

Evotec

Pipeline update

Growth drivers intact despite EVT302 setback

EVT302 has failed to meet the primary endpoint of a Phase IIb trial in Alzheimer's disease. Partner Roche will now fully evaluate all secondary endpoints to determine EVT302's future. We have lowered EVT302's probability of success to 5% (from 20%), reducing our valuation to €486m. Despite this pipeline disappointment, we continue to believe that Evotec remains well placed to accelerate growth, with the Sanofi deal providing capacity, guaranteed future revenues and enhanced capabilities.

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.

EVT302 misses primary endpoint in AD trial

The [Phase IIb](#) trial investigated two doses of EVT302 in 544 Alzheimer's disease (AD) patients as add-on to standard AD treatment, compared to standard treatment alone. The primary endpoint measured cognition (ADAS-Cog) after 12 months of treatment, with EVT302 failing to show any benefit. No further details have been provided, so it is unclear if any trends, including dose-dependent responses, were observed. Roche will now assess the entire dataset, including secondary endpoints, to determine EVT302's future; we expect an update later in the year.

Valuation lowered with reduced likelihood of success

Until there are further details on the Phase IIb data and clarity on EVT302's potential future, we have reduced the probability of success to 5% (from 20%), while maintaining our previous assumptions (2019 launch, \$3.2bn peak sales, 12.5% royalty). This lowers our EVT302 valuation to €35m (from €140m).

Growth driver remains EVT Innovate

EVT302 is just one of a number of fully funded partnered pipeline projects. These diversify risk and could, in the long-term, provide a source of recurring revenues if successful. In the near- to mid-term, the key growth driver remains EVT Innovate (the collaborative academic/pharma drug discovery business), supported by EVT Execute (the preclinical "services" business). Growth prospects were recently further underpinned with the acquisition of Sanofi's Toulouse facility, providing additional capacity, guaranteed future revenues and additional capabilities, which could help drive future EVT Innovate and EVT Execute collaborations.

Valuation: DCF valuation of €486m or €3.69/share

Our valuation is lowered to €486m (from €589m), predominantly with the reduced probability for EVT302. We have made no other major changes to our valuation or our financial forecasts, and continue to expect revenue growth of >40% in FY15.

Pharma & biotech

2 July 2015

Price €3.37

Market cap €444m

\$1.11/€

Net cash (€m) at end March 2015 73.5

Shares in issue 131.8m

Free float 65%

Code EVT

Primary exchange Frankfurt

Secondary exchange N/A

Share price performance



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

Q215 results 12 August 2015

Q315 results 10 November 2015

Analysts

Dr Philippa Gardner +44 (0)20 3681 2521

Christian Glennie +44 (0)20 3077 5727

healthcare@edisongroup.com
[Edison profile page](#)

Valuation

We have updated our valuation to reflect the EVT302 setback, lowering our probability of success for this programme to 5% (from 20%). We have also updated the valuation to reflect FX moves (with slight strengthening of the US dollar from \$1.15/€ to \$1.11/€) and an updated number of shares. Our valuation is now €486m (from €589m) or €3.69/share (Exhibit 1).

Exhibit 1: Summary of risk-adjusted DCF valuation

	Value (€m)	Value per share (€)	Notes
Drug alliance business	319.0	2.42	Three-stage DCF valuation, terminal growth rate from 2025: 2.5%; includes impact of Sanofi deal.
EVT302	35.1	0.27	Probability of success reduced to 5% (from 20%); maintain other assumptions of 2019 launch; peak sales \$3.2bn; royalties: 12.5% (excludes potential commercial milestones).
Other clinical assets (EVT201, EVT401, Somatoprim, undisclosed oncology asset)	52.7	0.40	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 assets: Expected launch: 2020; peak sales per product: \$750m; likelihood of success: 10%; royalties: 5%.
EVT770 milestones	5.9	0.05	Estimated clinical milestones risk-adjusted by industry standards.
Net cash	73.5	0.56	Net cash position at end Q115.
Total	486.3	3.69	

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

Future potential catalysts for the shares include the formation of major strategic alliances, particularly commercial partnerships for the CureX initiatives. Evotec has successfully expanded its CureX/TargetX programmes in recent times, which has led to more alliances and a return to double-digit growth in recent quarters. Evotec also acquired Sanofi's Toulouse facility earlier this year, which underpins our revenue growth expectations for FY15 and should support future growth.

As a reminder, under the terms of the Sanofi deal, Evotec acquired a facility in Toulouse with c 200 employees, providing sufficient capacity to meet EVT Innovate initiatives until 2018. Evotec will receive €250m to cover running costs over the next five years. The deal also provides Evotec with access to Sanofi's library of 1.3m compounds and Evotec obtains a pipeline of 14 assets, five of which are in pre-IND studies. Sanofi will also support development of Evotec's CureX alliances.

Financials

We have made no changes to our financial forecasts and continue to expect revenues of €125.8m in FY15, with growth of 40.6% (versus company guidance of >35%), primarily from revenues associated with the Sanofi deal (Evotec will receive €250m over five years).

Evotec remains in a strong financial position with a gross cash position of €95.7m (net cash: €73.5m) at end Q115. This means 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. However, we believe the near-term priority will be integration of the Toulouse facility, in addition to the formation of strategic alliances and commercial partnerships.

Exhibit 2: 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	(2,578)	(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	131.7	131.8	131.8
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	4.6	4.0	9.4	11.7
Operating Margin (before GW and except.) (%)		3.5	8.6	-2.2	-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

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