"An idea was formed in the early nine-ties to increase the throughput of drug discovery to match the genomics revolution. Industry leaders have come to rely on us, our fundamental technologies and dependable drug discovery solutions. We have adopted change as a constant ingredient to our business strategy, broadening our capabilities through innovations and acquisitions. Our future prosperity will be determined by anticipating the needs of our customers and building long-term value in drug discovery."

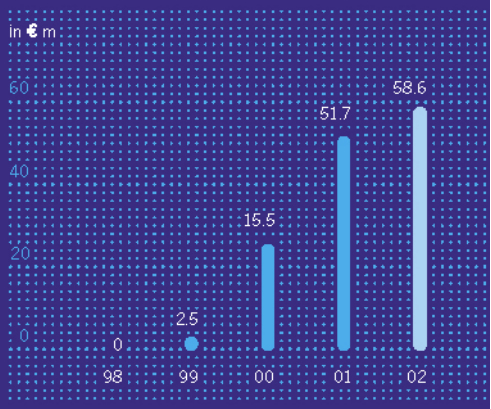
## Discovery and Development Services

> Evotec OAI's core business
> Drug discovery and development solutions from target to IND
> Truly integrated process platform covering biology, chemistry and screening
> Internal programmes in CNS|Alzheimer disease
> Strong customer network, often including milestone and royalty agreements

### Condensed key figures

| | | 2002 |
|---|---|---|
| Revenue | T€ | 58,588 |
| Share of total revenue | % | 83.7 |
| Operating result | T€ | (133,373) |
| Operating result adjusted for non-cash amortisation and impairment | T€ | (12,426) |
| R&D expenses | T€ | 15,213 |
| Depreciation | T€ | 10,558 |
| Number of employees as of 31 December without corporate overhead | | 458 |

### Revenue



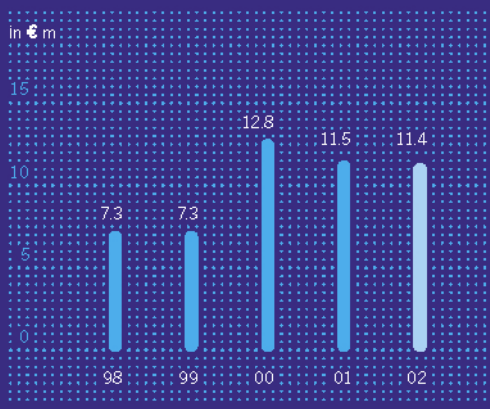

## Tools and Technologies

> Instrument and technology provider for drug discovery, diagnostics and life science research
> Separate and focussed unit with independent management team
> EVOscreen® established as industry standard for miniaturised uHTS
> Promising new product line of bench-top instrumentation
> Pfizer to become first equity partner in 2003

### Condensed key figures

| | | 2002 |
|---|---|---|
| Revenue | T€ | 11,407 |
| Share of total revenue | % | 16.3 |
| Operating result | T€ | (2,139) |
| R&D expenses | T€ | 7,799 |
| Depreciation | T€ | 547 |
| Number of employees as of 31 December without corporate overhead | | 88 |

### Revenue



The partner of choice for drug discovery and development services
> broad and stable network of over 120 customers

Continued strong growth in discovery chemistry and biology services
> overall service revenues +13%, even in a challenging environment

Integrated Target-to-IND platform broadened and further refined
> ability to keep pace with and adjust to new market opportunities

Clear strategic focus on drug discovery
> Evotec Technologies unit spun out and growing

Strict cash management and cost reduction measures implemented
> solid cash position of € 21 m at year end

Solid order book with 73% of expected 2003 revenues covered (as of February 2003)
> on track to reach positive EBITDA in 2003

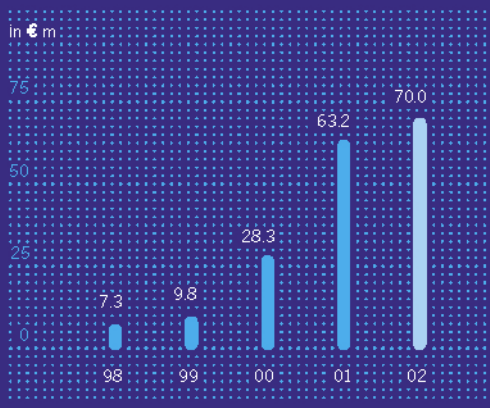
## Condensed key figures

| Evotec OAI AG | Page | | 2001 | 2002 | Δ 02\|01 in % |
|---|---|---|---|---|---|
| **Results** | | | | | |
| Revenue | 28 | T€ | 63,225 | 69,995 | 10.7 |
| R&D expenses | 44 | T€ | 23,012 | 23,012 | – |
| Operating loss [1] | 28 | T€ | 12,294 | 14,105 | 14.7 |
| Net loss | 30 | T€ | 147,750 | 131,630 | (10.9) |
| EBITDA | 30 | T€ | (1,011) | (2,221) | (119.7) |
| Cash flow | 30 | T€ | (12,733) | 5,313 | 141.7 |
| **Balance sheet data** | | | | | |
| Stockholders' equity | 31 | T€ | 347,591 | 195,407 | (43.8) |
| Capital expenditure [2] | 31 | T€ | 17,531 | 7,327 | (58.2) |
| Cash including marketable securities | 30 | T€ | 27,833 | 21,308 | (23.4) |
| Balance sheet total | 31 | T€ | 394,617 | 241,042 | (38.9) |
| **Personnel data** | | | | | |
| Employees as at 31 Dec. | 47 | | 585 | 635 | 8.6 |
| **Per share** | | | | | |
| Result | 30 | € | (4.17) | (3.71) | 11.0 |

1) before amortisation and impairment
2) purchase of fixed and intangible assets, excluding capital leases

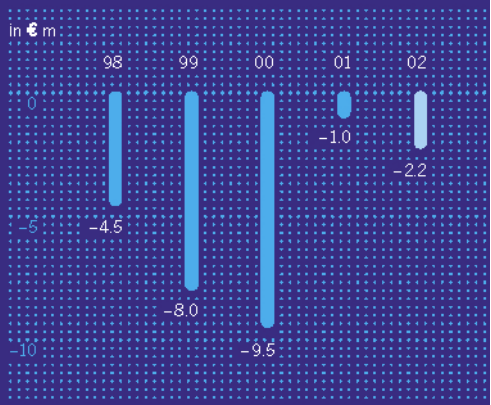
### Revenue

Solid growth in a challenging market environment



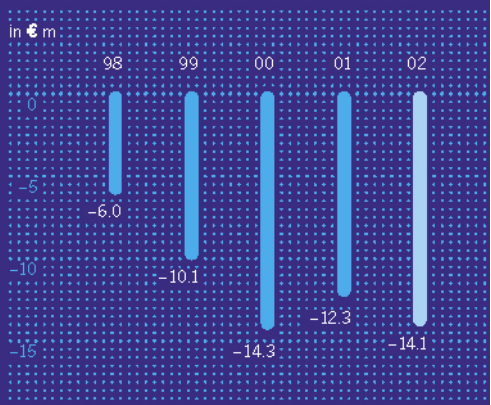

### EBITDA

Again close to break-even




### Operating result [1]

Changes in sales mix affect gross margin



Evotec OAI has established itself as the partner of choice for drug discovery and development services for the world's premier pharmaceutical and biotechnology companies, maintaining its leadership role through innovation and unmatched customer service.

Our business strategy is clearly focussed on drug discovery. We have established the most comprehensive technology platform and skills that integrate our world-class biology and chemistry capabilities. We leverage this discovery engine in providing assay development and screening through to compound optimisation and drug manufacturing services to a broad and stable network of customers. In addition, we engage in selected discovery programmes ourselves to develop drug candidates for out-licencing. Our instrument and technology business is now successfully handled by our affiliate, Evotec Technologies.

With over 600 people in Hamburg, Germany, and Abingdon, UK, Evotec OAI is dedicated to return value to its shareholders and employees through a sustainable business strategy that balances short-term and long-term revenue opportunities.











Joern Aldag
Chief Executive Officer and President

Dr Timm-H. Jessen
Chief Scientific Officer

## To our shareholders

Evotec OAI has clearly established its position as the partner of choice for drug discovery and development services. Since our last annual report we:

> delivered a number of exciting drug molecules for preclinical validation to our partners;
> established new or expanded partnerships with more than 100 customers;
> expanded our relationship with Pfizer, the largest pharmaceutical company in the world, under a new three year agreement; and
> validated the power of our discovery platform with the announcement of a clinical milestone with our customer, Vertex.

**We recorded a 11% growth in revenues and significantly reduced our cash burn rate.**

On the financial front we were able to record an 11% growth in revenues and we ended the year with a significantly reduced cash burn rate and € 21 m in the bank. We are now on track to meet our goal of reaching positive EBITDA in 2003. The challenging financial markets may have slowed our growth momentum, but not our focus. The crash of the financial markets and the declining investor appetite for risky and long-term pharmaceutical research projects, as customary in the biotech industry, reduced the pace of research for a number of our biotech customers. In addition, increased earnings pressures driven by patent expirations and reduced output of new medicines, led big pharmaceutical companies to review their research strategies. Both of these developments led to a decline in our growth rate, primarily through significantly longer lead times in closing new deals. However, despite this environment we achieved revenue growth and have managed to stay focussed on meeting our customer needs through strategic change and innovation.


Dr Dirk H. Ehlers
Chief Financial Officer

Dr Ian M. Hunneyball
President, Services Devision

**Or broad technology platform capabilities increase the efficiency of drug discovery and hedge the risk of compound failures.**

**Quality discovery platform.** Operationally we have made great progress. We established and validated our truly integrated platform by delivering excellent performance in our numerous services to over 120 customers worldwide. Through our internal research activities, we added additional proprietary technologies that complement our platform, with the goal to further enhance the selection process for promising compounds earlier in the discovery phase of drug development projects. Our broad platform capabilities reduce the cost of drug discovery and hedge the risk of compound failures later on in the pharmaceutical development process.

**Our growing expertise and established track record in drug discovery will allow us to concentrate on more extended collaborations.**

**Constant change.** These capabilities have helped us to finalise several integrated Target-to-IND service contracts, which comprise the full breadth of our compound screening and chemical optimisation activities. We can now take on internal discovery programmes with more favourable risk|return ratios than previously possible. As a first step, we expanded our promising target identification and validation programme for Alzheimer's disease within our subsidiary, Evotec Neurosciences. At the same time, we reduced the focus on our tools and technologies business by completing the spin out of Evotec Technologies GmbH in 2002, thus creating a separate legal entity with independent management. These changes in concert with our growing expertise and track record in drug discovery will enable us to enter into more extended collaborations with the pharmaceutical industry in the coming years.

**A healthy cash position of € 21 m and our measures to save cost and adapt capacity make us confident to grow our core businesses without requiring a capital increase through the stock exchange.**

**Stable financial developments.** Considering the difficult environment, we are pleased with our revenue growth, which rose from € 63.2 m in 2001 to € 70.0 m, an 11% increase over last year. However, due to the contracting markets and reduced spending in the industry, a few important orders for our development chemistry services slipped into 2003, which led to a sizeable under-utilisation of our new pilot plant. This and other effects, such as a changed sales mix, translated into a gross profit slightly lower than in 2001. In consequence, we initiated various cost saving measures in 2002. We also shifted the focus of the R&D capacity in Evotec Technologies from consortium technology developments to the commercial launch of instruments. We finished the year with a liquidity position of € 21 m, only € 7 m lower than the previous year and significantly higher than expectations. Based on our cash position, a strong pipeline of new contracts and our efforts to reduce cost and manage capacity, we remain confident that we can continue to expand our core businesses without requiring a capital increase through the stock exchange.

**Our most valuable asset is our unmatched network of customers and new innovative partnerships.**

**Long-term customer relationships.** Our most valuable business asset is our unmatched network of customers. We continue to work for virtually all of the leading pharmaceutical and biotechnology companies, and in the past year, we added several new clients and many contract expansions. A perfect example of this network is the October 2002 extension of our multi-year technology and assay development collaboration with Pfizer, which has a financial value of about € 25 m. Around the same time, we signed an innovative three-year umbrella agreement with Oxford Bioscience Partners (OBP), a U.S. venture capital firm, giving us a strong head start as the preferred supplier and discovery partner to many of OBP's portfolio companies. The arrangement encourages this group of venture-stage companies to outsource activities that lie outside of their core expertise rather than build in-house discovery capabilities. Furthermore, the quality and value of our contract research is demonstrated by our ability to attain success based milestone payments and potential royalties. At year-end, we achieved the first clinical milestone in our collaboration with Vertex which triggered a milestone payment. We are quite proud of the progress we have achieved with this leading biotechnology company.

**For 2003, we planned 10% to 15% growth over 2002, with 73% of expected 2003 revenues already secured through contracts.**

**Outlook for 2003.** Looking ahead to 2003, we are fundamentally well positioned, having built the critical mass and capabilities that make us an attractive long-term partner to our current and prospective customers. Furthermore, the initiation of our internal discovery programmes will add a new quality of high-value pharmaceutical research collaborations. Overall, our order book is healthy; already 73% of the revenues expected for 2003 were secured through contracts as of February. We expect to achieve modest growth for the year of 10 to 15% over 2002; however, we still believe that a longer term trend of 20 to 30% revenue growth is feasible once the markets recover. We are confident that we will continue to deliver on our business strategy to be the partner of choice to the drug discovery industry.

We thank our shareholders, customers and our staff for their loyalty, collaborative spirit and professional realism during the past year. Together, even in this adverse environment, we managed to achieve significant progress in many respects. With your continued support, we look forward to a successful year in 2003.

Joern Aldag
Chief Executive Officer and President

Dr Dirk H. Ehlers
Chief Financial Officer

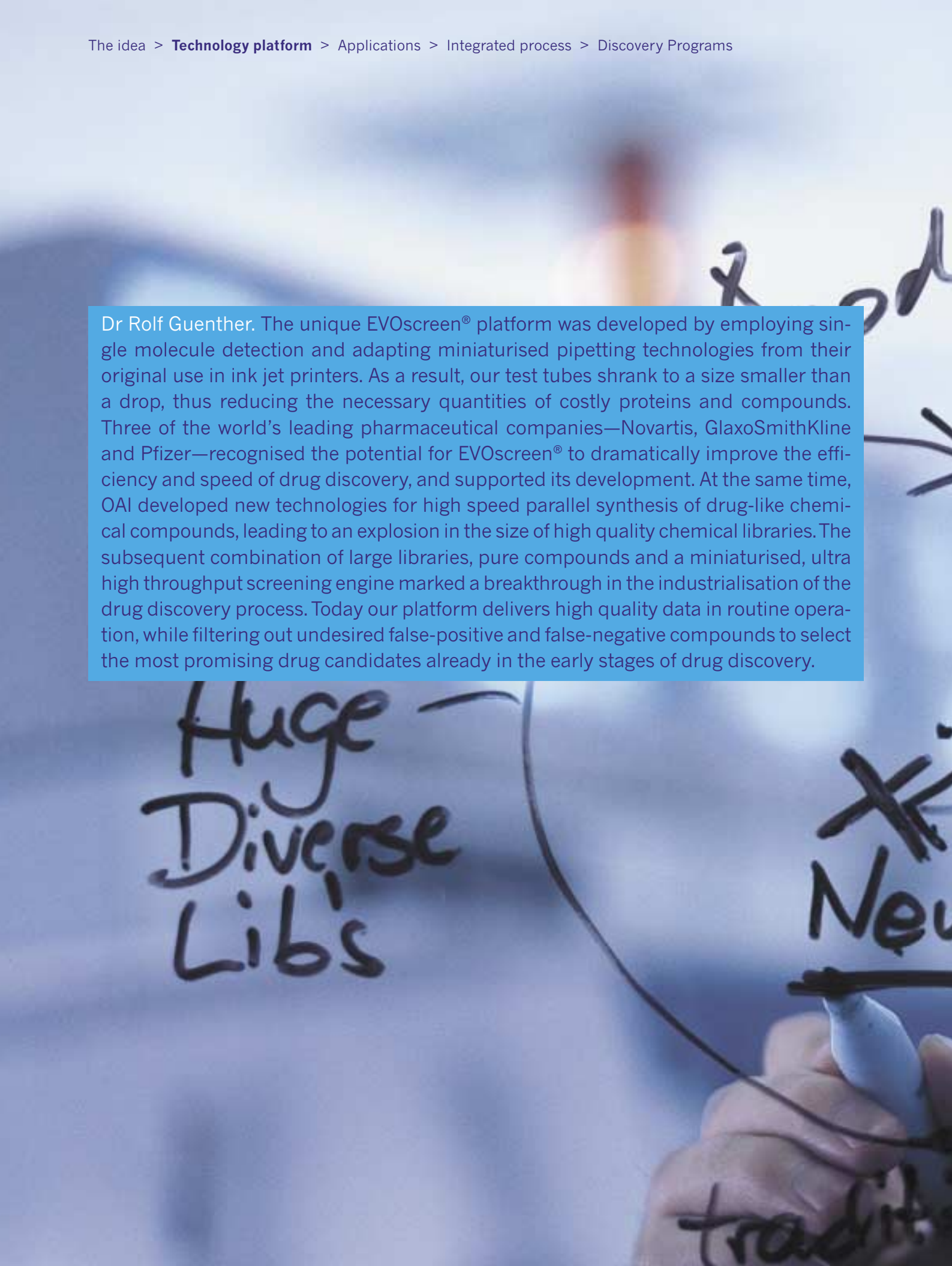
Dr Ian M. Hunneyball
President, Services Division

Dr Timm-H. Jessen
Chief Scientific Officer

# Our strategy

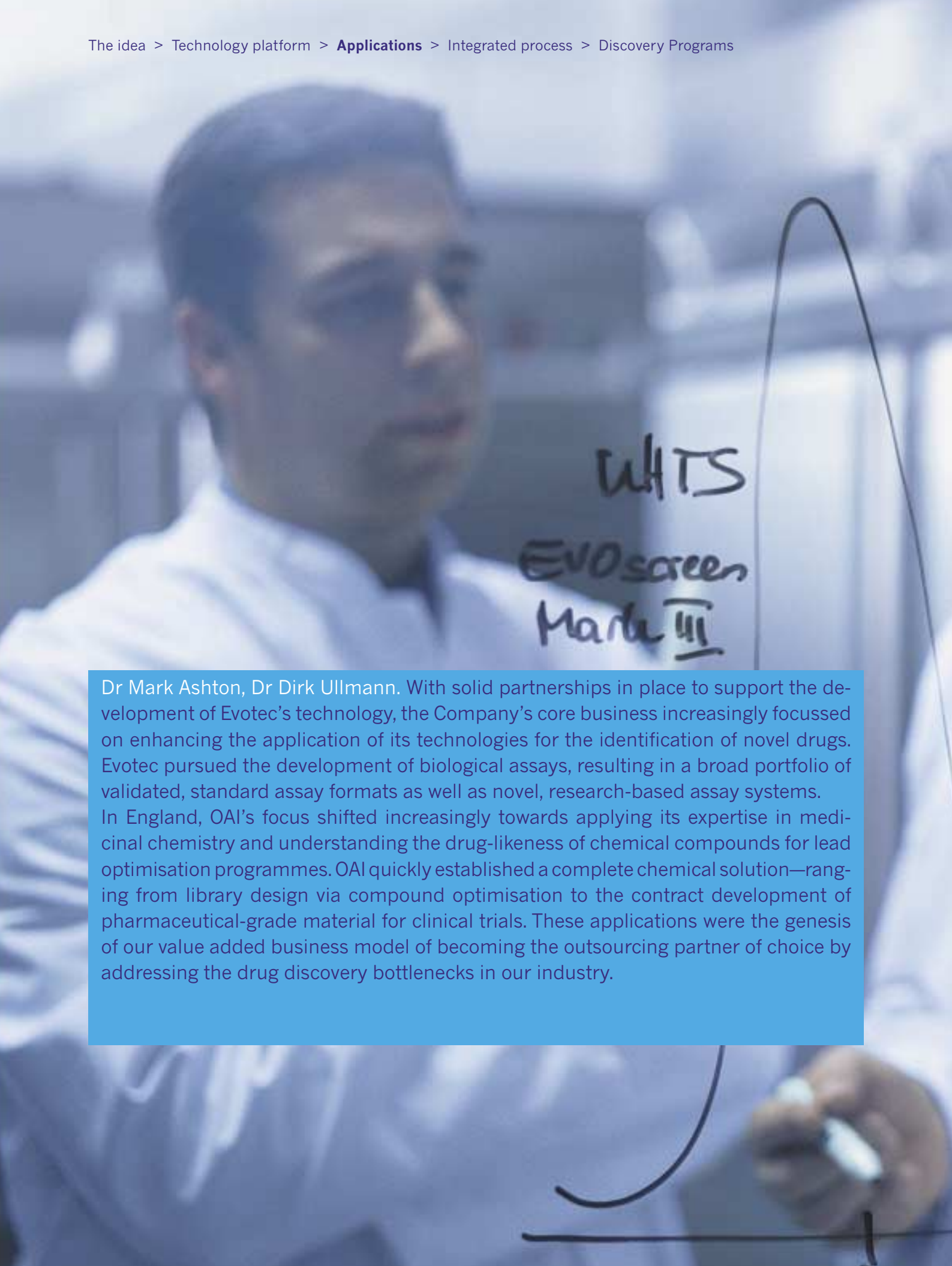

Dr Edwin Moses, Dr Karsten Henco. Evotec BioSystems was founded in '93 in Hamburg, Germany, to commercialise novel technologies (FCS) for the detection of compound | protein interactions at the molecular level. Initially, Evotec sought to apply FCS and methods of directed evolution to optimise the functional properties of biomolecules. However, it was quickly recognised that FCS was ideally suited for screening large numbers of molecules to identify new drug candidates. The scientific horizon at the time promised a flood of new targets from the Human Genome Project and a wealth of novel compounds from advances in combinatorial chemistry. These emerging opportunities formed the starting point for the development of our successful EVOscreen® platform. The initial application of FCS for directed evolution is pursued today within Direvo, an independent affiliate of Evotec. In England, Oxford Asymmetry Int. (OAI) was founded in '92 to perform high performance chemistry with an emphasis on stereo-specific chemistry to provide chiral compounds to its customers. As the needs of OAI's growing customer base began to shift, OAI expanded its scope to include a new subject of even greater value, the synthesis of high quality compound libraries with drug like properties.


OA1
libraries
clinical
non-clinical

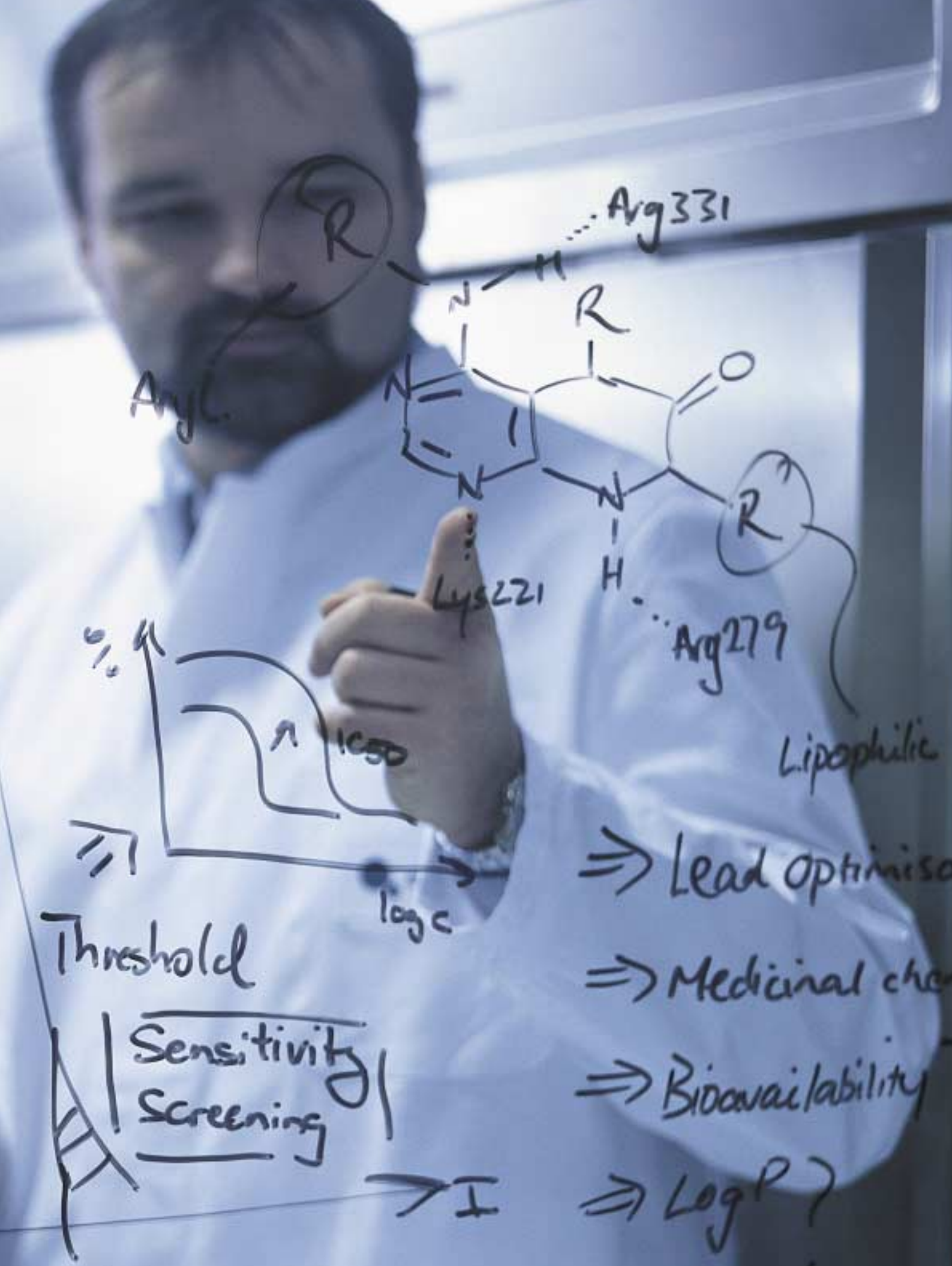



Dr Rolf Guenther. The unique EVOscreen® platform was developed by employing single molecule detection and adapting miniaturised pipetting technologies from their original use in ink jet printers. As a result, our test tubes shrank to a size smaller than a drop, thus reducing the necessary quantities of costly proteins and compounds. Three of the world's leading pharmaceutical companies—Novartis, GlaxoSmithKline and Pfizer—recognised the potential for EVOscreen® to dramatically improve the efficiency and speed of drug discovery, and supported its development. At the same time, OAI developed new technologies for high speed parallel synthesis of drug-like chemical compounds, leading to an explosion in the size of high quality chemical libraries. The subsequent combination of large libraries, pure compounds and a miniaturised, ultra high throughput screening engine marked a breakthrough in the industrialisation of the drug discovery process. Today our platform delivers high quality data in routine operation, while filtering out undesired false-positive and false-negative compounds to select the most promising drug candidates already in the early stages of drug discovery.


too many weak cands.
better screen tech
Drug!




