

Recommendation: **BUY** (BUY) Risk: **Medium** (Medium) Price Target: **EUR 3.60** (3.60)

11 November 2011

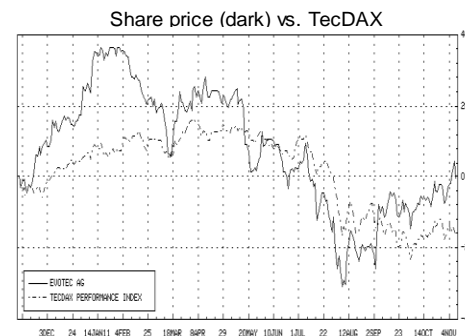
3Q/2011 figures: Another strong quarter

- On 10 November, Evotec again reported strong 3Q/11 and 9M/11 results. Results were positively impacted in 3Q by a USD 10m (EUR 6.9m) upfront payment from a partnering signed with Roche. Revenues for 9M/11 increased to EUR 59.7m (PY: EUR 38.8m; +54%) incl. EUR 8.7m (PY: EUR 0.2m) from the acquisitions of DeveloGen, Kinaxo and Compound Focus. R&D expenses increased to EUR 6.8m (PY: EUR 4.2m; +62%), mainly from the strategic build-up of Evotec's beta cell franchise "CureBeta" and the inclusion of Evotec Göttingen and Evotec Munich R&D expenses. Operating income for 9M/11 was EUR 9.5m (PY: EUR 1.0 m). The Company continues to operate at a strong gross margin of more than 40%. Liquidity including cash, cash equivalents and investments incl. long-term financial assets amounted to EUR 60.4m (as of 30 September 2011).
- In 2011 total Group revenues are expected to grow by ~40%, leading to revenues of EUR 77 to 79m. 2011 year-end liquidity target is >EUR 60m at constant year-end 2010 currencies. R&D expenses are expected to increase to ~EUR 10m from 2010 levels. The company expects operating result before impairment charges, if any, is expected to be profitable and improve over 2010. According to, management's assessment the order backlog is very upbeat and provides a firm basis for revenue growth in 2012.
- For FY 2011 we expect sales to reach the upper range of company's guidance at EUR 79m. Due to the notably higher R&D expenses expected in 4Q we forecast EBIT for the entire FY 2011 to amount to EUR 7.2m, which is below 9M/11 operating result.
- We leave our price target at EUR 3.60 unchanged and retain BUY recommendation.

Key data

Y/E 31.12., EUR m	2008	2009	2010	2011E	2012E	2013E
Revenues	39.6	42.7	55.3	79.0	83.6	92.2
Gross profit	17.6	18.4	24.3	36.6	41.0	47.0
EBITDA	-68.4	-38.2	6.5	12.9	11.5	16.8
EBIT	-73.2	-42.3	1.7	7.2	6.6	11.8
Net income/loss	-78.3	-45.5	3.0	6.1	5.2	9.6
EPS	-0.82	-0.43	0.03	0.05	0.04	0.08
CPS	-0.43	-0.20	0.00	0.10	0.07	0.00
Gross margin	44.5%	43.2%	44.1%	46.3%	49.0%	51.0%
EBITDA margin	-172.7%	-89.6%	11.7%	16.3%	13.7%	18.2%
EBIT margin	-184.8%	-99.1%	3.1%	9.1%	7.9%	12.8%
EV/Sales	6.3	5.9	4.5	3.2	3.0	2.7

Source: Evotec AG; CBS Research AG;



Source: CBS Research AG, Bloomberg

Change	2011E		2012E		2013E	
	new	old	new	old	new	old
Revenue	-	79.0	-	83.6	-	92.2
EBIT	7.2	10.8	-	6.6	-	11.8
EPS	0.05	0.08	-	0.04	-	0.08

Internet: www.evotec.com Sector: Biotechnology
WKN: 566480 ISIN: DE0005664809
Reuters: EVTG.DE Bloomberg: EVT GY

Short company profile

Evotec is a drug discovery alliance and development partnership company focused on rapidly progressing innovative product approaches with leading pharmaceutical and biotechnology companies.

Share data:

Share price (last closing price, EUR):	2.59
Shares outstanding (m):	115.60
Market capitalisation (EURm):	299.40
Enterprise value (EURm):	250.80
Ø daily trading volume (3 m., no. of shares):	307,278

Performance data:

High 52 weeks (EUR):	3.48
Low 52 weeks (EUR):	1.58
Absolute performance (12 months)	-0.4%
Relative performance: (vs. TecDAX)	
1 month	6.2%
3 months	44.7%
6 months	9.4%
12 months	18.9%

Shareholders:

Roland Oetker/ROI	13.5%
TVM V Life Science Ventures	10.5%
Free float	76.0%

Financial calendar:

