

12 May 2010

Evotec

Year End	Revenue (€m)	PBT* (€m)	EPS* (c)	DPS (c)	P/E (x)	Yield (%)
12/08	39.6	(47.7)	(53.0)	0.0	N/A	N/A
12/09	42.7	(21.7)	(21.2)	0.0	N/A	N/A
12/10e	50.1	(1.9)	(2.3)	0.0	N/A	N/A
12/11e	57.7	0.0	(0.3)	0.0	N/A	N/A

Note: *PBT and EPS are normalised, excluding goodwill amortisation and exceptional items.

Investment summary: A sustainable biotech

Evotec has refocused its efforts on building the drug alliance business while cutting costs since Werner Lanthaler became CEO in March 2009. By 2012 the company should have gained the critical mass required to allow it to invest in its own pipeline or extend its service offering. The current share price is largely supported by its drug discovery services, implying that there is limited downside risk if its pipeline experiences setbacks, but considerable upside if there are successes.

Restructuring programme delivering results

The aim of the restructuring programme is to build revenues and reduce costs at the same time. In its first year it has already reduced R&D by 51%, SG&A by 16% and reduced the operating cash burn rate by 53% to €19.9m. Evotec was also successful in signing three new collaborations, extending two existing ones during H209 and it has just entered a major alliance with Genentech.

Achieving critical mass

Evotec has continued its investment in innovation and in developing its capacity so that it can maintain its revenue growth. The forecast increase in sales would enable it to lever its central administrative and sales expenses and enable the company to fund fully its investment in its proprietary portfolio in a sustainable manner from 2012.

Roche option on EVT 101/103

Evotec's most promising product in its young portfolio is the EVT 100 family of drugs, which are being developed for treatment resistant depression. Roche has an option to in-license the products after EVT 101 has completed its first Phase II trial (mid 2011) for \$65m.

Valuation: €298m based on DCF calculation

Our DCF valuation indicates that the drug alliance business is worth €144m, EVT 101/103 are worth €100m and the company has net cash of €54m.

Price €1.90
Market Cap €207m

Share price graph



Share details

Code EVT
Listing Frankfurt, Prime Standard
Sector Pharmaceuticals & Biotech
Shares in issue 108.8m

Price

52 week High Low
€2.45 €0.62

Balance Sheet as at March 2010

Debt/Equity (%) N/A
NAV per share (€) 1.03
Net cash (€m) 54.1

Business

Evotec is a drug discovery business that provides outsourcing solutions to the pharmaceutical industry and develops its own proprietary drugs.

Valuation

	2009	2010e	2011e
P/E relative	N/A	N/A	N/A
P/CF	N/A	N/A	N/A
EV/Sales	3.4	2.9	2.6
ROE	N/A	N/A	N/A

Revenues by geography

	Europe	US	Other
N/A	N/A	N/A	N/A

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Investment summary: A sustainable biotech

Company description: A drug discovery company

Evotec is a German drug discovery company that provides services to the pharmaceutical industry and develops its own drugs. It was founded in 1993 and employs 485 people. It can undertake all parts of the drug discovery process but does not have a proprietary target identification system. The company has just undergone a major restructuring programme to reduce costs and focus more on the services it offers pharmaceutical companies to drive revenue growth. This growth is being helped by the current strategy of many large companies to outsource more of their drug discovery. Evotec is aiming to have expanded its service division sufficiently from 2012 so that it can fund the development of its proprietary pipeline in a sustainable manner. Its most promising drugs are EVT 101/103 for treatment-resistant depression (Phase II).

Valuation

We value Evotec at €298m, based on a discounted cashflow (DCF) valuation (drug alliance business: €144m; EVT 101/103: €100m; and net cash: €54m), compared to the current market cap of €207m.

Based on this valuation and sales multiples, the current valuation is largely supported by the company's cash position and the value of its drug discovery business. This suggests that there is limited downside associated with setbacks with its proprietary pipeline and considerable upside should Evotec be successful in out-licensing products or advancing them through clinical development.

Sensitivities

Unlike most biotech companies, Evotec is not heavily exposed to the outcome of clinical trials because of the early stage of the pipeline and its diversity. It is more sensitive to factors that affect its drug alliance business, which include:

- the outsourcing strategy of the pharmaceutical companies,
- Evotec's rate of innovation so that it can maintain its competitive advantage,
- the pharmaceutical industry's preference for working with companies that offer a high quality integrated service, and
- sustaining its strong reputation as a leading provider of drug discovery solutions.

