

**Translation of  
Financial Statements as of  
December 31, 2007  
and Management Report**

**Evotec AG  
Hamburg**



## Shareholder's equity and liabilities

	31.12.2007	31.12.2006
	EUR	EUR
<b>A Stockholder's equity</b>		
<b>I. Share capital</b>	73 868 447 00	68 078 819 00
--conditional Capital EUR 7,199.380 00 (2006: EUR 5.122.996 00)--		
<b>II. Additional paid-in capital</b>	144.119.047 56	128.619.837 16
<b>III. Reserve for treasury shares</b>	57 532 36	63 993 24
<b>IV. Net loss carried forward</b>	-81 190 068 97	-83.234.628 55
<b>V. Net income for the year</b>	2,250,010.35	2,044,559.58
	<u>139,104,968.30</u>	<u>115,572,580.43</u>
<b>B. Accrued liabilities</b>		
1. Pension accrual	67 621 00	64 362 00
2. Other accrued expenses	3,890,819.30	3,663,804.10
	<u>3,958,440.30</u>	<u>3,728,166.10</u>
<b>C. Liabilities</b>		
1. Bank loans	3 000 000 00	1 277.107 79
--thereof due within one year EUR 0 00 (2006: EUR 1 277 107 79)--		
--thereof due from one to five years EUR 3 000.000 00 (2006: EUR 0 00)--		
2. Advanced payments received	94 825 74	413.318 02
--thereof due within one year EUR 94 825 74 (2006: EUR 413 318 02)--		
3. Trade accounts payable	2 962 719 10	888.588 32
--thereof due within one year EUR 2,962.719 10 (2006: EUR 888.588 32)--		
4. Accounts payable due to affiliated companies	11 100 913 00	6 082.544 56
--thereof trade accounts payable EUR 0 00 (2006: EUR 862 244 18)--		
--thereof due within one year EUR 11 100.913 00 (2006: EUR 862 244 18)--		
--thereof due from one to five years EUR 0 00 (2006: EUR 5 220 300 38)--		
5. Other liabilities	658 774 81	25 497 629 64
--thereof due within one year EUR 658.744 81 (2006: EUR 23 517 629 64)--		
--thereof due from one to five years EUR 0.00 (2006: EUR 1 980 000 00)--		
--thereof taxes EUR 146 603 97 (2006: EUR 218 161 82)--		
--thereof social security EUR 3,133.11 (2006: EUR 0.00)--		
	<u>17,817,232.65</u>	<u>34,159,188.33</u>
<b>D. Deferred income</b>	670,315.25	817,112.17
	<u>161,550,956.50</u>	<u>154,277,047.03</u>

Evotec AG, Hamburg

Income Statement for the period  
from January 1 to December 31, 2007

	2007		2006	
	EUR	EUR	EUR	EUR
1 Revenues		13 324 375 40		10 201 070 29
2 Decrease (2006: Increase) in inventories		-120 382 37		221 645 82
3 Other operating income		6 068 726 44		12 386 479 09
4 Cost of materials				
a) Raw materials and supplies	-1 895 045 32		-1 927 234 53	
b) Costs of services	-545 083 66	-2 440 128 98	-771 542 94	-2 698 777 47
5 Personnel costs				
a) Salary	-6 829 683 91		-6 116 260 04	
b) Social security expenditure	-864 855 58	-7 694 539 49	-805 364 82	-6 921 624 86
-thereof pension costs				
EUR 3 258 00 (2006: EUR 3 115 00)-				
6 Depreciation				
a) of intangible assets and fixed assets	-1 299 907 25		-1 730 746 31	
b) of current assets to the extent that they exceed provisions normally recorded by the company	-396 899 32	-1 696 806 57	-39 958 47	-1 770 704 78
7 Other operating expenses		-11 497 434 24		-10 792 043 00
8 Income from investments		4 239 595 30		5 043 07
-thereof from subsidiaries				
EUR 3 772 095 30 (2006: EUR 0 00)-				
9 Other interest income		2 232 103 77		1 805 823 70
-thereof from subsidiaries				
EUR 1 259 960 00 (2006: EUR 982 157 30)-				
10 Amortisation of financial assets		0 00		-4 100 00
11. Other interest expense		-161,756.94		-385,472.25
12 Operating result		2 253 752 32		2 047 339 61
13. Other taxes		-3,741.97		-2,780.03
14 Net income for the year		2 250 010 35		2 044 559 58
15. Net loss carried forward		-81,190,068.97		-83,234,628.55
16. Accumulated deficit		-78,940,058.62		-81,190,068.97

Evotec AG, Hamburg

## Notes to the Financial Statements 2007

### I. General Information

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

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

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

From February 11, 2003, to March 19, 2007, the company has been listed in the German Stock Exchange’s TecDAX index, having formerly been listed in the Neue Markt index from November 10, 1999, onwards. Since March 19, 2007, the company is listed in the German Stock Exchange.

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

The presentation system applied for the balance sheet and the statement of operations in the preceding financial year 2006 have been maintained.

**Intangible assets and Property, plant and equipment** are recorded at historical cost or manufacturing cost less scheduled straight-line depreciation or amortization over their useful lives. Non-real-estate fixed assets are depreciated on a monthly basis. Low-value fixed assets are fully depreciated in the year of acquisition and are recorded as disposals in the fixed asset movement schedule.

The useful lives are estimated as follows:

	Years
Buildings	10-15
Technical equipment and machinery	5-10
Furniture and fixtures	5-10
Computer equipment	3

**Financial assets** are recorded at historical cost or on the basis of information given by the insurer, in regards to the actuarial reserve plus surplus dues

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

**Current assets** are recorded at nominal value or at lower attributable value. Foreign currency assets, all of which are short-term, are recorded on the basis of the period-end exchange rates, taking into account the principle of the lower of cost or market.

**Treasury Shares** are recorded at historical cost in accordance with the principle of lower of cost or market.

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

**Accrued liabilities** make allowance for all risks and contingent liabilities that are identifiable with sound business judgement. **Pension accruals and similar commitments** are recorded at current worth in accordance with tax law, taking into account Prof. Dr. Klaus Heubeck's reference tables („Richttafeln“) issued in 2005.

