EDISON

Evotec

Sanofi deal, Q115 results

A deal to dream for and key data due soon

Pharma & biotech

The exceptional deal with Sanofi for its Toulouse facility at no cost provides Evotec with a platform to accelerate its growth. Evotec gains much-needed capacity, as well as expertise and other capabilities. The company has already seen an improvement in revenue growth over the last two quarters, and the Sanofi deal should enable it to maintain double-digit growth in the coming years. Evotec is also approaching an important data readout from the Alzheimer's disease (AD) Phase IIb trial with EVT302, which could lead to partner Roche initiating Phase III studies.

Year end	Revenue (€m)	PBT* (€m)	EPS* (c)	DPS (c)	P/E (x)	Yield (%)
12/13	85.9	5.1	4.0	0.0	N/A	N/A
12/14	89.5	(0.7)	(2.0)	0.0	N/A	N/A
12/15e	125.8	(0.4)	(0.8)	0.0	N/A	N/A
12/16e	139.9	4.7	2.6	0.0	N/A	N/A

Note: *PBT and EPS are normalised, excluding intangible amortisation and exceptional items.

Sanofi deal: Cost-free expansion

Evotec has completed the acquisition of Sanofi's Toulouse site with all the running costs covered by €250m in guaranteed revenue over five years. The Toulouse facility also solves Evotec's capacity constraints, enhances its expertise in oncology, adds a compound management facility with access to Sanofi's library of 1.3m compounds and includes c 14 discovery and preclinical oncology assets.

Revenue growth regaining momentum

Evotec ended FY14 strongly, with sales growing by 19.3% in Q414, and delivered revenue growth of 22.3% in Q115; this compares to sales falling by 1.5% in FY13 and increasing by only 4.1% in FY14. The improved performance is due to more major alliances (mainly with biotech companies), more milestones being achieved and the strengthening dollar. We forecast that Evotec will deliver revenue growth of 40.6% in FY15, with the Sanofi deal being the primary cause for the jump in sales.

Important EVT302 data in AD approaches

Roche is due to report data from the Phase IIb trial in AD with Evotec's lead product EVT302 in mid-2015. The compound is believed to slow disease progression by reducing oxidative stress and, if the data support this view, we would expect the product to advance into Phase III and for Evotec's shares to be re-rated. However, it should be remembered that AD is a notoriously difficult indication to treat.

Valuation: DCF valuation of €589m (€4.48/share)

We have increased our valuation from €465m to €589m, primarily because of the Sanofi deal and the improvement in Evotec's growth prospects. In the valuation, EVT302 accounts for €140m and we estimate that this could increase to €325m if data from the Phase IIb trial are promising and Roche initiates a Phase III study.

28 May 2015

Price	**€3.91**
Market cap	**€514m**
	$1.15/€
Net cash (€m) at 31 March 2015	73.5
Shares in issue	131.5m
Free float	65%
Code	EVT
Primary exchange	Frankfurt
Secondary exchange	N/A

Share price performance

%	1m	3m	12m
Abs	(0.2)	2.0	9.8
Rel (local)	2.0	(1.2)	(7.3)
52-week high/low		€4.20	€2.54

Business description

Evotec is a drug discovery business that provides outsourcing solutions to pharmaceutical companies, including Bayer, Boehringer Ingelheim, Janssen and Roche. It has operations in Germany, France, the UK and the US.

Next events

AGM	9 June 2015
Phase IIb data on EVT302	Mid-2015
Q215 results	12 August 2015
Q315 results	10 November 2015

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Edison profile page

Investment summary

Company description: A leading drug discovery company

Evotec is a German biotechnology company that provides high-quality drug discovery services to the pharmaceutical industry and has collaborations with academic institutions to create novel drug discovery programmes. It was founded in 1993 by a group of eminent German scientists, including the Nobel Laureate Professor Manfred Eigen, and employs c 920 people in France, Germany, the UK and US. It can undertake all parts of the drug discovery process and has particular expertise in pain, CNS, immunology, metabolic and oncology indications and regenerative medicine. It has a broad range of long-term collaborations with pharmaceutical companies, including Bayer, Genentech (Roche), Janssen (J&J) and Boehringer Ingelheim.

It has two business divisions: EVT Execute, which provides drug discovery services on an FTE basis with performance-related payments; and EVT Innovate, which aims to discover novel therapies through its CureX and TargetX initiatives with academic institutions and subsequently to form collaborations with industry partners.

Valuation: €589m based on DCF

We have raised our valuation of Evotec by €124m to €589m (€4.48 per share), after taking into account the impact of the Sanofi deal (including Evotec's enhanced growth potential with the additional capacity, capabilities and expertise), the strengthening of the US dollar and adjustments to discount factors due to the progression of time. Following the deal with Sanofi, Evotec has increased its capacity with the 20,000m^2 Toulouse facility, c 200 employees and guaranteed revenues of €250m over five years.

A major catalyst for the shares is expected imminently with the results from the Phase IIb trial with EVT302 in Alzheimer's disease due in mid-2015. If the data are positive and Roche advances EVT302 into Phase III, our valuation could increase to €774m. However, Evotec's future is not dependent on this clinical trial because of the strength of its drug discovery business and fast growing portfolio of partnerships.

Sensitivities

Unlike most biotechnology companies, Evotec is profitable (or reports small losses only) and has a strong balance sheet so has a lower risk profile than most companies in the sector. All its clinical programmes are partnered, so the company bears none of the financial risk associated with clinical trials. However, its value is clearly still affected by the outcome of studies, especially the Phase IIb trial with EVT302.