Financials

Evotec's restructuring programme combined with its focus on revenue growth is expected to enable the company to fund its proprietary drug discovery in a sustainable manner from 2012. We are forecasting that Evotec will maintain its industry leading gross margin of 43%, but reduce its SG&A expense as a proportion of revenues from 50% in 2008 to 26% in 2012.

The company is in a strong financial position with net cash of €54.1m (including €9.7m in auction rate securities and €3.0m of non-current cash equivalents), and has the financial flexibility to invest in its own pipeline or pursue an M&A strategy.

Company description: A drug discovery company

Evotec's investment case depends on the continued strong growth of its drug alliance business and the progress of its proprietary pipeline. The growth of the service business is necessary so that the company has the critical mass to fund its own drug discovery and the extension of its service offering without needing to raise additional capital. Evotec has a broad but early portfolio of products. Its most promising products are for treatment-resistant depression (which Roche has an option on).

Evotec was founded in 1993 by a group of eminent German scientists, including the Nobel Laureate Professor Manfred Eigen. It is based in Hamburg and provides drug discovery services to the pharmaceutical business. It expanded its offering through internal development (eg the high-throughput screening system, the EVOscreen, launched in 2000) and by acquisition (eg Oxford Asymmetry International in 2000). This has led to it entering many collaborations with companies such as Boehringer Ingelheim and Roche.

In 2006, Evotec made a strategic shift towards focusing more on drug discovery, which led to it selling in 2007 its 89% interest in its instrumentation and software division to Perkin Elmer for €24m, and its active pharmaceutical ingredient division to Aptuit for €43m. In the same year it announced the acquisition of Renovis in a stock transaction for \$152m to obtain a portfolio of products in clinical development.

However, this approach has been adjusted following Jörg Aldag's resignation as CEO in December 2008 after 11 years in the position, and Werner Lanthaler's appointment in March 2009. The new strategy that is currently being implemented is called "Evotec 2012 – Action Plan to Focus and Grow" and aims to make the company sustainably profitable by 2012.

To achieve this goal, Evotec is refocusing its efforts on growing its service division, the drug alliance business, to achieve critical mass while implementing a number of cost cutting measures so that it generates sufficient profits to support its proprietary drug discovery. Last year it closed the facility that it acquired with Renovis in San Francisco, which contributed to it reducing its R&D expense by 51% and also reduced its SG&A expense by 16%; it had been targeting reductions of over 30% and 10% respectively (some of the extra R&D saving was because of EVT 302 failing its Phase II trial). At the same time it has developed the range of capabilities that it can offer its partners, most notably it has:

- extended its ability to identify drugs that interact with ion channels through internal development;
- bought the zebrafish screening platform from Summit Corporation; and
- acquired a controlling stake in an Indian drug service company, RSIPL, to increase its capacity significantly and to provide it with a low-cost capability.

These initiatives appear to be reaping rewards as revenues excluding milestone payments grew 23% in 2009; Evotec also announced during H209 three new collaborations (with Alios Biopharma, Biogen Idec and Cubist) and the extension of two others (with Boehringer Ingelheim and Ono). In May 2010, it entered a multi-year alliance with Genentech to identify novel CNS small molecule therapeutics that it describes as being one of its largest alliances.

Discovery Alliance Business

Evotec has a proven track record in discovering new chemical entities that target novel proteins, having identified over 100 lead compounds, 20 preclinical drugs and 15 clinical compounds. It has particular expertise in:

- assay development and screening,
- fragment-based drug discovery,
- medicinal chemistry, and
- ADMET (absorption, distribution, metabolism, excretion and toxicology assays) including its proprietary zebrafish screening.

A list of Evotec's main drug development partnerships are detailed in Exhibit 1. Its leading client in 2009, Boehringer Ingelheim, generated c 20% of total revenues. It is aiming to reduce its dependence on any one client slightly to 15-20% of total revenues with four to six core clients, and to enter more collaborations with clients rather than fee-for-service relationships.

