



Evotec OAI AG, Third Quarter Report 2001

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Dear shareholders,

Evotec OAI continues to expand its service offering based on proprietary technologies and proven expertise in biology, ultra High Throughput Screening (uHTS) and chemistry. Over the past few months we have built significant further expertise particularly in the areas of assay technologies and medicinal chemistry. We have made major progress in developing our new cell detection system, and we are expanding our ability to offer integrated processes from disease target to IND (Investigational New Drug) across most target classes and biochemical and cell based assay types. With our service offering growing, we are also expanding our business development activities with both pharma and biotech customers. Additions to our sales team in the US and in Europe are helping build significant interest in our services.

Our investments have been focussed on either short-term operational improvements or on mid-term R&D projects, in particular in the area of biological assay technologies. The new pilot plant, that can provide GMP material to support clinical trials, was commissioned and began operations in July. The ultra High Throughput Screening platform, EVOscreen® Mark II, is running well, both at the sites of our Consortium Partners and in our in-house screening factory. In parallel the next generation EVOscreen® (Mark III) is nearer to completion.

Several new partnerships signed

In the third quarter of 2001 Evotec OAI entered into several new agreements with leading pharmaceutical and biotechnology companies. In addition to numerous new orders in the Development Chemistry Services Division (process research and development, custom preparation and pilot plant manufacture) we started or extended a series of contracts in Discovery Chemistry and Biology Services.

In August 2001 Evotec OAI signed a new four-year contract with **Pharmacia Corporation**. The contract extends an original agreement signed in February 1998. Under the terms of the new contract, Evotec OAI will provide Pharmacia with high quality libraries for pharmaceutical screening.

In September, Evotec OAI secured a medicinal chemistry collaboration with **Rigel Pharmaceuticals** for the optimisation of small molecules focused on inhibitors of ubiquitin ligases. Research on this target class is an important new area in the field of oncology. Evotec OAI will use its leading-edge, integrated drug discovery platform to select and synthesise lead compounds with optimised properties for Rigel to screen against their target proteins.

In parallel, Evotec OAI signed a contract with **Byk Gulden**, Altana AG's pharmaceutical group. In close collaboration with Byk Gulden, Evotec OAI will start an assay development programme based on our novel detection platform for high throughput imaging. Following the successful development of the assay principle, Byk Gulden will purchase our cell reader and will integrate it into their own screening systems. Evotec OAI has the right to use this application in the Company's service offering.

In October, we announced the extension of our collaboration with **VitaResc Biotech** for the development of VitaResc's anti-thrombotic drug VTR-TI. Under the terms of the agreement signed in summer 2000, VitaResc and Evotec OAI successfully developed a protocol for high yield synthesis of VTR-TI. Now, VitaResc and Evotec OAI will extend this co-operation to scale-up production of VTR-TI.

Business progressing well

Our drug discovery services, which cover all the major biology and chemistry activities, made good progress in the course of this year. Our collaborations with leading pharmaceutical and biotechnology companies continue to be successful and bring value to their drug discovery efforts. This emphasises both the expertise of our scientists and the quality of our technology platforms for assay development, ultra High Throughput Screening (uHTS) and chemistry services. The closing of several new contracts and extending existing collaborations is a testament to our track record with our customers. As usual, we are able to charge for our high-quality services, and secure upsides through milestones and royalty provisions. Major advances have been achieved in our internal benchmarking program for assay development and screening. High quality assays have been developed and screened using the EVOscreen® Mark II

system for important target classes such as GPCRs, protein-protein interactions, kinases, phosphatases and proteases.

In technology development our scientists have almost completed the final development of the next generation of our screening platform, EVOscreen® Mark III. The system is now almost ready for customer acceptance testing by GlaxoSmithKline and is expected to be complete by the end of the year. In our co-operation with Olympus we have developed the first prototype of the signal-processing unit, a core module of the new generation of our research detector.

We have continued to build our business development team world-wide, with two managers recruited on the West Coast, USA and two managers on mainland Europe. We have continuously monitored risks which we are confronted with in our business through our established risk management systems in place. Overall, we do not assume our risk profile to have changed significantly compared to the end of the last financial year.

