



Evotec OAI AG, First Quarter Report 2002

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Dear shareholders,

we are pleased to report on the Q1 2002 progress of Evotec OAI. Our comprehensive drug discovery service, encompassing all the major biology, screening and chemistry activities to develop candidate drugs, continued to perform well. A number of new deals have been signed as well as extensions and expansions of existing ones. This reflects the continuing quality of our integrated services and its value to our collaborators. New contracts have been signed with Ionix, Point, SiREEN, whilst we have extended contracts with Vertex, Amgen, Roche and Serono. Two important milestones in our collaborations with MediGene and Byk Gulden have also been met in March. As usual, we were able to charge fees for our high-quality services, and secure upsides through milestones and royalty provisions.

In technology development we are particularly proud that our long-term partner Novartis has decided to acquire additional Evotec OAI screening devices (EVOscreen®) exceeding the scope agreed in the original screening technology contract signed in 1996. This is a further blue chip validation of our leading screening platform EVOscreen® Mark III after the acceptance of the first clone by GlaxoSmithKline at the end of last year. This demonstrates Novartis' high degree of trust in our technology and their appreciation of our collaboration.

Several partnerships signed...

In January we announced the second one-year, EUR 2.4 million extension of our lead optimisation programme with **Serono S.A.**. As part of the programme Evotec OAI scientists provide lead optimisation services and synthesise small molecule focused libraries exclusively for Serono's drug discovery projects. The collaboration, which started in October 1998 as a focused chemical library agreement, has grown into a long-term discovery and development partnership. Evotec OAI will receive milestone payments for all patented compounds which may enter clinical trials and royalties for those which may be commercialised.

We also extended our original one-year discovery chemistry agreement with **Roche** for an additional two years, following a highly successful collaboration during 2001/2. Evotec OAI will supply chemical compound libraries and related data to Roche on a range of chemical structures. These compounds will be added to Roche's worldwide compound library collection and used in their drug discovery screening programmes to strengthen Roche's ability to discover new medicines.

At the beginning of 2002 Evotec OAI and **Ionix** started a collaboration on the design and synthesis of drug-like chemical compounds for evaluation as potential inhibitors of an Ionix ion channel drug target that is involved in the perception and signalling of pain. Antagonists for this target may lead to potent new drugs for the management of chronic inflammatory and neuropathic pain, with a novel mechanism of action.

With **SiREEN** we added another customer to our client list for which Evotec OAI provides services along the entire target-to-IND value chain. Evotec OAI performs assay development, screening - using its high-quality lead discovery library - and chemical synthesis for up to four targets over the next three years. For the initial programme SiREEN will pay to Evotec OAI fees for services. In addition, Evotec OAI received an equity stake in SiREEN.

The agreement combines both companies' core technologies and allows either party to access these for use in their drug discovery and service offerings respectively. Both companies will receive milestone and royalty payments for the services provided. The agreement also includes an option to extend the collaboration beyond discovery to drug development programmes.

... and important milestones achieved validate the quality of our services

In March we successfully completed phase 1 of the agreement with **Byk Gulden**. In close collaboration with Byk Gulden Evotec OAI scientists have developed a new and complex assay programme using Evotec OAI's novel detection platform for high-throughput cell imaging (Opera). The assay principle has been successfully demonstrated, providing excellent scientific data. As a result of the accomplishments to date, Evotec OAI received the first milestone payment in Q1 2002.

Following the completion of phase 1 the programme progressed into the assay optimisation phase. In addition, Byk Gulden will now order Evotec OAI's cell reader (Opera) to integrate into their own drug discovery efforts.

Also in March Evotec OAI and **MediGene** successfully completed the screening of Evotec OAI's corporate compound library against a MediGene target to identify new active compounds to treat cardiac diseases. Series of compounds have been identified ready for optimisation. Evotec OAI received a milestone payment for the successful conclusion of this stage of their cooperation.

In our development laboratories and pilot plant we continue to develop scalable routes and produce active pharmaceutical ingredients to support our clients' clinical trials. In Q1 we have produced material for customers such as Achillion, Celgene, Elan, VitaResc and Alizyme.