Exhibit 1: Evotec's main collaboration partners

Partner	Value	Indications	Notes
Biogen Idec	N/A	N/A	Partnership started in September 2009 to identify compounds against a specified target, with the option of further targets being added at a later date.
Boehringer Ingelheim	€15m over four years + milestones + royalties	CNS, inflammation, cardiometabolic, respiratory and oncology	Collaboration commenced in September 2004 with a three-year contract to identify GPCR modulators to treat CNS diseases. The initial agreement has been extended on three occasions, with the latest extension in November 2009. Seven milestone payments have been received to date with the first one nine months after the collaboration started.
CHDI	Up to \$37.5m over three years	Huntingdon's disease	CHDI is a not-for-profit organisation that is attempting to develop new therapies using an outsourcing approach. It also has collaborations with Galapagos, AMRI and Vertex. The partnership was initiated in March 2006 and was extended in February 2008 in a deal worth up to \$37m; this was extended further in January 2008 and again in January 2010.
Cubist	N/A	Anti-bacterial	Collaboration initiated in July 2009 to support two of Cubist's projects, and was extended in February 2010 for it to continue until the end of 2010.
Genentech	N/A	CNS	The multi-year alliance started in May 2010, one of Evotec's largest alliances.
InterMune	N/A	N/A	Collaboration began in early 2007 with Evotec using a broad range of its drug discovery capabilities.
Ono	N/A	Protease and ion channels targets	The partnership began in March 2008 with protease targets and was extended in October 2009 for ion channel targets. In December 2009, a milestone was achieved for progression into lead optimisation.
Novartis	Milestones of >\$28m + royalties	N/A	Evotec is responsible for identifying drugs against a nominated target until they are ready for pre-clinical testing, after which Novartis will continue the development. The deal was initiated in December 2008 and is due to be completed in three years. The agreement could be expanded to include a second target.
Pfizer	Milestones of \$170m + double-digit royalties	Analgesia	The initial agreement was signed in May 2005 with Renovis, which Evotec bought in 2007. There are combined research teams working on developing treatments to relieve pain by targeting the ion channel, VR1 (vanilloid receptor 1).
Roche	>€200m in milestones + royalties	CNS and other indications	In June 2006 it was announced that a global alliance was formed to discover novel drugs; this is the continuation of the long-running relationship between the two companies that began in June 2001. Roche also has an option on the EVT 100 family of products for treatment-resistant depression.
Spermatech	N/A	Contraception	Partnership began in March 2008. High throughput screening with Evotec's 250,000 drug-like compounds to identify compounds that inhibit a sperm-specific target protein, for non-hormonal reversible contraception.
Vifor	>€5.5m	Anaemia	In February 2010, Evotec agreed to identify a preclinical candidate for the treatment of anaemia within an agreed budget.

Source: Edison Investment Research

Its main therapeutic areas of focus are central nervous system (CNS) disorders, inflammation, oncology and metabolic diseases. Many of the individual processes of drug discovery are

becoming commoditised, but importantly Evotec can deliver an integrated drug discovery service to the standards required by the major pharmaceutical companies. This accelerates the drug development process to extend effectively a product's life span and makes it less onerous for its partner process, which is why Evotec is able to charge more than some of its competitors.

Pipeline

Evotec currently has four products in clinical development, including a backup compound, as indicated in Exhibit 2. It also has an H3 receptor antagonist in preclinical development for the treatment of cognition and narcolepsy (a grant of up to €1.5m has just been awarded to Evotec to advance the programme into the clinic) and three other compounds for the alleviation of pain and for autoimmune diseases.

The company's main focus is on CNS indications. It is also following a pragmatic approach to drug development and only proceeding with compounds that have received commercial validation from a third party to limit its risk exposure. It has, for example, put the clinical development of EVT 201 for insomnia on hold because it cannot find a partner and is unwilling to fund the size of trial that would be required in Phase III despite promising Phase II data. Similarly, it has a flexible out-licensing approach and aims to out-license products at various stages of development depending on:

- the level of investment a drug needs,
- the other projects that need funding,
- the risk associated with a product,
- the potential of Evotec to increase significantly the value to a product, and
- the amount a partner is willing to pay for the drug.

This approach means that there will be increased earnings volatility as Evotec focuses on long-term value creation, but that the future of the company is unlikely to be dependent on the success on any one clinical trial.