**Liabilities** are recorded at the amount repayable. Foreign currency liabilities are recorded on the basis of the period-end exchange rates, taking into account the recognition-of-loss principle.

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

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

The development of the fixed assets is specified in the fixed asset movement schedule (see pages 4 and 5), and includes gross cost, historic cost and manufacturing cost of items.

## Fixed Assets Movement Schedule for the year 2007

	Acquisition and manufacturing costs				31.12.2007
	1.1.2007	Additions	Disposals	Reclasses	
	EUR	EUR	EUR	EUR	EUR
<b>I. Intangible Assets</b>	2,588,140.00	237,856.58	82,351.64	0.00	2,743,644.94
<b>II. Property, plant and equipment</b>					
1 Land, land rights and buildings including buildings on third party land	1 991 287 08	13 047 24	0 00	2,500.00	2 006 834 32
2 Technical equipment and machinery	16 021 984 13	1 234 274 16	683 345 05	(832.50)	16 572 080 74
3 Fixtures and fittings	3 981 239 05	333 125 10	879 993 83	832.50	3 435 202 82
4. Payments in advance	2,500.00	0.00	0.00	(2,500.00)	0.00
	21,997,010.26	1,580,446.50	1,563,338.88	0.00	22,014,117.88
<b>III. Financial Assets</b>					
1 Shares in affiliated companies	66 443 153 17	21 128 984 28	3 314 780 15	0 00	84 257 357 30
2 Participations	356 858 04	9 950 00	356 858 04	0 00	9 950 00
3. Other financial assets	55,937.00	12,822.00	0.00	0.00	68,759.00
	66,855,948.21	21,151,756.28	3,671,638.19	0.00	84,336,066.30
	91,441,098.47	22,970,059.36	5,317,328.71	0.00	109,093,829.12



Depreciations			Net book value		
1.1.2007	Additions	Disposals	31.12.2007	31.12.2007	31.12.2006
EUR	EUR	EUR	EUR	EUR	EUR
2,522,303.34	113,470.58	82,348.07	2,553,425.85	190,219.09	65,836.66
1 037 429 07	161 280 79	0 00	1 198 709 86	808 124 46	953 858 01
13 209 203 62	695 870 62	680 465 94	13 224 608 30	3 347 472 44	2 812 780 51
3 399 531 26	329 285 26	872 957 02	2 855 859 50	579 343 32	581 707 79
0.00	0.00	0.00	0.00	0.00	2,500.00
17,646,163.95	1,186,436.67	1,553,422.96	17,279,177.66	4,734,940.22	4,350,846.31
4 100 00	0 00	4 100 00	0 00	84 257 357 30	66 439 053 17
324 358 04	0 00	324 358 04	0 00	9 950 00	32 500 00
0.00	0.00	0.00	0.00	68,759.00	55,937.00
328,458.04	0.00	328,458.04	0.00	84,336,066.30	66,527,490.17
20,496,925.33	1,299,907.25	1,964,229.07	19,832,603.51	89,261,225.61	70,944,173.14

## Financial assets

As of the balance sheet date of December 31, 2007, Evotec held direct equity investments in the following companies:

		Total Equity	Share interest	Net income/loss
		TEUR	%	TEUR
1.	ENS Holdings Inc . Wilmington/Delaware, USA*	24,538	100 00	74
2	EVOTEC NeuroSciences GmbH, Hamburg* (indirectly through 1 <sup>st</sup> )	-55 909	100 00	-43,303
3	Evotec Neurosciences AG, Zürich, CH* (indirectly through 1 <sup>st</sup> )	197	100 00	30
4	Evotec UK Ltd , Abingdon, UK	72 123	100 00	24,510
5	Evotec Inc , Wilmington/Delaware. USA* (indirectly through 4 <sup>th</sup> )	0	100 00	0
6	Oxford Diversity Ltd., Abingdon. UK* (indirectly through 4 <sup>th</sup> )	3	100 00	0
7	Oxford Asymmetry Employee Shares Trust Ltd . Abingdon, UK* (indirectly through 4 <sup>th</sup> )	4	100 00	0
8	Neuro3d SA. Mulhouse. France	22,270	100 00	4.663
9	Evotec RSIL Ltd , Maharashtra (Thane). India* (indirectly through 4 <sup>th</sup> )	1,247	49 00	-44
10	European ScreeningPort GmbH i G., Hamburg*	0	19 90	0
11	Prolysis Ltd . Oxford, UK* (indirectly through 4 <sup>th</sup> )	-2,748	1 93	-1 871
12	KeyNeurotek Pharmaceuticals AG (formerly KeyNeurotek AG), Magdeburg (2006)	3 996	0 06	-2,876

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

\*unaudited

## **2. Inventories**

The work in process essentially consists of order based research and development work.

## **3. Accounts receivable and other assets**

Accounts receivable from affiliated companies refer to EVOTEC NeuroSciences GmbH with TEUR 45,272 (2006: TEUR 0), which are due in more than one year, they also include accounts receivable from Evotec (UK) Ltd. amounting to TEUR 205 (2006: TEUR 0) and from Neuro3d SA amounting to TEUR 0.5 (2006: TEUR 0) which all are due within one year. Furthermore there are accounts receivable in respect of Evotec Neurosciences AG amounting to TEUR 0 (2006: TEUR 7)

Other current assets include accounts receivables of TEUR 595 (2006: TEUR 284) to Capital Yields Tax, TEUR 359 (2006: TEUR 143) pertain to Value Added Tax (VAI) and TEUR 33 (2006: TEUR 0) to wage tax. Furthermore, the other current assets include TEUR 5 (2006: TEUR 5) accounts receivable from paid deposits, which are due in more than one year. The other current assets also include also an amount of TEUR 1,980 regarding the sale of Evotec Technologies. This amount is part of the total selling price which is paid into an escrow account until 2008.

