



## Evotec OAI AG, Second Quarter Report 2002

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Dear shareholders,

we have met our growth targets in the first six months of 2002. Despite the difficult capital market environment and its growing impact on the pharmaceutical and biotechnology industries we have secured several new partnerships and continued to achieve excellent performance in existing discovery and development contracts. We are particularly pleased that we have grown revenues by 26 % over the first half of last year and have signed several biology and/or integrated discovery collaborations with new customers in the second quarter: Taisho, Infinity and U3 Pharma. We continue to deliver successfully on many of our big pharma and big biotech collaborations such as Merck, Amgen and Serono. Biotech and pharma companies use our integrated assay development, screening and chemistry discovery activities to develop drug candidates more quickly and efficiently.

**Several new partnerships signed in a challenging market environment**

In May Evotec OAI entered into a drug discovery collaboration with **Taisho Pharmaceutical**. Evotec OAI will perform biology R&D on selected Taisho targets (including target expression and reagent production) and will develop assays for those targets using Evotec OAI's proprietary VLIP™ technology. Upon successful development of the assays, Evotec OAI will screen the targets against compounds from the Evotec OAI corporate chemical library using EVOscreen®, its proprietary ultra-high-throughput screening platform, and will characterise the hits that are identified. This agreement represents our first integrated biology and chemistry collaboration with a Japanese pharmaceutical company.

In June **Infinity Pharmaceuticals** chose Evotec OAI as their drug discovery partner to identify novel active compounds against multiple Infinity targets. Using its EVOscreen® technology, Evotec OAI will perform reagent production, assay development, screening and some further characterisation of identified hits (hit profiling). Evotec OAI's technology platform complements Infinity's novel approach to the design and synthesis of diverse and complex drug-like compounds for drug discovery. █

In the same month Evotec OAI signed a collaborative agreement with **U3 Pharma**, an emerging company developing innovative therapeutics for hyper-proliferative diseases. U3 Pharma will provide Evotec OAI with novel cellular assays based on proprietary signalling pathways. Evotec OAI will perform assay miniaturisation and ultra-high-throughput screening using EVOscreen® and its corporate chemical library to identify novel drug candidates based on U3 Pharma's signal transduction targets. Upon successful identification of such candidates, U3 Pharma may then use Evotec OAI's expertise to optimise the structures identified.

**Excellent performance on customer projects**

We continue to deliver on many of our ongoing projects in biology and chemistry. For example, we made good progress on assay development and screening for Abbott and have significantly advanced our highly important contract with Merck & Co. We successfully completed a number of projects in the first half with Ionix, GelTex, Aventis, Roche and Organon. In Development Chemistry we have continued to support our clients' clinical trials. In the first six months we have successfully produced material for customers such as Pfizer, Biogen, Point Therapeutics, Serono, Achillion, Celgene, Elan, Alizyme and UCB Pharma. The market environment in this sector is the most challenging. While we have a promising order pipeline, some biotech customers are delaying the production of clinical trial material to conserve cash.

**Building on our expertise in drug discovery**

In the second quarter Evotec OAI has continued to build on its competence in drug discovery. Research activities have focussed on expanding our expertise in cellular assays and computational chemistry. Our own EVOscreen® Mark III system has passed internal acceptance testing in Hamburg and is now demonstrating its excellence in cellular uHTS. For the analysis of cellular events and their detection in uHTS, Evotec OAI has licensed Reef Coral Fluorescent Proteins (RCFPs) as fluorescent markers from BD Biosciences Clontech. By integrating RCFPs into our platform we provide our customers in the pharmaceutical industry with an extremely powerful and reliable cell-based screening system. Additionally, we expanded our functional cell-based assay portfolio by implementation of medium throughput screening systems using complementary detection technologies.

**EVOscreen® delivering on its promises**

After installation of our first EVOscreen® Mark III system at **GlaxoSmithKline** during the first quarter 2002, substantial testing has now proven the excellent performance of the system in miniaturised cellular screening in uHTS format. This has triggered the payment of the cellular upgrade in the second quarter of 2002. Also, our partner has achieved excellent results in an internal screening campaign, which was started shortly after the completion of the site acceptance testing in Q1. The upgrade of the EVOscreen® Mark II system for **Novartis** is close to completion. The build of their Mark III system is running on schedule. Site acceptance testing at Novartis is scheduled for the end of 2002. The excellent performance of our screening technology is being very favourably received and continues to attract considerable interest from our consortium partners and discovery service customers.

