



Evotec OAI AG, First Quarter Report 2003

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Dear shareholders,

We are pleased to report another good performance for Evotec OAI again in Q1 2003. Although our biotech clients continue to face considerable financing pressures, our strong competitive position in drug discovery services and innovative deal structures, such as the umbrella contract we signed last year with the venture capital firm Oxford Bioscience Partners to serve their portfolio companies, helped our discovery business to perform strongly. New contracts have been signed with Novartis, British Biotech, Chroma Therapeutics and the OBP portfolio companies Dynogen Pharmaceuticals and Psychiatric Genomics. In addition, we have extended our collaborations with UCB and Amgen. These achievements have contributed significantly towards our order book for the year.

In addition to delivering a strong revenue performance, executing on our cost containment programme will be a key focus in 2003. In Q1 we significantly reduced our R&D and SG&A expenses compared to last year, as outlined in October 2002. Thanks to these cost savings, the operating loss improved by 17% over the same period of 2002 and we maintained our cash position at EUR 21 million (Dec 31, 2002: EUR 21 m).

In summary, we are confident that 2003 will be a good year for Evotec OAI and that the measures taken have helped the company to build a cash flow positive services business.

Highlights

Successfully delivering customer projects

We have continued to shape our offering to support our customers in efficient drug discovery and development. This is evidenced by a whole series of new contracts and contract extensions.

Discovery chemistry programmes with companies like **Amgen, Curis, Pharmacia, Roche and Solvay** continued to develop according to plan. In addition to several OBP portfolio companies, **Chroma Therapeutics** was added to our list of customers in Q1 2003. **Amgen** extended their extensive lead optimisation programme with us, which significantly added to our order book for the year. In our collaboration with **Merck & Co.** the chemistry for the synthesis of further libraries has been agreed after delivery of previous libraries in December.

Key projects in discovery biology included various target screens for **Key Neurotek, Elixir and Infinity Pharmaceuticals** as well as our assay development project with **Pfizer**. In addition to our assay development and screening collaboration we started our first virtual screening project with **SiREEN**.

Performance in development chemistry exceeded our cautious expectations in Q1. One of our key customers, **GlaxoSmithKline**, expanded its outsourcing activities with us. GSK projects ranged from custom preparations to several process research and development programmes which subsequently progressed into kilogramme production of GMP material for clinical trials. Further key projects involved **Pfizer, AstraZeneca, Elan, Neurocrine, Celgene, Serono, Oxigene and UCB**. UCB extended its collaboration with Evotec OAI for an additional 12 months, increasing the number of chemists dedicated to development projects. **Infinity** was also added to our client list in development chemistry, and now takes a wide range of our services.

Assay development and screening agreement signed with Novartis Pharma

Following a successful collaboration in the development of our EVOscreen® uHTS system, **Novartis Pharma** has chosen Evotec OAI to support their lead discovery efforts. In March, we signed an assay development and screening contract to identify drug candidates for several Novartis targets.

Research group and discovery contracts taken over from British Biotech

We announced in March that **British Biotech**, as part of their merger with RiboTargets, would transfer 17 research scientists to Evotec OAI, effective April 1st, and outsource medicinal chemistry and biology research activities to Evotec OAI.

Evotec OAI will work under contract for British Biotech on its anti-inflammatory and anti-bacterial drug discovery research programmes, which are managed by British Biotech and its collaborative partners - Serono for inflammatory disease and GeneSoft for bacterial infections.

The transfer of British Biotech's associated laboratory operations is in line with our growth strategy, extending our capacity through immediate access to an established group of high caliber research scientists. In 2002, we also commissioned additional chemistry laboratories at our site at Abingdon, near Oxford, to accommodate new and expanding programmes

OBP partnership further strengthens presence in US biotech market

Genomics/proteomics companies are increasingly concentrating on their key competence – disease biology as a source of novel drug targets - and seeking external specialists in other areas. Examples of this trend were two contracts with OBP portfolio companies in Q1 2003, **Dynogen Pharmaceuticals and Psychiatric Genomics**, further strengthening our presence in the US biotech market.

