

# EVOTEC BioSystems AG

Second Quarter Report 2000

To our shareholders

The second quarter of 2000 for EVOTEC was marked by the achievement of a critical milestone. Our EVOscreen® Mark II system has been successfully put into operation at the research facilities of Novartis in Basel, Switzerland and Pfizer in Sandwich, England.

**Site acceptance tests for EVOscreen® Mark II technology successfully concluded.** On June 30, 2000 our two partners confirmed successful completion of the site acceptance tests for their Mark II systems. With this step, Novartis and Pfizer have each taken delivery of an EVOscreen® system which will immediately become an integral component of their drug discovery research. It also signals that EVOTEC has completed the development of the first fully-integrated and automated high-throughput screening system worldwide. This system features the ability to test potential new pharmaceutically active substances in a volume as small as one microlitre. In combination with new assay technology developed by EVOTEC, this system helps realize a significant improvement in efficiency in the identification of new drugs with regard to cost, as well as with regard to the time required to conduct the individual tests.

At the same time, in cooperation with Pfizer, we have developed a new detection method for individual chemical molecules: measurement of fluorescence lifetime for individual fluorescent molecules. We have integrated this method as an additional evaluation parameter into our optical detection system. This means an expansion in the range of methods we have at our disposal to discover novel pharmaceutical compounds for new biological targets arising from genome research, as well as the ability to shorten development time required for new assays for our own projects and those of our clients.

The scientists from SmithKline Beecham are currently using an EVOscreen® system designated for them for tests and training courses here in Hamburg. They are also carrying out acceptance tests of the EVOscreen® Mark II system in EVOTEC's laboratories. In collaboration with SmithKline Beecham, we have also completed development of a 1536-well assay plate, which will come into use in our Mark III system. The plate itself has moved from drawing board into production. The acceptance of this assay plate also represents a further important milestone. In the last quarter we reported the completion of its prototype. We expect considerable demand by pharmaceutical and biotech companies for these assay plates.

**Service unit increases capacity for pharmaceutical clients.** Contract drug discovery research has been conducted through the development of assays and using our EVOscreen® Mark I prototype for screening. Since July, the service unit at EVOTEC has had their own EVOscreen® Mark II system in operation. This system now allows the service unit to put our highly efficient screening technology to work for even more service clients. In the framework of the existing contracts with Roche and Knoll – BASF Pharma we have already been able to confirm the throughput as well as the quality of the data collected with this new system. The development of suitable assay systems for some target classes was greatly facilitated by applying our technology. In the second half of 2000, and in particular in the fourth quarter, we will concentrate on using the new system for the successful completion of existing contracts and to aid in the acquisition of new contracts. By the end of June, we had already booked about 60 % of the contract volume required to fulfill our service unit's revenue target for the year. Furthermore, we are currently negotiating with a number of well-known pharmaceutical and biotech companies and expect to finalize several contracts in the coming two quarters in order to achieve our revenue goal for 2000.

**EVOTEC's competence with cell-based assay systems significantly improved.** In the past, EVOTEC was particularly known for its strength in the development of biochemical assay systems. However, a significant part of our research has also been focused on developing technologies and instruments which are suitable for the implementation of assays on living cells. In this field, we were able to significantly advance our efforts by producing a new generic test system (VLIP technology) and by the acquisition of GENION Forschungsgesellschaft mbH.

**VLiP Technology.** After achieving initial successes over the past few years, in May we reported a breakthrough in testing cellular systems with the introduction of our VLiP technology. Problems which have plagued many conventional cellular assay systems for drug discovery, such as lack of precision and reproducibility, are eliminated by this innovative new method. Impressive data we were able to confirm in recent weeks show that this technology not only achieves excellent results for an important target group of the cellular membrane receptors (in particular GPCRs), but also for a multitude of other cellular target families. We have shown applicability to the study of nuclear receptors and for measuring signal transduction pathways in individual cells. These results have been communicated at various scientific conferences, and has received a resoundingly positive response. The interest in gaining access to the VLiP technology via service arrangements and technology licenses is significant not only with existing clients, but also potential new customers. We assume that we will be able to complete several negotiations in this area within the coming months.