New company name registered

The new company name – Evotec OAI AG – has officially been registered in the trade register in September 2001.

Financial Report

Revenue

In the first nine months of 2001 Evotec OAI revenues amounted to EUR 39.6 million, an increase of 304% over the respective period in 2000. This strong increase over 2000 is largely attributed to the acquisition of the chemistry business late in 2000 as well as strong organic growth in drug discovery services.

In the Drug Discovery Service division Evotec OAI achieved revenues of EUR 34.7 million (previous year: EUR 1.5 million). On a pro-forma basis (including the chemistry business for the respective period of 2000), growth over last year amounted to EUR 5.9 million, up 20%. This is primarily attributable to growth in biology services (EUR 4.0 million, which is up 115%) and the very successful development of our discovery chemistry division (EUR 18.5 million, +24%). Revenues in development chemistry amounted to EUR 12.2 million, slightly above previous year (EUR 12.0 million). First production in our new pilot plant started in July. Several new contracts have been secured in the third quarter so that this service line will show further growth in the fourth quarter of this year.

In our Drug Discovery Tools and Technology division we achieved sales of EUR 4.8 million. As anticipated, revenues in this division were EUR 3.5 million below the previous year with revenues from our consortium partnerships declining due to the successful completion of the EVOscreen® agreement with Novartis and the delivery of three EVOscreen® Mark II systems last year. However, revenues in our Drug Discovery Tools and Technology Division from sources other than consortium partner contracts grew from EUR 0.3 million to EUR 2.9 million or by 779%. This reflects in particular our successful collaboration in diagnostic and other instruments with Olympus.

In the first nine months of 2001 the geographical mix of our revenues again demonstrates the continued strong presence in the US pharmaceutical market. 56 % of our Company's revenues were generated in the United States, while Europe contributed 39% and Japan 5%.

We are pleased with our performance to date. We expect significant additional revenues from deliveries in Q4, which is usually the strongest quarter for revenue recognition in our fiscal year.

Research and development

Research and development expenses increased from EUR 13.2 million to EUR 16.9 million (+28%). On a pro-forma basis, including R&D expenses for the chemistry business in the first nine months of 2000, the increase amounted to +20%. This level of R&D is in line with our expectations for R&D expenditure for the entire fiscal year. A significant portion of R&D is

still devoted to hardware and software technologies for our screening and detection systems. Going forward we expect to reduce the amount of R&D for systems and will further increase our effort in the development of new assay systems and drug discovery research.

Result

Cost of goods sold grew from EUR 3.7 million to EUR 20.2 million as a consequence of the integration of the chemistry business in late 2000. On a pro-forma basis cost of goods sold decreased from EUR 21.0 million to EUR 20.2 million. Our gross margin increased as a consequence from 44% to 49%. The lower cost of goods sold and the higher gross margin is a result of a particular sales mix within the period and on a full year basis we expect cost of goods sold and margins to return to their average levels.

SG&A increased from EUR 6.1 million to EUR 14.4 million in the first nine months of 2001. This is purely a result of the integration of OAI. On a pro-forma basis SG&A expenses increased by a moderate 1% from EUR 14.3 million to EUR 14.4 million.

Excluding non-cash effects (primarily goodwill amortisation from acquisitions) the Evotec OAI group **loss from operations** for the first nine months decreased as expected from EUR (13.2) million in 2000 to EUR (11.9) million in 2001.

Including non-cash effects of EUR 103 million, the **operating loss** amounted to EUR (114.9) million. The largest part of non-cash effects is goodwill amortisation, a type of charge which will no longer be accounted for from January 1, 2002 onwards. This accounting change is following a new regulation by the US accounting authority "Financial Accounting Standards Board (FASB)".

Excluding these non-cash effects, **net loss** in the first nine months was EUR (11.8) million. The net loss includes a tax charge totalling EUR 1.8 million representing unpaid, deferred tax liabilities in the UK.

Net income per share amounted to EUR (3.24). Adjusted for acquisition related non-cash expenses, net income per share improved from EUR (0.47) in 2000 to EUR (0.33) in 2001.