## **4. Treasury shares**

The company bought 15,511 treasury shares by a nominal value of EUR 15,511.00 in 2007. The shares were bought at a rate of EUR 3.79 on March 2, 2007. On December 31, 2007, the company held 24,692 treasury shares which were shown in the balance sheet 2007 with the market rate of EUR 2.33 from December 31, 2007. The treasury shares represent 0.03 % of the nominal capital. The company bought the shares as a part of the remuneration to the supervisory board.

## **5. Equity**

Due to a decision of the management board in 2007 with the authorization of the annual general meeting on June 8, 2006 and the approval by the supervisory board a share capital increase of EUR 5,726,012.00 to EUR 73,699,128.00 was accomplished in terms of a contribution in kind. The entry in the commercial register is dated July 16, 2007. Within the capital increase the company issued 5,726,012 shares with a nominal value of EUR 1.00.

Another increase of the capital in kind by the exercise of stock-options amounted to EUR 169,319.00. The entry in the commercial register will be in 2008

The capital reserve increased by EUR 15,499,210.40 to EUR 144,119,047.56 due to the capital increase, exercise of stock options and adjustments to treasury shares.

Additionally, the company built a reserve for treasury shares of EUR 57,532.36

The conditional capital rose due to a decision of the general annual meeting on May 30, 2007, by an amount of EUR 2,140,000.00 and amounted to EUR 7,199,380.00 on December 31, 2007 after the exercise of stock-options mentioned above. It was created to give stock options to employees and members of the management board of the company or affiliated companies.

On December 31, 2007, the approved capital amounted to EUR 36,849,564.00 equal to 36,849,564 shares.

Absolute Capital Management Holdings Limited, George Town, Grand Cayman, Cayman Islands, informed according to Section 21 par. 1 WpHG that its investments in Evotec crossed the 3.0 % hurdle on July 22, 2007 and amounted to 3.037 %. Thereof, 3.037 % are assigned to Absolute Capital Management Holdings Limited according to Section 22 par. 1 sentence 1 no. 1 and 6 WpHG.

Absolute Capital Management Holdings Limited, George Town, Grand Cayman, Cayman Islands, informed according to Section 21 par. 1 WpHG that its investments in Evotec fell below the 3.0 % hurdle on July 27, 2007 and amounted to 2.686 %. Thereof, 2.686 % are assigned to Absolute Capital Management Holdings Limited according to Section 22 par. 1 sentence 1 no. 1 and 6 WpHG.

Mayflower L.P., St Helier, Jersey, Channel Island, informed according to Section 21 par. 1 WpHG that its investments in Evotec fell below the 3.0 % hurdle on March 30, 2007 and amounted to 2.51 %

Mayflower GP Ltd, London, UK, informed according to Section 21 par. 1 WpHG that its investments in Evotec fell below the 3.0 % hurdle on March 30, 2007 and amounted to 2.51 %

3i Investments plc, London, UK, informed according to Section 21 par. 1 WpHG that its investments in Evotec fell below the 3.0 % hurdle on March 30, 2007 and amounted to 2.51 %.

3i plc, London, UK, informed according to Section 21 par. 1 WpHG that its investments in Evotec fell below the 3.0 % hurdle on March 30, 2007 and amounted to 2.51 %.

3i Holdings plc, London, UK, informed according to Section 21 par. 1 WpHG that its investments in Evotec fell below the 3.0 % hurdle on March 30, 2007 and amounted to 2.51 %

3i Group plc, London, UK informed according to Section 21 par. 1 WpHG that its investments in Evotec fell below the 3.0 % hurdle on March 30, 2007 and amounted to 2.51 %

## **6. Pension accruals**

Pension accruals were set up according to a valuation by MERCER Human Resource Consulting GmbH and pertain a former director of Evotec Biosystems GmbH, of which Evotec is the successor in title.

## **7. Other accruals**

Other accruals are composed mainly of outstanding invoices (TEUR 1,768, 2006: 1,258). The accruals also include accruals for bonuses (TEUR 1,354, 2006: TEUR 1,089) as well as special payments to employees of in affiliated companies (TEUR 0, 2006: TEUR: 401) and unclaimed vacation (TEUR 262, 2006: TEUR 234). Contained in the accruals for outstanding invoices is a reserve of TEUR 198 (2006: TEUR 199) for supervisory board remuneration and a reserve of TEUR 285 (2006: TEUR 340) for the payment to inventors.

## **8. Liabilities**

The liabilities to banks at December 31, 2007 comprise of a loan of TEUR 3,000 (2006: TEUR 1,277) which is due between one and five years. The loan will be repaid by December 10, 2009. The interest rate is 1.15 % over six month EURIBOR per annum. The loan is secured by a general terms and conditions lien. The loan of TEUR 1,277 at the beginning of the financial year was repaid in 2007.

Liabilities owed to affiliated companies relate to Evotec (UK) Ltd. by a sum of TEUR 11,101 (2006: TEUR 6,083).

In 2006 the other liabilities contained TEUR 22,167 which was a partial payment of the price of sale of Evotec Technologies GmbH.

## IV. Notes to the Statement of Operations

### 1. Revenues

Service Division recorded revenues of TEUR 13,324 (2006: TEUR 10,201) through services, of which TEUR 4,066 were with affiliated companies (2006: TEUR 1,601).

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

	2007	2006
	TEUR	TEUR
Germany	1 311	2 062
United Kingdom	380	455
Netherlands	378	42
Belgium	203	65
Rest of Europe	1 517	973
United States of America	4 566	3 064
Japan	577	1 037
Canada	36	308

### 2. Other operating income

Other operating income comprises of TEUR 3,467 (2006: TEUR 5,999) of income from costs charged to affiliated companies. Furthermore the other operating income includes TEUR 1,373 (2006: TEUR 1,196) from the sublease of the building as well as TEUR 15 (2006: TEUR 19) of purpose-tied public grants. In 2006 were TEUR 5,900 included which were the result of the correction of an impairment of a loan to ET from 2005.

Income unrelated to the accounting period resulted mainly from the reversal of accruals (TEUR 171; 2006: TEUR 143).

### **3. Other operating expenses**

Other operating expenses substantially consist of consultancy expenses with TEUR 3,673 (2006: TEUR 2,147), rental expenses including related costs with TEUR 1,729 (2006: TEUR 1,576), maintenance costs with TEUR 577 (2006: TEUR 587) and patent costs with TEUR 363 (2006: TEUR 330).