**Evotec Neurosciences makes further good progress**

Evotec Neurosciences' (ENS) Alzheimer target identification continues to develop on track. ENS intends to maximise the value of the programme by partnering the project with an appropriate pharmaceutical partner in the short-medium term.

**Evotec Technologies to launch new bench-top devices**

Evotec Technologies (ET) is making good progress. The company is about to introduce several new bench-top devices. Prototypes of the bench-top system for the analysis of cellular events (Opera) are currently undergoing final testing for manufacturing release. The product will be launched at the SBS Conference (Society for Biomolecular Screening) in September of 2002. First systems will be delivered to customers in Q3. After the first order from Altana Pharma, ET has now received a second order from GlaxoSmithKline.

The joint development of a new reader for SNP analysis with Olympus Optical has been completed. SNP analysis promises to be an important tool in the study of patient specific drug responses and the detection of disease-related genes. Olympus plans to start taking orders for the system in Japan from the end of August 2002 and will make the product available in overseas markets in due course. The system employs single molecule fluorescence spectroscopy, a technology that not only permits high-speed measurements, but also facilitates inexpensive high-precision analysis. The principal target market for sales includes universities, other academic research institutions, pharmaceutical firms and contract research organisations. The development of several further system applications is also underway.

## Financial Report

### Revenue

In the first half of 2002 Evotec OAI achieved revenues of EUR 33.2 million, an increase of 26% over the first six months of the previous year (2001: EUR 26.3 million).

The **Discovery Services Division** revenues grew by 26% to EUR 28.8 million (2001: EUR 22.9 million), in line with our growth expectations of 20 – 30 % p.a. Discovery chemistry services continued to perform particularly well. There were new collaborations with Merck, Rigel, Ionix, Point Therapeutics and Geltex together with a number of significant existing long-term partnerships such as Serono, Vertex, and others.

The **Discovery Tools and Technologies Division** experienced growth of 29% to EUR 4.4 million (2001: EUR 3.4 million). Evotec Technologies' bench-top and applications business recorded revenues of EUR 2.3 million (2001: EUR 2.6 million). This is a slight decline but last year's sales included the exceptional stock-building delivery of 15 analysers to Olympus, Japan.

Evotec OAI recorded 50% of its revenues in the United States, 48% in Europe and 2% in Japan.

### Research and development and other cost

**R&D** expenses for the first six months amounted to EUR 12.1 million. As planned, they remained at last year's level (2001: EUR 11.9 million). Our research activities are mainly focussed on drug discovery applications (in particular cellular assays, ADME/T and computational chemistry) and our discovery programme in the field of Alzheimer disease (Evotec Neurosciences).

**Cost of revenues** grew by 32% to EUR 18.5 million (2001: EUR 14.0 million). This increase exceeds revenue growth primarily due to the additional depreciation charge from the new pilot plant. Margins in the remaining discovery service division were as planned.

**SG&A** cost grew by only 14% to EUR 10.8 million (2001: EUR 9.5 million). This increase was mainly due to the strengthening of our business development resources.

### Result

**Operating loss** for the first six months improved significantly to EUR (15.3) million, 80% lower than in the comparable period for the previous year (2001: EUR (77.7) million). To a large extent this is a consequence of lower amortisation of goodwill and other intangible assets. According to changes in US GAAP regulations, goodwill from acquisitions is not regularly

amortised anymore, but reviewed for impairment at least once a year. Following these new regulations, we have reviewed goodwill against the fair value of our chemistry business as of January 1st, 2002. The analysis revealed that there was no necessity for an impairment write-down. Therefore, amortisation is limited to non-goodwill intangible items as required by the new regulation. As a result of the recent developments in the financial and customer markets, we have decided to repeat the impairment review later this year.

