Evotec OAI AG, Third Quarter Report 2003

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Dear shareholders,

Q3 results have been particularly strong for Evotec OAI. We have achieved revenue growth of 53% in the third quarter and 20% in the first nine months of 2003. At constant (last year's) exchange rates revenue growth would have amounted to 64% and 31% respectively. This outstanding performance was supported by above average growth in Discovery Biology services and in Evotec Technologies following the delivery of a suite of discovery instruments to Pfizer. As a consequence of this strong top line performance and stringent cost management, EBITDA was positive for the quarter and for the nine month period starting in January 2003. Positive cash flow from operations contributed to strengthening our cash position to EUR 19.0 million, up from EUR 16.3 million end of June.

	Jan. – Sept. 2003	Jan. – Sept. 2003 constant currencies*
Revenues	EUR 56.7 m	EUR 62.0 m
Growth over 2002	20%	31%
- Thereof Discovery and Development Services	EUR 42.8 m	EUR 48.1 m
- DDS growth over 2002	4%	17%
Gross margin	39.6%	41.3%
EBITDA	EUR 3.5 m	EUR 5.5 m

Table: Currency effect on key numbers

**Currency adjustment using exchange rates used in the comparable period of 2002*

We also made good progress with regard to our Discovery Programs Division with two important contracts signed in Q3 - Takeda and DeveloGen. Both collaborations underline that we are delivering on our strategy of creating long-term value through in-house indication-specific drug discovery programmes. These programmes are intended to complement our services offering and more significantly add to our business growth in the mid term.

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Highlights

Strong progress in Discovery and Development Services

Performance in our core business has been strong with a focus on delivery on customer programmes. Our **discovery** collaborations with leading *pharmaceutical* customers continued to deliver excellent results:

- We carried out screening of adherent cells in a high throughput format closing two screening projects ahead of schedule for Novartis.
- Our focus has increasingly shifted towards complex multifunctional cellular applications expanding information content in the search for new drugs. One example of this is our assay development programme with Pfizer.
- We delivered libraries of very high purity to our partners including Merck, Roche and Solvay.
- Customers in the design and synthesis of compound libraries such as Roche have expanded the collaboration with us into medicinal chemistry programmes.

In addition, we continued to deliver high quality solutions to our expanding *biotech* customer base:

- We have performed a number of integrated projects identifying promising hits which were progressed into chemical optimisation.
- We have integrated *in vitro* and *in silico* ADMET assays into medicinal chemistry projects and successfully expanded the application of molecular modelling and virtual screening in many of our customer's programmes to enhance the decision making process.
- Our initiative with Oxford Bioscience Partners (a venture capital firm that signed an umbrella agreement on behalf of their portfolio companies) continues to provide important medicinal chemistry support to their portfolio companies.
- We signed a similar umbrella contract with another major venture capital firm in Q3.
- We increased the services provided for Evotec Neurosciences and our collaboration with DeveloGen.

In the **development** of drug candidates we continued our long-term relationships with companies including Pfizer, GlaxoSmithKline, AstraZeneca, Elan, Serono, Celgene, UCB, Alizyme and Oxigene in all segments of the value chain from custom preparations through process research and development (PRD) to pilot plant production. In addition, we performed laboratory-scale projects for new customers such as Anormed and Stiefel. Capacity utilisation in our pilot plant has further improved as we have received several pilot plant orders for delivery in Q4.

Although the market environment for discovery and development services continued to be challenging new deal flow was successful in general, but even more so considering the performance we see of most of our peers.

New collaboration with Takeda in Alzheimer's Disease

As already stated in our Q2 report, Evotec OAI, Evotec Neurosciences (ENS) and **Takeda** entered into a EUR 20 million four-year collaboration in the area of Alzheimer's disease (AD) on 1 August 2003 – a strong validation of our CNS research performed over the past years. Together the companies will work on the identification and validation of novel targets relating to different aspects of the causes and progression of AD, with the goal of developing innovative therapeutics.

Strategic alliance for Metabolic Diseases signed with DeveloGen

On 10 September 2003, **DeveloGen** and Evotec OAI announced that they have entered into a joint drug discovery and development partnership in the field of obesity and diabetes. The partnership creates an integrated venture combining DeveloGen's pipeline of over 200 primary targets and 30 validated targets as well as its know-how in pharmacology, metabolic diseases and assay development together with Evotec OAI's competences ranging from assay development and screening all the way through to medicinal chemistry and drug manufacture. The combination brings together top tier competitive expertise and professional resources of the highest quality across the entire drug discovery value chain.
With this partnership Evotec OAI is delivering on its strategy to use its world class discovery platform to provide higher value added programmes to its partners. By sharing risks and rewards equally with a disease-focussed biotech company we are leveraging both parties' complementary skills to rapidly produce potent and promising product candidates to fill our partners' clinical pipelines.

