

BIOTECHNOLOGY

A Research Publication by DZ BANK AG

Evotec⁵⁾⁶⁾

Reuters: EVTG.DE

Bloomberg: EVT GY

Year *	Sales		Adj. IFRS- Earnings per sh.	Cash flow per share		PER	PCF	Dividend per share
	EUR m			EUR				
2008	39.6	(51.9)	-0.41	(-)	-0.36	(-0.27)	-	0.00
2009e	40.8	(42.9)	-0.37	(-)	-0.33	(-0.40)	-	0.00
2010e	46.9	(-)	-0.11	(-)	-0.07	(-)	-	0.00
2011e	54.0	(-)	-0.05	(-)	-0.01	(-)	-	0.00

* Fiscal year end December – In brackets: Figures from the last publication

Profitability thanks to “Evotec inside” instead of “Made by Evotec”

- » We believe further consolidation and the need to save R&D costs will increase the pressure on pharmaceuticals and biotech companies to outsource an increasing proportion of their R&D to external service companies.
- » With the action plan “Evotec 2012 – Action Plan to Focus and Grow”, the company is refocusing on commissioned discovery and development with the aim of achieving profitability from 2012. Clear positioning and profiling in the market will be achieved by concentrating on the areas of neurosciences and pain therapy as well as inflammation.
- » The new agreements recently signed as well as long-term extensions of existing research alliances form the basis for the targeted growth and confirm the establishment of the “Evotec brand” in the market.
- » Strategic investments have been closed in 2009 in the areas of drug testing (zebra fish business) and chemical synthesis in order to further increase the portfolio on offer for customers and plans for additional acquisitions have already been announced.
- » In a mix of methods we have calculated a fair value for the Evotec shares of EUR 2.40. The fair value is made up of a DCF valuation and a separate pipeline valuation of advanced development projects.

We regard the company as well placed in a growth market in strategic terms. We are expecting newsflow in 2010 from the conclusion of further agreements with partners, milestone payments and strategic acquisitions. The agreement with Roche above all offers both medium and long-term upside potential. We are taking the shares of Evotec AG into our coverage with a fair value of EUR 2.40 per share and a Buy recommendation.

Selected Companies	Price on 4 Feb 2010	PER		EV / EBITDA		EV / Sales 10e	Re- com.
		10e	11e	10e	11e		
Evotec	1.96 EUR	-	-	-	-	4.03	↑
Galapagos Genomics	10.65 EUR	36.7	13.2	27.4	8.3	1.74	-
WuXi Pharmatech	15.85 USD	17.8	13.9	9.0	6.5	2.81	-
MediGene	3.57 EUR	18.7	-	12.7	-	2.11	↑
MorphoSys	16.06 EUR	41.6	25.9	13.7	8.3	2.40	↑
Median for all peer group companies		23.4	20.3	12.8	9.5	4.28	-

↑ = Buy, → = Hold, ↓ = Sell, ● = not rated, n/a = not appropriate
Source: DZ BANK, I/B/E/S, FactSet

EQUITIES

Flash
5 Feb 2010

Buy

Closing price 4 Feb 2010

(in EUR): 1.96

Fair value: 2.40

Risk classification: 5

Financial ratios 2010e:

Book value per share (in EUR):	0.90
Equity ratio (in %):	74.1
Net margin (in %):	-25.7
ROE (in %):	-12.2
Dividend yield (in %):	0.0
Free cash flow (EUR m):	-7.8
Net debt (EUR m):	-25.4

Number of shares

(million units): 109.0

Market cap

(in EUR m): 213.72

Free float (in %): 82.5

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DZ BANK
Bank on Germany

INVESTMENT CASE

Profitability thanks to “Evotec inside” instead of “Made by Evotec”

We believe the continuing consolidation in the pharmaceutical and biotech sectors as well as the need to save R&D costs is increasing the pressure on the companies to increasingly outsource also parts of their R&D activities to external service providers. Eli Lilly, for example, has already started to outsource larger parts of its development departments. Evotec AG should be one of the clear beneficiaries of this trend.

Need to save R&D costs is accelerating outsourcing

Set up in 1993 as a technology provider for high throughput screening, Evotec changed through the acquisition of Oxford Asymmetry International in 2000 into a service provider in the area of drug research. From 2004 the company also focused more strongly on proprietary drug development. Clinical setbacks led at the beginning of 2009 to the examination and adjustment of the hybrid business model as a both, a service provider and drug developer.

Adjustment of the business model with the focus on services

With the action plan “Evotec 2012 – Action Plan to Focus and Grow“, the profitable area of discovery and development alliances (“Evotec inside“) will now be expanded strongly while proprietary development projects (“Made by Evotec“) have been reprioritised. Owing to cuts above all in R&D and negotiations over the external financing of proprietary development projects, around EUR 14m are expected to have already been saved in 2009 and the cash reach secured well beyond 2012. The company’s stated aim is to reach break-even in 2012.

Focus shifted from proprietary development (“Made by Evotec“) to profitable alliances (“Evotec inside“)

Although the shares already turned in an above-average performance in 2009, we expect this to be repeated in 2010 thanks to positive newsflow following the signing of further cooperation agreements with well-known partners, milestones in development projects being reached as well as strategic acquisitions to round off the technology portfolio. We see medium (possible milestone payment of USD 65m in 2011) and long-term upside potential via commercial payments for a product with blockbuster potential above all in the agreement with Roche which we believe the market has not yet sufficiently priced in.

Upside potential in the short, medium and long term not yet priced in

In a mix of valuation methods we have determined a fair value for the Evotec shares of EUR 2.40. The fair value is made up of: 1. Products in clinical phases (EVT101/103, EVT302 and EVT 401) for which the DZ BANK pipeline valuation model comes up with a value of EUR 1.40 per share (rPV). 2. Our DCF model based on our estimate for the trend in sales.

Fair value: EUR 2.40 per share

We are taking Evotec up in our coverage with a Buy recommendation and a fair value of EUR 2.40. In strategic terms we see Evotec as an “established brand” in the biotechnology sector which is in a good position owing to a large number of concluded or extended research alliances with well-known partner companies (e.g. Roche, Boehringer Ingelheim, Biogen Idec) and a development pipeline whose value enhancement potential is to be realised in conjunction with partners. Cash flows from the research alliances and cost saving measures from the “Action Plan to Focus and Grow“ will secure the financing. The targeted growth should enable break even in 2012.