Excluding amortisation of intangible assets, losses from operations for the first six months amounted to EUR (9.2) million (2001: EUR (9.1) million). The increase in gross profits of EUR 2.4 million was compensated by the above mentioned increase in SG&A and other operating expenses related to the start up of the new pilot plant.

During the first six months of 2002 **net loss** improved by 82% to EUR (13.7) million (2001: EUR (77.6) million). This again is primarily a consequence of reduced amortisation charges. Additionally, tax treatment reduced net loss. Deferred tax expenses in the UK (EUR (0.9) million) and current taxes worldwide (EUR (0.1) million) were offset against deferred tax benefits from the amortisation of merger-related non-goodwill intangible assets (EUR 1.6 million).

**Net income per share** amounted to EUR (0.39) (2001: EUR (2.19)).

Earnings before interest and taxes, depreciation and amortisation (**EBITDA**) improved by 28% to EUR (3.1) million (H1 2001: EUR (4.3) million). EBITDA per share improved by 28% to EUR (0.09) from EUR (0.12) in 2001.

#### **Capital expenditure**

Investments in fixed assets amounted to EUR 4.4 million, including a new system for medium throughput screening, software for computational chemistry and additional laboratory and analytical equipment.

#### **Cash flow and cash equivalents**

Cash flow from operating activities for the first six months of 2002 amounted to EUR (4.8) million (2001: EUR (4.7) million). This includes a net increase of working capital of EUR 2.0 million (e.g. Merck, Novartis, etc.).

Cash and marketable securities, as of June 30, 2002, amounted to EUR 18.3 million, a decline of EUR 9.5 million compared to the beginning of the year. This is a consequence of the net loss incurred (and the resulting negative cash flow from operations), and capital expenditures of EUR 4.4 million. Overall cash burn was significantly reduced compared to the first half year 2001, largely due to lower capital expenditures. Based on our

business development pipeline and our business plan we are confident that our cash position will improve by the end of 2002.

## **Employees and management**

On June 25, 2002, Evotec OAI announced a number of key management appointments. These were designed to enhance the Company's offering of integrated discovery services and programmes and to prepare it for the next phase of growth.

Dr John Kemp, 49, joined Evotec OAI as Chief Executive Officer of Evotec Neurosciences GmbH (ENS), effective July 1, 2002. Dr Kemp has 18 years' research experience in the area of Central Nervous System (CNS) diseases and has strong links with the neuroscience community. He joined Hoffmann-La Roche, Basel, in 1994, where most recently he was Vice President and Head of Pre-clinical CNS Research.

To reflect the Group's strategy of building significant partnerships with pharmaceutical and biotech companies, Sean Marett, 37, was promoted to Chief Business Officer and Member of the Management Board, effective July 1, 2002. He joined the Company in April 2001 as Commercial Director. Before joining Evotec OAI, Sean Marett was Director of New Product Development, US Operating Division at GlaxoSmithKline.

Dr Mario Polywka, Chief Operating Officer, is leaving at the end of August 2002 after 11 years at Evotec OAI and Oxford Asymmetry International (OAI). Dr Polywka has played a major part in the growth and development of the OAI chemistry business, and in the merger and subsequent integration of Evotec Biosystems and OAI in 2000. The company wishes to thank Dr Polywka for the major contribution that he has made to the establishment of Evotec OAI as a leader in its field.

Headcount increased by 5% over the end of last year. Evotec OAI employed 615 people at the end of June 2002. We have added mainly scientific personnel to support the strong growth in discovery chemistry.

## **Stock option programme**

In the first six months of 2002 no options were granted, 3,083 were exercised. As of June 30, 2002, the total number of options that are available for future exercise amounts to 1,598,084.

## **Order book situation and outlook**

We achieved strong revenue growth in the first half of the year. While our targets were initially projected at a time of stronger general market environment, we continue to expect annual revenue growth this year to be 20-30% and positive EBITDA despite challenging market conditions. Looking forward, we realise that our customers in the biotechnology industry are experiencing significant pressure to carefully manage their R&D spending. However, although predictability is seen to be lower for the next few months, pharmaceutical companies continue to show a strong

commitment to strategic outsourcing of drug discovery. We believe that with our integrated biological and chemistry discovery services we are particularly well positioned to offer real economic and efficiency improvements to our clients.