Evotec’s growth in FY15 is being boosted by the Sanofi deal, but in future years Evotec's growth will largely be driven by the company's ability to form major strategic alliances. These collaborations might be integrated contracts or commercialisation alliances for CureX initiatives. We expect the latter programmes to be the most important value driver, following Evotec's increased investment in the programmes. There should be significant interest in the programmes from big pharma due to their innovative nature, but there is a high level of risk associated with each initiative.

Financials

Evotec's revenue growth accelerated over the last six months, and is forecast to be maintained because of the Sanofi deal in FY15. However, the impact of the increased revenues on the bottom line will be limited due to investment in R&D, which is estimated to increase by 49% to €18.5m.

Evotec stays well financed with gross liquidity of €95.8m at Q115. The company is expected to use its cash position to make bolt-on acquisitions to keep its technological leadership in drug discovery.

Outlook: A deal to dream of

Evotec has strengthened its position as a leading provider of drug discovery outsourcing services by acquiring Sanofi's Toulouse facility and solved potential capacity constraints. The deal also enhances its capabilities, especially in the field of oncology, and provides it with access to Sanofi's library of 1.3m compounds. Evotec's revenue growth has improved recently, and the addition of the Toulouse facility will give a boost to its two divisions – EVT Execute and EVT Innovate – and should allow the company to deliver double-digit revenue growth again in the coming years. Consequently, we have increased our valuation to €589m, and there is a major catalyst in the imminent future with Phase IIb data from the trial in Alzheimer's disease with EVT302 due in mid-2015.

Sanofi deal provides valuable space for expansion

Evotec's ability to grow was being affected by capacity constraints caused by limited space and the challenges of hiring properly qualified personnel, but these issues have been resolved by acquiring Sanofi's Toulouse facility at no cost. On top of this, Evotec has a new strategic alliance, support to expand its CureX initiatives in Europe and a portfolio of preclinical oncology assets.

The details of the deal with Sanofi are as follows:

- Over the next five years, Evotec will receive €250m to cover the running costs of the Toulouse facility with c 200 employees and conducting the drug discovery services outsourced by Sanofi.
- Sanofi will support Evotec's efforts to develop its network of CureX alliances (collaborations with academia focused on developing innovative therapies in areas of major unmet medical need) across Europe, and all the commercial rights from any resulting collaborations will belong to Evotec.
- Evotec will take over the compound management system in Toulouse, with access to Sanofi's library of 1.3m compounds. Evotec Execute will be able to screen this library, combined with its own 400,000-compound library, for drug discovery contracts with third parties.
- Evotec obtains a pipeline of 14 assets, five of which are in pre-IND studies. Payments will be to Sanofi, as the assets achieve development and regulatory milestones.

Evotec estimates that it now has sufficient capacity to meet its demands from third parties and EVT Innovate for CureX and TargetX initiatives until 2018 and there is space in Toulouse to expand the facility. This will allow the company to form major integrated alliances such as the ones with Boehringer Ingelheim and Bayer. It should be noted that Evotec has thorough confidentiality systems in place; major companies like Sanofi are not concerned about forming a strategic alliance with Evotec, although it is working with many competitors, and Evotec's enhanced capabilities following the transaction should make the company a more attractive outsourcing partner.

The extra capacity was also vital to allow Evotec's CureX strategy to progress smoothly. EVT Innovate currently has 16 CureX initiatives underway, all of which are expected to use the services provided by EVT Execute increasingly to carry out the drug discovery processes to develop drugs against the targets originating from the academic collaborations.

The alliance with Sanofi will enable Evotec to expand EVT Innovate's activities more quickly across Europe. So far, eight of the 12 academic collaborations are with US institutions (some CureX initiatives are with companies). It is likely that Sanofi and Evotec will target French universities initially, but the plan is to develop new CureX alliances in other European countries.

Until this deal, Evotec could only provide compound management services in the US from its facilities in Branford and San Francisco, but is now in a position to offer the same services in Europe from Toulouse. More importantly, it gains access to Sanofi's library of 1.3m compounds. This means that EVT Execute can now offer potential clients the ability to screen a library with c

1.7m compounds as part of a drug discovery contract. Evotec has already reported that this is stimulating interest from pharma and biotech companies.

The agreement provides Evotec with a pipeline of 14 oncology assets. We expect the company to develop the assets until they are IND-ready before looking to partner them. Four of the compounds are already in IND-enabling studies and could be partnered within the year. There will be modest milestones payments and royalties payable to Sanofi, if certain milestones are met and products reach the market. However, we estimate that the total milestones payable will be <€10m with low single-digit royalties and Evotec owning the majority of the economic value of the assets.

Finally, Evotec is considerably enhancing its expertise in the field of oncology. The company already had alliances with Boeringher Ingelheim and Roche, as well as four TargetX collaborations, in oncology. However, Evotec is mainly recognised for its expertise in the field of neuroscience and metabolic diseases, so that it probably missed out on potential oncology drug discovery alliances in the past. In the future, we would expect a greater proportion of new collaborations to be in oncology as a fifth of all INDs are in this therapeutic area, more than double the amount in any other field.

In summary, the deal with Sanofi has provided the capacity and expertise to enhance Evotec's growth prospects and give Evotec's Action Plan 2016 a significant boost, with all the costs covered by Sanofi.

Action Plan 2016 – update

Evotec initiated Action Plan 2016 in Q112 to build on the success of Action Plan 2012, which had transformed the company into a sustainably profitable entity. Originally, the new strategic plan had three principle parts - EVT Execute, EVT Integrate and EVT Innovate; but, the plan was simplified in Q114 and Evotec's business structure was amended to better enable the company to meet its goals. To this end, two separate business divisions were established: EVT Execute (including EVT Integrate's activities) managed by Mario Polykwa and EVT Innovate led by Cord Dohrmann.