Taken up in coverage with a buy recommendation

Strategic reorientation by the new management

Founded in 1993 in the early days of German biotechnology, Evotec can look back on a colourful history. The company went public in 1999 with the business model of a technology provider. By acquiring Oxford Asymmetry International Evotec was transformed into a service provider in the area of drug research. The focus shifted to drug development in 2004 and led to acquisitions, particularly in the area of neurological illnesses. Clinical setbacks concerning the most advanced drug developments led to the review of the business model at the beginning of 2009.

The changing face of Evotec - a veteran of German biotechnology

Out of the crisis with the “Action Plan to Focus and Grow”

At the end of March 2009 the new CEO, Dr. Werner Lahnthaler, announced the action plan “Evotec 2012 – Action Plan to Focus and Grow”. By making cuts, particularly in research and development, savings of around EUR 14m are already expected to have been generated in 2009 and the financial range secured well beyond 2012. The stated aim is profitability from 2012. At the same time, the company is reorganising its pipeline at the expense of the two main development projects – the insomnia drug EVT 201, for which no partner could be found, and EVT 302 for smoking cessation, which showed no proof of concept in a phase II study.

New CEO with “Action Plan to Focus and Grow”

In order to reach this goal, the hybrid business model will be maintained in principal, but the profitable area of development alliances will be expanded further. For proprietary projects from a certain degree of maturity, negotiations over external financing are being conducted within the scope of strategic development partnerships. Where possible, though, investments are still to be made in new, highly innovative discovery projects in areas of high medical need.

Focus on profitable development alliances – proprietary development programmes only in partnerships

The company plans to circle its indication focus around neuroscience, pain and inflammation. Establishing core areas of competence provides for clear positioning and profiling in the market in order to offer customers competent contacts in the respective indications. Based on an example from the computer industry, Evotec therefore sees itself as being on the way to establishing the “Evotec inside” label as a seal of quality/franchise.

Profiling and positioning through the establishment of core areas of competence in selected indications

With the development partnership signed/extended with Roche in March 2009, Evotec has taken an important step forward in order to diversify the risk and at the same time maintain the potential of its current clinical assets. After the conclusion of the proof-of-concept trial (Phase II), in the event of success Evotec will possibly receive a payment of USD 65m in 2011 from Roche for the EVT100 product family already stipulated when the agreement was signed. Evotec is also eligible for further milestone payments and commercial payments in the mid single-digit percentage region for this product with blockbuster market potential.

Development partnership with Roche brings high milestone payments and possible commercial payments

Furthermore, four milestone payments from existing alliances were received in 2009 alone. Existing agreements were extended and a new partner was gained (see Table “Overview of important alliances”).

Extension of existing and conclusion of new alliances as well as milestone payments in 2009

Liquidity planning with a buffer for strategic acquisitions as well

In financial terms the company plans not to fall below the current liquidity buffer of EUR 60m. However, the management itself also sees EUR 40m in cash as sufficient liquidity. This means that around EUR 20m would be available which, together with

Acquisitions still possible and already considered

20 million shares from authorised capital, would enable acquisitions up to EUR 60m based on the current price.

The focus should be on additions which make sense in strategic terms, e.g. in the area of further animal models which can be used for the indications in focus or to supplement the technological platform.

Evotec's pipeline

Even after reprioritising the development of EVT201 (insomnia drug) and EVT302 (smoking cessation), Evotec still has a comprehensive proprietary pipeline:

CURRENT PIPELINE

Programme	Status	Indication	Market potential	Next value generating milestone	Possible submission
EVT 101/ EVT 103	Phase I completed/ Phase I started	Treatment-resistant depression (TRD)	> EUR 3bn	Proof-of-concept Phase II trial (2011)	2014
EVT 401 (P2X7)	Phase I completed	i.a. rheumatoid arthritis	> EUR 3bn	Start of Phase II for proof-of-concept (2010/2011)	2015
EVT 302	Phase I completed	Alzheimer's disease	> EUR 3bn	Partnering for further development	2016
H3	Preclinical	Narcolepsy (excessive need to sleep, pain)	> EUR 1bn	Start of Phase I (2010)	2015
P2X3	Preclinical	Urology, pain	> EUR 3bn	Start of Phase I (2010)	2015
VR1	Preclinical	Pain	> EUR 3bn	Phase I started by partner Pfizer	unclear
Further	Preclinical	CNS indications	> EUR 2bn	Potential for long-term partnership	2016

Source: Evotec AG

The further development of the projects within the scope of clinical studies is only to be carried out together with a financially strong partner, though. Based on the reduction of R&D costs already introduced over the course of 2009, we are expecting R&D costs of only EUR 22.8m in 2009 after EUR 42.5m in 2008 and a further decline in R&D costs in 2010 to around EUR 15m.

Despite this planned decline in R&D costs, "personnel investments" in individual experts for certain indications are envisaged within the scope of the new business model in order to be able to offer customers a "dialogue partner of equal standing".

The EVT100 product family and here in particular the project EVT101, which was originally discovered by Roche and which Evotec brought to clinical development, is assigned special status. The next stages (Phase II proof-of-concept trial in the treatment of treatment-resistant depression with respect to EVT 101 and a Phase I study of the follow-up component EVT 103) of clinical development have already been financed and are therefore secured by an agreement with Roche dating back to March 2008.

Strategic investments in animal models and technology make sense

Comprehensive proprietary pipeline with programmes in depression, rheumatoid arthritis, Alzheimer, sleep and pain therapy

Further development of proprietary projects only after validation via partnership

Personnel investments in "dialogue partners of equal standing"

Special status for development projects for the EVT100 project family

The results of the Phase II proof-of-concept trial are expected to be announced at the end of 2010 or beginning of 2011. In the event of positive proof-of-concept, Roche can buy back the projects in return for a payment of USD 65m, further development, sales performance and commercial payments. If Roche does not exercise this option, Evotec will be granted exclusive worldwide rights to the product family and can then look for its own partner.

Buy-back of the EVT100 family for USD 65m envisaged in the event of success

There could be a chance again for the insomnia drug EVT201, the partnering of which was reprioritised in spring 2009 following safety worries at the end of 2009 with respect to the rival Almorexant from Actelion which could be removed or confirmed by longer-term studies (source: Actelion, Reuters, 21.12.09).

New chance for EVT201 conceivable after problems with Almorexant

Evotec's future business model

The future business model is based on a combination of technology and expertise in the area of the respective illness. If possible there is only to be one large partner for the respective indications, for example the Swiss company Roche for diseases of the central nervous system (CNS), the German company Boehringer Ingelheim for oncology and CHDI for Sydenham's chorea/Huntington's disease.

