evotec OAI

Evotec OAI AG Annual Report 2004 'taking the lead'

Evotec OAI operates through three business divisions:

> Discovery Programs Division: proprietary drug candidates
> Discovery and Development Services: contract research and development
> Tools and Technologies | Evotec Technologies: technologies and instruments

Discovery Programs Division (DPD)

Evotec OAI's Discovery Programs Division (DPD) is developing a deep portfolio of proprietary drug candidates. With years of experience in assay development, screening, chemistry and optimisation, Evotec OAI has established a strong track record of successfully identifying such candidates for its customers.
In its proprietary research DPD has built up extensive knowledge about diseases of the central nervous system (CNS) through Evotec Neurosciences (ENS) and about metabolic disorders through the joint venture with DeveloGen. Through the acquisition of full ownership interest in ENS in March 2005, the Company has now established its own attractive CNS pipeline. DPD plans to rapidly progress the current programmes, to expand these activities and to engage in early partnerships and | or out-license the drugs at proof-of-concept to the pharmaceutical industry which is continuously searching for novel drug candidates to fill their clinical development pipelines.

Discovery and Development Services (DDS)

Evotec OAI's Discovery and Development Services (DDS) division provides drug discovery contract research and development support to a large group of global customers and to Evotec OAI's internal research in the Discovery Programs Division. DDS' state-of-the-art industrial scale engine attracts both biotech customers who lack expertise in a number of elements in the drug discovery processes as well as big pharmaceutical partners who wish to enhance their R&D productivity. The DDS division has evolved as one of the fastest growing solution providers from target to clinic through its unmatched range of integrated capabilities, a strong track record in delivering results and an outstanding customer network.

Tools and Technologies (Evotec Technologies | ET)

Evotec Technologies (ET) is developing innovative drug discovery technologies and instruments for the pharmaceutical and biotechnology industries and academic research institutions. The Company provides cutting-edge solutions for miniaturisation, automation and measurement by seamlessly integrating hardware, software and bioware modules. ET's product portfolio includes optical detectors for single cells and molecules, automated liquid handling devices, automation systems, data handling and interpretation as well as micro plates, chips and assays. The adoption of ET's products worldwide and its biological competence provides ET a significant competitive advantage in the industry.

Evotec OAI overview

Content

Condensed key figures Evotec OAI AG

	Page		2003	2004	Δ04|03 in %
Results					
Revenue	36	T€	77,228	72,730	(5.8)
R&D expenses	38	T€	15,466	13,772	(11.0)
Operating loss[1)]	38	T€	5,106	11,759	130.3
Net loss	39	T€	14,242	84,203	491.2
EBITDA	39	T€	4,086	(3,246)	(179.4)
Cash flow	40	T€	(1,333)	(3,624)	(171.9)
Balance sheet data					
Stockholders' equity	41	T€	172,101	102,010	(40.7)
Capital expenditure[2)]	40	T€	14,204	1,646	(88.4)
Cash including					
marketable securities	40	T€	19,471	15,277	(21.5)
Balance sheet total	41	T€	220,919	138,534	(37.3)
Personnel data					
Employees as of 31|12	42		644	646	0.3
Per share					
Result	47	€	(0.40)	(2.30)	(475.0)

[1)] Before amortisation and impairment
[2)] Purchase of fixed and intangible assets, excluding capital leases

Segment overview >

v = value
Pharmaceutical companies create value by delivering medicines to patients. To bring new drugs to market, they are increasingly complementing their internal research from outside sources. The pharmaceutical industry seeks strong partners who can deliver a continuous stream of high value drug candidates to fuel new products into their clinical development pipeline.

t = target
Biotech companies and leading academic institutions have validated a vast number of important biological disease targets providing tremendous opportunities to identify innovative drugs and improve healthcare globally. Many of these targets lie idle in a bottleneck caused by limited chemistry discovery resources and funding. Unlocking their value is a major challenge of this decade.

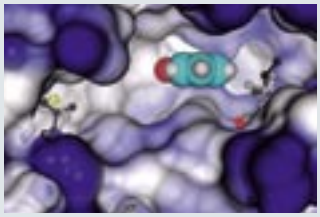
i = integration
Evotec OAI unlocks the assets of biotech companies and academia with its fully integrated industrial discovery engine that both validates their targets and provides novel, intermediary drug candidates that are in demand by the pharmaceutical companies. Evotec OAI's goal is to be a leading provider of high quality drug candidates to the pharmaceutical and biotech industry.

Value through integration

Pharmaceutical research and development is a highly complex and integrated endeavour that creates new medicines for unmet medical needs. Successful results depend upon the quality and intelligent integration of the many individual steps within the discovery part of the process. At Evotec OAI we take pride in delivering the highest industry standards in many of the essential chemical and biological research skills, concentrating our efforts on integrating these skills to help deliver high quality drug candidates to the pharmaceutical and biotech industry.

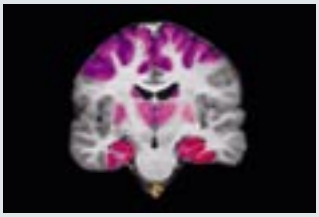
Highlights 2004

Evotec OAI is successfully collaborating with numerous pharmaceutical and biotechnology companies worldwide. Selected new contracts and highlights of 2004 are illustrated on the following two pages. Noted collaborations include a new strategic partnership with Boehringer Ingelheim, an expanded discovery chemistry contract with Roche, the rapid progress in Metabolic Disease drug discovery with DeveloGen and the successful development of Evotec Neurosciences.



February

> Evotec OAI and Toray sign integrated medicinal chemistry, virtual screening and compound profiling agreement

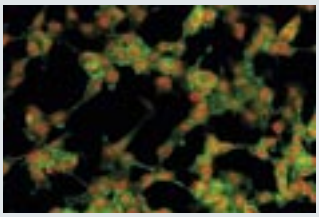


March

> Evotec Neurosciences to licence NMDA receptor NR2B subunit selective antagonists from Roche
> Evotec OAI and Panacos enter into medicinal chemistry agreement to design and optimise novel anti-HIV compounds
> Evotec Neurosciences completes € 25 million Series A financing

August

> Seikagaku selects Evotec OAI as assay development and screening partner
> Second Metabolic Disease compound advanced into lead optimisation in DeveloGen joint venture



September

> Evotec Neurosciences and Evotec OAI enter into joint drug discovery collaboration with Boehringer Ingelheim to identify GPCR modulator-based new medicines
> Evotec Technologies and QIAGEN demonstrate significant benefits of combining high-content cellular imaging systems with RNAi applications

April

> Evotec OAI increases shares in parenteral formulation subsidiary ProPharma to 81%
> Evotec OAI enters into integrated virtual screening and medicinal chemistry agreement with Fujisawa
> Evotec OAI to expand agreement with Oxford Bioscience Partners through integration of its new rational drug design platform, EVOrationale™

May

> Evotec OAI and Roche enter into strategic global discovery chemistry agreement
> Guilford Pharmaceuticals selects Evotec OAI as their assay development and screening partner
> Evotec OAI enters into discovery agreement with Nuvios

June

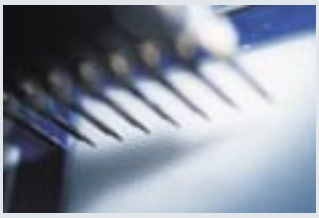
> NeuroNova selects Evotec OAI as their assay development and screening partner
> Evotec OAI undergoes successful FDA inspection

July

> Evotec OAI successfully increased its share capital
> Biogen Idec selects Evotec OAI as a service provider for process research & development
> Morphochem selects Evotec OAI as a partner for the chemical and pharmaceutical development of its dual action antibiotic Oxaquin®
> Evotec OAI to apply new rational drug design platform, EVOrationale™, to high priority research programme from ActivBiotics

October

> ALTANA Pharma selects Evotec OAI as partner for a kinase lead identification programme



December

> Evotec Technologies provides EVOscreen® and Opera™ to Korea

To our shareholders

Joern Aldag
President and Chief Executive Officer

2004 was a difficult year for Evotec OAI in terms of top and bottom line performance. Our contract research (Discovery and Development Services, DDS) and technology (Evotec Technologies, ET) groups are still considered the best in the industry; however, in a stagnant pharmaceutical outsourcing market aggravated by the weak U.S.-Dollar, consistent growth as a pure service company is a challenge.
With that said, we are optimistic about the future prospects for Evotec OAI. 2005 will be a critical year in the development of our company and we have successfully taken a number of measures necessary to keep Evotec OAI on a continued growth track:

Increased emphasis on proprietary drug discovery

We see 2005 as being the year that our business strategy for proprietary drug development becomes more apparent as we aggressively seek multiple opportunities to expand our pipeline and retain a greater proportion of the value Evotec creates through its drug discovery and development expertise. In a first significant step in this direction we have re-acquired full ownership interest in Evotec Neurosciences (ENS) in early March 2005, complemented by a significant PIPE financing commitment of € 27 m. This brings the total funds available to finance the growth of our company to over € 60 m. The funds provide a very strong basis to advance the programmes in the ENS pipeline with the objective of having two products in clinical trials in 2006, and at least one product developed to proof-of-concept and ready for partnering by 2008. In addition, we will be increasing our in-licensing and out-licensing efforts and expand our internal expertise to manage many more late stage projects.
ENS has built a promising portfolio of products to treat CNS disorders. The most advanced, NR2B selective NMDA antagonists in-licensed from Roche, are being developed for the treatment of Alzheimer's Disease, Parkinson's disease and neuropathic pain and are expected to enter clinical trials later this year. Combining the pipeline at ENS with our powerful industrial scale platform creates a fully integrated biotechnology company that is well positioned to build a sustainable preclinical and clinical CNS pipeline that can withstand the attrition common in our industry. The successes we have been able to deliver to our customers in contract research as well as

our progress with ENS and DeveloGen make us confident that we have the right technologies, capabilities and people to successfully execute CNS focused drug discovery and development. We are poised for success because our proprietary pipeline focused strategy:

> Leverages the high quality drug discovery and development capabilities that we have built over the past decade;
> Takes the strong relationships we have built with the leading companies in the pharmaceutical and biotechnology industry to a new level;
> Maximizes our long-term top and bottom line potential through shared commercial rights and milestones on the development of novel drug candidates; and
> Addresses the need of the pharmaceutical industry for in-licensed products in a very unique way.

Emphasis on cash generation in contract research

Moving into 2005, our contract research business (Discovery and Development Services) is building momentum. Whilst the market for discovery services is still challenging, biotech companies increasingly need our services for the development of their advanced clinical candidates. Evotec OAI does benefit from this trend as those companies appreciate the comprehensive solutions and the consultancy we can offer to support them in bringing new drugs to market.

Going forward, contract research remains the heart of our business and very much underpins the success of our expanding focus on proprietary drug discovery programmes. Our goal with this division is to maintain market share in basic contract research services, while increasing market share in higher-valued, strategic shared risk | reward contracts (see Boehinger Ingelheim collaboration on page 11) that provide milestones and royalties. Rather than just maximizing revenues short-term, we will focus on maximizing bottom-line performance. Combined with a tightened cost structure this should allow us to generate cash to re-invest in and support our proprietary product programmes.

We believe that our DDS division will:

> Continue to build on our industry reputation as the leader in customer service and quality in discovery and development services;
> Provide significant value to our internal programmes through target-class expertise, screening, medicinal chemistry and process chemistry, utilising state-of-the-art technologies; and
> Provide cash flow resources to assist in funding the growth of our proprietary pipeline.

In summary, we are well set for 2005 as we embark on an exciting phase of our development. With the additional focus on developing compounds selectively through to proof-of-concept in man, Evotec will be able to retain significantly more value in partnerships with pharmaceutical customers. By the end of 2005 we expect that the value drivers for our shareholders will be the optimum combination of a successful drug discovery and development company—alliances, product data and pipeline growth; and a quality-driven contract research company—revenues and earnings.

We thank our shareholders, customers and dedicated employees for their continued support. We look forward to updating you throughout the year on the progress we have made in implementing our exciting strategic direction of finding new drugs to treat important diseases.

Joern Aldag
President and Chief Executive Officer

Building pharmace pipelines

eutical

Over the past decade, Evotec OAI has advanced into a fully integrated drug discovery and development company to help build the pipelines of their customers in the pharmaceutical and biotechnology industry. Today, Evotec OAI's strategy is to add to its high quality contract research business by building its own pipeline of drug candidates to both meet the evolving demands of its customers >>>

>>> for in-licensed products and reap the rewards of a successful pharmaceutical franchise. This new business is strengthened by the Company's proven industrial scale engine, the capabilities in lead discovery and optimisation for its customers and the recent re-acquisition of Evotec Neurosciences. Success shall come in the advancement of Evotec OAI's own drug candidates, the out licensing of these compounds for clinical development and commercialisation and the continued growth of the Evotec OAI pipeline of drugs that truly meet customer needs as well as unmet medical needs.

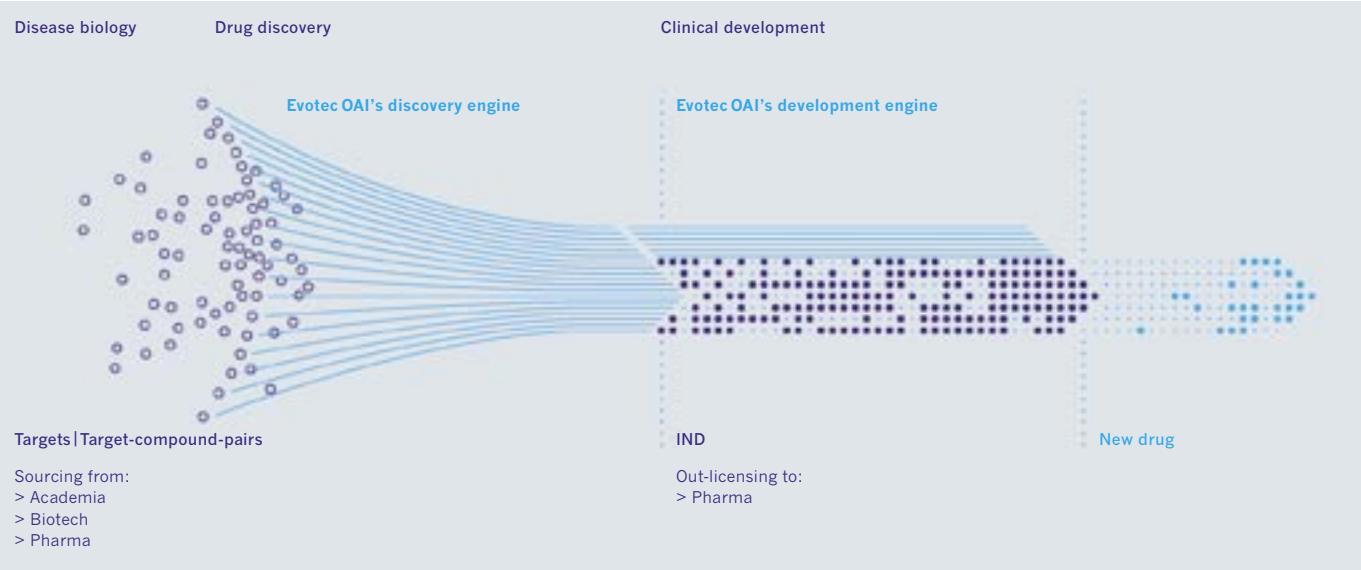
Evotec OAI is one of the world's leading contract research providers for the life sciences industry. We have one of the most comprehensive and cutting-edge drug discovery and development service platforms, consistently generating novel drug candidates, which are ultimately tested on human beings in clinical trials.

The success of our business has been clearly influenced by our strategy to meet and exceed the demands of our customers, the leading companies in the pharmaceutical and biotechnology industry. Over the past decade we have evolved with our customers by expanding our capabilities from technologies to screening to medicinal and process chemistry to providing fully-integrated discovery and development services.

Today, many factors have changed the macro-economic environment of our industry resulting in a shift in the business goals and priorities of the pharmaceutical industry—our primary customer group. In the past, pharmaceutical companies have enjoyed above-average revenues and earnings which were funnelled into early and late stage research projects. This situation has noticeably changed over recent years due to global pricing pressures and patent expiration of important drugs. In addition, the costs for the development of new products have been rising steadily and regulatory requirements for the registration of drugs have become more stringent. This has been exacerbated by some spectacular recalls of billion dollar products such as Baycol and VIOXX, straining both the companies and the industry as a whole.

The reaction of our pharmaceutical customers to these pressures is clear. They have shifted their priorities away from early discovery to concentrating on more mature drug candidates to fuel near-term product introductions. To achieve this goal, they will have to concentrate more resources on the late phase of clinical development and marketing where the pharmaceutical industry has its biggest competitive advantage. The origin of these drug candidates—be it in-house research or production under license—is less important today than it used to be in the past.

Evotec OAI's engine for pharma and biotech research



This is a real treasure trove for companies such as Evotec OAI who have built integrated drug discovery and development capabilities that are capable of producing products ready for clinical development. The opportunity for Evotec OAI is clear and incorporates a higher risk and higher reward business strategy that we believe will ultimately allow us to retain higher value for our shareholders:

1. In our contract research business (Discovery and Development Services) we will maintain our commitment to the strong customer relationships we have developed. We continue to deliver high quality research results to our customers, continuously benchmarking our engine against the highest standards in our industry. In these relationships, however, we will increasingly engage in higher value, higher margin deal structures. We intend to access innovative disease expertise though alliances with biotech companies or academia and provide pharmaceutical companies with research results, (e. g. drug candidates or INDs) in outcome based collaborations (see Boehringer Ingelheim, page 11). This allows Evotec OAI to participate to a more significant extent in the success of its research through milestones and royalties. Based on these new deal structures and our careful analysis of cost and efficiency in contract research, we will focus this business on achieving positive cash flows to assist in funding the growth of our proprietary pipeline.
2. It is the same proven industrial scale engine that also provides the Company with the necessary expertise and critical mass to deliver proprietary, clinically-ready novel compounds to our customers' doorstep. These proprietary drug candidates can garner tremendous value in upfront payments, milestones and royalties, far above anything we can achieve under our established service business model. By leveraging our skills and expertise, we intend to accumulate a body of disease-related knowledge internally to build a sustainable pipeline of proprietary programmes. To this end, we have built up extensive knowledge about diseases of the central nervous system through Evotec Neurosciences (ENS) and about metabolic disorders through our joint venture with DeveloGen. We are now planning to focus on and pursue such activities, not through minority held structures or joint ventures, but more via majority controlled subsidiaries or under the roof of the parent company Evotec OAI AG. Through the re-acquisition of ENS announced in March 2005, we have taken a big step forward in building our own CNS pipeline: we gained access to world class science, validated by partnerships with some of the world's major pharmaceutical companies, and an exciting portfolio of new drug candidates. As these programmes progress, we plan in the future to expand these drug discovery activities through product or company acquisitions with the ultimate goal to create a sustainable pre-clinical and clinical CNS pipeline.

“Now we think the time has come to capitalise on our integrated industrial scale platform and to retain more of the value of our research internally. With the necessary expertise and critical mass in drug discovery and development we are now in the position to build a substantial CNS pipeline and create more rewarding deals.”

Joern Aldag
President and Chief Executive Officer

In summary, our business strategy is clearly shifting to programmes that meet the demands of our pharmaceutical customers while leveraging our capabilities to provide a higher return to our shareholders. As we embark on investing in developing a pipeline of proprietary products we will be participating more directly in the tremendous upside that will be generated by the growth of our industry.

Boehringer Ingelheim

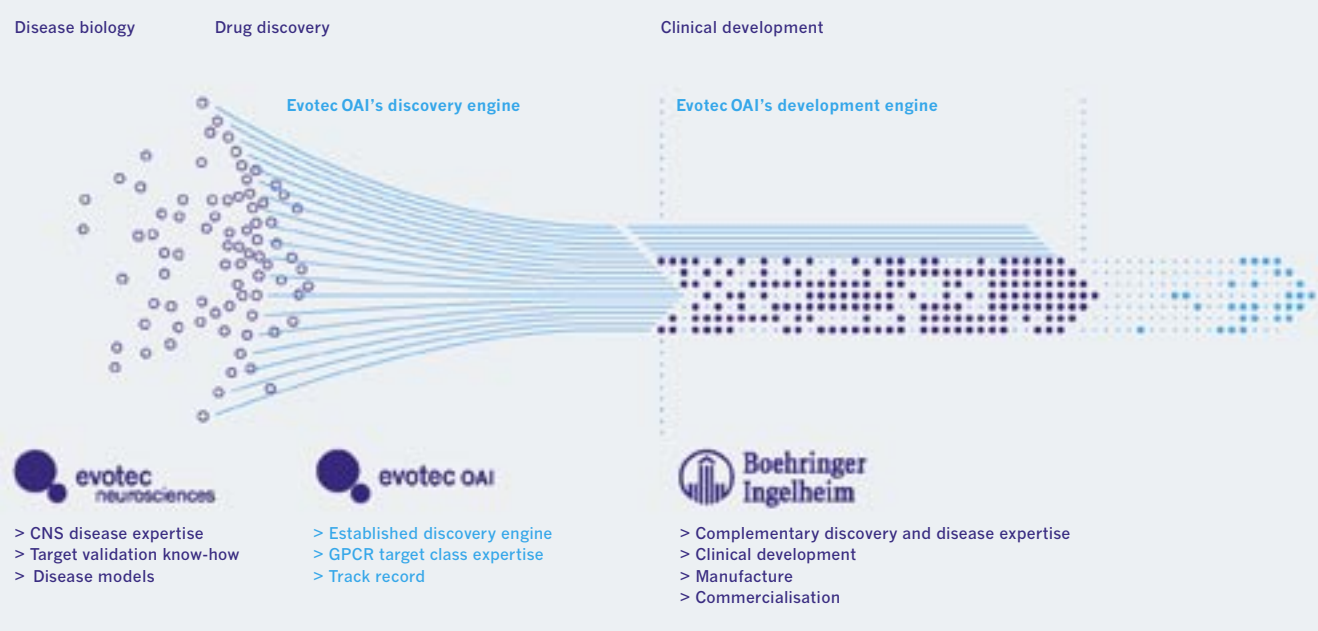
Combining Evotec OAI's discovery engine with the CNS expertise of ENS to develop promising drug candidates

Retaining higher value through results-based research partnerships

Evotec OAI's discovery and development platform is the heart of the Company's business. Combining this powerful industrial scale engine with the expertise from disease-focused research organisations, allows Evotec OAI to enter into results-based, higher value discovery collaborations with the pharmaceutical industry. There is a clear trend that pharmaceutical companies increasingly wish to in-licence products with research results instead of building own dedicated research capacity. Developing and delivering product candidates and thereby directly fuelling clinical drug pipelines enables Evotec OAI to participate more significantly in the success of its research programmes through substantial milestones and royalties.

Successful implementation of business concept

In September 2004, Evotec OAI combined its capabilities in finding and optimising novel drug molecules with Evotec Neurosciences' disease expertise in neurological disorders in a three year research partnership with Boehringer Ingelheim. The companies intend to jointly identify and develop small molecule therapeutics acting on selected G-Protein Coupled Receptors (GPCRs) with an initial focus on CNS diseases. The agreement includes a broad range of services from drug discovery to delivering drug candidates. Boehringer Ingelheim will have global responsibility for all clinical development activities, manufacture and commercialisation of the compounds identified in the collaboration. Evotec's success will be rewarded through research payments, pre-clinical and clinical discovery and development related payments and potentially royalties. The collaboration serves as a strategic model to all three parties and gives Boehringer Ingelheim an appealing opportunity to access such relevant technologies "under one roof".