Exhibit 1: Action Plan 2016 activities

Activity	Details
EVT Execute	Provision of the highest quality and most capital-efficient services spanning all areas of the drug discovery activities, with continual investment in best-in-class technology .
EVT Integrate (Part of EVT Execute)	In integrated collaborations, Evotec is responsible for the entire drug discovery processes and providing a package ready for IND submission and receives performance-based payments. EVT Integrate is now part of EVT Execute.
EVT Innovate	The goal is to develop novel approaches to treat indications with major unmet medical need. A core part of EVT Innovate are the CureX/TargetX alliances with academic institutions, which develop into industry collaborations.

Source: Edison Investment Research, Evotec

The initial target of Action Plan 2016 was to double revenues by 2016 at the latest (including improving the quality of the revenue mix by the addition of royalties), achieve an operating margin of c 15% (6.5% in FY11) and accelerate cash generation. Other goals include maintaining its position as a leading drug discovery company through innovation and building a more mature partnered pipeline, without increasing its financial risk.

Evotec is on track to deliver a more mature pipeline and maintain its leadership in the drug discovery CRO industry. However, it is unlikely to achieve all of its financial goals, even with the Sanofi deal. This is largely because of the setback with the DiaPep277 programme, which was terminated by Hyperion once it discovered the fraudulent activity of Andromeda (recently bought by Hyperion) and reflects the changing market environment for drug discovery outsourcing.

Drug discovery is always a dynamic area, with areas of interest going in and out of fashion. Currently the main trends affecting outsourcing of drug development include a greater focus on biologic and cell therapies than small molecules (the majority of high-throughput screening of small molecule libraries is already outsourced), continuing restructuring programmes by big pharma, a preference for outsourcing to European and US companies and different services being outsourced

(eg biomarker programmes). It also appears that the overall cost savings of outsourcing are becoming smaller due to the fixed costs associated with running an R&D facility, as well as the understandable desire of big pharma companies to maintain their knowledge base in early drug development, which is particularly affecting the complete outsourcing of drug development programmes. Some of these changes are beneficial to Evotec (eg preference for western partners), while others are not (eg strength in small molecules, fewer integrated alliances), but overall they are making the market more volatile and its growth less predictable.

Evotec is still targeting strong double-digit growth each year, but there is less focus on improving the margin at the moment as it looks to maximise the value of its CureX initiatives. The company is investing heavily in expanding the number of CureX/TargetX initiatives, and the initiation of new European academic collaborations will now be supported by Sanofi following the formation of their strategic alliance. Its strong balance sheet also means that Evotec will look to take some programmes all the way to IND filing to maximise the value of CureX initiatives rather than forming strategic collaborations at earlier stages. This has a negative impact on the company's revenues and profitability in the short term (lower revenues from FTE payments and fewer milestone payments, and higher R&D spending to advance the projects), but means that Evotec can retain more of the value from its CureX programmes.

EVT Execute: Preclinical drug discovery services

The EVT Execute operations offer a comprehensive range of high-tech services that are performed efficiently and can be reproduced on an industrial scale. These functions can be accessed flexibly, for instance as an integrated project or any one as a standalone service, with payments purely on a fee-for-service basis.

Drug discovery services

Revenues from drug service contracts although they have a relatively low gross margin (c 25%) and no scope for success milestones and royalties, have no development risk exposure. In addition, drug services numerous and varied projects generate a long-term, recurring income stream. Importantly, they also underpin the maintenance of a world-class expertise, capability and infrastructure for drug discovery.

EVT Execute provides a complete range of preclinical development services to biotech and pharmaceutical companies, which include:

- assay development and screening;
- fragment-based drug discovery;
- medicinal chemistry; and
- ADMET (absorption, distribution, metabolism, excretion and toxicology assays)

Importantly, Evotec executes these services to the same quality standards used by large pharmaceutical companies. This has resulted in Evotec developing a strong reputation and discovering more than 100 lead compounds, 20 preclinical drugs and 15 clinical compounds.

The rate of technological change means that much of this market can become commoditised, hence EVT Execute, despite its proven track record and history of repeat business, needs to continuously develop new capabilities to maintain its competitive advantage. Evotec invests c €8m a year developing new services and extending its current offering, which is being significantly enhanced following the deal with Sanofi as it now has a compound management in Europe and has tripled the size of compound library that it can offer to clients.

To offer the best services to its clients, EVT Execute also works with other companies. Evotec's collaboration with C4X Discovery (C4XD) is such an example; C4XD uses its nuclear magnetic resonance (NMR) based technology to accurately identify all the different structures that a small

molecule can form so that the compound can be optimised to bind better to the protein of interest and have fewer off-target effects.

Integrated drug discovery alliances

EVT Execute also provides an end-to-end solution for companies that want to outsource entire preclinical programmes. Integrated alliances, formerly within EVT Integrate, tend to be initiated by a pharmaceutical/biotech company providing a target to Evotec, which then conducts the entire preclinical drug development process. During these contracts, Evotec is responsible for making the decisions between the various phases of drug discovery, improving the efficiency of the process, whereas the client remains the decision maker during standard EVT Execute agreements and Evotec just carries out the services.

Evotec uses a different payment structure with integrated alliances to standard EVT Execute contracts. These tend to be at a lower FTE rate, but there are potentially performance-related payments and royalties payable. This means that Evotec's interests are better aligned with those of the client and the alliance will be more profitable for Evotec if it is successful in carrying out the drug discovery activities. Evotec normally likes to have three programmes included in an EVT Integrate collaboration, as drug discovery is inherently risky, and it is more likely that at least one project will advance into clinical development and the company can make a favourable return if there are several projects with which to begin.