Dr Mark Ashton, Dr Dirk Ullmann. With solid partnerships in place to support the development of Evotec's technology, the Company's core business increasingly focussed on enhancing the application of its technologies for the identification of novel drugs. Evotec pursued the development of biological assays, resulting in a broad portfolio of validated, standard assay formats as well as novel, research-based assay systems.
In England, OAI's focus shifted increasingly towards applying its expertise in medicinal chemistry and understanding the drug-likeness of chemical compounds for lead optimisation programmes. OAI quickly established a complete chemical solution—ranging from library design via compound optimisation to the contract development of pharmaceutical-grade material for clinical trials. These applications were the genesis of our value added business model of becoming the outsourcing partner of choice by addressing the drug discovery bottlenecks in our industry.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DISCOVERY
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L2C
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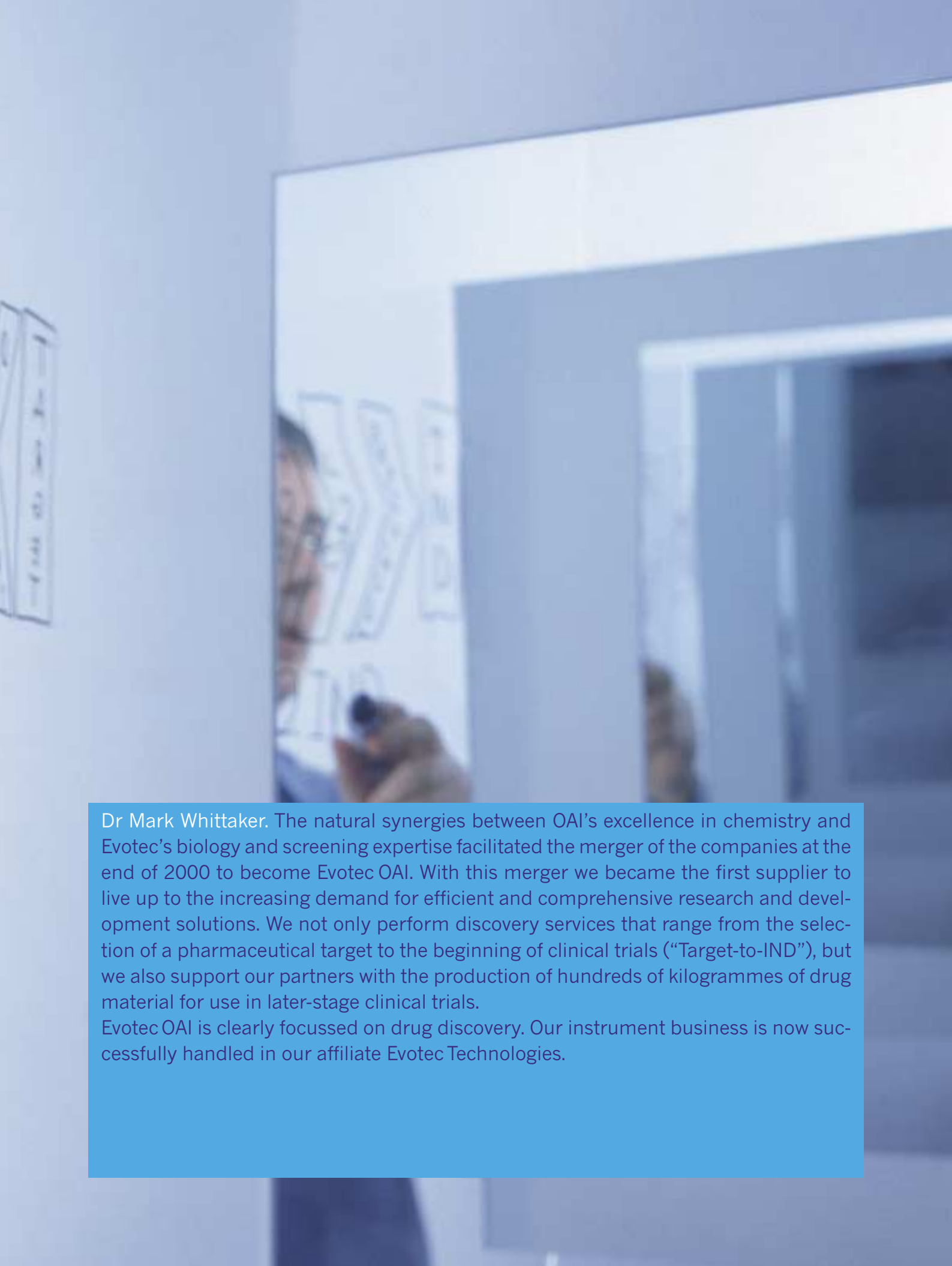
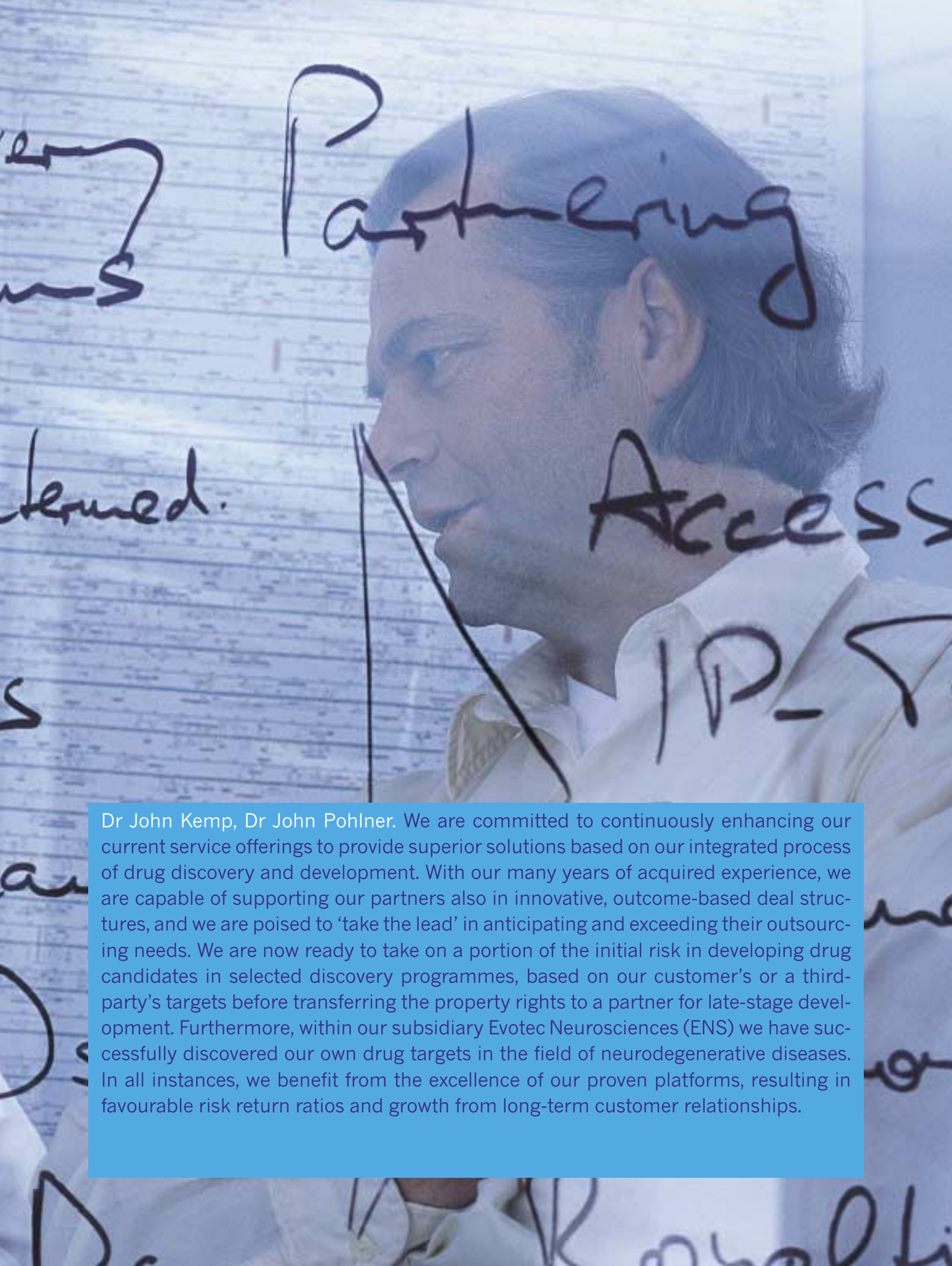
IND
T2IND



Dr Mark Whittaker. The natural synergies between OAI's excellence in chemistry and Evotec's biology and screening expertise facilitated the merger of the companies at the end of 2000 to become Evotec OAI. With this merger we became the first supplier to live up to the increasing demand for efficient and comprehensive research and development solutions. We not only perform discovery services that range from the selection of a pharmaceutical target to the beginning of clinical trials ("Target-to-IND"), but we also support our partners with the production of hundreds of kilogrammes of drug material for use in later-stage clinical trials.
Evotec OAI is clearly focussed on drug discovery. Our instrument business is now successfully handled in our affiliate Evotec Technologies.


Targets
Drug




Dr John Kemp, Dr John Pohlner. We are committed to continuously enhancing our current service offerings to provide superior solutions based on our integrated process of drug discovery and development. With our many years of acquired experience, we are capable of supporting our partners also in innovative, outcome-based deal structures, and we are poised to 'take the lead' in anticipating and exceeding their outsourcing needs. We are now ready to take on a portion of the initial risk in developing drug candidates in selected discovery programmes, based on our customer's or a third-party's targets before transferring the property rights to a partner for late-stage development. Furthermore, within our subsidiary Evotec Neurosciences (ENS) we have successfully discovered our own drug targets in the field of neurodegenerative diseases. In all instances, we benefit from the excellence of our proven platforms, resulting in favourable risk return ratios and growth from long-term customer relationships.

In the 10 year history of our Company, there has been one important constant: Change. The continued success of Evotec OAI is rooted in our ability to apply fast decision making and flexibility to keep pace with the changing business environment, whether to support the evolving needs of our customers' pharmaceutical research or to adapt to the fluctuations in market conditions.

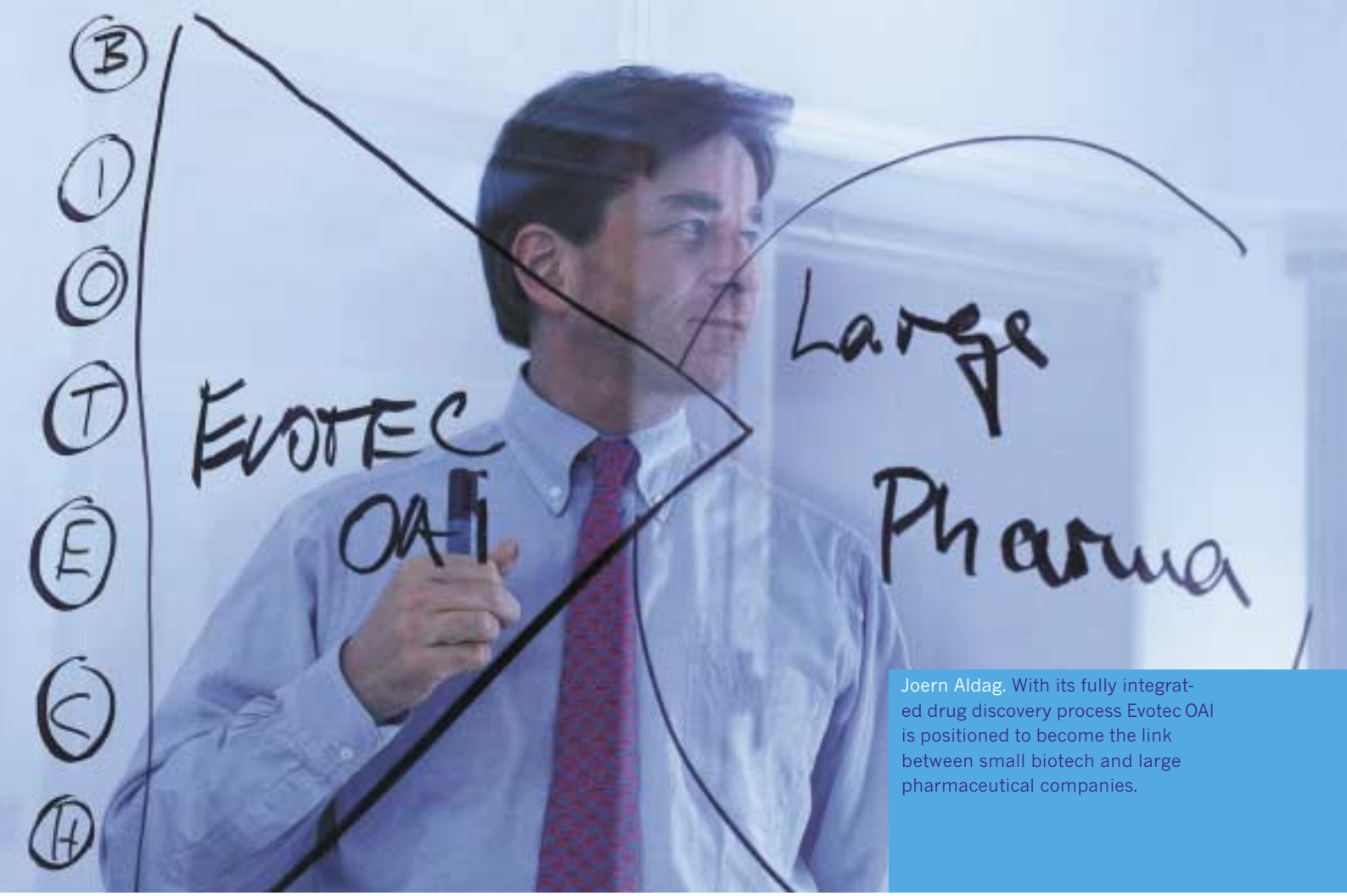
**In order to reverse the rapid decline in new drugs reaching the market, our industry requires creative new ways for improving drug research.**

**The target-rich biotechnology companies will need Evotec OAI's drug discovery capabilities to quickly provide proof of concept for their products.**

**Change as a constant.** The increasing drive to stay competitive through the discovery and development of new drugs has led our traditional customers, big pharmaceutical companies, to create larger entities through mergers and acquisitions. However, the simple fact is that increasing size will not necessarily help to boost R&D output. In order to reverse the rapid decline in new drugs reaching market, our industry requires creative new ways for improving drug research productivity. Evotec OAI is partnering with the world's leading pharmaceutical companies through our integrated offering of innovative solutions for drug discovery, from target to IND and beyond.
Furthermore, in the past 5 years a new set of customers has emerged. The field of biotechnology is rapidly expanding with numerous companies focussed on creating a wealth of new targets—receptors or pathways—which are instrumental in a disease. These target-rich biotechnology companies will need to quickly provide proof of concept by demonstrating the efficacy of their targets in man. Because many biotechnology companies must operate on limited cash resources, it is not feasible for them to spend cash on building expensive discovery infrastructures. Evotec OAI is quickly becoming the partner of choice for the biotechnology industry through our proven ability to find new drugs that act on these targets in a wide range of disease indications.
At Evotec OAI, we are of the fundamental belief that the future will bring about more change. We have always focussed on supporting our customers in developing drug candidates with a higher probability of success by solving new technological challenges, providing innovative drug discovery solutions and creating an integrated platform designed to develop drug candidates more quickly and efficiently.

**Becoming the leading provider of discovery solutions.** Evotec OAI has built one of the strongest brand names in the industry. Our cutting edge and often proprietary technologies together with a passion for "getting things done fast" has made us an excellent discovery engine for the life science industry: integrated, innovative, dedicated to quality, reliable and fast. Our path to the future is clear: We are striving to become the world's leading provider of drug candidates with proof of concept in man by providing support to our customer's internal research efforts through service partnerships and by delivering chemical compounds from our own internal or joint initiatives in selected fields.

**Operating through two core divisions: Discovery and Development Services and Discovery Programs Division.** Our goal in Discovery and Development Services (DDS) is to become the leading integrated supporter of research activities for our partners. Low productivity in the pharmaceutical industry, measured in New Chemical Entities (NCEs), and the need for target-rich bio-




Joern Aldag. With its fully integrated drug discovery process Evotec OAI is positioned to become the link between small biotech and large pharmaceutical companies.

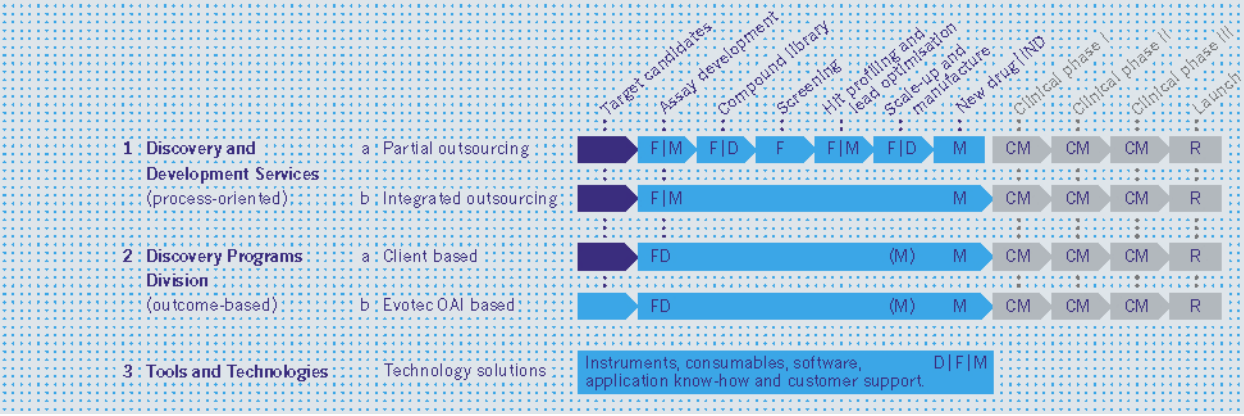
**We are striving to become the leading provider of proof of concept drugs by providing pure services or drug candidates identified by our own initiatives.**

technology companies to access cutting edge screening and chemistry expertise and infrastructure, continue to provide enormous growth opportunities. In 2002, growth for the overall DDS business was 13%, while within this unit discovery biology and chemistry services continued to grow significantly faster. We believe that our DDS division has the potential to grow in the medium term by 20 to 30% per year in a normal market environment.

Our Discovery Programs Division (DPD), since 2003 a seperate division, engages in selected discovery activities to develop compounds for out-licencing. This division enables us to benefit from the increasing trend by pharmaceutical companies to strengthen their pipelines through the acquisition of intermediary products such as qualified leads, pre-clinical development candidates, INDs and ultimately drug compounds with proof of concept demonstrated in man. The strategic objective of this activity is to generate proprietary intellectual property that can provide Evotec OAI with additional long-term upside through more significant milestones and royalties. Operationally, DPD contracts such discovery research to the DDS division as required, utilising the same high performance platform, and therefore combining our disease specific know how with the strongest discovery platform available.

We established a fully integrated DPD programme in the field of Alzheimer's disease, including pathophysiological models and access to patients for clinical material and early proof in man. This research is executed through our subsidiary Evotec Neuroscience GmbH in collaboration with the University of Zurich. We have identified more than 100 genes associated with Alzheimer's disease and have progressed four of these targets into validation and assay development.

## Business model




**We will continue to build our service brand and focus on the opportunities prevailing in our market area.**

**Capitalising on industry opportunities.** The market environment continues to be challenging. However, as this is the case for all our competitors and other industry participants, we continue to build our service brand and focus on the opportunities prevailing in our market area. We are well positioned to:

> Grow our custom assay development and high quality medicinal chemistry services to meet the growing outsourcing demand;
> Focus on forging large, lasting collaborations, thus effectively establishing ourselves as a first tier supplier with critical mass and a proven track record;
> Support biotechnology companies unable|unwilling to sustain a "do-it alone model" through outsourced services and innovative preferred provider programmes such as our partnership with Oxford Biosciences Partners (see "Our partners", page 25);
> Expand our pharmaceutical customer contracts into more integrated, results-oriented services from Target-to-IND; and
> Integrate targets from other biotechnology companies into joint development programmes with big pharma.

**Concentrating on our core business.** As of January 1, 2002, we spun our instrumentation business out into a separate legal entity, Evotec Technologies GmbH. The objective was to down scale the activity of technology development to eliminate any cash burden on the core business, to make Evotec Technologies profitable, to build strategic partnerships and, ultimately, to focus Evotec OAI on drug discovery and development. We are prepared to reduce our share to a minority financial interest, as long as we can maintain existing synergies between this technology group and our own DDS and DPD units.

**We have made the necessary adjustments to remain independent of stock markets, even if markets remain weak in 2003.**

**Prepared for continued growth.** We are prepared if capital markets remain weak in 2003 and short-term earnings pressures leave the outsourcing markets vulnerable. We have also made the necessary corporate adjustments to continue to grow our core business without a capital increase through the stock exchange. Our financial strategy is primarily based on cash revenues from our customers. Cash requirements from our Discovery Programs Division can be pro-actively managed as they depend predominantly on the number of programmes that we decide to progress. Short-term cash requirements for working capital or asset backed financing for the expansion of our facilities are secured, and we continue to reduce costs not covered by customer contracts. We have done well strategically in 2002, albeit in a negative environment with reduced growth rates, and we will continue to grow the Company strategically while managing our resources prudently. We are among the best partners for pharmaceutical and biotechnology companies today. Our fully integrated and comprehensive platform, world-class scientists, critical mass and the broadest portfolio of clients are the assets that will lead us to continued success.

# Our partners

Evotec OAI's integrated Target-to-IND platform is unsurpassed in the industry, in terms of technologies, know-how, critical mass and track record for delivery of high quality research results. The quality and breadth of our services has afforded us one of the broadest and most stable set of business relationships. During the year, we continued to deliver excellent results in existing programmes with pharmaceutical companies and large biotech partners and we expanded our customer base with more than 40 new clients. This solid performance plus the achievement of our first clinical milestone in a customer project validates the quality of our services.

**We enjoy long-term relationships with our customers, with almost half of them expanding their partnership with us in 2002.**

**Long-lasting customer relationships.** Large biotechnology and pharmaceutical companies use our skills to develop drug candidates more quickly and efficiently. We enjoy long-term relationships with many of our customers, with almost half of them expanding their partnership with us in 2002.

Discovery chemistry agreements, in which companies access several man-years of dedicated expert chemistry resources, are one of our strongest business assets. In 2002, we continued to collaborate in numerous long-lasting focussed library, medicinal chemistry and lead optimisation projects with leading companies like **Amgen**, **Vertex**, **Pharmacia**, **Roche**, **Serono**, **Solvay** and **Curis**. Several of these partnerships have been extended far into 2003 and beyond. In April, we extended our original one-year discovery chemistry agreement with **Roche** for an additional two years, following a highly successful collaboration during 2001|2. In November, we signed a one-year extension of our focussed library agreement with **Solvay Pharmaceuticals**. Back in 2001, we extended our 1998 contract with **Pharmacia Corporation** for another four years. Applying our world class expertise in high-speed and computational chemistry, we design and synthesise collections of small, drug-like molecules around selected customer templates in all these collaborations, which will be used in target screens to identify novel drug candidates.

At the end of 2001, we started a multi-year chemical library agreement with **Merck & Co.**—one of the most significant collaborations for Evotec OAI to date. During 2002, we synthesised several custom libraries which have been approved and delivered to Merck.

**We have continued to successfully work on several assay development contracts with leading pharmaceutical companies.**

We continued our close biology services relationship with **Pfizer**. Together we developed a new assay principle for Ser|Thr-assays based on a patent both companies jointly filed in August 2000. As a result, Pfizer commissioned Evotec OAI to work on several of Pfizer's kinase assays, among others. In addition, we successfully completed our substantial assay development and screening contract with **Knoll|Abbott Laboratories**. Over the past few years, we have developed numerous assays for different target classes and screened far more than 1 million compounds to identify novel and potent drug candidates.

## Alliance partners

AMGEN · VERTEX · PHARMACIA · Roche · serono biotech & beyond

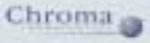
Solvay Pharmaceuticals · CURIS · MSD · Pfizer · Abbott Laboratories

ucb · ALIZYME · Celgene · ACHILLION Pharmaceuticals, Inc. · AstraZeneca


Cony D'Cruz. OBP selected us as a partner because our integrated biological and chemical services are capable of aiding their portfolio companies with a comprehensive range of activities from early stage discovery right through to chemical development.

In development chemistry, we have maintained strong relationships with key customers such as **Pfizer**, **UCB**, **Alizyme**, **Celgene** and **Achillion**, focussing increasingly on quick turnaround syntheses for big pharmaceutical companies. We are proud to have been awarded preferred supplier status with **AstraZeneca**, which attests to our high quality and reliability and has resulted in repeat business.

## Alliance partners




**The three-year extension of our long-term partnership with Pfizer is a strong validation of our expertise.**

One of Evotec OAI's most significant highlights in 2002 was the expansion of our long-term partnership with **Pfizer**, extending the contract for another three years. As part of this transaction, Pfizer acquires a 10% stake in Evotec Technologies GmbH (ET) and becomes the first equity partner for this technology company. A potential contract value in excess of $ 25 million makes this deal extension significantly larger than the original agreement signed in 1999—a strong validation for our scientific concepts and technological platforms. We will transfer our newly developed Mark III platform as well as assay development devices to Pfizer's research sites. In addition, we will dedicate over 20 man-years to extend the capabilities of the EVOscreen® platform as well as to develop fluorescence-based biochemical and cellular assays, customised to service Pfizer's internal drug discovery programmes.
The excellent performance of our screening technology is also being very favourably received by our additional technology development partners. EVOscreen® Mark III was successfully installed at **GlaxoSmithKline** during Q1 2002 and **Novartis** also acquired additional screening devices, exceeding the scope of the original contract signed in 1996.

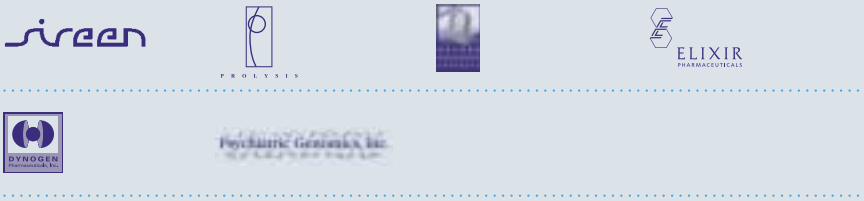
**Our ever-increasing skills in medicinal and computational chemistry as well as in ADMET services has attracted a large number of new customers.**

**Solid customer base with the addition of more than 40 new clients.** During the year we substantially expanded our customer base by signing over 40 new contracts with pharmaceutical and biotechnology companies from around the globe.
We continued to build our world class expertise in discovery chemistry by adding additional medicinal and computational chemistry capacity and skills. We further strengthened our already broad range of services with the integration of high-value ADMET services (see "R&D report", page 42). Our comprehensive drug discovery offerings have attracted a large number of new customers including **British Biotech**, **Avidex**, **Geltex**, **Point Therapeutics** and **Chroma Therapeutics**.

**In development chemistry we were able to penetrate the highly competitive market on the U.S. West Coast. We further built our biology services and expanded our market geographically with 12 new Japanese companies.**

In development chemistry we were able to penetrate the highly competitive market on the U.S. West Coast through relationships that include **Neurocrine** and **Amgen**. In 2002, we commenced building block synthesis for Amgen and both partnerships have resulted in repeat orders. In addition, we added the companies **Oxigene** and **Trommsdorf Pharma** to the list of customers utilising our development chemistry services.
We continued to build our biology services business, where Evotec OAI performs biology R&D, develops assays for selected targets and screens them against compounds from our clients' libraries or from our own corporate chemical library to identify active novel drug candidates. Five new customers, **Infinity**, **Taisho**, **U3**, **Oxagen** and **Key Neurotek**, are capitalising on our established biochemical and biology assets to complement their internal drug discovery efforts.

**Alliance partners**




In addition, we expanded our market geographically by establishing contracts with 12 new Japanese companies, including Taisho Pharmaceuticals, to focus on the discovery of ion channel targets and receptors.

**Multiple innovative partnerships with target-rich biotech companies are designed to create significant value for both parties.**

**Creative deal structures to establish long-term strategic relationships.** In 2002, we entered into multiple partnerships with target-rich biotech companies who needed services across the whole discovery process, from target to IND. In many cases, we were able to forge innovative deal structures that we believe will create substantial value for both parties through long-term relationships. These new agreements included joint ventures, preferred provider agreements and opportunities for Evotec OAI to become an equity partner in our customers, while at the same time receiving traditional cash-based cost compensation.
In March 2002, we entered into a three-year agreement with **SiREEN** and have started providing services along the entire Target-to-IND value chain. In addition to fees for services, Evotec OAI received an equity stake in SiREEN. As of year-end, the first screening campaigns have been successfully finalised and Hit-to-Lead programmes were under way.
In December 2002, Evotec OAI entered into a three-year drug discovery partnership with **Prolysis Ltd** in which we will receive fees for services as well as an equity stake in Prolysis. To search for new antibiotic drugs, we utilise our world-class biology, medicinal and computational chemistry skills to design and synthesise compounds against selected Prolysis targets. In this integrated biology and chemistry collaboration, Evotec OAI will optimise the drug-like and ADMET properties of the selected compounds using its cutting edge early ADMET platform.

**We combined the power of our biology and chemistry in a deal with OBP, in which we bridge the gap between target discovery and pharmacology for their portfolio companies.**

In November 2002, we combined the full power of our biology and chemistry offerings through a creative deal with **Oxford Bioscience Partners** (OBP), a prestigious Boston-based life sciences venture capital firm. Under the terms of the three-year agreement, OBP will promote Evotec OAI as a preferred provider of drug discovery and development services from target to IND to all OBP affiliates. These venture-stage companies will gain access to our dedicated resources that can be applied to a broad range of biology and|or chemical activities to accelerate the respective OBP affiliate's drug discovery programmes. In this way, the respective genomics|proteomics companies can focus their internal resources on the disease biology as a source of novel drug targets, while Evotec OAI helps to bridge the critical gap between target discovery and pharmacological validation. Later that November, **Elixir Pharmaceuticals** signed on as the first company to take advantage of the benefits of the OBP—Evotec OAI arrangement, followed by **Dynogen Pharmaceuticals** and **Psychiatric Genomics** early in 2003.

