evotec

Evotec AG Annual Report 2006 Tomorrow's Drugs Today™

Translating Innovation into Results

Condensed Key Figures Evotec AG (IFRS)

Continuing Business[1)]

	Page		2005	2006	Δ 06/05 in %
Results:					
Revenues	36	T€	64,115	67,354	5.1
R&D expenses	38	T€	9,304	30,307	225.7
Operating result[2)]	39	T€	(5,879)	(27,539)	(368.4)
Net income (loss)	40	T€	(31,212)	(36,296)	(16.3)
Cash flow	41	T€	36,167	26,253	(27.4)
Balance sheet data:					
Stockholders' equity	43	T€	148,669	137,176	(7.7)
Capital expenditures[3)]	41	T€	4,144	2,556	(38.3)
Cash	41	T€	52,185	78,723	50.9
Balance sheet total[4)]	43	T€	186,111	205,526	10.4
Personnel data:					
Employees as of 31/12	45		512	527	2.9
Per share:					
Result	40	€	(0.60)	(0.55)	–

[1)] Excluding contributions from Evotec Technologies which was sold effective 1 January 2007.
[2)] Before amortisation and impairment.
[3)] Cash relevant purchase of tangible and intangible assets, excluding finance leases.
[4)] Including assets held for sale.

In a marketplace where medical research is a rich source of innovation, Evotec is a catalyst to increased productivity in pharmaceutical research and development, increasingly playing the role of an intermediary between academic research institutes and pharmaceutical companies. Evotec has one of the most productive small molecule discovery and development engines in the biotech industry and deep therapeutic knowledge in CNS-related diseases. Through intensive external collaborations, we add scale and value to innovative research projects and advance drug candidates efficiently through to proof-of-concept.

By translating innovative ideas into novel drugs we address a major market need – to fuel the pipelines of leading pharmaceutical companies and to bring forth the next generation of therapies addressing unmet medical needs.

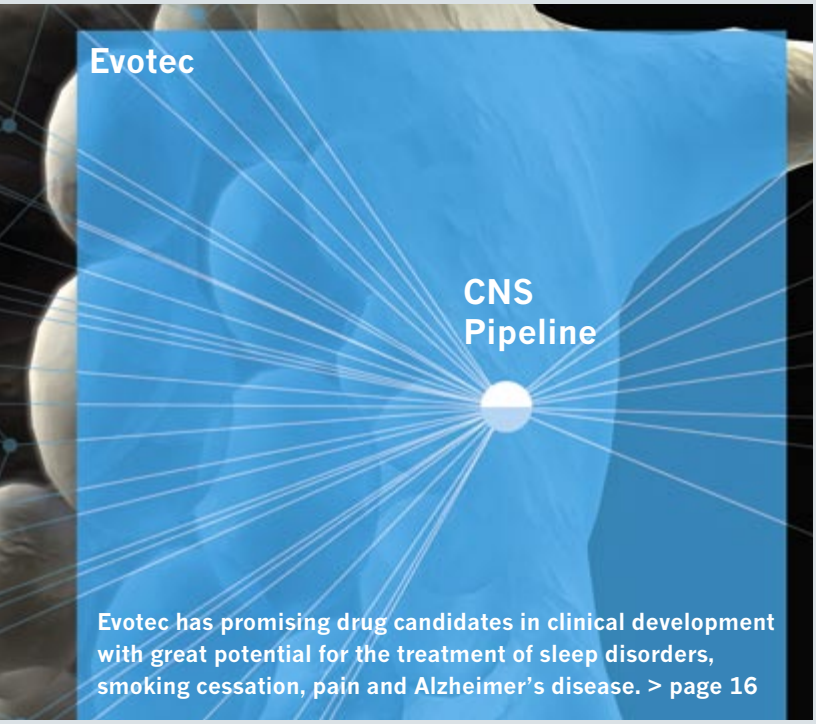
Content

04 To Our Shareholders
06 Interview: Translating Innovation into Results
12 Our Strategy
14 Evotec's Drug Discovery & Development Engine
16 Our Pipeline
24 Our Research Collaborations
33 Management Report 2006
55 The Evotec Stock
59 Corporate Governance

Consolidated Financial Statements:
66 Balance Sheets
67 Statements of Operations
68 Statements of Cash Flows
70 Fixed Asset Movement Schedule
70 Statements of Changes in Stockholders' Equity
70 Notes

92 Supervisory Board Report
94 Supervisory Board and Management Board
96 Executive Committee
97 Glossary
98 Financial Calendar and Imprint

Key Figures



Evotec has promising drug candidates in clinical development with great potential for the treatment of sleep disorders, smoking cessation, pain and Alzheimer's disease. > page 16

Evotec has one of the most productive drug discovery and development engines in the industry to fulfill it's partners' R&D needs. > page 24

EVT 201: A Strong Differentiating Potential in Insomnia

Evotec will report proof-of-concept results from two U.S. studies in insomnia patients in the second half of 2007. > page 20

Translating Innovation into Results

How a potent network of pharmaceutical companies, biotechnology companies and academic research institutes can increase R&D productivity. > page 06

Financial Targets for 2006 Fully Achieved

Solid revenue growth of 5% to € 67.4 m and an increased cash position of € 78.7 m. > page 33

To Our Shareholders

Among the most significant highlights in 2006 were the progress of our insomnia drug candidate EVT 201, our continued strong performance in research collaborations and our increased focus on our core business as evidenced by the divestment of our shareholding in Evotec Technologies.

We are proud that in 2006, the Company was able to continue on the path it had progressed on so successfully in the previous year. Evotec focused on the further strategic and operative developments of its core business, drug discovery and development, which encompasses the Company's proprietary pipeline of drug candidates for the treatment of diseases of the Central Nervous System (CNS) and its numerous research collaborations with partners in the pharmaceutical and biotechnology industries.

In Summary, the Highlights in 2006 Were:

1. We have expanded and further developed our CNS pipeline, with the centre of focus being our insomnia drug candidate, EVT 201. A second Phase I/II study confirmed the positive results of the previous proof-of-principle study in healthy volunteers. Two Phase II studies have begun in the U.S. to test whether this profile will be confirmed in insomnia patients. We expect to receive data from these studies in 2007.
2. Our service business again progressed well, forging many new partnerships and displaying strong performance. It achieved a revenue increase of 5 %, a positive operating result before amortisation, and it again generated cash flow.
3. Our cash reserves increased by € 40 m through extraordinary cash contributions during the course of 2006 to € 78.7 m, due mainly to the divestment of Evotec Technologies, which at the same time sharpened our focus on our core business.
4. We have reached or exceeded all major financial objectives for the year, both including and excluding Evotec Technologies.

CNS Pipeline Approaches Significant Value Inflection Points

In 2006, we further extended our pipeline by in-licensing from Roche two Phase I MAO-B inhibitors, EVT 301 and EVT 302, and we forged ahead rapidly with all other projects. Our most advanced programme, EVT 201 for the treatment of insomnia, is due to yield efficacy data in the latter half of 2007 from two patient studies. This stage generally represents a significant value inflection point in the development of drugs. Should the studies produce positive results, as we hope they will, we intend to forge a partnership with a larger pharmaceutical company in 2008 to further develop and market the product.

In addition to EVT 201, we have two further interesting compounds in Phase I clinical development. One is EVT 302, for which additional Phase I studies will commence in the first half of the year. EVT 302 is the follow-up compound of EVT 301 which, upon weighing up all the risks and benefits, we have decided to discontinue developing. If the EVT 302 studies prove successful, we will focus clinical development for this product on smoking cessation, a therapeutic area not only with a huge market potential but also requiring comparatively little time and cost for development. Our third product EVT 101, a treatment of Alzheimer's disease and | or pain, successfully concluded Phase I trials in the third quarter of 2006. We are now planning Phase Ia/IIb short-term studies for different indications.

Overall, we believe we have made good progress with our clinical pipeline. As planned, we have also invested in early research projects both to strengthen our pipeline and to generate interesting initial results that facilitate forging large, results-based partnerships see Service Business, below. Our most advanced research programme, focused on a compound that addresses an interesting target related to pain, is currently in lead optimisation. In two further projects with obesity and cognition targets, we have identified effective and highly selective lead structures that will shortly enter lead optimisation.

Sharpened Focus on Results-Based Partnerships; Service Business Again Achieves Positive Operating Result Before Amortisation

The strategic consultancy project that was conducted in 2006 reaffirmed our view that, in order to become an attractive partner for larger, results-based collaborations and to capture the increasing value of early stage research projects, it is increasingly important to invest in interesting discovery projects and to generate initial results early. With our broad customer network, our expertise and scope of capabilities in drug discovery, complemented by our profound knowledge of CNS-related diseases, we are one of only a few drug discovery service providers in a position to do so on an industrial scale. Based on initial research results on a CNS target, we are already undertaking such a partnership with Roche, the resulting benefits and risks of which are shared equally. We have also extended and doubled in volume our results-based partnership with Boehringer Ingelheim having reached a second milestone in 2006.

We once again achieved excellent performance in our Services Division, especially when considering its challenging market environment, which is characterised by competition from low cost countries such as China and India. Thanks to high revenues in pilot plant production of APIs and drug formulation, we have again recorded significant growth in our development services. Consequently, before amortisation the Services Division again achieved a positive operating result in 2006 and was able to generate funds for parts of our early research projects.

Focus on Core Business

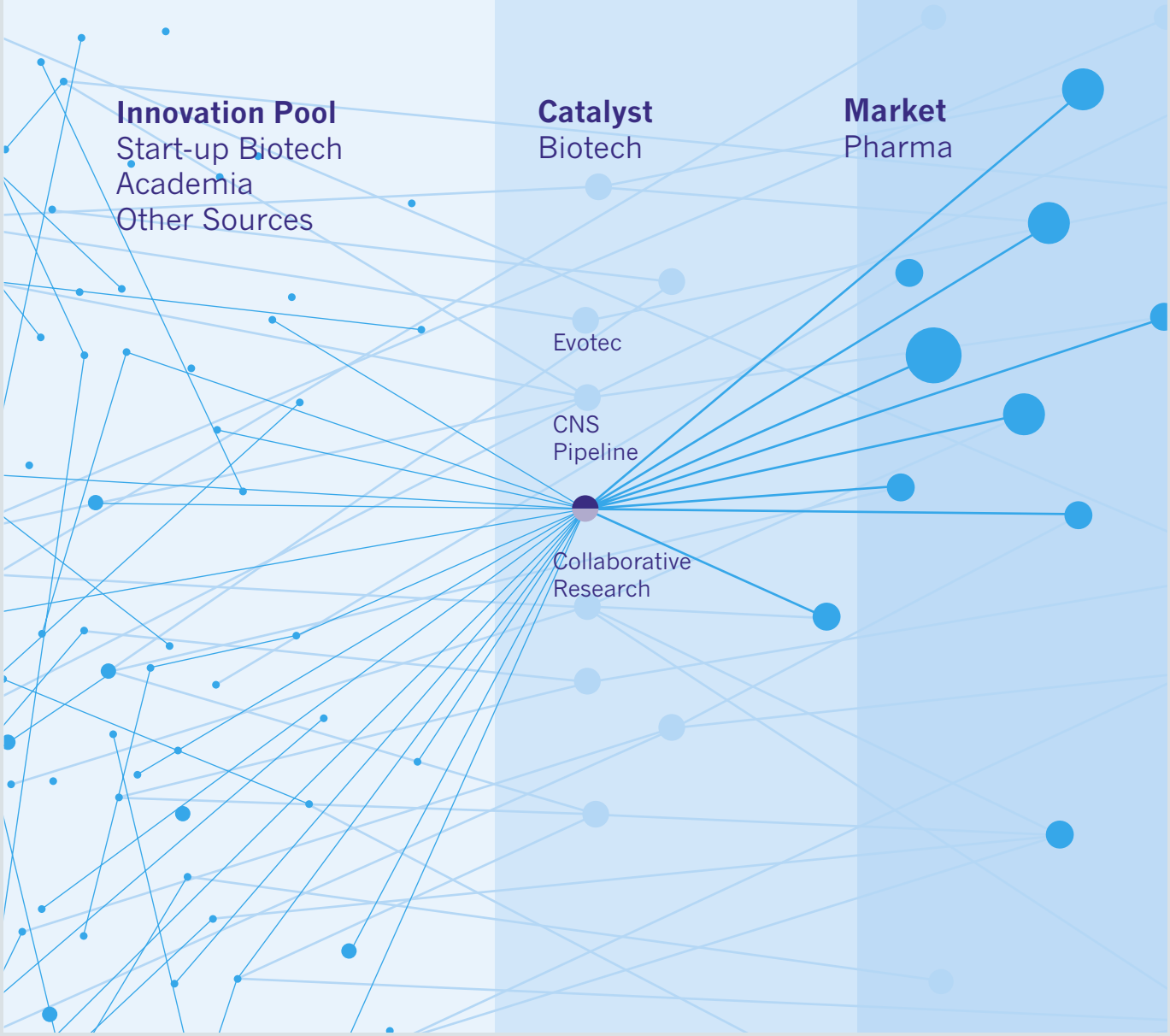
To finance the expansion and development of our pipeline through to Phase II, we have further increased our cash reserves. A capital increase in April yielded approximately € 18 m. In addition, effective 1 January 2007, we have sold our shareholding in Evotec Technologies. PerkinElmer as the new parent will add strength to Evotec Technologies' sales and distribution efforts and will be instrumental in guaranteeing a worldwide after-sales service, thus creating an ideal environment for Evotec Technologies to continue and perhaps expand its operations in Hamburg. For Evotec, this transaction has sharpened our focus on our core business and, at the same time, provides us with approximately € 23 m for the further development of our pipeline.

In summary, we are delighted with Evotec's performance in 2006, to which our outstanding employees have contributed so greatly with their combined wealth of experience, know-how and commitment. We are upbeat about 2007, a year which will see the results of both of our patient studies with EVT 201. We also expect further significant news flow on other pipeline projects and our research partnerships.

Finally, I would like to thank you, our shareholders, for your past support and trust in Evotec AG. I would be delighted by your continued faith in us as we take on the challenge of developing new treatments for unmet medical needs.

Jörn Aldag
President & Chief Executive Officer

Exploiting the Innovation Pool's Full Potential



The pharmaceutical industry can look back on some very good times. To the envy of many other industries it has been blessed with sustained growth of revenues and profitability. Long-term trends such as the rapidly increasing population in less developed countries and aging societies in the developed world are also pointing to ongoing increases in demand and robust future growth. But the path to success is not clearly signposted and the challenges that lie ahead are immense.

In recent years, the cost of developing new drugs has skyrocketed, as has per capita health expenditure. At the same time, the industry's huge revenues from blockbuster drug sales are in jeopardy from expiring patents. Pharmaceutical companies have reacted to these challenges by conducting mega-mergers, taking over small product companies and by in-licensing clinical stage drug candidates. The biotechnology industry has become a prime source of these new drug candidates, with the biggest firms having grown to become pharmaceutical companies in their own right.

Company size alone, however, has not proven to be a success factor for increasing R&D productivity. Pharmaceutical companies have to adapt their strategies to a changing research environment, tapping biotechnology firms for innovation with a more targeted approach. While the VC sector has been driving its portfolio companies to in-license new products and thus to compete with the pharmaceutical industry, the strengths of biotechnology companies remain in establishing and taking advantage of differentiated technologies and innovative biology, enabling them to generate new preclinical candidates on their own and to do so more effectively than has been done in the past. Equally, academic institutes have come to the forefront of medical research, but lack the downstream capabilities to bring candidates through to market. A potent network of pharmaceutical companies, biotechnology companies and academic research institutes, coupled with appropriate levels of funding, could therefore bridge the innovation gap that we are currently witnessing.

> Evotec: **Bridging the innovation gap is critical to the pharmaceutical industry's future. What are the specific challenges facing your company, and how do you intend to meet them?**

> Peter Hug, Roche: The biotech sector is an excellent source of innovation that can complement internal activities. The challenge is to recognise these potential innovations and, together with our partners, to bring them to the marketplace in order to make a difference to patient lives. In 2007, we aim to remain an industry leader in transforming partnered projects into successful products on the market. To do this, we need to continue refining our approach in a number of areas: the search for partners who fit our scientific, financial and strategic objectives; creative deal making to ensure that our partners are motivated by terms that meet their needs as well as ours; flexibility in deal making and effective alliance management to encourage and build on successes with both new and established partners. Our long-standing relationship with Evotec is an example of how a productive partnership can evolve and expand to the benefit of both companies.

> Evotec: **What is the role of biotechnology companies today as sources of innovation for the pharmaceutical industry?**

> Jörn Aldag, Evotec: Biotechnology firms – here defined as research-driven companies with no product sales – are usually relatively small and agile. They are fast in spotting new ideas, often in academic environments, and they are typically extremely focused. They are usually dependent on the success of a few projects and they are resource constrained. In my mind, their core strength is in turning innovative ideas quickly into practice.

"Basic research in academic institutes – this is most likely where the next blockbuster is coming from." J Penninger

Peter Hug, Ph. D.
Executive Vice President and Global Head Pharma Partnering
Roche Pharmaceuticals Division, Basel, Switzerland

The more innovative the approach the more likely it will be partnered. Hence, the role of biotechs is to be a key driver of innovation, bringing novel approaches for unmet medical needs up to proof-of-concept and then partner to retain maximum product equity.

> Peter Hug, Roche: Biotechs and traditional pharma companies are both innovative. With biotechs, we see our role as a supportive one, providing our partners with the resources and the benefits of our experience to realise the potential of their innovations. We believe that biotechs are most creative when they have the autonomy to drive their ideas forward. Both pharma and biotech have different strengths but our destination is the same – together we can bring forth medicines more quickly to make a difference in patients' lives.

"The core strength of biotech companies is in turning innovative ideas quickly into practice." J Aldag

> Evotec: **What can academic research institutes contribute to the development of new drugs that are so badly needed?**

> Josef Penninger, IMBA: I have worked for many years with a very big biotech company in the U.S. and they spent billions of dollars on research. However, most of the real innovations did not come from 'directed' efforts but from small academic

Prof Dr Josef Penninger,
Managing Director Science,
Institute of Molecular Biotechnology (IMBA) of the Austrian Academy of Sciences, Vienna, Austria

laboratories. Large companies are very good in the development of such initial ideas. The reasons for this lie in the nature of the business – small academic groups need to be innovative to survive and can work on issues that might be currently off the radar screen of mainstream science. True innovation, in my opinion, is mostly based on serendipity. Therefore, the biotech and pharmaceutical industries should actively nurture basic research in academic institutes – this is most likely where the next new blockbuster will come from.

Jörn Aldag,
President & Chief Executive Officer,
Evotec AG, Hamburg, Germany

> Evotec: **Where does Evotec position itself? What efforts are undertaken to develop research ideas into the new products that are of value to the pharmaceutical industry?**

> Jörn Aldag, Evotec: Evotec attracts innovative projects from academia and research foundations but also from other industry partners, preferably focusing on projects with some sort of *in vivo* validation. Based on one of the most productive small molecule discovery and development engines in the biotech industry, we are driving those discovery projects forward to (i) partner them early for revenues or (ii) to feed our own pipeline in the field of Central Nervous System disease treatment. In addition, we use this engine to fulfil the research needs of our numerous pharma and biotech partners.

> Evotec: **Are strategic partnerships between pharmaceutical companies, biotechnology firms and academic research institutes a model for the future?**

> Peter Hug, Roche: It's an established model. Academia with its proven ability to nurture curiosity-driven research is a rich resource for innovation that will continue to be at the forefront of emerging technologies. The traditional path to commercialise these innovations, through the formation of new biotech companies or through relationships with established companies is a well proven path that will continue to evolve.

> Josef Penninger, IMBA: Such cooperations are essential and I personally always enjoy working with companies. In our new institute in Vienna, IMBA, I make a concerted effort to raise awareness on such partnerships among our scientists. Academia is very good in generating ideas but then there is an enormous lack of financing and sometimes also knowledge to translate these ideas into real drugs. This is where both sides can benefit immensely. But one also has to be careful because academia abides by very different rules than industry, e.g. we in academia are driven by the spreading of our ideas (publications) which can sometimes prove to be a detrimental path for drug development in a company. My simple model for such partnerships would be to have two equal partners that bring their unique strength: academic freedom and 'undirected' research from academic institutes and drug development from companies.

"Pharma companies should put their claims into as many opportunities as possible through open partnerships." J Aldag

> Jörn Aldag, Evotec: Pharmaceutical companies are engaged in a race to find new products to survive and prosper. At the same time, the pace of innovative discoveries is extremely fast and the amount of information gathered is enormous. In such an environment, pharmaceutical companies should no longer attempt to control all areas of research. They should instead put their claims into as many opportunities as possible through open partnerships. This really leads to an open model of networked R&D with biotech and academia forming a core element of this net. I would not be surprised if biotechs like Evotec will increasingly play the role of an intermediary between pharma and academia adding scale and efficiency to academic projects and translating them to value inflection points.

> Evotec: **What are the current trends in academic research? For which indications will we see great progress made in the coming years?**

> Peter Hug, Roche: The trends in academia are still primarily driven by basic research. Of the areas with the greatest promise for therapeutic application, stem cells are among the most exciting. Stem cells have enormous potential in a broad range of areas – oncology, cardiovascular and neurology, to name a few. Advances are also being made in drug formulation, another area of increasing interest to pharma and in the embryonic science of experimental medicine.

> Josef Penninger, IMBA: More and more, academia is moving into large scale projects such as whole functional genomics screens, proteomes or SNP mapping in defined human populations. Huge sets of data are being generated, but it is still a lot of work to go from these data sets to the understanding of basic pathophysiology of disease. For some indications, modern science has made real breakthroughs not only in basic research but in new treatments, for example, in the understanding of diseases associated with bone loss such as osteoporosis or cancer metastases to bone. Genetic research has opened the door for the possible treatment of bone diseases that literally affect hundreds of millions of people. In other areas such as cancer, I am not too hopeful because the basic biology of cancer cells is much too similar to that of other cells in our body. I also think that stem cells hold great promise for medicine but it will take probably 20–30 years before we really know how to harness their potential. But I do believe that we will learn to understand the key 'lego' pieces with which a fly, a mouse, or a human being is built. What is important for law makers and companies to understand is that one needs to support basic research into areas that do not yet have any obvious practical implications. The genetic revolution has just started and has already revealed some amazing fundaments of life and, most importantly, key insights into diseases that affect millions of people. It is indeed exciting and a privilege to be part of this future.

> "Creative deal structures can also lead to creative financing models." P Hug

> Evotec: **Do you believe that venture capital firms will return to higher levels of investment for early stage research projects? Which other forms of financing will be available?**

> Peter Hug, Roche: Development is a long, costly and an unpredictable road. The challenge for the whole pharmaceutical community is the need to find solutions to finance investment in innovation with an acceptable return for the risks being taken. I believe that as long as there is innovation that can be eventually commercialised there will be venture capital there to make an investment. The novelty of the innovation and the market potential will dictate the size of these investments. Creative deal structures can also lead to creative financing models. Our partnership with Amira is one such example. This is a three-way partnership between Roche, the VC community and individuals which saw the birth of a new biotech company, Amira. Venture capitalists invested heavily in order to provide the funding to allow the company to be born, while Roche provided assets and fundamental expertise.

> Josef Penninger, IMBA: The real benefit of partnerships comes to fruition when it allows early access to ideas and to provide the proper funds to develop these ideas. This can be badly neglected by academics who believe their research ends

when a paper is published. In my experience, governmental agencies are reluctant to fund this risky grey zone – as can pharma and biotech companies – which mostly invest in later stage projects. One could, for instance, imagine a trust funded by the industry that allows academic institutes to set up proper translational units to develop their ideas to a stage where drug development becomes realistic. Both sides win – we in academia might one day get real awards for our ideas and companies would get an early handle on truly innovative projects.

> Jörn Aldag, Evotec: Over the past few years venture capital firms have focused their investments on biotech companies with later stage development compounds. From my perspective, this model is not sustainable. If biotech firms have a competitive advantage over traditional industry players, then this is in early stage innovative biology and related discovery and development work up to proof-of-concept. Pharma and venture capital's focus on late stage product development has led to a significant early stage pipeline gap, as well as a growing need for financing in early research and development. As a consequence, the value of earlier stage projects is now increasing substantially, as witnessed by recent acquisitions of early stage companies by big pharma. We are seeing venture capital now returning to projects in this phase of the value chain. This is a great chance for those who are working on translating early research into assets relevant to pharma companies. Evotec's ability to run a multitude of such projects in parallel, eliminating the need to create a new company around each new research project, creates an interesting strategic opportunity for the Company and its partners.

> Evotec: **Thank you very much for the interview.**

Our Strategy

Leveraging Evotec's Resources to Help Bring New Drugs to Market

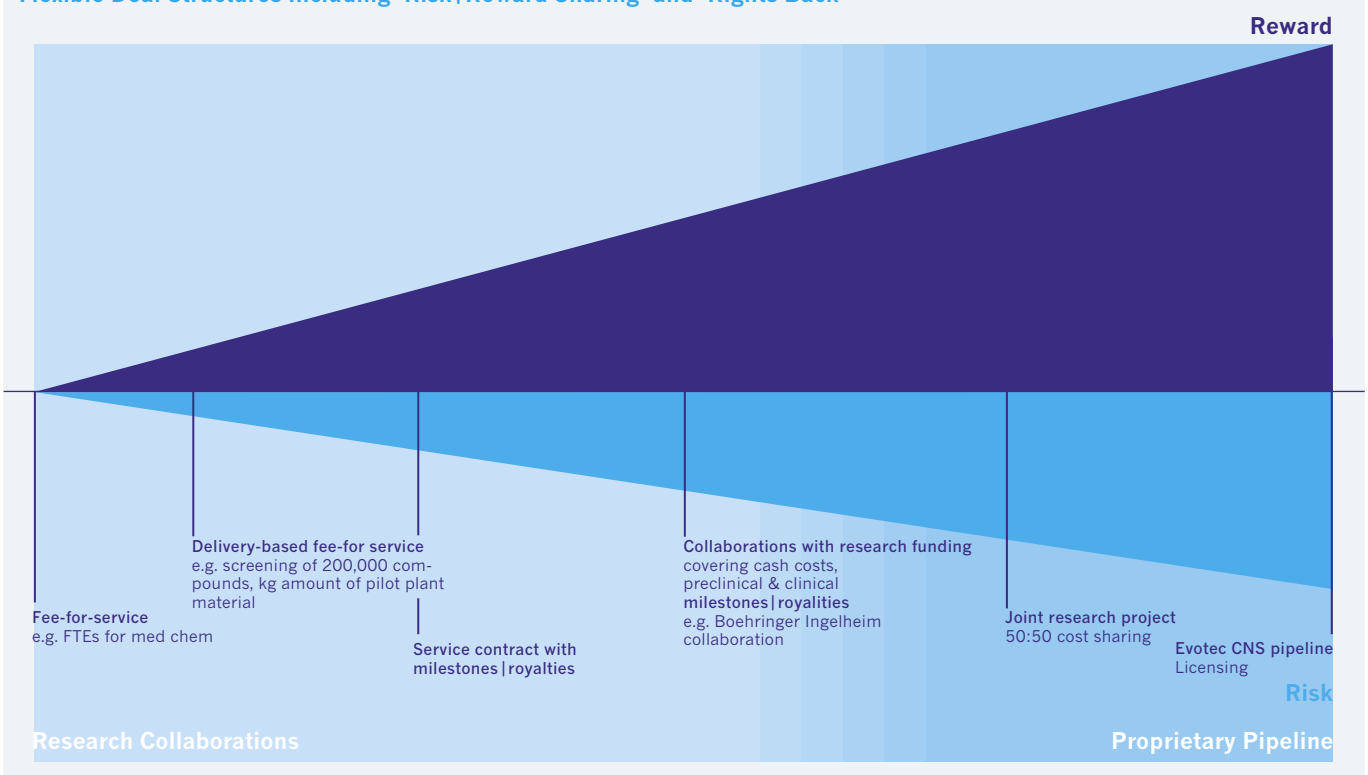
Evotec has established a strong position in the small molecule drugs sector, having built a powerful discovery and development engine that is able to deliver the innovative candidates badly needed to fill the productivity gap seen in today's pharmaceuticals market. The Company's industrialised platform covers the entire spectrum of discovery and development (see page 14) and is applicable to targets across all indication areas. In addition, Evotec has built a deep internal knowledge base in the treatment of Central Nervous System (CNS) related diseases. Evotec's strategy is to leverage this broad competence to deliver outstanding research results to the global pharmaceutical industry in two ways:

Research Collaborations

Applying its proven expertise in collaborative R&D with industry partners is central to Evotec's business. With its integrated engine, Evotec provides its customers with a choice of solutions for projects from 'target to clinic' and is committed to delivering the highest standards of research efficiency and service quality throughout the entire process. Evotec can rely on outstanding references from past and present research collaborations as the names of the world's leading pharmaceutical and biotechnology companies appear among its many partners.

In the past, the Company has mainly offered its capabilities on a fee-for-service basis. Now, however, clients increasingly look for broader, more creative drug discovery solutions in which the collaborative research provider contributes additional disease expertise, specific know-how and | or assets previously generated internally. To fully exploit the potential of its capabilities and to capture the increasing value of early stage discovery projects, Evotec therefore complements its traditional

Flexible Deal Structures Including 'Risk | Reward Sharing' and 'Rights Back'



business model with higher value, results-based projects in which the Company shares in its customer's success through significant milestone payments and royalties along with substantial research fees. This traditional and results-based business is cash generative, providing a stable foundation for Evotec.

Proprietary CNS Pipeline

The same integrated engine that supports Evotec's research collaborations also provides the foundation for the Company's higher reward, proprietary drug discovery and development projects. The clinical focus is on novel treatments for major CNS-related conditions including Alzheimer's disease, sleep disorders, and pain management – fast growing therapeutic areas with large unmet medical needs. Through both selective in-licensing as well as its own discovery projects, Evotec intends to build a sustainable pipeline of drug candidates which have the potential to provide a steady flow of compounds for partnering, with significant future growth potential.

Proprietary drug development, however, requires high R&D spending. To reduce exposure to financial and scientific risks, Evotec engages in multiple discovery and development programmes of varying risk, scope and duration. Evotec's current clinical pipeline comprises three distinct drug candidates with high market potential that act through well characterised mechanisms of action. While the market potential for innovative or differentiated compounds is high, developing drugs with an established mechanism of action lowers the risk of failure.

Once the CNS pipeline generates promising drug candidates with high value, be it with clinical proof-of-concept (Phase II data) or earlier, Evotec intends to partner and out-license these compounds to pharmaceutical companies for upfront and milestone payments, as well as royalties for the future sale of drugs. Such royalties can be significant given the market potential of Evotec's clinical candidates.

Evotec's Drug Discovery & Development Engine: Powering the Progression of Drug Candidates from Target to Clinic

Setting off with the Target

The drug discovery process builds on research showing that certain genes, or their corresponding proteins, play a role in the outbreak or course of a disease *(***target** *identification and validation)*. The approaches and technologies employed in this phase of research vary significantly and are highly sophisticated. Although Evotec conducts its own target research in the field of Alzheimer's disease, the Company focuses its services primarily on subsequent phases in which drug candidates are identified and optimised.

Drug candidates are molecules that interact with a target and thus possess the potential to influence the course of disease progression in a positive manner. Most of the targets Evotec works on are provided by the Company's partners. The Company has broad therapeutic knowledge in many indication areas, including a deep understanding of diseases of the Central Nervous System.

Primary Screening

The search for new drugs begins with *screening*. In an automated process, the selected target is brought together with numerous chemical compounds to test for biological interactions. The chemical collection used for the screen may contain tens, or even hundreds of thousands of structurally diverse compounds and is referred to as a **compound library.** Evotec uses its own library, which contains approximately 250,000 compounds, as well as those of the Company's research partners. Evotec has also supported its customers for many years in the rapid and efficient design and synthesis of compound libraries employing automated, *high-speed synthesis* methods that combine the latest design strategies with novel chemistries.

In the next step, targets and individual compounds are brought together in a tailored test system known as an *assay*. The compounds that biologically interact with the target are subsequently referred to as 'hit compounds' or simply **'hits'**. The closer an assay reflects the natural biological processes within the human body, the more meaningful its results.

In addition to standard screening methods, Evotec has a proprietary ultra-High-Throughput Screening (uHTS) system, EVOscreen®. A significant advantage of this technology is that it requires only very small quantities of the chemical compounds and targets, which can be quite expensive. By simultaneously analysing multiple read-out parameters, EVOscreen® also yields data of higher information content than competing technologies. This provides Evotec's research scientists with a better understanding of the nature of the interaction between a target and its hit molecules and is therefore crucial for predicting whether a selected hit can be developed into a successful drug candidate.

Evotec's detection technologies are more sensitive than others in that they can also identify compounds with only weak binding properties. This is especially important for *fragment-based drug discovery*. Fragments are small organic molecules that are typically only one-third the size of drug molecules and tend to interact only weakly with target proteins. Nevertheless, they are very useful starting points for medicinal chemists to optimise into more active drug molecules. They provide the flexibility to add additional chemical groups, leaving chemists with more room to manoeuvre and increase the likelihood of developing a successful compound.

Further building on the undisputed competitive advantage of Evotec's detection technology, the Company has, in the past 12 to 18 months, significantly extended its fragment-based drug discovery engine. Complementary to identifying hits by chemical means, sophisticated computational methods that simulate how compounds bind to targets are increasingly employed in a process known as *virtual screening*. This helps to narrow down the number of chemical compounds for subsequent testing in the lab. Evotec has a powerful computer infrastructure at its disposal, enabling the Company to employ both classical 'wet' and virtual screening methods in a complementary manner that brings even greater efficiency to Evotec's quest to identify new hit compounds.

Focused Screening and Compound Optimisation

Hit compounds must undergo considerable development and optimisation before they can be clinically tested in humans as new drug candidates. On the basis of the hit structures that resulted from primary screening, Evotec designs and synthesises smaller, more **focused compound libraries** of similar molecules. These 'sister' structures are then screened against the original target to identify compounds with improved drug properties.

The biologically active molecules, or **'lead structures'**, that the above process yields are subsequently pharmacologically optimised. In *biological testing* and *optimisation*, selectivity tests are performed against similar targets, generating extensive side effect profiles. ADMET assays, which test for absorption, distribution, metabolism, excretion and toxicity properties of compounds, are also conducted. For the first time, the impact of the lead compounds is then tested in living organisms, resulting in primary *in vivo* data. In *chemical optimisation*, the knowledge gained in biological testing is used to optimise the molecular structure by means of computational chemistry and medicinal chemistry methods.

In compound optimisation Evotec has a breadth and depth of expertise across all major target classes and therapeutic areas. With more than 200 programmes completed for 75 partners to date, Evotec's medicinal chemistry platform consistently delivers results with (among other achievements) more than 15 preclinical development candidates produced for its partners and six compounds approved for clinical trials. Evotec's range of services in preclinical drug discovery is supplemented by state-of-the-art high-speed analytical methods and highly specialised information management systems. These ensure the efficient capture, storage and easy retrieval of the significant volume of data that is generated throughout the process.

Preclinical Drug Research Leads to IND Filing

When a drug candidate is generated with the right pharmacological properties, it is ready to be tested in clinical trials for its safety and suitability as a therapeutic for humans. To enter into these clinical trials an **IND (Investigational New Drug)** application must be filed.