Evotec Technologies successfully completes a 1st year in Pfizer collaboration, growing 251% in Q3

Evotec Technologies (ET) had an exceptional third quarter 2003, growing 251% over the same period last year. In the context of its extended collaboration with Pfizer signed in October 2002 ET integrated an additional EVOscreen® Mark III system at a Pfizer US research site and installed several Opera confocal imaging readers. Pfizer is extremely pleased with the provision of this flexible instrument portfolio which includes the integration of the Opera as well as third party hardware and software solutions into their ultra-high-throughput screening (uHTS) systems.
In September ET launched its new bench-top device Clarina II at the SBS Conference in Portland, US. Clarina is an automated instrument for assay development and profiling in medium-throughput format. It is based on the same cutting-edge technologies integrated into EVOscreen®. Clarina consists of an FCS single molecule detection reader, the proprietary scheduling software Bernstein, a robotic device as well as consumables.

Important events after the end of the third quarter

No major event to be reported occurred since the end of the reported period.

Financial Report

Revenue

For the first nine months to September 2003 Evotec OAI achieved revenue growth of 20% to EUR 56.7 million (2002: EUR 47.5 million). As expected, the third quarter has been particularly strong, up 53% over the same period in 2002. Considering the current market environment this is an excellent achievement even considering the fact that the strong sales growth was strongly supported by sizeable instrument deliveries in Evotec Technologies.

Third-party revenues in our **Discovery and Development Services Division** (DDS) increased 4% to EUR 42.8 million (2002: EUR 41.2 million) in the first nine months of 2003. Here third quarter revenues alone grew by 20%. This performance was mainly driven by strong growth in Discovery Biology, following an earlier than expected completion of primary screening campaigns on two targets with Novartis.

Following the agreement with Takeda signed in August 2003, revenues were shown for the first time in our **Discovery Programs Division (DPD)**. They amounted to EUR 0.5 million, which consist of FTE based R&D payments and the allocation of the target database access fee, which is spread over a four-year contract period.

Third-party revenues in our **Tools and Technologies Segment "Evotec Technologies"** were propelled by the delivery of several instruments to Pfizer. Sales rose by 116% to EUR 13.4 million (2002: EUR 6.2 million) following the successful integration of two EVOscreen® and several Opera confocal imaging readers at Pfizer's research sites.

Evotec OAI recorded 50% of total revenues in Europe, 45% in the United States, and 5% in Japan and Rest of World.

Operating cost structure

Cost of revenues amounted to EUR 34.3 million (2002: EUR 26.5 million) resulting in gross margins of 39.6% for the first nine months 2003. Gross margins in Q3 (38.0%) were lower than in the first half of 2003 (40.5%) since a significant portion of Q3 sales resulted from lower margin instrument deliveries to EVOscreen® development partners.
Compared to the first nine months 2002 (gross margin 44.2%) 2003 gross margin performance has been also adversely effected by US-Dollar exchange rates (see table above).

R&D expenses amounted to EUR 11.6 million (2002: EUR 17.5 million), down 34% compared to the same period last year and in-line with the development seen throughout the year. This improvement is mainly a result of our planned cost reductions in technology development R&D which more than halved compared to the same period in 2002. R&D activities in drug discovery, the Company's core business, remained at the same high level as in the previous year (EUR 9.6 million). These activities are increasingly directed towards our own discovery programmes. As a second effect on R&D cost, income from FTE-based technology R&D services performed for Pfizer (EUR 0.8 million) were netted against actual R&D cost since Q2 as already indicated in our Q2 report.

SG&A costs were reduced by 20% to EUR 13.0 million (2002: EUR 16.3 million) for the first nine months of the year, reflecting Evotec OAI's successful efforts to save costs. The significant improvement in Q3 (-33%) is a result of timing of SG&A projects as well as personnel expenses.