Earnings before interest and taxes, depreciation and amortisation (**EBITDA**) improved to EUR (4.1) million compared to EUR (10.9) million in the previous year. EBITDA per share improved to EUR (0.11) from EUR (0.45) in 2000.

Capital expenditure

Capital expenditures in the first nine months amounted to EUR 12.3 million. We invested in facility projects, i.e. the completion of the new pilot plant as

well as the extension of new labs in Abingdon and the construction of the screening factory in Hamburg. We have purchased new laboratory equipment and set up our own Mark III system for screening operations in Hamburg.

Cash flow and cash equivalents

In the first nine months of 2001 cash flow from operating activities was EUR (8.5) million compared to EUR (13.9) million in the same period of 2000. The current cash consumption is driven by the net loss from operations, and increased inventories due to the assembly of Mark III for GlaxoSmithKline and work in progress in pilot plant manufacturing. Investments in property, plant and equipment amounted to EUR 11.9 million.

Our cash position as of September 30, 2001 was EUR 27.4 million (cash and investment securities). In 2002 we expect a continuous improvement of net cash used in operating activities and a level of investment significantly lower than in 2001.

Employees and management

At the beginning of September 2001, Evotec OAI appointed Dr Dirk Horst Ehlers to the position of Chief Financial Officer. Dr Ehlers is responsible for Finance and Administration, Controlling and Investor Relations within the Company. In this position he succeeds Joern Aldag who was appointed to Chief Executive Officer at Evotec OAI as of 1 July, 2001. Dr Ehlers, 41, has more than seven years experience in the healthcare industry. He brings an excellent combination of sector specific business and financial background to our team to further build on our leadership position as a provider of drug discovery and development solutions. Before joining Evotec OAI he was Member of the Management Board at Fresenius Kabi AG, Bad Homburg, Germany.

We have continued with our focussed recruitment campaign, adding headcount particularly in support of our service businesses. Evotec OAI employed 575 people at the end of September 2001. This strong increase over the previous year (+320 people) is mainly due to the merger with OAI. On a pro-forma basis, headcount increased by 13%.

Segment information

The company has two core business segments. Revenues from continuing operations for the period ended September 30, 2001 and 2000 were as follows:

		actual	actual
		30/09/2001	30/09/2000
Drug discovery tools and technology	TEUR	4,804	8,322
Drug discovery services	TEUR	34,772	1,475
Total	TEUR	39,576	9,797

Management is in the process of implementing a system to capture additional segmental information.

Stock option programme

In September 2001, Evotec OAI granted 685,045 subscription rights to employees and members of the Management Board. The options can be exercised in accordance with the Company's stock options programme at a strike price of EUR 6.80. The total number of options that are available for exercise as at the end of the third quarter amounts to 1,605,573.

Outlook

Evotec OAI grew as planned during the first nine months of 2001. For the current year our order book today already accounts for 93% of analysts' revenue expectations of around EUR 67 million. The completion of our Mark III system is proceeding well and according to plan. In line with expectations, revenue recognition from this exciting project as well as a stronger sales contribution from pilot plant production towards the end of the year should lead to an extraordinarily strong fourth quarter of 2001.

Evotec OAI's business development pipeline is strong and makes us confident we will achieve further growth in 2002. We expect to build on our numerous and long-lasting relationships with blue chip pharmaceutical companies and expect to further increase new collaborations with biotech partners.

Our research and development efforts will emphasise the expansion of our service platform, e.g. with the addition of cellular assays and ADME-T capabilities as well as the extension of our corporate compound library. The continued excellence of our integrated service offering is our primary objective. It distinguishes Evotec OAI as a true leader in drug discovery services from target to IND based on proprietary technologies.