Exhibit 2: Clinical R&D pipeline

Product	Development stage	Indication / Partner	Notes
EVT 101/103	Phase II	Treatment resistant depression /Roche	NR2B-selective NMDA antagonists, originally discovered by Roche. EVT 103 is a back-up compound or for other CNS indications. Roche bought option for \$10m to buy-back the rights to EVT 100 family at end of Phase II for \$65m, funding current development programmes. Milestones worth over \$235m, escalating double-digit royalties. Evotec completing Phase II PoC trial for EVT 101, completion expected mid 2011 (FDA approved for trial to start Q209). Successfully completed Phase I trial with EVT 103 (72 healthy males, with single and multiple dosing, safe and well tolerated).
EVT 401	Completed Phase I	Rheumatoid arthritis, inflammatory diseases	Antagonist of P2X ₇ ATP-gated ion channel, thought to be involved in the inflammatory process. Phase I trial: 96 healthy males with ascending doses, no serious adverse events or withdrawals occurred. A pharmacodynamic assay demonstrated that EVT 401 blocked ATP-stimulated IL-1 β release in whole blood samples taken from the volunteers. Drug being reformulated for Phase II study at start of 2011.
EVT 302	Phase II	Alzheimer's disease	Monoamine oxidase-B (MAO-B) inhibitor, discovered by Renovis, initially being developed for smoking cessation, but in April 2009 it announced that it had failed to demonstrate any benefit over nicotine replacement therapy alone in a PoC Phase II study. It is now being developed for Alzheimer's disease, but the company is looking for a partner to continue its development.
EVT 201	Completed Phase II	Insomnia	GABA(A) receptor modulator, shown efficacy in two Phase II trials. In one trial, 75 adults, doses 1.5mg and 2.5mg, both primary endpoints met with increased total sleep time (TST, 33.1, 45.0 min; both p<0.0001) and reduced wake after sleep onset (-16.7, -25.7 min; p<0.0001) in a dose responsive manner. In second trial, 149 elderly pts, doses 1.5mg and 2.5mg, TST increased (30.9, 56.4min; p=0.0001, p<0.0001). No serious or unexpected adverse events. Further development on hold until partnered.

Source: Edison Investment Research

Management

Werner Lanthaler was appointed CEO in March 2009 and has already had a beneficial influence on the company. At the time of his appointment there was some concern that Evotec would have to come to the market to raise capital because its operating cash flow in 2008 was -€41.3m although it had net cash of €81.8m. He rapidly developed and started to implement a restructuring plan that has already delivered a profitable quarter before restructuring charges, largely because of major cost cutting. At the same time he increased the prospect of strong revenue growth through additional collaboration and by raising capacity by increasing headcount by c 200 people. This has led to Evotec being named M&A Advisor Global Healthcare Turnaround Company of the Year.

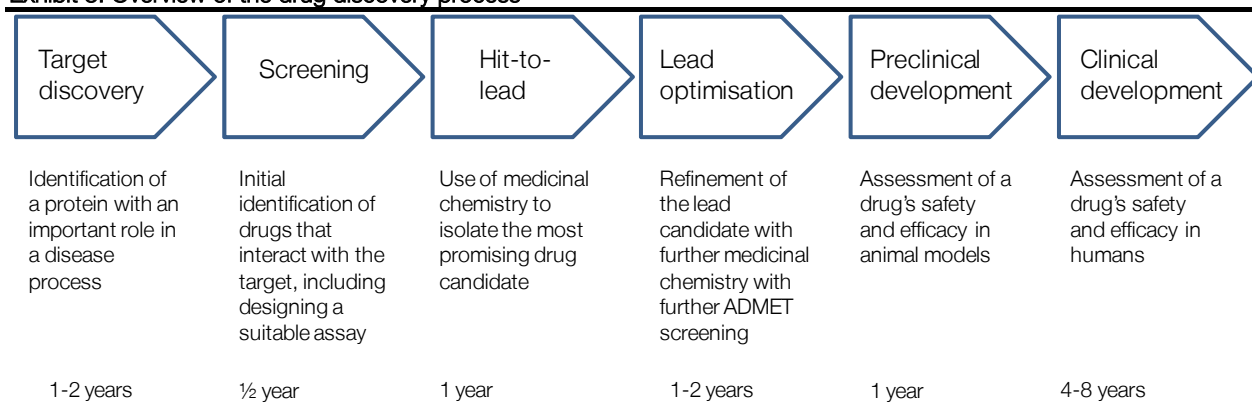
Evotec should also benefit from the experience of Mr Lanthaler and Dr Klaus Maleck, CFO who have both taken products to market and understand the challenges of negotiating the regulatory system. During Mr Lanthaler's eight years as CFO at Intercell he was involved with taking its Japanese encephalitis vaccine through clinical trials and gaining market approval for the product. While Dr Maleck was CFO and vice president of business development at Bio-Generix he helped take products to market.

Drug discovery industry

Pharmaceutical companies are outsourcing their drug discovery activities as they look to improve their productivity and decrease the fixed costs associated with them. This is driving the growth of the drug discovery industry, however not all companies are benefiting so far because of over capacity and competition in the market.

The drug discovery process is summarised in Exhibit 3. It takes on average six years to get a product into clinical development from the start of the process. Companies such as Evotec enable pharmaceutical companies to outsource the process, so that they can convert some of their R&D spending into a variable cost, and have a more flexible approach to drug discovery and there is also the prospect that they can save costs and have the process accelerated. The pharmaceutical industry is in the process of increasing its outsourcing of drug discovery. For example GlaxoSmithKline announced in February 2010 that it was going to reduce its R&D spend on fixed infrastructure by a third, increase its collaborations so that the number of drugs originating from inside the company falls from c 70% to around 50% to help it improve the productivity of its drug discovery and save c £250m pa by 2014. It is estimated that only 9% of drug discovery activities were outsourced in 2008; this indicates that there is considerable scope for companies to outsource more of their drug discovery activities and drive strong revenue growth among those companies providing the services.

