

BIOTECHNOLOGY

A Research Publication by DZ BANK AG

Evotec⁵⁾⁶⁾

Reuters: EVTG.DE

Bloomberg: EVT GY

Year *	Sales		Adj. IFRS-Earnings per sh.		Cash flow per share		PER	PCF	Dividend per share
	EUR m		EUR		EUR				
2009	42.7	(40.8)	-0.48	(-0.37)	-0.43	(-0.33)	-	-	0.00
2010e	49.1	(46.9)	-0.04	(-0.11)	0.02	(-0.07)	-	106.5	0.00
2011e	56.4	(54.0)	-0.01	(-0.05)	0.04	(-0.01)	-	53.1	0.00
2012e	64.9	(-)	0.01	(-)	0.06	(-)	185.6	34.1	0.00

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

15% growth and profitable in 2012 at the latest

- Results:** revenues of the Evotec group have increased by 8% to EUR 42.7m (2008: EUR 39.6m), although only EUR 4.0m of milestone payments have been received in 2009 (2008: EUR 8.5m). Since expenditure has also declined (R&D costs: -51% to EUR 20.9m, sales and administration costs: -16% to EUR 16.7m), Evotec's operating loss before extraordinary expenditure for the 2009 financial year has fallen by 57% to EUR 19.6m (2008: EUR 45.5m).
- In the fourth quarter** earnings would have been positive for the first time with EUR 2.0m (2008: EUR -10.4m) if extraordinary factors and write-down's were excluded.
- Impairments:** EUR 18.2m have been booked for the company's own risky development programmes EVT 201, EVT 401 and VR1. Including all impairments and EUR 4.8m of restructuring costs, Evotec's operating loss was reduced by 42% to EUR 42.3m in 2009 (2008: EUR 73.2m).
- Outlook:** sales growth of at least 15% (DZ BANKe: EUR 49.1m), R&D expenditure of around EUR10m (DZ BANKe: EUR 10.5m), significant improvement in operating profit before provisions, with profitability to be reached at the latest in 2012, liquidity of >EUR 64m.

The restructuring plan "Evotec 2012 – Plan to focus and grow" is already bearing fruit and, together with targeted growth of 15%, should help to achieve sustained profitability from 2012 at the latest. We expect positive news from the company already in the first half of 2009 from the conclusion of additional research alliances and the start of the Phase II trial of EVT101. In a mix of methods (DCF-valuation and pipeline evaluation) we derive the new fair value of EUR 2.80 (before: EUR 2.40) with a Buy recommendation.

Selected Companies	Price on 30 Mar 2010	PER		EV / EBITDA		EV / Sales 10e	Re-com.
		10e	11e	10e	11e		
Evotec	2.00 EUR	-	-	115.2	45.3	3.53	↑
Galapagos Genomics	11.34 EUR	46.3	16.9	16.9	7.3	1.87	-
WuXi Pharmatech	15.51 USD	18.6	15.8	9.8	7.6	2.94	-
MediGene	3.38 EUR	86.8	-	34.9	-	2.33	↑
MorphoSys	16.71 EUR	53.1	34.1	18.1	11.7	2.64	↑
Median for all peer group companies		41.1	22.0	16.9	11.7	4.60	-

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

EQUITIES

Flash
31 Mar 2010

Buy (prev. Buy)

Closing price 30 Mar 2010

(in EUR): 2.00

Fair value: 2.80 (prev. 2.40)

Risk classification: 5

Financial ratios 2010e:

Book value per share (in EUR): 0.99
Equity ratio (in %): 74.6
Net margin (in %): -6.8
ROE (in %): -3.1
Dividend yield (in %): 0.0
Free cash flow (EUR m): 2.0
Net debt (EUR m): -45.4

Number of shares

(million units): 108.9

Market cap

(in EUR m): 217.99

Free float (in %): 82.5

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DZ BANK
Bank on Germany

15% GROWTH AND PROFITABLE IN 2012 AT THE LATEST

Trend in operating business

Based on the 2012 action plan, Evotec decided in March 2009 to strengthen research alliances and use them as key drivers for strategic growth and to implement stringent cost-saving and restructuring measures.