Combination of technology and illness expertise

Customers are to be acquired by the offer of translating fixed costs (in case of internal development) into variable costs with the external placement of development orders. Upon commissioning, stipulations over early no/no-go decisions are to be made at the same time which can lead to direct cost savings for the customer. Simultaneously, creative and new/new types of milestones are to break down the traditional payment sequences with payments made after the conclusion of large development blocks.

Earlier go/no-go decisions as a customer advantage

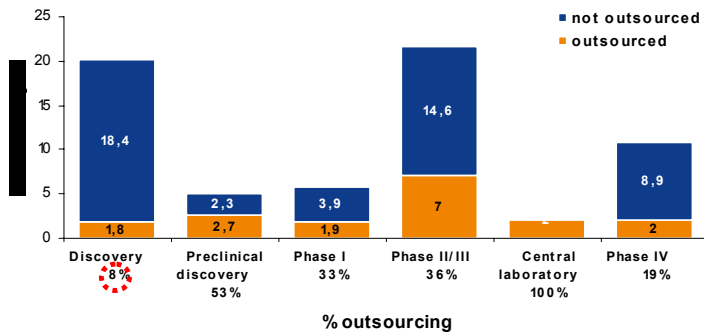
In this way, Evotec will try to transfer to the pharmaceuticals industry a trend towards greater outsourcing of early development stages, which is already widespread for example in the automotive industry, the IT industry or at telecommunications companies, but not yet in the pharmaceutical industry. In Evotec's view, this is a "mind-set problem" which we believe could however take several years to solve.

Mind-set for outsourcing early development stages still has to be created in part

One company which has quite obviously embarked more strongly on this path than others is Eli Lilly, which outsourced a significant part of its early R&D (the areas of toxicology, in vivo pharmacology, imaging and quality control) to Covance in 2008 and entered into a 10-year partnership with Covance at the same time. Roche AG, with which Evotec is already in a long-term partnership which was only extended in March 2009, also outsources early R&D. On 4 January 2010 Roche secured access to the technology platform of the company Evolva specifically for the discovery and development of substances for treating cancer or infections. Other companies should follow these examples driven by further consolidation and the need for more efficient research associated with it.

Outsourcing of early R&D also at Eli Lilly or Roche

SHARE OF OUTSOURCED PROCESSES DEPENDING ON THE DEVELOPMENT STAGE



Source: Evotec; Wall Street research 2008; evaluate Pharma; BioWorld

Strategic investments

On the way to becoming a One-Stop-Shop for research and development, Evotec strengthened its strategic position in 2009 by investing in a zebra-fish business and a majority stake (70%) in the Indian company RISPL, which produces chemical substances for use in research and development projects. Expansion of the product range to include the production of material for clinical development phases is planned. Investment in state-of-the-art technologies will also ensure that the range of products available to customers continues to reflect the latest developments.

Strategic investments on the way to a One-Stop-Shop

Zebra-fish are clearly defined model organisms, which are used in the screening of potential drug candidates and which accelerate the development process or may even reduce the risks involved in this process. They make it possible to generate in vivo data relating to the safety and efficacy of drugs even in the early phases of drug research and during the development process itself. This can help to reduce failure rates and the development costs of new drug candidates. With comparatively low material utilisation, it is also therefore possible to achieve rapid characterisation of a large number of substances.

Zebra-fish as a rapid and favourable selection system

Disease models are already established in the areas of cognition, epilepsy, hearing, skin pigmentation and osteoporosis. In future, further models will be added for Parkinson’s disease and Alzheimer’s, eating disorders, for dependency and addictive behaviour.

Disease models established

As a result of Evotec’s new Indian subsidiary RSIPL, within the framework of drug research programmes Evotec can provide its customers with multi-level syntheses from the milligram to the gram scale plus targeted synthesis of metabolites or standards. Other focuses are natural-product-like, heterocyclic scaffolds, modules, and intermediate products. The product range is supplemented by the analysis of substances but also impurities. While capacity utilisation at RSIPL was only around 30% at the time of the takeover, Evotec already expects the figure to increase to 80% in 2010 as a result of integration into existing and new development contracts.

Chemical synthesis and analysis expanded

Based on the current workforce of around 500, future projections envisage organic growth. The number of employees in India is therefore already set to increase from currently 160 to well above 200 in 2010. In the long term the company plans to expand to around 1,000 employees, to be achieved not only via organic growth but also by “qualitative acquisitions”.

Long-term growth target maximum of 1,000 employees

1)2)3)4)5)6) Wichtig: Bitte lesen Sie die Hinweise zu möglichen Interessenkonflikten und die Disclaimer am Ende dieser Studie.

Business model/general range of services:

The future structure of the company is based on the three pillars Discovery & Development Platform (DDP), Discovery alliance business (DAB) und Product Franchise:

Business model based on three pillars

DDP (Discovery & development platform)	DAB (Discovery alliance business)	Product Franchise
Assay development and screening	Cooperation with 35 of the top 50 pharmaceutical and biotech companies, e.g. with	Core expertise with clinical development candidates e.g. rheumatoid arthritis, treatment-resistant depression
Fragment-based drug research	Boehringer Ingelheim, Novartis, Ono and Roche	
Medicinal chemistry		Preclinical projects as assets for partnering or in-house development
ADMET and zebra-fish screening		

Source: Evotec AG

The business strategy is based on an expansion of the profitable DAB business and the financing of the company's own R&D via DAB and revenue from development partnerships. While growth of 10% is generally being forecast for the order development division, Evotec has set itself the target of achieving at least 15% growth p.a. towards achieving its objective of becoming profitable by 2012. We regard this target as achievable given the market positioning already achieved and the extensions of existing contracts in 2009 but above all the new contracts.

15% growth p.a. targeted

Evotec is planning to achieve above-average growth from a convincing and extensive range of technologies and services in the area of specialised indications.

Extensive product range to secure growth

The current double-digit growth rates of peer companies such as the Chinese WuXi or the Belgian Galapagos NV confirm the continuing high demand in the order development sector.

Also double-digit growth at peer companies

SPECIFIC SERVICES DEPENDING ON DEVELOPMENT PHASES

Development phase				
Screening	Lead structure	Optimisation of lead structure	Preclinical development	Clinical development
Assay development & screening	Medicinal chemistry	Medicinal chemistry	Customer-specific synthesis	Clinical alliances
(Ultra) high throughput screening	Construction of libraries	In vitro biology	Development of analysis	Clinical project management
Complex cellular testing systems	High throughput chemistry	Specific biological know-how for indication	Process development	
Electrophysiology	Crystallography of binding complexes	Computer-based chemistry and structure-based substance design	Synthesis on a large scale	
In silico screening	In vitro biology	In silico ADMET	Pharmacology	
Fragment-based drug research	ADMET investigations	Structural biology		
		ADMET and zebra-fish screening		
		In vivo pharmacology		

Source: Evotec AG

Deal structures

¹⁾²⁾³⁾⁴⁾⁵⁾⁶⁾ Wichtig: Bitte lesen Sie die Hinweise zu möglichen Interessenkonflikten und die Disclaimer am Ende dieser Studie.

