

BIOTECHNOLOGY

A Research Publication by DZ BANK AG

Evotec⁶⁾

Reuters: EVTG.DE

Bloomberg: EVT GY

Year *	Sales EUR m	Adj. IFRS- Earnings per sh. EUR	Cash flow per share EUR	PER	PCF	Dividend per share EUR
2009	42.7 (42.7)	-0.43 (-0.43)	-0.38 (-0.38)	-	-	0.00
2010e	54.0 (53.0)	0.00 (0.00)	0.05 (0.05)	n.a.	55.1	0.00
2011e	63.9 (62.7)	0.02 (0.02)	0.07 (0.07)	146.5	42.2	0.00
2012e	73.5 (72.1)	0.04 (0.03)	0.09 (0.08)	75.0	32.8	0.00

* Fiscal year end December – In brackets: Figures from the last publication

Upward trend should continue in 2011

- » **New discovery alliances I:** the company has signed new co-operations in the last few weeks, including one with Merck KGaA for the joint development of pre-clinical candidates for the treatment of neurological diseases.
- » **New discovery alliances II:** Evotec has also signed an agreement with MedImmune/ AstraZeneca for the treatment of metabolic diseases: the aim is to obtain new alternatives in the treatment of metabolic diseases diabetes 1 and 2 through the regeneration of insulin-producing beta cells. Apart from an upfront payment of EUR 5m and the reimbursement of costs for research activities, this project alone could generate up to EUR 254m in milestone payments plus royalties.
- » **Further upside potential:** similar regenerative treatment approaches and hence discovery alliances could also be envisaged in the case of other lifestyle diseases such as chronic renal or heart failure, which would lead to further milestone payments, research financing and a possible royalties.
- » **Sales:** we now expect earnings of EUR 54m in 2010, at the higher end of the guidance (EUR 52-54m). We regard the target of >15% sales growth in 2011 as entirely realistic.

The signing of new cooperation agreements confirms Evotec's reputation as a contract drug discovery company and its expertise in indications with a high unmet medical need. The acquisition of Develogen has therefore already paid for itself and moreover offers the possibility of further lucrative discovery alliances. Evotec's aim of reaching lasting profitability "by 2012 at the latest" should already be on the agenda in 2011. Buy! New fair value: EUR 3.50.

Selected Companies	Price on 10 Jan 2011	PER		EV / EBITDA		EV / Sales 11e	Re- com.
		11e	12e	11e	12e		
Evotec	3.08 EUR	146.5	75.0	34.3	24.5	4.73	↑
Galapagos Genomics	11.96 EUR	26.2	26.6	11.3	9.5	1.39	-
WuXi Pharmatech	17.44 USD	15.3	12.9	8.8	7.0	2.74	-
Evolva	1.72 CHF	-	-	-	-	9.97	-
MorphoSys	18.19 EUR	31.2	19.4	10.1	6.4	2.54	↑
Median for all peer group companies		26.0	21.2	10.1	8.8	6.11	-

↑ = Buy, → = Hold, ↓ = Sell, ● = not rated, n/a = not appropriate
Source: DZ BANK, I/B/E/S, FactSet

EQUITIES

Flash
11 Jan 2011

Buy (prev. Buy)

Closing price 10 Jan 2011

(in EUR): 3.08

Fair value: 3.50 (prev. 3.00)

Risk classification: 4

Financial ratios 2011e:

Book value per share (in EUR): 1.12
Equity ratio (in %): 72.9
Net margin (in %): 3.5
ROE (in %): 1.7
Dividend yield (in %): 0.0
Free cash flow (EUR m): 8.0
Net debt (EUR m): -54.7

Number of shares

(million units): 115.7

Market cap

(in EUR m): 356.11

Free float (in %): 76.0

SIN: 566480

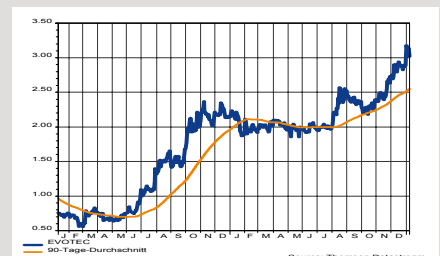
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DZ BANK
Bank on Germany

UPWARD TREND SHOULD CONTINUE IN 2011

New discovery alliances pave the way forward

New alliance with Merck KGaA

Evotec has signed new alliances in the last few weeks, including one with Merck KGaA for the joint development of pre-clinical candidates for the treatment of neurological diseases. As part of this alliance, Evotec will work in the field of in vitro biology, medical chemicals and in vitro/in vivo pharmacokinetics. Evotec will also be entrusted with the identification and optimisation of innovative, small molecule candidates against selected targets.

