

**Translation of  
Financial Statements as of  
31 December 2010  
and Management Report**

**Evotec AG  
Hamburg**

# Evotec AG, Hamburg

## Balance Sheet as at 31 December 2010

### Assets

	31 December 2010		31 December 2009	
	EUR	EUR	EUR	EUR
<b>A. Fixed Assets</b>				
<b>I. Intangible Assets</b>				
Patents, licences and similar rights		5.533.357,51		6.448.237,16
<b>II. Property, plant and equipment</b>				
1. Land, land rights and buildings including buildings on third party land	340.794,01		503.488,57	
2. Technical equipment and machinery	4.607.830,75		4.924.404,77	
3. Fixtures and fittings	456.345,87		516.751,38	
4. Payments in advance	166.618,65	5.571.589,28	62.593,31	6.007.238,03
<b>III. Financial Assets</b>				
1. Shares in affiliated companies	70.999.817,96		76.744.902,84	
2. Participations	9.950,00		9.950,00	
3. Other financial assets	3.000.000,00	74.009.767,96	3.065.354,00	79.820.206,84
		85.114.714,75		92.275.682,03
<b>B. Current Assets</b>				
<b>I. Inventories</b>				
1. Raw materials and supplies	1.713.767,20		1.819.543,80	
2. Work in process	265.731,35		362.807,58	
3. Payments in advance	65.800,00	2.045.298,55	0,00	2.182.351,38
<b>II. Receivables and other assets</b>				
1. Trade accounts receivables	1.158.249,80		1.130.916,36	
--thereof due after one year				
EUR 0.00 (2009: EUR 0.00)--				
2. Accounts receivables due from affiliated companies	3.391.845,65		279.547,93	
--thereof due after one year				
EUR 2,440,000.00 (2009: EUR 260,000.00)--				
3. Accounts receivables due from investments in other companies	139.080,94		248.904,96	
4. Other assets	261.729,53		336.548,59	
--thereof due after one year				
EUR 90,536.00 (2009: EUR 12,651.98 )--		4.950.905,92		1.995.917,84
<b>III. Investments</b>				
Other investments		19.891.275,92		2.995.519,64
<b>IV. Cash and cash equivalents</b>				
		11.740.631,10		25.483.572,65
		38.628.111,49		32.657.361,51
<b>C. Prepaid expenses</b>				
		364.246,27		453.356,11
		124.107.072,51		125.386.399,65

## Shareholder's equity and liabilities

	31 December 2010	31 December 2009
	EUR	EUR
<b>A. Stockholder's equity</b>		
<b>I. Share capital</b>	115.595.729,00	108.838.715,00
--conditional capital EUR 10,592,380.00 (2009: EUR 10,599,380.00)--		
<b>II. Additional paid-in capital</b>	144.185.023,92	144.176.579,92
<b>III. Net loss carried forward</b>	-146.976.285,27	-103.386.682,10
<b>IV. Net loss for the year</b>	-2.494.027,16	-43.589.603,17
	110.310.440,49	106.039.009,65
<b>B. Accrued liabilities</b>		
1. Pension accrual	44.040,00	74.611,00
2. Tax accrual	0,00	217.946,71
3. Other accrued expenses	5.112.926,27	4.743.773,72
	5.156.966,27	5.036.331,43
<b>C. Liabilities</b>		
1. Bank loans	6.500.000,00	6.500.000,00
--thereof due within one year EUR 6,500,000.00 (2009: EUR 6,500,000.00)--		
2. Advance payments received	277.917,36	298.879,66
3. Trade accounts payable	1.067.707,51	1.030.443,23
--thereof due within one year EUR 1,067,707.51 (2009: EUR 1,030,443.23)--		
4. Accounts payable due to affiliated companies	139.699,95	5.548.821,83
--thereof due within one year EUR 139,699.95 (2009: EUR 5,548,821.83)--		
5. Other liabilities	421.839,31	559.009,81
--thereof due within one year EUR 421,839.31 (2009: EUR 559,009.81)-- --thereof taxes EUR 156,782.89 (2009: EUR 118,057.29)--		
	8.407.164,13	13.937.154,53
<b>D. Deferred income</b>	232.501,62	373.904,04
	124.107.072,51	125.386.399,65

# Evotec AG, Hamburg

## Statement of Operations for the period from 1 January to 31 December 2010

	2010		2009	
	EUR	EUR	EUR	EUR
1. Revenues		19.240.936,94		14.604.385,64
2. Increase (-)/Decrease in inventories (+)		97.076,23		-4.335,57
3. Other operating income		10.092.748,87		4.841.558,47
4. Cost of materials				
a) Raw materials and supplies	-2.163.389,38		-1.616.608,85	
b) Costs of services	-4.531.393,70	-6.694.783,08	-947.988,26	-2.564.597,11
5. Personnel costs				
a) Salaries	-8.544.718,72		-6.796.319,58	
b) Social security expenditure	-1.261.011,26	-9.805.729,98	-866.585,45	-7.662.905,03
--thereof pension costs				
EUR 4,018.00 (2009: EUR 3,577.00)--				
6. Depreciation				
a) of intangible assets and fixed assets	-1.562.158,61		-1.295.179,85	
b) of current assets to the extent that they exceed provisions normally recorded by the company	-2.160.407,61	-3.722.566,22	-38.440.783,37	-39.735.963,22
7. Other operating expenses		-13.896.764,33		-10.532.799,03
8. Income from investments		0,00		4.180.037,86
--thereof from subsidiaries				
EUR 0.00 (2009: EUR 4,013,243.49)--				
9. Other interest income		2.333.898,25		5.919.878,53
--thereof from subsidiaries				
EUR 2,256,516.59 (2009: EUR 5,651,773.33)--				
10. Amortisation of financial assets and current investments		0,00		-12.253.319,78
11. Other interest expense		-147.606,06		-107.319,93
12. Operating result		-2.502.789,38		-43.315.379,17
13. Extraordinary expenses		-30.127,00		0,00
14. Income tax		38.889,22		-274.224,00
15. Net loss for the year		-2.494.027,16		-43.589.603,17
16. Net loss carried forward		-146.976.285,27		-103.386.682,10
17. Accumulated deficit		-149.470.312,43		-146.976.285,27

# Evotec AG, Hamburg

## Notes to the Financial Statements 2010

### **I. General Information**

Evotec AG, henceforth referred to as „Evotec” or „the company”, fulfils the size criteria of a medium-sized company in the meaning of section 267 par. 2 HGB („Handelsgesetzbuch”; German commercial code) but according to section 267 par. 3 sentence 2 HGB is classified as large company.

With regards to financial reporting and valuation practices, the company complies with sections 242 et seq. HGB, with sections 264 et seq. HGB (which specifically apply to incorporated firms) as well as to the regulations of the German Stock Corporation Act AktG („Aktien-gesetz”).

The statement of operations is presented in the total expenditure format (section 275 paragraph 2 HGB).

From 11 February 2003, to 19 March 2007, the company was listed in the German Stock Exchange’s TecDAX index, having formerly been listed in the Neue Markt index from 10 November 1999, onwards. Since 19 March 2007, the company had been listed on the German Stock Exchange. Since 28 October 2009 the company is listed in the German Stock Exchange’s TecDAX index again. Additionally, the company was listed on the NASDAQ Global Market in the US since 5 May 2008. The company voluntarily delisted from the NASDAQ effective 30 November 2009. On 30 December 2010, in accordance to the US security law (Securities and Exchange act OF 1934), the deregistration of the ADS (American Depository Shares) was submitted with the form 15F at the SEC (Securities and Exchange Commission). The deregistration is estimated to be effective in March 2011.

## II. Basis of Presentation, Accounting and Valuation Practices

The presentation system applied for the statement of operations and for the balance sheet of the preceding financial year 2009 has been maintained in 2010.

According to Section 66 Par. 3 S. 1 EGHGB, the Company adopted BilMoG for the first time in the fiscal year 2010. Changes in measurement mainly affect accruals for pensions and are described separately in the respective note (no. 9). Prior years' balances have not been adjusted according to Section 67 par. 8 EGHGB.

**Intangible assets and Property, plant and equipment** are recorded at historical cost or manufacturing cost less scheduled straight-line depreciation or amortization over their useful lives. Non-real-estate fixed assets are depreciated on a monthly basis.

Assets which are not yet available for operational use and have a presumably lasting decrease in its value will be unscheduled depreciated to the proved amount of the closing date.

As from 1 January 2008 low-value fixed assets will be valued in accordance with Section 6 par. 2 and par. 2a EStG.

The useful lives are estimated as follows:

	Years
Buildings	10-15
Technical equipment and machinery	5-10
Factory and office equipment	5-10
Computer equipment and software	3

**Financial assets** are recorded at historical cost.

**Inventories** are recorded at historical cost or manufacturing cost less purchase price reductions, taking into account the principle of the lower of cost or market.

**Accounts receivable and other current assets** are recorded at nominal value or at lower attributable value. Foreign currency assets, all of which are short-term, are valued at period-end exchange rates.

**Trade securities** are recorded at historical cost in accordance with the principle of lower of cost or market. Trade securities held in foreign currency are valued at period-end exchange rates.

**Cash and cash equivalents** are recorded at nominal value.

**Accrued liabilities** make allowance for all risks and contingent liabilities that are identifiable with sound business judgement. Future increases in price and costs are also considered according to Section 253 par. 1 HGB. Accruals having a maturity of more than one year are discounted using a discount rate which is equivalent to a market interest rate over the last seven years according to Section 253 par. 2 HGB. **Pension accruals and similar commitments** are recorded in accordance with the "Bilanzrechtsmodernisierungsgesetz". The provisions have been estimated using the Projected Unit Credit-method with an interest rate of 5.0% and the consideration of Prof. Dr. Klaus Heubeck's reference tables („Richttafeln") issued in 2005. The interest rate is equivalent to a market interest rate over the last seven years considering a maturity of 15 years. This interest rate is determined on the interest rates which are released by the Deutsche Bundesbank. Pension progression was considered at a rate of 2%.

**Liabilities** are recorded at the amount repayable. Foreign currency liabilities are valued at period-end exchange rates.

Future taxable temporary differences which would lead to **deferred tax liabilities** do not exist. Deferred tax asset for future taxable differences in accruals and losses carried forward have been calculated using a combined tax rate of 32.28% and have not been activated according to section 271 par. 1 s. 2 HGB.

### **III. Notes to the Balance Sheet**

#### **1. Fixed assets**

The development of the fixed assets is specified in the fixed asset movement schedule (see pages 7 and 8), and includes gross cost, historic cost and manufacturing cost of items and the accumulated depreciations.

In 2009, the company has bought from its affiliates EVOTEC Neurosciences GmbH and Renovis Inc. research projects with the purchasing price of TEUR 6,296. Evotec will continue these research projects in the following years. In the financial year 2010, one of these proprietary research programs was discontinued and TEUR 989 was recorded as loss from asset disposal reducing the carrying amount by this amount.

## 2. Financial assets

In the financial year Evotec acquired the majority of shares from the DeveloGen AG in Göttingen. Since 3<sup>rd</sup> September 2010 the DeveloGen AG is with 99.4% in the affiliated companies of Evotec included.

The carrying amount of this investment amounts to TEUR 8,403 and contains the already paid portion of the purchase price amounting to TEUR 6,750, a success-dependent component (Earn Out) amounting to TEUR 1,500, as well as costs of acquisition of TEUR 153.

In 2010, the carrying amount of the investment in Renovis Inc. was written-up by TEUR 1,315. Subsequently, the costs of acquisition were reduced by TEUR 17,792 due to a cash payment out of the capital reserve.

The impairment from 2009 of the investment in ENS Holdings Inc. amounted to TEUR 2,329 and was fully written-up in 2010 again.

As of the balance sheet date of 31 December 2010, Evotec held direct equity investments in the following companies:

	Total Equity	Share interest	Net income/ loss
	TEUR	%	TEUR
1. ENS Holdings Inc., Wilmington/Delaware, USA*	27,161	100.00	-66
2. EVOTEC NeuroSciences GmbH, Hamburg (indirectly through 1 <sup>st</sup> )	-101,378	100.00	4,988
3. Evotec Neurosciences AG, Zurich, CH (indirectly through 1 <sup>st</sup> )	326	100.00	50
4. Evotec (UK) Ltd., Abingdon, UK	17,213	100.00	2,209
5. Evotec Inc., Wilmington/Delaware, USA* (indirectly through 4 <sup>th</sup> )	226	100.00	17
6. Renovis Inc., San Francisco, USA	11,381	100.00	-2,719
7. DeveloGen AG, Göttingen	4,878	99.40	-3,012
8. Evotec (India) Private Limited, Maharashtra (Thane), Indien**)	1,250	70.00	-592
9. Evotec (Asia) Pte. Ltd, Singapore* (indirectly through 4 <sup>th</sup> )	77	100.00	-34
10. European ScreeningPort GmbH ,Hamburg***	-362	19.90	-169

\* unaudited

\*\* local stats as per March 31<sup>st</sup> 2009

\*\*\* local stats as per December 31<sup>st</sup> 2009



With regards to companies whose annual statements were set up in a foreign currency, the exchange rate on recording day was used for equity, and the average exchange rate for annual profit or loss.

The company bought a bearer bond amounting to TEUR 3,000 in 2009. The market value of the bearer bond is 100.1% as of December 31 with a fair value of TEUR 3,003 at year end. Taking into account the principle of lower of cost or market, the investment was valued at TEUR 3,000 as on December 31<sup>st</sup> 2010.