Continued improvement of technology platform and skills

Evotec OAI is committed to continuously enhancing the excellent performance of its drug discovery platform and applications skills. To this end, research activities of our core business in Q1 2003 were focussed primarily on the extension of our cellular assay portfolio as well as the further improvement of data quality. Auto-fluorescent particles are a common problem encountered frequently when working with fluorescent assays. To reduce the amount of false positive and false negative results in the selection of drug candidates stemming from such auto-fluorescent particles we have put significant effort into automatically eliminating this undesired effect in uHTS through a proprietary filtering algorithm. As part of the extension of our assay portfolio we are adapting translocation and reporter gene assays to the uHTS format.

Evotec Technologies building on strong customer relations

Evotec Technologies (ET) was successful in building on its long-term collaborations with existing clients in Q1. Ahead of schedule we achieved site acceptance testing of EVOscreen® Mark III at Pfizer's research site in Sandwich, UK, as part of the new contract signed in October 2002. The system complements the Mark II platform installed in 2001, providing Pfizer with a powerful engine for ultra-high-throughput screening. Its cellular module is scheduled for delivery in mid 2003 and this will trigger a milestone payment. In addition, our partner Olympus Optical has extended the application development contract for the MF 10 and MF 20 readers for another 12 months.

ET's cell-analyser, "Opera", which combines the high resolution of confocal laser scanning microscopy with the speed of ultra high-throughput performance, was successfully launched in the US at Screentech (San Diego) in March 2003. We have had positive feedback and the first customer workshops have been booked in our application centres in the US and Germany.

Financial Report

Revenue

Evotec OAI revenues for the first quarter of 2003 amounted to EUR 17.8 million (2002: EUR 16.9 million). With this 5% increase over Q1 2002 we exceeded our internal expectations for the quarter and are on track to reach our growth target of 10 to 15% for the full year 2003.

Commenting on Q1 growth, two effects need to be taken into account:

1. Our business was affected by adverse currency effects from sales recognised in US-Dollar and UK Sterling, which depreciated against the Euro. If the exchange rates seen in Q1 2002 were applied to Q1 2003, revenues in Q1 2003 would have been EUR 1.7 million higher and growth would have been 15%.
2. Q1 sales the previous year were particularly strong. They included EUR 2.3 million extraordinary revenues deferred from Q4 2001. After adjusting for this deferral last year, Q1 2003 revenue growth reached an impressive 22%.

Our **Discovery and Development Services Division** (DDS) achieved third party revenues of EUR 13.3 million (2002: EUR 14.9 million) in the first quarter of 2003. In 2002, the accounting for milestones in our collaborations with MediGene and Altana Pharma, as well as revenues from pilot plant orders which were deferred from 2001, contributed to an extremely strong Q1 in this division. In addition, the currency effect described above affected our DDS.

Our core product lines, discovery chemistry and biology services, continued to perform strongly in line with our expectations. We were particularly pleased that development chemistry services exceeded our cautious internal expectations although the market environment remains highly competitive.

For the three months to March 31, 2003, our **Tools and Technologies Division “Evotec Technologies”** demonstrated an excellent performance. Revenues grew by 122% to EUR 4.5 million (2002: EUR 2.0 million). This strong growth over the comparable period of 2002 is attributed to the successful installation of the first EVOscreen® Mark III system under the extended Pfizer contract.

In Euro currency terms, 60% of total group revenues were recorded in Europe, 37% in the United States, and 3% in Japan and Rest of World.

Research and development and other cost

As planned, **R&D** expenses were reduced significantly as a result of the cost-cutting measures initiated in October 2002 which reduced R&D expenses in the area of our EVOscreen® development. Q1 R&D costs

amounted to EUR 4.4 million, down 19% over the same period of the previous year (2002: EUR 5.5 million). Following the successful development of our EVOscreen® platform, we have cut headcount in the area of technology research. Reductions in R&D spending are not in areas which are considered core to our business plan.

Cost of revenues were EUR 11.0 million (2002: EUR 10.1 million). The decline in gross margins to 38.3% (2002: 40.4%) is a result of the unfavourable US-Dollar exchange rate effect which accounts for approximately EUR 0.7 million deterioration in gross margin. If last year's US-dollar exchange rates were applied, the Q1 gross margin would have exceeded last year's level (40.6%).