Our order book continued to increase steadily: as of July, 2002, it already accounted for 73% of analysts' revenue expectations for the current fiscal year (consensus: EUR 85 million) with many new contracts currently under negotiation. As in the previous years, we expect Q4 to be the strongest quarter in terms of revenue recognition.

The general condition of capital markets and the resulting uncertainties regarding timing of new contracts do make us more cautious and have led to an even stronger emphasis on cost and capacity management.

Strategically we are well on track. We will continue to build our core business, integrated drug discovery and development services, drive forward their short-term financial performance and maximise their mid- to long-term upsides from milestones and royalties. In addition, we are using our powerful platform and are building our expertise in selected drug discovery programmes to maximise long-term value creation and prepare for future high value outsourcing models. Here, the core of our activities today is our ENS Alzheimer programme. Evotec OAI will focus its resources on discovery and development services and programmes which are important for future value creation for the company.



### Shareholdings of the Boards of Evotec OAI AG

	Number of shares	Share options
<b>Management Board</b>		
Joern Aldag	281,000	72,600
Dr Timm-H. Jessen	136,172	53,232
Dr Mario Polywka	32,565	45,000
Dr Dirk H. Ehlers	0	30,000
<b>Supervisory Board</b>		
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

June 30, 2002

### Segment reporting according to US GAAP

#### Evotec OAI AG and Subsidiaries

Euro in thousands except share data	Discovery services	Discovery tools and technologies
Revenues:		
– Drug discovery products & development of technologies	419	4,358
– Drug discovery services	28,424	-
<b>Total revenues</b>	<b>28,843</b>	<b>4,358</b>
– Cost of revenues	17,066	1,424
<b>Gross Profit</b>	<b>11,777</b>	<b>2,934</b>
– Selling, general and administrative expenses	9,243	1,552
– Research and development expense	6,256	5,875
– Other operating expense	996	-
– Amortisation (and impairment) of goodwill amongst other things	5,788	318
<b>Operating income (loss)</b>	<b>(10,506)</b>	<b>(4,811)</b>

## Condensed consolidated statements of operations according to US GAAP

### Evotec OAI AG and Subsidiaries

Euro in thousands except share data

	01-06/2002	01-06/2001	Δ in %	04-06/2002	04-06/2001	Δ in %
<b>Revenues:</b>						
– Drug discovery products & development of technologies	4,777	3,477	37.39	2,489	2,695	(7.64)
– Drug discovery services	28,424	22,847	24.41	13,768	12,362	11.38
<b>Total revenues</b>	<b>33,201</b>	<b>26,324</b>	<b>26.13</b>	<b>16,257</b>	<b>15,057</b>	<b>7.97</b>
– Cost of revenues <sup>1</sup>	18,490	14,027	31.82	8,400	7,196	16.73
<b>Gross profit</b>	<b>14,711</b>	<b>12,297</b>	<b>19.63</b>	<b>7,857</b>	<b>7,861</b>	<b>(0.05)</b>
– Selling, general and administrative expenses <sup>2</sup>	10,795	9,472	13.97	5,560	5,119	8.61
– Research and development expense	12,131	11,882	2.10	6,660	5,683	17.19
– Other operating expenses	996	-	100.00	996	-	100.00
– Amortisation (and impairment) of goodwill amongst other things	6,106	68,679	(91.11)	2,999	34,318	(91.26)
<b>Operating income (loss)</b>	<b>(15,317)</b>	<b>(77,736)</b>	<b>80.30</b>	<b>(8,358)</b>	<b>(37,259)</b>	<b>77.57</b>
– Interest income (expense)	325	948	(65.72)	177	304	(41.78)
– Income from investments and participations	-	-	-	-	-	-
– Income (expense) from associated companies <sup>3</sup>	-	(161)	(100.00)	-	(96)	(100.00)
– Foreign currency exchange gain (loss) <sup>4</sup>	144	(63)	328.57	(2)	58	(103.43)
– Other income (expense)	502	284	76.76	102	67	52.24
<b>Result before income taxes and minority interest</b>	<b>(14,346)</b>	<b>(76,728)</b>	<b>81.30</b>	<b>(8,081)</b>	<b>(36,926)</b>	<b>78.12</b>
Income tax	591	(891)	166.33	45	(611)	107.36
Extraordinary income (expenses)	-	-	-	-	-	-
<b>Result before minority interest</b>	<b>(13,755)</b>	<b>(77,619)</b>	<b>82.28</b>	<b>(8,036)</b>	<b>(37,537)</b>	<b>78.59</b>
Minority interest	22	17	29.41	7	19	(63.16)
<b>Net income / loss</b>	<b>(13,733)</b>	<b>(77,602)</b>	<b>82.30</b>	<b>(8,029)</b>	<b>(37,518)</b>	<b>78.60</b>
Net income per share (basic)	(0.39)	(2.19)		(0.23)	(1.06)	
Net income per share (diluted) <sup>5</sup>	-	-		-	-	
Weighted average common share outstanding (basic)	35,508,427	35,452,148		35,508,427	35,452,148	
Weighted average common share outstanding (diluted)	-	-		-	-	
Depreciation of property, plant and equipment included in total operating expense	5,434	4,681	16.09	2,816	2,536	11.04

