EVOTEC BioSystems AG

Third Quarter Report 2000

evotec

To our shareholders

Today our clients are increasingly confronted with the need to manage a growing number of biotech partnerships. One of the big challenges in these partnerships is the necessity to align the different interfaces between the various technology platforms of individual cooperation partners – quite often a difficult undertaking. This is why we believe that in the next few years pharmaceutical companies will favor biotech companies able to generate validated targets with disease indication, provide the attendant biology, develop miniaturized assays for ultra-high throughput screening and finally, along with expertise in combinatorial and medicinal chemistry, generate leads for clinical development. Providing complete solutions along these lines will be paramount for success.

In the third quarter of 2000, EVOTEC BioSystems AG (EVOTEC) and Oxford Asymmetry International plc (OAI) announced a merger of the two companies which, it is believed, will address the current urgent demands of the pharmaceutical industry through the provision of sophisticated, integrated drug discovery services. OAI provides the “Complete Chemical Solution” – an integrated range of chemical services from discovery through development to production. EVOTEC meanwhile provides a complementary series of assay development and screening services for the rapid identification of chemical substances with potential disease-modifying properties. The merger thus creates a one-stop-shop which will significantly help our customers to overcome major bottlenecks in drug discovery and to reduce the complexity of managing a large number of individual biotech alliances.

Merger with OAI declared wholly unconditional. On July 31, 2000 we announced our intention to merge EVOTEC with OAI by way of an all share offer for the entire share capital of OAI. This offer was submitted to OAI shareholders on August 12, 2000. Since then the following formal steps to complete the transaction have been taken: on September 21, 2000 an Extraordinary General Meeting of EVOTEC approved the merger and the related capital increase with a 99% majority vote. On September 29, 2000 the German Stock Exchange approved the offering prospectus for the new EVOTEC shares. Since then all legal conditions necessary to complete the merger have been fulfilled.
On 26 October 2000 we announced that we had received valid acceptances in respect of more than 90% in value of the OAI shares, clearing the way for the compulsory acquisition of minority interests. By the end of October 2000, a total number of 10,786,832 new EVOTEC shares had been listed for trading on the Frankfurt Stock Exchange. While the increased number of shares resulted in a temporary pressure on our stock price, in spite of weak market conditions, we have been able to stabilize the share price through controlled exits for shareholders who did not want to hold the stock for the long term. The past performance of the stock price cannot be relied upon as guide to future performance. From the fourth quarter 2000 onwards, EVOTEC will consolidate revenue and profit with OAI. In 1999, OAI achieved revenues of Euro 32.6 million and realized a net profit of Euro 5.9 million. The fully integrated product portfolio of EVOTEC and OAI as well as the large customer base of the combined entity promises excellent prospects for growth.

The merger rationale is to combine two complementary businesses to form a “one-stop-shop” for our customers. Hence, for this merger to be successful, the rapid combination of business development activities of both entities is the most significant task in integrating the two entities. We have therefore immediately combined these activities into a single cross regional function. We have already seen substantial interest in the industry for our joint product offering.

Screening service business in Hamburg set up. In July 2000 with a short delay the first EVOscreen® system became fully operational. The EVOscreen® system, the heart of our service business, is now in place in Hamburg. In addition, we strengthened our group “Applied Assay Development” adding new employees from outside the company and from our research department. In this quarter the first screens for BASF Pharma, Pfizer and SmithKline Beecham have been performed successfully on the new EVOscreen®

system. We have generated exceptional results, particularly with regard to reconfirmation rates of active compounds identified from the primary screens.

Additionally, we have started a substantial investment program, locating all our service activities including assay development, EVOscreen® system and an automatic compound storage system into an extension of our building in Hamburg. We have added Dr. Hans Grünhagen to our management team. Dr. Grünhagen formerly was Vice President “Drug Discovery Services and Technology” of BASF Knoll, Ludwigshafen and brings to EVOTEC extensive management experience in drug discovery. He will be responsible for EVOTEC’s “Screening Services”. One of the major tasks in the near future will be the integration of the service offerings of EVOTEC and OAI. This should be facilitated by order processing and quality assurance that we have already started to integrate into Standard Operating Procedures.