### **4. Remuneration of the Auditor**

In 2007, remunerations of KPMG Deutsche Treuhand-Gesellschaft Aktiengesellschaft Wirtschaftsprüfungsgesellschaft are shown as expenses for auditing with TEUR 558, other consultancy and valuation with TEUR 25, tax consultancy with TEUR 25 and other services with TEUR 1.

## **V. Other Disclosures**

### **Employees**

In 2007, the average employee count was 94 (2006: 83).

As part of the stock option plan, employees of the company and its affiliates received a total of 595,000 options (2006: 818,196) as well as the management board received 220,000 options (2006: 150,000).

### **Other financial obligations**

The other financial obligations for 2008 are mainly obligations from service contracts, rent and leasing and add up to TEUR 2,268 (thereof to affiliated companies TEUR 0). The sum of all existing obligations until the year 2010 is TEUR 6,568 and with a longer term is TEUR 2,831.

## **Guarantees and Other Commitments**

In order to prevent the legal consequence of over-indebtedness of EVOTEC NeuroSciences GmbH (TEUR 55.909) Evotec AG issued letter of comfort in 2007.

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

## **Corporate Governance Code**

Both the Management Board and the Supervisory Board have issued a statement in accordance with section 161 AktG, which has been made available to all shareholders on Evotec's Internet-Site.

## **Management Board**

Jörn Aldag, Business Executive, Hamburg (President and Chief Executive Officer),

Dr. Dirk H. Ehlers, Physicist, Wohltorf (Chief Financial Officer until August 31, 2007),

Dr. Klaus Maleck, Biotechnologist Engineer, Hamburg (Chief Financial Officer from November 1, 2007)

Dr. Mario Polywka, Chemist, Oxfordshire, UK (Chief Operating Officer from November 1, 2007)

The remuneration paid to the members of the Management Board in the financial year totalled TEUR 993 (2006: TEUR 917), of which TEUR 381 (2006: TEUR 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 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 2007, payable on the achievement of certain strategic targets for the business year 2006, was 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. The scheme for the variable portion of the remuneration in 2008 refers to the financial year 2007 and is based on the following arrangements:



	Achivement of defined corporate Milestones	Achivement of budget financial targets	Achivement of share price targets	Achivement of personal objectives
	%	%	%	%
Jörn Aldag	40	30	30	-
Dr. Klaus Maleck	40	40	-	20

Under the Company's stock option plans, the members of the Management Board received in 2007 220,000 (2006: 150,000) options. The options granted in 2007 and 2006 are subject to the stipulation of the Option Plan 2005 and may be exercised after three years provided the conditions of this plan are met.

	2007	2007	2007
	Fixed remuneration	Variable remuneration	Stock options
	T€	T€	
Jörn Aldag	365	252	200,000
Dr. Dirk Ehlers	207	129	0
Dr. Klaus Maleck	40	0	20,000
Total	612	381	220,000

Dr. Mario Polywka receives no remuneration for his Management Board membership from Evotec AG.

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 insurance expense amounted to TEUR 60 in total in 2007 (2006: TEUR 84), and was paid by the Company.

Jörn Aldag is member of the Monopolkommission der Bundesrepublik Deutschland and President of the Board of Directors of Molecular Partners AG, Zurich-Schlieren, CH (since October 2007)

Dr. Mario Polywka is Chairman of the Board of Directors of Glycoform Ltd, Oxfordshire, UK, as well as Pharminox Ltd, Oxfordshire, UK.

## **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 of Techno Venture Management GmbH, Landsham/Pliening;

Dr. Peter Fellner, Executive Chairman Vernalis plc, Oxfordshire, UK;

Dr. William J. Jenkins, Pharmaceuticals Consultant, Basel, CH;

Mary Tanner, Financial Advisor, New York, USA.

The remuneration paid to the members of the Supervisory Board in the financial year amounted to TEUR 198 (2006: TEUR 199). The members of the Supervisory Board were members of the following other Supervisory Boards, Committees and Bodies according to section 125 paragraph 1 clause 3 AktG:

### **Prof. Dr. Heinz Riesenhuber**

Chairman of the supervisory board:

Kabel Deutschland GmbH, Unterfoehring.

Member of the supervisory board:

Altana AG, Bad Homburg (until May 2007); Frankfurter Allgemeine Zeitung GmbH, Frankfurt am Main; Henkel KGaA, Duesseldorf; VFW AG, Cologne; Vodafone Deutschland GmbH, Duesseldorf (until June 2007).

Member of the board of administration of HBM BioVentures AG, Baar, CH.

**Peer Schatz**

Member of the supervisory board:

Mulligan BioCapital AG, Hamburg (until October 2007).

Non-Executive Chairman of the Board of Directors:

Digene France SAS, Paris, F (from October 2007); Egene, Inc Fitch, USA (from May 2007); GenoVision Inc, West Chester, USA; Qiagen AS, Oslo, N; Qiagen Canada Inc, Montreal, CAN; Qiagen Gaithersburg, Inc. Gaithersburg, USA (from July 2007); Qiagen Hong Kong, Hong Kong (from May 2007); 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, F; Qiagen S.p A., Mailand, I; Qiagen Sciences, Inc, Germantown, USA; Qiagen Synthetic DNA, Inc, Alameda, USA; Xeragon, Inc, Germantown, USA

Non-Executive Member of the Board of Directors:

Digene Italy, s r l., Mailand, I (from October 2007); Digene UK (Holding) Ltd., London, UK (from September 2007), Digene UK Ltd., London, UK (from September 2007); 5 Prime Inc, Boulder, USA; Genaco Biomedical Products, Inc., Huntsville, USA; Gentra Systems, Inc., Minneapolis, USA; PG Biotech Ltd, Shenzhen, CN; Qiagen Iberia S.L., Madrid, E (from October 2007); Qiagen Inc, Mississauga, CAN; Qiagen K.K., Tokio, JP; Qiagen Malaysia Sdn Bhd, Kuala Lumpur, MY; Research Biolabs Pte. Ltd, SG; Research Biolabs Technologies Pte Ltd, SG

**Dr. Hubert Birner**

Chairman of the supervisory board:

DIREVO Biotech AG, Cologne.