Fundamentally, the contracts consist of remuneration for the research expenditure and milestone payments for project transitions e.g. from medicinal chemistry to lead structure optimisation, the completion of preclinical, the start of clinical phases, approval milestones and revenue shares in the mid single-digit percentage sector.

Contract structures with performance-related elements

For the so-called “integrated deals“ a typical deal structure looks as follows:

- Assumption of total costs by the partner, with around 20 – 30% overhead.
- Plus preclinical milestones – level and figure dependent on targets and partners, and
- Revenue shares/royalties for many deals and targets 2-4%

Integrated deals with cost reimbursement, milestones and revenue shares

In contrast are traditional service alliances, which are usually concluded via cost reimbursement plus a premium.

Traditional service contracts: cost reimbursement plus fixed premium

While such agreements are typically concluded for two years, it is Evotec's stated aim to extend the term of contracts where possible to four years.

Longer terms sought for individual contracts

One example of this is the oncology alliance with Boehringer Ingelheim with a minimum duration of 4 years, a minimum contract size of EUR 15m, milestones and revenue shares.

Contract with BI the blueprint for other contracts

In contrary, the strategic alliance between Roche and Galapagos NV in the area of chronic obstructive lung diseases (COPD) announced on 13.01.2010 was designed on the basis of a similar pattern: with the help of its platform, Galapagos will identify new target structures and will then develop new drugs to treat them. In addition to an upfront payment and milestones for certain development progress or sales figures, revenue shares of an unspecified amount will be generated, however no direct cost reimbursement has been fixed.

Different contract structures in alliances of peer Galapagos

Strategic alliances

For various reasons listed below, three deals stand out from the ranks of the strategic alliances:

Excellent strategic alliances: Biogen-Idec, Ono and Roche

- 1.) Biogen-Idec, since this is a new partner with which no alliances have previously existed,
- 2.) Ono, since this is a very extensive and long-term agreement. While Evotec already received a milestone payment on 14.12.2008 from Ono Pharmaceutical Co. Ltd (Ono) for the project transition from medicinal chemistry to lead structure optimisation as part of the research alliance to identify new types of protease inhibitors, a second target structure and an ion channel target have been added.
- 3.) Roche, on account of the fairly short-term upside due to the milestone at the end of Phase II (DZ BANke: end of 2011), which in the case of Roche taking control of the project, makes provision for a payment of USD 65m as well as further milestones and revenue shares. If Roche does not take over the project, it reverts to Evotec without any payment obligation.

New alliance partner: Biogen-Idec

Extensive and extended alliance with Ono

Roche contract with acquisition clause

Overview of important current alliances

Alliance partner	Indication	Guaranteed payment/s	Technology/basis	Status
CHDI	Chorea Huntington	EUR 37m	Medicinal chemistry, assay development, medium and ultra-high throughput screening (uHTS), synthesis of a library and management services	Extended on 14.01.2010 for 3 years (end 2012)
Boehringer Ingelheim	Oncology	EUR 15m (plus milestones and royalties)	Joint identification and development of pre-clinical candidates	Extended on 09.11.2009 for 4 years
Ono	Protease target	Advance payments, cost reimbursement, preclinical and clinical milestones	Fragment-based development platform, EVOlution™ incl. protein X-ray crystallography, virtual chemistry, structural biology, biochemical and NMR-based screening, medicinal chemistry and ADMET	Extended on 15.10.2009
Biogen Idec	Target not published	Not disclosed	Screening technologies, substance library, protein production and assay development	Extended on 09.09.2009
Cubist	Antibiotics	Not disclosed	EVOlution™ Biochemistry, NMR and BiaCore-Screening technologies for screening low molecular substances; crystallography	Extended on 14.07.2009
Ferrer Grupo	Target not published	Not disclosed	Production of substance libraries	Extended by 2 years on 07.07.09
Roche	ZNS/treatment resistant depression	USD 10 advance plus cost reimbursement; USD 65m on takeover after Phase II; potential > 300m)	Phase II development of EVT 101 and Phase I of EVT 103	Extended on 09.03.09
Novartis	Target not published	Advance payments, cost reimbursement, preclinical and clinical milestones >USD28m	Fragment-based development platform, EVOlution™ in combination with extensive biological expertise	Extended on 03.12.2008 for 3 years
Spermatech	Non-hormonal reversible contraception for men	Not disclosed	Assay development, high throughput screening, NMR screening of the library with 250,000 drug candidates	Extended on 12.03.2008
Intermune	Target not published	Not disclosed	EVOlution™, in combination with ultra-high throughput screening (uHTS) technologies	Extended on 06.03.2008
Pfizer	Pain (VR-1 receptor)	Development and commercialisation milestones (USD 170m) plus royalties	Candidates have been handed over to Pfizer for further development	Second candidate now in preclinical
Vifor Pharma	Anaemia	Reimbursements (5,5 Mio EUR) and mile stones	In-vitro biology, medicinal chemistry, in-vitro and in-vivo pharmacology	New alliance as of 02.02.10

Source: Evotec

Evotec has also successfully applied for government research funding. For example, in November 2009 the company announced that it has received research funding of up to EUR 2.5m from the German Federal Ministry for Education and Research (BMBF) to develop a serine racemase inhibitor. Within the Neu2 consortium, which includes for example Merck-Serono and the University Hospital of Hamburg-Eppendorf, Evotec will receive development funds and will use its substance library and its fragment-based development platform to develop drugs to treat multiple sclerosis and other neurodegenerative diseases.

Further success in government research funding programmes

Peer companies of Evotec AG

WuXi AppTec was created in 2008 out of the merger of WuXi PharmaTech Inc., a Chinese company with chemical expertise, and AppTec Laboratory Services, a US American company with biological expertise. The product range covers pure R&D services in chemistry or biology and also includes the areas of process development, formulation development and GMP drug production. The company has a workforce of 3,700, market capitalisation of more than USD 1bn and annual sales in the region of USD 270m. In the Laboratory Services division, which includes a large number of business segments also present in a similar form at Evotec, growth rates of more than 20% (current guidance for 2009: 23-26%) are being achieved.

