of mezzanine funding in Q1 FY07. AIA launched a share buyback programme from January 2007 to March 2007. Under the programme, the Company repurchased 0.93 million shares for €1.86 million, or an average price of €2.01 per share.

### Healthy Revenue Growth Expected

We forecasted AIA's revenues on the basis of number of IFE customers. The Company had 116 customers for its IFE services in FY06. The group's IFE revenues for FY06, after including the whole year revenues for Inflight Productions, aggregated €73.6 million. This works out to about €0.6 million per IFE customer.

We expect both the number of customers and revenue per customer to increase in the coming years. Currently, there are more than 1800 airlines operating globally. Increased demand for air travel and liberalization of developing markets should increase the number of airlines. Many of these airlines may be too small to offer IFE services to their passengers. However, there still remains a large potential market base for AIA's IFE services. With the Company's global sales network and strong presence in developing markets, we believe AIA should be able to steadily capture additional clients in the future.

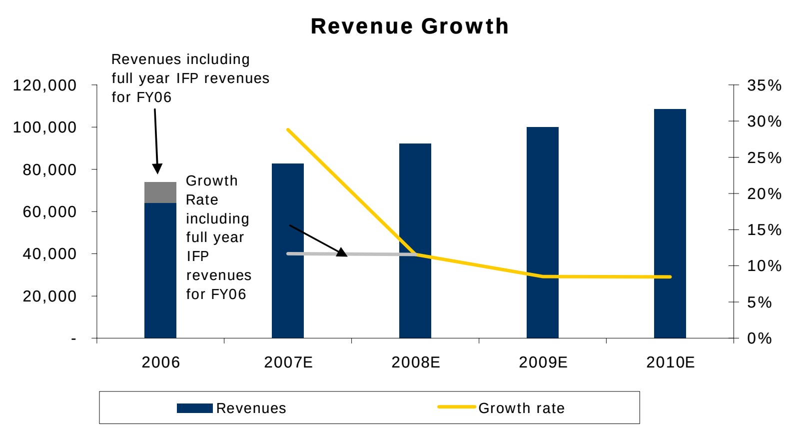
**Figure 8: IFE Customers and Revenue per Customer**




Source: AIA, VEM Aktienbank AG

We expect the average revenue per customer to increase, going forward. Airlines are rediscovering the importance of IFE services as a differentiating factor. The improving financial health of airlines should also allow them to spend more on IFE services. AIA's revenue model for the licensing of IFE services largely depends on the number of flights on which content, such as a movie, is shown. Hence, an increase in airline travel would in all likelihood increase the Company's revenues. The contribution of the traditional film licensing segment to AIA's future sales is expected to be marginal.

**Figure 9: Revenue Forecast**




Source: AIA, VEM Aktienbank AG

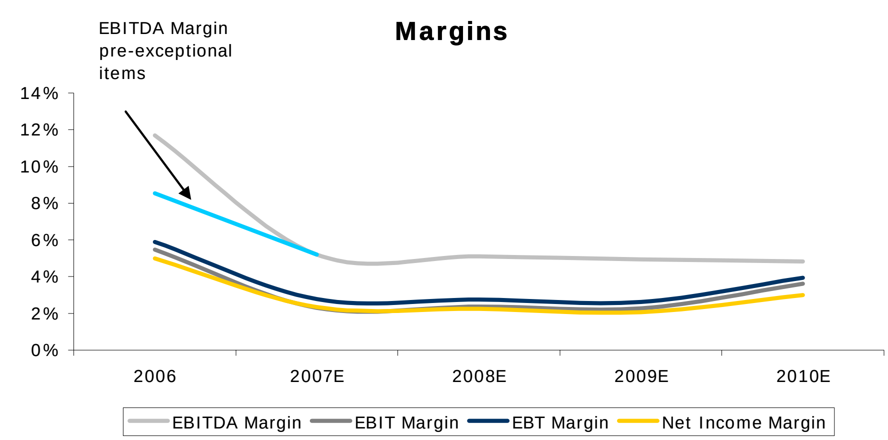
Based on our forecast, we expect revenues to grow 28.8% to €82.6 million in FY07. The growth rate for FY07 should be analyzed based on the fact that only nine months of Inflight Productions' revenues were included in AIA's financial statement for FY06. After including the entire portion of Inflight Production's revenues for FY06, our expected growth rate in revenues is 11.7%.