The leading providers of integrated drug discovery services are listed in Exhibit 4. There are also other companies such as Parexel, Charles River Laboratories and many Chinese and Indian clinical research companies, but these companies tend offer specific services rather provide a complete integrated solution that does not require continual direction from a pharmaceutical company.

Exhibit 3: Overview of the drug discovery process

Source: Edison Investment Research

Although there is strong growth in the outsourcing of drug discovery activities, some areas of the process have increased supply ahead of the rise in demand. Charles River suspended the operations at one of its preclinical services division in Massachusetts, and Exhibit 4 shows that AMRI and Cerep saw their revenues fall in 2009 by 14% and 15% respectively.

Exhibit 4: Competitor analysis

Companies	Location	Revenues in 2009 (€m)	Revenue growth in 2009	Gross margin	Notes
Evotec	Germany, UK, India	42.7	8%	43%	
BioFocus	UK, The Netherlands, Switzerland, the US	56.5	6%	39%	Part of Galapagos NV
WuXi Pharmatech	US, China	194.1	7%	40%	Sales of US services division increased 2% to €46.1m. Being acquired by Charles River Laboratories for €1.6bn.
AMRI	US, UK, Hungary, Singapore, India	141.2	(14%)	29%	
Cerep	France, US, Japan, China	26.2	(15%)	N/A	
Argenta	UK	14.1	8%	41%	Acquired by Galapagos NV in February 2010 for €16.5m.

Source: Edison Investment Research

Growth prospects

The success of Evotec's drug discovery alliance business depends on the relationships it has with its clients and the high quality integrated service that it provides. Its size and geographic footprint mean that it cannot compete on price against larger competitors who have their main operations in China and India (WuXi was achieving gross margins of c 50% before it opened its US operation).

Evotec's reputation, its track record of developing drugs and its European base enable it to maintain its relationships in the pharmaceutical industry. Similarly, its operating standards and quality of decision making mean that Evotec is one of few drug discovery businesses with which pharmaceutical companies can execute a comprehensive outsourcing strategy (Evotec is able to undertake all parts of the drug discovery process with the exception of target discovery). The value of these attributes is demonstrated by the deepening collaborations, and initiations of new ones with sustained gross margins ahead of its western peers.

We expect this trend to continue given the momentum the business is enjoying with its strongest February order book (February's sales and order book is 17% higher in 2010 than 2009 at €28m),

Q110 revenues have grown 19.5% and the conservatism of the pharmaceutical industry. The industry is going through a considerable amount of change but is still inherently cautious. It is thus willing to pay a premium to work with partners with a proven track record, experience of the industry's demands and that operate in countries that it is more used to working in, especially if there is the prospect of the drug discovery process occurring at a faster rate.

To sustain its growth, Evotec needs to evolve continuously so that it does not just provide commodity drug discovery solutions that can be provided more cheaply in China and India. Despite the focus on cost cutting in 2009, the company has continued to invest in the future and in May 2009 it bought a zebrafish platform to help identify potential toxicity issues of novel drugs.

Similarly it has expanded its capacity by acquiring 70%, with a call option on the remaining 30%, of Indian drug discovery company RSIP, which employs 147 people (30% of Evotec's workforce). As well as significantly increasing Evotec's growth potential, this acquisition gives the company a low cost facility so that it can keep its pricing competitive while maintaining its margins.

Pipeline

The growth of its core drug discovery business should be supplemented by its proprietary drug pipeline, which is close to being funded in a sustainable manner. Last year it had a few setbacks, most notably when EVT 302 failed to demonstrate efficacy in smoking cessation in a Phase II trial, and when it was unable to out-license EVT 201 for the treatment of insomnia despite promising Phase II data. But it still has five products in clinical development and four others that should enter the clinic over the next few years.

Its most promising products are EVT 101 and EVT 103 for treatment-resistant depression (TRD). It is estimated that there are c 15m people in the US with major depressive disorder (MDD) and that c 30% do not respond to at least two antidepressants, normally selective serotonin reuptake inhibitors (SSRI) or serotonin norepinephrine reuptake inhibitors (SNRI). People with TRD are then treated with tricyclic antidepressants (TCA), monoamine oxidase inhibitors (MAOI) or electroconvulsive therapy (ECT), but there remains a significant unmet medical need for new methods to treat TRD and few treatments are in development. The only clinical trials currently underway for its treatment are being run by Eli Lilly, investigating the combination therapy of olanzapine and fluoxetine (Phase III) and by AstraZeneca with AZD6765 (Phase II); Evotec is expected to start its Phase II trial with EVT 101 in Q210. The EVT 100 family of drugs are NMDA (N-methyl-D-aspartic-acid) receptor antagonists and offer a novel method of treatment for TRD.