Alliance in the field of metabolic diseases

Through the recent acquisition of Develogen, Evotec has also been able to sign an agreement with MedImmune – AstraZeneca's global biology business unit – aimed at developing a new alternative in the treatment of metabolic diseases diabetes 1 and 2 through a regeneration of insulin-producing beta cells.

This first cooperation in the field of beta cell regeneration is based on Develogen technology. The company was acquired by Evotec in September for up to EUR 14m in shares. Apart from an upfront payment of EUR 5m and reimbursement of costs for research activities involved in the programme, this project alone could attract up to EUR 254m in milestone payments plus a share of sales. Milestone payments will be dependent on reaching various clinical, regulatory and commercial targets.

The acquisition of Develogen has therefore already paid for itself in our view and moreover offers Evotec the possibility of signing further lucrative discovery alliances since similar regenerative treatment approaches and hence discovery alliances could be envisaged in the case of other metabolic diseases such as chronic renal or heart failure. This would lead to further milestone payments, research financing and a potential share of sales.

Upside through further Develogen assets

1.) When Evotec acquired Develogen, it also took over an integrated discovery alliance with Boehringer Ingelheim on small molecules aimed at treating insulin-resistant (type 2) diabetes. From this, Evotec stands to receive ongoing research payments and will be entitled to potential milestone payments of up to EUR 237m as well as a share of any sales after market launch.

2.) Evotec also acquired a development partnership with Andromeda, which is part of the Teva Group. The development candidate DiaPep277, a synthetic immunomodulatory substance for the treatment of type 1 diabetes is currently in a pivotal clinical phase III trial. Here also, Evotec will be entitled to milestone payments and a share of sales after market launch.

Under the terms of the Develogen acquisition, Develogen shareholders will be entitled to 30% of any future milestone payments and sales, and Evotec to 70%.

Status of further projects

A clinical phase II trial on the antidepressant EVT101 developed for Roche began in mid-2010. Results are expected in 1H 2012. If Roche takes over the product, Evotec stands to receive a one-off payment of USD 65m along with further payments of USD 300m depending on the success of the drug.

New alliance with Merck KGaA in neurology

First alliance in field of metabolic diseases with Astra Zeneca

Agreement will bring up-front payment of EUR 5m and substantial milestone payments

Application to other metabolic diseases conceivable

Further project with Boehringer

Immunomodulator in phase III

Evotec directly entitled to 70% of upside potential

USD 65m option payment dependent on results of clinical phase II trial involving EVT101

¹⁾⁻⁹⁾ Important: Please read the references to possible conflicts of interest and disclaimers/disclosures at the end of this report.

The insomnia drug EVT201 was licensed out to the Chinese company Jingxin Pharmaceutical in October. Jingxin plans to continue to develop the product for the Chinese market in 2011 with a phase I and the start of a phase II trial. Apart from a small upfront payment, Evotec will receive milestone payments along with a significant share of future sales, plus the right to use any clinical results for a potential further development of EVT201 in other countries.

EVT201 insomnia drug already licensed out to Chinese company

US listing withdrawn

After starting the process of deregistration from the US's NASDAQ technology index in November 2009 as part of its cost-cutting programme, Evotec submitted its actual deregistration application to the Securities and Exchange Commission at the end of December 2010; it is now expected to be effective from the end of March 2011. The stock's high liquidity should not be affected in any way by this move.

Deregistration from US stock exchange not expected to have impact on liquidity

Sales expectations for 2010 and 2011

We now expect earnings of EUR 54m in 2010, which is at the top end of the guidance (EUR 52-54m). None of the company's discovery alliances is expected to expire in 2011. Taking into account the two new research alliances Evotec should well be able to reach its sales guidance for 2011 of >15% growth (DZ BANKe: 18%).

2010e sales at the top end of expectations; >15% increase in sales a realistic target

Summary and rating

The signing of new cooperation agreements confirms Evotec's reputation as a contract drug discovery company and its expertise in indications which still have a high unmet medical need. In our view, the acquisition of Develogen from September 2010 has already paid for itself through the contract with MedImmune/AstraZeneca. In addition, the platform acquired should offer Evotec the chance to sign further lucrative discovery alliances or to broaden this alliance towards additional indications.