Shareholdings of the Boards of Evotec OAI AG

	Number of shares	Share options
Management Board		
Joern Aldag	278,000	32,600
Dr Timm-H. Jessen	132,672	26,732
Dr Mario Polywka	32,565	15,000
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

September 30, 2001

Key figures

Evotec OAI AG and Subsidiaries

		actual	pro forma
		30/09/2001	30/09/2000
Revenue	TEUR	39,576	37,181
Net loss	TEUR	114,821	113,286
Loss per share	EUR	3.24	3.20

Condensed consolidated statements of operations according to US GAAP

Evotec OAI AG and Subsidiaries

Euro in thousands except share data

	01-09/2001	01-09/2000	Δ in %	07-09/2001	07-09/2000	Δ in %
Revenues:						
– Drug discovery products & development of technologies	4,836	8,320	(41.88)	1,359	2,456	(44.67)
– Drug discovery services	34,740	1,477	-	11,893	943	-
Total revenues	39,576	9,797	303.96	13,252	3,399	289.88
– Cost of revenues ¹	20,207	3,725	442.43	6,180	1,311	371.30
Gross Profit	19,369	6,072	218.99	7,072	2,088	238.70
– Selling, general and administrative expenses ²	14,407	6,084	136.80	4,935	1,967	150.87
– Research and development expense	16,908	13,166	28.42	5,026	4,898	2.62
– Other operating income and expenses	-	-	-	-	-	-
– Amortization (and impairment) of goodwill amongst other things	102,997	56	-	34,318	18	-
Depreciation of property, plant and equipment included in total operating expenses	7,251	1,868	288.17	2,599	699	271.82
Operating income (loss)	(114,943)	(13,234)	768.53	(37,207)	(4,795)	676.02
– Interest income and expenditure	1,326	1,398	(5.12)	378	612	(38.19)
– Income from investments and participations	-	-	-	-	-	-
– Income (expense) from associated companies ³	(189)	(264)	(28.49)	(28)	(72)	(61.27)
– Foreign currency exchange gain (losses) ⁴	(114)	-	-	(50)	-	-
– Other income (expense)	895	690	29.71	610	347	75.79
Result before income taxes and minority interest	(113,025)	(11,410)	890.58	(36,297)	(3,908)	828.79
Income tax	(1,806)	(14)	-	(915)	-	100.00
Extraordinary income (expenses)	-	-	-	-	-	-
Result before minority interest	(114,831)	(11,424)	(905.17)	(37,212)	(3,908)	(852.20)
Minority interest	10	44	(77.08)	(7)	5	(251.37)
Net income/ loss	(114,821)	(11,380)	908.93	(37,219)	(3,903)	853.52
Net income per share (basic)	(3.24)	(0.47)		(1.05)	(0.16)	
Net income per share (diluted) ⁵	-	-		-	-	
Weighted average common share outstanding (basic)	35,452,148	24,333,844		35,452,148	24,685,666	
Weighted average common share outstanding (diluted)	-	-		-	-	

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	30/09/2001	31/12/2000	Δ in %
Assets			
Current assets:			
–Cash and cash equivalents	15,625	32,484	(51.90)
–Short-term investments / Marketable securities ⁶	11,789	16,440	(28.29)
–Trade accounts receivable	7,898	10,228	(22.78)
–Accounts receivable due from related parties ⁷	296	504	(41.27)
–Inventories	8,831	5,434	62.51
–Deferred tax assets	229	229	0.00
–Prepaid expenses and other current assets	5,050	4,536	11.33
Total current assets	49,718	69,855	(28.83)
Property, plant and equipment ⁸	65,439	59,800	9.43
Intangible assets	46,132	54,793	(15.81)
Investments	3,129	3,319	(5.72)
Notes receivable / loans	–	–	–
Goodwill ⁹	250,932	344,900	(27.24)
Deferred taxes	–	–	–
Other assets	39	39	0.00
Total assets	415,389	532,706	(22.02)
Liabilities and stockholders' equity			
Current liabilities:			
– Current portion of capital lease obligation	–	–	–
–Short-term debt and current portion of long-term debt ¹⁰	751	718	4.60
–Trade accounts payable	4,258	3,752	13.49
–Advanced payments received ¹¹	1,583	306	417.32
–Accrued expenses	5,575	9,589	(41.86)
–Deferred revenues	1,147	3,456	(66.81)
–Income tax payable ¹²	449	449	0.00
–Deferred taxes	–	–	–
– Other current liabilities	1,862	1,584	17.55
Total current liabilities	15,625	19,854	(21.30)
Long-term debt, less current portion ¹³	3,176	3,527	(9.95)
Capital lease obligations, less current portion	–	–	–
Deferred revenues	–	373	(100.00)