Service portfolio further expanded

We have continued to build on our service offering in order to further increase the expertise in our target to IND processes. The corporate chemical library is being augmented and we are in the process of adding medium throughput screening alongside our high throughput screening platform. Dependant on customers requirements Evotec OAI will use this platform in particular to complement the portfolio of cellular assays run on our proprietary ultra-high-throughput EVOscreen® Mark III system.

EVOscreen® partners intensify relationship

After achieving outstanding results during the factory acceptance test in Hamburg last year, the next generation of our screening platform, EVOscreen® Mark III, was installed at **GlaxoSmithKline**. Site acceptance testing at our partner's site was successfully completed. Today the performance and quality of our screening technology is being very favourably received from our consortium partners and beyond.

In March **Novartis** decided to acquire additional Evotec OAI screening devices (EVOscreen®). The robust automation achieved, superior data quality and the throughput of the EVOscreen® Mark II system delivered to Novartis in summer 2000 led them to broaden the application of the technology. Novartis commissioned Evotec OAI to upgrade the current EVOscreen® Mark II system in Basel to further increase its throughput. In addition, they have decided to implement the next generation Mark III system. In parallel, Novartis ordered additional benchtop devices in order to secure a corresponding capacity increase in assay development.

Significant progress in Alzheimer target identification / validation

Evotec Neurosciences (ENS) made excellent progress in the identification and validation of Alzheimer disease targets. ENS identified more than 100 potential target candidates through differential gene expression analysis. The close collaboration with the University of Zurich (department of Psychiatry Research) provides ENS with access to first class animal models as well as additional targets and diagnostic markers derived from genetic screens. To date already a broad range of patent applications have been filed building excellent value through a strong IP position.

Separation of Evotec Technologies completed

The separation of the technology division from the core of our business, drug discovery, was completed in Q1. We have transferred approximately 60 employees and the corresponding tangible and intangible assets into an independent legal entity called Evotec Technologies (trading as: Evotec Analytical Systems GmbH). Evotec Technologies (ET) will initially focus on low throughput benchtop applications of various core technologies, including those derived from our proprietary EVOscreen® technology. ET will also expand its applications into areas outside drug discovery.

Due to the different characteristics of this instrument business, and in order to focus Evotec OAI on its core business, we are in the process of looking for a strategic and/or financial partner for ET. We intend to utilise the partner's marketing and sales organisation for broader market access of our technologies.

ET continued its growth strategy with own products in Q1 2002. The customer support business is growing steadily and, in addition, ET has delivered a further five devices for SNP genotyping via Olympus, Tokyo, to the Japanese market. In addition to the existing collaborations for the MMF reader technology and the ongoing supply of instruments, core modules, reagents and consumables ET agreed in March with Olympus a "Application Support Contract", including e.g. SNP assay development for diagnostic applications.

Financial Report

Revenue

Evotec OAI revenues amounted to EUR 16.9 million, an increase of 50% over Q1 of the previous year (2001: EUR 11.3 million). EUR 2.3 million of revenues were deferred from Q4 2001 into Q1 2002 as a result of our strictly adopting the relevant revenue recognition policy (SAB 101) under US GAAP and US GAAS. Even after adjusting for this deferral, Q1 revenue growth reached an impressive 30%, the upper end of our internal organic growth expectations.

The **Drug Discovery Services Division** revenues grew by an impressive 42% to EUR 14.9 million (2001: EUR 10.5 million). This is primarily attributable to growth in discovery activities, both biology and chemistry, where the achievement of milestones in our collaborations with MediGene and Byk Gulden contributed. In addition, revenues from pilot plant orders which were completed but not delivered in 2001, were booked in Q1 sales.

The **Drug Discovery Tools and Technologies Division** Q1 revenues grew by 160% to EUR 2.0 million (2001: EUR 0.8 million). This strong growth over the comparable period of 2001 is attributed to the recognition of the remaining revenues for the EVOscreen® Mark III system successfully installed at GlaxoSmithKline in this quarter and to strong progress in our instrument business from sources other than consortium partner contracts (i.e. Evotec Technologies, ET). ET's benchtop and applications business grew to EUR 0.9 million (2001: EUR 0.3 million).

During Q1 2002 we maintained our strong presence in the United States where the company generated 49% of its revenues. Europe contributed 49% and Japan 2% to total sales.