Linking strengths

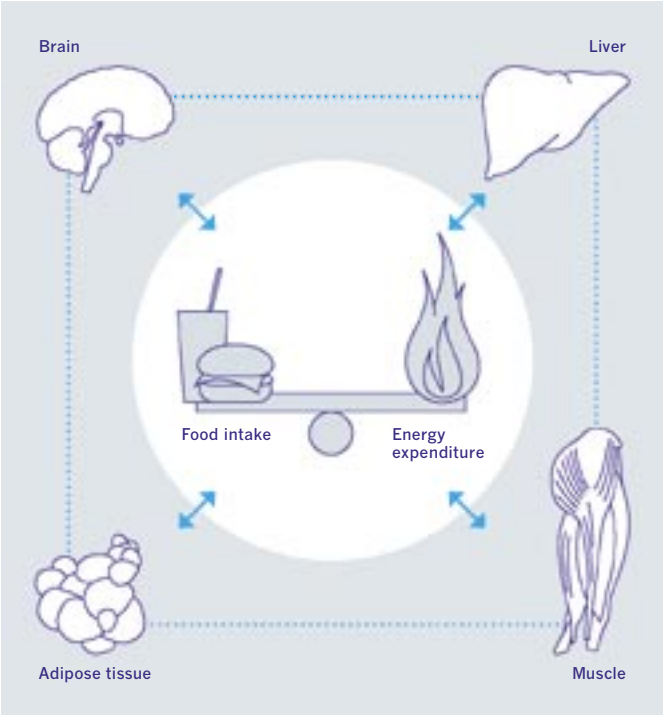
The Evotec OAI brand, diversity of capabilities and quality of services have made the Company the partner of choice for the industry. Evotec OAI's three core business segments provide a broad range of solutions to the pharmaceutical and biotechnology industries from state-of-the-art drug discovery equipment, to high throughput screening, to medicinal and process chemistry expertise, to the discovery and development of proprietary drug compounds for out-licensing. The future of Evotec OAI lies in linking the strengths of these core divisions to provide higher value drug candidates to the industry and ultimately better drugs to meet the world's healthcare needs.

Discovery Programs Division (DPD)
Advancing high value drug candidates

> In-licensed five late pre-clinical drug candidates from Roche for CNS diseases (ENS)
> Raised € 25 million VC funding for ENS in March
> Made strong progress in Metabolic Disease collaboration with DeveloGen

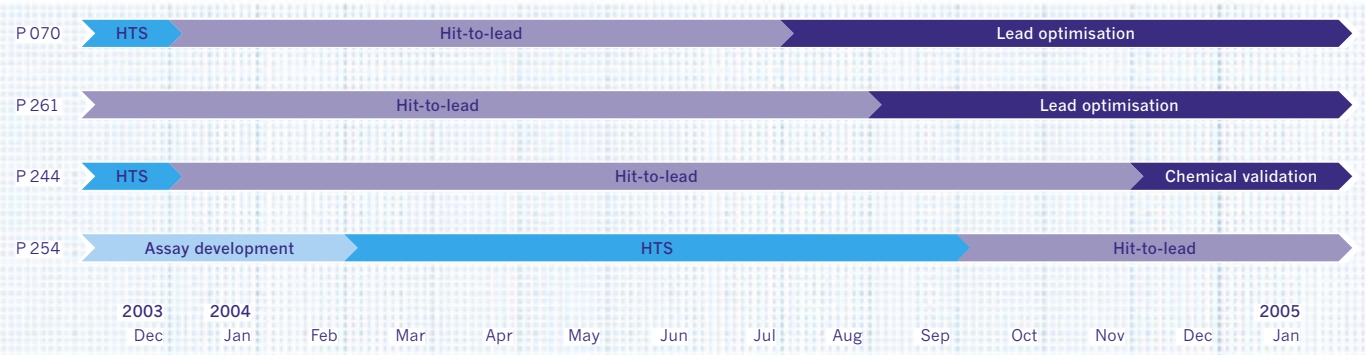
Progress supports DPD expansion strategy

In 2004, Evotec OAI successfully advanced and expanded its discovery programmes in Central Nervous Systems (CNS) and Metabolic Disease. The business potential of the CNS programmes was validated by a significant financing from outside investors for Evotec OAI's affiliate Evotec Neurosciences. These achievements provide a strong basis to accelerate the Company's strategy of expanding its internal discovery programmes with the objective to provide higher returns for Evotec OAI and its shareholders over the longer term.



Food uptake and energy balance is regulated by the interplay of various organ systems including the brain, liver and pancreas. This offers various targets for therapeutic intervention against diabetes and obesity, the fastest growing diseases in the developed world.

Metabolic Disease pipeline



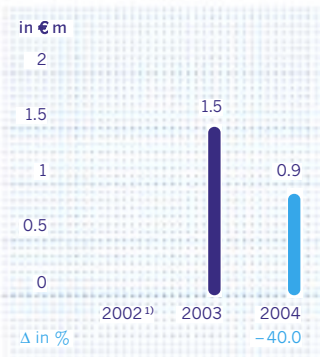
Successful year for Evotec Neurosciences (ENS)

ENS has continued to add value to its CNS pipeline by in-licensing pre-clinical drug candidates from Roche. On the back of this contract and a target validation agreement signed with Takeda shortly before, ENS raised € 25 m of venture capital at the end of March. The first tranche of this financing diluted the Evotec OAI ownership of ENS to 42%. Consequently, since April 2004 ENS' financials are no longer reflected in the Discovery Programs Division's financials but are consolidated as non-operating result ("at equity") in Evotec OAI's group financial statements. Evotec OAI therefore reports on ENS in a separate special on page 17 and 18.

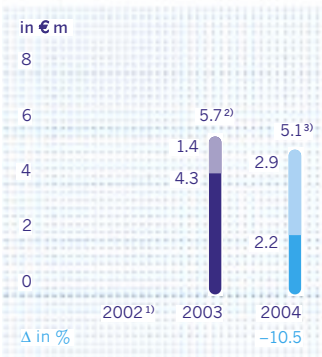
Two drug candidates in Metabolic Disease advanced into lead optimisation

Since Evotec OAI and DeveloGen established their joint drug discovery venture in the field of Metabolic Disease (Type II diabetes, obesity and metabolic syndrome) in late summer 2003, this venture has made substantial operational progress. Having started with early assay development and screening, two out of four discovery projects have been advanced into lead optimisation stage. Patents have been filed for the respective lead series and first *in vivo* efficacy data has been obtained. A third project has also yielded highly potent inhibitors which have been directly used for initial biological studies *in vivo*. In summary, the joint venture has translated the scientific assets and investments in Metabolic Disease discovery into potential commercial products that have attracted pharmaceutical companies to begin early discussions regarding purchasing development candidates arising from this programme.

Revenue DPD



R&D expenses DPD



1) Included in Discovery and Development Services (DDS)
2) Including consolidated € 1.4 m contribution to DeveloGen joint venture R&D expenses
3) Including consolidated € 2.9 m contribution to DeveloGen joint venture R&D expenses

Condensed key figures Discovery Programs Division

		2004	2003
Revenue	T€	944	1,479
– Thereof 3rd party	T€	925	1,464
Gross margin	%	38.8	55.7
R&D expenses	T€	2,210[1)]	4,324[2)]
SG&A expenses	T€	1,001	1,801
Operating result before non-cash amortisation and impairment	T€	(2,845)	(5,301)
Operating result	T€	(2,936)	(5,356)
– Thereof depreciation and allowances	T€	249	425
Employees (31|12, without overhead)		5	28

1) Excluding consolidated € 2.9 m contribution to DeveloGen joint venture R&D expenses
2) Excluding consolidated € 1.4 m contribution to DeveloGen joint venture R&D expenses

Financial discussion

In 2004, the Evotec OAI Discovery Programs Division achieved revenues of € 0.9 m (2003: € 1.5 m), resulting from the collaboration between Evotec Neurosciences (ENS) and Takeda. Revenues declined over 2003 as 2004 ENS revenues were booked in the first quarter only. Thereafter, they were no longer consolidated in the Evotec OAI group accounts due to the reduction of Evotec OAI's shareholding in ENS following the venture capital round closed in March. ENS stand-alone had total revenues for the year of € 4.2 m.

R&D costs, including the research expenses dedicated to the Metabolic Disease programme with DeveloGen (€ 2.9 m consolidated, booked as net loss from equity investments under non-operating expenses), decreased slightly as planned to € 5.1 m (2003: € 5.7 m). Q1 ENS R&D expenses declined over 2003. In Q1 the Takeda collaboration triggered revenues and hence costs previously recorded under R&D expenses are now accounted under cost of goods sold. Not taking into account ENS, which in 2004 was deconsolidated since 1 April, R&D expenses including the contributions to the DeveloGen joint venture increased by 88%, in line with Evotec OAI's strategy to shift R&D activities to this division.

Further expansion

Going forward, DPD is intended to become a significant value driver for Evotec OAI. The trend of early compound in-licensing will be further pursued and expanded by the pharmaceutical industry. Therefore, Evotec OAI is committed to directing its efforts increasingly on truly internal projects and building a pipeline of promising drug compounds, subject to financial resources, that provide higher-value return. The DPD portfolio may also be supplemented with selected third party compounds obtained by in-licensing or acquisition in order to accelerate the ramp-up to a steady state sustainable pipeline of both pre-clinical and clinical drug candidates.

Evotec Neurosciences (ENS)

A banner year 2004

In 2004, ENS delivered on its strategy with the achievement of all its major development objectives. In addition, ENS secured a multi-year drug discovery collaboration with Evotec OAI and Boehringer Ingelheim.

Lead programme close to the clinic
In March 2004, ENS announced the acquisition of an exclusive worldwide license to develop and market a portfolio of NMDA receptor antagonists from Roche. The compounds have rapidly progressed at ENS into late preclinical development for the treatment of a variety of CNS disorders including Alzheimer's Disease, neuropathic pain and Parkinson's disease. This class of compounds is highly selective for the NMDA NR2B receptor subtype exhibiting high potency *in vivo* and improved side-effect profiles over non-selective NMDA antagonists (e.g. Memantine). Evotec OAI has contributed process research and development services, scale-up and small quantity production to this programme. ENS has now placed an order for kilogramme amounts of a lead compound to be made by Evotec OAI as this project is expected to yield a phase I candidate in 2005.

The largest European Series A biotech financing in two years
Facilitated by its recent achievements, ENS closed a € 25 m first round of venture capital financing in March. Investors included a lead investment by TVM (Techno Venture Management) with 3i plc and MVM as co-lead investors. This substantial funding provides ENS the financial stability to accelerate the development of its proprietary and in-licensed compounds and to execute its strategy of building a well balanced and sustainable CNS pipeline.

University of Zurich link reinforced
In June 2004, ENS started to hire scientists in Switzerland to facilitate the ongoing multi-year collaboration with leading scientists in neurological and psychiatric research at the University of Zurich as well as to conduct pharmacologic profiling of ENS compounds and future clinical trial management. These employees are part of the Company's newly formed subsidiary Evotec Neurosciences AG.

Adding CNS expertise to GPCR collaboration with Boehringer
In September 2004, ENS and Evotec OAI entered into a three-way, three year collaboration with Germany's largest

Evotec Neurosciences' portfolio 2004

1) Alzheimer's Disease

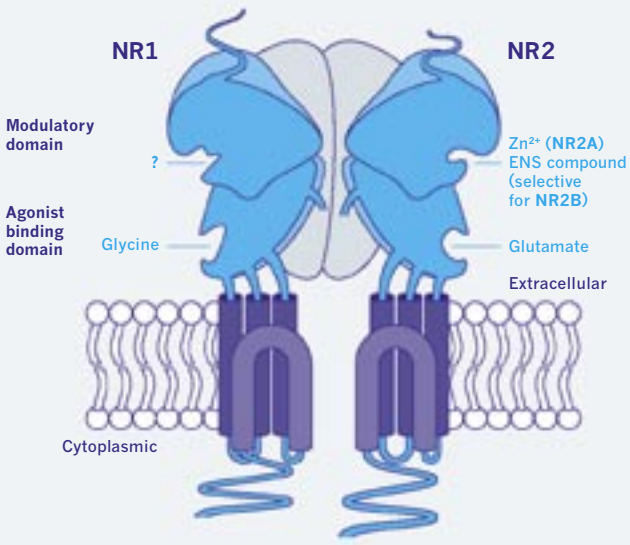
pharmaceutical group Boehringer Ingelheim. The collaboration is focused on identifying and developing small molecule therapeutics that target G-Protein Coupled Receptors (GCPRs). This substantial new contract is a strong recognition of ENS' expertise in drug discovery and CNS diseases.

Solid progress in Alzheimer's Disease collaboration with Takeda

ENS and Takeda are on track towards achieving their four-year goal to identify and validate novel targets relating to different aspects of the causes and progression of Alzheimer's Disease. More than 20 scientists are currently working on the project. The key milestones for 2004 have been accomplished and 2005 should see targets being selected for downstream drug discovery programmes.

In summary, ENS has made significant progress in establishing a promising CNS product portfolio. Looking forward, the company intends to aggressively advance its current projects and to supplement its pipeline though compounds in-licensed or acquired from third parties to build on its position as a strong player in CNS indications.

NMDA receptor



The function of the brain is largely dependent upon the communication between individual nerve cells. In mammals, a single nerve cell communicates with another by releasing chemicals that alter the electrical activity of the receiving cell. These chemicals are known as "neurotransmitters". By far the most abundant excitatory neurotransmitter in the mammalian brain is glutamate. Curiously, this is exactly the same as the taste enhancer commonly used in Asian cooking known as "Umami" or MSG (Mono Sodium Glutamate)!

Glutamate changes the activity of the receiving nerve cell by binding to specific proteins on the surface of the nerve cells, known as "receptors". When glutamate binds to such receptors, the flow of positively charged ions, such as sodium, calcium, and potassium, across the membrane of the nerve cell is altered. This different flow of ions is "felt" by the receiving nerve cell as "communication" inducing a certain action of that cell. To improve the specificity of such action, glutamate acts on many different types of receptors and at least 30 different proteins contribute to the heterogeneity of glutamate receptors. A major glutamate receptor family is known as the NMDA receptor family. This rather cumbersome name arises from a glutamate analogue "N-methyl-D-aspartate" that was found to activate these receptors selectively.

Apart from their normal physiological communication roles, NMDA receptors are important players in certain diseases such as neuro-degeneration, pathological pain states, and in conditions such as Parkinson's disease and epilepsy. The hypothesis is that when you can block the NMDA function with an "antagonist", this will positively impact the disease. Extensive studies over the last 15 years have indicated a potential role for NMDA receptor antagonists in the treatment of these diseases. However, the clinical development of non-selective antagonists has shown unfavourable side-effects such as hallucinations and effects on movement. In the early 1990's it was found that multiple NMDA receptor subtypes exist which contain different NR2(A-D) subunits. Compounds selectively targeting NR2B subunit-containing receptors are expected to retain many of the beneficial effects of earlier non-selective compounds but have much improved side effect profiles. Such NR2B specific compounds are at the heart of ENS' NMDA receptor programme.

Discovery and Development Services (DDS)
Integrating solutions into our partners' needs

> Up-turn in deal flow despite undeniably challenging market conditions
> Leveraging drug discovery expertise through higher value, outcome-based deals as evidenced with strategic Boehringer Ingelheim collaboration
> Large strategic discovery chemistry contract signed with Roche
> Chemical and Pharmaceutical Development building momentum
> Shares in parenteral formulation subsidiary ProPharma increased to 81%

Underlying performance overshadowed by challenging markets and foreign exchange

The DDS division's 2004 performance has been overshadowed by the continuing challenging macro environment in the life science industry combined with an adverse shift in foreign exchange rates. The weak U.S.-Dollar has left the Company exposed to pricing pressures due to U.S. competition and U.S.-Dollar denominated contracts. Together with the strong GBP-Sterling, which has increased the UK cost base, it has capped top-line performance and eroded gross margins. Irrespectively, the DDS division was successful in gaining business with many new customers in 2004 with widespread deal flow across all areas of discovery and development.

Strategic alliance with Roche strengthens discovery business

Within Discovery Services, Evotec OAI expanded its long-standing relationship with Roche through a strategic worldwide agreement. Supporting the four worldwide Roche R&D sites the project entails the design and synthesis of high quality chemical compounds for their medicinal chemistry programmes. In addition, the DDS division extended a separate medicinal chemistry contract with Roche in oncology as well as signing new contracts or contract extensions with customers including e.g. Altana Pharma, Curis, sanofi-aventis, Solvay Pharmaceuticals, Elixir and Panacos. DDS further strengthened its position in the Japanese market through integrated medicinal chemistry and virtual screening contracts with Toray and Fujisawa as well as an assay development and uHTS deal with Seikagaku. Further assay development and screening contracts were particularly positive in the year with deals signed with customers including NuVios, Guilford and NeuroNova (now Affectis Pharmaceuticals).
In summary, Evotec OAI is proud of the fact that its Discovery Services have performed well compared to many peers in what is currently an undeniably difficult market.

Sample of Evotec OAI's customer portfolio 2004

"The drug discovery environment in the research-based pharmaceutical industry necessitates collaborations with competent external partners to supplement in-house expertise, knowledge and experience."

Professor Dieter Hinzen, Head of Research and Development at Boehringer Ingelheim Germany

Leveraging Evotec OAI's expertise through high value, outcome-based deals

Evotec OAI is expanding its business model by developing higher value, outcome-based strategic partnerships. The prime example is its three-year research alliance on GPCR targets with Germany's largest pharmaceutical group, Boehringer Ingelheim and Evotec Neurosciences. The agreement comprises a wide range of contract research from discovery to the identification of development candidates with an initial focus in CNS. Evotec OAI will receive research payments, project related payments, clinical milestones and potentially royalties. There is a clear trend in our industry where customers increasingly wish to in-license results rather than acquire additional capacity. Such contracts are structured to bring tremendous financial rewards, even when taking into account the natural attrition in drug discovery. These deals will typically pay at a later stage with higher margins and enable the Company to participate in the commercial success through sizeable milestones and royalties. In summary, they will enable Evotec OAI to leverage its expertise and state-of-the-art platform to add significant value to customer programmes focusing its attention on a higher value, high margin business.

Our discovery and development engine

OBP agreement continues to open the door to U.S. market

The innovative umbrella contract with the U.S. venture capital firm Oxford Bioscience Partners (OBP), signed in November 2002, continues to open doors to the U.S. market for DDS. The agreement promotes Evotec OAI as the premier solution provider to emerging OBP portfolio biotech companies. It enables DDS to provide them with integrated drug discovery and development solutions. The agreement was extended in April 2004 to include EVOrationale™, Evotec OAI's structure based drug design platform (see R&D report page 34). In addition, a new contract with NuVios was added to the existing customer base that includes Artesian, Dynogen and Elixir. A compound has now progressed from Discovery Services to Chemical and Pharmaceutical Development in the collaboration with Artesian that began in 2003. A similar umbrella contract was struck with private venture firm MPM Capital in 2004.

Filtration of a drug intermediate during a GMP custom preparation

Chemical and Pharmaceutical Development on the right path

Evotec OAI's development business has built momentum throughout the year. Despite a weak first quarter, it concluded 2004 with a stable year-on-year performance and contract negotiations for 2005 orders are promising. Several pilot plant projects were completed for customers including AnorMED, Celgene, Morphochem and Point Therapeutics, and laboratory development work was conducted for Stiefel, Morphochem, Artesian, among others. The progression of Artesian's compound from Evotec OAI's Discovery Services through to Chemical Development is a true validation of Evotec OAI's integrated range of chemistry capabilities. Biotech companies appreciate the comprehensive solutions and the consultancy the DDS division can offer in identifying and bringing new drugs to market. The DDS division will have three commercially manufactured products in the pilot plant in 2005.

In 2004, Evotec OAI signed a significant new contract with Morphochem to support the development of their dual-action antibiotic Oxaquin® and Biogen Idec expanded their relationship with Evotec OAI in process research and development under a master services agreement. Biogen Idec and Evotec OAI have collaborated for five years on a variety of projects including novel route selection all the way through to scale-up and cGMP manufacturing.

Development capabilities validated and further strengthened

In June, the successful general GMP audit and FDA pre-approval inspection of Evotec OAI's cGMP manufacturing facilities once again validated its high quality process development, manufacturing, analytical and quality assurance capabilities and confirmed the position of Evotec OAI as a world leader in the supply of customer's development needs through its EVOdevelop™ platform.

In April, Evotec OAI increased its holdings in its formulation subsidiary ProPharma to 81% and relocated the operations from Strathclyde University to dedicated facilities in the Glasgow Business Park. Additional capacity will be on stream by mid 2005 and the current changes already have a positive impact also on sales for Q4, and contracts for H1 2005.

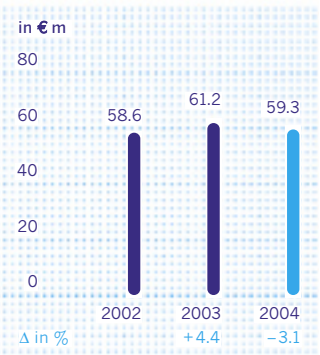
Evotec OAI's factory for screening biochemical and cellular assays with a throughput of >400,000 compounds per day

Financial discussion

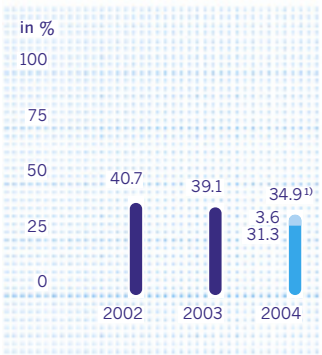
Despite the up-turn in terms of deal flow, the contract research environment affected top line growth in 2004. Discovery and Development Services (DDS) achieved revenues of € 59.3 m (–3.1%, 2003: € 61.2 m) including intra-group revenues of € 5.1 m, largely from the delivery of services to the joint venture with DeveloGen. Third party revenues declined by 8% to € 54.1 m due to some long-term contracts being scaled-down or terminated in the challenging market environment. Although business has recovered strongly since the start of the year, DDS was not able to compensate for this initial shortfall and therefore had to revise its targets for 2004 in October. This updated situation has also led to a non-cash impairment of parts of the Company's assets (see Status report on page 41). Gross margins in DDS declined to 31.3% (2003: 39.1%). This is mainly a result of the adverse foreign exchange from a weak U.S.-Dollar and a strong GBP-Sterling but also of relatively low sales volumes, particularly in Q1, and the resulting capacity underutilisation. If 2003 exchange rates were applied, the gross margin would have amounted to 34.9% for DDS.

The operating loss before amortisation and impairment for the division amounted to € (7.8) m (2003: € 0.01 m) reflecting mainly the margin decline in addition to increased SG&A costs. SG&A costs increased by 12% to € 14.7 m due to rent for a new building in the UK, increased costs for marketing and sales and currency effects.

Revenue DDS



Gross margin DDS



1) Currency pro-forma adjustment using exchange rates of 2003

Condensed key figures Discovery and Development Services

		2004	2003
Revenue	T€	59,249	61,214
– Thereof 3rd party	T€	54,123	58,582
Gross margin	%	31.3	39.1
R&D expenses	T€	8,084	8,112
SG&A expenses	T€	14,657	13,088
Operating result before non-cash amortisation and impairment	T€	(7,763)	9
Operating result	T€	(87,136)	(10,422)
– Thereof depreciation and allowances	T€	9,441	9,319
Employees (31|12, without overhead)		450	440

Market recovery remains uncertain

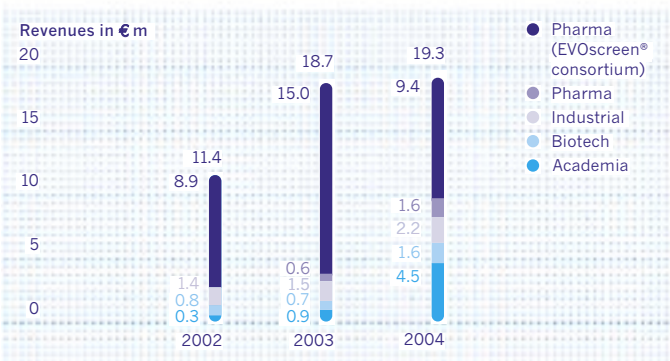
While the contract research sector is finally starting to show signs of recovery, progress is still slow. Initial positive signals primarily within the U.S. market have failed to be followed by the European market, and the continued emphasis on cost control by pharmaceutical companies combined with the limited success of the biotech IPO market means 2005 is unlikely to be a general recovery year. There are, however, some positive signs including the trend of academia moving into early drug discovery and some stabilisation of the FX position. In this environment, Evotec OAI's primary goal for 2005 will be to manage the business such that DDS will be able to deliver positive cash flows. Management will also focus increasingly on higher value, high margin business where Evotec OAI can leverage its expertise to add significant value to customer programmes. Looking forward, the contract pipeline for 2005 for DDS is stronger today than it was for 2004 at the same time last year.

