



## Evotec OAI, Second Quarter Report 2001

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Dear shareholders,

Evotec OAI continues its expansion as planned during the first half of 2001. Both our business units developed successfully and contributed to another quarter of satisfactory results. In only six months since the merger with Oxford Asymmetry International we have made significant progress in integrating both parts of the Company. Business Development, IT and Finance were the first functions which were successfully combined. In parallel our integration team is implementing our product strategy “from pharmaceutical target to IND filing” (IND = Investigational New Drug Application). Specialists from our chemistry division in Oxford and our biology group in Hamburg are crafting a truly unique product offering spanning the entire drug discovery phase. Emphasis is being put on medicinal chemistry, early proof of pharmaceutical concept and early ADMET. Our Business Development pipeline reflects the progress we are making and this has been demonstrated by the first integrated deals with MediGene and Serono.

**Innovative technology used to good effect**

Our research partnerships in the field of biology and screening got off to a good start and have shown excellent results to date. In co-operation with **Sugen / Pharmacia Upjohn**, we have developed high-throughput assays for three cancer targets and have finished the relevant screening runs – results that are judged a clear success by both sides. When performing the fourth screening run, Sugent will now also use compounds from the Evotec OAI compound library. We are particularly pleased with this as it means that yet another partner is now using our chemistry in addition to our biology and screening expertise - a further validation of our objectives in the merger: integrate the product offering and cross-sell to our partners.

We have already taken the first steps in our research co-operations with **Serono** and **Celltech**, which commenced in the second quarter. Both companies employ our innovative and VLiP™ (vesicle like particle) technology for assay development. With Celltech, we reached the first milestone completing the expression of their targets on schedule.

**Chemistry services continue their success**

We made further good progress in drug discovery and development chemistry. In April 2001 Evotec OAI won a one-year contract to supply chemical compound libraries to **Roche**. The substances will be used to identify new drug candidates in Roche's internal drug discovery programmes.

An indication of our customer satisfaction is the number of current contracts that we were again able to extend and/or substantially expand in the first half of 2001. These customers include **Pharmacia**, **Pfizer** and **Curis**.

**Development of Mark III system on track**

Our Swiss partner for the manufacture of mechanical modules for our EVOscreen® systems shipped the new modules of our next generation EVOscreen® Mark III system to Hamburg on time. Evotec OAI employees are currently working on the software control as well as on the integration of in-house and external components for detection and liquid handling. The individual modules and the integrated system as a whole will then be prepared for customer acceptance testing at the end of the year.

**Strong instrument sales from our co-operations with Olympus and Pfizer**

In the second quarter, Evotec OAI delivered fifteen diagnostic analysers for SNP analysis as well as four novel SNP assays to **Olympus**, Japan. Milestone payments for technology support and training are being received according to plan. The joint research work for the new generation of laboratory equipment, which will have a substantially larger range of applications, continues on schedule.

In June 2001, we delivered in time the second profiling reader with automated plate handling to **Pfizer**. In the same month, we received an order for an additional profiling reader from our affiliated company Direvo. Delivery for this system is planned for the fourth quarter 2001.

**MelTec and Evotec  
OAI synergistically  
combine their drug  
discovery expertise**

In June 2001 we announced a powerful Joint Venture with MelTec GmbH, a pioneer in topological proteomics. The agreement involves development and marketing of a novel joint service package reaching from target validation to drug discovery. The joint venture also specialises in discovery, development and marketing of a few selective, highly effective and well tolerated drugs in certain autoimmune and cancer disease types. We plan to conclude the initial financing round with institutional venture capital investors by the end of this year.

MelTec's innovative proteomics technology gives Evotec OAI access to a sophisticated solution for "early proof of pharmacological concept". This allows to prioritise hits and lead structures for higher probability of success in clinical trials earlier in the process. In a separate program, both companies agreed to jointly develop novel ADMET assays examining side effect profiles and the toxicity of drug candidates in model systems and human tissue.