Result

On the basis of revenue growth and the reduced cost base the Evotec OAI **operating result** improved by 48% for the first nine months of 2003 to EUR (12.3) million (2002: EUR (23.5) million). Excluding amortisation charges, operating losses declined by 71% to EUR (4.2) million (2002: EUR (14.4) million), with our Drug Discovery Services as well as Evotec Technologies' business achieving a positive operating result. In the third quarter alone, overall operating result before amortisation was positive for the first time in the company's history.
Net loss amounted to EUR (9.9) million, improving 52% (2002: EUR (20.6) million). Net income tax benefits totalled EUR 2.1 million. Deferred tax benefits in the UK (EUR 0.3 million) and current taxes worldwide (EUR (0.3) million) added to deferred tax benefits from the amortisation of merger-related non-goodwill intangible assets (EUR 2.1 million).
Net income per share amounted to EUR (0.28) (2002: EUR (0.58)).

In line with company guidance **earnings before interest and taxes, depreciation and amortisation** (**EBITDA**) was positive for Q3. Following this particularly strong Q3, EBITDA for the first nine months improved significantly from EUR (5.0) million in 2002 to EUR 3.5 million.

Capital expenditure

Investments in fixed assets amounted to EUR 10.0 million. In Q3 spend on the new laboratory building in Oxford made up most of the investment during that quarter and has now reached its peak. The building will be completed end of this year, and capital expenditures will go back to regular levels thereafter.

Cash flow and cash equivalents

Cash, cash equivalents and marketable securities as of 30 September 2003 increased to EUR 19.0 million, mainly as a result of cash flow from operating activities amounting to EUR 2.4 million in Q3. For the first nine months the Evotec OAI group reached an operating cash break-even of EUR 0.2 million, a significant improvement over the same period of last year (2002: EUR (11.2) million).
Net cash flow from financing activities amounted to EUR 8.2 million (2002: EUR 4.9 million). In the third quarter, we have matched the continued investment in the new laboratory building in Oxford with further loan finance to be cash neutral.

Net working capital increased by EUR 3.3 million in the first nine months. This includes an increase of trade accounts receivable following the instrument sales to Pfizer in September which will translate into a strong operating cash flow in Q4 2003. Compared to Q2, inventories were reduced by EUR 0.8 million, to EUR 11.4 million and will be further reduced in Q4.

Employees and management

As of 30 September, Evotec OAI employed 643 people. Following the sharp build-up of capacity in discovery chemistry through the recruitment of 17 research scientists from British Biotech in Q1, headcount came back to target levels.
As announced in August, Bernard Questier joined Evotec OAI as Chief Business Officer and member of the Management Board with effect from 6 October 2003.

Stock option programme

As already communicated we issued 46,000 stock options to new employees in Q1. In the second and third quarter, stock options were neither granted nor exercised. As of 30 September 2003, the total number of options that are available for future exercise amounts to 2,053,614, or approximately 6% of currently issued shares.

Outlook

Evotec OAI has reported a strong performance in the first nine months of 2003. In light of the overall market weakness management believes this to be a very successful development compared to most of its peers. In the current market environment, trends are not very clearly identifiable. We at Evotec OAI however are seeing pharma and biotech companies continuing to shift budgets from discovery into development and to focus on fewer projects to be pushed into the market faster. In the short term, this puts pressure on outsourcing revenue growth potential. With a longer term perspective, however, this trend underscores our strategy as pharma companies need to fill their pipelines and will increasingly have to do so by in-licensing and sourcing of discovery programmes. In addition, the strong Euro continues to have a negative impact on our short term growth potential.
In summary, both effects decrease short term revenue visibility and may result in short-term adverse quarterly fluctuations. However, given the quality reputation we have built in the individual areas of our offering, and given in particular our high degree of integration along the value chain, we are well positioned for the future. We remain confident that when the market returns to more strength, we will able to take full advantage.
For 2003, we expect to meet or to come very close to our guidance of 10-15% annual growth despite strong currency effects. Assuming last year's exchange rates, Evotec OAI would have clearly outperformed the upper end of that range. Following an extraordinarily strong Q3, revenues in Q4 are expected to be slightly lower than in Q3 (which was high due to sales related to EVOscreen® effect). Our sales and order book as of October amounted to EUR 76 million for 2003, covering 97% of analysts' revenue expectations for the full year (consensus: EUR 78 million). On this basis we

are on track towards our goal to reach a positive EBITDA for the full year 2003. We will give guidance for 2004 in early February.