EVOscreen® Mark II now also successfully implemented at Pfizer USA. On June 30, 2000, our Mark II systems passed site acceptance testing at Novartis and Pfizer at their research facilities in Switzerland and England respectively. In the third quarter we have now achieved another important milestone: earlier than anticipated, a third EVOscreen® uHTS system was successfully implemented and accepted at Pfizer’s research facilities in Groton, USA.

Milestone reached in the collaboration with SmithKline Beecham for 4-channel-reader. With the acceptance of the EVOscreen® Mark II system, we have established our highly efficient screening technology platform in EVOTEC’s and our partners’ drug discovery research functions. During the third quarter we have now, as part of our cooperation with SmithKline Beecham, reached the milestone for the development of a higher performance 4-channel-detection system. This new detection device represents a significant part of the next generation EVOscreen® Mark III. The detector is designed for the use of four parallel objectives, again increasing throughput at highest read-out quality to up to 200,000 tests per day. The performance of the detector has surpassed the project expectations. The remaining phases of the Mark III technology development project are running according to plan. Mark III will enhance our systems capabilities for cell-based assays in high-throughput mode and will have an open architecture to facilitate the use of third party read-out devices. During the third quarter, we have transferred design drawings of Mark III to our partner Sysmelec in Switzerland for manufacturing and assembly.

We have made significant progress developing novel biological test systems. Our integrated screening machines have proven their functionality in operations at our pharmaceutical partners’ research sites. Through OAI, we have now integrated the appropriate chemical platform covering the full range of chemical synthesis in the drug discovery and development process. We have therefore established a unique strategic position and technological base for providing the full portfolio of drug discovery services from target validation to lead compound production. As a “one-stop-shop”, we will be a partner of choice for our clients in the pharma and biotech industries.

Financial Report

Revenues. During the first nine months of 2000, EVOTEC group's revenue rose in line with our expectations by 106% over the comparable period of 1999. It reached DM 19.2 million and herewith already exceeds after nine months the total revenue of 1999. The Drug Discovery Tools and Technology division accounted for DM 16.3 million exceeding our internal forecast for the first three quarters due to the early acceptance of Mark II at Pfizer's site in Groton, USA. This business unit's revenue includes research funding and milestone payments from technology development and transfer contracts with EVOTEC's pharmaceutical partners Novartis, SmithKline Beecham and Pfizer (DM 8.1 million), as well as the sale of instruments (DM 8.2 million). The high volume of instrument sales mainly results from the successful acceptance of the three EVOscreen® Mark II systems by our partners Novartis and Pfizer (UK and USA) in the second and third quarter 2000. The remainder, amounting to DM 2.9 million, results from the Drug Discovery Products and Services division. There are mainly included fees for the development of assays and for screening runs performed on EVOTEC's own Mark II platform. Because of a delay implementing our screening system we have not fully reached our goals for the first three quarters in the Drug Discovery Services unit. Our screening services infrastructure has, however, been successfully implemented now and work for our customers is being performed according to plan.

Personnel. By the end of September 2000 the number of employees rose to 255 (+14 employees) as planned, including 7 employees from the acquisition of GENION Forschungsgesellschaft mbH. 206 people were employed at EVOTEC BioSystems AG, the remainder at our affiliated companies EVOTEC Analytical Systems GmbH, EVOTEC NeuroSciences GmbH and GENION.

Result. In the first nine months of fiscal 2000 EVOTEC realized a net loss of DM 22.3 million representing an increase of 31% over the same period of the previous year (1999: DM 17.0 million). This result is in line with our expectations, as net income has not grown comparatively with turnover. The loss mainly is resulting from three effects:

1. Although headcount was only insignificantly increased over the past twelve months, the average number of employees in the current year was higher than in the same period of the previous year. As a result, research and development expenses increased by 32% over the comparable period of the previous year.
2. The increase in selling, general and administrative expenses compared to the first nine months in 1999 is mainly resulting from intensified marketing activities in light of establishing our service business as well as from activities in the area of Investor Relations. Selling expenses reflect the increased expenditure for scientific conferences and trade fair attendances. Also, we have held two General Meetings. The cost of the AGM and financial communication are accounted for under administrative cost.
3. As expected, in the first nine months costs of product sales increased from DM 0.3 million in the previous year to DM 7.3 million. This increase resulted primarily from three EVOscreen® systems passing site acceptance testing at Novartis and Pfizer. As part of the technology development contracts these systems are sold almost at cost to our partners with no research and development allocation as they have funded the research and development program for the EVOscreen® technology over the past four years.