3Q/2011 Figures	21-23 November
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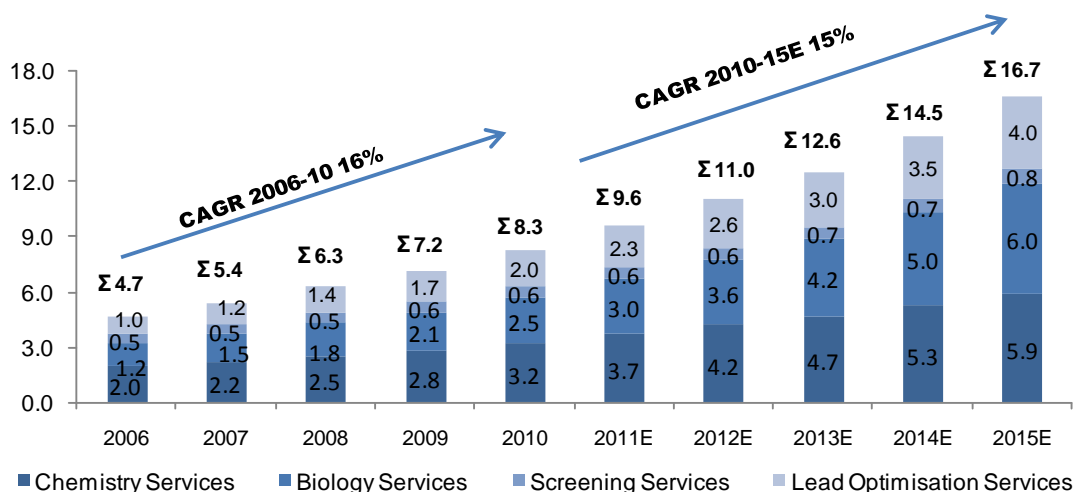
Brief update on CRO industry

The global drug discovery market reached USD 8.3bn in 2010. According to Kalorama research the market is expected to grow with 15% CAGR over the period 2010-15E reaching USD 16.7bn in 2015E.

While Chemistry Services (CAGR 10-15E: 13%) continue to remain traditionally dominant segment among drug discovery services, the overall market growth is expected to be driven particularly by Biology Services (CAGR 10-15E: 19%). Also Lead Optimisation Services are expected to grow rapidly with CAGR 10-15E of 15%. The estimated average growth rate over 2010-15E of Screening Services is expected to be moderate with 7%.

Contract drug discovery services by market segment: Revenues in USD bn

	2006	2007	2008	2009	2010	2011E	2012E	2013E	2014E	2015E	CAGR 06-10	CAGR 10-15E
Chemistry Services	2.0	2.2	2.5	2.8	3.2	3.7	4.2	4.7	5.3	5.9	12%	13%
Biology Services	1.2	1.5	1.8	2.1	2.5	3.0	3.6	4.2	5.0	6.0	20%	19%
Screening Services	0.5	0.5	0.5	0.6	0.6	0.6	0.6	0.7	0.7	0.8	5%	7%
Lead Optimisation Services	1.0	1.2	1.4	1.7	2.0	2.3	2.6	3.0	3.5	4.0	20%	15%
Total drug discovery services	4.6	5.4	6.3	7.2	8.3	9.6	11.0	12.6	14.5	16.7	16%	15%



Source: Kalorama Information; CBS Research AG;

Thus, as a result of these trends the market share of Chemical Services will shrink to 35% in 2015E (Currently ~39%), that will be offset by increased share of Biology Services segment 36% in 2015E (Currently 30%). The revenues in Screening Services are expected to remain flat in absolute terms in medium run, while the market share of these services will decrease to 5% (Currently 7%). The market share of Lead Optimisation Services is expected to remain constant over the period 2010-15E.

Contract drug discovery services by market segment: Share market

	2006	2007	2008	2009	2010	2011E	2012E	2013E	2014E	2015E
Chemistry Services	43%	41%	40%	39%	39%	39%	38%	37%	36%	35%
Biology Services	26%	28%	29%	29%	30%	31%	33%	33%	34%	36%
Screening Services	10%	9%	8%	8%	7%	6%	6%	5%	5%	5%
Lead Optimisation Services	21%	22%	23%	24%	24%	24%	24%	24%	24%	24%

Source: Kalorama Information; CBS Research AG;

Trends that fuel the demand for drug discovery outsourcing

According to Kalorama, major trends that have led to an increase in demand for contract services in drug discovery include:

- development of new technologies that continued to increase the number of targets and accelerate the identification of active compounds;
- pressure to develop new lead compounds due to the patent cliff;
- increased pressure to reduce the time spent in drug discovery and to bring drugs to market sooner;
- increased focus on converting fixed costs to variable costs and streamlining operations by contracting for research and development services;
- heightened regulatory environment and increased complexity that made the internal management of complicated discovery projects more difficult and costly;
- biotechnology and emerging pharmaceutical companies, in many cases, lacking the required in-house drug discovery and development expertise.

Some thoughts on CRO industry consolidation

A relatively untapped market coupled with rapid revenue growth encouraged new players to enter the CRO industry. With this trend, the market became highly fragmented, with over 1,100 CROs worldwide. This led to a significant market consolidation, which has notably accelerated in the last time.