## Purchasing and Operating Efficiencies Should Counteract Pricing Pressure from Customers

Customer pricing pressure is expected to continue exerting downward pressure on AIA's gross margins. The Company's bargaining position with its customers, especially large airlines, is unlikely to improve in the future. Purchasing efficiencies for content licenses could counteract the effect to an extent. The Company plans to begin negotiating for content licenses on a companywide basis rather than having its subsidiaries negotiate individually. AIA should also be able to leverage its current technical services infrastructure to service additional customers. Hence, believe the fall in gross margin would be only gradual in the future.

Improvements in operating efficiency should counteract the fall in gross margins in the medium term. Cost synergies in between the subsidiaries could play a role in improving efficiency. Even though AIA is limiting the integration of its subsidiaries, the Company plans to optimize some of its subsidiaries' operations. We forecast an EBITDA margin of 5.2% in FY07 and 5.1% in FY08. Forecasted EBITDA margins should be compared to an adjusted EBITDA margin of 8.5% in FY06, which excludes the effect of exceptional items.

**Figure 10: Margin Forecast**




Source: AIA, VEM Aktienbank AG

The effective tax rate declined from 28.6% in FY05 to 14.7% in FY06. While it is possible that the effective tax rate might stay at the FY06 level, we have conservatively assumed a gradually increasing effective tax rate. Interest expense is expected to decline in the future as well. The Company is scheduled to pay off the biggest portion of its debt by the end of FY07.

AIA's balance sheet would decline in FY07 due to the repayment of debt payable to the former shareholders of Inflight Productions. The repayment of this debt will not lead to a net cash outflow as financial assets have been reserved for repayment. Investments for technical equipment are expected to constitute the Company's main capital expenditure. AIA is expected to begin paying dividends in FY08. A potential source of cash inflow in FY07 or FY08 is the possible sale of Telcast Media. However, since the timing of the sale and the amount it will garner is not certain, we have decided to ignore its impact on the cash flow.

# Appendices – Financial Statements

## Income Statement

| ( in € thousands) | 2005 | 2006R | 2007E | 2008E | 2009E | 2010E |
|---|---|---|---|---|---|---|
| Sales revenue | 25,854 | 64,155 | 82,643 | 92,197 | 100,070 | 108,557 |
| Cost of Goods Sold | (18,032) | (43,884) | (59,503) | (66,659) | (72,651) | (79,030) |
| **Gross Profit** | 7,822 | 20,271 | 23,140 | 25,539 | 27,419 | 29,528 |
| Employee Costs | (3,229) | (9,506) | (11,983) | (13,138) | (14,110) | (15,198) |
| Other operating expenses | (3,003) | (6,154) | (7,851) | (8,713) | (9,407) | (10,150) |
| Other operating income | 1,221 | 2,889 | 1,000 | 1,020 | 1,040 | 1,061 |
| **EBITDA** | 2,811 | 7,500 | 4,306 | 4,708 | 4,943 | 5,241 |
| Depreciation and amortization | (598) | (3,989) | (2,402) | (2,514) | (2,664) | (1,312) |
| **EBIT** | 2,213 | 3,511 | 1,903 | 2,194 | 2,279 | 3,929 |
| Income from investments | (2) | - | - | - | - | - |
| Finance income | 88 | 1,017 | 962 | 538 | 538 | 538 |
| Finance costs | (155) | (748) | (566) | (198) | (193) | (189) |
| **EBT** | 2,144 | 3,780 | 2,299 | 2,534 | 2,624 | 4,278 |
| Taxes on income | (612) | (557) | (345) | (456) | (551) | (1,027) |
| Minority interest | - | (15) | (11) | - | - | - |
| **Net income** | **1,532** | **3,208** | **1,943** | **2,078** | **2,073** | **3,251** |
| Earnings per share | 0.17 | 0.21 | 0.13 | 0.14 | 0.14 | 0.21 |
| Weighted Average number of shares ('000) | 8,948 | 15,515 | 15,464 | 15,312 | 15,312 | 15,312 |