Tools and Technologies (Evotec Technologies | ET)

Providing cutting-edge research tools

> Significantly expanded customer base and product portfolio
> First EVOscreen® system delivered outside of original pharma consortium
> Increased demand for cellular image analysis
> U.S. sales network established
> Promising sales opportunities in academic research

ET tripled the revenues with customers outside the EVOscreen® consortium



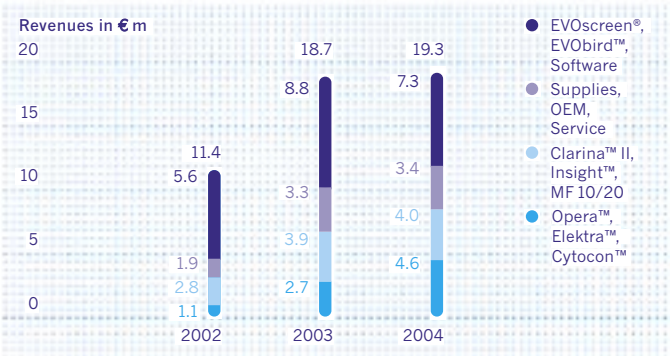
Another year of growth

2004 was an exciting year for Evotec Technologies. The challenge at the beginning of the year was to compensate for a single large contract with EVOscreen® partner Pfizer which boosted revenues in 2003, setting a high hurdle for growth in 2004. By gaining new customers outside the EVOscreen® consortium with Pfizer, Novartis and GlaxoSmithKline and by introducing new products into the market, the Company has mastered its task successfully. ET demonstrated a spectacular year-end rally and reported another year of revenue growth.

EVOscreen® goes Far East, first system established outside of consortium

In 2004, Evotec Technologies delivered its first screening platform to Asia. The Institut Pasteur Korea ordered an EVOscreen® system and two Opera™ cell analysers which were successfully installed in December. It was the first EVOscreen® delivery ever to a customer outside the consortium. This highlights EVOscreen®'s leadership position in the universe of biochemical as well as cellular ultra-high-throughput screening not only for pharma and biotech companies, but also for academic research organisations.

ET's product portfolio shifted further towards cell-handling and analysis



Bench-top devices successfully marketed: Opera™, Clarina™ II

ET's **Opera™** cell imaging detector gained considerable market share in 2004 with the number of installed devices increasing by 50%. Orders were received from a broad range of customers including Altana Pharma, Xantos, two large U.S. drug discovery companies, the German academic Max Planck Institute, and the Institut Pasteur and KRICT in Korea. ET expects to further increase market share and awareness for this core product with recent product enhancements, expanded applications and a new co-marketing agreement with Qiagen for siRNA applications on the Opera™.

Clarina™ II continues to be a successful product for ET. In 2004, upgrades to the bench-top device have made it one of the best automated fluorescence life-time detectors available. Units and upgrades were sold to Pfizer and Novartis. Olympus continues to market the core of the Clarina™ II line (MF 10 and MF 20) into academic institutions and universities in Japan.

EVOscreen®
established worldwide with 12 systems at 8 sites

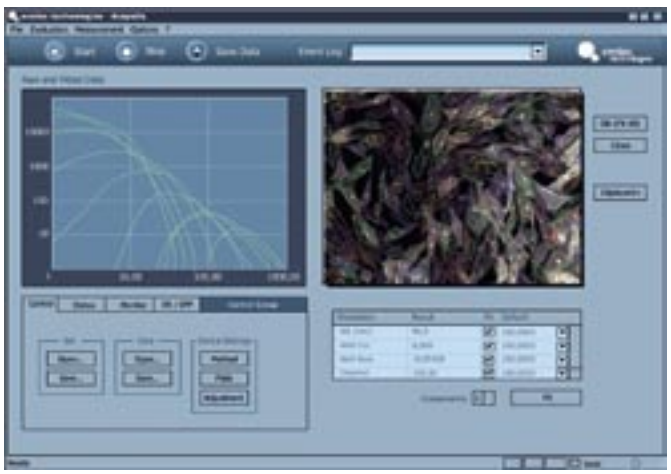
EVOscreen®
ultra-High-Throughput Screening platform for cellular and biochemical assays

Clarina™ II
High content analyser for biochemical assays

Opera™
High speed confocal cell imaging detector

Elektra™
Bench-top device for automated single cell selection and recovery

EVObird™
Compound reformatting for miniaturised ultra-High-Throughput Screening



Acapella™: Integrated analysis software for all ET and third party devices

New products EVObird™ and Acapella™

Evotec Technologies launched a new automated device, **EVObird™**, in Q3 that is designed to reformat compounds for screening adherent cells in a high throughput format. Several systems were already sold in 2004. A second new product introduction, the **Acapella™** software, is designed to facilitate the interpretation of the massive amount of screening data generated in drug discovery. It can be operated on individual workstations, i.e. independently from the research detection device. In 2004, one of ET's partners incorporated Acapella™ as the core analytical tool for all ET instruments. The commercialisation of Acapella™ is a major step for ET in establishing software solutions as a new business area.

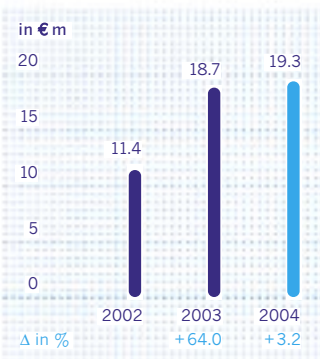
All milestones achieved with Pfizer

All milestones agreed in ET's 2002 contract with Pfizer were successfully achieved in 2004. Milestones included the performance of the technologies in terms of compound savings, increases in throughput and the screening of 100,000 wells containing an adherent cellular assay within 24 hours on EVOscreen® Mark III.

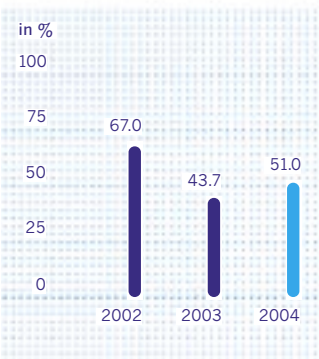
Financial discussion

Evotec Technologies' sales increased by 3% to € 19.3 m (2003: € 18.7 m). Revenues were heavily back-end loaded due to the delivery of the EVOscreen® to the Institut Pasteur and Opera™ units to several other customers in Q4. Approximately 50% of the annual sales were booked in this quarter alone. Third party revenues amounted to € 17.7 m. Gross margin increased strongly from 43.7% to 51.0%, reflecting the higher proportion of non-EVOscreen® business. R&D expenses increased by 30% to € 6.5 m (2003: € 5.0 m) resulting in both functional enhancement and application expansion for its bench-top devices, as well as integration of these devices into EVOscreen® for higher throughput. For the Opera™, this included for example additional excitation sources and applications for kinetic studies. In addition, several demonstration assays were developed to support the sales effort for the devices and to broaden the spectrum of its possible applications. R&D expenses for 2005 are expected to decline with a significant portion of the product development goals completed in 2004. SG&A expenses increased by 15% to € 3.8 m (2003: € 3.3 m) primarily due to the expanded sales presence in the U.S. In 2004, the Company relocated from Miami to Boston, one of the main centres of pharmaceutical and biotech research in the U.S., where it has invested in the development of a demo lab designed to showcase its current offerings. Going forward, SG&A expenses are expected to continue to increase modestly as ET is committed to further investing in building a strong international presence. ET came again close to operating breakeven before non-cash amortisation in 2004 (€ (0.4) m; 2003: € (0.2) m) as a result of strong margin improvement, offset by increased R&D and SG&A expenses. Before allocation of corporate overheads, ET achieved even positive operating results.

Revenue ET



Gross margin ET



Condensed key figures Tools and Technologies

		2004	2003
Revenue	T€	19,315	18,668
– Thereof 3rd party	T€	17,683	17,197
Gross margin	%	51.0	43.7
R&D expenses	T€	6,479	5,043
SG&A expenses	T€	3,788	3,283
Operating result before non-cash amortisation and impairment	T€	(413)	(161)
Operating result	T€	(1,232)	(1,140)
– Thereof depreciation and allowances	T€	843	1,030
Employees (31|12, without overhead)		91	84

Exciting sales potentials

Evotec Technologies' enhanced business development effort in the U.S. has provided numerous sales prospects for 2005. In addition, the delivery of equipment to the Institut Pasteur Korea is an indicator for how important the academic market could become for ET. In the past academia has mainly focused on basic research. Academic institutes are now moving into drug discovery, opening up a totally new customer group for ET.

"The Korean government plans to increase the proportion of R&D budget to the national budget from 3% to 7% by 2007, which would raise the volume of R&D investments to U.S.-Dollar 25 billion."

www.korea.net, Gateway to Korea, December 2004

ET has observed growth trends for ET products in multiple locations around the world arising from academic research. With the National Institute of Health (NIH) Road Map in place, U.S. academic institutions will establish several national screening centres. ET could participate in this initiative by providing instrumentation, software and screening know-how. The stem cell initiative in the U.S. could also further boost demand for ET's cell handling and analysis devices. In addition, East Asia has become an interesting growth market. As an example, the Korean Ministry of commerce, industry and energy is strongly supporting biotechnology in their country to enhance national scientific competitiveness. The collaboration with the Institut Pasteur Korea has created a lot of awareness for ET and ET hopes to be able to continue to benefit from this strong trend.

New website:
www.evotec-technologies.com

Shifting th portfolio

ne

Evotec was founded on technologies that have changed the way the industry finds new drugs. Building on this technology and expanding into higher value screening and chemistry services over the last seven years has provided Evotec OAI with a customer base that is unmatched in the drug discovery industry, and with proven expertise in drug discovery. It is time for Evotec OAI to shift its strategic R&D focus from enhancing a portfolio of services for customers to also building a portfolio of proprietary drug candidates that can change the course of health care and provide a significant return to its shareholders.

Accessing innovative disease biology

Sustainable and reliable sources of validated targets and target-compound pairs are key to successful drug discovery. Evotec OAI fuels its internal discovery pipeline through partnerships with biotech companies and academic institutions that have a deep understanding of the underlying causes of disease as well as target identification | validation expertise. Evotec OAI will also look at accessing target-compound pairs from pharmaceutical companies with multiple non-core discovery programmes that can be accelerated when combined with Evotec OAI's capabilities.

Collaborations with disease-focused biotech companies

Expertise successfully exploited in Metabolic Disease programme with DeveloGen

In mid 2003, Evotec OAI entered into a partnership with DeveloGen that combines DeveloGen's genetic-based discovery platform including a number of validated drug targets and insight into novel mechanisms of Metabolic Disease with Evotec OAI's leading drug discovery and development engine. The cooperation brought together top tier competitive expertise and professional resources across the entire drug discovery value chain, leveraging both parties' complementary skills to rapidly produce potent and promising product candidates to fill clinical pipelines. To date, four projects have successfully matured into a small, hence promising discovery pipeline (see DPD segment report, page 15):

Progress is illustrated on two projects

Building on a phenotype-first genetic approach, the proprietary enzyme target P244 was selected for high throughput screening. High potent, low double digit nanomolar inhibitors were rapidly identified, employing Evotec OAI's proprietary detection technologies and compound library. Evotec OAI medicinal chemists optimised these compounds based on *in vitro* pharmacology and structural biology data as well as co-crystallisation experiments on the target binding sites which supported the medicinal chemists' strategies.

The enzyme target P070 was also subjected to high throughput screening against both a target-focused library and a diversity-oriented library subset. Chemical structures for the hit-to-lead programme were identified with the help of Evotec OAI's computational chemistry. Early ADMET studies guided Evotec OAI scientists to generate promising compounds for *in vivo* studies. Since the selectivity of enzyme inhibitors is key to reducing the risk of target-unrelated side effects, a broad panel of counter-screens against related enzyme targets have been executed. Based on this selectivity, activity and ADMET data, compounds were selected for efficacy studies in an established and validated animal model for type II diabetes.

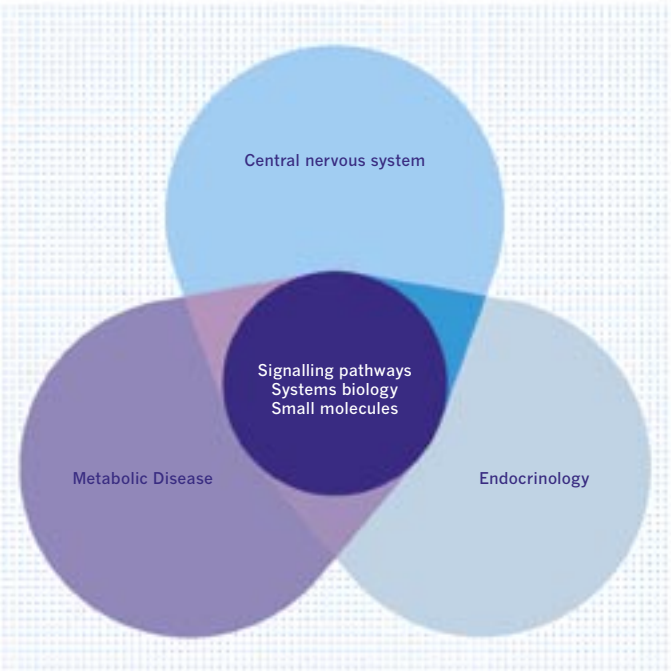
The proprietary target has been validated *in vivo* with the proprietary lead compound. For instance, the test compounds reduce blood glucose, improve glucose tolerance and reduce body weight in a diet-induced obesity mouse model. Further *ex vivo* and *in vitro* studies with primary cells and cell cultures from relevant tissues such as muscle, hepatocytes and adipocytes point to an intriguing mode of action. In summary, the pharmacological effects are very promising for future therapeutic intervention.

Sourcing assets from academic partners

Directly exploring compound activity in systems close to human nature ...

Evotec OAI is in discussions with various large academic research institutions to benefit from their research productivity in early drug discovery. The purpose of these discussions is—like in the case of ENS and the University of Zurich—to source know-how and intellectual property on promising targets and their interplay in human signalling pathways, and to analyse the effect of early stage compounds on such biological systems. Evotec OAI is in the process of selecting targets to then rapidly generate novel small drug candidates by directly validating their activity in comprehensive and predictive systems which mimic human biological activity. With this research approach (best described as systems biology) the Company can rapidly understand both compound activity and pathway specificity of the selected target. This systems biology approach eliminates the time consuming traditional steps of running multiple stand alone assays in multiple cell types which do not predict the effects and side effects of compounds in a real life environment.

First-in-class drug candidates based on systems biology fuel Evotec OAI pipeline



... to rapidly identify disease-relevant target compound pairs

The most relevant biological pathways are those that regulate cell growth, metabolism, proliferation and differentiation into specific cell types and organ systems. Evotec OAI's discovery projects will originate from an intimate understanding of human signalling pathways and their interplay. Through its proprietary detection and imaging technologies, its chemical expertise, and its data analysis tools Evotec OAI has the capability to rapidly generate and screen small molecules to dissect these signalling pathways so that only the desired disease-relevant function is activated through the pathways involved. This approach can result in the identification of disease-relevant target-compound pairs with a reduced risk for unwanted target-related and target-non-related side-effects. In this systems biology process the massive amount of information generated about the interplay of targets in disease-relevant pathways guides the chemistry process for making rational decisions about structural changes to optimise pharmacokinetic, pharmacological and pharmaceutical properties of hit and lead compounds.

The challenge: Finding promising drug candidates in systems close to real life

Dr Erich Greiner, Scientific Director DPD, Evotec OAI

> Evotec OAI: What is the advantage of stem cells in a systems biology approach?
> Dr Greiner: Stem cells contain genetic instructions for all human signalling pathways and can be coaxed into becoming any cell or tissue type. I believe that stem cells and their differentiated derivatives are ideal tools for Evotec OAI's systems biology approach to finding small molecules which control the underlying mechanisms of action of cell growth, proliferation and differentiation. A number of small molecules that can be used to selectively control stem cell proliferation and differentiation have been identified in cell-based phenotypic and pathway-specific screens of natural products and synthetic compounds.
> Evotec OAI: Does Evotec OAI have expertise in identifying drugs in stem cell systems?
> Dr Greiner: We have worked for several partners on stem cell relevant targets. For example, Evotec OAI has utilised its expertise in medicinal chemistry to support Curis in the development of small molecule agonists and antagonists of the Hedgehog signaling pathway. They can modulate stem cell proliferation and prolongation. Curis has since entered into substantial strategic partnerships with Wyeth and Genentech to continue the pre-clinical and eventual clinical development of the compounds, focusing in particular on neurology and oncology indications, respectively.
> Evotec OAI: Does stem cell modulation have applications in other core therapeutic areas?
> Dr Greiner: Small molecules modulating stem cells may also have potential uses in the treatment of neurodegenerative disease, diabetes, musculoskeletal disease and cardiovascular disease. Evotec OAI has already proven expertise in addressing several additional pathways which are relevant for stem cell proliferation or differentiation including Wnt-, Notch-, and growth factor-signalling and is now working to identify novel drug candidates for relevant therapeutic areas under its internal discovery programmes.
> Evotec OAI: How does Evotec OAI's expertise stand out in systems biology research?
> Dr Greiner: Evotec OAI is poised to be successful in its systems biology approach to drug discovery with the application of its wide range of in-house technologies, including those developed by Evotec Technologies, to identify drugs in cell-based systems. With the bench-top device Elektra™ we can handle and separate single cells to rapidly produce stable cell lines for screening. Using the high content cell imager Opera™ we can analyse the activity of small molecules on such cells, which increases confidence in the mechanism of action and the safety of novel target-compound pairs. Evotec OAI also brings un-paralleled capabilities in high speed parallel synthesis, medicinal chemistry, lead optimisation and pharmacology. The combination of all of Evotec OAI's core competences will generate high-value drug candidates with predictive pharmacokinetic, toxicology and efficacy profiles in man already at an early stage of the drug discovery process.

Intellectual property

Evotec OAI's state-of-the-art technologies are covered by strong and broad patent and know-how protection to provide the Company with a strong competitive position. The Evotec OAI group holds more than 160 families of rights. Of these rights, 15 German utility models are already registered and 35 German, 44 European, 37 U.S. and 4 Japanese patents issued. In particular in Europe and in the U.S., the Company's position in detection and cell-handling technology was strengthened through the issue of several patents. In addition, Evotec OAI focused on the patenting of chemical compounds arising from its joint activities with DeveloGen AG.

Evotec OAI's families of protective rights at 31 | 12 | 2004 [1)]

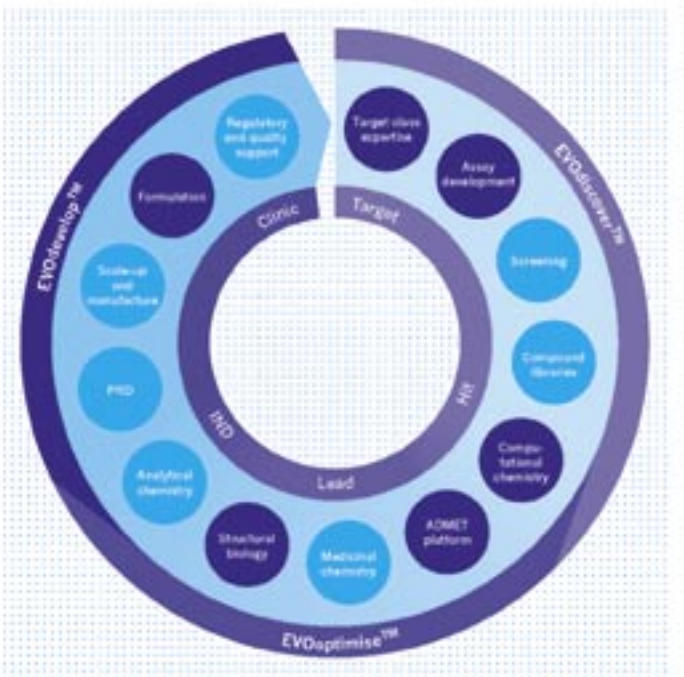
FCS and FCS+ plus detection technology	47
Assay development including cell-handling technologies	60
Microfluidics	20
Labelling strategies	8
Sample carriers	16
Molecule optimisation	4
Potential target genes (anti-infective)	3
Compounds	4
Others	4

[1)] These include Evotec OAI's proprietary and in-licenced patent and utility model rights. Following dilution of Evotec OAI's ownership in Evotec Neurosciences, protective rights held by Evotec Neurosciences, in particular in the field of potential target genes, are not considered.

Enhancing our engine for modern drug discovery

The focus of Evotec OAI's continued R&D activities to enhance its discovery engine has been primarily on the further development of existing capabilities and their integration into the platform offerings termed EVOdiscover™, EVOoptimise™ and EVOdevelop™ (see figure "Our discovery and development engine"). During the year 2004 the Company has focused its platform R&D on six projects.

Our discovery and development engine



EVOdiscover™ is a platform that integrates random and rational, meaning computer-based, discovery solutions for faster access to high quality validated hit molecules.
EVOoptimise™ is an integrated platform for multiparameter medicinal chemistry optimisation of hit and lead molecules. EVOoptimise™ is the process used to effectively identify the ideal drug candidate out of a lead series to advance into clinical trials.
EVOdevelop™ is a platform that addresses all process chemistry and pharmaceutical scale-up requirements from preclinical development, through clinical development to commercial manufacture.

EVOdiscover™

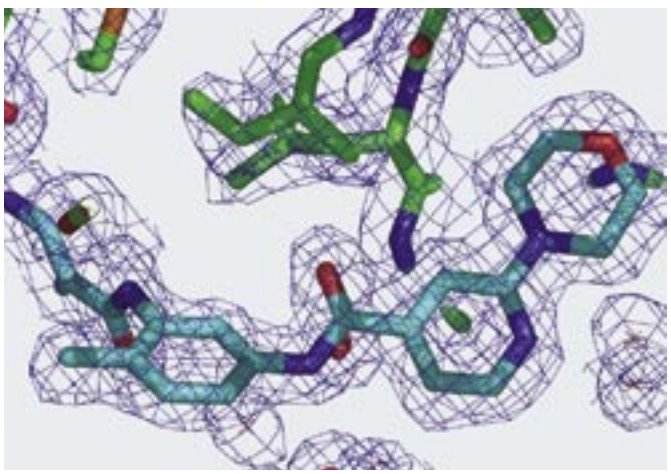
1) As part of Evotec OAI's ongoing library enhancement R&D programme, the in-house synthesis of approximately 10,000 novel compounds was completed. The addition of these compounds adds to the diversity and novelty of the Company's corporate screening library (>250,000 compounds) increasing the likelihood of identifying valuable hit molecules. During the year, scientists have demonstrated that Evotec OAI's fluorescence based approach to biochemical assays can also be used for both the screening of fragment libraries and natural product collections. Fragments are small organic molecules that are typically a third of the size of drug molecules and because of their small size tend to interact only weakly with proteins. Evotec OAI has proven that its screening platform

can be used to identify these weak binders which are very useful starting points for medicinal chemists to optimise into more active drug molecules. These fragments provide the flexibility to add extra chemical groups leaving chemists more room to manoeuvre which increases the likelihood of developing an innovative and successful compound.

