EDISON

Evotec

Company outlook

Healthy cash flows in the future

Pharma & biotech

Evotec operates a hybrid business model and offers a unique risk-reward profile for investors, with steady growth from its EVT Execute business and potential drug development upside from its EVT Innovate arm. We base our investment thesis for Evotec on supportive company-specific and macro trends and forecast healthy cash flows in the future. Our valuation of Evotec is virtually unchanged at €575m.

Year end	Revenue (€m)	PBT* (€m)	EPS* (€)	DPS (€)	P/E (x)	Yield (%)
12/14	89.5	(0.7)	(0.02)	0.0	N/A	N/A
12/15	127.7	1.2	(0.01)	0.0	N/A	N/A
12/16e	159.4	7.0	0.02	0.0	N/A	N/A
12/17e	179.8	15.5	0.08	0.0	45.9	N/A

Note: *PBT and EPS are normalised, excluding amortisation of acquired intangibles, exceptional items and share-based payments.

Favourable macro and company-specific trends

Our investment thesis for Evotec is built on company-specific progress as well as positive industry trends that point towards healthy cash flows in the future. The drug discovery services industry continues to benefit from the need for R&D cost reduction and increasing comfort with outsourcing at pharma and biotech companies. Service providers such as Evotec offer scalability, efficiency and flexibility with different outsourcing models, which all point towards continuing growth of the drug discovery services market. Due to the high-tech nature of drug discovery, quality of the service is key for long-term relationships and increasing integration level with customers, which also means higher margins. For example, the total number of Evotec's alliances increased significantly in 2014 and 2015 reaching 177, of which 67 were new clients. Twenty-one alliances generated more than €1m revenues each for Evotec, indicating a trend of an increasing number of quality customers.

Organic growth to continue in 2016 and 2017

With the sales growth continuing into Q116, we have only fine-tuned our 2016 and 2017 forecasts. For 2016 we expect 25% underlying revenue growth (more than 15% guided) and EBITDA of €19.2m, an improvement from €8.7m in 2015. Evotec remains in a strong financial position, with a gross cash position of €122m (net cash €100m) at Q116. The company could make bolt-on acquisitions to develop its expertise further, although no indications have been provided in this direction yet.

Valuation: €575m or €4.34/share

We maintain our valuation approach, which includes a DCF model for the services business and separate risk-adjusted NPV models for the R&D programmes. However, we have made a number of changes to the projects to reflect recent developments and now include preclinical-stage projects. Our Evotec valuation is marginally lower at €575m or €4.34/share, from €577m or €4.36/share previously. Healthy cash flows and a maturing preclinical pipeline should support the share price in 2016 and 2017, in our view.

29 June 2016

Price	**€3.67**
Market cap	**€487m**

Net cash (€m) at end Q116	100
Shares in issue	132.6m
Free float	87%
Code	EVT
Primary exchange	Frankfurt
Secondary exchange	N/A

Share price performance

%	1m	3m	12m
Abs	(7.1)	12.6	1.2
Rel (local)	1.1	17.5	23.1
52-week high/low		€4.24	€2.93

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

Half-year 2016 interim report	10 August 2016
Further strategic alliances	2016

Analysts

Jonas Peciulis	+44 (0)20 3077 5728
Lala Gregorek	+44 (0)20 3681 2527

healthcare@edisongroup.com

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Investment summary

Company description: A diversified hybrid business model

Evotec is a German biotechnology company founded in 1993 by a group of eminent German scientists, including the Nobel Laureate Professor Manfred Eigen, and employs c 1,000 people in France, Germany, the UK and US. Evotec provides drug discovery and early stage drug development services to the pharmaceutical industry, has collaborations with academic institutions to advance novel drug discovery programmes and also invests in its own R&D projects. The structure of this business model allows for prudent investing in R&D projects, supported by the stable, high-visibility and profitable service business. Recently Evotec has spun out an internal drug discovery platform into a standalone biotech company, Topas Therapeutics, which was also backed by a consortium of venture capital investors, with Evotec remaining the largest shareholder.

Evotec's client base is well diversified, with 53% of 2015 revenues coming from top 20 pharma clients, another 30% from mid-sized pharma and biotech and the remaining 17% from foundations, not-for-profit and academic institutions. It has two business divisions: EVT Execute, which provides drug discovery services; 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

Our overall valuation approach is unchanged, including a combination of DCF-based model with rNPV calculations for R&D assets. However, as the preclinical pipeline is maturing, we have made a detailed revision of our valuation of the R&D pipeline, which now includes preclinical stage projects where there is a defined development pathway. Our Evotec valuation is marginally lower at €575m or €4.34/share, from €577m or €4.36/share previously. A lower net cash position and the removal of clinical stage projects were offset by the addition of the preclinical assets and a slightly higher valuation of drug discovery services mostly due to rolling our model forward in time.

Sensitivities

Evotec's risk profile is balanced compared to the risk associated with 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. 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. Evotec's growth in FY15 was boosted by the Sanofi deal, while our future forecasts are based on organic growth, which will require Evotec to maintain existing and/or attract new collaborations.