## Alliance partners

ALTANA Pharma AG

MediGene

**Achieving milestones—a true validation of our results-oriented services.** During the year, we achieved a number of drug discovery milestones that validate our ability to make significant high value contributions to the success of our partners' drug discovery programmes.

In our project with **ALTANA Pharma**, we contributed innovative tools to help our partner significantly reduce assay development times. To accomplish this, we successfully completed a new and complex assay programme using our novel cell analyser, Opera. In 2002, we achieved two milestones for the establishment and optimisation of assays for this programme.

In March 2002, Evotec OAI and **MediGene** successfully completed the screening of our corporate compound library against a MediGene target to identify new active compounds to treat cardiac diseases. Evotec OAI received a milestone payment for the successful identification of a series of compounds that are ready for optimisation.

We are particularly pleased that we achieved our first clinical milestone for the successful advancement into Phase I testing of a compound that we synthesised through a medicinal chemistry programme with **Vertex Pharmaceuticals**. In partnership with Vertex, the compound was jointly optimised by leveraging both companies' chemistry technologies to improve the drug-like properties of small molecule leads.

**We strongly believe that maturing long-term relationships are instrumental to our success.**

We strongly believe that maturing long-term relationships with our customers are instrumental to our success and we are well positioned to build on our achievements in 2003.

# Management report

# Status report 2002

Evotec OAI has reacted swiftly to the changing financial and business environment, putting us on track to positive EBITDA in 2003. Revenues reached € 70 m in 2002, an 11% increase over the previous year.

**Number of NMEs continued to decline. FDA approvals per year:**
**1998 = 30 NMEs**
**1999 = 35 NMEs**
**2000 = 27 NMEs**
**2001 = 24 NMEs**
**2002 = 18 NMEs**

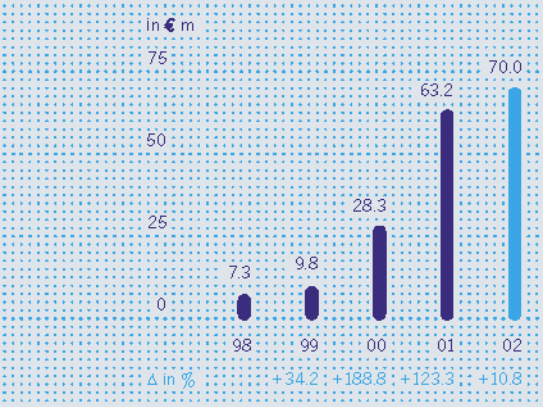
**Current industry status—pressure on traditional outsourcing.** 2002 was characterised as a challenging year throughout the biotechnology and pharmaceutical industries. Never before has the pharmaceutical industry experienced a sharp new product cycle downturn of similar proportions accompanied by a continuing decline of new molecular entities (NME) and an ever more aggressive generics industry. High margin pressure as well as lagging R&D productivity has prompted pharmaceutical companies to re-think their outsourcing strategies as well as their R&D approach.
The capital markets continued to decline even after the post-2000 bubble adjustment. These declines were fuelled by a series of corporate financial scandals, notably in the United States and Europe, eroding investors' trust and appetite for risky and long-term pharmaceutical research projects as is customary in the biotech industry. The lack of vibrant equity markets has caused fund-raising problems for small biotechnology companies, resulting in scale backs in R&D spending by a number of our customers. Both of these developments led to a decline in our growth rates in 2002.

**Our core Discovery and Development Services business continued to grow by 13%, even in a deteriorating market that began in Q3 2002.**

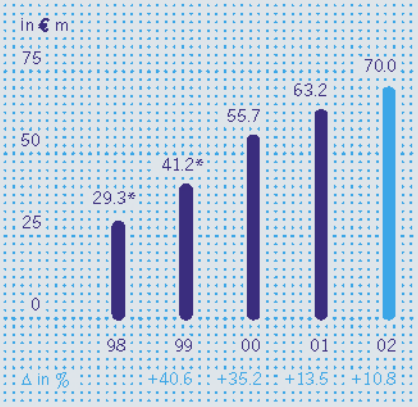
**2002 revenues—solid growth in a challenging market environment.** Total revenues of Evotec OAI increased by 11% to € 70.0 m (2001: € 63.2 m). While the growth rate for the first nine months was still in line with our target of 20% to 30% per year, the market environment began to deteriorate in the third quarter, increasingly affecting our customers. Biotech companies implemented delays in parts of their research and clinical development to conserve cash. Pharmaceutical companies became more restrictive on outsourcing as part of their tighter R&D budget management.
Our pilot plant and chemical process development services were affected by this trend. However, our core business, discovery chemistry and biology services, continued its healthy growth pattern. The stable performance of our Discovery and Development Services division resulted in revenues of € 58.6 m and growth of 13% compared to last year (2001: € 51.7 m).
Evotec OAI recognises a substantial amount of revenues in GB Pounds, which depreciated strongly against the Euro in 2002. If the exchange rates seen in 2001 were applied to 2002, revenues in 2002 would have been € 1.6 m higher.

**2002 operating results—changes in sales mix affect gross margin.** The 2002 operating loss amounted to € 135.5 m (2001: € 152.5 m). The improvement of 11% over the previous year is the combined effect of the discontinuaton of goodwill amortisation countered by the current year impairment of goodwill. Our operating loss before amortisation or impairment of goodwill and other intangible assets amounted to € 14.1 m (2001: € 12.3 m). This increase in loss was primarily a consequence of a different sales mix resulting in lower gross margins. Planned idle capacity costs of our new pilot plant contributed to the loss as well.

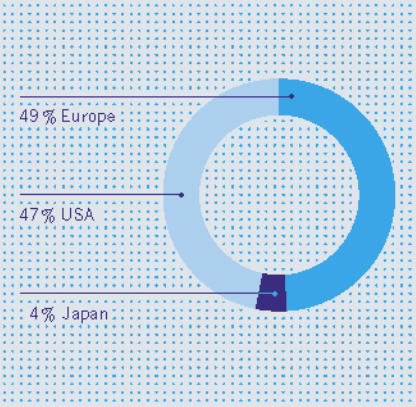
**Revenue**




**Pro-forma revenue**
(*unaudited)




**Revenue by regions**




With total cost of revenues of € 38.5 m (2001: € 33.3 m) and an increase of 16 % compared to last year, we realised a gross margin of 45 % (2001: 47 %). The decline was primarily impacted by a changed revenue mix:

> The high proportion of fixed cost in development chemistry, particularly in pilot plant services, together with the under-utilisation in 2002 have negatively impacted gross profit.

> In discovery chemistry, the mix of projects was weighted towards lower margin library contracts versus the higher margin medicinal chemistry projects.

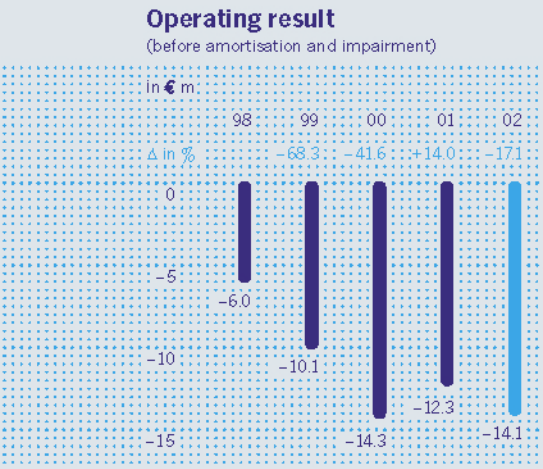
**As planned, R&D expenses remained about the same as last year, reflecting our strong commitment to focus on drug discovery.**

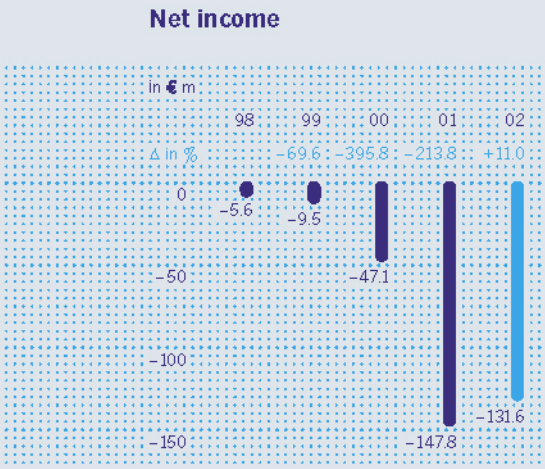
As planned, the Evotec OAI research and development (R&D) expenses remained at last year's level, amounting to € 23.0 m (2001: € 23.0 m). This reflects our continued strong commitment to the core R&D areas that we consider key to our long-term business success. These include the ongoing enhancement of our discovery service offerings as well as our drug discovery programme activities. On the other hand, we started to reduce headcount in the area of technology development. Following the successful completion of our EVOscreen® platform, this area will now only require a significantly lower level of R&D activity to support planned growth.

Selling, General and Administrative (SG&A) costs increased by 7 % to € 20.5 m (2001: € 19.2 m). This was primarily due to the expansion of our corporate and business development resources in 2001. In the third quarter of 2002, we took action to reduce SG&A expenses to reflect the current environment. Measures for both R&D and SG&A cuts did not have their full impact on overall 2002 results, but will more significantly influence 2003 spending.

**In light of the market developments and with the decline of our market capitalisation, we undertook a second impairment review in October, resulting in a non-cash impairment charge of € 109.4 m in Q4.**

**Goodwill amortisation | impairment—compliance with SFAS 142.** Evotec OAI adopted the new accounting standard SFAS No. 142, "Goodwill and Other Intangible Assets" as of 1 January 2002. This rule requires that our goodwill (and other intangible assets with indefinite useful lives), primarily created in the merger with Oxford Asymmetry International (OAI), may no longer be amortised, but tested for impairment at least once a year. At a first review of our goodwill as of 1 January 2002, we saw no indication for an impairment charge. In addition to the January test, SFAS 142 requires that a date be decided during the year on which all future impairment tests will be performed. In light of the developments in the financial and customer markets and with the decline of our market capitalisation, we decided to perform a second impairment review as of 31 October 2002. This prudent review resulted in a non-cash impairment charge of € 109.4 m in Q4 2002. This is less then the goodwill amortisation which we would have accounted for under the rules prior to the changes of U.S. GAAP literature, when we amortised goodwill over a three year period, incurring annually € 127.6 m goodwill amortisation. Additionally we will continue to amortise the other merger-related intangible assets over three to five years, totalling annually including other intangibles to € 12.0 m amortisation charge.




As of 31 December 2002, we had already amortised and impaired 71% of the original value of goodwill and other merger-related intangible assets resulting primarily from the merger with OAI. Fundamentally, the overall business objectives and synergies we targeted with the acquisition of OAI have been achieved as planned.

**The reduction in net loss was mainly a consequence of lower goodwill adjustments. Non-operating income and taxes also contributed positively.**

**2002 net loss—only slight improvement.** Net loss for the year, including the non-cash effects relating to the impairment of goodwill and other intangible assets, improved to € 131.6 m (2001: € 147.8 m). This reduction was again mainly a consequence of lower goodwill impairment compared to the previous year's goodwill amortisation. Non-operating income of € 1.1 m as well as tax treatment positively contributed to a reduced net loss. We reported € 2.8 m net tax benefits in 2002, resulting from € 3.2 m deferred tax benefits from the amortisation of developed technology and customer list and € 0.2 m deferred tax expenses in the UK as well as € 0.2 m current taxes worldwide.
The loss per share was € 3.71 (2001: € 4.17). The weighted average number of shares used in calculating basic earnings per share (EPS) was increased from 35,455,457 to 35,509,285 as a result of the exercise of stock options by employees.

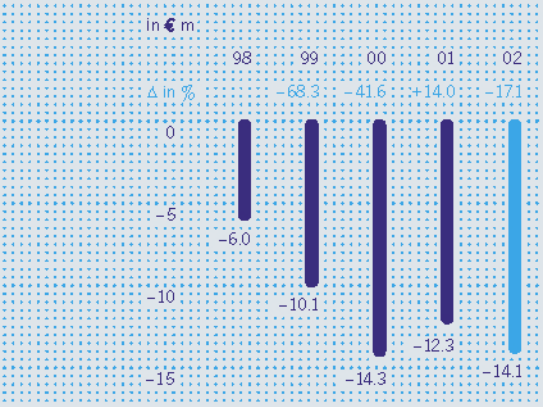
| | | | |
|---|---|---|---|
| | **Net income** | **€** | **(131.6) m** |
| – | **Interest income** | **€** | **0.7 m** |
| + | **Interest expense** | **€** | **0.3 m** |
| – | **Tax benefits** | **€** | **2.7 m** |
| + | **Amortisation** | **€** | **12.0 m** |
| + | **Impairment** | **€** | **109.4 m** |
| + | **Depreciation** | **€** | **11.1 m** |
| = | **EBITDA** | **€** | **(2.2) m** |

**2002 EBITDA—again close to break-even.** Earnings before interest, tax, depreciation and amortisation or impairment (EBITDA) totalled € (2.2) m, only slightly below last year's level (2001: € (1.0) m). As a result of reduced growth rates in the second half of 2002, Evotec OAI did not reach positive EBITDA, as originally planned.

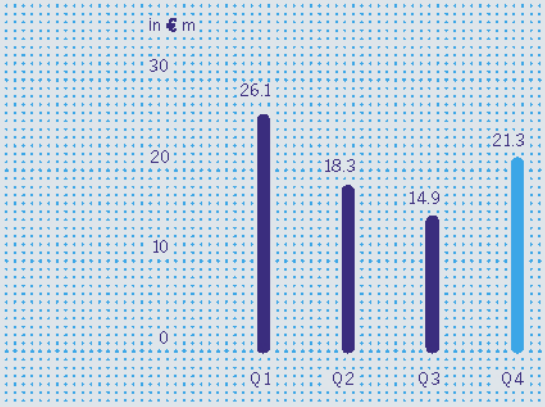
**2002 cash flow—reducing cash consumption.** Cash flow from operating activities amounted to € (1.0) m (2001: € (2.5) m). 2002 cash consumption was mainly driven by continued strong R&D expenses, the declining gross margin effects previously mentioned, and increased inventories primarily as a result of existing customer contracts with Merck and Pfizer. It has, however, been largely compensated by reduced trade accounts receivables.
The 2002 capital expenditures were invested in the further expansion of our laboratory capacities in Abingdon and the screening factory in Hamburg. As planned, we invested a significantly lower amount of € 8.7 m (2001: € 17.5 m) in tangible and intangible assets following higher investments in the prior year. To finance parts of this capital expenditures we drew down long-term bank loans of € 4.9 m and entered into capital lease agreements of € 1.4 m.

**As planned, we invested a significantly lower amount of € 8.7 m in tangible and intangible assets. They were directed towards the expansion of our laboratory capacities and our screening factory.**

**Operating result**
(before amortisation and impairment)




**Liquidity at quarter end**




## Condensed cash flow statement

| T€ | 2002 | 2001 |
|---|---|---|
| Net cash used in operating activities | (970) | (2,525) |
| Net cash (used in) provided by investing activities | 2,172 | (10,171) |
| Net cash (used in) provided by financing activities | 4,111 | (37) |
| **Net increase\|decrease in cash and cash equivalents** | **5,313** | **(12,733)** |
| Exchange rate difference | (2,656) | (1,100) |
| Cash and cash equivalents at beginning of year | 18,651 | 32,484 |
| Cash and cash equivalents at end of year | 21,308 | 18,651 |
| Cash and cash equivalents including marketable securities | 21,308 | 27,833 |

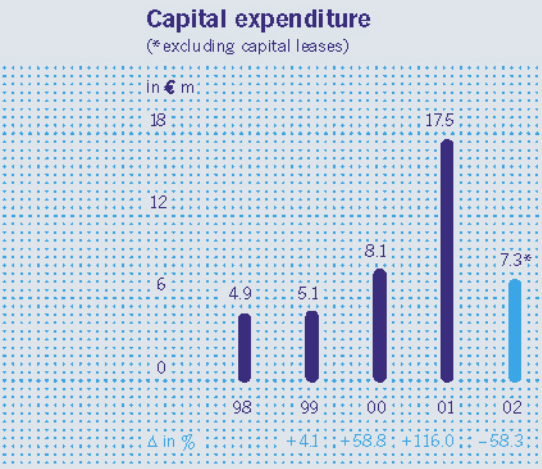
**Our cash position at year-end amounted to € 21.3 m, which makes us confident to be able to finance continued strong growth of our services business.**

**Strong liquidity built-up towards year end.** At 31 December 2002, our cash amounted to € 21.3 m, up from € 14.9 m at the end of Q3 2002. With this healthy liquidity position, combined with the cost cutting measures that we started implementing in the second half of 2002, we remain confident that Evotec OAI can deliver on its business plan and finance continued strong growth of its services business.

**Balance sheet—solid asset and capital structure.** The impairment charges according to SFAS No. 142 led to an intangible asset book value significantly reduced to € 132.4 m (2001: € 273.1 m). Fixed asset book value decreased slightly due to lower capital expenditures compared to corresponding deprecation.

## Balance sheet structure of Evotec OAI

| T€ | 2002 | 2001 |
|---|---|---|
| Cash, cash equivalents and securities | 21,308 | 27,833 |
| Inventories | 8,408 | 6,524 |
| Other current assets | 16,316 | 18,770 |
| Property, plant and equipment | 61,951 | 67,847 |
| Intangible assets | 132,452 | 273,131 |
| Other non-current assets | 607 | 512 |
| **Total assets** | **241,042** | **394,617** |
| Accruals | 5,552 | 8,972 |
| Other current liabilities | 15,908 | 13,121 |
| Long-term liabilities and minority interest | 8,631 | 3,712 |
| Deferred tax liabilities | 15,544 | 21,221 |
| Total stockholders' equity | 195,407 | 347,591 |
| **Total liabilities and stockholders' equity** | **241,042** | **394,617** |




The Company's liabilities include primarily deferred tax liabilities of € 15.5 m (2001: € 21.2 m), as well as an increase in bank loans to € 7.9 m (2001: € 3.8 m) which have been drawn for selected asset financing.
Following the exercise of stock options, the share capital increased to € 35,510,130. Despite the reduction of total equity in line with the goodwill impairment, our equity ratio for 2002 was 81% (2001: 88%), representing a solid equity cushion.

**As of 1 January 2002, we spun out our instrumentation and technology business into a majority-owned subsidiary—Evotec Technologies.**

**Legal structure—focus on drug discovery.** Effective 1 January 2002, we spun out our instrumentation and technology business into the majority-owned subsidiary, Evotec Analytical Systems (EAS). The name of this entity was changed to Evotec Technologies GmbH (ET). The objectives were to down-scale the activity of tools and technology development to eliminate any cash burden on our core business, to allow Evotec Technologies to streamline its operations outside of the service business processes, to find a strategic partner and, ultimately, to focus Evotec OAI on drug discovery. We also terminated the joint venture between EAS and Qiagen GmbH.
Additionally, we merged our ion channel drug discovery business, Genion Forschungsgesellschaft GmbH, with Evotec OAI AG in 2002 to fully capture the synergies across our assay and screening technologies as well as our customer projects.
In Q4 2002, we increased the capital of Evotec Neurosciences GmbH by € 1.5 m, with Evotec OAI AG holding a 83.1% stake thereafter. In addition, we increased the capital of ET by € 2.5 m and sold shares to its management, reducing the stake of Evotec OAI to 95.7%.

**Production and procurement—cost reduction measures successfully implemented.** Evotec OAI's Discovery and Development Services business largely consists of laboratory based contract research with a high percentage of costs going towards personnel and a respectively lower portion of costs going towards material usage. Even the custom preparation and pilot plant production, part of our services business, is labour intensive and contains a relatively small portion of material cost.
Only in our Tools and Technologies business do we have a lower value-added role, with all of the production activities beyond the prototype stage being outsourced to strategic suppliers. Here, we internally focus on the technology development and technical support of the installed base of our instruments.
Overall, we are continuing our Company's policy to reduce the number of suppliers with emphasis on long-term partnerships. As part of the cost reduction measures started in 2002, we continued to improve our procurement and inventories management group-wide.

**2002 was an uneventful year due to the continued commitment of our employees to safe working practices in the laboratories.**

**Occupational safety and environmental protection—strong emphasis.** We believe that we have an obligation to exceed statutory requirements in protecting our employees and the environment. 2002 was an uneventful year due to the continued commitment of our employees to safe working practices in the laboratories.

At Abingdon, we successfully implemented our Health and Safety plan, including increasing tailored safety training for staff and appointing a new Health and Safety advisor. Our rolling programme of safety monitoring, documentation review, risk assessment and training has helped us to improve our safety performance. In addition, we are currently working towards achieving ISO 14001 accreditation for our Environmental Management System. Our manufacturing facilities at Abingdon continue to comply with the highest standards of environmental protection, and with all procedures in the UK Environmental Act of 1990.

In Hamburg, we continued to train our management and staff in environmental safety and we continuously applied our standardised operating procedures for waste disposal management, including instructions for improving safety while working with biological and genetically engineered organisms. We maintain close contact with all local responsible public authorities as well as the relevant professional organisations. The Hamburg authorities audited the operations in our screening facilities and our genetic engineering practice. We demonstrated our commitment to environmental protection when we documented a basic Quality Management System for our biological services.

**We are continuously reviewing our risk management system, including regular commercial and R&D project reviews, and per-form monthly financial reviews focussing on key performance drivers.**

**Risk management—comprehensive and reliable.** We regard risk management as an ongoing management task which has a very high priority within Evotec OAI. This applies also to the Corporate Governance element (see “Evotec OAI shares and Corporate Governance”, page 48). We believe that clear commitments to Corporate Governance are paramount in light of the recent scandals in the U.S. and Europe.

We are continuously reviewing our overall risk management system including all important elements such as regular commercial and R&D project reviews. In addition, we perform monthly financial reviews with a strong emphasis on cash and key performance drivers such as revenues, order book status and gross margins. Strict application of investment approval processes, legal contract review procedures, signing authorities, and currency management are also standardised operating procedures. Moreover, we particularly emphasised our IT security throughout the Company. In summary, we are confident that our current systems are adequate and reliable.

**With our cash-generating services business, many cost-cutting measures already implemented and our flexibility in managing R&D spending pro-actively, we feel well prepared to face the current market challenges.**

**Business risks and future development—the ability to adapt to constant change in our environment is paramount.**

> The current world-wide capital market conditions have affected our biotechnology customers' ability to fund their R&D programmes. This adversely affected our sales numbers in 2002 and we reduced our growth expectations for 2003 accordingly. However, if the outsourcing markets do not recover in the longer term, this may have a material adverse effect on our financial position.

> Our Tools and Technologies business is characterised by high capital expenditures by our customers. As a result of the world-wide reductions of capital investments in life science research, the markets of Evotec Technologies could be negatively affected despite our focus on innovative solutions to research bottlenecks. Nevertheless, the high level of already existing orders ensures healthy growth for 2003.

> During 2002, we established a Discovery Programs Division, in which we plan to engage in selected discovery activities for our customers, carrying some of the risk of these programmes ourselves to enhance the risk|reward relationship. In this business, we are exposed to project attrition rates customary in the drug discovery industry. Even if we identify promising targets and compounds, it will take time before we could sell or licence any drug candidates, if at all. Hence, expenditure on internal discovery programmes or related acquisitions of technologies or intellectual property could substantially reduce our profitability. We intend to reduce parts of the business risk through early partnering and upfront licencing agreements.

Evotec OAI is also affected by usual business risks such as the dependence on large pharmaceutical customers, the financing of investments and foreign exchange rate fluctuations which we explain in more detail in the notes to the financial statements (No. 17).

Overall, our success depends on our ability to retain our highly skilled staff and key management, and to adapt to changing technologies and market environments as well as customer expectations. If we fail to adapt to market needs, our ability to grow profitably could seriously suffer.

In summary, we expect to deliver continued fundamental growth performance. With our cash-generating Discovery and Development Services business, many cost cutting measures already implemented and our flexibility in managing R&D spending pro-actively, we feel well prepared to face the current market challenges. We have shaped the Company to deliver on our business plan.

**Post-balance sheet events.** There are no significant subsequent events to be reported.

## Outlook

**We expect to achieve modest growth of 10–15% for the year. However, we continue to believe that we can reach mid- to long-term growth of 20–30% p. a., once the markets recover.**

**Sales—well positioned for continued solid growth.** We achieved solid performance in 2002, albeit in a negative environment. Assuming that the outsourcing market may remain weak, we expect to achieve modest growth of 10–15% for the year. However, we continue to believe that we can reach mid- to long-term growth of 20–30% p. a., once the markets recover. As of February, the order book for 2003 amounted to € 57 m, covering 73% of current revenue expectations for 2003 (analyst consensus: € 78 m). This compares favourably to contracted revenues of € 37 m at the same time in 2002. We are confident that our high quality discovery platform, team of high calibre scientists, and broad and stable network of customer relations will lead us to continued success.

**As of February, the order book for 2003 amounted to € 57 m, covering 73% of current revenue expectations for 2003 (analyst consensus: € 78 m).**

**Results—on track to reach positive EBITDA.** In the second half of 2002, we took measures to reduce our R&D and SG&A expenditures by 20% to reflect the current market environment and to adjust our capacity following the completion of the EVOscreen® technology development programme. The R&D areas supporting our core service business were not affected by these measures. With our strong order situation and stringent cost management, the Company is now on track to reach its target of positive EBITDA in 2003.

**With our strong order situation and stringent cost management, the Company is now on track to reach its target of positive EBITDA in 2003.**

**Human resources—focussing on realignment of resources.** Despite the completition of our restructuring in selected R&D areas, overall headcount in 2003 will remain approximately at the 2002 level as we continue to hire scientists in our Discovery and Development Services division to support customer contracts. As of 31 December 2002, Evotec OAI had 635 employees.

**Investment—maintaining a leadership position.** In order for Evotec OAI to maintain its position as an outsourcing partner of choice, investments in 2003 will reflect our need to build further capacity and to maintain our state-of-the-art technology platform. The majority of these investments will be directed towards leasehold improvements and the purchase of laboratory equipment.

**Legal structure.** In October 2002, we announced that Pfizer Inc. will acquire a 10% share in Evotec Technologies (ET) in the first half of 2003. In the mid-term, we are prepared to reduce our stake in ET to a minority financial interest.

**Dividends.** The payment of dividends in the future is dependent on the results of Evotec OAI AG, its financial situation and liquidity requirements, the general market conditions, and statutory, tax and regulatory requirements. We currently intend to retain any profits generated from the development of our business and to use them to create further development and growth for our Company. We do not expect the Evotec OAI AG to be profitable in 2003.

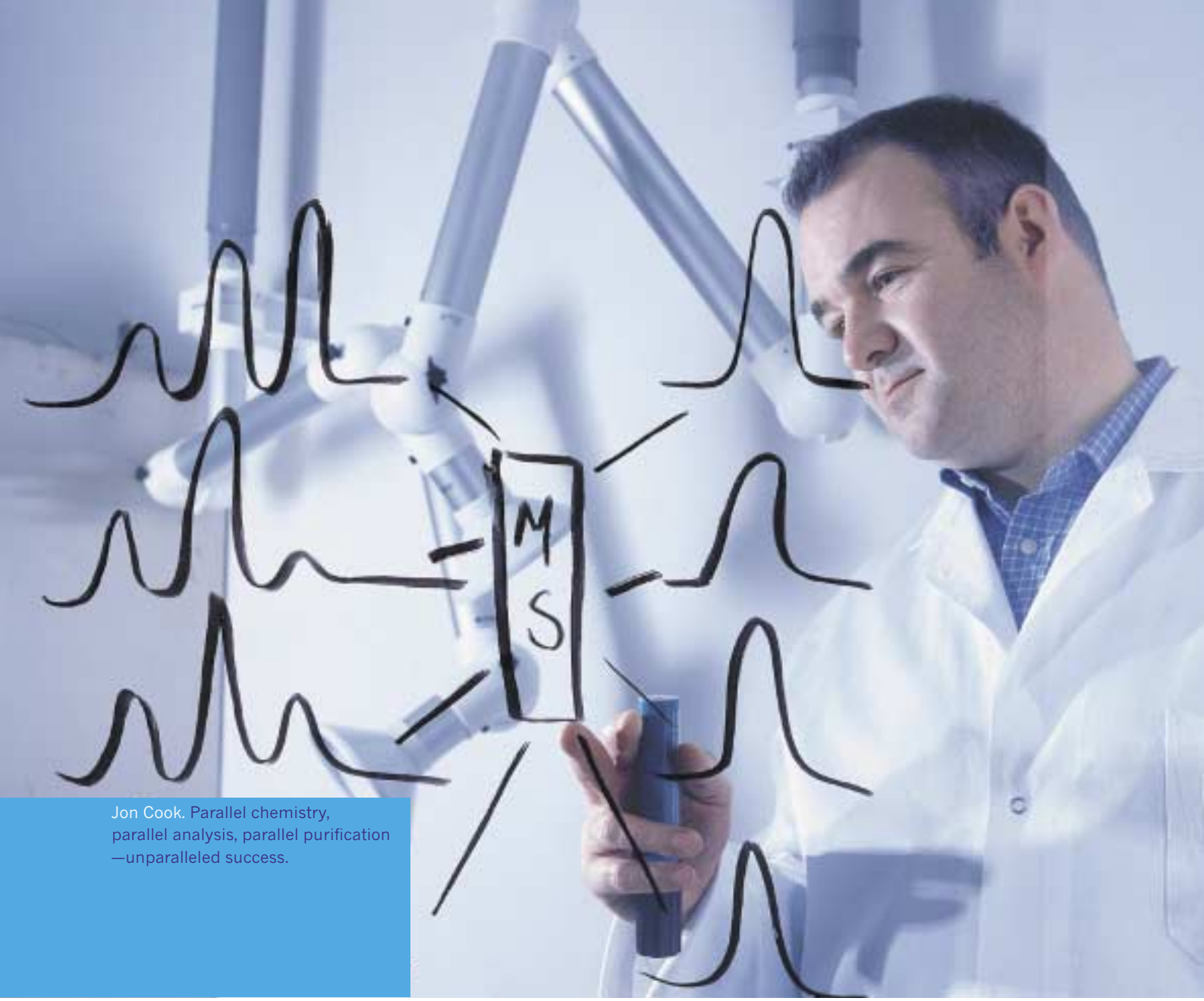
## Segment report | Discovery and Development Services

Our offering of a full range of solutions "from target to IND and beyond" has established Evotec OAI as the discovery and development partner of choice. The Discovery and Development Services division continued its historically strong growth pattern in 2002, despite a difficult market environment. The division contributed positively to the company's cash flows for the year and with a strong order book we are confident that it will continue to have a solid financial performance in 2003.