Member of the supervisory board:

Jerini AG, Berlin.

Non-Executive Chairman of the Board of Directors:

Aigos Therapeutics Inc., Durham/North Carolina, USA; Spepharm Holding BV, Amsterdam, NL.

Non-Executive Member of the Board of Directors:

BioXcell SA, Milan, I; Proteon Therapeutics, Inc., Waltham, USA (from July 2007).

**Dr. Peter Fellner**

Non-Executive Chairman of the Board of Directors:

Astex Therapeutics Ltd, Cambridge, UK; Acambis plc, Cambridge, UK; Premier Research Group plc, Bracknell, UK (from September 2007).

Non-Executive Member of the Board of Directors:

Consort Medical plc (former Bepak plc), Milton Keynes, UK; Isis Innovation Ltd, Oxford, UK; QinetiQ Group plc, London, UK; UCB SA, Brussels, B

**Dr. William J. Jenkins**

Non-Executive Member of the Board of Directors:

Acambis plc, Cambridge, UK; BTG plc, London, UK; Eurand Pharmaceutical Holdings, N V., Amsterdam, NL; Monogram Biosciences, Inc., San Francisco, USA

**Mary Tanner**

Non-Executive Member of the Board of Directors:

Ariad Pharmaceuticals, Inc, Cambridge, USA (until January 2007); Synvista Therapeutics, Inc., Montvale, USA (former Alteon, Inc , Parsippany, USA)

### Scientific Advisory Board

The Scientific Advisory Board comprises the following five members:

Dr. Karsten Henco, Duesseldorf;

Prof. Dr. Christoph Hock, Zurich, CH;

Dr. William J. Jenkins, MD, Basel, CH;

Prof. Dr. Hanns Möhler, Zurich, CH;

Ian Ragan, Ph.D., London, UK;

Prof. Dr. Roger Nitsch, Zurich, CH (until March 2007)

During 2007 there was one meeting of the board. The remuneration amounted to IEUR 27 (2006: IEUR 35).

### Other Statements

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

Hamburg, February 27, 2008

  
Jörn Aldag

  
Dr. Klaus Maleck

  
Dr. Mario Polywka

## **Evotec AG, Hamburg**

### **Management Report for the financial year 2007**

#### **I. General Business Description**

##### **Company structure and business operations**

Evotec AG (Evotec or Company) is a publicly listed stock corporation operating under German law, with all of its shares (73,868,447 as of December 31, 2007) registered for trading on the Frankfurt Stock Exchange. The Company has subsidiaries in Hamburg, Oxford, UK and North Potomac, USA and employed 100 people at the end of 2007.

Evotec offers integrated and rational discovery biology solutions for third-party biotechnology and pharmaceutical companies and provides administrative and corporate services for the Evotec group.

Evotec provides partners with a choice of integrated research support capabilities from 'target to clinic', including assay development, screening, medicinal and computational chemistry, all of which can be provided as individual disciplines or as integrated research solutions.

In September 2007, Evotec proposed to acquire 100% of the shares of Renovis, Inc., a company incorporated in Delaware and located in South San Francisco, USA, active in research and development of drugs for pain and inflammatory conditions. This transaction is subject to a successful listing of Evotec's shares on National Association of Securities Dealers Automated Quotations (NASDAQ) and is planned to close in the second quarter 2008.

In 2007, Evotec acquired all of the shares of the privately held French company Neuro3d S.A. in exchange for 5,726,012 newly issued ordinary shares of Evotec.

Effective January 1, 2007, Evotec sold its 89% interest in Evotec Technologies GmbH (ET) to PerkinElmer for EUR 23.4 million in cash.

Evotec is governed by a dual board structure; a Supervisory Board (Aufsichtsrat) consisting of six members representing the interests of the shareholders and a Management Board (Vorstand) consisting of three members responsible for the strategic and operational management of the company together with Evotec's extended Management Team. This Team draws its membership from the senior executives with diverse expertise and experience in Finance, Research, Clinical Development, Business Development, Investor Relations and Human Resources.

## **Business and Operating Environment**

### **Global business environment in 2007**

Globalization and the relentless growth of the "new economies" China and India, including their growth in private wealth and consumer spending, a weakening US Dollar and US economy, an emerging crisis in global capital markets and continuous reform of healthcare legislation and regulation are the dominant factors influencing our macro environment.

#### *Globalization increases competition*

Globalization has in the last decade led to a borderless world where communication and business exchanges take place daily, even among countries separated by broad geographies. As the industrialization of China, India and other Asian countries continues apace, increasingly skilled local entrepreneurs are fuelling local growth by creating new high-value industries that can effectively compete with Western companies on the basis of lower labour inputs. Just as the information technology industry exploded in India and in China in the 1990's, life science support services are emerging in under-developed but emerging economies to respond to the high cost of biotechnology and pharmaceutical drug discovery and development. To date, the new entrants had their primary focus on delivering stand alone services, in particular in chemistry, out-competing their Western competition on cost and pushing Western companies to higher value added and more integrated offerings.

#### *Weak US-Dollar negatively impacts financial performance of non-dollar denominated competitors*

During 2007, the US Dollar continued to weaken against the Euro. The impact of this for Evotec is a reduction in revenues. Overall, Evotec lost approximately EUR 0.4 million gross margin due to currency effects, when compared to last year's level.

#### *Global capital markets severely hit by US housing crisis*

The summer of 2007 saw the beginning of a severe down-turn of global capital markets as a consequence of the dramatic cool down of an overheated US housing credit market (sub-prime credit market). Global financial institutions needed to make massive write downs and reduce interest rates despite fear of rising inflation. In this environment share prices have come under enormous

pressure and the ability of many companies to raise new equity has almost disappeared.

