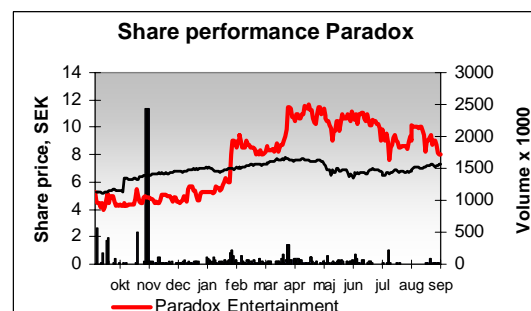


**Bolagsanalys**
**Paradox Entertainment (PDXE.NGM)**
**Barbarians at the gate to success**

- Paradox Entertainment owns the rights to fantasy figure Conan and 1,000 other similar characters.
- By licensing these rights to film production companies, PC software games companies and publishing houses, Paradox Entertainment faces a bumper harvest in the coming years. A remake of Conan the Barbarian film is under production and if this proves to be a box-office success, then the company has indeed hit a jackpot.
- We have assessed Paradox in three different scenarios based on the license revenues the company expects to obtain in the next few years. In a positive scenario we see a value of SEK 16 per share while in a negative scenario, SEK 8 per share. In our normal scenario we see a value of roughly SEK 10 to 11 per share.

List: NGM Equity  
 Market Cap: 384 MSEK  
 Sector: Entertainment  
 CEO: John Fällström  
 Chairman: Peter Sederowsky


**Redeye Rating**

Company	Share / Financials
History	Financial situation
Management	Fundamental valuation potential
Market	Relative valuation potential
Positioning	Shareholder focus
Profitability potential	

**Key figures**

	2005	2006e	2007e	2008e	2009e
Revenue, MSEK	25	29	70	137	143
Growth	31%	14%	147%	95%	4%
EBIT	8	14	30	67	83
Pre tax profit	13	14	30	67	83
Net profit	13	14	22	48	59
Net margin	53%	48%	31%	35%	42%
EPS	0.3	0.3	0.5	1.1	1.4
P/E	29	28	18	8	6
EV/EBITA	44	27	12	5	3
P/S	15	13	5	3	3
EV/S	15	13	5	2	2

**Facts**

Share price, SEK	9.0
Nr of shares	43
Market cap, MSEK	384
Net debt, MSEK	5.7
Free float %	50
Turnover/day/1000	20

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## Definitions Company

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**History** Reflects the company's historical development regarding growth, profitability development, share issue history, and the ability to manage better than its competitors.

**Company management** An evaluation of management's competence, track record and ability to manage the company towards good future results.

**Market** An evaluation of growth and profitability potential on the current market / market segment. Factors that influence the market, such as external threats and possible mergers and acquisitions, are analysed as well.

**Positioning** Analyses the company's position on the market measured in market share and competitive situation. Decisive factors are the company's competitive power and brand value. Possible partnerships and international establishments can also strengthen a company's positioning.

**Profitability potential** Considering all aspects of the company's business, the company's future profitability and longterm margins are estimated.

## Definitions Shares / Finance

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**Financial situation** An analysis of the company's financial status considering debt, equity, cash, dependence on individual clients (client categories and the owners' financial strength).

**Fundamental valuation potential** The company's potential is analysed based on fundamental key figures and a cash flow evaluation of the company's activities. The fundamental evaluation also includes the evaluation of the share's options in case of changes in dividend requirements or the share's specific risk level. High rating means a low fundamental valuation.

**Relative valuation potential** The company's key figures are compared with similar companies in Sweden and internationally. The fundamental level of the key figures is not taken into account. The relative evaluation includes the possibility to value the share based on the chosen comparative objects. A high rating means a low relative valuation.

**Shareholder focus** The share is analysed according to the parameters dividend, share liquidity, free float, the company's information policy and analyst coverage. The analysis also includes ownership structure and the financial position of the owners.

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## Summary

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- Paradox Entertainment is publicly listed on NGM (Nordic Growth Market) Equity. It owns and commercializes among others literary rights to the library of author Robert E. Howard. The brand portfolio includes more than 1,000 proprietary characters such as Mutant Chronicles, Kull of Atlantis, Solomon Kane, Bran Mak Morn and Conan the Barbarian, which is the most famous fantasy character.
- To facilitate commercialization of this portfolio, Paradox has organized its operation in three business areas: Entertainment; Publishing and Other Licensing. Within Entertainment, the company licences rights to films, DVD, TV and PC/video games. This business area promises to be the most important revenue potential for the future, according to Redeye. Within Publishing, Paradox licenses characters for books and comic series and within Other Licensing you can find collector's items, clothes and games.
- On June 15, US film studio Warner Bros announced it was using its option to make a movie based on the Conan character. With a production budget of MUSD 80, exclusive marketing, Conan is in a favourable position to become a blockbuster hit when it holds its premiere in mid-2008. The movie is crucial for Paradox – not just because the company stands to gain huge licence fees from movie theatres, DVD, TV syndication and computer games but also because interest in the rest of Robert E. Howard's characters is set to increase dramatically.
- Paradox is a small company working in a large market. The licensing rights alone from the consumer products are estimated at SEK 1 300 billion annually. A key forerunner in the industry is American Marvel Entertainment with the popular characters X-Men and Spider-Man and whose successful business model Paradox has embraced. Precisely like Marvel, Paradox is expected to exploit its extensive brand portfolio for licensing in the different media. With its current business model, which is based on license revenues, Paradox is facing limited risks for now. To boost its potential, Redeye expects Paradox to increase the portion of self-financing. Marvel has already taken this path by getting external financing for coming films.
- In evaluating Paradox, we worked with three different scenarios: normal, positive and negative based on estimates for the company's various sources of revenues in the coming years. In the negative scenario, we assume that the market has become tired of fantasy figures, which adversely affects revenues. In this scenario, the Paradox share is worth about SEK 8.50. In our positive scenario, we assume a huge interest in Paradox's various characters in general, and in the Conan films in particular. In this scenario the share is worth roughly SEK 16.
- In our normal scenario, we expect a good revenue and profit trend in the coming years. As early as 2007 we already expect revenues to accelerate, driven by film and computer games launches. However, the major upswing is expected to occur from year 2008 and onwards when Paradox starts capitalizing on license revenues from the Conan films. In this scenario we think that the share is worth about SEK 11, corresponding to a market value of approximately MSEK 450.

## Background

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Paradox Entertainment (Paradox) was established in 1997. During the years 2000-2001, Paradox developed software for interactive entertainment, with focus on online games. In 2001, Paradox restructured its operations in order to minimize business risks as the market conditions for online games at the time had begun to deteriorate.

*The business was revamped in 2004 and focus re-directed towards Paradox's licensing portfolio.*

In 2004, Paradox aligned its operations further by divesting its interactive games production and started working to a greater extent with partners. Business was directed towards the company's brand portfolio. Paradox now has a business model that is solely focused on licensing of literary rights.

In 2002 Paradox acquired 20 per cent of the rights to the Conan the Barbarian figure from Conan Properties International. A key milestone for Paradox occurred already at the end of the same year, when film company Warner Bros acquired an option with the intent to produce a film based on the Conan character. During 2004 Paradox acquired exclusive literary rights to Robert E. Howard's Conan character and in February this year, Paradox acquired the rest of author Robert E. Howards' library of tales and fantasy figures.

*The portfolio consists of more than 1,000 characters, with Conan the Barbarian the most famous one.*

The property rights portfolio thus comprises mainly of Robert E. Howard's library of more than 1,000 stories and characters in diverge genres such as fantasy, science fiction, historical adventures, horror and western. Paradox has also developed its own characters in the portfolio, in particular Mutant Chronicles.

On June 15, 2006 Warner Bros announced that the film studio would pursue production of the Conan film. Warner Bros aims to produce a series of Conan movies.

*Paradox was publicly listed on November 25 at the stock exchange NGM Equity.*

The target for the future is to get wider exposure on the capital market and in this way, gain possibility to further strengthen the company's finances, increase flexibility and raise the level of preparedness to acquire and exploit qualitative and attractive property rights.

Peter Sederowsky is Chairman of the Board of Paradox Entertainment AB as well as CEO and President of subsidiary Paradox Entertainment Inc. To be in close proximity to the entertainment industry, Paradox Entertainment has been headquartered in Los Angeles, California since 2004.

## Business operations

*Paradox is licensing rights to characters to film studios, TV and computer games companies.*

Paradox Entertainment sells licensing rights to stories and characters created by author Robert E. Howard. The licensing rights cover entertainment such as films and consumer products, including toys, games, books and publications. In total Paradox owns rights to more than 1,000 characters in which Conan the Barbarian is the most famous one in its library. The other well known fantasy figures are Mutant Chronicles, Kull of Atlantis, Solomon Kane and Bran Mak Morn. Some of Paradox's most vital characters are described more extensively in Appendix 1. Paradox has organized its operations in three business areas as shown in the table below.

Business areas		
Entertainment	Publishing	Other licensing
Theatrical	Comics	Collectibles
Computer / Video-games	Books	Toys
Wireless		Clothes

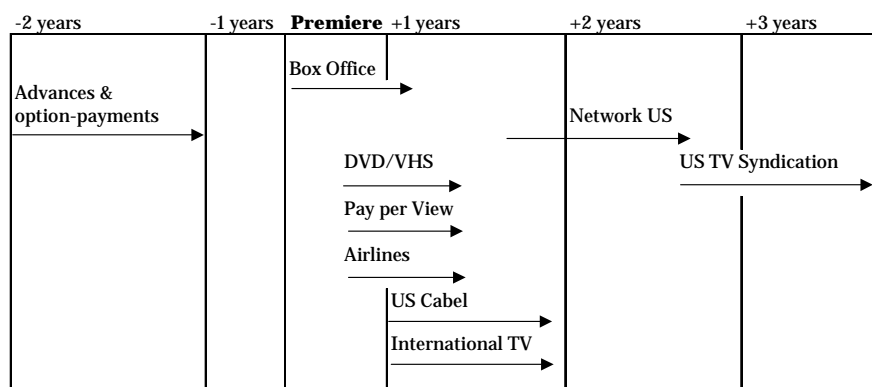
Source: Paradox Entertainment

### Business area Entertainment

*Business area Entertainment is the most crucial one.*

Entertainment is Paradox's biggest business area at present in terms of revenues. This is also the area where we see the most growth potential ahead. The business segment is divided into three business units where license revenues stem from all types of film-related rights as well as from computer and TV/video games and Wireless. Wireless, the third business unit, consists of license rights from games on mobile terminals, where we expect relatively modest revenues in the near future. The image below shows a timeframe on how revenues from a movie are expected to be allocated across Paradox.

#### Timeline for income in business area Entertainment



Source: Paradox Entertainment

*License revenues can last 4 to 5 years or even longer.*

As we can see, the revenues stretch over a period of 4 to 5 years depending on the movie's box-office success and how well Paradox succeeds in licensing the film to various media. As early as 1 to 2 years prior to the movie's launch, Paradox can already start getting advanced payments from film studios for movies in the pipeline. The bulk of the revenues are expected to come in connection with the movie premiere as Paradox receives royalty from box-office revenues. Royalty fees from films are expected to go on for about a year, with the biggest slice early in the period and then gradually waning over time. Revenues from DVD, Pay per View and airlines can also become substantial; they are expected to start pouring in about six months following the movie premiere and stretch over a period of roughly a year. The rest of the revenues come from cable TV and the rest of the TV channels in the US and other parts of the world.

## Film

Business unit Film is perhaps Paradox's more crucial one in the future since it is here that the huge revenues are expected to come alongside computer games licenses. A box-office success also tends to spark interest in other revenue sources such as DVD and TV syndication. In the table below we have listed the films that are up for production in the next few years. Given that there are more than 1,000 fantasy figures in Paradox's library, more films are likely to be decided upon in the succeeding years.

