EVOTEC BioSystems AG

Annual Report 1999

evotec

EVOTEC		1997	1998	1999	TEUR	Δ98/99 in %
Operational results						
Revenue	TDM	13,810	14,294	19,140	9,786	33.90
R&D expense	TDM	11,401	16,200	25,426	13,000	56.95
Operating loss	TDM	2,152	11,873	19,859	10,154	67.26
Net loss	TDM	2,675	10,932	18,545	9,482	69.64
Cash flow	TDM	553	25,182	81,262	41,549	222.70
Balance sheet data						
Subscribed capital	TDM	9,779	13,882	23,622	12,078	70.16
Number of shares*	Mio.	5,000	7,098	12,078		70.16
Shareholders' equity	TDM	(13,129)	27,047	117,936	60,299	336.04
Equity ratio	%	–	51.98	81.70	–	–
Investments	TDM	2,770	9,524	9,895	5,059	3.90
– Intangible assets	TDM	100	382	659	337	72.51
– Tangible fixed assets	TDM	2,648	9,121	9,222	4,715	1.11
– Financial assets	TDM	22	21	14	7	(33.33)
Cash	TDM	5,993	31,175	112,437	57,488	260.66
Balance sheet total	TDM	10,454	52,034	144,352	73,806	177.42
Personnel data						
Employees as of Dec. 31		96	141	228		61.70
Total corporate personnel expenditures	TDM	8,102	13,324	20,573	10,519	54.40
Revenue per employee	TDM	144	101	84	43	(16.83)
Per share						
Result	DM	(0.54)	(1.60)	(2.35)	(1.20)	46.88
Cash flow	DM	0.11	3.69	10.31	5.27	179.40
Dividends	DM	–	–	–	–	–
Securities identification number 566480						

*refers to 1 Euro shares
Deutsche Mark in thousands (TDM)
Euro in thousands (TEUR)

EVOTEC – technologies for efficient preclinical drug discovery

Mar. 2000
EVOTEC enters into drug discovery alliance with SUGEN

Jan. 2000
EVOTEC and Trega form strategic alliance

Dec. 1999
EVOTEC ships EVOscreen® system to Novartis

Dec. 1999
EVOTEC signs drug discovery service agreement with Knoll / BASF Pharma

Dec. 1999
EVOTEC ships nanoliter dispenser unit DINA to SmithKline Beecham

Nov. 1999
EVOTEC IPO

Jun. 1999
EVOTEC enters into drug discovery alliance with U.S. pharmaceutical company Pfizer

May 1999
Qiagen and EVOTEC form joint venture for the development and commercialization of high-throughput systems

Apr. 1999
GPC and EVOTEC enter drug discovery alliance for novel genomics-derived antibacterial targets

Absorption Process of taking in; chemicals can be absorbed into the bloodstream after breathing or swallowing.

ADME/Tox Absorption, distribution, metabolism, excretion and toxicology of a drug.

Alzheimer's disease (AD) Progressive, neurodegenerative disease characterized by loss of function and death of nerve cells in several areas of the brain leading to loss of cognitive function, such as memory and language.

Antibiotics Drugs that fight infection caused by bacteria and other micro-organisms.

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

Biochemical assay Assay run on targets previously purified from cells.

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

Chemoinformatics Computer processing of data relating to chemical molecules and reactions.

Cellular assay Assay performed using whole living cells.

Dispenser Device used to rapidly and precisely distribute very small volumes of liquid samples.

Clinical trials Drug research studies that involve patients.

Combinatorial chemistry Chemical synthesis whereby a very large number of organic compounds are created by putting chemical »building blocks« together in every possible combination.

Confocal optics Lens system using the same optical path for entry and exit light.

Compound Substance made up of two or more elements that cannot be separated.

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

Drug Any chemical compound that may be used on humans to help in diagnosis, treatment, cure, mitigation, or prevention of disease or other abnormal conditions.

Enzyme Protein that acts as a catalyst, affecting the rate at which chemical reactions occur in cells.

Fluorescence Process whereby colors (dyes) absorb radiant energy at one wavelength and immediately emit it at a longer wavelength.

Fluorescent dye Dye molecule that emits fluorescence light upon excitation from a light source.

Gene Unit of inheritance; a working subunit of DNA containing the code for a specific product, typically a protein, such as an enzyme.

Genome All the genetic material contained in the chromosomes of a particular organism.

Genome project Research and technology development efforts aimed at mapping and sequencing some or all of the genome of human beings and other organisms.

High-throughput screening (HTS) Technique of rapidly searching for molecules with desired biological effects from very large compound libraries.

Hit (compound) Compound found by screening to have a desired biological effect.

Human Genome Project International research effort aimed at mapping and sequencing all of the genome of the human species.

Ion channel Receptor which, when activated, allows the passage of ions across cell membranes.

Lead (compound) Substance that is chosen for experimental evaluation on the basis of its predicted qualities and its likelihood of becoming a drug.

Metabolism All the chemical reactions in an organism that enable the organism to live.

Microliter One millionth liter (10^{-6} l)

Nanoliter One billionth liter (10^{-9} l)

Nucleic acid Large linear molecule composed of subunits. Chemically, genes consist of nucleic acids.

On-bead screening Screening of compounds bound to the surface of tiny polymer beads. Beads facilitate solid phase synthesis and handling of compounds.

Orphan target screening Screening against targets of (still) unknown function.

Phosphatases Enzymes that remove phosphate residues from proteins.

Photons Light particles. A quantum of electromagnetic radiation.

Preclinical phase The phase of drug discovery research extending from target identification, the search for chemical compounds with desired properties, through to the end of efficacy studies in animal models.

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

Reagent Any chemical used in a laboratory test or experiment.

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 a compound libraries using an established assay format.

Symptom Recognizable sign, pattern or malformation characterizing a particular disease.

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 identification Identification of a biomolecule which is essential for a particular disease process (though not necessarily directly involved) with the intent of eliciting a therapeutic effect by regulating the biomolecule's action.

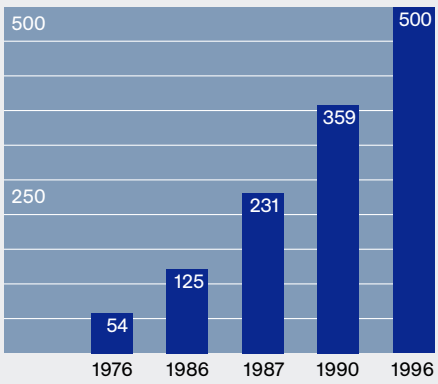
Target validation A key part of drug discovery research: verification of the action of a target on the course of a specific illness; validated targets are preferentially screened.

Toxicology Scientific discipline concerned with understanding the mechanisms by which chemicals produce noxious effects on living tissues or organisms.

Pharmaceutical research at a crossroads

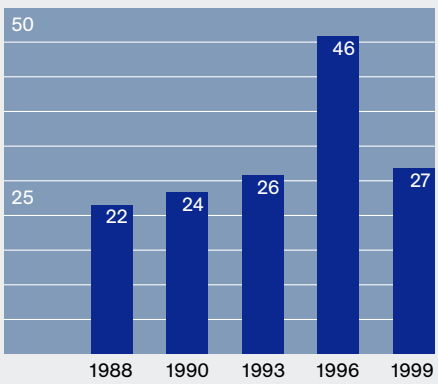
Only one third of all known diseases can be cured with drugs at the present time. The ratio of green dots to blue dots on the right hand side helps to visualize the acute need for new medications – and therefore also highlights the range of new opportunities open to biotechnology in the decades to come.

Costs for the development of a new drug (cumulative in USD million)



Source: J. Drews, S. Ryser, Nature Biotechnology. Volume 15, December 1997

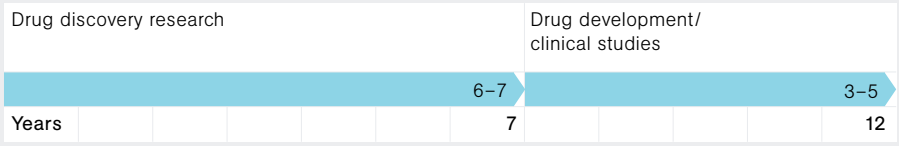
Number of new molecular entities, licences granted by the FDA per year



Source: Lehman Brothers Pharmaceutical Research, U.S. Food and Drug Administration

Times are changing. At the beginning of the new millennium, the pharmaceutical industry faces great challenges. The background against which new drugs are developed has drastically changed in recent decades. Demands for a better quality of life and the shifting age distribution of the population, due to increased life expectancy, are leading to increased expenditures on healthcare. The authorities concerned have tried to counter this trend during the nineties with measures to reduce costs, resulting in considerable reductions in the formerly lucrative margins on drug sales. In addition, the revenues of pharmaceutical companies are being jeopardized by the expiration of numerous patents on profitable blockbuster products. On the other hand, higher development costs and strict regulations imposed by the licensing authorities have inevitably caused expenditures on research to rise. The cost of an average ten year development period for a new marketable drug has risen from about U.S. dollar 50 million in the seventies to about U.S. dollar 500 million today. Assuming an annual inflation rate of 5 %, this means that research and development costs have increased four-fold in this period. On the other hand, the licensing rate of new drugs has fallen in proportion to the rise in research costs, with the result that the sector's profitability has dramatically decreased. Today, the twenty major pharmaceutical companies each bring, on average, less than one new drug onto the market per year. In order to maintain the currently forecast growth rates of an average of 7 % per year in the future, this innovation gap must be closed. Three to five new drugs should successfully leave a pharmaceutical company's development pipeline every year. The marked trend toward mergers among pharmaceutical companies, ostensibly to reduce costs and increase market share through strength in sales and marketing, can nevertheless be only a partial answer to the enormous challenges facing the industry. New ways of increasing productivity in research and development must be found.

The process of drug development

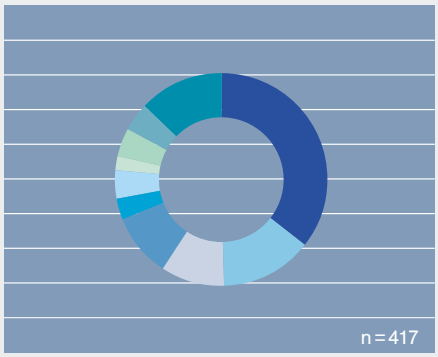


The trend towards outsourcing. The pharmaceutical industry has recognized that its internal organizational structure cannot adapt quickly enough to the changed situation. Increasingly, pharmaceutical companies hope to achieve greater profitability through strategic use of services outside the company. Since the beginning of the nineties, complex clinical studies have largely been carried out by CROs (Contract Research Organizations). Pharmaceutical companies can then target their use of specialist expertise and can structure costs more flexibly. This trend towards outsourcing is also apparent in drug discovery research, although this development is still in the early stages.

The end of the »me-too« era. In the past, the pharmaceutical industry could also achieve profits with products which were only slightly innovative. Although new therapeutic advances were seen in the eighties in the form of some block-buster products, a considerable proportion of growth in the sector resulted from so-called »me-too« products. These drugs are based on chemical structures which differ only slightly from products already on the market. The pharmaceutical effectiveness of the class of substances has already been demonstrated, and the risk that the product will fail to be licensed is thus much lower than with entirely new products. Even the fourth, fifth or sixth variation of a chemical structure could still achieve excellent margins. Under these circumstances, the pharmaceutical companies became less and less willing to take risks. This is the reason why, for example, there are currently more than 15 ACE-inhibitors for the treatment of high blood pressure on the market world-wide, differing only slightly in aspects such as dosage frequency or the nature of their side effects. More difficult and risky areas of research, such as cancer and diseases of the central nervous system, on the other hand, have been somewhat neglected. The measures taken to control costs during the nineties have put an end to this »me-too« development. Margins on »me-too« products have continually decreased and the industry has found itself having to face the necessity of opting for innovative drugs with stable profit margins in order to be able to maintain their growth rates.

The patient is waiting. This development has positive consequences for the population, since it is in health matters that innovation is of the greatest importance. For two thirds of the 30,000 diseases known today there is currently no medical cure, or at best there are only drugs for purely symptomatic treatment. These include asthma, Alzheimer's disease, arthritis, osteoporosis and many life-threatening diseases such as arteriosclerosis, stroke, AIDS and cancer. The development of substances which can treat the causes of these diseases has absolute priority.

Targets for drug therapy

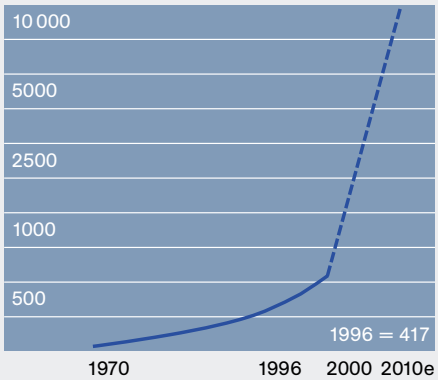


- Synaptic & neuroeffector junctional sites & CNS 33 %
- Hormone and hormone antagonists 13 %
- Neoplastic diseases 9 %
- Blood and blood formation 9 %
- Vitamins 3 %
- Immunomodulation 4 %
- Uterine motility 2 %
- Gastrointestinal functional 4 %
- Renal and cardiovascular function 4 %
- Inflammation 12 %

Source: J. Drews; Nature Biotechnology, Volume 14; November 1996

Targets: The site of action. Parallel to the increasing pressure for innovation in the pharmaceutical industry, biotechnology has opened up new fields of knowledge and has developed technologies which can make a contribution to narrowing the innovation gap. Of great significance is the area of genome research (genomics), i.e. the decoding of human genes and using this knowledge to identify and validate targets. Targets are biological structures in the human body which play an important role in the origin or the development of disease. The number of known targets involved in drug therapy was about 420 in 1996; today we believe about 500 targets are involved. These include receptors, enzymes, ion channels and other structures on which drugs presently on the market have a direct remedial or alleviating effect.
Modern biotechnology plays a decisive role in understanding disease processes in the body, and provides the basis for the development of new treatments. Traditional methods of identifying and developing drugs were purely empirical, with new substances being produced using chemical or pharmacological techniques without having any clear picture of the mechanism of the disease. The Human Genome Project, initiated in 1990, represents an entirely new approach. The goal of this project is to elucidate the structure of all human genes and thus also to gain a deeper insight into the origin of disease. Some experts consider that this project, which is forecast to be completed in 2003, promises the identification of 3,000 to 10,000 new targets as possible points of action for innovative drugs – a unique opportunity for the pharmaceutical industry to raise its output of new medications to the level required by commercial considerations.