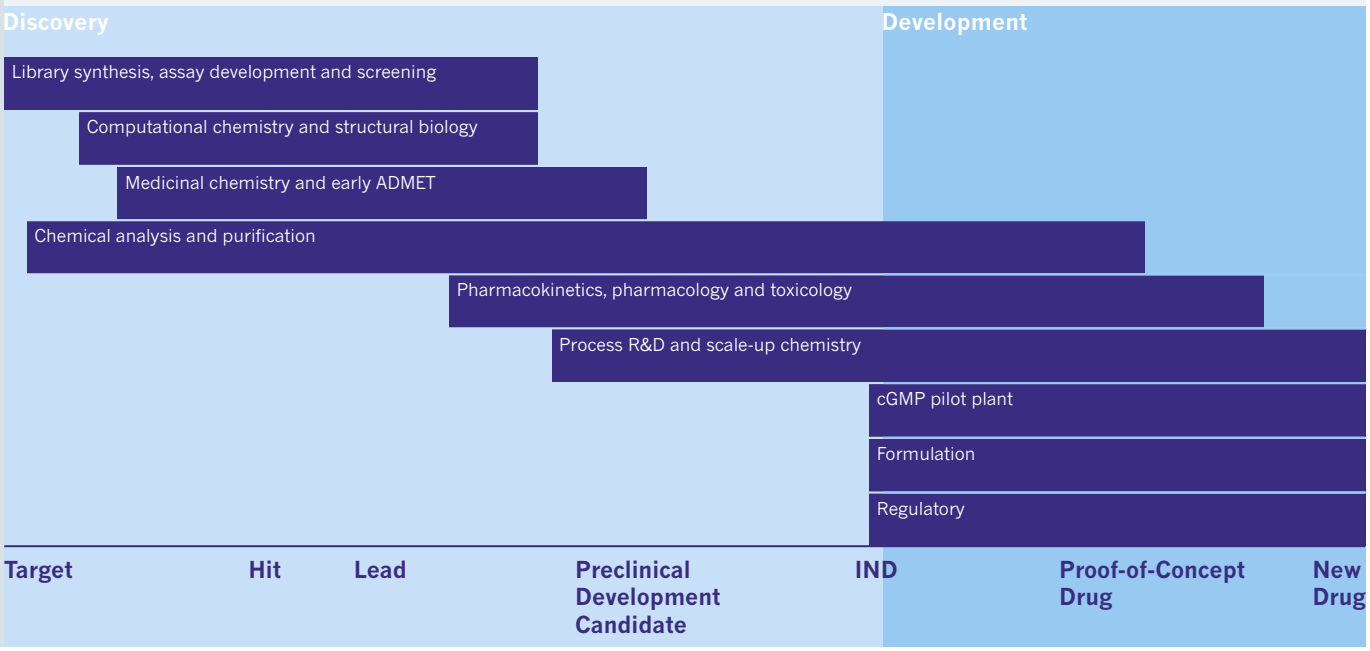
Clinical Development

After preclinical drug discovery, clinical development is the next significant stage towards bringing a **new drug** onto the market. Each drug candidate needs to go through three phases of clinical development successfully, testing for both safety and efficacy, before it can be registered for approval (see graph Our Pipeline, page 18).

For clinical development too, Evotec offers a wide range of chemistry services: *laboratory-scale compound synthesis*; the development of efficient chemical processes for larger-scale production of drug candidates *(process research & development)*; and the actual *pilot plant production* of high-quality intermediate products and clinical grade final actives for use in clinical trials and sometimes also for commercialisation. Although production quantities can range from one gram to hundreds of kilograms, all compounds are produced according to the good manufacturing practice (GMP) guidelines and accompanied by the relevant analytical and regulatory data. Evotec's subsidiary in Glasgow also offers *pharmaceutical formulation* services in which a drug compound converted into the format it will be administered in (e.g. vials or syringes). With over 150 staff dedicated to development, Evotec goes beyond simply providing a drug product, offering a full consultancy service with complete project management at every stage of the process.

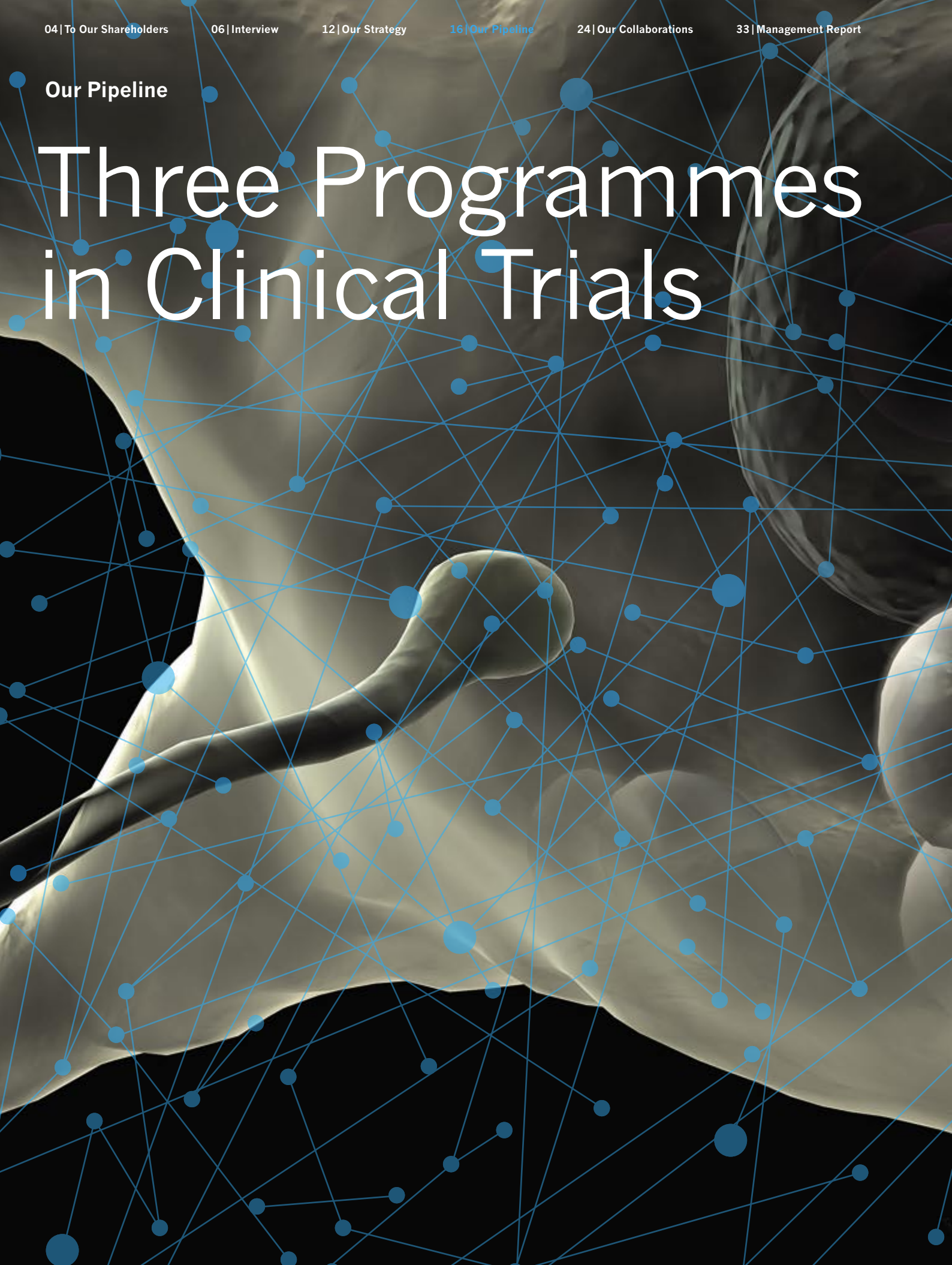
Evotec makes use of all these capabilities in its proprietary research programmes, as well as in those for its partners, offering integrated services that cover selected portions or the entire span of the R&D process.

Evotec's Drug Discovery & Development Engine



Our Pipeline

Three Programmes in Clinical Trials

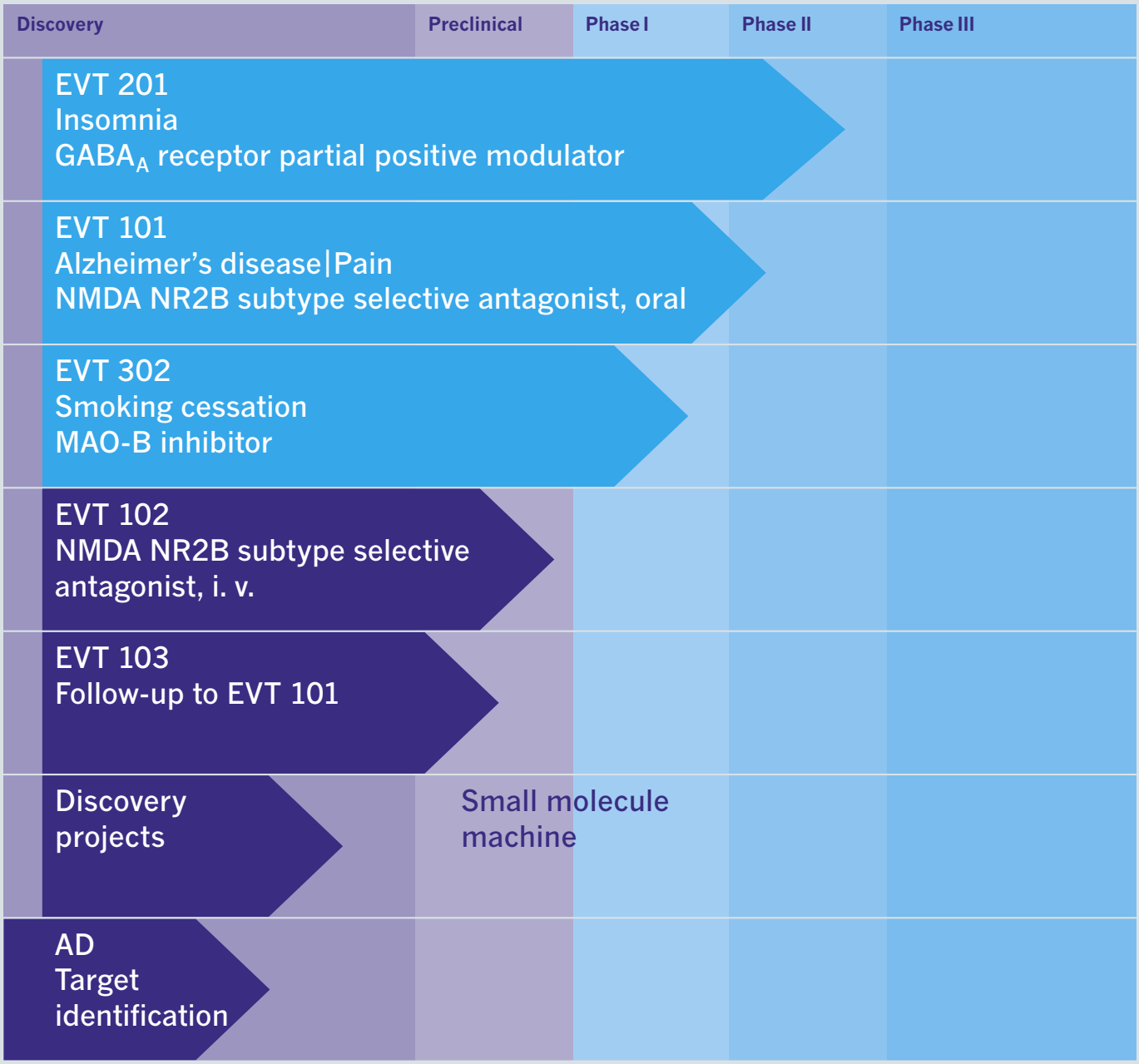


Evotec

CNS Pipeline

Evotec has three promising compounds in clinical development with potential in blockbuster indications such as insomnia, smoking cessation, Alzheimer's disease and pain. With their differentiated modes of action they have great potential for the improvement of treatment in those conditions where current medications provide only limited benefits.

Lead Compound EVT 201 to Yield Phase II Data for Insomnia in 2007



Discovery
Phase of drug discovery from target identification to the search for and optimisation of chemical compounds with desired properties.

Preclinical
Regulatory studies required prior to clinical trials.

Clinical Phase I
Clinical trial conducted in a small number of healthy volunteers, used to determine pharmacokinetics, preferred route of administration, and safe dosage range of a drug.

Clinical Phase II
Phase II trials are performed on patients and are designed to assess the clinical efficacy of the therapy. In addition, the assessment of safety continues in a larger group.

Clinical Phase III
Clinical trial involving a larger number of patients, designed to assess safety, effectiveness and optimum dosage of a drug as administered in a treatment setting.

3 compounds in clinical development:

> Second Phase I/II study with insomnia drug candidate EVT 201 confirmed previous encouraging results

> Two U.S. Phase II studies ongoing in insomnia patients

> Phase I studies with EVT 101 successfully completed

> Focus reset on EVT 302 in smoking cessation after Phase I of EVT 301

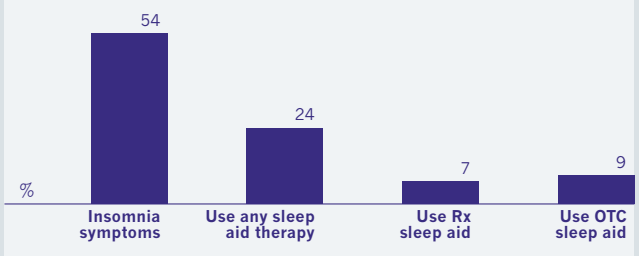
Evotec specialises in finding new treatments for diseases of, and related to, the Central Nervous System (CNS), one of the largest therapeutic areas with large unmet medical needs. The Company has built an attractive CNS pipeline and has three compounds in clinical development for blockbuster indications: EVT 201, a partial positive allosteric modulator (pPAM) of the $GABA_A$ receptor for the treatment of insomnia; EVT 101, a subtype selective NMDA receptor antagonist for the treatment of Alzheimer's disease and pain; and EVT 302, a selective and reversible inhibitor of MAO-B for smoking cessation with potential in Alzheimer's disease. They all act through well characterised mechanisms mitigating, to some extent, the risk inherent in drug discovery.

During 2006, the development of EVT 201 and EVT 101 continued according to plans. EVT 101 successfully completed a Phase I safety and tolerability study and, encouragingly, the second Phase I/II proof-of-principle trial with EVT 201 confirmed the positive results seen in the previous study. Two U.S. Phase II trials for EVT 201 in patients therefore started as planned in the second half of the year. In January 2006, Evotec in-licensed two Phase I MAO-B inhibitor compounds, EVT 301 and EVT 302, from Roche and started Phase I clinical development for EVT 301. During a safety and tolerability study, clinical evidence emerged that led the Company to discontinue the development of this compound in September 2006. Whilst this was a disappointment, early cessation of clinical development is prudent and allows internal resources to be redeployed to other candidates within the clinical pipeline. Indeed, the back-up compound EVT 302 has been evaluated for further clinical development and will start additional Phase I studies in the first half of 2007.

Why Another Insomnia Drug?

Insomnia is a common complaint that is under-treated. While 54 % of the U.S. population report insomnia symptoms at least a few nights a week, only 7 % use a prescription sleep aid[1)]. The National Sleep Foundation in the U.S. notes that "there is a wealth of research indicating that people with insomnia have poorer overall health, more work absenteeism, and a higher incidence of depression". While there are a number of treatments for insomnia available, the challenge remains "to develop a drug that induces sleep quickly, helps individuals remain asleep and allows them to awaken feeling refreshed rather than hung over"[2)]. Traditional benzodiazepines are seen as most effective treatments; however, concerns remain with hang-over effects, addiction, abuse and tolerance. Therefore, novel compounds were developed that selectively target the same $GABA_A$ receptor or completely novel targets, however, a significant portion of patients do not adequately respond to those therapies. For example, many of the most widely used current treatments have shown a limited ability to improve sleep maintenance. This is a particular issue for the elderly, who have an increased tendency to wake during the night and wake up too early[1)]. Some therapies also have a different pharmacokinetic profile in the elderly, which may also show considerable variation between individuals. This is likely to impact on the efficacy and side effects of the drug, such as next day 'hang-over'. A molecule which could demonstrate the efficacy of traditional benzodiazepines without residual effects and with reduced liability for addiction and tolerance could therefore meet a major unmet need.

Insomnia market: Growing and under-penetrated

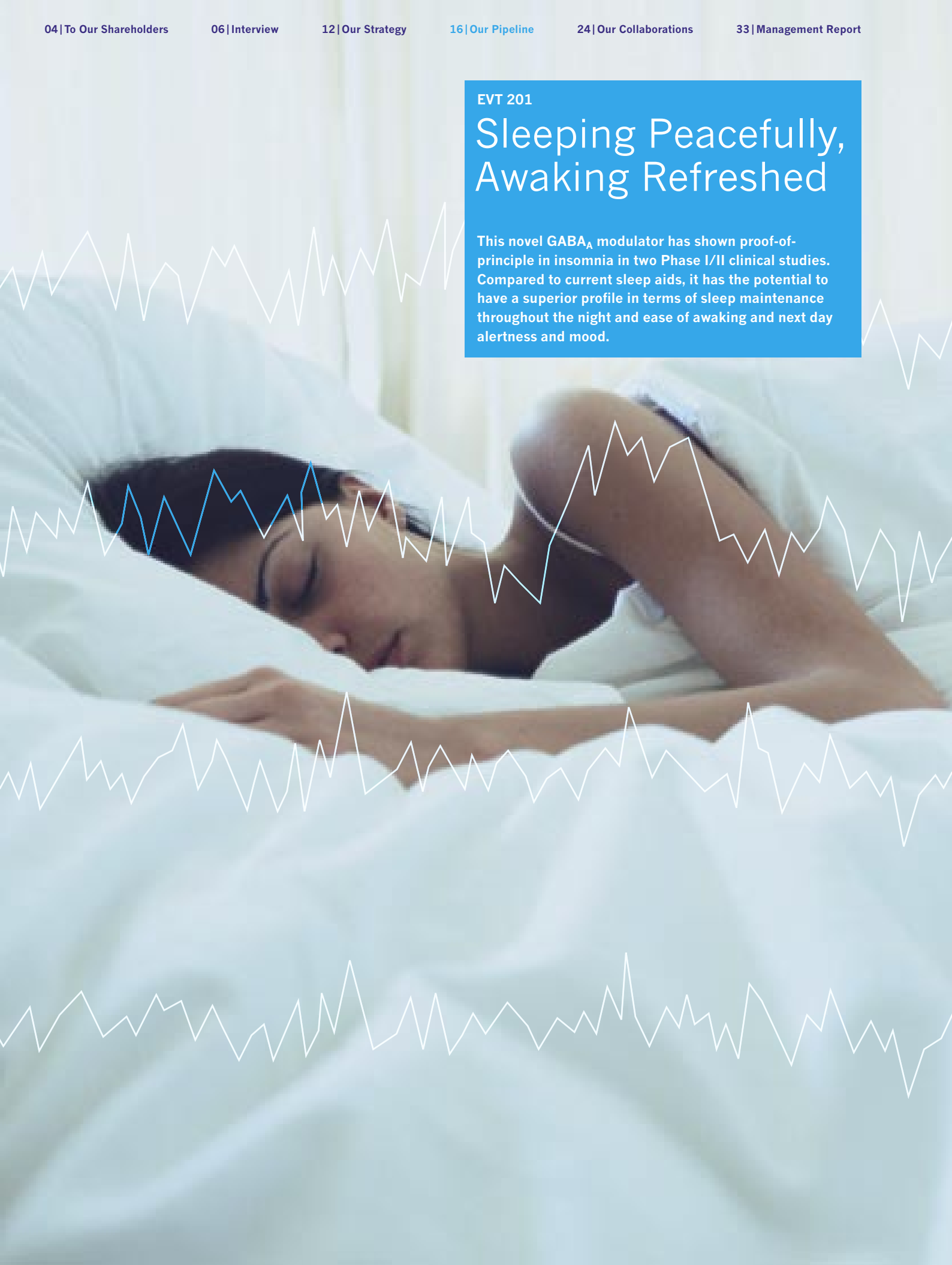


Sources: [1)] Sleep in America poll, 2005; [2)] Datamonitor, Pipeline report on insomnia.

EVT 201

Sleeping Peacefully, Awaking Refreshed

This novel $GABA_A$ modulator has shown proof-of-principle in insomnia in two Phase I/II clinical studies. Compared to current sleep aids, it has the potential to have a superior profile in terms of sleep maintenance throughout the night and ease of awaking and next day alertness and mood.



Addressing the Gold Standard Mechanism with a Differentiated Profile

Insomnia is an important condition to treat and there is a clear need for better sleep drugs (see Why another insomnia drug?, above). Evotec has a promising drug candidate (EVT 201) for the treatment of insomnia in Phase II clinical trials. EVT 201 is a partial positive allosteric modulator (pPAM) of the $GABA_A$ (gamma-aminobutyric acid) receptor complex. Acting on the $GABA_A$ receptor, it addresses the gold standard mechanism for insomnia treatment with more than 90% of current insomnia drugs using this mechanism, including market leaders. Importantly, however, its close to ideal half life of 3 to 4 hours and its partial agonist activity gives EVT 201 a differentiated preclinical profile and mechanism of action. It produces a lower maximal potentiation of $GABA_A$ receptors, which supports a clinical profile that induces and maintains sleep throughout the night, but doesn't knock people out, i.e. avoids residual effects. Preclinically, EVT 201 showed no adverse effects, no potentiation of sedative effects of alcohol and exhibited a low level of liability for the development of dependence – problems with a number of traditional insomnia drugs.

Proof-of-Principle Demonstrated in Volunteers with Induced Insomnia

In Phase I clinical studies undertaken by Roche and Evotec, EVT 201 was well tolerated in more than 120 young and elderly subjects for up to 14 nights repeat dosing. In 2005 and 2006, Evotec conducted two Phase I/II proof-of-principle studies to prove the compound's potential as a novel sleep agent in subjects with induced insomnia. In these studies recorded traffic noise was played throughout the night thereby provoking insomnia. This is a well accepted model for investigating compounds for this indication and has been used with several compounds currently in development or on the market. The results were encouraging and, importantly, consistent across both studies. EVT 201 significantly reduced wake after sleep onset (WASO) while significantly increasing the total sleep time (TST) and quality of sleep with no subjective residual effects. Unlike many other sleep promoting agents, the compound showed efficacy in sleep maintenance in both first and second halves of the night. Should this profile of efficacy, together with freedom from significant adverse effects, be confirmed in the ongoing Phase II trials this would represent a very attractive profile for EVT 201 in the management of this under served condition.

Phase II Results in Insomnia Patients Expected in Q3 2007

Two Phase II studies are currently ongoing in the U.S. The first one is a three way cross-over design study in 66 patients with primary insomnia. Patients will receive two dose levels of EVT 201 and placebo, in a random order, for two consecutive nights with a 5–12 day washout between each period. The primary endpoints of this first patient trial with EVT 201 are to assess WASO as well as TST determined by polysomnography. The second trial is a parallel design study with two doses of EVT 201 and placebo in 135 elderly patients with chronic primary insomnia and daytime sleepiness. It is designed to assess the hypnotic efficacy of EVT 201 during seven nights' treatment with TST as the primary endpoint. It will also determine the effect of improved sleep quality on daytime performance as measured by a variety of tests of daytime sleepiness and functional performance. The elderly are a poorly served and large segment of the insomnia patient population with a higher prevalence of waking during the night and waking too early than other age groups. EVT 201 has a promising profile for the treatment of the elderly, including a similar half life in the elderly compared to young subjects. Results of both Phase II studies are expected for the second half of 2007.

EVT 101

Multi-Indication Potential

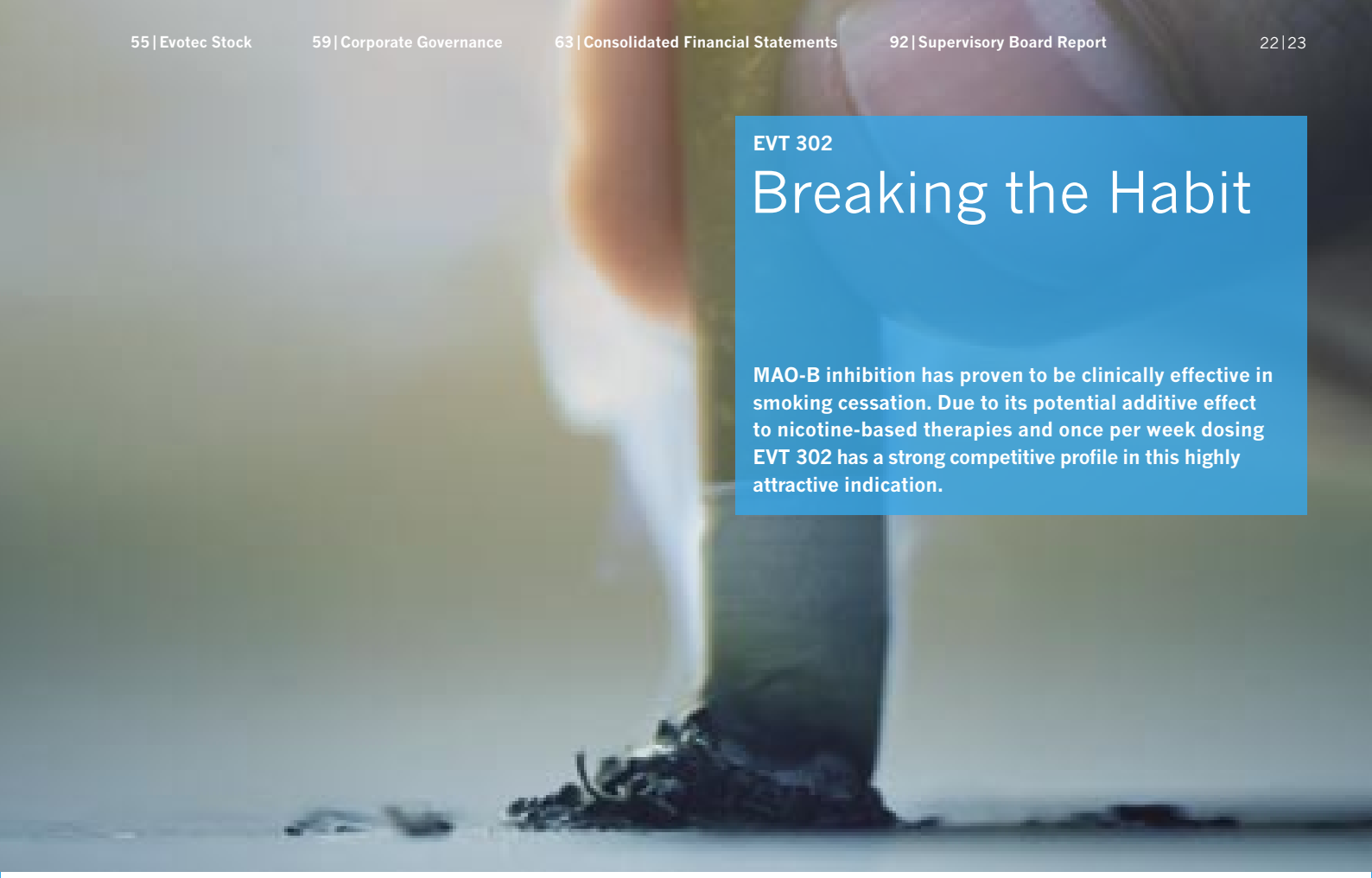
EVT 101 is one of the very few orally active and selective NMDA antagonists in clinical development. A non-selective drug of this compound class is one of the four drugs marketed for Alzheimer's disease and is on its way to becoming a blockbuster. The selectivity of EVT 101 may offer clinical advantages and therefore clear opportunities in a number of indications.

Addressing Major Markets with Substantial Unmet Medical Need

Extensive studies over the past 20 years have indicated that NMDA (N-methyl-D-aspartic acid) receptors are important players in Alzheimer's disease, Parkinson's disease and pain sensation. The NMDA receptor antagonist 'memantine' is currently one of the very few drugs marketed for the treatment of Alzheimer's disease (AD). In the early 1990's it was found that multiple NMDA subtypes exist which contain different NR2 (A-D) subunits. Compounds selectively targeting the NR2B subunit-containing receptors are thought to retain many of the beneficial effects of non-selective compounds such as 'memantine' but with much improved side effect profiles.
Selective NMDA antagonists are therefore attractive candidates for the treatment of a variety of poorly served CNS diseases. For example, NR2B selectivity could translate into clinical advantages over memantine in Alzheimer's disease. The AD market is one of the fastest growing CNS markets but only four AD drugs are approved today that provide only moderate and temporary symptomatic benefit. There is still no treatment available that can actively slow the progression or cure AD. There is also significant potential for NMDA antagonists in a number of different pain indications. Older non selective NMDA antagonists have been shown to reduce post operative pain following molar extraction and major abdominal or gynaecological surgeries when administered perioperatively. Preoperative dosing of NMDA antagonists before surgery has the potential to reduce post operative pain and the amount of opiates given to treat this condition. In addition, a previous NR2B selective compound has shown clinical proof-of-concept in neuropathic pain in patients after spinal cord injury. Similar to AD, current treatment options in this indication are limited with only five approved therapies and new entrants are predicted to grow rapidly and increase total market value.

Selectivity on NR2B Subtype Provides Potential Differentiation

EVT 101 is the lead candidate of the EVT 100 series which includes over 360 compounds, many of which are potent and highly selective antagonist of the NR2B subunit-containing NMDA receptors such as EVT 101. The compound shows strong efficacy and a favourable side effect profile in preclinical studies compared to non-selective NMDA receptor antagonists. It also has excellent drug-like properties, good oral bioavailability and *in vivo* pharmacokinetics and was well tolerated in Phase I clinical trials, showing a good exposure and pharmacokinetic profile. Evotec is preparing for short-term Phase Ib/IIa studies with EVT 101 in cognition and pain to determine the therapeutic dose and to show early proof-of-concept in these indications. Based on the results of these studies, data from preclinical longer-term toxicology studies and the varying time, risk, cost and also reward profiles of potential future indications, Evotec will determine the clinical strategy for longer-term Phase IIb studies.



EVT 302

Breaking the Habit

MAO-B inhibition has proven to be clinically effective in smoking cessation. Due to its potential additive effect to nicotine-based therapies and once per week dosing EVT 302 has a strong competitive profile in this highly attractive indication.

Potential Add-On to Nicotine-Based Therapies in Smoking Cessation

Dopaminergic mechanisms are involved in nicotine dependence. Nicotine acts by stimulating dopamine release in neuronal reward pathways, but cigarette dependence is due to more than just the effects of nicotine. Smokers also have reduced MAO-B (monoamine oxidase B) activity due to non-nicotine com-ponents of tobacco smoke which potentiates nicotine's effect on dopamine release and may increase the addictive properties of tobacco. When smokers quit, MAO-B activity returns to normal and consequently dopamine-based reward goes down and craving goes up. MAO-B inhibition by EVT 302 as smokers quit therefore alleviates one of the two fundamental changes occurring as smokers stop. Earlier MAO-B inhibitors have already been shown to improve smoking cessation rates when used as monotherapy, at a quit rate comparable to existing therapies. Evotec therefore believes that EVT 302 has a high probability of demonstrating a successful efficacy profile as monotherapy but unlike current marketed drugs can also be given with nicotine replacement therapy.

The market potential for smoking cessation therapies is enormous. There are 44.5 million smokers in the U.S. alone, 70 % of which report a desire to quit, and the average smoker will make six to nine attempts to quit during their lifetime. There is also strong health economic support for the benefits of quitting. The market is dominated by nicotine replacements such as patch and gum, and only two prescription therapies are currently approved, one of which has an inferior safety profile. Any drug that could improve smoking cessation rates therefore could have a good opportunity for a quick market penetration and provide an additional treatment tool for physicians.

Potential for Once a Week Dosing

EVT 302 is an orally active, potent, highly selective and reversible inhibitor of MAO-B. The compound has a superior safety profile over first generation MAO-B inhibitors with no food restriction (e.g. cheese, cooked meats or red wine) and better tolerability compared to current treatments. In a Phase I single ascending dose study EVT 302 was safe and well tolerated up to high dose levels and showed excellent pharmacokinetic properties with the potential for once a week dosing at very low exposure levels. This is a significant advantage for a condition where smokers' motivation for quitting can vary from day to day.

Evotec plans to start further Phase I safety and tolerability studies and brain imaging studies which measure the inhibition by EVT 302 of MAO-B in the brain in the first half of 2007. If the results of those are positive, Phase II in smoking cessation will begin in mid 2008. The preclinical and Phase I programme for smoking cessation would also support the development of EVT 302 as a disease modifying agent for Alzheimer's disease at no extra cost. As this is a higher development risk opportunity, Evotec has postponed the decision to pursue this indication to 2008.

Our Research Collaborations

Powerful Partnerships

Evotec

Collaborative Research

Evotec has built one of the most productive small molecule discovery and development engines in the biotechnology industry. In its collaborations with numerous pharmaceutical and biotechnology companies, Evotec uses this engine to fulfil the research needs of its partners in traditional fee-for-service and results-based projects.

Boehringer Ingelheim, Research Building, Biberach | Germany.

Complementing Success in Fee-for-Service with Results-Based Collaborations

Evotec has a proven track record of success in providing high value integrated drug discovery and development solutions to the world's leading pharmaceutical and biotechnology companies. Since 2000, the Company has supported its many customers in more than 1,200 programmes, providing 35 lead compounds, 15 preclinical development candidates and 6 drug candidates approved for clinical testing. Evotec now complements its traditional fee-for-service business with higher value, results-based projects in which the Company shares in its customer's success through royalties and milestone payments (see Our Strategy, page 12). Such projects are accounted for in either the Company's Services or Pharmaceuticals Division, depending on the level of proprietary ownership Evotec retains in the particular project. Evotec has contracts with Roche, Boehringer Ingelheim, DAC and Apeiron (see page 30), illustrating the progress the Company is making in this area.

Boehringer Ingelheim

Results-Based, Long-Term, ~80 People

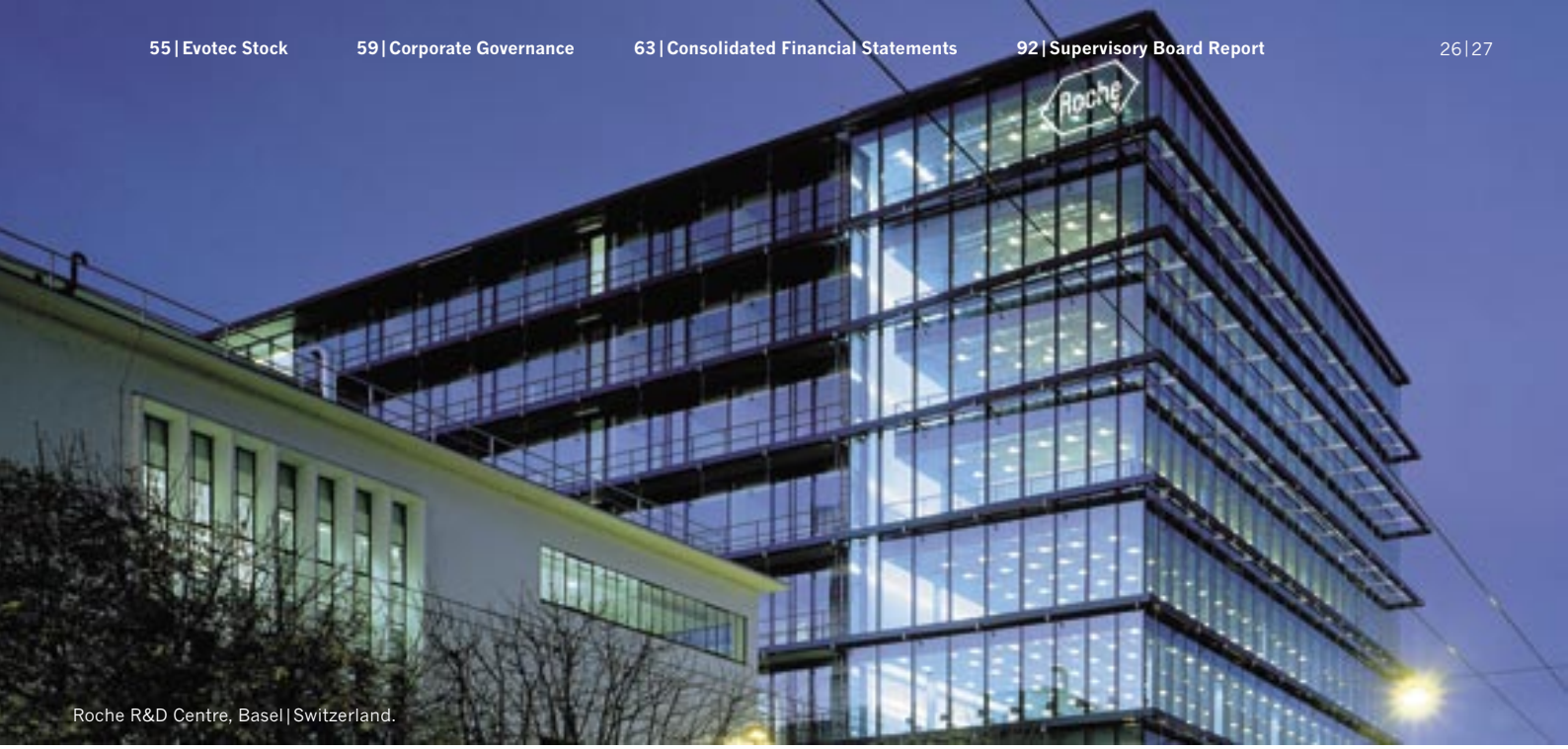
The collaboration has been extended and doubled in size. To date, Evotec achieved two project milestones and is expecting further payments in 2007.