Financials

With growth continuing into Q116, we have only made minor changes to our 2016 and 2017 forecasts. Evotec finished FY15 strongly, with total revenues growing by 43% year-on-year or 57% if excluding milestones, upfront and licence payments, which is more reflective of the performance of the underlying business. The acceleration in growth in 2015 was primarily because of the Sanofi deal in Q215. For 2016 we expect 25% underlying revenue growth (more than 15% guided) and adjusted EBITDA of €19.2m, an improvement from €8.7m in 2015. Evotec remains in a strong financial position with gross cash of €122m (net cash: €100m) at Q116. Evotec could make more bolt-on acquisitions to develop its expertise further and ensure it remains a technological leader in the field of drug discovery, although no indications have been provided in this direction yet.

Outlook: Healthy cash flows fuel the innovation

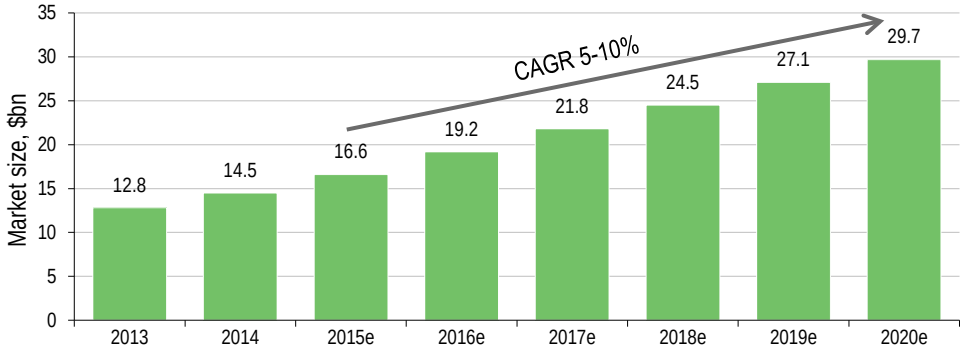
Evotec operates a profitable business providing services for partners that outsource drug discovery processes and early stage preclinical development (EVT Execute segment). This provides Evotec with high-visibility revenues and supports its strong balance sheet (end-Q16 cash and short-term investments of €122.5m). As a result, Evotec is able to invest in its innovative discovery and preclinical drug development programmes (EVT Innovate) via collaborations or on a standalone basis. Evotec's performance shows that such a hybrid business model is sustainable and offers a unique twofold exposure to risk/reward for investors: the low-risk, high-visibility services business is combined with potential upside from riskier R&D projects. Notably, Evotec has limited financial downside risk associated with clinical stage projects, as they all are progressed through licensing agreements with their partners covering the costs. Our investment thesis is built on both positive company-specific and industry trends that point towards healthy cash flows in the future.

Macro trends: Secular growth of the drug discovery market

The global outsourcing market is estimated to grow at a CAGR of 5-10% between 2015 and 2020 (source: Visiongain). The main macro trends that underpin the drug discovery outsourcing market's growth are:

- **Need for R&D cost reduction and increasing comfort with outsourcing**. The need to control rising costs is a compelling incentive to look for ways of outsourcing at least part of the R&D activities. This has become especially acute with the decreasing efficiency of the in-house R&D efforts at large pharma companies. Biotech and pharma started outsourcing a range of different activities with varying degrees of complexity and, with increasing complexity, the quality of the service provider becomes crucial.
- **Efficiency, expertise of the provider, access to novel technologies**. A specialised service provider accumulates expertise in specific research stages and becomes expert in certain therapeutic areas. To maintain the competitive advantage, the provider has to employ cutting-edge technologies, which may not be owned by outsourcing companies. Established providers can also attract top talent in the industry.
- **Flexibility with different outsourcing models**, which range from typical fee-for-service contracts (eg outsourcing of synthesis of a library of compounds) to fully integrated drug discovery projects, through different FTE-based partnership structures involving research fees, milestones and royalties (margins increase accordingly).
- **Scalability**. Outsourcing allows for fixed costs to be converted to variable costs. The extent of work can be rapidly increased or decreased, while accomplishing this in-house would involve hiring, reassigning or laying off personnel. This especially true when the outsourcing company is of smaller scale or so called "virtual", in which case all the R&D activities are outsourced.