**A strong core business.** Our Discovery and Development Services division is at the core of Evotec OAI. The division provides discovery and development solutions to pharmaceutical and biotechnology companies in order to increase both the efficiency and effectiveness of our partners' drug discovery programmes. Our services are applicable throughout the drug discovery and development value chain, and because of this, we are able to offer collaborative approaches "from target to IND and beyond". Utilising our truly integrated process platform of state-of-the-art biology, screening and chemistry, we are also well positioned to competitively pursue carefully selected internal discovery programmes where we seek high value partnering of intermediary products.

**Revenues in our Discovery and Development Services division increased by 13% in 2002. While development services experienced a decline in new orders, discovery chemistry and biology services continued to grow strongly.**

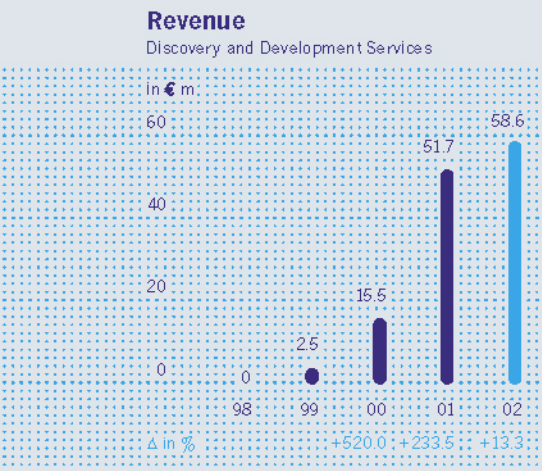
**Good growth in a difficult year.** The year 2002 was not kind to the pharmaceutical and biotechnology industries. Despite the difficult market environment, our Discovery and Development Services business grew by more than 13% over 2001. This growth was not uniform however. Our development services experienced a decline in new orders during the second half of 2002 as smaller biotechnology companies looked to conserve cash by delaying clinical development programmes. This decline was more than compensated for by new programmes and extensions of existing programmes involving discovery biology and chemistry. We are particularly pleased with the significant growth of our discovery services (excluding development services), thus demonstrating customers' appreciation of Evotec OAI's proprietary technologies in biology and chemical services and their diligent execution in this sector.




Jon Cook. Parallel chemistry, parallel analysis, parallel purification —unparalleled success.

**The division now employs 361 scientists. To accommodate new and expanding programmes we have commissioned additional chemistry laboratories at our Abingdon site.**

**Building from a position of strength.** The signing of new collaborations, and the extension of existing collaborations, further enhanced Evotec OAI's reputation as the service provider of choice during 2002. Many of our customer relationships are multi-year in nature, and often include downstream milestone and royalty payments in the contracts, thus enabling us to share in the future success of our customers. To accommodate our new and expanding programmes we have commissioned additional chemistry laboratories at our Abingdon site. In addition, we are now able to offer a portfolio of early ADMET services in conjunction with our accelerated medicinal chemistry programmes to further enhance our discovery offering (see "R&D Report", page 42). We continued to strengthen our biology expertise when our ion channel group achieved GLP-certification for our activities in the electrophysiological laboratories. The Discovery and Development Services division now employs 361 scientists in both direct project and support roles with 48% at PhD level. This scale of operation combined with the breadth of our services allows us to support many varied programmes in parallel for our customers—from the smallest biotech to the largest pharmaceutical company.




**A positive contribution to the Company's cash flows.** The division achieved positive operating results before amortisation, impairment and allocation of corporate R&D and corporate overhead, totalling € 13.7 m. Overall, gross margin was lower than originally planned for 2002, due to the decline in development orders in the second half of the year and a change in the mix of discovery chemistry projects. The lower development orders were particularly disappointing as this prevented us from recovering the full amount of fixed costs associated with our new pilot plant, which was commissioned in 2001. The R&D costs of the division included internal projects focussed on extending and enhancing our platform. The SG&A costs reflected the build up of our marketing and sales teams during 2001. In response to the adverse market conditions in 2002, we took decisive action in the second half of the year including reviewing our recruitment strategy, reducing headcount in some areas and capitalising on the skills and flexibility of our scientific staff. These actions helped to mitigate the impact of the changing environment on the division's overall performance.

**Evotec OAI has tremendous strengths in the depth of services we offer as well as the quality of our service teams, enabling us to anticipate and react to the challenges ahead.**

**Confidence in the future.** As we start 2003 our sales order book is strong, and we are confident of the continued growth and solid financial performance of this division, driven by the expanding needs of our pharmaceutical and biotechnology customers. 2003 may be another difficult year for the pharmaceutical and biotechnology industries, but Evotec OAI has strength in the depth of the services we offer and the quality of the services teams, both of which will enable us to anticipate and react to the challenges ahead. To complement the provision of high quality discovery and development services that we offer to external customers we will also receive upside value by leveraging these same services to Evotec OAI's new Discovery Programs Division.

### Condensed key figures Discovery and Development Services

| | | 2002 |
|---|---|---|
| Revenue | T€ | 58,588 |
| Share of total revenue | % | 83.7 |
| Operating result | T€ | (133,373) |
| Operating result adjusted for non-cash amortisation and impairment | T€ | (12,426) |
| R&D expenses | T€ | 15,213 |
| Depreciation | T€ | 10,558 |
| Number of employees as of 31 December without corporate overhead | | 458 |

## Segment report | Tools and Technologies

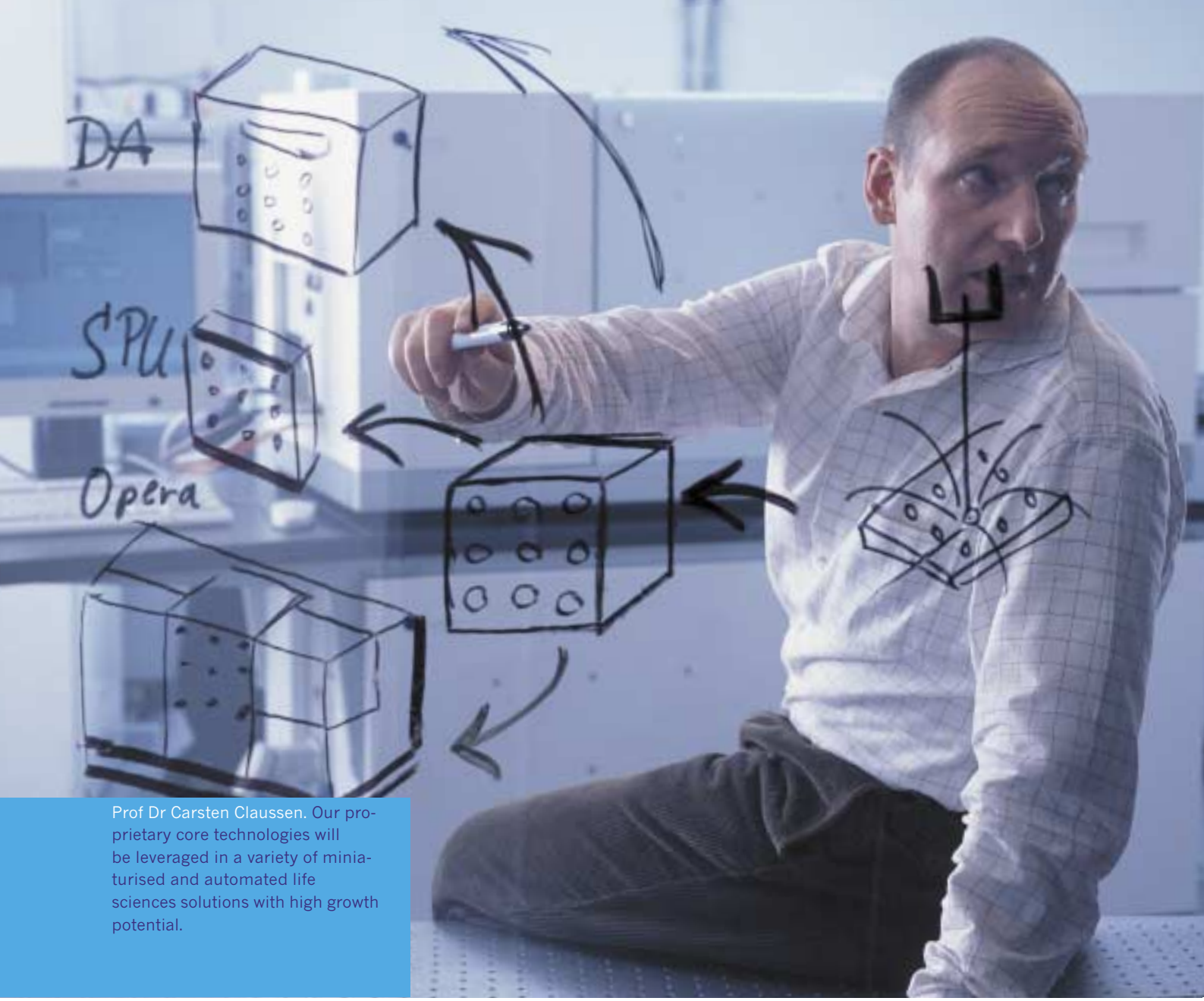
In 2002, Evotec OAI completed the spin out of its subsidiary Evotec Technologies (ET) so that Evotec OAI can focus on drug discovery. Since 1 October all of Evotec OAI's technology related businesses and projects (incl. the former TDTA consortium business) have been combined into this completely separate and focussed unit with 88 employees at year-end, led by an independent management team. ET's mission is to build on its position as the preferred provider of the most innovative drug discovery technologies serving current and future needs in the life sciences industry. ET achieved proof of its promising business concept by building and maintaining strong business relationships, successfully launching several new products, and securing revenues of € 11.4 m in 2002 with a total forward order book of € 15 m.

**ET has established a strong portfolio of state-of-the-art automated and miniaturised processes which comprise our established EVOscreen® system and several innovative bench-top devices.**

**Meeting the needs of the industry—quality and reliability.** ET has established a powerful engine to transfer customers' needs via prototypes into industrialised applications for life sciences laboratories. The Company provides state-of-the-art automated and miniaturised processes that result in extremely high data content and quality output by seamlessly integrating hardware, software and bioware modules.
ET's current portfolio comprises our established uHTS EVOscreen® system for large pharmaceutical companies and a product line of innovative bench-top instruments, consumables and reagents. The foundation of these solutions are based on our broad patent portfolio, scientific excellence and technical know-how which are core to our ET business strategy. In particular, the strengths at ET are in the fields of detection and analysis in molecular dimensions, liquid handling of minimal volumes and high-speed interpretation methods and software.

**EVOscreen®'s industry success is evidenced by working installations at GSK, Novartis, Pfizer and Evotec OAI, a full order book for 2003 and public feedback by customers.**

**Promising new product lines.** ET's EVOscreen® platform is on its way to becoming the industry standard for miniaturised ultra high-throughput-screening. EVOscreen®'s industry success is evidenced by working installations at GlaxoSmithKline, Novartis, Pfizer and Evotec OAI in 2002, a full order book for this type of revenues in 2003, and various presentations at conferences by customers documenting their outstanding results with EVOscreen®. In the field of bench-top instrumentation, ET successfully continued its co-operation with Olympus in the area of single molecule detection. The first two products of a family of fluorescence microplate readers MF10 and MF 20 have been launched and introduced to the Japanese market. ET is participating in the sale of each instrument by supplying the Signal Processing Unit (SPU) for the detector,

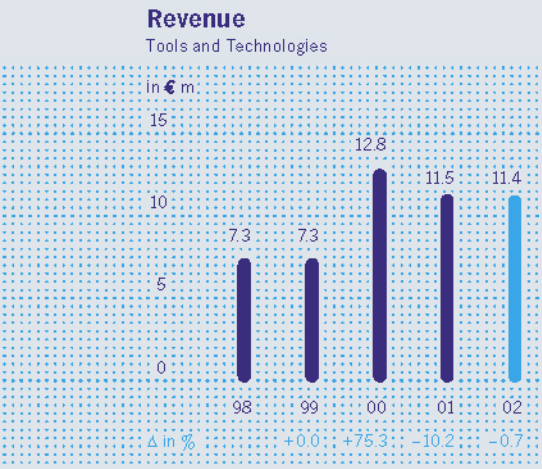



Prof Dr Carsten Claussen. Our proprietary core technologies will be leveraged in a variety of miniaturised and automated life sciences solutions with high growth potential.

**We are looking forward to sound business prospects for our innovative cell-imager Opera, which was successfully introduced in 2002. Elektra, our automated cell-cloning solution, will be launched in mid 2003.**

kits and an FTE-based application programme. In parallel, ET sold its Diagnostic Analysers for SNP genotyping and the Insight research reader to several academic institutes world-wide.

The majority of current R&D activities are focussed on future solutions for cell handling and analysis instrumentation. In September, our high-content cell-analyser, Opera, was successfully introduced to the market at the Society for Biomolecular Screening Conference 2002 in The Hague, Netherlands. During the remaining year, four instruments were already successfully installed. We are looking forward to sound business prospects for this innovative bench-top device which will be propelled by the establishment of an additional U.S.-based sales force. We also achieved substantial progress in the development of Elektra, our automated cell-handling device. Promising results from beta testing give us confidence that we will be able to launch this automated solution for today's manual cloning operations in cell labs in mid 2003.




**Validating ET's technology platforms through Pfizer.** A major milestone for ET was the extension of our three-year partnership with Pfizer in October 2002 with a contract value in excess of U.S.-Dollar 25 million. As part of this transaction, Pfizer will make an equity investment into Evotec Technologies GmbH.

**As a result of ET's strong bench-top business ET managed in 2002 to match the strong revenue performance of 2001.**

**Maintaining solid revenues.** Despite the expiration of external R&D funding for the development of EVOscreen®, Tools and Technologies managed in 2002 to match the strong revenue performance of 2001 (2002: € 11.4 m; 2001: € 11.5 m) as a result of ET's strong bench-top business revenues in 2002. This shows that we are successfully transitioning this unit away from being a provider of uHTS to the limited number of our original customers to being partner to a large number of new customers. The 2002 operating result amounted to € (2.1) m due to continued high investment in new product development (R&D) in the first half of 2002.

**With our measures taken to reduce headcount, mainly in technology R&D, and anticipated revenue growth, ET is on track to break-even in 2003.**

**Moving forward in 2003.** Looking forward, we expect to continue our strong growth pattern in 2003. Our order book which, as of February, covers already more than 70% of expected revenues for the year gives us great confidence in achieving this goal. During 2002, we undertook a tough cost management programme. As a consequence of the completion of the EVOscreen® technology development project and the establishment of an international network of suppliers, we took action to reduce headcount, mainly in technology R&D. With these measures and anticipated revenue growth, ET is on track to reach break-even in 2003. On the strategic front, we are always evaluating independent financing opportunities or business partnerships that can broaden the ET product offerings and|or set-up joint marketing and sales organisations around the world.

### Condensed key figures Tools and Technologies

| | | 2002 |
|---|---|---|
| Revenue | T€ | 11,407 |
| Share of total revenue | % | 16.3 |
| Operating result | T€ | (2,139) |
| R&D expenses | T€ | 7,799 |
| Depreciation | T€ | 547 |
| Number of employees as of 31 December without corporate overhead | | 88 |

# R&D report

Evotec OAI is committed to ensuring that its drug discovery and development services are world class—incorporating the most innovative technologies in terms of efficiency and delivery. The multi-parameter optimisation process of modern drug discovery relies on the close integration of chemistry and biology to generate rapidly high quality data as well as effective decision making based on detailed and thorough analysis of the data. With this in mind, the R&D activities throughout 2002 focussed both on extending the comprehensiveness of our data generation capabilities and on the continued development of proprietary knowledge management and decision support tools. Our aim is to provide the most effective and comprehensive offering in knowledge-driven drug discovery from Target-to-IND.

**We have significantly extended our autopurification capabilities to meet increasing client demand for the highest compound purity.**

**From target preparation to hit generation.** Evotec OAI has proven expertise in generating large diverse compound libraries and smaller gene family focussed libraries by parallel synthesis. In order to meet increasing client demand for discrete compounds in very high compound purity, Evotec OAI has significantly extended its autopurification capacity to provide adequate speed and excellent recoveries.

During 2002, Evotec OAI expanded greatly its corporate compound library with the addition of compounds prepared internally at Evotec OAI and compounds sourced externally selected by directed cheminformatic searches. The Evotec OAI corporate library now comprises over 280,000 drug-like and lead-like, high quality compounds that are all available for screening on the EVOscreen® uHTS platform. These compounds contain subsets selected to provide broad as well as focussed diversity for specific, well-defined gene family targets including GPCRs, kinases, and proteases.

**Supported by new technical achievements, we have greatly increased our capability to perform cellular assays. Today we provide solutions to tackle the most challenging targets.**

New efficient compound handling systems are now in place to facilitate the rapid reformatting of compounds for post uHTS hit confirmation and potency profiling. In 2002 we greatly increased our capabilities in performing cellular assays including reporter assays, protein translocation and cytotoxicity assays at the medium throughput and uHTS level. Technical developments carried out in our subsidiary, Evotec Technologies, supported these initiatives, especially by the newly launched Opera reader, a confocal imaging reader for fast, high-content cell assays. The extended capabilities of our Mark III EVOscreen® platform (such as nanodispensing of cells, imaging capabilities and sustainably low operational costs) has led to the substantial extension of our Pfizer relationship.

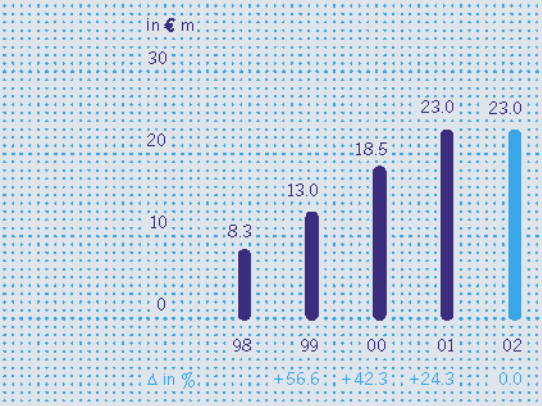

Dr Erich Greiner. Guided by the understanding of disease biology our corporate R&D will leverage latest technologies in molecular biology, cell biology, biophysics and chemistry in our drug discovery platform.

Finally, we are utilising these integrated capabilities for our leading proprietary drug discovery programme through Evotec Neurosciences (ENS) which has obtained further validation of target candidates in the field of Alzheimer's disease.

**To develop candidate drugs even more efficiently, we have continued to strengthen our medicinal chemistry expertise and to expand our computational chemistry group and ADMET portfolio.**

**Drug candidate optimisation (H2L and L2C).** We continue to develop our capabilities in medicinal chemistry to optimise lead compounds into promising candidate drugs for preclinical development. This is driven by our multi-parameter optimisation processes that facilitate efficient Hit-to-Lead (H2L) and Lead-to-Candidate (L2C) programmes. We have also expanded our computational chemistry group which utilises state-of-the-art commercial and proprietary software to tackle drug design problems all the way along the Target-to-IND chain. This group has established a capability in virtual screening which is a logical and useful addition to our wet screening activities. This allows our medicinal chemists to make use of available structural biology knowledge to prioritise design ideas prior to the parallel synthesis of focussed compound libraries. Our virtual screening activities are conducted using a high performance Linux cluster and a 250 node Entropia distributed computing platform. This allows us to utilise the idle computer time on our corporate network to increase computing power for our computational chemistry group. We have expanded our portfolio of early ADMET assays so that our medicinal chemists can access and make use of important drug property information as early as possible in the optimisation process. These include assays for aqueous solubility, permeability and in vitro metabolism. Together with our assays for cytochrome P450 inhibition, HERG channel inhibition and cytotoxicity this provides us with a comprehensive suite of early ADMET assays.

**R&D expenses**




We have demonstrated our ability to make use of our EVOscreen® platform in this field with the screening of 120,000 compounds for the inhibition of cytochrome P450 3A4 enzyme. We are now making use of these large datasets on ADMET properties to build proprietary in silico ADMET models to support our medicinal chemistry programmes.

**Development chemistry.** It is often the case that the active pharmaceutical ingredient (API) can exist in more than one crystalline form or polymorph. It is important during the scale-up process to understand the propensity for polymorphic variation and to develop procedures to control which polymorph is formed on crystallisation. We have now established a capability to rapidly analyse for polymorphic variation. For certain development candidates it is possible to modify the pharmaceutical properties of the API by salt formation and we have established a rapid screen for salt counter ions to enable the selection of the most advantageous salt form in terms of stability, dissolution and oral availability. The addition of these capabilities enables Evotec OAI to provide an even more comprehensive service in development chemistry.

**Informatics.** To support the continued development of Evotec OAI's informatics-driven drug discovery platform, additional proprietary knowledge management and decision support software tools were written in-house and deployed to our scientists during 2002. An improved chemistry electronic laboratory notebook system with reaction searchability ensures that the information generated by our synthetic chemists in both discovery and development is effectively captured. Our A+ software speeds up the interpretation of data from the EVOscreen® uHTS screening systems. EVOseek, a data warehouse system for chemistry and biology information, allows our scientists to analyse and interpret data from multiple assays. Our application of the LeadScope software enables our medicinal chemists to develop structure activity relationships and hypotheses from large sets of screening data. In silico ADMET models developed by our computational chemistry group, using both in-house and literature data, are a further addition to the decision support for our medicinal chemists to profile multiple design ideas before selecting particular compounds for synthesis.

**For the benefit of our customers and our own discovery programmes we will focus in 2003 on the further enhancement of our Target-to-IND portfolio, addressing speed and knowledge extraction from our processes.**

In conclusion, the development and addition of cellular assays, the extension of our ADMET portfolio and the increased use of computational chemistry have significantly improved our offering, increased the efficiency of our processes and integrated our biology and chemistry capabilities. In 2003 we will further enhance our process portfolio from Target-to-IND, address speed and knowledge extraction from our processes and continue to apply these to the benefit of our customers and our own drug discovery programmes.

**Evotec OAI holds more than 170 families of protective rights, comprising 11 German utility models and 31 German, 20 European, 21 U.S. and one Japanese issued patents.**

**Intellectual property.** Obtaining strong and broad patent and know-how protection for our state-of-the-art technologies provides us with a strong competitive position. Evotec OAI holds more than 170 families of rights, each of which protects one invention in different countries. Of these rights, 11 German utility models are already registered and 31 German, 20 European, 21 U.S. and one Japanese patents issued.

We continued our licencing policy and received equity in a joint venture with Microscience, a pioneer in anti-infectives, in return for target licences. We issued licences for our proprietary technologies in return for up-front payments, milestones and royalties, e. g. to the Roche diagnostic division on our melting curve technology to analyse genes in PCR reactions.

In accordance with our business strategy, we granted rights to use specific intellectual property relating to instrumentation and technology to Evotec Technologies GmbH. These rights will put our subsidiary in a unique market position for its future business.

**Distribution of Evotec OAI's families of protective rights by technologies at 31 December**

| Technology | Number of families of protective rights* | |
|---|---|---|
| | 2002 | 2001 |
| FCS and FCS$^+$ plus detection technology | 42 | 34 |
| Assay development including cell-handling technologies | 50 | 45 |
| Microfluidics | 19 | 15 |
| Labelling strategies | 8 | 5 |
| Sample carriers | 17 | 17 |
| Molecule optimisation | 4 | 4 |
| Potential target genes (Alzheimer, anti-infective etc.) | 35 | 17 |
| Others | 4 | 4 |

* These include our proprietary and in-licenced patent and utility model rights.

# Our people

In 2002, the focus has been on targeted growth, strengthening of numbers and building capacity in our Discovery and Development Services business. In a multicultural environment with over 630 people at year end we continue to build our strong university network and to nourish scientific excellence to gain access to the latest thinking in drug discovery.

**Our highly qualified workforce with over 500 scientific and technical graduates, of which more than 200 have scientific doctorates, is our strongest competitive advantage.**

**Another year of change.** In 2002, the focus has been on targeted growth and realignment of our human resources to match the evolving company strategy and needs of our customers. Overall, across all groups, our employee count grew by 9% from 2001 to over 630 employees who are dedicated to providing first class services to our customers. Strengthening of numbers and building capability in our Evotec Neurosciences programmes and Discovery and Development Services business, the two core areas that provide Evotec OAI's strategic discovery focus, were predominant tasks. Unfortunately, this has also meant that 23 redundancies took place some of which have become effective in early 2003. We reduced R&D and SG&A staff by 7 employees at our instruments business, Evotec Technologies GmbH, to move that division closer to profitability. We continued to maintain our strength in highly qualified people with over 500 scientific and technical graduates, over 200 of which have scientific doctorates.

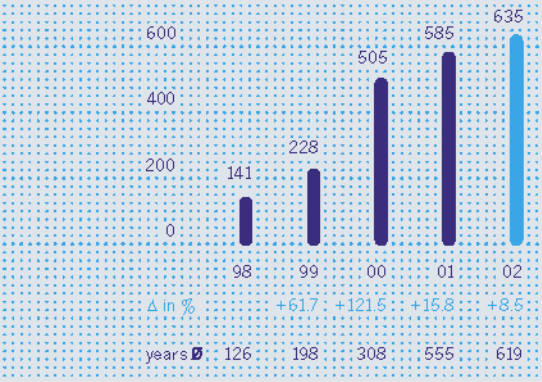
**Listening to our people.** Listening to our employees' needs continues to be important to ensure that we achieve the highest possible level of engagement to meet our business goals and objectives. This is a very active and frequent process which we have implemented through regular company briefings with senior management. We have taken this to a new level in 2002 with an Employee Attitude Survey in the UK, responded to by 88% of the UK employees, in which they gave valuable and constructive feedback in terms of job satisfaction and the working environment at Evotec OAI. This has provided us with important guidance as to how to further develop employees' career plans and benefit programmes.

**Strong university network.** In order to maintain a flow of future, high-calibre recruits for Evotec OAI, we continued to develop alliances with leading scientific universities in Europe, especially in Germany, the UK, France, Estonia and Sweden. We also provide opportunities for students from different disciplines to gain valuable work experience in chemistry and biology as well as technology development. In the UK, we were sponsors of the Exemplarchem 2002 Competition for Chemistry Students run by the Royal Society of Chemistry.

**Nourishing scientific excellence.** Numerous training courses and scientific conferences were attended by our employees in their own countries and abroad during the year to gain experience and access to the latest thinking in drug discovery. Evotec OAI employees also present and validate Evotec OAI's capabilities at many leading industry events through speaking presentations, poster sessions and trade show exhibits. In fact, one of the Evotec OAI's posters presented at the 8th annual conference and exhibition of the Society for Biomolecular Screening was given the top award.