Discovery Collaboration with Boehringer Ingelheim Progressing Well: Contract Extended and Second Milestone Achieved

In September 2004, Evotec entered into a three-year research collaboration with Boehringer Ingelheim to jointly identify and develop preclinical development candidates for the treatment of CNS-related disorders and other diseases. The initial focus was on G-Protein Coupled Receptor (GPCR) targets, the most abundant and most diverse type of cell surface receptors and the single most important target class (26 of the top 100 pharmaceutical products are compounds that target GPCRs, which in total account for annual sales of over $30 billion). In the agreement, Boehringer Ingelheim has full ownership and global responsibility for clinical development, manufacture and commercialisation of the compounds identified. In return, Evotec receives not only preclinical milestones and ongoing research payments, but also clinical milestones and royalties on future sales of drugs derived from the collaboration.

In January 2006, the collaboration doubled in volume and extended to the end of 2008. The new contract also expands the scope to different target classes including ion-channels and enzymes.

Evotec achieved its first milestone of the collaboration in June 2005. The payment was granted for the identification of a number of lead series compounds for a priority GPCR target. In March 2006, Evotec advanced another target into lead optimisation resulting in a second milestone payment. The collaboration is progressing well and Evotec is expecting further milestone payments during 2007.



Roche R&D Centre, Basel | Switzerland.

Global Alliance with Roche to Jointly Discover Novel Drugs

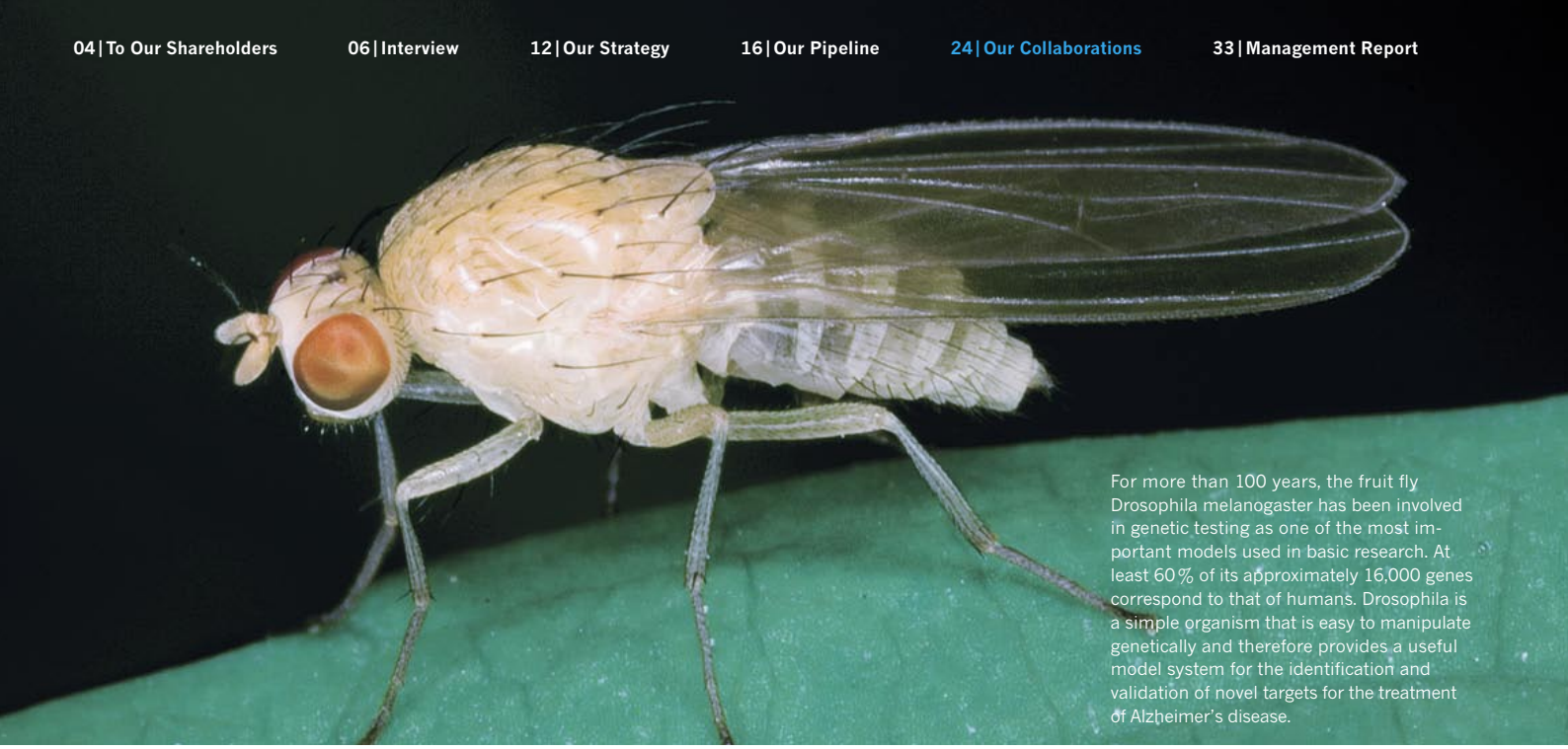
A core element in building results-based drug discovery alliances is Evotec's ability to generate proprietary assets using its state-of-the-art discovery and development platform. Research results on one of its high priority targets for CNS diseases and other indications have convinced Roche to partner. On 21 June 2006, both companies announced a deal to jointly discover and develop compounds building on IP previously generated on this target by Evotec. Both companies committed R&D resources to jointly drive novel compounds into clinical development in a 50:50 collaboration. At this stage Roche will have exclusive rights to the development of the drug candidates whilst Evotec could receive in excess of € 100 m in milestones plus royalties.

Evotec and Roche share a long history of deals in collaborative research. Through a large global discovery chemistry agreement, Evotec for many years has been supporting all of Roche's European and U.S. research sites in the design and synthesis of high quality compounds for lead finding and optimisation programmes. In addition, Evotec acquired an extensive patent portfolio covering NR2B subtype specific NMDA antagonists, MAO-B inhibitors as well as a compound acting on the $GABA_A$ receptor complex, the foundation of Evotec's proprietary CNS-pipeline.

Roche

Shared Cost, Shared IP in CNS

Based on IP generated on a 'hot' CNS target at Evotec both companies joined forces to drive novel compounds into clinical development.



For more than 100 years, the fruit fly Drosophila melanogaster has been involved in genetic testing as one of the most important models used in basic research. At least 60 % of its approximately 16,000 genes correspond to that of humans. Drosophila is a simple organism that is easy to manipulate genetically and therefore provides a useful model system for the identification and validation of novel targets for the treatment of Alzheimer's disease.

Progress in the Identification of Novel Alzheimer's Disease Targets

With its deep knowledge in CNS-related diseases, Evotec has established a strong position in the identification and validation of targets for Alzheimer's disease and other neurogenerative diseases. Over the past years the Company has made excellent progress in building substantial expertise and IP around novel targets and has entered two major alliances with large pharmaceutical partners.

Second Alzheimer Target Identified in Takeda Collaboration

In August 2006, Evotec achieved the second milestone in its four-year target discovery collaboration with Takeda. The Company granted Takeda exclusive rights to a second novel Alzheimer target, triggering a milestone payment of over € 1 m. Evotec is also eligible for future milestone payments on the successful clinical development of compounds acting on this target. The collaboration is in its fourth year and Evotec is entitled to further milestone payments should Takeda select additional targets from Evotec's database.

New Alzheimer's Disease Target Identification Alliance with Boehringer Ingelheim

At the beginning of 2007, Evotec entered into a multi-year collaboration with Boehringer Ingelheim to jointly identify novel targets as potential points of intervention in the treatment of Alzheimer's disease (AD). The collaboration which also involves the Research Institute of Molecular Pathology in Vienna (IMP) expands Evotec's ongoing successful partnership with Boehringer Ingelheim into another area of strength.

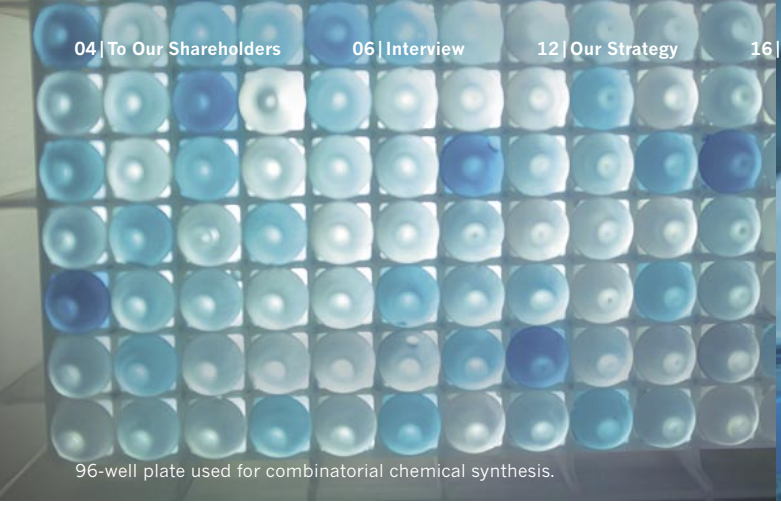
Evotec scientists together with the IMP will apply their proprietary and well validated disease models to identify novel AD targets. Based on these models Boehringer Ingelheim will select and further validate target candidates for its in-house drug discovery programme with the goal of developing innovative novel therapeutics. Financial details of this collaboration are not disclosed.

The contract also includes an option for Evotec to support Boehringer Ingelheim in the target validation process. If Boehringer Ingelheim exercises this option, Evotec is eligible for milestone payments of up to € 20 m plus royalties.

Excellent Customer Network

Selection 2006

ACHILLION
Adherex
ALIZYME
Almirall
ALTANA
ALTANA Pharma AG
AnorMED
APEIRON BIOLOGICS
aspen
astex
AstraZeneca
Boehringer Ingelheim
Celgene
CHDI
Chroma
CURIS
EPIX PHARMACEUTICALS
FERRING PHARMACEUTICALS
GENEXTRA
GRÜNENTHAL
nabriva THERAPEUTICS
neuren pharmaceuticals
NOVARTIS
NovImmune
OXAGEN
OXIGENE THE VASCULAR TARGETING COMPANY
Panacos
point therapeutics
P&G Pharmaceuticals
RECORDATI
Roche
SEIKAGAKU CORPORATION
serono biotech & beyond
Solvay Pharmaceuticals SOLVAY
Takeda
Trigen Advancing Cardiovascular Care
ucb
Vernalis
VERTEX
Vifor International



96-well plate used for combinatorial chemical synthesis.

Automated compound reformatting.

Major New Alliances Established for Discovery Services

The market for more traditional fee-for-service collaborations in discovery continues to be challenging. With continued strong competition from low cost countries such as India and China, there has been consolidation in the market with several companies exiting the sector. However confidence is slowly returning back and upcoming opportunities are expected to lead to more visible growth within the coming years.
In this environment Evotec has performed strongly in 2006, signing several contracts with new and existing customers. The driver for this strong performance is that Evotec can offer what companies are increasingly looking for, namely a provider of collaborative research services that provides selected disease biology expertise in addition to fully integrated chemistry and biology drug discovery capabilities.

Broad and Integrated Collaboration with CHDI in Huntington Disease

Evotec's breadth of skills and expertise in drug discovery coupled with its profound knowledge of CNS diseases has led CHDI to choose Evotec as a strategic drug discovery partner. CHDI is a not-for profit organisation pursuing a biotech approach to finding therapies for Huntington Disease. It operates as a virtual biotechnology company, progressing its discovery research entirely through third-party collaborations. Since March 2006, Evotec and CHDI have signed five agreements to help CHDI advance its drug discovery programmes. These contracts include accessing most of Evotec's integrated discovery offering such as assay development, ultra-high-throughput, high-content and fragment-based screening, structural biology and medicinal and computational chemistry. In addition, Evotec is building and managing the CHDI corporate compound library. Tremendous progress has already been made despite the collaboration being less than a year old.

Strong Combination of Drug Discovery and Disease Expertise

Evotec's breadth of skills and expertise in drug discovery coupled with profound disease know-how has led a number of customers to choose Evotec as strategic drug discovery partner.

Evotec and Apeiron Biologics Discover Novel Pain Therapeutics

Another collaboration building on Evotec's integrated drug discovery and CNS expertise is the contract with Apeiron Biologics. Both companies have entered into a discovery collaboration to develop small molecules targeting an innovative therapeutic concept for pain relief. This concept is based on breakthrough research by Prof Josef Penninger, Director of the Institute for Molecular Biotechnology at the Austrian Academy of Sciences (IMBA) (see also page 08).
During the initial phase of this collaboration, Apeiron Biologics and Evotec jointly developed tailored biochemical and cellular assays, and Evotec applied its proprietary ultra-high-throughput screening technology to identify promising hit molecules. Both companies will now aim at advancing a selected lead compound into pre-clinical development and beyond.
Evotec is co-investing in the programme and commercialisation rights are shared equally. This programme could add drug candidates to Evotec's growing CNS pipeline or may be out-licensed to, or progressed with, a pharmaceutical partner.

High throughput rotor-mixer used in solid-phase chemistry.

Cellular analysis using fluorescence microscope.

DAC Selects Evotec as Partner for HSP90 Cancer Project

Generating compound intellectual property on an interesting target through Evotec's proprietary fragment-based screening platform led to a significant collaboration with the Italian biotechnology company DAC, a wholly owned subsidiary of Genextra SPA. In April 2006, DAC chose Evotec to identify small molecule therapeutics on the HSP90 target, a key protein involved in a variety of pathways in cancer related diseases. The aim of the collaboration is to take active compounds identified by Evotec and further optimise them to the point of clinical development. For its contributions to the discovery project, which may run for an initial period of over 2 years, Evotec will receive R&D service revenues, plus potentially preclinical and clinical milestone payments.

Evotec Supports Daiichi in Medicinal Chemistry and Compound Profiling

In October 2006, Evotec announced a traditional fee-for-service collaboration agreement with Daiichi Pharmaceutical Co., Ltd. (a wholly owned subsidiary of DAIICHI SANKYO COMPANY, LIMITED) for medicinal chemistry and compound profiling. A dedicated group of Evotec scientists have started working on two programmes for Daiichi to identify lead structures for further progression into clinical trials.

Capitalising on Superior Technologies

Applying its unique fragment-based drug discovery platform Evotec generated IP on an interesting cancer target which resulted in a significant discovery collaboration.

Production of up to several hundred kilogrammes of drug candidates in Evotec's state-of-the art pilot plant facilities.

Evotec develops and manufactures liquid drug formulations such as syringes or vials in its subsidiary in Glasgow.

A Strong Year for Development and Pharmaceutical Formulation

Chemical development and pharmaceutical formulation had a very successful year with high pilot plant and formulation sales. Evotec's customers continue to use and benefit from its range of development capabilities from preclinical synthesis to commercial API manufacture. The Company has moved down the value chain with a number of discovery customers, now providing additional support for their programmes moving towards and into clinical trials. In the collaboration with Panacos, for example, a lead project progressed into preclinical development resulting in development support from Evotec. The discovery collaboration is ongoing and it is hoped that further preclinical candidates will be identified in 2007. Evotec is also particularly pleased that despite the recent flow of development work to India and China large pharmaceutical companies like AstraZeneca and Novartis were looking to Evotec for fee-for-service business in larger FTE-based collaborations.

Commercial Manufacture of Four APIs Leads to Steady Production Business

Throughout 2006, Evotec was the commercial supplier of four APIs for Vernalis, AnorMED, Point Therapeutics and another U.S. biotechnology company. The Company synthesised additional batches of Frova® under a global master supply agreement with Vernalis and supplied several batches of an approved anti-cancer compound to its long-term U.S. biotech partner. In Evotec's continued work with Point Therapeutics, the Company manufactured additional batches of their anti-cancer drug talabostat and successfully completed the validation of the process for commercial manufacture.

Building Strategic Accounts

An increased need for niche, small volume, parenteral clinical products has fuelled Evotec's growth in 2006.

Integration of Formulation Business Propelled Further Growth

Evotec's formulation activities based in Glasgow, Scotland, had another exceptional year, showing significant growth. An increased need for niche, small volume, parenteral clinical products within the industry has fuelled this growth. Furthermore, following the full integration of this business into the Evotec brand in 2005, Evotec was able to leverage its global sales team to boost sales not only in Europe but increasingly into the U.S. market. Evotec has continued to build strategic accounts with companies such as Aspen and Novimmune. Additionally, the average size of deals has increased and customers are returning for multiple orders on different manufacturing campaigns. To cope with the growing market demand Evotec has expanded its clean room facilities in Glasgow. This expansion will come on-line in the first quarter of 2007, increasing the amount of manufacturing business the Company is able to carry out.

Management Report 2006

Content
(Numbering according to German Accounting Standards)

34 Business and Operating Environment (1)
36 Results of Operations (2)
41 Financing and Financial Position (3)
43 Assets and Liabilities (4)
45 Human Resources
46 Tools & Technologies (Evotec Technologies)
48 Risk Management and Risk Report (6)
52 Post-Balance Sheet Events (5)
52 Outlook (7)

General Business Description

Company Structure and Business Operations

Evotec AG is a publicly listed stock corporation operating under German law, with all of its currently outstanding shares (68.078.819 as of 31 December 2006) registered for trading on the Frankfurt Stock Exchange. Together with its affiliates in Germany, Switzerland, the US and in particular the UK, where it employs the majority of its people (408 of 607), the Group has been organised as and has operated in three business segments up to the end of 2006. Its **Services** and **Pharmaceuticals Divisions** engage in drug discovery and development projects for third-party biotechnology and pharmaceutical companies, and in proprietary programmes, respectively. The third segment **(Tools & Technologies)**, developing and manufacturing research instruments, has been divested effective 1 January 2007 (see Post-Balance Sheet Events). As a consequence, the description of Evotec's business status as well as the report on pro-forma financials refers to the two continuing business segments only. Explicit reference to the **Tools & Technologies** business (Evotec Technologies) is made where appropriate and the analysis of this discontinued business is reported separately in this report.

With its products and services, Evotec addresses the global life science market, with many of the world's leading pharmaceutical and biotechnology companies as its partners. In the **Services Division**, Evotec applies its industrialised platform to provide its customers with a choice of services from 'target to clinic'. These services include assay development, screening, medicinal and computational chemistry, drug manufacturing and formulation, all of which can be provided as individual services or as integrated programmes covering a number of different service lines. In the **Pharmaceuticals Division**, the Company leverages the same platform to generate internally promising drug candidates up to proof-of-concept in man (Phase II data), which it intends to partner and out-license to pharmaceutical companies.

The Evotec Group is governed by a dual board structure: managed by its Management Board and controlled by the Supervisory Board. The Management Board is supported in the strategic and operational management of the Group by a larger Executive Committee. This Committee draws its membership from the senior executives of the **Pharmaceuticals** and **Services Divisions**, and through the diverse expertise and experience of these committee members, reflects the diverse environment in which the Company operates.

Business and Operating Environment (1)

Global Business Environment in 2006

New Economies Turning to Higher Value Industries such as Life Science

A number of topics dominated the economic news in 2006; the rise of energy and commodity prices, and the relentless growth of the 'new economies' of China and India, including their growth in private wealth and consumer spending. Companies have reacted in differing ways in different industries, but all seek to reduce their costs by more efficient use of raw materials and energy. Industrialisation of China, India and other Asian countries continues apace, with their increasingly skilled populations now turning to the higher value industries of the traditional developed Western countries for additional growth. This has resulted in the build up of life science service companies in much the same way that the 1990s saw the development of support to the information technology industry, particularly in India. These companies today have limited scale and breadth of capabilities compared to their Western peers, specifically regarding integrated solutions to drug discovery. However, in chemistry they deliver stand-alone services effectively from early discovery research, through to development chemistry. They have also engaged in clinical research support services. The expansion of the European Union eastwards in Europe has seen further economic development in these countries, with their workforce adding to the skills and competitiveness of the Western European nations.

There has been continued fall-out from the increased regulatory and legal environment, particularly in the US but also in the EU. This is putting added cost and complexity onto businesses, almost irrespective of company size. In addition, many companies in Europe and around the world converted their accounting regime to reporting under IFRS during 2005. 2006 will be the first full year of reporting without conversion needs for many companies. In 2006 this was complemented by further local reporting requirements, and some of these changes created increased hurdles for mergers or acquisitions by smaller companies, or for stock listings on additional markets.

Business Environment in the Biotechnology Sector in 2006

Biotech Dominated by Mergers & Acquisition and Bullish Financial Markets

For biotechnology companies overall conditions to raise finance were favourable in 2006. This was seen both in venture capital financings, and initial public offerings (IPO) or secondary offerings on the public markets, with the general quality of IPO candidates improving. In addition, 2006 saw significant merger and acquisition activity within and between the various segments and niches of the biotechnology and pharmaceutical industries. As pharmaceutical companies continued to experience a slow pace of new product launches combined with continued deterioration of their internal late stage pipeline and a plethora of patent expiries, the pressure to in-licence products continued to escalate. This has resulted in the estimated average cost of in-licensing a late stage drug increasing from around $70 m in 2000 to more than $400 m in 2005. Large companies therefore acquired small and mid-sized biotechnology companies owning promising assets in order to complement their development pipelines. In turn, some of the mid-sized and small biotechnology companies also undertook mergers and acquisitions to improve their portfolios. All of these factors supported the development of the biotechnology industry: companies increased earlier stage research, commissioned more early stage discovery research with companies like Evotec, advanced their own products, and increased the licensing value of drug candidates. This then helped to fuel share price appreciation of biotechnology companies in the capital markets.

The year ended with the US Dollar weak against both Evotec's functional currency (Euro) and the currency of its UK operations (UK Sterling). This impacted unfavourably on companies with the majority of their value creation in Europe, but an important part of their customer base in the US. This can only partly be offset by increasing activities in the US or ongoing cost reduction initiatives. On the other hand, the year saw a degree of stability between Evotec's operating currencies, with Euro: UK Sterling trading between £1.43:€ 1.00 and £1.47:€ 1.00 during most of 2006, only reaching £1.47:€ 1.00 to £1.49:€ 1.00 during the latter part of the year.

In summary, the market environment for the biotechnology industry as a whole and Evotec in particular continues to be competitive and challenging. There are however significant positive factors supporting Evotec's growth and strategy based on fundamental competitive strengths compared to its peers.

Impact of Business Environment on Evotec's Strategy

Well positioned to Benefit from the Opportunities in Life Science

Evotec has a strong business presence in drug discovery and development research collaborations, despite the challenges in this market segment. Customers for all of Evotec's services demand ever more flexible or specialised solutions, yet there is pressure on prices due to the increased availability of competitor offerings mainly from China and India. Service providers continue to seek consolidation to achieve scale in their operations or to compensate for lost business. In addition, a number of Western competitors have exited the services sector.

In this environment Evotec has performed strongly in 2006, signing several contracts with new and existing customers. Cost is an important consideration but by far not the only one in drug discovery and development. Evotec's reputation for delivering highest quality results within agreed budgets and timescales has been at the core of the Company's success. Additionally, Evotec is increasingly filling the needs of customers to engage in collaborative research programmes providing disease biology expertise as well as its fully integrated drug discovery process know-how. In 2006, Evotec increased such higher value, results-driven activities in which the Company shares in its customers' success through royalties and milestones along with substantial research fees. Asian service providers and even many of Evotec's Western competitors lack the scale and breadth of capabilities to be able to take this route, or have chosen to focus on other specific niche areas.

The value of out-licensing drug candidates increased dramatically over recent years. There is an opportunity for a company such as Evotec to benefit from this trend through its proprietary drug pipeline. The **Pharmaceuticals Division** focuses on Central Nervous System (CNS) related diseases, a fast growing therapeutic area in the context of rapidly aging populations in all regions of the world. Evotec has multiple CNS discovery projects and had three compounds in clinical development at the end of 2006. The Company intends to dedicate the majority of its funds to expand this business and to advance its current pipeline candidates with the goal of out-licensing them in the next few years. The plan is to out-license the first candidate in 2008. In addition, Evotec intends to increase the number of clinical candidates in its pipeline. As in-licensing of clinical stage drug candidates becomes more competitive and expensive (see above), the Company will put increasing emphasis on building its pipeline through internal discovery efforts or business acquisitions (see Outlook).

Financial Report

As mentioned above, the following financial discussion focuses primarily on the continuing business of the Evotec Group, the **Pharmaceuticals** and the **Services Division**. In the following report this is referred to as 'Group', unless explicitly stated differently. The detailed results of the **Tools & Technologies Division** and its consolidated contributions to the different elements of the Group financial statements can be found separately in this report as well as in the Financial Statements.

Condensed Profit & Loss Statement

		2005	2006
Revenues	T€	64,115	67,354
Gross margin	%	33.0	34.1
– R&D expenses	T€	9,304	30,307
– SG&A expenses	T€	15,540	18,576
– Amortisation and impairment	T€	27,086	9,223
– Other operating expenses	T€	2,163	1,607
Operating income (loss)	T€	(32,965)	(36,762)
Net income (loss)			
continuing business	T€	(31,212)	(36,296)
Net income (loss)			
discontinued operations	T€	(2,371)	3,828
Net income (loss) total	T€	**(33,583)**	(32,468)

Results of Operations (2)

Review of 2006 Financial Objectives

In terms of its financial performance, Evotec had a very successful year in 2006. It over-achieved on its revenue targets and met all other financial guidance given for the Group including Evotec Technologies in March 2006. Evotec exceeded its revenue target of 0% to 5% growth. In line with the Company's strategy and projections, Evotec continued to manage its Services Business for profitability and cash generation, with positive operating income before amortisation and impairment charges at €2.5m. The **Services Division's** expected revenue growth for 2006 of 0% over 2005 was exceeded, with growth of 5%, and an improved forward order book situation of 2007 seen in January 2007 (€28m) compared to the order book of 2006 seen at the same time in 2006 (€26m). As planned, the **Pharmaceuticals Division** ramped up its R&D expenditures which resulted in the loss for the Division and the Group seen in the financial results.

Revenues 2006

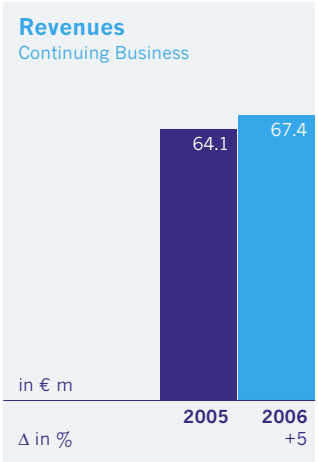
Solid Revenue Growth

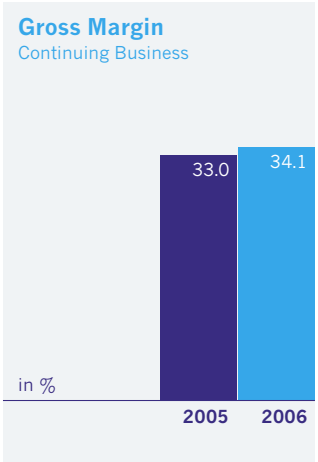
Evotec Group revenues (continuing business) increased by 5% to €67.4m (2005: €64.1m). Due to the movements in the exchange rate of the US Dollar, particularly in the second half of the year, revenues were 0.6% points lower than would have been the case if 2005 average currency rates had been experienced during the year. The geographical spread of revenues for the Group continues to be diverse and matches the main markets for Evotec's products and Services.

The revenues of the **Pharmaceuticals Division** are predominantly a result of the ongoing collaboration with Takeda, and at €3.2m, are in line with those achieved in 2005 (2005: €3.2m). During the year the Company granted Takeda exclusive rights to another novel target, triggering the second milestone payment in the Alzheimer's disease collaboration. More significant revenues in this division will be seen once the first internal programme or drug candidate is partnered.

The **Services Division** showed steady growth in overall revenues at 5% to €64.3m (2005: €61.0m). This is particularly satisfying because the increased focus on higher value collaborations with downstream elements means that the Company is foregoing some short-term revenues (lower direct R&D funding in exchange for later milestones and royalties). The Services Division was able to compensate for this shortfall, in particular through a milestone payment, and strong performances from the Manufacturing and Formulation Services throughout 2006. Major new and extended collaborations were signed with Boehringer Ingelheim, CHDI (a US not-

Revenues by Regions
Continuing Business





for-profit organisation), DAC (a subsidiary of Genextra SPA), Daiichi, Panacos, Point Therapeutics and Roche. Many new collaborations have tended to be broader and more integrated, calling upon the services of the Company's assay development, screening, medicinal chemistry and analytical scientists. For another year this growth in Services Division revenues is a pleasing result given the market pressures, the weakness of the US Dollar and the Company's emphasis on collaborations with larger contributions in the longer-term projects.

Cost of Revenue

Focus on Capacity Optimisation

Cost associated with the Group's revenues consists of personnel expenses of direct employees associated with revenue-generating projects, facilities and overhead used to support those projects and materials consumed in the provision of the product or service. The relative significance of these cost types varies with the service or product provided – for example, laboratory based projects require higher personnel cost but may require smaller quantities of materials, whereas Pilot Plant scale production of active pharmaceutical ingredients involves lower personnel cost, but higher relative facility cost and material cost. Improved use of capacities allowed the Company to reduce fixed costs at the Abingdon site, while capacity was expanded in Glasgow to meet increased formulation demand. The cost of revenue of the **Pharmaceuticals Division** amounted to € 0.4 m and that of the **Services Division** to € 44.0 m in 2006 (2005: € 1.0 m and € 42.0 m respectively).

Gross Margin

Product Mix Managed for Improved Margin

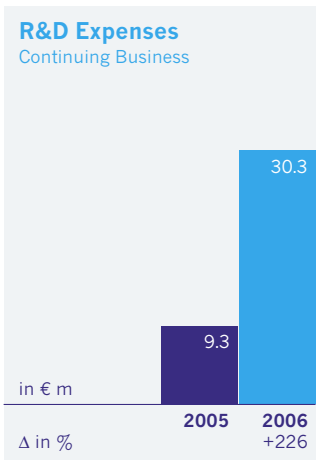
The Group's overall gross margin for 2006 was 34.1 % (2005: 33.0 %). The improvement in the Group margin is driven by the changing mix within and between the two operating divisions. The margin in the **Pharmaceuticals Division** at 86.2 % (2005: 68.1 %) is relatively high as this represents a high proportion of milestone income from the Company's ongoing collaboration with Takeda. The margin of the **Services Division** at 31.6 % (2005: 31.1 %) is influenced by the achievement of a milestone within a results-based project, but also by the mix of the varying product and service offerings. The year saw continued high utilisation of the more asset intensive product offerings (Pilot Plant and Formulation Services) and a relatively lower overall use of discovery resources for customer collaborations. The positive margin effects from the preclinical project milestone and the high utilisation in chemical and pharmaceutical development were balanced by the anticipated lower margins on the results-based discovery projects with Boehringer Ingelheim between milestones. In January, the Company announced the doubling in size of this already sizeable collaboration, and

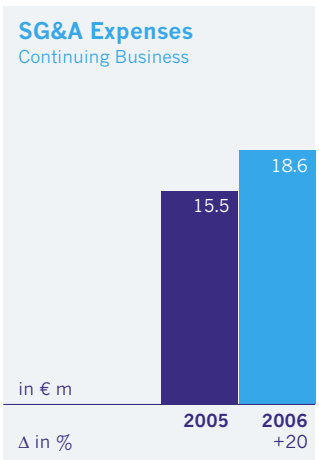
the additional resource placed on the enlarged project inevitably reduced average margins in the short-term as the second tranche of projects are not anticipated to reach milestone events until 2007 and 2008. In all operational areas Evotec has sought to align project requirements for personnel or facilities with operation capacity. Currency fluctuations between US Dollar/UK Sterling/Euro affect Group margin as well as revenue, and contributed –0.6%-points to overall margin in 2006.

Research & Development

Proprietary Programmes Progress

2006 saw the focus of Evotec's research and development (R&D) activity firmly within the **Pharmaceuticals Division**. Of the Group's total R&D spend of € 30.3 m (2005: € 9.3 m), only € 2.7 m (2005: € 3.9 m) was spent by the **Services Division** to further specific platform technologies, a further reduction of 31% after a 52% reduction the year before. With the capabilities built in prior years, such platform R&D was focused on structural biology and fragment-based and high content screening. The majority of the Group R&D expenditure was on furthering the **Pharmaceuticals Division** proprietary drug development programmes, with the division spending overall € 28.1 m (2005: € 6.0 m). The divisional expenditure covered internal discovery projects (approximately 25%) focused on delivering assets to the development pipeline in future years, together with expenditure in support of the various clinical programmes (approximately 75%).





Internal discovery projects make use of Evotec's dedicated CNS specialists as well as the wide variety of other skills and resources available within the Group. This allows internal and external projects to be run with the same level of efficiency, benefiting both the **Services** and the **Pharmaceuticals Divisions**.
In January 2006, the Company in-licensed two Phase I MAO-B (Monoamine Oxidase B) inhibitor compounds, EVT 301 and EVT 302, and proceeded to further their clinical development. During a safety and tolerability study of EVT 301 clinical evidence emerged that led the Company to discontinue its development in September 2006. Whilst this was a disappointment, early cessation of clinical development is prudent and allows internal resources to be redeployed to other candidates within the clinical pipeline. Indeed, the backup compound EVT 302 has been evaluated for further clinical development and will start additional Phase I studies in the first half of 2007. In contrast to EVT 301, Phase I trials for the Company's compound to treat insomnia, EVT 201, and the NMDA NR2B subtype-specific antagonist EVT 101 to treat Alzheimer's disease and/or pain continued to schedule during 2006. EVT 101 completed its Phase I testing during Q3 2006, and in September EVT 201 commenced Phase II clinical trials in insomnia.
Due to the nature and timing of the various clinical programmes during the year there has inevitably been some volatility in the **Pharmaceuticals Division's** R&D expenditure between quarters, with R&D amounting to € 8.3 m, € 5.4 m, € 6.2 m and € 8.2 m in Q1 to Q4 respectively. The Q1 R&D costs included the mid single digit million Euro upfront in-licensing expense for the MAO-B inhibitors and the increase from Q2 towards the end of 2006 is a result of the commencement of a number of clinical trials including the two Phase II studies for EVT 201. In addition, the clinical development team has been strengthened by the recruitment of further clinical project managers to plan and execute the clinical strategy.