Exhibit 1: Drug discovery services market size

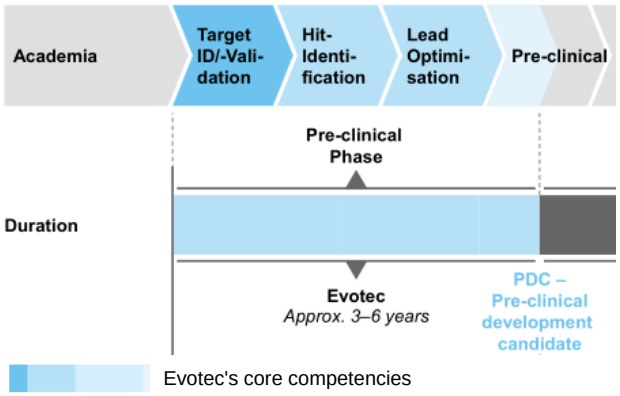


Source: Evotec

Company-specific trends: A sustainable hybrid business model

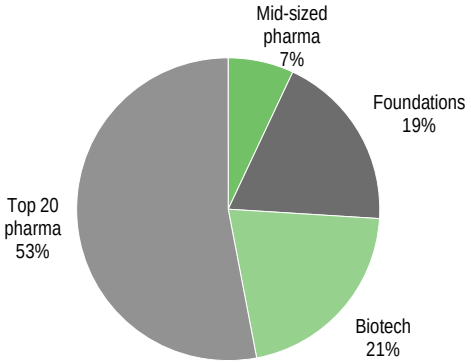
Evotec's core expertise lies in the earliest stages of drug discovery and development (Exhibit 2), allowing its clients to drive innovation efficiently, reduce costs and increase the development speed. The company has become one of the largest service providers in the Western markets with a diverse client base. Since its inception in 1993, Evotec has been involved in more than 250 partnerships, and has developed more than 30 preclinical candidates and 20 clinical candidates. Notably, Evotec's customers are very diverse and range from large pharma to "virtual" small biotech companies, to not-for-profit organisations and foundations.

Exhibit 2: Evotec's expertise



Source: Evotec

Exhibit 3: Customers by type, 2015

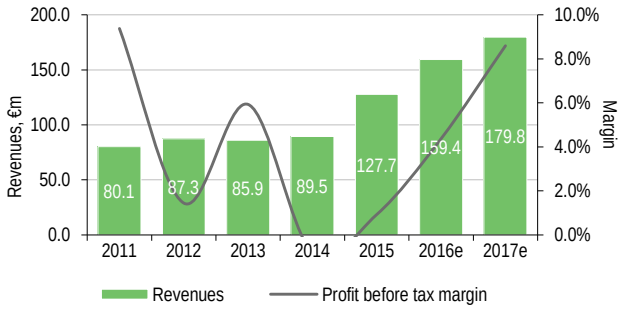


Source: Evotec

Evotec also owns a portfolio of assets (partnered and unpartnered) in different development stages ranging from discovery to clinical. In terms of therapeutic areas, Evotec has developed expertise in diabetes and diabetic complications, pain and inflammation, oncology, infectious diseases and neuroscience. The strategy for the R&D portfolio is to partner the assets early in the discovery or to develop them up to preclinical candidate nomination. Evotec avoids financial risk associated with the later preclinical or clinical development, at which stage the partner takes over via out-licensing agreements.

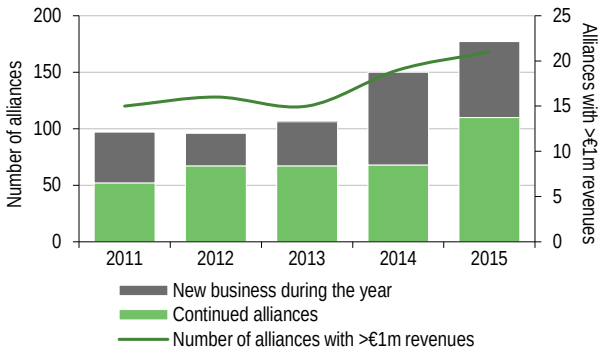
Although the long-term macro trends in drug discovery services seem favourable to Evotec, over the past few years the industry has experienced a number of changes, such as financial pressures resulting from the "patent cliff", cost cutting, consolidation, large mergers and optimisation of in-house R&D. Over the past five years Evotec has navigated these changes, emerging as an established service provider with long-term relationships with the customers (Exhibits 4 and 5). The number of alliances (customers) directly correlates with Evotec's revenues; therefore important indicators to observe are new clients, those that continue working with the company and the quality of customers, ie those that significantly contribute to Evotec's top line. The total number of alliances increased significantly in 2014 and 2015 reaching 177, of which 67 were new clients. Twenty-one alliances generated more than €1m revenues for Evotec, indicating a trend of an increasing number of quality customers.

Exhibit 4: Evotec's revenues and profitability



Source: Evotec. Note: PBT is normalised.

Exhibit 5: Evotec's alliances



Source: Evotec

Transformational deal with Sanofi

The acquisition of Sanofi's Toulouse facility at no cost in April 2015 was transformational to Evotec's corporate structure and ability to grow, as the deal alleviated its capacity constraints. On top of this, Evotec acquired a new strategic alliance for drug discovery services outsourcing and the development of innovative assets. The key highlights of the deal are listed below (more detailed discussion is in our last outlook):

- Over the next five years, Evotec will receive €250m from Sanofi 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 across Europe (part of EVT Innovate; collaborations with academia focused on developing innovative therapies), and all the commercial rights from any resulting collaborations will belong to Evotec.
- Evotec will manage the compound management system in Toulouse, with access to Sanofi's library of 1.3m compounds. EVT 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 more than 10 assets, five of which are in pre-IND studies. Payments will be to Sanofi, as the assets achieve development and regulatory milestones.