WuXi App Tec – growth of more than 20% in laboratory services

Very comparable in terms of size (500 employees), market capitalisation (around EUR 230m) and business model (based on alliances with risk spread and financially secured with profits from the service division), Galapagos' product range also includes antibody-based drugs (in cooperation with MorphoSys AG). In 2008, Galapagos thus generated sales of EUR 77m. Preliminary figures for 2009 indicate a 29% sales growth to EUR 100m. Sales are also expected to surge by 20% in 2010. The company can demonstrate 6 alliances with pharmaceutical companies, e.g. Merck & Co. in arteriosclerosis since October 2009, GSK with arthritis and antibiotics and Eli Lilly in osteoporosis. Using a patented development platform and assuming an 8% success rate, Galapagos' objective is to identify twelve targets within a programme and where appropriate also develop them further to Phase II. The partner finances the progress of the development work via milestone payments and has the opportunity in the course of the programme to fully licence the programme.

Galapagos – alliances used to finance in-house developments

GROWTH OF SELECTED PEER COMPANIES

Peer companies with double-digit growth

Revenues/Year	2007	2008	YoY	2009e	YoY
WuXi (USD)	102	147	44%	182	24%
Galapagos (EUR)	66	77	17%	100	30%

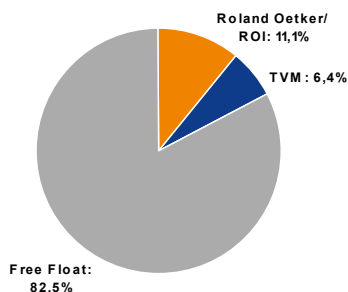
Source: company web sites

Shareholder structure of Evotec AG

In contrast to many other biotech companies with free floats in some cases of less than 50%, the free float proportion here is around 82.5%. With a total of 108.8m shares issued, the average daily trading volume in the months of September to December of 2009 was around 605,968 shares (0.56%) at an average share price of EUR 1.95, which represent a daily trading volume of EUR 1,2m.

High free float – liquid shares

SHAREHOLDER STRUCTURE



Source: Evotec

COMPANY GUIDANCE

¹⁾²⁾³⁾⁴⁾⁵⁾⁶⁾ Wichtig: Bitte lesen Sie die Hinweise zu möglichen Interessenkonflikten und die Disclaimer am Ende dieser Studie.

Financial forecast 2009

- » In conjunction with the announcement of the “Action plan to Focus and Grow“ on 27.03.2009, the 2009 guidance has been published along with the release of the 2008 full year results. Costs are to be cut significantly by reducing personnel strength in the R&D divisions by 50% and in administration by 20%. Revenue excluding licensing should reach at least EUR 35m, while R&D expenditure should fall to below EUR 30m.
- » The other financial targets were confirmed with the announcement of the second quarter results, however the sales guidance has been increased to more than EUR 40m. This guidance was confirmed with the Q3 results. Including the published milestone payments of EUR 40.8m for 2009, we do expect a 3% increase on the previous year.

2009 guidance and action plan published

Sales guidance raised at half-year and confirmed

DZ BANK FINANCIAL MODEL

We have constructed our DZ BANK Financial Model as follows:

- » Based on the results up to and including Q3, the announced milestone payments and the confirmation of the guidance for full-year 2009, our sales forecasts amount to EUR 40.8m (+3% year-on-year). Given the announced extensions to research alliances and additional agreements, we expect a much sharper increase in sales in subsequent years compared to previous years.
- » With respect to production costs (COGS) we expect a decline from 2010 onwards due to the cost benefit contributed by the Indian subsidy RS IPL.
- » In terms of personnel costs in sales and administration, after 50% in 2008 and Q1/2009, based on the trend from Q1 to Q3, we now expect an administration cost ratio of 43% in 2009, which should fall to below 30% in subsequent years.
- » We expect R&D costs to fall to EUR 22.8m in 2009 (compared to 42.5m in the previous year). Based on the Q3 results, we expect a further decline in research expenditure and R&D cost ratios of only 32% from 2010.

Sales expected to increase by 3% over 2008

Reduction of COGS from 2010

SG&A costs declining to below 30% till 2013

R & D costs reduced from 107% in 2008 over 56% in 2009 to around 30% from 2010

Overall, this gives 2009 EBITDA of EUR -27.4m (compared to 2008: EUR -41m) and a loss per share of EUR 0.37 (in 2008: EUR -0.82).

EBITDA loss reduced drastically

VALUATION

- » At the beginning of the valuation section, we look at Evotec's price performance (one year comparison) and contrast this performance with that of the German DAX share index, the TecDAX – Germany's technology index, the American technology index NASDAQ and the Euro Stoxx healthcare index.
- » We then carry out a qualitative SWOT analysis, looking at major strengths/weaknesses and opportunities/threats.

Sector performance

SWOT analysis

DCF and pipeline valuation

- » This is followed by a DCF valuation and a valuation of the two prioritised pipeline products, EVT 101 and 401, using DZ BANK’s pipeline valuation model.
- » The chapter concludes with a valuation overview.

Valuation overview

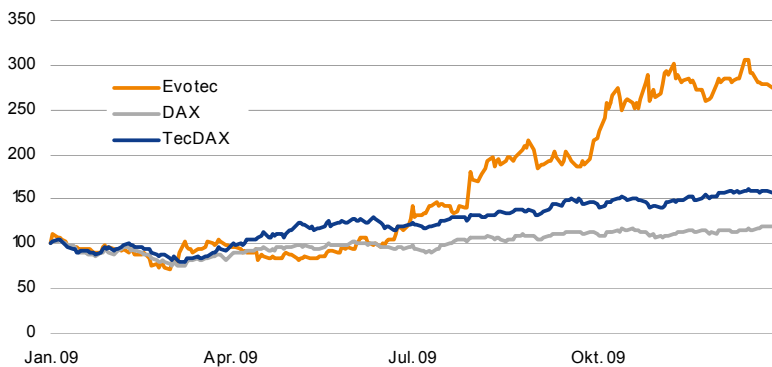
Performance against share indices:

We have compared Evotec with the two most important German share indices, the DAX 30 and TecDAX, in which Evotec has been listed again since 28.10.2009. Evotec’s price performance in 2009 shows a marked outperformance both compared with the TecDAX (117% points) and against the DAX (158% points). We attribute this to the company’s strategic repositioning, the reprioritizing after clinical failures of EVT 201 and 302 and the prospects surrounding the Roche deal.

Clear outperformance against the DAX and TecDAX in 2009

In 2009 the Evotec share performed 117% points better than the TEC-DAX and 158% points better than the DAX.