Selling, General & Administration

Strategic Review of the Services Business

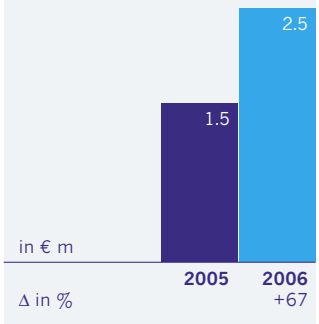
Selling, general & administration (SG&A) costs for the Group increased to € 18.6 m (2005: € 15.5 m), including transaction costs related to the divestment of Evotec Technologies. The continuing segments also contributed to this increase during the year, in particular the **Services Division**. Synergies within the Group allowed the **Pharmaceuticals Division** to contain SG&A cost at € 4.0 m (2005: € 4.0 m), despite the fact that Evotec Neurosciences (ENS) was not fully consolidated into the Group until May 2005 and therefore the prior year comparative figures excluded some ENS SG&A.
Early in 2006 the Group engaged an external consulting firm for a strategic and operational business review. As the **Services Division** is expected to benefit most from this review, the majority of the cost was allocated to this division. In addition, the cost of expanding the **Services Division's** business development team, and the increased SG&A support required by the formulation business as a result of growth, all contributed to an increase of divisional SG&A costs to € 13.5 m (2005: € 11.4 m).

Operating Result

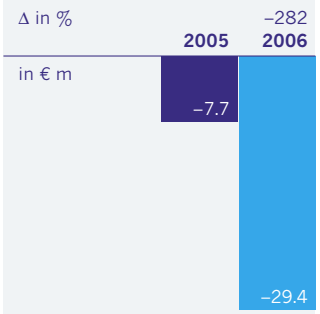
Operating Result Reflects Increased R&D Investment

The operating loss for the Group increased in 2006 to € 36.8 m (2005: € 33.0 m). Much higher R&D spend of the **Pharmaceuticals Division** and also higher SG&A costs were not fully offset by improved gross profit, lower other operating costs and significantly lower amortisation and impairment charges in 2006. As a result of the Company's regular impairment review, a non-cash intangible asset impairment charge of € 6.6 m and a non-cash tangible asset unimpairment benefit of € 0.6 m were recognised in the 2006 result (for a more detailed explanation see Net Assets section). Regular amortisation of intangible assets amounted to € 3.3 m. In total, impairment charges and regular amortisation amounted to € 9.2 m in 2006 and € 27.1 m in 2005. The majority of the impairment charges in 2005 were related to the acquisition of ENS. Excluding these non-cash items Evotec recorded an increase in operating loss to € 27.5 m (2005: € 5.9 m). At the same time the **Services**

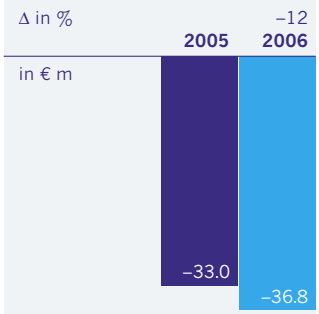
Services Division Operating Result
before amortisation and impairment



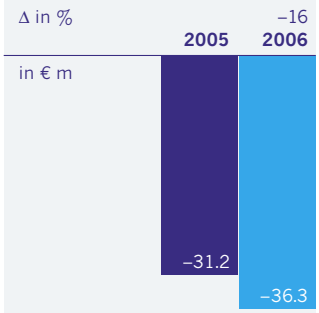
Pharmaceuticals Division Operating Result
before amortisation and impairment



Operating Result
Continuing Business



Net Income
Continuing Business



Division showed an improved positive operating result of € 2.5 m (2005: € 1.5 m) before the inclusion of amortisation and impairment, this despite the expense of the strategic review.
Other operating costs associated with planned unused capacity in the **Services Division** decreased again compared to the previous year to € 1.6 m (2005: € 2.2 m). Due to improved Pilot Plant utilisation and the reduction of facility space in 2006, these costs will no longer be separated out from 2007 onwards but fully included within the cost of goods sold.
In 2006 as well as in 2005, the majority of the Group operating loss arises from the **Pharmaceuticals Division** reflecting the Company's focused investments in its proprietary research programmes. The increased expenditure on these programmes resulted in an operating loss for the division of € 32.6 m (2005: € 28.1 m), and if the comparison is made excluding amortisation and impairment charges, the operating loss is € 29.4 m (2005 € 7.7 m) and can more clearly be seen to have increased due to the increased operational investment.

Net Loss

Increased R&D Investment Leads to Increase in Net Loss

2006 sees a slight increase in net loss of the continuing business to € 36.3 m (2005: € 31.2 m). The main factor below the operating line that has increased the net loss position, is the absence of the large deferred tax benefit, which was € 4.8 m in 2005. This could only partially be offset by higher interest income received from higher average cash balances and higher deposit interest rates in 2006, the absence of losses from equity investments as a result of the DeveloGen joint venture which was terminated in early 2006, and a reduced foreign exchange loss for the year of € 0.2 m (2005: loss of € 0.8 m). As is explained in the section on risks, the Company enters into foreign exchange hedging contracts to provide predictability of revenues. With the volatility of foreign exchange markets and the duration of the revenue streams that are being protected, theoretical or actual gains or losses are experienced during the year.
Total net loss including contributions of the discontinued operations **Tools & Technologies**, improved to € 32.5 m (2005: € 33.6 m). This translates into a total net loss per share of Evotec

Segment Reporting Services Division
Key Financial Figures

		2005	2006
Revenues	T€	60,961	64,321
Gross profit	T€	18,966	20,311
Gross margin	%	31.1	31.6
– Research & development expenses	T€	3,864	2,666
– Selling, general & administrative expenses	T€	11,433	13,491
– Amortisation of intangible assets	T€	7,375	67
– Impairment of goodwill	T€	0	6,560
– Impairment of tangible assets	T€	(643)	(593)
– Other operating expenses	T€	2,163	1,607
Operating income (loss)	T€	(5,226)	(3,487)
Operating income (loss) before amortisation and impairment	T€	1,506	2,548
– Total assets	T€	105,575	95,835
– Total liabilities	T€	12,876	16,753
– Capital expenditures	T€	4,447	3,116

Segment Reporting Pharmaceuticals Division
Key Financial Figures

		2005	2006
Revenues	T€	3,231	3,198
Gross profit	T€	2,199	2,755
Gross margin	%	68.1	86.2
– Research & development expenses	T€	5,957	28,102
– Selling, general & administrative expenses	T€	3,974	4,033
– Amortisation of intangible assets	T€	1,876	3,189
– Impairment of goodwill	T€	18,478	0
– Impairment of tangible assets	T€	0	0
– Other operating expenses	T€	0	0
Operating income (loss)	T€	(28,086)	(32,569)
Operating income (loss) before amortisation and impairment	T€	(7,732)	(29,380)
– Total assets	T€	6,798	9,206
– Total liabilities	T€	4,854	7,637
– Capital expenditures including M&A transaction	T€	30,515	659

of € 0.49 (2005: € 0.65). The weighted average number of shares used in calculating basic earnings per share (EPS) increased by 14,367,672 shares to 66,355,953 following the issue of additional shares for the capital increases in 2005 and April 2006.

Financing and Financial Position (3)

Financial Management Principles

The Group looks to secure the financial resources to pursue its strategy of taking clinical programmes through development to stages where partnering is profitable to the Company. The clinical assets to be developed are found from within the Company's own **Pharmaceuticals Division**'s discovery projects, or identified externally for in-licensing or acquisition. Sufficient funds therefore need to be available to successfully pursue these programmes. In order to ensure funding the Company generates cash flows from its **Services Division**, takes advantage of selected bank debt offerings when appropriate and raises capital through issuance of new shares. Apart from bank debt and asset finance there are no major long-term financial obligations or liabilities on the business. Evotec retains liquidity primarily to fund its R&D programmes.

Capital expenditure proposals are carefully evaluated by management as to their contribution to furthering the business strategy, either by retaining and enhancing the Company's platform technologies and capacities largely used by the **Services Division**, or furthering the specific discovery research of the **Pharmaceuticals Division**. The Company adheres to the principle of cost consciousness without compromising on long-term viability.

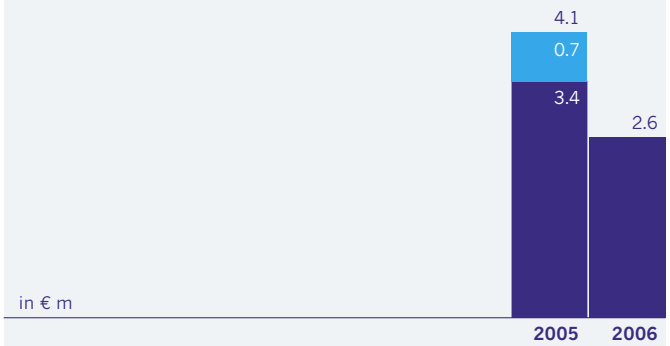
Condensed Cash Flow Statement

Continuing Business

T€	2005	2006
Net cash provided by (used in)		
– Operating activities	(2,137)	(9,225)
– Investing activities	12,367	19,369
– Financing activities	25,937	16,109
Net increase/decrease in cash		
and cash equivalents	**36,167**	**26,253**
Exchange rate difference	1,102	285
Cash and cash equivalents		
– at beginning of year	14,916	52,185
– at end of year	52,185	78,723

Capital Expenditure[1)]

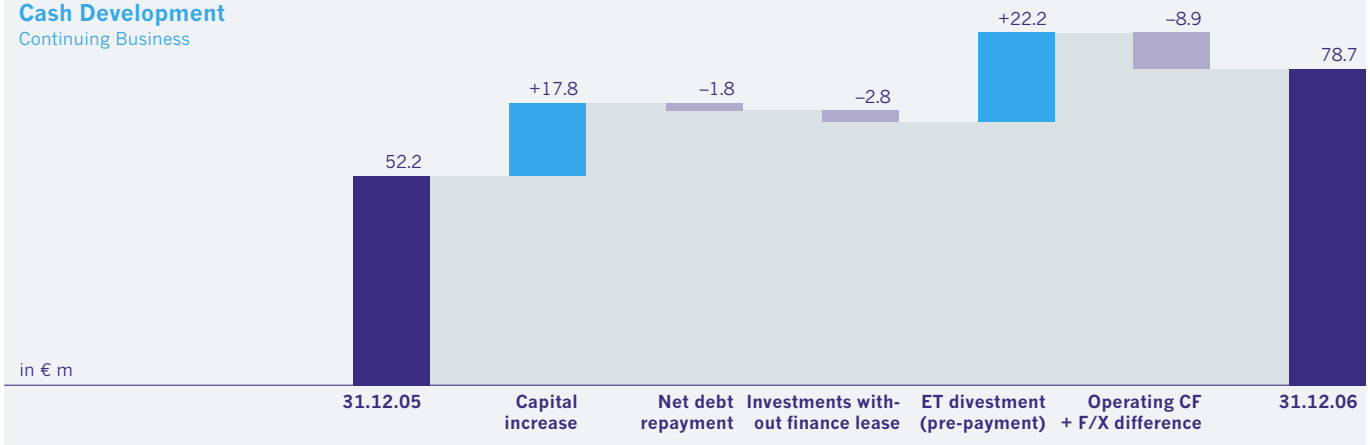
Continuing Business



[1)] without finance lease.

Cash Development

Continuing Business



Cash Flow

Cash Flow from Operations Reflects Investments in R&D

Group cash flow from operating activities was € (9.2) m (2005: € (2.1) m). Within this result, the **Services Division** was cash generative, mitigating to a certain degree the cash consumption of the **Pharmaceuticals Division**. This negative operating cash flow was also mitigated by a € 3.8 m working capital reduction.

Cash flow from investing activities was € 19.4 m (2005 € 12.4 m). The net positive 2005 cash flow was a result of factors including the receipt of cash during the acquisition of ENS offset by capital expenditure and investments in the formulation business and the DeveloGen joint venture. In 2006, the positive cash flow benefited from € 22.2 m received from the divestment of Evotec's 89 % shareholding in Evotec Technologies to PerkinElmer, which became effective on 1 January 2007 (see Post-Balance Sheet Events). 2006 capital expenditure amounted to € 2.6 m, including the second phase of clean room build for the formulation business. No development expenditures have been capitalised outside Evotec Technologies.

Net cash flow from financing activities was € 16.1 m (2005: € 25.9 m). The previous year saw cash in-flow from financing due to the proceeds of € 28.4 m from the Company's secondary offering in June 2005 offset by some repayment of bank debt amounting to € 2.5 m. The 2006 cash flow benefited from the capital increase in April 2006 of net € 17.8 m, offset by further net repayment of debt amounting to € 1.8 m.

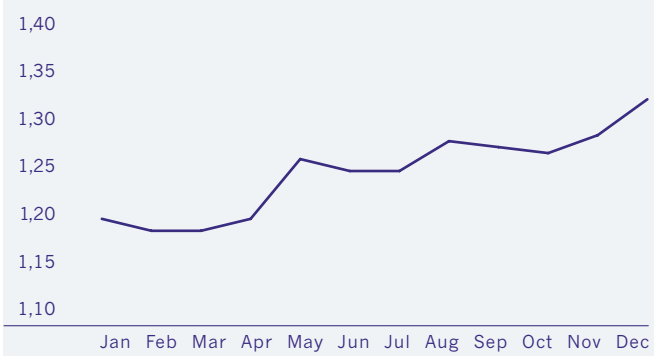
Liquidity and Hedging

Maintaining Liquidity for R&D Investments

The Group closed 2006 with € 78.7 m of cash (2005: € 52.2 m), cash equivalents or marketable securities and held 100 % as liquid investments with a maturity of less than 3 months (2005: 63 %). The increased emphasis on investment in proprietary programmes in the **Pharmaceuticals Division** necessitates forward management of liquidity in line with such plans and the Company's risk management policies (see below). Deposits are held in the currencies related to contractual receipts from customers and the major currencies of expenditure – Euro, UK Sterling and US Dollar. At the end of 2006 the Group cash balance consisted of € 74.0 m in Euro, € 2.5 m in UK Sterling and the balance of € 2.2 m in US Dollar.

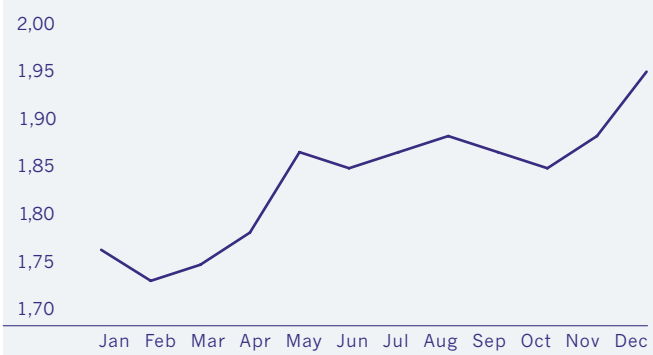
With Group revenues in US Dollar exceeding US Dollar expenditures, and UK Sterling expenditures exceeding revenues in UK Sterling, the combination of strengthening UK Sterling and weakening US Dollar during 2006, provided a challenging cash management environment. Evotec used financial instruments to reduce the risk associated with currency movements, in particular to sell US Dollars against UK Sterlings. Towards the end of 2006 US Dollar expenditure started to increase with more clinical trials performed in the US, and this is expected to develop further during 2007 and thus reduce the risk exposure. The foreign exchange gain or loss shown in the financial statements is derived from the transaction gains and losses on transactions denominated in a currency other than the local

US Dollar vs Euro 2006



Average monthly foreign exchange rates Source: www.oanda.com

US Dollar vs UK Sterling 2006



Average monthly foreign exchange rates Source: www.oanda.com

currency, the change in the value of foreign currency assets and liabilities retranslated into local currency at the balance sheet date, and fair value adjustments relating to financial instruments held. The 2006 exchange loss includes a gain of € 0.1 m relating to fair value adjustments (2005 € 0.3 m). The notional amounts of currency related financial instruments held at 31 December 2006 were $1.5m (2005: $10.0 m).
As an additional tool to manage short-term and medium-term liquidity, the Company makes use of long-term bank loans and asset finance, primarily for equipment used by the **Services Division**. The sum of these debt elements – including their current portions – ended 2006 at € 11.9 m (2005: € 12.6 m). The currency of the year end debt position was € 10.5m and € 1.4 m in UK Sterling (2005: € 10.1 m and € 3.2 m respectively). No other material financing tools, including instruments such as off-balance-sheet financing structures, have been used by the Company.

Condensed Balance Sheet

T€	Pro forma 2005	2006
Cash, cash equivalents and securities	52,184	78,723
Inventories	4,581	4,782
Other current assets	12,291	10,885
Property, plant and equipment	36,445	34,669
Intangible assets	62,710	55,002
Other non-current assets	54	2,036
Assets held for disposal	17,846	19,429
Total assets	**186,111**	**205,526**
Provisions	4,211	5,232
Pre-payment ET divestment	0	22,167
Other current liabilities	19,430	21,041
Long-term liabilities	7,770	12,875
Deferred tax liabilities	0	0
Liabilities held for disposal	6,031	7,035
Total stockholders' equity	148,669	137,176
Minority interest	0	0
Total liabilities and stockholders' equity	**186,111**	**205,526**

Assets and Liabilities (4)

Capital Structure

Capital Increase in April 2006

Evotec increased its share capital during 2006 with the issue of a total of 5.2 m new shares through a capital increase at a price of € 3.55 per share. The capital increase generated net cash proceeds of € 17.8 m. As a result, share capital in the Company increased to € 68.1 m (2005: € 62.8 m), and total equity changed to € 137.2 m (2005: € 148.7 m). Only a relatively small number of employees exercised their employee share options during the year, such that the amount of share capital in issue was not significantly affected by these exercises. Evotec's strong equity ratio reduced temporarily to 66.7 % (2005: 79.9 %) due to the prepayment received from the divestment of the **Tools & Technologies** business. At € 11.9 m, Evotec continues to hold a low amount of debt (see Liquidity and Hedging above).

Net Assets

Regular Impairment Review Performed

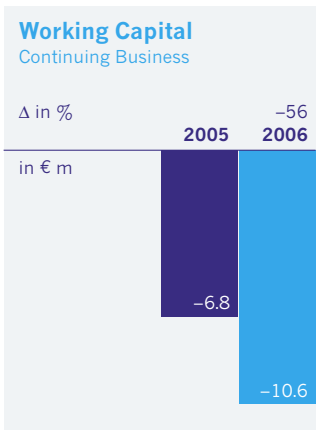
The Company owns fixed assets consisting of property (not land) and capitalised leasehold improvements to property, predominantly through laboratory fit out and scientific and technical equipment for use in these laboratories. In addition, the Company has offices and information technology to support both operational and overhead areas. Evotec seeks at all times to make the most efficient use of its property assets (see Financial Management Principles above) and during the year consolidated its laboratory operations on the Abingdon site into three buildings from the previous four. Other operational fixed assets were added (see Cash Flow section). Nevertheless, due to the longevity of laboratory and Pilot Plant assets, depreciation exceeded capex, and hence tangible fixed assets decreased slightly to € 34.7 m in the Group (2005: € 36.4 m).
The Company performed its annual regular review of tangible and intangible assets for impairment under IFRS during the final quarter of 2006. This has resulted in the Group taking an impairment charge of € 6.6 m against the carrying value of the goodwill attributable to the laboratory-based development chemistry business. This reflects Evotec management's view

that this particular service line is unlikely to be able to generate the level of profitable growth targeted for the services business. The goodwill originates from the acquisition of Oxford Asymmetry International (OAI) in 2000 and was allocated to the **Services Division** at this time (see also the P&L impact in the Operating Result section). A review of previously impaired tangible fixed assets resulted in an unimpairment of € 0.6 m being recognised against certain operational assets due to improved asset utilisation in the three remaining buildings at the Abingdon site.

Regular amortisation of acquired intangible assets was much reduced in 2006 at € 3.3 m (2005: € 9.3 m) due to the completion in September 2005 of the amortisation associated with the customer list and technologies acquired with OAI. Customer related intangibles in ENS have been regularly amortised to the tune of € 2.9 m during 2006 (2005: € 1.8 m). Total Group intangible assets (including goodwill) amounted to € 55.0 m at the end of 2006 (2005: € 62.7 m).

Even when excluding the current liabilities that resulted from the early payment received for Evotec Technologies (€ 22.2 m), the working capital for the Group decreased to € (10.6) m at year end 2006 (2005: € (6.8) m) mainly as a result of improved collection and timing of trade accounts receivable, and high year end accounts payable from the increase in R&D expenditure. Inventory levels comprising stocks of materials and work in progress as at year end 2006 remained with € 4.8 m approximately the same as at year end 2005.

Maturing bank debt was either repaid or rescheduled in 2006, leading to an increase in the long-term (non-current) portion and corresponding decrease in the current portion of bank debt. Most of the other elements of non-current liabilities (finance leases, deferred revenues, provisions) remained relatively constant such that the increase in total non-current liabilities to € 12.9 m (2005: € 7.8 m) can be ascribed to the debt rescheduling and the amount in escrow associated with the divestment of Evotec Technologies (see Post-Balance Sheet Events) also shown as other non-current assets.



Intellectual Property, Assets not Shown in Balance Sheet

Clinical Development Costs Expensed, not Capitalised

By virtue of the significant expenditure on research and development within the Company, both for the maintenance and enhancement of the platform technologies of the **Services Division** and for the generation of clinical assets internally or through in-licensing within the **Pharmaceuticals Division**, Evotec generates intellectual property (IP) that is often not represented on the balance sheet as a tangible or intangible asset. The latter is the case, for example with some of the drug candidates in-licensed from Roche, where the in-licensing cost has been expensed when incurred. Irrespective of this, Evotec engages in an active IP management process, where it encourages its employees to file patents or scout for interesting in-licensing opportunities, and where the Company actively maintains and exploits its IP estate. Examples of this are assays that support drug discovery or discovery results themselves (targets or compounds). The generation of IP from discovery results is linked to Evotec's strategy, as this IP, if successful, encourages results-based collaborations or the generation of a proprietary pipeline of drug candidates. These programmes with the medium to long-term aim of generating significant value for shareholders are the most important assets not represented in the Company's balance sheet. Due to the uncertain nature of pharmaceutical research and development, work on internal programmes cannot be capitalised until such time as revenue generation from the assets is reasonably assured, and this is likely to be at or around the time of partnering.

Evotec currently owns an IP estate on drug discovery and development which can be summarised as follows:

> Assays: 15 patent families
> Targets: 46 patent families
> Compounds: 3 patent families

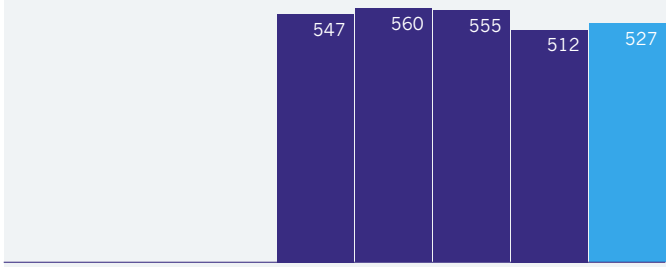
Additionally, Evotec has exclusively in-licensed several drug candidates from Roche which are protected by diverse patent families.

IP on detection and other platform technologies supports Evotec's firm IP position. Evotec owns a portfolio of IP on such technologies, many of which have been out-licensed to Evotec Technologies GmbH. Furthermore, Evotec is the holder of non-exclusive licenses for technologies owned by Evotec Technologies GmbH, Olympus Corporation and other third parties.
Other assets of the Company are its broad customer network, serving more than 100 companies each year, with typically more than 75 % repeat business, and the strong brand Evotec has built within the industry over the past years.

Human Resources
Developing Clinical Expertise

After various restructuring measures in 2004/2005, Evotec's headcount (without Evotec Technologies) increased during 2006, from 512 to 527.
During the year the Group made significant progress in a number of key areas. Evotec continued to bring in to the Company experienced senior staff from pharmaceutical companies as it grew its Clinical Development team to the required strength with the right mix of skills for its programmes. The Company also continued to grow the **Services Division** with particularly strong headcount growth in Glasgow, where the growing formulation business is based, and in Business Development which received additional resources in the USA. At the same time, Evotec tightly managed its capacities and reduced headcount in operational areas which saw lower demand in 2005. In addition, the Company increased its organisational flexibility and made higher use of discovery operations for the proprietary activities within its **Pharmaceuticals Division**.

Employees as of 31 December 2006
Continuing Business



	2002	2003	2004	2005	2006
Δ in %		2	–1	–8	3

Headcount Analysis by Area and Qualification as of 31 December 2006
Continuing Business

	Total	Male	Female	Biologists, Biochemists	Chemists	Physicians, Pharma-cologists	Engineers, (R&D), IT experts, Physicists	Lab technicians and others
– Discovery Hamburg	79	36	43	20	6	3	10	40
– Discovery Abingdon	180	114	66	5	118	0	0	57
– Development Services								
Abingdon	115	96	19	0	89	0	0	26
– Development Services								
Glasgow	47	22	25	0	0	0	3	44
– Clinical Development	9	5	4	1	5	2	0	1
– Sales & Administration	88	49	39	8	18	0	10	52
– Corporate	9	4	5	1	0	0	1	7
Total (without ET)	527	326	201	35	236	5	24	227

Tools & Technologies (Evotec Technologies) Discontinued Operations

The **Tools & Technologies** segment of Evotec AG consisted of the majority controlled Evotec Technologies GmbH and its US subsidiary Evotec Technologies, Inc. (jointly referred to as ET) until 31 December 2006. Effective 1 January 2007 ET was sold to PerkinElmer (see Post-Balance Sheet Events) and thus reported as a discontinued operation for 2006. Until the change of control, ET's managing director was a member of Evotec's Group Executive Committee. Since its spin out in 2001/2002, ET operated independently because of the different nature of its business and the different business processes required, whilst still being governed by the Group's risk management principles and with Evotec's CFO chairing its board.

ET develops, manufactures, sells and services various tools for life science research, with a strong emphasis on automated instrumentation for cell biology research and drug discovery. Current products are its high performance imaging reader Opera™, the chip based cell handling devices Cytoclon™/Cytocon™/Cytoman™ and the integrated automation devices plate:explorer™ and EVOscreen®. The intellectual property on its single molecule detection technologies was sold to Olympus in March 2006.

ET supports biotechnology and pharmaceutical companies as well as academic research institutions around the world. As funds are often scarce in research organisations, even after some signs of an improved financing climate for many organisations outside 'Big Pharma', ET focuses on providing automated solutions for bottlenecks in laboratory processes that are both affordable and provide financial payback within a reasonable time. With science and technology continually developing, and to provide such cost effective solutions, ET engages in R&D projects that further improve the flexibility, performance or ease-of-use of its existing products.

The Opera™ system has continued to have tremendous success in its markets, and this has helped the Company to grow top and bottom line, despite limited sales resources and a weak US Dollar.

Financial Report

The financials of the discontinued **Tools & Technologies** business reported here comprise ET's financial results after consolidation with contributions from Evotec's continuing operations. Only revenues with third parties are reported, all costs are taken net of intra-group margins, and ET's assets and liabilities are considered only where they relate to third parties.

In addition, it should be noted that the discontinued operations do not include corporate overhead allocations from the Evotec Group (formerly € 0.4 m) that stay with the continued businesses after the change of control. The comparative 2005 numbers in this report therefore differ from the **Tools & Technologies** segment numbers reported in prior years, as these showed the full business as part of the Evotec Group.

Results

Third party revenues grew 11% to € 17.3 m, mainly as a result of strong sales of the Opera™ device. Gross profit reduced slightly to € 7.7 m (2005: € 7.8 m) due to inventory write offs and an inferior US Dollar exchange rate compared to the prior year. R&D expenses reduced by 34% to € 3.1 m (2005: € 4.8 m), because of a larger proportion of activities being lower risk product enhancements, in particular for the Opera™, which are capitalised under IFRS. As these intangible assets are amortised over several years, 2006 amortisation expenses increased by € 0.3 m to a total of € 0.8 m. SG&A expenses increased markedly to € 5.4 m (2005: € 4.4 m), following a planned ramp-up of sales resources and related activities. As a consequence of the increased marketing focus of ET, the

Consolidated Key Financial Figures
Discontinued Operations

		2005	2006
Revenues	T€	15,670	17,327
Gross profit	T€	7,837	7,660
Gross margin	%	50.0	44.2
– Research & development expenses	T€	4,784	3,136
– Selling, general & administrative expenses	T€	4,362	5,390
– Amortisation of intangible assets	T€	482	811
– Impairment of goodwill	T€	0	0
– Restructuring expenses	T€	917	606
Operating income (loss)	T€	(2,708)	(2,283)
Operating income (loss) before amortisation and impairment	T€	(2,226)	(1,472)
– Total assets	T€	21,553	23,099
– Total liabilities	T€	26,548	24,963
– Capital expenditures	T€	3,764	2,390

Company undertook further personnel reductions and incurred a restructuring cost of € 0.6 m (2005: € 0.9 m). Overall, ET saw an improved loss from operations for 2006 of € 2.3 m (2005: € 2.7 m), and before amortisation and restructuring charges of € 0.9 m (2005: € 1.3 m).
The sale of ET's single molecule detection business to Olympus provided the majority of an additional net non-operating income of € 6.6 m, contributing in a net profit of € 3.8 m (2005: net loss of € 2.4 m).

Financing, Cash and Balance Sheet

During the period of the last few years when ET has been broadening its product range and its customer base it has inevitably shown a cash burn. In 2006, the sale of the single molecule detection business helped ET deliver a positive cash contribution to the Group, despite continued investments and limited asset finance. Historically, ET's growth and short and mid-term cash needs were financed primarily with loans from its majority shareholder Evotec AG. These are not shown in the consolidated accounts of discontinued operations, and were taken over and paid back by PerkinElmer effective 1 January 2007.
Total consolidated assets of the discontinued **Tools & Technologies** business as at year end amounted to € 19.4 m and included € 2.2 m of cash. Total consolidated (or third party) liabilities were € 7.0 m, with no third party debt other then small short-term finance leases. Cash and debt free, net assets to be disposed were thus € 10.2 m.
These numbers do not include the sizeable intangible assets built by Evotec over the past years, in particular the related patent estate and product rights, as well as the know-how of the skilled workforce of ET.

Headcount

Overall headcount of ET was 80 at the end of 2006 (2005: 92). Operational headcount was reduced as product development was focused on the Opera™ and other cell biology instrumentation, whilst at the same time business development resource was slightly increased, to capture the growth potential foreseen.

Outlook

From 1 January 2007 PerkinElmer has assumed the responsibility to build this business further. PerkinElmer as the new parent will add strength to Evotec Technologies sales and distribution efforts and will be instrumental in guaranteeing a strong after sales service. To Evotec's knowledge, PerkinElmer intends to maintain the current site in Hamburg and make it a Center of Excellence in Cellular Sciences within the PerkinElmer Group. To that degree some of the operational synergies with Evotec's continuing business might survive the change of control.

Risk Management and Risk Report (6)

Risk and Opportunity Management System

Comprehensive and Reliable Risk Management Systems in Place

To increase the chances of successfully capturing business opportunities, and at the same time limiting the associated risks, Evotec 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 as laid out in the German Corporate Sector Supervision and Transparency Act (KonTraG).

According to the Company's **risk management policy**, Evotec engages in material 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. Currency exposures are reduced through natural hedges and hedging vehicles, in general with 12 months forward view. 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)).

To cover other risks associated with the Company's business, including IT risks and others that would not have a short-term financial impact, Evotec performs regular commercial, R&D project, and R&D portfolio reviews. Strict application of R&D 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 Group and reviews its insurance coverage regularly. Compliance with the regulatory environment, for example for environment and health and safety, has high priority at all operational sites of the Group, and corresponding training programmes are in place. Compliance with standards such as ISO 14001 in sensitive areas like the Pilot Plants, and involving its suppliers where appropriate, underlines the Company's principle to exceed local statutory or legal requirements where sensible. This principle also applies to Corporate Governance, where the Company complies with publicly promoted codes of practice.

Evotec's **risk management system** is regularly reviewed in order to adjust to changing environments, risk profiles and business opportunities. Since January 2007 it comprises the following elements:

Through internal *ad hoc notifications* any risks, that might have a material impact on the Company's financial performance, are raised and reported as they emerge by the manager concerned. The manager compiles a summary and assessment of the specific risk and the counter measures taken and reports the foregoing to the Group Risk Manager and to the responsible superior line management without any undue delay. On a quarterly basis, responsible line managers forward *periodical risk reports* which (i) give an update on the risks described in the interim *internal ad hoc notifications*, (ii) report about any other material risk 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 Group Risk Manager evaluates and summarises the various risk sheets into a quarterly report for the Management Board and Executive Committee. In addition, 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 emphasises the principle of risk prevention across the Group.

Change-of-Control Risk

Evotec's management focuses on value creation, irrespective of the composition of the Company's shareholder base. To that degree, any change-of-control or takeover offer, that realises some of the embedded value of the Company for the benefit of current shareholders, is carefully analysed with regard to the synergies proposed and the future value creation claimed. There are no specific takeover-defence measures in place. All shares are bearer shares and have the same voting rights, and existing stock option schemes do not allow for immediate vesting or additional issuance in the case of a takeover offer. Also, no binding lock-up agreements have been made with any shareholder, and neither stock loans, nor pre-emptive stock purchase rights are known to the Company. Also, the Company does not control voting rights of any shares owned by employees. No shareholder holds the right to have representatives in the Company's Supervisory Board, or is restricted or bound to specific votes at annual shareholder meetings. Only two organisations, TVM V Life Science Ventures GmbH & Co. KG and ROI Verwaltungsgesellschaft mbH, together with its affiliates, hold more than 5% and 10% of the shares each respectively as at 31 December 2006. The Management Board is elected by the Supervisory Board and has only customary change-of-control rights (see Notes to the Financial Statements No (25f)). It also has been authorised by the last shareholder meeting to repurchase stock only to the degree needed for Supervisory Board compensation, and to issue new stock only up to 50% of existing capital. Additionally, this can be done without pre-emptive purchase rights of existing shareholders only under certain well defined conditions.

Systematic Management Approach to Capturing Business Opportunities

Evotec's businesses rely on its access to innovation, for example via academic partnerships or in-licensing opportunities from industry partners, and to partnership business with pharmaceutical or biotechnology companies. Identifying and capturing opportunities therefore requires active and systematic management as much as the confinement of the associated risks. The Company has established regular scouting for interesting technologies and projects that might qualify for in-licensing, acquisition or partnering. The Company's business development teams also closely monitor the pharmaceutical and biotechnology industries' R&D needs in order to provide a focused approach to their customers.

Based on solid market intelligence, R&D and revenue budgets and mid range plans are established that then allow maximum entrepreneurial flexibility, to select the individual project content and content portfolio with the best overall risk/return ratio. The timing of partnering certain drug candidates is discussed and decided only after balancing short-term goals and needs against longer-term financial opportunities. The management of all these opportunities is made possible through the various processes described above and in addition the high motivation and ambition of the Company's employees. The Executive Committee of the Company and the management bodies dedicated to discovery, development and collaborative service relationships strive for consensus decisions that will maximise the business opportunities and achieve the Company's long-term aims. Such decision processes are supported by incentive schemes that align with the Company's and the Management Board's objectives. Details of the Management Board remuneration are disclosed in the Notes to the Financial Statements No (25f).

Specific Business Risks

Evotec's operating segments differ in their specific risk profiles, reflecting their different approaches to value creation within the pharmaceutical R&D sector.

Evotec's **Pharmaceuticals Division** engages in proprietary discovery and development activities that promise significant returns when such programmes are successful, but also carry higher business, scientific and financial risk, concentrated on fewer individual projects. More significant returns are expected to materialise when upfront and milestone payments are received and/or royalties from the future sale of drugs. Evotec expects to achieve this 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 whilst still retaining some marketing rights. The associated risks are those inherent to the biotechnology and drug development industry in general:

> The market environment and competitive landscape for licensing and licensed projects or individual drug candidates, as well as the regulatory and reimbursement environment, in general or for individual treatments, 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. The Company believes, however, that overall the market value of licensable projects/ drug candidates will continue to increase (see above Business Environment in the Biotechnology Sector) rather than significantly decrease.

> Evotec's strategy to serve as a supplier of drug candidates to the pharmaceutical industry makes it highly dependent on individual larger out-licensing or partnering events and hence on individual, typically larger customers. At the same time it deepens the relationship with such partners and therefore increases the chances for further high value deals.

> Even if Evotec identifies promising targets and compounds, 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. To reduce the dependence on the success of individual projects Evotec seeks to build a broader and more balanced project portfolio, to the degree affordable.