Source: AIA, VEM Aktienbank AG

## Balance Sheet

| ( in € thousands) | 2005 | 2006R | 2007E | 2008E | 2009E | 2010E |
|---|---|---|---|---|---|---|
| **Assets** | | | | | | |
| Current assets | | | | | | |
| Cash and equivalents | 6,815 | 14,778 | 17,068 | 19,493 | 21,428 | 22,800 |
| Film rights | 1,075 | 881 | 587 | 294 | - | - |
| Trade receivables | 1,600 | 13,561 | 17,887 | 20,713 | 23,304 | 25,875 |
| Current tax assets | 7 | 319 | 263 | 263 | 263 | 263 |
| Other financial assets | - | 16,949 | - | - | - | - |
| Other assets | 385 | 2,977 | 3,510 | 3,855 | 4,133 | 4,430 |
| **Total current assets** | 9,882 | 49,465 | 39,316 | 44,617 | 49,127 | 53,368 |
| Film assets | 5,616 | 3,664 | 2,442 | 1,221 | - | - |
| Goodwill | 2,421 | 11,243 | 11,217 | 11,217 | 11,217 | 11,217 |
| Other intangible assets | 1,374 | 5,021 | 4,519 | 4,017 | 3,515 | 3,013 |
| Total Intangibles | 9,411 | 19,928 | 18,178 | 16,455 | 14,732 | 14,229 |
| Property, plant and equipment | 78 | 2,346 | 3,227 | 4,113 | 4,968 | 5,786 |
| Investments | 2,387 | 2,391 | 2,391 | 2,391 | 2,391 | 2,391 |
| Other financial assets | 108 | 112 | 79 | 79 | 79 | 79 |
| Deferred tax assets | 666 | 1,656 | 1,773 | 1,773 | 1,773 | 1,773 |
| **Total non-current assets** | 12,651 | 26,433 | 25,649 | 24,811 | 23,942 | 24,259 |
| **Total Assets** | **22,533** | **75,898** | **64,965** | **69,429** | **73,069** | **77,627** |
| **Liabilities and Shareholder's Equity** | | | | | | |
| Current liabilities | | | | | | |
| Other provisions | 1,101 | 504 | 107 | 107 | 107 | 107 |
| Current tax liabilities | 887 | 595 | 640 | 640 | 640 | 640 |
| Financial liabilities | 3,909 | 17,179 | - | - | - | - |
| Trade payables | 3,651 | 21,554 | 25,268 | 27,394 | 28,861 | 30,313 |
| Other payables to affiliates | - | 36 | - | - | - | - |
| Other liabilities | 541 | 4,899 | 6,416 | 7,047 | 7,568 | 8,131 |
| **Total Current Liabilities** | 10,089 | 44,767 | 32,431 | 35,188 | 37,176 | 39,191 |
| Non-current liabilities | | | | | | |
| Financial liabilities | - | 367 | 2,308 | 2,250 | 2,192 | 2,134 |
| Deferred tax liabilities | 728 | 2,934 | 2,737 | 2,737 | 2,737 | 2,737 |
| **Total Non-current Liabilities** | 728 | 3,301 | 5,046 | 4,988 | 4,929 | 4,871 |
| **Total Liabilities** | **10,817** | **48,068** | **37,477** | **40,175** | **42,106** | **44,062** |
| Shareholder's Equity | | | | | | |
| Issued capital | 9,280 | 16,240 | 15,312 | 15,312 | 15,312 | 15,312 |
| Capital reserves | 746 | 7,104 | 6,938 | 6,938 | 6,938 | 6,938 |
| Retained earnings | 1,583 | 4,792 | 5,801 | 7,567 | 9,277 | 11,878 |
| Accumulated other equity | 108 | (460) | (563) | (563) | (563) | (563) |
| Minority Interest | - | 155 | - | - | - | - |
| **Total Shareholder's Equity** | 11,716 | 27,830 | 27,488 | 29,254 | 30,964 | 33,564 |
| **Total Liabilities and Shareholder's Equity** | **22,533** | **75,898** | **64,965** | **69,429** | **73,069** | **77,627** |