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> and in <other current liabilities>

12 Before included in <other current liabilities>

13 Before reported as <long-term loan>

Deferred taxes	7,271	5,820	24.93
Pension accruals	7	7	0.00
Minority interests	606	630	(3.81)
Shareholders' equity:	388,704	502,495	(22.65)
–Share capital	35,452	35,452	0.00
–Additional paid-in capital	538,667	538,476	0.04
–Treasury stock	–	–	–
–Retained earning/accumulated deficit	(184,447)	(69,626)	(164.91)
–Accumulated other comprehensive income/loss	(968)	(1,807)	46.43
Total liabilities and stockholders' equity	415,389	532,706	(22.02)

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

Euro in thousands	30/09/2001	30/09/2000
Cash flows from operating activities:		
Net loss	(114,821)	(11,380)
Adjustments to reconcile net loss to net cash used in operating activities	112,293	2,106
Change in assets and liabilities	(6,008)	(4,591)
Net cash used in operating activities	(8,536)	(13,865)
Cash flows from investing activities:		
Purchase of investment securities	(23,262)	(52,359)
Purchase of fixed assets	(11,945)	(3,983)
Purchase of intangible assets	(355)	(35)
Cash acquired	–	361
Proceeds from sale of investment securities	27,913	5,814
Net cash used in investing activities	(7,649)	(50,202)
Cash flows from financing activities:		
Net proceeds from capital increase	–	7,740
Repayment of bank loan	(317)	(320)
Net cash flow provided by financing activities	(317)	7,420
Net increase in cash and cash equivalents	(16,502)	(56,647)
Exchange rate difference	356	–
Cash and cash equivalents at beginning of year	32,483	57,488
Cash and cash equivalents at end of the third quarter	15,625	841
Cash, cash equivalents and investment securities at end of the third quarter	27,414	47,386

Consolidated statements of changes in stockholders' equity

Evotec OAI AG and Subsidiaries

Euro in thousands except share data								
	Share capital Shares	capital Amount	Additional paid-in capital	Unearned compen- sation	Accumulated other com- prehensive income	Subscription rights receivable	Accumu- lated deficit	Total stock- holders' equity
Balance at December 31, 1999	24,156,000	24,156	58,746	(51)	–	–	(22,552)	60,299
Receipt of share capital subscription	–	–	7,740	–	–	–	–	7,740
Acquisition of Genion	52,913	53	2,503	–	–	–	–	2,556
Acquisition of OAI	11,225,744	11,226	465,756	–	–	–	–	476,982
Share capital increase in Direvo	–	–	2,828	–	–	–	–	2,828
Share capital increase	17,491	17	893	–	–	–	–	910
Stock option plan	–	–	713	(652)	–	–	–	61
Comprehensive loss								
– Net loss	–	–	–	–	–	–	(47,074)	(47,074)
– Foreign currency translation	–	–	–	–	(2,443)	–	–	(2,443)
– Unrealized holding gains on available-for-sale securities	–	–	–	–	636	–	–	636
Total comprehensive loss	–	–	–	–	(1,807)	–	(47,074)	(48,881)
Balance at December 31, 2000	35,452,148	35,452	539,179	(703)	(1,807)	–	(69,626)	502,495
Stock option plan				191				191
Comprehensive loss								
– Net loss	–	–	–	–	–	–	(114,821)	(114,821)
– Foreign currency translation	–	–	–	–	1,151	–	–	1,151
– Unrealized holding gains on available-for-sale securities	–	–	–	–	(313)	–	–	(313)
Total comprehensive loss	–	–	–	–	839	–	(114,821)	(113,982)
Balance at Sept. 30, 2001	35,452,148	35,452	539,179	(512)	(968)	–	(184,447)	388,704

The financial statements of the reported period were prepared using the same accounting policies as for the year 2000.