The main integrated alliances that Evotec has include:

- Bayer: the five-year alliance to develop three clinical candidates for endometriosis began in 2012; both companies share responsibility for discovery and preclinical development. Evotec could earn milestones totalling €580m and low double-digit royalties.
- CHDI (a not-for-profit research organisation focused on finding a cure for Huntington's disease): the alliance first started in 2006 and will run at least until 2017.
- UCB: Evotec has alliances in neurology and immunology, both of which were initiated in 2011.

These integrated alliances used to be almost exclusively with major pharmaceutical companies, and >80% of EVT Executes revenues come from these companies. However, there is a trend towards more biotech companies using Evotec, including outsourcing entire drug discovery programmes, largely driven by the fact that many biotech companies have been able to raise significant capital in recent years. This is reflected in the fact that Evotec has formed an integrated alliance with the private biotech company Facio Therapies this year.

Having said that, it is possible that the new major collaboration with Sanofi across a range of therapeutic areas could be the catalyst for other big pharma companies outsourcing more drug discovery programmes in integrated alliances to Evotec. The latter has always been known for being able to carry out early drug discovery to the levels expected by pharmaceutical companies, but the added expertise that Evotec is gaining, especially in oncology, and the access to Sanofi's compound library could encourage big pharma companies to use Evotec more.

EVT Innovate – CureX and TargetX fuel pipeline

EVT Innovate has developed considerably since the formation in Q112 of Action Plan 2016, in part to seed new strategic discovery alliances as the rate at which Evotec was able to form new integrated alliances with big pharma had slowed down. EVT Innovate is now an important growth driver for Evotec and this is indicated by the company's decision to report revenues from EVT Innovate separately to those from EVT Execute since the beginning of last year, and in FY14 it generated revenues of €14.7m.

The cornerstones of EVT Innovate are the CureX and TargetX collaborations with leading academic centres (Exhibit 2), in which Evotec and its partners work in an integrated manner to enable efficient innovation. These alliances give Evotec access to the work and expertise of professors so that it

can develop truly novel therapies that address the underlying causes of diseases. Most of the collaborations are with US institutions, but the deal with Sanofi should help Evotec to form more European alliances, starting in France with the French Academic Bridge with Sanofi.

The academic groups benefit from the ability to commercialise their research in a capital-efficient manner, without venture capitalists, while still being able to advance their careers by publishing scientific papers (often not possible if academic groups form alliances with pharmaceutical companies). They can also advance their research more quickly using Evotec's expertise in high-content screening assays to carry out systematic, unbiased and comprehensive discovery screens.

The first CureX alliance was CureBeta with Professor Doug Melton of Harvard University and Howard Hughes Medical Institute (HHMI, Exhibit 2) and this has confirmed the potential of the CureX strategy. After investing less than $2m in the project with the academic institutions over 16 months, the programme was partnered with Janssen for $8m, high-margin research payments to fund research until the end of preclinical development, potential milestone payments of up to $200-300m per product and royalties. Janssen decided to withdraw from this collaboration in 2014 for strategic reasons as the programme was advancing more slowly than expected. Despite Janssen's withdrawal, Evotec has already made a favourable return on its initial CureBeta investment and could form new industry alliances like the one with Janssen.

Pharmaceutical companies are becoming more focused on developing innovative therapies. Pressure from regulators and reimbursement agencies means that new treatments need to have significant benefits over existing treatments to be approved and reimbursed at favourable levels. All Evotec's cure initiatives are designed to generate first-in-class products to meet this demand from pharmaceutical companies. Given this and the fact that 12 CureX collaborations have been running since 2013 without a commercial partner, we believe it is likely that Evotec will form two to three commercial alliances based on its CureX collaborations.

Pipeline approaches a key data point

An important goal of Action Plan 2016 is to expand its clinical pipeline (Exhibit 3), with its partners bearing the financial risk. There was a surprising setback when Hyperion announced that it was discontinuing the development of DiaPep277 due to serious misconduct with data manipulation by Andromeda Biotech. However, this was offset by Janssen's unexpected decision to continue the development of the EVT100 series, NMDA receptors. The focus is now on Evotec's lead product, EVT302, which is being developed by Roche in Alzheimer's disease, as data from the Phase IIb trial in 420 patients are due to be reported in mid-2015.

EVT302 (sembragiline, RG1577) could be the first product approved for the treatment of moderate AD, which alters disease progression. The rationale for EVT302 (a highly selective MAO-B inhibitor, which was initially developed for smoking cessation and shown to have a good safety profile) in AD is that the expression of MAO-B is upregulated around amyloid plaques (Exhibit 4), which is thought to cause oxidative damage to neurons around them. Data from the current Phase IIb trial could be reported in mid-2015, which could lead to EVT302 advancing into pivotal Phase III studies.

Evotec's clinical pipeline should be expanded significantly over the next 18 months, as at least 11 assets are all in formal preclinical development and could enter the clinic during this period but will only do so with a partner. These include EVT770 partnered with AstraZeneca for diabetes, the five oncology assets acquired from Sanofi and products being developed with Novartis, Boehringer Ingelheim and Bayer. It is also looking more likely that Janssen will advance a member of the EVT100 series into the clinic for treatment-resistant depression in this timeframe, following the milestone payment to Evotec in December 2014.