Roche will decide at the end of the Phase II PoC trial whether or not to exercise the option on the drug family. If the option is exercised, Evotec would receive \$65m, and Roche might decide to do so even with unconvincing Phase II data because both EVT 101 and EVT 103 have demonstrated favourable safety profiles in Phase I and they can be developed for indications other than TRD, such as schizophrenia or Alzheimer's disease.

We forecast that EVT 101 could generate peak sales of \$2.7bn in TRD.

EVT 401 also has potential, as there would be considerable demand for an oral drug for rheumatoid arthritis if it can demonstrate similar efficacy to the injectable drugs such as etanercept (Enbrel), which generated sales of \$1.18bn in 2009 for Amgen and Pfizer.

Valuation

Our valuation of €298m suggests that the current market cap of €207m is largely supported by its drug discovery business and net cash position, with significant upside available should its proprietary pipeline develop valuable drugs.

DCF valuation

We value Evotec's drug discovery business excluding R&D at €144m by DCF (WACC=10%, terminal growth=2.5%); the EVT 100 family at €100m using a risk-adjusted DCF (WACC=12.5%, 50% probability of Roche exercising option and 15% probability of subsequent milestones and royalties at a 12% rate; the value associated with Roche exercising its option is €21m). It has net cash (including auction rate securities) of €54m and we assume that the rest of the pipeline, including EVT 401, will offset the costs associated with R&D. This implies a fair valuation of €298m for Evotec.

Relative valuation

Evotec's sales multiple compared to those of its peers shows that Evotec is trading near to WuXi Pharmatech, before Charles River Laboratories announced that it was going to acquire it, and significantly ahead of some of its peers (Exhibit 5). We believe this is justified because of Evotec's strong revenue growth and high gross margin (Exhibit 4) before taking into account its drug pipeline. Unfortunately other relative valuation techniques cannot be used because Evotec is not currently profitable at the EBITDA level or below. The acquisition of WuXi Pharmatech for a 40% premium also suggests that the industry values drug discovery companies more highly than the market.

Exhibit 5: Peer analysis

Note: * Valuation of WuXi Pharmatech before announcement of acquisition by Charles River Laboratories.

	Market cap (€)	Enterprise value (€)	EV/sales 2009	EV/sales 2010
Evotec	207	149	3.5	3.0
Albany Molecular Research Inc	181	106	0.7	0.7
Cerep	21	21	0.8	0.7
Galapagos	260	212	2.0	1.7
WuXi Pharmatech*	881	858	4.1	3.5
Average			2.2	1.9

Source: Edison Investment Research

Sensitivities

Evotec's risk profile is considerably lower than that of most companies in the biotechnology sector and while its products are at early stages of development or on hold there is limited risk associated with the outcome of clinical trials. Instead the main issues that affect the investment case are regarding Evotec's ability to grow revenues and to keep control of its cost structure, including:

- **Strategy of the major pharmaceutical companies:** The current vogue among the large pharmaceutical companies is to enter into more collaborations to diversify their drug discovery attempts and to reduce fixed costs. However, the rate at which the industry will increase its use of outsourcing and the level at which it will stabilise is uncertain.

- **Innovation:** Evotec's competitive advantage is largely derived from its innovations that enable it to develop potentially better drugs, faster than other drug discovery companies. If it is unable to maintain this advantage, its rate of revenue growth and gross margin will decline; conversely, they could grow if the rate of innovation increases.
- **Geographic benefits:** Evotec is currently benefiting from being able to charge premium prices, in part because it is a western company; as the pharmaceutical industry increases its operations in China and India there might be greater price pressure.
- **Reputation:** Evotec has established a strong reputation for being a leading drug discovery company, which it has maintained throughout the recent challenging period.

Financials

The key to Evotec becoming a sustainably profitable company is the growth of its drug discovery business to achieve critical mass. The restructuring programme has already made Evotec a lean company and Exhibit 4 demonstrates that it is achieving industry-leading gross margins. Therefore the only way the company can significantly improve its profitability is by growing revenues so that it benefits from scale economies. These can be primarily achieved at the SG&A level as central administrative expenses are spread across a broader revenue base and as the company develops deeper collaborations that require a lower level of marketing to be sustained as a proportion of revenues.