2) Evotec OAI also expanded its portfolio of cell-based assays including protein translocation assays, functional GPCR assays and ion channel assays. The wealth of information that can be acquired from these cell-based assays is of enormous value because the biological target is in a more physiologically relevant setting than in a biochemical assay, where it is isolated in solution. These new assays both measure the effect of small molecules on the target itself as well as within the target's natural environment.

EVOoptimise™

3) As part of its R&D activities to enhance the EVOoptimise™ platform, Evotec OAI developed the **EVOrationale™** platform during 2004. This platform is built on protein X-ray crystallography that was established at Evotec OAI at the end of 2003 to provide an integrated offering encompassing protein production and engineering, structure determination and computational chemistry. Success in compound optimisation is greatly enhanced by high quality structural information on which to base decisions on the design of compounds for the next iteration of chemical synthesis. The EVOrationale™ platform has been validated on a number of enzyme drug targets to aid in the effective design of active inhibitors.



Atomic resolution of a target protein structure with the related electron density map as derived from X-ray crystallography

4) An important aspect of Evotec OAI's approach to multiparameter medicinal chemistry optimisation has also been the expansion of its capabilities to perform ADMET assays. These assays provide valuable insight into how compounds will be absorbed, distributed, metabolised and excreted as well as potential toxicological liabilities in humans. During 2004 the company has added additional assays to its ADMET portfolio (**EVOprofile™**) and, following GLP accreditation for the hERG assay in 2003, has now obtained GLP accreditation for the analytical lab in which samples used in this assay are being analysed. The observation of activity against the hERG ion channel is highly predictive for a particular adverse cardiovascular side-effect in man and it is a regulatory requirement to test all new drugs for such activity prior to human clinical trials.

5) Evotec OAI has continued to enhance its **EVOseek™** software that provides scientists with a chemistry and biology database and desktop decision tools to mine the wealth of biological and chemical data that is generated by the EVOdiscover™ and EVOoptimise™ programmes.

EVOdevelop™

6) During 2004, Evotec OAI also invested in predictive software which assists development chemists in the development and selection of the most effective synthetic route for scale-up investigations. In addition, small volume liquid formulation for injection is now part of the Company's offering through close integration of ProPharma into Evotec OAI.

Our performance 2004

Financial report

For Evotec OAI, 2004 was a difficult year in terms of top and bottom-line performance. Due to the weak U.S.-Dollar and the extremely challenging market environment for preclinical contract research the Company could not grow revenues for the first time in its history. In addition, the strong impact of foreign exchange did prevent Evotec OAI from achieving positive EBITDA, as originally planned.

Industry situation

Limited signs of recovery in contract research

2004 was another challenging year for the contract research sector of the life science industry. Many of Evotec OAI's customers in the pharmaceutical industry continue to be impacted by margin pressure, product withdrawals and increasing generic competition leading to increased emphasis on cost control. In addition, the need to maintain growth through new product launches has shifted the industry's R&D priorities to advancing clinical candidates that are closer to market. The shortfall of new drugs in their pipelines has also driven these companies to accelerate their in-licensing activities of pre-clinical and clinical candidates to fuel new product introductions.
The biotechnology industry as a whole has had a relatively strong financing year with over $ 20 billion raised through the venture and equity markets. However, continued pressure from investors to realise quicker gains or show more advanced product opportunities has also directed most of this new funding to later-stage clinical development programmes, with many companies completely dropping their discovery activities.
These trends are shifting resources from pre-clinical discovery into clinical development activities, resulting in less business for contract research providers such as Evotec OAI's Discovery and Development Services. The Company believes this trend must be temporary as the industry may soon see a serious shortfall in pre-clinical compounds.

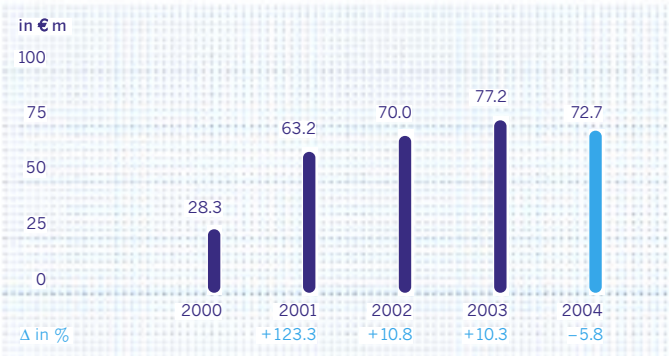
Revenues 2004

Operational performance overshadowed by adverse market and foreign exchange

Total group revenues decreased by 6% to € 72.7 m (2003: € 77.2 m). At constant 2003 exchange rates, revenue decline would have been only 3%. As anticipated, Q4 sales performance was strong with a revenue growth of 23% to € 25.3 m (2003: € 20.5 m). While Evotec OAI's instrumentation business Evotec Technologies showed continued growth, the total group decline resulted from a revenue shortfall in the Discovery and Development Services (DDS) division as a result of

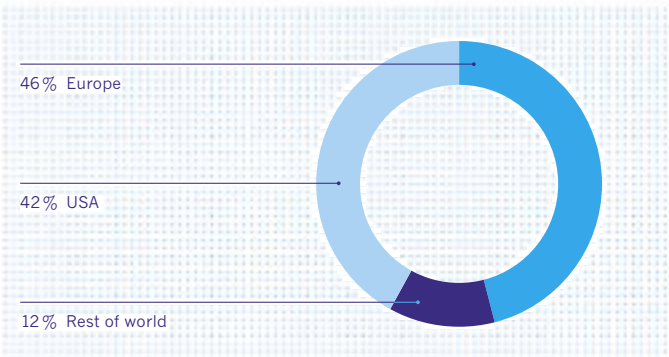
Revenue

Challenging contract research environment and currencies



Revenue by regions

Strong U.S. contribution despite Dollar decline



the challenging contract research market environment and the deteriorating value of the U.S.-Dollar.

While the performance in the second half of the year was much stronger, the weak first half, when several long-term contracts were scaled-down or terminated, could not be over-compensated. Still, the DDS division managed to gain market share. Its top-line performance was better than that of most of its peers, in particular when measured in constant currencies. DDS' diverse and well perceived portfolio of capabilities has enabled the business to reach total 3rd party revenues of € 54.1 m (2003: € 58.6 m).

The Tools and Technologies Division (Evotec Technologies) grew by 3 % to € 17.7 m of revenues with 3rd parties (2003: € 17.2). This is a very strong performance considering that 2003 had an extraordinarily large percentage of revenues with Pfizer, one of its EVOscreen® consortium partners, setting a high hurdle for future revenue growth. These 2003 revenues were mostly substituted with new customers.

Evotec OAI recognised revenues of € 0.9 m from the Discovery Programs Division (DPD), resulting from Evotec Neurosciences' (ENS) business with Takeda in Q1. After Q1, ENS was no longer consolidated, following its successful venture capital finance on 31 March and resulting dilution of ownership. ENS stand-alone had total revenues for the year of € 4.2 m.

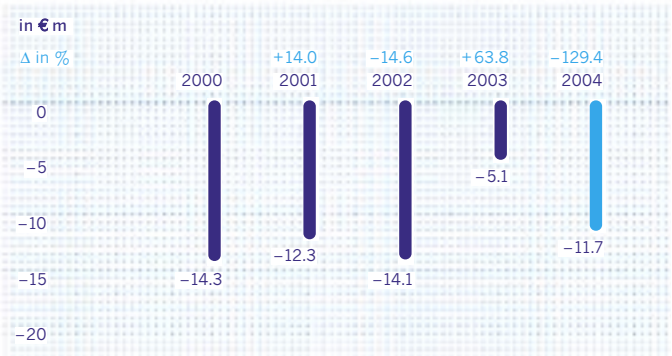
With total revenues of € 30.7 m, the U.S. market continues to contribute substantially to the group's well balanced regional sales mix. Despite the U.S.-Dollar decline the proportion of U.S. sales to total sales reduced only to 42 % (2003: 46 %).

Currency effect on key numbers

		2004	2004 constant currencies[1)]
Revenue	€ m	72.7	74.8
Gross margin	%	34.3	37.1
Gross margin DDS	%	31.3	34.9
EBITDA	€ m	(3.3)	(0.3)

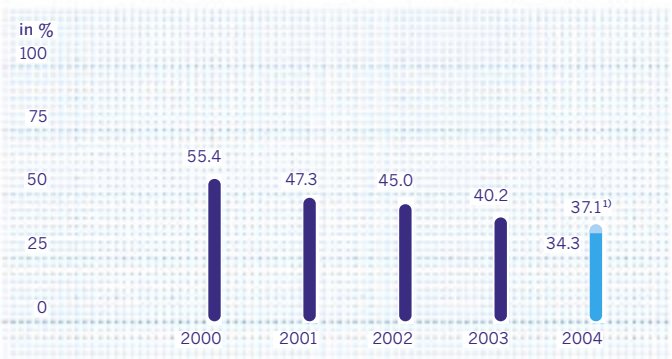
[1)] Currency pro-forma adjustment using exchange rates of 2003

Operating result [1)]
Revenue decline and margin erosion



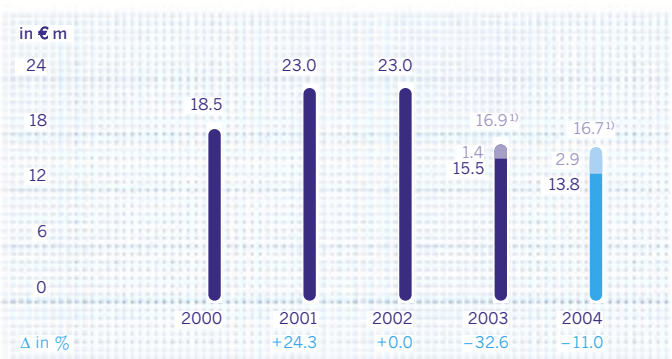
[1)] Before amortisation and impairment

Gross margin
Adverse currency effects are the main contributor



[1)] Currency pro-forma adjustment using exchange rates of 2003

R&D expenses
Decline due to deconsolidation of ENS

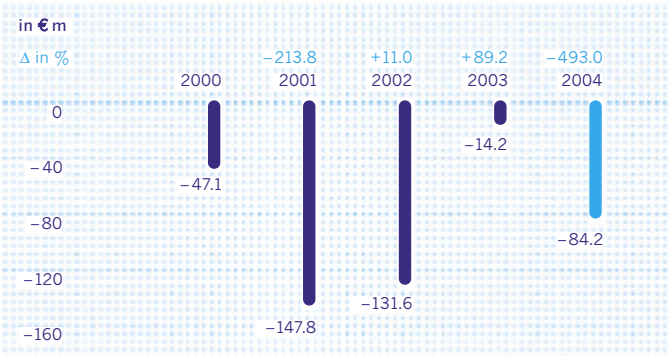


[1)] Including DeveloGen joint venture R&D expenses (R&D expenses related to Evotec Neurosciences | 2004: € 0.2 m, 2003: € 3.1 m)

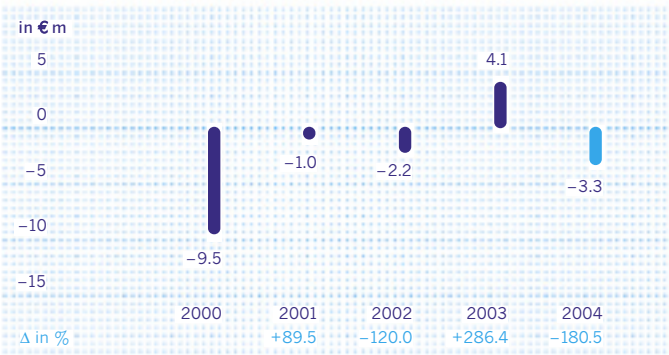
2004 Operating result
Impact of non-cash impairment and margin erosion

The Evotec OAI's operating loss increased to € 91.3 m (2003: € 15.8 m). The main negative impact was derived from a € 69.5 m non-cash impairment, including goodwill and underutilised capacities in the Company's second pilot plant and the new laboratory building in Abingdon, in addition to regular amortisation of € 10.0 m. Excluding this 2004 non-cash charge, the operating loss would be € 11.8 m (2003: € 5.1 m). As in 2003, Evotec Technologies (ET) was again close to break-even, before taking amortisation charges into account. Before allocation of corporate overheads, ET achieved even positive operating results.
Evotec OAI realised a **gross margin** of 34.3 % (2003: 40.2 %) with cost of revenues of € 47.8 m (2003: € 46.2 m). Gross margin performance was adversely affected by the weak U.S.-Dollar, strong GBP-Sterling exchange rates, a less favourable sales mix and pricing pressures. If last year's exchange rates were applied, the gross margin would have amounted to 37.1 %.
Other operating costs from planned unused capacity increased slightly to € 3.6 m (2003: € 3.2 m), mainly as a consequence of the completion of a new laboratory building in Abingdon in December 2003.
R&D expenses amounted to € 13.8 m (2003: € 15.5 m), an expected cost reduction of 11 %. The main reason for this decline is the deconsolidation of Evotec Neurosciences (ENS) since 1 April 2004. R&D activities for internal discovery programmes within DPD, adding the 50 | 50 joint venture with DeveloGen (€ 2.9 m consolidated shown under non-operating expenses), amounted to € 5.1 m (2003: € 5.7 m). Not taking the ENS business into account (R&D expenses 2004: € 0.2 m | 2003: € 3.1 m) DPD related R&D expenses including to contribution to the DeveloGen joint venture increased by 88 %, in line with Evotec OAI's strategy to shift R&D to proprietary drug discovery. As anticipated, platform R&D in the DDS division was slightly reduced, as projects were completed and added to Evotec OAI's product offering. ET continued to invest € 6.5 m (+30 %, 2003: € 5.0 m) in upgrades of new instruments and their applications to prepare the division for continued future growth.
SG&A costs increased by 8 % to € 19.3 m (2003: € 17.9 m) as a result of costs denominated in the stronger GBP-Sterling, and of higher marketing and sales expenses in DDS. In addition, ET invested more heavily in its U.S. and Asian sales efforts (see segment reports, page 26). Evotec OAI continues to be very stringent with regard to SG&A costs going forward.

Net income
Impact of substantial non-cash impairment



EBITDA
Investment in internal research increased as planned



EBITDA calculation

T€	2004	2003
Net income	(84,203)	(14,242)
– Interest income	451	540
+ Interest expense	820	714
– Tax benefits	9,237	2,825
+ Amortisation	10,030	10,671
+ Impairment	69,459	–
+ Depreciation and allowances	10,336	10,308
= EBITDA	(3,246)	4,086

2004 Net loss

Increased operating loss, focused research investment offset by tax benefits and FX gains

Net loss for the year increased to € 84.2 m (2003: € 14.2 m) primarily as a result of the substantial impairment. Excluding the € 79.5 m impairment and amortisation charge, net loss was € 4.7 m (2003: € 3.6 m), reflecting the decline in operating results. In line with Evotec OAI's strategy, R&D investments in its Metabolic Disease research programme with DeveloGen (€ 2.9 m) and in Evotec Neurosciences (€ 0.8 m), classified as non-operating "net loss from equity investments", increased and impacted net loss by € 3.7 m (2003: € 1.6 m). This increase was however offset by foreign exchange gains and higher deferred tax benefits.
Evotec OAI realised total net tax benefits of € 9.2 m. Deferred tax benefits in the UK (€ 6.2 m) and current taxes worldwide (€ 0.1 m) added to deferred tax benefits from the amortisation of merger related non-goodwill intangible assets (€ 2.9 m).
The total net loss per share for Evotec OAI was € 2.27 (2003: € 0.40). The weighted average number of shares used in calculating basic earnings per share (EPS) increased by 1,120,218 shares to 36,630,348 following a capital increase in July 2004.

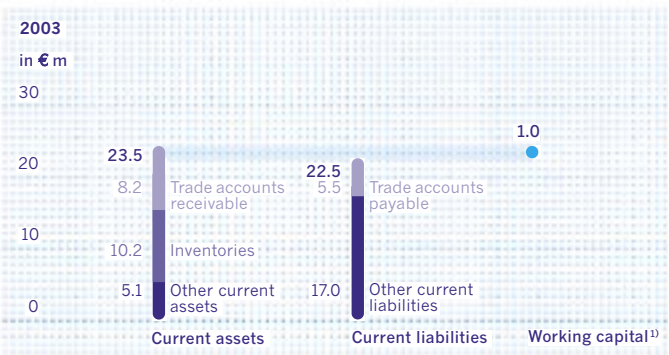
2004 EBITDA

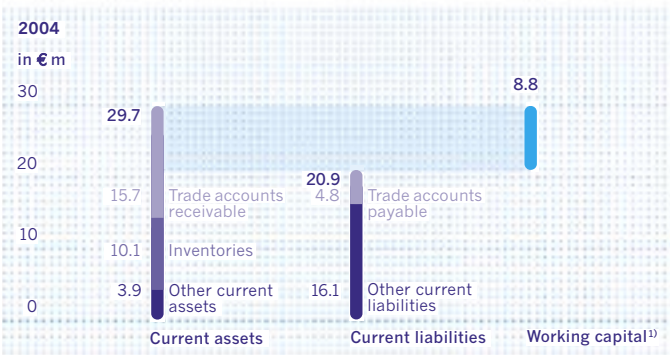
Investment in internal discovery programmes increased as planned

Despite the 2004 revenue shortfall and margin decline, non-operating expenses from the investment in the Metabolic Disease research programme with DeveloGen increased as planned. This translated into a negative € (3.3) m (2003: € 4.1 m) earnings before interest, tax, depreciation and amortisation (EBITDA). At constant 2003 currencies EBITDA would be close to break-even at € (0.3) m.

Working capital as at 31 December 2003 and 31 December 2004

High receivables after strong December business

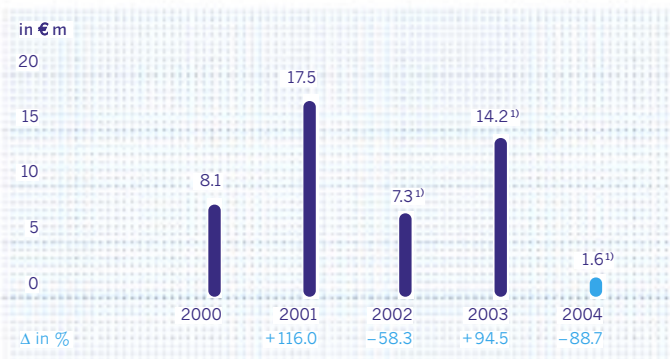




[1] Current assets (excluding cash) – current liabilities = working capital

Capital expenditure

No investment in capacities needed to maintain sales volumes



[1] Excluding capital leases

2004 Cash flow

Strong December business leads to high receivables and increase in working capital

Cash flow from operating activities was negative, amounting to € (4.7) m (2003: € 7.8 m). This was primarily a result of the increased operating loss. In addition, receivables doubled to € 15.7 m (2003: € 8.2 m), primarily due to very strong revenues in December 2004, which were collected in early 2005.

Cash flow from investing activities was significantly lower than in 2003, when Evotec OAI invested in the fit-out of a new laboratory building in the UK. In addition to the purchase of smaller fixed assets for laboratory equipment (€ 2.7 m), cash outflows included research expenses related to the DeveloGen joint venture, which are not included in operating cash flow (€ 2.9 m), and the acquisition of shares in ProPharma in the second quarter of 2004 (€ 0.4 m).

Net cash flow from financing activities was reduced to € 5.2 m (2003: € 7.2 m). Evotec OAI did not increase its bank liabilities, but received issue proceeds of € 7.5 m from the capital increase offered and closed on 14 July 2004.

As of 31 December 2004, cash, cash equivalents and marketable securities totalled € 15.3 m (2003: € 19.5 m), providing a strong foundation for 2005.

Condensed cash flow statement

T€	2004	2003
Net cash (used in) provided by		
operating activities	(4,702)	7,812
Net cash used in investing activities	(4,121)	(16,371)
Net cash provided by financing activities	5,199	7,226
Net decrease in cash		
and cash equivalents	**(3,624)**	**(1,333)**
Exchange rate difference	138	(1,212)
Cash and cash equivalents		
– at beginning of year	18,763	21,308
– at end of year	15,277	18,763
Cash and cash equivalents including		
marketable securities	15,277	19,471

Condensed balance sheet

T€	2004	2003
Cash, cash equivalents and securities	15,277	19,471
Inventories	10,080	10,225
Other current assets	19,592	13,296
Property, plant and equipment	41,545	62,051
Intangible assets	49,192	115,149
Other non-current assets	2,848	727
Total assets	**138,534**	**220,919**
Accruals	7,042	7,794
Other current liabilities	13,844	14,736
Long-term liabilities and minority interest	13,172	14,959
Deferred tax liabilities	2,466	11,329
Total stockholders' equity	102,010	172,101
Total liabilities and stockholders' equity	**138,534**	**220,919**

2004 Balance sheet
Strong equity ratio 74%

As required by U.S. GAAP accounting, the Company conducted an extensive review of intangible and tangible assets in 2004. Considering the adverse market environment and a more conservative scenario for growth and margins, this review concluded that it was prudent to write-off approximately 50% of merger-related goodwill and 50% of the fixed assets in the Company's second pilot plant, which was most heavily hit by underutilisation and pricing pressures. In addition, regular depreciation exceeded new investments in fixed tangible assets resulting in a decrease of total fixed assets from € 62.1 m to € 41.6 m.
The total group's working capital increased significantly to € 8.8 m (2003: € 1.0 m) due to extraordinarily high revenues and resulting receivables in the last month of the year. Long-term bank loans and capital lease obligations of € 11.6 m (2003: € 12.5 m), mainly used for asset financing remained relatively stable.
Evotec OAI increased its share capital and paid-in capital with the issue of 2.5 million new shares, receiving issue proceeds amounting to € 7.5 m. As no employee stock options were exercised, the share capital increased by the above mentioned € 2.5 m to € 38,010,130 as of 31 December 2004. Despite the sizable impairments, Evotec OAI's traditionally high equity ratio was still 74% for 2004 (2003: 78%), emphasizing the Company's relatively low debt.

Legal structure
Significant VC financing of ENS

In March 2004, Evotec OAI closed a sizable € 25 m venture capital financing round for Evotec Neurosciences (ENS). As a consequence of the first tranche of this capital increase in ENS Holdings, Inc. (USA) being paid out, Evotec OAI's shareholding in ENS was reduced from approximately 85% to 42%. Since 1 April, Evotec OAI no longer fully consolidated ENS in the Group accounts. ENS' increased investments in internal drug discovery are now being shown "at equity" under non-operating loss.
In May, Evotec OAI also bought additional shares of ProPharma Ltd from its co-founders, thus increasing its share from 61% to 81%. It is the intention to more closely link ProPharma with the other Evotec OAI Development Services business.

Operational report

Employees as of 31 December
Only slightly changed over 2003

Human resources

Headcount balanced against requirements

The Company's success depends on its ability to attract and retain highly skilled staff. During the year Evotec OAI carefully maintained balanced staffing levels to meet customer needs while ensuring continual training. Evotec OAI also provided flexible work patterns and hours to meet employees increasing requests for more varied and flexible approaches to work. Evotec OAI has always maintained a commitment to internal communications and held face to face briefings between senior management and staff at its major sites. The total employee count at 31 December 2004 stands at 646 only slightly changed from 644 at the same time in 2003. The quality and commitment of Evotec OAI's employees continues to enhance its reputation.