<sup>1</sup> Previously reported as <cost of product sales>

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

<sup>3</sup> Previously reported as <equity in net loss of investees>

<sup>4</sup> Previously included in <other non-operating income (expense)>

<sup>5</sup> 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	30/06/2002	31/12/2001	Δ in %
<b>Assets</b>			
<b>Current assets:</b>			
– Cash and cash equivalents	18,292	18,651	(1.92)
– Marketable securities, at fair value <sup>6</sup>	-	9,182	(100.00)
– Trade accounts receivable	9,245	11,890	(22.25)
– Accounts receivable due from related parties <sup>7</sup>	211	676	(68.79)
– Inventories, at cost	6,972	6,524	6.87
– Deferred tax assets	43	104	(58.65)
– Prepaid expenses and other current assets	7,069	6,100	15.89
<b>Total current assets</b>	<b>41,832</b>	<b>53,127</b>	<b>(21.26)</b>
Property, plant and equipment, net <sup>8</sup>	63,712	67,847	(6.09)
Intangible assets, excluding goodwill, net	36,333	44,519	(18.39)
Notes receivable / loans	-	-	-
Investments	3	463	(99.35)
Goodwill, net <sup>9</sup>	215,787	228,612	(5.61)
Deferred taxes	-	-	-
Other non-current assets	49	49	-
<b>Total assets</b>	<b>357,716</b>	<b>394,617</b>	<b>(9.35)</b>
<b>Liabilities and stockholders' equity</b>			
<b>Current liabilities:</b>			
– Current portion of capital lease obligation	-	-	-
– Current portion of long-term debt <sup>10</sup>	1,173	829	41.50
– Trade accounts payable	5,792	5,677	2.03
– Accounts payable to related parties	26	40	(35.00)
– Advanced payments received <sup>11</sup>	918	70	
– Accrued expenses	7,884	8,972	(12.13)
– Deferred revenues	1,179	3,983	(70.40)
– Income taxes payable <sup>12</sup>	-	-	-
– Deferred taxes	-	-	-
– Other current liabilities	1,972	2,522	(21.81)
<b>Total current liabilities</b>	<b>18,944</b>	<b>22,093</b>	<b>(14.25)</b>
Long-term debt, less current portion <sup>13</sup>	2,541	3,009	(15.55)
Capital lease obligations, less current portion	-	-	-