Because of the changes due to the Bilanzrechtsmodernisierungsgesetz, which came into effect on January 01<sup>st</sup> 2010, the insurance liability amounting to TEUR 68 as of December 31<sup>st</sup> 2010, was netted with the pension accrual and therefore is not included in the financial assets as on December 31<sup>st</sup> 2010. In 2009, the insurance liability was included in the financial assets with an amount of TEUR 65.

## Fixed Assets Movement Schedule for the year 2010

	Acquisition and manufacturing costs					31 December 2010
	1 January 2010	Additions	Disposals	Reclasses	Reclasses BilMoG	
	EUR	EUR	EUR	EUR	EUR	
<b>I. Intangible Assets</b>						
Patents, licences and similar rights	9.178.911,87	125.822,85	1.227.704,35	35.850,00	0,00	8.112.880,37
<b>II. Property, plant and equipment</b>						
1. Land, land rights and buildings including buildings on third party land	2.027.650,33	0,00	0,00	0,00	0,00	2.027.650,33
2. Technical equipment and machinery	19.414.693,65	750.860,05	2.441.129,73	0,00	0,00	17.724.423,97
3. Fixtures and fittings	3.465.441,56	179.792,63	102.055,87	4.597,56	0,00	3.547.775,88
4. Payments in advance	62.593,31	144.472,90	0,00	-40.447,56	0,00	166.618,65
	24.970.378,85	1.075.125,58	2.543.185,60	-35.850,00	0,00	23.466.468,83
<b>III. Financial Assets</b>						
1. Shares in affiliated companies	88.988.846,08	8.402.575,99	17.792.410,19	0,00	0,00	79.599.011,88
2. Participations	9.950,00	0,00	0,00	0,00	0,00	9.950,00
3. Other financial assets	3.065.354,00	0,00	0,00	0,00	-65.354,00	3.000.000,00
	92.064.150,08	8.402.575,99	17.792.410,19	0,00	-65.354,00	82.608.961,88
	126.213.440,80	9.603.524,42	21.563.300,14	0,00	-65.354,00	114.188.311,08

Depreciations				Net book value		
1 January 2010	Additions	Appreciation	Disposals	31 December 2010	31 December 2010	31 December 2009
EUR	EUR	EUR	EUR	EUR	EUR	EUR
2.730.674,71	87.318,99	0,00	238.470,84	2.579.522,86	5.533.357,51	6.448.237,16
1.524.161,76	162.694,56	0,00	0,00	1.686.856,32	340.794,01	503.488,57
14.490.288,88	1.067.433,56	0,00	2.441.129,22	13.116.593,22	4.607.830,75	4.924.404,77
2.948.690,18	244.711,50	0,00	101.971,67	3.091.430,01	456.345,87	516.751,38
0,00	0,00	0,00	0,00	0,00	166.618,65	62.593,31
18.963.140,82	1.474.839,62	0,00	2.543.100,89	17.894.879,55	5.571.589,28	6.007.238,03
12.243.943,24	0,00	3.644.749,32	0,00	8.599.193,92	70.999.817,96	76.744.902,84
0,00	0,00	0,00	0,00	0,00	9.950,00	9.950,00
0,00	0,00	0,00	0,00	0,00	3.000.000,00	3.065.354,00
12.243.943,24	0,00	3.644.749,32	0,00	8.599.193,92	74.009.767,96	79.820.206,84
33.937.758,77	1.562.158,61	3.644.749,32	2.781.571,73	29.073.596,33	85.114.714,75	92.275.682,03

### 3. Inventories

	TEUR	TEUR
	31.12.2010	31.12.2009
Raw materials	1,714	1,819
Work in progress	265	363
Advance Payments	66	0
	<u>2,045</u>	<u>2,182</u>

The raw materials and supplies including compound libraries amount to TEUR 1,579.

The work in progress essentially consists of order based research and development work amounted to TEUR 265.

### 4. Accounts receivable and other assets

#### Account receivable from affiliated companies

	Maturity			
	< 1 year	> 1year	< 1 year	> 1 year
	31.12.2010		2009	
	TEUR	TEUR	TEUR	TEUR
Evotec (India) Private Ltd.	0	340	2	260
EVOTEC NeuroSciences GmbH	704	0	0	0
Evotec (UK) Ltd.	175	0	0	0
DeveloGen AG	54	2,100	0	0
Renovis Inc.	19	0	0	0
Evotec Neurosciences AG	0	0	18	0
	<u>952</u>	<u>2,440</u>	<u>20</u>	<u>260</u>

Accounts receivables from affiliated accompanies include trade accounts receivables in an amount of TEUR 952 (2009: TEUR 20).

The long term receivables of DeveloGen AG consist of loan receivables amounting to TEUR 2,100.

Accounts receivables were netted with liabilities of affiliated companies, including TEUR 86 liabilities from EVOTEC NeuroSciences GmbH, TEUR 1 from DeveloGen AG and TEUR 539 from Evotec (UK) Ltd were included.

Due to the indebtedness of EVOTEC NeuroSciences GmbH the accounts receivable were according to the prudence principle impaired by TEUR 2,160. After a repayment of the loan of TEUR 2,500 the accumulated depreciation now amounts to TEUR 101,091 (previous year TEUR 101,431).

#### Accounts receivable from affiliated companies

	Maturity			
	< 1 year 31.12.2010	> 1year	< 1 year 2009	> 1 year
	TEUR	TEUR	TEUR	TEUR
European ScreeningPort GmbH	139	0	249	0
	139	0	249	0

The accounts receivables from EuropeanScreeningPort GmbH only consist of trade accounts.

The accounts receivable from the European ScreeningPort GmbH were impaired by TEUR 989 according to the prudence principle in 2009. The company declared a cancelation of debt subject to restoration to the European ScreeningPort GmbH amounted to TEUR 1,098. In 2010 the loan was additionally impaired by TEUR 398 according to the prudence principle. The accumulated impairment amount on December 31<sup>st</sup> 2010 amounts to TEUR 1,387.

#### Other assets

	Maturity			
	< 1 Year 31.12.2010	> 1 Year	< 1 Year 2009	> 1 Year
	TEUR	TEUR	TEUR	TEUR
Tax authorities				
- Capital Yields Tax	26	0	150	0
- Value added tax	0	0	27	0
Deposits	91	5	0	13
Others	140	0	147	0
	257	5	324	13

## **5. Other investments**

The other investments include shares from listed investment funds which were used as a short-term liquidity reserve. The company invested Euro and US-Dollar in these shares. These shares will not be used for permanent business operation purposes.

## **6. Cash and cash equivalents**

The cash in hand on December 31st 2010 was TEUR 3 and the cash equivalents amounted to TEUR 11,738. (Including TEUR 1,130 US-Dollar and TEUR 473 GB-Pound.) On December 31st 2010 TEUR 7,278 cash and cash equivalents were pledged as security (Previous year TEUR 8,303). Thereof TEUR 6,813 are only with acceptance by the bank available.

## **7. Deferred Taxes**

The deferred taxes receivable mainly a result of taxable losses broad forward. According to Section 274 par. 1 s. 2 HGB the receivable from deferred taxes were not activated. The tax rate for the deferred tax is a combined rate of 32.28 %.

## **8. Equity**

In 2010, the nominal capital rose due to the authorization of the Management Board at the annual general meeting on the 28<sup>th</sup> of August 2010, with agreement of the supervisory board, by EUR 6,750,014.00 and amounted to EUR 115,595,729.00 at the end of period. For this capital increase, the approved capital was used. This increase is due to a contribution in kind. Therefore, 6,750,014 shares were issued by an exchange of stocks to acquire the DeveloGen AG. The entry in the Commercial Register of companies has taken place on the 7<sup>th</sup> of October 2010.

The remaining approved capital amounted to EUR 14,983,864.00 equal to 14,983,864 shares as of 31 December 2010.

Another increase of nominal capital is due to the exercise of stock-options of EUR 7,000. The entry in the commercial register will be made in 2011.

On 31 December 2010 the conditional capital amounted to EUR 10,529,380.00. It was created to give stock options to employees and members of the management board of the company or affiliated companies.

The additional paid-in capital rose due to the exercise of stock-options of EUR 8,444.00 to EUR 144,185,023.92.

Evotec's subsidiary Renovis Inc. owns 1,328,624 of Evotec shares, representing 1.15% of Evotec's nominal capital.

In the course of the merger between Renovis Inc. and Evotec AG, certain options and deferred Stock units (DSUs) held by Renovis employees were transformed into Renovis shares. These shares were delivered into an irrevocable Company Trust for the benefit of the Renovis employees. (Under the conditions of the original agreements entered into when these options or DSU's were granted.). At closing of the merger, the Renovis shares delivered into the Company Trust were exchanged in Evotec American Depositary Receipts (ADR), whereby one ADR represents two Evotec shares. Upon valid exercise of options/DSU's by Renovis employees, the Company Trust delivers the respective number of ARDs to these employees. The trust agreement between Renovis Inc and the trustee provides that once all obligations of the trust to deliver ADR's under the options agreements or the DSU agreements are satisfied or otherwise extinguished. (e.g. due to an expiry of exercise periods or non-occurrence/discontinuance of exercise conditions), any ADRs held by the company Trust shall be delivered to Renovis, Inc or Evotec AG, as instructed by Renovis, Inc.

The ADR's in the Company Trust are treated as economically owned by Renovis, Inc. Legal ownership of these ADRs will be acquired by Renovis, Inc. or Evotec AG, respectively, once all rights of Renovis employees will have been satisfied or extinguished and the shares remaining in the company Trust will have been delivered to either Renovis, Inc or Evotec AG according to instructions by Renovis, Inc. That acquisition of legal ownership will not require a considerable, section 71 paragraph 1 number 4 AktG.

On 30 September 2010, LBBW Asset Management Investmentgesellschaft mbH, Stuttgart, Germany, ("LBBW") gave notice pursuant to Section 21 Para 1 WpHG that on 29 September 2010 its voting interest in Evotec AG exceeded the threshold of 3% and on that day its shareholding of 3.335.730 shares amounted to 3.065% of the total Evotec voting rights. Thereof 3.065% (3.335.730 shares) were attributed to LBBW according to Section 22 Para 1 Sentence 1 No. 6 WpHG.

On 8 October 2010, LBBW Asset Management Investmentgesellschaft mbH, Stuttgart, Germany, ("LBBW") gave notice pursuant to Section 21 Para 1 WpHG that on 7 October 2010 its voting interest in Evotec AG fell short of the threshold of 3% and on that day its shareholding of 3.365.730 shares amounted to 2.912% of the total Evotec voting rights. Thereof 2.912% (3.365.730 shares) were attributed to LBBW according to Section 22 Para 1 Sentence 1 No. 6 WpHG.

As a correction of its notice dated 30 September 2010, LBBW Asset Management Investmentgesellschaft mbH, Stuttgart, Germany, ("LBBW") on 19 October 2010 gave notice pursuant to Section 21 Para 1 WpHG that on 29 September 2010 its voting interest in Evotec AG exceeded the threshold of 3% and on that day its shareholding of 3.335.730 shares amounted to 3.065% of the total Evotec voting rights. Thereof 2.706% (2.945.730 shares) were attributed to LBBW according to Section 22 Para 1 Sentence 1 No. 6 WpHG.

As a correction of its notice dated 8 October 2010, LBBW Asset Management Investmentgesellschaft mbH, Stuttgart, Germany, ("LBBW") on 19 October 2010 gave notice pursuant to Section 21 Para 1 WpHG that on 7 October 2010 its voting interest in Evotec AG fell short of the threshold of 3% and on that day its shareholding of 3.365.730 shares amounted to 2.912% of the total Evotec voting rights. Thereof 2.566% (2.965.730 shares) were attributed to LBBW according to Section 22 Para 1 Sentence 1 No. 6 WpHG.

On 19 October 2010, LBBW Asset Management Investmentgesellschaft mbH, Stuttgart, Germany, ("LBBW") gave notice pursuant to Section 21 Para 1 WpHG that on 15 October 2010 its voting interest in Evotec AG exceeded the threshold of 3% and on that day its shareholding of 3.480.730 shares amounted to 3.011% of the total Evotec voting rights. Thereof 2.652% (3.065.730 shares) were attributed to LBBW according to Section 22 Para 1 Sentence 1 No. 6 WpHG.

## **9. Pension accruals**

Pension accruals were set up according to a valuation by Mercer Deutschland GmbH and pertain to a former director of Evotec Biosystems GmbH, of which Evotec is the successor in title. This accrual includes an extraordinary increase because of the revaluation according to the BilMoG. The company decided to add this amount (TEUR 30) in total to the accrual. The accruals for pensions were netted with a liability insurance. The insurance is valued at TEUR 68 and is bonded to the pension.



## 10. Other accruals

### Other accruals

	31.12.2010	2009
	TEUR	TEUR
Outstanding invoices	1,605	1,595
Uncertain accounts payable	1,500	748
Bonus	1,020	1,326
Unclaimed vacation	260	299
Outstanding intercompany invoices	260	43
Termination Agreement	0	352
Others	468	381
	<u>5,113</u>	<u>4,744</u>

Contained in the accruals for outstanding invoices is an accrual with the amount of TEUR 248 (2009: TEUR 280) for Supervisory Board remuneration and an accrual of TEUR 55 (2009: TEUR 165) for the payment to inventors.