Headcount (average age: 34 years)

	Employees	Male	Female	Biologists & Biochemists	Chemists	Engineers (R&D) Physicists	Engineers (R&D) and IT experts	Others
Discovery and Development	**450**	**297**	**153**	**19**	**286**	**1**	**11**	**133**
Services								
– Discovery Hamburg	64	27	37	13	9	1	10	31
– Discovery Abingdon	238	159	79	4	163	0	0	71
– Chemical & Pharmaceutical Development	148	111	37	2	114	0	1	31
Discovery Programs Division	**5**	**3**	**2**	**2**	**1**	**0**	**0**	**2**
Evotec Technologies	**91**	**69**	**22**	**9**	**3**	**21**	**44**	**14**
Overhead	**100**	**51**	**49**	**4**	**18**	**1**	**18**	**59**
– Sales & Administration	94	48	46	3	18	0	18	55
– Corporate	6	3	3	1	0	1	0	4
Grand total	**646**	**420**	**226**	**34**	**308**	**23**	**73**	**208**

Production and procurement

Moving towards higher margin activities

Evotec OAI's Discovery and Development Services (DDS) division provides mostly contract research services with a high percentage of expenses going towards personnel and a respectively lower portion of expenses going towards material usage. Evotec Technologies (ET) has a lower value-added percentage, as all of the production expenses beyond the prototype stage are being outsourced to strategic suppliers.
In the Discovery Programs Division (DPD), future revenues will largely result from research funding and | or out-licensing of intangible assets generated or progressed in internal research and development. Evotec OAI's value added will depend on the number of internal programmes and the stage at which programmes are in- and out-licensed. Milestones and royalties may lead to significant margins if DPD programmes can be successfully licensed to customers.

Occupational safety and environmental protection

Strong commitment rewarded

Evotec OAI believes that it has an obligation to exceed local statutory requirements in protecting its employees and the environment. Thanks to the continued commitment of its employees, its safety performance and environmentally sound working practices consistently score high. Evotec OAI is also committed to ensuring that it works in concert with local communities and the relevant regulatory authorities.
In September, Hamburg's Authority for Occupational Safety honoured Evotec OAI for "Exemplary Practices in Occupational Safety". Of the 2,200 companies audited so far, only five percent have been granted this distinction. Evotec OAI Hamburg has further improved and standardised operating procedures for facility management, including the expansion of GLP standards in Analytical Chemistry. In addition, the Company has implemented occupational medicine programmes that ensure that employees are appropriately immunised.

At Abingdon, Evotec OAI has achieved registration for ISO 14001, an internationally recognised standard for environmental management systems, for its two pilot plants. The Company has put procedures and systems in place, for staff and contractors, auditing waste contractors and energy consumption. The Company has extended its recycling schemes and continues to review waste to maximise recoverability. Obtaining this certification demonstrates that Evotec OAI is in control of its impact on the environment. In addition, the Company has organised a Climate Change Levy Agreement with the UK Government in which Evotec OAI commits to controlling its energy consumption in exchange for a refund of some of the tax on energy.
At Abingdon, Evotec OAI has implemented its Annual Health and Safety plan and underwent a successful audit by external Health and Safety consultants. For example, the Company has initiated a major programme to review all risk assessments on the Pilot Plants, especially related to compliance with legal requirements on hazardous area classification. New inspection and environmental monitoring programmes and emergency procedures were put in place.
Evotec OAI continues to improve its induction and ongoing safety training programmes, including increased use of the Company Intranet to ensure that advice and information is readily available.

Risk report and risk management

Risk management

Comprehensive and reliable systems in place

Evotec OAI puts important emphasis on risk management as an ongoing management task within the Evotec OAI Group. This also applies to Corporate Governance, where the Company strives for maximum meaningful compliance with publicly promoted codes of practice.

Evotec OAI is continuously reviewing its overall risk management systems including regular commercial and R&D project reviews. Management performs monthly financial reviews with a strong emphasis on cash and key performance drivers such as revenues, order book status and gross margins. Evotec OAI periodically enters into foreign currency contracts to hedge a significant proportion of foreign currency exposures based upon pooled estimated cash flows over the next twelve months. The bases of these estimates are signed sales contracts less anticipated foreign currency expenses having regard to payment terms. Strict application of investment approval processes, legal contract review procedures and signing authorities are also standardised operating procedures. Moreover, the Company continues to emphasise its IT security throughout the Group and reviews its insurance coverage regularly. In 2004, a new risk monitoring programme for Evotec OAI's pilot plant was put in place which is described on page 43. In summary, Evotec OAI believes that its current internal control and risk management systems operate at an appropriate level for its business.

Business risks and future development

Well positioned to defy market and currency trends

> Evotec OAI's Discovery Programs Division (DPD) engages in selected discovery and development activities which carries many risks inherent to the drug discovery industry. Even if DPD identifies promising targets and compounds, or in-licenses promising drug candidates for development, it could take several years before the Company could sell or license any clinical candidates, if at all. Hence, expenditure on internal discovery programmes or related acquisitions of technologies or intellectual property rights could substantially reduce its short- to mid-term profitability. Evotec OAI intends to reduce part of the business risk through early partnering agreements and balanced portfolio management, to the degree possible and affordable. The Company does not intend to engage in programmes unless appropriate funding is allocated or secured.

> Evotec OAI's revenues depend to a large extent on outsourced research and development projects by pharmaceutical and biotechnology customers. In the last three years the weak world-wide capital markets, as well as the general economic pressures in the industry, have in a number of cases altered the balance of R&D spending by the Company's customers. Decreased discovery expenditures put pressure on Evotec OAI's short-term growth expectations for its Discovery and Development Services (DDS) division. The Company believes this shift in R&D expenditures is temporary, but it remains to be a continued threat to growth and profitability of contract research.

> The business of Evotec Technologies (ET) is dependent upon significant capital expenditure by its customers. These capital expenditure budgets were generally reduced in the past years, but there have been some signs of recovery in instrument spending. Also, ET has been creative in constantly seeking innovative new product features and applications to provide solutions to research bottlenecks. Nevertheless, pricing pressures, IP protection and aggressive marketing by competition as well as further reduced capital expenditure budgets of key customers could threaten ET's growth and profitability.

Evotec OAI is also affected by usual business risks such as the general dependence on large pharmaceutical customers, the financing of investments and in particular foreign exchange rate fluctuations which is explained in more detail in the notes to the financial statements (no. 18).

Overall, the Company's success depends on its ability to adapt to changing technologies and market environments as well as customer expectations. If Evotec OAI fails to adapt to market needs, its ability to create value and grow could seriously suffer.

In summary, Evotec OAI expects to be able to create long-term value through high value service collaborations and increased internal discovery programmes. Firm cost management should allow the Company to generate positive cash flows from its Discovery and Development Services even in times of slow growth and adverse currencies. With the Company's efficient infrastructure, its high level and breadth of skills and high quality international reputation, Evotec OAI feels well prepared to face the current market challenges and to deliver on its strategy.

Post-balance sheet events and outlook

Post-balance sheet events

On 1 January 2005, Evotec Technologies acquired the ultra High Throughput Screening (uHTS) business of Carl Zeiss. This acquisition establishes ET as clear market leader in this segment of the industry. The transaction is providing ET with an expanded base of leading pharmaceutical customers and instruments installed. It also generates critical mass in technical field service.

Outlook

Sales: Strong position but limited visibility for market recovery

With its integrated and well perceived drug discovery and development solutions, Evotec OAI is among the strongest brands in the industry and is therefore well positioned to drive the Company's short-term revenue performance with an upswing in the contract research and instrument markets. Market recovery, however, remains uncertain. While the much-mooted recovery in the sector is finally starting to show signs of becoming a reality, progress is still slow. Initial positive signals primarily within the U.S. market have failed to be followed by the European market, and the continued emphasis on cost control by pharmaceutical companies combined with the limited success of the biotech IPO market (especially in Europe) means 2005 is unlikely to be a recovery year. One can note, however, some positive signs including the trend of academia moving into early drug discovery, some stabilisation of the FX position and limited recovery of the biotech capital markets. Looking forward, the contract pipeline for 2005 for the services business is better today than it was for 2004 at the same time last year. As of the end of January 2005, it totalled approximately € 31 m (2004: € 26 m).

Results: DPD investments to drive group results

One of Evotec OAI's primary goals for 2005 will be to manage the business such that its Discovery and Development Services division generates positive cash flow even under current adverse market and currency scenarios. Total Group results will be therefore primarily driven by the level of investment of its Discovery Programs Division into the internal development of drug candidates. Assuming the necessary funding to be in place, Evotec OAI will accept an interim negative EBITDA in return for a faster ramp-up of a broader, risk balanced portfolio of proprietary pharmaceutical compounds, which is expected to ultimately drive mid- to long-term shareholder value.

Dividends: Short-term profits will be invested in long-term value creation

The payment of dividends in the future is dependent on Evotec OAI's financial situation and liquidity requirements, the general market conditions, and statutory, tax and regulatory requirements. Evotec OAI currently intends to retain any profits generated within its divisions, and to use them to create further development and value for the company. Evotec OAI AG does not expect to report positive net income in 2005.

Evotec OAI shares
Shares lose ground gained in 2003

While 2004 was on the whole a quiet year for stock markets in Germany, Evotec OAI shares declined 48%, losing most of the ground it had gained during 2003, when the Company considerably outperformed its peer group and most standard indexes. Despite a sound operational performance, Evotec OAI was not able to deliver on its 2004 guidance, due mainly to the ongoing difficult market environment for contract research and adverse currency effects. Although intensive investor relations efforts succeeded in stabilising Evotec OAI's core shareholder base, the uncertainty in the markets persisted, reflected in a highly volatile share price. It was only after the Company announced the results for the fourth quarter that share price signals pointed towards a recovery. The share price gained momentum in early 2005.

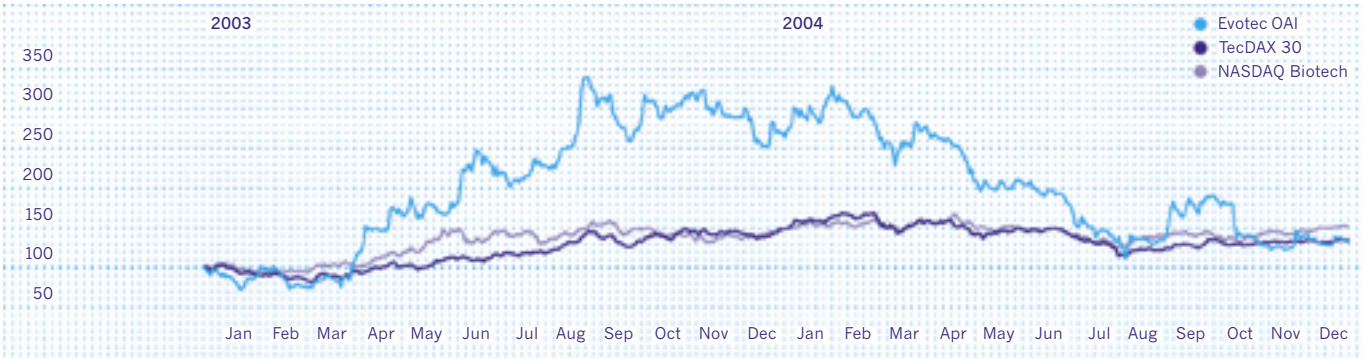
Few surprises in a mixed year for capital markets

German stock markets had a quiet 2004. The DAX index traded up 7%, in line with the other leading European stock markets in London and Paris. Stock markets worldwide have been making headway for two consecutive years, an indication that they had stabilised. However, stock prices fluctuated only slightly, prompting many investors to look to small cap companies for higher returns. In this segment, selecting the right companies turned out to be decisive. While the German index for growth and technology stocks declined (TecDAX lost 4%) some of its constituent shares performed strongly. However, private investors are finding it increasingly difficult to get a picture of many of the shares in the TecDAX as institutional analysts are scaling back their research coverage.

A difficult year for pharma

Surprisingly, shares in pharmaceutical companies, Evotec OAI's main customer base, underperformed the market in 2004. The year saw the withdrawal from the market of Vioxx®, Merck & Co's arthritis and acute pain blockbuster drug. The ensuing public debate about side-effects of drugs and about the independence of U.S. regulatory authorities fuelled fears that, in the future, the FDA would require even more time to approve a drug. Expiring patents, some difficulties in the supply of popular new drugs and the continuation of the seemingly never-ending debate over the cost of health care have led to a mixed year and have not helped the pharmaceutical industry to shift its focus away from cost reduction.

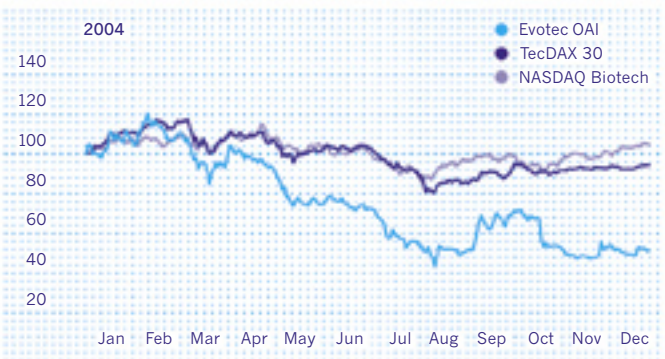
Development of Evotec OAI share price 2003 and 2004 (indexed)



Evotec OAI shares lose ground gained in 2003

While in 2003 Evotec OAI shares were among the strongest performers within the TecDAX, this changed markedly in 2004. Against the trend of the NASDAQ Biotech index, which gained 7%, the share price lost 48% and footed the TecDAX index. The challenging market for contract research, continued uncertainty as to when the pharma sector would recover and the adverse currency effects on Evotec OAI's results all took their toll on the share price. Following a weak third quarter performance and the downward correction of Evotec OAI's revenue and EBITDA guidance for 2004, the share price dipped to a low of € 2.15. It was only when the favourable results for the fourth quarter were announced that it recovered to over € 3.

Development of Evotec OAI share price 2004 (indexed)



Evotec OAI shares 2004

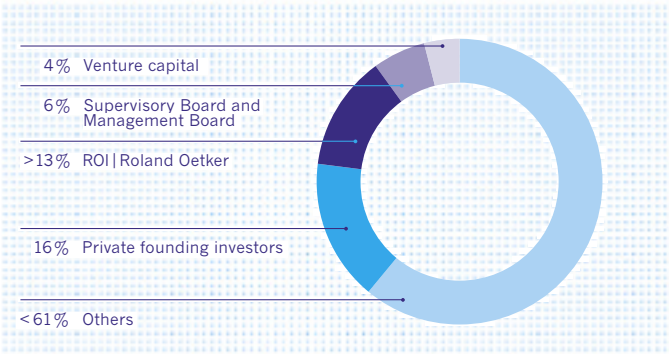
Xetra	High (11|02)	€	6.63
	Low (13|08)	€	2.15
	Average share price	€	4.28
	Average daily trading volume[1)]	pcs.	246,938
	Price decrease	%	48
	Closing price as at 31|12	€	2.63
	Market capitalisation as at 31|12	€ m	100.0
	Number of shares as at 31|12	pcs.	38,010,130
Key share data	Earnings	€	(2.30)
	Dividend	€	0.00

ISIN: DE 000 566 480 9
German securities identification number: 566480
Ticker symbol: EVT

[1)] Based on the trading volumes of all German stock exchanges

Shareholder structure

Core shareholder distribution basically unchanged



Source: Evotec OAI latest estimate 12 | 2004

Following the capital increase in July, the number of shares used in calculating the 2004 estimates increased by 2.5 million over 2003.

Management and Supervisory Board make a mark by acquiring shares

In August 2004, members of the Management and Supervisory Board, including CEO Joern Aldag, CFO Dr Dirk Ehlers and Supervisory Board member Dr Karsten Henco, acquired Evotec OAI shares at prices of around € 2.25. Second quarter results had led to a drop in the share price, reaching a level at which they believed the Company was grossly undervalued. Several founders of the Company joined in and also bought shares. On 16 August 2004 and in accordance with the provisions of the German Securities Trading Act ("Wertpapierhandelsgesetz"), all transactions in excess of € 25,000 were reported as so-called Directors' Dealings.

Directors' Dealings 2004

		No. of shares	Share price
16 August	Dr Karsten Henco		
	Member of the		
	Supervisory Board	21,834	2.29 €
13 August	Joern Aldag		
	President & CEO	10,000	2.24 € – 2.27 €
16 August	Joern Aldag		
	President & CEO	1,500	2.44 €

€ 7.5 million raised in capital increase

On 14 July 2004, Evotec OAI issued 2.5 million new shares to institutional investors in Europe by means of an accelerated bookbuilding, thereby increasing its share capital to € 38,010,130.

The proceeds amounting to € 7.5 m were intended to reinforce Evotec OAI's core business (Discovery and Development Services) and to help the Company further its internal research programmes (Discovery Programs Division).

Stock option programme: new options issued, none exercised

In 2004, Evotec OAI granted a total of 361,150 stock options to its staff. Thereof, 34,200 were granted in January at an exercised price of € 5.97 and 326,950 in November at exercised prices of € 2.52 and € 2.65. None of the options granted in previous years were exercised in 2004. As of 31 December 2004, a total of 2,579,558 options were available for future exercise, equivalent to approximately 7% of currently issued shares. A list of the stock options that have been issued can be found in the Notes on page 71.

Capital Investor Relations Award 2004
The analysts of Deutsche Vereinigung für Finanzanalyse und Asset Management (DVFA), which is the Society of Investment Professionals in Germany, ranked the financial communication of Evotec OAI third in the TecDAX.

Capital, a German trade publication, anually awards companies who demonstrate outstanding shareholder communications with private and institutional investors by the Investor Relations Prize.

Evotec OAI awarded investor relations prize

Evotec OAI's investor relations were honoured in 2004 by the German business magazine "Capital". The Company was awarded third prize from among the TecDAX companies in the "Investor Relations Prize 2004" for its credible communication with analysts and investors. This honour encourages Evotec OAI to improve its investor relations work further still. The Company is regularly in contact with its shareholders, more than half of whom it knows even without maintaining detailed shareholder records. Evotec OAI places great emphasis on communicating with professionals in the financial sector as a means of getting across its strategy, of pointing to progress being made and of explaining current developments.

Evotec OAI's Annual Shareholder Meeting in June 2004 was again well attended. The 246 participants represented 38% of the share capital (2003: 41%). Over the course of 2004, senior management intensified dialogue with investors, holding approximately 120 one-to-one presentations at the Company's offices in Hamburg, Germany, and Oxford, UK, at 18 international investor conferences and at several roadshows in key financial centres across Europe and the U.S.

The Company advocates "Fair Disclosure of Information" and thus places significant emphasis on its internet site, which it updates and expands on a regular basis. Investors cannot only read and download financial reports, but also tune in live to telephone conferences, analyst events and presentations given at international investor conferences as well as key parts of the Annual Shareholder Meeting. Recordings of these events are kept on the Company's website for a certain length of time after the live events. Shareholders who were unable to attend the 2004 Annual Shareholder Meeting received the opportunity to cast their votes and to change their instructions to proxies online—another first for Evotec OAI.

Financial institutions which report on Evotec OAI

Bank Vontobel AG
BHF-Bank
Cazenove Equities
Credit Suisse First Boston
DZ Bank AG
equinet Institutional Services AG
Landesbank Baden-Württemberg
M. M. Warburg & Co.
Sal. Oppenheim jr. & Cie. KGaA
SES Research GmbH

Corporate Governance
In almost full compliance with the Code

Evotec OAI has always been committed to responsible and value-driven corporate management. The Company complies with all but one of the Corporate Governance requirements as defined by the German Corporate Governance Code in its revised version as of 21 May 2003 as well as with most of the suggestions the Code contains.

Evotec OAI's Management and Supervisory Boards are committed to working together towards enhancing the value of the Company. In accordance with Section 3.10 of the German Corporate Governance Code, Evotec OAI's Management Board, speaking also on behalf of the Supervisory Board, declares the following about Corporate Governance at Evotec OAI:

Declaration of compliance

In December 2004, the Management Board and the Supervisory Board of Evotec OAI stated in accordance with § 161 German Stock Corporation Act (AktG):
"Evotec OAI intends to comply with the recommendations of the Government Commission's German Corporate Governance Code (revised version as of 21 May 2003) and has complied with such code in 2004, with the following exception:
The stock option programmes in place are based on binding resolutions of several Annual General Meetings. While the exercise of these options requires an increase in the share price, the exercise is not related to other performance benchmarks as recommended in the revised version of Section 4.2.3 of the Code. This recommendation will be followed in relevant future proposals to the AGM."

Shareholdings of the Board of Evotec OAI AG

	Holdings 31 December 2004		Holdings 31 December 2003	
	Shares	Stock options	Shares	Stock options
Management Board				
Joern Aldag	298,056	222,600	286,556	159,600
Dr Dirk H Ehlers	4,540	111,500	0	75,000
Prof Dr Ian M Hunneyball	0	73,500	0	55,000
Dr Timm-H Jessen [1]	136,172	104,732	136,172	98,232
Bernard Questier [2]	0	40,000	0	40,000
Supervisory Board				
Prof Dr Heinz Riesenhuber	110,400	0	110,400	0
Peer Schatz	3,892	0	3,892	0
Dr Pol Bamelis	1,500	0	1,500	0
Dr Karsten Henco	1,328,190	26,732	1,306,356	26,732
Dr Edwin Moses	313,058	15,000	313,058	15,000
Michael Redmond [3]	1,000	0	1,000	0

[1] As at 30 June 2004; [2] As at 31 August 2004; [3] As at 30 September 2004

Adjustment of the Company's articles: remuneration of Supervisory Board adapted to comply with Code

In December 2003, the Management and Supervisory Boards declared that the Company was making two exceptions to the code. One of these, regarding the remuneration of the Supervisory Board, no longer applies. In addition to their basic remuneration, the Supervisory Board Members now receive remuneration for membership or chairmanship of a Supervisory Board Committee. The Annual General Meeting on 1 June 2004 amended the Company's articles of association accordingly. Evotec OAI now fully complies with the recommendation of Section 5.4 of the Code. In accordance with the suggestions in Section 5.4.5 of the Code, the Supervisory Board also receives remuneration based on the Company's long-term performance: if the shareholders receive a dividend, every Supervisory Board member will receive an extra € 500 for every cent that the dividend per share exceeds 15 cents.

Detailed report on remuneration of Management and Supervisory Boards in the Notes

Evotec OAI reports on the remuneration of every member of the Management Board and the Supervisory Board separately in note 22 (e and f) of the Notes to consolidated financial statements (see page 76). In accordance with the suggestions of the Code, the remuneration paid to Management Board members contains both a portion contingent on the Company attaining set goals, such as revenue and EBITDA targets, and a portion contingent on each member's success in achieving his or her individual objectives for the year in question. In addition, Management Board members receive long-term incentives in the form of share options as a further variable portion of their remuneration with inherent risks (see Section 4.2.3).

Mere suggestions also generally complied with

In addition to complying with the two suggestions mentioned above, the Company also conforms to most of the other suggestions laid down in the Code.

Best possible support and transparency at Annual General Meetings

Evotec OAI offers shareholders who are unable to attend Annual General Meetings the opportunity to tune in to key parts of the event live on the internet (Section 2.3.4). The Company also supports non-attendees to exercise their voting rights by arranging Company independent proxies. These proxies can also be reached through electronic media while the Annual General Meeting is in progress (Section 2.3.3).

Supervisory Board Committees set up in accordance with the Code

Evotec OAI has set up an Audit Committee with a spectrum of tasks comprising financial reports, risk management and guaranteeing the auditors' independence. The Company has also set up a Remuneration Committee (Sections 5.1.2 and 5.3.3 of the Code), which, among others, prepares the appointment of new members to the Management Board. As suggested in Section 5.1.2 of the Code each appointment is effective for a maximum of three years. Evotec OAI also makes sure that neither the Chairman of the Supervisory Board nor a former member of the Management Board serve as Chair of the Audit Committee (Sections 5.2 and 5.3.2). In addition, the Company complies with the suggestion for the Supervisory Board to meet without the Management Board if necessary (Section 3.6).

All of Evotec OAI's publications in both English and German

Evotec OAI is committed to "Fair Disclosure of Information". It is the Company's prime concern in its corporate communication strategy that the same information be made available to all relevant target groups at the same time, and this implies communicating in both English and German. The Company's publications are readily available on its website for viewing or downloading.