### Pipeline Film

	Partner	Structure	Status
Feature Film "Conan"	Warner Bros.	Gross Participation	In pre production
Animated D-T-V "Red Nails"	Swordplay	Gross Participation	In production
Feature Film "Mutant Chronicles"	Ed Pressman Film	Advance + Net Profit part.	In production
Feature Film "Vultures"	Internal Development	Internal Development	In pre production
Feature Film "Bran Mak Morn"	Working Title	In Development	2008
Feature Film "Solomon Kane"	Wandering Star/Davies Prod.	In Development	Advances paid
"Thulsa Doom"	Red Sonja Corp.	In Development	2008

Source: Paradox Entertainment

### The Conan-movie

<b>Producer:</b>	Akiva Goldsman
<b>Writer:</b>	Boaz Yakin
<b>Studio:</b>	Warner Bros
<b>Publisher:</b>	Paradox Ent.
<b>Budget:</b>	80 MUSD
<b>Production start:</b>	Early 2007
<b>Premiere:</b>	2007

Källa: Paradox Entertainment

## Warner Bros makes the next Conan movie

On June 15 Warner Bros made an important announcement that it was pushing for its option to produce the Conan movie. Since Conan is Paradox's key asset, the announcement was vital for the company. WB has had this option since 2002 but various circumstances had forced the film company to postpone production and extend the option period. In June 2005, WB renewed the option agreement for another year. The production start is now planned for early 2007 with the premiere held sometime in 2008 (probably before the summer). WB has handpicked Boaz Yakin to write the movie script. Yakin has written several screenplays for films such as "The Rookie" with Clint Eastwood and Charlie Sheen in the lead roles.

Yakin also directed the movie “Remember the Titans”, which had Denzel Washington as lead actor. Akiva Goldsman, who is behind several well known films, has been named producer. He recently co-produced “Da Vinci Code.” Goldsman also wrote the script for the movies “A Beautiful Mind” and “Batman & Robin.”

### **Series of Conan films expected**

According to Warner Bros, the idea is to have a series of Conan films, with the Conan movie remake being the first in the series. It is not totally unexpected that WB plans to produce a series of films. Trilogies, especially within the fantasy genre, are commonplace in Hollywood. The first Conan movie from 1982, “Conan the Barbarian” directed by John Milius and with Arnold Schwarzenegger in the leading role, had a sequel later, “Conan the Destroyer” (1984) directed by Richard Fleischer. The sequel was, however, not as successful as the first movie, which could be the reason why Universal, which at the time had the film rights to Conan, chose not to produce a third movie.

*The first Conan movie came in 1982 and was directed by John Milius.*

The first version of “Conan the Barbarian” (1982) was far from Robert E. Howard’s original character. We expect the new film to be more faithful to the original character and storyline. The coming film can be seen not only as an independent production but also as the first chapter in a long narrative similar to “Lord of the Rings,” “X-Men” and many others. The first movie will most likely depict the character and provide it with a background history that is necessary to understand the world that Conan lives in. The movie will also probably leave a string of loose threads that makes it possible to make a sequel and maintain public interest in the coming films. The first movie is crucial since a lot of information about the character will be revealed while ensuring that the audience does not get bored. If the first movie becomes somewhat of a success then the film producers in the succeeding movies can focus on the plot and avoid many of the “transition links” necessary in the first movie. It is also easier to sell a sequel since both the brand and the character are already known to the public. The conditions for a sequel depend, of course, on how well the first movie succeeds in the box office.

*Conan became a well known character after the first movie, making it easier for the producers.*

### **Success of film crucial**

In Redeye’s view, it is crucial for Paradox that the Conan movie becomes a success. A box-office hit will, at the very least, pave the way for a sequel and generate add-on sales. Apart from lower revenues for Paradox, a flop could also deal a blow to the Conan brand and worsen the prospects for the rest of Robert E. Howard’s library of fantasy figures.

*A flop will dent the Conan brand and worsen prospects for the other Robert E. Howard characters.*

It is difficult at the moment to gauge how well the Conan movie will fare in the box office. There are, however, two key factors indicating favourable conditions for the movie to become a bigger success.

*The first Conan movie raked in profits that were 3.5x the investment, which is excellent.*

- The first Conan film that Dino de Laurentis produced in 1982 with Arnold Schwarzenegger in the main role was a huge success. The budget, which at the time was worth MUSD 20, can be compared to the total recorded amount of MUSD 69 (non-inflation adjusted). This matches 3.5 times the investment, which should be regarded as excellent. Among the movies that premiered in 1982, “Conan the Barbarian” placed 17th on the list of films that made the most money to date. “Conan the Barbarian” was ranked ahead of, for instance, “Blade Runner” but behind “E.T”. A more interesting detail is that the movie, measured in terms of Grand Openings” (ticket sales during the weekend premiere) placed 5th in 1982. Also interesting to note is that “Conan the Barbarian” during its Grand Opening was shown in 1,395 cinemas in the US, which was the third highest number in 1982. We take this as a sign of the huge interest in the Conan character, at any rate, in the US.

*“Lord of the Rings” has created a huge interest in the fantasy film genre.*

- Probably the most important factor that speaks for success for the movie is the huge interest in the fantasy/series genre that Marvel’s success with X-Men and Spider-Man as well as Peter Jackson’s Lord of the Rings trilogy have created. Following the latest box-office hit “X-Men- The last stand,” Marvel owns the rights to two of the four films that to date<sup>1</sup> had raked in the most money during the first three days of screening. What could go against success for the coming Conan film is if the market gets tired of this type of genre films. Redeye believes, however, that there is still huge interest as shown by the latest super-hero movie “Superman Returns,” which raked in roughly MUSD 50 during its weekend premiere in the US alone.

### **Mutant Chronicles – production underway**

Mutant Chronicles is the only character in Paradox’s library that is not created by Robert E. Howard. Film production is now underway at the famous Pinewood Shepperton studios outside London. The producer is Edward Pressman Film Corp. (“Wall Street, American Psycho, The Crow”) together with Peter Sederowsky and Fredrik Malmberg at Paradox. The

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<sup>1</sup> The other Marvel film is Spider-Man. The two others are “Star Wars Episode 3” and “Shrek 2”.

director is the relatively unknown Simon Hunter while those playing the leading roles are more familiar names such as John Malkovich (“In the Line of Fire”, “Dangerous Liaisons”) and Thomas Jane (“Face/Off”, “The Punisher”). The budget is approximately MUSD 25 and according to Paradox’s annual report for 2005, the movie is expected to have its premiere in 2008. However, Redeye expects the launch to take place already in 2007 since production has already come a long way, something that we have also take into account in our forecasts. Apart from the film, Paradox has the opportunity to generate significant income from the games business. Mutant Chronicles is originally a role play, which bodes well for a natural transition to online games

*The “Vultures” character is produced in-house, which increases both risk and revenue potential.*

### **Vultures – Paradox’s first self-financed film**

Vultures of Wahpeton is the very first movie that Paradox is producing with own funding, a move that offers a strong upside when it comes to the revenue allocation. However, the risk is also greater should the movie fail to make it in the box office. The rest of the movies have been financed by external partners, in line with Paradox’ current strategy. “Vultures” is based on Robert E. Howard’s book “Vultures of Wahpeton” and the story unfolds in a Western environment with the character Steve Corcoran. The film was in the early phase of production in April 2006 and is expected to have its premiere in 2008.

### **Working Title and Universal to produce Bran Mak Morn**

Since Paradox acquired the rights to the rest of Robert E. Howard’s literary works in early February, it became clear that the character Bran Mak Morn will become a movie. Film studios Working Title and Universal will produce the movie while Peter Berg (“Collateral”, “Chicago Hope”, “Cop Land”) is the director. At present the idea is to have the movie premiere during 2008.

*Production company Wandering Star is making a film based on the Solomon Kane character.*

### **Solomon Kane – payment advanced**

In April this year, production company Wandering Star/Davis Productions decided to use its eight-year old option to make a movie adaptation of the Solomon Kane figure by paying Paradox roughly MSEK 3.3 in advance. The film will be directed by the relatively unknown Michael Bassett.

### **Computer and TV Games**

Along with the film segment, Redeye considers computer and TV games as the most important business area for Paradox. In the last few years, the computer industry has created a successful revenue model, which means that a payment first takes place when the game is purchased, either by downloading it on the internet or bought in a shop. Afterwards the user has

to make monthly payments for the latest updates. The portion of recurring revenues grows over time and with rising volume of players – a pattern that is expected to comprise a growing portion of Paradox’s future earnings.

Pipeline Games			
	Partner	Structure	Status
Online Action Game "Age of Conan"	Funcom	Subscription Participation	Release Q4 2006
Console Games "Conan"	THQ	Guarantee + Royalties	Release 2007

Source: Paradox Entertainment

*Expectations on Funcom's MMOG-version "Age of Conan" are justifiably high.*

Paradox has an ongoing license agreement with Norwegian games developer Funcom, which has agreed to develop a massive multiple player online game (MMOG) release of "Age of Conan: Hyborian Adventures." Funcom has held the license since early 2003 but recently prolonged its license period by another 10 years or until 2018. The game, planned for release in Q2 2007<sup>2</sup>, has already won several awards. Paradox has received advanced payment from Funcom for the rights and will receive royalty payments on the number of sold games (actually downloaded games). Paradox has also entered into a license deal with THQ, which will develop and launch one or more offline games based on the Conan character in all major platforms, including Xbox and Play station. These PC games will most likely be released before the launch of the coming Conan movie.

### Wireless

*Revenues within Wireless are expected to be negligible.*

In Redeye’s view, the revenues generated within Wireless will be relatively modest ahead, in spite of the games in mobile handsets becoming increasingly popular. There are several indicators why we, for now, believe that revenues from Wireless could be negligible: 1) it is doubtful whether the character-based games suit handheld devices; 2) THQ showed in its Q2 2006 report that growth within Wireless/Mobile Gaming declined by 26 percent compared to the corresponding period last year (from MUSD 10.33 to MUSD 7.63). This means that game developers will be less inclined to invest in mobile games during the coming period. We are therefore not counting on any large revenues from this operation in the next few years.

<sup>2</sup> www.ageofconan.com

## Business area Publishing

Paradox has gathered its licensing of rights for use in the print media (such as books and comic series) under business area Publishing.

<b>Pipeline Comics&amp;Books</b>			
	<b>Partner</b>	<b>Structure</b>	<b>Status</b>
Comics "Conan"	Dark Horse	Guaranteed + Royalties	Bi-weekly release
Comics "Kull"	Dark Horse	Guaranteed + Royalties	Monthly release
Comics "Salomon Kane"	Dark Horse	Guaranteed + Royalties	Monthly release
Comics "Pigeons from Hell"	Dark Horse	Guaranteed + Royalties	Monthly release
Comics "REH Savage Tales"	Dark Horse	Guaranteed + Royalties	Monthly release
Ulimite Conan	DK Publishing	Advance + Royalties	Ongoing
Rob. E. Howard's Library	Random House	Advance + Royalties	Ongoing
Books "Age of Conan"	ACE/Penguin	Advance + Royalties	Ongoing

*Source: Paradox Entertainment*

*Conan is the biggest title of comic book publisher Dark Horse.*

Paradox has an extensive cooperation with Dark Horse Comics, one of the world's leading publisher of comic books. Conan is the biggest title of Dark Horse Comics at present. Paradox gets guaranteed revenues and license payments on the volume of sold comic books. Furthermore, Paradox has an ongoing partnership with publishing house Penguin regarding books based on Conan. In the long term, Redeye expects Paradox's other characters to also be launched through comic series and books. How interest in Conan will hold up in the future is likely to be strongly linked to the movie. Success for the Conan movie will likely trigger a sharp upswing even for comic series and books.

## Business area Other Licensing

In the third business area Other Licensing, Paradox has gathered its licensing of rights towards different types of collector's items such as **toys, clothes and collectors cards.**

### Pipeline Toys&Collectibles

	Partner	Structure	Status
Toys "Conan"	McFarlane Toys	Guarantee + Royalties	Ongoing
Collectible Game "Mutant Chronicles"	Fantasy Flight Games	Advance + Royalties	Release Q3 2006
Role playing game "Mutant Chronicles"	Pinnacle Games	Advance + Royalties	Release Q2 2007

Source: Paradox Entertainment

*Demand for toys and collector's items strongly linked to the release of the Conan movie.*

We expect revenues stemming from this business area to be strongly linked to the release of the Conan movie in 2008. However, there is reason to be skeptical about the business area's revenue prospects. The Conan movie is more likely to attract a somewhat older target group than those who normally consume toys. Here, Paradox must together with Warner Bros strike a delicate balance between having a Conan character that is as genuine as possible, a move that will likely result in several parts of the film being child-censored, while also attracting a young target group in order to boost film-add-on sales.