In the end of the financial year 2010 the accrual for uncertain accounts payable is a contingent consideration from the acquisition of the DeveloGen AG shares. In 2009, this accrual was in regard to the acquisition of Evotec India which was completely paid in 2010.

## 11. Liabilities

### Liabilities to banks

The liabilities to banks as of 31 December 2010 comprise of two loans of TEUR 6,500 (2009: TEUR 6,500) which are both short term. Both loans will be repaid by 30 June 2011. The interest rate for both loans is 0.9 % over six month EURIBOR per annum. The loans are secured by a general terms and conditions lien.

### Liabilities to affiliated companies

	Maturity			
	< 1 Jahr	> 1 Jahr	< 1 Jahr	> 1 Jahr
	31.12.2010		2009	
	TEUR	TEUR	TEUR	TEUR
Evotec (India) Private Ltd	140	0	0	0
Evotec (UK) Ltd.	0	0	337	0
Renovis Inc.	0	0	3,494	0
Evotec RSIL Ltd.	0	0	3	0
EVOTEC NeuroSciences GmbH	0	0	1,715	0
	140	0	5,549	0

The balance only consists of trade payables.

In balancing the accounts receivables and liabilities of affiliated companies, TEUR 48 accounts receivables from Evotec (India) Private Ltd were included.

### Other Liabilities

The other liabilities contain of a wage tax liability (TEUR 157) and some credit debtors (TEUR 201).

#### IV. Notes to the Statement of Operations

##### 1. Revenues

The company recorded revenues of TEUR 19,241 (2009: 14,604) through research and development services, thereof TEUR 5,246 with affiliated companies (2009: TEUR 2,391).

The external revenues amounted to TEUR 13,955 (2009: 12,213) includes licence income amounted to TEUR 1,615 (2009: TEUR 3,165)

Revenues with third parties can be split based on customers' locations, in the following geographical regions:

	2010	2009
	<u>TEUR</u>	<u>TEUR</u>
United States of America	5,914	5,363
Switzerland	3,183	656
Germany	2,762	4,208
Japan	1,011	381
Rest of Europe	640	105
United Kingdom	485	849
Denmark	0	637
Rest of the world	0	14
<b>Total</b>	<b><u>13,995</u></b>	<b><u>12,213</u></b>

## 2. Other operating income

	2010	2009
	TEUR	TEUR
Revaluation of investments	3,644	0
Costs charged to affiliated companies	1,319	2,516
Sublease of building	877	1,099
Subsidies	638	0
Income relating to other periods		
Income from repayments of loans	2,500	0
Income from reversal of accruals	456	162
Others	659	1,065
	<u>10,093</u>	<u>4,842</u>

The income due to the revaluation of investments relates to the carrying amount of the investment in ENS Holdings Inc. amounting to TEUR 2,329 as well as Renovis Inc. amounting to TEUR 1,315.

## 3. Depreciation

The depreciation of TEUR 2,160 is the result from the depreciation of loans concerning EVOTEC NeuroSciences GmbH.

#### 4. Other operating expenses

	2010	2009
	TEUR	TEUR
Costs charged from affiliated companies	2,259	1,072
Rental expenses including related costs	2,034	1,924
Service and maintenance	1,050	827
Asset disposal	989	0
Legal and consultancy expenses	933	1,130
Provision on loan	398	0
Security disposal	311	0
Costs for Services	307	418
Royalty costs	235	392
Others	5,381	4,770
	<u>13,897</u>	<u>10,533</u>

#### 5. Income from investments

	2010	2009
	TEUR	TEUR
Evotec (UK) Ltd.		
- reduction of capital	0	2,770
Direvo Biotech AG		
- disposal convertible bond	0	167
Neuro3d S.A.		
- liquidation	0	1,243
	<u>0</u>	<u>4,180</u>

#### 6. Extraordinary result

The extraordinary expenses contain adjustments with an amount of TEUR 30 for accruals for pensions due to BilMoG.

## V. Other Disclosures

### Audit Fees for KPMG AG Wirtschaftsprüfungsgesellschaft

	2010	2009
	TEUR	TEUR
Auditing	125	177
Other consultancy	49	191
Tax consultancy	0	24
Other services	1	0
	<u>175</u>	<u>392</u>

### Employees

In 2010, the average employee count was 126 (2009: 99).

As part of the stock option plan, employees of the company and its affiliates received a total of 694,250 options (2009: 621,450) and the Management Board received 625,000 options (2009: 700,000).

### Other financial obligations

The other financial obligations for 2011 are mainly obligations from service contracts, rent and leasing and add up to TEUR 3,726 (thereof to affiliated companies TEUR 0). The sum of all existing obligations until the year 2015 is TEUR 8,873 and with a longer term is TEUR 11,007.

According to the loan agreement with European Screening Port GmbH the company is obliged to disburse a loan with an amount of up to TEUR 1,500. This loan has been utilised with an amount of 1,387 on 31 December 2010.

According to the acquisition of the DeveloGen AG the company is obliged to make an earn out payment to the former share holders of DeveloGen of 30% of the net income from certain licence- and cooperation contracts after the receipt of the payment.

## **Guarantees and Other Commitments**

In order to prevent the legal consequence of over-indebtedness of EVOTEC NeuroSciences GmbH (TEUR 101,378) Evotec AG issued letter of comfort. The company doesn't expect a claiming of this because the material amount is in regard to a loan liability for the Evotec AG.

## **Corporate Governance Code**

Both the Management Board and the Supervisory Board have issued a statement in accordance with section 161 AktG, which has been made permanently available to all shareholders on Evotec's website: [www.evotec.com](http://www.evotec.com).

## **Management Board**

Dr Werner Lanthaler; Business Executive, Hamburg (Chief Executive Officer)

Colin Bond; Chartered Accountant, Hamburg (Chief Financial Officer) from August 2010

Dr. Cord Dohrmann; Biologist, Göttingen (Chief Scientific Officer) from September 2010

Dr Mario Polywka; Chemist, Oxfordshire, UK (Chief Operating Officer)

Dr Klaus Maleck, Biotechnologist, Hamburg (Chief Financial Officer until August 2010, Member of the Management Board until October 2010)

The remuneration paid to the members of the Management Board in the financial year totalled TEUR 2,088 (2009: TEUR 1,734), of which TEUR 433 (2009: TEUR 395) is variable remuneration and of which TEUR 587 is a long term remuneration. The remuneration includes TEUR 398 for Dr. Mario Polywka which was not paid by Evotec AG. Fixed remuneration includes base salaries, contributions to personal pension plans, premiums for accident and accidental death insurances as well as the benefit derived from the use of company cars. The variable remuneration of the Management Board is based on a bonus scheme designed by the Remuneration Committee of the Supervisory Board and is then approved by the Supervisory Board. The variable portion of the remuneration in 2010, payable on the achievement of certain strategic targets for the business year 2009, was based on the following criteria

	Achievement of five defined corporate mile- stones	Achievement of personal objectives
	%	%
Dr Werner Lanthaler	100	0
Dr Klaus Maleck	90	10
Dr Mario Polywka	90	10

The variable portion of the remuneration in 2011 will be referred to the business year 2010 and is based on the following criteria:

	Achievement of four defined corporate milestones	Achievement of personal objectives
	%	%
Dr Werner Lanthaler	80	20
Colin Bond *)	60	40
Dr Cord Dohrmann **)	60	40
Dr Mario Polywka	60	40
Dr Klaus Maleck ***)	60	40

\*) Member of the Management Board as of 1. August 2010

\*\*) Member of the Management Board as of 1. September 2010

\*\*\*) Member of the Management Board until 31. October 2010



In 2010 under the Company's stock option plans, the members of the Management Board received 625,000 (2009: 700,000) options which may be exercised after three years provided the conditions of this plan are met. The details of the fair value of the options are explained in the remuneration report of the management report.

	2010	2010	2010	2010	
	Fixed remuneration	Variable remuneration	Stock options	Value of stock options	Total remuneration
	TEUR	TEUR	in pcs	TEUR	TEUR
Dr Werner Lanthaler	373	243	200,000	180	796
Colin Bond *)	126	0	100,000	102	228
Dr Cord Dohrmann **)	91	0	100,000	102	193
Dr Mario Polywka	287	111	150,000	135	533
Dr Klaus Maleck ***)	191	79	75,000	67.5	337,5
<b>Total</b>	<b>1.068</b>	<b>433</b>	<b>625,000</b>	<b>586.5</b>	<b>2,087.5</b>

\*) Member of the Management Board as of 1. August 2010

\*\*\*) Member of the Management Board as of 1. September 2010

\*\*\*\*) Member of the Management Board until 31. October 2010

The contracts of the Management Board members contain a change-of-control clause that would allow them, in the event of a takeover of the Company, to terminate their current contract.

Upon contract termination the Management Board member Dr Werner Lanthaler is entitled to severance payments of a two year's base salary. Dr Mario Polywka is entitled to severance payments of 18 month salary. Colin Bond as well as Dr. Cordmann are entitled to severance payments of a one year's base salary plus bonus. But in all cases no more than the total remuneration due for the remaining term of the contract.

The company has a Directors and Officers (D&O) insurance policy in place for the Management Board the Supervisory Board, the executive management and the managers of subsidiary companies. The insurance expense amounted to TEUR 214 in total in 2010 (2009: TEUR 180), and was paid by the company.

When Jörn Aldag resigned from the Company's Management Board effective 31 December 2008, he and Evotec entered into a non-competition agreement exceeding the regular duration of his service agreement. They also agreed upon a lump-sum payment equivalent to the remuneration that Jörn Aldag would have received had his contract expired and not been terminated. No further severance payments were agreed. The exit agreement stipulated gross total payments of T€2,022 to Jörn Aldag. These payments consisted of T€573 fixed and T€805 variable remuneration for the period until his contract would have expired if not terminated as well as T€644 for the non-competition agreement. Of this sum, T€1,700 were paid in early 2009 and the remaining T€322 in early 2010.

Apart from the payments to Jörn Aldag, no payments were made to any former Management Board member.

It exist a liability for a former manager of the former Evotec Biosystems GmbH for which the Evotec AG is the assignee which is declared in the management report.

Dr Werner Lanthaler is Member of the Verwaltungsrat of Pantec Biosolutions AG (from October 2010).

Dr Cord Dohrmann is Chief Executive Officer of DeveloGen AG, Göttingen.

Dr Klaus Maleck is chairman of the board of Directors of European SceningPort GmbH, Hamburg.

Dr Mario Polywka is Non Executive Chairman of the Board of Directors of Pharminox Ltd, Oxfordshire, UK and Member of the Board of Directors of Evotec India (Private) Ltd., Maharashtra, India.

## **Supervisory Board**

Dr Flemming Ørnskov, Zurich, CH, Head General Medicine, Bayer HealthCare AG (formerly: Bayer Schering Pharma AG) (Chairman);

Dr Walter Wenninger, Leverkusen, DE, Former Member of the Management Board of Bayer AG (Vice Chairman since 9 June 2010, previously Member);

Dr Hubert Birner, Gräfelfing, DE, General Partner, Techno Venture Management Capital GmbH;

Dr Peter Fellner, Winnersh, UK, Non-Executive Chairman Vernalis plc.;

Mary Tanner, New York, NY, US, Managing Director, Peter J. Solomon LLC;

Dr Corey Goodman, Marshall, CA, US, Managing Partner, venBio, LLC (Vice Chairman) (until 31 January 2010).

The remuneration paid to the members of the Supervisory Board in the financial year amounted to TEUR 248 (2009: TEUR 280). The members of the Supervisory Board were members of the following other Supervisory Boards, Committees and Bodies according to section 125 paragraph 1 clause 3 AktG:

The Supervisory Board had the following additional memberships in supervisory boards and memberships in comparable governing bodies of enterprises according to § 125 par. 1 third sentence of the AktG:

### **Dr Flemming Ørnskov**

#### Non-Executive Chairman of the Board of Directors:

Astion Pharma A/S, Kopenhagen, DK (until December 2010);

Santaris Pharma A/S, Kopenhagen, DK.

Non-Executive Member of the Board of Directors:

PCI Biotech Holding ASA, Oslo, NO;

Shangdong Bausch & Lomb Freda Pharmaceutical Company Limited, Jinan, CN (until May 2010);

Spepharm Holding BV, Amsterdam, NL.

**Dr. Walter Wenninger**

Chairman of the Supervisory Board:

Paion AG, Aachen;

Noxxon Pharma AG, Berlin.

Non-Executive Member of the Board of Directors:

Recordati S.p.A. Mailand, I;

Santharis Pharma A/S, Hoersholm, DK.

Member of the Advisory Group:

Novo A/S, Hellerup, DK (since September 2010).

**Dr. Hubert Birner**

Non-Executive Chairman of the Board of Directors:

Argos Therapeutics Inc., Durham, North Carolina, USA.

Non-Executive Member of the Board of Directors:

BioXell SA, Segrate, IT (until March 2010);

Nitec Pharma AG, Reinach, CH (until April 2010);

Proteon Therapeutics Inc., Waltham, USA;

Spepharm Holding BV, Amsterdam, NL;

Transmolecular, Inc., Cambridge, MA, USA;

Horizon Therapeutics, Northbrook (from April 2010).

**Dr Peter Fellner**

Non-Executive Chairman of the Board of Directors:

Astex Therapeutics Ltd., Cambridge, UK; Consort Medical plc, Hemel Hempstead, UK;  
Biotie Therapeutics Corp., Turku, FI (from April 2010, formerly Non-Executive Member);  
Consort Medical plc, Hemel Hempstead, UK; Optos plc, Dunfermline, UK (since January 2010)  
Optos plc, Dunfermline, UK (from January 2010).

