

EVOTEC BioSystems AG First Quarter Report 2001



Dear shareholders,

In the first quarter, we largely completed the key measures for integrating EVOTEC and Oxford Asymmetry International (OAI). Combining these companies' respective expertise in biology and chemistry brought us substantially closer to reaching our goal of managing the drug discovery process for our customers as a single-source provider and of substantially increasing the quality, speed and productivity of this process. This has made our offering more attractive to customers in the pharmaceuticals and biotechnology industry and has allowed us to expand our potential customer base considerably.

**Joint orders validate strategy of the merger**

Today, just a few months after the completion of the merger, we already booked two orders which combine products from EVOTEC's biology and OAI's chemistry segments. In March, we announced the first order, in which our client will receive the benefits of OAI's chemical expertise and compound library combined with EVOTEC's EVOscreen® technology. We will look for therapeutic molecules for MediGene AG that bind to a certain target discovered by this company in the context of heart diseases. In addition to the basic contract, the agreement contains an option for processing up to four additional targets. Apart from a fixed payment for the services agreed under the contract, Evotec OAI will also receive milestone payments from MediGene when certain stages of development are successfully completed, as well as royalties on marketed drugs.

In the second trend setting cooperation with Serono, Evotec OAI will develop a new type of biological test system (assay) to identify new pharmaceutical agents for a cellular target from Serono. Evotec OAI will use its innovative VLiP™ (virus like particle) technology for this. After it has been successfully developed, Evotec OAI will test the assay on EVOscreen® equipment and profile substances in order to identify those which interact with Serono's target. Evotec OAI has already synthesised a large number of the 200,000 chemical test substances to be used in this program in a separate contract with Serono. The company will receive milestone payments for the clinical success of compounds produced under the original contract with Serono, as well as royalties from revenues of marketed products.

**First attractive orders for patented VLiP™ technology**

In addition to Serono, Evotec OAI will also apply its VLiP™ technology to two of Celltech's GPCR targets (G-protein coupled receptors, one of the main target classes) under a contract with this company. Evotec OAI will express the protein for both targets, develop test systems (assays) for screening, and produce highly concentrated VLiP™ protein for further characterisation. Celltech has the option of acquiring a non-exclusive license for Evotec OAI's VLiP™ technology after the successful conclusion of this agreement. This license agreement entitles Evotec OAI to receive milestone payments for each agent discovered using VLiP™ technology in addition to an up-front payment and an annual license fee.

**New agreements with prominent chemicals customers**

Two major one-year projects were initiated with Eli Lilly (with options to expand and extend). In the discovery programme Evotec OAI will design and synthesise compounds for lead generation and validation as well as undertaking lead optimisation. The development programme involves process research and development support for various projects with subsequent scale-up of several of Lilly's drug candidates for use in clinical trials.

For Solvay Evotec OAI will synthesise focused libraries over a period of two years. Solvay will use these compounds in screens against targets in their drug discovery programmes. Milestones will be payable to Evotec OAI if any compound supplied enters advanced clinical trials and/or is commercialised.

**Stronger business development**

Strengthening our business development activities is a key criterion for the continued effective marketing of our two complementary product programmes. We recruited several new employees for this area in the first quarter. Sean Marrett has taken over the management of Evotec OAI's business development activities as Commercial Director, and is now responsible for the business development of the company's entire offering. Before joining Evotec OAI, Sean Marrett was Director of "New Product Development, US Operating Division" at Glaxo-SmithKline. To reinforce our business development activities in

the United States, we also appointed Jeff Naroian who joined us in March after working at UCB Bioproducts and Pharm-Eco Labs in the USA.

**EVOscreen® partners  
signal positive feedback**

Following the successful purchase of four systems by Novartis, Pfizer and GlaxoSmithKline last year, all our partners are now using EVOscreen® for screening. The equipment has already generated excellent assay data in numerous screening processes. At ScreenTech 2001, a specialist international conference in San Diego, Pfizer positively highlighted the results obtained from the use of the EVOscreen® system by emphasizing the savings in reagent costs, the identification of new hit structures and the recovery of known hits when compared with traditional screening methods.

**Encouraging results for  
technological development**

We also made advances in technology development in the first quarter. The development of the Mark III system for GlaxoSmithKline is progressing according to plan. We were also successful in delivering a profiling reader to Pfizer and passed the acceptance test at Evotec OAI. This detector combines Evotec OAI's research reader with a device for automated test plate handling. This additional automation increases the efficiency of processes upstream and downstream of actual screening, i. e. in the development of test systems (assay development) and in the characterisation of promising chemicals (hits). A second device will soon be delivered to Pfizer's US operations. Evotec OAI's unique detection technology can also be used for diagnosis. Olympus received the first prototypes for genetic tests in the first quarter. Other devices will follow in the second quarter. The sale of cell processors—Evotec OAI's technology for analysing and processing individual cells in microchips—on the research market began according to plan in the first quarter with the delivery of the first systems.