**Takeover of GENION GmbH.** The second aspect, which contributed decisively to strengthening EVOTEC's competitive position in the development of cellular assay systems, is the acquisition of the Hamburg GENION Forschungsgesellschaft mbH. GENION has special expertise in the field of ion channel assays, in particular with potassium channels. Technically difficult to access, ion channels represent an important target class for the development of new medications from two distinct perspectives. On the one hand, they are directly associated with the development of various diseases, for example diseases of the central nervous system. On the other hand, ion channels are often indirectly affected as an unwelcome side effect of many drugs. For example, cardiac arrhythmia can result when drugs act on ion channels of a specific class. By combining the GENION technology and specially developed cell lines with our optical detection technology and innovative technologies for automated high-throughput screening, we shall be able to significantly broaden access to ion channels for the pharmaceutical industry. Already today GENION has a wide pharmaceutical customer base.

**Innovative business model implemented by founding DIREVO AG.** We see ourselves as service providers for the pharmaceutical and biotechnology industry. In pharmaceutical product development, we hope to share in potential profit, but do not wish to carry the full financial risk, which particularly in the area of pharmaceuticals, is related to the high failure rates of projects in clinical development. Against this background, we have developed a business model that we have implemented for the first time in founding DIREVO AG. By granting a license for EVOTEC technologies to this new company, we received 65 percent of their initial share capital. The financing of the independently managed company will be secured this year with the introduction of venture capital. The aim of the company is to develop biomolecules, such as enzymes, whose function has been optimized through a process of rapid evolution for pharmaceutical and industrial applications. For venture capitalists, the attraction of this model lies in the fact that DIREVO, with access to EVOTEC's existing technology platform, is able to initiate development projects efficiently, immediately and without expensive technological development of its own. It means hundreds of thousands different varieties of biomolecule-producing cells can be generated, their biomolecular products being rapidly and quantitatively analyzed for specific characteristics. We are in the process of initiating other such alliances with biotech partners.



## Financial Report

**Revenues.** During the first six months of 2000, EVOTEC group's revenue rose by 186 % over the same period in 1999 to DM 12.5 million. The Drug Discovery Tools and Technology division accounted for DM 11.5 million, including milestone payments and research funding from the contracts with EVOTEC's pharmaceutical partners Novartis, SmithKline Beecham and Pfizer (DM 5.4 million), as well as from the sale of instruments (DM 6.1 million). The high volume of instrument sales results from the successful acceptance of our EVOscreen® Mark II systems by our partners Novartis and Pfizer in the second quarter of 2000. The remainder, amounting to DM 1.0 million, resulted from the Drug Discovery Services and Products division, in particular from payments for the development of assays.

**Personnel.** In the second quarter of 2000 the number of employees in the EVOTEC group (excluding GENION) remained constant at 234 as planned. At the end of June 2000, EVOTEC BioSystems AG had 189 employees, EVOTEC Analytical Systems GmbH, 25, and EVOTEC NeuroSciences GmbH, 20. As a result of the acquisition of GENION Forschungsgesellschaft mbH, the number of employees increased by seven on 30th June 2000.

**Operating result.** As expected, in the first half of 2000 EVOTEC recorded a net loss of DM 14.6 million. The planned further expansion of the Drug Discovery Services and Products division, as well as increased development activities in comparison to last year are the primary reasons for the loss. As expected, the operating loss in the first six months of 2000 increased by 34 % over the comparable period of the previous year. Compared to revenue growth (+186 %), operating costs have grown significantly less.

As a result of the sharp increase in personnel over the past year, research and development expenses increased by 42 % over the comparable period of the previous year. The expected increase in the cost of product sales compared to the first quarter resulted primarily from EVOscreen® systems passing site acceptance testing as part of the technology development and transfer contracts. The increase in selling, general and administrative expenses by 60 %, compared to the first half of 1999, results mainly from increased marketing activities as part of establishing the service business, as well as from activities in the area of investor relations. The increase in comparison with the first quarter mainly stems from the costs resulting from the Annual General Meeting.