## Financial Report

### Revenue

Evotec OAI achieved revenues of EUR 26.3 million in the first half year of 2001, an increase of 311% over the respective period in 2000. This strong increase over 2000 can be attributed to the acquisition of the chemistry business late in 2000 and good growth in biology services. Revenues for the first half were in line with our expectations. Although on a pro-forma basis this is no increase over the same period in 2000, we are pleased with the result for two reasons: 1. As revenues from our consortium partnerships declined as expected, significant growth in the biology services business successfully compensated for this decline. 2. Added capacity for our scale-up chemistry business went online in June of 2001, now adding capacity for a significant revenue increase in the second half of 2001.

The Drug Discovery Service division of Evotec OAI achieved revenues of EUR 22.9 million (previous year: EUR 0.5 million). On a pro-forma basis (including the chemistry business for the respective period of 2000), growth of EUR 2.1 million over last year is primarily attributable to growth in biology services. This service line which we started only last year achieved sales of EUR 2.6 million, up 189%. Chemistry services revenues amounted to EUR 20.3 million, slightly above previous year (EUR 19.9 million). Very strong revenue recognition in discovery chemistry more than compensated for the expected decline in custom library work following the successful completion of our large Bayer collaboration in 2000.

In our Drug Discovery Tools and Technology division we achieved sales of EUR 3.4 million, including 16 analysers and 1 spectrometer to Olympus as well as two closed loop readers to Pfizer. As expected, revenues were EUR 2.4 million below the previous year as last year saw above average revenues from the delivery of two Mark II screening systems.

56 % of our Company's revenues were generated in the United States, demonstrating our very strong presence in this largest pharmaceutical market in the world. In the first half of 2001 Europe contributed 37% and Japan 7% to revenues.

### Research and development

Research and development expenses increased from EUR 8.3 million to EUR 11.9 million (+44%). On a pro-forma basis, including R&D expenses for the chemistry business in the first half year of 2000, the increase amounted to +32%. R&D expenses during 2001 are in line with our budget. The increase is due to

- a substantial peak workload in software development during the first half of 2001 due to the parallel developments of our Mark III system, a cell reader and a parallelized four channel optical unit. To avoid adding additional capacity and to cover shortages we outsourced significant parts of our software development.
- an extensive in-house assay development and uHTS screening program in certain important target classes (such as GPCRs or PDZ domains).

## Result

Cost of goods sold increased from EUR 2.4 million to EUR 14.0 million due to the integration of OAI. On a pro-forma basis cost of goods sold slightly decreased from EUR 14.8 million to EUR 14.0 million as a result of a higher proportion of higher margin service revenues. Our gross margin increased as a consequence from 45% to 47%.

SG&A grew from EUR 4.1 million to EUR 9.5 million. This is primarily a consequence of the integration of OAI. On a pro-forma basis SG&A expenses increased by 22% from EUR 7.8 million to EUR 9.5 million. This is in line with expectations and reflects primarily increased activities in Business Development.

Excluding non-cash effects (primarily goodwill amortisation from acquisitions) the Evotec OAI group loss from operations amounted to EUR (9.1) million compared to EUR (8.4) million in the respective period of 2000. This is in line with our expectations. It is primarily a consequence of higher R&D investments in the current year, an activity which we consciously supported to expand our product offering.

Including non-cash effects, the operating loss was EUR (77.7) million. As of June 29, 2001, the US accounting authority "Financial Accounting Standards Board (FASB)" decided that under US GAAP goodwill will no longer be amortised. As of January 1, 2002 the operating result of the company will no longer be impacted by goodwill amortisation charges. Instead, a regular impairment review of the goodwill will be required. The amortisation of other intangible assets will not be effected.

Excluding the non-cash effects, net loss in the first six months amounted to EUR (9.0) million. At the group level, this includes a tax charge totalling EUR 0.9 million which mainly represents unpaid deferred tax assets in the UK. Earnings per share amounted to EUR (2.19) or EUR (0.25) adjusted for acquisition related non-cash expenses, compared to EUR (0.31) in the previous year.

Earnings before interest and taxes, depreciation and amortisation (EBITDA) were EUR (4.3) million compared to EUR (7.1) million in the previous year. EBITDA per share improved to EUR (0.12) from EUR (0.29) in 2000.

