

20 July 2010

Evotec

Year End	Revenue (€m)	PBT* (€m)	EPS* (c)	DPS (c)	P/E (x)	Yield (%)
12/08	39.6	(47.7)	(52.5)	0.0	N/A	N/A
12/09	42.7	(21.7)	(20.9)	0.0	N/A	N/A
12/10e	50.1	(1.9)	(2.0)	0.0	N/A	N/A
12/11e	57.7	0.0	(0.4)	0.0	N/A	N/A

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

Investment summary: Strategic acquisition

Evotec's proposed acquisition of DeveloGen would expand its disease expertise into metabolic indications, a major focus for pharmaceutical companies. This should enable it to extend collaborations or enter new ones in this field and maintain its strong growth. There is limited risk associated with the acquisition because of its size and the deal structure – €14m in shares of which €6m is conditional and a cash earn-out.

Gains a Phase III product

Evotec would obtain DiaPep277, which is in Phase III studies for the treatment of Type I diabetes and has been out-licensed to Andromeda. It would also gain a preclinical programme, which is subject to a collaboration with Boehringer Ingelheim (Type II diabetes, deal worth up to €237m with royalties), and other promising programmes in early preclinical development.

Extends expertise into metabolic field

Evotec already has expertise in the fields of pain, CNS indications and oncology; the acquisition of DeveloGen would expand its service offering into metabolic diseases. It should be able to exploit its reputation and relationships to develop new collaborations in diabetes and other metabolic diseases.

Low risk acquisition

It is a bolt-on acquisition of another German company with a similar business model, and Cord Dohrmann, CEO of DeveloGen, is becoming CSO of Evotec. It is being bought for €14m in shares, of which €6m is contingent on milestones being achieved and 30% on future milestone/royalty income from the current existing assets.

Valuation: €335m based on DCF

The acquisition increases our valuation of Evotec from €306m to €335m, primarily because of the impact of the DiaPep277 with estimated peak sales of \$450m. There is no change to the company's financial guidance for FY10, but in the medium term the acquisition should support the strong growth of Evotec with new collaborations and extra milestones.

Price €2.01
Market Cap €219m

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 €1.00

Balance Sheet as at 31 March 2010

Debt/Equity (%) N/A
NAV per share (c) 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	37.0
EV/Sales	3.7	3.2	2.9
ROE	N/A	N/A	N/A

Revenues on geography

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

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Strategic acquisition of DeveloGen

Evotec's proposed acquisition of DeveloGen is a significant step in its strategy to become a sustainable biotech company. It has gained an interest in a drug to treat Type I diabetes that is in Phase III studies, and added another collaboration deal with Boehringer Ingelheim. It is also acquiring expertise in metabolic diseases including diabetes, which should enable the company to exploit its drug discovery platform and extend current collaborations or enter new ones in this field. No significant impact of the acquisition is expected in the short term, but in the longer term it should help to sustain Evotec's growth.

DeveloGen is a private German company with 15 employees based in Gottingen. It provides contract services for metabolic diseases and has its own proprietary pipeline. The company was founded in 1997 by three professors from the Max Planck Institute and the University of Freiburg to focus on developing innovative treatments for diabetes and other metabolic diseases. Over three financing rounds it raised a total of €64.5m. Its business model was similar to Evotec's as it provided drug discovery services to the pharmaceutical industry which partially funded its proprietary drug discovery.

The acquisition is expected to be completed in August 2010. 99.3% of DeveloGen shareholders have already agreed to the acquisition and Evotec has sufficient approved share capital to proceed without requiring approval from its shareholders.

Following the acquisition of DeveloGen, Evotec will add a Phase III product to its clinical pipeline as shown in Exhibit 1.

Exhibit 1: Updated Clinical R&D pipeline

Product	Development stage	Indication / Partner	Notes
DiaPep277	Phase III	Type I diabetes / Andromeda	A synthetic peptide of 24 amino acids derived from human Hsp60. Phase II studies demonstrated that it can preserve β -cell function (assayed using c-peptide levels), and that more patients reached glycemic control of HbA1c<7%. Currently in two pivotal Phase III studies with 457 and 450pts, due to report end of 2011 and 2014 respectively. Teva is the exclusive distributor. Evotec could earn significant short- and mid-term milestones + single-digit royalties. Potential launch in 2015.
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 an option for \$10m to buy-back the rights to EVT 100 family at end of Phase II for \$65m, and is funding the current development programme. Milestones worth over \$235m, escalating double-digit royalties. Evotec conducting 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 developed for smoking cessation, but in April 2009 it 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 a partner is need to continue 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

Evotec is also expanding its early stage pipeline with an insulin sensitizer in preclinical development that has been partnered with Boehringer Ingelheim, a β -cell programme in the discovery phase and other early projects in the early discovery phase. DeveloGen's unpartnered product, DG3173 (Somatoprim), in Phase II for the treatment of acromegaly and diabetic retinopathy, is excluded from the deal. Evotec is not buying this product as it does not want to take on the risk of developing an unpartnered Phase II product.