Exhibit 2: Partnered CureX/TargetX initiatives

Collaboration	Partners	Disease area	Notes
CureBeta	Harvard University/ Howard Hughes Medical Institute (HHMI)	Diabetes	Formed in March 2011 to develop novel treatments for diabetes that cause beta cell regeneration. Evotec is working with Professor Doug Melton and his laboratories. 16 months after the start of the collaboration, a strategic alliance was established with Janssen with an upfront payment of $8m; milestones up to $200-300m per product and royalties. Janssen left the alliance in 2014 because the programme was advancing more slowly than hoped. Evotec and Harvard are continuing to invest in the programmes and looking for new commercial partners.
CureNephron	Harvard University/Brigham and Women's Hospital	Kidney disease	Formed in January 2012 to discover and develop new biomarkers and therapies to enable more accurate diagnosis and treatment of chronic and acute kidney disease. Evotec is working with professors Andy McMahon and Ben Humphreys. The programme is in the discovery phase.
CureMN (CureMotorNeuron)	Harvard Stem Cell Institute	Neurology	Formed in September 2013 to identify compounds that prevent or slow down the loss of motor neurons, which is characteristic of amyotrophic lateral sclerosis (ALS). Collaborating with Dr Lee Rubin of HSCI and Dr Kevin Eggan of HHMI, HSCI and Harvard University. The programme is in the discovery phase.
TargetASIC	Undisclosed pharmaceutical company/BMBF	Neurology	TargetASIC evolved from the work conducted within the Neu2 consortium, which included MerckSerono, began in November 2009 and is funded by the BMBF (Federal Ministry of Education and Research). The current pharmaceutical partnership was not reported and research costs are now shared. Programme is in lead generation.
TargetImmuniT (formerly TargetCbl-b)	Apeiron Biologics	Cancer	Formed in October 2011 to develop a cancer immunotherapy, which targets the Cbl-b protein (a negative regulator of cytotoxic lymphocytes). Research costs and potential milestones and royalties will be shared. Programme is in preclinical development; next milestone is a partnership with a pharmaceutical company.
TargetPicV	Haplogen	Anti-viral	Internal programme initiated in 2012. No details of Haplogen alliance or discovery alliance have been disclosed.
TargetCanMet (formerly TargetIDH)	Debiopharm	Cancer	Internal programme initiated in 2012, which led to an alliance with Debiopharm being started in April 2014. Evotec will receive R&D funding, and potentially high double-digit milestones and royalties. TargetCanMet is developing novel compounds that target the epigenetic factors, isocitrate dehydrogenases (IDH), with potential in acute myeloid leukaemia, prostate cancer and glioblastoma. It is in the hit-to-lead stage of early drug discovery.
TargetAD	J&J Innovation Centre (California)/ Netherlands Brain Bank	Neurology	Formed in November 2013 to identify new targets for Alzheimer's disease drug discovery and development by analysing high-quality brain samples from the Netherlands Brain Bank. J&J funds target discovery with FTE and success-based payments totalling up to $10m; Evotec can also earn potential milestones worth $125-145m in total and royalties. Programme is in discovery phase.
TargetKDM	Belfer Institute/ Dana-Farber Cancer Institute	Cancer	Formed in April 2013 to discover novel cancer treatments based on epigenetic drug mechanisms. It is focused on lysine demethylases, a class of histone deacetylases (HDACs, c 18 members). Programme is in preclinical development; next milestone is a partnership with a pharmaceutical company.
TargetPGB	Harvard University	Anti-bacterial	Formed in May 2013 to discover novel anti-bacterial agents based on a highly validated target family involved in bacterial cell wall biosynthesis (peptidoglycan biosynthesis). Collaboration with professors Daniel Kahne and Suzanne Walker of Harvard University. Programme is in discovery phase.
Target EEM (Enteroendocrine Mechanisms)	Harvard University/HHMI	Diabetes	Formed in October 2013 to identify enteroendocrine signals and mechanisms, which are involved in regulating key metabolic process and thereby develop compounds with disease-modifying potential in diabetic patients. Collaboration is with Prof Doug Melton. The programme is in the discovery phase.
TargetDBR	Yale University	Cancer	Formed in December 2013 to discover novel mechanisms, targets and compounds that interfere with DNA repair and could increase the effectiveness of radiotherapy and chemotherapy. The initial focus will be on glioblastomas, but could be expanded to other tumours. Programme is in discovery phase.
TargetCytokine	DRFZ	Multiple Sclerosis	Evotec and its partner Deutsches Rheuma-Forschungszentrum (DRFZ) were awarded €5m over three years to conduct research into cytokines, with a view to developing novel therapies for MS.
TargetSX	Undisclosed	Undisclosed	
TargetKX	Undisclosed	Undisclosed	
Undisclosed	Fraunhofer	Undisclosed	
Yale Open Innovation Alliance	Yale University	N/A	An alliance formed in January 2013, in which Evotec and Yale jointly access the potential of novel assays, screens, models and most importantly drug targets and compounds, so that Evotec's drug discovery infrastructure can be seamlessly integrated into projects to facilitate the commercialisation of discoveries. The collaboration covers many fields, including metabolism, neurology, immunology and oncology. So far, it has led to the formation of TargetDBR.
French Academic Bridge	Sanofi	N/A	An alliance formed in March 2014 to initiate CureX/TargetX initiatives in France. Evotec will only share commercial rights with potential academic partners, without sharing them with Sanofi. This initiative could be expanded across Europe.