Topas Therapeutics – new partnership model

On 22 March 2016, Evotec announced a spinout of Topas Therapeutics with a €14m series A funding round co-led by three VC companies: Epidarex Capital, EMBL Ventures and Gimv. Evotec will remain the largest shareholder. While not many details about the technology were released, Topas has a nanoparticle-based platform with potential to deliver multiple projects in autoimmune and inflammatory disorders. The most advanced project is for multiple sclerosis and is expected to progress to Phase I in 2017. Overall, we view this as a novel corporate development solution for Evotec. Since Topas's technology is a platform and can be used in multiple projects, a standalone company was viewed as a better vehicle for execution, risk sharing and fund-raising efforts. Evotec indicated that more similar deals are possible, but that will be driven by the nature and prospects of a particular technology.

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 and the collaborations between EVT Execute and clients can range from purely fee-for-service contracts to fully integrated drug discovery alliances.

Drug discovery services

Fee-for-service contracts have a relatively low gross margin and no scope for success milestones and royalties, yet no development risk exposure. This is a stable, long-term, recurring income stream. EVT Execute provides a complete range of preclinical development services to biotech and pharmaceutical companies. The rate of technological change means that much of this market is increasingly 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 €10m 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 facility in Europe and has tripled the size of the compound library it can offer to clients.

Integrated drug discovery alliances

On the other end of the spectrum of services provided by EVT Execute is an end-to-end solution for companies that want to outsource entire preclinical programmes. Integrated alliances 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. The new major collaboration with Sanofi across a range of therapeutic areas could serve as a good reference, in our view, for other big pharma companies outsourcing more drug discovery programmes in integrated alliances to Evotec.

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 Evotec shares in the development upside and its interests are better aligned with those of the client, ie the alliance will be more profitable for Evotec if it is successful in carrying out the drug discovery activities.

A notable trend is that more biotech companies are using Evotec for outsourcing entire drug discovery programmes, largely driven by the fact that many biotech companies have been able to raise significant capital in recent years, which can now be spent on R&D activities. Padlock Therapeutics is a recent example of such an integrated partnership with a small biotech company. On 10 March, Evotec announced that it had achieved a key preclinical milestone in the three-year collaboration with Padlock. Evotec provided a full range of drug discovery services to Padlock, which has now been acquired by Bristol-Myers Squibb for $600m in total deal value.

EVT Innovate: CureX and TargetX initiatives to fuel pipeline

EVT Innovate is leveraging Evotec's growing expertise in delivering full range, integrated drug discovery services. The strategy here is to create in-house intellectual property via unpartnered or partnered innovative projects and seek partnering agreements in early drug research stages or when the preclinical candidate is selected.

The cornerstones of EVT Innovate are the CureX and TargetX initiatives. These are collaborations with leading academic centres (Exhibit 6) and pharma companies, in which Evotec and its partners work in an integrated manner to enable efficient innovation. 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).

Exhibit 6: Partnered CureX/TargetX initiatives

Collaboration	Partners	Disease area	Notes
TargetFibrosis	Pfizer	Fibrosis	A four-year alliance with Pfizer announced in August 2015. The partnership explores novel mechanisms of action of targeted anti-fibrotics. Evotec received an undisclosed prepayment with potential development and commercial milestones.
TargetBCD	Sanofi	Diabetes	An alliance announced in August 2015 for beta cell replacement therapy derived from human stem cells. Triggered an upfront payment of €3m, total deal value up to €300m + royalties.
TargetMB	Second Genome	Microbiome	An alliance announced in March 2015 for small molecule discovery and development activities for the treatment of microbiome-related diseases. Triggered an undisclosed upfront payment to Evotec; also eligible for milestone and royalty payments.
TargetImmuniT	Apeiron Biologics, Sanofi	Cancer	Collaboration was established in early 2013 to develop a cancer immunotherapy based on first-in-class small molecules. In August 2015 a strategic partnership was announced among the three companies involving next generation immuno-oncology therapies. Total deal value for Evotec and Apeiron can total up to €200m + royalties.
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 is on glioblastomas, but could be expanded to other tumours.
TargetEEM (Enteroendocrine Mechanisms)	Harvard University, HHMI	Diabetes	Formed in October 2013 to identify enteroendocrine signals and mechanisms, which are involved in regulating key metabolic processes, and thereby develop compounds with disease-modifying potential in diabetic patients.
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.
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).
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). Financial details not disclosed.
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).
TargetPicV	Haplogen	Anti-viral	In November 2012, Evotec and Haplogen signed a collaboration agreement to discover and develop small molecules against viral infectious diseases. Financial terms not disclosed.
CureNephron	Harvard, 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.
CureBeta	Harvard Stem Cell Institute	Diabetes	Formed in March 2011 to develop novel treatments for diabetes that cause beta cell regeneration. 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 collaboration in 2014 for strategic reasons. Evotec and Harvard are continuing the work and looking for new commercial partners.
TargetASIC	Undisclosed pharmaceutical company, BMBF	Neurology	TargetASIC evolved from the work conducted within the Neu2 consortium, which included Merck Serono, 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.
TargetCytokine	DRFZ, BMBF	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.
Yale Open Innovation Alliance	Yale University	N/A	An alliance announced 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 other undisclosed initiatives: TargetATD, TargetFRX, TargetNTR, TargetKras (Ohio), Targetasn (MJFF), TargetBispecifics (ex-scientia), TargetDR, TargetFX, TargetKX.