DeveloGen has over 10 years' experience in metabolic diseases together with *in vivo* and *in vitro* assays specifically designed for drug discovery in this field. These capabilities complement those of Evotec in general drug discovery and those in pain, CNS and oncology. After the acquisition is completed, Evotec should be able to lever its reputation and relationships in drug discovery to enter new collaborations in metabolic indications, to add to the ones it has gained from DeveloGen.

The main collaborations that DeveloGen has are with Boehringer Ingelheim and Teva. The insulin sensitizer programme is part of the alliance that was signed in 2009 with Boehringer Ingelheim which is worth €237m in milestones and single-digit royalties on top of the upfront payment of €7m received by DeveloGen and the funding of research until the nomination of a preferred drug candidate (extension possible). Boehringer Ingelheim is already a major partner of Evotec in a four-year collaboration across many disease areas. The partnership with Teva was signed in 2007 giving Teva access to DeveloGen's protein kinase B technology to develop oncology products; no financial details have been disclosed.

DeveloGen is being bought for a total of €14m plus deferred cash payments, but the deal has been structured to limit Evotec's risk exposure. On completion of the acquisition (expected in August 2010), 4m shares (valued at €2 each) will be issued to the shareholders of DeveloGen, a further 3m shares (in three separate escrow accounts) could be issued depending on certain company events and they will receive 30% of future milestone/royalty income from existing assets after third-party expenses. There are also c €2m of acquisition related expenses that include the paying down of debt and working capital commitments.

The risk associated with the acquisition is further limited by the small size of DeveloGen compared to Evotec; both companies are German with similar business models and the CEO of DeveloGen, Cord Dohrmann, is being appointed CSO of Evotec.

Financials and valuation

Our DCF valuation of Evotec has increased from €306m to €335m, primarily because of the value of DiaPep277 which we estimate will generate peak revenues of \$450m and is worth €28m to Evotec.

The impact on the FY10 results is limited beyond the €2m in acquisition related expenses and the company has reiterated its guidance that it will grow revenues by at least 15% and keep liquidity above €64m. The main benefits from the transaction will probably be realised in the medium term with Evotec earning potential milestones and entering into new collaborations in the area of metabolic diseases, as the company seeks to maintain its strong revenue growth and become sustainably profitable from 2012.

Exhibit 2: Financials

Note: Company is targeting liquidity of over €64m at FY10, this is comprised of cash, auction rate securities and non-current cash equivalents; we forecast liquidity of €66m at FY10. Net debt includes auction rate securities and non-current cash equivalents.

Year end 31 December	€'000s	2007	2008	2009	2010e	2011e	2012e
		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)	594	697	850
Other		36,392	0	0	0	0	0
Profit Before Tax (norm)		(42,618)	(47,702)	(21,677)	(1,916)	46	2,745
Profit Before Tax (FRS 3)		(15,380)	(75,970)	(44,819)	(2,263)	(242)	2,459
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)	(2,168)	(473)	2,148
Profit After Tax (FRS 3)		(6,513)	(78,693)	(45,812)	(2,389)	(761)	1,862
Average Number of Shares Outstanding (m)		71.8	95.2	106.8	108.9	112.3	114.8
EPS - normalised (c)		(53.5)	(52.5)	(20.9)	(2.0)	(0.4)	1.9
EPS - FRS 3 (c)		(9.1)	(82.7)	(42.9)	(2.2)	(0.7)	1.6
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	79,036	77,612	76,652
Intangible Assets		76,399	60,455	45,567	47,841	47,553	47,266
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	66,695	70,220	76,169
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	53,523	55,961	60,659
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	113,149	113,994	116,255
CASH FLOW							
Operating Cash Flow		(32,726)	(42,562)	(19,915)	(1,514)	6,110	7,593
Net Interest		1,590	2,116	(29)	(86)	(110)	(79)
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	(2,000)	0	0
Financing		(1,023)	(1,951)	234	(44)	0	0
Dividends		0	0	0	0	0	0
Other		(543)	15,254	(1,568)	72	0	0
Net Cash Flow		4,658	(1,479)	(25,080)	(5,904)	3,196	4,698
Opening net debt/(cash)		(69,841)	(83,254)	(81,775)	(57,750)	(53,803)	(56,798)
HP finance leases initiated		0	0	0	0	0	0
Exchange rate movements		8,831	0	(272)	(2,830)	0	0
Other		(76)	0	1,327	4,587	(0)	(0)
Closing net debt/(cash)		(83,254)	(81,775)	(57,750)	(53,803)	(56,798)	(61,496)

Source: Evotec accounts, Edison Investment Research

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