> Evotec depends on external contract research organisations as well as the professionalism and commitment of its own personnel, in particular its scientists and project managers. However, it depends to a lesser degree on individuals, as it has built strong discovery and development teams and processes to share knowledge.

> Evotec's intellectual property might be challenged by, depend upon or be restricted by third parties, or, when built internally, it might fail to be accepted for patent protection. This 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 abortion. To reduce these risks Evotec puts a high emphasis on patent protection and patent monitoring.

> Evotec's expenditures on internal discovery and development programmes or related acquisitions of technologies or intellectual property rights are likely to reduce its short- to mid-term profitability and cash reserves. Evotec intends to reduce part of this financial exposure through early partnering agreements with sizeable down-payments by the partner, to the degree possible and advisable when trying to maximise longer term returns. Evotec management defines minimum cash levels which should be maintained. If the Company should not be successful in partnering or new opportunities arise that require additional financing, the option to improve the financing situation through capital increases, be it against cash or acquired assets, for example as part of an in-licensing agreement, is always being considered. The Company does not intend to engage in projects or project phases unless appropriate funding is allocated or secured.

Evotec's **services business** is well established within the industry, and has shown good growth in 2005 and 2006. The continuous drive for increasing research efficiency, combined with superior service quality, allows Evotec to generate value through positive cash contributions and building customer networks also beneficial to the Pharmaceuticals Division, for example through giving them access to jointly developed drug candidates. However, in this context business specific risks also need to be managed:

> 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, cost management, continuous enhancement of capabilities and technologies, careful market positioning and sales from high value results-based contracts are mandatory. In addition, Evotec continues to explore ways to capture some of the cost advantages in countries like India.

> Evotec intends to employ increasing parts of its capacity for results-based deals, with the goal to increase average margins. This strategy has been validated to date with only a few customers, and the positive experiences might not be transferable to other customers and contracts.

> Even when exhibiting growth, fluctuating capacity utilisation and resource allocation between different parts of the business can significantly decrease profitability, unless these are carefully and flexibly adjusted. In addition, dependence on individual larger customer contracts needs to be carefully monitored. To date, Evotec's revenues are fairly well split amongst a large number of customers. In 2006, the largest volume generated with one single customer was 8%.

> Some of the service contracts contain scientific or technical delivery risks, which can be mitigated only with high quality project work.

> With a high proportion of sales denominated in US Dollar currency exposure, in particular relative to the UK Sterling, creates a risk to Evotec's profitability. The Company manages this exposure through either natural hedges with US Dollar expenses of the Pharmaceutical Division, or through active hedging techniques during service contract work (see above and Notes to the Financial Statements No (21)).

Separate business risks from **Evotec Technologies** (ET) have been exited through the divestment of ET to PerkinElmer. The surviving risks here are limited to customary guarantees given to PerkinElmer as well as the risk of PerkinElmer terminating existing sublease and administrative service agreements with Evotec AG. The Company believes that these are limited and existing pre-cautionary measures are sufficient.

Overall and across the two continuing businesses, the Company's success depends on its ability to attract and retain highly skilled staff and to recognise and adapt to changing technologies and market environments as well as customer expectations. If Evotec fails to retain its key people and to adapt to market needs, its ability to create longer term value could suffer, a risk that is mitigated only by the Company's strong corporate culture. Financing risks are manageable through active R&D portfolio decisions, including termination of some of the R&D projects, and through access to external financing.

Management Summary Risk Assessment

The Company's management believes that the business opportunities outweigh the foreseeable risks and that it is able to create long-term value through building its own pipeline of drug candidates and maintaining a highly competitive services business. With the Company's efficient infrastructure and its high level and breadth of skills, supported by adequate risk and opportunity management systems, Evotec is well prepared to deliver on its strategy.

This self assessment is supported by the perception of relevant participants in the financial markets. Despite not being profitable in its **Pharmaceutical Division** and on a Group level, Evotec continues to receive regular debt finance by its banks, underlining the trust in the business. Also, since launch of the current **Pharmaceuticals Division** in early 2005, equity investors have repeatedly supported Evotec's strategy through their participation in capital increases, most recently in April 2006. Management believes that this generally positive attitude of the equity capital markets will continue, whilst Evotec's corporate milestones are being met, in particular the progression of the majority of its proprietary drug candidates through clinical development.

Post-Balance Sheet Events and Outlook

Post-Balance Sheet Events (5)

Effective 1 January 2007, Evotec Technologies GmbH (ET), together with its subsidiary Evotec Technologies, Inc., were sold to PerkinElmer in a cash transaction valued at approximately € 23 m. This transaction is another milestone in Evotec's strategy to focus the Company on its drug discovery and development core business. The resulting changes to the Group's investment and the relating profit and loss impact will be shown in the first quarter of 2007, while the cash impact of this transaction has largely already been seen in 2006. Anticipated purchase price adjustments and transaction related expenditures are expected to be offset and paid for by approximately 10 % of the proceeds from the divestment, which will still be held in escrow until 2008, as is customary with such transactions. ET's consolidated operating income continued to be negative in 2006. Consequently, the divestment will improve Evotec's operating results going forward. The Company expects ET to remain in its current location under the new ownership, and so continue to share Evotec's infrastructure cost at the Hamburg site. As a consequence, the only major contribution of the divestment to the Group's financial statements going forward are a Group balance sheet gain of approximately € 10 m in the first quarter of 2007, and potential small adjustments in 2008, when the escrow is released.

Outlook (7)

Business Direction

Evotec will continue to transform into a drug discovery and development business, translating biological and chemical innovation into drug candidates valuable to the pharmaceutical industry. Evotec pursues this aim through research collaborations and proprietary projects where the Company itself holds rights to drug candidates. The focus of proprietary projects is expected to remain predominantly diseases of, or related to, the Central Nervous System (CNS). In research collaborations, it is Evotec's strategy to increase its level of participation through results-based partnerships with pharmaceutical companies. These will be accounted for either in the **Services** or in the **Pharmaceuticals Division** depending on Evotec's degree of proprietary ownership. In all these collaborations Evotec will carefully balance short-term fee-based payments and longer-term value creation through milestones and royalties.

The markets addressed will continue to include academia, biotechnology and pharmaceutical companies. Geographically, North America and Europe are expected to contribute more than 80 % of revenues, as these are the largest markets for drug discovery and development. Evotec will exploit its strong customer relationships and networks in those regions when discussing new results-based deals as well as more traditional business.

To ensure maximum competitive advantage, Evotec uses advanced technologies, superior know-how and expertise in areas such as fragment-based drug discovery and Positron Emission Tomography (PET) imaging, multiple target classes and deep domain knowledge in CNS related diseases. Evotec will complement its current skills and assets with access to innovative starting points for novel drug candidates (new technologies, new areas of scientific interest, and new therapeutic pathways) through collaborations with small biotechnology companies or academic partners.

Evotec intends to employ its broad and integrated drug discovery and development skills and assets in research collaborations and proprietary drug discovery programmes.

Market Environment

Evotec operates in an economic environment, where healthcare spending is under significant public pressure in most developed countries. At the same time the aging population is generating higher healthcare needs. Evotec expects that total spending on therapeutics will continue to increase, despite a larger number of cheaper generic drugs coming onto the market, and reimbursement remaining under pressure.

For the pharmaceutical industry, the challenges are significant. High revenues historically enjoyed by companies from blockbuster drug sales are increasingly in jeopardy due to expiring patents, whilst at the same time the costs of developing a new drug have increased dramatically. The industry is responding to these pressures with cost reductions, for example by outsourcing individual elements of traditional discovery, and with pipeline building to offset revenue losses from generic competition. Pharmaceutical companies have realised that megamergers did not help to increase research productivity. They are increasingly turning to the biotechnology industry as a prime source of new products or drug candidates – either by in-licensing or acquisitions. Increasing licensing competition has driven up prices of drug candidates in early clinical or even late preclinical development. Companies supplying these candidates, such as Evotec, can benefit significantly. However, in-licensing opportunities – even at early stages of development – have become increasingly scarce. Evotec therefore believes that pharmaceutical companies will increase levels of outsourcing and will focus more on early stage opportunities, increasingly looking to external sources of innovation. Academic institutes, often at the forefront of medical research, lack the robust downstream capabilities available in biotechnology companies such as Evotec to translate their assets into value for the pharmaceutical industry. Evotec expects to benefit from this trend by playing the role of catalyst in a powerful network connecting the pharmaceutical industry and academic research, and providing drug candidates to pharmaceutical companies through results-based collaborations.

Profitability Outlook

Evotec continues to invest in R&D. The level of spending in its clinical development programmes is increasing as Evotec advances more drug candidates into the clinic. The Company is also ramping up its internal discovery efforts to support its results-based collaborations and organic pipeline growth. Overall, R&D spending in the **Pharmaceuticals Division** in 2007 is expected to grow faster than any increased profitability from the **Services Division** that may arise from increased milestones payments and the potential absence of goodwill impairment over the same period.

Evotec's Group operating result for 2007 is therefore expected to decline slightly compared to 2006. Based on non-operating profits in both 2006 and 2007, from the divestment of Evotec Technologies' (ET) assets and shares respectively, net income would then be relatively stable in 2007. With successful out-licensing of clinical candidates and the ability to achieve milestones from collaborations, profitability could significantly improve in 2008 and 2009. Actual results, however, as well as the individual contributions from revenues and costs, could materially deviate from these projections.

The potential revenues contributions from licensing in 2008/2009, are uncertain and subject to successful research and development activities. Therefore, on the Group level, both results-based deals and clinical out-licensing are likely to lead to more revenue volatility in the mid-term. In 2007, the **Pharmaceuticals Division** is expected to continue to report low single digit millions in revenues. Including the **Services Division**, total Group revenues are expected to reach € 65 m to € 70 m, depending on the contribution from success-based milestone payments. While in 2007 the Boehringer Ingelheim (BI) collaboration is expected to yield further milestone contributions, in 2008 Evotec plans to close additional results-based deals, in addition to continued success with the BI projects.

In January 2007, the sales and order book for 2007, excluding milestones, totalled approximately € 28 m (2006: € 27 m).

Gross margins are also expected to become more volatile, as they are dependent upon contributions from high margin milestones or upfront payments. Unlike the significant increase in R&D expenses discussed above, SG&A expenses are only expected to increase in line with inflation unless impacted by extraordinary expenses.

The 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 profits generated when out-licensing its clinical candidates, and to re-invest to build its pipeline further in order to enhance shareholder value.

Finance Outlook

The Evotec Group started the year 2007 with € 78.7 m in cash reserves. This amount, supported by cash generated by the **Services Division**, is expected to be sufficient to develop Evotec's pipeline projects, provided that the Company successfully out-licenses its clinical assets after proof-of-concept. Further financing may be required in case of an expansion of Evotec's pipeline.

Considering the age of large parts of Evotec's technical infrastructure, regular investment in fixed assets is likely to remain slightly below depreciation levels over the next few years. Thus, finance lease and regular debt finance should remain at current levels of approximately € 12 m.

In the absence of any changes in financing, Evotec's liquidity position to a large degree will move in line with the operating result before amortisation or impairment. It is therefore likely to show large volatility – decreases due to R&D spend, and increases due to out-licensing or milestone revenues. Liquidity at the end of 2007 is targeted to exceed € 40 m and also in 2008, subject to a successful out-licensing of a clinical candidate.

Management's Mid-Term Assessment

The lack of attractive R&D assets for new therapeutics will remain one of the key bottlenecks within the pharmaceutical industry. These assets will determine which companies succeed, in a market characterised by generic competition and by margins dependent upon therapeutic product differentiation.

Strategically, Evotec should benefit from the urgent needs of the pharmaceutical industry (i) for clinical drug candidates that complement their existing pipelines, and (ii) for collaborations that give access to innovation and research productivity. Competing demand for Evotec's products and product offering could therefore result in higher retained value for the Company.

If Evotec continues to provide high R&D productivity and leverages its critical mass and capabilities through access to innovation from outside the Company, Evotec may outperform most of its peers. Should Evotec consequently be able to leverage those assets and successfully manage the build-up of (i) multiple results-based collaborations, and (ii) its pipeline of proprietary clinical candidates, the Company has the chance to build very sizeable long-term value for its shareholders.

The Evotec Stock

In 2006, the equity markets took both investors and strategists by surprise with both European and American shares recording considerable gains. In the biotechnology sector it was the European shares that performed best. The maturing product pipelines of many companies and M&A shifted the focus towards smaller companies. Evotec shares closed the year up 30 %, with investors rewarding the Company's achievement of surpassing all its major objectives for the year.

A Buoyant Year for Stock Markets Around the World

Investors can look back on a thoroughly enjoyable year. Unexpectedly high growth rates in corporate earnings, favourable economic data in Germany and around the globe, as well as M&A speculation helped push up stock prices internationally. The German DAX Index took a plunge in May | June, when inflation fears arose, but recovered to end the year at 6,597 (+22 %), thus recording a gain for the fourth consecutive year. German mid and small caps fared even better, with the MDAX up 29 %, closing the year at an all-time high of 9,405 points, and the TecDAX up 25 % at 748. German blue chips are still considered to be reasonably valued, leaving investment strategists to be optimistic for 2007. The other European and American stock markets also faired well with the European Stoxx50 moving up 15 % to 4,120 points, the Dow Jones climbing 16 % to reach a record high of 12,463 points, and the Nasdaq Composite Index rising up 10 % to 2,415 points.

Evotec Shares 2006

Xetra	High (27/02)	€	4.88
	Low (03/01)	€	2.38
	Average share price	€	3.31
	Average daily trading volume[1)]	pcs.	408,552
	Price increase	%	30
	Closing price as at 31/12	€	3.25
	Market capitalisation as at 31/12	€ m	221.3
	Number of shares as at 31/12	pcs.	68,078,819
Key share data[2)]	Earnings	€	(0.55)
	Dividend	€	0.00

[1)] Based on the trading volumes of all German stock exchanges.
[2)] Excluding contributions from Evotec Technologies which was sold effective 1 January 2007.

Basic Share Data

Security identification number	ISIN: DE 000 566 480 9
	WKN: 566480
Ticker symbol	Frankfurt Stock Exchange: EVT
	Bloomberg Xetra: EVT GY
	Reuters Xetra: EVTG.DE

Investors Focus on European Biotechnology Shares

Although the life science industry experienced an overall global increase in market performance, there was marked disparity between the growth of the pharmaceutical and the biotechnology sectors. Large cap biopharmaceutical companies (market caps greater than U.S.$ 1 billion) gained just 1 % in value, while global small and medium cap biotechnology companies saw average returns in excess of 20 %. The strong performance seen by the small & mid cap group may be the result of maturing late-stage product portfolios and M&A speculation, especially within Europe where the biotechnology sector posted a stellar price performance (+45 %) in 2006. Pharmaceutical companies continued to experience a dearth of new product launches, significant deterioration of internal late stage pipelines and a plethora of patent expiries. As a result, the pressure to in-licence products or acquire smaller drug companies continues to escalate and the average cost for late stage drugs continues to rise.

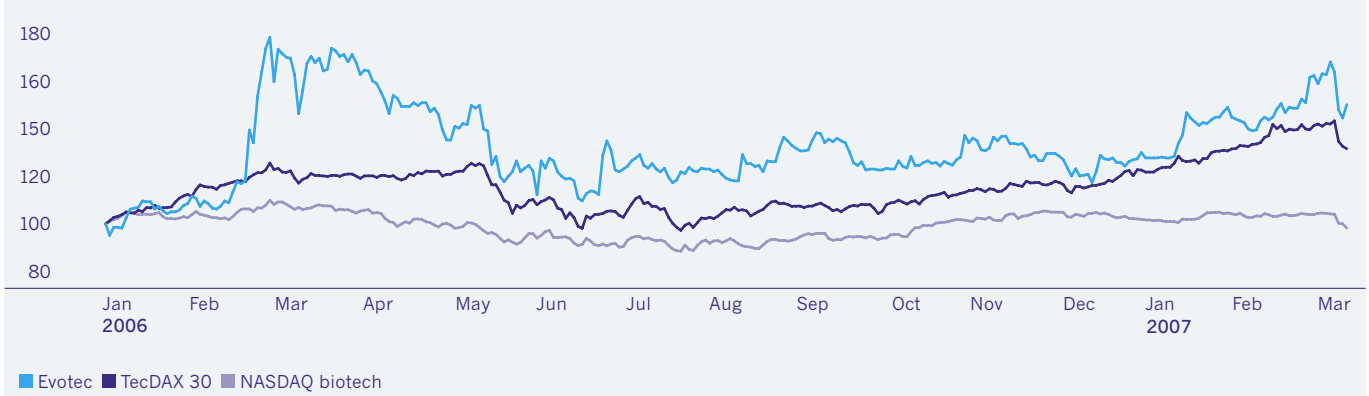
Compared with Europe, the overall 2006 performance of the U.S. biotechnology sector was lacklustre. The AMEX Biotech Index gained only 11% with the NASDAQ Biotech Index barely passing even, closing the year up 1%. The U.S. sector has seen a stream of 'blow ups,' including the non-approvable letter for Neurocrine's insomnia tablets, Indiplon XR. These set-backs have harshly reminded investors about the inherent risk in drug development and investment in small cap biotechnology companies as a whole. At the same time, recent failures have incentivised U.S. investors to look abroad for undervalued European opportunities, helping to narrow the U.S. | EU valuation gap.

Evotec's Progress Reflected in the Stock's 30 % Gain

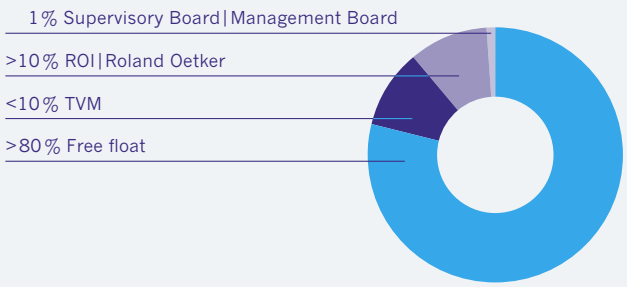
The ascent of Evotec's share price through 2006 has reflected the Company's success in its research collaborations and progress in developing a proprietary pipeline of promising drug candidates. The shares forged ahead 30 % year-over-year to EUR 3.25, moving in line with the European biotechnology sector, but outperforming most of its peers (peer companies according to the BioCentury classification system: chemistry companies: –10 %, High-Throughput-Screening companies: –4%, neurology companies: +21%). Evotec shares continued their upward trend into early 2007, with investors positioning themselves for initial Phase II patient data from the insomnia drug candidate EVT 201, which is expected during the year. In the first two months of 2007 the share price increased by 14 % to EUR 3.69.

The surge in investor interest in Evotec shares has also translated into a substantial increase in the liquidity of the stock. In 2006, the average daily trading volume on all German stock exchanges more than doubled over 2005, to approximately 400,000 shares.

Development of Evotec Share Price 2006 (indexed)

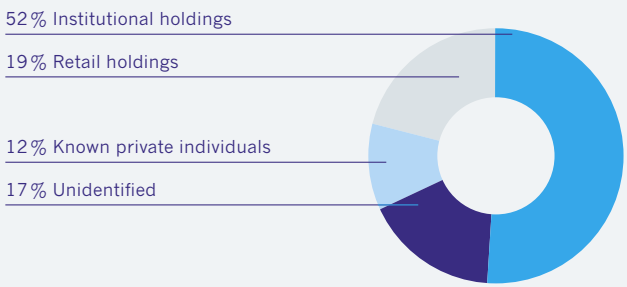


Overall Shareholder Structure



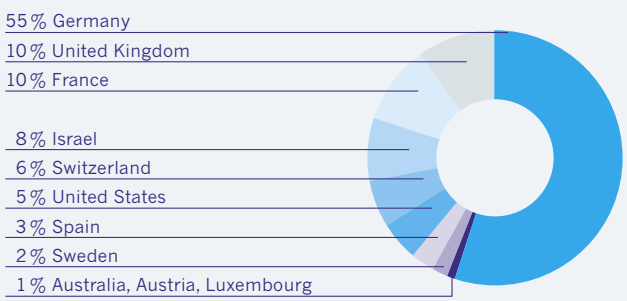
Source: Evotec 02 | 2006

Distribution of Shares by Shareholder Category



Source: Evotec 02 | 2006

Distribution of Identified Shares by Geographic Regions



Source: Evotec 02 | 2006

EUR 18.5m Capital Increase to Implement Strategy

By early 2006, Evotec's pipeline had developed further than anticipated due to the Company's successful in-licensing strategy and encouraging results from initial clinical trials. This left the Company with additional options to enhance the value of its CNS programmes in clinical development. In order to enhance Evotec's flexibility to develop internal programmes and create higher value inflection points prior to partnering, the Company increased its capital in April 2006 by issuing approximately 5.2 million new shares at a price of € 3.55 per share. The number of Evotec shares outstanding increased to 68,078,819 shares at year end (31/12/2005: 62,759,424) following this capital increase and the inclusion of the exercise of conditional capital from share option.

Shareholder Structure: > 80 % Free Float

In early 2007, Evotec conducted a detailed analysis of the Company's shareholder structure through which 83 % of the shares outstanding were identified. 52 % of the shares are in hands of institutional and 19 % on hands of retail holders. An additional 12% are owned by private individuals known to Evotec AG. The largest identified shareholders are ROI Verwaltungsgesellschaft mbH with more than 10 % of the total shares outstanding and TVM V Life Science Ventures GmbH & Co. KG with approximately 9 %. Geographically, Germany dominates the overall shareholding with 30 institutions holding 28 % of the total shares outstanding.

Communication is a Top Priority

Evotec has always placed great emphasis on a continuous dialogue with all capital market professionals. The basis of a fair company valuation is to communicate the Company's strategy, point to progress being made and to explain the potential of Evotec's pipeline of drug candidates with its associated opportunities and risks.

Therefore, also in 2006, the Company management conducted more than 150 one-on-one meetings at 14 national and international investor conferences, as well as 18 road shows in key financial centres in Europe, the U.S. and at the Company's sites in Germany and the UK. Evotec also continued with its extensive investor relations programme in the U.S. that was started in 2005. Last year was Evotec's first calendar year with an extended U.S. programme and the Company gained considerable traction amongst the U.S. investment community. In March, Evotec hosted an R&D day in Frankfurt and London, where participants were given the opportunity to scrutinise Evotec's broad spectrum of research activities.

The increase in interest for Evotec shares was also reflected by the greater number of publications about the Company. Besides meetings with management, financial analysts are playing a decisive role in bringing visibility to the Company's story. It was encouraging to see numerous in-depth reports about Evotec being published in 2006, including one from Deutsche Bank, which initiated coverage of the Company in December.

At the Annual Shareholder Meeting in June 2006, Evotec shareholders showed great interest in the progress of the Company's research programmes and collaborations. Approximately 250 shareholders participated, representing 47 % of the share capital (2005: 51 %).

As a consequence of its commitment to "Fair Disclosure of Information", it is of the utmost importance to Evotec that all shareholders have access to share price relevant information as promptly as possible. The internet plays a significant role in this venture enabling investors to read and download financial reports, press releases and ad hoc notifications. It also provides the opportunity to tune in live to telephone conference calls relating to the Company's quarterly and annual financial results, R&D days, presentations at international investor conferences, as well as the opening of the Annual Shareholder Meeting and the CEO's address. A replay of these events is regularly available.

Financial Institutions which Report on Evotec

Bank Vontobel AG
BHF-Bank
Credit Suisse
Deutsche Bank AG
DZ Bank AG
equinet Institutional Services AG
Landesbank Baden-Württemberg
Sal. Oppenheim jr. & Cie. KGaA
SES Research GmbH

Corporate Governance

An effective Corporate Governance is crucial for the management of a company's business affairs as well as for capital market communication. This has always been of utmost significance to Evotec. Our commitment to high Corporate Governance standards is our chance to (i) demonstrate to the market participants our dedication to well-balanced and transparent rules and to (ii) internally emphasise the importance of our clearly defined management tools and responsibilities.

Based on this conviction, the Company complies with all but one (see Declaration of Compliance below) of the Corporate Governance requirements as defined by the German Corporate Governance Code as well as with most of the suggestions the Code contains.

German Corporate Governance Code

The German Corporate Government Code (the 'Code') presents essential legal regulations for the management and supervision of German listed companies. In addition, it contains internationally recognised standards for good and responsible company management. With these regulations and standards the Code aims at strengthening the confidence of international and national investors, customers, employees and the public.

Besides the presentation of key legal regulations, the Code sets out a broad range of recommendations and, in addition, suggestions concerning Corporate Governance. With regard to the recommendations, Evotec has been able to make a declaration of compliance as follows:

Declaration of Compliance

In December 2006, the Management Board and the Supervisory Board of Evotec stated in accordance with §161 German Stock Corporation Act (AktG):

"Evotec AG has complied in 2006 with the recommendations of the Governmental Commission on the German Corporate Governance Code as published in the official section of the electronic Federal Gazette and intends to comply in the future with the recommendations of such Code with the following exception:

The stock option programmes in place are based on binding resolutions of several Annual General Meetings. While the exercise of these options requires an increase in the share price, the exercise is not related to other comparison parameters as recommended in Section 4.2.3 of the Code."

The Company has chosen not to introduce a relative hurdle to the exercising of its stock options due to (i) the lack of relevant (industry, geography etc) stock indices as measured by the low correlation of Evotec's shares against such indices, as well as (ii) the significant, firm-specific targeted shareholder value creation.

High Level Compliance also with the Code's Suggestions

In addition to complying with the recommendations of the Corporate Governance Code as mentioned above, the Company also conforms to almost all suggestions laid down in the Code, some of them being described below.

Best Possible Support and Transparency at Annual General Meetings

Evotec offers shareholders who are unable to attend Annual General Meetings the opportunity to access key parts of the event live on the Internet as suggested by Section 2.3.4 of the Code. The Company also encourages non-attendees to exercise their voting rights by arranging Company independent proxies.

Supervisory Board Committees Set Up in Accordance with the Code

Evotec has set up an Audit Committee with a spectrum of tasks comprising among others the review of financial reports and risk management, and guaranteeing the auditors' independence. The Company has also set up a Remuneration Committee (Sections 5.1.2 and 5.3.3 of the Code), which, among other things, prepares the appointment and remuneration of members to the Management Board. As suggested in Section 5.1.2 of the Code each appointment is effective for a maximum of three years. Evotec also makes sure that neither the Chairman of the Supervisory Board nor a former Member of the Management Board serve as Chair of the Audit Committee (Sections 5.2 and 5.3.2). In addition, the Company complies with the suggestion for Supervisory Board Members to hold occasional separate preliminary discussions (Section 3.6).

All of Evotec's Publications in Both English and German

Evotec is committed to "Fair Disclosure of Information". It is the Company's prime concern in its corporate communication strategy that the same information is made available to all relevant target groups at the same time, and this implies communicating in both English and German. The Company's publications are readily available on its website for viewing or downloading.

Remuneration of Supervisory Board

The members of Evotec's Supervisory Board are entitled to a fixed and a performance-related remuneration. Chair and Deputy Chair positions in the Supervisory Board as well as the chair and membership in committees are considered in determining the fixed remuneration of the individual members.

Besides the fixed remuneration, and in accordance with the suggestions of the Code, the members of the Supervisory Board receive a remuneration based on the Company's long-term performance: They receive an element of the remuneration to be made in shares of the Company in order to further align the interests of the individual Supervisory Board members and the development of Evotec's share price. In addition, if the shareholders receive a dividend, every Supervisory Board Member will receive an extra EUR 500 for every cent that the dividend per share exceeds 15 cents.

For their contribution in 2006, the individual members of the Evotec Supervisory Board received the following compensation:

Compensation of the Supervisory Board 2006

Names of members	Fixed remuneration in T€	Equity-based compensation in T€	Total in T€
Prof Dr H Riesenhuber	37.5	15.0	52.5
P Schatz	30.0	11.3	41.3
Dr H Birner	22.5	7.5	30.0
Dr P Fellner	18.8	7.5	26.3
M Tanner	18.8	7.5	26.3
Dr W Jenkins[1)]	8.4	4.2	12.6
Dr A Oberholz[1)]	6.5	3.3	9.8
Total	**142.5**	**56.3**	**198.8**

[1)] Dr William J Jenkins succeeded Dr Alfred Oberholz following the 2006 Shareholder Meeting.

Remuneration of the Management Board

The remuneration paid to the members of the Management Board in the financial year 2006 totalled T€ 917 of which T€ 243 was variable remuneration.

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 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 paid out in 2006, payable on the achievement of certain strategic targets for the business year 2005, was based on the following criteria: 40% based on the achievement of defined corporate milestones, 40% on the achievement of budgeted financial targets and 20% on the achievement of personal objectives. The scheme for the variable portion of the remuneration in 2007 relating to the business year 2006 is based on the following criteria: 30% based on the achievement of defined corporate milestones, 30% on the achievement of share price targets, 30% on the achievement of budgeted financial targets and 10% on the achievement of personal objectives.

In addition, under the Company's stock option plans, the members of the Management Board received in 2006 150,000 options. The options granted in 2006 and 2005 are subject to the stipulations of the Option Plan 2005 and may be exercised after three years if the conditions of this plan are met.

Compensation of the Management Board 2006

	Fixed remuneration in T€	Variable compensation in T€	Stock options
Jörn Aldag	364	145	90,000
Dr Dirk H Ehlers	310	98	60,000
Total	**674**	**243**	**150,000**

The fair value of the options granted to the members of the Management Board in 2006 has been calculated to be € 1.22 per option. For a detailed outline of the assumptions used for the binominal model establishing the fair value, reference is made to No (17) of the Notes to the Consolidated Financial Statements.

The individual contracts of the Management Board contain a change-of-control clause, which would allow Management to terminate their current contracts in the event of a change of control. A change-of-control exists when a major portion of the shares of the Company is held by a new investor. The resulting severance entitlement is one year base salary and bonus calculated on the basis of the prior year's remuneration.

Directors and Officers Insurance

The Company has a Directors and Officers (D&O) insurance policy in place for the Management Board, the Supervisory Board, the Executive Committee and the managers of subsidiary companies. The insurance expense amounted to T€ 84 in total in 2006, and was paid by the Company.

Ownership of Shares by Board Members

The share ownership of members of the Management Board and of the Supervisory Board on 31 December 2006 was as follows:

Ownership as of 31 December 2006

Management Board	No. of shares	No. of stock options
Jörn Aldag	298,056	402,600
Dr Dirk H Ehlers	4,540	231,500
Supervisory Board	**No. of shares**	**No. of stock options**
Prof Dr Heinz Riesenhuber	132,480	0
Peer Schatz	3,892	0
Dr Hubert Birner	0	0
Dr Peter Fellner	0	0
Mary Tanner	46,690	0
Dr William Jenkins	0	0

Directors' Dealings

During 2006, no Directors' Dealings were reported.

Additional Information Relevant to Corporate Governance

Additional information relevant to Corporate Governance and Supervisory Board activity can be found in the Supervisory Board Report (page 92). Information on professional affiliations of Board Members, on related party transactions as well as on stock options and consolidated subsidiaries and equity investees are available on pages 94, 87, 81 and 88.

Consolidated Financial Statements According to IFRS

Content

64 Auditors' Report
66 Consolidated Balance Sheet
67 Consolidated Statements of Operations
68 Consolidated Statements of Cash Flows
69 Supplemental Disclosures of Cash Flow Information
70 Consolidated Fixed Asset Movement Schedule
70 Consolidated Statements of Changes in Stockholders' Equity
72 Notes to Consolidated Financial Statements for the Year Ended 31 December 2006

Auditors' Report

We have rendered the audit opinion in German, which was translated as follows:

We have audited the consolidated financial statements prepared by the Evotec AG, Hamburg, comprising the balance sheet, the statement of operations, statement of changes in stockholder's equity, cash flow statement and the notes to the consolidated financial statements, together with the group management report for the business year from January 1 to December 31, 2006. The preparation of the consolidated financial statements and the group management report in accordance with IFRSs, as adopted by the EU, and the additional requirements of German commercial law pursuant to § 315a par. 1 HGB are the responsibility of the parent company's management. Our responsibility is to express an opinion on the consolidated financial statements and on the group management report based on our audit.

We conducted our audit of the consolidated financial statements in accordance with § 317 HGB (Handelsgesetzbuch 'German Commercial Code') and 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 consolidated financial statements in accordance with the applicable financial reporting framework and in the group management report are detected with reasonable assurance. Knowledge of the business activities and the economic and legal environment of the Group 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 consolidated financial statements and the group management report are examined primarily on a test basis within the framework of the audit. The audit includes assessing the annual financial statements of those entities included in consolidation, the determination of entities to be included in consolidation, the accounting and consolidation principles used and significant estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements and the group 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 consolidated financial statements comply with IFRSs as adopted by the EU, the additional requirements of German commercial law pursuant to § 315a par. 1 HGB and give a true and fair view of the net assets, financial position and results of operations of the Group in accordance with these requirements. The group management report is consistent with the consolidated financial statements and as a whole provides a suitable view of the Group's position and suitably presents the opportunities and risks of future development.

Hamburg, February 26, 2007

KPMG Deutsche Treuhand-Gesellschaft
Aktiengesellschaft
Wirtschaftsprüfungsgesellschaft

Schadeck
German Public Auditor
(Wirtschaftsprüfer)

Dr. Haußer
German Public Auditor
(Wirtschaftsprüfer)

Evotec AG and Subsidiaries
Consolidated Balance Sheet as of 31 December 2006 According to IFRS

T€ except share data	Footnote reference	31 Dec 2006	31 Dec 2005 [2]	Changes in % [3]
Assets				
Current Assets				
– Cash and cash equivalents	(4)	78,723	53,520	47.09
– Trade accounts receivable	(5)	6,189	12,758	(51.49)
– Accounts receivable due from related parties		454	840	(45.95)
– Inventories	(6)	4,782	10,502	(54.47)
– Current tax receivables		1,127	531	112.24
– Prepaid expenses and other current assets		3,115	3,822	(18.50)
Total current assets		94,390	**81,973**	15.15
Non-current assets				
– Long-term investments	(7)	–	–	–
– Property, plant and equipment	(8)	34,669	38,163	(9.16)
– Intangible assets, excluding goodwill	(9)	4,461	10,927	(59.17)
– Goodwill	(9)	50,541	54,994	(8.10)
– Other non-current financial assets		56	54	3.70
– Other non-current assets	(10)	1.980	–	100.00
Total non-current assets		91,707	**104,138**	(11.94)
Assets classified as held for sale	(11)	19,429	**–**	**100.00**
Total assets		205,526	**186,111**	**10.43**

	Footnote reference	31 Dec 2006	31 Dec 2005	Changes in % [3]
Liabilities and stockholders' equity				
Current liabilities				
– Current maturities of long-term loans	(12)	2,586	6,042	(57.20)
– Current portion of finance lease obligations	(13)	1,197	1,702	(29.67)
– Trade accounts payable		11,480	8,105	41.64
– Accounts payable to related parties		4	6	(33.33)
– Advanced payments received		413	801	(48.44)
– Provisions	(14)	5,232	6,563	(20.28)
– Deferred revenues		2,975	4,417	(32.65)
– Current tax payables		–	125	(100.00)
– Other current liabilities	(15)	24,553	1,911	1,184.82
Total current liabilities		48,440	**29,672**	63.25
Non-current liabilities				
– Long-term loans	(12)	6,296	3,399	85.23
– Long-term finance lease obligations	(13)	1,827	2,130	(14.23)
– Deferred revenues		1,119	726	54.13
– Provisions	(14)	1,653	1,515	9.11
– Other non-current liabilities	(10)	1,980	–	100.00
Total non-current liabilities		12,875	**7,770**	65.70
Liabilities classified as held for sale	(11)	7,035	**–**	100.00
Stockholders' equity				
– Share capital [1]	(18)	68,079	62,759	8.48
– Treasury shares		(83)	–	100.00
– Additional paid-in capital		610,071	596,525	2.27
– Reserve		(34,009)	(36,207)	(6.07)
– Retained deficit		(506,876)	(474,408)	6.84
– Minority interests		(6)	–	100.00
Total stockholders' equity		137,176	**148,669**	(7.73)
Total liabilities and stockholders' equity		205,526	**186,111**	10.43

[1] 107,188,373 and 94,131,629 shares, 1€ nominal amount, authorised at 31 December 2006 and 2005, respectively
68,078,819 and 62,759,424 shares issued and outstanding in 2006 and 2005, respectively
[2] 2005 balance sheet numbers include the discontinued operations, which are seperately disclosed in Note (11)
[3] Ratios unaudited

See accompanying notes to consolidated financial statements.