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. Consequently, its value will still be affected by the outcome of preclinical and clinical trials.

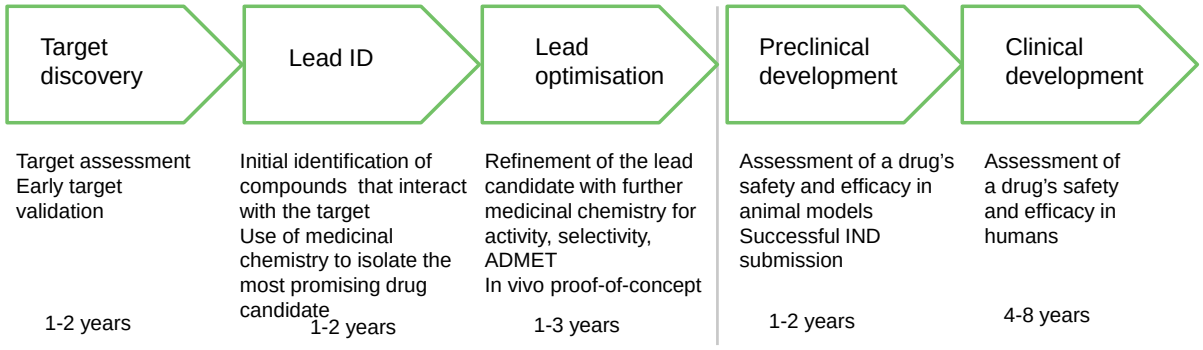
Evotec's growth in FY15 significantly accelerated largely because of the Sanofi deal. The rate of revenue increase subsequently will depend mainly on Evotec's ability to achieve milestones from existing alliances, form new EVT Integrate alliances and find pharmaceutical partners for its maturing preclinical assets.

Valuation

We maintain our valuation approach, which includes a DCF model for the services business and separate risk-adjusted NPV models for the R&D programmes. For Evotec's drug discovery business, we use a DCF model with a cost of capital of 10%, a terminal growth rate of 2.5%, a long-term operating profit margin of c 25% achievable within the next 10 years and maintenance capex of around €10m. For our R&D pipeline valuation, we have made a number of changes to the projects to reflect recent developments and have decided to include preclinical stage projects, while previously we valued only those in the clinic. Evotec's hybrid business model is focused on early stage research and is maturing with the expanding discovery and preclinical pipeline.

In its 2015 annual report, Evotec described an R&D pipeline with 28 projects (some of which have multiple compounds) ranging from discovery stage to clinical. Exhibit 7 demonstrates the rationale we employed in order to select which projects to include in our valuation. Early stage drug development can be broadly classified into discovery and preclinical stages. As a general rule, we assume that value should be assigned to those preclinical projects that are likely to move to clinical stage if the data from the ongoing studies is supportive. In our view, this corresponds to the preclinical stage when the project is already past the discovery stage, is being tested in *in vivo* studies and the data package for the initial new drug application is being accumulated.

Exhibit 7: Overview of the drug discovery process



Source: Edison Investment Research

With this in mind, we now include several of the preclinical stage projects, for which we believe there is enough information to make reasonable assumptions as to the development pathway. Given the substantial risk-adjustment commensurate with the early stage projects, especially in preclinical stage, there will be a natural turnover in the projects with some of them progressing

forward, while other ones are terminated due to a variety of reasons. Exhibits 8 and 9 summarise our assumptions and the sum of the parts company valuation.