Development of target identification (Number of targets)



Source: J. Drews; Nature Biotechnology Volume 14; November 1996

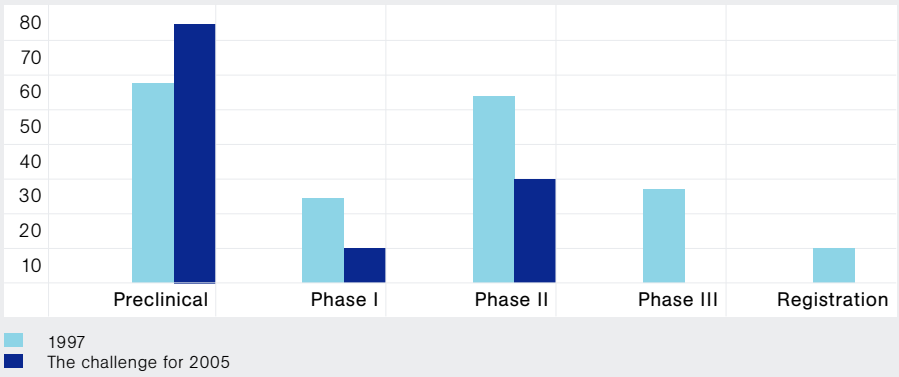
Millions of substances. There will be no lack of new targets in the future. But what about the chemical substances which are supposed to work on these targets in order to achieve the desired pharmacological effect? Using traditional methods, a chemist was in the past able to synthesize a maximum of a few hundred substances per year. Using such methods, pharmaceutical companies required years to build up their compound libraries. Using the methods of combinatorial chemistry, by which chemical building blocks can be assembled in myriad combinations, collections of several hundred thousand compounds can now be produced in a few weeks.

To date, approximately 300,000 of EVOTEC's own substances have been stored in microtiter plates in EVOTEC's cold storage facility.

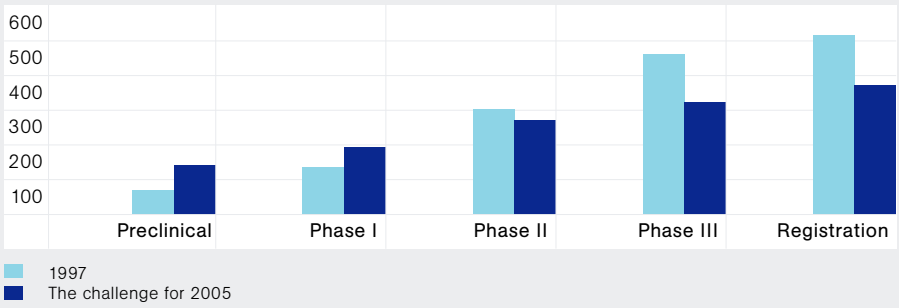
There are now millions of substances available to scientists for the screening of their new and validated targets. The production of chemical test substances is therefore no longer the limiting and time-determining factor in the search for new drugs. It will now be the throughput and quality of screening processes that will have to meet the demands of the expected quantity of targets and the substantially increased range of substance libraries.

The preclinical bottleneck. The development briefly described here opens up almost limitless opportunities for the pharmaceutical companies to identify drugs for previously incurable diseases. However, drug discovery remains an expensive and laborious procedure with a large part of the costs spent on substances which fail before they reach the market. Products often fail at a late stage of the development process because their therapeutic effect is inadequate or because there are unexpected side effects. For this reason, a purely quantitative solution with an ever increasing number of molecular candidates will not by itself remove the productivity bottleneck which characterizes the pharmaceutical industry. It will be necessary to identify these »false positive« substances at an early stage and, conversely, to develop highly promising substances more quickly and less expensively than has previously been the case.

Failure rate of drug candidates at various stages of development (in %)



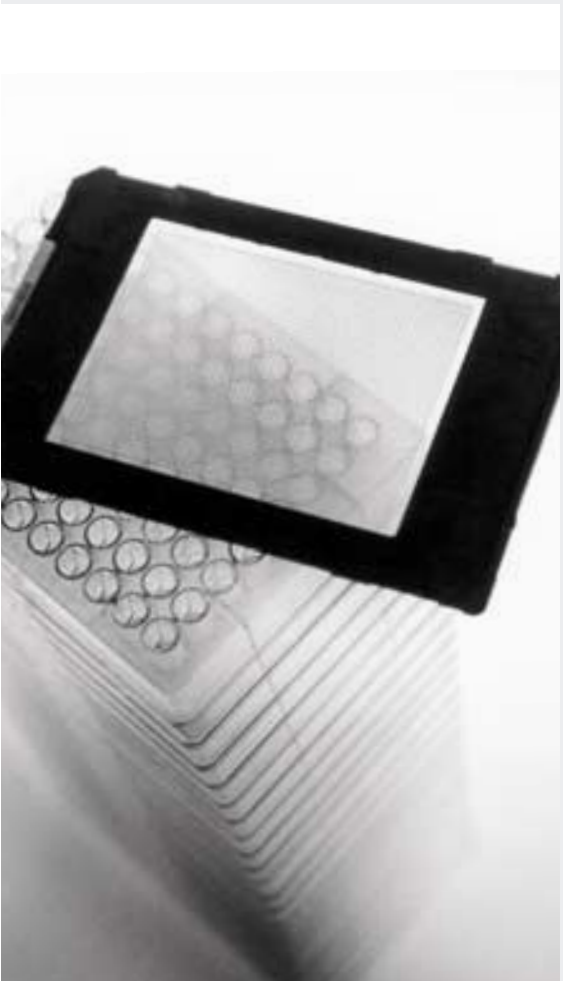
Cumulative research and development costs (in USD million)



Source: The Company's assumptions; PricewaterhouseCoopers, Pharma 2005, 1998

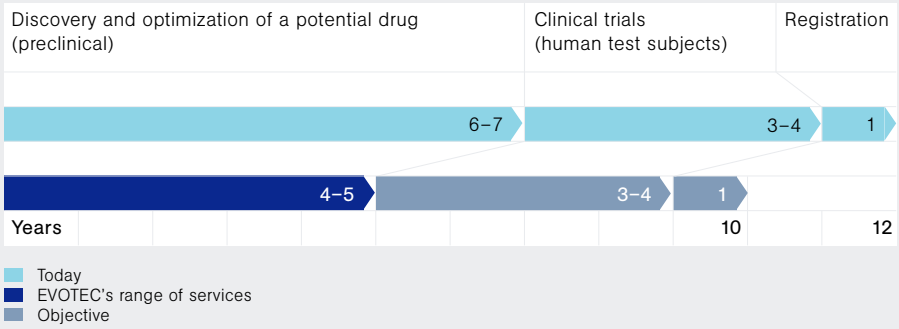
Keep the good ones. The cost of research and development for new drugs is unevenly distributed over the numerous stages of the process. Although the costs for the preclinical phase do not normally exceed U.S. dollar 50 million, costs for clinical development and the statutory registration procedure can cumulatively amount to an average of U.S. dollar 500 million for each new marketable drug. Thus it is of paramount importance for the pharmaceutical industry to lower the number of candidates which subsequently prove to be unsuitable by eliminating these before the start of clinical trials. On the other hand, the number of substances which, in spite of their good characteristics as drugs, are not detected using traditional screening methods (so-called »false negatives«) must be reduced as much as possible. One method of minimizing the failure rate is to collect more data in the early stages of the drug discovery process in order to gain as much information as possible on the characteristics of a substance at this early stage. Conventional detection methods are normally only suitable for measuring a single parameter. There is a great demand for screening systems in which multiple parameters can be measured to rapidly evaluate the interaction of chemical substances and targets. In this manner, those substances which are only apparently positive or negative can be eliminated at an early stage of the drug discovery process, which leads to a considerable reduction in cost.

A single EVOTEC Nanocarrier™ contains as many test wells as 21 conventional microtiter plates.



Less is more. The probability of identifying substances which appear promising for pharmaceutical development can only be increased if the actual procedures are quicker and more efficient. A basic prerequisite for this is the reduction of the quantities used in screening. Most systems for drug discovery work use sample carriers of 96 or 384 test wells containing a sample volume of 50 to 200 microliters (microtiter plates). Today's advanced screening systems provide reliable data from 10 to 100 microliter sample volume. Although the length of time for measurement does not normally represent a limiting factor in screening, the time required to fill the microtiter plates with reagents, automatically transport the plates to the detection unit, adjust the detection equipment and remove the microtiter plates from the detection unit can add up to a significant amount of time. Automated high-throughput screening has increasingly become the norm, although the consumption of targets and reagents has at the same time become a considerable cost factor. Greater efficiency can only be achieved if the proportion of sample wells per plate is significantly increased and the amount of substance per well is reduced, so that more than 96 or 384 substances can be processed per plate. It is very often the case that a screen comprising more than 100,000 substances requires the additional use of large-scale fermenters for the preparation of sufficient quantities of biological material. The use of smaller test volumes is therefore one of the most obvious ways to reduce the cost of screening. Although the advantages of miniaturization are obvious, most screening systems cannot operate with small assay volumes. The detection technology of these systems cannot pick up the weaker signals produced by smaller volumes. In addition, many manufacturers do not have the appropriate technology for handling very small quantities of liquids, which is necessary in order to cope with nanoliter quantities, and to deal with evaporation and physical problems arising from a greater surface-to-volume ratio.

Saving time with modern methods of drug discovery



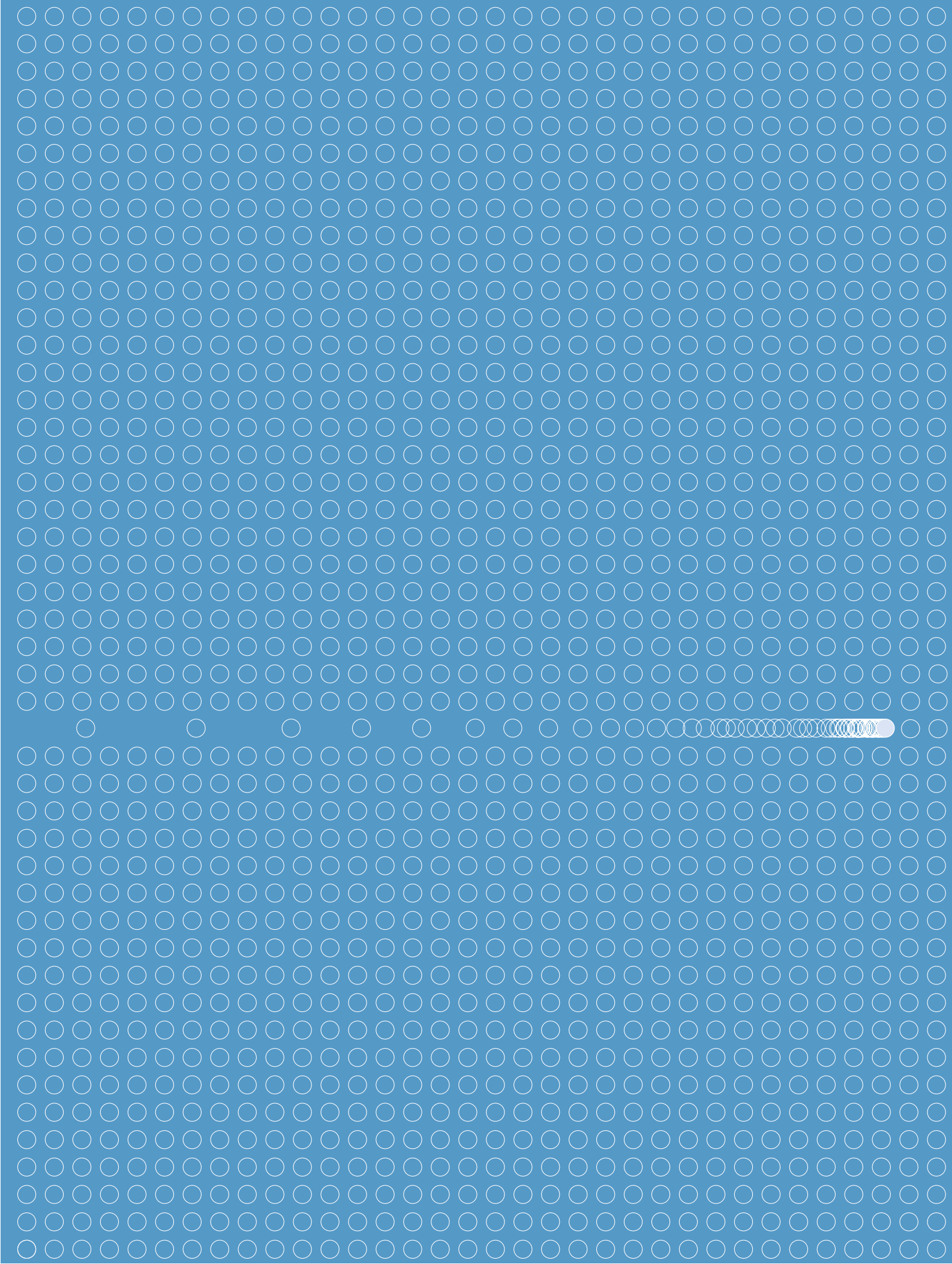
Source: The Company's estimates

Time is money. The rapid evaluation of multiple parameters describing the interaction of chemical substances and targets on the one hand, together with increased throughput and miniaturized test volumes on the other, make a key contribution to accelerating the identification of new drugs. Experts believe that with the use of new technologies, the development time for a potential drug before the start of clinical trials will almost halve in the next two to three years. Any time saving in the over-all process of drug development automatically extends the duration of the exclusive marketing period before the expiry of patent protection, and means a considerable increase in profit for the pharmaceutical company. This can mean billions of dollars in additional profit for a blockbuster drug. In the situation described here, EVOTEC can make a significant contribution as a partner to the pharmaceutical industry in increasing efficiency of drug discovery thanks to its technological innovations and its specialized expertise.