Within the framework of the action plan, the number of employees in administration and clinical development has been reduced and the main focus of the company's research and development activities has been redefined. Total number of employees was reduced from 418 to 325. With the acquisition of the zebra fish business (13 employees) and the company Indian Research Support International Private Limited (RSIPL) with 147 employees, the total number at year end comes to 485.

The impact of the action plan is already evident in the results for the 2009 financial year: sales at the Evotec group increased by 8% to EUR 42.7m (2008: EUR 39.6m) despite smaller milestone payments (EUR 4.0m compared to EUR 8.5m in 2008). As a result of the reduction in operating expenditure (R&D costs: -51% to EUR 20.9m) and selling and administrative costs: -16% to EUR 16.7m) Evotec's operating loss before extraordinary expenditure for the 2009 financial year declined by 57% to EUR 19.6m (2008: EUR 45.5m).

Including all provisions and EUR 4.8m of restructuring costs, Evotec's operating loss declined by 42% to EUR 42.3m in 2009 (2008: EUR 73.2m). Liquidity was around EUR 70.6m at year-end.

Fourth-quarter earnings would have been positive for the first time at EUR 2.0m (2008: EUR -10.4m) excluding extraordinary factors and writedowns. The greatest impact of Evotec's strategic restructuring was the 87% decline in R&D expenditure to EUR 1.4m (previous year: EUR 11.1mm) and the 50% reduction in selling and administrative costs to EUR 3.6m (EUR 7.1m).

EUR 18.2m of impairments have been booked over the year for higher-risk in-house development programmes (to a respective level of around EUR 1m) which Evotec has not yet been possible to transfer to partnerships with pharmaceutical companies. These include EVT 201 (sleeping pill, for which no partner has been found as yet), EVT 401 (autoimmune diseases) and the VR1 programme (pain, incontinence).

The EVT 101/103 development programme for which Roche AG is taking over the development costs and thus the risk in return for an option worth USD 65m is specifically excluded here. The potentially crucial Phase II trial for treatment-resistant depression is to commence here in the first half.

Research alliances

New contracts have been signed, for example with Cubist Pharmaceutical, Alios Biopharma and Biogen Idec, while other alliances have been extended, for example with Ono Pharmaceutical (new research project for an ion channel target) and the CHDI Foundation (after the end of the reporting period) to develop drugs for treating Huntington's disease.

Restructuring plan 2012

Reduction of workforce and redefinition

Impact of restructuring clearly visible

Operating loss reduced

Fourth quarter at least theoretically positive

Impairments for risky projects

Roche is shouldering risk of the EVT101/103 development projects

New research alliances and extension of existing alliances secure growth

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

Financial forecast for 2010

Based on an order backlog of around EUR 28m in February 2010 (2009: EUR 24m), likely new contracts and contract extensions plus the achievement of certain milestones, Evotec is forecasting sales growth of at least 15% (DZ BANKe: +15% to 49.1m), a significant improvement in operating profit before provisions with profitability to be reached at the latest in 2012. Provision of liquid funds will remain in excess of EUR 64m. We regard this guidance to be achievable.

Sales guidance seems achievable

Valuation

In our two-stage DCF model based on the entity method, we have discounted the free cash flow after tax using the company-specific, weighted, average cost of capital (WACC). The basis of the DCF valuation is the DZ BANK financial model shown in the Appendix.

DCF valuation based on the entity method

The DZ BANK financial model includes only sales and profits from the research alliances. Our DCF valuation does not include the value of drugs in development.

DCF includes expected profits from research alliances

With growth of 2% in continuous cash flow and WACC of 7.1 % our DCF model now shows an equity capital value of EUR 1.40 per share (before: EUR 1.00).