Evotec AG and Subsidiaries
Consolidated Statements of Operations for the period from 1 January to 31 December 2006 According to IFRS

T€ exept share data and per share data	Footnote reference	Continuing operations Years ended December 2006	2005	Changes[1] in %	Discontinued operations Years ended December 2006	2005	Total Years ended December 2006	2005
Revenue								
– Drug discovery products & development of technologies		12	275	(95.64)	17,327	15,670	17,339	15,945
– Drug discovery services		67,342	63,840	5.49	–	–	67,342	63,840
Total revenue		67,354	64,115	5.05	17,327	15,670	84,681	79,785
Costs of revenue								
– Drug discovery products & development of technologies		5	145	(96.55)	9,667	7,833	9,672	7,978
– Drug discovery services		44,398	42,842	3.63	–	–	44,398	42,842
Total costs of revenue		44,403	42,987	3.29	9,667	7,833	54,070	50,820
Gross profit		22,951	21,128	8.63	7,660	7,837	30,611	28,965
Operating costs and expenses								
– Research and development expenses		30,307	9,304	225.74	3,136	4,784	33,443	14,088
– Selling, general and administrative expenses		18,576	15,540	19.54	5,390	4,362	23,966	19,902
– Amortisation of intangible assets	(9)	3,256	9,251	(64.80)	811	482	4,067	9,733
– Impairment of goodwill	(9)	6,560	18,478	(64.50)	–	–	6,560	18,478
– Impairment of tangible assets	(8)	(593)	(643)	(7.78)	–	–	(593)	(643)
– Restructuring expenses		–	–	100.00	606	917	606	917
– Other operating expenses		1,607	2,163	(25.71)	–	–	1,607	2,163
Total operating costs and expenses		59,713	54,093	10.39	9,943	10,545	69,656	64,638
Operating loss		(36,762)	(32,965)	11.52	(2,283)	(2,708)	(39,045)	(35,673)
Other non-operating income (expense)								
– Interest income		1,367	851	60.63	25	5	1,392	856
– Interest expense		(671)	(698)	(3.87)	(35)	(31)	(706)	(729)
– Loss from equity investments	(7)	–	(2,552)	(100.00)	–	–	–	(2,552)
– Other income from financial assets		5	–	100.00	–	–	5	–
– Foreign currency exchange gain (loss), net		(189)	(782)	(75.83)	13	51	(176)	(731)
– Other non-operating expense		(280)	–	100.00	(268)	–	(548)	–
– Other non-operating income		554	614	(9,77)	6,873	326	7,427	940
Total non-operating income (expense)		786	(2,567)	(130.62)	6,608	351	7,394	(2,216)
Income (loss) before taxes and minority interests		(35,976)	(35,532)	1.25	4,325	(2,357)	(31,651)	(37,889)
– Current tax income (expense)	(16)	(321)	(226)	42.04	(497)	(9)	(818)	(235)
– Deferred tax benefit	(16)	1	4,753	(99.98)	–	(5)	1	4,748
– Minority interests		–	(207)	(100.00)	–	–	–	(207)
Net income (loss)		(36,296)	(31,212)	16.29	3,828	(2,371)	(32,468)	(33,583)
Weighted average shares outstanding		66,355,593	51,987,921		66,355,593	51,987,921	66,355,593	51,987,921
Net income (loss) per share		(0.55)	(0.60)		0.06	(0.05)	(0.49)	(0.65)

[1] Ratios unaudited

See accompanying notes to consolidated financial statements.

Evotec AG and Subsidiaries
Consolidated Statements of Cash Flows According to IFRS

T€	31 Dec 2006	31 Dec 2005
Cash flows from operating activities:		
Net loss	(36,296)	(31,212)
Adjustments to reconcile net loss to net cash used in operating activities:		
– Depreciation of property, plant and equipment	6,335	6,637
– Amortisation of intangible assets	3,256	9,251
– Depreciation of current assets	21	511
– Reversal of impairment of tangible assets	(593)	(643)
– Impairment of goodwill	6,560	18,478
– Impairment of investment in affiliates	–	324
– Net loss from equity investments	–	2,228
– Stock compensation expense	1,127	749
– Gain on sale of investments	(5)	–
– Loss on sale of property, plant and equipment	92	2
– Profit on sale of property, plant and equipment	–	(1)
– Deferred tax benefit	1	(4,753)
– Minority interests	–	207
Decrease (increase) in:		
– Accounts receivable	2,020	1,703
– Inventories	(137)	(1,149)
– Other assets	(2,372)	(466)
Increase (decrease) in:		
– Accounts payable	4,617	1,396
– Advanced payments received	(95)	(84)
– Deferred revenues	(175)	(3,061)
– Provisions	1,010	(1)
– Current taxes payable	–	238
– Other liabilities	2,931	1,095
Cash paid during the year for:		
– Interests	(520)	(727)
– Taxes	(263)	(318)
Transactions with discontinued operations	3,261	(2,541)
Net cash used in operating activities	**(9,225)**	**(2,137)**
Cash flows from investing activities:		
– Acquisition costs	–	(366)
– Purchase of long-term investments	(266)	(2,369)
– Purchase of property, plant and equipment	(2,556)	(3,396)
– Purchase of intangible assets	–	(748)
– Cash acquired	–	19,244
– Proceeds from sale of property, plant and equipment	19	2
– Proceeds from sale of shares in subsidiaries	22,172	–
– Proceeds from sale of marketable securities	–	–
Net cash provided by investing activities	**19,369**	**12,367**
Cash flows from financing activities:		
– Proceeds from capital increase	18,766	28,460
– Transaction costs	(727)	–
– Proceeds from increase of loans	7,441	5,893
– Purchase of own stock	(83)	–
– Repayment of loans	(9,288)	(8,416)
Net cash provided by financing activities	**16,109**	**25,937**
Net increase in cash and cash equivalents	26,253	36,167
Exchange rate difference	285	1,102
Cash and cash equivalents at beginning of year	52,185	14,916
Cash and cash equivalents at end of year	**78,723**	**52,185**

See accompanying notes to consolidated financial statements.

Evotec AG and Subsidiaries
Supplemental Disclosures of Cash Flow Information

T€	31 Dec 2006	31 Dec 2005
Supplemental schedule of non-cash activities:		
– Acquisition of long-term investments	–	40,802
– Acquisition to finance leases	936	1,264

See accompanying notes to consolidated financial statements.

Evotec AG and Subsidiaries
Consolidated Fixed Asset Movement Schedule According to IFRS

	Acquisition and manufacturing costs					
T€	01.01.2006	Foreign exchange	Discontinued operations	Additions	Disposals	31.12.2006
I. Intangible assets						
1. Patents and licences	6,251	–	(708)	–	–	5,543
2. Goodwill	54,994[3)]	1,224	–	923	6,600	50,541
3. Capitalised development expenses	1,177	–	(1,177)	–	–	–
4. Developed technology	30,744	618	(577)	–	–	30,785
5. Customer list	28,758	450	(1,291)	–	–	27,917
	121,924	**2,292**	**(3,753)**	**923**	**6,600**	**114,786**
II. Tangible fixed assets						
1. Buildings and leasehold improvements	27,663	605	–	119	121	28,266
2. Plant, machinery and equipment	57,164	1,071	(1,855)	805	5,942	51,243
3. Furniture and fixtures	11,937	213	(562)	575	258	11,905
4. Purchased software	1,355	–	(275)	108	–	1,188
5. Finance leases	5,753	117	(467)	936	–	6,339
6. Assets under construction	42	1	–	1,000	8	1,035
	103,914	**2,007**	**(3,159)**	**3,543**	**6,329**	**99,976**
III. Financial assets						
1. Long-term investments	760	–	–	–	–	760
2. Other financial assets	54	–	–	2	–	56
	814	**–**	**–**	**2**	**–**	**816**
	226,652	**4,299**	**(6,912)**	**4,468**	**12,929**	**215,578**

[1)] calculated at the yearly average foreign exchange rate results in an increase of T€ 5
[2)] calculated at the yearly average foreign exchange rate results in a decrease of T€ 53
[3)] net of accumulated amortisation as of 31 December 2001 of T€ 162,195 and impairment as of 2002 and 2004 of T€ 109,389 and T€ 55,824, respectively

See accompanying notes to consolidated financial statements.

Evotec AG and Subsidiaries
Consolidated Statements of Changes in Stockholders' Equity According to IFRS

	Share capital		Additional paid-in capital	Own shares
T€ exept share data	Shares	Amount		
Balance at 01 January 2005	**38,010,130**	**38,010**	**552,360**	**–**
Acquisition of ENS Holdings, Inc.	14,276,883	14,277	26,266	–
Capital increase 24 June	10,457,402	10,457	17,880	–
Capital increase (stock options)	15,009	15	19	–
Stock option plan	–	–	–	–
Stock option plan acquired	–	–	–	–
Minority interests	–	–	–	–
Income and expense recognised directly in equity:				
– Foreign currency translation	–	–	–	–
– Revaluation	–	–	–	–
– Net loss	–	–	–	–
Total income and expense recognised directly in equity				
Balance at 31 December 2005	**62,759,424**	**62,759**	**596,525**	**–**
Capital increase	5,228,701	5,229	12,605	–
Capital increase (stock options)	90,694	91	114	–
Stock option plan	–	–	817	–
Purchase of treasury stock	–	–	–	(83)
Minority interests	–	–	10	–
Income and expense recognised directly in equity:				
– Foreign currency translation	–	–	–	–
– Revaluation	–	–	–	–
– Net loss	–	–	–	–
Total income and expense recognised directly in equity				
Balance at 31 December 2006	**68,078,819**	**68,079**	**610,071**	**(83)**

See accompanying notes to consolidated financial statements.

	Depreciation, amortisation and writedowns							Net book value	
	01.01.2006	exchange	Foreign operations	Discontinued Additions	Disposals	Revaluation	31.12.2006	31.12.2006	31.12.2005
	3,248	–	(45)	304	–	–	3,507	2,036	3,003
	–	–	–	–	–	–	–	50,541	54,994
	163	–	(163)	–	–	–	–	–	1,014
	30,244	618	(77)	–	–	–	30,785	–	500
	22,348	455	(258)	2,947	–	–	25,492	2,425	6,410
	56,003	**1,073**	**(543)**	**3,251**[1)]	**–**	**–**	**59,784**	**55,002**	**65,921**
	13,984	326	–	1,426	120	(408)	15,208	13,058	13,679
	38,617	756	(709)	2,816	5,755	(185)	35,540	15,703	18,547
	9,595	190	(447)	989	246	–	10,081	1,824	2,342
	1,201	–	(213)	60	–	–	1,048	140	154
	2,354	51	(72)	1,097	–	–	3,430	2,909	3,399
	–	–	–	–	–	–	–	1,035	42
	65,751	**1,323**	**(1,441)**	**6,388**[2)]	**6,121**	**(593)**	**65,307**	**34,669**	**38,163**
	760	–	–	–	–	–	760	–	–
	–	–	–	–	–	–	–	56	54
	760	**–**	**–**	**–**	**–**	**–**	**760**	**56**	**54**
	122,514	**2,396**	**(1,984)**	**9,639**	**6,121**	**(593)**	**125,851**	**89,727**	**104,138**

	Reserve				
Unearned compen-sation	Foreign currency translation	Revaluation reserve	Retained deficit	Minority interests	Total stockholders' equity
(1,716)	**(39,005)**	**1,110**	**(440,825)**	**574**	**110,508**
–	–	–	–	–	40,543
–	–	–	–	–	28,337
–	–	–	–	–	34
749	–	–	–	–	749
(655)	–	–	–	–	(655)
–	–	–	–	(574)	(574)
–	3,149	–	–	–	3,149
–	–	161	–	–	161
–	–	–	(33,583)	–	(33,583)
					(30,273)
(1,622)	**(35,856)**	**1,271**	**(474,408)**	**–**	**148,669**
–	–	–	–	–	17,834
–	–	–	–	–	205
310	–	–	–	–	1,127
–	–	–	–	–	(83)
–	–	(4)	–	(6)	–
–	1,922	–	–	–	1,922
–	–	(30)	–	–	(30)
–	–	–	(32,468)	–	(32,468)
					(30,576)
(1,312)	(33,934)	1,237	(506,876)	(6)	137,176

Evotec AG and Subsidiaries
Notes to Consolidated Financial Statements for the Year Ended 31 December 2006

(1) Business Description and Basis of Presentation

Evotec AG, Schnackenburgallee 114, 22525 Hamburg, Germany and subsidiaries ('Evotec' or the 'Company') is a biotechnology group dedicated to the discovery and development of novel small molecule drugs through both its own discovery programmes and through research collaborations. The Company provides innovative and often integrated solutions from target to clinic through an unmatched range of capabilities, including early stage assay development and screening through to medicinal chemistry and drug manufacturing. In proprietary projects, Evotec specialises in finding new treatments for diseases of the Central Nervous System (CNS). The Company's instrument business which is shown in the discontinued operations is focused on high-end technologies for automated cell biology.

The Company was founded on 8 December 1993 as EVOTEC BioSystems GmbH. Evotec completed an initial public offering in Germany on 10 November 1999.

All amounts herein are shown in thousands of Euro ("T€"), unless indicated otherwise. In the following notes all amounts shown are related to the continuing operations for 2006 and 2005 for a better comparison, unless indicated otherwise.

(2) Summary of Significant Accounting Policies

According to Section 315a HGB (German Commercial Law) the Company's consolidated financial statements of 31 December 2006 are prepared in accordance with International Financial Reporting Standards (IFRS). The following is a summary of significant accounting policies followed in the preparation of the accompanying consolidated financial statements.

Principles of Consolidation

The consolidated financial statements have been prepared in accordance with IFRS adopted by the International Accounting Standards Board, London (IASB) in consideration of interpretations of the Standing Interpretations Committee (SIC) and the International Financial Reporting Interpretations Committee (IFRIC) and include the accounts of Evotec AG and all companies which are under its control. All intercompany transactions and balances have been eliminated in consolidation. The basis of consolidation changed as of 26 May 2005. From this date ENS Holdings, Inc. (ENS) has been a 100% owned subsidiary and was therefore fully consolidated. Before, ENS Holdings, Inc. was accounted for using the equity method. Therefore, the consolidated financial statements of 2006 are not fully comparable to the ones of 2005.
Investments where Evotec does not have a controlling interest, but is in a position to influence the operating or capital decisions of the investee are carried at equity.

Cash and Cash Equivalents

The Company considers all highly liquid short-term investments with original maturities of three months or less to be cash equivalents.

Derivative financial instruments

In accordance with IAS 39, the Company has classified all of its debts and equity securities as available-for-sale and states them at fair value as determined by the most recently traded price of each security at the balance sheet date. Any resulting unrealised gains or losses are included in the revaluation reserve, a separate component of stockholders' equity.

Realised gains and losses from the sale of available-for-sale securities are determined based on specific identification of the cost of securities sold and are reported in other non-operating income and expense.

Inventories

In accordance with IAS 2 inventories are valued at the lower of cost or net realisable value, cost being generally determined on the basis of an average method. Net realisable value is the estimated selling price in the ordinary course of business, less the estimated costs of completion and selling expenses. Cost consists of purchased component costs and manufacturing costs, which are comprised of direct material and labour costs and certain indirect costs. Costs are removed from inventories to costs of revenue based on specific identification.

Property, Plant and Equipment

Property, plant and equipment acquisitions, including leasehold improvements, are recorded at cost less any vendor rebates. Depreciation of leasehold improvements is calculated using the straight-line method over the shorter of the related lease term or the estimated useful life. Leased property, plant and equipment meeting certain criteria are capitalised and the present value of the related lease payments is recorded as a liability. Depreciation of property, plant and equipment, which includes depreciation of assets under finance leases, is

calculated using the straight-line method over the estimated useful lives of the assets as follows:

Buildings and leasehold improvements	11–35 years
Plant, machinery and equipment	3–20 years
Furniture and fixtures	3–15 years
Computer equipment and software	3–5 years

The depreciation period and method is reviewed at each balance sheet date and potential differences are recognised directly in the revaluation reserve. Differences from previous estimates shall be accounted for as a change in an accounting estimate in accordance with IAS 8. The costs included in property, plant and equipment related to assets under construction are not depreciated until the assets are placed into service by the Company. Upon sale or retirement, the costs and the related accumulated depreciation are removed from the respective accounts, and any gain or loss is included in other operating income and expense. Maintenance and repairs are expensed as incurred.

Intangible Assets, excluding Goodwill

Intangible assets, excluding goodwill, consist of separately identified intangible assets such as developed technologies, customer lists and patents which were acquired in business combinations, purchased licenses and patents, as well as capitalised development expenditures according to IAS 38.

Intangible assets with definite useful lives are recorded at cost and are amortised using the straight-line method over the estimated useful lives of the assets:

Developed technologies	3–5 years
Customer list	3–5 years
Patents and licenses	15 years or shorter life
Capitalised development expenditures	3–5 years

The amortisation period and method is reviewed at each balance sheet date.

Goodwill

Goodwill acquired in a business combination represents the exceeding amount of a payment made by the Company in anticipation of future economic benefits not capable of being individually identified and separately recognised. The Company recognises separately the acquired identifiable assets, liabilities and contingent liabilities at the acquisition date. The goodwill results mainly from the acquisition of Oxford Asymmetry International plc. in October 2000 and the acquisition of the remaining shares in ENS Holdings, Inc. in May 2005. Additional goodwill has arisen from the acquisition of the remaining minority interests in Evotec (Scotland) Ltd from the founding directors in May 2004 and the University of Strathclyde in September 2005 as well as from the acquisition of minority interests in Evotec Technologies GmbH in December 2006.

The acquisition of the remaining shares in ENS Holdings, Inc. in 2005 was made on a share for share basis. The Company issued 14,276,883 shares to acquire the outstanding shares in ENS Holdings, Inc. Since then ENS Holdings, Inc. is a 100% owned subsidiary and therefore a fully consolidated company. The purchase price was allocated to the assets acquired as well as to goodwill (T€ 18,478).

In May 2004 the Company acquired 19,000 shares in Evotec (Scotland) Ltd from the founding directors for the initial sum of T€ 362. In addition to the initial sum, further consideration is payable based on the financial performance of the Company between May 2004 and December 2006. The deferred consideration provided for at the balance sheet date is T€ 1,001 and T€ 1,193 in 2006 and 2005, respectively. In respect of this share purchase, goodwill of T€ 117 was recognised on the date of purchase. Goodwill was increased to T€ 663 at the balance sheet date 2004 and then revised to T€ 1,258 at the balance sheet date 2005 based on the estimate at the balance sheet dates of the consideration due to be paid at year end 2006. In September 2005 the Company purchased the remaining 18,000 shares in Evotec (Scotland) Ltd for the sum of T€ 586. This acquisition resulted in additional goodwill amounting to T€ 153 in 2005. The goodwill was increased at the balance sheet date 2006 to T€ 1,671 due to the changed estimate in 2006 of the consideration due to be paid at year end 2006.

In December 2006 the Company acquired shares in the nominal amount of Euro 1,290 in Evotec Technologies GmbH for the sum of T€ 695. This acquisition resulted in additional goodwill amounting to T€ 695 in 2006.

Discontinued Operations

The discontinued operation is a component of the Company that is classified as held for sale, and represents a separate major line of business operations. According to IFRS 5 discontinued operations are separately disclosed from the continuing operations. Assets, liabilities, income and expenses relating to discontinued operations are separately disclosed in the balance sheet and the statements of operations. All data in the Notes refer to continuing operations for 2006 and 2005, except where otherwise indicated. Notes disclosures for 2005 are therefore adjusted for the discontinued operations to achieve a better comparability. Discontinued operations are described in Note (11).

Revenue Recognition

Revenue is recognised when it is probable that the economic benefits associated with the transaction will flow to the Company based upon the performance requirements of the respective agreements. Advance payments received in excess of amounts earned are recorded as deferred revenue.

Product and chemical compound sales are recorded as revenue upon delivery if the Company has received a customer order, the price is determinable and collectibility is reasonably assured. The Company assesses collectibility based on a number of factors, including past transaction history with the customer and their credit-worthiness.

Service revenues generated from contracted services are recognised as the services are rendered. Revenue from compound access fees is recognised rateably over the related forecasted service period. Payments for contracted services are generally paid in advance and recorded as deferred revenue until earned. Some contracted services are settled in part by non-monetary payments. Due to the insignificant portion of the contract value which is represented by the non-monetary

portion, revenues derived from these particular contracts are recognised on the same basis as that used in monetary transactions.
Revenue under long-term collaborative agreements includes but is not limited to the following:

1. Database Access Fees – Revenue from database access fees is recognised rateably over the related contract period.
2. Research Payments – Revenue from research payments finances both direct costs incurred in connection with the Company's ongoing research and development activities and indirect costs incurred as part of an allocation of certain other administrative expenses. Revenue from research payments is recognised rateably over the related forecasted research period as services are provided.
3. Success Payments – Revenue contingent upon the attainment of certain milestones is recognised in the period the milestone is successfully achieved. This usually occurs when the contract partner agrees that the requirements stipulated in the agreement have been met.

In the discontinued operations revenues from the sale of systems, equipment and devices are recognised when the amount of revenue can be measured reliably and it is probable that the economic benefits associated with the transaction will flow to the Company. For the recognition of revenue Evotec has transferred to the buyer the significant risks and rewards of ownership of the goods and retains neither continuing managerial involvement to the degree usually associated with ownership nor effective control over the goods sold. The costs incurred or to be incurred in respect of the transaction can be measured reliably. Revenues from the sale of systems, equipment and devices are recorded at the time of delivery, title transfer or upon final acceptance by the customer as required by agreement. Advance payments received are recorded as prepayments received.
The Company has entered into multiple-element contracts and carefully determined whether the different revenue-generating elements are sufficiently separable and whether there exists sufficient evidence of their fair values to separately account for some or all of the individual elements of the contracts. Only if an element is considered to meet these criteria it represents a separate unit of accounting.
Under the terms of various contractual arrangements, Evotec receives royalty payments which are incremental to the other company's respective product sales. Royalty income of T€ 523 and T€ 1,062 is included in product revenue for 2006 and 2005, respectively.

Derivative policy
The Company does not engage in derivatives trading, market-making or other speculative activities. The Company periodically enters into agreements to obtain foreign currencies at specified rates based on expected future cash flows for each currency.

Income Taxes
Under the liability method, deferred tax assets and liabilities are recognised for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases as well as for tax loss carry forwards. Deferred tax assets and liabilities are measured using tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be realised or settled based on enacted or substantially enacted tax rates. The effect on deferred tax assets and liabilities of a change in tax rates is recognised in the period that includes the date of enactment or substantially enactment. In assessing the recoverability of deferred tax assets, management considers whether it is probable that some portion or all of the deferred tax assets will not be realised. Deferred tax assets are reduced to the extent that it is not probable that the related tax benefit will be realised.

Research and Development
Research and development costs that are internally generated are capitalised or expensed depending on whether the expenditure incurred falls under the classifications of research or development expenditure given by IAS 38. When it is not certain that research and development projects will generate probable future economic benefits, the costs are expensed as incurred. Those projects which are expected to generate probable future economic benefits are capitalised as an intangible asset and amortised if all criteria set out in IAS 38 are met. This principle is also used for the accounting of developed software. The software included in property, plant and equipment consists only of purchased software.
The Company receives grants from government authorities for the support of specific research and development projects. The grants are requested when qualifying expenses have been incurred and are recognised as a reduction of research and development expense when they are received. The amounts recognised as a reduction of the Company's research and development expense were T€ 187 and T€ 242 in 2006 and 2005, respectively. Under the terms of the grants, the governmental agencies generally have the right to audit the submitted qualifying expenses of the Company.

Translation of Foreign Operations and Foreign Currency Denominated Transactions
The assets and liabilities of foreign subsidiaries with functional currencies other than the Euro are translated into Euro using period-end exchange rates, while the revenues and expenses of such subsidiaries are translated using average exchange rates during the period. Gains or losses resulting from translating foreign functional currency financial statements are reported as a separate component of stockholders' equity. Transactions in foreign currencies are translated into Euro using the foreign exchange rate ruling at the date of the transaction. Assets and liabilities denominated in foreign currencies at the balance sheet date are translated into Euro using period-end exchange rates. Gains or losses resulting from foreign currency denominated transactions are included in other non-operating income and expense.

Impairment of Long-Lived Assets and Goodwill
The Company reviews long-lived assets (tangible and intangible assets including goodwill) for impairment in accordance with IAS 36 and as part of a business combination in accordance with IFRS 3. An impairment review is performed annually

for intangible assets and goodwill, or whenever events or changes in circumstances indicate that the carrying amount of an asset or assets may not be recoverable. In line with our policy in previous years concerning the impairment of long-lived assets and goodwill, the company carried out an impairment test in the fourth quarter of 2006 (see Note (9)).
An impairment loss is recognised if the carrying amount of an asset (or a group of assets when considering a cash generating unit) in the accounts exceeds the greater of its fair value less costs to sell or value in use. The value in use for an asset or cash generating unit is calculated by estimating the pre-tax net present value of future cash flows arising from that asset or cash generating unit. The pre-tax discount rate used to calculate the value in use is determined to reflect the risks inherent for each asset or cash generating unit. Considerable management judgement is necessary to estimate discounted pre-tax future cash flows.
Any impairment is reported as a separate component of operating costs and expenses in the consolidated statement of operations. An impairment of tangible assets and intangible assets excluding goodwill is reversed if there has been a change in the estimates used to determine the value in use leading to an increase in value for a previously impaired asset. It is reversed only to the extent that the asset's carrying amount does not exceed the carrying amount that would have been determined, net of depreciation or amortisation, if no impairment loss had been previously recognised. Impairments to the carrying amount of goodwill are not reversed.

Stock Compensation
The Company applies the provisions of IFRS 2 in accounting for options granted under its stock option plan. Compensation cost from the issuance of employee stock options is measured using the fair value method at the measurement date and is charged to expense over an estimated period in which the employee renders the services.

Use of Estimates
The preparation of the accompanying consolidated financial statements requires management to make estimates and assumptions that affect both the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities as of the date of the financial statements as well as the reported amounts of revenues and expenses during the reporting period. Main estimates and assumptions affect impairment testing, provisions, measurement of compensation expense and the valuation allowance on deferred taxes. Actual results could differ from Management's estimates. In addition, changes in the current economic conditions and other events could also have a significant effect on reported amounts.

Recent Pronouncements and Adoptions
IFRS 7 "Financial Instruments: Disclosures and the Amendment to IAS 1 Presentation of Financial Statements: Capital Disclosures" requires extensive disclosures about the significance of financial instruments for an entity's financial position and performance, and qualitative and quantitative disclosures on the nature and extent of risks. IFRS 7 and amended IAS 1 are effective for financial years beginning on or after 1 January 2007. The Company has not completed its assessment of the impact, if any, that IFRS 7 and amended IAS 1 will have on its reporting.
In 2006, IFRS 8 'Segment reporting' was issued. IFRS 8 changes the segment reporting from a risk and reward approach as described in IAS 14 to a management approach with regard to the presentation of segments. Relevant for the definition of segments are according to IFRS 8 the information which are presented on a regular basis to the chief operating decision maker. On the same time the valuation of segments will be changed from financial accounting approach according to IAS 14 to the management approach. IFRS 8 is effective for financial years beginning on or after 1 January 2009. Adaptation of IFRS 8 before this effective date is allowed. The Company has not completed its assessment of the impact, if any, that IFRS 8 will have on its segment reporting.
In 2006, IFRIC 11 "IFRS 2 – Group and Treasury Share Transactions" was issued. This regulation provides guidance for the accounting of group wide share based remunerations, the impact of employees changing employment in the Group companies. Additionally accounting of share based remunerations where the company grants treasury shares or acquires shares from third parties. IFRIC 11 is effective for fiscal years beginning on or after 1 March 2007. An early adaptation is recommended. The Company has not completed its assessment of the impact, if any, that IFRIC 11 will have on its financial position or results of operations.

EBITDA
EBITDA stands for earnings before interest, taxes, depreciation (incl. allowance for accounts receivables and inventories) and amortisation.

(3) Use Restrictions on the Company's Technology

Evotec was subject to certain restrictions concerning technologies arising in the course of its cooperations with Glaxo SmithKline (GSK) and Novartis.
A fourth amendment to the contract with GSK, signed in May 2001, allows Evotec in its discontinued operations to sell detection systems and liquid handling devices, which have a restricted throughput of compounds per day. As part of the amendment, GSK grants Evotec the right to enter into other collaborative agreements with two additional funding partners.
With regards to the "external target collaborations" under an agreement with Novartis, Evotec must pay royalties equal to 5% of qualifying revenue to Novartis for a period of ten years expiring on 16 March 2008. The Company has recorded related royalty expenses of T€ 31 and T€ 29 in 2006 and 2005, respectively.
Evotec was subject to certain restrictions concerning intellectual property arising in the course of its cooperation with Takeda. During the period of Takeda's exclusive access to the Target Database, Evotec will not grant access to the Target Database to any third party for purposes of exploration in the field of neurodegenerative disease. The period of exclusive access ends on 28 August 2007.

(4) Cash and Cash Equivalents

On 31 December 2006 and 2005 an amount of T€ 275 and T€ 0, respectively of cash and cash equivalents is pledged as security.

(5) Trade accounts receivables

The Company has assessed the non-payment risk of all trade accounts receivables which resulted in an allowance of T€ 123 and T€ 173 in 2006 and 2005, respectively. There are no use restrictions on trade accounts receivable.

(6) Inventories

Inventories consist of the following:

T€	31 Dec 2006	31 Dec 2005
Raw materials	2,942	2,867
Work-in-progress	1,840	1,714
Total inventories	**4,782**	**4,581**

Raw materials consist of biological materials and substances and chemicals. Work-in-progress in 2006 primarily consists of costs incurred on customer projects which were not completed at year end. The Company carries an allowance on raw materials of T€ 1,360 and T€ 1,458, included in the amounts above, as of 31 December 2006 and 2005, respectively. Additionally, an allowance on work-in-progress of T€ 0 and T€ 0 in 2006 and 2005, respectively is included in the amounts above. Write-ups of previously written down inventories did not occur.

(7) Long-term Investments

Evotec acquired a 3.88% investment in 2002 in the common stock of **Prolysis Ltd.** as part of a three year drug discovery agreement where Evotec earned the shares by performing services for Prolysis. All shares have been acquired through non-monetary payments. A financing round diluted Evotec's share in Prolysis to 2.38%. An additional capital increase of Prolysis in 2006 diluted Evotec's share in Prolysis to 2.1%. The shares are held as a long-term investment at cost and are subject to a regular fair value impairment review, at least once a year. In December 2004 the value of the investment was fully impaired. As of 31 December 2006 and 2005 the carrying amount of the investment is T€ 0.
In November 2005, Evotec transferred their shares in Sirenade Pharmaceuticals AG to **KeyNeurotek AG** ("KeyNeurotek"), Magdeburg in return against shares in this company. The original investment was partly paid by services provided in a drug discovery agreement between Evotec and SiREEN AG. Following this, Evotec is holder of 98 shares in KeyNeurotek AG, Magdeburg, representing a shareholding in this company of 0.06%. The investment is accounted for at cost. The impairment review in 2005 concluded that the value of the investment is uncertain, and that the investment should be fully impaired, due to financial risks. As of 31 December 2006 and 2005 the carrying amount of the investment is T€ 0.
Evotec acquired a 46.36% investment in the common stock of **Vmax Ltd.** ("Vmax") on 22 August 2002, which was accounted for under the equity method of accounting. Due to a capital increase in 2004 the investment of Evotec decreased from 46.36% to 30.6%. In 2006 Vmax was liquidated by winding up. On winding up Vmax Evotec received a partial repayment of the assets and agreed to waive the remaining balance of loan stock.
Evotec has a 22.72% voting interest by virtue of a 65.0% investment in the common stock of **DIREVO Biotech AG** ("Direvo"), which is accounted for under the equity method of accounting. Due to the redeemable feature of the preferred shares, the Company reduced the investment in Direvo to zero in 2001. The Company's share of the net loss of Direvo amounted to T€ 0 in 2006 and 2005. Our maximum exposure to loss as a result of our involvement with DIREVO Biotech AG is limited to the original investment in Direvo in the amount of T€ 32.
The Company and **DeveloGen AG** formed a 50:50 Joint Venture in August 2003 which was terminated on 23 January 2006 with effective date 31 December 2005. In 2005 research and development expenses of the Company relating to the Joint Venture in the amount of T€ 1,780 were shown under loss from equity investments. This Joint Venture incurred research and development expenses in the amount of T€ 4,839 in 2005.
The long-term investments of Evotec continue to have losses and, therefore, do not have undistributed profits.
The Company has recorded revenues in the ordinary course of business with the investments Sirenade Pharmaceuticals AG as the predecessor of KeyNeurotek AG and Prolysis Ltd. in the amount of T€ 0 and T€ 0 in 2006 as well as T€ 9 and T€ 1,501 in 2005, respectively. No further material transactions with investments of the Company were recorded. Transactions with affiliates of investments were notably performed with EVOTEC NeuroSciences GmbH before full consolidation in 2005.

(8) Property, Plant and Equipment

Property, plant and equipment consist of the following:

T€	31 Dec 2006	31 Dec 2005
Buildings and leasehold improvements	28,266	27,663
Plant, machinery and equipment	51,243	55,309
Furniture and fixtures	11,905	11,375
Purchased software	1,188	1,080
Finance leases	6,339	5,286
Assets under construction	1,035	42
Fixed assets, at cost	99,976	100,755
Less accumulated depreciation		
without impairment and software	48,469	46,940
Plus accumulated adjustment		
of depreciation	(1,237)	(1,237)
Less accumulated impairment	17,027	17,619
Less accumulated depreciation		
of software	1,048	988
Total property, plant and equipment	34,669	36,445

The main additions in 2006 relate to the fitting out of additional clean room facilities in Glasgow, UK, upgrades of our screening facility in Hamburg and analytical equipment. Upon completion of the assets under construction, costs are transferred into their respective fixed assets classification. Depreciation expense amounted to T€ 6,335 and T€ 6,733 in 2006 and 2005, respectively. As per 31 December 2005 the estimation of useful lives of some individual identified assets resulted in an adjustment of the depreciation periods and relating depreciation expenses in the amount of T€ 161. Those changes were recorded in the revaluation reserve directly in equity. No further revaluation of property, plant and equipment was performed.

The Pilot Plant cash generating unit located in Abingdon, UK, was reassessed for impairment during the 2005 impairment review in accordance with IAS 36, and the value in use found to have increased following improved utilisation during 2005 and revised expectations of future performance. This has resulted in a partial reversal in 2005 of the previously recognised asset impairment of T€ 643. This cash generating unit was reassessed for impairment in the 2006 impairment review with the result that no further impairment, nor any reversal of impairment, is deemed necessary.

Laboratory premises in Abingdon, UK, were also reassessed for impairment in the 2005 impairment review with the result that no further impairment, nor any reversal of impairment, was deemed necessary. During the asset impairment review in 2006, as permitted under IAS 36, management estimated the asset impairment using a method based on the physical usage of the laboratory premises. This has resulted in a partial reversal in 2006 of the previously recognised asset impairment of T€ 593.

The net book values included in the fixed assets, which are held under finance leases, are plant and machinery as well as fixture and fittings of T€ 2,859 and T€ 50 as of 31 December 2006 and T€ 2,940 and T€ 62 as of 31 December 2005, respectively. The related depreciation amounts to T€ 1,052 and T€ 31 in 2006 and T€ 842 and T€ 28 in 2005, respectively.