In other movies with fantasy or comics figures, the sale of toys and other film-related consumer products has been phenomenal. In the "Batman" and "Star Wars" movies, consumer products accounted for roughly 50 percent<sup>3</sup> of the total movie revenues, corresponding to MUSD 200 to MUSD 460 per movie. In other movies such as "Lord of the Rings," consumer products comprised only 4 percent of the total box office sales. This depends partly on the extremely high ticket sales for "Lord of the Rings." To date, the Lord of the Rings trilogy has raked in approximately USD 3 billion in box-office sales<sup>4</sup> and thus generated sales of more than USD 1 million in consumer products. Another explanation is that the Star Wars series has been remarkably successful with product sales since the first film was shown in 1977, rendering it difficult to make comparisons on sales success.

<sup>3</sup> Smith Barney Tutorial Series – May 30, 2003

<sup>4</sup> www.boxofficemojo.com

## The market

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The market for licensing rights based on consumer products is estimated to be worth SEK 1,300 billion annually<sup>5</sup>. In order for Paradox to achieve a major sales success of licensing rights within consumer products, it has to continually offer well thought-out brands and characters from Robert E. Howard's library. It is therefore imperative to assess how well the company can turn its assets and intellectual properties into franchises/brands by identifying the respective strengths and weaknesses of the assets. In order to evaluate what makes Paradox's assets unique, we have chosen to compare Robert E. Howard's library of more than 1,000 fantasy figures with that of Marvel Entertainment, whose library boasts of more than 5,000 characters.

### Lack of antagonists triggers imaginative constellations

To start with, we notice that Marvel's library is five times larger than the library owned by Paradox. One reason for this is that for each hero/protagonist in Marvel's library there are numerous colorful arch enemies/antagonists, as illustrated in the charts on the left. One weakness in Paradox's artillery is the lack of clear-cut antagonists - arch rivals - which Marvel has plenty of. The Conan fantasy figure, which is Paradox's most important character, lacks for instance, an obvious arch enemy. In the first filming of Conan (1982) with Arnold Schwarzenegger in the lead role, this problem was solved by putting in another character from the Paradox library, Thulsa Doom (played by James Earl Jones), as the arch antagonist. In our view, Paradox must resort to this type of cross-usage of characters that exist in the library in order to achieve similar successes that Marvel has managed to reap.

Colorful superheroes and bad guys attract younger target groups, which makes it rewarding to produce film-related toys and other consumer products. A variety of colorful antagonists to each hero-figure also makes it easier to further evolve the storyline/plot which, in turn, helps sustain interest in the characters. This is something that comic book publishers have taken note of and, in recent years, in the film industry where movie trilogies have become increasingly common.

### Hard to identify with Robert E. Howard's characters

Another crucial matter to look at when judging the strengths and weaknesses of the library is the type of emotions and qualities that the literary properties relay to the consumer. That which characterizes both Marvel's and DC Comics' worlds is that most of their hero figures have aliases, which allows many younger children to identify themselves with the characters. For example, Superman's alter ego is the journalist Clark Kent, Spider-Man has the photographer Peter Parker, and the mighty green giant Hulk is scientist Bruce Banner. In comparison, Robert E. Howard's

Character	Publisher	Villain
Batman	DC Comics	The Joker
Robin		The Penguin
Batgirl		Catwoman
		Two-Face
		Mr Freeze
		The Scarcrow

Character	Publisher	Villain
Spider-Man	Marvel	The Green Goblin
		Doctor Octopus
		The Scorpion
		Man-Wolf
		The Chameleon

Character	Publisher	Villain
(X-Men)	Marvel	Magneto
Wolverine		Mystique
Storm		Toad
Cyclops		Sabretooth
Iceman		Juggernaut
Colossus		Callisto
Nightcrawler		Lady Deathstrike
Archangel		
Beast		
Rogue		

Source: Redeye Research

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<sup>5</sup> Mindbranch

characters such as Conan and Solomon Kane are robust types but difficult to identify with. Bryan Singer, the director of the latest Superman movie, said that he identified himself with Superman when he was young because he himself was adopted as a child. The strength with a younger audience being drawn to the characters is that they get all wrapped up in the fantasy world of Marvel and DC Comics at an early stage, making them fiercely loyal fans their entire lives. This can be a key factor behind the success of characters both in comic books and on the big screen.

*Young men in the age group 18-25 are interested in Paradox's fantasy figures.*

Another feature of the Marvel and DC Comics worlds is that super heroes often operate in a world that the readers/viewers themselves live in and recognize. Again, this allows one to identify with the fictional characters. The fantasy worlds of Conan, Kull and Solomon Kane make it harder to attract younger target groups and capture their interest. On the other hand, we think that the somewhat older target group of young men between 18 and 25 years of age are more interested in this type of entertainment, primarily in the form of movies and computer games. This is why we see the biggest potential in online gaming and computer games in the same footing as the film industry. There is, nonetheless, a possibility to reach the younger target groups through sales of toys similar to He-Man, created by toymaker Mattel with the Conan figure clearly the source of inspiration.

*It is a Hollywood trend to adapt comic books and tales of fantasy worlds into the big screen.*

#### **Inherent potential within online games**

We think that the biggest potential lies within online and computer games, where the Paradox characters are best suited. Robert E. Howard's figures as strong brands in the fantasy genre. Another major potential is that Robert E. Howard offers fantastic tales and fantasy worlds, which proves rewarding for filmmakers in Hollywood where it is a trend to screen-adapt comic book stories in which the classic theme of struggle between good and evil dominates. The fantasy worlds also facilitate a shift in focus from expensive actors to computer animations, which is more cost efficient for the film studios.

*We have collated the revenue-cost ratios of all super hero- and fantasy movies from 1995 till 2006.*

#### **Success a prerequisite for a sequel**

In Appendix 2 you'll find a table where we have gone through all the films based on super heroes, fantasy films and movies that generate large add-on sales such as "Star Wars" and "Harry Potter". We have excluded animations in the collation. The table shows how much revenues the movies had generated in the box office globally, from the grand opening date until today. We also look at the production budgets; the costs needed to produce the film (excluding marketing costs) and compiled the revenue/cost ratios. The ratios should be read as the higher the figure, the better the yield generated by the film for the producers. Although these ratios are not rock steady as a gauge, they provide an indication of how well movies fared in terms of return on investment. Something that seems to apply generally is that the higher the ratio of the first movie, the more often sequels are produced. Observe that the revenue and cost figures are not inflation-adjusted. We collate the date for each year starting from 1995 until 2006.

*Marvel and DC Comics are the two biggest intellectual property rights owners in this genre.*

### **Marvel and DC Comics dominate**

It is primarily two publishers (owners of literary rights to the fantasy figures) that dominate this genre - Marvel Entertainment and DC Comics (Superman and Batman among others). We also view Warner Brothers (which is making the new Conan movie) as among the top film studios most of the years, which indicates a great determination on the part of the company to invest in film production in this genre. For the film to be regarded as a success, it must reach a revenue/cost ratio of about 3.5. Films that achieved a ratio of 2 and below are considered in the movie circles as flops. Some of these flops are "Catwoman" (2004) which had a ratio of 0.8 and "Elektra" (2005) which had 1.3. "Hulk" (2003) reached a ratio of 1.8 but was still viewed as less of a disappointment. This means that the new Conan movie (a remake) with a production budget of MUSD 80 must generate revenues of MUSD 160 to avoid being labeled as a fiasco. Should the revenues amount to roughly MUSD 100 or lower, then there is small likelihood that Warner Bros will continue to invest in Conan with a sequel or more follow-up films. The goal at the moment is to make a series of Conan series, which we think implies a trilogy.

A prevailing trend in the film industry is to allow the first movie to determine whether there will be follow-up movies. If the movie turns out to be a blockbuster success, then it is possible that the producers will make two or three films simultaneously. Examples of this are "Matrix" and "Pirates of the Caribbean." In the case of "Lord of the Rings," the whole trilogy was filmed simultaneously, something that will probably not happen in the case of Conan.

*The gaming industry is bigger than the film and music industries combined.*

### **Market for computer and TV/video games**

The games industry has a turnover of nearly USD 30 billion a year, which makes it larger than the entire global music and film industry combined. In the more traditional part of the gaming sector, the so-called offline games, the user plays via a PC or a console, such as Xbox or Play station. The total global market for computer games and interactive entertainment is forecast to generate sales of USD 33.4 billion in 2008<sup>6</sup>. However, it is primarily in the so-called online games, which also go by the name massive multiplayer online game (MMOG) that the fastest growth is taking place. The online market is estimated to generate USD 9 billion in sales in 2009 and it is in the Asian countries, with China in the lead, which is driving growth. In MMOG the user plays against others over the Internet, which can be as many as 100,000 persons simultaneously logged in. Since MMOG is played around the world, this means that the game takes place round the clock. One of the most popular games today is World of Warcraft. This game has more than six million subscribers who pay USD 15 per month over and above the USD 50 they paid to download the software.

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<sup>6</sup> McElroy Translation (2005)

*Online games attract an increasingly wider public.*

Among the driving forces behind the strong growth in the gaming market are increased computer usage, extensive broadband connections and greater use of the Internet at the expense of other media. Games are increasingly distributed through the broadband, which makes the games more accessible to the users. At the same time, this is more economically advantageous for the gaming companies since the games will not take up shelf space and small volumes are enough for the games to circulate. Online games have also begun to attract a wider public as more women play and the average age for playing increases both in Sweden and abroad. The average age in Sweden is around 30 years while in the US it is 33. Women account for 46 percent of the console purchases (Nintendo, Xbox, Play station etc.) and 55 percent of the computer games purchases<sup>7</sup> which, however, does not solely imply that they are buying the products for own usage. But it is clear that the gaming industry is trying to adjust their offerings with a wider variation than before, showing that women and older persons have become increasingly significant as consumers.

### **Paradox has obvious limitations within gaming**

*An increase in the average age within computer games can indirectly benefit Paradox.*

In Redeye's view the trend of rising average age for computer gaming can benefit Paradox since their apparent customer base is in the age group 13 years to 25 years and above. Furthermore, this age group is much sought-after by advertising agencies. There are a lot of signs that product placements and advertising in computer games are set to grow ahead since the development of new console games costs MUSD 20 to 30 per piece. Here we see a dilemma for Paradox; it will probably be very difficult to carry out product placements in the fantasy worlds of Conan and the rest of the characters in Robert E. Howard's library compared to those in sports and racing competitions where it is more natural to set up appropriate advertising space. This can pose limitations to Paradox in the long term since license revenues from computer games and video games are seen declining in the long run.

Comprising another threat are the various regulatory restraints that certain countries such as Germany and Australia have implemented against raunchy and violent video games. This could mean that gaming companies that develop games based on Paradox's brand portfolio might not extend the agreements because their potential markets are waning. However, the Paradox management is aware of this problem and is trying in several cases to tone down the violent features of its fantasy figures.

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<sup>7</sup> Mainelli, Tom. "Video Games Go Mainstream", PCWorld.com

## Marvel and the new business model

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*Marvel Entertainment is a pioneer in the industry.*

US Marvel Entertainment is the world's largest independent owner of intellectual property rights and a pioneer in the industry for companies including Paradox. Marvel and Paradox have relatively similar business models and organizations, which is why it is important to describe Marvel's history and evolution in recent years from a comic book publishing company to a well-known intellectual property company that also produces its own movies. To a large extent this is also the path that we think Paradox will be taking.

*Marvel has evolved from a small comic-book publisher to a major intellectual property rights company.*

Marvel was founded in 1939 by comic book writers Stan Lee and Jack Kirby. During the nationalist post-war era, heroes such as the Hulk, X-Men and Spider-Man were created. The revenues stemmed primarily from comic books and toys. A crucial juncture for Marvel was when Isaac Perlmutter and Avi Arad took over the company as CEO and head of studio respectively, in 1998. They gradually restructured the business model from comic books to licensing business for film and computer companies, which Paradox also did five years later. This was followed by huge successes such as the "X-Men" trilogy and "Spider-Man" 1 & 2. Successes in the box office have enabled Marvel to negotiate a much better licensing agreement (see below). In short, Perlmutter and Arad transformed Marvel from a small comic book publisher to a major and well known intellectual property company with revenues of MUSD 400 and profit of MUSD 170 in 2005. Market capitalization amounts to USD 1.7 billion (around SEK 12.5 billion).