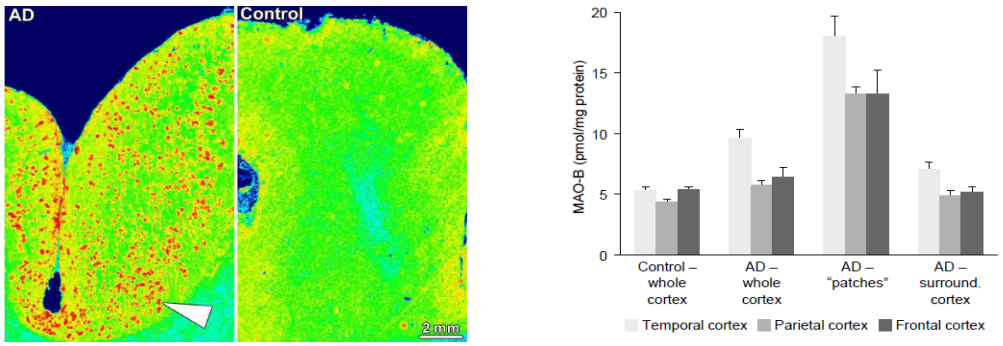
Source: Edison Investment Research. Note: EVT Innovate also has the following internal TargetX initiatives: TargetBCD, TargetColCan, TargetDR, TargetFX, and TargetSP.

Exhibit 3: Summary of clinical R&D pipeline

Product	Development stage	Indication/ partner	Notes
EVT302/ RG1577/ RO4602522/ Sembragiline	Phase II	Alzheimer's disease/ Roche	Monoamine oxidase-B (MAO-B) inhibitor, initially licensed from Roche in 2006. Evotec licensed EVT302 back to Roche in 2011 for development in Alzheimer's disease (AD). Evotec was paid $12m upfront and could receive $170m in development milestones, $650m in commercial milestones and tiered double-digit royalties on sales. The Phase IIb MAyflOwer RoAD trial was initiated in September 2012 in moderately severe AD (n=495); trial due to be completed in June 2015. Potential launch 2019.
EVT201	Phase II	Insomnia/ Jingxin Pharma	$GABA_A$ receptor modulator, shown efficacy in two Phase II trials with no serious or unexpected adverse events. Jingxin Pharma in-licensed the exclusive rights to the drug in China and is due to initiate Phase IIb trials in China; Evotec received a small upfront payment and could receive milestones and significant royalties. Development outside China is on hold.
Somatoprim (DG3173)	Phase II	Acromegaly and other growth hormone related indications/ Aspireo Pharmaceuticals	Novel somatostatin (growth hormone-inhibiting hormone) analogue developed to compete against Novartis's octreotide (Sandostatin) and Ipsen's lanreotide (Somatuline) in the $1.7bn market. A Phase IIa study in acromegaly showed a dose-dependent lowering of excess growth hormone in treatment-naive patients, with no serious adverse events. Evotec provided Aspireo with strategic and operational advice. Cortendo is in the process of acquiring the programme from Aspireo for c$30m in equity
EVT401	Phase I/II	Rheumatoid arthritis, inflammatory diseases/ Conba Pharmaceutical	Antagonist of P2X7 ATP-gated ion channel. Phase I trial: 96 healthy males with ascending doses, no serious adverse events or withdrawals occurred. Conba Pharmaceutical in-licensed the exclusive rights to the drug in China and is preparing a Phase II trial using the "Green Path" fast track of the CFDA. Evotec received a small upfront payment and could receive milestones up to €60m and tiered double-digit royalties.
Not disclosed	Phase I	Oncology/ Boehringer Ingelheim	Boehringer Ingelheim initiated a Phase I trial with an oncology compound in September 2013, triggering a €2m payment to Evotec. No further details have been disclosed.
Not disclosed	Phase I	Oncology/Roche	No details have been disclosed

Source: Edison Investment Research. Note: More than 12 products including the EVT100 series (NMDA antagonists, partnered with Janssen) could enter clinical development over the next 18 months. Development of Diapep277 was terminated by Hyperion on discovering serious misconduct by Andromeda Biotech, from which it had in-licensed the treatment.

Exhibit 4: Upregulation of MAO-B in brain tissue with amyloid plaques



Source: Evotec

Sensitivities

Evotec's risk profile is considerably lower than that of most companies in the biotechnology sector because of its drug discovery alliance strategy. It is undertaking a large number of discovery projects at once, so that the inevitable failure of some programmes should not undermine the business. Evotec also spreads the risk associated with the majority of its projects with a partner.

The company does not take unpartnered assets into clinical development, so it is not exposed to the significant financial risk associated with clinical development, while retaining some of the upside linked with successful clinical development. However, its value will still be affected by the outcome of clinical trials, in particular the results of the current Phase IIb of EVT302 in AD in mid-2015.

The company's revenues grew at a CAGR of 21.8% between FY08 and FY12 and it has been profitable since FY10, although growth slowed over the last two years (CAGR of 1.2%). Evotec's growth in FY15 will accelerate largely because of the Sanofi deal, but the rate of revenue increase subsequently will depend mainly on Evotec's ability to achieve milestones from existing alliances, form new EVT Integrate alliances and find pharmaceutical partners for its CureX programmes.

Valuation

We have increased our valuation of Evotec from €465m to €589m (€4.48 per share, Exhibit 5). The main reasons for the growth are the impact of the Sanofi deal, including enhanced future growth prospects, the strengthening of the US dollar (from $1.35/€ to €1.15/€) and adjustments to the discount factors due to the progression of time. There is additional upside to our valuation from the potential royalties from all the products in preclinical development, or milestones for EVT302.