**Revenue**

The Evotec OAI group's revenue increased by 440 % in the first quarter of 2001 from EUR 2.1 million to EUR 11.3 million. This was in line with our budget which is phased towards the second half of the fiscal year.

Our "Drug Discovery Tools and Technologies" business unit generated revenue of EUR 0.8 million. A key part of this was due to Pfizer's technology transfer services. This expected year-on-year decline is primarily due to the planned conclusion of the contract with Novartis, to whom we successfully transferred our powerful screening technology EVOscreen®.

In the "Drug Discovery Services and Products" business unit, we generated revenue of EUR 10.5 million (previous year: EUR 0.3 million). The increase is primarily attributable to the inclusion of the newly acquired chemistry business in the consolidated financial statements. However, even on a pro forma basis (including the chemistry business for the respective period of 2000) the increase in revenue in the service business amounted to 24 % year-on-year. Significant increases in revenue were achieved through new partnerships in the areas of chemical research and the pilot plant.

**Staff development**

The company employed 520 people at the end of March 2001—an increase of 286 over the previous year. Here, too, the increase is mainly due to the inclusion of OAI. Taking OAI's numbers for the previous year into consideration on a pro forma basis, the rise amounted to around 7 %. The recruitment of new employees is progressing well, in part due to Evotec OAI's excellent reputation.

## Research and development

Research and development expenses amounted to EUR 6.2 million in the first quarter. This is a 58 % increase compared to Q1 2000. Cost increases are a result of:

- A significant assay development and screening programme to generate benchmarks for major target classes in uHTS format (GPCRs using our VLiP™ technology, PDZ domains, caspases).
- Parallel development of our next generation screening system Mark III, a new analytical instrument for analysing cells and a reader device with parallel optics. We are using contractors to get over this peak.
- OAI's research and development contributes 10 % points of the overall increase.

## Result

The operating loss of the Evotec OAI Group amounted to EUR 6.2 million in the first quarter (before goodwill amortisation and other intangible assets of EUR 34.3 million from the acquisition of OAI and GENION Forschungsgesellschaft mbH)—an increase of EUR 2.2 million year-on-year. After inclusion of this purely notional cash free accounting effect, the operating loss amounted to EUR 40.5 million.

This increased loss corresponds to our forecasts and mainly reflects our increased commitment in the area of research and development.

The income taxes reported relate almost exclusively to deferred tax liabilities of OAI. These are cash neutral.

The net loss of the Evotec OAI Group amounted to EUR 5.7 million in the first quarter. Including non cash effects from the amortisation of goodwill and similar items, net loss amounts to EUR 40.1 million.

## Capital expenditure

Capital expenditure amounting to EUR 2.7 million were made in the first quarter of 2001, most of which were in property, plant and equipment. This expenditure mainly focused on the further establishment of the company's pilot plant in Abingdon, its screening factory in Hamburg (including the compound handling system), and on laboratory equipment developed by us.

## Cash flow and cash equivalents

Positive cash flow from operating activities in the first quarter of 2001 of EUR 3.3 million is primarily the result of the decrease in trade accounts receivable and to the increase in trade accounts payable. Accounts receivable at the end of the fiscal year are typically high, resulting in high payments in the first quarter. Net cash used in investing activities amounted to EUR 2.7 million in the first quarter of 2001, mainly attributable to investments in property, plant and equipment. Cash flow from financing activities is almost zero and is attributable to the repayment of a bank loan. Accordingly, liquidity amounted to EUR 49.2 million at 31 March 2001, including security holdings, compared to EUR 48.9 million as of December 31, 2000.

## Outlook

We concluded a number of trend setting contracts with prominent companies in the first quarter. We are working hard towards further implementing our strategy, to generate short-term revenue growth while still participating in the longer-term success of our partner's drug discovery programmes through milestones and royalties. We anticipate continued commercial successes and believe that our performance for the year will be broadly in line with our expectations.

## Shareholdings of the board of EVOTEC BioSystems AG

March 31, 2001	Number of shares	Share options
<b>Management Board</b>		
Dr Karsten Henco	1,306,356	20,866
Dr Edwin Moses	313,058	15,000
Joern Aldag	278,000	23,800
Dr Timm-H. Jessen	146,672	20,866
Dr Mario Polywka	32,565	15,000
<b>Supervisory Board</b>		
Prof Dr Heinz Riesenhuber	110,000	0
Peer Schatz	3,892	0
Roland Oetker	545,998	0
Prof Dr Hans-Juergen Quadbeck-Seeger	5,400	0
Michael Redmond	0	0