## Capital expenditure

In the first half of 2001 capital expenditure amounted to EUR 8.6 million, most of which was related to property, plant and equipment:

- we completed new facilities such as the new pilot plant in Abingdon and the screening factory in Hamburg;
- we fitted out new laboratories and purchased new laboratory equipment;
- we set up our Mark III system for screening operations in Hamburg.

## Cash flow and cash equivalents

Cash flow from operating activities in the first half of 2001 of EUR 4.7 million was negative, primarily due to net loss adjusted for non-cash items (EUR 3.1 million). Investments in property, plant and equipment were EUR 9.1 million. We have also reduced bank loans by EUR 0.3 million.

We continue to have a very healthy cash position of EUR 35.6 million (cash and investment securities). Our cash burn related to operations was on average EUR 1.4 million per month in the first six months.

## **Employees and management**

As of July 1, 2001, we implemented a number of management changes. The group's former Chief Financial Officer, Joern Aldag, became President and Chief Executive Officer. Dr Karsten Henco, formerly CEO of Evotec OAI, and Dr Edwin Moses, then President, moved into the Supervisory Board. In addition, Dr Henco will chair the Scientific Advisory Board of the company, continuously contributing to the scientific development of the group.

Evotec OAI is very pleased that Dr Pol Bamelis, former Chief Scientific Officer and member of the Management Board of Bayer AG, joined the Supervisory Board in June 2001. Dr Bamelis was responsible for a significant number of strategic developments of Bayer's pharmaceutical division. We expect to benefit from his vast experience of the pharmaceutical and biotechnology industries. Roland Oetker and Prof. Dr Hans-Juergen Quadbeck-Seeger resigned from the Board. We thank both of them for their highly valuable advice during many years in which they helped to guide the Company to its current strength.

In the first half of 2001 Evotec OAI filled two important management positions. The Group appointed Sean Marett as Commercial Director, heading the Group's Business Development function. Sean Marett joined Evotec OAI in April 2001 from GlaxoSmithKline, where he was Director, New Product Development US Operating Division. We were also pleased to recruit Mark Whittaker as Director of Drug Development. Dr Whittaker will bring his broad experience in drug discovery chemistry to support Evotec OAI's integrated projects from target to IND. He joined us from British Biotech Pharmaceuticals Ltd., where he was Director of Chemistry.

Recruiting has been very successful in the first half of 2001. Evotec OAI employed 541 people at the end of June 2001. This strong increase over the previous year (+307 people) is mainly due to the merger with OAI. On a pro-forma basis, headcount increased by 10% in particular supporting operations of our service business.

## **Outlook**

We are pleased with our performance in the first half of 2001. We extended our customer portfolio of blue chip pharmaceutical and biotechnology partners. We for the first time successfully sold exciting, integrated services to new and existing customers. Our new research collaborations for integrated biology and chemistry drug discovery got off to a strong start. Today we have an order book which already accounts for 84% of budgeted 2001 revenues and extends well into 2002. Production of chemicals in our new pilot plant commenced in July 2001 and will contribute positively to sales growth in development chemistry in the second half of 2001. On the basis of a very healthy cash position we have the resources to continue our R&D programs to achieve our ambitious corporate objectives: to expand

and integrate our service offering to become the true leader in “research collaborations from pharmaceutical target to IND filing”. We have focussed our attention on these objectives and are putting all the necessary resources behind them.

### Shareholdings of the board of EVOTEC BioSystems AG

	Number of shares	Share options
<b>Management Board</b>		
Joern Aldag	278,000	32,600
Dr Timm-H. Jessen	132,672	26,732
Dr Mario Polywka	32,565	15,000
<b>Supervisory Board</b>		
Prof Dr Heinz Riesenhuber	110,000	0
Peer Schatz	3,892	0
Dr Pol Bamelis	0	0
Dr Karsten Henco	1,306,356	26,732
Dr Edwin Moses	313,058	15,000
Michael Redmond	1,000	0

June 30, 2001

Please take into account that the share options were not correctly stated in the First Quarter Report 2001 because they were not adjusted for the stock split of August 18, 2001.