Exhibit 5: Summary of risk-adjusted DCF valuation

	Value (€m)	Value per share (€)	Notes
Drug alliance business	319.0	2.43	Three-stage DCF valuation, terminal growth rate from 2025: 2.5%; includes impact of Sanofi deal.
EVT302	139.6	1.06	Expected launch: 2019; peak sales: $3.2bn; likelihood of success: 20%; royalties: 12.5% (excludes potential commercial milestones).
Other clinical assets (EVT201, EVT401, Somatoprim, undisclosed oncology asset)	50.9	0.39	EVT201: Expected launch: 2018; peak sales: $100m; likelihood of success: 30%; royalties: 5% EVT401: Expected launch: 2018; peak sales: $200m; likelihood of success: 30%; royalties: 5% Somatoprim: Expected launch: 2019; peak sales: $295m; likelihood of success: 30%; royalties: 5% two undisclosed asset: Expected launch: 2020; peak sales per product: $750m; likelihood of success: 10%; royalties: 5%.
EVT770 milestones	6.7	0.05	Estimated clinical milestones risk-adjusted by industry standards.
Net cash	73.5	0.56	Net cash position at Q115.
Total	**588.9**	**4.48**	

Source: Edison Investment Research. Note: For drug discovery business: WACC=10%; for product valuations: WACC=12.5%.

The next major catalyst for Evotec's shares is the results from the Phase IIb study with EVT302 in AD. If data from the trial are compelling and Roche advances the programme into Phase III, our valuation could increase to €774m with the likelihood of success increasing to 50%. Other potential catalysts for the shares are the formation of commercial partnerships for its CureX initiatives.

Financials

Evotec finished FY14 strongly with revenues growing by 19.3% in Q414, enabling the company to report top-line growth of 4.1% for the full year with sales of €89.4m. This performance has been maintained into Q115 with revenues growing by 22.3% to €21.5m, and we forecast that revenues will increase by 40.6% to €125.8m in FY15 (the company guides for growth of >35%). The acceleration in growth is primarily because of the Sanofi deal, from which Evotec will receive €250m over five years, although the structuring of the deal means that a portion of the revenue (we estimate €86m) with associated costs (15% margin) will be recognised as other income.

In line with company guidance, we expect underlying EBITDA in FY15 to be similar to that in FY14, due to the increased level of R&D. We forecast it will rise from €12.4m to €18.5m because of the Sanofi deal and more investment in CureX initiatives.

Changes to our estimates in FY15 are summarised in Exhibit 6, and we introduce our forecasts for FY16 and FY17 in Exhibit 7. We are now forecasting a loss in FY15 because of lower revenues, to be more conservative about the formation of new major integrated alliances and increased R&D and SG&A costs associated with the expansion of the CureX strategy in Evotec's core business (excluding the Toulouse site). We estimate the operating margin for the Sanofi facility will only be c 8%, but any additional revenues to Toulouse should essentially fall directly to the bottom line.

Exhibit 6: Summary of changes to estimates

	Sales (€m)			PBT (€m)			EPS (c)		
	Old	New	% chg.	Old	New	% chg.	Old	New	% chg.
2015e	105.5	125.8	29.2	8.0	(0.4)	N/A	5.4	(0.8)	N/A

Source: Edison Investment Research

Evotec remains in a strong financial position with a gross cash position of €95.7m (net cash: €73.5m) at Q115. This means that the company can still make more bolt-on acquisitions to develop

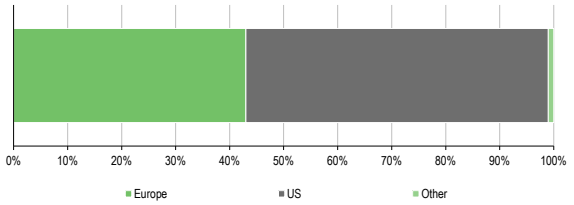
its expertise further and ensure that it remains a technological leader in the field of drug discovery, although it will probably wait until the integration of the Toulouse facility has been largely completed.