Non-Executive Member of the Board of Directors:

UCB SA, Brüssel, BE.

**Dr Corey Goodman**

Non-Executive Chairman of the Board of Directors:

iPierian, Inc., South San Francisco, USA;  
Limerick BioPharma, Inc., South San Francisco, USA;  
Oligasis, LLC, Palo Alto, USA;  
PhyloTech, Inc., San Francisco, USA.

Non-Executive Member of the Board of Directors:

Mirna Therapeutics Inc., Austin, USA;  
Neuro Therapeutics Pharma, Inc., Chicago, USA.

**Scientific Advisory Board**

In 2010 there was no meeting of the board. The remuneration amounted to TEUR 28 (2009: TEUR 86).

### **Subsequent events**

On 9 February 2011, Evotec signed a definitive agreement to acquire all shares in Kinaxo Biotechnologies GmbH, a Munich-based drug discovery alliance company supporting the development of targeted drugs.

The purchase price consists of 2,597,403 shares from authorised capital, a cash consideration of T€ 3,000 and an earn-out component of up to T€ 4,000 in cash. 614,165 shares out of the 2,597,403 shares from authorised capital are held in escrow and their release is subject to certain company events and representations. The deal is expected to close in April 2011.

### **Others**

The company has prepared Consolidated Financial Statements that qualify as statutory obligatory Consolidated Financial Statements pursuant to section 315a par. 1 HGB, which will be published in the electronic German Federal Official Gazette („Bundesanzeiger“). The company prepares Consolidated Financial Statements for the largest and smallest possible number of companies. These statements can be obtained at the Commercial Register in Hamburg, Germany.

Hamburg, 1 March 2011

Dr Werner Lanthaler

Colin Bond

Dr. Cord Dohrmann

Dr Mario Polywka

# Evotec AG, Hamburg

## Management Report for the Financial Year 2010

### I. Operations and Business Environment

#### Organisational Structure and Business Activities

##### - Group Structure

Evotec AG (hereinafter referred to as “Evotec” or “the Company”) is a publicly listed stock corporation operating under German law. The Company has its headquarters in Hamburg, Germany, and operating subsidiaries in Abingdon, UK, Thane, India, Göttingen, Germany, North Potomac, Maryland, USA, and Singapore. In Hamburg Evotec employed 138 people at the end of 2010.

##### - Products and Services

Evotec AG is the parent company of Evotec group. Evotec AG is focused on drug discovery and development for novel small molecule therapeutics. Through various research programs Evotec generates high quality research results, building a portfolio of proprietary drug candidates and feeding into the pipeline of its partners in the pharmaceutical and biotechnology industries.

Through its Discovery Platform, Evotec provides innovative solutions to the pharmaceutical and biotechnology industry from target to clinical development through a range of capabilities and capacities. This includes early-stage assay development and screening, fragment-based drug discovery and *in vivo* pharmacology. Evotec's partners include, among others, Boehringer Ingelheim, CHDI, Genentech, Novartis, Ono Pharmaceutical and Roche. In exchange for access to its integrated discovery offerings Evotec receives contractual service fees and ongoing Full Time Equivalent (FTE) -based research payments and, in certain circumstances, up-front technology access fees, and milestone and royalty payments related to the achievement of certain research, development and sales milestones.

#### Significant Corporate Development Events

In 2009, Evotec published its 'Evotec 2012 – Action Plan to Focus and Grow'. With this initiative, the Company communicated its refocused strategy to invest into and grow its core discovery platform. In addition, Evotec decided to concentrate its pipeline R&D on the most valuable assets and also to significantly reduce SG&A expenses. The Company has continued this focus in 2010. This strategy had resulted in revenue growth of more than 25% in 2010 compared to prior year and is the best result in the history of Evotec.

During the third quarter of 2010, Evotec's investments changed through the acquisition of DeveloGen announced on 14 July and closed on 3 September 2010. DeveloGen is a biopharmaceutical company engaged in the discovery of novel therapeutic approaches for the treatment of metabolic and endocrine disorders.

Evotec AG became owner of 99.4 % of the shares in DeveloGen AG at the closing of the transaction on 3 September 2010. The agreed purchase price consisted of up to €13,500,028 in Evotec shares and an earn-out component in cash. The €13,500,028 in shares was fulfilled by the issue of 6,750,014 new Evotec shares - to determine the number of shares, the parties of the share purchase agreement had agreed upon a value of €2 per share. These shares were issued from the authorised capital of the Company. They were registered by the trade register on 7 October 2010. Following the registration 3,976,338

shares were immediately issued to the sellers and the remaining 2,773,676 shares were conditional. The respective conditional shares are held in escrow and their release is subject to certain company events and representations. Following the signing of a beta cell agreement by DeveloGen AG in December 2010, 1,398,561 shares will be released from this escrow to the sellers in March 2011. All shares issued are subject to a six months lock-up. In addition, former DeveloGen shareholders are eligible for success-based cash payments (earn-out) based on future milestone and royalty income generated from three agreements between DeveloGen AG and certain third parties. The signing of the above mentioned beta cell agreement resulted in a cash payment of € 1.5m which has been accrued as of 31 December 2010.

On 30 December 2010, Evotec filed Form 15F with the Securities and Exchange Commission (SEC) to deregister and terminate its reporting obligations under the US Securities Exchange Act of 1934 (Exchange Act) for its American Depositary Shares (ADSs) and its ordinary shares underlying the ADSs. The deregistration and termination of reporting obligations is expected to take effect in March 2011. This deregistration from the SEC is the final step following delisting from NASDAQ, which was initiated in November 2009. Evotec shares of course continue to be traded on Frankfurt Stock Exchange. Evotec's ADSs are traded on the over-the-counter (OTC) market in the US.

### **Group Management and Supervision**

As required by the German Stock Corporation Act (Aktiengesetz), Evotec AG has a two-tier board system consisting of the Evotec Management Board (Vorstand) and the Evotec Supervisory Board (Aufsichtsrat). The Management Board is responsible for managing Evotec and representing the Company in its dealings with third parties, while the Supervisory Board appoints and dismisses the members of the Evotec Management Board and oversees the management of the Company. German law prohibits the Supervisory Board from making management decisions.

The Evotec Supervisory Board consists of six members - as provided in the current Articles of Association - all of whom are elected by the shareholders by a simple majority of the votes cast at a shareholders' meeting. The Supervisory Board appoints a chairman and one or more vice-chairmen from among its members. The members of the Supervisory Board are elected for five years and may be re-elected. The term of the current members of the Evotec Supervisory Board will expire at the end of the annual general shareholders' meeting held in the year 2014.

Under Evotec's Articles of Association, the Supervisory Board determines the size of the Management Board, which must have at least one member under the German Stock Corporation Act. The statutory maximum term for members of the Management Board is five years, but Evotec's current practice is to limit the terms to three years. Management Board members may be reappointed and may be dismissed with good cause prior to the termination of their terms of office.

In 2010, Colin Bond was appointed as member of the Management Board effective 1 August. He took over the responsibilities of Chief Financial Officer. Bond has more than 25 years experience in multi-national companies most recently as the Chief Financial Officer of Novelis Europe. Dr Klaus Maleck, the predecessor as Chief Financial Officer, took over the responsibilities for Corporate Development as member of the Management Board until 31 October 2010 and further on as Executive Vice President Corporate Development. Dr Cord Dohrmann was appointed as Chief Scientific Officer and member of the Management Board effective 1 September. Dr Dohrmann has spent over 20 years in biomedical research at leading academic institutions including the Max-Planck Institute, Harvard Medical School and the Massachusetts' General Hospital. For the last 10 years, Dr Dohrmann served DeveloGen in various management positions including CEO, growing DeveloGen from a



start-up to internationally recognised metabolic disease company with a focus on developing highly innovative therapies for diabetes. Dr Werner Lanthaler, Chief Executive Officer, and Dr Mario Polywka, Chief Operating Officer, continued in their Management Board positions.

Information regarding the remuneration of Evotec's Management Board and Supervisory Board can be found in the 'Remuneration Report' on page 10 of this Management Report.

## **Declaration of Corporate Management**

More information on Company management practices can be found in the Company's "Declaration of Corporate Management" according to section 289a HGB on Evotec's website at [www.evotec.com](http://www.evotec.com), Investors > Corporate Governance.

## **Corporate Performance Measures, Objectives and Strategy**

Management's objective is to systematically and continuously increase the value of the Company. Management has in the past years successfully transformed Evotec and its subsidiaries from a small technology provider into a focused discovery and development company. Non-core research services and the discovery instruments business were divested for cash. Today the Company has integrated into its cash generative discovery alliance business disease know-how, in particular in neuroscience, pain, metabolic diseases as well as in oncology and inflammation, and has a number of drug candidates at various stages of development that are either partnered or available for partnering.

### **- Growth Strategy and Non-Financial Performance Measures**

Evotec's strategy is to build sustainable, profitable drug discovery alliances. Consequently, Evotec focuses on high value, revenue generating partnerships with pharmaceutical and biotechnology companies. Additionally, Evotec will continue to fund a limited number of its internal pipeline products to a position where they become partnerable. The key elements and related non-financial performance measures of Evotec's strategy are as follows:

#### Focus and grow the discovery platform

Evotec has built substantial drug discovery expertise and an industrialized platform that can assist pharmaceutical and biotechnology partners to drive new innovative small molecule compounds into the clinic. This expertise covers the entire spectrum of discovery and is applicable to targets across multiple therapeutic indications. Its capabilities include high-throughput and high-content screening, fragment-based drug discovery and *in vivo* pharmacology. In addition, Evotec has built a deep internal knowledge base in various therapeutic areas. Leveraging these skills and expertise, the Company intends to organically grow its discovery platform through strategic partnerships with pharmaceutical and biotechnology companies. Evotec will also seek to expand its technology and capabilities in offering an integrated drug discovery platform in areas that complement its current operations.

#### Establish corporate collaborations to assist in the development and commercialisation of Evotec's pipeline products

Evotec reduced its pipeline by the B1 antagonists for the treatment of neuropathic pain and inflammation. However, the company focused and continues the work in proprietary late-stage preclinical research programmes with focus on H3 antagonists for the treatment of cognitive disorders and narcolepsy, and antagonists for the purinergic receptor P2X<sub>3</sub> for the treatment of inflammation and urinary incontinence. Evotec seeks to selectively partner or publicly fund these assets for further development.

## **- Financial Control Criteria**

Evotec's goal is to reach operating profitability and to generate cash sustainability by 2012. The Company believes that the strong growth achieved and anticipated in its discovery platform, combined with strict cost control and a prudent investment policy, are the basis for future financial success and shareholder value creation.

Management engages in monthly financial reviews with a strong emphasis on key financial performance drivers such as revenues, order book status and gross margins as well as careful cost analysis (SG&A, R&D expenses) to measure its performance against its financial targets and to understand performance versus prior year.

In addition, cash forecasts, including the definition of minimum cash levels, the monitoring of contract research revenues and milestones, and operational cash flow are critical for Evotec to short and mid-term financial performance. The same is true for the reporting of liquidity and treasury performance. It is performed in a comprehensive and timely manner with the focus on cash management, FX exposure, funding optimisation and investment opportunities.

Value analysis based on discounted cash flow models is the most important financial control criterion for Evotec's investment decisions and development projects.

## **General Market and Healthcare Summary**

### **- Economic and Healthcare Overview**

The global economy experienced a recovery since the end of the recession in the middle of 2009. However, underlying this growth there is a substantial divergence between the rapid annual growth of the key emerging markets and the sluggish pace of recovery in the advanced nations, and uncertainty has gripped observers about the sustainability of growth in the world's three biggest markets: the United States, Europe and China. In Germany, solid growth was experienced in contrast to the hesitant trend in other industrialised countries and export performance was on a high level. Consequently, stock market activity increased significantly. During 2010, the DAX index gained 16% and the German technology index TecDAX 4%.

Evotec's business performance as a provider of drug discovery solutions is not directly impacted by the economic cycle. The performance of the pharmaceutical industry is affected by a significant imbalance between new product introductions and patent losses. Instead of developing a product from early stage research, which involves significant funds, pharma companies are increasingly looking for promising pipeline candidates. The industry has experienced significant M&A activity over the last few quarters and in-licensing transactions to make up for the loss of revenues that will arise with key products losing patent exclusivity. During the third quarter of 2010, for example, SanofiAventis made a tender offer to acquire the biotech company Genzyme. At the same time, a number of major pharmaceutical companies announced restructuring programmes, including closure plans for entire research facilities, reducing the number of disease areas of focus within their therapeutic portfolio and focusing on externalisation. This trend is expected to continue into 2011. This constitutes a shift in the pharmaceutical landscape where the world is moving more and more towards collaborative work processes between discovery solution providers such as Evotec and dedicated project groups amongst the pharmaceutical companies, thus resulting in increased outsourcing of drug discovery projects. According to a study from Kalorama Information (June 2010) the global drug discovery market is expected to experience robust growth, exceeding \$8 bn in 2010 and reaching \$14 bn in 2014. Outsourcing has proven to be a useful tool by which pharmaceutical companies manage their core functions and increase

capital efficiency. Strategic outsourcing has provided a valuable way to achieve time and cost savings as well as provide financial and operational flexibility.