## Condensed consolidated statements of operations according to US GAAP

### EVOTEC BioSystems AG and Subsidiaries

Euro in thousands except share data

	2001	six months ended June 30, 2000	Δ in %	2001	three months ended June 30, 2000	Δ in %
<b>Revenue:</b>						
– Drug discovery products & development of technologies	3,477	5,864	(40.71)	2,695	4,032	(33.15)
– Drug discovery services	22,847	534	-	12,362	280	-
<b>Total revenue</b>	<b>26,324</b>	<b>6,398</b>	<b>311.42</b>	<b>15,057</b>	<b>4,312</b>	<b>249.17</b>
<b>Operating costs and expenses:</b>						
– Research and development expense	11,882	8,268	43.71	5,683	4,354	30.52
– Cost of product sales	14,027	2,414	481.00	7,196	2,113	240.51
– Selling, general and administrative expenses	9,472	4,117	130.04	5,119	2,217	130.85
– Amortization expense	68,679	38		34,318	19	
<b>Total operating costs and expenses</b>	<b>104,060</b>	<b>14,838</b>	<b>601.31</b>	<b>52,316</b>	<b>8,704</b>	<b>501.06</b>
Loss from operations	(77,736)	(8,440)	821.09	(37,259)	(4,392)	748.40
<b>Other non-operating income (expense)</b>						
– Interest income (expense)	948	786	20.59	304	338	(10.10)
– Other non-operating (expense) income	221	343	(35.55)	125	49	155.72
<b>Total non-operating income</b>	<b>1,169</b>	<b>1,129</b>	<b>3.54</b>	<b>429</b>	<b>387</b>	<b>10.84</b>
Loss before income taxes, minority interests and equity in net loss of investees	(76,567)	(7,311)	947.35	(36,830)	(4,005)	819.69
Income tax (expense) benefit	(891)	-	100.00	(611)	-	100.00
Minority interests	17	39	(56.50)	19	-	100.00
Equity in net loss of investees	(161)	(192)	(16.21)	(96)	(86)	11.45
<b>Net loss</b>	<b>(77,602)</b>	<b>(7,464)</b>	<b>939.68</b>	<b>(37,518)</b>	<b>(4,091)</b>	<b>817.09</b>
<b>Weighted average common share outstanding</b>						
	35,452,148	24,156,000		35,452,148	24,156,000	
<b>Loss per share</b>						
	(2.19)	(0.31)		(1.06)	(0.17)	

## Key figures

### EVOTEC BioSystems AG and Subsidiaries

		actual 30/06/2001	pro forma 30/06/2000
Revenue	TEUR	26,324	26,646
Net loss	TEUR	77,602	72,930
Loss per share	EUR	2.19	2.06



**Condensed consolidated balance sheets according to US GAAP**  
**EVOTEC BioSystems AG and Subsidiaries**

Euro in thousands except share data	30/06/2001	31/12/2000	Δ in %
<b>Assets</b>			
<b>Current assets:</b>			
– Cash and cash equivalents	18,655	32,484	(42.57)
– Investment securities	16,926	16,440	2.96
– Trade accounts receivable	9,656	10,732	(10.03)
– Inventories	6,572	5,434	20.94
– Deferred tax assets	229	229	0.00
– Prepaid expenses and other current assets	4,196	4,536	(7.50)
<b>Total current assets</b>	<b>56,234</b>	<b>69,855</b>	<b>(19.50)</b>
Investments	3,158	3,319	(4.85)
Fixed assets, net	65,962	59,800	10.30
Intangible assets, net	331,268	399,693	(17.12)
Other non-current assets	39	39	0.00
<b>Total assets</b>	<b>456,661</b>	<b>532,706</b>	<b>(14.28)</b>
<b>Liabilities and stockholders' equity</b>			
<b>Current liabilities:</b>			
– Current maturities of long-term loan	736	718	2.51
– Trade accounts payable	5,800	3,752	54.58
– Accrued liabilities	5,777	9,589	(39.75)
– Deferred revenues	3,407	3,762	(9.44)
– Other current liabilities	2,654	2,033	30.55
<b>Total current liabilities</b>	<b>18,374</b>	<b>19,854</b>	<b>(7.45)</b>
Long-term loan	3,176	3,527	(9.95)
Deferred revenues	–	373	(100.00)
Deferred tax liabilities	6,627	5,820	(13.87)
Other non-current liabilities	7	7	0.00
Minority interests	616	630	(2.22)
Total stockholders' equity	427,861	502,495	(14.85)
<b>Total liabilities and stockholders' equity</b>	<b>456,661</b>	<b>532,706</b>	<b>(14.28)</b>