In the following sections we will give you information on our basic strategy, the steps we have already undertaken as a partner to the pharmaceutical and biotechnology industries, and our future projects. We will present our staff, our collaborative scientific ventures and our extensive patent portfolio – and of course also the results of the 1999 fiscal year, with one of the highlights being our initial public offering in November.

EVOTEC – a key role

Acceleration is the key objective in drug discovery. New technologies not only make it possible for the number of substances tested to be substantially increased, but also enable the quantities required to be dramatically reduced leading to a significant improvement in results through the exclusion of so-called »false positive« results. This all leads to a shortening of the preclinical drug discovery phase resulting in a new dynamic in the pharmaceutical industry – EVOTEC is energetically driving this development forward.

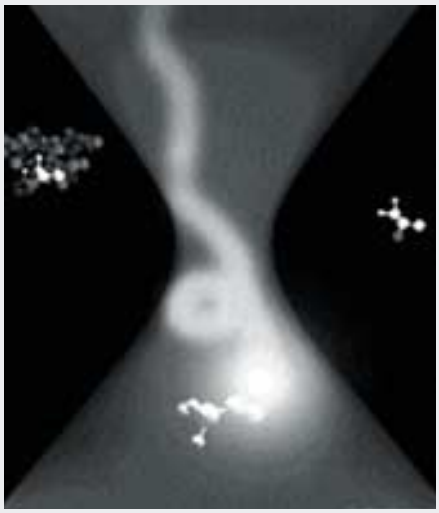


Karsten Henco

Dear Shareholders and business partners,

During the eighties and early nineties, Nobel prize-winner Professor Manfred Eigen and his colleagues at the Max Planck Institute for Biophysical Chemistry in Göttingen developed new methods for improving biomolecules. Using combinatorial methods to produce billions of variants of naturally-occuring molecules, their aim was to pinpoint those variants which demonstrated improved efficacy characteristics. The team developed a new procedure for measuring the interaction of individual biomolecules – a technology which would soon prove to be of inestimable significance for the discovery of new pharmacological agents. With the rapidly increasing and now astronomic number of chemical combinations available, and the similarly increasing quantity of new targets, pharmaceutical companies have critical need for efficient test systems which can identify potential drugs more reliably, more quickly and more cost-efficiently. The decision to place this technology at the service of pharmaceutical research and to exploit it commercially led to the foundation of a new biotechnology enterprise in December 1993: EVOTEC BioSystems.

Zeroing in on the molecule. Together with our state-of-the-art knowledge in the fields of molecular biology and biochemistry, the single molecule measurement method known as FCS – »Fluorescence Correlation Spectroscopy« – today represents an established cornerstone of EVOTEC's drug discovery research. A laser beam is concentrated on a very small focal point using a special confocal lens. The relationship of the volume of this focal point to the actual liquid sample, which itself is only the size of a pinhead, is equivalent to that of a thimble to a large swimming pool. The focal point is so small that it only accommodates a very small number of molecules. The biological substances, marked with a fluorescent dye, show up brightly at the focal point of the laser. Their light – individual photons – is picked up by a highly sensitive detector as a function of time. As soon as a labeled substance binds to a



Green laser light is focused on a detection volume of only 1 femtoliter used to measure the behavior of individual molecules.

biological target, the optical characteristics change as a result of the interaction. The downstream computer system precisely evaluates the measured changes and provides scientists with important pharmaceutical and biophysical data on the test substances in the form of a database.

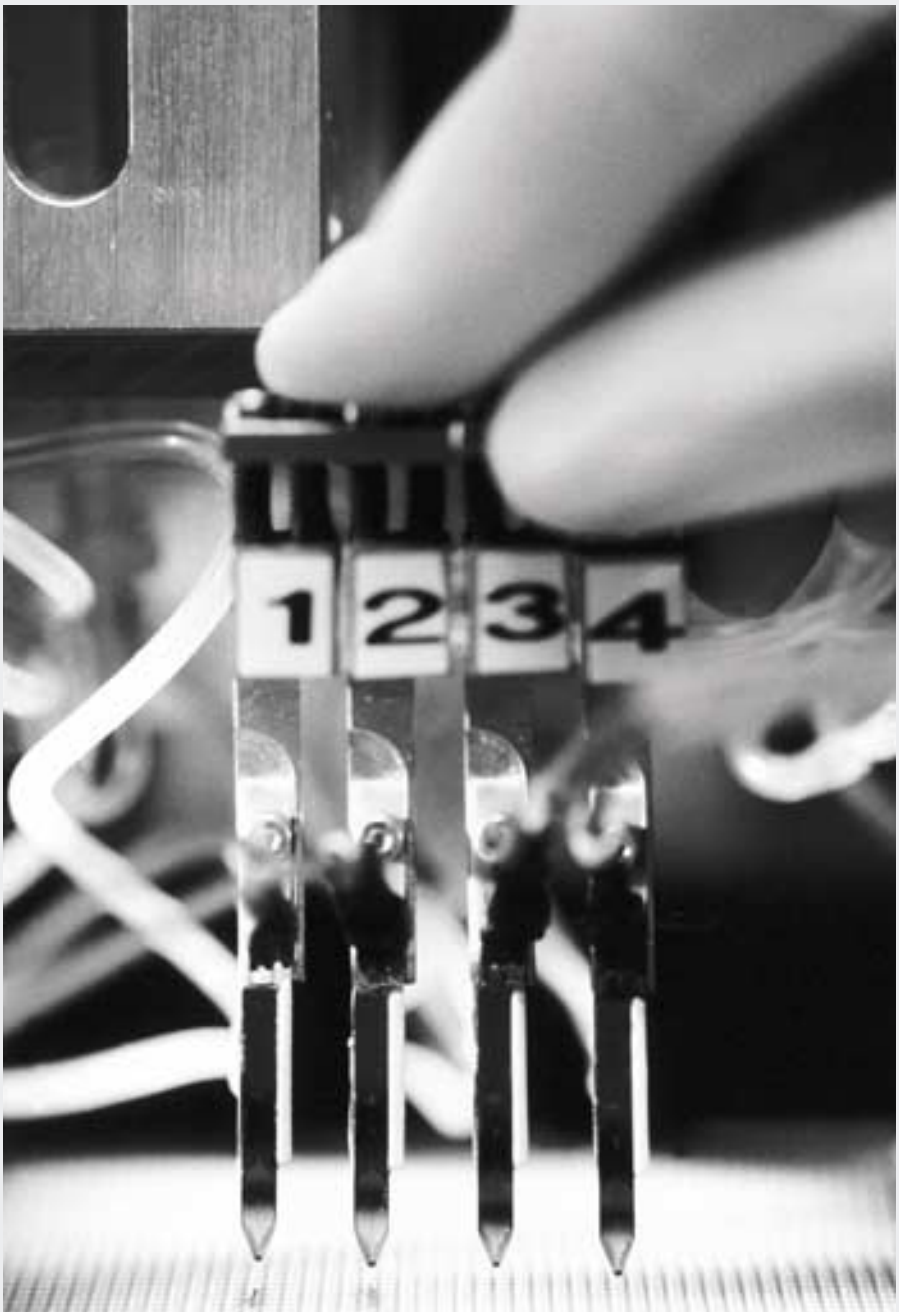
Together with new biological, chemical and computing techniques, we protected our single molecule measurement method, FCS, by a series of patents. FCS is at the core of EVOscreen®, the EVOTEC technology platform for drug discovery research. Our biologists, chemists, physicists, engineers and IT experts have developed a powerful set of tools for the precise measurement of the interaction of individual molecules in the highly demanding environment of high-throughput screening. This toolbox is applicable to all the reactions which otherwise would have to be analyzed using a wide variety of traditional methods – with one significant difference: EVOTEC uses one and the same platform with which all types of reaction can be evaluated, to take a single one second measurement per sample. All the information contained in this measurement is then passed to special evaluation programs. Beginning with the detection of an interaction between test substance and biological target, the method provides precise information regarding the use of that substance as a pharmaceutical agent. This results in considerably lower screening costs and greater efficiency, since one single test run already provides more information on the tested substances than traditional methods involving several consecutive stages.

Conquering the nano realm. EVOTEC uses its own sample carrier system instead of those which have been used in screening by the pharmaceutical industry up till now (so-called microtiter plates with 96 or 384 wells). 2080 wells occupy the same area as that occupied by a few hundred in traditional plates. Each well is the size of a pinhead, with a volume of one microliter – less than one hundredth of the volume required in traditional methods. This makes it possible not only to handle and process a significantly greater number of samples at the same time, but also drastically reduces the consumption of often exorbitantly expensive reagents and test substances.

For other optical methods which require the cumulative signal of all molecules present in the sample, miniaturization means a loss of data quality and reliability, and as a consequence there is a natural miniaturization limit which is determined by the minimum signal strength.

EVOTEC has at its disposal the best measurement methods for making reliable and accurate measurements on such small samples. The obstacles presented by miniaturization for dealing with liquid samples and reagents have been overcome by EVOTEC with the development of pipetting and dispensing techniques with which the reagents can be »shot« into each well as thousands of extremely small nano droplets per second – a thimble would contain almost a billion such droplets.

With the help of EVOTEC's liquid handling technology, thousands of tiny nano droplets are shot into every test well each second.



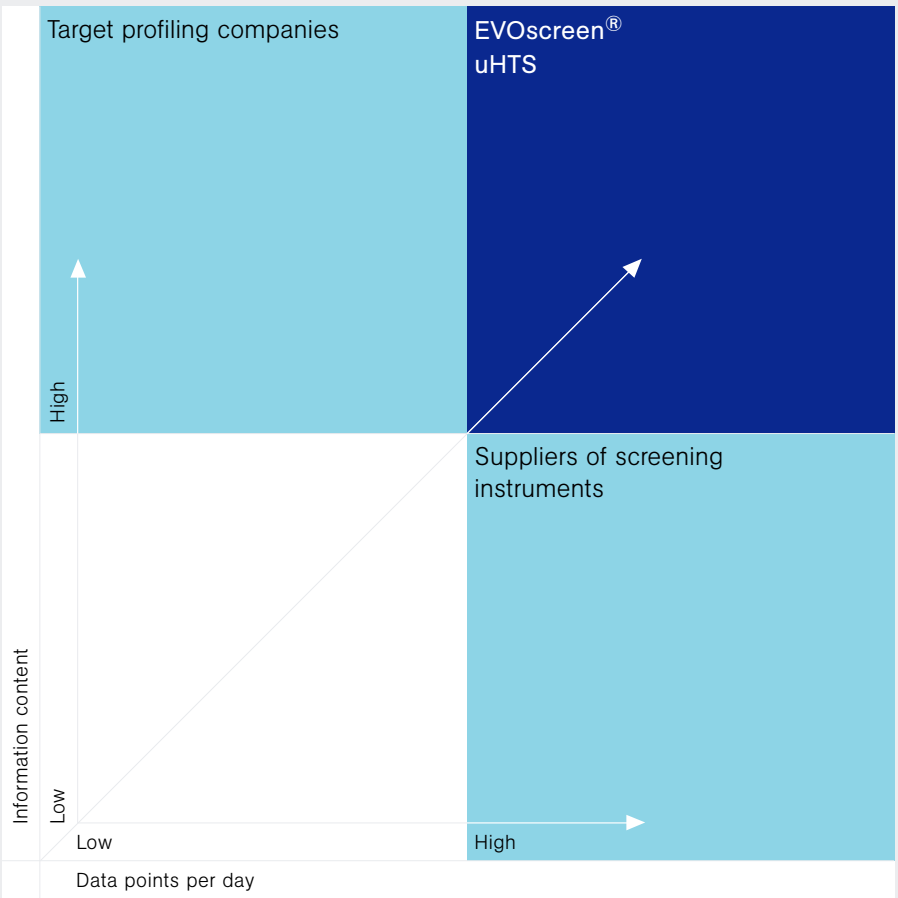
Building blocks for the future. The result of our development program is a new biotechnology which combines state-of-the-art molecular biology and chemistry with our EVOscreen® technology platform, a modular and fully-automated system operating with miniaturized samples at high throughput rates. This combination not only makes a significant contribution to saving time and money – it has also allowed EVOTEC to occupy a key role in drug discovery.

We are supported in this by the extensive expertise which our cellular and molecular biologists, chemists, physicists, engineers and computer specialists have jointly realized in the development of new test systems (assays), in the preparation and execution of highly efficient screening processes and in the competent evaluation and interpretation of the data acquired. Our interdisciplinary teams have already developed a large number of new assays which were previously considered unfeasible and which are already being used in the search for treatments for Alzheimer's disease, cancer and infectious diseases.