Exhibit 8: Assumption for R&D projects

Product	Stage	Indication/ partner	Proba-bility	Launch	Peak sales*, $m (see note)	Royalties/milestones** (see note)	Status
EVT201	Phase II	Insomnia/ Jingxin Pharma	30%	2020	100	Undisclosed; we assume 15% royalties, which also includes milestone payments	$GABA_A$ receptor modulator has 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 running a Phase II trial in China.
EVT401	Phase II ready	Rheumatoid arthritis, inflammation/ Conba Pharmaceutical	30%	2020	200	Milestones up to €60m + tiered double-digit royalties (15% assumed)	Antagonist of P2X7 ATP-gated ion channel. Phase I trial demonstrated safety and tolerability. Conba Pharmaceutical in-licensed the exclusive rights to the drug in China and is preparing a Phase II trial.
Two undisclosed projects	Phase I	Oncology/ Boehringer Ingelheim and Roche	10%	2021	Combined 1,500	Undisclosed; we assume 10% royalties including milestones, including milestone payments	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.
EVT770	Preclinical	Diabetes T 1/2/ MedImmune	5%	2022	500	Milestones up to €254m + royalties (we assume 7.5%)	The project is aimed at regenerating pancreatic beta cells that produce insulin with preclinical proof-of-concept. In December 2010 Evotec entered into a licence and collaboration agreement with MedImmune (the biologics unit of AstraZeneca) to develop EVT770 in the field of diabetes. For peak sales we used historic sales of glipizide and glimepiride.
Various	Preclinical	Endometriosis/ Bayer	5%	2020	310	Milestones up to €580m + double-digit royalties (we assume 10%)	In October 2012 Evotec and Bayer entered into a five-year, multi-target collaboration with the goal of developing three clinical candidates for the treatment of endometriosis (we assume one project to be carried forward to the clinic). For peak sales we used consensus estimates of 2022 sales of Elagolix, Visanne, Dinagest, Lupron and Leuplin.
Three undisclosed projects	Preclinical	Oncology/ Sanofi	5%	2023	Combined 2,250	Undisclosed; we assume 10%, including milestone payments	Licensed from Sanofi after the Toulouse deal in 2015. Potentially first- and best-in-class compounds for oncology indications. Further details undisclosed.
NdL platform	Preclinical	Multiple sclerosis/ Topas Therapeutics (spin-out)	5%	2023	3,000	Unpartnered; we assume out-licensing in clinical development with 15% royalties, including potential milestones payments	Topas Therapeutics is a platform spinout from Evotec, which maintained a 40% economic interest in the company. Only one indication included in our model, although there is potential for expansion. For peak sales we used consensus estimates of 2022 sales of Tecfidera, Ocrevus, Tysabri, Aubagio and Copaxone.
Undisclosed platform	Preclinical	Microbiome related diseases/ Second Genome	5%	2023	635	Undisclosed; we assume 15%, which includes potential milestones payments	In March 2015 Evotec and Second Genome announced a collaboration in small molecule-based discovery and development activities for the treatment of microbiome-mediated diseases. Specific indications were not disclosed; we assume irritable bowel disease as a likely option. More indications are possible as Second Genome has a proprietary platform to identify and modulate microbiome-mediated pathways. For peak sales we used consensus estimates of 2022 sales of Xifaxan 550, Viberzi and Donnatal.

Source: Edison Investment Research, Evotec, EvaluatePharma. Note: *Peak sales assumption is based on the average of reference drugs sales, where relevant, or on our best estimate. Historic peak sales of reference drugs used if available or consensus estimates from EvaluatePharma. **Where disclosed, we have used the licensing agreement details for NPV projects; if undisclosed, we have applied higher royalties than industry standard to account for the milestone payments.

The main changes compared to our previous valuation are:

- Removal of **EVT100**, a selective NMDA-antagonist. The project was licensed to Janssen in 2012 and was being developed for depression. Janssen decided to discontinue the development and Evotec will regain the licence rights. While Evotec is assessing further business opportunities with this asset, due to lack of visibility we have removed EVT100 from our valuation.
- Removal of **Somatoprim**, a novel somatostatin analogue for acromegaly. Originally owned by Aspireo Pharmaceuticals, the project was being developed in partnership with Evotec.

Cortendo (now Strongbridge Biopharma) acquired all rights from Aspireo in 2015, while Evotec received an undisclosed one-time fee.

- Addition of **four preclinical stage projects**, with the details and our assumptions summarised in Exhibit 8 (EVT770 was already included).
- We have also reflected the most recent developments in the projects that we previously included in our valuation. Namely, we have postponed the **EVT201** project by two years. The development of the Phase II stage asset by Evotec's partner Jingxin Pharma has been somewhat slower than we expected. However, according to the latest update in 2015 annual report, the Phase II trial has been initiated, with patient recruitment well underway. Similarly, we have postponed the **EVT401** project by two years and the two **oncology projects with Boehringer Ingelheim and Roche** by one year.

For the projects we have used industry standard assumptions. Probabilities to reach the market and timelines were selected according to the stage of the project. Royalty rates are assumed according to the stage of the project where milestone payments were disclosed. If undisclosed, then we increased the royalty rate to capture the milestones as well. We note that all the costs associated with the preclinical development of the assets are accounted for in the DCF valuation, while NPV calculations include only expected royalties and milestone payments from partners, which continue the clinical development (Evotec's strategy is not to invest in clinical development). As a result, our calculated NPV values represent an upside associated with the assets.

Our Evotec valuation is marginally lower at €575m or €4.34/share, from €577m or €4.36/share previously. The lower net cash position and the removal of clinical stage projects were offset by the addition of the preclinical assets and slightly higher valuation of drug discovery services, mostly due to rolling our model forward in time. We note a significant risk adjustment, which is typical in early preclinical projects. If, for example, all programmes are a success, as per our model, the valuation would be €1.9bn or €14.4/share.