As expected, the operating loss for the first nine months of 2000 increased by 40% over the comparable period of the previous year. The rate of increase of operating cost was less than the rate of increase of revenue growth.

Investments. Investments during the first nine months in 2000, primarily additions to fixed assets, totaled DM 7.9 million. The main emphasis was put on investments in laboratory devices developed in-house systems to equip our own laboratories for assay development programs and screening services. These devices include one of two EVOscreen® Mark II systems.
The acquisition of GENION Forschungsgesellschaft mbH on June 30, 2000 by means of an all share transaction accounted using the purchase-accounting method resulted in a surplus of the purchase price over net assets acquired (DM 4.2 million). This surplus is currently being examined with regard to its allocation to individual assets and the amortization of in process research and development. Resulting goodwill will be amortized over three to five years.

Cash flow. In the first nine months of 2000 cash flow from operations totaled - DM 27.1 million, resulting mainly from net loss incurred in the period (- DM 22.3 Million) and from additions to “Other Assets”. Other assets include costs of DM 0.6 million from the merger with Oxford Asymmetry International plc. Net cash used in investment activities for the first nine months of DM 98.2 million includes the acquisition of investment securities (DM 91.0 million). The actual net cash used was therefore DM 7.2 million. During the current period, cash flow from financing activities totaled DM 14.5 million, resulting mainly from the exercise of the over-allotment option in the context of EVOTEC’s IPO. The liquidity including investment securities totaled DM 92.7 million on September 30, 2000, giving us a solid foundation for future expansion of EVOTEC.

Oxford Asymmetry International plc, Abingdon/UK

EVOTEC Key Figures

	1–9/1999	1–9/2000	+/- %
Revenue	9.3	19.2	105.5
R & D expense	19.6	25.9	32.0
Loss from operations	(18.5)	(25.9)	40.1
Employees at the end of September	215	255	18.6

EVOTEC Financial Structure of Technology Development and Transfer Agreements

Partner	Contract period	Volume	Revenue achieved
Novartis	4/96–12/99	20	19.5
SmithKline Beecham	12/96–12/00	30	24.6
Pfizer	6/99–6/02	30	13.8

in DM million

Outlook. During the first nine months of the year 2000 EVOTEC has achieved or exceeded important milestones and budgets. This applies in particular to the implementation of technology as well as for the important strategic development of our technology platform: the merger with OAI adds the necessary expertise in chemistry and the takeover of GENION Forschungsgesellschaft mbH strengthens our assay portfolio in the important area of ion channel technology. Both companies significantly broaden EVOTEC's client base among large to medium sized pharmaceutical and well-known biotech companies. Looking forward, we expect to see EVOTEC's revenues on a stand-alone basis increase by 60 to 80% in 2000 over 1999.
After consolidation of OAI's fourth quarter results into the combined EVOTEC group accounts, group revenue will significantly exceed DM 50 million. The merger will also have a positive impact on the group´s operating results in the years 2001 and thereafter.
The rapid expansion of our high-margin service business in cooperation with OAI is of particular importance for our further development. The combination of resources in the area of "Business Development" within the EVOTEC Group and the ability to cross sale using EVOTEC's and OAI's complementary customer bases are important elements.
Expressed interest of the new group's clients in the integrated service offering and the very positive public reaction to the strategic potential of this merger make us confident, that we have formed a unique company to have the critical mass to become one of the most significant partners to the pharmaceutical and biotech industry. In the course of the coming years those biotech companies will be most successful, which are simultaneously in a position to develop validated targets, to provide the attendant biology, to develop high throughput assays and to generate leads using the chemical competence from combinatorial chemistry through lead optimizing medicinal chemistry. EVOTEC and OAI together, already, cover the most significant parts of this research process.