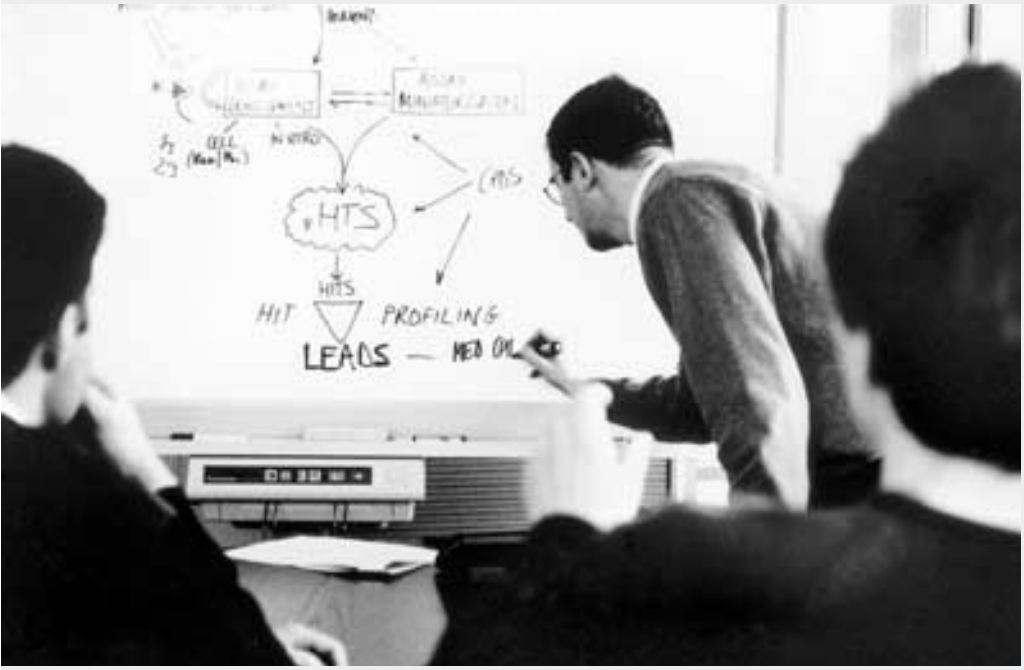
The doors of our laboratories are also open for our collaboration partners. In close collaboration with academic research groups and other biotechnology and pharmaceutical companies in Germany, Europe and overseas, new targets are being discovered, potential pharmacological agents synthesized and new assay strategies tested. Our biologists, for example, work together with researchers from the Munich biotechnology company GPC AG on new antibiotics against resistant bacterial pathogens, while chemists from EVOTEC and the American company Trega Biosciences, Inc., San Diego, jointly evaluate extensive libraries of

chemical substances. All partners profit from this sharing of experience. The expertise of our staff in the life sciences is part of the driving force enabling our technology platform to achieve its full performance potential. We have considerably more than two hundred man years of experience in the field of biological assay development alone, and this clearly sets us apart from manufacturers of automated laboratory equipment for drug discovery research, and makes cooperation with EVOTEC particularly attractive for the pharmaceutical industry, since our business is designed to meet the requirements of pharmaceutical molecular biology.

EVOTEC: competitive advantages



The increase in throughput is an important criterion in increasing the efficiency of drug discovery. It is at least equally as important to increase the amount of information obtained with each measurement, in order to characterize the »hits« found at an early stage and to select those with the highest probability of success. While other companies have focused on one of these two parameters, EVOTEC has combined both criteria and thus occupies a unique position in the field of high-throughput screening.



Dr. Tom Mander, Head of Applied Assay Development, discussing strategy with his staff.

Objectives and strategy

EVOTEC intends to cooperate with its customers from the pharmaceutical and biotechnology industries in the development of new drug products, covering the entire preclinical field (»one stop shop«). The primary aim is to considerably reduce the time to market – possibly by a matter of years. Thanks to our substantial technological development and scientific expertise, we have already made considerable progress in establishing EVOTEC as an integrated drug discovery company covering all stages from target identification to the start of clinical test phases for a new drug. We will constantly expand our wide range of assays for the identification of new targets and profiling of potential drugs and will also offer a growing portfolio of validated drug candidates.
With EVOscreen®, our fully-automated miniaturized technology platform, biological effects can be measured extremely quickly at the level of the individual molecule for large numbers of compounds and therefore extremely economically. The development time for assay systems can be significantly reduced, and material costs minimized by several orders of magnitude. We will thus be able to obtain reliable information on the pharmacological effects of individual natural and synthetic compounds from extremely large substance libraries, and gain valuable information on the characteristics of potential products: data on side effects, extent of absorption through the intestinal wall, distribution in various organs and cell types, metabolism, toxicity and excretion. In this way EVOTEC can create databases containing key information which can form the basis for evaluation of the potential clinical success of a drug candidate at an early stage. This information enables test substances to be better selected before the start of costly studies in animals and humans.

Strategic steps. Up until now, our patented technologies have largely been developed in-house. In the future, we will also be developing technology in partnership with other companies, such as in our collaboration with the American company Trega Biosciences, Inc. for the testing of pharmaceutical characteristics in cellular model systems. EVOTEC will look to third parties to supply important complementary technologies when this is prudent for the sake of efficiency. In order to achieve this, partnerships are planned in the fields of genome research, molecular optimization of potential drug compounds, and chemical information technology. EVOTEC is also supported by an increasing number of important alliances with leading scientific institutions in the field of molecular pathology models, in order to feed highly validated targets into EVOTEC's development pipeline.

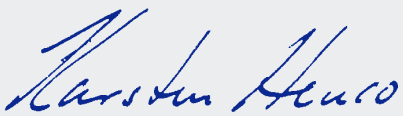
The main factors behind the expansion of our product range is our own constantly expanding portfolio of validated targets, the constantly growing EVOTEC substance library and the development of proprietary assay techniques for pharmacologically important target families. We are therefore increasingly in the position of reaching agreements which include milestone payments and, above all, participation in sales revenue from the subsequent marketing of products co-developed by EVOTEC. We have already reached an agreement of this kind with the American biotechnology company SUGEN, Inc. for cooperation started in 1999. We will also, in selected individual cases where this is considered particularly attractive by our scientific advisory board on the basis of risk / opportunity considerations, undertake the initial development of individual targets ourselves, for subsequent licensing to pharmaceutical companies.

In 2000, our subsidiary EVOTEC Analytical Systems GmbH, Düsseldorf, will continue to develop diagnostic products derived from our core technologies. These projects reflect the ever increasing necessity for diagnostic tools to accompany innovative therapeutic agents and their development. Our business milestones in 2000 are designated as extensive beta-testing of bench-top equipment which has already been designed, development of new proprietary assay systems, and independent financing of the company.

In addition, we will establish an operative base in the U.S. for our EVOscreen® technology in order to be able to participate directly in the largest pharmaceutical market in the world. Cooperation with an American company is planned as part of this important step. EVOTEC already enjoys a good position and reputation in one of the most interesting areas of biotechnology.

I would like to take this opportunity to extend special thanks to our employees for their exceptional commitment, and express my appreciation to our shareholders and partners for the trust they have placed in us.

Dr. Karsten Henco
Chairman of the Management Board



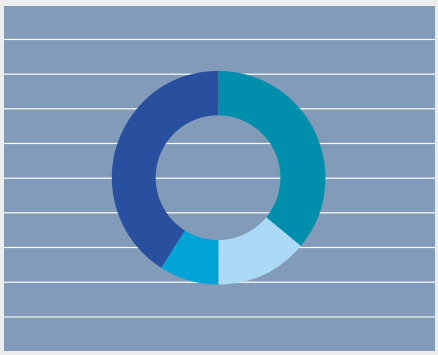
November 10th 1999

EVOTEC's launch on the Neuer Markt of the Frankfurt Stock Exchange was a resounding success. With an issue price of Euro 13.00, EVOTEC shares were placed at the upper end of the bookbuilding range of Euro 11–13 announced on November 2nd. The eagerly awaited first stock exchange quotation was listed at Euro 24.00, signifying a rise of 85 %. The huge demand led to an almost 30-fold oversubscription of the issue. The approximately 4.9 million shares, almost exclusively arising from a capital increase, produced an offer size totaling approximately Euro 64 million. We were particularly pleased with the high quality of the EVOTEC order book: the broad national and international demand from well-known investors interested in long-term investment reflects the attractiveness of our company and forms an ideal platform for further expansion. The allocation of 80 % of the shares to investment funds and the geographical distribution (42 % in Germany, 20 % in the U.S. and 10 % in the UK) together with the free float amounting to about 41 % of the share capital, complete this positive picture. EVOTEC shares closed at Euro 35.25 on December 30th 1999. This represents a rise of 171 % on the issue price and a considerable outperformance of the Neuer Markt. We have good reason to look to the future with confidence: since the middle of 1999, the American biotechnology sector has seen a considerable upturn. Analysts believe that this positive development will continue in 2000, particularly since biotechnology has been undervalued for some time in comparison to the pharmaceutical sector. In addition, the interest of investors is increasingly turning towards smaller companies. While blue chip companies were still favored in the first half of 1999 in the biotechnology sector, by the end of the year some previously unnoticed »pearls« with a market capitalisation of U.S. dollar 100-200 million were discovered. In the fourth quarter alone this segment saw growth of 75 % – promising figures for EVOTEC.

Investor relations. Our principal aims in this field is a policy of transparency and of providing our investors with timely information. Immediately following the IPO, measures were actively implemented for communicating with current and future investors: our Investor Relations department started its work, and in parallel a comprehensive IR site was set up on the corporate web-site. In addition, EVOTEC Biosystems AG made presentations at four well-known international investor conferences for the healthcare sector.

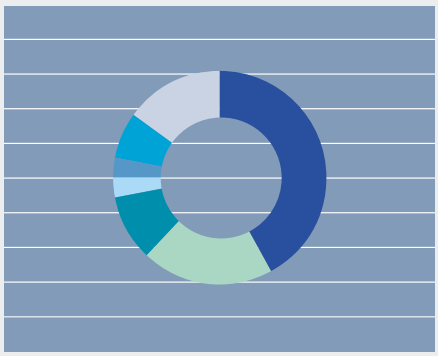
Intensive nurturing of investor relations will also form a focal point in the year 2000. We have set ourselves the goal of inviting about 50 individual investors to one-to-one meetings in Hamburg, and intensifying our research coverage, in addition to holding roadshows in Europe and in the U.S. EVOTEC's five consortium banks have continued with their coverage following the IPO; by the end of 2000, we wish to add at least another five leading German and international analysts.

Shareholder structure
Categories



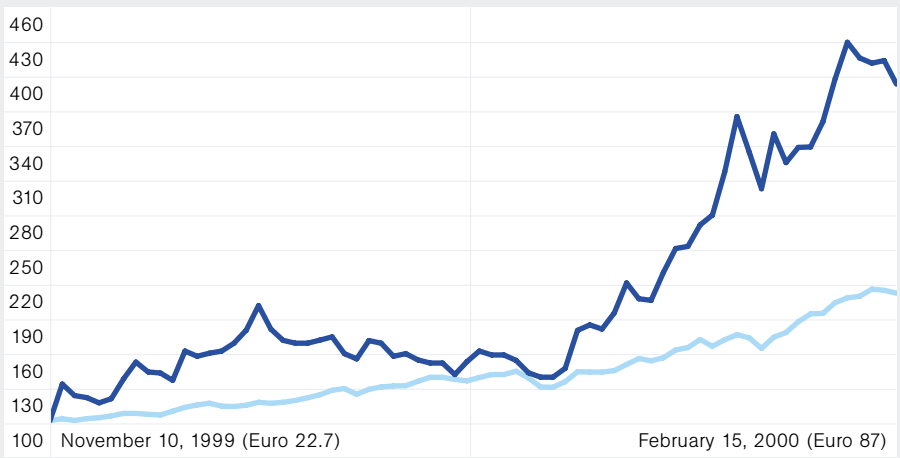
Private investors 36 %
Institutional investors 14 %
Management 9 %
Free float 41 %

Shareholder structure at the time of the IPO
Allocation of the free float by country



Germany 42 %
US 20 %
UK 10 %
Switzerland 3 %
France 3 %
Rest of Europe 7 %
Rest of world 15 %

Trend of EVOTEC shares



EVOTEC BioSystems NM, indexed
Neuer Markt (Germ.) DS-CALC.-Price Index, indexed

Share data

1999 per share	EUR
Earnings	(1.20)
Cash flow	5.27
High / low price	46.20/21.10
Price on December 30, 1999	35.25
Dividends	0.00

Market capitalization (Dec. 31) in DM million	425.75
Number of shares (Dec. 31) in thousands	12,078
Securities identification number 566480	

Fig. left: EVOscreen® Mark II

Fig. right: The MITONA module pipettes extremely small volumes of chemical compounds from standard 96-well sample carriers into EVOTEC's Nanocarrier™.

An outstanding achievement

The delivery of an EVOscreen® Mark II system to Novartis (Basel, Switzerland) in December 1999 represented an important milestone in the history of our company. After years of technological development, we had our first industrial product. We have delivered on our promise to provide noticeable benefits in time and cost savings to both customers and EVOTEC´s drug discovery service business.

In April 1996, Novartis became the first partner in the EVOscreen® technology consortium, working with EVOTEC to develop ultra-high-throughput screening systems. As early as autumn 1998, the prototype version of this system (Mark I) was completed in Hamburg and successfully tested. In conjunction with Novartis, we have incorporated improvements and further developments based on this basic prototype to produce the version of this system (Mark II) for industrial application. The transfer of Mark II is now under way, and during 2000 will also include our partners SmithKline Beecham and Pfizer.