Exhibit 9: Evotec summary of risk-adjusted DCF valuation

	Value (€m)	Value/share (€)	Probability	Risk-adjusted value (€m)	Risk-adjusted value/share (€)
Drug alliance business	388.1	2.93	100%	388.1	2.93
Clinical stage R&D assets					
EVT201	17.2	0.13	30%	5.2	0.04
EVT401	62.0	0.47	30%	18.6	0.14
Undisclosed programmes	187.5	1.41	10%	18.8	0.14
Preclinical stage R&D assets					
EVT770	146.8	1.11	5%	7.3	0.06
Endometriosis	251.3	1.90	5%	12.6	0.09
EVT801/701/601	223.8	1.69	5%	11.2	0.08
Multiple sclerosis	443.5	3.35	5%	8.9	0.07
Microbiome	93.9	0.71	5%	4.7	0.04
Net cash	99.9	0.75	100%	99.9	0.72
Total	1,914.1	14.44		575.2	4.34

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

Financials

Changes to our estimates are summarised in Exhibit 10. With growth continuing into Q116, we have only fine-tuned our 2016 and 2017 forecasts. Evotec finished FY15 strongly with total revenues growing by 43% year-on-year or 57% if excluding milestones, upfront and licence payments, which is more reflective of the performance of the underlying business. The acceleration in growth is primarily because of the Sanofi deal in Q215, 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 will be recognised as other income.

Evotec guides more than 15% underlying revenue growth in 2016; our expectation is 25% organic growth to €145m and also 25% total revenue growth to €159m. In line with company guidance, we expect FY16 R&D expenses of €20.7m (approximately €20m according to Evotec). The company guides that adjusted EBITDA should be significantly improved compared to 2015. Our expectation is €19.2m, an improvement from €8.7m in 2015. Our FY16 normalised profit before tax and EPS estimates were mainly affected by the foreign currency exchange loss recorded in Q116. Our estimates imply an adjusted EBITDA margin of c 12% in 2016 vs 6.8% in 2015. We forecast the margin growing to c 14% in 2017. We see a long-term sustainable adjusted EBITDA margin at around 30-35% and a total operating margin of 25-30%.

Evotec remains in a strong financial position with gross cash of €122m (net cash: €100m) at Q116. 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 Evotec has not provided any indications in this direction yet.

Exhibit 10: Summary of the main changes to our Evotec financial forecasts

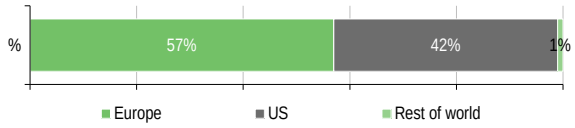
€000s	2015	2016e			2017e		
	Reported	Old	New	% change	Old	New	% change
Revenues	127,677	161,057	159,423	-1%	182,124	179,833	-1%
Underlying revenues*	115,400	145,697	144,708	-1%	160,156	158,703	-1%
Gross profit	37,987	55,213	53,851	-2%	65,581	64,320	-2%
Gross margin	29.8%	34.3%	34%	-0.5pp	36.0%	35.8%	-0.2pp
Research and development costs	(18,343)	(19,334)	(20,717)	+7%	(21,311)	(22,158)	+4%
Selling, general and administration costs	(25,166)	(26,810)	(25,468)	-5%	(28,577)	(26,631)	-7%
Adjusted EBITDA*	8,690	18,398	19,152	+4%	24,878	24,990	+0%
Adjusted EBITDA%	*6.8%*	*11.4%*	*12.0%*	*0.6pp*	*13.7%*	*13.9%*	*0.2pp*
Operating Profit	11,640	5,998	5,992	-0%	12,837	13,390	+4%
Operating Profit%	*9.1%*	*3.7%*	*3.8%*	*0.0pp*	*7.0%*	*7.4%*	*0.4pp*
Profit Before Tax (norm)	1,179	8,400	6,968	-17%	15,656	15,456	-1%
Profit After Tax (norm)	(1,462)	6,950	4,362	-37%	12,101	11,757	-3%
EPS (€, norm)	(0.01)	0.05	0.02	-61%	0.09	0.08	-17%

Source: Edison Investment Research, Evotec. Note: *Underlying revenues exclude milestones, upfront and licence payments.