At the beginning of October PPD, a third-largest CRO by revenue with USD 1.4bn in 2010 sales behind only Covance and Quintiles, was acquired in a USD 3.9bn cash buyout by the Carlyle Group and Hellman & Friedman.

A number of other smaller private equity deals occurred in spring of this year. Omnicare CR (Clinical Research) was acquired from its parent company Omnicare Inc by private equity Nautic Partners in April 2011 and CCMP Capital bought a majority stake for USD 600m in CRO MedPace in May this year. Private equity traditionally had interest in CRO industry, e.g. in 2003 industry leader Quintiles was taken private.

However private equity is not the only driving force behind the industry consolidation. Small and medium sized CRO companies are also actively involved in M&A activity in order to expand their offer range or enhance the quality of drug discovery and development process, which is one of the necessary strategy components to maintain and reinforce their competitive position. Additionally, the consolidation trend is spurred by the CRO customer preferences. According to Frost and Sullivan research, the pharmaceutical companies demonstrate a preference for a single outsourcing company instead of multiple providers for a project. This helps eliminate dealings with numerous outsourcing companies and enables optimal leverage of the knowledge obtained during the early stages of R&D process within the same organization.

Appendix

Profit and loss account

IFRS EUR 1,000	2008	2009	2010	2011E	2012E	2013E
Total revenues	39,613	42,683	55,262	78,965	83,609	92,201
YoY growth	-27.2%	7.7%	29.5%	42.9%	5.9%	10.3%
Cost of revenue	-21,977	-24,262	-30,916	-42,387	-42,640	-45,179
as % of sales	-55.5%	-56.8%	-55.9%	-53.7%	-51.0%	-49.0%
Gross profit	17,636	18,421	24,346	36,578	40,968	47,023
as % of sales	44.5%	43.2%	44.1%	46.3%	49.0%	51.0%
Research and development expenses	-42,537	-20,947	-6,116	-10,400	-10,500	-11,000
as % of sales	-107.4%	-49.1%	-11.1%	-13.2%	-12.6%	-11.9%
Selling, general and administrative (S,G&A)	-19,950	-16,695	-15,956	-16,792	-22,574	-23,050
as % of sales	-50.4%	-39.1%	-28.9%	-21.3%	-27.0%	-25.0%
Other operating expenses	-28,359	-23,078	-559	-2,169	-1,314	-1,163
as % of sales	-71.6%	-54.1%	-1.0%	-2.7%	-1.6%	-1.3%
EBITDA	-68,404	-38,234	6,480	12,890	11,462	16,764
as % of sales	-172.7%	-89.6%	11.7%	16.3%	13.7%	18.2%
Depreciation and amortisation	-4,806	-4,065	-4,765	-5,673	-4,882	-4,954
as % of sales	-12.1%	-9.5%	-8.6%	-7.2%	-5.8%	-5.4%
EBIT	-73,210	-42,299	1,715	7,217	6,580	11,809
as % of sales	-184.8%	-99.1%	3.1%	9.1%	7.9%	12.8%
Net financial results	-2,760	-2,520	2,152	648	162	682
EBT (Earnings before income taxes)	-75,970	-44,819	3,867	7,866	6,742	12,491
as % of sales	-191.8%	-105.0%	7.0%	10.0%	8.1%	13.5%
Income taxes	-2,317	-678	-882	-1,809	-1,551	-2,873
as % of EBT	3.0%	1.5%	-22.8%	-23.0%	-23.0%	-23.0%
Net income/loss	-78,287	-45,497	2,985	6,056	5,191	9,618
as % of sales	-197.6%	-106.6%	5.4%	7.7%	6.2%	10.4%
Basic earnings per share (EUR)	-0.82	-0.43	0.03	0.05	0.04	0.08

Source: Evotec AG; CBS Research AG;

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BUY: The expected performance of the share price is above +10%.

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Recommendation history over the last 12 months for the company analysed in this report:

Date	Recommendation	Price at change date	Price target
11 November 2010	BUY (Company Update)	EUR 2.49	EUR 3.00
15 December 2010	BUY (Company Update)	EUR 2.85	EUR 3.20
17 January 2011	BUY (Company Update)	EUR 3.33	EUR 3.70
11 February 2011	BUY (Company Update)	EUR 3.25	EUR 3.70
10 March 2011	BUY (Company Update)	EUR 3.00	EUR 3.70

24 March 2011	BUY (Company Update)	EUR 2.94	EUR 3.70
13 May 2011	BUY (Company Update)	EUR 3.00	EUR 3.70
14 June 2011	BUY (Company Update)	EUR 2.71	EUR 3.60
11 August 2011	BUY (Company Update)	EUR 1.74	EUR 3.60
12 September 2011	BUY (Company Update)	EUR 2.28	EUR 3.60
27 October 2011	BUY (Company Update)	EUR 2.38	EUR 3.60
11 November 2011	BUY (Company Update)	EUR 2.59	EUR 3.60

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