The successful completion of Mark II is evidence of the implementation of results-oriented project management. Having set clearly defined objectives, interdisciplinary teams of scientists provided their input, whilst expenditures and resources were closely controlled. In addition, outsourcing was rationally used and managed, and finally the client's own input was transferred and integrated via key account management. The experience obtained from this process has already contributed to the design and completion of other hardware systems.

Exploiting Synergies. EVOscreen® Mark II will also be put to work at EVOTEC in the year 2000. This will provide the capacity to further build our service business. An expansion in this area means that we will be able to continue to conduct screening for clients and also considerably improve the efficiency of our own drug research program. The use of the Mark II at EVOTEC for drug discovery means that synergies can easily be exploited for efficient customer service. Experience with EVOscreen® Mark II will be collected and evaluated from both EVOTEC and its clients; improvements will be implemented immediately and this will lead to suggestions for further improvements to be made. Even after delivery of the EVOscreen® system, close contact with our partners is a hallmark of EVOTEC's collaborations.

The implementation of EVOscreen® Mark II is one of the highlights of 1999 in many ways: as a technological success, as fulfilment of a contract, as the result of optimal internal process control and as the basis for expanding the company's range of services.

Fig.: Assay systems receive the final check on the MONA and DINA bench-top assay development stations before being transferred to the EVOscreen® unit for high-throughput screening.

Alain Maiore, Executive Vice President Corporate and Business Development.

Six Deals

In 1999 we entered into a number of forward-looking partnerships. These agreements show how far our business has developed over the last twelve months from pure research and development of innovative technologies in drug discovery to a profit-orientated enterprise. Concentration has been on new business units (services and products) which leverage the scientific and technological expertise that characterizes EVOTEC. This applies particularly to in-house programs for the identification and validation of potential drugs, to the provision of a range of services to the pharmaceutical industry, and to the continuing expansion of the scientific portfolio for future services and programs.

QIAGEN GmbH. Through our subsidiary, EVOTEC Analytical Systems GmbH, a joint venture was established with QIAGEN GmbH, one of the subsidiaries of QIAGEN N.V., to develop and market systems for the detection and purification of nucleic acids. This project, which is shared equally, will combine our proven methods for single molecule detection with QIAGEN's technological expertise in handling, separating, purifying and replicating nucleic acid samples.

GPC AG. In April we formed an alliance with Genome Pharmaceuticals Corporation (GPC) to develop new broad-spectrum antibiotics. GPC is an innovative enterprise in the field of functional genome analysis with its headquarters in Munich. It has developed an integrated technology platform for the identification of new bacteria-specific targets. EVOTEC has developed a special high-throughput screening assay and started a program for identifying small molecule compounds with a high level of antibacterial activity. This collaboration on the basis of sharing costs and income can be expanded in the future to include additional innovative targets from GPC's antibacterial research program.

Knoll AG/BASF AG. In December 1999, we signed a two-year service contract with Knoll AG, which is the central operating pharmaceutical company of BASF AG. EVOTEC assumes responsibility for developing assays and conducting miniaturized high-throughput screening for up to ten biological targets which using EVOscreen® will undergo scrutiny using BASF's own substance library. An option is included within the contract for widening the scope of our collaboration.

SUGEN, Inc./Pharmacia-Upjohn, Inc. Early in 2000 we announced a contract with SUGEN, Inc., a subsidiary of Pharmacia-Upjohn, headquartered in South San Francisco, California, for the use of EVOscreen® to identify small molecule substances targeted at phosphatases. SUGEN is a leader in the identification of new, cancer-specific targets. We have already developed new types of assays for phosphotyrosine phosphatases (PTPs) on behalf of SUGEN. These targets play an important role in the search for new cancer treatments. The agreement includes an upfront-payment for the assay development and screening services provided in 1999, milestone payments based on completed target screens and royalties on product sales which result from this alliance. In addition, Pharmacia-Upjohn invested U.S. dollar 2 million in EVOTEC at the time of the IPO in 1999, so that with this partnership the foundation was laid for further co-operation in the future.

Trega Biosciences, Inc. We have been able to expand our own drug discovery research program by forming a strategic alliance with Trega Biosciences, Inc. (San Diego, California). The agreement involves the acquisition of chemical compounds from Trega's Chem.Folio™ library, joint research programs for the development of new, secondary high-throughput screening assays in the ADME (Absorption, Distribution, Metabolism, Excretion) field, in order to optimize preclinical candidate lead structures, and a licence for Trega's IDEA™ simulation software for the assessment of chemical compounds. We shall use the substances from Trega's substance library for our own drug discovery research and in addition, within the framework of the contract, also offer them to screening service clients on the basis of charges for each substance used. This joint project is another example of new horizons in drug discovery research opening up by combining in-house expertise with specific contributions from outside partners.

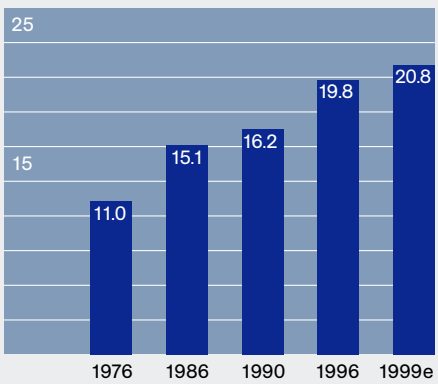
Pfizer, Inc. In addition, 1999 was the year when our uHTS-platform and our FCS^{+}plus detection method were given the seal of approval. In June, Pfizer, Inc. joined the EVOscreen® consortium by signing a three year contract (see page 37).

Where we are now

As a result of EVOTEC´s technological advances in various fields, the Company is in a position to fill a number of critical gaps in the complex field of drug discovery research:

- The ability to screen targets of unknown function takes advantage of the numerous results of genomic research to, relatively quickly, arrive at new therapeutic drugs.
- Hit profiling gives insight into the selectivity of potential drug candidates.
- Drug candidates are optimized using the methods of medicinal chemistry to identify and eliminate potential side effects.
- A universal screening system for cell-based targets provides a significant short-cut.
- The use of primary cells – taken directly from living organisms – in screening allows drug candidates to be developed in an environment closely resembling the natural biological system.

R&D expense as a percentage of sales for U.S. pharmaceutical companies



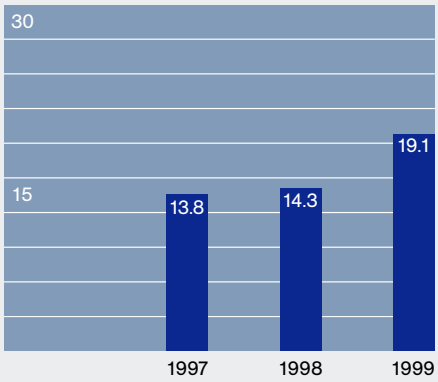
*Sources: Pharmaceutical Research and Manufacturers of America, PhRMA, Annual Survey 1999; Verband forschender Arzneimittelhersteller (Association of research-based pharmaceutical manufacturers) (VFA), Statistics '99.

Management report 1999

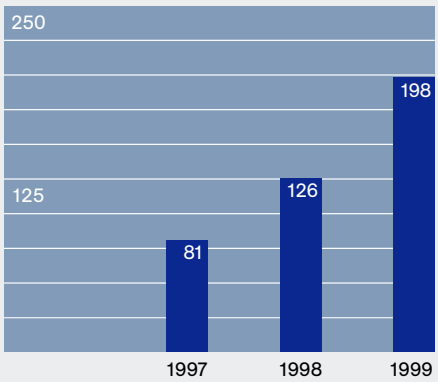
Sector overview*. Considerable progress has been made in healthcare over the last ten years with the development of a number of innovative drugs (various cardiovascular medications, ulcer treatments, anti-inflammatory drugs, etc.) – however, major challenges have gone unanswered. Diseases with no known cure, such as AIDS, Alzheimer's, arthritis, depression, diabetes, cancer, osteoporosis and stroke continue to threaten millions. In the U.S. alone, these incurable diseases lead to a healthcare expenditure of over U.S. dollar 645 billion annually. The pharmaceutical industry is continuing to bank on research and development, the expenditure for which, already at a high level, continues to increase. For 1999, R&D expense is estimated to have been U.S. dollar 24 billion in the U.S. alone (the reference market for the global pharmaceutical industry). This corresponds to an increase of 14.1% compared to the previous year and 20.8% of sales. Over the previous twenty years, R&D expense as a percentage of sales has grown from 11% to 20.8% for research-based drug manufacturers in the U.S., whereas in other industries it seldom exceeds 4%.

The cost of developing a new drug has increased dramatically in recent years and runs at about U.S. dollar 500 million per drug. However, in order for pharmaceutical companies to maintain the forecast average annual sales growth rate of 7%, three to five new drugs would have to leave the development pipeline of each individual concern every year (instead of less than one, statistically speaking, at present). In view of the enormous cost involved, this is no simple undertaking. That is why research-based pharmaceutical manufacturers are increasingly turning to alliances with young innovative start-up companies in the field of biotechnology and gene technology in order to increase productivity in research and development (refer to detailed account in the section »Pharmaceutical research at a crossroads«). Experts at the Boston Consulting Group believe that this trend towards outsourcing will continue to grow in preclinical drug discovery from 30% today to 45% by the year 2005. EVOTEC is following a clear strategy in order to gain maximum advantage from this development.

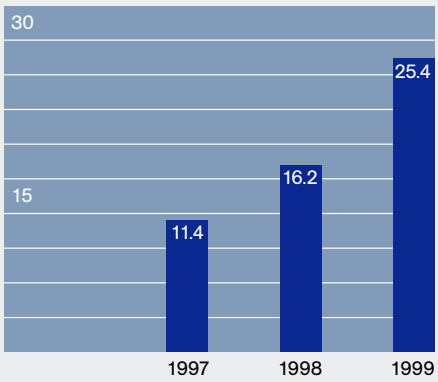
Revenue (in DM million)



Average number of employees



R&D expense (in DM million)



Revenue. In line with expectations, revenue rose by 33.9 % over the previous year to DM 19.1 million in fiscal 1999. In addition to Novartis and SmithKline Beecham, Pfizer, Inc. (U.S.) became another major pharmaceutical company to join the EVOscreen® consortium. Technology development and transfer contracts generated DM 12.3 million in revenue in fiscal 1999, of which DM 0.9 million related to service revenue and DM 1.0 million to instrument sales. Total revenue from instrument sales reached DM 3.9 million, of which DM 1.9 million were generated from the sale of research equipment. Service contracts with Roche Diagnostics, Knoll/BASF and SUGEN produced revenue of DM 3.8 million in 1999.

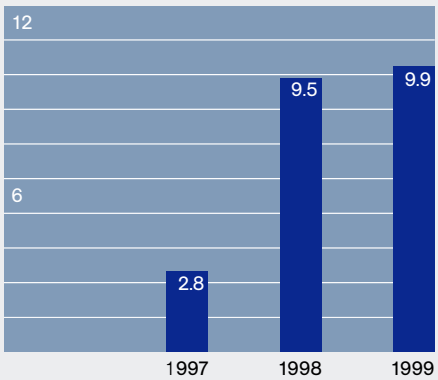
Personnel. The growth of our company is also reflected in the increase in the number of employees. In 1999 the number of staff increased by 87. Thanks to EVOTEC's reputation, we were able to attract a large number (59) of qualified scientists in the fields of biology, biochemistry, chemistry, physics, information technology and engineering. At the end of the year, the Company counted a staff of 228, of whom 187 are employed by EVOTEC BioSystems AG, 25 by EVOTEC Analytical Systems GmbH and 16 by EVOTEC NeuroSciences GmbH, translating to a 61.7 % increase over the prior year. This development reflects the transformation of the service business and our in-house preclinical drug discovery into strategic business units. Furthermore, the increase in staff helped to expand and strengthen our technological platform.

Research and development expense. As planned, research and development expense increased from DM 16.2 million in the previous year to DM 25.4 million in 1999. This includes the cost of platform technology development for members of the EVOscreen® consortium. This 56.9 % increase is primarly due to intensive recruitment of scientists.

High priority was given to strategic expansion of assay development capacity to effectively leverage the technology platform for the service business and in-house drug discovery projects – the expected future growth engines of the company.
Another key component of the R&D strategy of the EVOTEC group involves striking alliances with scientific organizations in Europe and the U.S. to provide access to the most recent research and technological advances while participating in their development. Also a priority in 1999 was the further development of the screening technology to full industrial maturity. In this regard, research information technology activities were intensified.

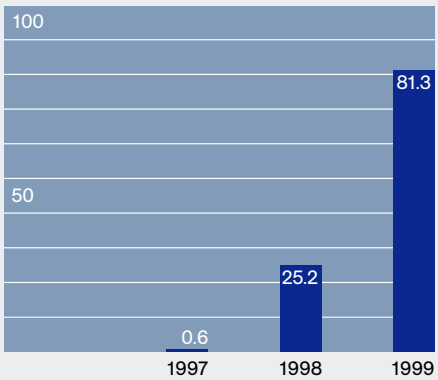
Operating result. The continuing expansion of new business areas for the Company and ongoing intensive development work generated an operating loss of DM 19.9 million in 1999, an increase of 67.3 % over the previous year. However, the annual deficit is still significantly less than forecasted.

Investments (DM million)



Investments. Investments amounted to DM 9.9 million in 1999, of which DM 9.2 million accounted for investments in fixed assets; DM 0.7 million in intangible assets. A key investment was in the development of a screening system, which will be commissioned in 2000. Important investments were also made to equip EVOTEC's laboratories with research instruments developed in-house. The start-up of EVOTEC NeuroSciences GmbH also resulted in significant investment for hardware and technical equipment. In addition, DM 1.8 million were invested in furniture and fixtures and DM 0.7 million in information technology hardware.