SG&A costs in Q1 declined by 13% to EUR 4.6 million (2002: EUR 5.2 million). This is a result of our various cost reduction initiatives as well as exchange rate effects.

Result

The Evotec OAI group **operating loss** for Q1 2003 decreased by 17% to EUR (5.8) million (2002: EUR (7.0) million). This improvement is mainly a consequence of reduced R&D in non-core areas as well as reduced SG&A expenses following our stringent cost management programme. Excluding amortisation charges, loss from operations for the first three months improved to EUR (3.0) million (2002: EUR (3.9) million).

Net loss improved by 12% to EUR (5.0) million (2002: EUR (5.7) million), again, primarily as a consequence of reduced R&D and SG&A cost. Income taxes totalled EUR 0.6 million, as deferred tax expenses in the UK (EUR (0.1) million) were offset against deferred tax benefits from the amortisation of merger-related non-goodwill intangible assets (EUR 0.7 million).

Net income per share amounted to EUR (0.14) (2002: EUR (0.16)).

Earnings before interest and taxes, depreciation and amortisation (**EBITDA**) improved by 48% to EUR (0.3) million (2002: EUR (0.7) million), almost achieving EBITDA break-even already in the first quarter of the year.

Capital expenditure

In Q1 we invested EUR 1.7 million in fixed assets, which mainly included laboratory/analytical equipment. We expect the majority of the company's anticipated capital expenditures to be recorded during the rest of the year. These investments will primarily be targeted at meeting the required capacity increase in discovery chemistry with leasehold improvements and the purchase of laboratory equipment.

Cash flow and cash equivalents

In Q1 2003 cash flow from operating activities improved to EUR (0.3) million (2002: EUR (0.7) million), despite an increase of our working capital

by EUR 0.1 million (2002: EUR (0.5) million). Net cash flow from financing activities totalled EUR 2.3 million (2002: EUR 0.1 million). We have drawn down bank loans for the financing of capital expenditures relating to the fit out of a new laboratory building in Abingdon. Cash and cash equivalents at the end of the first quarter were almost unchanged and amounted to EUR 21.0 million.

Employees and management

As of March 31, 2003, Evotec OAI employed 645 people. As planned, measures to reduce headcount in technology development continued to take effect in Q1 2003. At the same time we increased capacity in discovery chemistry to respond to market demand, and further strengthened our Discovery Programs Division.

Stock option programme

In Q1 2003 we issued 46,000 stock options to new employees at an exercise price of EUR 1.66, 1.93 and 2.03. The majority was granted to Dr Ian Hunneyball as new member of the Management Board. As of March 31, 2003, the total number of options that are available for future exercise amounts to 2,127,989 or approximately 6% of the currently issued shares.

Order book and outlook

Growing from a very strong base in Q1 2002 and despite considerable currency effects, our performance in the first three months exceeded our internal expectations. Our order book continues to be solid and as of April amounted to EUR 61 million for 2003, covering 78% of current revenue expectations for the year (analysts' consensus: EUR 78 million). Since the last time we have reported our order book we have now assumed the current adverse foreign exchange effect to remain for the entire year. Without this adjustment it would have amounted to EUR 64 million. On the basis of a promising pipeline of new orders, we are confident of achieving our growth target of 10 to 15 % for the year, even assuming that the outsourcing market environment remains challenging for the rest of the year.

The cost saving measures we took in the second half of 2002 have begun to take effect without impairing our core capabilities. The company was close to break-even at the EBITDA level in the first quarter and is on track for positive EBITDA for the full year 2003.

Shareholdings of the Boards of Evotec OAI AG

	Number of shares	Share options
Management Board		
Joern Aldag	286,556	132,600
Dr Dirk H. Ehlers	0	60,000
Dr Ian M. Hunneyball	0	40,000
Dr Timm-H. Jessen	136,172	83,232
Supervisory Board		
Prof Dr Heinz Riesenhuber	110,400	0
Peer Schatz	3,892	0
Dr Pol Bamelis	1,500	0
Dr Karsten Henco	1,306,356	26,732
Dr Edwin Moses	313,058	15,000
Michael Redmond	1,000	0

March 31, 2003

Pursuant to §15a of the German Securities Trading Act (Wertpapierhandelsgesetz), the above table lists separately for each member of our Management and Supervisory Board, the number of Company shares held, and rights for such shares granted to each board member as of March 31, 2003.