Evotec recognised this trend within the pharmaceutical landscape of optimising the whole drug discovery process and consequently implemented a strategy of providing innovation as the core of all its partnering activities. Evotec is one of the few drug discovery businesses that can execute a comprehensive outsourcing strategy due to the Company's highly integrated drug discovery capability.

#### **- Exchange Rate Development, Interest Rates and Financing**

Evotec's financial performance is affected by currency movements and to a much lesser extent by fluctuations in interest rates. However, changes in raw material prices do not materially influence Evotec's industry.

The Euros (EUR) to U.S. Dollars (USD) **exchange rate** fluctuated between 1.20 and 1.45 in 2010. The Euro weakened in the middle of the year in response to the default concerns of countries on the periphery of the Euro zone. However, it strengthened towards year-end in response to concerns about the weakness of the US economic recovery and the size of the US deficit. A strengthening USD leads to a reduction in Evotec's revenues in EUR and to a decreasing liquidity in EUR. Evotec's expenses in USD in 2010 were negligible. Due to the strength of the USD in H2 2009, taking the year as a whole, the USD was weaker and had a positive impact on 2010 revenues of approx. €0.4m in comparison to 2009.

Evotec policy is not to speculate on foreign exchange movements.

Historically low **interest rates** continued throughout 2010. In Europe the ECB inter-banking interest rate remained at 1% throughout the entire year. In the US the target range for the federal funds rate was kept at between 0 and 0.25 %. The main impact of low interest rates on the financial performance of Evotec is to reduce the interest income received on the cash deposits and the short-term investments of the Company.

Despite the overall availability of cheap money, traditional debt financing without cash collateral was still not available to the Company. However; Evotec is one of the very few European small cap biotech companies with a healthy liquidity position and believes this to be a competitive advantage in building the Company and shareholder value. Evotec will continue to operate as capital-efficiently as possible, to assess the funding of its R&D activities and capital investments carefully and to balance this against cash flow from revenue-bearing business to assure that Evotec's cash will be sufficient to develop the Company to sustainability.

#### **Management Board's General Assessment of Business Performance**

Due to a strong top-line performance in 2010, Core business revenues with third parties excluding license income improved over 2009 by 37%. The growth of the discovery alliances was clearly above expectations. Evotec achieved a number of new or extended collaborations in 2010. Evotec remains comfortably financed and continues its work on the internal research pipeline that includes several partnerable assets that could provide a significant upside. The investments in these assets, however, will be focused on the most value-generating steps and programmes.

## II. Financial Report

### Results of operations

#### Revenues

Evotec's total revenues in 2010 amounted to €19.2m, an increase of €4.6m or 32 % in comparison with the previous year (€14.6m).

Third party sales increased from €12.2m (2009) to €14.0m. Assay development and screening (incl. nuclear magnetic resonance (NMR) screening) performed well with an increase in revenues of €2.7m or 52 % to €8.0m compared to 2009 (€5.3m). The initiatives from the 'Evotec 2012 – Action Plan to Focus and Grow', implemented in spring 2009, become rewarded. FTE-based revenues increased by €0.6m (15 %) to €4.3m in 2010 mainly driven by one single customer (€0.7m). The improvement results from an increased number of FTEs during the year and profitable foreign currency effects due to a stronger US-Dollar. License income amounted to €1.6m (2009: €3.2m). The decrease resulted from unusual revenues in 2009 which included a milestone of €1.0m and a license payment from the former Joint Venture partner DeveloGen AG of €0.7m.

Internal sales increased from €2.4m (2009) to €5.2m. The internal demand from affiliated companies, which includes support for external projects and for internal R&D programmes of subsidiaries, increased by 2.8m. The support for customer work increased by €3.0m to €5.1m whereas the support for internal R&D programmes decreased by €0.1m to only €0.1m. The reduction of R&D related support is a consequence to focus on a few internal R&D programmes.

The geographical spread of revenues for Evotec continues to be global. The European market was the largest market for Evotec in 2010 (51 %) followed by the US market (42 %). The Asian market (7 %) is of lower significance. The top customer represented almost 31 % of the revenues, but the remaining third party revenues are spread over a large number of different customers.

#### Gross profit (Rohertrag)

The gross profit (Rohertrag) is defined as revenues plus change in inventories minus cost of materials. The gross profit for 2010 increased by €0.6m to €12.6m which translates into a gross profit margin of 65.7 % (2009: €12.0m respectively 82.4 %). The increase in revenues resulted mainly from an integrated deal that was closed by AG. The cost increased as well as several work packages of this integrated deal were outsourced to UK and India and caused the significant increase in outsourcing expenses (€2.7m). With the transfer of proprietary late-stage preclinical research programmes like H3 and P2X3 from Evotec's subsidiaries end of 2009 the need for external work, both from subsidiaries and third parties, increased by €0.9m. In summary, total outsourcing costs increased by €3.6m from €0.9m to €4.5m.

Total raw materials and supplies increased from €1.6m in 2009 to €2.2m in 2010.

Raw materials and supplies for external research programmes (€2.0m) occurred €0.4m higher in comparison to the previous year. Out of these, general materials and customer specific materials were higher by €0.3m as a result of the increasing revenue growth. A write off in the amount of €0.3m was recorded for Evotec's compound library in 2010 whereas a usage of €0.2m occurred in 2009.

Raw materials and supplies for internal research programmes increased by €0.2m as a result of the increased number of internal R&D projects in Evotec following the transfer from EVOTEC NeuroSciences GmbH.

## **Net result**

The net loss for the year improved by €41.1m from €43.6m in 2009 to €2.5m in 2010.

The improvement in net result was caused by the following effects:

As mentioned above there is a positive effect of €0.6m from the gross profit (Rohertrag).

Evotec benefited in 2010 from a loan repayment by the subsidiary EVOTEC NeuroSciences GmbH (€2.5m) which effects other operating income because the original loan receivables were written-off in 2009. Furthermore the write-off of the Investment in 2009 (€2.3m) in EVOTEC NeuroSciences GmbH was reversed in 2010 as a result of an impairment test. For the same reason a write-up of the investment in Renovis Inc. was recorded (€1.3m). In 2009 the liability was written-up by €0.4m. Evotec received grant income of €0.6m in 2010 and income from reversal of provisions increased by €0.3m. With the transfer of employees from EVOTEC NeuroSciences GmbH to Evotec AG in November 2009, Evotec AG strongly reduced the charge for administrative work. This is the main reason why Intercompany recharges and rent income decreased in total by €1.4m. All in all other operating income increased from €4.8m to €10.1m.

Personnel expenses increased by €2.1m to €9.8m. In November 2009 all employees of EVOTEC NeuroSciences GmbH were transferred to Evotec AG. The strong increase in demand required the recruitment of new employees (22 HCs during 2010), so that the average number of employees increased by 27 employees in comparison to previous year.

In 2010, further €2.2m loan receivables from EVOTEC NeuroSciences GmbH were written-off for the same reason as in 2009. The 2009 net result was affected by a number of uncommon effects. Loan receivables of €37.4m and the investment (€2.3m) in EVOTEC NeuroSciences GmbH were written-off as a result of the over-indebtedness of Evotec AG's subsidiary EVOTEC NeuroSciences GmbH. Additionally, a write-down of the investment in Renovis Inc. was recognised in 2009 amounting to €9.9m due to the wind down of the US operations. Also in 2009, a write-off of loan receivables amounting to €1.0m with the European ScreeningPort GmbH, a minority holding of Evotec, was recognised. This write-off was based on an insufficient cash forecast of the European ScreeningPort GmbH in the near future. And hence, Evotec's Management decided a cancellation of debt subject to restoration (Forderungsverzicht mit Besserungsabrede). As a consequence, write off and impairments in total decreased by €48.5m to 2.2m in 2010.

Other operating expenses increased by €3.4m to €13.9m. B1, one of the proprietary research programmes, was put on hold and removed from the project portfolio. This resulted in a loss from asset disposal in the amount of €1.0m as the company does not expect a benefit from research in the future. During the year, Evotec transferred the BMBF funded project Serine Racemase from its subsidiary EVOTEC NeuroSciences GmbH to AG (€0.7m). Also in 2010, a further write-off of loan receivables amounting to €0.4m from the European ScreeningPort was necessary for the same reasons as in 2009. Furthermore, Evotec received a higher charge from Evotec (UK) Ltd. for administrative work as well as for sales commissions based on increased revenues in Asia. Foreign currency losses increased by €0.5m. Losses from sale of current investments contributed €0.3m to the increase in other operating expenses. Furthermore, maintenance contracts increased due to new labour equipment, additional patent costs for new proprietary R&D Projects occurred and rent

increased. However, savings resulted from lower consultancy expenses for Sarbanes-Oxley compliance, from lower royalty costs following the decreased License income and from the preparation of the annual report.

No amortisation of financial assets and current investments was recognised in 2010. In 2009, Evotec reported a €2.8m gain from a reduction in capital reserves of Evotec (UK) and €1.2m earnings related to the liquidation of Neuro3d S.A.

Interest income from intercompany loans decreased by €3.4m to €2.3m due to a decrease in interest rates for the loan of the subsidiary EVOTEC NeuroSciences GmbH. Interest income, which results mainly from cash on deposits, decreased by €0.2m to 0.1m due to low interest rates in 2010. Total other interest income decreased from €5.9m to €2.3m.

## **Financing and financial position**

### **Cash and Financing**

As per 31 December 2010, Evotec's cash and cash equivalents together with bonds and investment funds, presented as other financial assets and other investments, amounted to €34.6m which is an increase of €3.1m compared to the end of 2009 (€31.5m). Evotec benefited from the distribution of share capital by Renovis, Inc. (€17.8m). A significant part of the liquidity was used to finance the know-how transfer of the proprietary R&D programmes from the affiliates EVOTEC NeuroSciences GmbH and Renovis, Inc. (in total €6.3m). Additionally, cash was used to finance the operational cost of these transferred R&D programmes. With the acquisition of DeveloGen AG, Evotec committed to grant DeveloGen an intercompany loan of €2.1m to enable DeveloGen AG to repay its debts. Furthermore, Evotec paid an earn-out in relation with the RSIPL acquisition (€0.7m).

### **Assets and liabilities**

#### **Capital structure**

Due to the acquisition of DeveloGen AG Evotec's share capital increased by €6.8m to €115.6m in comparison to 2009. Total equity increased to €110.3m (2009: €106.0m) following the acquisition but diminished by the net loss of €2.5m. In 2010, 7,000 stock options were exercised by employees of the Evotec group (2009: none) and converted into Evotec shares – using conditional capital. Hence, Evotec ended the year with an equity ratio of 88.9% (2009: 84.6%).

#### **Net assets and liabilities**

The Company owns fixed assets consisting of leasehold improvements, technical equipment and machinery, fixture and fittings (predominantly laboratories) and scientific and technical equipment for use in these laboratories. In addition, the Company has offices and information technology which are also used by its affiliated companies.

As in previous years, new investments in tangible fixed assets were handled restrictively. Tangible fixed assets decreased from €6.0m at end of 2009 to €5.6m in 2010 as capital expenditures (€1.1m) were lower than depreciation (€1.5m). Capital expenditures in 2010

were used to replace old machinery and equipment or were invested in new equipment which was required to support Evotec's long-term collaboration agreements.

Financial assets comprise the Company's shareholdings in affiliates and participations. These investments decreased to €71.0m (year-end 2009: €76,8m). In 2010, the carrying amount of the investment in Renovis Inc. was written-up by €1.3m. Subsequently, the costs of acquisition were reduced by €17.8m due to a cash payment out of the capital reserve. The investment in DeveloGen AG effective 3 September 2010, increased the investments by €8.4m. Furthermore, the write-off of the Investment in 2009 (€2.3m) in EVOTEC NeuroSciences GmbH was reversed in 2010 as a result of an impairment test.

As of 31 December 2010, inventories decreased slightly to €2.0m (2009: €2.2m), mainly due to finalized customer projects and associated decrease of work in progress. Receivables increased to €5.0m (2009: €2.0m) which is mainly due to an increase in accounts receivables from affiliated companies (€3.1m). Evotec provided a loan to DeveloGen AG in an amount of €2.1m. Further, a loan of €0.3m was granted to Evotec (India) Private Limited. Evotec AG's debt with financial institutions remained unchanged with €6.5m as per 31 December 2010. Trade accounts payable slightly increased from €1.0m to €1.1m. Accrued liabilities increased slightly from €5.0m to €5.2m. The major effects are provisions for the potential performance-related deferred payments (earn-out) from the acquisition of DeveloGen AG (€1.5m), partly offset by the utilization of the provision for the Earn-out for Evotec (India) Private Limited in the amount of €0.7m in 2010 as well as the provision in connection with the termination agreement with the former CEO Jörn Aldag (€0.3m). Liabilities with affiliates decreased to €0.1m (2009: €5.5m), primarily due to the payment of transfer of intellectual properties on proprietary research from EVOTEC NeuroSciences GmbH and Renovis Inc. invoiced in December 2009.

## **Employees**

On average Evotec employed 126 people in 2010 compared to 99 in the year before. To meet the increased demand in drug discovery services Evotec recruited 22 new employees. In November 2009, all employees from EVOTEC NeuroSciences GmbH were transferred to Evotec AG. The increase mainly resulted from operations. Employees in administration only increased by 3 to 29 people.