### Share of licenses on the rise

The table below shows the development of Marvel Entertainment's different business areas during the past four years.

Share of total sales	2002	2003	2004	2005
Licensing	27%	36%	42%	59%
Publishing	22%	21%	17%	24%
Toys	52%	43%	41%	17%

*Source: Marvel Entertainment, Redeye Research*

*Marvel's license revenues are rising gradually.*

The table above shows that the share of license-rights sales is gradually increasing, revenues from publications (comic books and books) are stable while sales of consumer products (including toys) are declining. For year 2005 we can see that sales of toys drop sharply compared to the preceding year. This can be explained partly by weak year in the cinemas, with "Fantastic Four" only raking in MUSD 330 in movie ticket sales compared to MUSD 784 generated by "Spider-Man 2" the year before. The movie "Spider-Man" also churned out much higher toy sales than "Fantastic Four", which suggests that not all movies based on comic-book figures automatically generate large add-on sales.

*Profitability has risen gradually, fueled by higher license revenues.*

**License rights lift margins**

Another interesting detail is that Marvel has become better at earning money on license rights. During the period 2002 to 2005, business unit License rights shows a compound annual growth rate (CAGR) of 42 percent and an increase in turnover from MUSD 80 in 2002 to MUSD 230 in 2005. This took place while movie revenues from Marvel-related films during the same period declined from USD 1.419 billion in 2002 to MUSD 386 in 2005. Operating margin for the whole Group also rose during these years from 27 percent in 2002 to 44 percent in 2005, which highlights the significance of growth in license sales.

Marvel Entertainment		MUSD	2002	2003	2004	2005
<b>Box office sales</b>			1419	831	967	386
from Comic related movies						
<b>Licensing</b>	Sales		80	124	215	230
	Growth			56%	73%	7%
	EBIT		69	83	83	143
	Margin		87%	67%	39%	62%
<b>Publishing</b>	Sales		64	73	86	92
	Growth			14%	17%	8%
	EBIT		20	25	25	36
	Margin		30%	35%	30%	39%
<b>Toys</b>	Sales		155	150	213	68
	Growth			-3%	42%	-68%
	EBIT		9	78	78	16
	Margin		6%	52%	37%	23%
<b>Corporate overhead</b>			-17	-19	-24	-24
		<b>Total sales</b>	<b>299</b>	<b>348</b>	<b>513</b>	<b>391</b>
		<b>Total EBIT</b>	<b>81</b>	<b>167</b>	<b>163</b>	<b>171</b>
		Growth		16%	48%	-24%
		EBIT-margin	27%	48%	32%	44%

Source: Marvel Entertainment, Box Office Mojo, Redeye Research

The table above also shows that both growth and margins fluctuated wildly from year to year. The 2005 was an extremely weak one for Marvel, what with the very few movie launches – we have only identified “Fantastic Four” and “Elektra” that year. None of these movies really made it as box-office hits. It shows that the sale of consumer products is correlated to the degree of success the film attains in movie ticket sales. It shows as well that this type of company is very vulnerable to how the movie is received by the market, something that has a clear bearing on Paradox.

**Marvel increases the risk**

During 2005 Marvel took a major decision to reposition the company. Prior to this, Marvel’s business model was based solely on license revenues, just like Paradox. The business risk is quite low but the potential for growth is also fairly limited. Instead, film and computer games producers are the ones making the big bucks. Through a subsidiary, Marvel borrowed MUSD 525 to finance incoming movies. “Hulk 2”, “Captain America” and “Iron Man” are some of the Marvel characters that are rumored to be in the pipeline. Moreover, Marvel has entered into a cooperation pact with film company Paramount for distribution of its coming films. By producing and financing

*Marvel is increasing the risk by using its own funds to produce incoming movies.*

its own movies, Marvel raises the stakes dramatically – both the economic upside as well as the risks. The table below identifies the parts in which Marvel can capture from the various media in pure licensing deals or if the movie is produced in-house.

	Box-office	DVD	TV & Others	Profit @ \$1 bln Box office	Profit @ \$ 50 M Box office flop
<b>Licence Deal</b>	<b>3%</b>	<b>1%</b>	<b>5%</b>	<b>43 MUSD</b>	<b>3 MUSD</b>
<b>Production Deal</b>	<b>46%</b>	<b>42%</b>	<b>92%</b>	<b>450 MUSD</b>	<b>(200) MUSD</b>

*Source: Business 2.0, Jeffries & Co., Figures are based on typical industry deals.*

**Large potential but risk also significantly higher**

The table above shows that there is huge potential in making movies on your own. A movie which, including add-on sales, generate a total of USD 1 billion in revenues gives back ten-fold (MUSD 43 or MUSD 450) compared to when the company only receives license revenues. The movies “Spider-Man” and “Spider-Man 2”, which Marvel owns the rights to, raked in MUSD 800 each in mere movie-ticket sales. Add to that are sales from DVD and other TV syndication that should at least amount to just as much. At the same time, the risks are higher; a box-office flop does not only mean agonizing loss but could also put the company’s entire future at stake.

*Significantly bigger potential but also higher risk associated with own financing.*

**Paradox follows Marvel’s lead**

In its prospectus ahead of the company’s market flotation on the NGM stock market, Paradox clearly indicated its goal to increase the share of self-financing. This is now being carried out to a limited extent in the in-house production of the movie Mutant Chronicles. According to the Paradox management, no financial risks are being taken in producing this film with own funds. In Redeye’s view, a larger percentage of self-financing under effective risk control is positive for Paradox and will clearly boost the company’s growth potential ahead.

*Paradox is also expected to raise the portion of self-financing but in a cautious pace.*

## Growth prospects and risks

To summarize the previous chapter and show Paradox’s market potential, competitive advantages and growth prospects within each business area, we have created a table below to show how we rate their outlook, with one star indicating low potential and five stars suggesting a very higher potential.

	Market potential	Competition advantage	Growth opportunity
<b>Entertainment</b>	****	****	*****
<b>Publishing</b>	***	****	**
<b>Other licensing</b>	***	***	***

Source: Redeye Research

### Growth prospects

In Redeye’s assessment, Paradox has the biggest market potential and growth prospects within business area Entertainment. Strong growth for online games and the film industry’s undeniable zest for producing movies based on fantasy and comic-book figures provide fertile grounds for Paradox to grow in an expanding market. Furthermore, Paradox is switching from a relatively profitable licensing model to a potentially more lucrative business model with self-financed productions (in-house). We are, however, not as upbeat on business area Publishing, in which we see sales of comic series and books facing tighter competition from other media. This is why we don’t see any major growth prospects for this business area. However, we think Paradox has a competitive advantage in this business area since the publication of the Conan comic series has been very successful and is the bestselling title of Paradox partner Dark Horses Comics. We are more cautious when it comes to business area Other Licensing where we see constraints on toy sales due to reasons already stated in the chapter on market.

*The interest of film companies in comic-book characters and fantasy figures favor Paradox.*

### Risks

Paradox is facing huge potential and growth prospects in the next few years although there are also risks to both the company and the share that are worth mentioning. One significant risk that all intellectual property companies face ahead – and which is particularly crucial for Paradox – is the “draining” or saturation of the characters. Given that Conan is Paradox’s heavyweight character, there is palpable risk that the brand and its revenue prospects are drained after two or three movies. Just like the “Superman” movies, the brand was so watered down that a new film could not be produced in 10 to 15 years. In the case of Conan, the interlude between the first two movies and the new one will be about 20 years. This implies that after making two to three Conan movies, Paradox will be dependent on the rest of its library, a large one at that with more than 1,000 characters, but considerably less known and untested. There is a risk that Robert E. Howard’s characters may not become popular in wider circles, which is necessary to increase the revenue base. The value beyond 2010 is at the

*There is a risk that Paradox’s characters don’t hit home in a broader audience necessary to reach a higher revenue base.*

same time important for the assessment of the share in our cash-flow analysis (see chapter on valuation and scenario analyses). Probably the most significant risk would be if the Conan movie flops. This would not only result in lower revenues for Paradox but would render it more difficult to make a sequel. More importantly, it could adversely affect the rest of Robert E. Howard’s characters. On the other hand, the mere act of producing a new Conan movie could increase awareness of the rest of the characters in Paradox’s brand portfolio, which should be positive in our view.

**SWOT-analysis**

Strengths	Weaknesses
Broad portfolio of interesting characters Low risk with present licensing model Established partners	Relatively unknown characters Limited upside with present licensing model Short staying power
Opportunities	Threats
Increased interest for fantasy Streamlined production from more advanced technology More games developed based on fantasy-characters	Saturated interest for the fantasy genre Brand intrusion could be expensive Regulatory amendments for violent games

Source: Redeye Research

*Paradox presently has well established partnerships with strong players in the respective sectors.*

Paradox has a broad portfolio with roughly 1,000 characters, Conan being the most famous one. Conan is one of the best known figures in the fantasy genre and is therefore a valuable asset to the company in negotiations concerning the rest of the characters in the Paradox portfolio. This, we believe, has led to Paradox today having well established partnerships with strong players in the respective business areas: Warner Bros in the film industry; Funcom and THQ within interactive entertainment; Dark Horse Comics and Penguin within publishing and McFarlane Toys when it comes to toys. These cooperation partners account for the production costs and marketing. The costs shouldered by Paradox are to a large extent of legal nature and stem from acquisitions of immaterial rights. Paradox is therefore carrying very minimum risks with the current business model. Unfortunately, the current license model also means that the upside for profits is limited by low royalty earnings. The Paradox characters (except for Conan) are also relatively unknown, making it vital for the company to push hard with marketing the various characters in Robert E. Howard’s library. In addition, we think that the characters in this genre have a relatively short staying power (public appeal) with the figures fading into the background over periods of time.

*Comic series and fantasy figures are well suited for online games.*

However, we note that the public still likes to see movies based on comic-book heroes and fantasy figures and that these characters are well suited for online games. We also know that the better the technology, the more efficient the production of films and computer games becomes. One trend that can be associated with the film industry is the shift in focus from expensive actors to computer-animated characters and fantasy worlds, which is more cost efficient. This can be valuable for those who own portfolios with interesting characters since demand for such could strengthen in the future.

However, this could lead to the market becoming tired of this type of films, which is a major threat. Furthermore, we anticipate a wave of brand intrusions in which features of the characters and the environment are used without permission, resulting in frequent and costly legal processes. A range of regulatory amendments entailing restrictions for violent computer games comprise a threat that mainly affects sales of computer games.

### **Finances and corporate structure**

In 2005, Paradox posted sales of MSEK 24.9 (16.1) and a pretax profit of MSEK 13.2 (1.3). The company's total assets amounted to MSEK 55.5 (40.5). For the first half of 2006, the company's sales totaled MSEK 16.9 and pretax profit was MSEK 1.8. Comparative figures for the corresponding quarters last year were not available since Paradox at the time was not yet publicly listed, thus interim reports were not produced.

*The company had sales of MSEK 25 and pretax profit of MSEK 13 last year.*

In connection with the Q2 2006 report, Paradox communicated to the market its outlook for full-year 2006 with revenues seen landing between MSEK 24 and 26 and pretax profit predicted at MSEK 12 to 14. These forecasts are in line with last year's revenue and profit.

*Net debt amounts to MSEK 5.7 following the acquisition of the rest of Robert E. Howard's characters.*

After a new share issue raised MSEK 14.4 in additional capital in 2005, Paradox – at the end of last year – has a robust financial position with net cash at MSEK 18. The acquisition of the entire Robert E. Howard library in February 2006 transformed the net cash into a net debt of MSEK 5.7 by the end of the first half of this year. Solvency was 79 percent and total assets amounted to MSEK 45.5 by the end of the second quarter 2006.