Segment reporting according to US GAAP

Evotec OAI AG and Subsidiaries

Euro in thousands except share data	Discovery and Development Services	Discovery Programs ¹	Tools and Technologies	Consolidation
Revenue:				
– Drug discovery products & development of technologies	1	-	4,519	(50)
– Drug discovery services	13,845	3	-	(498)
Total revenue	13,846	3	4,519	(548)
– Cost of revenue	8,329	2	2,766	(101)
Gross Profit	5,517	1	1,753	(447)
– Selling, general and administrative expenses	2,984	433	675	490
– Research and development expenses	1,884	1,290	1,673	(418)
– Other operating expenses	849	-	-	-
– Amortisation of goodwill amongst other things	2,681	17	254	(198)
Operating income (loss)	(2,881)	(1,739)	(849)	(321)

¹ In 2002 included in Discovery and Development Services

Condensed consolidated statements of operations according to US GAAP

Evotec OAI AG and Subsidiaries

Euro in thousands except share data and per share data

	01-03/2003	01-03/2002	Δ in %
Revenue:			
– Drug discovery products & development of technologies	4,470	2,288	95.4
– Drug discovery services	13,350	14,656	(8.9)
Total revenue	17,820	16,944	5.2
– Cost of revenue	10,996	10,090	9.0
Gross profit	6,824	6,854	(0.4)
– Selling, general and administrative expenses	4,582	5,235	(12.5)
– Research and development expenses	4,429	5,471	(19.1)
– Other operating expenses	849	-	100.0
– Amortisation of goodwill amongst other things	2,754	3,107	(11.4)
Operating income (loss)	(5,790)	(6,959)	16.8
– Interest income (expense)	46	148	(68.9)
– Income from investments and participations	-	-	-
– Income (expense) from associated companies	(36)	-	(100.0)
– Foreign currency exchange gain (loss), net	(96)	146	(166.4)
– Other income (expense)	310	400	(22.5)
Result before income taxes and minority interests	(5,566)	(6,265)	11.2
Income tax	614	546	12.5
Extraordinary income (expenses)	-	-	-
Result before minority interests	(4,952)	(5,719)	13.4
Minority interests	(46)	15	(406.7)
Net income / loss	(4,998)	(5,704)	12.4
Net loss per share (basic)	(0.14)	(0.16)	
Net loss per share (diluted)	-	-	
Weighted average common share outstanding (basic)	35,510,130	35,507,047	
Weighted average common share outstanding (diluted)	-	-	
Depreciation of property, plant and equipment included in total operating expense	2,556	2,618	(2.4)

Condensed consolidated balance sheets according to US GAAP Evotec OAI AG and Subsidiaries

Euro in thousands	31/03/2003	31/12/2002	Δ in %
Assets			
Current assets:			
– Cash and cash equivalents	20,987	21,308	(1.5)
– Marketable securities, at fair value	-	-	-
– Trade accounts receivable	10,298	10,166	1.3
– Accounts receivable due from related parties	523	244	114.3
– Inventories, at cost	8,789	8,408	4.5
– Deferred tax assets	43	45	(4.4)
– Current tax receivables	2,434	2,665	(8.7)
– Prepaid expenses and other current assets	2,429	3,196	(24.0)
Total current assets	45,503	46,032	(1.2)
Long-term investments	590	560	5.4
Property, plant and equipment, net	58,778	61,951	(5.1)
Intangible assets, excluding goodwill, net	25,580	29,601	(13.6)
Notes receivable / loans	-	-	-
Goodwill, net	99,296	102,851	(3.5)
Deferred taxes	-	-	-
Other non-current assets	47	47	-
Total assets	229,794	241,042	(4.7)
Liabilities and stockholders' equity			
Current liabilities:			
– Current portion of capital lease obligation	242	386	(37.3)
– Current maturities of long-term loans	1,384	1,067	29.7
– Trade accounts payable	3,849	4,565	(15.7)
– Accounts payable to related parties	19	8	137.5
– Advanced payments received	4,261	5,703	(25.3)
– Accrued expenses	4,944	5,552	(11.0)
– Deferred revenues	4,980	2,695	84.8
– Current tax payables	37	80	(53.8)
– Deferred taxes	-	-	-
– Other current liabilities	1,763	1,404	25.6
Total current liabilities	21,479	21,460	0.1
Long-term loans	8,907	6,820	30.6
Long-term capital lease obligations	1,006	1,113	(9.6)
Deferred taxes	14,259	15,544	(8.3)
Other non-current liabilities	53	53	-
Minority interests	690	645	7.0