## **Business environment in the biotechnology sector in 2007**

### *Strong start and dramatic decline of financing environment in 2007*

Overall conditions for financings started favorably for biotechnology companies in the first half of 2007. 2007 was the second largest year after 2000 for biotech financing. In 2007, a total of \$ 30.7 billion (2006: \$ 29.7 billion) was raised, including \$ 2.9 billion in IPOs, \$ 4.3 billion in follow-ons, \$ 7.0 billion in venture capital, and \$ 16.4 billion in other fundraising. The funding, however, slowed dramatically towards year-end due to concerns about the state of the US economy and the state of capital markets. Expectations are that financing will remain restricted at least into the first half of 2008, potentially much longer depending on how well the financial system is coping with the aftermath of the crisis.

### *Pharmaceutical companies under continuous pressure*

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 and spends even more significant portions of available income on healthcare. 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 and market fragmentation, 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.

## **Impact of business environment on Evotec's strategy**

### *Acquisition of Renovis provides Evotec with a footprint in the US, an even stronger CNS pipeline and funds to develop those assets*

The capital markets for biotech companies and the vivid, innovative climate in the US dominate the world-wide biotech efforts. Direct access to this market represents a clear asset for a company such as Evotec and would potentially enhance the Company's shareholder value and future growth.

Evotec has identified Renovis Inc, a biopharmaceutical company with late-stage preclinical programs in pain and inflammation, as an ideal combination to build an even stronger CNS pipeline and get the footprint in the US market, in addition to \$86m of funds at the time of the merger announcement in September 2007.



### *Focus collaborations business on high value-added research*

Evotec has established a strong position in drug discovery collaborations. Cost is an important consideration in drug discovery and development but by far not the only one. Evotec's reputation for delivering the highest quality results within agreed budgets and timescales has been at the core of the Company's success. Based on these strengths, Evotec decided to focus its collaborations business on research programs providing disease biology expertise as well as its integrated process knowledge of drug discovery. Such higher value, results-driven activities allow the Company to share in its customer's success through royalties and milestones along with substantial research fees. Most competitors lack the scale and breadth of capabilities to compete at this level, or have chosen to focus on other specific niche areas.

## **II. Financial Report**

### **Results of operations**

#### **Revenues**

Evotec's revenues in 2007 amounted to € 13.3m, an increase of € 3.1m or 31% in comparison with the previous year (€ 10.2m). Third party sales increased by € 0.7m from € 8.6m (2006) to € 9.3m. Assay development continued to improve its performance by € 0.7m or 17%, whereas screening services decreased by € 1.5m or 39%. The new business area nuclear magnetic resonance (NMR) screening which was acquired by Evotec in June 2007 contributed € 0.4m. In 2007 Evotec benefited from € 1.1m higher royalty payments compared to 2006. Capacity for third party customers, especially for screening operations, was limited due to an increased demand from affiliated companies (€ 2.4m), to support both, work for external projects of subsidiaries and for the internal R&D programmes. The geographical spread of revenues for Evotec continues to be diverse and matches the sizes of the main markets for its products and services. The US market displaced Europe as the largest market for Evotec, but only marginally. The Japanese market is of lower significance. The top customer represented almost 37% of the revenues, but the remaining third party revenues are spread over a large number of different customers.

#### **Gross profit (Rohertrag)**

The gross profit (Rohertrag) for 2007 improved by € 3.1m to € 10.8m (2006: € 7.7m). A good capacity utilisation of the screening facility supported by the increased demand from subsidiaries generated higher project margins. Despite the increase in service activities, the cost of materials could be slightly reduced. The margin was improved by additional royalty payments (€1.1 m) but decreased by the weakened US Dollar which depressed revenues and affected gross profit negatively with € 0.4m.

## **Net income**

The net income for the year increased to € 2.3m (2006: € 2.0m). In 2006 the result was positively impacted by the reversing entry of write-offs of inter-company loans (€ 5.9m) from 2005. This write-off has been reversed in 2006 with the divestment of Evotec Technologies GmbH. In 2007 the divestments of Evotec Technologies GmbH and Direvo Biotech AG contributed an one time income of € 4.2m. The increase in net profit was supported by the improved gross profit as described above (€ +3.0m) and interest income (€ +0.4m) resulting from the higher average cash position held in 2007. Personnel expenses increased to € 7.7m (2006: € 6.9m) mainly due to increased headcount in 2007 in Discovery Biology (in average +13 employees) and was required to satisfy the increased external orders and internal requests by the subsidiaries but also to expand the own capabilities in structural biology and fragment-based screening. Other operating expenses increased from € 10.8m to € 11.5m mainly driven by consulting cost in connection with the acquisition of Neuro3d S.A. and pre-merger cost for the aspired acquisition of Renovis Inc. Remaining Selling, General and Administrative (SG&A) expenses increased but were predominantly group related so that they were recharged to the operating units as Evotec provides administrative and corporate services for the group and recharges related costs to its subsidiaries.

## **Financing and financial position**

### **Cash and Financing**

As per December 31, 2007, Evotec's cash and cash equivalents of € 19.2m were substantially lower than at the end of 2006 (€ 56.0m), mainly caused by intercompany loans given to its affiliate EVOTEC NeuroSciences GmbH to finance Evotec's internal R&D programmes. Furthermore, cash was used for the diverse transactions in 2007 including a purchase price adjustments to PerkinElmer, buying of NMR Screening assets from Combinature Biopharm AG and the aspired acquisition of Renovis Inc. In 2006 Evotec AG benefited from a capital increase of net € 17.8m.

### **Assets and liabilities**

### **Capital structure**

Evotec increased its share capital in the second quarter of 2007 due to the issuance of 5.7 million new shares for the acquisition of Neuro3d S.A. in a share-for-share transaction. The price per share amounted to EUR 3.69. As a result, the share capital of the Company increased to €73.9m (year-end 2006: € 68.1m), and total equity to €139.1m (year-end 2006: €115.6). 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. Evotec ended the year with an equity ratio of 86.1% (2006: 74.9%), due to the generally low amount of liabilities (€ 17.8m 2006: € 34.2) held by

Evotec, thereof only € 6.0m with suppliers and banks, the rest mainly related to subsidiaries. The equity ratio at end 2006 was reduced short-term by the € 22.2m proceeds from the ET divestment that were classified as other current liabilities and therefore increased liabilities until January 1, 2007, when the sale became effective.