Since the company's business idea is to own, develop and commercialize character-based labels, it may carry out additional investments to acquire immaterial assets. The company's goal towards independently-financed operations would also entail larger investment needs ahead. This increases the likelihood of Paradox resorting to further share issues in the future to raise additional capital. However, we believe that the company in the coming quarters will focus on developing the literary rights it has acquired through ownership of Robert E. Howard's library of more than 1,000 characters. This makes us believe that Paradox's investment needs for the rest of the year will be modest.

### **Corporate structure**

Paradox Entertainment AB is publicly traded on the NGM stock exchange and has its Board of directors holding office in Sweden. The main part of the business is, however, run by subsidiary Paradox Entertainment Inc. in Los Angeles, California, USA which it owns to 96 percent. The remaining shares are owned by Peter Sederowsky, CEO of Paradox Entertainment Inc. Since the subsidiary Paradox Inc. comprises the absolute majority of the assets in Paradox AB, it is the opinion of Redeye that transparency and evaluation of the company would be simplified if Paradox AB conducts a new share issue and use the funds raised to buy out the CEO's shares in the subsidiary.

*That the parent company does not own its main asset to 100 percent is unfortunate and makes transparency more difficult.*

## Forecasts & sensitivity analyses

In the chart below, we outline our estimates that lay the grounds for our forecasts for the company's revenues. We have looked at how royalty revenues from movie theatre licenses, DVD licenses and other licensing can vary depending on the size of revenues that license-takers generate.

### Sensitivity analysis box office licences

<b>Biointäkter (MUSD)</b>		<b>50</b>	<b>75</b>	<b>100</b>	<b>150</b>	<b>200</b>	<b>300</b>	<b>400</b>	<b>500</b>
		<b>Royalties to Paradox (MSEK)*</b>							
<b>Percentage rate</b>	<b>1%</b>	<b>4</b>	<b>6</b>	<b>8</b>	<b>11</b>	<b>15</b>	<b>23</b>	<b>30</b>	<b>38</b>
	<b>2%</b>	<b>8</b>	<b>11</b>	<b>15</b>	<b>23</b>	<b>30</b>	<b>45</b>	<b>60</b>	<b>75</b>
	<b>3%</b>	<b>11</b>	<b>17</b>	<b>23</b>	<b>34</b>	<b>45</b>	<b>68</b>	<b>90</b>	<b>113</b>
	<b>4%</b>	<b>15</b>	<b>23</b>	<b>30</b>	<b>45</b>	<b>60</b>	<b>90</b>	<b>120</b>	<b>150</b>
	<b>5%</b>	<b>19</b>	<b>28</b>	<b>38</b>	<b>56</b>	<b>75</b>	<b>113</b>	<b>150</b>	<b>188</b>

\* Based on USD/SEK 7.5

Source: Redeye Research

In the table above, we make a sensitivity analysis of how Paradox's royalty fees develop vis-à-vis various movie revenues. For example, we see that if movie revenues amount to MUSD 150, Paradox gets MSEK 34 in royalty fees. The industry praxis is that the license holder receives royalty of about 3 percent of the gross revenues from the film producers, which we have highlighted in the table above.

### Sensitivity analysis DVD licences

<b>DVD-sales (MUSD)</b>		<b>50</b>	<b>75</b>	<b>100</b>	<b>150</b>	<b>200</b>	<b>300</b>	<b>400</b>	<b>500</b>
		<b>Royalties to Paradox (MSEK)*</b>							
<b>Percentage rate</b>	<b>1%</b>	<b>4</b>	<b>6</b>	<b>8</b>	<b>11</b>	<b>15</b>	<b>23</b>	<b>30</b>	<b>38</b>
	<b>2%</b>	<b>8</b>	<b>11</b>	<b>15</b>	<b>23</b>	<b>30</b>	<b>45</b>	<b>60</b>	<b>75</b>
	<b>3%</b>	<b>11</b>	<b>17</b>	<b>23</b>	<b>34</b>	<b>45</b>	<b>68</b>	<b>90</b>	<b>113</b>
	<b>4%</b>	<b>15</b>	<b>23</b>	<b>30</b>	<b>45</b>	<b>60</b>	<b>90</b>	<b>120</b>	<b>150</b>
	<b>5%</b>	<b>19</b>	<b>28</b>	<b>38</b>	<b>56</b>	<b>75</b>	<b>113</b>	<b>150</b>	<b>188</b>

\* Based on USD/SEK 7.5

Source: Redeye Research

In table above, we analyze how much Paradox receives in royalty fees depending on the performance of DVD sales. For instance, you can note in the chart that if DVD sales reach MUSD 150, Paradox gains MSEK 11.3 in royalty fees at one per cent royalty percentage, in line with the industry praxis. In addition, DVD revenues are correlated to the movie's box-office

### Sensitivity analysis DVD in relation to box office sales

<b>Share of total Box office sales</b>		<b>10%</b>	<b>25%</b>	<b>50%</b>	<b>75%</b>	<b>100%</b>	<b>125%</b>	<b>150%</b>	<b>200%</b>
<b>DVD-sales (MUSD)*</b>		<b>10</b>	<b>25</b>	<b>50</b>	<b>75</b>	<b>100</b>	<b>125</b>	<b>150</b>	<b>200</b>
		<b>Royalty till Paradox (MSEK) **</b>							
<b>Percentage rate</b>	<b>1%</b>	<b>1</b>	<b>2</b>	<b>4</b>	<b>6</b>	<b>8</b>	<b>9</b>	<b>11</b>	<b>15</b>
	<b>2%</b>	<b>2</b>	<b>4</b>	<b>8</b>	<b>11</b>	<b>15</b>	<b>19</b>	<b>23</b>	<b>30</b>
	<b>3%</b>	<b>2</b>	<b>6</b>	<b>11</b>	<b>17</b>	<b>23</b>	<b>28</b>	<b>34</b>	<b>45</b>
	<b>4%</b>	<b>3</b>	<b>8</b>	<b>15</b>	<b>23</b>	<b>30</b>	<b>38</b>	<b>45</b>	<b>60</b>
	<b>5%</b>	<b>4</b>	<b>9</b>	<b>19</b>	<b>28</b>	<b>38</b>	<b>47</b>	<b>56</b>	<b>75</b>

\* Assumption: 100 MUSD in box office sales

\*\* Based on USD/SEK 7.5

Source: Redeye Research

*Enormous success in DVD sales is necessary to generate substantial revenues.*

success, which is why we have made a sensitivity analysis for DVD sales versus movie-ticket sales.

In the model, we assume that a movie would rake in MUSD 100 (as an example). Afterwards, we calculate with different percentages the amount DVD sales would reach based upon the movie-ticket sales. Should DVD sales reach 50 percent of the movie-ticket sales, for instance, that would correspond to MUSD 50. We then take into account that Paradox gets one percent in license fees on the total DVD sales, in line with the industry praxis and that would amount to MSEK 4 in this case. The conclusion then is that DVD sales must be a tremendous success in order for Paradox to reap any substantial amount at all. The alternative is for the company to negotiate better license terms.

**Sensitivity analysis "others"**

<b>Sales "others" (MUSD)</b>		<b>50</b>	<b>75</b>	<b>100</b>	<b>150</b>	<b>200</b>	<b>300</b>	<b>400</b>	<b>500</b>
		<b>Royalties to Paradox (MSEK)*</b>							
<b>Percentage rate</b>	<b>1%</b>	<b>4</b>	<b>6</b>	<b>8</b>	<b>11</b>	<b>15</b>	<b>23</b>	<b>30</b>	<b>38</b>
	<b>2%</b>	<b>8</b>	<b>11</b>	<b>15</b>	<b>23</b>	<b>30</b>	<b>45</b>	<b>60</b>	<b>75</b>
	<b>3%</b>	<b>11</b>	<b>17</b>	<b>23</b>	<b>34</b>	<b>45</b>	<b>68</b>	<b>90</b>	<b>113</b>
	<b>4%</b>	<b>15</b>	<b>23</b>	<b>30</b>	<b>45</b>	<b>60</b>	<b>90</b>	<b>120</b>	<b>150</b>
	<b>5%</b>	<b>19</b>	<b>28</b>	<b>38</b>	<b>56</b>	<b>75</b>	<b>113</b>	<b>150</b>	<b>188</b>

\* Based on USD/SEK 7.5

Source: Redeye Research

In the diagram above, we show how much Paradox receives in royalty fees from the other licensing activities such as sale of toys, collectors' items and the like. We used five percent as the percentage, in accordance with industry practice. This is considerably higher than those for other licenses, such as DVD and movie licenses.

## Valuation & scenario analyses

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*We use the method of cash flow and relative valuation, respectively, in assessing the share.*

In evaluating Paradox Entertainment, we use the cash-flow valuation method Discounted Cash Flow (DCF) and relative valuation where Paradox is compared to other publicly-listed companies in the entertainment and license-sales business. The valuation is rendered difficult, however, by Paradox's decision in 2004 to change business model to one that is based on license revenues, which is difficult to gauge ahead. Moreover, Paradox has plans to make another switch in business models – from license sales to independently-financed productions – making it even harder to forecast future revenues and costs. We will therefore not be able to refer to historical financial figures when carrying out our cash-flow valuation.

### **Three possible scenarios**

*We have used 11.5 per cent as the required rate of return.*

Due to obvious difficulties, we are using different scenarios to estimate the company's value, which depends on the various possible outcomes. We have a positive (best-case), a normal and a negative (worst-case) scenario, with the normal scenario as our fundamental scenario. Redeye's forecasts for revenues and profits are based on Paradox's own data but with certain adjustments for Redeye's assumptions. In our DCF method, we have chosen 11.5 per cent as the weighted average cost of capital (WACC) for all the scenarios. We have opted to set the risk-free rate at 4.0 percent, the market risk premium at 5.0 percent and beta at 1.5. The market risk premium is set at 5 percent since we have taken into account the company's limited size and liquidity. Beta is set at 1.5 because we believe that the share will become more volatile than the market as a result of the fluctuating profit trend in the coming years. We have patterned the risk-free rate after the 10-year Swedish government bond, currently at 3.9 percent. In the US, the corresponding bond is higher, (4.9 percent) and since the larger part of the business takes place in the US, it is worth discussing whether the US rate should be selected. But since Paradox share is only trading on Stockholm Stock Exchange, we deem it reasonable to go for the Swedish bond rate.

*Having few comparable companies renders valuation difficult.*

To gain perspective on the cash-flow valuation, we have also conducted a relative valuation where we compared valuation multiples (such as P/E, P/S and EV/S) with a number of entertainment companies. The difficulties here lie in the companies' divergent sizes and the lack of relevant benchmark companies. This prompted us to look mainly at Marvel Entertainment's multiples since its business idea is the one most comparable to Paradox. We think that relative valuation can provide a good indication of Paradox's future valuation since Marvel lies a step ahead in the revamping its business model. Paradox is supposed to take the same direction.

## Normal scenario

MSEK	2004	2005	2006E	2007E	2008E	2009E	2010E
Entertainment			11	48	107	118	122
Publishing			10	12	15	13	15
Other licensing			8	10	15	12	15
<b>Total income</b>	<b>19</b>	<b>25</b>	<b>29</b>	<b>70</b>	<b>137</b>	<b>143</b>	<b>152</b>
Total cost	-14	-12	-15	-40	-70	-80	-70
<b>Pre tax profit</b>	<b>1</b>	<b>13</b>	<b>14</b>	<b>30</b>	<b>67</b>	<b>63</b>	<b>82</b>
Sales growth % (Y/Y)		31%	14%	147%	95%	4%	7%
Profitmargin %	7%	53%	48%	43%	49%	44%	54%

Source: Redeye Research, Paradox Entertainment

In the table above you can see Redeye's revenue forecasts for the different business areas as well as the cost and profit estimates for the period 2006 to 2010. Below we discuss the different business areas in more detail.

*In the accompanying charts and in Appendix 3 you'll find Redeye's detailed forecasts on revenue streams in the succeeding years.*

### Business area Entertainment

Business area Entertainment is Paradox's most important and Redeye has made detailed forecasts on the revenue streams in the coming years, which we have summarized in the chart below, where you'll find the forecasts and suppositions that form the basis for our normal scenario. In Appendix 3 on page 39 is a more detailed account of Redeye's suppositions and forecasts for the different business operations.