Over the next two years we are expecting revenues to grow at 17.5% and 15% respectively (the February sales and order book was 17% ahead of last year) and SG&A to fall 9.5% in 2010 because of the restructuring in 2009 and then to start rising at 6% pa. The impact of these assumptions on the adjusted operating profit before R&D is shown in Exhibit 6.

Exhibit 6: Selected lines from the income statement

Note: Adj operating profit before R&D excludes amortisation and restructuring costs.

	€'000s	2008	2009	2010e	2011e	2012e
Revenue		39,613	42,683	50,142	57,663	66,312
Revenue growth		20.5%	7.7%	17.5%	15.0%	15.0%
Gross margin		44.5%	43.2%	43.0%	43.0%	43.0%
SG&A		(19,950)	(16,695)	(14,464)	(15,332)	(16,252)
SG&A growth		12.0%	(16.3%)	(13.4%)	6.0%	6.0%
Adj. operating profit before R&D		(2,958)	1,335	6,740	9,175	11,976
Adj. operating margin before R&D		(7.5%)	3.1%	13.4%	15.9%	18.1%

Source: Edison Investment Research

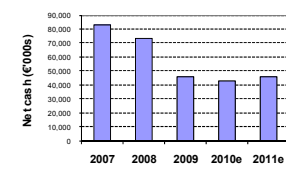
The company's restructuring programme has been so successful that it now has considerable financial flexibility. It ended 2009 with a net cash position (including €9.7m of auction rate securities and €3.0m of non-current cash equivalents) of €54.1m, and could become profitable immediately if it ceased R&D on its proprietary pipeline, well ahead of its target of 2012. This means that Evotec's management can now start to focus more on maximising the company's value by investing its resources in its pipeline or using M&A to acquire a technology or increase its client base.

Exhibit 7: Financial summary

Note: Net debt includes auction rate securities and non-current cash equivalents

	€'000s	2007	2008	2009	2010e	2011e	2012e
Year end 31 December		IFRS	IFRS	IFRS	IFRS	IFRS	IFRS
PROFIT & LOSS							
Revenue		32,885	39,613	42,683	50,142	57,663	66,312
Cost of Sales		(24,862)	(21,977)	(24,262)	(28,600)	(32,868)	(37,798)
Gross Profit		8,023	17,636	18,421	21,542	24,795	28,514
EBITDA		(40,271)	(40,689)	(15,547)	261	2,791	5,220
Operating Profit (before GW and except.)		(46,624)	(44,942)	(19,157)	(2,510)	(651)	1,895
Intangible Amortisation		(2,589)	(553)	(455)	(347)	(288)	(286)
Exceptionals/Other		(6,565)	(27,715)	(22,687)	0	0	0
Operating Profit		(55,778)	(73,210)	(42,299)	(2,857)	(940)	1,609
Net Interest		4,006	(2,760)	(2,520)	597	707	860
Other		36,392	0	0	0	0	0
Profit Before Tax (norm)		(42,618)	(47,702)	(21,677)	(1,914)	56	2,755
Profit Before Tax (FRS 3)		(15,380)	(75,970)	(44,819)	(2,261)	(232)	2,469
Tax		4,224	(2,317)	(678)	(252)	(519)	(597)
Deferred tax		4,643	(406)	(315)	126	(0)	(0)
Profit After Tax (norm)		(38,394)	(50,019)	(22,355)	(2,165)	(463)	2,158
Profit After Tax (FRS 3)		(6,513)	(78,693)	(45,812)	(2,386)	(751)	1,872
Average Number of Shares Outstanding (m)		71.8	95.2	106.8	108.1	108.8	108.8
EPS - normalised (c)		(53.5)	(52.5)	(20.9)	(2.0)	(0.4)	2.0
EPS - FRS 3 (c)		(9.1)	(82.7)	(42.9)	(2.2)	(0.7)	1.7
Dividend per share (c)		0.0	0.0	0.0	0.0	0.0	0.0
Gross Margin (%)		24.4	44.5	43.2	43.0	43.0	43.0
EBITDA Margin (%)		N/A	N/A	N/A	0.5	4.8	7.9
Operating Margin (before GW and except.) (%)		N/A	N/A	N/A	N/A	N/A	N/A
BALANCE SHEET							
Fixed Assets		96,037	89,822	77,642	77,036	75,612	74,652
Intangible Assets		76,399	60,455	45,567	45,841	45,553	45,266
Tangible Assets		18,561	18,468	19,162	17,763	16,627	15,954
Other		1,077	10,899	12,913	13,432	13,432	13,432
Current Assets		111,841	93,078	68,957	68,698	72,232	78,191
Stocks		2,394	2,139	2,425	3,134	3,602	4,142
Debtors		5,137	2,531	4,510	4,121	4,739	5,450
Cash		93,676	84,098	58,358	55,525	57,974	62,682
Other		10,634	4,310	3,664	5,917	5,917	5,917
Current Liabilities		(24,337)	(21,826)	(26,445)	(24,927)	(25,991)	(28,500)
Creditors		(23,040)	(19,247)	(17,358)	(15,840)	(17,661)	(20,170)
Short term borrowings		(1,297)	(2,579)	(9,087)	(9,087)	(8,330)	(8,330)
Long Term Liabilities		(12,988)	(11,215)	(8,667)	(7,655)	(7,846)	(8,066)
Long term borrowings		(9,125)	(8,047)	(3,757)	(3,616)	(3,616)	(3,616)
Other long term liabilities		(3,863)	(3,168)	(4,910)	(4,039)	(4,230)	(4,450)
Net Assets		170,553	149,859	111,487	113,152	114,006	116,278
CASH FLOW							
Operating Cash Flow		(32,726)	(42,562)	(19,915)	(1,514)	6,110	7,593
Net Interest		1,590	2,116	(29)	(84)	(100)	(68)
Tax		(536)	(832)	(1,909)	(425)	(498)	(164)
Capex		(4,349)	(3,447)	(1,893)	(1,907)	(2,307)	(2,652)
Acquisitions/disposals		42,245	29,943	0	0	0	0
Financing		(1,566)	13,303	391	(44)	0	0
Dividends		0	0	0	0	0	0
Net Cash Flow		4,658	(1,479)	(23,355)	(3,974)	3,206	4,708
Opening net debt/(cash)		(69,841)	(83,254)	(81,775)	(57,750)	(55,605)	(58,811)
HP finance leases initiated		0	0	0	0	0	0
Other		8,755	0	(670)	1,829	(0)	0
Closing net debt/(cash)		(83,254)	(81,775)	(57,750)	(55,605)	(58,811)	(63,519)