### **Net assets and liabilities**

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

As in previous years new investments in tangible fixed assets were handled restrictive also in 2007. Tangible fixed assets increased only from € 4.4m at year-end 2006 to € 4.7m despite the investment in NMR screening assets (€ 0.9m) from Combinature Biopharm AG in 2007.

During 2007, although financial assets were reduced by the sale of shares of Evotec Technologies GmbH and Direvo Biotech AG (€ 3,3m), overall, they increased to € 84.3m (year-end 2006: € 66.4m) due to the acquisition of Neuro3d S.A.

As per December 31, 2007 inventories were slightly lower (€ 1.9m) as per end of 2006 (€ 2.1m). Receivables increased to € 50.8m (2006: € 25.0m) mainly due to increased accounts receivable from affiliated companies (€ 24.8m) and trade accounts receivable (€ 0.6m). The increase in accounts receivable from affiliated companies is mainly caused by € 41.2m new inter-company loans granted to EVOTEC NeuroSciences deducted by € 16.7m inter-company loans with Evotec Technologies in 2006, which were credited against the purchase price. As mentioned before, these effects also had an impact on the lower cash position in 2007.

Evotec's debts towards financial institutions increased to € 3.0m as per December 31, 2007 (year-end 2006: € 1.3m). The remainder of the debt in 2006 was paid back in June 2007 and a new maturity loan of € 3.0m borrowed in December 2007, repayable end of 2009. Trade accounts payable changed from € 0.9m to € 3.0m. Liabilities with affiliates accumulated to € 11.1m (year-end 2006: € 6.1m), primarily as a result of inter-company loans from Evotec (UK) which increased by € 5.8m. Other current liabilities in 2006 mainly include the received purchase price from PerkinElmer for the sale of Evotec Technologies which became effective on January 1, 2007 as well as the liability for the minority shares of ET which together totalled € 24.8m. Adjusted for these effects, both years are on the same level.

## **Employees**

Evotec employed on average 94 staff in 2007 compared to 83 in the year before. Headcount was increased in discovery biology operations to satisfy the increased external orders and internal requests by the subsidiaries but also to expand the own capabilities in structural biology and fragment-based screening.

## **III. Risk Management and Risk Report**

### **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 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 company'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. 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 those 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 standardized procedures. In addition, the Company emphasizes 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 programs are in place. The Company also complies with the German Corporate Governance Codex, with the only exception being employee share options exercisable independent of the development of various comparison parameters, as recommended in section 4.2.3 of the Code.

Evotec's **risk management system** is regularly reviewed in order to adjust to changing environments, risk profiles and business opportunities. Since January 2007, preparations for an upgrade system were on going, which became effective in its current form in April 2007. This system 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 regular 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 Risk Manager evaluates and summarizes the various risk sheets into a quarterly report for the Management Board. 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 emphasizes the principle of risk prevention across the group.

#### **Change-of-control and authorizations**

Evotec's management focuses on value creation. To that degree, any change-of-control or takeover offer, that realizes some of the embedded value of the Company for the benefit of current shareholders, is carefully analyzed with regard to the synergies proposed and the future value creation claimed. A change in control will generally have occurred if, as a result of any takeover, exchange or other transfer, a single shareholder or a group of shareholders acting in concert acquires more than 50% of the outstanding voting rights in Evotec or, if as a result of a merger or reverse merger the shareholders of Evotec prior to the effective date of such transaction cease to own more than 50% of the outstanding voting shares in the merged entity.

There are no specific takeover-defense 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 organizations, TVM V Life Science Ventures GmbH & Co. KG and ROI Verwaltungsgesellschaft mbH, together with its affiliates, hold each more than 5% and 10% of the shares, respectively as at December 31, 2007.

The Management Board (Vorstand) is elected by the Supervisory Board for a maximum of three years and has only customary change-of-control rights. Their

individual contracts contain a change-of-control clause, which would allow management to terminate their current contracts in the event of a change-of-control. The resulting severance entitlement is one year base salary and bonus calculated on the basis of the prior year's remuneration.

As of December 31, 2007 the Company was not authorized to purchase Evotec stock to a larger extent. It has only been authorized by the last shareholder meeting to repurchase stock to the degree needed for Supervisory Board compensation. The Company was allowed to issue new stock up to 50% of existing capital (Authorized Capital). Any shares to be issued on this basis will be subject to the statutory subscription rights of Evotec's shareholders. It can be done without pre-emptive purchase rights of existing shareholders only under certain well defined conditions. In addition, the shareholders of Evotec approved conditional capital in an amount of up to €7,199,380.00. The capital increase takes effect only to the extent that holders of stock options awarded by Evotec on the basis of a shareholders' resolution exercise their rights to subscribe the new shares. Further detail regarding these capitals can be found in the Company's articles of association.

An amendment to the Company's articles of association requires a shareholder resolution. The shareholder resolution requires an affirmative vote of at least three quarters of the Company's share capital present at the general shareholder meeting.

In summary, current shareholders are free to choose the best route to capture the value of their stock, be it by agreeing to a proposed take over offer or be it by holding on to it believing in an increased internal value creation of the Company.

### **Systematic management approach to capturing business opportunities**

Evotec's businesses rely on its access to innovation, for example via academic partnerships or in-licensing and acquisition 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-adjusted value generation. 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 through the high motivation and ambition of the Company's employees. The Management Team of the Company and the management bodies dedicated to discovery, development and research collaborations strive for consensus decisions that will maximize 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.

### 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 Group's **Pharmaceuticals Division** is mainly performed outside Evotec AG. Operational activities in 2006 were two small innovative projects with the aim to access novel drug candidates through collaborations with small biotechnology companies or academic partners.
- Evotec's collaborations business (**Services Division**) is well established within the industry, and has generated a steady revenue stream over the last years. The continuous drive for increasing research efficiency, combined with superior service quality, allows Evotec to generate value through positive cash contributions, and a shared and leveraged research platform with its customers. 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, firm 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, as exemplified in the set-up of a Joint-Venture with RSIL to improve the cost basis of the chemical library business.
  - Evotec intends to employ increasing parts of its capacity for results-based deals, with the goal to keep a higher share of value creation. In return, there are scientific and technical delivery risks in the shorter term, which can expose Evotec's financial performance and particular the service business margins to the possible failure or delay of certain milestone payments. Overall, this value strategy has been validated to date with only a few customers, and the experiences might not be transferable to other customers and contracts.
  - Even when exhibiting a steady revenue stream, fluctuating capacity utilization 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 2007, the largest volume generated with one single customer was 37%.
  - Some of the service contracts contain scientific or technical delivery risks, which can be only partly mitigated with high quality project work.