(9) Other Intangible Assets and Goodwill

Intangible assets, excluding goodwill, consist of the following:

T€	31 Dec 2006	31 Dec 2005
Developed technologies	30,785	30,167
Customer list	27,917	27,467
Patents and licenses	5,543	5,543
Intangible assets, at cost	64,245	63,177
Less accumulated amortisation	59,784	55,460
Total intangible assets excl. goodwill	4,461	7,717

Amortisation expense of intangible assets amounted to T€ 3,256 and T€ 9,705 in 2006 and 2005, respectively. The customer lists acquired through the acquisition of ENS in 2005 have remaining years of amortisation of approximately 0.6 and 1.2 years.

In September 2005 the Company purchased the remaining 18,000 shares of Evotec (Scotland) Ltd. This acquisition resulted in additional goodwill in the amount of T€ 153. The goodwill for Evotec (Scotland) Ltd amounted to T€ 1,677 as of 31 December 2006 which was fully allocated to the Services Division. The goodwill associated with Evotec (Scotland) Ltd was assessed as part of the annual impairment review under IAS 36 and found not to be impaired.

In December 2006 the Company acquired shares in the amount of Euro 1,290 in Evotec Technologies GmbH for the sum of T€ 695. This acquisition resulted in additional goodwill amounting to T€ 695 in 2006 which is allocated to the Tools and Technologies Division.

In May 2005 the Company purchased the outstanding shares in ENS Holdings, Inc. This acquisition resulted in goodwill in the amount of T€ 18,478 which was fully allocated to the Pharmaceuticals Division. This goodwill was fully impaired due to the risks and uncertainties associated with early drug discovery and development in the acquired business.

Goodwill from the acquisition of Oxford Asymmetry International plc. with a carrying amount of T€ 48,864 at the balance sheet date of the Company has been allocated to the Services Division. The Company has tested its Services Division for impairment on the annual designated test date of 31 October 2006. The pre-tax discount rates considering the risks and rewards of the activities used in the impairment test were in the range of 15.2% to 16.4%. As a result of that test, the Company concluded that an impairment in the amount of T€ 6,560 was due for the goodwill carried as of that date. In 2005 the impairment amounted to T€ 0.

The total amount of foreign exchange differences related to goodwill denominated in a foreign currency amounted to T€ 1,224 and T€ 1,494 in 2006 and 2005, respectively and are recorded directly in equity.

(10) Other Non-Current Assets

Other non-current assets mainly consist of the portion of the purchase price for the sale of Evotec Technologies GmbH including their subsidiary Evotec Technologies Inc., Cincinnati, Ohio, USA, which is transferred to an escrow account in the amount of T€ 1,980. This amount is also reflected in the other non-current liabilities because the sale is effective 1 January 2007.

(11) Discontinued Operations

In 2006 the Company signed a purchase agreement for the sale of Evotec Technologies GmbH, Duesseldorf. This purchase will be effective as of 1 January 2007. The assets and liabilities classified as held for sale are valued at the lower of cost or market. The segment Tools and Technologies is totally allocated to the discontinued operations.
The assets and liabilities as of 31 December 2006 shown in the consolidated balance sheet as classified as held for sale as well as the assets and liabilities as of 31 December 2005 included in the consolidated balance sheet but not in the notes disclosures, are related to the following amounts:

T€	2006	2005
Current assets:		
– Cash and cash equivalents	2,168	1,336
– Trade accounts receivables	3,761	5,096
– Inventories	6,932	5,921
– Prepaid expenses and other current assets	618	564
Total current assets	13,479	12,917
Non-current assets:		
– Property, plant and equipment	2,034	1,718
– Intangible assets, excluding goodwill	3,916	3,211
Total non-current assets	5,950	4,929
Assets classified as held for sale	19,429	17,846
Current liabilities:		
– Current portion of finance lease obligations	294	639
– Trade accounts payable	1,089	1,297
– Advanced payments received	856	292
– Provisions	2,755	2,352
– Deferred revenues	1,141	928
– Current tax payables	418	7
– Other current liabilities	395	516
Total current liabilities	6,948	6,031
Non-current liabilities:		
– Long-term finance obligations	87	–
Total non-current liabilities	87	–
Liabilities classified as held for sale	7,035	6,031

The condensed cash flows of the discontinued operations are as follows:

T€	31 Dec 2006	31 Dec 2005
Net cash provided by operating activities	3,444	4,048
Net cash used in investing activities	(2,353)	(3,713)
Net cash provided by (used in) financing activities	(259)	639
Net increase in cash and cash equivalents	832	975
Cash and cash equivalents at beginning of the year	1,336	361
Cash and cash equivalents at end of the year	2,168	1,336

(12) Long-Term Loans

In February 1998, the Company entered into a T€ 5,113 loan agreement with a bank of which T€ 0 is outstanding at the balance sheet date. This loan carried a fixed interest rate of 5% per annum and was repayable in semi-annual instalments of T€ 320 ending on 30 September 2006.
In July 2002, the Company entered into a T€ 5,000 loan agreement with a bank of which T€ 1,277 is used and outstanding. This loan carries a fixed interest rate of 5.84% per annum, which is fixed until 30 June 2007 and is to be repaid in monthly instalments of T€ 216 (interest and repayment), starting on 31 August 2005. The repayment is included accordingly in the maturity table below. This loan is secured by certain fixed assets. The net book values of those assets amounted to T€ 0 and T€ 425 as per 31 December 2006 and 2005, respectively.
On 4 February 2003 the Evotec (UK) Ltd entered into a loan with another bank of T€ 2,937 secured by a charge on buildings and chattels in the UK of which T€ 1,362 is still outstanding. The loan carries an interest rate of 1.35% over three months Euro LIBOR per annum and is repayable in equal instalments over a period of five years. At 31 December 2006 the total carrying amount of property, plant and equipment which is subject to a charge to secure this bank loan amounted to T€ 3,564 (2005: T€ 2,890). A further loan facility of T€ 5,812 was agreed on the same date. This loan was repaid in full during the year prior to its due date of 28 February 2006. This loan was then re-negotiated and a loan facility of T€ 2,970 was agreed on 29 March 2006. This loan is contracted to Evotec (UK) Ltd but for the purpose of group financing. At the 31 December 2006 T€ 802 had been drawn down against this facility by Evotec (Scotland) Ltd an eligible party to the loan and subsidiary of Evotec AG. The loan is due for repayment in full on 28 February 2009. At the year end 2006 the loan covenants have been met. On 18 May 2005 Evotec entered into an unsecured loan of T€ 569. The loan is repayable in equal instalments over a period of three years and carries an interest rate of 1.2% over three months Euro LIBOR. At 31 December 2006 the total value of the loan still outstanding was T€ 238 (2005: T€ 424).

Further the Company has entered in 2006 into a T€ 5,000 loan agreement with a bank of which T€ 5,000 is outstanding at the balance sheet date. This loan carried a fixed interest rate of 5.4 % per annum and was repayable in semi-annual instalments of T€ 625 starting on 31 December 2007 and ending on 31 December 2011.
Evotec (Scotland) Ltd, a subsidiary of the Evotec AG has loan funding of T€ 1,006 at the balance sheet date 2006 (2005: T€ 1,058). New loan arrangements have been concluded during the year in order to bring the financing of Evotec (Scotland) Ltd into line with the other Evotec group member companies as outlined above. The loans are repayable in instalments through 2009. Current year maturities include a loan in Evotec (Scotland) Ltd of T€ 74 (2005: T€ 341).

The annual maturities of these debts are as follows:

T€	
2007	2,586
2008	2,314
2009	2,108
2010	1,250
2011	624
Thereafter	–
Total	**8,882**

The Company maintains lines of credit totalling T€ 2,296 to finance its short-term capital requirements, of which the entire balance is available as of 31 December 2006. These lines of credit provide for borrowings at various interest rates and have various expiration dates as well as no stated expiration date.

The fair values of the long-term loans as of 31 December 2006 amount to T€ 5,547.

(13) Finance Lease Obligations

The Company is obligated under finance leases of T€ 3,024 and T€ 3,180 as of 31 December 2006 and 2005, respectively that expire at various dates during the next five years. Property, plant and equipment are held under those finance leases. The future minimum lease payments under finance leases are as follows:

T€	
2007	1,315
2008	922
2009	566
2010	343
2011	112
Less interest	(234)
Total principal payable on finance leases	**3,024**

The fair values of the long-term finance lease obligation as of 31 December 2006 and 2005 amount to T€ 1,727 and T€ 2,017, respectively.

(14) Provisions

The provisions consist of the following:

T€	2006	2005
Bonus accruals	2,553	1,508
Contingent considerations	1,002	1,193
Lease incentives	1,571	1,469
Accrued vacation	571	576
Other provisions	1,188	980
Total provisions	**6,885**	**5,726**

The change of provisions is primarily due to a Management's decision to raise the variable component of compensation.

The following table summarises the provisions recorded during 2006:

T€	01 Jan 2006	Consumption	Disposal	Additions	31 Dec 2006
Personnel	2,084	1,544	292	2,876	4,124
Contingent considerations	1,193	430	–	239	1,002
Lease incentives	1,469	113	–	215	1,571
Other provisions	980	503	235	946	1,188
Total	**5,726**	**2,590**	**527**	**4,276**	**6,885**

Other provisions mainly consist of inventor remuneration (T€ 340) as well as a provision for social security (T€ 253). The provision for personal costs may differ from the actual amounts due to the fact that the actual percentage of the variable portion of the remuneration may differ from the estimated ones. The estimated accrual for the contingent consideration may differ from the actual amounts payable due to the fact, that the agreed performance targets are either not met or are exceeded. The consumption of the actual lease incentive may vary from the estimated if the lease period changes.
An amount of T€ 1,653 as per 31 December 2006 (2005: T€ 1,515) is expected to be paid after 1 year and therefore is shown under non-current liabilities. This amount mainly derives from lease incentives. The fair values of those non-current liabilities as of 31 December 2006 amount to T€ 1,045.

(15) Other Current Liabilities

Other current liabilities mainly consist of the purchase price already received for the sale of Evotec Technologies GmbH effective 1 January 2007 in the amount of T€ 22,167. This purchase price may be subject to adjustments due to contractual agreements after the balance sheet date.

(16) Income Taxes

Income taxes comprise the current taxes (paid or owed) on income in the individual countries as well as the deferred taxes for the continuing and discontinued operations. For the calculation of current taxes, tax rates are used which are applicable or announced at the balance sheet date.
Loss before income taxes, minority interests and net loss from equity investments is attributable to the following geographic regions for the years ended 31 December 2006 and 2005:

T€	2006	2005
Germany	(30,027)	(27,718)
Foreign	(1,624)	(7,619)
Total	**(31,651)**	**(35,337)**

Income tax benefit (expense) for the years ended 31 December 2006 and 2005 is as follows:

T€	2006	2005
Current taxes:		
– Germany	(804)	(209)
– Foreign	(14)	(26)
Total current taxes	**(818)**	**(235)**
Deferred taxes:		
– Germany	–	2,877
– Foreign	1	1,871
Total deferred taxes	**1**	**4,748**
Total income tax benefit (expense)	**(817)**	**4,513**

The tax rate in the UK for the years ended 31 December 2006 and 2005 amounted to 30 %. For the years ended 31 December 2006 and 2005, the actual combined German federal corporation income and trade tax rate amounted to 40.38 % (2005: 40.38 %). The income tax benefit differed from the expected income tax benefit determined using the combined tax rate of 40.38 % (2005: 40.38 %) as follows:

T€	2006	2005
Expected income tax benefit	12,781	13,082
Non-deductible goodwill impairment and amortisation	(2,649)	(7,523)
Other permanent differences	1,824	1,813
Foreign tax differential	503	(378)
Effect of tax rate change	–	–
Change in valuation allowance	(14,506)	(2,516)
Other	1,230	35
Actual income tax benefit (expense)	**(817)**	**4,513**

Deferred income tax assets and liabilities as of 31 December 2006 and 2005 relate to the following:

T€	2006	2005
Deferred tax assets:		
– Loss carry forward	65,222	56,990
– Intangible assets	1,022	1,316
– Other	2,456	385
Total	**68,700**	**58,691**
Valuation allowances on deferred tax assets	(61,656)	(47,099)
Total deferred tax assets	**7,044**	**11,592**
Deferred tax liabilities:		
– Property, plant and equipment	4,740	6,471
– Intangible assets	1,838	2,630
– Loans	–	2,302
– Undistributed subsidiaries earnings	79	94
– Other	387	95
Total deferred tax liabilities	**7,044**	**11,592**
Deferred tax liabilities, net	**–**	**–**

No net deferred income tax assets and liabilities are recognised in the balance sheets as of 31 December 2006 and 2005.
For the years ended 31 December 2006 and 2005, Evotec recorded additional valuation allowances with respect to tax benefits of tax losses carried forward of T€ 8,049 and T€ 9,126, respectively. The valuation allowances on the Company's deferred tax assets are not recorded to the extent it is probable that such tax benefits would be realised in future years. These considerations include, but are not limited to, the ability under respective tax laws to carry forward incurred tax losses indefinitely and thereby offset taxable income in future years, tax planning strategies and estimates of future taxable income. Evotec has not generated taxable income in Germany since the start of operations and does not expect to in the foreseeable future. The rationale behind the valuation allowances is based on the potentially unlikely prospect of generating taxable income and, to a significant extent, the questionable nature, availability and benefit of the tax losses carried forward generated prior to material equity transactions in the past. Tax losses carried forward for Germany of T€ 143,555 and the UK

of T€ 24,180 do not expire. Due to changes in the German tax law in 2003, the tax losses carried forward can only be offset against an amount of 60 % of future taxable income after exceeding a fully deductible amount of T€ 1,000 per year.
Deferred taxes are accounted for as tax expenses or income in the statements of operations unless they relate to items included in equity in which case they are accounted for as part of equity.

(17) Stock-Based Compensation

The shareholders' meeting on 7 June 1999 established a stock option plan ('Option Plan 1999') and authorised the granting of stock options for up to 1,466,600 shares. The plan is subject to certain restrictions regarding the number of stock awards that may be granted in a year and the allocation of the grants to members of the Management Board, other key management personnel and all other employees. The annual shareholders' meeting in 2000 and 2001 provided for the authorisation of additional 949,000 and 1,129,600 stock options, respectively.
Under the terms of the plan, each option entitles the holder to purchase one share of the Company's stock within ten years of the grant date at a set strike price. For all options granted in 1999, the strike price was the price of the initial public offering of € 13.00 (€ 6.50 after stock split). Options granted in 2000 and 2001 can be exercised at a strike price equal to the closing price of the shares or at a strike price equal to the closing price of the shares plus 5 % on the trading day before the option was granted. Options have a graded vesting: a maximum of one-third of which can be exercised at the earliest after two years, a maximum of further two-thirds after three years and all remaining awarded options after four years. Options can only be exercised within certain specified two weeks period starting on the third day after one of the following events: (i) release of the quarterly results, (ii) annual press conference on the financial statements, or (iii) annual shareholders' meeting of the Company. The options can only be exercised if the stock price exceeds the strike price by at least 5 %.
The terms of the stock option plan further provide: a grant of options is allowed if the average closing price of the Company's stock has increased by at least 30 % when comparing the last quarter of the last business year before the grant with the last quarter of the preceding year. The Supervisory Board, however, has the authority to override this restriction and to authorise the granting of options to employees if such a decision is considered necessary for the interests of the Company.
The shareholders' meeting on 7 June 2005 established a new stock option plan ('Option Plan 2005') and authorised the granting of stock options for up to 1,741,481 shares. The plan is subject to certain restrictions regarding the number of stock awards that may be granted in a year and the allocation of the grants to members of the Management Board, other key management personnel and all other employees. Within one calendar year, no more than 40 % of these options shall be granted.
Each option entitles the holder to purchase one share of the Company's stock at a strike price equal to the price of one share at the time of the grant of the option. Options can be exercised after a vesting period of three years after the date of their grant but no later than six years after the respective grant. The Option Plan 2005 stipulates an exercise hurdle of a 33 % price increase against the share price at the time of granting. The option holder may exercise his options only if this hurdle is achieved on the day three years after the respective date of granting. In case the hurdle is not achieved, the same increase after four or five years, respectively, would make the options exercisable.
Options under the Option Plan 2005 can only be exercised within the specific two weeks period relevant also to the other option programmes.
Through the acquisition of ENS Holdings, Inc. in 2005 the Company acquired a stock option plan under which shares in the amount of 323,749 were granted on the date of consolidation 26 May 2005. Under the terms of the plan, each share which has to be treated as an option entitles the holder to receive one share of the Evotec AG's stock until April or November 2014 at a set strike price of zero. The corresponding new shares are being held in escrow and are released by an individually set amount every quarter as well as on achievement of individual milestones.

A summary of the status of the plans as of 31 December 2006 and 2005, and the changes during the years then ended is presented as follows:

pcs. and € per share	2006 Options	2006 Weighted average exercise price	2005 Options	2005 Weighted average exercise price
Outstanding at beginning of the year	3,412,984	6.21	2,579,558	8.34
Options granted	818,196	3.30	1,213,149	2.07
Options exercised	(169,170)	1.21	(52,409)	0.66
Options forfeited	(33,114)	17.66	(129,082)	8.65
Options waived (re-issueable)	(78,349)	7.32	(198,232)	8.43
Outstanding at end of the year	**3,950,547**	5.71	**3,412,984**	6.21
Thereof exercisable	1,721,547	9.33	1,500,141	10.59

A summary of the stock options outstanding as of 31 December 2006 is as follows:

Range of exercise prices	Outstanding in pcs.	Exercisable in pcs.	Weighted average remaining contractual life in years	Weighted average exercise price € per share
Exercise price 0.00 € per share	207,873	–	7.44	0.00
Exercise price 1.66 – 3.66 € per share	2,373,639	482,849	6.36	2.86
Exercise price 5.97 – 6.80 € per share	951,464	821,127	5.18	6.53
Exercise price 10.15 – 12.48 € per share	48,300	48,300	4.93	12.48
Exercise price 15.29 € per share	4,500	4,500	4.23	15.29
Exercise price 24.30 € per share	364,771	364,771	3.90	24.30

Evotec's stock option plans result in unearned compensation, a component of stockholders' equity of T€ 1,312 and T€ 1,622 as of 31 December 2006 and 2005, respectively. The Company recognised compensation expense in 2006 and 2005 for all options totalling T€ 1,127 and T€ 749, respectively, which was reflected as operating costs and expenses in the consolidated statements of operations.
The fair value of each option grant was estimated on the date of grant for the fiscal years ended 31 December 2006 and 2005 using a Binomial model with the following assumptions:

	25.11.2002	03.01.2003	27.01.2003	19.11.2003	06.01.2004	18.11.2004
Risk-free interest rate in %	4.14	3.59	3.59	4.03	3.81	3.30
Volatility in %	103.0	103.9	104.3	69.0	67.1	55.6
Fluctuation in %	15.0	10.0	10.0	10.0–15.0	10.0	10.0
Price range in Euro	2.20–2.31	1.93–2.03	1.66	5.99–6.29	5.97	2.52–2.65
Fair value per option	1.68–1.70	1.40–1.49	1.14–1.21	3.35–3.66	2.89–3.35	1.12–1.32

	04.03.2005	07.03.2005	11.07.2005	30.08.2005	16.12.2005
Risk-free interest rate in %	3.32	3.32	2.85	2.79	3.14
Volatility in %	58.4	58.4	56.4	49.1	34.8
Fluctuation in %	10.0	10.0	10.0	10.0	10.0
Price range in Euro	0.00	3.61	2.82	2.71–2.80	2.59–2.73
Fair value per option	2.87–2.90	1.59–1.82	1.30–1.48	1.09–1.23	0.84–0.98

	07.06.2006	06.11.2006
Risk-free interest rate in %	3.95	3.68
Volatility in %	45.1	50.5
Fluctuation in %	10.0	10.0
Price range in Euro	3.19	3.49–3.66
Fair value per option	1.22	1.47–1.73

The expected dividend yield is zero, the expected remaining life 6 years and the expected exercise price in percent of the option price is 200 % in all models.
Due to the transition to IFRS in 2005 and the related first time adoption of IFRS 2 only stock options which were granted after 7 November 2002 and are not vested on 31 December 2005 are included in the fair value calculation.

(18) Stockholders' Equity

On 31 December 2006, there are 68,078,819 shares issued and outstanding with a nominal amount of Euro 1 per share including converted ENS options held in escrow. Furthermore authorised but unissued shares consist of a conditional capital *(bedingtes Kapital)* of 5,122,996 shares available with respect to the stock option plan and an approved capital *(genehmigtes Kapital)*, of 33,986,558 shares. A capital increase out of the conditional capital in the amount of 105,703 shares in connection with the share options has not yet been registered in the trade register. At the balance sheet date the Company holds 19,751 treasury shares for the remuneration of the Supervisory Board.
The annual shareholders' meeting on 18 June 2001 had authorised the Management Board of the Company to issue up to 17,700,000 shares for cash or contributions in kind.
Effective 26 May 2005, the Company increased its stockholders' equity by issuing 14,276,883 new shares against contributions in kind out of the approved capital *(genehmigtes Kapital)*.
The annual shareholders' meeting on 7 June 2005 decided to increase the Company's stockholders' equity by issuing 10,457,402 new shares against cash. This increase was effective 24 June 2005. The price per share amounted to € 2.72.
This annual shareholders' meeting on 7 June 2005 also authorised the Management Board of the Company to issue up to 26,143,506 shares for cash or contributions in kind. In addition conditional capital had been authorised in the amount of 1,741,481 shares.
Effective 27 April 2006, the Company increased its stockholders' equity by issuing 5,228,701 new shares against cash out of the approved capital *(genehmigtes Kapital)*. The price per share amounted to € 3.55. Relating transaction costs in the amount of T€ 727 were recognised.
The annual shareholders' meeting on 8 June 2006 authorised the Management Board of the Company to issue up to 33,986,558 shares for cash or contributions in kind. Under German law, the shareholders of a stock corporation may empower the Management Board to issue shares in a specified aggregate nominal value not exceeding 50 % of the issued share capital at the time of the shareholder vote, in the form of approved capital *(genehmigtes Kapital)*. The authorisation expires on 7 June 2011.

(19) Segment Information

Segmentation is performed on the basis of risks and opportunities; recognition is based on the internal organisation and management structure as well as on internal management reporting. Therefore the Company's primary segments including the discontinued operations include three reportable operating segments which are: (i) Pharmaceuticals Division, (ii) Services Division and (iii) Tools and Technologies which is fully allocated to the discontinued operations.

(i) The Pharmaceuticals Division is specialised in finding new treatments for diseases of the Central Nervous System (CNS). It is engaged in selected research and development activities to develop compounds for out-licensing. The strategic objective of this division is to generate or augment proprietary intellectual property that can provide the Company with additional long-term upside through more significant milestones and royalties.

(ii) The Services Division provides integrated contract research support in drug discovery and development to a large group of global customers. It provides innovative and integrated solutions including early stage assay development and screening through to medicinal chemistry and drug manufacturing.

(iii) The Tools and Technologies segment allocated to the discontinued operations is a provider of confocal detection devices, cell handling devices and ultra-High-Throughput Screening (uHTS) systems. The product portfolio is focused on high-end technologies for automated cell biology. Tools and Technologies provides sophisticated automation skills, integrating hardware, software and bioware modules.

Net sales and operating expenses in the segments include both sales to customers and inter-segment transfers, which are priced to recover cost plus an appropriate profit margin according to the at arms length principle.
Revenues in the consolidated statements of operations are differentiated by products and by services. This definition is close to the definition used in the segment reporting. Differences between the revenue splits are mainly due to product deliveries from our service unit, which are reported in the Services segment.
The accounting policies of the segments are equivalent to those described in the summary of significant accounting policies (see note 2).

The following represents segment data of the Company's primary segments for the year ended 31 December 2006:

T€	Pharmaceuticals Division	Services Division	Discontinued operations (Tools and Technologies)	Not allocated	Total 2006
Revenues:					
– Drug discovery products and technologies	–	12	18,449	(1,122)	17,339
– Drug discovery services	3,198	64,309	–	(165)	67,342
Total revenues	**3,198**	**64,321**	**18,449**	**(1,287)**	84,681
Costs of revenue:					
– Drug discovery products and technologies	–	5	10,130	(463)	9,672
– Drug discovery services	443	44,005	–	(50)	44,398
Total costs of revenue	**443**	**44,010**	**10,130**	**(513)**	54,070
Gross profit	**2,755**	**20,311**	**8,319**	**(774)**	**30,611**
Research and development expenses	28,102	2,666	3,267	(592)	33,443
Selling, general and administrative expenses	4,033	13,491	6,736	(294)	23,966
Amortisation of intangible assets	3,189	67	1,539	(728)	4,067
Impairment of goodwill	–	6,560	–	–	6,560
Impairment of tangible assets	–	(593)	–	–	(593)
Restructuring expenses	–	–	606	–	606
Other operating expenses	–	1,607	–	–	1,607
Operating loss	**32,569**	**3,487**	**3,829**	**(840)**	39,045
Interest income	–	–	25	1,367	1,392
Interest expense	–	–	1,111	(405)	706
Othe income from financial assets	–	–	–	5	5
Foreign currency exchange gain (loss), net	–	–	67	(243)	(176)
Other non-operating expense	–	–	548	–	548
Other non-operating income	328	274	6,901	(76)	7,427
Net loss (income) before taxes and minorities	**32,241**	**3,213**	**(1,505)**	**(2,298)**	**31,651**
Total assets	9,206	95,835	23,099	77,386	205,526
Total liabilities	7,637	16,753	24,963	18,997	68,350
Capital expenditures	659	3,116	2,390	(1,699)	4,466

The following represents segment data of the Company's primary segments for the year ended 31 December 2005:

T€	Pharmaceuticals Division	Services Division	Discontinued operations (Tools and Technologies)	Not allocated	Total 2005
Revenues:					
– Drug discovery products and technologies	–	275	17,003	(1,333)	15,945
– Drug discovery services	3,231	60,686	–	(77)	63,840
Total revenues	**3,231**	**60,961**	**17,003**	**(1,410)**	79,785
Costs of revenue:					
– Drug discovery products and technologies	–	145	8,440	(598)	7,987
– Drug discovery services	1,032	41,850	–	(49)	42,833
Total costs of revenue	**1,032**	**41,995**	**8,440**	**(647)**	50,820
Gross profit	**2,199**	**18,966**	**8,563**	**(763)**	**28,965**
Research and development expenses	5,957	3,864	5,175	(908)	14,088
Selling, general and administrative expenses	3,974	11,433	4,833	(338)	19,902
Amortisation of intangible assets	1,876	7,375	1,276	(794)	9,733
Impairment of goodwill	18,478	–	–	–	18,478
Impairment of tangible assets	–	(643)	–	–	(643)
Restructuring expenses	–	–	917	–	917
Other operating expenses	–	2,163	–	–	2,163
Operating loss	**28,086**	**5,226**	**3,638**	**(1,277)**	35,673
Interest income	–	–	4	852	856
Interest expense	–	–	1,111	(382)	729
Net loss from equity investment	2,228	–	–	324	2,552
Foreign currency exchange gain (loss), net	–	–	(6)	(725)	(731)
Other non-operating income	479	485	506	(530)	940
Net loss before taxes and minorities	**29,835**	**4,741**	**4,245**	**(932)**	37,889
Total assets	6,798	105,575	21,553	52,185	186,111
Total liabilities	4,854	12,876	26,548	(6,836)	37,442
Capital expenditures	30,515	4,447	3,764	(57)	38,669

Not allocated to the Pharmaceuticals and Services Division are mainly loans, cash and other assets and liabilities in connection with the sale of Evotec Technologies. Depreciation included in the operating loss of Pharmaceuticals Division, Services Division and Tools and Technologies, amounts to T€ 786, T€ 5,884 and T€ 466, respectively (2005: T€ 328, T€ 6,383 and T€ 561, respectively).

The Company's secondary segment split is based on geographical aspects. Revenues can be split, based on customers' locations, in the following geographical regions:

T€	2006	2005
Germany	11,727	8,939
United Kingdom	8,436	11,993
Rest of Europe	21,685	19,379
United States	34,437	29,529
Rest of the world	8,396	9,945
Total	**84,681**	**79,785**

Total assets of T€ 111,793 and T€ 113,299 are located in foreign countries and the remaining amounts of T€ 93,733 and T€ 72,812 are in Germany as of 31 December 2006 and 2005, respectively. Capital expenditures in the amount of T€ 2,581 and T€ 3,686 have been made in foreign countries and the remaining amounts of T€ 4,275 and T€ 34,983 are in Germany as of 31 December 2006 and 2005, respectively.

(20) Financial Instruments

The fair value of cash and cash equivalents, trade accounts receivable and trade accounts payable approximate their carrying values in the consolidated financial statements due to the short-term nature. Financial assets are accounted for at the settlement date. The credit risk in connection with failures by counterparties to discharge their obligations, are assessed by the Company to be immaterial. The fair value of debt is determined using an appropriate discount rate. The fair values of long-term loans closely approximate their carrying values on 31 December 2006 and 2005. The Company is exposed to interest rate risk through variable interest-bearing loans and finance lease liabilities. These interest rate risks are deemed to be not significant.

The Company periodically enters into derivatives including foreign currency forward contracts and options. The objective

of these transactions is to reduce the risk of exchange rate fluctuations of its foreign currency denominated cash flows. Evotec does not enter into derivatives for trading or speculative purposes. As of 31 December 2006, the Company held USD forward contracts with Euro equivalent notional amounts of T€ 0 and a fair value of T€ 0 (2005: T€ 1,267 and T€ 1,267, respectively). Additionally, the Company held USD option contracts with Euro equivalent notional amounts of approximately T€ 1,659 and T€ 7,177 as of 31 December 2006 and 2005, respectively. The fair value of the option contracts is T€ 1,705 at 31 December 2006 (2005: T€ 7,010). Foreign currency contracts are carried at fair value which is determined using quoted market prices or discounted cash flows. The maturity for all foreign currency contracts held by the Company is short term. The carrying amount of the foreign currency contracts is included in current liabilities as per 31 December 2006 and prepaid expense and other current assets as per 31 December 2005. Gains and losses from the fair value accounting related to foreign currency derivatives are included in other non-operating income and expense and amounted to T€ 45 and T€ (290) for the years ended 31 December 2006 and 2005, respectively.

(21) Risks

The Company has credit risks primarily with respect to trade accounts receivables. Concentrations of credit risks with respect to trade accounts receivables are limited by a number of geographically diverse customers and the Company's monitoring procedures.

We expect that our current cash funds, together with operating revenues will be sufficient to finance our operations for at least two to three years, depending on the various scenarios of the Company's investments and strategic development. Our future cash requirements will depend on various factors, including our success in developing Evotec's pipeline projects, increasing sales of both existing and new services, expenses associated with sales growth as well as competition and the general economic situation. Expenditures on internal development programmes or related acquisitions of technologies or intellectual property rights are likely to reduce our short- to mid-term profitability and cash reserves. We intend to reduce part of this financial exposure through early partnering agreements, to the degree possible and advisable when trying to maximise returns. In addition, the option to improve the financing situation through capital increases either against cash or acquired assets, e.g. as part of an in-licensing agreement, is always being considered. The Company does not intend to engage in projects or project phases unless appropriate funding is allocated or secured.

The Company conducts clinical trials which have a risk of failure. This might have a negative impact on the Company's financial position, results of operations and cash flows.

The Company has important collaborations with pharmaceutical and biotechnology companies within all operating segments. Any termination of such collaborations or failure to achieve contracted milestones would probably have adverse impacts on the Company's financial position, results of operations and cash flows.

The Company has further expanded its customer's base. However the three largest customers of Evotec combined represent more than 20 % of the group revenues in 2006. A termination of these business relations could have adverse impacts on the Company's financial results.

With a high proportion of sales denominated in U.S. Dollar currency exposure creates a risk to our profitability, in particular relative to the UK Sterling with the respect to the UK subsidiaries. A weakening of the USD when accompanied by a relative strengthening of the GBP against the Euro will reduce revenues and profitability and constitutes a significant risk to the Company's financial situation. The hedging activities of the Company aim to mitigate the impact on the result before tax.

(22) Pension Plan

The Company operates a defined contribution Group Personal Pension Plan (GPPP) and makes contributions to employees' own schemes. The pension charge for the year represents contributions payable by the Company to the fund (and to employees' own pension schemes) and amounted to T€ 932 (2005: T€ 831). Contributions amounting to T€ 144 (2005: T€ 100) were payable to the fund at the year end and are included in provisions. The Company's contribution rate is determined by the employees contribution and their age. There were no changes in the basis for such contributions during the year. The statutory retirement insurances are defined as contribution plan under IAS 19.

The Company operates a pension plan for one former member of the Management Board of Evotec BioSystems AG. The provision for this pension is calculated using the projected unit credit method in accordance with IAS 19. An actuarial report was prepared in 2006 for this purpose. The calculations are based on assumed pension increases of 1.75 % and a usual discount rate. The discount rate reflects market conditions. Actuarial gains and losses are recorded using the 10 % corridor method. Due to the reason that the holder of this pension is no longer working for the Company results in unrecognised actuarial losses of T€ 0.

The actuarial report was prepared in 2006 the first time under IFRS. The resulting difference to the beginning balance is recorded in the reserve in equity (T€ 30).

Total expenses for the period for the defined benefit plan amounted to T€ 11 and consist of the following:

T€	2006
Current service cost	–
Interest cost	4
Amortisation of actuarial losses	7
Total	**11**

(23) Commitments and Contingencies

(a) Operating Lease Obligations

The Company leases office and laboratory space and other equipment under operating leases in accordance with IAS 17. The future minimum lease payments under non-cancellable operating leases are approximately as follows:

T€	
2007	4,903
2008	4,434
2009	4,524
2010	4,470
2011	4,469
Thereafter	41,788
Total	**64,588**

The majority of operating leases is related to rent expenses for facilities. The rent expense for such leases amounted to T€ 4,320 and T€ 3,931 for the years ended 31 December 2006 and 2005, respectively.

(b) Other Commitments and Contingencies

The Company has entered into consultancy contracts. During 2006 and 2005, payments under consultancy contracts totalled T€ 225 and T€ 280, respectively. The future minimum payments associated with long-term consultant and other miscellaneous long-term commitments totals approximately T€ 373 and T€ 444 at 31 December 2006 and 2005, respectively.

As discussed in note 3, the Company has certain commitments resulting from the amendments to our agreements with our technology funding partners.

The Company has given a guarantee with regard to all terms and conditions of a specific customer contract. No current liabilities from that guarantee exist at 31 December 2006.

The Company has, in the sale and purchase agreement regarding all shares in Evotec Technologies GmbH, provided certain guarantees customary for such agreements.

The Company is not aware of any significant litigation as of 31 December 2006.

(24) Related Party Transactions

The following Supervisory Board members and Executive Committee members of the Company are also supervisory board members or management board members in companies Evotec works with in the ordinary course of business:

Prof Dr Heinz Riesenhuber is a member of the supervisory board of Altana Pharma AG, with whom the Company entered into service agreements as well as agreements with regard to instrument sales in the ordinary course of business. Revenue from those agreements in 2006 and 2005 amounted to T€ 233 and T€ 346, respectively. Related product warranties amounted to T€ 0 and T€ 0 in 2006 and 2005, respectively. Accounts receivable from Altana as of 31 December 2006 and 2005 amounted to T€ 107 and T€ 67, respectively.

Peer Schatz is Chief Executive Officer of Qiagen N.V. From affiliates controlled by Qiagen N.V. the Company bought products in the amount of T€ 16 and T€ 47 in 2006 and 2005, respectively. The amount of payables to Qiagen on 31 December 2006 and 2005, including VAT amounts to T€ 4 and T€ 6, respectively.