Cash flow (DM million)



Cash flow and liquid resources. Cash flow from operations was DM -13.9 million. The negative cash flow mainly results from the losses of the period with adjustments for expenditures and proceeds with no cash flow effect. The negative net cash used in investing activity for 1999 of DM 5.8 million resulted mainly from investments in fixed assets (DM 9.9 million), as well as a reduction in securities of DM 4.4 million. Cash flow from financing activity amounted to DM 101.0 million, mainly due to the increase in capital through the successful IPO on November 10, 1999. The first issue consisted of 4,100,000 shares and a Greenshoe of 645,000 shares at a nominal value of Euro 1. The issue price was Euro 13 per share. Liquidity at the end of the financial year was DM 112.4 million which corresponds to 78 % of total assets.

Risks and future development. Our strategy involves some business areas where we only have limited experience, especially preclinical development of drugs and the development and manufacture of analytical and other instruments. Therefore, EVOTEC is subject to the risks which are typically associated with a new strategy in this area, e.g. failure to discover any highly promising validated targets or substances, difficulties in setting up efficient sales, marketing and distribution channels for these products, or failure to obtain market acceptance. In the long term, this could have adverse effects on business activity, the financial situation and results of the Company. The pharmaceutical and biotechnology market is characterized by rapid technological changes and short product life cycles. EVOTEC's success will depend on whether the Company is in the position to continually improve its products and services, as well as to develop and launch new products and services which meet the changing needs of its customers.

Risk management. EVOTEC's risk management, which attempts to rapidly respond to changing conditions, is primarily directed at making large-scale development projects economically viable.

This includes the direct involvement of the Management Board, which is kept constantly informed of relevant developments in all areas and projects so that appropriate measures can be taken immediately as the need arises.
As an additional instrument of risk analysis, a business development review occurs regularly to evaluate the opportunities and risks of all projects based on the most recent market information and provide up-to-date bases for decision making.

Each project, whether services for a client or an internal development program, is managed within the framework of a detailed project controlling system. This controlling function serves to analyze departures from the original plan and generates proposals to project members and the Management Board. The continual supervision of projects by the independent scientific committee, comprised of prominent research scientists, ensures critical evaluation of project progress. In addition, through the involvement of this committee, EVOTEC receives valuable information for planning and initiating projects based on the latest scientific advances.

The Company's economic planning is reviewed twice a year. The actual figures are compared with budget on a monthly or quarterly basis (according to U.S. GAAP) and form an integral part of the Company's management system.

Occupational safety and environmental protection. Exceeding compliance with official regulations, EVOTEC makes a firm commitment, through voluntary measures, to protect its staff and environment. In close collaboration with local authorities, the Berufsgenossenschaft Chemie (professional association of the chemical industry) and TÜV-Nord, and as part of a project commissioned by the Institut für Arbeitsschutz und Medizin (Institute for occupational safety and medicine) (IAS), a system has been initiated for this purpose, which is constantly maintained and supplemented. This includes occupational hazard analysis by a safety engineer for the protection of staff, as well as medical check-ups and vaccinations for all staff working in the laboratories. Apart from waste recycling for environmental protection, we give special priority to energy optimization using heat recovery as part of our building management technology.

EVOTEC Milestones 2000

Closing additional service contracts
Collaboration with genomics companies
Delivery of additional EVOscreen® systems
Establishment of the Company's U.S. facility
Initial product deal
Additional technological development cooperations

Outlook

EVOTEC expects a further significant revenue increase in 2000. In February the order volume already corresponded to 51% of forecast revenue for 2000. An important contribution to 2000 revenue will be made by the fulfillment of the EVOscreen® technology transfer contracts, including corresponding instrument sales. Following the delivery of the first EVOscreen® Mark II system to Novartis in December 1999, three more Mark II systems will be delivered to Pfizer and SmithKline Beecham in 2000.
The services business will also be significant to revenue in 2000. By establishing an operational base in the United States, EVOTEC expects to better position the service business in the world's largest pharmaceutical market, opening the door for even greater growth.

In the area of research and development, the primary emphasis will be on the optimization and functional expansion of screening systems and research instruments.
The increase in personnel will not be as dramatic as has been the case in 1999. Total staff should not exceed 280 at the end of 2000. The service business will be the main recipient of capital investment in 2000. Of primary importance will be further expansion of screening and assay development capacity.

In previous years, EVOTEC has pushed forward with development in areas that served to strengthen our competence in biological applications: namely, in screening assay development and in-house drug discovery efforts. These developments were not financed by the proceeds from our primary technology transfer partnerships. We will continue to adhere to this corporate strategy in the years ahead, meaning that the net loss in 2000 is likely to be higher than that in 1999 despite a strong increase in revenue. Thereafter, we expect an improvement in the earnings position thanks to a steadily rising share of aggregate revenue from the high-margin service business, and expect to break even in 2002.

EVOTEC's goal is to become a partner to the pharmaceutical and biotechnology industries in all areas of preclinincal drug discovery. Our core competencies today are in the areas of ultra-high-throughput screening (uHTS), hit optimization and the preclinical profiling of drug candidates. As well as expanding the service business, EVOTEC will concentrate its business development activities in 2000 on reinforcing the other elements in the preclinical drug discovery process via strategic alliances or acquisitions.

Patent rights

We attach great importance to strong and broadly applied patent rights which protect our biological and technological platform for preclinical drug discovery from our competitors. Our company is not exclusively dependent on one major technology, but instead has developed numerous technologies with broad spectrums of potential application. Since the Company was founded, we have continuously and strategically expanded our patent rights position through in-house developments, as well as by licensing the patents of third parties. In addition, through collaboration with external scientists, academic institutions and other companies, we have also obtained access to a wide range of other innovative technologies.

At the present time, EVOTEC owns a variety of patent rights – especially patents and patent applications which are pending in countries which are contracting states of the European Convention Agreement, in the U.S. and Japan.

On the basis of Fluorescence Correlation Spectroscopy (FCS), our interdisciplinary team has developed a large number of patented analysis procedures which not only accelerate the screening process, but also generate data with a level of information never before obtained. This makes it possible to assess the suitability of a test substance as a pharmaceutical agent at an earlier stage than ever before. Know-how and patents concerning sample carriers and microfluidic systems for handling the most minute sample quantities round off the patent portfolio in this sector. In addition to the innovations mentioned, our patented assay technology has led, in particular, to a continuous increase in the value of our services. Here we should especially highlight our patent position for diagnostic and screening assays in the area of neuropsychiatric and neurodegenerative diseases, such as Alzheimer's disease. We have also been able to patent a screening method for potential ligands of 7-transmembrane receptors, a major site of action for many drugs. Other EVOTEC patents pertain to strategies for discovering drugs against bacterial and viral infections, as well as for optimizing molecules, especially pharmaceutical and technical proteins.

During the fiscal year 1999 we were able to strengthen our position in the detection sector by concluding a licensing agreement for a digital signal processor. The patent holder has undertaken not to issue any more licences in the area of fluorescence spectroscopy. In addition, we have reached a successful resolution to BASF's opposition to one of our most important European patents in the sphere of detection technology. The patent was maintained unamended.

EVOTEC's patent-protected technologies

Technology	Number of patent-right families*
FCS and FCS^{+}plus detection technology	15
Assay development	28
Microfluidics	4
Labelling strategies	2
Sample carriers	5
Molecular optimization	4
Anti-infection agents	5

* A patent-right family protects an invention in several states. These include our proprietary and licensed patent rights.

Fig. left: Andreas Fetsch at the PICKOscreen: a new type of device for screening substances on small polymer beads.

Fig. right: The picker is a hollow glass needle – thinner than a human hair. Out of tens of thousands of beads, it aspirates those beads bearing compounds which have reacted positively and deposits them in glass vials.

Business unit: Technology

The development of new technologies to maximize efficiency in the search for innovative pharmaceutical agents is EVOTEC BioSystems AG's core business. The advances the Company has made and the expertise we have available have paved the way for long-term financial growth of the Company.

1999 was an extremely successful year for the technology business at EVOTEC. The first industrial version of our ultra-high-throughput screening system (uHTS), EVOscreen® Mark II, was completed during the year and delivered to Novartis (Switzerland), our first customer. Software integration is scheduled for completion during the first quarter of 2000. Our competitive edge in this field was confirmed by the initiation of a new partnership with the U.S. company Pfizer (see page 37).

Building on Success. In 1999, in close collaboration with our EVOscreen® partners, we developed the first plans for the next generation of our uHTS-systems: EVOscreen® Mark III. This version is exceptional as it not only draws on the success of the Mark II design as its foundation, but also integrates technological advances, particularly in the field of cellular assays. In addition, a flexible system architecture simplifies the use of external components. Mark III will reinforce and strengthen our present position as a market leader in this field.

Our range of fluorescence-based detection methods (e.g. multi-color detection and fluorescence life-time measurements) underwent further development in 1999, which was well documented by the successful achievement of experimental milestones. Our wide range of detection methods puts the EVOscreen® platform ahead of other technologies by achieving considerably greater flexibility

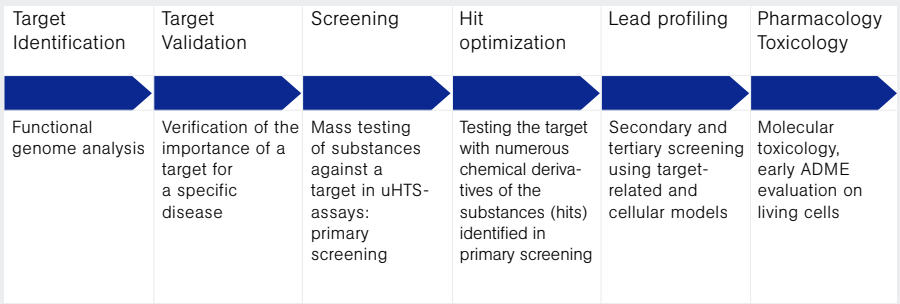
and applicability in the most widely differing assay classes, while at the same time ensuring further enhancement of data quality. By improving our screening information system (SIS), we have made data capture, processing and storage more user-friendly and efficient. The extremely high throughput of substances and targets generates so much data that adequate information processing has already become a fundamental issue in the pharmaceutical industry.

The assay protocols designed for the uHTS process were initially developed on so-called »benchtop assay development stations« which, while having the same functionality, are not equipped with the same degree of automation as the EVOscreen® modules themselves. During 1999, these benchtop units were further developed, and for the first time equipped to handle nanoliters, and have now been successfully tested and delivered to our technology partners.

Profiling Information. It is our aim to make significant improvements in maximizing time and cost efficiency throughout preclinical research through technological development. In 1999 we began work in the field of hit profiling. This involves investigating the potential drugs identified in screening (hits) for bioavailability, toxicity and stability (so-called ADME/Tox profiling) so as to obtain early understanding of their biochemical properties. In collaboration with the American biotech company Trega Biosciences, Inc. (see page 23), assay systems are being developed and subsequently miniaturized by EVOTEC. This promises to reduce the cost per test in this area, as well as to synchronize throughput with that of uHTS. Development programs on hit profiling are conducted outside the EVOscreen® consortium (see page 37), and initial discussions on new and separate technological partnerships in this field have already taken place.

We will further evaluate our technological development programs in the year 2000 to assess innovation capacity and areas for potential increases in efficiency, with a view to entering into new partnerships in the life sciences.

EVOTEC's technological contribution to the process of modern drug discovery



Preparation of cell cultures for use in assay development.

Business unit: Services

EVOTEC is increasingly using its technology to search for novel pharmaceutical agents under contract to pharmaceutical clients (independent of ongoing technology partnerships). In the third quarter of 1999, the screening services business began its operation: this will widen the application of our competence in the field of assay development and high-throughput screening technology and methodology. By using in-house single-molecule detection technology, FCS$^+$plus, and the fully automated EVOscreen® platform, we will be able to pass the benefits of efficiency and innovation on to our customers on a fee-for-service basis. They will also benefit from our team of some sixty scientists, who have over the years amassed a wealth of experience and expertise in the development of innovative assays. Our team has produced a number of novel miniaturized assays for targets which are of particular relevance for the pharmaceutical industry. In addition to this, processes have been developed to efficiently adapt existing customer assays to the high-throughput format. EVOTEC is the world leader in the routine performance of assays in a volume of 1 microliter, thereby ensuring our customers benefit from significant advantages in terms of cost and reagent savings.

Substantial expansion. As an extension of our range of services we offer companies access to EVOTEC's in-house targets (e.g. in the area of neurodegenerative diseases), as well as to a library which currently comprises some 300,000 chemical compounds enabling our customers to broaden the diversity of their own substance inventory quite significantly. This library is largely the result of our alliance with the U.S. company, Trega Biosciences, Inc. (see page 23), as is our range of ADME/Tox profiling assays. Service agreements which provide for the use of our targets or compounds from our library often contain separate licensing agreements for products which are later marketed. This is the case in our joint venture with SUGEN, Inc. (see page 23).
In addition to SUGEN, Roche and BASF Pharma have also signed service contracts with us: expanding this business will form the basis for EVOTEC's further development during 2000.