Stockholders' equity:			
– Share capital	35,510	35,510	-
– Additional paid-in capital	536,911	536,908	-
– Treasury stock	-	-	-
– Retained earning/accumulated deficit	(354,004)	(349,006)	(1.4)
– Accumulated other comprehensive income/loss	(35,017)	(28,005)	(25.0)
Total liabilities and stockholders' equity	229,794	241,042	(4.7)

**Condensed consolidated
statements of cash flows according to US GAAP**
Evotec OAI AG and Subsidiary

Euro in thousands	31/03/2003	31/03/2002
Cash flows from operating activities:		
Net loss	(4,998)	(5,704)
Adjustments to reconcile net loss to net cash used in operating activities	4,857	4,508
Change in assets and liabilities	(119)	525
Net cash (used in) provided by operating activities	(260)	(671)
Cash flows from investing activities:		
Purchase of marketable securities	-	-
Purchase of investment	-	(3)
Purchase of property, plant and equipment	(1,723)	(1,343)
Purchase of intangible assets	-	(942)
Proceeds from sale of property, plant and equipment	-	3
Proceeds from sale of investments	-	1,120
Proceeds from sale of marketable securities	-	4,938
Net cash (used in) provided by investing activities	(1,723)	3,773
Cash flows from financing activities:		
Net proceeds from capital increase	-	-
Net proceeds from increase of bank loan	2,843	54
Repayment of bank loan	(590)	-
Net cash flow (used in) provided by financing activities	2,253	54
Net increase in cash and cash equivalents	270	3,156
Exchange rate difference	(591)	(115)
Cash and cash equivalents at beginning of year	21,308	18,651
Cash and cash equivalents at end of the first quarter	20,987	21,692
Cash, cash equivalents and marketable securities at end of the first quarter	20,987	26,067

Consolidated statements of changes in stockholders' equity

Evotec OAI AG and Subsidiaries

Euro in thousands except share data								
	Share capital Shares	Share capital Amount	Additional paid-in capital	Unearned compen- sation	Foreign currency translation adjustment	Unrealised gains (losses) on securities	Accumu- lated deficit	Total stock- holders' equity
Balance at December 31, 2001	35,507,047	35,507	536,857	(635)	(6,914)	152	(217,376)	347,591
Share capital increase	3,083	3	17	-	-	-	-	20
Stock option plan	-	-	34	290	-	-	-	324
Comprehensive loss:								
- Foreign currency translation	-	-	-	-	(20,746)	-	-	(20,746)
- Unrealised holding gains on available-for-sale securities	-	-	-	-	-	(152)	-	(152)
- Net loss	-	-	-	-	-	-	(131,630)	(131,630)
Total comprehensive loss	-	-	-	-	-	-	-	(152,528)
Balance at December 31, 2002	35,510,130	35,510	536,908	(345)	(27,660)	-	(349,006)	195,407
Share capital increase	-	-	-	-	-	-	-	-
Stock option plan	-	-	3	72	-	-	-	75
Comprehensive loss:								
- Foreign currency translation	-	-	-	-	(7,084)	-	-	(7,084)
- Unrealised holding gains on available-for-sale securities	-	-	-	-	-	-	-	-
- Net loss	-	-	-	-	-	-	(4,998)	(4,998)
Total comprehensive loss	-	-	-	-	-	-	-	(12,082)
Balance at March 31, 2003	35,510,130	35,510	536,911	(273)	(34,744)	-	(354,004)	183,400

The financial statements of the reported period were prepared using the same accounting policies as for the year 2002.