**Condensed consolidated  
statements of cash flows according to US GAAP**  
EVOTEC BioSystems AG and Subsidiary

Euro in thousands	30/06/2001	30/06/2000
<b>Cash flows from operating activities:</b>		
Net loss	(77,602)	(7,464)
Adjustments to reconcile net loss to net cash used in operating activities:	74,448	1,149
Change in assets and liabilities:	(1,593)	(2,893)
<b>Net cash used in operating activities</b>	<b>(4,747)</b>	<b>(9,208)</b>
<b>Cash flows from investing activities:</b>		
Purchase of investment securities	(12,928)	(52,359)
Purchase of fixed assets	(8,334)	(2,759)
Purchase of intangible assets	(254)	–
Cash acquired	–	344
Proceeds from sale of investment securities	12,442	2,004
<b>Net cash used in investing activities</b>	<b>(9,074)</b>	<b>(52,770)</b>
<b>Cash flows from financing activities:</b>		
Net proceeds from capital increase	–	7,740
Repayment of bank loan	(333)	(320)
<b>Net cash flow provided by financing activities</b>	<b>(333)</b>	<b>7,420</b>
<b>Net increase in cash and cash equivalents</b>	<b>(14,154)</b>	<b>(54,558)</b>
Exchange rate difference	(326)	–
Cash and cash equivalents at beginning of year	32,483	57,488
<b>Cash and cash equivalents at end of the second quarter</b>	<b>18,655</b>	<b>2,930</b>
<b>Cash, cash equivalents and investment securities at end of the second quarter</b>		
	35,581	53,285

## Consolidated statements of changes in stockholders' equity

### EVOTEC BioSystems AG and Subsidiaries

Euro in thousands except share data								
	Share capital Shares	capital Amount	Additional paid-in capital	Unearned compen- sation	Accumulated other com- prehensive income	Subscription rights receivable	Accumu- lated deficit	Total stock- holders' equity
Balance at December 31, 1999	24,156,000	24,156	58,746	(51)	–	–	(22,552)	60,299
Receipt of share capital subscription	–	–	7,740	–	–	–	–	7,740
Acquisition of Genion	52,913	53	2,503	–	–	–	–	2,556
Acquisition of OAI	11,225,744	11,226	465,756	–	–	–	–	476,982
Share capital increase in Direvo	–	–	2,828	–	–	–	–	2,828
Share capital increase	17,491	17	893	–	–	–	–	910
Stock option plan	–	–	713	(652)	–	–	–	61
Comprehensive loss								
–Net loss	–	–	–	–	–	–	(47,074)	(47,074)
–Foreign currency translation	–	–	–	–	(2,443)	–	–	(2,443)
–Unrealized holding gains on available-for-sale securities	–	–	–	–	636	–	–	636
<b>Total comprehensive loss</b>	–	–	–	–	<b>(1,807)</b>	–	<b>(47,074)</b>	<b>(48,881)</b>
<b>Balance at December 31, 2000</b>	<b>35,452,148</b>	<b>35,452</b>	<b>539,179</b>	<b>(703)</b>	<b>(1,807)</b>	–	<b>(69,626)</b>	<b>502,495</b>
Stock option plan	–	–	–	127	–	–	–	127
Comprehensive loss								
–Net loss	–	–	–	–	–	–	(77,602)	(77,602)
–Foreign currency translation	–	–	–	–	2,923	–	–	2,923
–Unrealized holding gains on available-for-sale securities	–	–	–	–	(82)	–	–	(82)
<b>Total comprehensive loss</b>	–	–	–	–	<b>2,841</b>	–	<b>(77,602)</b>	<b>(74,761)</b>
<b>Balance at June 30, 2001</b>	<b>35,452,148</b>	<b>35,452</b>	<b>539,179</b>	<b>(576)</b>	<b>1,034</b>	–	<b>(147,228)</b>	<b>427,861</b>