Condensed Consolidated Balance Sheets according to U.S. GAAP

(unaudited)

EVOTEC BioSystems AG and Subsidiaries
Deutsche Mark in thousands

ASSETS			
	31/12/1999	30/9/2000	+/- %
Current assets			
Cash and cash equivalents	112,437	1,646	(98.5)
Investment securities	–	91,033	–
Trade accounts receivable	5,470	6,485	18.6
Inventories	7,623	7,447	(2.3)
Other current assets	2,981	7,372	147.3
Total current assets	**128,511**	**113,983**	**(11.3)**
Fixed assets, net	14,787	19,115	29.3
Purchase price exceeding net assets acquired	–	4,238	–
Other non-current assets, net	1,054	1,015	(3.7)
Total assets	**144,352**	**138.351**	**(4.2)**

LIABILITIES AND STOCKHOLDERS' EQUITY			
Current liabilities			
Current portion of long-term loan	1,250	1,250	–
Accounts payable	5,843	4,251	(27.2)
Accrued liabilities	4,400	4,318	(1.9)
Deferred revenues	5,641	2,748	(51.3)
Other current liabilities	966	1,861	92.7
Total current liabilities	**18,100**	**14,428**	**(20.3)**
Long-term loan	7,500	6,875	(8.3)
Deferred revenues	729	1,167	60.1
Other non-current liabilities	11	11	–
Minority interests	76	3	(96.1)
Total stockholders' equity	**117,936**	**115,867**	**(1.8)**
Total liabilities and stockholders' equity	**144,352**	**138,351**	**(4.2)**

Condensed Consolidated Statements of Operations according to U.S. GAAP
(unaudited)

EVOTEC BioSystems AG and Subsidiaries
Deutsche Mark in thousands

	9 months ended September 30,			3 months ended September 30,		
	1999	2000	+/- %	1999	2000	+/- %
Revenue						
– Drug discovery tools & technology	8,474	16,273	92.0	4,091	4,804	17.4
– Drug discovery services & products	851	2,889	239.5	851	1,844	116.7
Total revenue	**9,325**	**19,162**	**105.5**	**4,942**	**6,648**	**34.5**
Operating costs and expenses						
– Research & development expenses	19,587	25,860	32.0	8,138	9,614	18.1
– Cost of product sales	286	7,286	–	64	2,564	–
– Selling, general and administrative expenses	7,932	11,899	50.0	2,895	3,846	32.8
Total operating costs and expenses	**27,805**	**45,045**	**62.0**	**11,097**	**16,024**	**44.4**
Loss from operations	**(18,480)**	**(25,883)**	**40.1**	**(6,155)**	**(9,376)**	**52.3**
Other non-operating income (expense)						
– Interest income (expense)	449	2,734	508.9	74	1,196	–
– Equity in net loss of affiliate	(530)	(517)	(2.5)	(210)	(141)	(32.9)
– Other non-operating income (expense)	1,566	1,350	(13.8)	477	679	42.3
Total non-operating income	**1,485**	**3,567**	**140.2**	**341**	**1,734**	**408.5**
Loss before income taxes	**(16,995)**	**(22,316)**	**31.3**	**(5,814)**	**(7,642)**	**31.4**
– Income tax benefit	–	(26)	–	–	(26)	–
– Minority interests	18	85	372.2	–	9	–
Net loss	**(16,977)**	**(22,257)**	**31.1**	**(5,814)**	**(7,659)**	**31.7**

Weighted average common share outstanding	14,535,157	24,333,844	
Loss per share	-1.17	-0.91	

Consolidated statements of cash flows according to U.S. GAAP

(unaudited)

EVOTEC BioSystems AG and Subsidiaries
Deutsche Mark in thousands

	9 months ended September 30,	
	2000	1999
Cash flows from operating activities		
Net loss	(22,257)	(16,977)
Adjustment to reconcile net loss to net cash	4,119	3,049
Change in assets and liabilities	(8,981)	3,881
Net cash used in operating activities	(27,119)	(10,047)
Cash flows from investing activities		
Purchase of investment securities	(102,406)	(1,663)
Purchase of PPE	(7,858)	(6,313)
Proceeds from sale of investment securities	11,372	4,375
Cash acquired	706	–
Others	–	(307)
Net cash used in investing activities	(98,186)	(3,908)
Cash flows from financing activities		
Proceeds from capital increase	15,138	–
Proceeds from payables from shareholders	–	4,800
Decrease in bank loans	(625)	(625)
Others	–	17
Net cash flows provided by financing activities	14,513	4,192
Net increase in cash and cash equivalents	(110,791)	(9,763)
Cash and cash equivalents at beginning of year	112,437	31,175
Cash and cash equivalents at end of 3rd Quarter	1,646	21,412

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