EVOTEC's product portfolio

Services	Technologies
Assay development	FCS$^+$plus platform
High-throughput screening – Primary screening – Secondary profiling – Orphan target screening	 EVOscreen® system EVOscreen® and CESCA*
On-bead screening	PICKOscreen module
Screening natural extracts	HPLC module NACONA
ADME/Tox profiling	CESCA*
Biological fluorescence labelling	
Target identification/ validation	PICKOscreen module
Access to EVOlibrary	
Access to EVOtargets	

* Cellular screening for ADME properties

The Leitprojekt program:
Validated Lead / Target Systems,
target sources (last revision: December 1999)

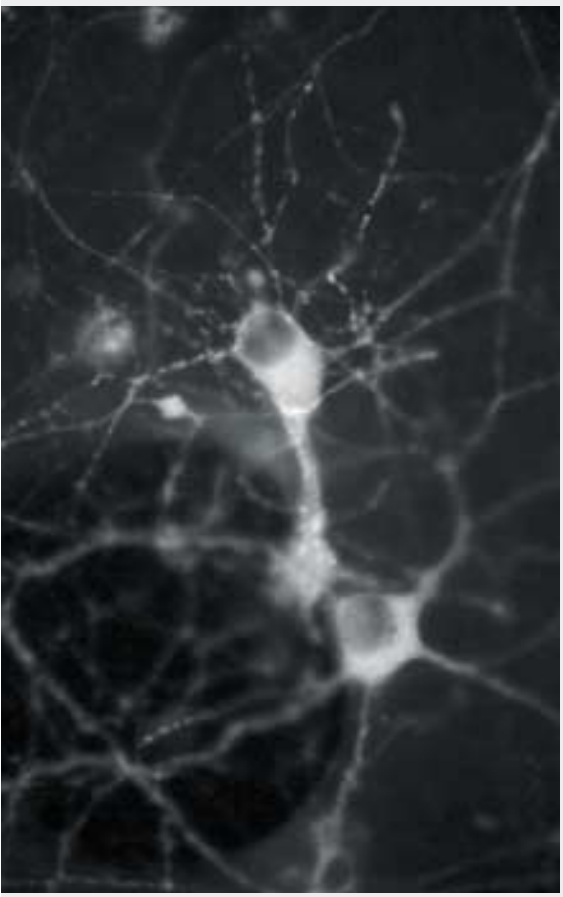
Collaboration with universities/ research institutions	Therapeutic areas: indications	Number of targets
University of Hamburg, Center for Molecular Neurobiology	CNS diseases: especially Alzheimer's disease	1
University of Zürich, Department of Psychiatry Research	CNS diseases: dementia, depression	2
University of Hamburg, Center for Molecular Neurobiology	CNS diseases: auto-immune diseases	1
University of Tübingen, Microbiology	Infectious diseases: new antibiotics for resistant pathogens	1
University of Tübingen, Medical Clinic	CNS diseases and oncology	2
University of Berlin, University Clinic Benjamin Franklin	oncology: tumors of various origin	1
Institute for Hormone and Fertility Research, Hamburg	oncology: tumors of various origin	1
Max Planck Institute for Molecular Physiology, Dortmund	oncology: tumors of various origin	1

Business unit: Products

In the area of our business concentrating on new products, our objective is to offer validated targets and related optimized compounds, so-called Lead/Target systems, to the pharmaceutical industry for direct clinical development. Our targets are classified within the following three therapeutic areas: central nervous system (CNS), oncology and bacterial infection. Targets in these areas are presently obtained from a variety of sources (see table).

1. The program »Validated Lead/Target Systems« was initiated in 1998 with a subsidy of DM 20 million from the German Federal Government (Bundesfördermittel). In this project, in association with nine leading German research institutes, we are in the process of developing new drug candidates.
2. Apart from this project, we have also increased our contact with a variety of research groups; for instance, we have initiated a drug discovery project in the area of oncology together with the internationally-renowned Max Planck Society to pursue a new approach in researching a well-known and well recognized target (ras protein).
3. Increasing importance will be assumed by collaboration with biotech companies which focus on the identification of new targets. These companies' aim is to increase the value of their targets by collaborating with EVOTEC and consequently obtaining a higher price for these when they offer them to pharmaceutical companies for further development. An example of this is our collaboration with Genome Pharmaceutical Corporation (GPC) on a project to find new antibiotics (see page 22).

In focus: The Central Nervous System. In May 1999 we set up a subsidiary, EVOTEC NeuroSciences GmbH, to deal specifically with the identification of targets and the development of substances relating to degenerative diseases of the central nervous system (CNS). This is one of the most attractive areas of the pharmaceutical market. In 1999, EVOTEC concentrated mainly on Alzheimer's disease, for which there is at present no satisfactory treatment available. As Alzheimer's is the most common cause of dementia, and in light of the change in the projected age distribution of the world population in the decades to come, therapeutic advances in this field would be of enormous socio-economic significance.



The focus of our research activities is the preservation of neuronal function in neurodegenerative diseases.

The impetus for founding EVOTEC NeuroSciences GmbH was the discovery and patenting of a new biological marker which plays an important role in the prognosis and diagnosis of Alzheimer's disease. This marker also opens up new possibilities for developing drugs active against Alzheimer's. In addition, an important gene was found in SELADIN-1, which protects brain cells and consequently shields them from the cell death typical of degenerative diseases. Alongside these two targets, which have already been investigated quite thoroughly, a molecular selection procedure was used to identify a large number of additional candidates which form a solid basis from which targets can be chosen with a high probability of providing therapeutic insight.

EVOTEC intends to successfully license lead/target systems to pharmaceutical companies in return for up-front payments, milestone premiums for achieving key advances, and royalty payments from the subsequent marketing of drugs produced from them.

EVOTEC has honored the exceptional performance of Sal. Oppenheim Bank on the extremely successful flotation of EVOTEC BioSystems AG on the Neuer Markt in November 1999 with a substantial voluntary special payment. In co-operation with the management of EVOTEC, Sal. Oppenheim elected to donate this total amount to endow a Sal. Oppenheim scholarship for research into Alzheimer's disease at EVOTEC for the year 2000/2001. This is to promote basic research and is linked to EVOTEC's endeavors to develop innovative pharmaceuticals to treat the causes of this serious disease.

The EVOscreen® Consortium

Early on we made the decision to become a fully integrated drug discovery enterprise by building on the foundation of our state-of-the-art technological expertise. In order to realize the technology platform necessary to achieve this, we entered into a limited number of partnerships with internationally renowned pharmaceutical companies. In this way EVOTEC gains the required customer-related application expertise and at the same time the consortium members finance a considerable proportion of the development. This exclusive group of partners – Novartis, SmithKline Beecham and Pfizer – receive, in return, the technological results of this cooperation which they may use semi-exclusively for their own drug discovery research.

Novartis. In April 1996, Novartis, convinced by the novelty of and the potential behind our concept, was the first company to sign an agreement for the development of EVOscreen®. With the delivery of the first industrial version of the system (Mark II) in December 1999, we have essentially fulfilled the terms of the agreement. In the future, cooperation with Novartis will continue in drug discovery and in the service and maintenance area.

SmithKline Beecham. In December 1996 SmithKline Beecham joined the consortium. The company is working with EVOTEC to develop the next generation of our EVOscreen® system, for which delivery is scheduled at the end of 2000. Mark III will offer a higher throughput than its predecessors using a four channel detection unit, as well as have greater assay format flexibility.

Pfizer. In June 1999 we signed a further contract with Pfizer. The pharmaceutical company chose EVOTEC as its partner in miniaturized high-throughput screening from amongst a number of biotech enterprises. The fact that EVOTEC was the only European company chosen as a drug discovery partner in 1999 validates the work carried out within the framework of the EVOscreen® consortium, as well as representing our first major success on the American continent. The contract provides for delivery of EVOscreen® systems and technology for assay development to three major Pfizer sites.

We may extend membership of the EVOscreen® consortium to a maximum total of five companies. In addition, EVOTEC is also working on technological solutions for further phases in the drug discovery process. In this context, we intend to form partnerships with pharmaceutical companies which are interested in jointly financing technological developments in return for early access to technology.

Financial structure
of technology transfer contracts

Partner	Contract Period	Volume (DM million)	Revenue achieved to date (DM million)
Novartis	04/96 – 12/99	20	17.0
SmithKline Beecham	12/96 – 12/00	30	19.6
Pfizer	06/99 – 06/02	30	4.7

Fig. left: Martin Kreutzer and Bernhard Hukelmann installing the EVOscreen® Mark II system.

Fig. right, top: Dr. Sung-Min Bae researching in the company library.
Fig. right, bottom: Daniel Broakye Cherbu braving the labyrinth of the EVOTEC computer network.

A Team for the Future

As a young, ambituous company, we have set ourselves high goals. The vertiginous development of the biotechnological industry in Germany and fierce international competition from the strong companies in Europe and the U.S. are the challenges we are facing.

The competence and creativity of our team of highly qualified, motivated and reliable employees have provided the foundation for our success. Due to their above-average performance and their tremendous commitment, EVOTEC has grown to be an internationally recognized company.

Our particular strength lies in interdisciplinary cooperation. Our project teams include specialists from various fields: biologists, biochemists, chemists, theoretical and experimental physicists, engineers of various disciplines, computer scientists, mathematicians and commercial staff, all united in the search for innovative solutions to complex problems. The interaction between a project-oriented management system and departments organized by technical speciality has proven itself to be an outstanding form of organization.

Even within highly specialized groups, experts from various disciplines meet and work closely together on a daily basis. The area of assay development

Employees by area of specialization

Area	1998	1999	+/- %
Detection & Microsystem technology	37	50	35
Assay development	48	60	25
Information technology	21	30	43
Services	–	14	–
EVOTEC NeuroSciences (ENS)/EVOtarget	–	20	–
EVOTEC Analytical Systems (EAS)	14	25	79
Administration	24	26	8

Employees by profession

Profession	1998	1999	+/- %
Biologists/biochemists	25	42	68
Chemists	19	27	42
Physicists	16	21	31
Computer scientists / mathematicians	7	8	14
Engineers	37	60	62
Commercial staff	4	7	75
Administrative assistants	11	13	18
Laboratory assistants	25	47	88

involves biologists and biochemists, as well as chemists and physicists who are specialized in addressing biological challenges. On the other hand, biologists and chemists take an active part in software development. This style of working creates the best environment for the germination of innovative ideas as a basis for technological advances – this is the key to EVOTEC's future.

A strong community. The basis for our personnel policy is to create a permanent bond between the men and women working with us and the Company, to support their efforts and reward them accordingly. Thus, as part of the IPO in November all employees were involved in a stock option scheme. All full-time employees received subscription rights which can be exercised within ten years. Other stock options have been approved and will be granted on a performance-related basis over the next four years. At the same time a preferential share distribution (»Friends and Family«) gave all employees the opportunity to obtain additional shares at an issue price of Euro 13. In order to be able to reward outstanding achievements in a more appropriate manner, we will also introduce a bonus scheme for all employees.

In the course of 1999, EVOTEC has almost doubled the number of employees. There were 141 employees in the company at the end of 1998, growing to 228 by December 1999, of which 77 are Ph.D.-level scientists. The average employee age is 33. This systematic expansion of staff represents a firm foundation for further strong growth of our company. Consequently, we were able to initiate the service business and the in-house identification of drug candidates – two new business areas with vast potential for the future which today they already employ 34 people. To support these business units, other areas were also strengthened and additional experienced scientists recruited.

Consolidated financial statements according to U.S. GAAP

Before studying the figures, one more figurative example: Whereas conventional screening technologies require a volume of up to 200 µl per test well, the miniaturization process developed by EVOTEC reduces the test volume to 1 µl – a graphic representation of this is given on the right, showing the relationship of the total number of circles to the marked circles (these correspond almost exactly to the well-diameter in EVOTEC's Nanocarriers™).

We have audited the consolidated financial statements, consisting of the balance sheets, the statements of operations and the statements of changes in shareholders' equity and cash flows as well as the notes to the financial statements prepared by EVOTEC BioSystems AG for the business year from January 1 to December 31, 1999. The preparation and the content of the consolidated financial statements are the responsibility of the Company's Executive Board. Our responsibility is to express an opinion, whether the consolidated financial statements are in accordance with Generally Accepted Accounting Principles in the United States of America (U.S. GAAP) based on our audit.

We conducted our audit of the consolidated annual financial statements in accordance with German auditing regulations and generally accepted standards for the audit of financial statements promulgated by the Institut der Wirtschaftsprüfer in Germany (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 Group for the business year in accordance with U.S. GAAP.
Our audit, which also extends to the group management report prepared by the Executive Board for the business year from January 1 to December 31, 1999, 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, 1999 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 accounting law.

Hamburg, March 6, 2000

KPMG Deutsche Treuhand-Gesellschaft
Aktiengesellschaft
Wirtschaftsprüfunsgesellschaft

Papenberg
Wirtschaftsprüfer

Schadeck
Wirtschaftsprüfer

Consolidated balance sheets according to U.S. GAAP as of December 31

Deutsche Mark in thousands/TEUR except share data

ASSETS	1998	1999	TEUR
Current assets			
Cash and cash equivalents	31,175	112,437	57,488
Investment securities	4,375	–	–
Trade accounts receivable	3,806	5,470	2,797
Inventories	781	7,623	3,898
Other current assets	1,872	2,981	1,524
Total current assets	**42,009**	**128,511**	**65,707**
Fixed assets			
Tangible fixed assets, net	9,543	14,787	7,560
Other non-current assets	482	1,054	539
Total assets	**52,034**	**144,352**	**73,806**

LIABILITIES AND SHAREHOLDERS' EQUITY (DEFICIT)	1998	1999	TEUR
Current liabilities			
Current maturities of long-term loan	1,250	1,250	639
Trade accounts payable	2,160	5,843	2,987
Accrued liabilities	430	3,629	1,856
Accrued vacation	595	771	394
Deferred revenues	2,985	5,641	2,884
Other current liabilities	624	966	494
Total current liabilities	**8,044**	**18,100**	**9,254**
Shareholders' loan	7,732	–	–
Long-term loan	8,750	7,500	3,835
Deferred revenues	450	729	373
Other non-current liabilities	11	11	6
Commitments and contingencies (Note 18)			
Minority Interests	–	76	39
Shareholders' equity (deficit)			
Share capital*: authorized 1,355,000 and 25,974; 12,078,000 and 7,098,000 shares issued and outstanding in 1999 and 1998, respectively	13,882	23,622	12,078
Additional paid-in capital	43,526	138,519	70,824
Unearned compensation	–	(99)	(51)
Share capital subscription	(4,800)	–	–
Retained deficit	(25,561)	(44,106)	(22,552)
Total shareholders' equity	**27,047**	**117,936**	**60,299**
Total liabilities and shareholders' equity	**52,034**	**144,352**	**73,806**

See accompanying notes to consolidated financial statements
* The share capital is denominated in Euro since June 3, 1999. The shares are retroactively reflected with a value of Euro 1 per share.