## **Shareholdings Exceeding 10% of Voting Rights**

In September 2009, Evotec had been notified by its shareholder Roland Oetker that he, via ROI Verwaltungsgesellschaft mbH, Königsallee 20, 40212 Düsseldorf, Germany, owned 11.07% of the shares of the Company. No further notification concerning this matter was received and the Company is not aware of any other direct or indirect shareholdings in its share capital exceeding 10% of its capital.

## **Amendment to the Company's Articles of Association/ Appointment of Management Board**

Any amendment to the Company's Articles of Association requires a shareholder resolution. According to sections 133 and 179 of the German Stock Corporation Act (AktG) and section 15 of the Articles, the shareholder resolution amending the Company's Articles of Association requires an affirmative vote of at least three quarters of the Company's share

capital present in a general shareholders' meeting. Appointment and dismissal of the members of the Management Board are governed by sections 84 and 85 of the German Stock Corporation Act (AktG).

#### **IV. Remuneration Report**

The Remuneration Report describes the Company's remuneration structure and provides information about the payments to the board members in accordance with the requirements of the German Corporate Governance Codex (the 'Code'). It is part of both the Consolidated Financial Statements and the Corporate Governance Report.

##### **Remuneration of the Management Board**

The total compensation of the individual members of the Management Board is determined at an appropriate amount based on a performance assessment and is oriented towards sustainable growth of Evotec. Criteria for determining the appropriateness of compensation include the tasks of the individual member of the Management Board, their personal performance, the economic situation, the performance and outlook of Evotec as well as the common level of compensation of Evotec's peer companies and the compensation structure in place in other areas of the Company.

In 2010, fixed and variable remuneration as well as components with a long-term incentive effect of active members of the Management Board totalled T€2,088, of which the variable part amounted to T€433 and the components with a long-term incentive effect amounted to T€587. The remuneration of the Management Board included T€398 for Dr Mario Polywka who was not paid by Evotec AG.

Fixed remuneration includes base salaries, contributions to retirement insurance, premiums for accident and accidental death insurances as well as the benefit derived from the use of company cars.

Variable remuneration is determined by a bonus scheme that is designed every year by the Remuneration and Nomination Committee of the Supervisory Board and is subsequently approved by the Supervisory Board. The variable portion of the remuneration paid out in 2010, payable upon the achievement of certain strategic targets for the business year 2009, was based on several criteria. For Dr Werner Lanthaler it was based on the achievement of five sets of corporate milestones. For Dr Klaus Maleck and Dr Mario Polywka it was based on these corporate milestones for 90% of their bonus and for the remaining 10% on the achievement of personal objectives.

The variable portion of the remuneration to be paid out in 2011 depends on the achievement of certain strategic targets for the business year 2010. For the Company's Chief Executive Officer Dr Werner Lanthaler it will be based on the achievement of four sets of corporate milestones for 80% of his bonus and for the remaining 20% on the achievement of personal objectives. For the other members of the Management Board it will be based on the same corporate milestones for 60% of their bonus and for the remaining 40% on the achievement of personal objectives.

In addition to their fixed and variable remuneration, the members of the Management Board received a total of 625,000 stock options in 2010 under the Company's stock option plans. The options granted in 2010 are subject to the stipulations of the Option Plan 2008 and may



be exercised after three years if the conditions of this plan are met. The fair values of options as of the grant dates amounted to a total of T€ 587.

<b>Remuneration of the Management Board 2010</b>					
	Fixed remuneration	Variable remuneration	Stock options	Fair values of options granted	Total remuneration
	in T€	in T€	in pcs	in T€	in T€
Dr Werner Lanthaler	373	243	200.000	180,0	796
Colin Bond *)	126	0	100.000	102,0	228
Dr Cord Dohrmann **)	91	0	100.000	102,0	193
Dr Mario Polywka	287	111	150.000	135,0	533
Dr Klaus Maleck ***)	191	79	75.000	67,5	338
<b>Total</b>	<b>1.068</b>	<b>433</b>	<b>625.000</b>	<b>586,5</b>	<b>2.088</b>

\*) Member of the Management Board as of 1 August 2010  
 \*\*) Member of the Management Board as of 1 September 2010  
 \*\*\*) Member of the Management Board until 31 October 2010

The members of the Management Board of Evotec AG have only customary rights in case of a change-of-control. Their contracts contain a change-of-control clause which would allow them to terminate their current contracts in the event of a change-of-control. In case members of the Management Board make use of their right to terminate their contracts in the event of a change-of control, they are entitled to severance payments determined as follows: For Dr Werner Lanthaler, the severance payment shall be equal to 24 months of base salary, for Dr Mario Polywka, the payment shall be equal to 18 months of base salary, and for Colin Bond and Dr Cord Dohrmann, respectively, the payment shall be equal to 12 months base salary plus bonus. In no case, the respective severance payment shall be higher than the total compensation due for the remaining term of the respective Management Board member's contract.

When Jörn Aldag resigned from the Company's Management Board effective 31 December 2008, he and Evotec had entered into a non-competition agreement exceeding the regular duration of his service agreement. They also agreed upon a lump-sum payment equivalent to the remuneration that Jörn Aldag would have received had his contract expired and not been terminated. No further severance payments were agreed. The exit agreement stipulated gross total payments of T€ 2,022 to Jörn Aldag. These payments consisted of T€ 573 fixed and T€ 805 variable remuneration for the period until his contract would have expired, if not terminated, as well as T€ 644 for the non-competition agreement. Of this sum, T€ 1,700 were paid in early 2009 and the remaining T€ 322 in early 2010.

Apart from the payments to Jörn Aldag, no payments were made in 2010 to any former Management Board member.

The Company has made a provision for pension for one former Management Board member amounting to T€ 112. This provision was netted by a liability insurance (T€ 68) closed for a pension obligation. Total net amount is T€ 44.

No further such provisions are due for other former Management Board members or their surviving dependents.

## Remuneration of the Supervisory Board

The general principles of Supervisory Board remuneration are set forth in the Company's Articles of Association by the Annual Shareholder Meeting.

The members of Evotec's Supervisory Board are entitled to fixed and performance-based payments. In accordance with the recommendations of the Corporate Governance Code, Chair and Deputy Chair positions on the Supervisory Board, as well as the chair positions and membership on committees are considered when determining the remuneration of individual members. Every Supervisory Board member receives T€15 per year, with the Chair receiving three times that amount and the Deputy Chair twice that amount. Members of Supervisory Board committees additionally receive T€3.75 per year, with the chairperson receiving T€10.

In addition to the fixed remuneration and in accordance with the suggestions of the Code, the members of the Supervisory Board receive payments tied to the Company's long-term performance, in the form of Evotec shares. Ordinary members of the Supervisory Board receive shares valued at T€10 (Chair three times, Deputy Chair twice this amount) and Committee Chairs receive additional shares valued at T€10. This share-based remuneration serves as a further incentive for Supervisory Board members to focus on the Evotec share price. In addition, if Evotec shareholders are paid a dividend, every Supervisory Board member will receive an extra T€0.5 for every cent that the dividend per share exceeds €0.15.

For their contributions in 2010, the individual members of the Evotec Supervisory Board receive the following compensation:

<b>Remuneration of the Supervisory Board 2010</b>			
	Cash remuneration	Value of share based remuneration	Total
T€			
Dr Flemming Ørnskov	48,7	30,0	78,7
Dr Walter Wenninger	37,2	25,6	62,8
Dr Hubert Birner	25,0	20,0	45,0
Dr Peter Fellner	18,8	10,0	28,8
Mary Tanner	18,8	10,0	28,8
Dr Corey Goodman 1)	2,5	1,7	4,2
<b>Total</b>	<b>151,0</b>	<b>97,3</b>	<b>248,3</b>

1) Member of the Supervisory Board until 31 January 2010

After his resignation from the Supervisory Board in August 2008, Professor Dr Heinz Riesenhuber had entered into a two-year consultancy agreement with Evotec. Thus the Company is able to call upon Professor Dr Riesenhuber's knowledge and expertise of the Company's business activities and its business environment. The term of this two-year agreement was extended for one further year that is for the period between 1 September 2010 and 31 August 2011. The agreed annual compensation amounted to T€22.5 in the first 12 months, to T€25.0 in the second 12 months, and to T€20.0 for the current term of the agreement.

There are currently no further consultancy agreements between Evotec and current or former members of the Supervisory Board.

## Directors and Officers Liability Insurance (D&O Insurance)

Evotec has procured directors and officers liability insurance coverage for its Management and Supervisory Board members, its senior management and the directors of its subsidiaries, at a cost to the Company of T€214 in 2010. For the members of Supervisory Board, an appropriately sized deductible, and for the members of the Management Board, a deductible in line with the stipulations of the legal provisions of the Act on Appropriateness of Management Board Compensation (VorstAG) were agreed upon.

## VI. Risks Management and Risk Report

### Risk Management System

Evotec is aware that it needs to regularly monitor and limit the risk exposure associated with its business and to successfully capture new business opportunities in order to secure the generation of shareholder value. Evotec therefore places substantial emphasis on risk management as an ongoing management task. Evotec employs a comprehensive risk management policy and risk management system which forms an integral part of the Group's management processes and complies with the legal requirements. Evotec's risk management system assesses on an ongoing basis all significant company activities to identify, analyse and value risks. These risks are documented and communicated to the Group Risk Manager and the Management board (Vorstand). Despite this appropriate and functioning system, there cannot be an absolute certainty that all possible risks are identified and managed. The system's efficacy is verified on a continuous basis. Beside the formal risk management policy as explained in the following, the risk management system is based upon Evotec's general guidelines of corporate management and the code of conduct, as described in the Declaration of Corporate Management.

According to the Company's risk management policy Evotec engages in businesses only when this is in line with its strategy and with risks common within the industry, and when adequate reward potential is offered. At least once a year the Management Board defines the Group's specific affinity to financial risk in accordance with the prevailing business and financial condition, including in particular the definition of minimum cash levels and milestones critical to short and mid-term financial performance. Management engages in monthly financial reviews with a strong emphasis on cash and cash forecasts, and key financial performance drivers such as revenues, order book status and gross margins, as well as careful cost analysis (SG&A, R&D expenses). It is Company policy not to speculate on foreign exchange movements, but to manage the risks arising from underlying business activities, for example, to gain foreign exchange certainty against the value of signed customer contracts. Financial investments are made in low risk categories (products or financial institutions rated A or better (Standard & Poor's ratings)). As a consequence of the financial crisis the Management Board has further increased its attention on mitigating financial risks. It is therefore directly involved in all decisions concerning financial assets and manages all businesses and transactions considered to be material for the Company, as reinforced by a revised set of Company policies.

To cover other risks associated with the Company's business, including those that would not have a short-term financial impact, Evotec performs regular commercial project portfolio reviews. Strict application of project and investment approval processes, legal contract review procedures and signing authorities are also standardised procedures. In addition, the Company emphasises its IT security throughout the Company and reviews its insurance coverage regularly. Compliance with the regulatory environment, for example environment, health and safety, has a high priority and corresponding training programmes are in place. All these measures and procedures, as well as further controls, were adapted and implemented. The Company also takes its Corporate Governance responsibilities very seriously. A

declaration according to section 161 AktG was made by the Management Board and the Supervisory Board of the Company. This declaration regarding the Company's compliance with the Corporate Governance Codex is accessible to the shareholders on Evotec's website.

Evotec's risk management system is regularly reviewed by the Company's Compliance Officer, the Management Board and the Audit Committee of the Supervisory Board in order to adjust to changing environments, risk profiles and business opportunities.

Evotec's risk management system comprises the following elements:

(i) a **Risk Early Detection System** to identify risks as early as possible, to precisely describe them, quantify them, estimate their probability of occurrence and to report them to the competent management in a timely fashion, and

(ii) a **Risk Prevention System** to monitor the risks incurred and/or the development of measures and systems to prevent potential risks from occurring.

The **Risk Early Detection System** is intended to identify and report risks as early as possible so as to allow management to deal with them from their very onset. It consists of the following two kinds of reports:

- a) Through *Prompt Notifications*, any risks that are either outside the normal course of business or might have a material impact on the Company's financial performance, are raised and reported to the Company Risk Manager as they emerge by the responsible employee together with a summary and assessment of the specific risk and the counter measures to be taken. The Company Risk Manager reports the received Prompt Notifications to the Chief Financial Officer.
- b) Moreover, on a quarterly basis, responsible line managers forward *Quarterly Risk Reports* which (i) give an update on the risks described in an interim Prompt Notification (if any), (ii) report about any other material risk that has occurred even when beneath the pre-defined thresholds, and (iii) monitor the success of any measure taken to deal with the previously reported risks.

The Company Risk Manager evaluates and summarizes the risk reports above into a quarterly report for the Management Board. This report also includes a cash stress test to examine whether Evotec could bear the cash effect of all captured risks should they fully materialize in parallel. To date, Evotec has always passed this cash stress test.

In addition, any triggering information for an ad hoc notification required under German statutory laws (German Securities Trading Act (WpHG)) will be reported directly to the Management Board immediately after the detection of such an event. In addition, an ad hoc committee convenes once a week to ensure that all relevant circumstances are evaluated properly with regard to ad hoc related stipulations.

All regular internal reports and meeting minutes that could be of relevance to important risk categories are formally included in the Company's risk management system (**Risk Prevention System**). This procedure increases general alertness to risk and risk management, and also emphasizes the principle of risk prevention across the Group.