## Employees

as of 31 December




## Headcount

Ø age: 32 years

| | Employees | Male | Female | Biologists/ Biochemists | Chemists | Physicists | Engineers (R&D), IT experts | Others |
|---|---|---|---|---|---|---|---|---|
| **Discovery and Development Services** | **458** | **294** | **164** | **36** | **263** | **7** | **9** | **143** |
| – Biology Services | 68 | 33 | 35 | 15 | 9 | 4 | 2 | 38 |
| – Discovery Chemistry | 194 | 123 | 71 | – | 141 | – | – | 53 |
| – Development Chemistry | 118 | 98 | 20 | – | 95 | – | – | 23 |
| – ProPharma | 25 | 12 | 13 | 2 | 9 | – | 1 | 13 |
| – R&D and Evotec Neurosciences | 53 | 28 | 25 | 19 | 9 | 3 | 6 | 16 |
| **Tools and Technologies** | **88** | **65** | **23** | **5** | **3** | **17** | **49** | **14** |
| **Corporate overhead** | **89** | **51** | **38** | **8** | **2** | **1** | **21** | **57** |
| **Grand total** | **635** | **410** | **225** | **49** | **268** | **25** | **79** | **214** |


Martyn Melvin, Dr Marianne Simonis. The Company that can adapt to change more quickly than its competitors will be more successful. At the end of the day we bet on people and not just on strategies to generate motivation and commitment to change.

**A multicultural environment.** Evotec OAI is a multicultural company, employing scientists from as far a field as China, Japan and the United States who are attracted to the values and varied work that a career at Evotec OAI can offer. Evotec OAI will continue to strive to become the employer of choice for ambitious scientists and we will continue to seek ways to encourage and support high performance and an innovative culture that creates a stimulating and successful place to work.

## Evotec OAI shares and Corporate Governance

Despite a solid underlying business performance, Evotec OAI shares were 82% down on the year ending at € 1.81. In particular, the share price started to suffer when the pharmaceutical tools and outsourcing markets became increasingly constrained, and we consequently reduced our 2002|2003 growth expectations. However, our ability to achieve numerous contract milestones and business successes throughout the year is clear evidence that Evotec OAI has continued to develop strongly. We are not satisfied with our current valuation but we are convinced that solid strategic and operational performance, the restructuring of the Frankfurt Stock Exchange and our admission to the TecDAX will ultimately translate into value appreciation and a rising stock price.

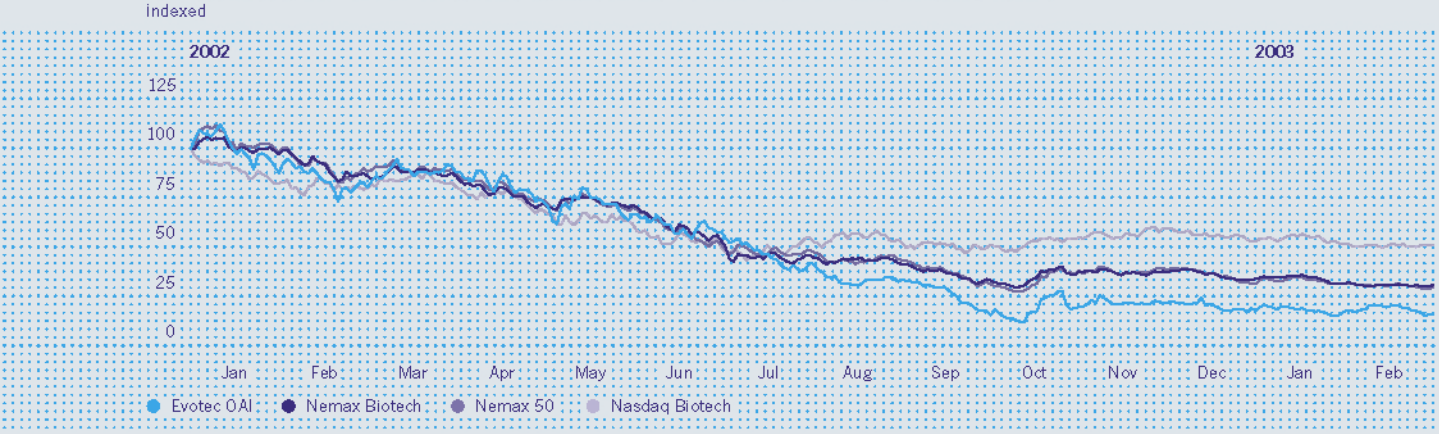
**Evotec OAI shares 2002**

| | | | | |
|---|---|---|---|---|
| 1st quarter | 10 January | High | € | 11.50 |
| | 20 February | Low | € | 7.30 |
| 2nd quarter | 02 April | High | € | 9.12 |
| | 20 June | Low | € | 5.34 |
| 3rd quarter | 01 July | High | € | 5.95 |
| | 30 September | Low | € | 1.37 |
| 4th quarter | 22 October | High | € | 3.00 |
| | 09 October | Low | € | 1.01 |

| | | | |
|---|---|---|---|
| 2002 | High | € | 11.50 |
| | Low | € | 1.01 |
| | Average share price | € | 5.47 |
| | Average daily trading volume | pcs. | 118,368 |
| | Price decrease | % | 82 |
| | Closing price as at 31 December 2002 (Xetra) | € | 1.81 |
| | Market capitalisation as at 31 December 2002 | m € | 64,273 |
| | Number of shares as at 31 December 2002 | pcs. | 35,510,130 |
| Key share data | Earnings | € | (3.71) |
| | Dividend | € | 0.00 |

German securities identification number: 566480
Abbreviation: EVT

**Development of Evotec OAI share price from January 2002 until February 2003**




**An increasingly risk averse market environment and the deteriorating public perception of the Neuer Markt negatively contributed to the performance of German biotech stocks.**

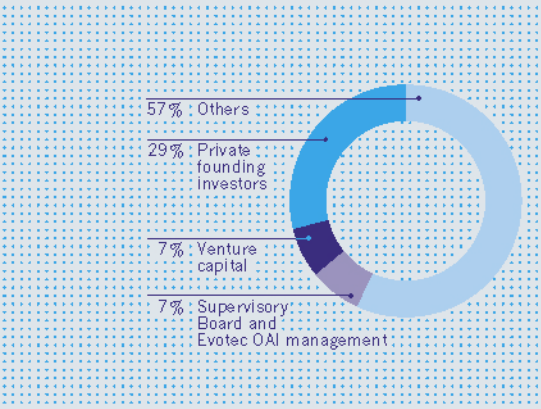
**Another year of significant losses for all major stock exchanges.** For the third year in a row, the capital markets declined significantly. The major indices of the stock exchanges in New York, Tokyo, and a number of leading European exchanges (e.g. London) lost up to 30% of their value. With a 44% loss for the year, the German DAX was at the bottom of the global stock exchanges—in part due to the strong weighting of finance and technology stocks in the index. These declines were primarily driven by international economic outlooks, companies reporting disappointing financial results and numerous corporate financial scandals, all of which have eroded investors' trust world-wide. This overall market depression was further compounded by rising instability in the global political environment.

**The Nemax biotech index lost almost 70% of its value. At year-end, the valuation of several biotech companies was significantly below their cash positions and|or book values.**

**Low investor appetite for high risk technology investments.** In 2002, German technology shares recorded the largest fall. The Nemax 50 closed the year at 358.79, down 69%. Initially, the biotech sector seemed to fare better in the midst of the breakdown of the "new economy" and the resulting general distrust in technology businesses. However, as the year progressed, biotechnology shares were falling out of favour in an increasingly risk averse market environment. Eventually, the stock performance of the biotech industry in the U.S. and Europe dropped significantly throughout the year. Biotechnology shares were plagued by set backs in clinical drug development, continued losses due to high research and development spending and reductions in near-term growth expectations for biotech tools companies as a result of cost containment across the whole sector.
In Germany, scandals and deteriorating public perceptions of the Neuer Markt contributed to poor stock price performance. In 2000, numerous biotechnology investments were more driven by an unusual hype common to Neuer Markt companies at the time and less by fundamental strategic investment decisions. As a consequence, the Nemax biotech index lost almost 70% of its value in 2002, marked by significant sell-offs in parallel to the Neuer Markt down-turn.

**The market has uncoupled fundamentals from stock performance.** Consequently, at year-end, the successful fundamental development of many biotechnology companies was not reflected in their respective stock prices, which we believe is particulary true for the Evotec OAI stock. Numerous other companies ended the year with valuations significantly below their cash positions and|or book values.

**Shareholder structure**
(Source: Evotec OAI latest estimate, 02|2003)




**Evotec OAI shares began trading as a member of the new TecDAX, a technology index of 30 mid-cap technology companies, on 24 March 2003.**

**Evotec OAI shares accepted to Prime Standard segment becoming member of the new TecDAX 30.** Evotec OAI shares were among the first to be accepted into the German stock exchange's new Prime Standard segment as of 1 January 2003. In autumn 2002, the German stock exchange introduced new trading segments as well as a new index systematic based on the sectors and industry groups within the Prime segment. Companies that meet the high international transparency criteria may apply to this Prime segment, while others will be traded in the General Standard segment. The Prime segment transparency criteria include quarterly reporting, financial statements according to international accounting standards (IAS or U.S. GAAP), a corporate calendar, at least one annual analyst conference, and ad-hoc disclosure in English. Evotec OAI has always strived to adhere to the highest standards in its corporate reporting and was in compliance with the Prime Standard criteria already before the new segment was introduced.
According to the new sector classification, Evotec OAI's shares have been assigned to the technology sector. As such, it was decided on 11 February 2003, that Evotec OAI will be a member of the TecDAX, a new technology index of 30 mid-cap technology companies. Our shares will begin trading as a member of the index on 24 March 2003.

## Shareholdings of the Board of Evotec OAI AG

| | Holdings 31 December 2001 | | Holdings 31 December 2002 | | Transactions | | |
|---|---|---|---|---|---|---|---|
| | Shares | Stock options | Shares | Stock options | Date | Transaction type | Quantity |
| **Management Board** | | | | | | | |
| Joern Aldag | 278,000 | 72,600 | 281,000 | 132,600 | 10\|06\|02 | Purchase of shares | 3,000 |
| | | | | | 25\|11\|02 | Issuance of stock options | 60,000 |
| Dr Dirk H. Ehlers | 0 | 30,000 | 0 | 60,000 | 25\|11\|02 | Issuance of stock options | 30,000 |
| Dr Timm-H. Jessen | 136,172 | 53,232 | 136,172 | 83,232 | 25\|11\|02 | Issuance of stock options | 30,000 |
| Sean Marett [1] | – | – | 0 | 20,000 | 25\|11\|02 | Issuance of stock options | 10,000 |
| Dr Mario Polywka [2] | 32,565 | 45,000 | 32,565 [3] | 45,000 [3] | | | |
| **Supervisory Board** | | | | | | | |
| Prof Dr Heinz Riesenhuber | 110,000 | 0 | 110,400 | 0 | 05\|12\|02 | Purchase of shares | 400 |
| Peer Schatz | 3,892 | 0 | 3,892 | 0 | | | |
| Dr Pol Bamelis | 0 | 0 | 0 | 0 | | | |
| Dr Karsten Henco | 1,306,356 | 26,732 | 1,306,356 | 26,732 | | | |
| Dr Edwin Moses | 313,058 | 15,000 | 313,058 | 15,000 | | | |
| Michael Redmond | 1,000 | 0 | 1,000 | 0 | | | |

1) Member of the Management Board from 1 July 2002 until 31 December 2002
2) Member of the Management Board until 31 August 2002
3) As of 31 August 2002

**Financial institutions which regularly report on Evotec OAI**

| | | |
|---|---|---|
| Bank Vontobel AG | Equinet Institutional Services GmbH | M. M. Warburg & Co. |
| Bankgesellschaft Berlin AG | Goldman Sachs Global Equity Research | Sal. Oppenheim jr. & Cie. |
| Bankhaus Julius Bär | Helaba Trust GmbH | SES Research GmbH |
| Delbrück Asset Management | HSBC Trinkaus & Burkhardt KGaA | SG Securities Ltd |
| Deutsche Bank AG | ING Financial Markets | UBS Warburg |
| DZ Bank AG | Landesbank Baden-Württemberg | West LB Panmure Ltd |

**Stock option programmes—an important incentive in attracting and retaining highly qualified employees.** Evotec OAI offers all its employees the opportunity to become shareholders through stock option programmes. In November 2002, we issued a total of 616,868 options to our employees at an exercise price of € 2.20 and € 2.31. Although the necessary stock price performance, as required by our stock option programmes, could not be achieved throughout the previous year, the Supervisory Board agreed that stock options should be granted. This decision was taken to reflect the fact that all options granted previously are under water and to reward our employees for their strong dedication to the Company's development in a challenging environment. We believe that the down-turn of our stock price was to a large extent a result of the difficult capital markets and the resulting impact on our customers.
From options granted in previous years, only 3,083 were exercised in April. At the end of the year, the total number of options issued but not exercised amounted to 2,129,526.

**Your Investor Relations contact:**
**Phone: +49.(0)40.56081-286**
**investor.relations@evotecoai.com**
**Investor Relations information is available on our website www.evotecoai.com**

**Continued delivery of our business messages through comprehensive Investor Relations.** The challenging financial market environment of 2002 and declining investor appetite for biotechnology stocks did not prevent us from regularly informing investors about our business through comprehensive Investor Relations work. A continued dialogue with the financial community is particularly important to Evotec OAI in order to explain our business strategy, to demonstrate progress and reliability and, ultimately, to create shareholder value. During the year, we were particularly successful in building our institutional shareholder base in the UK—an investor community with a thorough understanding of the biotechnology industry and its inherent risks.
Over the course of the year, we made approximately 100 one-to-one presentations on-site in Hamburg, Germany, and Abingdon, UK, and at conferences and roadshows in Frankfurt, London, Edinburgh, Amsterdam, Brussels, Zurich, Paris, Milan and Copenhagen, New York, Boston and other U.S. cities. We maintained a strong presence within the global financial community, giving presentations at 13 international investor events, including six prominent conferences for the health care industries in the U.S. Although the current environment led financial institutions to withdraw resources and refocus their research activities increasingly on pharmaceutical companies or switch to completely different sectors, 18 financial analysts regularly report on the Company and play an important role in shaping opinion within our sector. As in previous years, our Annual Shareholder Meeting in May was well attended with approximately 300 participants and representation from more than 30% of Evotec OAI's share capital. All in all, we have again demonstrated our commitment to create the basis for a fair valuation of our Company by continuing our dialogue with analysts and investors.

**We were among the first companies to make a public statement on compliance with the new Corporate Governance Code in the 2001 annual report. In September 2002, we agreed to sign an even further reaching declaration.**

**Committed to high Corporate Governance standards.** Evotec OAI was among the first companies to make a public statement on compliance with the new German Corporate Governance Code in its 2001 annual report. In September 2002, the Management Board and the Supervisory Board agreed to sign an even further reaching public Corporate Governance Declaration, by which Evotec OAI voluntarily undertakes to comply with all so-called "shall"-recommendations as well as most of the suggestions of the German Corporate Governance Code and thereby additionally undertakes to follow further internationally recognised standards of fair and responsible Corporate Governance.
In December 2002, the Management Board and the Supervisory Board of Evotec OAI AG stated in accordance with § 161 German Stock Corporation Act:
Evotec OAI AG complies with the recommendations of the "Government Commission's German Corporate Governance Code" with the following exception:
For the members of the Management Board and Supervisory Board, there is a directors' and officers' liability insurance policy in place for the year 2002 with no deductible (Code No. 3.8). It is planned to include a suitable deductible with the renewal of the policy.
This deductible has been implemented in the meantime. Our compliance to higher Corporate Governance standards gives testimony to our shareholders that we are committed to maximum transparency and that we adhere to clearly defined responsibilities internally.

# Consolidated financial statements according to U.S. GAAP

**We have issued the audit opinion in German, which was translated as follows:**

"We have audited the consolidated financial statements, comprising the balance sheet, the income statement and the statements of changes in shareholders' equity and cash flows as well as the notes to the financial statements prepared by the Evotec OAI AG, Hamburg, (hereinafter "Company" or "Group") for the business year from 1 January to 31 December 2002. The preparation and the content of the consolidated financial statements in accordance with Accounting Principles Generally Accepted in the United States of America (U.S. GAAP) are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audit.

We conducted our audit of the consolidated financial statements in accordance with German auditing regulations and German generally accepted standards for the audit of financial statements promulgated by the Institut der Wirtschaftsprüfer (IDW). Those standards require that we plan and perform the audit such that it can be assessed with reasonable assurance whether the consolidated financial statements are free of material misstatements. Knowledge of the business activities and the economic and legal environment of the Group and evaluations of possible misstatements are taken into account in the determination of audit procedures. The evidence supporting the amounts and disclosures in the consolidated financial statements are examined on an a test basis within the framework of the audit. The audit includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the consolidated financial statements give a true and fair view of the net assets, financial position, results of operations and cash flows of the Group for the business year in accordance with Accounting Principles Generally Accepted in the United States of America.

Our audit, which also extends to the Group management report prepared by the Company's management for the business year from 1 January to 31 December 2002, has not led to any reservations. In our opinion on the whole the Group management report provides a suitable understanding of the Group's position and suitably presents the risks of future development. In addition, we confirm that the consolidated financial statements and the Group management report for the business year from 1 January to 31 December 2002, satisfy the conditions required for the Company's exemption from its duty to prepare consolidated financial statements and the Group management report in accordance with German law."

Hamburg, 27 February 2003

KPMG Deutsche Treuhand-Gesellschaft
Aktiengesellschaft Wirtschaftsprüfungsgesellschaft

| | |
|---|---|
| Papenberg | Dr Erle |
| German Public Auditor | German Public Auditor |
| (Wirtschaftsprüfer) | (Wirtschaftsprüfer) |

If the consolidated financial statements (either with or without the Group management report) are published or made available to third parties in a version other than the one on which we have issued our audit opinion (including translations into other languages) it is necessary to obtain our written agreement, in such cases where our audit opinion is quoted or where a reference is made to our audit; we refer in particular to § 328 of the German Commercial Code.

## Evotec OAI AG and Subsidiaries
## Consolidated balance sheets according to U.S. GAAP as of 31 December

| T€ except share data | Footnote reference | 2002 | 2001 | Δ 02\|01 in %* |
|---|---|---|---|---|
| **Assets** | | | | |
| **Current assets:** | | | | |
| – Cash and cash equivalents | | 21,308 | 18,651 | 14.25 |
| – Marketable securities | (4) | – | 9,182 | (100.00) |
| – Trade accounts receivable, net | | 10,166 | 11,890 | (14.50) |
| – Accounts receivable due from related parties | | 244 | 676 | (63.91) |
| – Inventories | (5) | 8,408 | 6,524 | 28.88 |
| – Deferred tax assets | (12) | 45 | 104 | (56.73) |
| – Current tax receivables | | 2,665 | 2,211 | 20.53 |
| – Prepaid expenses and other current assets | | 3,196 | 3,889 | (17.82) |
| **Total current assets** | | 46,032 | **53,127** | (13.35) |
| Long-term investments | (6) | 560 | 463 | 20.95 |
| Property, plant and equipment, net | (7) | 61,951 | 67,847 | (8.69) |
| Intangible assets, excluding goodwill, net | (8) | 29,601 | 44,519 | (33.51) |
| Goodwill | (8) | 102,851 | 228,612 | (55.01) |
| Other non-current assets | | 47 | 49 | (4.08) |
| **Total assets** | | 241,042 | **394,617** | (38.92) |

| | footnote reference | 2002 | 2001 | Δ 02\|01 in %* |
|---|---|---|---|---|
| **Liabilities and stockholders' equity** | | | | |
| **Current liabilities:** | | | | |
| – Current maturities of long-term loans | (10) | 1,067 | 829 | 28.71 |
| – Current portion of capital lease obligations | (11) | 386 | – | 100.00 |
| – Trade accounts payable | | 4,565 | 5,677 | (19.59) |
| – Accounts payable to related parties | | 8 | 40 | (80.00) |
| – Advanced payments received | | 5,703 | 1,590 | 258.68 |
| – Accrued liabilities | (9) | 4,726 | 8,160 | (42.08) |
| – Accrued vacation | | 826 | 812 | 1.72 |
| – Deferred revenues | | 2,695 | 2,463 | 9.42 |
| – Current tax payables | | 80 | – | 100.00 |
| – Other current liabilities | | 1,404 | 2,522 | (44.33) |
| **Total current liabilities** | | 21,460 | **22,093** | (2.87) |
| Long-term loans | (10) | 6,820 | 3,009 | 126.65 |
| Long-term capital lease obligations | (11) | 1,113 | – | 100.00 |
| Deferred tax liabilities | (12) | 15,544 | 21,221 | (26.75) |
| Other non-current liabilities | | 53 | 50 | 6.00 |
| **Minority interests** | | 645 | 653 | (1.23) |
| **Stockholders' equity:** | | | | |
| – Share capital** | (14) | 35,510 | 35,507 | 0.01 |
| – Additional paid-in capital | | 536,908 | 536,857 | 0.01 |
| – Unearned compensation | | (345) | (635) | (45.67) |
| – Other comprehensive loss | | (27,660) | (6,762) | 309.05 |
| – Retained deficit | | (349,006) | (217,376) | 60.55 |
| **Total stockholders' equity** | | 195,407 | **347,591** | (43.78) |
| **Total liabilities and stockholders' equity** | | 241,042 | **394,617** | (38.92) |

* unaudited
** 53,210,130 and 53,207,047 shares, 1 € nominal amount, authorised at 31 December 2002 and 2001, respectively; 35,510,130 and 35,507,047 shares issued and outstanding in 2002 and 2001, respectively

See accompanying notes to consolidated financial statements.

## Evotec OAI AG and Subsidiaries
## Consolidated statements of operations according to U.S. GAAP for the years ended December

| T€ except share data and per share data | footnote reference | 2002 | 2001 | Δ 02\|01 in %* |
|---|---|---|---|---|
| **Revenue:** | | | | |
| – Drug discovery products & development of technologies | | 11,825 | 12,358 | (4.31) |
| – Drug discovery services | | 58,170 | 50,867 | 14.36 |
| **Total revenue** | | 69,995 | **63,225** | 10.71 |
| **Costs of revenue:** | | | | |
| – Drug discovery products & development of technologies | | 3,768 | 5,212 | (27.71) |
| – Drug discovery services | | 34,763 | 28,102 | 23.70 |
| **Total costs of revenue** | | 38,531 | **33,314** | 15.66 |
| **Gross profit** | | 31,464 | **29,911** | 5.19 |
| **Operating costs and expenses:** | | | | |
| – Research and development expenses | | 23,012 | 23,012 | 0.00 |
| – Selling, general and administrative expenses | | 20,467 | 19,193 | 6.64 |
| – Amortisation of intangible assets | (8) | 12,018 | 140,175 | (91.43) |
| – Impairment of goodwill | | 109,389 | – | 100.00 |
| – Other operating expenses | | 2,090 | – | 100.00 |
| **Total operating costs and expenses** | | 166,976 | **182,380** | (8.45) |
| **Operating loss** | | (135,512) | **(152,469)** | (11.12) |
| **Other non-operating income (expense)** | | | | |
| – Interest income | | 681 | 1,743 | (60.93) |
| – Interest expense | | (331) | (249) | 32.93 |
| – Net loss from equity investments | (6) | (62) | (1) | 6,100.00 |
| – Foreign currency exchange gain (loss), net | | 210 | (246) | (185.37) |
| – Other non-operating income, net | | 615 | 1,663 | (63.02) |
| **Total non-operating income** | | 1,113 | **2,910** | (61.75) |
| **Loss before taxes and minority interests** | | (134,399) | **(149,559)** | (10.14) |
| – Income tax benefit | (12) | 2,755 | 1,831 | 50.46 |
| – Minority interests | | 14 | (22) | (163.64) |
| **Net loss** | | (131,630) | **(147,750)** | (10.91) |

| | | |
|---|---|---|
| **Weighted average shares outstanding** | 35,509,285 | 35,455,457 |
| **Net loss per share** | (3.71) | (4.17) |

* unaudited

See accompanying notes to consolidated financial statements.

## Evotec OAI AG and Subsidiaries
## Consolidated statements of cash flows according to U.S. GAAP for the years ended 31 December

| T€ | 2002 | 2001 |
|---|---|---|
| **Cash flows from operating activities:** | | |
| Net loss | (131,630) | (147,750) |
| Adjustments to reconcile net loss to net cash used in operating activities: | | |
| – Depreciation of property, plant and equipment | 11,105 | 9,889 |
| – Amortisation of intangible assets | 12,018 | 140,175 |
| – Impairment of goodwill | 109,389 | – |
| – Net loss from equity investments | 62 | 1 |
| – Stock compensation expense | 324 | 272 |
| – Gain on sale of marketable securities, net | (55) | (252) |
| – Loss on sale of long-term investments | 20 | – |
| – Loss on sale of property, plant and equipment, net | 68 | 7 |
| – Deferred tax benefit | (2,928) | (2,036) |
| – Minority interests | (14) | 22 |
| – Decrease (increase) in: | | |
| – Accounts receivable | 1,602 | (1,600) |
| – Inventories | (2,072) | (1,002) |
| – Other assets from sale of shares in subsidiaries | (5) | – |
| – Other assets | 57 | (1,488) |
| – Increase (decrease) in: | | |
| – Accounts payable | (912) | 1,879 |
| – Advanced payments received | 4,113 | 1,128 |
| – Deferred revenues | 423 | (1,298) |
| – Accrued liabilities | (1,603) | (706) |
| – Current taxes payable | 80 | (698) |
| – Other liabilities | (1,012) | 932 |
| **Net cash used in operating activities** | **(970)** | **(2,525)** |
| **Cash flows from investing activities:** | | |
| – Purchase of marketable securities | (1,923) | (24,960) |
| – Purchase of long-term investments | (11) | – |
| – Purchase of property, plant and equipment | (7,299) | (16,652) |
| – Purchase of intangible assets | (28) | (879) |
| – Proceeds from sale of property, plant and equipment | 11 | 1 |
| – Proceeds from sale of shares in long-term investments | 443 | – |
| – Proceeds from sale of shares in subsidiaries | 1 | – |
| – Proceeds from sale of marketable securities | 10,978 | 32,319 |
| **Net cash provided by (used in) investing activities** | **2,172** | **(10,171)** |
| **Cash flows from financing activities:** | | |
| – Proceeds from capital increase | 20 | 357 |
| – Net proceeds from increase of loans | 4,914 | – |
| – Repayment of loans | (823) | (394) |
| **Net cash provided by (used in) financing activities** | **4,111** | **(37)** |
| | | |
| Net increase (decrease) in cash and cash equivalents | 5,313 | (12,733) |
| Exchange rate difference | (2,656) | (1,100) |
| **Cash and cash equivalents at beginning of year** | **18,651** | **32,484** |
| | | |
| **Cash and cash equivalents at end of year** | **21,308** | **18,651** |

See accompanying notes to consolidated financial statements.

## Evotec OAI AG and Subsidiaries
## Supplemental disclosures of cash flow information for the years ended 31 December

| T€ | 2002 | 2001 |
|---|---|---|
| **Cash paid during the year for:** | | |
| – Interest | 331 | 176 |
| – Taxes | 1,018 | 795 |

| | | |
|---|---|---|
| **Supplemental schedule of non-cash activities:** | | |
| – Acquisition of long-term investments | 611 | – |
| – Additions to capital leases | 1,335 | 870 |
| – Removal of embargo | (942) | 1,600 |
| – Change in embargo intangibles | (658) | – |
| – Acquisition adjustment of Evotec OAI Ltd (formerly Oxford Asymmetry International plc.) | (1,432) | 16,690 |
| – Transfer of assets under construction to inventory | – | 375 |
| – Other adjustments to investment | – | (2,828) |
| – Acquisition of GENION Forschungsgesellschaft mbH | – | 1,077 |

See accompanying notes to consolidated financial statements.

## Evotec OAI AG and Subsidiaries
## Consolidated fixed asset movement schedule according to U.S. GAAP

| T€ | Acquisition and manufacturing costs | | | | | |
|---|---|---|---|---|---|---|
| | 01\|01\|2002 | Foreign exchange | Additions | Disposals and impairments | Reclass | 31\|12\|2002 |
| **I. Intangible assets** | | | | | | |
| 1. Patents and licences | 3,736 | – | 28 | 658 | – | 3,106 |
| 2. Goodwill | 228,612*** | (14,940) | – | 110,821 | – | 102,851 |
| 3. Developed technology | 33,741 | (2,079) | – | – | – | 31,662 |
| 4. Customer list | 22,948 | (1,515) | – | – | – | 21,433 |
| | **289,037** | **(18,534)** | **28** | **111,479** | **–** | **159,052** |
| **II. Tangible fixed assets** | | | | | | |
| 1. Buildings and leasehold improvements | 25,633 | (1,653) | 284 | – | 517 | 24,781 |
| 2. Plant, machinery and equipment | 41,817 | (2,545) | 2,665 | 542 | 5,911 | 47,306 |
| 3. Furniture and fixtures | 9,570 | (514) | 1,168 | 185 | 432 | 10,471 |
| 4. Purchased software | 847 | – | 349 | – | – | 1,196 |
| 5. Capital leases | 870 | (57) | 1,335 | – | – | 2,148 |
| 5. Assets under construction | 7,229 | (236) | 2,833 | – | (6,860) | 2,966 |
| | **85,966** | **(5,005)** | **8,634** | **727** | **–** | **88,868** |
| **III. Financial assets** | | | | | | |
| 1. Long-term investments | 463 | – | 622 | 525 | – | 560 |
| 2. Other financial assets | 49 | – | – | 2 | – | 47 |
| | **512** | **–** | **622** | **527** | **–** | **607** |
| | **375,515** | **(23,539)** | **9,284** | **112,733** | **–** | **248,527** |

* calculated at the yearly average foreign exchange rate results in an increase of T€ 405
** calculated at the yearly average foreign exchange rate results in an increase of T€ 267
*** net of accumulated amortisation as of 31 December 2001 of T€ 162,195

See accompanying notes to consolidated financial statements.