- With a high proportion of sales denominated in US Dollar currency exposure creates a risk to Evotec's profitability.

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

Similarly, the risks assumed in the acquisition of Neuro3d are limited to customary guarantees given to the old shareholders. Evotec does not foresee any material warranty of future liability claims.

### **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 maintaining a highly competitive research collaborations 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. 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.

### **IV. Post balance sheet events**

On January 7, 2008 the Company has filed a registration statement on Form F-4 to register with the US Securities and Exchange Commission (SEC) the Evotec AG ordinary shares.

On February 14, 2008 Evotec reported a three-year contract extension with CHDI for integrated drug discovery support in the treatment of Huntington's Disease.



## **V. Outlook**

### **Business direction**

The Company divested non-core activities for cash and announced an agreement to acquire Renovis Inc. to enhance its proprietary pipeline on a group level. Evotec's business strategy is based on innovative collaborations in which customers fund research. In its research collaborations, the Company works with customers on a wide variety of disease areas and target classes. Evotec's strategy focuses on increasing its level of participation through results-based partnerships, resulting in milestones and royalties for Evotec in addition to research payments. The customer segments addressed include pharmaceutical and biotechnology companies, research foundations, and academia.

Geographically, North America and Europe are expected to contribute more than 90% to external revenues, as these are the largest markets for drug discovery and development.

Evotec has a broad spectrum of integrated drug discovery and development skills and assets. To maintain its competitive advantage, Evotec will continue to leverage advanced technologies, superior know-how and expertise in areas such as fragment-based drug discovery and for multiple target classes, in particular ion channels and GPCRs.

#### *Acquisition of Renovis Inc.*

On September 18, 2007, Evotec signed a definitive agreement to acquire the shares of Renovis, the US-based biopharmaceutical company, in a share-for-share transaction. Renovis has multiple preclinical programs for the treatment of pain and inflammatory conditions, two of which are expected to progress into clinical trials in 2008.

Upon the successful closing of this transaction, Evotec will issue to Renovis shareholders American Depositary Shares (ADSs) representing 1.0542 Evotec shares in exchange for each outstanding share of Renovis. After the closing of the transaction, current Evotec stockholders would own approximately 68.8% of the combined company and Renovis stockholders would own up to 31.2%. The transaction is expected to close during the second quarter of 2008 and is subject to the approval of Renovis' stockholders, approval of Evotec's NASDAQ listing and antitrust regulatory clearance, as well as other customary closing conditions.

## **Market environment**

### *Well positioned in a more adverse market environment*

The business environment in the biotechnology sector in 2007 including future trends and the impact on Evotec's business strategy are described in detail in the section Business and Operating Environment of this report.

Evotec expects to be well positioned in difficult financial markets and in a more challenging regulatory environment. The pharmaceutical industry remains under pressure to increase R&D productivity and the prices for drug candidates continue to rise due to increased licensing competition. Analysts expect this trend to continue. Companies delivering innovation and R&D productivity in research collaborations, such as Evotec, can benefit enormously.

## **Profitability outlook**

### **Revenues**

For 2008, the contract pipeline for the Services business shows increased demand from third parties as well as from affiliated companies in comparison to 2007 at the same time last year. The demand from affiliated companies relates to both work for external projects of subsidiaries and proprietary projects where the Evotec group itself holds rights to drug candidates. Revenues in 2009 are expected to be in the range of 2008 projections.

### **Results**

Evotec's result will operationally depend on the financial performance of its Services Business. Negative contributions will originate from corporate expenses not chargeable to the affiliates. Due to the proposed acquisition of 100% of the shares of Renovis, Inc., and the related listing of Evotec's shares on NASDAQ those corporate expenses will increase in 2008. In 2009 these expenses will decrease again, but not back onto the 2007 level.

It has to be noted that actual results as well as individual contributions from revenues and costs could materially deviate from these assumptions.

Evotec's technical infrastructure requires regular investment in fixed assets which are currently expected to be at the same level as depreciation over the next few years.

## Management's mid-term assessment

Evotec has executed transactions during the last two years that allow the Company to benefit more than in the past from the value creation in the pharmaceutical industry. The environment in which Evotec acts is in urgent need for collaborations that give access to innovation and research productivity.

Competing demand for Evotec's collaborative product offerings could therefore result in higher retained value for the Company. Should Evotec be able to use these strength optimally and successfully manage the build-up of multiple results-based collaborations, the Company has an opportunity to build significant long-term value for its shareholders.

## Dividends

A 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 and to use them to further develop the Company and to enhance shareholder value.

Hamburg, February 27, 2008



Jörn Aldag



Dr. Klaus Maleck



Dr. Mario Polywka



## 7 Auditor's Report

We have rendered our unqualified auditor's report in German as set out in Appendix B5 which was translated as follows:

### „Auditor's Report

We have audited the annual financial statements, comprising the balance sheet, the income statement and the notes to the financial statements, together with the bookkeeping system, and the management report of Evotec AG, Hamburg, for the financial year from January 1 to December 31, 2007. The maintenance of the books and records and the preparation of the annual financial statements and management report in accordance with German commercial law are the responsibility of the Company's management. Our responsibility is to express an opinion on the annual financial statements, together with the bookkeeping system, and the management report based on our audit.

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

Our audit has not led to any reservations.

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

Hamburg, February 27, 2008

KPMG Deutsche Treuhand-Gesellschaft  
Aktiengesellschaft  
Wirtschaftsprüfungsgesellschaft

Schadeck  
Wirtschaftsprüfer

Boßow  
Wirtschaftsprüfer