**Condensed consolidated balance sheets according to U.S. GAAP**

EVOTEC BioSystems AG and subsidiaries

Euro in thousands	31/03/2001	31/12/2000	Δ in %
<b>Assets</b>			
<b>Current assets:</b>			
– Cash and cash equivalents	32,738	32,484	0.78
– Investment securities	16,482	16,440	0.26
– Trade accounts receivable	5,463	10,732	(49.10)
– Inventories	4,942	5,434	(9.05)
– Deferred tax assets	229	229	0.00
– Prepaid expenses and other current assets	4,025	4,536	(11.27)
<b>Total current assets</b>	<b>63,879</b>	<b>69,855</b>	<b>(8.55)</b>
Investments	3,253	3,319	(1.99)
Fixed assets, net	61,129	59,800	2.22
Intangible assets, net	365,335	399,693	(8.60)
Other non-current assets	39	39	0.00
<b>Total assets</b>	<b>493,635</b>	<b>532,706</b>	<b>(7.33)</b>
<b>Liabilities and stockholders' equity</b>			
<b>Current liabilities</b>			
– Current maturities of long-term loan	720	718	0.28
– Trade accounts payable	8,946	3,752	138.43
– Accrued liabilities	3,897	9,589	(59.36)
– Deferred revenues	3,199	3,762	(14.97)
– Other current liabilities	3,539	2,033	74.08
<b>Total current liabilities</b>	<b>20,301</b>	<b>19,854</b>	<b>2.25</b>
Long-term loan	3,509	3,527	(0.51)
Deferred revenues	149	373	(60.05)
Deferred tax liabilities	5,868	5,820	0.82
Other non-current liabilities	7	7	0.00
Minority interests	616	630	(2.22)
Total stockholders' equity	463,185	502,495	(7.82)
<b>Total liabilities and stockholders' equity</b>	<b>493,635</b>	<b>532,706</b>	<b>(7.33)</b>

**Condensed consolidated statements of operations according to U.S. GAAP**

EVOTEC BioSystems AG and subsidiaries

Euro in thousands except share data	3 months ended March		
	2001	2000	Δ in %
<b>Revenue:</b>			
– Drug discovery products and development of technologies	782	1,832	(57.31)
– Drug discovery services	10,485	254	–
<b>Total revenue</b>	<b>11,267</b>	<b>2,086</b>	<b>440.12</b>
<b>Operating costs and expenses:</b>			
– Research and development expense	6,199	3,914	58.38
– Cost of product sales	6,831	301	–
– Selling, general and administrative expenses	4,353	1,900	129.11
– Amortization expense (page 07 “Result”)	34,361	19	
<b>Total operating costs and expenses</b>	<b>51,744</b>	<b>6,134</b>	<b>743.56</b>
<b>Loss from operations</b>	<b>(40,477)</b>	<b>(4,048)</b>	<b>899.93</b>
<b>Other non-operating income (expense)</b>			
– Interest income (expense)	644	448	43.75
– Other non-operating income (expense)	96	294	(67.35)
<b>Total non-operating income</b>	<b>740</b>	<b>742</b>	<b>(0.27)</b>
<b>Loss before income taxes, minority interests and equity in net loss of investees</b>	<b>(39,737)</b>	<b>(3,306)</b>	<b>–</b>
Income tax (expense) benefit	(280)	–	100.00
Minority interests	(2)	39	(105.13)
Equity in net loss of investees	(65)	(106)	(38.68)
<b>Net loss</b>	<b>(40,084)</b>	<b>(3,373)</b>	<b>–</b>
<b>Weighted average common share outstanding</b>	<b>35,452,148</b>	<b>24,156,000</b>	
Loss per share	(1.13)	(0.14)	

**Condensed consolidated statements of cash flows according to U.S. GAAP**

EVOTEC BioSystems AG and subsidiaries

Euro in thousands	31/03/2001	31/03/2000
<b>Cash flows from operating activities:</b>		
Net loss	(40,084)	(3,373)
Adjustments to reconcile net loss to net cash used in operating activities	36,909	488
Change in assets and liabilities	6,495	(738)
<b>Net cash used in operating activities</b>	<b>3,320</b>	<b>(3,623)</b>
<b>Cash flows from investing activities:</b>		
Purchase of investment securities	(11,940)	(52,359)
Purchase of fixed assets	(2,652)	(791)
Purchase of intangible assets	(3)	(11)
Proceed from sale of investment securities	11,897	–
<b>Net cash used in investing activities</b>	<b>(2,698)</b>	<b>(53,161)</b>
<b>Cash flows from financing activities:</b>		
Net proceeds from capital increase	–	7,740
Repayment of bank loan	(15)	–
<b>Net cash flow provided by financing activities</b>	<b>(15)</b>	<b>7,740</b>
<b>Net increase in cash and cash equivalents</b>	<b>607</b>	<b>(49,044)</b>
Exchange rate difference	352	–
Cash and cash equivalents at beginning of year	32,483	57,488
<b>Cash and cash equivalents at end of the first quarter</b>	<b>32,738</b>	<b>8,444</b>
Cash, cash equivalents and investment securities at the end of the first quarter	49,220	60,803

**Key figures**

Evotec BioSystems AG		actual 2001	pro forma 2000
Revenue	TEUR	11,267	10,285
Net loss	TEUR	40,084	36,733
Loss per share	EUR	(1.13)	(1.04)



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