Further lucrative research alliance possible

As we are already assuming a profit in 2010 and none of the company's research alliances are expected to expire in 2011 but those two new alliances will materialize in 2011, we assume that the management's target of achieving lasting profitability "in 2012 at the latest" should already be clearly on the agenda in 2011. In 2012 then, crucial results of clinical trials are then expected in 2012 (EVT101 and DiaPep 277) which could be value-enhancing and do not contain any/hardly any downside as the studies are fully financed by partners Roche and Teva/Andromeda.

Achieving lasting profitability should already be on the agenda in 2011

We confirm our buy rating with a new fair value of EUR 3.50.

**New fair value: EUR 3.50
Rating: buy**

Evotec - At a glance

Company profile

Evotec specializes in contract drug discovery, primarily for the pharmaceutical industry and is benefiting from an ongoing trend towards outsourcing of research services to external providers. Evotec should ensure lasting profitability by specializing in commercially interesting indications and through its longer-term research alliances.

In addition to fees for its contract work, Evotec stands to receive payments once specific milestones or marketing targets are reached along with a share of sales after market launch. Contrary to Evotec's earlier strategy, it now only takes its own, self-financed development projects up to a certain level of maturity.

Justification for rating

The signing of **new cooperation agreements** confirms Evotec's **reputation** as a contract drug discovery company and its **expertise** in indications with a persistent unmet medical need. The recent acquisition of Develogen offers an **opportunity** to sign **further** lucrative discovery alliances in the field of metabolic diseases where there is still a high unmet medical need. None of the company's discovery alliances runs out in 2011; consequently, management's **target of achieving lasting profitability** "by 2012 at the latest" should already be firmly on the agenda in 2011. Crucial results of clinical trials (EVT101 and DiaPep 277) are then expected in 2012, which could potentially be value-enhancing.

Current price sensitive issues

- » Further expansion of drug discovery alliances
- » M & A activities to obtain "critical mass"
- » Development progress by partners

Risks and opportunities

Opportunities	Risks
Ongoing trend towards outsourcing incl. early development phases	Failure to build up expertise as much as necessary
Focus on contract development rather than on own development projects reduces conflicts of interest	Development failures by partners
Expertise in growth area of metabolic diseases enhanced by acquisition of Develogen	

R & D service provider

Revenues from contract work, milestone payments and royalties

Sustainable profitability already a topic in 2011

Opportunities outweigh

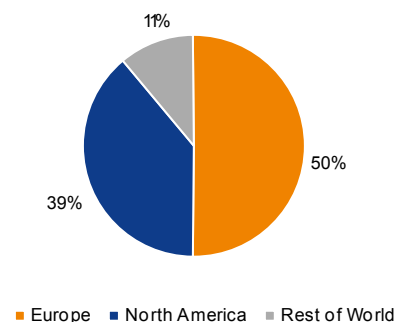
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RATIOS