DCF value per share: EUR 1.40

Valuation of drugs at early stages of development

The model developed and revised by DZ BANK for valuing drugs undergoing development makes it possible to calculate both the risk-adjusted cash value of individual substances and also the total value of all substances in the clinical phase of development. This calculation is based on a risk-adjusted, phase-dependent DCF valuation.

DZ BANK pipeline valuation model

In our DZ BANK pipeline valuation model we value prioritised product developments from a certain level of maturity (i.e. clinical development): EVT101 (treatment-resistant depression), EVT401 (rheumatoid arthritis), both having completed Phase 1. Of the other two advanced projects EVT201 and 302, both of which have been reprioritised by the company either following setbacks during clinical development, or on the basis of the continuing absence of a partnership (EVT201), we have included only EVT302 in our current evaluation. We anticipate here the opportunity for development in the new indication of Alzheimer's based on the results of the completed Phase I trial.

Valuation of products from clinical development (exception EVT201)

- » We attribute a 14% probability of success to EVT101/103. This gives a rPV per share of EUR 0.7.
- » We expect an 18% probability of success for EVT401, giving a rPV per share of EUR 0.5.
- » We expect a probability of success of 20% for EVT302, giving a rPV per share of EUR 0.2.
- » **Overall we value the pipeline with an rPV of EUR 1.40 per share.**

Pipeline valuation gives EUR 1.40 per share

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OVERVIEW OF PIPELINE VALUATION

Product	Indication	Phase	Current rPV (EUR m)	rpV/share (EUR)	adj. probability of success
EVT101/103	Treatment-resistant depression	Phase I completed	75	0.69	14%
EVT401	Rheumatoid arthritis	Phase I completed	56	0.52	18%
EVT302	Alzheimer's disease	Phase I completed	14	0.2	20%
Grand Total			145	1.4	

Source: DZ BANK pipeline valuation model

Valuation overview:

The new fair value of the Evotec shares is based on the following components:

1. Based on our revised DVF model we have calculated a new fair value of EUR 1.40 per share (before: EUR 1.00).
2. We have calculated a figure of EUR 1.40 per share for the products EVT101, EVT401 and 302 respectively in or before clinical Phase II, as previously described.

DCF value: EUR 1.40 per share

Products under development: EUR 1.40 per share

The overall new fair value of the Evotec shares is thus EUR 2.80 (before: EUR 2.40).

Fair value: EUR 2.80 per share

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RATIOS

Euro	2009	2010e	2011e	2012e	2013e
Profit and loss ratios					
Sales (m)	42.7	49.1	56.4	64.9	73.0
EBITDA margin	-87.5%	3.1%	6.6%	10.0%	15.2%
EBIT margin	-99.1%	-7.4%	-2.4%	2.0%	8.0%
Net margin	-106.6%	-6.8%	-1.8%	1.8%	6.0%
Investment ratio	0.0%	1.4%	1.2%	1.1%	1.0%
R&D as % of sales	49.1%	21.4%	21.4%	23.0%	23.0%
Admin and sales costs as % of sales	39.1%	30.0%	28.0%	25.0%	24.0%
Net other operating costs as % of sales	54.1%	0.0%	0.0%	0.0%	0.0%
Net financial income as % of sales	-5.9%	0.6%	0.6%	0.6%	0.6%
Interest cover					
Average sales growth next five years	13.0%				
Average earnings growth next five years					
Profitability ratios					
ROE	-40.8%	-3.1%	-1.0%	1.1%	3.9%
ROCE	-73.1%	-6.8%	-2.8%	3.0%	15.2%
Productivity ratios					
Sales per employee ('000)	94.54	98.74	108.14	118.44	126.90
EBIT per employee ('000)	-93.69	-7.31	-2.60	2.37	10.15
Balance sheet ratios					
Equity ratio	76.0%	74.6%	73.5%	72.6%	72.4%
Long term debt and equity / Fixed assets	154.8%	159.6%	168.3%	182.8%	207.5%
Liquidity (quick ratio)	250.3%	244.0%	244.7%	252.0%	270.2%
Receivables as % of sales	10.6%	10.6%	10.6%	10.6%	10.6%
Investment (net of GW) / Depreciation		13.6%	13.7%	13.5%	13.4%
Working capital as % of sales	-16.1%	-14.7%	-13.5%	-12.4%	-11.6%
Net debt (m)	-44.0	-45.4	-49.2	-55.6	-65.9
Net debt complete (m)	-55.5	-56.9	-60.7	-67.1	-77.4
Figures per share					
Earnings per share, diluted	-0.48	-0.04	-0.01	0.01	0.04
Diluted cash earnings per share	-0.43	0.02	0.04	0.06	0.09
Dividend per common share	0.00	0.00	0.00	0.00	0.00
Cash per share, diluted	0.30	0.32	0.35	0.41	0.50
Net debt per share, diluted	-0.40	-0.42	-0.45	-0.51	-0.60
Valuation ratios					
Enterprise value / Sales	4.4	3.5	3.0	2.5	2.1
Enterprise value / EBITDA		115.2	45.3	25.3	13.8
Enterprise value / EBIT				125.9	26.2
EV/Sales to sales growth	0.34	0.27	0.23	0.19	0.16
PEG ratio - common shares					