Source: Edison Investment Research, Evotec accounts

Growth	Profitability	Balance sheet strength	Sensitivities evaluation	
N/A	N/A		Litigation/regulatory	■
			Pensions	○
			Currency	■
			Stock overhang	○
			Interest rates	○
			Oil/commodity prices	○

Growth metrics	%	Profitability metrics	%	Balance sheet metrics		Company details	
EPS CAGR 07-11e	N/A	ROCE 10e	N/A	Gearing 10e	N/A	Address:	
EPS CAGR 09-11e	N/A	Avg ROCE 07-11e	N/A	Interest cover 10e	N/A	Schnackenburgallee 114	
EBITDA CAGR 07-11e	N/A	ROE 10e	N/A	CA/CL 10e	2.8	22525 Hamburg	
EBITDA CAGR 09-11e	N/A	Gross margin 10e	43.0	Stock turn 10e	22.8	Phone	+49(0)40 560 810
Sales CAGR 07-11e	15.1	Operating margin 10e	N/A	Debtor days 10e	30.0	Fax	+49(0)40 560 812
Sales CAGR 09-11e	16.2	Gr mgn / Op mgn 10e	N/A	Creditor days 10e	51.3	www.evotec.com	

Principal shareholders		%	Management team	
Roland Oetker		11.1	CEO: Dr Werner Lanthaler	
TVM Capital		6.4	Dr Werner Lanthaler became CEO in March 2009, having been CFO of Intercell for the previous eight years. Between 1995 and 1998 he was a senior consultant at McKinsey & Co. He holds a doctorate in economics from Vienna University.	
Dimensional Fund Advisors		2.0		
LBBW Asset Management		1.4		
Adamant Biomedical Inv.		0.9		
			CFO: Dr Klaus Maleck	
			Dr Klaus Maleck joined Evotec in 2007 from Bio-Generix which he co-founded in 2000. Beforehand, he worked at McKinsey & Co and at Novartis as a genomics scientist. He holds a doctorate in biochemistry from the Max-Planck-Institute in Cologne.	
Forthcoming announcements/catalysts		Date		
AGM		10 June 2010		
Q210 Results		12 August 2010	Chairman: Dr Flemming Ornskov	
Q310 Results		11 November 2010	Dr Flemming Ornskov became chairman of the supervisory board in August 2008. He was global president of Pharmaceuticals at Bausch & Lomb, CEO and president at LifeCycle Pharma and at Ikaria. He has also worked at Novartis and Merck & Co.	
Companies named in this report				
Albany Molecular Research Inc, Cerep, Galapagos, WuXi Pharmatech				

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