<sup>6</sup> Previously reported as <investment securities>

<sup>7</sup> Previously included in <trade accounts receivable>

<sup>8</sup> Previously reported as <fixed assets, net>

<sup>9</sup> Previously included in <intangible assets, net>

<sup>10</sup> Previously reported as <current maturities of long-term loan>

<sup>11</sup> Previously partially in <deferred revenues>

<sup>12</sup> Previously included in <other current liabilities>

<sup>13</sup> Previously reported as <long-term loan>

Deferred revenues	-	-	-
Deferred taxes	19,560	21,221	(7.83)
Other non-current liabilities	150	50	200.00
Minority interests	598	653	(8.42)
<b>Shareholders' equity:</b>			
- Share capital	35,510	35,507	0.01
- Additional paid-in capital	536,875	536,857	0,00
- Treasury stock	-	-	-
- Retained earning/accumulated deficit	(231,109)	(217,376)	6.32
- Accumulated other comprehensive income/loss	(25,353)	(7,397)	242.75
<b>Total liabilities and stockholders' equity</b>	<b>357,716</b>	<b>394,617</b>	<b>(9.35)</b>

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

Euro in thousands	30/06/2002	30/06/2001
<b>Cash flows from operating activities:</b>		
Net loss	(13,733)	(77,602)
Adjustments to reconcile net loss to net cash used in operating activities	10,930	74,448
Change in assets and liabilities	(1,963)	(1,593)
<b>Net cash (used in) provided by operating activities</b>	<b>(4,766)</b>	<b>(4,747)</b>
<b>Cash flows from investing activities:</b>		
Purchase of marketable securities	(1,923)	(12,928)
Purchase of investment	(3)	-
Purchase of fixed assets	(4,358)	(8,334)
Purchase of intangible assets	(23)	(254)
Proceeds from sale of equipment	4	-
Proceeds from sale of investments	219	-
Proceeds from sale of marketable securities	11,095	12,442
<b>Net cash (used in) provided by investing activities</b>	<b>5,011</b>	<b>(9,074)</b>
<b>Cash flows from financing activities:</b>		
Net proceeds from capital increase	22	-
Repayment of bank loan	(88)	(333)
<b>Net cash flow (used in) provided by financing activities</b>	<b>(66)</b>	<b>(333)</b>
<b>Net increase in cash and cash equivalents</b>	<b>179</b>	<b>(14,154)</b>
Exchange rate difference	(538)	326
Cash and cash equivalents at beginning of year	18,651	32,483
<b>Cash and cash equivalents at end of the second quarter</b>	<b>18,292</b>	<b>18,655</b>
<b>Cash, cash equivalents and marketable securities at end of the second quarter</b>	<b>18,292</b>	<b>35,581</b>

**Consolidated statements of changes in stockholders' equity**  
 Evotec OAI AG and Subsidiaries

Euro in thousands except share data								
	Share capital		Additional paid-in capital	Unearned compensation	Foreign currency translation adjustment	Unrealised gains (losses) on securities	Accumulated deficit	Total stockholders' equity
	Shares	Amount						
<b>Balance at December 31, 2000</b>	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)
<b>Comprehensive loss:</b>								
- Foreign currency translation	-	-	-	-	(4,471)	-	-	(4,471)
- Unrealized holding gains on available-for-sale securities	-	-	-	-	-	(484)	-	(484)
- Net loss	-	-	-	-	-	-	(147,750)	(147,750)
<b>Total comprehensive loss</b>	-	-	-	-	-	-	-	<b>(152,705)</b>
<b>Balance at December 31, 2001</b>	<b>35,507,047</b>	<b>35,507</b>	<b>536,857</b>	<b>(635)</b>	<b>(6,914)</b>	<b>152</b>	<b>(217,376)</b>	<b>347,591</b>
Share capital increase	3,083	3	18	-	-	-	-	21
Stock option plan	-	-	-	162	-	-	-	162
<b>Comprehensive loss:</b>								
- Foreign currency translation	-	-	-	-	(17,966)	-	-	(17,966)
- Unrealized holding gains on available-for-sale securities	-	-	-	-	-	(152)	-	(152)
- Net loss	-	-	-	-	-	-	(13,733)	(13,733)
<b>Total comprehensive loss</b>	-	-	-	-	-	-	-	<b>(31,851)</b>
<b>Balance at June 30, 2002</b>	<b>35,510,130</b>	<b>35,510</b>	<b>536,875</b>	<b>(473)</b>	<b>(24,880)</b>	<b>-</b>	<b>(231,109)</b>	<b>315,923</b>