COMPARISON WITH GERMAN INDICES DAX AND TECDAX IN 2009



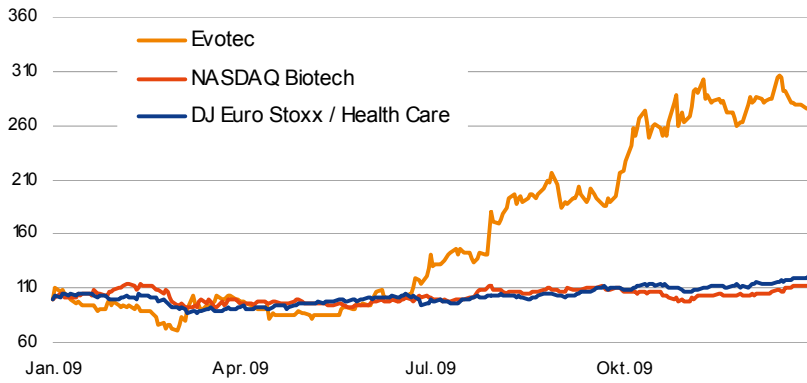
Source: FactSet

Relative to the Euro STOXX Healthcare the Evotec share outperformed by 158% points over 12 months. Relative to the NASDAQ Biotechnology index Evotec outperformed by 164% points over 12 months.

Marked outperformance against Euro STOXX Healthcare and NASDAQ in 2009 as well

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COMPARISON WITH NASDAQ BIOTECHNOLOGY AND EURO STOXX HEALTHCARE-INDEX IN 2009

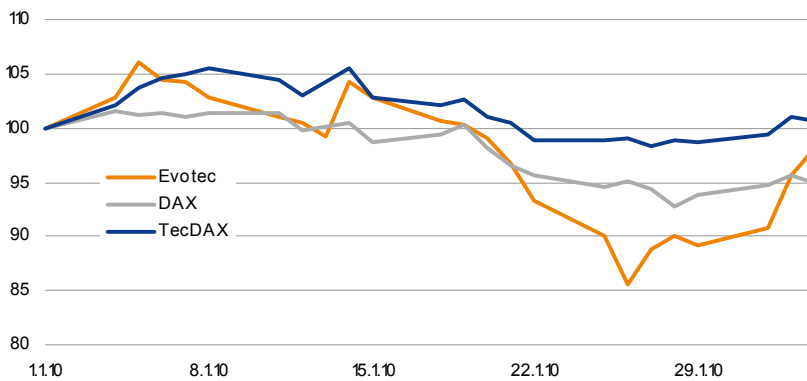


Source: FactSet

In 2010 (till February 3) the Evotec share performed 3 % points better than the DAX but 2% points worse than the TecDAX technology index:

In 2010 share is lagging behind indices so far

COMPARISON WITH GERMAN DAX AND TECDAX INDICES IN 2010

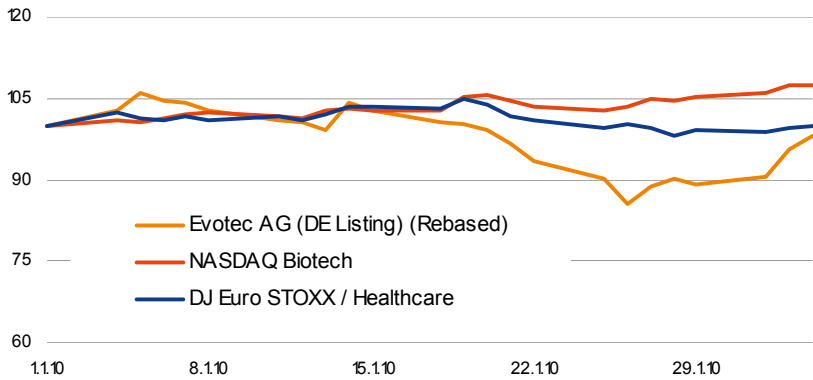


Source: FactSet

In 2010 (till February 3) the Evotec share performed 9% points worse than the NASDAQ Biotech Index and 2% points worse than the DJ Euro STOXX Healthcare:

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COMPARISON WITH NASDAQ BIOTECH INDEX AND DJ EURO STOXX HEALTHCARE IN 2010



Source: FactSet

SWOT analysis

In the following sub-section, we carry out a qualitative SWOT analysis of Evotec looking at the main strengths/weaknesses and opportunities/threats.

Qualitative SWOT analysis

SWOT ANALYSIS			
Strengths	<ul style="list-style-type: none"> Broad base of existing and recently extended development contracts with well-known pharmaceutical companies Indication-specific know-how Cost advantage through Indian subsidiary Very broad scope in terms of method (on the way to one-stop shop) Well-known and established name Strategic upside through project milestones and share of revenues 	<ul style="list-style-type: none"> Mind-set for outsourcing early development stages still has to be developed in some companies Past failures involving in-house projects now shelved weigh on company Cost advantages from Indian subsidiary can only be achieved through laborious steering/controlling Company still below critical mass 	Weaknesses
Opportunities	<ul style="list-style-type: none"> Evotec should benefit disproportionately from a trend towards outsourcing even of early-stage development projects Acceleration of stop-loss decision points and conversion of fixed into variable costs fits in with current conditions Focus on contract development and/or co-development will reduce conflicts of interest 	<ul style="list-style-type: none"> Currently still very dependent on Roche deal in indication with high risk of failure Trend towards outsourcing could fail to become firmly established Value creation from own pipeline not possible because of lack of partner 	Risks

Source: DZ BANK

Strengths/weaknesses

Established position in the market

¹⁾²⁾³⁾⁴⁾⁵⁾⁶⁾ Wichtig: Bitte lesen Sie die Hinweise zu möglichen Interessenkonflikten und die Disclaimer am Ende dieser Studie.

- » Evotec is outstandingly placed in the market with a name that is recognised far beyond its own biotechnology sphere and with a broad customer base consisting of well-known pharmaceutical and biotechnology companies.

Wide expertise for customers under just one roof
- » A broad scope in terms of method within the indication areas covered allows the company to offer customers comprehensive expertise under just one roof.

Know-how base reduces timeframe for customers
- » Evotec has a wide, indication-specific know-how through the development of a large number of customer and in-house projects; this can be used and built upon by customers, shortening development timeframes and bringing project successes or failures more rapidly to light.

Indian subsidiary has advantageous cost base
- » Whereas the costs of processing customer projects including a mark-up of 20%-30% depending on the contract are born by customers, Evotec offers upside potential through success-based payments once set project milestones have been reached and above all through royalties in the mid-one-digit percentage bracket in the event of the product in question making it onto the market.

Work on orders is profitable with additional upside through milestone payments and royalties
- » Evotec still lacks critical mass for a truly comprehensive offer, which might include animal models for example to provide as comprehensive in vivo testing of drug candidates in additional indication areas as possible, both at research level and also for formal pre-clinical analyses.