Business area Entertainment	2006e	2007e	2008e	2009e	2010e
Income from MMOG	8	10	12	8	6
Income from Computer- Videogames	0	10	12	9	22
Income from Box office	3	28	68	45	56
Income from DVD	0	0	9	30	2
Income from TV	0	0	6	26	36
<b>Total</b>	<b>11</b>	<b>48</b>	<b>107</b>	<b>118</b>	<b>122</b>

Source: Redeye Research

*Substantial revenues from computer and video games are expected to arise at the earliest in 2008.*

For year 2006 we expect the bulk of the revenues within entertainment to stem from MMOG games. The revenue of MSEK 8 comprises advance payments from Funcom prior to the release of the MMOG version of "Age of Conan: Hyborian Adventures" in Q2 2007. For the years 2007 and 2008 we expect the volumes for Funcom to reach its peak, which will make an impact on Paradox's license revenues (see appendix for more details). Even for computer and video games, we don't expect substantial revenues to come until 2008 when THQ is slated to release a Conan-based console game. However, we expect advance payments from THQ already in 2007.

The biggest revenues in business area Entertainment are expected to come from Film. We expect the movie Mutant Chronicles, which is now under

production, to already generate license revenues in 2007. Paradox has a profit-sharing deal with the film producer Ed. Pressman Film. During 2008 we expect Warner Bros' remake of the Conan movie to hold its premiere, an event that will greatly impact revenues for that year. In our normal scenario, we expect the movie to generate revenues of MUS\$ 300 globally and that Paradox receives a license fee of 3 per cent for the entire amount. In 2009 we anticipate that license revenues from the rest of the Paradox movies in the pipeline to start pouring in. And in 2010 we expect the sequel to the first Conan movie to have its grand opening.

*DVD revenues are also expected to start streaming in during 2008.*

We expect DVD license revenues to start streaming in during 2008 – a year after the premier of Mutant Chronicles. In 2009 we expect Paradox to start harvesting DVD license revenues from the Conan movie.

For revenues from TV we have gathered Cable-TV, syndication and other “Networks” around the world, which are expected to buy the movies. In this segment, revenues are expected to arise first during 2009-2010.

#### **Comments on Paradox's own forecasts**

*Paradox's own outlook is probably based on the Conan movie having its premiere in 2007 – which will be hard to materialize.*

According to its own outlook stated in the prospectus and annual report 2005, Paradox sees revenues for full year 2007 at MSEK 150 and profit at MSEK 85 to 90. This deviates a lot from Redeye's forecast, which pegs revenues at MSEK 70 and profit at MSEK 30 for next year. The reason for the discrepancy is that Redeye does not expect the Warner Bros Conan movie to be launched until 2008, which we think Paradox should take into account in its own guidance.

#### **Business area Publishing**

For business area Publishing, in which licensing for books and comic series falls under, we also expects an upswing in sales in conjunction with the Conan movie. At present, Redeye expects books and magazines to generate some MSEK 10 in annual license revenues for Paradox. Public interest, is, however, expected to rise sharply in connection with a movie release, which is why we anticipate license revenues in this business area to grow from 2007 once the marketing of the movie begins. In the long term, however, we think that growth within Publishing will be limited.

#### **Business area Other Licensing**

*Consumer products and collectors' items are expected to have a sharp upswing in connecton with the movie's release.*

Even business area Other Licensing is expected to enjoy a boost in connection with the film. Revenues in this business area stem mainly from license rights from toys, consumer products and collectors' items. Redeye does not have particularly high expectations on this business area in the

normal scenario. The reason is that we do not see any considerable add-on sales since the movie's target audience is too old for toys and the like.

In our normal scenario, we expect MSEK 15 in license revenues from this business area during 2008, arising mainly from sales of collectors' items. However, we forecast the license margin for toys and collectors' items to be around 5 percent, which is better than the license deals for film and DVD.

### Valuation in normal scenario

In the table below you can see Redeye's cash-flow forecasts for the specific forecast period 2006 to 2010.

	2004	2005	2006e	2007e	2008e	2009e	2010e	Period 2 2011-2020	Period 3 2021-
Net Sales	19	25	29	70	137	143	152		
EBITA	-1	8	14	30	67	83	62		
Adjusted Tax	0	0	0	-8	-19	-23	-17		
Noplat	-1	8	14	22	48	59	45	50	
Depreciation Ex GW	0	0	0	0	0	0	0		
Gross Cash Flow	-1	8	14	22	48	60	45		
Chg. Working Capital	-1	0	0	0	0	0	0		
(Net new) Investments	0	-4	-27	-3	-20	-3	-20		
<b>Free Cash Flow</b>	-2	5	-13	19	28	57	25	260	316
<b>NPV FCF</b>			<b>-13</b>	<b>16</b>	<b>22</b>	<b>40</b>	<b>16</b>	<b>163</b>	<b>198</b>

During period 2 we have assumed a normal profit (NOPLAT; Net Operating Profit Less Average Tax) of MSEK 50. In this scenario we expect NOPLAT to grow by 8 percent per year after 2011. With a required rate of return (WACC) of 11.5 percent, the model yields a share value of SEK 10.7, as shown in the adjacent table (on the left).

DCF Value	Total	Per Share
DCF Value, Period 1	81	1.0
DCF Value, Period 2	163	3.8
DCF Value, Residual	198	4.6
Non-Operative Assets	14	0.4
Interestbearing Debt	0	0.0
<b>DCF Value</b>	<b>0</b>	<b>10.8</b>
Share Price		9.0
DCF Relative To Share Price		20%

The DCF model is, however, extremely sensitive to changes in the required rate of return (WACC) and profit (NOPLAT) for the normal year. In the chart below, we have carried out a sensitivity analysis for varying WACC and NOPLAT. The chart shows how wide the gap is between the different share values. A WACC of between 9 and 13 percent and a NOPLAT of between MSEK 30 and 60 yield share values ranging from SEK 8 and 18. In the table we have marked with a square the values that we think are the most reasonable ones – in other words, those that stem from a NOPLAT of MSEK 50 and a WACC of between 11 and 12 percent.

WACC	NOPLAT 2011			
	30 MSEK	40 MSEK	50 MSEK	60 MSEK
9%	10	13	16	18
10%	9	11	13	15
11%	8	9	11	13
12%	7	8	10	12
13%	6	7	9	10

Source: Redeye Research

## Positive scenario

Positive scenario							
MSEK	2004	2005	2006E	2007E	2008E	2009E	2010E
Entertainment			8	70	140	110	160
Publishing			10	15	20	15	15
Other licensing			8	15	20	15	15
<b>Total income</b>	<b>19</b>	<b>25</b>	<b>26</b>	<b>100</b>	<b>180</b>	<b>140</b>	<b>190</b>
Total cost	-14	-12	-12	-45	-80	-65	-85
<b>Pre tax profit</b>	<b>1</b>	<b>13</b>	<b>13</b>	<b>55</b>	<b>100</b>	<b>75</b>	<b>105</b>
Sales growth % (Y/Y)		31%	4%	285%	80%	-22%	36%
Profitmargin %	7%	53%	50%	55%	56%	54%	55%

Source: Redeye Research, Paradox Entertainment

*We expect box office revenue of MUSD 320 around the world for the Conan movie.*

In this positive scenario, we expect strong revenue and profit growth for Paradox. We also expect the coming Conan movie to be a big success, which will result in higher revenue for Paradox than in the normal scenario. By a big success, we mean that box office revenue from the Conan movie will amount to some MUSD 320. This would result in a revenue/cost ratio of 4, which films such as Narnia and Sin City attained among those films that premiered last year. We assess this as reasonable for a successful box office movie, given the movie's budget. In turn, this means that Paradox will receive some MSEK 70 in royalty revenue for Conan alone from 2008 box office revenue. In the positive scenario we do not expect Warner Bros will succeed in completing the movie ahead of a major American public holiday in 2007, which is why the majority of the revenue is expected to come in 2008. We believe that the successful box office launch will cause Warner Bros to want to speed up the production of a follow-up with ambitions for a premiere in 2010. For 2009 we otherwise expect revenue to drop slightly in relation to 2008, but at the same time we expect it will stay at a healthy level through DVD sales, TV syndication and as the Conan movie continues to be shown to a lesser extent at cinemas around the world. We also expect that the computer game business, particularly MMOG games, will bring in significant revenue the further forward in time we look.

*We expect a profit margin of some 55 percent during 2007-2010.*

We assess the profit margin will be around 55 percent during the 2007 – 2010 period. This is higher than Marvel has shown in its profit margins in the past few years, but is explained by the fact that Paradox is expected to receive a larger proportion of revenue from MMOG games than Marvel had.

Beyond the specified forecast period, we expect a normal profit (NOPLAT) of MSEK 70 in 2011 compared to MSEK 50 in the normal scenario. In this scenario, we believe the entertainment sector will in the long term find more interesting characters than Conan and the other better known characters in Paradox's portfolio to make movie games and computer games with. When Paradox is more involved in self-financed production, it is fully possible to

raise the return on investments significantly, although it would raise the risk in the company considerably. The most likely scenario is that Paradox will form a partnership ahead of each film that is to be produced in order to spread the risk. It is also feasible that Paradox beforehand will sell the overseas movie rights before production of the movie has even begun.

*In a positive scenario for the company's revenue we believe that the share is worth approximately SEK 15.*

In this scenario, the warranted value of the share is slightly over SEK 15, which suggests a feasible upside of 85 percent. The large discount in this scenario is, we believe, due to the market at present only allowing for the Conan rights and several of the other best known characters that are in the pipeline for movie production. We assess that the market has not allowed for the rest of the Paradox portfolio in the market price, which is a significant underestimate since there are some 1,000 characters in the portfolio.

DCF Value	Total	Per Share
DCF Value, Period 1	128	3
DCF Value, Period 2	228	5
DCF Value, Residual	304	7
Non-Operative Assets	0	0.4
Interestbearing Debt	0	0
<b>DCF Value</b>	<b>0</b>	<b>16</b>
Share Price		8.5
DCF Relative To Share Price		87%

## Negative scenario

### Negative scenario

MSEK	2004	2005	2006E	2007E	2008E	2009E	2010E
Entertainment			8	35	75	65	70
Publishing			9	10	10	10	10
Other licensing			8	8	10	9	10
<b>Total income</b>	<b>19</b>	<b>25</b>	<b>25</b>	<b>53</b>	<b>95</b>	<b>84</b>	<b>90</b>
Total cost	-20	-17	-20	-40	-70	-65	-70
<b>Pre tax profit</b>	<b>-9</b>	<b>13</b>	<b>5</b>	<b>13</b>	<b>25</b>	<b>19</b>	<b>20</b>
Sales growth % (Y/Y)		31%	0%	112%	79%	-12%	7%
Profitmargin %	-47%	52%	20%	25%	26%	23%	22%

Source: Redeye Research, Paradox Entertainment

*In a negative scenario we expect the market has become satiated with fantasy characters.*

In this negative scenario, we expect roughly the same pipeline for movies and computer games as in the normal scenario, except that the market has become satiated with fantasy and serial characters, which makes us more pessimistic about the outcome and, consequently, Paradox's revenue opportunities. For example, in this scenario, we expect that the important Conan movie will flop for a number of different reasons. This will have a negative impact on Paradox's revenue, particularly in 2008, which we can see in the table above. Scant interest in the movie will spread to other

Robert E. Howard characters which will not be successful either. The low level of interest that we expect in this scenario means that Paradox will not fully succeed in licensing the characters in the computer game market apart from the existing contracts with Funcom and THQ. Funcom's launch of the MMOG game "Age of Conan" in the fourth quarter of 2006 will not live up to expectations in this scenario either, despite much advance interest. We have, therefore, somewhat lower revenue in 2007 within the entertainment business area compared to the normal scenario.

In this scenario we expect the costs to be approximately the same as those in the normal scenario, just slightly lower. We assess that Paradox has roughly the same costs, regardless of the interest for the movies and computer games. This will allow the profit margin in the harvest years' 2007-2010 to hover around 25 percent, which is approximately half of what we expect in a normal scenario. It is also considerably lower than Marvel, for example, whose profit margin has fluctuated around 30-50 percent in the past few years.