## Evotec OAI AG and Subsidiaries
## Consolidated statements of changes in stockholders' equity and comprehensive loss according to U.S. GAAP

| T€ except share data | Share capital | | Additional paid-in capital | Unearned compensation |
|---|---|---|---|---|
| | Shares | Amount | | |
| **Balance at 31 December 2000** | **35,452,148** | **35,452** | **539,179** | **(703)** |
| Share capital increase | 54,899 | 55 | 302 | – |
| Stock option plan | – | – | 204 | 68 |
| Other adjustments to additional paid-in capital | – | – | (2,828) | – |
| **Comprehensive loss:** | | | | |
| – Foreign currency translation | – | – | – | – |
| – Net unrealised holding losses on available-for-sale securities | – | – | – | – |
| – Net loss | – | – | – | – |
| **Total comprehensive loss** | | | | |
| **Balance at 31 December 2001** | **35,507,047** | **35,507** | **536,857** | **(635)** |
| Share capital increase | 3,083 | 3 | 17 | – |
| Stock option plan | – | – | 34 | 290 |
| **Comprehensive loss:** | | | | |
| – Foreign currency translation | – | – | – | – |
| – Net unrealised holding losses on available-for-sale securities | – | – | – | – |
| – Net loss | – | – | – | – |
| **Total comprehensive loss** | | | | |
| **Balance at 31 December 2002** | **35,510,130** | **35,510** | **536,908** | **(345)** |

See accompanying notes to consolidated financial statements.

| | Depreciation and amortisation | | | | | Net book value | |
|---|---|---|---|---|---|---|---|
| | 01\|01\|2002 | Foreign exchange | Additions | Disposals | 31\|12\|2002 | 31\|12\|2002 | 31\|12\|2001 |
| | 1,332 | – | 788 | – | 2,120 | 986 | 2,404 |
| | – | – | – | – | – | 102,851 | 228,612 |
| | 8,828 | (532) | 6,539 | – | 14,835 | 16,827 | 24,913 |
| | 5,746 | (387) | 4,286 | – | 9,645 | 11,788 | 17,202 |
| | **15,906** | **(919)** | **11,613*** | **–** | **26,600** | 132,452 | **273,131** |
| | 2,036 | (223) | 1,486 | – | 3,299 | 21,482 | 23,597 |
| | 10,671 | (844) | 6,633 | 465 | 15,995 | 31,311 | 31,146 |
| | 4,718 | (322) | 2,317 | 183 | 6,530 | 3,941 | 4,852 |
| | 648 | – | 165 | – | 813 | 383 | 199 |
| | 46 | (3) | 237 | – | 280 | 1,868 | 824 |
| | – | – | – | – | – | 2,966 | 7,229 |
| | **18,119** | **(1,392)** | **10,838**** | **648** | **26,917** | 61,951 | **67,847** |
| | – | – | – | – | – | 560 | 463 |
| | – | – | – | – | – | 47 | 49 |
| | **–** | **–** | **–** | **–** | **–** | 607 | **512** |
| | **34,025** | **(2,311)** | **22,451** | **648** | **53,517** | 195,010 | **341,490** |

| Foreign currency translation adjustment | Unrealised gains (losses) on securities | Accumulated deficit | Total stockholders' equity |
|---|---|---|---|
| **(2,443)** | **636** | **(69,626)** | **502,495** |
| – | – | – | 357 |
| – | – | – | 272 |
| – | – | – | (2,828) |
| (4,471) | – | – | (4,471) |
| – | (484) | – | (484) |
| – | – | (147,750) | (147,750) |
| | | | **(152,705)** |
| **(6,914)** | **152** | **(217,376)** | **347,591** |
| – | – | – | 20 |
| – | – | – | 324 |
| (20,746) | – | – | (20,746) |
| – | (152) | – | (152) |
| – | – | (131,630) | (131,630) |
| | | | **(152,528)** |
| **(27,660)** | **–** | **(349,006)** | **195,407** |

## (1) Business Description and Basis of Presentation

Evotec OAI AG and subsidiaries ("Evotec" or the "Company") is a biotechnology group serving the life science industry by designing and applying technologies for highly effective drug discovery. Evotec offers a comprehensive range of high-value added services and products required to increase the efficiency and at the same time reduce the risk in the identification of new drugs. By integrating proprietary state-of-the-art technologies and processes in biology, chemistry and screening, the Company has established a unique position for the critical elements in the drug discovery and development process—from target to clinical development.

The Company was founded on 8 December 1993 as EVOTEC BioSystems GmbH. Evotec had an initial public offering in Germany on 10 November 1999.

The consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America ("U.S. GAAP") and include the accounts of Evotec OAI AG and all companies which are under its control. All intercompany transactions and balances have been eliminated in consolidation.

Investments where Evotec does not have a controlling interest but is in a position to influence the operating or capital decisions of the investee are carried at equity.

All amounts herein are shown in thousands of Euro ("T€"), unless indicated otherwise.

Certain balances in the prior fiscal year consolidated financial statements and notes have been reclassified to conform to the presentation adopted in the current fiscal year.

## (2) Summary of Significant Accounting Policies

The following is a summary of significant accounting policies followed in the preparation of the accompanying consolidated financial statements.

**Cash and Cash Equivalents.** The Company considers all highly liquid short-term investments with original maturities of three months or less to be cash equivalents.

**Marketable Securities.** The Company applies Financial Accounting Standards Board ("FASB") Statement of Financial Accounting Standards ("SFAS") No. 115, "Accounting for Certain Investments in Debt and Equity Securities". In accordance with SFAS No. 115, the Company has classified all of its debt and equity securities as available-for-sale and states them at fair value as determined by the most recently traded price of each security at the balance sheet date. Unrealised gains and losses are included in accumulated other comprehensive loss, a separate component of stockholders' equity. Unrealised losses deemed to be other than temporary are reported in other non-operating expense.

Realised gains and losses from the sale of available-for-sale securities are determined based on specific identification of the cost of securities sold and are reported in other non-operating income and expense.

**Inventories.** Inventories are valued at the lower of cost or market, cost being generally determined on the basis of an average method. Cost consists of purchased component costs and manufacturing costs, which are comprised of direct material and labour costs and certain indirect costs. Costs are removed to costs of revenue based on specific identification.

**Property, Plant and Equipment.** Property, plant and equipment acquisitions, including leasehold improvements, are recorded at cost less any vendor rebates. Amortisation of leasehold improvements is calculated using the straight-line method over the shorter of the related lease term or the estimated useful life. Leased property, plant and equipment meeting certain criteria are capitalised and the present value of the related lease payments is recorded as a liability. Depreciation of property, plant and equipment, which includes amortisation of assets under capital leases, is calculated using the straight-line method over the estimated useful lives of the assets as follows:

| | |
|---|---|
| Buildings and leasehold improvements | 11–35 years |
| Plant, machinery and equipment | 3–20 years |
| Furniture and fixtures | 3–10 years |
| Computer equipment and software | 3 years |

The costs included in property, plant and equipment related to assets under construction are not depreciated until the assets are placed into service by the Company. Upon sale or retirement, the costs and the related accumulated depreciation are removed from the respective accounts, and any gain or loss is included in other operating income and expense. Maintenance and repairs are expensed as incurred.

**Intangible Assets, excluding Goodwill.** Intangible assets, excluding goodwill, consist of separately identified intangible assets such as developed technologies, customer lists and patents which were acquired in business combinations, as well as purchased licences and patents.
Intangible assets with definite lives are recorded at cost and are amortised using the straight-line method over the estimated useful lives of the assets:

| | |
|---|---|
| Developed technologies | 3–5 years |
| Customer list | 5 years |
| Patents | 10 years or shorter life |

The weighted average years of amortisation for developed technology, customer list and patents are 4.9, 5.0 and 8.3 years, respectively.

**Revenue Recognition.** Revenue under collaborative long-term research and development ("R&D") agreements is recognised when earned and realisable based upon the performance requirements of the respective agreements. Advance payments received in excess of amounts earned are recorded as deferred revenue. Revenue under these long-term collaborative agreements typically consists of the following:

1. Technology Access Fees—Lump-sum up-front fees are typically made to finance the Company's ongoing research and development activities. Revenue from technology access fees associated with collaborative research and development efforts is recognised rateably over the related forecasted research period.
2. Research Payments—Revenue from research payments finances both direct costs incurred in connection with the Company's ongoing research and development activities and indirect costs incurred as part of an allocation of certain other administrative expenses. Revenue from research payments is recognised rateably over the related forecasted research period as services are provided.
3. Success Payments—Revenue contingent upon the attainment of certain R&D milestones is recognised in the period the milestone is successfully achieved. This usually occurs when the funding party agrees that the requirements stipulated in the agreement have been met.

Revenues from the sale of systems, equipment and devices are recorded at the time of delivery, title transfer or upon final acceptance by the customer as required by agreement.
Product and chemical compound sales are recorded as revenue upon delivery if the Company has a customer order, the price is determinable and collectibility is reasonably assured. The Company assesses collectibility based on a number of factors, including past transaction history with the customer and their credit-worthiness.
Service revenues generated from contracted services are recognised as the services are rendered. Revenue from compound access fees is recognised rateably over the related forecasted service period. Payments for contracted services are generally paid in advance and recorded as deferred revenue until earned. Some contracted services are settled in part by non-monetary payments. Due to the relatively insignificant portion of the contract value which is represented by the non-monetary portion, revenues derived from these particular contracts are recognised on the same basis as that used in monetary transactions.
The Company has entered into multiple-element contracts and carefully determined the functionality of the individual elements of the contracts. Only if an element is considered not to be essential for other elements will it be accounted for on a single basis.
Under the terms of various contractual arrangements, Evotec receives royalty payments which are incremental to the other company's respective product sales. Royalty income of T€ 474 and T€ 18 is included in product revenue for 2002 and 2001, respectively.

**Derivative policy.** The Company does not engage in derivatives trading, market-making or other speculative activities. The Company enters from time to time into agreements to obtain foreign currencies at specified rates based on expected future cash flows for each currency. Changes in the value of derivative financial instruments are measured at the balance sheet date and recognised in current earnings.

**Income Taxes.** Under the asset and liability method, deferred tax assets and liabilities are recognised for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases as well as for operating tax loss carry forwards. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognised in the period that includes the enactment date. In assessing the recoverability of deferred tax assets, management considers whether it is more likely than not that some portion or all of the deferred tax assets will not be realised.

**Research and Development.** Research and development costs are expensed as incurred. Costs to develop software internally which is used as an integral part of a product or process is capitalised when both the technological feasibility of the software component is established and the research and development activities relating to the hardware component have been successfully completed. These conditions are usually met shortly be-

fore the product or process is launched and as a result no development costs of software have been capitalised. The software included in property, plant and equipment consists only of purchased software.
The Company receives grants from government authorities for the support of specific research and development projects. The grants are requested when qualifying expenses have been incurred and are recognised as a reduction of research and development expense when they are received. The amounts recognised as a reduction of the Company's research and development expense were T€ 1,071 and T€ 967 in 2002 and 2001, respectively. Under the terms of the grants, the governmental agencies generally have the right to audit the submitted qualifying expenses of the Company.

**Translation of Foreign Operations and Foreign Currency Denominated Transactions.** The assets and liabilities of foreign subsidiaries with functional currencies other than the Euro are translated into Euro using period-end exchange rates, while the revenues and expenses of such subsidiaries are translated using average exchange rates during the period which approximate the rates in effect on the dates transactions occurred. Gains or losses resulting from translating foreign functional currency financial statements are included in other comprehensive loss and are reported as a separate component of stockholders' equity. Gains or losses resulting from foreign currency denominated operating transactions are included in selling, general and administrative expenses. Gains or losses resulting from foreign currency denominated non-operating transactions are included in other non-operating income and expense.

**Impairment of Long-Lived Assets.** The Company reviews long-lived assets, excluding goodwill, for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. The recoverability of assets to be held and used is measured by a comparison of the carrying amount of an asset to the undiscounted amount of estimated future cash flows expected to be generated by the asset. If such assets are considered to be impaired, the impairment recognised is measured by the amount by which the carrying amount of the assets exceeds the discounted amount of estimated future cash flows. Considerable management judgement is necessary to estimate discounted future cash flows. Assets to be disposed of are reported at the lower of the carrying amount or the fair value less costs to sell and are not depreciated.

**Impairment of Goodwill.** In 2002, the Company adopted SFAS No.142, "Goodwill and Other Intangible Assets". SFAS No. 142 mandates a fair value approach to assessing the potential impairment of goodwill and other intangible assets with indefinite lives. No impairment was noted as of the date of adoption. In a first step of the impairment test, the fair values of each reporting unit are estimated using the discounted amount of estimated future cash flows. The discount rates for each reporting unit reflect an assessment of all inherent reporting unit risks. If the fair value of a reporting unit is less than its book value, a second step is performed that compares the implied fair value of the reporting unit's goodwill to the carrying value of its goodwill. Any difference between the carrying value and the lower implied fair value of goodwill is recorded as an impairment charge.
Any impairment is reported as a separate component of operating costs and expenses in the consolidated statement of operations.

**Comprehensive Loss.** Comprehensive loss consists of net loss, foreign currency translation adjustments, and unrealised gains (losses) on marketable securities and is presented in the consolidated statements of changes in stockholders' equity and comprehensive loss.

**Stock Compensation.** The Company has elected to apply the provisions of Accounting Principles Board Opinion ("APB") No. 25, "Accounting for Stock Issued to Employees" in accounting for options granted under its stock option plan. Compensation cost from the issuance of employee stock options is measured using the intrinsic value method and is charged to expense over the vesting period. The following table illustrates the effect on net loss and net loss per share if the Company had applied the fair value method provisions of SFAS No. 123, "Accounting for Stock-Based Compensation":

| T€ except per share data | 2002 | 2001 |
|---|---|---|
| Net loss, as reported | (131,630) | (147,750) |
| Add compensation expense | | |
| determined under APB 25 | 324 | 272 |
| Less compensation expense | | |
| determined under SFAS 123 | (1,265) | (1,090) |
| **Adjusted net loss** | **(132,571)** | **(148,568)** |
| Net loss per share \| As reported in € | (3.71) | (4.17) |
| Net loss per share \| Adjusted in € | (3.73) | (4.19) |

The adjusted amounts do not reflect any tax effects due to the 100% valuation allowance on the deferred tax assets in Germany.

**Use of Estimates.** The preparation of the accompanying consolidated financial statements requires management to make estimates and assumptions that affect both the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities as of the date of the financial statements as well as the reported amounts of revenues and expenses during the reporting period. Actual results could differ from Management's estimates. In addition, changes in the current economic conditions and other events could also have a significant effect on reported amounts.

**Recent Pronouncements.** In June 2002, the FASB issued SFAS No. 146, "Accounting for Costs Associated with Exit or Disposal Activities". SFAS No. 146 applies to costs associated with an exit activity that does not involve an entity newly acquired in a business combination or with a disposal activity covered by SFAS No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets". The Company plans to adopt SFAS No. 146, effective 1 January 2003. It is not expected that the adoption of SFAS No. 146 will have a material effect on the Company's consolidated financial statements.

In December 2002, the FASB issued SFAS No. 148, "Accounting for Stock-Based Compensation—Transition and Disclosure an amendment of FASB Statement No. 123". This statement amends SFAS No. 123, "Accounting for Stock-Based Compensation", to provide alternative methods of transition for an entity that voluntarily changes to the fair value based method of accounting for stock-based employee compensation as well as more prominent disclosure about the effects on reported net income of using the alternative intrinsic value method. The Company adopted SFAS No. 148, effective 31 December 2002, regarding the amended disclosure requirements. The Company has not changed to the fair value based method of accounting for stock-based employee compensation.

In December 2002, the FASB issued Interpretation No. 45, "Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others". This interpretation addresses the disclosures and liability recognition requirements in a guarantor's interim and annual financial statements. Under the new Interpretation, a liability must be recognised at the inception of a guarantee whether or not payment is probable. The Company adopted FASB Interpretation No. 45, effective 31 December 2002, regarding the disclosure requirements. The Company will adopt the initial recognition and measurement provisions of this Interpretation effective 1 January 2003.

In December 2002, FASB's Emerging Issues Task Force (EITF) issued its Consensus on EITF Issue 00-21, "Revenue Arrangements with Multiple Deliverables". The Consensus mandates how to identify whether goods or services or both that are to be delivered separately in a bundled sales arrangement should be accounted for individually because they are unique units of accounting. The Consensus applies to all contractually-binding arrangements to deliver more than one product or service. The guidance in EITF Issue 00-21 is effective for revenue arrangements entered into in fiscal periods beginning after 15 June 2003. It is not practicable to reasonably estimate the impact on the consolidated financial statements of the adoption of EITF Issue 00-21 at the date of this report.

**(3) Use Restrictions on the Company's Technology**

Evotec is subject to certain restrictions concerning technologies arising in the course of its cooperations with GlaxoSmithKline (GSK) and Novartis.

Under the terms of an amended contract with GSK, Evotec may use the results of a collaboration agreement for projects not related to pharmaceutical drug discovery, for internal projects in pharmaceutical drug discovery, or in "external target collaborations", i. e. cooperations which the Company enters into with third parties with respect to the screening of chemical or biological substances on a pharmaceutical target, provided that the number of molecular targets does not exceed certain restrictions. These restrictions lapse in April 2003.

A second amendment to this agreement, signed in May 2001, allows Evotec to sell detection systems and liquid handling devices, which have a restricted throughput of compounds per day. As part of the amendment, GSK was entitled to receive a specific number of systems and devices under preferred conditions. The estimated future commitment was accrued in 2001 and resulted in the recognition of an intangible asset. The intangible asset is amortised over the remaining period of the original restriction, that being two years. In 2002, the Company delivered all of the systems and devices which GSK was entitled to under the previously mentioned amendment. The settlement of this obligation resulted in the Company reducing the cost basis of the respective intangible assets. In addition, the amendment grants Evotec the right to enter into other collaborative agreements with two additional funding partners. In the case such agreements are established, GSK will receive a specified amount of credits against future goods depending on the number of additional funding partners. As of the balance sheet date, the Company has not entered into any additional funding partner collaborative agreements.

With regards to the "external target collaborations" under an agreement with Novartis, Evotec must pay royalties equal to 5% of qualifying revenue to Novartis for a period of ten years expiring on 16 March 2008. The Company has recorded royalty expenses of T€ 20 and T€ 54 in 2002 and 2001, respectively.

In December 2001, Evotec signed an amendment to the Novartis agreement which allows Evotec to sell detection systems and liquid handling devices which have a restricted throughput of compounds per day. As part of the amendment, Novartis was entitled to buy a specific number of systems and devices under preferred conditions and (or) participate in a share of the revenue on the sales of the equipment to third parties up to a limited amount. In consideration for the rights received in 2001, the Company accrued a liability and recognised an intangible asset, each in the amount of T€ 400. The intangible asset is amortised over the remaining period of the original restriction—that being two years. In 2002, the Company has fulfilled all its obligations under the previously mentioned amendment and settled its liability.

### (4) Marketable Securities

Marketable securities, considered available-for-sale securities, consist of the following:

| T€ | 31|12|2002 | 31|12|2001 |
|---|---|---|
| Money market mutual funds | – | 7,284 |
| Foreign corporate bonds | – | 1,898 |
| **Total marketable securities** | **–** | **9,182** |

All bonds in 2001 were publicly traded, were due within one year and were denominated in U.S. dollars.
The unrealised gain on these securities amounted to T€ 152 as of 31 December 2001. Realised losses on the sale of corporate bonds amounted to T€ 22 and T€ 42 in 2002 and 2001, respectively. Realised gains on the sale of money market mutual funds, foreign government bonds and corporate bonds amounted to T€ 70, T€ 0 and T€ 7 in 2002, respectively, and to T€ 280, T€ 5 and T€ 9 in 2001, respectively.

### (5) Inventories

Inventories consist of the following:

| T€ | 31|12|2002 | 31|12|2001 |
|---|---|---|
| Raw materials | 4,816 | 3,788 |
| Work-in-progress | 3,231 | 2,256 |
| Finished goods | 361 | 480 |
| **Total inventories** | **8,408** | **6,524** |

Raw materials consist of biological materials and substances, chemicals and components of instruments. Work-in-progress primarily consists of costs incurred on customer projects and laboratory equipment which were not completed at year end. Finished goods include finished laboratory equipment and customer projects which are ready for shipment. The Company carries an allowance on raw materials of T€ 205 and T€ 170, included in the amounts above, as of 31 December 2002 and 2001, respectively.

### (6) Long-term Investments

Long-term investments consist of the following:

| T€ | 31|12|2002 | 31|12|2001 |
|---|---|---|
| QE-Diagnostiksysteme GmbH | – | 463 |
| DIREVO Biotech AG | – | – |
| Vmax Ltd. | 52 | – |
| SiREEN AG | 125 | – |
| Prolysis Ltd. | 383 | – |
| **Total long-term investments** | **560** | **463** |

Evotec had a 50% investment in QE-Diagnostiksysteme GmbH ("QED"), which was accounted for under the equity method of accounting. The Company's accumulated equity contributions and advances to QED amounted to T€ 1,089 at 31 December 2001. The amount by which Evotec's share of QED's prior year losses exceeded Evotec's equity investment was set off against the advances due from QED. The remaining carrying amount of advances, recorded in long-term investments, was T€ 463 as of 31 December 2001. On 31 March 2002, Evotec sold its share in QED which resulted in a loss of T€ 20 shown under other non-operating income. The Company's share of the net loss of QED in 2002 amounted to T€ 0 prior to the sale and T€ 1 for 2001.
Evotec has a 32.5% voting interest by virtue of a 65% investment in the common stock of DIREVO Biotech AG ("Direvo"), which is accounted for under the equity method of accounting. Direvo is involved in screening-based directed evolution and applies its integrated proprietary technologies to the development of biopharmaceuticals, industrial enzymes, chemical biocatalysts and enzymes for food and feed. Due to the redeemable feature of the preferred shares, the Company reduced the investment in Direvo to zero in 2001. On 16 December 2002, at the annual general meeting, the shareholders of Direvo decided to issue 43,072 new shares of preference stock. Because of the voting rights held by the preferred stockholders, Evotec's proportionate voting interest of Direvo will decrease from 32.5% to 22.72% once the capital increase is registered in the trade register. As of 31 December 2002, this had not occurred.
The Company's share of the net loss of Direvo amounted to T€ 11 in 2002, which was set off against a current year advance, and T€ 0 for 2001. The remaining carrying amount of the investment is T€ 0 as of 31 December 2002 and 2001, respectively. For the year ended 31 December 2002, Direvo had generated revenues of T€ 267 and incurred a net loss of T€ 2,339.
Evotec acquired a 46.36% investment in the common stock of Vmax Ltd. ("Vmax") on 22 August 2002, which is accounted for under the equity method of accounting. Vmax specialises in the field of the discovery and development of small molecule antimicrobials. Through 31 December 2002, Vmax had not generated any revenue. The Company's accumulated equity contributions and advances to Vmax amounted to T€ 103 at 31 December 2002. The Company's share of the net loss of Vmax amounted to T€ 51 for 2002. The amount by which Evotec's share of the loss of the investee exceeded the equity investment was set off against the advances. The remaining carrying amount of advances, recorded in long-term investments, is T€ 52 as of 31 December 2002.
Evotec acquired a 5% investment in the common stock of SiREEN AG ("Sireen"), during the foundation of the Company in January 2002. This investment is accounted for at cost and is subject to a regular fair value impairment review. On 11 October 2002, Sireen issued to new

investors 118,548 shares of voting redeemable preference stock. Due to the participation of Evotec in this capital increase, the investment increased from 5% to 6.36%. This investment is partly paid by services provided in a drug discovery agreement between Evotec and Sireen (2002: T€ 115). The carrying amount of the investment is T€ 125 as of 31 December 2002.

Evotec acquired a 3.88% investment in the common stock of Prolysis Ltd. as part of a three year drug discovery agreement where Evotec will earn additional shares by performing services for Prolysis. All shares have or will be acquired through non-monetary payments. The shares are held as a long-term investment at cost and are subject to a regular fair value impairment review. As of 31 December 2002 the carrying amount of the investment is T€ 383, which was earned in accordance with the above mentioned agreement.

The long-term investments of Evotec continue to have losses and, therefore, do not have undistributed profits.

The Company has recorded revenues in 2002 with the investments SiREEN and Prolysis in the amount of T€ 565 and T€ 1,018, respectively. No further material transactions with investments of the Company were recorded.

## (7) Property, Plant and Equipment

Property, plant and equipment consist of the following:

| T€ | 31\|12\|2002 | 31\|12\|2001 |
|---|---|---|
| Buildings and leasehold improvements | 24,781 | 25,633 |
| Plant, machinery and equipment | 47,306 | 41,817 |
| Furniture and fixtures | 10,471 | 9,570 |
| Purchased software | 1,196 | 847 |
| Capital leases | 2,148 | 870 |
| Assets under construction | 2,966 | 7,229 |
| **Fixed assets, at cost** | 88,868 | 85,966 |
| Less accumulated depreciation | | |
| without software | 26,104 | 17,471 |
| Less accumulated amortisation | | |
| of software | 813 | 648 |
| **Total property, plant and equipment** | 61,951 | 67,847 |

The main additions in 2002 relate both to a new building situated in Abingdon, UK, which is included in assets under construction, and to laboratory equipment for the screening unit situated in Hamburg. Upon completion of the assets under construction, costs are transferred into their respective fixed assets classification. Depreciation expense amounted to T€ 11,105 and T€ 9,889 in 2002 and 2001, respectively.

The net book values included in the fixed assets as of 31 December 2002, are plant and machinery of T€ 1,768 and fixture and fittings of T€ 100 which are held under capital leases. The related amortisation in 2002 amounts to T€ 208 and T€ 29, respectively.

## (8) Other Intangible Assets and Goodwill

Intangible assets, excluding goodwill, consist of the following:

| T€ | 31\|12\|2002 | 31\|12\|2001 |
|---|---|---|
| Developed technologies | 31,662 | 33,741 |
| Customer list | 21,433 | 22,948 |
| Patents and licences | 3,106 | 3,736 |
| **Intangible assets, at cost** | 56,201 | 60,425 |
| Less accumulated amortisation | 26,600 | 15,906 |
| **Total intangible assets** | 29,601 | 44,519 |

Amortisation expense of intangible assets amounted to T€ 12,018 and T€ 11,820 in 2002 and 2001, respectively. The estimated aggregate amount of amortisation of developed technologies and customer list is as follows:

| T€ | |
|---|---|
| 2003 | 10,904 |
| 2004 | 10,292 |
| 2005 | 7,719 |
| Thereafter | – |
| **Total** | 28,915 |

All goodwill of the Company has been allocated to the discovery and development services segment. The Company has tested its discovery and development services segment for impairment on the annual designated test date of 31 October 2002. As a result of that test, the Company concluded that T€ 109,389 of the goodwill carried as of that date was impaired resulting in the write-off of all of the goodwill at the Biology Services and Pilot Plant reporting units, leaving a balance at 31 December 2002 of T€ 102,851. Management believes that deteriorating market conditions and increasing margin pressures have caused a sharp decline of the market capitalisation of the Company, this decline has led to a revision of Management's estimations and assumptions of operating profits and cash flows. The fair values of the Company's reporting units Discovery Chemistry Services, Biology Services, Development Chemistry and the Pilot Plant, which all belong to the discovery and development services segment, were estimated using established valuation techniques, specifically the discounting of estimated future cash flows.