Exhibit 11: Financial summary

€000s	2012	2013	2014	2015	2016e	2017e
Year end 31 December	IFRS	IFRS	IFRS	IFRS	IFRS	IFRS
PROFIT & LOSS						
Revenue	87,265	85,938	89,496	127,677	159,423	179,833
Cost of Sales	(56,242)	(54,715)	(60,118)	(89,690)	(105,573)	(115,513)
Gross Profit	31,023	31,223	29,378	37,987	53,851	64,320
Adjusted EBITDA*	10,217	10,394	7,711	8,690	19,152	24,990
Operating Profit (before GW and except.)	3,071	7,392	(1,942)	328	9,883	15,637
Intangible Amortisation	(2,768)	(3,222)	(2,462)	(2,860)	(2,474)	(2,247)
Other	(3,311)	2,430	(926)	5,850	1,522	105
Exceptionals	(3,505)	(25,521)	(1,977)	14,172	(1,417)	0
Operating Profit	(3,202)	(21,351)	(6,381)	11,640	5,992	13,390
Net Interest	(1,204)	(1,609)	(1,152)	(1,193)	(785)	(181)
Other	(608)	(688)	2,374	2,044	(2,130)	0
Profit Before Tax (norm)	1,259	5,095	(720)	1,179	6,968	15,456
Profit Before Tax (FRS 3)	(5,014)	(23,648)	(5,159)	12,491	3,077	13,209
Tax	(793)	(299)	(1,858)	(2,641)	(2,605)	(3,698)
Deferred tax	8,285	(1,486)	39	6,666	(73)	0
Profit After Tax (norm)	466	4,796	(2,578)	(1,462)	4,362	11,757
Profit After Tax (FRS 3)	2,478	(25,433)	(6,978)	16,516	398	9,510
Average Number of Shares Outstanding (m)	117.3	121.2	131.3	131.7	132.3	132.3
EPS - normalised (€)	0.00	0.04	(0.02)	(0.01)	0.02	0.08
EPS - FRS 3 (€)	0.02	(0.21)	(0.05)	0.13	(0.01)	0.06
Dividend per share (€)	0.00	0.00	0.00	0.00	0.00	0.00
Gross Margin (%)	35.6	36.3	32.8	29.8	33.8	35.8
EBITDA Margin (%)	10.4	15.5	4.6	7.4	12.0	13.9
Operating Margin (before GW and except.) (%)	3.5	8.6	-2.2	0.3	6.2	8.7
BALANCE SHEET						
Fixed Assets	137,323	104,854	99,300	121,598	115,458	111,950
Intangible Assets	105,608	79,962	75,025	70,802	64,435	62,188
Tangible Assets	27,181	24,239	24,045	38,334	37,413	36,152
Other	4,534	653	230	12,462	13,610	13,610
Current Assets	88,104	122,526	125,300	166,940	164,786	183,876
Stocks	2,445	2,358	3,111	3,133	5,206	5,697
Debtors	15,053	17,777	25,259	21,069	28,390	32,025
Cash	64,159	96,143	88,822	133,940	117,609	132,575
Other	6,447	6,248	8,108	8,798	13,580	13,580
Current Liabilities	(33,882)	(38,953)	(33,068)	(56,400)	(46,423)	(51,008)
Creditors	(20,659)	(21,731)	(19,705)	(42,187)	(32,078)	(36,663)
Short term borrowings	(13,223)	(17,222)	(13,363)	(14,213)	(14,345)	(14,345)
Long Term Liabilities	(38,998)	(29,460)	(33,149)	(45,044)	(49,199)	(50,312)
Long term borrowings	(4,178)	0	(8,186)	(8,730)	(8,278)	(8,278)
Other long term liabilities	(34,820)	(29,460)	(24,963)	(36,314)	(40,921)	(42,034)
Net Assets	152,547	158,967	158,383	187,094	184,621	194,506
CASH FLOW						
Operating Cash Flow	12,175	7,083	(3,701)	16,344	(5,737)	23,923
Net Interest	111	(237)	41	102	(578)	(181)
Tax	(329)	(190)	(137)	(792)	(661)	(683)
Capex	(10,129)	(4,607)	(5,282)	(11,496)	(8,708)	(8,092)
Acquisitions/disposals	(3,000)	(1,150)	(2,436)	37,114	0	0
Financing	701	32,398	658	1,971	5	0
Dividends	0	0	0	0	0	0
Other	0	(159)	(1,813)	(551)	(10)	0
Net Cash Flow	(471)	33,138	(12,670)	42,692	(15,689)	14,966
Opening net debt/(cash)	(46,895)	(46,758)	(78,921)	(67,273)	(110,997)	(94,986)
HP finance leases initiated	0	0	0	0	0	0
Exchange rate movements	(953)	501	(792)	(1,072)	(228)	0
Other	1,287	(1,477)	1,814	2,104	(94)	0
Closing net debt/(cash)	(46,758)	(78,920)	(67,273)	(110,997)	(94,986)	(109,952)

Source: Edison Investment Research, Evotec accounts. Note: *EBITDA is adjusted for changes in contingent considerations and income from bargain purchases.

Contact details	Revenue by geography (2015)
Manfred Eigen Campus Essener Bogen 7 22419 Hamburg Germany +49 (0) 40 560 810 www.evotec.com	

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: Enno Spillner

On 18 July 2016, Enno Spillner will join Evotec as the CFO. Most recently, he served as the chairman of the management board and the CEO/CFO of 4SC since April 2013 and the CFO since 2005. Before that he was head of finance and controlling at BioM, a German regional biotech venture fund.

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 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	(%)
Oetker Roland	12.98
Deutsche Asset Mgmt Invest Mbh	3.82
Allianz Se	2.98
Deutsche Bank Ag	2.75
BVF Inc	2.68
Allianz Global Investors	1.69
Dimensional Fund Advisors LP	1.01

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)

Frankfurt +49 (0)69 78 8076 960
Schumannstrasse 34b
60325 Frankfurt
Germany

London +44 (0)20 3077 5700
280 High Holborn
London, WC1V 7EE
United Kingdom

New York +1 646 653 7026
245 Park Avenue, 39th Floor
10167, New York
US

Sydney +61 (0)2 9258 1161
Level 25, Aurora Place
88 Phillip St, Sydney
NSW 2000, Australia

Wellington +64 (0)48 948 555
Level 15, 171 Featherston St
Wellington 6011
New Zealand