DCF Value	Total	Per share
DCF Value, Period 1	-17	0
DCF Value, Period 2	162	3.8
DCF Value, Residual	197	4.6
Non-Operative Assets	18	0
Interestbearing Debt	0	0
<b>DCF Value</b>	<b>360</b>	<b>8.4</b>
Share Price		8.7
DCF Relative To Share Price		-2%

Beyond the specific forecast period, we expect a normal profit (NOPLAT) of MSEK 40 in 2011, compared to MSEK 50 in the normal scenario. The reason is that in this scenario we see that Paradox's most important character Conan the Barbarian has been played out after three films. After that, Paradox will have to depend on other, less-tested characters. As we can see in the table below, the value of the share is approximately SEK 8 in this scenario.

### Relative valuation

It is difficult to make a relative valuation since there are no relevant objects for comparison that are listed (except for Marvel Entertainment). The majority of the companies in the segment such as Hit Entertainment and Platinum Studios are privately owned. DC Comics, one of the biggest companies in the sector, with characters such as Superman and Batman, is owned by Warner Bros. Marvel Entertainment, which is listed on the New York Stock Exchange, whose successful business model and organisation Paradox tried to emulate, is the natural object for comparison. Marvel is, however, more than 10x the size of Paradox and is in a more stable phase with a number of successful movies behind it and a tried and tested business model. Disney too, which owns a great many well known characters, could be an object for comparison but is many times the size of Paradox and is in a far more stable phase.

It is of interest, however, to see which price earnings multiples (P/E ratio) the market pays for these types of company that have achieved a more

*Most companies in the sector are unlisted.*

stable phase. In 2007, both Marvel och Disney would seem to be in a normal year where the P/E ratio will be between 16 and 17.

Company	MCAP (MUSD)	P/E-06e	P/E-07e	P/E-08e	EV/S-06e	EV/S-07e
Marvel Entertainment	1490	33.2	15.3	16.6	4.4	3.2
The Walt Disney Co	65625	20.2	18.2	15.7	2.3	2.2

Source: Redeye Research, Bloomberg

*We believe that a relative valuation supports our normal scenario.*

In a normal scenario, Redeye expects Paradox will achieve a normal year in 2011 with a NOPLAT of MSEK 50. After taxes, this corresponds to a profit of some MSEK 35 and discounted back to the same comparable year (2007) corresponds to some MSEK 30. Given the current price of approximately SEK 8.50 this gives a P/E ratio of around 12. With our warranted DCF value of approximately SEK 10.50 in a normal scenario this corresponds to a P/E ratio of around 15. However, a certain allowance for Marvel and Disney, whose business models are tried and tested, is reasonable. In summary, Redeye believes that the relative valuation supports our normal scenario that the share should be valued at around SEK 10-11.

#### **Transactions in the sector**

*Chorion was acquired in the summer to a valuation of P/E 27 and P/S 3.4.*

The sector (excluding Marvel) is relatively small and few transactions have been made recently. One transaction that is of interest, however, is the acquisition of the intellectual property firm Chorion from AIM (smaller growing companies market) in London this spring by the privately owned firm Planet Acquisitions Ltd. Chorion is best known for the rights to the authors Agatha Christie, Georges Simenon och Enid Blyton, among others. The bid of 430 pence per share indicates a company value of MGBP 110 (MSEK 150). This corresponds to a P/E ratio of 27 and a P/S ratio of 3.4, based on Chorion's result and turnover for 2005. The multiples should, however, be taken with a grain of salt and should not be directly transferred to Paradox. Intellectual property firms' sales and profits fluctuate considerably between years depending on which films and books are produced based on the characters. The price tag in the Chorion bid does, however, indicate that well-known characters command a high price.

#### **Valuation conclusion**

*We believe that the share is worth approximately SEK 10-11 based on our existing forecasts.*

Based on our existing forecasts, we believe that the Paradox share is worth SEK 10-11 at present, in accordance with our normal scenario. The relative valuation supports the normal scenario. In a more optimistic scenario for Paradox in the coming years, we consider the value would be some SEK 16 per share. On the other hand, in a negative scenario, we consider the value would be approximately SEK 8 per share.

Income Statement, SEKm					
	2004	2005	2006e	2007e	2008e
Net sales	19.0	24.9	28.5	70.3	137.2
Total operating costs	-19.5	-16.6	-14.8	-40.0	-70.0
<b>EBITDA</b>	<b>-0.5</b>	<b>8.3</b>	<b>13.7</b>	<b>30.3</b>	<b>67.2</b>
Depreciation Ex GW	0.0	-0.1	-0.1	-0.1	-0.1
Amortization	0.0	0.0	0.0	0.0	0.0
<b>EBIT</b>	<b>-0.6</b>	<b>8.2</b>	<b>13.6</b>	<b>30.2</b>	<b>67.1</b>
Share in profits	0.0	0.0	0.0	0.0	0.0
Interest income and similar items	2.4	5.7	0.0	0.0	0.0
Interest expenses and similar items	-0.5	-0.6	0.0	0.0	0.0
<b>Earnings before tax</b>	<b>1.3</b>	<b>13.2</b>	<b>13.6</b>	<b>30.2</b>	<b>67.1</b>
Tax	0.0	0.0	0.0	-8.4	-18.8
<b>Net earnings</b>	<b>1.3</b>	<b>13.2</b>	<b>13.6</b>	<b>21.7</b>	<b>48.3</b>
Income Statement adj, SEKm					
	2004	2005	2006e	2007e	2008e
Items affecting comparability	0.0	0.0	0.0	0.0	0.0
EBITDA adj.	-0.5	8.3	13.7	30.3	67.2
EBIT adj.	-0.6	8.2	13.6	30.2	67.1
PTP adj.	1.3	13.2	13.6	30.2	67.1
Net earnings adjust	1.3	13.2	13.6	21.7	48.3
Amortization	0.0	0.0	0.0	0.0	0.0
Balance Sheet, SEKm					
	2004	2005	2006e	2007e	2008e
Assets					
Current Assets					
Cash and bank balances	5.0	18.0	27.1	46.0	74.4
Customer receivables	0.0	3.9	4.1	4.5	4.6
Finished goods	0.0	0.0	0.0	0.0	0.0
Other receivables	5.9	0.5	0.5	0.6	0.6
<b>Total current assets.</b>	<b>10.9</b>	<b>22.3</b>	<b>31.7</b>	<b>51.1</b>	<b>79.6</b>
Fixed assets					
Equipment	0.0	0.4	0.3	0.7	0.5
Financial assets	0.0	0.0	0.0	0.0	0.0
Goodwill	0.0	0.0	0.0	0.0	0.0
Capitalized expenditure for dev.	29.5	32.8	34.8	36.8	38.8
Other intangible assets	0.0	0.0	0.0	0.0	0.0
<b>Total fixed assets</b>	<b>29.6</b>	<b>33.2</b>	<b>35.1</b>	<b>37.5</b>	<b>39.4</b>
<b>Total Assets</b>	<b>40.5</b>	<b>55.5</b>	<b>66.8</b>	<b>88.6</b>	<b>119.0</b>
Liabilities					
Current liabilities					
Accounts payable	0.2	0.2	0.2	0.2	0.3
Other liabilities	4.3	2.9	3.0	3.1	3.1
<b>Total current liabilities</b>	<b>4.4</b>	<b>3.1</b>	<b>3.2</b>	<b>3.3</b>	<b>3.4</b>
Long-term non interest bearing liab.	0.0	0.0	0.0	0.0	0.0
Long-term liabilities	7.1	0.4	12.9	12.9	0.0
<b>Total liabilities</b>	<b>11.6</b>	<b>3.5</b>	<b>16.1</b>	<b>16.2</b>	<b>16.3</b>
Provisions	0.0	0.0	0.0	0.0	0.0
Shareholder's equity	28.9	52.0	50.6	72.4	102.6
Minority	0.0	0.0	0.0	0.0	0.0
<b>Minoritet &amp; Equity</b>	<b>28.9</b>	<b>52.0</b>	<b>50.6</b>	<b>72.4</b>	<b>102.6</b>
Total liabilities & equity	40.5	55.5	66.8	88.6	119.0
Free cashflow, SEKm					
	2004	2005	2006e	2007e	2008e
Net Sales	19.0	24.9	28.5	70.3	137.2
Total operating costs	-19.5	-16.6	-14.8	-40.0	-70.0
Depreciation Ex GW	0.0	-0.1	-0.1	-0.1	-0.1
Amortization	0.0	0.0	0.0	0.0	0.0
EBIT	-0.6	8.2	13.6	30.2	67.1
Tax On EBIT	0.0	0.0	0.0	-8.4	-18.8
<b>NOPLAT</b>	<b>-0.6</b>	<b>8.2</b>	<b>13.6</b>	<b>21.7</b>	<b>48.3</b>
Depreciation Ex GW	0.0	-0.1	-0.1	-0.1	-0.1
Amortization	0.0	0.0	0.0	0.0	0.0
<b>Gross cash flow</b>	<b>-0.5</b>	<b>8.3</b>	<b>13.7</b>	<b>21.8</b>	<b>48.4</b>
Change in working capital	-1.5	0.2	-0.1	-0.4	0.0
Investments	0.0	-3.7	-27.0	-2.5	-20.0
<b>Free cashflow</b>	<b>-2.1</b>	<b>4.7</b>	<b>-13.5</b>	<b>18.9</b>	<b>28.4</b>
Capital structure					
	2004	2005	2006e	2007e	2008e
Equity ratio	0.7	0.9	0.8	0.8	0.9
Debt/equity ratio	0.2	0.0	0.3	0.2	0.0
Net debt	2.1	-17.6	-14.2	-33.1	-74.4
Capital employed	36.0	52.4	63.6	85.3	115.6
Capital turnover rate	1.1	0.6	0.5	0.9	1.4
Growth (%)					
	2004	2005	2006e	2007e	2008e
Growth of sales	n.m.	31.2	14.4	146.5	95.2
DCF valuation					
Risk premium	5.0	NV FCF projection period			
Beta	1.5	NV FCF, phase 2			
Riskfree interest	4.0	NV FCF, phase 3			
Interest premium	1.0	Non-operating assets			
WACC	11.5	Interest-bearing liabilities			
ROIC phase 2	24.0	Motivated value, SEKm			
ROIC phase 3	11.5				
Growth phase 2 (g*)	8.0	<b>Motivated value per share, SEK</b>			
Growth phase 3 (g*)	0.0	Market value quote, SEK			
Noplat normal year		<b>Mot. value/Market value quote</b>			
		10.8			
		9.0			
		0.2			
Profitability					
	2004	2005	2006e	2007e	2008e
Return on Equity (ROE, %)	9.2	32.6	26.5	35.3	55.2
ROCE (%)	-3.1	18.4	23.4	40.5	71.4
ROIC (%)	-3.1	18.4	23.4	29.2	48.1
EBITDA-margin (adjust,%)	-2.9	33.2	48.1	43.1	49.0
EBIT adjust-margin	-2.9	32.8	47.7	42.9	48.9
Net adjust-margin	7.0	52.9	47.7	30.9	35.2
Data per share, SEK					
	2004	2005	2006e	2007e	2008e
EPS	0.0	0.3	0.3	0.5	1.1
EPS adj.	0.0	0.3	0.3	0.5	1.1
EPS adj. ex gw	0.0	0.3	0.3	0.5	1.1
Dividend	0.0	0.0	0.0	0.0	0.0
Total Shares	32.2	42.6	42.6	42.6	42.6
Valuation					
	2004	2005	2006e	2007e	2008e
Enterprise value	385.8	366.1	389.4	389.4	389.4
P/E	217.8	29.1	28.2	17.7	7.9
P/E adj.	217.8	29.1	28.2	17.7	7.9
P/E adj. ex gw	217.8	29.1	28.2	17.7	7.9
P/S	20.2	15.4	13.5	5.5	2.8
EV/S	20.3	14.7	13.7	5.5	2.8
EV/EBITDA adj.	-710.5	44.3	28.4	12.9	5.8
EV/EBIT adj.	-698.9	44.9	28.6	12.9	5.8
P/BV	13.3	7.4	7.6	5.3	3.7
Share Development					
		Growth/Year, %		04/06P	
1 months	1.0%	Net sales		22.6	
3 months	-15.0%	Operating profit, adjust		n.a	
12 months	98.0%	EPS, adj.		177.8	
Beginning year	78.0%	Equity		32.4	
Share structure %					
		Capital	Votes		
Mikael Wirén via bolag		30.7	30.7		
Rothsay Ltd.		14.4	14.4		
Leif Rahmquist Skandia		6.5	6.5		
Fredrik Malmberg via bolag		4.6	4.6		
Bank of New York, Schewiz		1.4	1.4		
Ralph Muhlrad		1.2	1.2		
Credit Suisse, Luxemburg		1.2	1.2		
ACH Securities		1.1	1.1		
Valpurgius 2 AB		0.0	0.0		
Ovriga aktieägare		39.2	39.2		
The share					
List		NGM Equity			
Price, SEK		9.0			
Total shares, million		42.6			
Market cap, MSEK		384			
Round lot		500.0			
Management & Board					
CEO	John Fallström				
IR	Joakim Zetterberg				
Chairman	Peter Sederowsky				
Financial information in 2005					
Delårsrapport Q2	2006-08-24				
Delårsrapport Q3	2006-11-23				
Bokslutskommuniké 2006	2007-02-26				
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## Appendix 1: Most important characters

### **Conan the Barbarian**

The tale of Conan of Cimmeria takes place in the mythical Hyborian Age between the time of the sinking of Atlantis and the rise of the known ancient civilizations. Conan was born on the battlefield and by the age of 15 is already a respected warrior. Conan appears in the guise of several characters. He travels around as a thief, a pirate and an outlaw and encounters monsters, evil characters and beautiful princesses, to become at the age of 40 king of Aquilonia, the most powerful kingdom of the age.