Exhibit 7: Financial summary

€'000s	2012	2013	2014	2015e	2016e	2017e
Year end 31 December	IFRS	IFRS	IFRS	IFRS	IFRS	IFRS
PROFIT & LOSS						
Revenue	87,265	85,938	89,496	125,843	139,918	159,202
Cost of Sales	(56,242)	(54,715)	(60,118)	(86,697)	(95,035)	(104,531)
Gross Profit	31,023	31,223	29,378	39,146	44,884	54,671
EBITDA	9,119	13,335	4,132	5,062	13,214	18,555
Operating Profit (before GW and except.)	3,071	7,392	(1,942)	(1,418)	5,836	10,650
Intangible Amortisation	(2,768)	(3,222)	(2,462)	(2,296)	(2,133)	(2,034)
Other	(3,311)	2,430	(926)	629	2,025	2,025
Exceptionals	(3,505)	(25,521)	(1,977)	0	0	0
Operating Profit	(3,202)	(21,351)	(6,381)	(3,714)	3,702	8,615
Net Interest	(1,204)	(1,609)	(1,152)	(1,109)	(1,186)	(1,196)
Other	(608)	(688)	2,374	2,160	0	0
Profit Before Tax (norm)	1,259	5,095	(720)	(367)	4,650	9,454
Profit Before Tax (FRS 3)	(5,014)	(23,648)	(5,159)	(2,663)	2,517	7,419
Tax	(793)	(299)	(1,858)	(726)	(1,259)	(2,077)
Deferred tax	8,285	(1,486)	39	83	(0)	(0)
Profit After Tax (norm)	466	4,796	3,968	(1,093)	3,391	7,376
Profit After Tax (FRS 3)	2,478	(25,433)	(6,978)	(3,306)	1,257	5,342
Average Number of Shares Outstanding (m)	117.3	121.2	131.3	131.5	131.5	131.5
EPS - normalised (c)	0.4	4.0	(2.0)	(0.8)	2.6	5.6
EPS - FRS 3 (c)	2.1	(21.0)	(5.3)	(2.5)	1.0	4.1
Dividend per share (c)	0.0	0.0	0.0	0.0	0.0	0.0
Gross Margin (%)	35.6	36.3	32.8	31.1	32.1	34.3
EBITDA Margin (%)	10.4	15.5	11.9	4.0	9.4	11.7
Operating Margin (before GW and except.) (%)	3.5	8.6	5.1	-1.1	4.2	6.7
BALANCE SHEET						
Fixed Assets	137,323	104,854	99,300	106,451	107,433	109,434
Intangible Assets	105,608	79,962	75,025	76,451	74,317	72,283
Tangible Assets	27,181	24,239	24,045	29,822	32,938	36,973
Other	4,534	653	230	179	179	179
Current Assets	88,104	122,526	125,300	154,429	156,595	164,092
Stocks	2,445	2,358	3,111	4,275	4,687	5,155
Debtors	15,053	17,777	25,259	22,410	24,917	28,351
Cash	64,159	96,143	88,822	117,251	116,500	120,094
Other	6,447	6,248	8,108	10,492	10,492	10,492
Current Liabilities	(33,882)	(38,953)	(33,068)	(34,114)	(34,930)	(37,806)
Creditors	(20,659)	(21,731)	(19,705)	(20,602)	(21,418)	(24,294)
Short term borrowings	(13,223)	(17,222)	(13,363)	(13,512)	(13,512)	(13,512)
Long Term Liabilities	(38,998)	(29,460)	(33,149)	(65,299)	(65,873)	(66,653)
Long term borrowings	(4,178)	0	(8,186)	(8,719)	(8,719)	(8,719)
Other long term liabilities	(34,820)	(29,460)	(24,963)	(56,580)	(57,154)	(57,934)
Net Assets	152,547	158,967	158,383	161,468	163,225	169,067
CASH FLOW						
Operating Cash Flow	12,175	7,084	(3,701)	39,721	12,187	17,411
Net Interest	111	(237)	41	(881)	(1,186)	(1,196)
Tax	(329)	(190)	(137)	(1,108)	(1,259)	(680)
Capex	(10,129)	(4,607)	(5,282)	(11,353)	(10,494)	(11,940)
Acquisitions/disposals	(3,000)	(1,150)	(2,436)	0	0	0
Financing	701	32,398	658	49	0	0
Dividends	0	0	0	0	0	0
Other	0	(159)	(1,813)	0	0	0
Net Cash Flow	(471)	33,139	(12,670)	26,427	(752)	3,594
Opening net debt/(cash)	(46,895)	(46,758)	(78,921)	(67,273)	(95,020)	(94,269)
HP finance leases initiated	0	0	0	0	0	0
Exchange rate movements	(953)	501	(792)	358	0	0
Other	1287	-1477	1814	962	0	0
Closing net debt/(cash)	(46,758)	(78,921)	(67,273)	(95,020)	(94,269)	(97,863)

Source: Edison Investment Research, Evotec accounts

EDISON

Contact details	Revenue by geography
Manfred Eigen Campus Essener Bogen 7 22419 Hamburg Germany +49 (0) 40 560 810 www.evotec.com	

CAGR metrics		Profitability metrics		Balance sheet metrics		Sensitivities evaluation	
EPS 12-16e	59.6%	ROCE 15e	0.1%	Gearing 15e	N/A	Litigation/regulatory	◖
EPS 14-16e	N/A	Avg ROCE 12-16e	2.4%	Interest cover 15e	N/A	Pensions	○
EBITDA 12-16e	9.7%	ROE 15e	N/A	CA/CL 15e	4.5	Currency	◖
EBITDA 14-16e	11.2%	Gross margin 15e	31.1%	Stock days 15e	12.4	Stock overhang	○
Sales 12-16e	12.5%	Operating margin 15e	N/A	Debtor days 15e	65.0	Interest rates	○
Sales 14-16e	25.0%	Gr mgn / Op mgn 15e	N/A	Creditor days 15e	27.6	Oil/commodity prices	○

Management team

CEO: Dr Werner Lanthaler

Dr Werner Lanthaler became CEO in March 2009, having been CFO of Intercell for the previous eight years. Between 1995 and 1998 he was a senior consultant at McKinsey & Co. He holds a doctorate in economics from Vienna University.

CFO: Colin Bond

Colin Bond became CFO in August 2010. Previously he was CFO at Novelis Europe in Switzerland; he was also CFO EMEA for Ecolab and CFO for Jet Aviation Group. He is a chartered accountant and pharmacist.

CSO: Dr Cord Dohrmann

Dr Cord Dohrmann became CSO in September 2010 following the acquisition of DeveloGen, where he was CEO. He had worked at DeveloGen from 1999 in various management positions. Previously he was a research fellow at the Massachusetts General Hospital.

Chairman: Dr Wolfgang Plischke

Dr Plischke became chairman of the supervisory board in June 2014. He worked at Bayer AG for over 30 years. He was a member of Bayer's management board responsible for technology, innovation and sustainability and the Asia/Pacific region from 2006 until 2014, and was previously its Head of the Pharmaceutical Business Group from 2002 to 2006

Principal shareholders	(%)
Roland Oetker	13.2
Biotechnology Value Fund	12.2
TVM Capital	9.4
Allianz Global Investors	3.0
Deutsche Bank	2.7

Companies named in this report

AstraZeneca (LON:AZN), Bayer (GR:BAYN); Boehringer Ingelheim, Bristol-Myers Squibb (US:BMY), Conda Pharmaceuticals, Jingxin Pharma (CH:002020), J&J (US:JNJ), Novartis (VX:NOVN), Roche (VX:ROG), UCB (BB:UCB)

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