## Internal Controls over Financial Reporting

Section 289 paragraph 5 of German Commercial Code (HGB) requires the Management Board to take responsibility for adhering to and reporting on an internal control system for reliable financial reporting. The internal control system is part of the risk management system and primarily secures the preparation of financial statements according to regulatory and legal requirements. It is continually further developed and is an integral part of the accounting and financial reporting process in all relevant legal entities and central functions. The internal control system comprises all the principles, processes and measures (such as preventive and detective controls) that are applied to secure effective, economical and proper accounting and compliance with the pertinent legal provisions. Evotec complies with the German Commercial Code requirements. In addition, throughout 2010 the Company also acts in adherence to the requirements of section 404 of the Sarbanes Oxley Act. This was due to the fact that Evotec shares are registered with the SEC under the Securities Exchange Act of 1934, as amended until formal deregistration from the SEC. The deregistration and termination of reporting obligations is expected to take effect in March 2011.

According to the German Commercial Code Evotec's Management Board is required to annually assess the effectiveness of internal controls over financial reporting. Internal assessments identified no material weaknesses and detected deficiencies were remediated immediately. The effectiveness of Evotec's internal controls over financial reporting is also audited by its independent registered public accounting firm. The Audit Committee of the Supervisory Board is informed regularly and discusses the auditing activities.

Evotec maintains an adequate internal control system to provide reasonable assurance regarding the reliability of financial reporting and the preparation of the firm's financial statements for external reporting purposes in accordance with applicable International Financial Reporting Standards and to avoid fraud risks. Our control system is based upon various automated and manual, preventive and detective controls, segregation of financial related duties as well as the adherence to Evotec's policies. Among other things, we regularly check that:

- issues relevant for financial reporting and disclosure from agreements entered into are recognized and appropriately presented;
- processes exist for the segregation of duties and for the "four-eyes principle" in the context of preparing financial statements;
- risks related to relevant IT accounting systems are mitigated by a well defined set of state of the art IT controls such as restricted authorization and defined rules for access, change and system recovery.

Management has determined that our internal controls over financial reporting based on the integrated framework of the Committee of Sponsoring Organization of the Treadway Commission (COSO) were effective in the design and operation as of 31 December 2010.

In addition, Evotec routinely engages external specialists, for example to value share-based compensation or to derive deferred taxes.

Evotec is confident that the systems and processes that have been implemented significantly reduce the risk of negative impacts on the financial reporting and enable specific company related issues to be appropriately recognised in the consolidated financial statements. However, due to the very nature of business activity, discretionary decision-making, faulty checks, criminal acts or specific circumstances that might restrict the efficacy of internal

controls, the application of the risk management systems cannot completely guarantee the accurate, complete and timely recording of facts in accounting.

## Risks

Evotec AG is exposed to a range of risks entirely consistent with its business undertaking. The business, financial condition and results of Evotec may be materially adversely affected by each of these risks. If not stated differently, the risks mentioned below are unchanged in comparison to 2009.

### Business environment, industry and strategy risks

#### (i) Risks inherent to collaboration business

Evotec's collaborations business platform is well established within the industry, and has generated a growing revenue stream over the last years. A satisfied customer base, increased efficiency and superior service quality allow Evotec to generate value through its leveraged research platform and positive gross margin contributions.

However, certain business specific risks need to be managed. Evotec considers that these risks could be assessed as medium and remain in the main unchanged in comparison to the previous year:

> The market environment is marked by pricing pressures originating from funding restrictions of some biotechnology customers and from evolving and strengthening competition in individual drug discovery disciplines in low cost countries. Therefore, firm cost management, continuous enhancement of capabilities and technologies, careful market positioning and sales from high-value results-based contracts are critical for Evotec.

> Even with a stable revenue stream, fluctuating capacity utilisation and resource allocation between different parts of the business can significantly impact profitability, unless these are carefully and flexibly adjusted. In addition, dependence on individual larger customer contracts needs to be closely monitored. In 2010, Evotec's largest customer accounted for 30.5% of total revenues.

> Some of the service contracts contain scientific or technical delivery risks, which can be only partly mitigated with high quality project work. It is an explicit goal of Evotec to grow the business to leverage such risks through the required scale.

> Evotec's past success builds in part on customer recognition and branding. It is therefore of utmost importance to maintain this good reputation and avoid any negative impact on its branding. Evotec has protected its trade name in all active countries and has increased its awareness to strengthen and protect its global market position.

#### (ii) Risks inherent to proprietary drug discovery and development

Evotec has a clear strategic focus on collaboration business and engages in selective proprietary discovery and development activities in order to kick-start such collaborations. These activities clearly carry scientific and financial risk, concentrated on few individual projects. Today, Evotec has no commercial drug products and there is no assurance that Evotec or its strategic partners will successfully develop and commercialize potential drugs. Significant returns are only expected to materialize when successful research leads to upfront and milestone payments and potential royalties from future drug sales are received. Evotec expects to achieve significant payments when any one of the drug candidates is either out-licensed to a pharmaceutical or biotechnology company, or when Evotec decides

to partner the drug. Evotec believes that the associated risks have to be assessed as medium/high but remain more or less unchanged in comparison to the previous year. The associated risks are those inherent to the biotechnology and drug development industry in general:

> Evotec acts carefully and responsibly to prove that clinical product candidates are safe and effective for human use and approvable by regulatory agencies. Drug discovery and development, however, is expensive, time consuming and subject to a high degree of failure. At each stage there is an inherent risk that developments need to be aborted or delayed due to unpredictable results. The rate of failure is highest the earlier the stage of a programme. However, the cost of failure tends to be higher the later the stage of development and preclinical studies and early clinical trials involving limited numbers of patients may not accurately predict the results obtained in later stage clinical testing. A number of companies have suffered significant setbacks in late-stage clinical trials even after achieving promising results in earlier development activities. Even if Evotec identifies promising compounds to valuable targets, or in-licenses or otherwise acquires promising projects or drug candidates, any resulting internal R&D project could experience delays or even fail and it could take several years before the Company could sell or license any drug candidates, if at all.

> Research and Development activities, the approval and marketing of a pharmaceutical product are subject to extensive regulation by the US FDA, the European Medicines Agency (EMA, formerly known as EMEA) and similar regulatory agencies elsewhere. The approval of the relevant authorities is required before a product can be tested in humans and later sold in a given market. The regulatory approval process is intensive, time-consuming and the timing of receipt of regulatory approval is difficult to predict. The authorities can deny their approval for various reasons. In the recent past the regulatory environment has become less predictable, in particular in the US. Therefore, even if the further development of Evotec's drug candidates is successful, regulatory approval might not be received, might be restricted to certain geographical regions or indications, later withdrawn or significantly delayed which could significantly impact the receipt of product revenues, if any. It can be very hard to predict potential regulatory difficulties and their influence on further discovery and development of a proprietary drug candidate. Evotec seeks early discussions with the regulatory bodies at all stages of development to ensure that investments are in conformity with legal and ethical requirements.

> Evotec depends on external contract research organisations (CROs), and independent clinical investigators to conduct certain preclinical studies and clinical trials. Despite their contractual rights, Evotec cannot control the amount of time and resources that the CROs devote to such programmes. The programmes may therefore not be diligent, careful or timely, and there may be mistakes in the conduct of these studies. For example, failure to enrol patients for clinical trials may cause delays in developing Evotec's product candidates.

> The use of any of Evotec's product candidates in clinical trials may expose Evotec to product liability claims in excess of Evotec's limited insurance coverage, although it is diligently assessed for each trial. As of today, Evotec is not aware of any pending threats of product liability claims.

In 2010, Evotec continued to focus its internal R&D activities on its most valuable assets in order to decrease its risk exposure. At present, the Company has no plans to build-up a more extensive pipeline, but will concentrate its efforts on bringing proprietary products from its existing portfolio to important value inflection points. In addition, Evotec intends to partner or publicly fund proprietary programmes to share the risk wherever possible.

### **(iii) Merger and acquisitions**

Evotec's market position is well established and Evotec is known for its first class services by its customers. However, the Company pursues ambitious goals regarding its growth rate through both internal organic growth development and opportunistic acquisitions of financially rewarding and suiting service capacities and capabilities. In 2010, this was exemplified in the acquisition of a 99.4% controlling majority stake of DeveloGen AG in Göttingen. However, such merger and acquisition activities encompass specific risks that need to be managed.

The acquisition of DeveloGen AG bears the risk that the integration of the company into the Evotec Group may be difficult and expensive to achieve. The transaction will present challenges to Evotec's management including the integration of DeveloGen AG's operations and personnel and a potential squeeze-out of the remaining third-party shareholders. In addition, the merger may present special risks including possible unanticipated liabilities, unanticipated costs, diversion of management attention and loss of personnel. Evotec may not be able to integrate DeveloGen AG into its operations or successfully manage the activities acquired in the acquisition. If Evotec's management is not able to implement a business plan that effectively integrates DeveloGen AG's operations, the anticipated benefits of the merger may not be realised which may adversely affect the price of Evotec ordinary shares.

### **(iv) Commercial risks**

The commercial risks inherent to Evotec's collaboration business platform are described in detail in the section 'Risks inherent to collaboration business' on page 16 of this Risk Report. Regarding other commercial risk Evotec trusts that the associated risks could be assessed as medium and are unchanged in comparison to the previous year. Those risks are:

> Although Evotec adjusted its strategy in 2009 and focused its activities on collaboration business, the Company continues to be engaged in a selected number of active drug discovery and development programmes that it intends to license to pharmaceutical companies for clinical development and commercialisation.

The market environment and competitive landscape for licensing and licensed projects or individual drug candidates, in general or for individual treatments, however, might change while engaging in individual projects. The timing and commercial values of, or financial proceeds from partnering individual projects could therefore deviate significantly from earlier projections, for better or worse. During 2010, the out-licensing market in general remained challenging with the impact of the financial crisis hitting the biotech industry.

> Evotec's ongoing efforts to serve as an innovative source of drug candidates to the pharmaceutical industry makes it dependent on individual larger out-licensing or partnering events and hence on individual, typically larger customers. The total amount of payments and the split of these payments obtained in a future out-licensing agreement are unknown and depend on many factors, such as degree of innovation and IP position as well as on external factors not within the control of the Company. In addition, the reliance on corporate partners is subject to additional risks. For example, Evotec's collaboration partner may not devote sufficient time and resources to the development, introduction and marketing of Evotec's products or may not pursue further development and commercialisation of the products resulting from the collaboration. To control this risk to the extent possible detailed project reporting is established within Evotec and stipulated in any collaboration agreement.

> Even if drug products are approved and commercialized by Evotec or its license partner, hospitals, physicians or patients may conclude that Evotec's products are less safe or less effective or otherwise less attractive than existing drugs. In addition, Evotec's competitors may achieve product commercialisation or patent protection earlier than Evotec and/or



develop new products that could be more effective or less costly, or seem more cost-effective, than Evotec's products.

Evotec's financial planning is not based on any partnering of product candidates or product commercialisation and is solid even in the absence of such an event.

### **Business Financing and other financial risks**

Evotec is currently well financed and assesses the financial associated risks to be low/medium, remaining unchanged or slightly decreased in comparison to the previous year. No further financing will be expected for Evotec's subsidiary EVOTEC NeuroSciences GmbH but there will be additional cash outflow to proceed with the new R&D programmes bought from Renovis, Inc. and EVOTEC NeuroSciences at beginning of the Year. The financial risk is expected to be balanced out by these effects.

> As reported last year, in March 2009 Evotec initiated a restructuring process to concentrate on drug discovery alliances and selected development partnerships. With this new strategic focus, Evotec de-risked its business model further with the aim to eventually become sustainable.

> Notwithstanding, expenditures on internal discovery and early development programmes and other costs, as well as reduced revenues, might negatively impact Evotec's short- to mid-term profitability and cash reserves. To actively address any related risk, Evotec's management defined minimum liquidity levels and prepared a scenario planning to safeguard its cash position. As a result of the restructuring measures, Evotec believes that existing liquidity reserves are sufficient under the risk management plan to cope with all cumulated, identified risk implications and that those reserves are a strong basis to develop the Company to sustainability.

> Evotec AG continues to finance its shareholdings and affiliates. But in 2011, only Evotec (India) Private Ltd. is expected to require financing efforts from Evotec AG. All other Subsidiaries should generate most of its financing needs through its operations. However, despite reductions in research and development activities, expenditures on internal discovery and development programs may reduce its short- to mid-term profitability and cash reserves.

> Evotec is currently well financed and has no plans or necessity to raise capital in the near- to mid-term. However, the option to increase capital may always be considered. This might be the case if new opportunities arise in terms of M&A and in-licensing requiring additional financing. The Company does not intend to engage in projects unless appropriate funding is allocated or secured.

> Evotec has not had any relationships with unconsolidated entities or financial partnerships, such as entities often referred to as structured finance or special purpose entities, which would have been established for the purpose of facilitating off-balance sheet arrangements or other contractually narrow or limited purposes. Therefore, Evotec is not materially exposed to any financing, liquidity, market or credit risk that could arise if it had been engaged in these relationships.

> Evotec's customers are generally financially stable pharmaceutical companies, foundations and larger biotech companies. There has been no history of doubtful receivables and this is not expected to change.

> The general risk of losing a significant amount of cash in cash investments is continuously mitigated by spreading the investments across several different banks in high-credit quality

instruments in full compliance with the Company's approved investment policy. Evotec monitors its banks and investments on an ongoing basis.

### **Intellectual property risks**

The intellectual property (IP) associated risks could be assessed as low and remaining stable in relation to the previous year.