### **Mutant Chronicles**

Mutant Chronicles takes place in a future, fictitious age in which four corporations control the world and the solar system. The green Earth has been transformed into a dark and very hostile place. The human civilization has collapsed following an epidemic and is made up of a few remaining Mutants. Humans settle in sealed enclaves where they fight the Dark Legion for supremacy of the solar system.

### **Kull of Atlantis**

Kull was born in Atlantis c. 20 000 BC at a time when the barbarian tribes ruled. Kull is a barbarian who becomes a gladiator, a gladiator who takes over a magnificent kingdom from a mad tyrant and crowns himself king. Kull holds his throne from conspirators and murderous rivals. He broods over the mysteries of eternity, rewrites unjust laws and responds to his enemies' threats with his ally Brule the Spear-Slayer.

### **Bran Mak Morn**

Bran Mak Morn is depicted as a descendant of Brule the Spear-Slayer. Bran Mak Morn is deeply aware of the inevitable path to extinction, but like all Howard's characters he chooses to fight this rather than succumb. The dark warrior fights for his people's freedom and survival and among his main enemies are the Roman Legions.

### **Solomon Kane**

God's angry warrior, Solomon Kane, is described as a somber and gloomy man dressed in black with several weapons in his coat. Kane wanders the world with no apparent goal other than to vanquish evil in all its forms. Pirates, vampires, mad queens, bandits, all of them are brought down by Solomon Kane's sword. His adventures take place in modern times and usually take him from Europe to Africa's jungles and back.

**Vultures of Whapeton**

Vultures are criminal bandits who terrorize the mining town of Whapeton. Since no one knows who is a member of the Vultures, a sheriff by the name of Middleton hires Texan gunslinger Steve Corcoran. Eventually it turns out however that Middleton is the brains behind the Vultures deeds. Even worse, with Corcoran's help he plans to double-cross his own gang and skip town with a fortune in stolen gold. Unfortunately, Corcoran falls in love with a girl who gets in Middleton's way.

## Appendix 2: Films in the same genre

2006*	Income (MUSD)	Production budget (MUSD)	I/C-ratio*	Publisher	Studio
X-Men: The Last Stand	341	210	1,6	Marvel	Fox
V for Vendetta	131	54	2,4	DC Comics	WB
* So far this year					
2005	Income (MUSD)	Production budget (MUSD)	I/C-ratio*	Publisher	Studio
Harry Potter and the Goblet of Fire	892	150	5,9		WB
Star Wars: Episode III - Revenge of the Sith	849	113	7,5	Lucasfilm	Fox
Narnia: The Lion, the Witch and the Wardrobe	744	180	4,1	Disney	Buena Vista
Batman Begins	372	150	2,5	DC Comics	WB
Fantastic Four	330	100	3,3	Marvel	Fox
Constantine	230	100	2,3	DC Comics	WB
Sin City	159	40	4,0	Dark Horse	Dimension
Elektra	56	43	1,3	Marvel	Fox
2004	Income (MUSD)	Production budget (MUSD)	I/C-ratio*	Publisher	Studio
Harry Potter and the Prisoner of Azkaban	790	130	6,1		WB
Spider-Man 2	784	200	3,9	Marvel	Sony
Van Helsing	300	160	1,9		Universal
Blade: Trinity	129	65	2,0	Marvel	New Line
Resident Evil: Apocalypse	129	45	2,9		Sony
The Chronicles of Riddick	115	105	1,1		Universal
Hellboy	99	66	1,5	Dark Horse	Sony
Catwoman	82	100	0,8	DC Comics	WB
The Punisher	54	33	1,6	Marvel	Lions Gate
2003	Income (MUSD)	Production budget (MUSD)	I/C-ratio*	Publisher	Studio
The Lord of the Rings: The Return of the King	1119	94	11,9		New Line
The Matrix Reloaded	738	150	4,9		WB
Terminator 3: Rise of the Machines	433	200	2,2		WB
Matrix Revolutions	425	150	2,8		WB
X2: X-Men United	407	110	3,7	Marvel	Fox
Hulk	245	137	1,8	Marvel	Universal
Daredevil	179	78	2,3	Marvel	Fox
2002	Income (MUSD)	Production budget (MUSD)	I/C-ratio*	Publisher	Studio
The Lord of the Rings: The Two Towers	926	94	9,9		New Line
Harry Potter and the Chamber of Secrets	877	100	8,8		WB
Spider-Man	822	139	5,9	Marvel	Sony
Star Wars: Episode II - Attack of the Clones	649	115	5,6	Lucasfilm	Fox
Men in Black II	442	140	3,2	Marvel	Sony
Road to Perdition	181	80	2,3	DC Comics	DreamWorks
The Scorpion King	165	60	2,8		Universal
Blade II	155	54	2,9	Marvel	New Line
Resident Evil	102	33	3,1		Sony
2001	Income (MUSD)	Production budget (MUSD)	I/C-ratio*	Publisher	Studio
Harry Potter and the Sorcerer's stone	976	125	7,8		WB
The Lord of the Rings: The Fellowship of the Ring	871	93	9,4		New Line
2000	Income (MUSD)	Production budget (MUSD)	I/C-ratio*	Publisher	Studio
X-Men	296	75	3,9	Marvel	Fox
1999	Income (MUSD)	Production budget (MUSD)	I/C-ratio*	Publisher	Studio
Star Wars: Episode I - The Phantom Menace	924	115	8,0	Lucasfilm	Fox
The Matrix	460	63	7,3		WB
1998	Income (MUSD)	Production budget (MUSD)	I/C-ratio*	Publisher	Studio
Blade	131	N/A		Marvel	New Line
1997	Income (MUSD)	Production budget (MUSD)	I/C-ratio*	Publisher	Studio
Men in Black	589	90	6,5	Marvel	Sony
Batman and Robin	238	125	1,9	DC Comics	WB
Spawn	88	40	2,2	Image Comics	New Line
1996	Income (MUSD)	Production budget (MUSD)	I/C-ratio*	Publisher	Studio
The Phantom	17	N/A		DC Comics	Paramount
1995	Income (MUSD)	Production budget (MUSD)	I/C-ratio*	Publisher	Studio
Batman Forever	336	100	3,4	DC Comics	WB
Judge Dredd	113	90	1,3	Rebellion	Buena Vista

Source: Box Office Mojo, Redeye Research

\* Income / Cost ratio i.e. Box office income / Production budget

## Appendix 3: Suppositions and forecasts

### MMOG

Licence price per user \$	12
Sell trough for initial software \$	40

		2006e	2007e	2008e	2009e	2010e
Sales of software (units)			400000	500000	300000	200000
Average nr of users			250000	300000	250000	270000
Income from software sales	MUSD		16	20	12	8
Licence income	MUSD		3	4	3	3
Total income to development company	MUSD		19	24	15	11
Royaltyrate (7%)	MUSD		1	2	1	1
Royalty income to Paradox	MSEK		10	12	8	6
Advances	MSEK	8				
<b>Income to Paradox from MMOG</b>		<b>8</b>	<b>10</b>	<b>12</b>	<b>8</b>	<b>6</b>

### Computer & Video games

Sell trough Console games \$	35
Sell trough PC-games \$	25
Sell trough wireless \$	5

Advances per game (USD)	750000
Advance 2 per game (USD)	250000
Royaltyrate for console games (%)	8
Royaltyrate for computer games (%)	10
Royaltyrate for wireless (%)	10

		2006e	2007e	2008e	2009e	2010e
Nr of sold units console games			300000	500000	50000	1000000
Nr of sold units PC-games			100000	60000	90000	50000
Nr of sold units wireless-games			30000	10000	50000	20000
Total royaltyincome	MSEK		8	12	3	22
Advances	MSEK		2		6	
Profit participation to WB	MSEK		-8			
<b>Income to Paradox from Computer &amp; Videogames</b>		<b>0</b>	<b>10</b>	<b>12</b>	<b>9</b>	<b>22</b>

**Film**

		2006e	2007e	2008e	2009e	2010e
Conan 1				9		
Conan 2						8
Mutant Cronicles			3			
Red Nails D-T-V			1			
Bran Mak Morn				3		
Solomon Kane		0			3	
Vultures					3	
Total royalty income	USD	0	4	12	6	8
Total royalty income	MSEK	3	28	90	45	56
Advances	MSEK			-23		
<b>Income to Paradox from Film</b>	<b>MSEK</b>	<b>3</b>	<b>28</b>	<b>68</b>	<b>45</b>	<b>56</b>

Estimated royalty rate Film	3%
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Total Box office Conan 1 (MUSD)	300
Total Box office Conan 2 (MUSD)	250
Total Box office Mutant Cronicles (MUSD)	100
Total Box office Bran Mak Morn (MUSD)	100
Total Box office Solomon Kane (MUSD)	100
Total Box office Vultures (MUSD)	100
Total Box office Red Nails D-T-V (MUSD)	25

**Home Video / DVD**

		2006e	2007e	2008e	2009e	2010e
Conan 1					3	
Conan 2						
Mutant Cronicles				1		
Red Nails D-T-V				0		
Bran Mak Morn					1	
Solomon Kane						1
Vultures						1
Total royalty income	USD			1	4	2
Total royalty income	MSEK			9	30	15
Advances	MSEK					
<b>Income to Paradox from DVD</b>	<b>MSEK</b>			<b>9</b>	<b>30</b>	<b>2</b>

Estimated royalty rate DVD	1%
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Total Box office Conan 1 (MUSD)	300
Total Box office Conan 2 (MUSD)	250
Total Box office Mutant Cronicles (MUSD)	100
Total Box office Bran Mak Morn (MUSD)	100
Total Box office Solomon Kane (MUSD)	100
Total Box office Vultures (MUSD)	100
Total Box office Red Nails D-T-V (MUSD)	25

**Cabel-TV / Networks / Syndication**

		2006e	2007e	2008e	2009e	2010e
Conan 1					2	2
Conan 2						
Mutant Cronicles				1	1	1
Red Nails D-T-V				0,2	0,2	0,2
Bran Mak Morn					1	1
Solomon Kane						1
Vultures						1
Total royalty income	USD			1	4	5
Total royalty income	MSEK			6	26	36
Advances	MSEK					
<b>Income to Paradox from TV</b>	<b>MSEK</b>			<b>6</b>	<b>26</b>	<b>36</b>

Estimated royaltyrate TV	5%
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Estimated share of Box office revenues	40%
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Total Box office Conan 1 (MUSD)	300
Total Box office Conan 2 (MUSD)	250
Total Box office Mutant Cronicles (MUSD)	100
Total Box office Bran Mak Morn (MUSD)	100
Total Box office Solomon Kane (MUSD)	100
Total Box office Vultures (MUSD)	100
Total Box office Red Nails D-T-V (MUSD)	25