In summary, we overachieved our revenue goals for Q1 and are on track for the full year 2002. As in the previous years we expect Q4 to be the strongest quarter for revenue recognition in our fiscal year.

Research and development

Our R&D activities continue to be increasingly focused on drug discovery applications, namely the development of new biological assay systems and to a limited extent proprietary drug discovery research. Overall R&D costs amounted to EUR 5.5 million, 12% less than in the comparable period of 2001 (EUR 6.2 million) when the completion of the EVOscreen® Mark III platform was hitting a high.

Result

Cost of revenues grew slightly less than revenues, increasing by 48% to EUR 10.1 million (2001: EUR 6.8 million). Our gross margin, 40.4%, improved slightly compared to Q1 of the previous year. The particular sales mix within the period has been less favourable than in the full year 2001.

SG&A in Q1 grew to EUR 5.2 million, up 20% on Q1 2001 (EUR 4.4 million). This is mainly a result of strengthening our business development team and activities in the second half of 2001.

The Evotec OAI group **operating loss** for Q1 2002 decreased significantly by 83% to EUR (7.0) million (2001: EUR (40.5) million). This is mainly a consequence of changes in US GAAP regulations regarding goodwill amortisation from acquisitions. Amortisation is therefore significantly lower and limited to non-goodwill intangible items. Also excluding merger-related amortisation of intangible assets (non-cash effect) the Evotec OAI group loss from operations for the first three months improved by 33% to EUR (4.1) million (2001: EUR (6.1) million).

Net loss in the first three months amounted to EUR (5.7) million, an 86% improvement over Q1 2001 (EUR (40.1) million). Net loss includes tax benefits totalling EUR 0.5 million. Deferred tax expenses in the UK (EUR (0.3) million) and current taxes worldwide (EUR (0.1) million) were offset against deferred tax benefits from the amortisation of merger-related intangible assets (EUR 0.9 million).

Net income per share amounted to EUR (0.16) (Q1 2001: EUR (1.13)).

Earnings before interest and taxes, depreciation and amortisation (**EBITDA**) improved by 83% to EUR (0.7) million (2001: EUR (3.9) million). EBITDA per share improved to EUR (0.02) from EUR (0.11) in 2001.

Capital expenditure

Investments in fixed assets in Q1 2002 amounted to EUR 1.3 million. The majority of the company's capital expenditure will come through during the rest of the year.

Cash flow and cash equivalents

In Q1 2002 cash flow from operating activities was EUR (0.7) million compared to EUR 3.3 million in the same period of 2001. Positive cash flow from operating activities in Q1 2001 was primarily the result of a reduction of working capital, showing a higher decrease of trade accounts receivable (resulting in high payments) and an increase in the trade accounts payable.

Cash and marketable securities as of March 31, 2002 amounted to EUR 26.1 million, only EUR 1.8 million less than year end 2001. As expected, our cash burn improved significantly over the same period in 2001.

Employees and management

Headcount increased by 15% over the previous year. As of March 31, 2002, Evotec OAI employed 599 people (2001: 520). Recruiting highly qualified personnel remains an important success factor for growing our company. We have added mainly scientific personnel to support the strong growth in drug discovery services, in particular in discovery chemistry.

Stock option programme

In Q1 2002 no options were granted or exercised. As of March 31, 2002, the total number of options that are available for future exercise amounts to 1,641,976.

Order book situation and outlook

Evotec OAI continued strong growth in Q1 2002 as planned. Our order book is strong: as of May 1, 2002, it already accounts for approximately 60% of analysts' revenue expectations for the current fiscal year (consensus: EUR 85 million). Our performance is a clear validation of our business strategy. On the basis of a promising business development pipeline we remain confident to achieve analysts' revenue targets for 2002. As expected, we significantly improved our financial performance almost achieving EBITDA break-even in the first quarter. Our priority going forward is to develop, complete and aggressively market our integrated drug discovery services, drive forward their short-term financial performance and maximise their mid- to long-term upsides from milestones and royalties. This stable and validated core element of our business gives us the fundamental financial strength to continuously work towards long term value maximisation.