Additional information relevant to Corporate Governance can be found in the risk report (page 44) and in the report of the Supervisory Board (page 78). Information on professional affiliations of Board members, on related party transactions as well as on stock options and consolidated subsidiaries and equity investees are available on pages 80, 74, 70 and 75. More information on Directors' Dealings can be found in "Evotec OAI shares" on page 48.

Consolidated financial statements according to U.S. GAAP

Auditors' report

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 shareholder's equity and Cash flow as well as the notes to the financial statements prepared by the Evotec OAI AG, Hamburg, for the business year from January 1 to December 31, 2004. The preparation and the content of the consolidated financial statements in accordance with Accounting Principles Generally Accepted in the United States of America (US-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 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 Evotec OAI AG, Hamburg, 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 January 1 to December 31, 2004, 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 January 1 to December 31, 2004 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, February 25, 2005

KPMG Deutsche Treuhand-Gesellschaft
Aktiengesellschaft
Wirtschaftsprüfungsgesellschaft

Schadeck
German Public Auditor
(Wirtschaftsprüfer)

Kniese
German Public Auditor
(Wirtschaftsprüfer)

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

T€ except share data	Footnote reference	2004	2003	Δ 04 | 03 in %[1]
Assets				
Current assets:				
– Cash and cash equivalents	(4)	15,277	18,763	(18.58)
– Marketable securities	(4)	–	708	(100.00)
– Trade accounts receivable, net	(5)	14,689	7,714	90.42
– Accounts receivable due from related parties		1,035	506	104.55
– Inventories	(6)	10,080	10,225	(1.42)
– Deferred tax assets	(13)	99	76	30.26
– Current tax receivables		620	2,754	(77.49)
– Prepaid expenses and other current assets		3,149	2,246	40.20
Total current assets		44,949	**42,992**	4.55
Long-term investments	(7)	2,796	677	313.00
Property, plant and equipment, net	(8)	41,545	62,051	(33.05)
Intangible assets, excluding goodwill, net	(9)	7,507	18,731	(59.92)
Goodwill, net	(9)	41,685	96,418	(56.77)
Other non-current assets		52	50	4.00
Total assets		138,534	**220,919**	(37.29)

	Footnote reference	2004	2003	Δ 04 | 03 in %[1]
Liabilities and stockholders' equity				
Current liabilities:				
– Current maturities of long-term loans	(10)	1,240	1,590	(22.01)
– Current portion of capital lease obligations	(11)	786	615	27.80
– Trade accounts payable		4,679	5,510	(15.08)
– Accounts payable to related parties		117	18	550.00
– Advanced payments received		609	917	(33.59)
– Accrued liabilities	(12)	6,151	6,869	(10.45)
– Accrued vacation		891	925	(3.68)
– Deferred revenues		4,833	4,545	6.34
– Current tax payables		7	62	(88.71)
– Other current liabilities		1,573	1,479	6.36
Total current liabilities		20,886	**22,530**	(7.30)
Long-term loans	(10)	9,591	10,758	(10.85)
Long-term capital lease obligations	(11)	2,055	1,777	15.64
Deferred tax liabilities	(13)	2,466	11,329	(78.23)
Deferred revenues		845	1,661	(49.13)
Other non-current liabilities		107	98	9.18
Minority interests		574	665	(13.68)
Stockholders' equity:				
– Share capital[2]	(15)	38,010	35,510	7.04
– Additional paid-in capital		550,533	540,035	1.94
– Unearned compensation		(77)	(150)	(48.67)
– Other comprehensive loss		(39,005)	(40,046)	(2.60)
– Retained deficit		(447,451)	(363,248)	23.18
Total stockholders' equity		102,010	**172,101**	(40.73)
Total liabilities and stockholders' equity		138,534	**220,919**	(37.29)

[1] Ratios unaudited
[2] 53,210,130 and 53,210,130 shares, 1 € nominal amount, authorised at 31 December 2004 and 2003, respectively
38,010,130 and 35,510,130 shares issued and outstanding in 2004 and 2003, 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 31 December

T€ except share data and per share data	Footnote reference	2004	2003	Δ 04 | 03 in %[1)]
Revenue:				
– Drug discovery products & development of technologies		17,808	17,223	3.40
– Drug discovery services		54,922	60,005	(8.47)
Total revenue		72,730	**77,228**	(5.82)
Costs of revenue:				
– Drug discovery products & development of technologies		8,955	9,952	(10.02)
– Drug discovery services		38,854	36,241	7.21
Total costs of revenue		47,809	**46,193**	3.50
Gross profit		24,921	**31,035**	(19.70)
Operating costs and expenses:				
– Research and development expenses		13,772	15,466	(10.95)
– Selling, general and administrative expenses		19,324	17,924	7.81
– Amortisation of intangible assets	(9)	10,030	10,671	(6.01)
– Impairment of goodwill	(9)	55,824	–	100.00
– Impairment of tangible assets	(8)	13,635	–	100.00
– Other operating expenses		3,584	2,751	30.28
Total operating costs and expenses		116,169	**46,812**	148.16
Operating loss		(91,248)	**(15,777)**	478.36
Other non-operating income (expense)				
– Interest income		451	540	(16.48)
– Interest expense		(820)	(714)	14.85
– Net loss from equity investments	(7)	(3,704)	(1,568)	136.22
– Foreign currency exchange gain (loss), net		915	(327)	(379.82)
– Other non-operating income, net		875	713	22.72
Total non-operating income		(2,283)	**(1,356)**	68.36
Loss before taxes and minority interests		(93,531)	**(17,133)**	445.91
– Income tax benefit	(13)	9,237	2,825	226.97
– Minority interests		91	66	37.88
Net loss		(84,203)	**(14,242)**	491.23

Weighted average shares outstanding	**36,630,348**	**35,510,130**
Net loss per share	(2.30)	(0.40)

[1)] Ratios 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€	2004	2003
Cash flows from operating activities:		
Net loss	(84,203)	(14,242)
Adjustments to reconcile net loss to net cash used in operating activities:		
– Depreciation of property, plant and equipment	9,203	9,835
– Amortisation of intangible assets	10,030	10,671
– Depreciation of current assets	1,133	473
– Impairment of tangible assets	13,635	–
– Impairment of goodwill	55,824	–
– Net loss from equity investments	3,704	1,568
– Stock compensation expense	96	271
– Loss on sale of property, plant and equipment, net	71	63
– Deferred tax benefit	(9,154)	(3,186)
– Minority interests	(91)	(66)
Decrease (increase) in:		
– Accounts receivable	(8,081)	1,727
– Inventories	(750)	(2,339)
– Other assets	1,165	481
Increase (decrease) in:		
– Accounts payable	2,175	1,144
– Advanced payments received	(308)	(4,786)
– Deferred revenues	1,113	3,691
– Accrued liabilities	(474)	2,392
– Current taxes payable	(55)	(13)
– Other liabilities	265	128
Net cash provided by (used in) operating activities	**(4,702)**	**7,812**
Cash flows from investing activities:		
– Purchase of marketable securities	–	(4,230)
– Purchase of long-term investments	(3,314)	(1,524)
– Purchase of property, plant and equipment	(1,488)	(12,515)
– Purchase of intangible assets	(158)	(1,689)
– Proceeds from sale of property, plant and equipment	107	15
– Proceeds from sale of marketable securities	732	3,572
Net cash provided by (used in) investing activities	**(4,121)**	**(16,371)**
Cash flows from financing activities:		
– Proceeds from capital increase	7,500	–
– Capital contributed by minorities	–	3,065
– Net proceeds from increase of loans	5,459	5,496
– Repayment of loans	(7,760)	(1,335)
Net cash provided by financing activities	**5,199**	**7,226**
Net increase (decrease) in cash and cash equivalents	(3,624)	(1,333)
Exchange rate difference	138	(1,212)
Cash and cash equivalents at beginning of year	**18,763**	**21,308**
Cash and cash equivalents at end of year	**15,277**	**18,763**

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€	2004	2003
Cash paid during the year for:		
– Interest	756	690
– Taxes	134	401
Supplemental schedule of non-cash activities:		
– Acquisition of long-term investments	–	198
– Additions to capital leases	1,257	1,352
– Share capital in ENS Holdings, Inc.	5,475	–

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|2004	Foreign exchange	Additions	Disposals	Reclass	31|12|2004
I. Intangible assets						
1. Patents and licences	4,795	–	158	1,892	–	3,061
2. Goodwill	96,418 [3]	998	93	55,824	–	41,685
3. Developed technology	29,469	(80)	17	–	–	29,406
4. Customer list	19,834	(59)	6	–	–	19,781
	150,516	**859**	**274**	**57,716**	**–**	**93,933**
II. Tangible fixed assets						
1. Buildings and leasehold						
improvements	26,956	(79)	7	–	–	26,884
2. Plant, machinery and equipment	53,271	(129)	734	1,326	648	53,198
3. Furniture and fixtures	11,264	(26)	462	753	–	10,947
4. Purchased software	1,219	–	85	40	–	1,264
5. Capital leases	3,242	(9)	1,214	–	(547)	3,900
6. Assets under construction	104	–	30	–	(101)	33
	96,056	**(243)**	**2,532**	**2,119**	**–**	**96,226**
III. Financial assets						
1. Long-term investments	685	(1)	6,252	3,704	–	3,232
2. Other financial assets	50	–	2	–	–	52
	735	**(1)**	**6,254**	**3,704**	**–**	**3,284**
	247,307	**615**	**9,060**	**63,539**	**–**	**193,443**

[1] Calculated at the yearly average foreign exchange rate results in an increase of T€ 409
[2] Calculated at the yearly average foreign exchange rate results in an increase of T€ 460
[3] Net of accumulated amortisation as of 31 December 2001 of T€ 162,195 and impairment as of 2002 of T€ 109,389

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 2002	**35,510,130**	**35,510**	**536,908**	**(345)**
Stock option plan	–	–	76	195
Capital contributed by minorities	–	–	3,051	–
Comprehensive loss:				
– Foreign currency translation	–	–	–	–
– Net loss	–	–	–	–
Total comprehensive loss				
Balance at 31 December 2003	**35,510,130**	**35,510**	**540,035**	**(150)**
Capital increase	2,500,000	2,500	5,000	–
Share capital in ENS Holdings, Inc.	–	–	5,475	–
Stock option plan	–	–	23	73
Comprehensive loss:				
– Foreign currency translation	–	–	–	–
– Net loss	–	–	–	–
Total comprehensive loss				
Balance at 31 December 2004	**38,010,130**	**38,010**	**550,533**	**(77)**

See accompanying notes to consolidated financial statements.

	Depreciation, amortisation and writedowns					Net book value	
01|01|2004	Foreign exchange	Additions	Disposals	Reclass	31|12|2004	31|12|2004	31|12|2003
2,526	–	242	157	–	2,611	450	2,269
–	–	–	–	–	–	41,685	96,418
19,949	(52)	5,424	–	–	25,321	4,085	9,520
12,892	(38)	3,955	–	–	16,809	2,972	6,942
35,367	**(90)**	**9,621**[1)]	**157**	**–**	**44,741**	49,192	**115,149**
4,584	(17)	6,434	–	–	11,001	15,883	22,372
19,924	(51)	13,233	911	547	32,742	20,456	33,347
7,773	(20)	1,410	674	–	8,489	2,458	3,491
958	–	137	27	–	1,068	196	261
766	(2)	1,164	–	(547)	1,381	2,519	2,476
–	–	–	–	–	–	33	104
34,005	**(90)**	**22,378**[2)]	**1,612**	**–**	**54,681**	41,545	**62,051**
8	–	428	–	–	436	2,796	677
–	–	–	–	–	–	52	50
8	**–**	**428**	**–**	**–**	**436**	2,848	**727**
69,380	**(180)**	**32,427**	**1,769**	**–**	**99,858**	93,585	**177,927**

Other comprehensive loss	Retained deficit	Total stockholders' equity
(27,660)	**(349,006)**	**195,407**
–	–	271
–	–	3,051
(12,386)	–	(12,386)
–	(14,242)	(14,242)
		(26,628)
(40,046)	**(363,248)**	**172,101**
–	–	7,500
–	–	5,475
–	–	96
1,041	–	1,041
–	(84,203)	(84,203)
		(83,162)
(39,005)	**(447,451)**	**102,010**

Evotec OAI AG and Subsidiaries
Notes to consolidated financial statements

(1) Business Description and Basis of Presentation

Evotec OAI AG and subsidiaries ("Evotec" or the "Company") is a biotechnology group dedicated to the discovery and development of the next generation of novel molecule based drugs through both contract research partnerships and discovery programmes for out-licensing. The Company provides innovative solutions from target to clinic through a range of integrated capabilities ranging from assay development and screening to medicinal chemistry and drug manufacturing.
The Company was founded on 8 December 1993 as EVOTEC BioSystems GmbH. Evotec completed an initial public offering in Germany on 10 November 1999.
All amounts herein are shown in thousands of Euro ("T€"), unless indicated otherwise.

(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.

Principles of Consolidation

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. The basis of consolidation changed as of 31 March 2004. The ENS Holdings, Inc. is since then consolidated at equity. Therefore the consolidated financial statements of 2004 are not fully comparable to the ones of 2003. The following unaudited pro forma information is based on the assumption that the dilution of the investment in ENS Holdings, Inc. occurred as of the 1 January 2003:

T€ except per share data	2004	2003
Pro forma revenues	71,817	76,619
Pro forma net loss	84,153	12,453
Pro forma net loss per share	2.30	0.35

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.

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 from inventories 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	3–5 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 licenses and patents.
Intangible assets with definite useful 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	3–5 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 7.1 years, respectively.

Goodwill
The goodwill results mainly from the acquisition of Oxford Asymmetry International plc. which was completed in October 2000.
In May 2004 Evotec OAI Limited acquired a further 19,000 shares in ProPharma Limited from the founding directors for the sum of T€ 362. This acquisition resulted in additional goodwill in the amount of T€ 93 and intangible assets other than goodwill amounting to T€ 23. The goodwill associated with ProPharma Ltd was assessed as part of the annual impairment review under SFAS 142 and found not to be impaired.

Revenue Recognition
Revenue under collaboration 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 includes but is not limited to the following:

1. Database Access Fees—Revenue from database access fees is recognised rateably over the related contract 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 milestones is recognised in the period the milestone is successfully achieved. This usually occurs when the contract partner 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 received 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 whether the different revenue-generating elements are sufficiently separable and whether there exists sufficient evidence of their fair values to separately account for some or all of the individual elements of the contracts. Only if an element is considered to meet these criteria it represents a separate unit of accounting.
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€ 586 and T€ 480 is included in product revenue for 2004 and 2003, respectively.

Advertising costs
The company expenses advertising costs in the year incurred.

Derivative policy
The Company does not engage in derivatives trading, market-making or other speculative activities. The Company periodically enters 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 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 before 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€ 1,514 and T€ 1,012 in 2004 and 2003, 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. 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 transactions are included in other non-operating income and expense.

Impairment of Long-Lived Assets
The Company reviews long-lived assets in accordance with SFAS 144, 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.
Any impairment is reported as a separate component of operating costs and expenses in the consolidated statement of operations.

Impairment of Goodwill
According to SFAS 142, "Goodwill and Other Intangible Assets" we perform goodwill impairment tests on an annual basis and between annual tests, if economic weaknesses, unexpected declines in operating results of reporting units and non-temporary market capitalisation declines are indicative of goodwill impairment. The process of evaluating the potential impairment of goodwill requires significant judgement during the analysis. 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. As required by SFAS 142, we performed our annual goodwill impairment test in the fourth quarter of 2004 (see Note (9)).
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", amended by SFAS 148 "Accounting for Stock-Based Compensation—Transition and Disclosure":

T€	2004	2003
Net loss, as reported	(84,203)	(14,242)
Add compensation expense		
determined under APB 25	96	271
Less compensation expense		
determined under SFAS 123	(278)	(1,111)
Adjusted net loss	**(84,385)**	**(15,082)**
Net loss per share		
As reported in €	(2.30)	(0.40)
Adjusted in €	(2.30)	(0.42)

The adjusted amounts do not reflect any tax effects due to the 100 % valuation allowance on the deferred tax assets in Germany. The adoption of SFAS 148 had no impact on our financial position or results of operations, because the Company has not applied SFAS 148.

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 and Adoptions

In December 2004, the Financial Accounting Standards Board ("FASB") issued SFAS No. 123 (revised 2004), "Share-Based Payment" ("SFAS 123R"), which is a revision of SFAS No. 123, "Accounting for Stock-Based Compensation". SFAS 123R supersedes APB Opinion No. 25, "Accounting for Stock Issued to Employees". SFAS 123R requires all share-based payments to employees, including grants of employee stock options, to be recorded as an expense based on their fair values. The grant-date fair value of employee share options and similar instruments will be estimated using an option-pricing model adjusted for any unique characteristics of a particular instrument. If an equity award is modified after the grant date, incremental compensation cost will be recognized in an amount equal to the excess of the fair value of the modified award over the fair value of the original award immediately before the modification. SFAS 123R is effective for the first quarterly reporting period that begins after 15 June 2005. The Company has not completed its assessment of the impact, if any, that this statement will have on its financial position or results of operations.

In November 2004, the FASB issued SFAS No. 151, "Inventory Costs: an Amendment to ARB No. 43" ("SFAS 151"). This statement clarifies the types of costs that should be expensed rather than capitalised as inventory. This statement also clarifies the circumstances under which fixed overhead costs, such as abnormal amounts of idle facility expense, freight, handling costs and wasted material, associated with operating facilities involved in inventory processing should be expensed or capitalised. The provisions of this statement are effective for fiscal years beginning after 15 June 2005. The Company has not completed its assessment of the impact, if any, that this statement will have on its financial position or results of operations.

In March 2004, the Emerging Issues Task Force (EITF) reached a consensus on Issue No. 03-01, "The Meaning of Other-Than-Temporary Impairment and Its Application to Certain Investments." EITF 03-01 provides guidance on other-than-temporary impairment models for marketable debt and equity securities accounted for under SFAS No. 115, "Accounting for Certain Investments in Debt and Equity Securities," and SFAS No. 124, "Accounting for Certain Investments Held by Not-for-Profit Organizations," and non-marketable equity securities accounted for under the cost method. The EITF developed a basic three-step model to evaluate whether an investment is other-than-temporarily impaired. The provisions (except paragraph 16) of EITF 03-01 have been effective beginning after 15 June 2004. The adoption of EITF 03-01 does not have any impact on the Company's consolidated financial statements.

In April 2004, the EITF issued EITF Issue No. 03-06 ("EITF 03-06"), Participating Securities and the Two-Class Method Under FASB Statement No. 128, Earnings Per Share, which addresses a number of questions regarding the computation of earnings per share by companies that have issued securities other than common stock that contractually entitle the holder to participate in dividends and earnings of the company when, and if, it declares dividends on its common stock. The issue also provides further guidance in applying the two-class method of calculating earnings per share, clarifying what constitutes a participating security and how to apply the two-class method of computing earnings per share once it is determined that a security is participating, including how to allocate undistributed earnings to such a security. EITF 03-06 is effective for fiscal periods beginning after 31 March 2004. The adoption of EITF 03-06 does not have any impact on the Company's consolidated financial statements.

On 9 March 2004, the Securities and Exchange Commission (SEC) issued Staff Accounting Bulletin No. 105, "Application of Accounting Principles to Loan Commitments". This bulletin summarizes the views of the SEC staff regarding the application of generally accepted accounting principles to loan commitments accounted for as derivative instruments. The adoption of this bulletin did not impact our consolidated financial statements.

EBITDA

EBITDA stands for earnings before interest, taxes, depreciation (incl. allowance for accounts receivables and inventories) and amortisation.

(3) Use Restrictions on the Company's Technology

Evotec was 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 lapsed in April 2003.
A fourth 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 reducing the cost basis of the respective intangible asset at the Company. 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.
Furthermore, the sale of the biochemical Mark III to non-funding companies is restricted until the third anniversary of the Mark III delivery date, which is mid of December 2004. The sale of the cell upgrade on the Mark III was restricted until May 2005. This restriction on the sale of cell upgrades on the Mark III was waived by GSK on 17 November 2004. The related future commitment was accrued in 2004.
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€ 15 and T€ 42 in 2004 and 2003, respectively.

(4) Cash and Cash Equivalents and Marketable Securities

On 31 December 2004 an amount of T€ 130 of cash and cash equivalents is pledged as security.
All marketable securities on 31 December 2003 in the amount of T€ 708 consisted of foreign corporate bonds which are publicly traded, are due within one year, are denominated in GBP and are considered as available for sale. The marketable securities were sold before the maturity date. On 31 December 2004 no marketable securities exist.

(5) Trade accounts receivables

The Company has determined the non-payment risk of all trade accounts receivables which resulted in an allowance of T€ 246 and T€ 126 in 2004 and 2003, respectively.

(6) Inventories

Inventories consist of the following:

T€	31 | 12 | 2004	31 | 12 | 2003
Raw materials	4,376	4,647
Work-in-progress	4,046	4,234
Finished goods	1,658	1,344
Total inventories	**10,080**	**10,225**

Raw materials consist of biological materials and substances, chemicals and components of instruments. Work-in-progress in 2004 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€ 1,029 and T€ 205, included in the amounts above, as of 31 December 2004 and 2003, respectively. Additionally, an allowance on work-in-progress and finished goods of T€ 115 and T€ 35 in 2004, respectively and of T€ 115 and T€ 114 in 2003 is included in the amounts above.

(7) Long-term Investments

Long-term investments (unconsolidated) consist of the following:

T€	31 | 12 | 2004	31 | 12 | 2003
ENS Holdings, Inc. (at equity)	2,473	–
Sirenade Pharmaceuticals AG (formerly SiREEN AG)	323	323
Prolysis Ltd.	–	354
Vmax Ltd. (at equity)	–	–
DIREVO Biotech AG (at equity)	–	–
DeveloGen Joint Venture (at equity)	–	–
Total long-term investments	**2,796**	**677**

In 2003, Evotec OAI AG transferred its shares in Evotec Neurosciences GmbH to ENS Holdings, Inc. ("ENS") incorporated in Delaware | USA. Evotec sold 781 shares on 30 March 2004 which decreased the investment from 84.7 % to 84.1 %. On 31 March 2004, ENS Holdings, Inc. issued to new investors 142,980 shares of preferred stock. Due to Evotec not participating in this capital increase, Evotec has a voting interest of 42.2 % by virtue of an 84.1 % investment in common stock. The investment in ENS is accounted for under the equity method of accounting. The Company's share of the net loss of ENS amounted to T€ 832 in 2004.
Evotec acquired a 3.88 % investment in 2002 in the common stock of Prolysis Ltd. as part of a three year drug discovery agreement where Evotec earned the shares by performing

services for Prolysis. All shares have been 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, at least once a year. The impairment review in December 2004 concluded that the value of the investment was uncertain, and that the investment should be fully impaired, due to the risk associated with the business activities and the nature of fulfilling funding requirements. The impairment amounted to T€ 354. As of 31 December 2004 and 2003 the carrying amount of the investment is T€ 0 and T€ 354, respectively.

Evotec acquired a 5.0% 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, at least once a year. 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 5.0% to 6.36%. This investment is partly paid by services provided in a drug discovery agreement between Evotec and Sireen (2004: T€ 0; 2003: T€ 198). In the context of a merger of Sireen and Nukleotide Analogue Design AG a new company Sirenade Pharmaceuticals AG was formed, effective 14 May 2004. Evotec contributed all its shares in Sireen as contribution in kind into Sirenade Pharmaceuticals AG and now holds an investment of 2.23% of Sirenade Pharmaceuticals AG shares.