The following table shows the effect of SFAS No. 142 as if it had been adopted or all periods represented:

| T€ except per share data | 2002 | 2001 |
|---|---|---|
| Net loss, as reported | (131,630) | (147,750) |
| Add amortisation of goodwill | – | 128,355 |
| **Adjusted net loss** | (131,630) | (19,395) |
| Net loss per share \| As reported in € | (3.71) | (4.17) |
| Net loss per share \| Adjusted in € | (3.71) | (0.55) |

## (9) Accrued Liabilities

The accrued liabilities consist of the following:

| T€ | 31|12|2002 | 31|12|2001 |
|---|---|---|
| Accrued outstanding invoices | 1,558 | 3,517 |
| Bonus accruals | 1,527 | 2,735 |
| Liabilities to collaborative partners | – | 1,600 |
| Other accrued liabilities | 1,641 | 308 |
| **Total accrued liabilities** | **4,726** | **8,160** |

The change of accrued liabilities is primarily due to the reduction of outstanding invoices and settlement of the liabilities to collaborative partners. The reduction of outstanding invoices is due to the finished outstanding work for the pilot plant in Abingdon and a change in utility providers invoicing policy. Additionally, the bonus accruals were reduced due to Management's decision to reduce the variable component of compensation.

## (10) Long-Term Loans

In February 1998, the Company entered into a T€ 5,113 loan agreement with a bank of which T€ 2,556 is still outstanding. This loan carries a fixed interest rate of 5% per annum and is repayable in semi-annual instalments of T€ 320 ending on 30 September 2006. This loan is secured by certain patents, receivables and equipment. In July 2002, the Company entered into a T€ 5,000 loan agreement with a bank of which T€ 4,700 is used and outstanding. This loan carries a fixed interest rate of 5.84% per annum, which is fixed until 30 June 2007 and is to be repaid in monthly instalments of T€ 96.5, starting one month from the day of full exercise of the loan. Management anticipates drawing the full amount of the loan after 2007 and has included repayments commencing after this date in the maturity table below. This loan is secured by certain fixed assets.
ProPharma Ltd., a subsidiary of the Company has debt of T€ 585. It is repayable in instalments through 2007 and secured by all of that subsidiary's assets. This agreement contains typical debt covenants. The Company is in compliance with all debt covenants at 31 December 2002. This subsidiary has also debt related to government grants in the amount of T€ 46.
The annual maturities of these debts are as follows:

| T€ | |
|---|---|
| 2003 | 1,067 |
| 2004 | 714 |
| 2005 | 694 |
| 2006 | 693 |
| 2007 | 586 |
| Thereafter | 4,133 |
| **Total** | **7,887** |

The Company maintains lines of credit totalling T€ 128 to finance its short-term capital requirements, of which the entire balance is available as of 31 December 2002. These lines of credit provide for borrowings at various interest rates and have no stated expiration date.

## (11) Capital Lease Obligations

If leased assets are capitalised within fixed assets, the Company recognises the present value of the liabilities from the capital leases as financial obligations at lease inception.
The future minimum lease payments under capital leases are as follows:

| T€ | |
|---|---|
| 2003 | 462 |
| 2004 | 379 |
| 2005 | 298 |
| 2006 | 295 |
| 2007 | 258 |
| Less interest | (193) |
| **Total principal payable on capital leases** | **1,499** |

## (12) Income Taxes

Loss before income taxes, minority interest and equity in net loss of investees is attributable to the following geographic regions for the years ended 31 December 2002 and 2001:

| T€ | 2002 | 2001 |
|---|---|---|
| Germany | (18,720) | (19,977) |
| Foreign | (115,617) | (129,581) |
| **Total income (loss)** | **(134,337)** | **(149,558)** |

Income tax benefit (expense) for the years ended 31 December 2002 and 2001 is as follows:

| T€ | | 2002 | 2001 |
|---|---|---|---|
| **Current taxes:** | – Germany | – | (14) |
| | – Foreign | (173) | (191) |
| **Total current taxes** | | **(173)** | **(205)** |
| **Deferred taxes:** | – Germany | – | 423 |
| | – Foreign | 2,928 | 1,613 |
| **Total deferred taxes** | | **2,928** | **2,036** |
| **Total income tax benefit** | | **2,755** | **1,831** |

Included in the total deferred tax benefit is a benefit in the amount of T€ 76 relating to a reduction of the beginning-of-the-year valuation allowance because of a change in the circumstances that caused a change in judgement about the realisability of the deferred tax assets in future years.
The tax rate in the UK for the years ended 31 December 2002 and 2001, amounted to 30%. For the years ended

31 December 2002 and 2001, the actual income tax benefit differed from the amounts determined using the combined German federal corporation income and trade tax rate of 40.38% (2001: 40.38%) as follows:

| T€ | 2002 | 2001 |
|---|---|---|
| Expected income tax benefit | 54,245 | 60,392 |
| Non-deductible goodwill impairment and amortisation | (44,171) | (51,830) |
| Other permanent differences | 891 | (236) |
| Foreign tax differential | (646) | (170) |
| Effect of tax rate change | – | (58) |
| Change in valuation allowance | (7,305) | (7,121) |
| Other | (259) | 854 |
| **Actual income tax benefit** | **2,755** | **1,831** |

Deferred income tax assets and liabilities as of 31 December 2002 and 2001 relate to the following:

| T€ | 2002 | 2001 |
|---|---|---|
| **Deferred tax assets:** | | |
| – Losses carried forward | 37,146 | 32,214 |
| – Intangible assets | 2,277 | – |
| – Deferred revenue | – | 474 |
| – Other | 129 | 206 |
| **Total** | **39,552** | **32,894** |
| Valuation allowances on deferred tax assets | (31,889) | (24,647) |
| **Total deferred tax assets** | **7,663** | **8,247** |
| **Deferred tax liabilities:** | | |
| – Property, plant and equipment | 14,117 | 15,879 |
| – Intangible assets | 8,891 | 13,102 |
| – Undistributed subsidiaries earnings | 146 | – |
| – Marketable securities | – | 60 |
| – Accrued liabilities | – | 73 |
| – Other | 8 | 250 |
| **Total deferred tax liabilities** | **23,162** | **29,364** |
| **Deferred tax liability, net** | **15,499** | **21,117** |

In 2002, the Company recognised tax benefits in the amount of T€ 1,433 which were credited to goodwill because of a change in circumstances that caused a revaluation of the realisability of tax loss carry forwards for the subsidiaries of the Company, Evotec OAI Ltd and ProPharma Ltd.

Net deferred income tax assets and liabilities are presented in the accompanying balance sheets as of 31 December 2002 and 2001 as follows:

| T€ | 2002 | 2001 |
|---|---|---|
| **Net deferred tax assets, current** | | |
| – Germany | – | 17 |
| – Foreign | 45 | 87 |
| **Net deferred tax liabilities, non-current** | | |
| – Germany | – | (17) |
| – Foreign | (15,544) | (21,204) |
| **Total** | **(15,499)** | **(21,117)** |

For the years ended 31 December 2002 and 2001, Evotec recorded additional valuation allowances with respect to tax benefits of tax loss carry forwards T€ 4,883 and T€ 7,121, respectively. The valuation allowances on the Company's deferred tax assets are not recorded to the extent it is considered more likely than not that such tax benefits would be realised in future years. These considerations include, but are not limited to, the ability under respective tax laws to carry forward incurred tax losses indefinitely and thereby offset taxable income in future years without limitation, tax planning strategies and estimates of future taxable income. Evotec has not generated taxable income in Germany since the start of operations and does not expect to in the foreseeable future. The rational behind the valuation allowances is based on the potentially unlikely prospect of generating taxable income and, to a significant extent, the questionable nature, availability and benefit of the tax loss carry forwards generated prior to the completion of the initial public offering in 1999 and the acquisition of the UK subsidiaries in 2000. Tax loss carry forwards for Germany of T€ 74,413 and the UK of T€ 23,661 do not expire.

In determining the allowance, income tax expense for 2002 and 2001 was allocated entirely to continuing operations, with nothing allocated to accumulated other comprehensive loss on the basis that a valuation allowance is established on the net deferred tax asset positions in Germany.

## (13) Stock-Based Compensation

The shareholders' meeting on 7 June 1999 established a stock option plan and authorised the granting of stock options for up to 1,466,600 shares. The plan is subject to certain restrictions regarding the number of stock awards that may be granted in a year and the allocation of the grants to members of the Management Board, other key management personnel and all other employees. In connection with the acquisition of OAI in 2000 and the increased number of employees, the shareholders approved an additional 949,000 shares which may be issued in connection with the granting of stock options. In 2001, the annual shareholders' meeting provided for the authorisation of an additional 1,129,600 stock options.

Under the terms of the plan, each option entitles the holder to purchase one share of the Company's stock within ten years of the grant date at a set strike price. For all options granted in 1999, the strike price was the price of the initial public offering of € 13.00 (€ 6.50 after stock split). Options granted in 2000 and thereafter can be exercised at a strike price equal to the closing price of the shares or at a strike price equal to the closing price of the shares plus 5% on the trading day before the option was granted. Options have a graded vesting: a maximum of one-third of which can be exercised at the earliest after two years, a maximum of two-thirds after three years

and all remaining awarded options after four years. Options can only be exercised within certain specified two week periods starting on the third day after one of the following events: (i) release of the quarterly results, (ii) annual press conference on the financial statements, or (iii) annual shareholders' meeting of the Company. The options can only be exercised if the stock price exceeds the strike price by at least 5%. The Company deems the 5% stock price increase probable at the grant date, thereby effectively converting this variable plan to a fixed plan.

The terms of the stock option plan provides that for a further granting of options the price of the Company's stock should increase by at least 30% compared to the average closing price of the stock during the last quarter of the year preceding the year of the date of any subsequent grant. The Supervisory Board, however, has the authority to override this restriction and to authorise the granting of options to employees if such a decision is considered necessary for the interests of the Company.

A summary of the status of the plan as of 31 December 2002 and 2001, and the changes during the years then ended is presented as follows:

| pcs. and € per share | 2002 | | 2001 | |
|---|---|---|---|---|
| | Options | Weighted average exercise price | Options | Weighted average exercise price |
| Outstanding | | | | |
| at beginning of the year | 1,666,451 | 13.53 | 1,001,403 | 18.45 |
| Options granted | 616,868 | 2.27 | 823,445 | 7.75 |
| Options exercised | (3,083) | 6.50 | (54,899) | 6.50 |
| Options forfeited | (150,710) | 13.10 | (103,498) | 18.88 |
| Outstanding | | | | |
| at end of the year | 2,129,526 | 10.31 | 1,666,451 | 13.53 |
| Thereof exercisable | 320,279 | 16.53 | 49,446 | 6.50 |

A summary of the stock options outstanding at 31 December 2002 is as follows:

| € per share and pcs. | | | | 2002 |
|---|---|---|---|---|
| Range of exercise prices | Outstanding | Exercisable | Weighted average remaining contractual life | Weighted average exercise price |
| 2.20–2.31 | 616,068 | – | 9.90 years | 2.27 |
| 6.50–6.80 | 835,525 | 139,783 | 8.18 years | 6.72 |
| 10.15–12.48 | 132,050 | – | 8.94 years | 12.37 |
| 15.29 | 4,500 | – | 8.23 years | 15.29 |
| 24.30 | 541,383 | 180,496 | 7.90 years | 24.30 |

Evotec's stock option plan results in compensation expense when Evotec's stock price exceeds the strike price subsequent to the issuance of the options. Total compensation costs of T€ 34 and T€ 204 were determined at the measurement dates of the granted options in 2002 and 2001, respectively. These amounts were reflected in unearned compensation, a component of stockholders' equity. The Company recognised compensation expense in 2002 and 2001 for all options totalling T€ 324 and T€ 272, respectively, which was reflected as selling, general and administrative expenses in the consolidated statements of operations.

The fair value of each option grant was estimated on the date of grant for the fiscal years ended 31 December 2002 and 2001 using a Black-Scholes option pricing model with the following weighted average assumptions:

| % | 2002 | 2001 |
|---|---|---|
| Risk-free interest rate | 4.2 | 4.5 |
| Volatility | 104.49 | 100.95 |
| Dividend yield | – | – |
| Average expected life | 3 years | 3 years |
| Options expected to be exercised | 70 | 80 |

The weighted average fair value of each option granted during the year ended 31 December 2002 and 2001 was € 0.37 and € 1.31, respectively.

## (14) Stockholders' Equity

On 31 December 2002, authorised but unissued shares consist of a conditional capital (bedingtes Kapital) of 3,487,218 shares available with respect to the stock option plan and an approved capital (genehmigtes Kapital), as decided upon at the annual general meeting in 2001, of 17,700,000 shares. On 31 December 2002, there are 35,510,130 shares issued and outstanding.

On 11 April 2002, the Company issued 3,083 new shares to its employees in connection with the exercise of stock options pursuant to the existing stock option plan. The price per share paid was € 6.50.

On 27 November 2001, the Company issued 54,899 new shares to its employees in connection with the exercise of stock options. The price per share paid was € 6.50.

The annual shareholders' meeting on 18 June 2001 authorised the Management Board of the Company to issue up to 17,700,000 shares for cash or contributions in kind. Under German law, the shareholders of a stock corporation may empower the Management Board to issue shares in a specified aggregate nominal value not exceeding 50% of the issued share capital at the time of the shareholder vote, in the form of approved capital (genehmigtes Kapital). The authorisation expires five years after the date of the shareholders' resolution.

## (15) Segment Information

The Company has two core business segments which are application focussed: (i) tools and technologies (formerly named: drug discovery tools and technologies) and (ii) discovery and development services (formerly named: drug discovery services and products).

The tools and technologies segment collaborates with pharmaceutical companies to develop its platform technology and to design, manufacture, assemble and deliver instruments and disposables for its drug discovery systems. Tools and technologies conducts research and development activities with collaborative and strategic partners in the pharmaceutical or diagnostic industry to develop new technologies and enhance the screening systems resulting from those contracts.

The discovery and development services segment enters into service contracts with third parties to provide screening, assay development, chemical compound optimisation and production and disease targets. The business activities of the UK are included in this second segment.

The Company makes decisions about resources to be allocated to the segments and assesses their performance using revenues and gross profits. Evotec does not identify or allocate assets to the operating segments nor does the Company evaluate the segments on these criteria. Due to the specific application and product base nature of the operating segments, there are no sales transactions between segments. Accordingly, net sales by operating segments represents sales to external customers.

Revenues in the consolidated statements of operations are differentiated by products and by services. This definition is close to the definition used in the segment reporting. Differences between the revenue splits are mainly due to product deliveries from our service unit, which are reported in services in the segment reporting.

The accounting policies of the segments are the same as those described in the summary of significant accounting policies (see note 2).

The following represents segment data, revenues and gross profit, for the years ended 31 December 2002 and 2001:

| T€ | 2002 | 2001 |
|---|---|---|
| **Revenues:** | | |
| – Tools and technologies | 11,407 | 11,489 |
| – Discovery and development services | 58,588 | 51,736 |
| **Total revenues** | **69,995** | **63,225** |
| **Costs of revenue:** | | |
| – Tools and technologies | 3,768 | 5,021 |
| – Discovery and development services | 34,763 | 28,293 |
| **Total costs of revenue** | **38,531** | **33,314** |
| **Gross profit** | | |
| – Tools and technologies | 7,639 | 6,468 |
| – Discovery and development services | 23,825 | 23,443 |
| **Total gross profit** | **31,464** | **29,911** |

Due to more detailed available information in 2002 the segment reporting was extended down to the operating loss. Such information is not available for 2001. The following represents segment data, revenues, gross profit and operating loss from continuing operations, for the year ended 31 December 2002:

| T€ | Tools and technologies | Discovery and development services | Total 2002 |
|---|---|---|---|
| **Revenues:** | | | |
| – Drug discovery products and technologies | 11,407 | 418 | 11,825 |
| – Drug discovery services | – | 58,170 | 58,170 |
| **Total revenues** | **11,407** | **58,588** | **69,995** |
| **Costs of revenue:** | | | |
| – Drug discovery products and technologies | 3,768 | – | 3,768 |
| – Drug discovery services | – | 34,763 | 34,763 |
| **Total costs of revenue** | **3,768** | **34,763** | **38,531** |
| Gross profit | 7,639 | 23,825 | 31,464 |
| Research and development expenses | 7,799 | 15,213 | 23,012 |
| Selling, general and administrative expenses | 1,519 | 18,948 | 20,467 |
| Amortisation of intangible assets | 460 | 11,558 | 12,018 |
| Impairment of goodwill | – | 109,389 | 109,389 |
| Other operating expenses | – | 2,090 | 2,090 |
| **Operating loss** | **(2,139)** | **(133,373)** | **(135,512)** |

Depreciation included in the operating loss of tools and technologies and discovery and development services amounts to T€ 547 and T€ 10,558, respectively.

Revenues can be split into the following product and service lines:

| T€ | 2002 |
|---|---|
| Biology Services | 6,105 |
| Chemical Discovery | 33,894 |
| Chemical Development | 18,589 |
| **Discovery and development services** | **58,588** |
| Technology development and transfer agreements | 4,777 |
| Evotec Technologies | 6,630 |
| **Tools and technologies** | **11,407** |
| **Total revenues** | **69,995** |

Revenues can be split, based on customers' locations, in the following geographical regions:

| % | 2002 | 2001 |
|---|---|---|
| Germany | 6 | 8 |
| United Kingdom | 16 | 14 |
| Rest of Europe | 27 | 23 |
| United States | 47 | 51 |
| Rest of the world | 4 | 4 |
| **Total revenues** | 100 | 100 |

Long-lived assets of T€ 181,078 and T€ 323,987 are located in UK, and the remaining amounts of T€ 13,932 and T€ 17,503 are in Germany as of 31 December 2002 and 2001, respectively.

## (16) Financial Instruments

The fair value of cash and cash equivalents, trade accounts receivable and trade accounts payable approximate their carrying values in the consolidated financial statements due to the short-term nature. The fair value of debt is determined on the basis of discounted cash flows using an appropriate discount rate. The fair values of long-term loans closely approximates their carrying values on 31 December 2002 and 2001. Marketable securities are carried at their quoted market price which represents their fair value.

The Company periodically enters into derivatives including foreign currency forward contracts and options. The objective of these transactions is to reduce the risk of exchange rate fluctuations of its foreign currency denominated cash flows. Evotec does not enter into derivatives for trading or speculative purposes. As of 31 December 2002, the Company held U.S. dollar forward contracts with Euro equivalent notional amounts of approximately T€ 0 and a fair value of T€ 0 (2001: T€ 560 and T€ 16, respectively). Additionally, the Company held U.S. dollar option contracts with Euro equivalent notional amounts of approximately T€ 11,449 and T€ 5,004 as of 31 December 2002 and 2001, respectively. The fair value of the option contracts is T€ 167 at 31 December 2002 (2001: T€ 81). Foreign currency contracts are carried at fair value which is determined using quoted market prices or discounted cash flows. The carrying amount of the foreign currency contracts is included in prepaid expense and other current assets. Gains and losses related to foreign currency derivatives are included in other non-operating income or expense and amounted to T€ 286 and T€ 225 for the years ended 31 December 2002 and 2001, respectively.

## (17) Risks

Credit risks of the Company consist primarily with respect to trade accounts receivables. Concentrations of credit risks with respect to trade accounts receivables are limited by a number of geographically diverse customers and the Company's monitoring procedures.

We expect that our current cash funds, together with operating revenues will be sufficient to finance our operations for at least one to three years, depending on the various scenarios of the Company's investments and strategic development. Our future cash requirements will depend on various factors, including our success in developing existing and new technologies and products, increasing sales of both existing and new products and services, expenses associated with growth as well as competition and overall market development. Moreover, in order to remain competitive, Evotec should continue to make substantial investments in research and development which may require additional financing. However, significant commitments for any funding requirements would not be entered into without secured financing.

The Company has important collaborations with pharmaceutical companies within both operating segments. Any termination of such collaborations would probably have adverse impacts on the Company's financial position, results of operations and cash flows.

The Company has one customer in the discovery and development services segment with approximately 10% of the group revenues. A termination of this contract could have adverse impacts on the Company's financial results.

Foreign exchange risk of the Company stems from our exposure to the GBP with respect to the UK subsidiaries. To the extent that the exchange rate of GBP|EUR falls, the Company would realise an adverse impact on revenues and net assets.

## (18) Commitments and Contingencies

**(a) Operating Leases.** The Company leases office space and other equipment under operating leases. The future minimum lease payments under non-cancellable operating leases are approximately as follows:

| T€ | |
|---|---|
| 2003 | 4,069 |
| 2004 | 3,532 |
| 2005 | 3,384 |
| 2006 | 3,111 |
| 2007 | 3,091 |
| Thereafter | 25,499 |
| **Total** | 42,686 |

The majority of operating leases is related to rent expenses for facilities. The rent expense for such leases amounted to T€ 3,336 and T€ 2,793 for the years ended 31 December 2002 and 2001, respectively. Rental income under sub-lease agreements in the UK amounts to T€ 30 and T€ 409 for the years ended 31 December 2002 and 2001, respectively. The rental income over the next 5 years is expected to be immaterial.

**(b) Other Commitments.** The Company has entered into long-term consultant contracts. During 2002 and 2001, payments under consultant contracts totalled T€ 366 and T€ 269, respectively. The future minimum payments associated with long-term consultant and other miscellaneous long-term commitments totals approximately T€ 2,083 and T€ 206 at 31 December 2002 and 2001, respectively. As discussed in note 3, the Company has certain commitments resulting from the amendments to our agreements with our technology funding partners.

**(c) Product warranties.** The warranties of the Company are issued by the Tools and Technology segment. They are usually accompanied by a twelve month warranty for systems and devices delivered to customers. These warranties cover factors such as non-conformance to specifications and defects in material.
Estimated warranty costs are recorded in the period in which the related product sales occur. The warranty liability recorded at each balance sheet date reflects the estimated average of historical yearly warranty payments. The following table summarises product warranties recorded during 2002.

| T€ | | 2002 | |
|---|---|---|---|
| | 01\|01\|2002 | net change | 31\|12\|2002 |
| Product warranties | 475 | (6) | 468 |

## (19) Related Party Transactions

The following Supervisory Board members of the Company are also supervisory board members or management board members in companies Evotec works with in the ordinary course of business:
Prof Dr Heinz Riesenhuber is a member of the supervisory board of Altana Pharma AG, with whom the Company entered into a service agreement in the ordinary course of business. Revenue from this agreement in 2002 amounted to T€ 975. Accounts receivable from Altana as of 31 December 2002 amount to T€ 232.
Peer Schatz is the CFO of Qiagen, from whom the Company bought products in the amount of T€ 45 and T€ 31 in 2002 and 2001, respectively. The amount of payables to Qiagen on 31 December 2002, including VAT amounts to T€ 2. The Company sold its share in QE Diagnostiksysteme GmbH to Qiagen, which resulted in a loss of T€ 20.
Dr Pol Bamelis is a member of the supervisory board of Innogenetics N.V. from whom the Company bought raw materials in the ordinary course of business in the amount of T€ 2 in 2002. The amount of payables to Innogenetics as of 31 December 2002, including VAT amounts to T€ 1. Dr Bamelis is also a member of the supervisory board of MediGene AG with whom the Company entered into a service agreement in 2002 which resulted in revenues of T€ 647 in 2002.
Dr Karsten Henco is a member of the supervisory board of NewLab BioQuality AG with whom the Company entered into a rental agreement for laboratory space in the ordinary course of business. Rental expenses amounted to T€ 176 and € 180 in 2002 and 2001, respectively. He is also a member of the Kuratorium of the Fraunhofer Institut für biomedizinische Technik, St. Ingbert with whom the Company entered into a scientific research cooperation agreement. The expenses in 2002 amounted to T€ 263, related payables to the Fraunhofer Institut as of 31 December 2002 amounted to T€ 4. Dr Henco is also a member of the supervisory board of Garching Innovation GmbH from which the Company has obtained licences in 2001. Licence expense amounted to T€ 88 and T€ 35 in 2002 and 2001, respectively. The Company entered into a consultancy contract, in the ordinary course of business and with the approval of the Supervisory Board, with Dr Karsten Henco in order to exploit his significant expertise in the business and industry of the Company. The associated expenses in 2002 amounted to T€ 172 and the related payables to Dr Henco as of 31 December 2002 amounted to T€ 52.
Dr Edwin Moses is a member of the supervisory board of Prolysis Ltd with whom the Company entered into a service agreement and acquired a 3.88% equity interest. The related revenues associated with the service agreement amounted to T€ 1,018 in 2002 and the related accounts receivable as of 31 December 2002 amounted to T€ 504. He is also a member of the supervisory boards of BioImage A|S and Ionix Ltd. with whom the Company entered into service agreements in the ordinary course of business. Revenues in 2002 amounted to T€ 37 and T€ 367, respectively, and the related accounts receivable as of 31 December 2002 amounted to T€ 17 and T€ 0, respectively.
Dr Michael Redmond is chairman of the supervisory board of Microscience Ltd. with whom the Company founded Vmax Ltd.
Dr Phil Boyd, an officer of the Company is a member of the board of Vmax Ltd. with whom the Company entered into a loan stock and investment agreement. See note 6.

## (20) Other Disclosures

The following additional disclosures are required by German law in accordance with the European Directives on Accounting and the Corporate Governance Codex:

**(a) Number of Employees.** The average number of persons employed by the Company in 2002 was 619 (2001: 555).

**(b) Personnel Expenses and Cost of Material.** The personnel expenses of the Company amounted to T€ 35,768 of which T€ 20,009 relates to personnel expenses in the UK (2001: T€ 31,917 and T€ 16,476, respectively).
Cost of materials amounted to T€ 18,505, thereof T€ 8,027 are cost of materials in the UK (2001: T€ 13,789 and T€ 5,645, respectively).

**(c) Corporate Governance Codex.** A declaration according to § 161 AktG was made by the Management Board and the Supervisory Board of the Company. This declaration regarding the Company's compliance with the Corporate Governance Codex was accessible to the shareholders on Evotec's website. See also Management's discussion and analysis.

**(d) Consolidated Subsidiaries and Equity Investees.** Information below is as per the statutory financial statements prepared in accordance with the respective local generally accepted accounting principles.

| | Company's voting interest in % | 2002 Net income (loss) in T€ | 2002 Equity in T€ |
|---|---|---|---|
| **Subsidiaries (verbundene Unternehmen)** | | | |
| Evotec OAI Ltd.[1] | 100.0 | 5,186 | 53,295 |
| Evotec Technologies GmbH[2] | 95.7 | (5,449) | (2,924) |
| EVOTEC NeuroSciences GmbH, Hamburg | 83.1 | (2,469) | (820) |
| ProPharma Ltd, Glasgow, UK | 58.0 | 90 | 1,442 |
| Evotec OAI Inc.[3] | 100.0 | 36 | 90 |
| Oxford Diversity Ltd., Abingdon, UK | 100.0 | 60 | – |
| Oxford Asymmetry Employee Shares Trust Ltd., Abingdon, UK | 100.0 | – | – |
| **Investees (assoziierte Unternehmen)** | | | |
| DIREVO Biotech AG, Cologne | 32.5 | (2,525) | 15,169 |
| SiREEN AG, Munich | 6.4 | (1,316) | 1,754 |
| Vmax Ltd., Winnersh Triangle, UK | 46.4 | (110) | 95 |
| Prolysis Ltd., Oxford, UK (2001 figures) | 3.9 | 16 | 134 |

1 formerly Oxford Asymmetry International plc., Abingdon, UK
2 formerly EVOTEC Analytical Systems, Erkrath
3 formerly Oxford Asymmetry International Inc., Delaware, USA

**(e) Management Board.** The members of the Management Board are listed at the end of this report.
The remuneration paid to the members of the Management Board in the financial year totalled T€ 1,249 (2001: T€ 1,459) of which T€ 183 (2001: T€ 301) was variable. The bonuses paid in 2002 were based on the achievement of personal objectives as set and assessed by the remuneration committee. The variable portion of the remuneration in 2003 for the business year 2002 will be contingent upon 20% each for revenue and EBITDA based on achievement of the budget and 60% personal objectives. Under the Company's stock option plan, the members of the Management Board received 130,000 (2001: 130,000) options of which one-third may be exercised after two years.

| | Fixed remuneration T€ | Variable renumeration T€ | Stock options pcs. |
|---|---|---|---|
| Joern Aldag | 279 | 65 | 60,000 |
| Dr Dirk Ehlers | 243 | 23 | 30,000 |
| Dr Timm Jessen | 218 | 36 | 30,000 |
| Sean Marett | 103 | – | 10,000 |
| Dr Mario Polywka | 223 | 59 | – |
| **Total** | **1,066** | **183** | **130,000** |

Joern Aldag is member of the suoervisory board of LION Biosciences AG, Heidelberg and member of the Monopolkommission der Bundesrepublik Deutschland (from June 2002).
Dr Mario Polywka was member of the supervisory board of ProPharma Ltd, Glasgow, UK until 31 August 2002.