Shareholdings of the Boards of Evotec OAI AG

	Number of shares	Share options
Management Board		
Joern Aldag	278,000	72,600
Dr Timm-H. Jessen	136,172	53,232
Dr Mario Polywka	32,565	45,000
Dr Dirk H. Ehlers	0	30,000
Supervisory Board		
Prof Dr Heinz Riesenhuber	110,000	0
Peer Schatz	3,892	0
Dr Pol Bamelis	0	0
Dr Karsten Henco	1,306,356	26,732
Dr Edwin Moses	313,058	15,000
Michael Redmond	1,000	0

March 31, 2002

Segment reporting according to US GAAP

Evotec OAI AG and Subsidiaries

Euro in thousands except share data	Drug discovery	Drug discovery
	services	tools and technology
Revenues:		
– Drug discovery products & development of technologies	253	2,035
– Drug discovery services	14,656	-
Total revenues	14,909	2,035
– Cost of revenues	9,319	771
Gross Profit	5,590	1,264
– Selling, general and administrative expenses	4,472	763
– Research and development expense	2,822	2,649
– Amortization (and impairment) of goodwill amongst other things	2,948	159
Operating income (loss)	(4,652)	(2,307)

Condensed consolidated statements of operations according to US GAAP

Evotec OAI AG and Subsidiaries

Euro in thousands except share data

	01-03/2002	01-03/2001	Δ in %
Revenues:			
– Drug discovery products & development of technologies	2,288	782	192.58
– Drug discovery services	14,656	10,485	39.78
Total revenues	16,944	11,267	50.39
– Cost of revenues ¹	10,090	6,831	47.71
Gross Profit	6,854	4,436	54.51
– Selling, general and administrative expenses ²	5,235	4,353	20.26
– Research and development expense	5,471	6,199	(11.74)
– Other operating income and expenses	-	-	-
– Amortization (and impairment) of goodwill amongst other things	3,107	34,361	(90.96)
Operating income (loss)	(6,959)	(40,477)	82.81
– Interest income and expenditure	148	644	(77.02)
– Income from investments and participations	-	-	-
– Income (expense) from associated companies ³	-	(65)	100.00
– Foreign currency exchange gain (losses) ⁴	146	(121)	220.66
– Other income (expense)	400	217	84.33
Result before income taxes and minority interest	(6,265)	(39,802)	84.26
Income tax	546	(280)	295.00
Extraordinary income (expenses)	-	-	-
Result before minority interest	(5,719)	(40,082)	85.73
Minority interest	15	(2)	850.00
Net income/ loss	(5,704)	(40,084)	85.77
Net income per share (basic)	(0,16)	(1,13)	
Net income per share (diluted) ⁵	-	-	
Weighted average common share outstanding (basic)	35,507,047	35,452,148	
Weighted average common share outstanding (diluted)	-	-	
Depreciation of property, plant and equipment included in total operating expenses	2,618	2,145	22.05

¹ Before reported as <cost of product sales>

² Selling and marketing expenses are included in <selling, general and administrative expenses>. Up to now they were not reported separately.

³ Before reported as <equity in net loss of investees>

⁴ Before included in <other non-operating income (expense)>

⁵ According to US GAAP the definition of net income per share does not allow to report diluted net income per share as long as the Company shows a net loss.

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

Euro in thousands	31/03/2002	31/12/2001	Δ in %
Assets			
Current assets:			
–Cash and cash equivalents	21,692	18,651	16.30
–Marketable securities, at fair value ⁶	4,375	9,182	(52.35)
–Trade accounts receivable	6,988	11,890	(15.82)
–Accounts receivable due from related parties ⁷	3,021	676	346.89
–Inventories, at cost	6,158	6,524	(5.61)
–Deferred tax assets	104	104	0.00
–Prepaid expenses and other current assets	5,618	6,100	(7.90)
Total current assets	47,956	53,127	(9.73)
Property, plant and equipment, net ⁸	66,490	67,847	(2.00)
Intangible assets, excluding goodwill, net	42,285	44,519	(5.02)
Investments	3	463	(99.35)
Notes receivable / loans	–	–	–
Goodwill, net ⁹	228,311	228,612	(0.13)
Deferred taxes	–	–	–
Other non-current assets	49	49	0.00
Total assets	385,094	394,617	(2.41)
Liabilities and stockholders' equity			
Current liabilities:			
– Current portion of capital lease obligation	–	–	–
– Current portion of long-term debt ¹⁰	966	829	16.53
– Trade accounts payable	4,168	5,677	(26.58)
– Accounts payable to related parties	935	40	22.38
– Advanced payments received ¹¹	440	70	528.57
– Accrued expenses	7,884	8,972	(12.13)
– Deferred revenues	2,112	3,983	(46.97)
– Income tax payable ¹²	–	–	–
– Deferred taxes	–	–	–
– Other current liabilities	2,845	2,522	12.81
Total current liabilities	19,350	22,093	(12.42)
Long-term debt, less current portion ¹³	2,925	3,009	(2.79)
Capital lease obligations, less current portion	–	–	–