Dr Peter Fellner is Non-Executive Chairman of the Board of Directors of Astex Therapeutics Ltd, Cambridge, UK, with whom the Company entered into a service agreement in the ordinary course of business. Related revenues amounted to T€ 1,175 and T€ 23 in 2006 and 2005 (starting with Dr Fellner's membership in the Company's Supervisory Board), respectively. The amount of accounts receivables as of 31 December 2006 and 2005 amounted to T€ 291 and T€ 27, respectively. Dr Peter Fellner is also Non-Executive Member of the Board of Directors of UCB SA, with whom the company entered into a service agreement in the ordinary course of business. Related revenues amounted to T€ 533 and T€ 0 in 2006 and 2005, respectively.

Dr William J. Jenkins is Non-Executive Member of the Board of Directors of BTG plc., London, with whom the Company entered into a service agreement in the ordinary course of business. Related revenues amounted to T€ 199 (starting with Dr Jenkins' membership of the board). The amount of accounts receivables as of 31 December 2006 amounted to T€ 57.

Dr Karsten Henco is a chairman of the supervisory board of Garching Innovation GmbH from which the Company has obtained licences in 2001. Licence expense amounted to T€ 74 in 2005 (until his departure from the Supervisory Board). He was in 2005 also a member of the supervisory board of U3 Pharma AG with whom the Company entered into a service agreement in the ordinary course of business. The Company entered into a consultancy contract, in the ordinary course of business and with the approval of the Supervisory Board, with Dr Karsten Henco. The associated expenses in 2005 until his departure from the Supervisory Board amounted to T€ 28 and the related payables to Dr Henco as of 31 December 2005 amounted to T€ 39.

Dr Edwin Moses is a Non-Executive Chairman of the board of BioImage A/S with whom the Company entered into service agreements in the ordinary course of business. Revenues amounted to T€ 162 in 2005 until his departure from the Supervisory Board, and the related accounts receivable as of 31 December 2005 amounted to T€ 0. Dr Moses is also Non-executive Chairman of the board of Paradigm Therapeutics Ltd. with whom the Company entered into a service agreement. The related revenues amounted to T€ 0 in 2005. There were no related accounts receivables as of 31 December 2005. The Company entered into a consultancy contract (effective date April 2005), in the ordinary course of business and with the approval of the Supervisory Board, with Dr Moses in order to exploit his significant expertise in the business of the Company. There were no associated expenses during his membership in the Supervisory Board.

Dr Mario Polywka, who currently is a key member of the Executive Committee of the Company is non-executive chairman of the board of Glycoform Limited who uses laboratory equipment at the site in Abingdon, UK. Revenues amounted to T€ 9 and T€ 13 in 2006 and 2005, respectively and the related accounts receivable as of 31 December 2006 and 2005 amounted to T€ 0 and T€ 2, respectively. He is also non-executive director of the board of Pharminox Limited with whom the Company entered into a service agreement in the ordinary course of business. Revenues

amounted to T€ 0 and T€ 51 in 2006 and 2005, respectively. There were no related accounts receivable as of 31 December 2006 and 2005.
Jesper Wiklund, who currently is a member of the Executive Committee of the Company received loans in 2005 to cover personal tax obligations relating to stock options granted. As of 31 December 2006 and 2005, respectively these loans including accrued interest amounted to T€ 0 and T€ 22.
Dr John Kemp, who currently is a key member of the Executive Committee of the Company had a loan granted in 2003 which has an outstanding balance as of 31 December 2006 of T€ 96 (T€ 91 in 2005). Further he received a loan to cover personal tax obligations relating to stock options granted. As of 31 December 2006 this loan including accrued interest amounts to T€ 68, the loan will be due in the first quarter of 2007.
A member of the management of a subsidiary has been granted a loan in 2006 to cover personal tax obligations relating to stock options granted which including interest amounts to T€ 28 as of 31 December 2006.
Dr Phil Boyd, an officer of the Company was a member of the board of Vmax Ltd. until its winding up in 2006 with whom the Company entered into a loan stock and investment agreement. See note 7.
The Evotec AG has recorded revenues with related parties in the amount of T€ 4 and T€ 279 in 2006 and 2005, respectively. Subsidiaries of Evotec AG recorded revenues in the amount of T€ 2,152 and T€ 316 in 2006 and 2005, respectively.
Hubert Birner, Peter Fellner and Mary Tanner consulted the Company outside the scope of their Supervisory Board activities with the approval of the full Supervisory Board. The total relating expenses amounted to T€ 0 and T€ 18 in 2006 and 2005, respectively. The consultancy was ended during 2006.
Administrative services provided by the Company to Management Board or Supervisory Board members for their private purposes, if any are reimbursed to the Company at cost.

(25) Other Disclosures
The following additional disclosures are required by German law in accordance with the European Directives on Accounting and the Corporate Governance Codex. Those disclosures include the continuing and the discontinued operations.

(a) Number of Employees
The average number of persons employed by the Company in 2006 was 599 (2005: 613).

(b) Personnel Expenses and Cost of Material
The personnel expenses of the Company amounted to T€ 39,544 of which T€ 23,391 relate to personnel expenses in the UK (2005: T€ 39,538 and T€ 23,584, respectively). Thereof expenses for the statutory retirement insurance amounted to T€ 2,913 of which T€ 2,073 relate to expenses in the UK (2005: T€ 3,154 and T€ 2,244, respectively).
Cost of materials amounted to T€ 36,897, thereof T€ 8,702 are cost of materials in the UK (2005: T€ 39,544 and T€ 7,895, respectively).

(c) Remuneration of the Auditor
In 2006, remunerations, shown as expenses, to KPMG Deutsche Treuhand-Gesellschaft Aktiengesellschaft and other KPMG companies totalled T€ 419 (2005: T€ 487) broken down into year end auditing (T€ 250; 2005: T€ 233), tax consultancy (T€ 88; 2005: T€ 81), other auditing and valuation services (T€ 16; 2005: T€ 32) as well as other services (T€ 65; 2005: T€ 141).

(d) Corporate Governance Codex
A declaration according to § 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.

(e) Consolidated Subsidiaries and Equity Investees
Information below is as per the statutory financial statements as of 31 December 2006 prepared in accordance with the respective local generally accepted accounting principles.

	Company's voting interest in%	2006 Net income/(loss) in T€	2006 Equity in T€
Subsidiaries (verbundene Unternehmen)			
– Evotec (UK) Ltd, Abingdon, UK	100.0	2,835	50,533
– ENS Holdings, Inc., Wilmington/Delaware, USA (unaudited)	100.0	(236)	27,297
– Evotec Technologies GmbH, Duesseldorf	88.6	6,930	(4,546)
– EVOTEC NeuroSciences GmbH, Hamburg (unaudited)	100.0	(27,847)	(12,607)
– Evotec Neurosciences AG, Zurich, CH (unaudited)	100.0	48	173
– Evotec (Scotland) Ltd, Glasgow, UK	100.0	1,913	4,179
– Evotec Technologies Inc., Cincinnati/Ohio, USA (unaudited)	88.6	47	98
– Evotec Inc., Wilmington/Delaware, USA (unaudited)	100.0	21	152
– Oxford Diversity Ltd, Abingdon, UK (unaudited)	100.0	–	3
– Oxford Asymmetry Employee Shares Trust Ltd, Abingdon, UK (unaudited)	100.0	–	4
– ProPharma Ltd, Glasgow, UK, (shell company)	100.0	–	–
Investment in associated Companies			
– DIREVO Biotech AG, Cologne (unaudited)	22.7	(5,016)	2,193
Other Investments			
– KeyNeurotek AG, Magdeburg (2005 figures)	0.1	(6,400)	(2,677)
– Prolysis Ltd., Oxford, UK	2.1	(3,452)	(960)

(f) Management Board

Jörn Aldag, Business Executive, Hamburg (President and CEO) and Dr Dirk H Ehlers, Physicist, Wohltorf, (Chief Financial Officer).

The remuneration paid to the members of the Management Board in the financial year totalled T€ 917 (2005: T€ 744, including T€ 116 paid to Prof Ian Hunneyball, who was member until 30 June 2005) of which T€ 243 (2005: T€ 0) was variable remuneration. 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 2006, payable on the achievement of certain strategic targets for the business year 2005, was based on the following criteria: 40% based on the achievement of defined corporate milestones, 40% on the achievement of budget financial targets and 20% on the achievement of personal objectives. The scheme for the variable portion of the remuneration in 2007 relating to the business year 2006 is based on the following criteria: 30% based on the achievement of defined corporate milestones, 30% on the achievement of share price targets, 30% on the achievement of budget financial targets and 10% on the achievement of personal objectives. Under the Company's stock option plans, the members of the Management Board received in 2006 150,000 (2005: 150,000) options. The options granted in 2006 and 2005 are subject to the stipulation of the Option Plan 2005 and may be exercised after three years if the conditions of this plan are met. The fair values of the options are described in Note (17) and are recognised over their respective vesting periods.
The individual contracts of the Management Board contain a change-of-control clause, which would allow Management to terminate their current contracts in the event of a change of control. A change-of-control exists when a major portion of the shares of the company is held by a new investor. The resulting severance entitlement is one year base salary and bonus calculated on the basis of the prior year's remuneration. The Company has a Directors and Officers (D&O) insurance policy in place for the Management Board, the Supervisory Board, the Executive Committee and the managers of subsidiary companies. The insurance expense amounted to T€ 84 in total in 2006, and was paid by the Company.

Jörn Aldag is a member of the Monopolkommission der Bundesrepublik Deutschland.

(g) Supervisory Board

Prof Dr Heinz Riesenhuber, former Federal Minister of Research and Technology, Frankfurt am Main (Chairman);
Peer Schatz, Chief Executive Officer Qiagen N.V., Duesseldorf (Vice Chairman);
Dr Hubert Birner, General Partner Techno Venture Management GmbH, Landsham-Pliening;
Dr Peter Fellner, Executive Chairman Vernalis plc., Oxfordshire, UK;
Dr William J Jenkins, Pharmaceuticals Consultant (from 8 June 2006), Basel, CH;
Mary Tanner, Financial Advisor, New York, USA and
Dr Alfred Oberholz, Member of the management board Degussa AG, Duesseldorf (until 8 June 2006).

The remuneration accrued for the members of the Supervisory Board in the financial year 2006 amounted to:

T€	Cash remuneration	Value of share based remuneration	Total
Prof Dr Riesenhuber	37.5	15.0	52.5
Peer Schatz	30.0	11.3	41.3
Dr Hubert Birner	22.5	7.5	30.0
Dr Peter Fellner	18.8	7.5	26.3
Dr William J Jenkins	8.4	4.2	12.6
Mary Tanner	18.8	7.5	26.3
Dr Alfred Oberholz	6.5	3.3	9.8
Total	**142.5**	**56.3**	**198.8**

The remuneration for the chairman of the Supervisory Board is twice, for the vice chairman is one and a half the amount of the remuneration for the Supervisory Board members. The additional remuneration for a member of a supervisory board Committee amounts to T€ 3.8, for the chairman of those committee's to T€ 7.5. The total remuneration paid to Supervisory Board members in 2005 totalled T€ 192,0. The Company has a Directors and Officers (D&O) insurance policy in place for the Management Board, the Supervisory Board, the Executive Committee and the managers of subsidiary companies. The insurance expense amounted to T€ 84 in total in 2006, and was paid by the Company.

	2006 Fixed renumeration T€	2006 Variable renumeration T€	2006 Stock options in pcs.	2006 Fair value Stock options T€
Jörn Aldag	364	145	90,000	110
Dr Dirk Ehlers	310	98	60,000	73
Total	**674**	**243**	**150,000**	**183**

The Supervisory Board and their additional memberships in supervisory boards and memberships in comparable governing bodies of enterprises according to § 125 (1) third sentence of the AktG are listed at the end of this report.

(h) Scientific Advisory Committee
Dr Karsten Henco, Duesseldorf, DE;
Prof Dr Christoph Hock, Zurich, CH;
Dr William J Jenkins, MD, Basel, CH;
Prof Dr Hanns Möhler, Zurich, CH;
Prof Dr Roger Nitsch, Zurich, CH;
Ian Ragan, Ph.D., London, UK.

The remuneration for the Scientific Advisory Board in 2006 amounts to T€ 35 (2005: T€ 37).

(i) Summary of Significant Differences between IFRS and HGB Accounting Requirements

Introduction
Evotec AG, as a German company, is subject to the German Commercial Code ('Handelsgesetzbuch', 'HGB'), which principally requires the Company to prepare consolidated financial statements in accordance with the HGB accounting principles and regulations ('German GAAP'). Pursuant to HGB Section 315a, the Company prepares consolidated financial statements in accordance with IFRS. The following is a description of the significant differences between German GAAP and IFRS.

Fundamental Differences
The emphasis of IFRS is to provide all relevant information to investors in order to facilitate future investment decisions. The primary difference between German GAAP and IFRS is that they are based on different concepts. German GAAP is oriented towards the protection of creditors and emphasis on the prudence concept. Accordingly, IFRS prescribes strict separation of commercial and tax accounting, provisions for expenses are not permitted, recognition and valuation of options are more narrowly defined, and more extensive notes and explanations are required.

Management report
According to HGB companies have the obligation to disclose a management report. IFRS requires no management report.

Discontinued operations
IFRS requires that assets meeting the criteria to be classified as held for sale have to be measured at the lower of carrying amount and fair value less costs to sell and that depreciation on such assets has to cease. Additionally, assets that meet the criteria to be classified as held for sale are to be presented separately on the face of the balance sheet and the results of discontinued operations are to be presented separately in the statement of operations. Under German GAAP assets and liabilities held for sale and the results of discontinued operations are not presented separately.

Revenue Recognition
Revenue recognition is generally the same under German GAAP and IFRS, whereby revenue is recognised when it is probable that the economic benefits will flow to the Company. Differences in the timing of recognition can exist in transaction when the Company retains on-going financial, operational or performance commitments or the contractual amounts are not objectively verifiable.

Leased assets
Both IFRS and German GAAP stipulate that leased assets should be recognised on the basis of economic ownership. However, the definition of economic ownership varies. Under German GAAP a tax law approach is applicable.

Goodwill
Under IFRS, pursuant to IFRS 3, 'Business Combinations', goodwill arising from business combinations accounted for as a purchase is no longer amortised but is reviewed for impairment once a year. German accounting standards continue to permit companies to amortise goodwill or offset it against retained earnings.

Intangible assets
Under IFRS, internal costs associated with intangible assets are capitalised and amortised over their estimated useful lives. Under German GAAP, such non-current costs are expensed as incurred.

Financial Instruments
Under German GAAP, derivative financial instruments are not recorded on the balance sheet but detailed disclosures apply. Unrealised gains are not recognised and unrealised losses are accrued. Under IFRS, derivative financial instruments are recorded on the balance sheet at their fair value. Changes in fair value are recorded in current earnings or in stockholders' equity, depending on whether the derivative financial instruments are designated as part of a hedge transaction and depending on the type of hedge transaction.

Stock-Based Compensation
Under German GAAP, the Company recognises no stock-based compensation expenses. Under IFRS, the Company accounts for stock-based compensation pursuant to IFRS 2.

Provisions
Under German GAAP, certain costs can be accrued for anticipated future events in certain circumstances. Under IFRS, recognition of an accrued liability represents an existing liability to third parties or must meet specific recognition criteria. Pension provisions are calculated using the projected unit credit method, taking into account future increases in remuneration and pensions. The German tax-based method is under IFRS not permitted.

Non-current liabilities
IFRS requires that long-term liabilities be disclosed with the present value of the future payments using an interest rate commensurate with the risk involved. Under German GAAP, the long-term liabilities are disclosed with their repayment amounts.

Deferred taxes
Under German GAAP it is not permitted to capitalise deferred tax assets resulting from tax loss carryforwards. IFRS requires deferred taxes to be recognised for all temporary differences between the tax and accounting balance sheets. Deferred taxes must also be recognised for tax loss carryforwards if it is sufficiently probable that these tax loss carryforwards can be utilised.

Equity transaction costs
Under German GAAP, costs in connection with a capital increase are expensed as incurred. Under IFRS, such costs are recorded as a reduction of additional paid-in capital.

Foreign Currency Translation
Under German GAAP, foreign currency denominated assets and liabilities are recorded at spot rate on the transaction date with only unrealised losses reflected in income at the balance sheet date. Under IFRS, foreign currency denominated assets and liabilities are translated at the spot rate at the balance sheet date, with both unrealised gains and losses reflected in income.

Supervisory Board Report

Prof Dr Heinz Riesenhuber
Chairman of the Supervisory Board

The primary task of the Supervisory Board is to regularly supervise and provide advice to the Management Board on the management of the enterprise.

Through 2006, the Supervisory Board convened for four formal meetings and held ten telephone conferences to discuss the operational and strategic developments of Evotec AG. The Audit Committee met separately for two meetings and three additional telephone conferences; the Remuneration Committee convened twice.

The Management Board provided continuous updates to the Supervisory Board through regular verbal and written reports that included in depth analysis of the status of operations. The information provided included written monthly management reports with in depth coverage of the Company's financial figures for the previous month accompanied by detailed comments and explanatory text. In addition, the Chairman of the Supervisory Board and the Chief Executive Officer discussed current and ongoing topics via regular conference calls, typically carried out every two weeks and whenever appropriate.

Further to business updates, the status of the Company's proprietary programmes and standard agenda items, the Supervisory Board discussed at its meetings the following subjects in detail:

> In March, the Board discussed the future organisation of the Company and focused on the 2005 annual financial statements in presence of the auditors.
> In June, the Board focused on Company strategy and its implementation as well as mid term cash scenarios.
> In August, the Board discussed in depth the status of various R&D programmes in the Pharmaceuticals Division and continued its discussion on strategy implementation.
> In November, the Board focused on budget planning for the year 2007 and the Company's mid-range plan for 2007 to 2011.

Following in depth discussions concerning Evotec Technologies, including its divestiture and other possible options; the Supervisory Board eventually agreed in its October telephone conference to a recommendation to sell Evotec Technologies to PerkinElmer.

The Supervisory Board was not aware of any conflict of interests among any of its members during the year 2006. Every member was thus eligible to participate in all discussions and decisions of the Supervisory Board.

The financial statements and the management report for Evotec AG for the year 2006, as well as the consolidated financial statements together with the consolidated management report of the Evotec Group, were audited by KPMG Deutsche Treuhandgesellschaft Aktiengesellschaft Wirtschaftsprüfungsgesellschaft, Hamburg. The auditors issued an unqualified audit opinion.

The auditors discussed their findings with the Audit Committee and provided the Committee with a list of all extraordinary items which had been reviewed by the auditors. The Audit Committee discussed the organisation of the audit, audit findings and other topics with the auditors and used this as a guideline for its own evaluation of the statements and reports. The auditors participated in the March meeting of the Supervisory Board and presented a comprehensive report on the audit and their observations. The Supervisory Board examined both the financial statements and the consolidated financial statements prepared by the Management Board based on its own judgement, taking into account the Audit Committee's input as well as information on key topics provided by the auditors. The accounting provisions in connection with the divestiture of Evotec Technologies GmbH were discussed in detail by the Audit committee and by the Supervisory Board. Following this, the Supervisory Board approved the financial statements and the consolidated financial statements.

Due to additional professional responsibilities in his role as Executive Director of Degussa AG, Dr Alfred Oberholz resigned from the Supervisory Board, effective from the end of the Annual General Meeting (AGM) on 8 June 2006. The AGM elected in his place Dr William Jenkins, MD to the Board for a term of office until the AGM 2009.

The Chairman of the Supervisory Board thanked Dr Alfred Oberholz for his highly valuable contribution to the Company's development.

The Supervisory Board thanks the Management Board and the Company‘s employees for their hard work during the year and wishes them continued success for 2007.

Hamburg, 14 March 2007

The Supervisory Board
Prof Dr Heinz Riesenhuber

Supervisory Board and Management Board

Supervisory Board

Prof Dr Heinz Riesenhuber Frankfurt am Main	DE Former Federal Minister of Research and Technology	**Chairman of the Supervisory Board**	**Chairman of the Supervisory Board:** Kabel Deutschland GmbH, Unterfoehring	DE **Member of the Supervisory Board:** Altana AG, Bad Homburg	DE Frankfurter Allgemeine Zeitung GmbH, Frankfurt am Main	DE Henkel KGaA, Duesseldorf	DE VfW AG, Cologne	DE Vodafone Deutschland GmbH, Duesseldorf	DE **Member of the Verwaltungsrat:** HBM BioVentures AG, Baar	CH
Peer Schatz Duesseldorf	DE Chief Executive Officer Qiagen N.V.	**Vice Chairman of the Supervisory Board**	**Member of the Supervisory Board:** Mulligan BioCapital AG, Hamburg	DE **Non-Executive Chairman of the Board of Directors:** GenoVision Inc, West Chester	USA Qiagen AS, Oslo	NOR Qiagen Canada Inc, Montreal	CAN Qiagen Inc, Valencia	USA Qiagen Ltd, Crawly West Sussex	UK Qiagen North American Holdings, Inc, Valencia	USA Qiagen Pty Ltd, Clifton Hill, Victoria	AUS Qiagen S.A., Courtaboeuf Cedex	FRA Qiagen S.p.A., Milan	IT Qiagen Sciences, Inc, Germantown	USA Qiagen Synthetic DNA, Inc, Alameda	USA Xeragon, Inc, Germantown	USA **Non-Executive Member of the Board of Directors:** 5 Prime Inc, Boulder	USA (from January 2006) Genaco Biomedical Products, Inc., Huntsville	USA (from October 2006) Gentra Systems, Inc., Minneapolis	USA (from August 2006) PG Biotech Ltd, Shenzhen	CHN (from April 2006) Qiagen Inc, Mississauga	CAN Qiagen K.K., Tokyo	JPN Qiagen Malaysia Sdn Bhd, Kuala Lumpur	MYS (from April 2006) Research Biolabs Pte. Ltd	SGP (from August 2006) Research Biolabs Technologies Pte. Ltd	SGP (from August 2006)
Dr Hubert Birner Landsham	Pliening	DE General Partner Techno Venture Management GmbH	**Member of the Supervisory Board**	**Chairman of the Supervisory Board:** Direvo Biotech AG, Cologne	DE **Member of the Supervisory Board:** Jerini AG, Berlin	DE **Non-Executive Chairman of the Board of Directors:** Argos Therapeutics Inc., Durham	North Carolina	USA Spepharm Holding BV, Amsterdam	NL (from July 2006) **Non-Executive Member of the Board of Directors:** BioXell SA, Milan	IT (from March 2006)
Dr Peter Fellner Oxfordshire	UK Executive Chairman Vernalis plc	**Member of the Supervisory Board**	**Non-Executive Chairman of the Board of Directors:** Acambis plc, Cambridge	UK (from October 2006) Astex Therapeutics Ltd, Cambridge	UK **Non-Executive Member of the Board of Directors:** Acambis plc, Cambridge	UK (from February 2006 until September 2006) Bespak plc, Milton Keynes	UK Isis Innovation Ltd, Oxford	UK QinetiQ Group plc, London	UK UCB SA, Brussels	BE

Dr William J Jenkins Basel	CH Pharmaceutical Consultant	**Member of the Supervisory Board** (from 8 June 2006)	**Non-Executive Member of the Board of Directors:** Acambis plc, Cambridge	UK (from December 2006) BTG plc, London	UK Eurand Pharmaceutical Holdings, N.V., Amsterdam	NL Monogram Biosciences, Inc., San Francisco	USA
Mary Tanner New York, USA Financial Advisor	**Member of the Supervisory Board**	**Non-Executive Member of the Board of Directors:** Alteon, Inc., Parsippany	USA (from July 2006) Ariad Pharmaceuticals, Inc, Cambridge	USA (until January 2007) HaptoGuard, Inc., Fort Lee	USA (until July 2006)
Dr Alfred Oberholz Duesseldorf	DE Member of the Management Board Degussa AG	**Member of the Supervisory Board** (until 8 June 2006)	**Chairman of the Supervisory Board:** Infracor GmbH, Marl	DE **Non-Executive Member of the Board of Directors:** Degussa (China) Co. Ltd., Shanghai	CHN Degussa Corporation, Parsippany	USA Degussa Japan Co. Ltd., Tokyo	JPN (until February 2006)

Management Board

Jörn Aldag Hamburg	DE Business Executive	**President & Chief Executive Officer**	**Member of the Monopolkommission der Bundesrepublik Deutschland**
Dr Dirk H Ehlers Wohltorf	DE Physicist	**Chief Financial Officer**	

Executive Committee

Jörn Aldag
President &
Chief Executive Officer

Dr Mark Ashton
Executive Vice President
Business Development
Services Division

David Brister
Chief Business Officer

Dr Dirk H Ehlers
Chief Financial Officer

Dr Erich Greiner, MD
Chief Innovation Officer

Anne Hennecke
Senior Vice President
Investor Relations &
Corporate Communications

Dr John A Kemp
Chief Research &
Development Officer

Martyn Melvin
Senior Vice President
Human Resources

Dr Mario Polywka
Chief Operating Officer

Dr Tim Tasker, MD
Executive Vice President
Clinical Development

Jesper Wiklund
Senior Vice President
Business Development
Pharmaceuticals Division

Glossary

Allosteric modulator. Drug exerting its effect on the → receptor → protein at a site different from the binding site of the endogenous substance, thereby enhancing (positive modulator) or reducing (negative modulator) the effect of the endogenous substance.

Antagonist. Drug that binds a cellular → receptor thereby blocking the action of the natural activator of the receptor.

API. Active **P**harmaceutical **I**ngredient.

Assay. Any combination of → targets and compounds which is exposed to a detection device to measure chemical or biological activity.

Bioavailability. The percent of a drug entering the systemic circulation after administration of a given dose. This is usually determined from the ratio of the amount of drug 'absorbed' from an oral → formulation to the amount 'absorbed' after administration of an aqueous solution of the drug given intravenously.

Blockbuster drug. Drug generating more than $1 billion of peak annual sales.

Cell biology. Study of cells. This includes their → physiological properties, biochemistry, structure, the organelles they contain, interactions with their environment, their life cycle, division and death.

Central nervous system (CNS). The CNS represents the largest part of the nervous system, including the brain and the spinal cord. Together with the peripheral nervous system, it has a fundamental role in the control of behaviour.

Clinical development|trials. Drug research studies that involve patients or healthy volunteers.

Compound library. Collection of a multitude of different molecules; used for → screening.

Computational chemistry. Discipline of using computational methods to calculate properties of chemical compounds and their interaction with biological → targets (e.g. → proteins).

Cross-over study design. Patient receiving all selected doses of a drug candidate in → clinical trials including → placebo in a radomised, sequential fashion.

Dopamine. A neurotransmitter released from pathways involved in reward, motivation and movement control.

Double blind study. Neither the patient nor the physician knows whether the patient is receiving active treatment or → placebo during a → clinical study. The treatments are coded until the end of the study. Double blind studies are the most commonly used as they eliminate both patient and physician bias.

Enzyme. → Protein that acts as a catalyst, speeding up the rate at which a biochemical reaction proceeds.

Focused library. Well characterised, high quality library or compound array designed primarily to be targeted towards gene product families or to contain specific known pharmacophoric → fragments. They allow hits to be identified from specific classes of compounds and permit the rapid initiation of hit-to- → lead programmes.

Formulation. The formulation by which a drug is delivered → *in vivo* can have a profound effect on its → bioavailability. Therefore it is necessary to develop the optimal formulation: this will involve the selection of the dosage form (e.g. soft gel capsule or tablet), choice of excipients and studies on the chemical stability of the formulated drug.

Fragment. Small organic molecules that are typically a third of the size of drug molecules and because of their small size tend to interact only weakly with → proteins. Nevertheless, they are very useful starting points for → medicinal chemists to optimise them into more active drug molecules. They provide the flexibility to add extra chemical groups leaving chemists more room to manoeuvre which increases the likelihood of developing an innovative and successful compound.

Functional genomics. The study of how gene polymorphisms or mutations effect the function of the gene product|organism.

G-Protein Coupled Receptor (GPCR). Large family of related cell surface → receptors which play a very important role in drug therapy. These receptors stimulate and convey signals within cells harbouring these → proteins through interactions with a conserved family of proteins known as G-proteins.

Generic drug|Generic competition. Drugs having the same active ingredient as an initial patented supplier product and the same therapeutic effect, but that are offered at significantly lower prices than the equivalent drugs of initial suppliers after the expiration of the patent or other applicable commercial property rights.

High-content screening. Analysis of individual cells by looking at more than one cellular event at a time. Thus detailed information about the mechanism|activity of a compound| → lead in a cell is generated, thereby speeding up the drug discovery process.

IND (Investigational **N**ew **D**rug**).** Substance which enters → clinical development in humans following approval for initiation of clinical trials by the FDA (Food and Drug Administration, U.S.) or similar regulatory authority.

Inhibitor. A compound that binds to an → enzyme| → receptor and decreases or blocks its activity.

***in vivo*.** In the living organism as opposed to *in vitro*.

***in silico*.** Pertaining to the computational modelling of biological tests or experiments.

Ion channel. Transmembrane → protein which, when activated, allows the passage of ions across cell membranes that influence the → physiology of a cell.

Lead (compound). A representative of a compound series with sufficient potential (as measured by potency, selectivity, → pharmacokinetics, physicochemical properties, novelty and absence of toxicity) to progress to a full drug optimisation programme.

Lead optimisation. The synthetic modification of a biologically active compound, to fulfil all → pharmacological, physicochemical, → pharmacokinetic and toxicologic requirements for → clinical usefulness.

Medicinal chemistry. A chemistry-based discipline, also involving knowledge and aspects of biological, medicinal and pharmaceutical sciences. It is concerned with the invention, discovery, design, identification and preparation of biologically active compounds, the study of their ADMET properties, the interpretation of their mode of action at the molecular level and the construction of structure activity relationships. Medicinal chemistry optimisation is 'fine tuning' required to turn a validated → lead into a → preclinical candidate involving subtle structural changes to the lead using a 'hand-crafted' approach.

Monotherapy. Treatment of an illness by a single medicine as opposed to combinational therapy, where two or more drugs are given.

Parallel design study. Where different groups of patients receive a different dose of a compound or → placebo in a → clinical trial as opposed to → cross-over design.

Partial positive allosteric modulator. A compound that can only maximally enhance the activity to a fraction of that produced by a full positive → allosteric modulator.

Pathophysiology. Summarises processes within cells, tissues, organs or the whole body under conditions of illness as opposed to the healthy state. It is necessary to understand pathophysiology for purposes of therapeutic intervention.

Pharmacology. The science concerned with drugs, their sources, appearance, chemistry, actions and uses.

Physiology. Science of living organisms and their parts.

Pilot plant. A set of large fixed vessel and ancillary devices for conducting organic synthesis on a large scale. A pilot plant is often used for synthesis of larger amounts of a candidate drug molecule required for → clinical trials in man. It provides an intermediate scale between lab scale and full manufacturing scale.

Pipeline. All the company's drug candidates that are under development.

Pharmacokinetics. Time-dependent availability and compartmental distribution, as affected by absorption, distribution, metabolism, excretion (ADME).

Placebo. Drug dummy, → pharmacologically ineffective used as a control in → clinical trials.

Polysomnography. In the study of sleep this multi-parametric test is used to record biophysiological changes that occur during sleep and the efficacy of a drug candidate. This diagnostic test monitors many body functions including brain (EEG), eye movements (EOG), muscle activity or skeletal muscle activation (EMG), heart rhythm (ECG), and breathing function or respiratory effort during sleep.

Positron Emission Tomography (PET) imaging. A nuclear medicine medical imaging technique which produces a three-dimensional image or map of functional processes, such as → enzyme or → receptor activity, in the living body.

Preclinical discovery. The phase of drug discovery extending from → target identification, the search for chemical compounds with desired properties, through to the end of efficacy studies in animal models and safety evaluation prior to → clinical trials.

Profiling. A detailed analysis and characterisation of compounds detected in → screening with respect to their dose-response activities and to their interaction with the members of the same → target family.

Proof-of-concept drug (POCD). Drug candidate which has completed Phase IIa → clinical trials demonstrating that the molecule proves the concept that → pharmacological intervention of the selected biological → target will be therapeutically useful in the selected → clinical indication.

Protein. Large, complex molecule composed of amino acid sub-unites. Proteins are essential to the structure, function and regulation of the body.

Proteome. The entire complement of → proteins in a given organism or system at a given time.

Receptor. → Protein in a cell or on its surface that selectively binds a specific substance (ligand). Upon binding its ligand, the receptor triggers a specific response in the cell.

Scale-up. The process by which a laboratory-based synthetic process is developed to allow safe and reproducible production on a larger scale.

Screening. Mass testing of → compound libraries using an established → assay format.

Small molecule. A low molecular weight organics compound. These are preferred for drugs as they usually are orally available (unlike → proteins that must be administered by injection). The size of small molecules is less than 1,000 Daltons, and is usually in the range from 250 to 700 Daltons.

Stem cell. A cell that can replicate indefinitely and which can differentiate into all other cell types; stem cells serve as a continuous source of cells for analysis and → screening.

Structural biology. The structural determination and analysis of living material that leads to an understanding of biological function in terms of three-dimensional molecular structure.

Target. Specific biological molecule, such as an → enzyme, → receptor or → ion channel, assumed to be relevant to a certain disease. Most drugs work by binding to a target, thereby affecting its biological function.

Target identification. Identifying a molecule (often a → protein) that is instrumental to a disease process (though not necessarily directly involved), with the intention of finding a way to regulate that molecule's activity for therapeutic purposes.

Target validation. Involves the verification of the relevance of a → target to the course of a specific illness.

Ultra-High-Throughput Screening. Technique of rapidly searching for molecules with desired biological effects from very large → screening libraries often exceeding 100,000 tests a day.

Financial Calendar and Imprint

Financial Calendar

29 March 2007	Annual Report 2006
10 May 2007	First Quarter Report 2007
30 May 2007	Annual General Meeting
14 August 2007	Second Quarter Report 2007
13 November 2007	Third Quarter Report 2007

Imprint

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This annual report is also available in German.

Key Figures (IFRS)

Evotec AG

		2004	2005	2006	2005	2006	Δ 06/05 in %
Results:		Including discontinued operations			Continuing business[1]		
Revenue	T€	72,730	79,785	84,681	64,115	67,354	5.1
R&D expenses	T€	13,490	14,088	33,443	9,304	30,307	225.7
Operating loss	T€	85,622	35,673	39,045	32,965	36,762	11.5
Operating loss[2]	T€	11,697	8,105	29,011	5,879	27,539	368.4
Net loss	T€	77,812	33,583	32,468	31,212	36,296	16.3
Net loss[2]	T€	3,887	6,015	22,434	4,126	27,073	556.2
Cash flow	T€	(3,624)	37,141	27,085	36,167	26,253	(27.4)
Balance sheet data:							
Subscribed capital[3]	T€	38,010	62,759	68,079	62,759	68,079	8.5
Number of shares[3]	T	38,010	62,759	68,079	62,759	68,079	8.5
Stockholders' equity	T€	110,508	148,669	137,176	148,669	137,176	(7.7)
Equity ratio	%	75	80	67	80	67	–
Investments[4]	T€	9,903	40,298			4,468	
– Intangible assets	T€	1,117	32,050			923	
– Tangible fixed assets	T€	2,532	6,466			3,543	
– Financial assets	T€	6,254	1,782			2	
Cash including marketable securities	T€	15,277	53,520	80,891	52,185	78,723	50.9
Balance sheet total	T€	146,544	186,111	205,526	186,111[5]	205,526[5]	10.4
Personnel data:							
Employees as of 31 December		646	604	607	512	527	2.9
Total corporate personnel expenditures	T€	37,553	39,538	39,544	31,677	33,324	5.2
Revenue per employee	T€	113	132	140	125	128	2.4
Per share:							
Result	€	(2.12)	(0.65)	(0.49)	(0.60)	(0.55)	–
Dividends	€	–	–	–	–	–	–
ISIN						DE0005664809	
Security identification No.						566480	

[1] Excluding contributions from Evotec Technologies which was sold effective 1 January 2007 and thus reported as discontinued operations in this report.
[2] Before amortisation and impairment.
[3] Refers to 1 €.
[4] Including additions from acquisitions of ENS and Evotec (Scotland) Ltd.
[5] Including assets held for sale.

www.evotec.com