**(f) Supervisory Board.** The members of the Supervisory Board and their additional memberships in supervisory boards and memberships in comparable govering bodies of enterprises according to § 125 (1) third sentence of the AktG are listed at the end of this report.
The remuneration paid to the members of the Supervisory Board in the financial year amounted to T€ 30 for Prof Dr Riesenhuber, T€ 22.5 for Peer Schatz, and T€ 15 each for Dr Pol Bamelis, Dr Karsten Henco, Dr Edwin Moses and Michael Redmond. The total remuneration paid to Supervisory Board members totalled T€ 112.5 (2001: T€ 33).

**(g) Scientific Advisory Committee.** The Scientific Advisory Board has not changed in the current year.

**(h) Summary of Significant Differences between U.S. GAAP and HGB Accounting Requirements.**

**Introduction.** Evotec OAI AG, as a German company, is subject to the German Commercial Code ("Handelsgesetzbuch", or "HGB"), which principally requires the Company to prepare consolidated financial statements in accordance with the HGB accounting principles and

regulations ("German GAAP"). Pursuant to HGB Section 292a, the Company is exempt from this requirement if consolidated financial statements are prepared and issued in accordance with a body of internationally accepted accounting principles (such as U.S. GAAP). Accordingly, the Company has prepared its consolidated financial statements in accordance with U.S. GAAP. The following is a description of the significant differences between German GAAP and U.S. GAAP.

**Fundamental Differences.** The emphasis of U.S. GAAP is to provide all relevant information to investors in order to facilitate future investment decisions. The primary difference between German GAAP and U.S. GAAP is that they are based on different concepts. German GAAP is oriented towards the protection of creditors and emphasis on the prudence concept.

**Financial Statement Presentation.** The balance sheet presentation under U.S. GAAP is based on the planned realisation of assets and the maturity of liabilities in the normal course of business. The balance sheet under German GAAP is principally defined in HGB section 266 and is based on enterprise's planned holding time for the respective asset, liability or equity.

**Revenue Recognition.** Revenue recognition is generally the same under German and U.S. GAAP, whereby revenue is recognised when realised and earned. Differences in the timing of recognition can exist in transaction when the Company retains on-going financial, operational or performance commitments or the contractual amounts are not objectively verifiable.

**Marketable Securities.** Under German GAAP, marketable debt and equity securities are valued at the lower of acquisition cost or fair market value as of the balance sheet date. Under U.S. GAAP, the Company's marketable securities are classified as available-for-sale and valued at fair market value as of balance sheet date. Unrealised gains and losses are reported in other comprehensive income, net of deferred taxes.

**Inventories.** Inventory valuation is based on manufacturing cost under both German and U.S. GAAP. Manufacturing costs under U.S. GAAP, however, are defined as production costs on a full absorption basis, whereby manufacturing overhead is included together with material and other direct manufacturing costs.

**Goodwill.** Under U.S. GAAP, pursuant to SFAS No. 141, "Business Combinations", in connection with SFAS No. 142, "Goodwill and Other Intangible Assets", goodwill arising from business combinations accounted for as a purchase is no longer amortised but is reviewed for impairment once a year.

**Financial Instruments.** Under German GAAP, derivative financial instruments are not recorded on the balance sheet. Unrealised gains are not recognised and unrealised losses are accrued. Under U.S. GAAP, derivative financial instruments are recorded on the balance sheet at their fair value. Changes in fair value are recorded in current earnings or other comprehensive income, depending on whether the derivative financial instruments are designated as part of a hedge transaction and depending on the type of hedge transaction.

**Deferred Taxes.** The main difference in accounting for deferred taxes relates to the fact that under German GAAP deferred tax assets are not recorded for net operating losses. Under U.S. GAAP, deferred tax assets are recorded for net operating losses and a valuation allowance is established when it is deemed "more likely than not" that the deferred tax asset will not be realised.

**Stock-Based Compensation.** Under German GAAP, the Company recognises as expense the difference between the fair market value of the Evotec shares and the exercise price of the stock options, if the fair market value is higher. Under U.S. GAAP, the Company accounts for stock-based compensation on the intrinsic value method pursuant to APB Opinion No. 25.

**Accrued Liabilities.** Under German GAAP, certain costs can be accrued for anticipated future events in certain circumstances. Under U.S. GAAP, recognition of an accrued liability represents an existing liability to third parties or must meet specific recognition criteria.

**Foreign Currency Translation.** Under German GAAP, foreign currency denominated assets and liabilities are recorded at spot rate on the transaction date with only unrealised losses reflected in income at the balance sheet date. Under U.S. GAAP, foreign currency denominated assets and liabilities are translated at the spot rate at the balance sheet date, with both unrealised gains and losses reflected in income.

The key task of the Evotec OAI Supervisory Board is to regularly advise and supervise the Evotec OAI Management Board in the management of the enterprise.

During the year 2002, the Supervisory Board convened for four formal meetings to discuss the operational and strategic development of Evotec OAI AG. In addition, the Supervisory Board discussed important issues in four teleconferences and approved four separate management decisions through written circulation. The Audit committee separately met in three additional teleconferences. The Management Board continuously provided updates to the Supervisory Board through regular verbal and written reports that included information on the status of operations. Furthermore the Chairman of the Supervisory Board and the CEO discussed ongoing and current topics on the telephone regularly, typically every two weeks, and whenever appropriate.

In addition to the standard agenda items, the Supervisory Board discussed at its meetings the following specific subjects in detail:

> In March, the Board discussed the 2001 annual financial statements in presence of the auditors, the company's strategic development, the formation of Evotec Technologies, and corporate governance topics.
> In May, the Board prepared for the Annual General Meeting.
> At its meeting in August, the Board discussed strategic development plans as well as the financial forecast for the year 2002.
> In November, the Board focussed on the budget for the year 2003 and again discussed strategic aspects of the business; in addition it implemented Rules of Procedure concerning its own activities.

In September 2002, the members of the Supervisory Board agreed to sign the Corporate Governance Declaration of Nemax 50 companies which was released in November. With this declaration, Evotec OAI AG voluntarily undertakes to comply with all so-called "shall"-recommendations and many of the so-called "should"-suggestions of the German Corporate Governance Code, and thereby undertakes to follow further internationally recognised standards of fair and responsible corporate governance.

In order to avoid a potential conflict of interest, one Supervisory Board member abstained from the discussion about and the voting on the divestiture of Evotec OAI AG's shares in QE Diagnostiksysteme GmbH. We are not aware of any other conflict of interest situation during the year 2002.

The financial statements and the management report of Evotec OAI AG, as well as the consolidated financial statements together with the consolidated management report of the Evotec OAI Group were audited by KPMG Deutsche Treuhandgesellschaft Aktiengesellschaft Wirtschaftsprüfungsgesellschaft, Hamburg, and were given an unqualified audit option. These auditors had been appointed by the 2002 Annual General Meeting. They gave a comprehensive report on the audit and their observations at the Supervisory Board meeting on 10 March 2003. The Supervisory Board examined and approved both the financial statements and the consolidated financial statements prepared by the Management Board.
Mario Polywka resigned from the Management Board and as Chief Operating Officer effective 31 August 2002 in order to take up another senior role in the industry after 11 years at Evotec OAI AG and Oxford Asymmetry International Ltd.
Sean Marett was appointed member of the Management Board and Chief Business Officer effective 1 July 2002. He resigned from the Management Board at year end 2002, but continues to work for the Company in the position of Senior Vice President, Licencing and Negotiations.
The Supervisory Board appointed Ian Hunneyball to the Management Board as President, Services Division effective 1 January 2003.

The Supervisory Board thanks the Management Board and the company's employees for their hard and successful work during the year and wishes them continued success for 2003.

Hamburg, 10 March 2003

The Supervisory Board
Prof Dr Heinz Riesenhuber

## Supervisory Board

| | | |
|---|---|---|
| **Prof Dr Heinz Riesenhuber**<br>Chemist, Frankfurt am Main | D | **Chairman of the Supervisory Board** | **Member of the Supervisory Board:**<br>Altana AG, Bad Homburg | D<br>Frankfurter Allgemeine Zeitung, Frankfurt am Main | D<br>Henkel KGaA, Duesseldorf | D<br>Osram GmbH, Munich | D<br>Portum AG, Frankfurt am Main | D<br>Vodafone AG, Duesseldorf | D<br>(formerly Mannesmann AG, Duesseldorf | D)<br>**Member of the Investorenbeirat:**<br>Heidelberg Innovation BioScience Venture II GmbH & Co. KG, Heidelberg | D<br>**Member of the Verwaltungsrat:**<br>HBM BioVentures AG, Baar | CH |
| **Peer Schatz**<br>Business Executive, Duesseldorf | D | **Vice Chairman of the Supervisory Board** | **Chairman of the Supervisory Board:**<br>Qiagen S.A., Courtaboeuf Cedex | F<br>**Member of the Supervisory Board:**<br>Mulligan BioCapital AG, Hamburg | D<br>Qiagen AS, Oslo | N (from August 2002)<br>Qiagen Genomics, Inc, Bothell | USA (from August 2002)<br>Qiagen Inc, Valencia | USA (from January 2002)<br>Qiagen K.K., Tokyo | J<br>Qiagen Ltd, Crawly West Sussex | UK<br>Qiagen North American Holding, Inc, Valencia | USA (from August 2002)<br>Qiagen Operon, Inc, Alameda | USA (from August 2002)<br>Qiagen Pty Ltd, Clifton Hill, Victoria | AUS<br>Qiagen S.p.A., Milan | I<br>Qiagen Sciences, Inc, Germantown | USA (from August 2002)<br>Sawady Technology Co, Ltd, Tokyo | J<br>Xeragon, Inc, Germantown | USA (from April 2002)<br>**Member of the Beirat:**<br>ACS Moschner & Co. GmbH, Vienna | A<br>Venture Capital Partners KEG, Vienna | A<br>**Member of the Boersenrat:**<br>Frankfurter Wertpapierboerse, Frankfurt | D |
| **Dr Pol Bamelis**<br>Chemist, Knokke | B | **Member of the Supervisory Board** | **Chairman of the Supervisory Board:**<br>Agfa-Gevaert N.V., Mortsel | B (from April 2002, formerly member)<br>Crop Design N.V., Gent | B<br>**Member of the Supervisory Board:**<br>Bekaert N.V., Kortrijk | B<br>Innogenetics, Gent | B (from March 2002)<br>MediGene AG, Munich | D<br>Oleon N.V., Ertvelde | B |
| **Dr Karsten Henco**<br>Biochemist, Duesseldorf | D | **Member of the Supervisory Board** | **Chairman of the Supervisory Board:**<br>Direvo Biotech AG, Cologne | D<br>**Member of the Supervisory Board:**<br>Garching Innovation GmbH, Munich | D<br>NewLab BioQuality AG, Erkrath | D<br>U3 Pharma AG, Martinsried | D<br>**Member of the Kuratorium:**<br>Fraunhofer-Institut für Biomedizinische Technik (IBMT), St. Ingbert | D<br>Universitätsklinikum Hamburg-Eppendorf, Hamburg | D<br>(from June 2002) |

| | | |
|---|---|---|
| **Dr Edwin Moses**<br>Chemist, Goring, Berkshire | UK | **Member of the Supervisory Board** | **Chairman of the Supervisory Board:**<br>Amedis Ltd, Cambridge \| UK<br>Avantium Technologies, Amsterdam \| NL (from March 2002)<br>BioImage A\|S, Copenhagen \| DK<br>(from July 2002, formerly member)<br>ProImmune Ltd, Oxford \| UK<br>Prolysis Ltd, Oxford \| UK<br>Inhibox Ltd, Oxford \| UK (until September 2002)<br>**Member of the Supervisory Board:**<br>Inpharmatica Ltd, London \| UK<br>Ionix Ltd, Cambridge \| UK<br>Personal Chemistry AB, Uppsala \| S (from April 2002)<br>Centre for Scientific Enterprise Ltd, London \| UK<br>(until December 2002)<br>London Technology Network, London \| UK<br>(from June 2002 until November 2002) |
| **Michael Redmond**<br>Business Executive, Bury St Edmunds \| UK | **Member of the Supervisory Board** | **Chairman of the Supervisory Board:**<br>Arakis Ltd, Cambridge \| UK<br>Dechra Pharmaceuticals plc, Stoke-on-Trent \| UK<br>(from June 2002, formerly member)<br>Microscience Ltd, Reading \| UK<br>Synexus Ltd, Chorley \| UK<br>**Member of the Supervisory Board:**<br>Atugen AG, Berlin \| D<br>Strakan Group Ltd, Galashiels \| UK<br>Biocompatibles International plc, Farnham \| UK (until June 2002) |

## Management Board

| | | |
|---|---|---|
| **Joern Aldag**<br>Business Executive, Hamburg \| D | **President & Chief Executive Officer** | **Member of the Supervisory Board:**<br>LION bioscience AG, Heidelberg \| D<br>**Member of the Monopolkommission der Bundesrepublik Deutschland**<br>(from June 2002) |
| **Dr Dirk H. Ehlers**<br>Physicist, Wohltorf \| D | **Chief Financial Officer** | |
| **Dr Ian M. Hunneyball**<br>Biochemist, Abingdon, Oxfordshire \| UK | **President, Services Division**<br>(from 1 January 2003) | |
| **Dr Timm-H. Jessen**<br>Chemist, Fleckeby \| D | **Chief Scientific Officer** | |
| **Sean Marett** *<br>Biochemist, Halstenbek \| D | **Chief Business Officer**<br>(from 1 July 2002<br>until 31 December 2002) | |
| **Dr Mario Polywka**<br>Chemist, Abingdon, Oxfordshire \| UK | **Chief Operating Officer**<br>(until 31 August 2002) | **Member of the Supervisory Board:**<br>ProPharma Ltd, Glasgow \| UK (until 31 August 2002) |

* Senior Vice President, Licencing and Negotiations (from 1 January 2003)

## Evotec OAI's financial calendar

| | |
|---|---|
| **25 March 2003** | Annual report 2002, press conference and analysts' meeting |
| **08 May 2003** | First quarter report 2003 |
| **28 May 2003** | Annual general meeting |
| **12 August 2003** | Second quarter report 2003 |
| **12 November 2003** | Third quarter report 2003 |

## Imprint


| | | |
|---|---|---|
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| **Photography** | **Knut Koops** | Hamburg \| D |
| **Print** | **Eberl Graphische Betriebe** | Immenstadt \| D |
| **Lithography** | **Colorlux new** | Verona \| I |

This annual report is also available in German.

## Key figures

| Evotec OAI AG | | 1998 | 1999 | 2000 | 2001 | 2002 | Δ 02\|01 in % |
|---|---|---|---|---|---|---|---|
| **Results** | | | | | | | |
| Revenue | T€ | 7,308 | 9,786 | 28,276 | 63,225 | 69,995 | 10.7 |
| R&D expenses | T€ | 8,283 | 12,952 | 18,480 | 23,012 | 23,012 | – |
| Operating loss | T€ | 6,071 | 10,154 | 48,926 | 152,469 | 135,512 | (11.1) |
| Operating loss [1] | T€ | 5,993 | 10,106 | 14,291 | 12,294 | 14,105 | 14.7 |
| Net loss | T€ | 5,589 | 9,482 | 47,074 | 147,750 | 131,630 | (10.9) |
| Net loss [1] | T€ | 5,511 | 9,434 | 12,493 | 7,575 | 10,223 | 35.0 |
| EBITDA | T€ | (4,516) | (7,953) | (9,459) | (1,011) | (2,221) | (119.7) |
| Cash flow | T€ | 12,875 | 41,549 | (24,760) | (12,733) | 5,313 | 141.7 |
| **Balance sheet data** | | | | | | | |
| Subscribed capital [2] | T€ | 14,196 | 24,156 | 35,452 | 35,507 | 35,510 | – |
| Number of shares [2] | T | 14,196 | 24,156 | 35,452 | 35,507 | 35,510 | – |
| Stockholders' equity | T€ | 13,829 | 60,299 | 502,495 | 347,591 | 195,407 | (43.8) |
| Equity ratio | % | 51.98 | 81.70 | 94.33 | 88.08 | 81.07 | – |
| Investments [3] | T€ | 4,870 | 5,059 | 493,757 | 36,908 | 9,284 | (74.8) |
| – Intangible assets | T€ | 195 | 337 | 433,819 | 20,246 | 28 | (99.9) |
| – Tangible fixed assets | T€ | 4,663 | 4,715 | 56,626 | 16,652 | 8,634 | (48.2) |
| – Financial assets | T€ | 11 | 7 | 3,312 | 10 | 622 | – |
| Cash including marketable securities | T€ | 18,176 | 57,488 | 48,924 | 27,833 | 21,308 | (23.4) |
| Balance sheet total | T€ | 26,605 | 73,806 | 532,706 | 394,617 | 241,042 | (38.9) |
| **Personnel data** | | | | | | | |
| Employees as at 31 December | | 141 | 228 | 505 | 585 | 635 | 8.6 |
| Total corporate personnel expenditures | T€ | 6,812 | 10,519 | 17,997 | 31,917 | 35,768 | 12.1 |
| Revenue per employee | T€ | 52 | 43 | 56 | 108 | 110 | 1.9 |
| **Per share** | | | | | | | |
| Result | € | (0.41) | (0.60) | (1.75) | (4.17) | (3.71) | 11.0 |
| Dividends | € | – | – | – | – | | |
| Security identification No. | | | | | | 566480 | |

1) before amortisation and impairment
2) refers to 1 € (retrospectively adopted to stock split)
3) including additions from acquisitions of OAI and GENION

## Auditors' independence

**Translation of declaration of independence**

"In accordance with the German Corporate Governance Code, auditors are required to issue a declaration of independence.
We have required those of our employees assigned to this audit to confirm their independence, and we can issue you with the following declaration:

None of our executive body members, partners or employees involved in this audit have an employment relationship or any other relationship (e. g. as an asset manager) with Evotec OAI AG that compromises their independence. None of our executive body members, partners or employees involved in this audit are members of the Supervisory Board or Management Board of Evotec OAI AG. None of the partners or employees of this audit firm involved in this audit hold a direct or indirect equity interest in Evotec OAI AG or any of its subsidiaries. Likewise, our audit firm holds no shares in Evotec OAI AG or any of its subsidiaries. None of our partners or employees involved in this audit is related to a legal representative of Evotec OAI AG. To the best of our knowledge, there are no other relationships or circumstances that could compromise our independence with respect to Evotec OAI AG."

22 May 2002

KPMG Deutsche Treuhand-Gesellschaft
Aktiengesellschaft
Wirtschaftsprüfungsgesellschaft

**Note**

In addition to audit services, KPMG rendered to the Evotec OAI Group "other services" valued at T€ 194 in fiscal year 2002 (2001: T€ 197). These services dealt in particular with regular tax advice as well as other tax related consultancy.

# Glossary

**ADMET.** Acronym for **A**bsorption, **D**istribution, **M**etabolism, **E**xcretion and **T**oxicity of a substance reflecting the physiological processes *in vivo*. ADMET studies are used to characterise how drugs are taken up by the body, where they go in the body, the chemical changes they undergo in the body and how they are eliminated from the body.

**Assay.** Any combination of → targets and compounds which is exposed to a detection device to measure chemical or biological activity.

**Biochemical assay.** → Assay run on → targets previously purified from cells.

**Biomolecule.** Complex molecules produced in the body in a biological process, such as → proteins and DNA; → targets are biomolecules.

**Bioware.** Reagents, kits disposables as well as → assay or application development capabilities.

**Building block synthesis.** The synthesis of organic compounds can be considered as the connecting together of two or more chemical building blocks. Such building blocks often have to be first synthesised. Hence the term building block synthesis.

**Cellular assay.** → Assay performed using whole living cells.

**Cheminformatics.** Computer processing of data relating to chemical molecules and reactions.

**Chiral.** An organic compound that contains one or more chiral centers can exist in two chiral forms or enantiomers that are mirror images of each other due to the arrangement of the substituents about the chiral centers. Whilst enantiomers possess identical physical properties to each other (e. g. melting point and solubility) their biological activities can differ greatly. Therefore, it is desirable to prepare single enantiomers of drug molecules by stereo-specific synthesis.

**Clinical trials.** Drug research studies that involve patients or healthy volunteers.

**Combinatorial chemistry.** Chemical synthesis whereby a very large number of organic compounds is created by putting chemical → "building blocks" together in every possible combination.

**Compound library.** Collection of a multitude of different molecules; used for → screening.

**Computational chemistry.** Discipline of using computational methods to calculate properties of chemical compounds and their interaction with biological → targets (e. g. → proteins). → Chemoinformatics, molecular modelling, → virtual screening and → *in silico* → ADMET are all computational chemistry activities.

**Cytochrome P450 (CYP).** Key → enzymes responsible for metabolism of drugs. Inhibition of CYPs by drugs is a frequent cause of adverse drug-drug-interactions that can lead to the late failure of a drug. The early testing of CYP inhibition by compounds identifies such potential liabilities at a stage where they can be designed out during the course of compund optimisation.

**Cytotoxicity.** Destruction of cells.

**Directed evolution.** An extremely efficient technology for the optimisation of biomolecular functions, be it single → protein properties or whole cell processes, by transferring the principles of Darwinian evolution to the molecular level, i.e. by applying variation, amplification and selection in a cyclic manner.

**Drug design.** Process undertaken by medicinal chemists in collaboration with computational chemists during the compound optimisation phases of the Target-to-IND process. Candidate drug compounds are designed, synthesised and tested in → assays in a series of iterative cycles during which the results (SAR = structure activity relationships) from the previous cycle are used to guide the drug design for the next cycle. The aim of drug design is to meet predefined criteria for a drug molecule in terms of potency, selectivity, pharmacokinetics, → *in vivo* activity and pharmaceutical properties by selecting which changes to make to the structure of a → hit or → lead compound.

**Enzyme.** → Protein that acts as a catalyst, speeding up the rate at which a biochemical reaction proceeds.

**Focussed library.** Well characterised libraries or compound arrays designed primarily to be targeted towards particular families of biological → targets or to contain specific known pharmacophoric fragments.

**Gene.** A working sub-unit of DNA which contains the code for a specific product, typically a → protein, such as an → enzyme or a → receptor.

**Genetic engineering.** Modification of → genes or other genetic material to introduce the desired property.

**Genomics.** Identification and functional characterisation of → genes.

**GLP.** The principles of Good Laboratory Practice (GLP) define a set of rules and criteria for a quality system concerned with the organisational process and the conditions under which non-clinical health and environmental safety studies are planned, performed, monitored, recorded, archived and reported.

**GPCRs.** (**G**-**P**rotein **C**oupled **R**eceptors). Large family of related cell surface → receptors which play a very important role in drug therapy. These receptors stimulate and convey signals within cells harbouring these → proteins through interactions with a conserved family of proteins known as G-proteins.

**HERG channel.** A potassium channel that plays an important role during the excitability of the human heart. As interactions with the HERG channel can cause cardiotoxicity problems and as a result are responsible for the termination of a large number of development projects, drug candidates of nearly all pharmacological areas are tested for their effect on this → target before clinical investigations are carried out.

**High-speed chemistry.** It involves making more compounds more quickly through the use of new chemical technologies for the synthesis of compound arrays and libraries in manual, semiautomated and automated approaches. These technologies increase compound purities whilst allowing the production of structurally diverse libraries | arrays.

**Hit** (compound). A molecule which has a robust dose-response activity in a primary screen, of known confirmed structure and preliminary SAR information.

**IND** (**I**nvestigational **N**ew **D**rug). Is a substance which enters → clinical trials in humans following approval for initiation of clinical trial by the FDA or similar regulatory authority.

***In silicio***. Pertaining to the computational modelling of biological tests or experiments.

***In vitro***. A biological test or experiment conducted outside a living body (e. g. in a test tube).

**Ion channel.** → Receptor which, when activated, allows the passage of ions across cell membranes that influence the physiology of a cell.

**Kinase.** Any of several → enzymes that catalyse the transfer of a phosphate group from one molecule to another.

**Lead** (compound). A representative of a compound series with sufficient potential (as measured by potency, selectivity, pharmacokinetics, physicochemical properties, novelty and absence of toxicity) to progress to a full drug optimisation programme.

**Lead optimisation.** The synthetic modification of a biologically active compound, to fulfil all pharmacological, physicochemical, pharmacokinetic and toxicologic requirements for clinical usefulness.

**Medicinal chemistry.** A chemistry-based discipline, also involving knowledge and aspects of biological, medicinal and pharmaceutical sciences. It is concerned with the invention, discovery, design, identification and preparation of biologically active compounds, the study of their → ADMET properties, the interpretation of their mode of action at the molecular level and the construction of structure activity relationships. Medicinal chemistry optimisation is the "fine tuning" required to turn a validated → lead into a → pre-clinical candidate involving subtle structural changes to the lead using a "hand-crafted" approach.

**Molecular biology.** A branch of biology dealing with the ultimate physicochemical organisation of living matter and especially with the molecular basis of inheritance and → protein synthesis.

**New chemical entity (NCE).** Small molecule drug not previously described in the literature.

**New molecular entity (NME).** Drug distinctly different in structure from those already on the market; includes small molecules and → biomolecules.

**Pathophysiology.** Summarises processes within cells, tissues, organs or the whole body under conditions of illness as opposed to the healthy state. It is necessary to understand pathophysiology for purposes of therapeutic intervention.

**Pathway.** Involves multiple functional components (→ genes or gene products) that act in a defined sequence.

**Phase I.** Closely monitored → clinical trial of a drug or vaccine conducted in a small number of healthy volunteers, used to determine pharmacokinetics, preferred route of administration, and safe dosage range of a drug.

**Pilot plant.** A set of large fixed vessel and ancillary devices for conducting organic synthesis on a large scale. A pilot plant is often used for the synthesis of larger amounts of a candidate drug molecule required for → clinical trials in man. A pilot plant provides an intermediate scale between lab scale and full manufacturing scale for the synthesis of candidate drug molecules.

**Polymorph.** Drug molecules as for all organic compounds that are solids can exist in more than one crystalline form or polymorph. Polymorphs can be distinguished by their physical properties such as melting point and solubility.

**Post uHTS hit confirmation.** The compounds identified as → hits in the first → screening run are retested several times under the identical conditions as in the primary screen in order to verify the results of the primary screen.

**Potency profiling.** Concentration titrations of primary or confirmed → hits to determine the inhibition potency of compounds. This potency is a measure of the attractiveness of a compound for further studies.

**Pre-clinical phase.** The phase of drug discovery extending from → target identification, the search for chemical compounds with desired properties, through to the end of efficacy studies in animal models and safety evaluation prior to clincal trials.

**Protease.** Any → enzyme that catalyses the cleavage of a peptide or → protein.

**Protein.** Large, complex molecule composed of amino acid sub-units. Proteins are essential to the structure, function and regulation of the body.

**Proteomics.** The study of → proteins in terms of their synthesis, structure and function.

**Protein translocation assay.** A functional → receptor assay. Upon ligand binding, some → receptors are internalised to the cytoplasm or even translocate into the nucleus of the cell. By appropriate labelling, it is possible to measure a dynamic of the fluorescence, upon ligand-induced binding, from the outer plasma membrane to internal parts of the cell.

**Receptor.** → Protein in a cell or on its surface that selectively binds a specific substance (ligand). Upon binding its ligand, the receptor triggers a specific response in the cell.

**Reporter assay.** Particular type of → cellular assay whereby the activity of a compound is reported by the activity of a newly synthesised protein in the cell.

**Salt counter ions.** For organic compounds that contain basic or acidic functionality it is usually possible to form a salt by the addition of a compatible inorganic or organic acidic or basic compound which provides a salt counter ion. A salt form of a drug molecule may possess certain advantages over the parent molecule in terms of physical and pharmaceutical properties.

**Scale up.** The process by which a laboratory-based synthetic process is developed to allow safe and reproducible production on a larger scale.

**Screening.** Mass testing of → compound libraries using an established → assay format.

**SNP genotyping.** Identification of genetic differences between individuals by analysis of known single nucleotide polymorphisms (SNPs). SNPs represent evolutionary stable mutations and make up more than 90% of the variations within the human genome.

**Stereo-specific chemistry.** Refers to asymmetric synthesis whereby the stereochemical outcome of a chemical reaction or sequence of chemical reactions is controlled to provide a product with defined stereochemistry at each of its → chiral centres.

**Structural biology.** Dealing with the structural analysis of living material that lead to an understanding of biological function in terms of molecular and supermolecular structure.

**Target.** Specific biological molecule, such as an → enzyme, → receptor or → ion channel, assumed to be relevant to a certain disease. Most drugs work by binding to a target, thereby affecting its biological function.

**Target validation.** Involves the verification of the relevance of a → target to the course of a specific illness.

**Template.** The constant core structural entity for a → compound library to which are attached the variable chemical substituent groups that provide points of diversity.

**uHTS** (**u**ltra-**h**igh **t**hroughput **s**creening). Technique of rapidly searching for molecules with desired biological effects from very large → compound libraries, often exceeding 100,000 tests a day.

**Virtual screening.** A → computational chemistry technique whereby existing → compounds and | or virtual collections of compounds are → screened → *in silico*.

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