6 Before reported as <investment securities>

7 Before included in <trade accounts receivable>

8 Before reported as <fixed assets, net>

9 Before included in <intangible assets, net>

10 Before reported as <current maturities of long-term loan>

11 Before partially in <deferred revenues>

12 Before included in <other current liabilities>

13 Before reported as <long-term loan>

Deferred revenues	-	-	-
Deferred taxes	20,562	21,221	(3.11)
Other non-current liabilities	50	50	0.00
Minority interests	637	653	(2.45)
Shareholders' equity:	341,570	347,591	(1.73)
-Share capital	35,507	35,507	0.00
-Additional paid-in capital	536,857	536,857	0.00
-Treasury stock	-	-	-
-Retained earning/accumulated deficit	(223,080)	(217,376)	(2.62)
-Accumulated other comprehensive income/loss	(7,714)	(7,397)	(4.29)
Total liabilities and stockholders' equity	385,094	394,617	(2.41)

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

Euro in thousands	31/03/2002	31/03/2001
Cash flows from operating activities:		
Net loss	(5,704)	(40,084)
Adjustments to reconcile net loss to net cash used in operating activities	4,508	36,909
Change in assets and liabilities	525	6,495
Net cash (used in) provided by operating activities	(671)	3,320
Cash flows from investing activities:		
Purchase of marketable securities	-	(11,940)
Purchase of investment	(3)	-
Purchase of fixed assets	(1,343)	(2,652)
Purchase of intangible assets	(942)	(3)
Proceeds from sale of equipment	3	-
Proceeds from sale of investments	1,120	-
Proceeds from sale of marketable securities	4,938	11,897
Net cash provided by (used in) investing activities	3,773	(2,698)
Cash flows from financing activities:		
Net proceeds from increase in bank loan	54	-
Repayment of bank loan	-	(15)
Net cash flow provided by (used in) financing activities	54	(15)
Net increase in cash and cash equivalents	3,156	607
Exchange rate difference	(115)	(352)
Cash and cash equivalents at beginning of year	18,651	32,483
Cash and cash equivalents at end of the first quarter	21,692	32,738
Cash, cash equivalents and marketable securities at end of the first quarter	26,067	49,220

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	Unrealized gains (losses) on securities	Accumu- lated deficit	Total stock- holders' equity
Balance at December 31, 2000	35,452,148	35,452	539,179	(703)	(2,443)	636	(69,626)	502,495
Share capital increase	54,899	55	302	–	–	–	–	357
Stock option plan	–	–	204	68	–	–	–	272
Other adjustments to additional paid-in capital	–	–	(2,828)	–	–	–	–	(2,828)
Comprehensive loss:								
– Foreign currency translation	–	–	–	–	(4,471)	–	–	(2,443)
– Unrealized holding gains on available-for-sale securities	–	–	–	–	–	(484)	–	(484)
– Net loss	–	–	–	–	–	–	(147,750)	(147,750)
Total comprehensive loss								(152,705)
Balance at December 31, 2001	35,507,047	35,507	536,857	(635)	(6,914)	152	(217,376)	347,591
Stock option plan				81				81
Comprehensive loss:								
– Foreign currency translation	–	–	–	–	(434)	–	–	(434)
– Unrealized holding gains on available-for-sale securities	–	–	–	–	–	36	–	36
– Net loss	–	–	–	–	–	–	(5,704)	(5,704)
Total comprehensive loss								(6,102)
Balance at March 31, 2002	35,507,047	35,507	536,857	(554)	(7,348)	188	(223,080)	341,570

The financial statements of the reported period were prepared using the same accounting policies as for the year 2001.