Source: AIA, VEM Aktienbank AG

## Cash Flow Statement

| ( in € thousands) | 2005 | 2006 | 2007E | 2008E | 2009E | 2010E |
|---|---|---|---|---|---|---|
| Net Income | 1,532 | 3,208 | 1,943 | 2,078 | 2,073 | 3,251 |
| Depreciation and amortization of non-current assets | 598 | 3,491 | 2,402 | 2,514 | 2,664 | 1,312 |
| Changes in deferred taxes | 115 | (633) | (212) | - | - | - |
| Other non-cash income and expense items | 90 | (2,068) | | | | |
| Changes in provisions | (100) | (710) | (397) | - | - | - |
| Changes in other assets from operating activities | 1,084 | (3,481) | (4,859) | (3,170) | (2,869) | (2,869) |
| Changes in other liabilities from operating activities | (488) | 1,973 | 5,195 | 2,756 | 1,989 | 2,015 |
| **Cash flow from operating activities** | **2,831** | **1,780** | **4,072** | **4,178** | **3,856** | **3,709** |
| Cash received for the disposal of property, plant and equipment | - | 24 | - | - | - | - |
| Investments in PP&E and Intangibles | (56) | (580) | (1,240) | (1,383) | (1,501) | (1,628) |
| Investments in film assets | (222) | (723) | - | - | - | - |
| Expenditure in companies consolidated, net of cash acquired | - | (5,287) | | | | |
| Expenditure for investments | (2,377) | - | | | | |
| Changes of other financial assets | (39) | (16,949) | 16,981 | - | - | - |
| **Cash Flow from investing activities** | **(2,694)** | **(23,515)** | **15,741** | **(1,383)** | **(1,501)** | **(1,628)** |
| Financial loans | 762 | 16,949 | 2,000 | - | - | - |
| Proceeds from capital increase by stockholders | 1,946 | 13,572 | | | | |
| Adjustments to other shareholder's equity items | | | (424) | | | |
| Payments for share-buyback program | | | (1,862) | | | |
| Dividend Payments | | | - | (312) | (363) | (650) |
| Repayment of loans | (353) | (1,244) | (17,237) | (58) | (58) | (58) |
| **Cash Flow from financing activities** | **2,355** | **29,277** | **(17,523)** | **(370)** | **(421)** | **(708)** |
| Changes in cash and cash equivalents due to currency translation | 194 | (77) | | | | |
| **Cash Flow for the Year** | **2,686** | **7,465** | **2,290** | **2,425** | **1,934** | **1,373** |
| Cash and cash equivalents as at January 1 | 4,129 | 6,815 | 14,778 | 17,068 | 19,493 | 21,428 |
| Cash and cash equivalents as at December 31 | 6,815 | 14,778 | 17,068 | 19,493 | 21,428 | 22,800 |

Source: AIA, VEM Aktienbank AG

## Ratios

| | 2005 | 2006R | 2007E | 2008E | 2009E | 2010E |
|---|---|---|---|---|---|---|
| **Growth** | | | | | | |
| Revenues | | 148.1% | 28.8% | 11.6% | 8.5% | 8.5% |
| EBITDA | | 166.8% | -42.6% | 9.3% | 5.0% | 6.0% |
| EBIT | | 58.7% | -45.8% | 15.3% | 3.9% | 72.4% |
| EBT | | 76.3% | -39.2% | 10.2% | 3.5% | 63.0% |
| Net Income | | 109.4% | -39.4% | 6.9% | -0.2% | 56.9% |
| **Margins** | | | | | | |
| Gross Margin | 30.3% | 31.6% | 28.0% | 27.7% | 27.4% | 27.2% |
| EBITDA Margin | 10.9% | 11.7% | 5.2% | 5.1% | 4.9% | 4.8% |
| EBIT Margin | 8.6% | 5.5% | 2.3% | 2.4% | 2.3% | 3.6% |
| EBT Margin | 8.3% | 5.9% | 2.8% | 2.7% | 2.6% | 3.9% |
| Net Income Margin | 5.9% | 5.0% | 2.4% | 2.3% | 2.1% | 3.0% |
| Dividend Payout | 0.0% | 0.0% | 95.8% | 15.0% | 17.5% | 20.0% |
| **Balance Sheet Ratios** | | | | | | |
| ROE | 13.1% | 11.5% | 7.1% | 7.1% | 6.7% | 9.7% |
| ROIC | 10.5% | 7.1% | 6.9% | 6.2% | 6.1% | 8.9% |
| ROCE | 10.2% | 6.0% | 4.4% | 3.9% | 3.9% | 5.8% |
| Debt Ratio | 25.0% | 38.7% | 7.7% | 7.1% | 6.6% | 6.0% |
| Equity Ratio | 75.0% | 61.3% | 92.3% | 92.9% | 93.4% | 94.0% |
| Asset Turnover Ratio | 1.15 | 0.85 | 1.27 | 1.33 | 1.37 | 1.40 |
| **Per Share** | | | | | | |
| EPS | 0.17 | 0.21 | 0.13 | 0.14 | 0.14 | 0.21 |
| *EPS growth* | | 20.8% | -39.2% | 8.0% | -0.2% | 56.9% |
| Cash EPS | 0.24 | 0.46 | 0.28 | 0.30 | 0.31 | 0.30 |
| DPS | - | - | 0.12 | 0.02 | 0.02 | 0.04 |
| *DPS growth* | | | | -83.1% | 16.4% | 79.3% |
| Book Value per share | 0.15 | 0.52 | 0.61 | 0.84 | 1.06 | 1.26 |
| Free Cash Flow per share | 0.01 | (0.29) | 0.16 | 0.16 | 0.14 | 0.12 |
| **Market Measures** | | | | | | |
| P/Sales | 1.02 | 0.41 | 0.32 | 0.29 | 0.26 | 0.24 |
| EV/Sales | 0.38 | 0.15 | 0.12 | 0.11 | 0.10 | 0.09 |
| EV/EBITDA | 3.52 | 1.32 | 2.30 | 2.10 | 2.00 | 1.89 |
| P/Earnings | 17.29 | 8.26 | 13.63 | 12.75 | 12.78 | 8.15 |
| P/Book Value | 2.26 | 0.95 | 0.96 | 0.91 | 0.86 | 0.79 |
| P/Cash Earnings | 12.44 | 3.67 | 6.08 | 5.77 | 5.59 | 5.81 |
| Dividend Yield | 0.0% | 0.0% | 7.0% | 1.2% | 1.4% | 2.5% |
| Free Cash Flow yield | 0.8% | -17.0% | 9.5% | 9.5% | 7.9% | 6.9% |