> Evotec is dependent on patents and proprietary technology, both its own and those licensed from others, and puts a high emphasis on patent protection and patent monitoring. The Company's success depends in part on its ability, and the ability of its licensors, to obtain patent protection for technologies, processes and product candidates, to preserve trade secrets, to defend patents against third parties seeking to invalidate such patents, and to reinforce rights against infringing parties. Any disputes could result in sizeable additional expenses, project delays and absorption of management attention, and in a dramatic reduction of project values or even in full project abandonment.

### **Legal risks**

With a letter of 19 August 2010, BaFin requested certain information with regard to an ad hoc release made by the Company on 12 August 2010. The Company provided such info with a detailed letter on 13 September 2010. BaFin informed the Company on 14 October 2010 that there might be an indication that the timing of the ad hoc publication constituted an infringement of section 15 German Securities Trading Act (WpHG) and that an administrative offence may have occurred. No further information was received from BaFin until the date of this report. The release of the ad hoc publication was made in line with a prominent position in legal literature. The Company therefore is convinced that no infringement took place.

### **HR risks: Dependence on key personnel**

> Evotec, like many biotechnology companies, is highly dependent on the key members of its management and scientific staff. The loss of any of Evotec's key employees or key consultants could impede the achievement of Evotec's research and development objectives. However, Evotec has set up its management such that the Company's knowledge is shared amongst key employees. Furthermore, recruiting and retaining qualified scientific personnel to perform research and development work in the future is critical to Evotec's success. If Evotec is unable to attract and to retain personnel on acceptable terms despite its strong corporate culture and industry leadership position, this may delay Evotec's development efforts or otherwise harm its business.

> In the recent past, Evotec has not encountered difficulties in attracting and retaining qualified employees and no change is currently foreseen. The risk is therefore assessed as low and is unchanged compared to prior year.

### **Currency risks**

> With a high proportion of sales denominated in US Dollars, currency exposure creates a risk to Evotec's profitability.

Evotec's business and reported profitability are affected by fluctuations in foreign exchange rates between the US Dollar, UK Sterling, the Indian Rupee and the Euro. The Company manages this exposure via natural hedges and selective hedging instruments. Currency exchange movements also impact Evotec's reported liquidity primarily through the translation of liquid assets held in US Dollars or UK Sterling into Euros. A portion of the funds are held in currencies other than the Euro in order to meet local operating needs.

> Overall, currency associated risks are considered as medium and remain unchanged in comparison to prior year.

### **Other risks, including IT**

Other risks, such as IT risks, environmental risks, and risks involving production and procurement are not considered to be significant and remain stable in relation to the previous year.

Evotec does not foresee any material warranty or future liability claims.

### **Management Board's Assessment of Risk Situation**

Management believes that although the risks in any drug discovery and development business are significant, the Company has great opportunities to create long-term value that outweigh the foreseeable risks. At present, no risks have been identified that either individually or in combination could endanger the continued existence of Evotec AG.

Following its restructuring, Evotec has further reduced its risk exposure and mitigates its business risk through multiple customer contracts. With a highly competitive research alliances business, a significantly reduced cost structure, a pipeline of development candidates partnered or available for partnering, supported by substantial financing and adequate risk and opportunity management systems, Evotec is well prepared to deliver on its strategy and to develop the Company to sustainability.

Evotec has no external rating.

### **Post-Balance Sheet Events**

On 9 February 2011, Evotec signed a definitive agreement to acquire all shares in Kinaxo Biotechnologies GmbH, a Munich-based drug discovery alliance company supporting the development of targeted drugs. The acquisition complements Evotec integrated drug discovery offering, adding proprietary technology for response prediction and early decisions on drug efficacy and safety, especially in the key area of oncology. It significantly strengthens the Company's performance-based discovery offering to customers with this unique value proposition. The Kinaxo business is slightly profitable and strongly growing with an expected revenue contribution of €2.0m in 2011.

The purchase price consists of a cash consideration of €3m, 2.597.400 shares from authorised capital (approximately €8m based on the share price of €3.08) and an earn-out component of €4m in cash. €2m in shares are held in escrow and their release is subject to certain company events and representations. All shares issued are subject to a six months lock-up. The deal is expected to close in March or April 2011.

### **Outlook**

Information set forth in this section contains forward-looking statements. These statements are neither promises nor guarantees, but are subject to a variety of risks and uncertainties, many of which are beyond our control, and which could cause actual results to differ materially from those contemplated in these forward-looking statements.

## Expected General Market and Healthcare Development

### Economic Development

Overall analysts are forecasting an improvement in the global economy in 2011 compared to 2010 and especially in comparison to 2009. However, expected year-on-year growth rates differ significantly by country. Nevertheless economic recovery remains fragile and will not be led by the world's advanced industrialised nations. There is a high degree of uncertainty which makes economic cycles much less predictable than ever before.

### The Drug Discovery Market

The global drug discovery market is expected to experience robust growth, exceeding a 5% annual growth rate. The total market for outsourced early-stage drug discovery work is estimated to be between €2 – 4 bn. (According to a study from Kalorama Information (June 2010) the global drug discovery market including later-stage *in vivo* work is expected to experience robust growth, exceeding \$8 bn in 2010 and reaching \$14 bn in 2014.)

As outlined in the General Market and Healthcare Summary on page 4 of this Management Report, the global pharmaceutical industry continues to face a significant R&D productivity challenges. There is increasing pressure for pharmaceutical companies to develop new drug compounds due to the near-term loss of patent protection for many drug products. As a consequence, the industry has experienced significant M&A activity over the last few quarters and in-licensing deals to make up for the loss of revenues that will arise with key products losing patent exclusivity and is continuing to do so. In addition, there is pressure to reduce the time and money spent in drug discovery in order to bring drugs to market faster and more affordably. The resulting implementation of restructuring programmes, including closure plans for entire research facilities, reduction of the number of disease areas of focus within their therapeutic portfolio and the focus on externalisation is also expected to continue into 2011.

These developments constitute a shift in the pharmaceutical landscape where pharmaceutical companies increasingly turn to outsourcing R&D activities which provides them with expertise in required areas without the need to build additional infrastructure and capabilities internally. In addition, biotechnology companies often lack the technical staff or technology to process their targets internally. This is where discovery outsourcing solutions, such as those provided by Evotec, can help make the drug discovery and development process more efficient.

### Trends in Research & Development

In terms of proprietary research and development of novel drug compounds, experts believe that sufficient capital resources remain a critical competitive advantage for biotechnology companies as funding availability will continue to be limited for the coming years. Hence, in line with Evotec's approach, many companies across the globe are expected to continue to cut non-core programmes and focus on a few high-value assets.

## Business Direction and Strategy

In its research collaborations, the Company will continue to work with customers on a wide variety of disease areas and target classes, Evotec aims to further expand its level of participation through results-based partnerships with pharmaceutical companies, building on the competitive advantages and reputation established especially in the last 18 months. These efforts should result in increasing milestones and royalties for Evotec in addition to research payments. The customer segments addressed will continue to include pharmaceutical and biotechnology companies as well as academia and not-for-profit organisations.

With proceeding in the proprietary research programmes, Evotec is trying to develop at least one programme to a promising stage to maintain the chance to profit from a partnering event.

Evotec's competitive advantage is its advanced technologies, superior know-how and expertise in areas such as fragment-based drug discovery, library enhancement, multiple target classes, in particular ion channels and GPCRs, and profound disease biology expertise in CNS. To maintain its competitive advantage, Evotec will continue to leverage these expertises.

## Expected Research & Development, New Products, Services and Technologies

As a drug discovery and early development partner for pharma and biotech companies, all of Evotec's new products, services or technologies are based on either internal R&D activities, entering into technology agreements with other companies or the acquisition of assets. Evotec is continually upgrading its technology base and enhancing its offering to partners. In terms of proprietary drug development, Evotec expects to further develop its H3 antagonist for narcolepsy and cognition through the preclinical and potentially its first clinical phase.

## Financial Outlook for 2011 and 2012

### Expected Operating Results

In 2011, Evotec's third party **revenues** for assay development, screening and FTE based revenues are expected to grow in comparison with 2010. This assumption is based on the current order book, expected new contracts and contract extensions. Further growth is expected for 2012.

Evotec AG's **operating result** will depend on the financial performance of its drug discovery business. Due to the growth of revenues, the operating result is expected to remain materially unchanged despite growing material and outsourcing cost as well as personnel costs. Furthermore, outsourcing costs are expected to increase due to additional expenses for research programs. Negative contributions will originate from corporate expenses not chargeable to the affiliates. For 2011 and 2012, these costs are expected to be on a lower level as in 2010. In 2011, Evotec will move into a new facility in Hamburg. Related to the expected revenue growth, a further growth of employees is necessary. As the current rooms of Evotec are fully utilized, a new building was rented to cover these needs. Cost related to the movement into the new building will burden the operating result significantly in 2011. Despite these fact, operating result before "Depreciation of current assets to the extent that they exceed provisions normally recorded by the company", "Amortisation of financial assets and current investments" as well as "Income from investments" is expected to remain unchanged in 2011 but improved in 2012.

Actual results as well as individual contributions from revenues and costs could materially deviate from these projections.

### Expected Financing and Financial Position

In 2011, Evotec will invest to support its long-term growth aspirations. This is one of the most significant investment programme for **capital expenditures** of the last 10 years. Nearly €3m are planned to be invested in the long-term upgrading of the Evotec capacities. One very visible sign for this strategy will be the move into a new high-tech facility in Hamburg, which will be the center for Evotec's screening and early biology work. In 2012, capital expenditures are expected to remain on a similar level to keep upgrading the quality of Evotec's offering.

Evotec could nearly stop to finance its subsidiaries in 2010. Except for a loan to DeveloGen AG which was part of the acquisition, only European Screening Port required financing over €0.4m. EVOTEC NeuroScience GmbH was able to finance itself. No further financing efforts are expected for these subsidiaries, but Evotec (India) public limited might require a loan from Evotec AG in 2011 or 2012.

Liquidity outflow is expected to increase with further investments in proprietary research. However, despite increasing investments in capital expenditures and the move in a new building, the focus on the growing drug discovery platform will lead to higher cash generating in the near future so that liquidity of Evotec AG will be sufficient to fund its operations over the next 3 years.

A successful partnering event may influence the critical threshold positively.

### **Dividends**

Future payment of dividends is dependent upon Evotec's financial situation and liquidity requirements, the general market conditions, and statutory, tax and regulatory requirements. Evotec currently intends to retain any potential future profits and to re-invest into the Company. Consequently, dividend payments are not foreseen in the near- to mid-term.

### **Opportunities**

Evotec operates in a market which has excellent growth opportunities. The need to improve efficiency forces pharmaceutical and biotechnology companies to continuously increase their investment in R&D and to outsource drug discovery and development. There is an obvious trend towards larger contracts in a full-service outsourcing model with increased opportunities for an alliance partner such as Evotec, offering integrated drug discovery capabilities and project management from hit identification to IND application.

### **General Statement of Expected Development**

Evotec has executed important transactions to strengthen its business. The Company is well positioned to bring expertise and real value to the pharmaceutical and biotechnology industry, addressing the industry's growing demand for innovative drugs.

Management's core strategy for Evotec is to continue to focus on its alliance business to lead the path to profitability and sustainability, to expand base business capabilities through strategic investments in platform technologies, know-how and disease expertise, and to partner with more strategic customers.

By focusing on and expanding its highly profitable alliances, the Company has the opportunity to build significant long-term value for its shareholders.

Hamburg, 1 March 2011

Management Board

Dr Werner Lanthaler

Colin Bond

Dr Cord Dohrmann

Dr Mario Polywka



## Auditors' report

We have audited the annual financial statements comprising the balance sheet, the income statement and the notes to the financial statements, together with the bookkeeping system and the management report, of Evotec AG, Hamburg, for the business year from January 1 to December 31, 2010. The maintenance of the books and records and the preparation of the annual financial statements in accordance with German commercial law are the responsibility of the Company's management. Our responsibility is to express an opinion on the annual financial statements, together with the bookkeeping system and the management report, based on our audit.

We conducted our audit of the annual financial statements in accordance with § 317 HGB ["Handelsgesetzbuch: German Commercial Code"] and the German generally accepted standards for the audit of financial statements promulgated by the Institut der Wirtschaftsprüfer (IDW). Those standards require that we plan and perform the audit such that misstatements materially affecting the presentation of the net assets, financial position and results of operations in the annual financial statements in accordance with German principles of proper accounting and in the management report are detected with reasonable assurance. Knowledge of the business activities and the economic and legal environment of the Company and expectations as to possible misstatements are taken into account in the determination of audit procedures. The effectiveness of the accounting-related internal control system and the evidence supporting the disclosures in the books and records, the annual financial statements and the management report are examined primarily on a test basis within the framework of the audit. The audit includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall presentation of the annual financial statements and management report. We believe that our audit provides a reasonable basis for our opinion.

Our audit has not led to any reservations.





In our opinion, based on the findings of our audit, the annual financial statements comply with the legal requirements and give a true and fair view of the net assets, financial position and results of operations of Evotec AG in accordance with German principles of proper accounting. The management report is consistent with the annual financial statements and as a whole provides a suitable view of the Company's position and suitably presents the opportunities and risks of future development.

Hamburg 1 March 2011

KPMG AG  
Wirtschaftsprüfungsgesellschaft

[Original German version signed by:]

Kniese	Zander
Wirtschaftsprüfer	Wirtschaftsprüfer
[German Public Auditor]	[German Public Auditor]