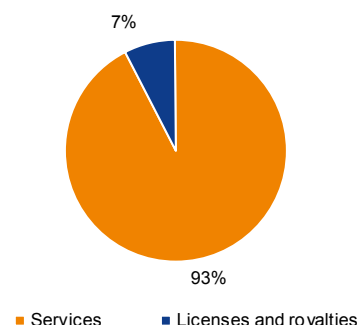
Euro	2009	2010e	2011e	2012e	2013e
Profit and loss ratios					
Sales (m)	42.7	54.0	63.9	73.5	82.6
EBITDA margin	-87.5%	11.0%	13.8%	16.3%	18.0%
EBIT margin	-99.1%	1.0%	5.0%	8.5%	11.0%
Net margin	-106.6%	1.2%	3.5%	6.0%	7.8%
Investment ratio	0.0%	64.8%	1.6%	1.4%	1.2%
R&D as % of sales	49.1%	12.0%	14.5%	13.5%	12.0%
Admin and sales costs as % of sales	39.1%	29.0%	26.5%	25.0%	24.0%
Net other operating costs as % of sales	54.1%	4.0%	0.0%	0.0%	0.0%
Net financial income as % of sales	-5.9%	0.6%	0.1%	0.1%	0.2%
Interest cover					
Average sales growth next five years	16.3%				
Average earnings growth next five years					
Profitability ratios					
ROE	-40.8%	0.5%	1.7%	3.3%	4.6%
ROCE	-73.1%	0.6%	3.8%	7.8%	12.2%
Productivity ratios					
Sales per employee ('000)	94.54	106.52	118.02	129.26	138.49
EBIT per employee ('000)	-93.69	1.07	5.90	10.99	15.23
Balance sheet ratios					
Equity ratio	76.0%	73.5%	72.9%	72.6%	72.6%
Long term debt and equity / Fixed assets	154.8%	145.2%	155.0%	168.6%	186.3%
Liquidity (quick ratio)	250.3%	222.9%	233.7%	249.5%	269.4%
Receivables as % of sales	10.6%	9.3%	9.3%	9.3%	9.3%
Investment (net of GW) / Depreciation		649.5%	17.9%	17.6%	17.3%
Working capital as % of sales	-16.1%	-9.0%	-8.1%	-7.4%	-6.9%
Net debt (m)	-44.0	-47.4	-54.7	-64.4	-76.1
Net debt complete (m)	-55.5	-44.8	-52.0	-61.4	-73.0
Figures per share					
Earnings per share, diluted	-0.43	0.00	0.02	0.04	0.06
Diluted cash earnings per share	-0.38	0.05	0.07	0.09	0.11
Dividend per common share	0.00	0.00	0.00	0.00	0.00
Cash per share, diluted	0.30	0.13	0.19	0.27	0.37
Net debt per share, diluted	-0.40	-0.41	-0.47	-0.56	-0.66
Valuation ratios					
Enterprise value / Sales	4.4	5.4	4.7	4.0	3.4
Enterprise value / EBITDA		49.2	34.3	24.5	18.9
Enterprise value / EBIT		539.2	94.6	46.9	30.9
EV/Sales to sales growth	0.28	0.33	0.29	0.24	0.21
PEG ratio - common shares					
Fiscal year end December					

Source: Evotec, DZ BANK estimates

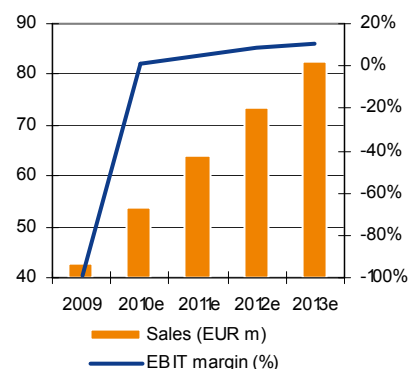
SALES BY REGION 2009



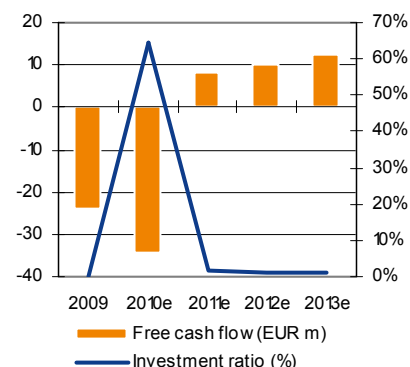
SALES BY BUSINESS SEGMENT 2009



SALES AND MARGIN DEVELOPMENT



FREE CASH FLOW AND INVESTMENT RATIO



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- Hold: price changes between +5% and -5%
- Sell: more than 5% decrease in share price

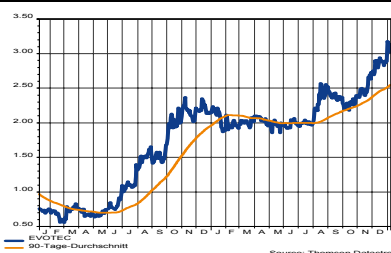
7.a) Note: - Any fair values / price targets shown for companies discussed in this report may not be achieved due to multiple risk factors, including, without limitation, market volatility, sector volatility, corporate actions, the state of the economy, the failure to achieve earnings and/or revenue projections, the unavailability of complete and accurate information and/or a subsequent occurrence that affects the underlying assumptions made by DZ BANK or by other sources relied upon in the report.

b) DZ BANK may also have published other research about the company during the period covered that did not contain a fair value / price target but that discussed valuation matters. The fair values / price targets shown should be considered in the context of all prior published research as well as developments relating to the company, its industry and financial markets.

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RATING HISTORY

Recommendation	Date	Price
Buy	5 Feb 2010	1.96 EUR
Coverage stopped	21 Apr 2008	1.80 EUR

¹⁾ - ⁹⁾ Important: Please read the references to possible conflicts of interest and disclaimers/disclosures at the end of this report.

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