Source: AIA, VEM Aktienbank AG

## Calendar of Events

| Date | Event |
|---|---|
| 15 November 2007 | Publication of Quarterly Report for Q3 FY07 |
| January 2008 | Earnings release for FY07 Financials and Analyst Call |
| February 2008 | Publication of Annual Report for FY07 |
| February 2008 | Shareholder's General Meeting |
| July 2008 | Earnings release for Q2 FY08 Financials and Analyst Call |
| August 2008 | Publication of Quarterly Report for Q2 FY08 |

Source: AIA

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3) manage the financial instruments that are, or whose issuers are, the subject of the financial analysis on a market by placing buy or sell orders,
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Specific notes of potential conflicts of interests (No. 1) - 9)) with respect to the company that is the subject of this analysis:

2) VEM regularly holds shares of Advanced Inflight Alliance AG in its trading portfolio.
3) VEM is serving as a market maker for Advanced Inflight Alliance AG's securities on the basis of an existing designated sponsorship contract.
5) VEM has been providing investment banking services for Advanced Inflight Alliance AG during the last 12 months for which a compensation has been paid.

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**Company responsible for the preparation and communication of this financial analysis:**

VEM Aktienbank AG, Munich („VEM")

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**Details of material sources of information:**

This financial analysis is based on public available information (Company presentations, Annual Reports, Press Informations etc.). Moreover, management interviews for more detailed information about the current business development were held with the company.

The analysis was not made available for the company before publishing it.

**Summary of the valuation methods and principles applied in the preparation of the financial analysis:**

The valuations underlying the ratings of the securities analysed by VEM are based on generally accepted and widely used methods of fundamental valuation, such as DCF model, Peer group comparison, NAV valuation and - where applicable - a Sum-of-the-parts model.

VEM applies an absolute equity rating system with 3 grades. Each grade complies with following expectations (Ratings refer to time period of 6 months):

BUY: The expected return (composed of the projected change of the share price and the anticipated dividend yield) is at least + 10 %.
HOLD: The expected return (composed of the projected change of the share price and the anticipated dividend yield) ranges from – 10 % and + 0 %.
SELL: The expected return (composed of the projected change of the share price and the anticipated dividend yield) is worse than – 0 %.

For further important details concerning the valuations methods applied in the preparation of this analysis, the meaning of the specific investment recommendation (including the recommended investment period, the risks associated with the investment and the sensitivity of the valuation parameters) please see the Section "Valuation" in this analysis.

**Additional important information:**

Date of first publication of this analysis by VEM : 23 October, 2007
Date and Time of relevant Share Price (see first page): 22 October, 2007, 5:30 P.M. CEST

A schedule for an update of this Analysis is not appointed yet. VEM reserves to update any individual analysis without prior notice.

VEM has not published a financial analysis in the twelve months prior to the publication of the present financial analysis that covers the same financial instruments or issuers and that contains a different specific investment recommendation.