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 issued in 2004 to existing shareholders 50 shares as well as to new investors 440 shares of common stock. Due to this capital increase the investment of Evotec decreased from 46.36% to 30.6%. Vmax specialises in the field of the discovery and development of small molecule antimicrobials. Through 31 December 2004 and 2003, Vmax had not generated any revenue. The Company's accumulated equity contributions and advances to Vmax amounted to T€ 270 and T€ 196 at 31 December 2004 and 2003, respectively. 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 T€ 8, recorded in long-term investments has already been written down to T€ 0 as of 31 December 2003. The Company's share of the net loss of Vmax therefore amounted to T€ 0 and T€ 137 for 2004 and 2003, respectively.

Evotec has a 22.72% voting interest by virtue of a 65.0% 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. The Company's share of the net loss of Direvo amounted to T€ 0 in 2004 and T€ 0 for 2003. For the year ended 31 December 2004, Direvo had generated revenues of T€ 1,011 and incurred a net loss of T€ 2,347. Our maximum exposure to loss as a result of our involvement with DIREVO Biotech AG is limited to the original investment in DIREVO AG in the amount of T€ 32.

The Company and DeveloGen AG formed a 50:50 Joint Venture in August 2003 to discover, develop and commercialise drug candidates in certain areas of metabolic diseases and to collaborate with pharmaceutical companies for defined projects in these areas. This Joint Venture is consolidated at equity in the financial statements. Evotec's total investment in 2004 amounted to T€ 0 (2003: T€ 0). Research and development expenses of the Company related to the Joint Venture in the amount of T€ 2,872 (2003: T€ 1,431) are shown under net loss from equity investments.

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

The Company has recorded revenues in the ordinary course of business with the investments Sirenade Pharmaceuticals AG and Prolysis Ltd. in the amount of T€ 0 and T€ 2,001 in 2004 as well as T€ 704 and T€ 1,747 in 2003, respectively. No further material transactions with investments of the Company were recorded.

(8) Property, Plant and Equipment

Property, plant and equipment consist of the following:

T€	31|12|2004	31|12|2003
Buildings and leasehold		
improvements	26,884	26,956
Plant, machinery and equipment	53,198	53,271
Furniture and fixtures	10,947	11,264
Purchased software	1,264	1,219
Capital leases	3,900	3,242
Assets under construction	33	104
Fixed assets, at cost	96,226	**96,056**
Less accumulated depreciation		
without impairment and software	40,247	33,047
Less impairment	13,366	–
Less accumulated amortisation		
of software	1,068	958
Total property, plant and equipment	**41,545**	**62,051**

The main additions in 2004 relate to the purchase of laboratory equipment in Abingdon, UK and the commencement of fitting out of new clean room facilities in Glasgow, UK and several laboratory equipments in Hamburg. Upon completion of the assets under construction, costs are transferred into their respective fixed assets classification. Depreciation expense amounted to T€ 9,203 and T€ 9,834 in 2004 and 2003, respectively. Included in 2004 is an impairment on the Pilot Plant located in Abingdon, UK in the amount of T€ 9,673. The impairment exercise under SFAS 144 implied an impairment due to the underutilised capacities in the Pilot Plant. As a result of this test management have concluded that an asset impairment of the Pilot Plant operational assets was required.

An additional impairment is included in 2004 in relation to laboratory premises assets in Abingdon, UK in the amount of T€ 3,962. The impairment of the laboratory premises assets reflects recognition of excess capacity and the likelihood of continuing under utilisation.

The net book values included in the fixed assets, which are held under capital leases, are plant and machinery as well as fixture and fittings of T€ 2,519 and T€ 0 as of 31 December 2004 and T€ 2,462 and T€ 14 as of 31 December 2003, respectively. The related depreciation amounts to T€ 1,362 and T€ 19 in 2004 and T€ 540 and T€ 14 in 2003, respectively.

(9) Other Intangible Assets and Goodwill

Intangible assets, excluding goodwill, consist of the following:

T€	31|12|2004	31|12|2003
Developed technologies	29,406	29,469
Customer list	19,781	19,834
Patents and licenses	3,061	4,795
Intangible assets, at cost	**52,248**	**54,098**
Less accumulated amortisation	44,741	35,367
Total intangible assets excl. goodwill	**7,507**	**18,731**

Amortisation expense of intangible assets amounted to T€ 10,030 and T€ 10,671 in 2004 and 2003, respectively.
The estimated aggregate amount of amortisation of developed technologies and customer list is as follows:

T€	
2005	7,229
2006	8
2007	3
Thereafter	–
Total	**7,240**

In May 2004 Evotec OAI Limited acquired a further 19,000 shares in ProPharma Limited. This acquisition resulted in additional goodwill in the amount of T€ 93.
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 2004. As a result of that test, the Company concluded that T€ 55,824 of the goodwill carried as of that date was impaired leaving a balance at 31 December 2004 of T€ 41,685. The continuing market pressures during 2004, including the adverse movement of the USD against the Company's operating currencies of the Euro and GBP, have led management to revise estimations and assumptions of operating profits and cash flows. The fair values of the Company's reporting units Discovery Services, Development Chemistry, Pilot Plant and ProPharma, which all belong to the discovery and development services segment, were estimated using established valuation techniques, specifically the discounting of estimated future cash flows. We also considered our market capitalisation on the dates of our impairment tests under SFAS 142 in determining the fair value of the respective businesses.

(10) Long-Term Loans

In February 1998, the Company entered into a T€ 5,113 loan agreement with a bank of which T€ 1,278 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. The first maturity date of the loan could be 30 June 2007. The repayment is included accordingly in the maturity table below. This loan is secured by certain fixed assets.
On 4 February 2003 the Company entered into a loan with another bank of T€ 2,937 secured by a charge on buildings and chattels in the UK of which T€ 2,202 is still outstanding. The loan is repayable in equal instalments over a period of five years. A further loan facility of T€ 5,667 was agreed on the same date secured on trade accounts receivable and funds deposited at the bank. An amount of T€ 1,766 had been drawn down from this facility as of 31 December 2004. This loan is repayable in full by 28 February 2006 or in instalments before that date and is subject to covenants being fulfilled. At the year end 2004 there were no restrictions of use over the funds on deposit as all the requirements of the loan covenants have been met.
ProPharma Ltd., a subsidiary of the Evotec OAI AG has debt of T€ 885. New loan arrangements have been concluded in order to finance the fitting out of new clean room facilities in Glasgow, UK. The loans are repayable in instalments through 2009 and secured by all of that subsidiary's assets. The Company is in compliance with all debt covenants at 31 December 2004. Current year maturities include an overdraft in ProPharma of T€ 0 (2003: T€ 484). This overdraft is secured by a bond and floating charge over all of ProPharma's assets dated 20 January 2000, assignations of Zurich life assurance policies on the lives of two directors and a letter of security from a Bank, which is contingent upon a T€ 424 deposit at this bank.
The annual maturities of these debts are as follows:

T€	
2005	1,240
2006	3,198
2007	5,258
2008	1,076
2009	59
Thereafter	–
Total	**10,831**

The Company maintains lines of credit totalling T€ 5,980 to finance its short-term capital requirements, of which the entire balance is available as of 31 December 2004. These lines of credit provide for borrowings at various interest rates and have various expiration dates between 2005 and 2008 as well as no stated expiration date.

(11) Capital Lease Obligations

The Company is obligated under capital leases of T€ 2,841 and T€ 2,392 as of 31 December 2004 and 2003, respectively that expire at various dates during the next five years.
The future minimum lease payments under capital leases are as follows:

T€	
2005	876
2006	852
2007	781
2008	399
2009	125
Less interest	(192)
Total principal payable on capital leases	**2,841**

(12) Accrued Liabilities

The accrued liabilities consist of the following:

T€	31 | 12 | 2004	31 | 12 | 2003
Accrued outstanding invoices	1,433	2,430
Bonus accruals	1,298	2,003
Rent	1,039	198
Other accrued liabilities	2,381	2,238
Total accrued liabilities	**6,151**	**6,869**

The change of accrued liabilities is primarily due to a Management's decision to decrease the variable component of compensation. Additionally, the outstanding invoices decreased on 31 December 2004. On the other hand an amount of T€ 1,039 (2003: T€ 198) was included for rent in relation to lease incentives received in the year on property occupied in Abingdon and Glasgow (UK).

(13) Income Taxes

Loss before income taxes, minority interests and net loss from equity investments is attributable to the following geographic regions for the years ended 31 December 2004 and 2003:

T€	2004	2003
Germany	(9,200)	(10,135)
Foreign	(80,630)	(5,430)
Total	**(89,830)**	**(15,565)**

Income tax benefit (expense) for the years ended 31 December 2004 and 2003 is as follows:

T€	2004	2003
Current taxes:		
– Germany	(39)	–
– Foreign	122	(361)
Total current taxes	**83**	**(361)**
Deferred taxes:		
– Germany	–	–
– Foreign	9,154	3,186
Total deferred taxes	**9,154**	**3,186**
Total income tax benefit	**9,237**	**2,825**

The tax rate in the UK for the years ended 31 December 2004 and 2003 amounted to 30%. For the years ended 31 December 2004 and 2003, the actual income tax benefit differed from the amounts determined using the combined German federal corporation income and trade tax rate of 40.38% (2003: 40.38%) as follows:

T€	2004	2003
Expected income tax benefit	37,777	6,624
Non-deductible goodwill impairment and amortisation	(22,542)	–
Other permanent differences	1,592	1,266
Foreign tax differential	(2,578)	(525)
Effect of tax rate change	–	(44)
Change in valuation allowance	(5,032)	(4,756)
Other	20	260
Actual income tax benefit	**9,237**	**2,825**

Deferred income tax assets and liabilities as of 31 December 2004 and 2003 relate to the following:

T€	2004	2003
Deferred tax assets:		
– Loss carry forward	47,140	43,297
– Intangible assets	1,636	1,957
– Other	151	245
Total	**48,927**	**45,499**
Valuation allowances on deferred tax assets	(41,677)	(36,645)
Total deferred tax assets	**7,250**	**8,854**
Deferred tax liabilities:		
– Property, plant and equipment	7,421	14,928
– Intangible assets	2,173	5,013
– Undistributed subsidiaries earnings	34	146
– Other	(11)	20
Total deferred tax liabilities	**9,617**	**20,107**
Deferred tax liability, net	**2,367**	**11,253**

Net deferred income tax assets and liabilities are presented in the accompanying balance sheets as of 31 December 2004 and 2003 as follows:

T€	2004	2003
Net deferred tax assets, current:		
– Germany	–	–
– Foreign	99	76
Net deferred tax liabilities, non-current:		
– Germany	–	–
– Foreign	(2,466)	(11,329)
Total	**(2,367)**	**(11,253)**

For the years ended 31 December 2004 and 2003, Evotec recorded additional valuation allowances with respect to tax benefits of tax loss carry forwards T€ 5,276 and T€ 4,604, 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, 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€ 98,881 and the UK of T€ 19,802 do not expire. Due to changes in the German tax law in 2003, the tax loss carry forwards can only be offset against an amount of 60% of future taxable income after exceeding a fully deductible amount of T€ 1,000 per year.

In determining the allowance, income tax expense for 2004 and 2003 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.

(14) 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 giving the variable plan a fixed character.

The terms of the stock option plan provides that for a further granting of options the average closing price of the Company's stock should have increased by at least 30% during the last quarter of the year preceding the year of the date of any subsequent grant compared to the last quarter of the year prior to the preceding year. 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 2004 and 2003, and the changes during the years then ended is presented as follows:

pcs. and € per share	2004		2003	
	Options	Weighted average exercise price	Options	Weighted average exercise price
Outstanding at beginning of the year	2,474,176	9.30	2,129,526	10.31
Options granted	361,150	2.95	523,400	5.84
Options exercised	–	–	–	–
Options forfeited	(107,925)	10.41	(113,750)	10.71
Options waived (re-issueable)	(147,843)	9.72	(65,000)	12.76
Outstanding at end of the year	**2,579,558**	8.34	**2,474,176**	9.30
Thereof exercisable	1,232,740	12.71	784,535	14.60

A summary of the stock options outstanding at 31 December 2004 is as follows:

	Outstanding in pcs.	Exercisable in pcs.	Weighted average remaining contractual life in years	Weighted average exercise price € per share
Exercise price 1.66 – 2.65 € per share	903,398	177,085	8.63	2.38
Exercise price 5.50 – 6.80 € per share	1,162,914	562,788	7.16	6.54
Exercise price 10.15 – 12.48 € per share	56,650	37,771	6.93	12.40
Exercise price 15.29 € per share	4,500	3,000	6.23	15.29
Exercise price 24.30 € per share	452,096	452,096	5.90	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€ 23 and T€ 76 were determined at the measurement dates of the granted options in 2004 and 2003, respectively. These amounts were reflected in unearned compensation, a component of stockholders' equity. The Company recognised compensation expense in 2004 and 2003 for all options totalling T€ 96 and T€ 271, respectively, which was reflected as operating costs and 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 2004 and 2003 using a Black-Scholes option pricing model with the following weighted average assumptions:

	2004	2003
Risk-free interest rate	3.5%	4.0%
Volatility	57.1%	75.6%
Dividend yield	–	–
Average expected life	3 years	3 years
Options expected to be exercised	63.9%	74.7%

The weighted average fair value of each option granted during the year ended 31 December 2004 and 2003 was € 0.31 and € 0.70, respectively.

(15) Stockholders' Equity

On 31 December 2004, 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, decreased by a capital increase on 20 July 2004, of 15,200,000 shares. On 31 December 2004, there are 38,010,130 shares issued and outstanding.
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. Effective 20 July 2004, the Company increased its stockholders' equity by issuing 2,500,000 new shares against cash out of the approved capital (genehmigtes Kapital). The price per share amounted to € 3.00.

(16) Segment Information

The Company's operations include three reportable operating segments which are: (i) Tools and Technologies, (ii) Discovery and Development Services and (iii) Discovery Programs Division.

(i) The Tools and Technologies segment is developing innovative drug discovery technologies and instruments for the pharmaceutical and biotechnology industries and academic research institutions. Tools and Technologies provides cutting-edge solutions for miniaturisation, automation and measurement by seamlessly integrating hardware, software and bioware modules.

(ii) The Discovery and Development Services segment provides integrated drug discovery contract research and development support to a large group of global customers and to internal drug discovery programmes in the Discovery Programs Division segment. The total business activities of the UK are included in this second segment.

(iii) The Discovery Programs Division segment is engaged in selected discovery activities to develop compounds for out-licensing. The strategic objective of this division is to generate proprietary intellectual property that can provide the Company with additional long-term upside through more significant milestones and royalties. The Discovery Programs Division utilises group synergies by contracting its discovery research to the Discovery and Development Services segment at arms length.

The Company makes decisions about resources to be allocated to the segments and assesses their performance using revenues, gross profits and operating income and loss. Evotec does not identify or allocate all assets to the operating segments nor does the Company evaluate the segments on these criteria. Net sales and operating expenses in the segment's include both sales to customers and inter-segment transfers, which are priced to recover cost plus an appropriate profit margin according to the at arms length principle.

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 2004 and 2003:

T€	2004	2003
Revenues:		
– Discovery and Development Services	59,249	61,214
– Tools and Technologies	19,315	18,668
– Discovery Programs Division	944	1,479
– Consolidation	(6,778)	(4,133)
Total revenues	**72,730**	**77,228**
Costs of revenue:		
– Discovery and Development Services	40,687	37,254
– Tools and Technologies	9,461	10,503
– Discovery Programs Division	578	655
– Consolidation	(2,917)	(2,219)
Total costs of revenue	**47,809**	**46,193**
Gross profit:		
– Discovery and Development Services	18,562	23,960
– Tools and Technologies	9,854	8,165
– Discovery Programs Division	366	824
– Consolidation	(3,861)	(1,914)
Total gross profit	**24,921**	**31,035**

The following represents segment data, revenues, gross profit and operating loss from continuing operations, for the year ended 31 December 2004:

T€	Discovery and Development Services	Tools and Technologies	Discovery Programs Division	Consolidation	Total 2004
Revenues:					
– Drug discovery products and Technologies	125	19,315	–	(1,632)	17,808
– Drug discovery services	59,124	–	944	(5,146)	54,922
Total revenues	**59,249**	**19,315**	**944**	**(6,778)**	**72,730**
Costs of revenue:					
– Drug discovery products and Technologies	–	9,461	–	(506)	8,955
– Drug discovery services	40,687	–	578	(2,411)	38,854
Total costs of revenue	**40,687**	**9,461**	**578**	**(2,917)**	**47,809**
Gross profit	**18,562**	**9,854**	**366**	**(3,861)**	**24,921**
Research and development expenses	8,084	6,479	2,210	(3,001)	13,772
Selling, general and administrative expenses	14,657	3,788	1,001	(122)	19,324
Amortisation of intangible assets	9,914	819	91	(794)	10,030
Impairment of goodwill	55,824	–	–	–	55,824
Impairment of tangible assets	13,635	–	–	–	13,635
Other operating expenses	3,584	–	–	–	3,584
Operating loss	**87,136**	**1,232**	**2,936**	**(56)**	**91,248**

Depreciation including allowances, included in the operating loss of Discovery and Development Services, Tools and Technologies and Discovery Programs Division, amounts to T€ 9,441, T€ 843 and T€ 249, respectively (2003: T€ 9,319, T€ 1,030 and T€ 425, respectively).
Revenues can be split into the following product and service lines:

T€	2004	2003
Biology Services	9,232	10,603
Chemical Discovery	32,275	31,666
Chemical Development	17,742	18,945
Discovery and Development Services	59,249	61,214
Discovery Programs Division	944	1,479
Tools and Technologies	19,315	18,668
Consolidation	(6,778)	(4,133)
Total revenues	72,730	77,228

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

%	2004	2003
Germany	10	6
United Kingdom	16	20
Rest of Europe	20	23
United States	42	46
Rest of the world	12	5
	100	100

Long-lived assets of T€ 82,439 and T€ 165,150 are located in foreign countries and the remaining amounts of T€ 11,146 and T€ 12,777 are in Germany as of 31 December 2004 and 2003, respectively.

(17) 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 approximate their carrying values on 31 December 2004 and 2003. 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 2004, the Company held USD forward contracts with Euro equivalent notional amounts of approximately T€ 1,503 and a fair value of T€ 1,509 (2003: T€ 0 and T€ 0, respectively). Additionally, the Company held USD option contracts with Euro equivalent notional amounts of approximately T€ 3,666 and T€ 8,500 as of 31 December 2004 and 2003, respectively. The fair value of the option contracts is T€ 3,932 at 31 December 2004 (2003: T€ 8,552). 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 related to foreign currency derivatives are included in other non-operating income and amounted to T€ 856 and T€ 459 for the years ended 31 December 2004 and 2003, respectively.

(18) Risks

The Company has credit risks 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 sales growth as well as competition and the general economic situation. Moreover, in order to remain competitive and develop its Discovery Programs Division, Evotec will 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 unless appropriate funding is allocated or secured.
The Company has important collaborations with pharmaceutical and biotechnology companies within all operating segments. Any termination of such collaborations or failure to achieve contracted milestones would probably have adverse impacts on the Company's financial position, results of operations and cash flows.
The Company has two customers in the Discovery and Development Services segment and in the Tools and Technologies segment with more than 18% combined revenues of the group revenues. A termination of these contracts could have adverse impacts on the Company's financial results.
Foreign exchange risk of the Company stems from our exposure to the USD as well as to the GBP with respect to the UK subsidiaries. The continued strong weakening of the USD when accompanied by a relative strengthening of the GBP constitutes a significant risk to the Company's financial situation. Any further weakening will reduce reported revenues. The hedging activities of the Company aim to mitigate the impact on the result before tax.

(19) Pension Plan

The Company operates a defined contribution Group Personal Pension Plan (GPPP) and makes contributions to employees' own schemes. The pension charge for the year represents contributions payable by the Company to the fund (and to employees' own pension schemes) and amounted to T€ 689 (2003: T€ 594).
Contributions amounting to T€ 105 (2003: T€ 103) were payable to the fund managers at the year end and are included in creditors.
The Company's contribution rate is determined by the employees contribution and their age. There were no changes in the basis for such contributions during the year. The Company's disclosure for its pension is in compliance with FAS 132, Employers' Disclosures about Pensions and Other Post-Retirement Benefits.

(20) Commitments and Contingencies

(a) Operating Leases

The Company leases office and laboratory space and other equipment under operating leases. The future minimum lease payments under non-cancellable operating leases are approximately as follows:

T€	
2005	5,101
2006	4,656
2007	4,604
2008	4,473
2009	4,519
Thereafter	41,360
Total	**64,713**

The majority of operating leases is related to rent expenses for facilities. The rent expense for such leases amounted to T€ 4,478 and T€ 3,021 for the years ended 31 December 2004 and 2003, respectively.

(b) Other Commitments and Contingencies

The Company has entered into consultant contracts. During 2004 and 2003, payments under consultant contracts totalled T€ 434 and T€ 543, respectively. The future minimum payments associated with long-term consultant and other miscellaneous long-term commitments totals approximately T€ 761 and T€ 1,471 at 31 December 2004 and 2003, respectively.
As discussed in note 3, the Company has certain commitments resulting from the amendments to our agreements with our technology funding partners.
The Company has given a guarantee with regard to all terms and conditions of a specific customer contract. No current liabilities from that guarantee exist at 31 December 2004.
In May 2004 the Company entered into a share purchase agreement with a share buy out scheme including provisions to pay further monies to former shareholders of an affiliate contingent upon future performance criteria. As at the balance sheet date no current liabilities exist.
The Company is not aware of any significant litigation as of 31 December 2004.

(c) Product Warranties

Product warranties of the Company are issued only by the Tools and Technologies 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 2004.

T€	01|01|2004	Changes for preexisting warranties	Changes for 2004 warranties	31|12|2004
Product warranties	442	442	516	516

(21) Related Party Transactions

The following Supervisory Board members and Executive Committee 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 2004 and 2003 amounted to T€ 723 and T€ 84, respectively. Accounts receivable from Altana, as of 31 December 2004 and 2003 amount to T€ 70 and T€ 0, respectively.

Peer Schatz is a managing director of Qiagen N.V. From affiliates controlled by Qiagen N.V. the Company bought products in the amount of T€ 229 and T€ 215 in 2004 and 2003, respectively. The amount of payables to Qiagen on 31 December 2004 and 2003, including VAT amounts to T€ 117 and T€ 5, respectively.
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€ 0 and T€ 1 in 2004 and 2003, respectively. There were no payables to Innogenetics as of 31 December 2004 and 2003, respectively. The Company also entered into a service agreement with Innogenetics N.V. in the ordinary course of business. Revenues from this agreement amounted to T€ 0 and T€ 6 in 2004 and 2003, respectively. Accounts receivable from Innogenetics, as of 31 December 2004 and 2003 amount to T€ 0 and T€ 2, respectively. 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€ 0 and T€ 256 in 2004 and 2003, respectively.
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€ 0 and T€ 16 in 2004 and 2003, 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 2004 and 2003 amounted to T€ 169 and T€ 283, respectively, related payables to the Fraunhofer Institut as of 31 December 2004 and 2003 amounted to T€ 0 and T€ 0, respectively. The revenues in 2004 and 2003 with Fraunhofer Institut amounted to T€ 0 and T€ 74, respectively. There were no related receivables as of 31 December 2004 and 2003, respectively. 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€ 288 and T€ 88 in 2004 and 2003, respectively. He is also a member of the supervisory board of U3 Pharma AG with whom the Company entered into a service agreement in the ordinary course of business. Revenues amounted to T€ 344 in 2004 and the relating accounts receivable as of 31 December 2004 amounted to T€ 70. 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 2004 and 2003 amounted to T€ 99 and T€ 170, respectively and the related payables to Dr Henco as of 31 December 2004 and 2003 amounted to T€ 22 and T€ 27, respectively.
Dr Edwin Moses was a member of the supervisory board of Prolysis Ltd until June 2003 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€ 2,001 and T€ 1,747 in 2004 and 2003, respectively and the related accounts receivable as of 31 December 2004 and 2003 amounted to T€ 595 and T€ 466, respectively. 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 amounted to T€ 935 and T€ 0 in 2004, respectively, and to T€ 575 and T€ 0 in 2003, respectively, and the related accounts receivable as of 31 December 2004 amounted to T€ 105 and T€ 0, respectively, and as of 31 December 2003 amounted to T€ 38 and T€ 0, respectively. Dr Moses is also chairman of the supervisory board of Paradigm Therapeutics Ltd. with whom the Company entered into a service agreement. The related revenues amounted to T€ 165 in 2004. There were no related accounts receivables as of 31 December 2004.
Dr Michael Redmond is chairman of the supervisory board of Microscience Ltd. with whom the Company founded Vmax Ltd.
Dr Mario Polywka, a member of the Executive Committee of the Company is non-executive chairman of the board of Glycoform Limited who uses laboratory equipment at the site in Abingdon, UK. Revenues amounted to T€ 5 in 2004 and the related accounts receivable as of 31 December 2004 amounted to T€ 1. He is also non-executive director of the board of Pharminox Limited with whom the Company entered into a service agreement in the ordinary course of business. Revenues amounted to T€ 59 in 2004. There were no related accounts receivables as of 31 December 2004.
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 7.
Included in the accounts receivable due from related parties is an amount of T€ 183 due to associated companies. Administrative services provided by the Company to the Management Board and Supervisory Board for their private purposes are reimbursed to the Company at cost.