Evotec has yet to reach critical mass
- » Many companies still lack the mind-set needed to outsource early stages of development and this still has to be worked on in many cases. This process could very well take longer than expected.

Mind-set still not developed
- » Whereas potential failures cannot necessarily be ascribed directly to Evotec, a history of unsuccessful in-house projects which have since been scrapped such as EVT201 (insomnia) or EVT302 (smoking cessation) will certainly play a role in customers' decision-making.

History of failed projects weighs on Evotec
- » Evotec can only benefit from its Indian subsidiary's undisputed cost advantage from low wage costs, which only equate to a fraction of the European equivalent, through a laborious system of steering/controlling.

Evotec can only benefit from subsidiary's cost advantage through laborious steering and controlling

Opportunities/threats

- » Whereas in the past conflicts of interest surrounding projects in direct competition with Evotec's own products were a barrier, these conflicts have now been reduced substantially by focusing on contract development and the fact that Evotec has now wound up most of its own development projects. This will enable the company to extend its customer base, and existing know-how can be injected directed into customer projects.

Conflicts of interest now reduced
- » On this basis, together with its position in the market, Evotec could benefit disproportionately from the incipient trend towards outsourcing of even early development stages.

Evotec could benefit disproportionately from outsourcing trend

¹⁾²⁾³⁾⁴⁾⁵⁾⁶⁾ Wichtig: Bitte lesen Sie die Hinweise zu möglichen Interessenkonflikten und die Disclaimer am Ende dieser Studie.

- » Evotec's business model meets present day requirements firstly by offering customers the possibility of changing fixed costs for their own staff into variable costs for the contractor through outsourcing and secondly by building in stop-loss decisions into development projects from the outset.
- » One major risk is the high dependence – at least at the moment – on the Roche deal in an indication with a high risk of failure (treatment-resistant depression). The option of falling back of the follow-on substance EVT103 which is already in development only partly reduces this risk. In the event of a replacement of EVT101 by EVT103, the timeframes and hence milestone payments and above all any potential share of revenues would be delayed by at least one year.
- » Despite all expectations, the trend towards further outsourcing could fail to become firmly established – e.g. on the back of internal resistance in the area of early R&D – and growth in this segment would decline as a result. Even if Evotec managed to capture a disproportionate share of the segment's growth, the aim of reaching profitability by 2012 at the latest would no longer be realistic.
- » The actual freeze on projects in Evotec's own pipeline – Evotec has indicated that it could only carry on with development if it can attract financing from partners – could prevent the realisation and further development of value generated so far if the company cannot find partners. Patent expiries would call for write-offs, which would reduce the company's goodwill.

Business model meets present day requirements

Still a high dependence on the Roche deal

Will the trend towards outsourcing really hold?

Threat of loss of value creation without successful partnering

SWOT conclusion

Successes achieved in extending existing cooperations and attracting new customers demonstrate that Evotec is working successfully on eliminating its weaknesses and, moreover that the risk of the trend towards outsourcing not becoming firmly established seems manageable. The conclusion of further development alliances expected in 2010 and forthcoming milestone payments should confirm Evotec's strength and more than offset the potential negative impact of past failures. We therefore see an outweighing of strengths and opportunities.

Strengths and chances outweigh

DCF valuation

In our two-tier DCF using the entity method, we have discounted the free cash flows after tax with the help of the company-specific WACC. Our DCF analysis is based on the DZ BANK financial model shown in appendix.

DCF valuation based on the entity method

DZ BANK's financial model only takes into account sales and earnings from research alliances. We have not taken into account the value of drugs in early phases of development in our DCF.

DCF includes expected earnings from research alliances

Our DCF gives a value of equity of EUR 1.0 per share based on a terminal growth rate of 2% and WACC of 7%.

DCF value: EUR 1.0

Valuation of drugs in early stages of development

The sum of the NPV of a pharmaceutical or biotechnology company’s products in development corresponds to part of the total enterprise value; in the case of younger biotechnology companies, it in fact makes up most of the enterprise value. The model developed and revised by DZ BANK to value drugs in development makes it possible to calculate both the risk-adjusted present value of individual substances and the overall value of all the substances in clinical development. This calculation is based on a risk-adjusted, phase-dependent DCF valuation.

Investors can estimate both the current and potential future contribution from individual substances and from the entire product pipeline to enterprise value over their future development by discounting risk-adjusted expected long-term cash flows. This is the basis which we use to calculate the risk-adjusted present value in individual phases. A comprehensive description of DZ BANK’s valuation model for products in development can be found in DZ BANK sector reports from 2003 and 2004 (e.g.: Hope from Cancer Drugs dated 09.05.2003).

In our DZ BANK pipeline valuation model, we have valued prioritised product developments from a certain level of clinical development, namely EVT101 (treatment-resistant depression) and EVT401 (rheumatoid arthritis), both of which have completed phase I. Of the other two advanced projects, that have been reprioritized after setbacks in clinical development (EVT302) and in view of the fact that the company has still not found a partner (EVT201) we have only considered EVT 302. Here we do see the possibility of development in the Alzheimer’s disease indication, building up on the results of the phase I study.

- » We attribute EVT101/103 a success probability of 14%, which gives an rPV per share of EUR 0.7.
- » We see a success probability of 18% for EVT401, which gives an rPV per share of EUR 0.5.
- » For EVT 302 we calculate with the success probability of 20%, which gives an rPV per share of EUR 0.2
- » **Overall, we value the pipeline with an rPV of EUR 1.4 per share.**

DZ BANK pipeline valuation model

Separate valuation of Evotec’s early candidates

Valuation of projects in clinical development except EVT201

Pipeline valuation results in EUR 1.4 per share

OVERVIEW PIPELINE VALUATION

Product	Indication	Phase	Current rPV (EUR m)	rpV/share (EUR)	adj. Success Probability
EVT101/103	Treatment-resistant depression	Phase I completed	56	0.53	14%
EVT401	Rheumatoid arthritis	Phase I completed	55	0.52	18%
EVT 302	Alzheimer’s disease	Phase I completed	14	0.2	20%
Total			125	1.4	

Source: DZ BANK pipeline valuation model

Valuation overview:

Evotec's fair value is based on the following components:

1. Based on our DCF analysis, we calculate a fair value of EUR 1.0 per share; **DCF value: EUR 1.0 per share**
 2. We calculate a value of EUR 1.4 per share as the value of the EVT101, EVT 401 and 302 products which are in or before clinical phase II. **Development products: EUR 1.4 per share**
- Overall, this gives a fair value of EUR 2.2 per Evotec share. **Fair value: EUR 2.4 per share**