**Investments.** During the first half of 2000, investments totalled DM 5.4 million. Additions to fixed assets, primarily investments in research laboratory instruments developed in-house to equip our own laboratories, as well as the construction of an additional EVOscreen® Mark II system accounted for the majority of capital spending.

On June 30, 2000 EVOTEC acquired GENION Forschungsgesellschaft mbH in a share for share transaction. The surplus of the purchase price over the acquired net assets (DM 4.2 million) is currently being examined with regard to its distribution to the individual assets and the possible depreciation of research and development programmes still in progress. No decision has been taken yet in regard to the possibility of applying the Pooling-of-Interest method according to US-GAAP.

**Cash flow and liquidity.** The negative cash flow from operations during the first six months of 2000 was DM 18.0 million, which results mainly from negative net income, as well as build-up of other assets. Other assets include costs associated with a planned acquisition amounting to DM 1.1 million. The negative net cash used in investment activities for the first six months of DM 103.2 million includes the purchase of investment securities amounting to DM 98.5 million. The actual net cash used was therefore DM 4.7 million. During the current period, cash flow from financing activities was DM 14.5 million, which resulted mainly from the generation of additional funds by the exercise of the over-allotment option in the context of EVOTEC's IPO. Cash, cash equivalents and investment securities totalled DM 104.2 million on June 30, 2000.

## EVOTEC Key Figures

	1-6/1999	1-6/2000	+/- %
Revenue	4.4	12.5	185.5
R&D Expense	11.4	16.2	41.9
Loss from operations	(12.3)	(16.5)	33.9
Employees at the end of March	184	234	27.2

## Financial Structure of technology development and transfer agreements

Partner	Contract Period	Volume	Revenue achieved
Novartis	4/96-12/99	20	19.1
SmithKline Beecham	12/96-12/00	30	24.1
Pfizer	6/99-6/02	30	11.0

in DM million

**Outlook.** EVOTEC has continued to successfully grow according to plan during the first half of 2000. The acceptance and validation of our technology in the area of cellular assay systems have built significant foundations for the future. As of June 30, EVOTEC's order book reflects that 75 % of our projected revenue for the year 2000 has been secured. Achieving our revenue target is highly dependent on the timely fulfillment of existing contractual obligations. The majority of these contractual obligations are targeted for completion in the 4th quarter of 2000. As a result, the revenue recognition in this quarter will be significantly above average.



## Condensed Consolidated Balance Sheets according to U.S. GAAP

(unaudited)

EVOTEC BioSystems AG and Subsidiaries

Deutsche Mark in thousands

<b>ASSETS</b>			
	31/12/1999	30/6/2000	+/- %
<b>Current assets</b>			
Cash and cash equivalents	112,437	5,730	(94.9)
Investment securities	-	98,486	-
Trade accounts receivable	5,470	4,293	(21.5)
Inventories	7,623	7,284	(4.4)
Other current assets	2,981	5,781	93.9
<b>Total current assets</b>	<b>128,511</b>	<b>121,574</b>	<b>(5.4)</b>
Fixed assets, net	14,787	18,010	21.8
Purchase price exceeding net assets acquired	-	4,238	-
Other non-current assets, net	1,054	1,027	(2.6)
<b>Total assets</b>	<b>144,352</b>	<b>144,849</b>	<b>0.3</b>
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>			
<b>Current liabilities</b>			
Current portion of long-term loan	1,250	1,250	0.0
Accounts payable	5,843	3,651	(37.5)
Accrued liabilities	4,400	4,136	(6.0)
Deferred revenues	5,641	2,557	(54.7)
Other current liabilities	966	1,256	30.0
<b>Total current liabilities</b>	<b>18,100</b>	<b>12,850</b>	<b>(29.0)</b>
Long-term loan	7,500	6,875	(8.3)
Deferred revenues	729	1,604	120.0
Other non-current liabilities	11	11	0.0
Minority interests	76	-	-
<b>Total stockholders' equity</b>	<b>117,936</b>	<b>123,509</b>	<b>4.7</b>
<b>Total liabilities and stockholders' equity</b>	<b>144,352</b>	<b>144,849</b>	<b>0.3</b>