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

30 September 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 30 September 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	38	-	14,275	(880)
– Drug discovery services	43,971	518	-	(1,223)
Total revenue	44,009	518	14,275	(2,103)
– Cost of revenues	26,083	273	8,690	(790)
Gross Profit	17,926	245	5,585	(1,313)
– Selling, general and administrative expenses	9,691	1,165	2,161	(4)
– Research and development expenses	6,085	3,559	3,402	(1,429)
– Other operating expenses	2,029	-	-	-
– Amortisation of goodwill amongst other things	7,828	47	758	(595)
Operating income (loss)	(7,707)	(4,526)	(736)	715

[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	01-09/2003	01-09/2002	Δ in %	07-09/2003	07-09/2002	Δ in %
Revenues:						
– Drug discovery products & development of technologies	13,433	6,625	102.8	6,524	1,848	253.0
– Drug discovery services	43,266	40,826	6.0	15,338	12,402	23.7
Total revenues	56,699	47,451	19.5	21,862	14,250	53.4
– Cost of revenue	34,256	26,499	29.3	13,545	8,009	69.1
Gross profit	22,443	20,952	7.1	8,317	6,241	33.3
– Selling, general and administrative expenses	13,013	16,253	(19.9)	3,662	5,458	(32.9)
– Research and development expense	11,617	17,543	(33.8)	3,640	5,413	(32.7)
– Other operating expenses	2,029	1,544	31.4	357	547	(34.7)
– Amortisation of goodwill amongst other things	8,038	9,105	(11.7)	2,650	2,999	(11.6)
Operating income (loss)	(12,254)	(23,493)	47.8	(1,992)	(8,176)	75.6
– Interest income (expense)	(79)	361	(121.9)	(82)	36	(327.8)
– Income from investments and participations	-	-	-	-	-	-
– Income (expense) from associated companies	(115)	-	(100.0)	(64)	-	(100.0)
– Foreign currency exchange gain (loss), net	(3)	245	(101.2)	-	101	(100.0)
– Other income (expense)	471	996	(52.7)	97	494	(80.4)
Result before income taxes and minority interests	(11,980)	(21,891)	45.3	(2,041)	(7,545)	73.0
Income tax	2,118	1,307	62.1	369	716	(48.5)
Extraordinary income (expenses)	-	-	-	-	-	-
Result before minority interests	**(9,862)**	**(20,584)**	**52.1**	**(1,672)**	**(6,829)**	**75.5**
Minority interests	(26)	(40)	35.0	(29)	(62)	53.2
Net income / loss	**(9,888)**	**(20,624)**	**52.1**	**(1,701)**	**(6,891)**	**75.3**
Net loss per share (basic)	(0.28)	(0.58)		(0.05)	(0.19)	
Net loss per share (diluted)[2]	-	-		-	-	
Weighted average common share outstanding (basic)	35,510,130	35,509,001		35,510,130	35,509,001	
Weighted average common share outstanding (diluted)	-	-		-	-	
Depreciation of property, plant and equipment included in total operating expense	7,406	8,149	(9.1)	2,279	2,715	(16.1)

[2] 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.

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Condensed consolidated balance sheets according to US GAAP

Evotec OAI AG and Subsidiaries

Euro in thousands	30/09/2003	31/12/2002	Δ in %
Assets			
Current assets:			
– Cash and cash equivalents	15,393	21,308	(27.8)
– Marketable securities, at fair value	3,595	-	100.0
– Trade accounts receivable	11,039	10,166	8.6
– Accounts receivable due from related parties	557	244	128.3
– Inventories, at cost	11,370	8,408	35.2
– Deferred tax assets	48	45	6.7
– Current tax receivables	2,433	2,665	(8.7)
– Prepaid expenses and other current assets	3,412	3,196	6.8
Total current assets	**47,847**	**46,032**	**3.9**
Long-term investments	706	560	26.7
Property, plant and equipment, net	61,422	61,951	(0.9)
Intangible assets, excluding goodwill, net	19,969	29,601	(32.5)
Notes receivable / loans	-	-	-
Goodwill, net	97,881	102,851	(4.8)
Deferred taxes	-	-	-
Other non-current assets	47	47	-
Total assets	**227,872**	**241,042**	**(5.5)**

Liabilities and stockholders' equity			
Current liabilities:			
– Current portion of capital lease obligation	440	386	14.0
– Current maturities of long-term loans	1,496	1,067	40.2
– Trade accounts payable	3,256	4,565	(28.7)
– Accounts payable to related parties	9	8	12.5
– Advanced payments received	1,925	5,703	(66.3)
– Accrued expenses	7,088	5,552	27.7
– Deferred revenues	6,714	2,695	149.1
– Current tax payables	48	80	(40.0)
– Deferred taxes	-	-	-
– Other current liabilities	2,199	1,404	56.6
Total current liabilities	**23,175**	**21,460**	**8.0**
Long-term loans	10,990	6,820	61.1
Long-term capital lease obligations	1,495	1,113	34.3
Deferred taxes	12,229	15,544	(21.3)
Other non-current liabilities	53	53	-
Minority interests	901	645	39.7