PROFIT AND LOSS ACCOUNT

Euro m	2008	2009e	2010e	2011e	2012e	2013e
Sales	39.6	40.8	46.9	54.0	62.1	69.8
% against prev. year		3%	15%	15%	15%	13%
Cost of goods sold	-22.0	-25.2	-28.2	-29.7	-31.0	-31.4
Gross profit	17.6	15.6	18.8	24.3	31.0	38.4
% against prev. year		-11%	20%	29%	28%	24%
Sales costs	-20.0	-17.5	-16.0	-16.2	-15.5	-17.5
Administration costs	0.0	0.0	0.0	0.0	0.0	0.0
R&D expenditure	-42.5	-22.8	-15.0	-14.0	-14.9	-16.1
Other operating income	2.3	4.7	0.0	0.0	0.0	0.0
Other operating expenses	-30.6	-18.4	0.0	0.0	0.0	0.0
Extraordinary income/expenses	0.0	0.0	0.0	0.0	0.0	0.0
Operating profit (EBIT)	-73.2	-38.5	-12.2	-5.9	0.6	4.9
For information: EBIT adjusted	-52.9	-38.5	-12.2	-5.9	0.6	4.9
% against prev. year						688%
Interest paid / received	-2.8	-0.9	0.1	0.1	0.1	0.2
Profit before tax	-76.0	-39.5	-12.1	-5.8	0.7	5.1
For information: EBT adjusted	-55.7	-39.5	-12.1	-5.8	0.7	5.1
% against prev. year						599%
Income taxes from continuing operations	-2.3	0.0	0.0	0.0	-0.2	-1.5
Tax rate	-3%	0%	0%	0%	30%	30%
Net profit from continuing operations	-78.3	-39.5	-12.1	-5.8	0.5	3.5
Net profit from discontinued operations	0.0	0.0	0.0	0.0	0.0	0.0
Net profit	-78.3	-39.5	-12.1	-5.8	0.5	3.5
Profit or loss attributable to minority interest	0.0	0.0	0.0	0.0	0.0	0.0
Profit or loss attributable to shareholders	-78.3	-39.5	-12.1	-5.8	0.5	3.5
thereof from continuing operations	-78.3	-39.5	-12.1	-5.8	0.5	3.5
thereof from discontinued operations	0.0	0.0	0.0	0.0	0.0	0.0
Weighted average number of shares, diluted (m)	95.199	106.775	106.875	107.775	107.875	108.775
IFRS earnings per share, diluted	-0.82	-0.37	-0.11	-0.05	0.00	0.03
Adjusted earnings per share, diluted (contin.)	-0.41	-0.37	-0.11	-0.05	0.00	0.03
For information						
Depreciation	32.2	11.1	4.9	4.9	4.9	5.0
EBITDA	-41.0	-27.4	-7.3	-1.1	5.6	9.9
EBITDA adjusted	-48.3	-33.8	-7.3	-1.1	5.6	9.9
Fiscal year end December						

Source: Evotec and DZ BANK estimates

RATIOS

Euro	2008	2009e	2010e	2011e	2012e	2013e
Profit and loss ratios						
Sales (m)	39.6	40.8	46.9	54.0	62.1	69.8
EBITDA margin	-122.0%	-82.8%	-15.5%	-2.0%	9.0%	14.2%
EBIT margin	-133.6%	-94.4%	-26.0%	-11.0%	1.0%	7.0%
Net margin	-98.4%	-96.7%	-25.7%	-10.8%	0.8%	5.1%
Investment ratio	0.0%	15.3%	1.5%	1.3%	1.1%	1.0%
R&D as % of sales	107.4%	56.0%	32.0%	26.0%	24.0%	23.0%
Admin and sales costs as % of sales	50.4%	43.0%	34.0%	30.0%	25.0%	25.0%
Net other operating costs as % of sales	71.6%	33.7%	0.0%	0.0%	0.0%	0.0%
Net financial income as % of sales	-7.0%	-2.3%	0.3%	0.2%	0.2%	0.2%
Interest cover						
Average sales growth next five years	12.0%					
Average earnings growth next five years						
Profitability ratios						
ROE	-26.0%	-35.5%	-12.2%	-6.3%	0.5%	3.6%
ROCE	-75.6%	-54.9%	-18.4%	-9.5%	1.1%	8.8%
Productivity ratios						
Sales per employee ('000)	60.02	61.82	71.09	81.76	94.02	211.55
EBIT per employee ('000)	-80.18	-58.37	-18.48	-8.99	0.94	14.81
Balance sheet ratios						
Equity ratio	81.9%	76.9%	74.1%	72.0%	71.1%	70.9%
Long term debt and equity / Fixed assets	179.3%	144.6%	137.2%	137.0%	146.1%	163.2%
Liquidity (quick ratio)	410.4%	258.0%	214.0%	198.7%	208.6%	231.7%
Receivables as % of sales	6.4%	17.0%	17.0%	17.0%	17.0%	17.0%
Investment (net of GW) / Depreciation		132.3%	14.2%	14.3%	14.2%	14.0%
Working capital as % of sales	-22.5%	-9.5%	-7.3%	-5.5%	-3.8%	-2.6%
Net debt (m)	-71.2	-33.6	-25.4	-23.2	-27.6	-35.9
Net debt complete (m)	-81.2	-43.6	-35.3	-33.2	-37.5	-45.8
Figures per share						
Earnings per share, diluted	-0.41	-0.37	-0.11	-0.05	0.00	0.03
Diluted cash earnings per share	-0.36	-0.33	-0.07	-0.01	0.05	0.08
Dividend per common share	0.00	0.00	0.00	0.00	0.00	0.00
Cash per share, diluted	0.51	0.21	0.13	0.11	0.15	0.23
Net debt per share, diluted	-0.65	-0.31	-0.23	-0.21	-0.25	-0.33
Valuation ratios						
Enterprise value / Sales	0.3	4.9	4.0	3.5	3.0	2.6
Enterprise value / EBITDA					33.7	18.1
Enterprise value / EBIT					301.8	36.7
EV/Sales to sales growth		0.41	0.34	0.30	0.25	0.21
PEG ratio - common shares						

Fiscal year end December

Source: Evotec and DZ BANK estimates

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RATING HISTORY

Recommendation	Date	Price
Buy	5 Feb 2010	1.96 EUR
Coverage stopped	21 Apr 2008	1.80 EUR

^{1) - 9)} Important: Please read the references to possible conflicts of interest and disclaimers/disclosures at the end of this report.

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