Fiscal year end December

Source: Evotec and DZ BANK estimates

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

CASH FLOW STATEMENT

Euro m	2009	2010e	2011e	2012e	2013e
Operating profit (EBIT)	-42.3	-3.6	-1.4	1.3	5.8
Income taxes paid	-1.9	0.0	0.0	-0.1	-0.9
Depreciations/Reversals	0.0	5.1	5.1	5.2	5.2
Earnings from sale of assets	0.0	0.0	0.0	0.0	0.0
Change in non current provisions	0.0	0.0	0.0	0.0	0.0
Change in working capital	0.0	0.3	0.4	0.4	0.4
Non cash fair value-changes	0.0	0.0	0.0	0.0	0.0
Other non cash items	22.4	0.0	0.0	0.0	0.0
Operating CF (cont.)	-21.9	1.8	4.1	6.7	10.5
Operating CF (discont.)	0.0				
Cash outflow for additions to assets	0.0	-0.7	-0.7	-0.7	-0.7
Proceeds from sale of assets	0.0	0.0	0.0	0.0	0.0
Dividends from investments accounted for using the equity method	0.0	0.0	0.0	0.0	0.0
Interest received	0.0	0.9	0.9	0.9	1.0
Other influences from investing activities	-2.1	0.0	0.0	0.0	0.0
Investing CF (cont.)	-2.1	0.2	0.2	0.2	0.3
Investing CF (discont.)	0.0				
Free cash flow (cont.)	-23.9	2.0	4.3	7.0	10.9
Free cash flow (discont.)	0.0				
Capital increase/repayment	0.0	0.0	0.0	0.0	0.0
Issuances/repayments of debt	0.0	0.0	0.0	0.0	0.0
Interest paid	0.0	-0.5	-0.5	-0.5	-0.5
Dividends paid	0.0	0.0	0.0	0.0	0.0
Other influences from financing activities	1.5				
Financing CF (cont.)	1.5	-0.5	-0.5	-0.5	-0.5
Financing CF (discont.)	0.0				
Change in cash and cash equivalents	-22.4	1.4	3.7	6.4	10.3
Change in cash due to changes in scope of consolidation	0.0	0.0	0.0	0.0	0.0
Change in cash due to exchange rate movements	0.3	0.0	0.0	0.0	0.0
Cash contained in assets available for sale	0.0	0.0	0.0	0.0	0.0
Increase/decrease of cash	-22.4	1.4	3.7	6.4	10.3
Fiscal year end December					

Source: Evotec and DZ BANK estimates

IMPRINT

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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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