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Stockholders' equity:			
– Share capital	35,510	35,510	-
– Additional paid-in capital	539,746	536,908	0.5
– Treasury stock	-	-	-
– Retained earning/accumulated deficit	(358,894)	(349,006)	(2.8)
– Accumulated other comprehensive income/loss	(37,333)	(28,005)	(33.3)
Total liabilities and stockholders' equity	**227,872**	**241,042**	**(5.5)**

Condensed consolidated statements of cash flows according to US GAAP

Evotec OAI AG and Subsidiary

Euro in thousands	30/09/2003	30/09/2002
Cash flows from operating activities:		
Net loss	(9,888)	(20,624)
Adjustments to reconcile net loss to net cash used in operating activities	13,380	15,591
Change in assets and liabilities	(3,318)	(6,156)
Net cash (used in) provided by operating activities	**174**	**(11,189)**
Cash flows from investing activities:		
Purchase of marketable securities	(4,230)	(1,923)
Purchase of investment	(64)	(3)
Purchase of property, plant and equipment	(9,966)	(6,882)
Purchase of intangible assets	(36)	(23)
Proceeds from sale of property, plant and equipment	15	12
Proceeds from sale of investments	-	444
Proceeds from sale of marketable securities	718	11,095
Net cash (used in) provided by investing activities	**(13,563)**	**2,720**
Cash flows from financing activities:		
Net proceeds from capital increase	-	22
Capital contributed by minorities	3,064	-
Net proceeds from increase of bank loan	6,341	4,838
Repayment of bank loan	(1,177)	-
Net cash flow (used in) provided by financing activities	**8,228**	**4,860**
Net increase in cash and cash equivalents	**(5,161)**	**(3,609)**
Exchange rate difference	(754)	(105)
Cash and cash equivalents at beginning of year	21,308	18,651
Cash and cash equivalents at end of the third quarter	**15,393**	**14,937**
Cash, cash equivalents and marketable securities at end of the third quarter	**18,988**	**14,937**

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 compen-sation	Foreign currency translation adjustment	Unrealised gains (losses) on securities	Accumu-lated deficit	Total stock-holders' equity
	Shares	Amount						
Balance at 31 December 2001	35,507,047	35,507	536,857	(635)	(6,914)	152	(217,376)	347,591
Share capital increase	3,083	3	18	-	-	-	-	21
Stock option plan	-	-	-	242	-	-	-	242
Comprehensive loss:								
- Foreign currency translation	-	-	-	-	(9,083)	-	-	(9,083)
- Unrealised holding gains on available-for-sale securities	-	-	-	-	-	(152)	-	(152)
- Net loss	-	-	-	-	-	-	(20,624)	(20,624)
Total comprehensive loss	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**(19,433)**
Balance at 30 September 2002	**35,510,130**	**35,510**	**536,875**	**(393)**	**(15,997)**	**-**	**(238,000)**	**317,995**
Balance at 01 January 2003	**35,510,130**	**35,510**	**536,908**	**(345)**	**(27,660)**	**-**	**(349,006)**	**195,407**
Share capital increase	-	-	-	-	-	-	-	-
Stock option plan	-	-	3	217	-	-	-	220
Capital contributed by minorities	-	-	2,835	-	-	-	-	2,835
Comprehensive loss:								
– Foreign currency translation	-	-	-	-	(9,545)	-	-	(9,545)
– Unrealised holding gains on available-for-sale securities	-	-	-	-	-	-	-	-
– Net loss	-	-	-	-	-	-	(9,888)	(9,888)
Total comprehensive loss	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**(19,433)**
Balance at 30 Sept. 2003	**35,510,130**	**35,510**	**539,746**	**(128)**	**(37,205)**	**-**	**(358,894)**	**179,029**

Basis of presentation

The accompanying unaudited consolidated financial statements of Evotec OAI AG have been prepared in accordance with United States generally accepted accounting principles (USGAAP) for interim financial information. The accounting policies used to prepare interim information are the same as those used to prepare the audited financial statements for the year ended 31 December 2002. In the opinion of management, all adjustments, consisting of normal recurring adjustments, considered necessary for a fair presentation have been included.

The consolidated financial statements do not include all of the information and footnotes required by generally accepted accounting principles for complete financial statements. As a result, these financial statements should be read along with the audited consolidated financial statements and notes thereto for the year ended 31 December 2002.