(22) 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 2004 was 639 (2003: 646).

(b) Personnel Expenses and Cost of Material

The personnel expenses of the Company amounted to T€ 37,365 of which T€ 22,838 relates to personnel expenses in the UK (2003: T€ 36,364 and T€ 21,516, respectively).
Cost of materials amounted to T€ 24,166, thereof T€ 7,289 are cost of materials in the UK (2003: T€ 24,829 and T€ 7,173, 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 is accessible to the shareholders on Evotec's website.

(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 %	2004 Net income	(loss) in T€	2004 Equity in T€
Subsidiaries (verbundene Unternehmen)				
– Evotec OAI Ltd., Abingdon, UK	100.0		(9,117)	46,515
– Evotec Technologies GmbH, Duesseldorf	86.1		(1,267)	(1,616)
– Evotec Technologies Inc., Delaware, USA (unaudited)	86.1		(2)	18
– ProPharma Ltd, Glasgow, UK	81.1		(258)	1,116
– Evotec OAI, Inc., Delaware, USA (unaudited)	100.0		22	116
– Oxford Diversity Ltd., Abingdon, UK (unaudited)	100.0		–	–
– Oxford Asymmetry Employee Shares Trust Ltd., Abingdon, UK (unaudited)	100.0		–	–
Investment in associated Companies				
– DIREVO Biotech AG, Cologne (unaudited)	22.7		(2,347)	10,572
– Sirenade Pharmaceuticals AG, Martinsried				
(formerly SiREEN AG, Munich) (unaudited)	2.2		(4,792)	(8,685)
– Vmax Ltd., Winnersh Triangle, UK (unaudited)	30.6		(95)	35
– Prolysis Ltd, Oxford, UK (2003 figures)	3.9		(732)	2,459
– DeveloGen Joint Venture	50.0		–	–
– ENS Holdings, Inc., Delaware, USA (unaudited)	42.2		124	13,154
– EVOTEC NeuroSciences GmbH, Hamburg (unaudited)	42.2		(2,279)	625
– Evotec Neurosciences AG, Zurich, CH (unaudited)	42.2		24	89

(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€ 1,725 (2003: T€ 1,229) of which T€ 212 (2003: T€ 163) was variable. The variable pay for the Management Board is based on a bonus scheme designed by the Remuneration committee, which is composed on entirely non management board members of the supervisory board, and is then approved by the Supervisory Board. The variable portion of the remuneration in 2004 has been made for the business year 2003 and is based on a performance related bonus split into three parts; 20% was based on the achievement of a revenue target, 20% on an EBITDA target and 60% on the achievement of personal objectives. In the case of the C.E.O. these percentages were 30, 30 and 40 respectively. The scheme for the variable portion of the remuneration in 2005, which is based on the business year 2004, is based on the following performance related bonus split: 40% is based on the achievement of a revenue target, 40% on an EBITDA target and 20% on the achievement of personal objectives. Under the Company's stock option plan, the members of the Management Board received in 2004 124,500 (2003: 152,000) options of which one-third may be exercised after two years.

	Fixed remuneration in T€	Variable remuneration in T€	Stock options in pcs.
Joern Aldag	326	48	63,000
Dr Dirk Ehlers	278	48	36,500
Prof Dr Ian Hunneyball	281	38	18,500
Dr Timm Jessen	118	43	6,500
Bernard Questier	510[1)]	35	–
Total	**1,513**	**212**	**124,500**

[1)] Includes payment for dissolution of contract

Joern Aldag is member of the Monopolkommission der Bundesrepublik Deutschland and member of the supervisory board of ENS Holdings, Inc., Wilmington, USA (from December 2004, chairman from March 2004 until December 2004).

Dr Timm Jessen is member of the supervisory board of ascension GmbH, Munich.

Dr Dirk Ehlers was chairman of the supervisory board of ENS Holdings, Inc., Wilmington, USA (from January 2004 until March 2004).

(f) Supervisory Board

The members of the Supervisory Board and their additional memberships in supervisory boards and memberships in comparable governing 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€ 37.5 for Prof Dr Riesenhuber, T€ 33.8 for Peer Schatz, T€ 18.8 for Dr Edwin Moses, T€ 16.9 for Michael Redmond, T€ 15.9 for Dr Pol Bamelis and T€ 15 for Dr Karsten Henco. The remuneration for the chairman of the Supervisory Board is twice, for the vice chairman is one and a half the amount of the remuneration for the Supervisory Board members. The additional remuneration for a member of a supervisory board committee amounts to T€ 3.8, for the chairman of those committee's to T€ 7.5. The total remuneration paid to Supervisory Board members totalled T€ 137.8 (2003: T€ 112.5).

(g) Scientific Advisory Committee

Dr Karsten Henco, Duessledorf; Dr Thomas Lengauer, Bonn; Prof Dr Mark Bradley, Southamptton, UK; Prof Dr Mark Lathrop, Evry Cedex, F; Prof Dr Rainer N Zahlten, Hennigsdorf; Dr Frank Gannon, Heidelberg.

The remuneration for the Scientific Advisory Board in 2004 amounts to T€ 25.

(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.

Status report and fixed asset movement schedule

According to HGB companies have the obligation to disclose a status report and a fixed asset movement schedule. U.S. GAAP requires from public traded companies a disclosure of a Management Discussion and Analysis (MD&A) which differs from the status report in contents and scope. The disclosure of a fixed asset movement schedule is not required by U.S. GAAP.

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 but detailed disclosures apply. 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.

Stock-Based Compensation

Under German GAAP, the Company recognises the difference between the fair market value of the Evotec shares and the exercise price of the stock options as expense, 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.

Report of the Supervisory Board

Prof Dr Heinz Riesenhuber
Chairman of the Supervisory Board

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 2004, the Supervisory Board convened for four formal meetings and held four telephone conferences to discuss the operational and strategic development of Evotec OAI AG. In addition, the Supervisory Board discussed current issues and decision items in seven telephone calls and approved one separate management decision through written circulation. The Audit committee separately met in one physical meeting and engaged in five additional teleconferences; the Remuneration Committee convened twice. 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 Chief Executive Officer discussed ongoing and current topics on the telephone regularly, typically every two weeks, and whenever appropriate.

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

> In March, the Board discussed the 2003 annual financial statements in presence of the auditors, as well as the agenda of the 2004 AGM.
> In May, the Board focused on financial projections and a possible capital increase.
> In September, the Board discussed the longe range plan for the company, including strategy, financing, business development and possible merger & acquisition projects.
> In November, the Board focused on the budget for the year 2005.

In order to avoid a potential conflict of interest, one Supervisory Board member abstained from the discussion about a potential acquisition project. We are not aware of any other conflict of interest situation during the year 2004.

The financial statements and the management report of Evotec OAI AG for the year 2004, 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. The auditors issued an unqualified audit opinion. They gave a comprehensive report on the audit and their observations at the Supervisory Board Meeting on 11 March 2005. The Supervisory Board examined and approved both the financial statements and the consolidated financial statements prepared by the Management Board.

Michael Redmond resigned from office as a Supervisory Board member effective 30 September 2004. Following this, Mary C. Tanner, a former investment banker from New York with extensive experience in the health care and life science sector, has been appointed to the Supervisory Board by the trade register, based upon a joint application of the Supervisory Board and the Management Board.

Dr Timm-H. Jessen and Bernard Questier resigned from the Management Board effective 30 June 2005 and 31 August 2005, respectively.

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 2005.

Hamburg, 11 March 2005

The Supervisory Board
Prof Dr Heinz Riesenhuber

Supervisory Board and Management Board

Supervisory Board

Prof Dr Heinz Riesenhuber Chemist Frankfurt am Main | D	**Chairman of the Supervisory Board**	**Chairman of the Supervisory Board:** Kabel Deutschland GmbH, Unterfoehring | D (from December 2004) **Member of the Supervisory Board:** Altana AG, Bad Homburg | D Frankfurter Allgemeine Zeitung GmbH, Frankfurt am Main | D Henkel KGaA, Duesseldorf | D InSynCo AG, Hamburg | D VfW AG, Cologne | D Vodafone GmbH, Duesseldorf | D Osram GmbH, Munich | D (until November 2004) **Member of the Investorenbeirat:** Heidelberg Innovation BioScience Venture II GmbH & Co. KG, Heidelberg | D **Member of the Verwaltungsrat:** HBM BioVentures AG, Baar | CH
Peer Schatz Business Executive Duesseldorf | D	**Vice Chairman of the Supervisory Board**	**Chairman of the Supervisory Board:** GenoVision Inc, West Chester | USA (from January 2004, formerly member) Qiagen AS, Oslo | N (from January 2004, formerly member) Qiagen Genomics, Inc, Bothell | USA (from January 2004, formerly member) Qiagen Inc, Valencia | USA (from January 2004, formerly member) Qiagen Ltd, Crawly West Sussex | UK (from January 2004, formerly member) Qiagen North American Holdings, Inc, Valencia | USA (from January 2004, formerly member) Qiagen Operon, Inc, Alameda | USA (from January 2004 until August 2004, formerly member) Qiagen Pty Ltd, Clifton Hill, Victoria | AUS (from January 2004, formerly member) Qiagen S.A., Courtaboeuf Cedex | F Qiagen S.p.A., Milan | I (from January 2004, formerly member) Qiagen Sciences, Inc, Germantown | USA (from January 2004, formerly member) Qiagen Sciences K.K., Tokyo | J (from January 2004 until August 2004, formerly member) Qiagen Synthetic DNA, Inc, Alameda | USA (from August 2004) Xeragon, Inc, Germantown | USA (from January 2004, formerly member) **Member of the Supervisory Board:** Mulligan BioCapital AG, Hamburg | D Qiagen Inc, Mississauga | CAN Qiagen K.K., Tokyo | J **Member of the Beirat:** ACS Moschner & Co. GmbH, Vienna | A Venture Capital Partners KEG, Vienna | A **Member of the Boersenrat:** Frankfurter Wertpapierboerse, Frankfurt am Main | D
Dr Pol Bamelis Chemist Knokke | B	**Member of the Supervisory Board**	**Chairman of the Supervisory Board:** Agfa-Gevaert AG, Leverkusen | D Agfa-Gevaert N.V., Mortsel | B Crop Design N.V., Gent | B **Member of the Supervisory Board:** Bekaert N.V., Kortrijk | B Innogenetics N.V., Gent | B MediGene AG, Munich | D Oleon N.V., Ertvelde | B PolyTechnos (GP) II Ltd, St Peters Port, Guernsey | UK Recticel N.V., Brussels | B (from May 2004) Sioen NV, Ardooie | B Televic NV, Izegem | B Universität Leuven, Leuven | B

Dr Karsten Henco Biochemist Duesseldorf	D	**Member of the Supervisory Board**	**Chairman of the Supervisory Board:** Garching Innovation GmbH, Munich	D (from November 2004, formerly member) **Member of the Supervisory Board:** Direvo Biotech AG, Cologne	D NewLab BioQuality AG, Erkrath	D U3 Pharma AG, Martinsried	D **Member of the Kuratorium:** Fraunhofer-Institut für Biomedizinische Technik IBMT, St. Ingbert	D Universitätsklinikum Hamburg-Eppendorf, Hamburg	D
Dr Edwin Moses Chemist Goring, Oxfordshire	UK	**Member of the Supervisory Board**	**Chairman of the Supervisory Board:** Ablynx N.V., Gent	B (from September 2004) Avantium Technologies, Amsterdam	NL BioImage A	S, Copenhagen	DK Clinphone Group Ltd, Nottingham	UK (from August 2004) Inpharmatica Ltd, London	UK Paradigm Therapeutics Ltd, Cambridge	UK Phoqus Group Ltd, West Malling	UK (from November 2004) ProImmune Ltd, Oxford	UK Amedis Ltd, Cambridge	UK (until December 2004) **Member of the Supervisory Board:** Ionix Pharmaceuticals Ltd, Cambridge	UK
Michael Redmond Business Executive Bury St Edmunds	UK	**Member of the Supervisory Board** (until 30 September 2004)	**Chairman of the Supervisory Board:** Arakis Ltd, Cambridge	UK Dechra Pharmaceuticals plc, Stoke-on-Trent	UK Microscience Ltd, Reading	UK Synexus Ltd, Chorley	UK **Member of the Supervisory Board:** Atugen AG, Berlin	D (until February 2004) Strakan Group Ltd, Galashiels	UK (until July 2004)
Mary Tanner Financial Advisor New York, NY	USA	**Member of the Supervisory Board** (from 19 January 2005)	**Member of the Supervisory Board:** Ariad Pharmaceuticals, Inc, Cambridge	USA HaptoGuard, Inc., Fort Lee	USA

Management Board

Joern Aldag Business Executive Hamburg	D	**President & Chief Executive Officer**	**Member of the Supervisory Board:** ENS Holdings, Inc., Wilmington	USA (from December 2004, chairman from March 2004 until December 2004) **Member of the Monopolkommission der Bundesrepublik Deutschland**
Dr Dirk H Ehlers Physicist Wohltorf	D	**Chief Financial Officer**	**Chairman of the Supervisory Board:** ENS Holdings, Inc., Wilmington	USA (from January 2004 until March 2004)
Prof Dr Ian M Hunneyball Biochemist Abingdon, Oxfordshire	UK	**Chief Scientific Officer** (from 1 July 2004) **President, Discovery Programs Division** (from 1 March 2004) **President, Services Division** (until 29 February 2004)		
Dr Timm-H Jessen Chemist Fleckeby	D	**Chief Scientific Officer** (until 30 June 2004) **President, Discovery Programs Division** (until 29 February 2004)	**Member of the Supervisory Board:** ascenion GmbH, Munich	D
Bernard Questier Chemist Hamburg	D	**Chief Business Officer** (until 31 August 2004)		

Financial calendar and imprint

Evotec OAI's financial calendar

22 March 2005	Annual report 2004
10 May 2005	First quarter report 2005
07 June 2005	Annual general meeting
11 August 2005	Second quarter report 2005
09 November 2005	Third quarter report 2005

Imprint

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This annual report is also available in German.

Key figures

Evotec OAI AG

		2000	2001	2002	2003	2004	Δ 04 | 03 in %
Results							
Revenue	T€	28,276	63,225	69,995	77,228	72,730	(5.8)
R&D expenses	T€	18,480	23,012	23,012	15,466	13,772	(11.0)
Operating loss	T€	48,926	152,469	135,512	15,777	91,248	478.4
Operating loss[1]	T€	14,291	12,294	14,105	5,106	11,759	130.3
Net loss	T€	47,074	147,750	131,630	14,242	84,203	491.2
Net loss[1]	T€	12,493	7,575	10,223	3,571	4,714	32.0
EBITDA	T€	(9,459)	(1,011)	(2,221)	4,086	(3,246)	(179.4)
Cash flow	T€	(24,760)	(12,733)	5,313	(1,333)	(3,624)	(171.9)
Balance sheet data							
Subscribed capital[2]	T€	35,452	35,507	35,510	35,510	38,010	7.0
Number of shares[2]	T	35,452	35,507	35,510	35,510	38,010	7.0
Stockholders' equity	T€	502,495	347,591	195,407	172,101	102,010	(40.7)
Equity ratio	%	94.33	88.08	81.07	77.9	73.6	–
Investments[3]	T€	493,757	36,908	9,284	17,027	9,060	(46.8)
– Intangible assets	T€	433,819	20,246	28	1,689	274	(83.8)
– Tangible fixed assets	T€	56,626	16,652	8,634	13,613	2,532	(81.4)
– Financial assets	T€	3,312	10	622	1,725	6,254	262.6
Cash including marketable securities	T€	48,924	27,833	21,308	19,471	15,277	(21.5)
Balance sheet total	T€	532,706	394,617	241,042	220,919	138,534	(37.3)
Personnel data							
Employees as of 31 December		505	585	635	644	646	0.3
Total corporate personnel expenditures	T€	17,997	31,917	35,768	36,364	37,365	2.8
Revenue per employee	T€	56	108	110	120	113	(5.8)
Per share							
Result	€	(1.75)	(4.17)	(3.71)	(0.40)	(2.30)	(475.0)
Dividends	€	–	–	–	–	–	–
ISIN						DE 000 566 480 9	
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

Evotec OAI worldwide[1)]

Evotec OAI group

Evotec OAI

Operations

Evotec OAI AG
Hamburg | D

Evotec OAI Ltd
Abingdon | UK

ProPharma Ltd
Glasgow | UK

Sales representations

Evotec OAI, Inc.[2)]
North Potomac, MD | USA
San Jose, CA | USA
Winchester, MA | USA

Summit Pharmaceuticals
International Corporation
Tokyo | J

Evotec Technologies

Operations

Evotec Technologies GmbH
Hamburg | D

Evotec Technologies GmbH
Duesseldorf | D

Evotec Technologies GmbH
Tallinn | EST

Sales representations

Evotec Technologies, Inc.
Woburn, MA | USA

Quantum Design Japan, Inc.
Tokyo | J
(Cytocon™, Cytoman™ and Elektra™)

Bio-Medical Science Co Ltd
Seoul | ROK
(Opera™)

Evotec Neurosciences

Operations

Evotec Neurosciences GmbH
Hamburg | D

Evotec Neurosciences AG
Zurich | CH

U.S. Holdings

ENS Holdings, Inc.
Wilmington, DE | USA

[1)] Including sales representations
[2)] Which does business in California as Delaware Evotec OAI, Inc.

Glossary

Adherent cellular assay. Assay on cell cultures that are growing adherently on a surface.

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.

Agonist. Drug that binds a cellular → receptor which is ordinarily stimulated by naturally occurring substances, triggering a response.

Antagonist. Drug that binds a cellular → receptor thereby inhibiting the natural function of the receptor.

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

Biochemical assay|screening. → Assay|→ screen run on → targets previously purified from cells.

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

Cell line. Cells with an unlimited replication capacity, which maintain specific and useful characteristics identical between the parent and the daughter cells.

Cellular assay|screening. → Assay|→ screen performed using whole living cells.

Clinical development|trial. Drug research studies that involve patients or healthy volunteers.

Computational chemistry. Discipline of using computational methods to calculate properties of chemical compounds and their interaction with biological → targets (e.g. proteins).

Co-crystallisation. The crystallisation of a protein in the presence of a known ligand in order to obtain crystals of a protein ligand complex suitable for structure determination by → X-ray crystallography.

***ex vivo*.** A process that usually takes place in the body that is artificially performed outside of the body.

Development candidate. The molecule identified by the process of → medicinal chemistry optimisation to be a suitable candidate for development as a potential pharmaceutical entity.

FDA. Food and **D**rug **A**dministration, American authority for drug approval.

Formulation. The formulation by which a drug is delivered → *in vivo* can have a profound effect on its bioavailability. Therefore it is necessary to develop the optimal formulation: this will involve the selection of the dosage form (e.g. soft gel capsule or tablet), choice of excipients and studies on the chemical stability of the formulated drug.

GLP. The principles of **G**ood **L**aboratory **P**ractice 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.

GMP or cGMP. Current **G**ood **M**anufacturing **P**ractise is that part of quality assurance which ensures that medicinal products are constantly produced and controlled to the quality standards appropriate to their intended use and as required by the marketing authorisation (MA) or product specification. GMP is concerned with both production and quality control. Any active pharmaceutical ingredient (API) synthesised by Evotec OAI and destined for human use will need to be made to GMP standards. This is regulated by the → FDA in the US and the European Commission|MCA and other competent authorities in Europe.

G-Protein Coupled Receptors (GPCRs). 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.

Hedgehog. Signalling molecule for the normal development of skin, muscles, bones and other organs which binds to a → receptor called Patched. Defects in the gene for Patched result in skin cancer, e.g. in basal cell carcinoma.

hERG. A potassium channel that plays an important role in the control of the human heart beat. Drug molecules that interact with the hERG channel can cause cardiotoxicity problems and a significant number of development projects have been terminated because of this effect. Drug candidates in nearly all → pharmacological areas are tested for their effect on this → target before → clinical development is carried out.

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

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

***in vitro*.** In a test tube.

***in vivo*.** In the living cell or organism as opposed to *in vitro*.

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

Kinetic study. Study of the change of a property over time to determine the rate of change. This could be a reaction rate for a chemical process or the metabolic rate for a drug candidate.

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 "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.

Membrane. Covering or skin for cells, tissues or organs within the body.

Parenteral. Formulation of a drug substance such that it is suitable for administration by injection or intravenous infusion.

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.

Phase II. Controlled → clinical trial of a drug or vaccine to identify common short-term side effects and risks associated with the drug or vaccine, to collect information on its immunogenicity and to demonstrate its efficacy conducted on a limited number of patients with disease.

Phase III. → Clinical trial involving a larger number of patients, designed to assess safety, effectiveness and optimum dosage of a drug as administered in a treatment setting usually including several hundred or several thousand volunteers.

Pharmacokinetics. Movements of drugs within biological systems, as affected by absorption, distribution, metabolism, excretion (→ ADME).

Pharmacology. The science concerned with drugs, their sources, appearance, chemistry, actions and uses.

Phenotype first genetic approach. Identification of gene functions resulting from the phenotype of a cell or organism.

Physiology. Science of living organisms and their parts.

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.

Pre-clinical discovery. 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 → clinical trials.

Protein engineering. A technique for isolating and studying proteins and creating tailor-made ones by altering the genes that code for them.

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.

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

Screening library. Collection of a multitude of different molecules, used for → screening.

Signalling pathway. When cells respond to external stimuli such as natural hormones and environmental conditions they do so by a cascade of biochemical events within each cell termed the signal transduction pathway.

siRNA (**si**lencing **RNA**). Short double-stranded RNA molecules, which applied to cells, can specifically block gene expression.

Stem cell. A cell that can replicate indefinitely and which can differentiate into all other cell types; stem cells serve as a continuous source of cells for analysis and → screening.

Structure-based drug design. A drug design strategy based on the 3D structure of the → target obtained by → X-ray or NMR (**N**uclear **M**agnetic **R**esonance).

Structural biology. The structural determination and analysis of living material that leads to an understanding of biological function in terms of 3D molecular structure.

Systems biology. The study of whole biological systems within a cell, an organ or an organism with particular emphasis on → signalling pathways and their network.

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.

Type II diabetes. Usually is late-onset and develops gradually. It is diagnosed through a pathologically high blood glucose level and caused by defects of insulin release and sensitivity. Typically it is secondary to obesity.

Ultra-high-throughput screening (uHTS). Technique of rapidly searching for molecules with desired biological effects from very large → screening 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*.

X-ray crystallography. The determination of 3D structure of molecules from the diffraction pattern obtained upon irradiation of a crystalline form of the substance being studied by X-ray radiation.

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