## Condensed Consolidated Statements of Operations according to U.S. GAAP

(unaudited)

EVOTEC BioSystems AG and Subsidiaries

Deutsche Mark in thousands

	six months ended June 30,			three months ended June 30,		
	1999	2000	+/- %	1999	2000	+/- %
<b>Revenue</b>						
– Drug discovery tools & technology	4,383	11,469	161.7	2,674	7,887	195.0
– Drug discovery services & products	–	1,045	–	–	547	–
<b>Total revenue</b>	<b>4,383</b>	<b>12,514</b>	<b>185.5</b>	<b>2,674</b>	<b>8,434</b>	<b>215.4</b>
<b>Operating costs and expenses</b>						
– Research & development expenses	11,449	16,246	41.9	6,421	8,553	33.2
– Cost of product sales	222	4,722	–	222	4,133	–
– Selling, general and administrative expenses	5,037	8,053	59.9	2,419	4,338	79.3
<b>Total operating costs and expenses</b>	<b>16,708</b>	<b>29,021</b>	<b>73.7</b>	<b>9,062</b>	<b>17,024</b>	<b>87.9</b>
<b>Loss from operations</b>	<b>(12,325)</b>	<b>(16,507)</b>	<b>33.9</b>	<b>(6,388)</b>	<b>(8,590)</b>	<b>34.5</b>
<b>Other non-operating income (expense)</b>						
– Interest income (expense)	375	1,538	310.1	103	662	–
– Equity in net loss of affiliate	(320)	(376)	17.5	(320)	(168)	(47.5)
– Other non-operating income (expense)	1,089	671	(38.4)	914	96	(89.5)
<b>Total non-operating income</b>	<b>1,144</b>	<b>1,833</b>	<b>60.2</b>	<b>697</b>	<b>590</b>	<b>(15.4)</b>
<b>Loss before income taxes</b>	<b>(11,181)</b>	<b>(14,674)</b>	<b>31.2</b>	<b>(5,691)</b>	<b>(8,000)</b>	<b>40.6</b>
– Income tax benefit	–	–	–	–	–	–
– Minority interests	18	76	–	18	–	–
<b>Net loss</b>	<b>(11,163)</b>	<b>(14,598)</b>	<b>30.8</b>	<b>(5,673)</b>	<b>(8,000)</b>	<b>41.0</b>

**Consolidated statements of cash flows ended June 30**

(unaudited)

EVOTEC BioSystems AG and Subsidiaries

Deutsche Mark in thousands

	06/30/00	06/30/99
<b>Cash flows from operating activities:</b>		
Net loss	(14,598)	(11,163)
Adjustments to reconcile net loss to net cash	2,247	1,924
Change in assets and liabilities	(5,658)	(1,402)
<b>Net cash used in operating activities</b>	<b>(18,009)</b>	<b>(10,641)</b>
<b>Cash flows from investing activities:</b>		
Purchase of investment securities	(102,406)	(2,848)
Purchase of PPE	(5,396)	(3,357)
Proceeds from sale of investment securities	3,919	4,375
Others	672	(309)
<b>Net cash used in investing activities</b>	<b>(103,210)</b>	<b>(2,139)</b>
<b>Cash flows from financing activities:</b>		
Proceeds from capital increase	15,138	0
Proceeds from payables from shareholders	0	4,800
Decrease in bank loans	(625)	(625)
<b>Net cash flows provided by financing activities</b>	<b>14,513</b>	<b>4,175</b>
<b>Net increase in cash and cash equivalents</b>	<b>(106,707)</b>	<b>(8,605)</b>
Cash and cash equivalents at beginning of year	112,437	31,175
<b>Cash and cash equivalents at end of 2. Quarter 2000</b>	<b>5,730</b>	<b>22,570</b>



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