Consolidated statements of operations according to U.S. GAAP for the years ended December 31

Deutsche Mark in thousands/TEUR except per share data

	1998	1999	TEUR
Revenue			
Research and development revenue	13,145	11,283	5,769
Product sale revenue	1,149	7,857	4,017
Total revenue	**14,294**	19,140	**9,786**
Operating costs and expenses			
Research and development expense	16,200	25,426	13,000
Cost of product sales	303	2,110	1,079
Selling, general and administrative expense	9,664	11,463	5,861
Total operating costs and expenses	**26,167**	38,999	**19,940**
Loss from operations	**(11,873)**	**(19,859)**	**(10,154)**
Other non-operating income (expense)			
Interest income	1,246	1,288	659
Interest expense	(277)	(479)	(245)
Equity in net loss of affiliate	(17)	(689)	(352)
Foreign exchange transaction gain (loss)	(202)	417	213
Other non-operating (expense) income	174	315	161
Total non-operating income	**924**	852	**436**
Loss before income taxes	**(10,949)**	**(19,007)**	**(9,718)**
Income tax (expense) benefit	17	22	11
Minority interests	–	440	225
Net loss	**(10,932)**	**(18,545)**	**(9,482)**
Weighted average common share outstanding	**6,820,114**	**7,885,219**	
Loss per share	(1.60)	(2.35)	(1.20)

See accompanying notes to consolidated financial statements.

Consolidated statements of cash flows for the years ended December 31

Deutsche Mark in thousands/TEUR

	1998	1999	TEUR
Cash flows from operating activities			
Net loss	(10,932)	(18,545)	(9,482)
Adjustments to reconcile net loss to net cash used in operating activities			
– Depreciation and amortization	3,045	3,821	1,954
– Equity in loss of investment	17	689	352
– Foreign exchange income (loss) of investment securities	202	(203)	(104)
– Gain on sale of interests in subsidiary	–	(148)	(76)
– Profit on sale of fixed assets	–	(3)	(1)
– Loss on sale of fixed assets	–	11	5
– Minority interests	–	(440)	(225)
Change in assets and liabilities:			
– Decrease (increase) in:			
Accounts receivable	(3,667)	(1,664)	(851)
Inventories	(760)	(6,548)	(3,348)
Other assets	(1,130)	(1,205)	(616)
– Increase (decrease) in:			
Accounts payable	452	3,684	1,884
Deferred revenues	(3,794)	2,934	1,500
Accrued liabilities	618	3,375	1,726
Other liabilities	196	341	175
Net cash used in operating activities	**(15,753)**	(13,901)	**(7,107)**
Cash flows from investing activities:			
– Purchase of investment securities	(4,577)	–	–
– Investment in equity of joint venture	(25)	(475)	(243)
– Purchase of fixed assets	(9,503)	(9,881)	(5,052)
– Proceeds from sale of shares in consolidated subsidiary	–	150	77
– Proceeds from sale of equipment	–	30	15
– Proceeds from sale of **investment securities**	–	4,375	2,237
Net cash used in investing activities	**(14,105)**	(5,801)	**(2,966)**
Cash flows from financing activities:			
– Net proceeds from capital increase	38,708	96,897	49,543
– Repayment of liabilities due to shareholder	7,732	–	–
– Proceeds from payables from shareholders	–	4,800	2,454
– Proceeds from bank loan	10,000	–	–
– Repayment of loan from stockholder	(1,400)	–	–
– Repayment of bank loan	–	(1,250)	(639)
– Receipt of capital from minority shareholders	–	517	264
Net cash flow provided by financing activities	**55,040**	100,964	**51,622**
Net increase in cash and cash equivalents	**25,182**	**81,262**	**41,549**
Cash and cash equivalents at beginning of year	5,993	31,175	15,939
Cash and cash equivalents at end of year	**31,175**	**112,437**	**57,488**

See accompanying notes to consolidated financial statements.

Supplemental consolidated disclosures of cash flow information for the years ended December 31

Deutsche Mark in thousands/TEUR

	1998	1999	TEUR
Cash paid during the year for			
– Interest	201	470	240
– Income taxes	167	–	–
Supplemental schedule of non-cash financing activities			
Conversion of shareholder loan to additional paid-in capital	12,400	–	–
Conversion of liabilities due to shareholders' to additional paid-in capital	–	7,732	3,953
Patent aquired in exchange for equity in subsidiary	–	499	255

See accompanying notes to consolidated financial statements.

Fixed assets movement schedule according to U.S. GAAP

		Aquisition and manufacturing cost				
		1/1/1999	Additions	Disposals	Reclass	31/12/1999
		DM	DM	DM	DM	DM
I.	Intangible assets					
	Patents and licences	1,845,896.00	658,756.06	–	–	2,504,652.06
II.	Tangible fixed assets					
	1. Land, land rights and buildings,					
	including buildings on land					
	owned by others	1,626,635.14	71,973.43	–	–	1,698,608.57
	2. Plant and machinery	6,309,255.29	3,762,876.86	45,303.64	924,219.90	10,951,048.41
	3. Furniture and fixtures	4,591,528.67	1,750,855.31	458,066.47	–	5,884,317.51
	4. Software	635,761.61	697,438.01	–	–	1,333,199.62
	5. Assets under construction	1,165,507.91	2,938,836.49	213,288.01	(924,219.90)	2,966,836.49
		14,328,688.62	**9,221,980.10**	**716,658.12**	**–**	**22,834,010.60**
III.	Financial assets					
	1. Shares in group companies	7,973.45	–	7,973.45	–	–
	2. Other financial assets	44,090.00	13,894.00	–	–	57,984.00
		52,063.45	**13,894.00**	**7,973.45**	**–**	**57,984.00**
Total fixed assets		**16,226,648.07**	**9,894,630.16**	**724,631.57**	**–**	**25,396,646.66**

Consolidated statements of changes in shareholders' equity

Deutsche Mark in thousands/TEUR except share data

	Share capital		Additional paid-in capital	Unearned compensation	Share capital subscription	Retained deficit	Total shareholders' equity (deficit)
	Shares *	Amount					
Balance at December 31, 1997	**5,000,000**	**9,779**	**(3,479)**	**–**	**(4,800)**	**(14,629)**	**(13,129)**
Receipt of share capital subscription	471,002	921	–	–	–	–	921
Share capital increase on February 27, 1998	1,626,998	3,182	34,605	–	–	–	37,787
Conversion of silent partnership contribution	–	–	12,400	–	–	–	12,400
Net loss	–	–	–	–	–	(10,932)	(10,932)
Balance at December 31, 1998	**7,098,000**	**13,882**	**43,526**	**–**	**(4,800)**	**(25,561)**	**27,047**
Receipt of share capital subscription	–	–	–	–	4,800	–	4,800
Share capital increase on March 18, 1999	235,000	460	7,272	–	–	–	7,732
Share capital increase due to IPO	4,745,000	9,280	87,617	–	–	–	96,897
Stock option plan	–	–	104	(99)	–	–	5
Net loss	–	–	–	–	–	(18,545)	(18,545)
Balance at December 31, 1999	**12,078,000**	**23,622**	**138,519**	**(99)**	**–**	**(44,106)**	**117,936**
Balance at December 31, 1999 (TEUR)	**12,078,000**	**12,078**	**70,824**	**(51)**	**–**	**(22,552)**	**60,299**

* The share capital is denominated in Euro since June 3, 1999. The shares are retroactively reflected with a value of Euro 1.00 per share.
See accompanying notes to consolidated financial statements.

Depreciation, amortization and writedowns					Net book value			
1/1/1999	Additions	Disposals	Reclass	31/12/1999	31/12/1999		31/12/1998	
DM	DM	DM	DM	DM	DM	EUR	DM	EUR
1,415,714.36	93,264.34	–	–	1,508,978.70	995,673.36	509,079.71	430,181.64	219,948.38
108,441.85	110,942.92	–	–	219,384.77	1,479,223.80	756,315.12	1,518,193.29	776,239.90
3,008,258.37	1,907,734.82	17,452.09	–	4,898,541.10	6,052,507.31	3,094,597.85	3,300,996.92	1,687,772.93
1,406,772.27	1,412,271.56	448,074.71	–	2,370,969.12	3,513,348.39	1,796,346.51	3,184,756.40	1,628,340.09
261,763.71	296,838.16	–	–	558,601.87	774,597.75	396,045.54	373,997.90	191,222.09
–	–	–	–	–	2,966,836.49	1,516,919.41	1,165,507.91	595,914.73
4,785,236.20	**3,727,787.46**	**465,526.80**	**–**	**8,047,496.86**	14,786,513.74	**7,560,224.43**	**9,543,452.42**	**4,879,489.74**
–	–	–	–	–	–	–	7,973.45	4,076.76
–	–	–	–	–	57,984.00	29,646.75	44,090.00	22,542.86
–	**–**	**–**	**–**	**–**	57,984.00	**29,646.75**	**52,063.45**	**26,619.62**
6,200,950.56	**3,821,051.80**	**465,526.80**	**–**	**9,556,475.56**	**15,840,171.10**	**8,098,950.88**	**10,025,697.51**	**5,126,057.74**

(1) Business Description and Basis of Presentation

EVOTEC BioSystems AG (the Company) is a biotechnology company serving the life science industry by designing and applying technologies for highly effective drug discovery. It designs and develops systems for the efficient screening of a large number of chemical compounds, so-called ultra-high-throughput screening and offers products and services which are designed to increase the speed, accuracy and efficiency of the drug discovery process.

The Company was founded on December 8, 1993 as EVOTEC BioSystems GmbH. After its legal status was changed in 1998, its name was changed to EVOTEC BioSystems AG. EVOTEC BioSystems AG had an initial public offering on November 10, 1999.

The consolidated financial statements have been prepared in accordance with generally accepted accounting principles in the United States of America (U.S. GAAP) and include the accounts of EVOTEC BioSystems AG and all companies which are under its legal or de facto control. EVOTEC Analytical Systems GmbH has a 50 % investment in QE-Diagnostiksysteme GmbH (QE-Diagnostiksysteme) which is accounted for using the equity method. All intercompany transactions and balances have been eliminated in consolidation.

(2) Summary of Significant Accounting Policies

Cash and Cash Equivalents

The Company considers all highly liquid debt instruments with original maturities of three month or less to be cash equivalents. The Company has essentially deposited its liquid funds with a single bank. As deposits are 100 % insured in the event of a possible bank bankruptcy in the Federal Republic of Germany, there is no risk involved.

Investment Securities

The Company follows Statement of Financial Accounting Standards (SFAS) No. 115, Accounting for Certain Investments in Debt and Equity Securities (SFAS 115). According to SFAS 115, the Company classifies its debt and equity securities as available-for-sale and records them at fair value. Unrealized holding gains and losses are excluded from earnings and are reported as a separate component of shareholders' equity until realized. Realized gains and losses from the sale of available-for-sale securities are determined on a transaction-by-transaction basis.

Trade Accounts Receivable

The Company estimates its need for an allowance for doubtful accounts based on the credit worthiness of its customers as well as general economic conditions. No allowance was considered necessary as of December 31, 1999 and 1998.

Inventories

Inventories are valued at the lower of cost (using the average costing method) or market.

Fixed Assets

Fixed asset acquisitions, including leasehold improvements, are recorded at cost less any vendor rebates. Amortization of leasehold improvements is calculated using the straight-line method over the related lease term. Depreciation of other fixed assets is calculated using the straight-line method over the estimated useful lives of the assets as follows:

Machinery and equipment	5 years
Office equipment	10 years
Computer equipment and software	3 years

The amounts included in fixed assets 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 income. Maintenance and repairs are expensed as incurred.

Intangible Assets

Other non-current assets include intangible assets consisting of purchased licenses and patents. Intangible assets are recorded at cost and are amortized using the straight-line method over the estimated useful lives of the assets of ten years.

Revenue Recognition

Revenue under collaborative long-term research and development agreements is recognized when earned based upon the performance requirements of the respective agreements. Advance payments received in excess of amounts earned are recorded as deferred income. Revenue under these long-term collaborative agreements typically consist of the following:

1. Technology Access Fees – These lump-sum up-front fees are typically made to finance the Company's ongoing research and development activities. Revenue from technology access fees associated with collaborative research and development efforts is recognized ratably over the related forecasted research period.
2. Research Payments – Revenue from research payments is made to finance direct costs incurred in connection with the Company's ongoing research and development activities and an allocation of certain other administrative costs incurred. Revenue from research payments is recognized ratably over the related forecasted research period.
3. Success Payments – This revenue is contingent and is earned upon the attainment of certain research or development milestones as defined in each contract. The revenue is recognized in the period the milestone was successfully achieved, which is determined when the funding party agrees the required results stipulated in the agreement have been met.

The Company additionally earns revenue from

1. product sales which are recorded upon shipment,
2. screening orders which are realized according to the status of the order and
3. commission income which is received pursuant to various contractual agreements related to product sales and recognized upon receipt. Commission income is included in product revenue in the consolidated statement of operations.

Governmental Research and Development Grants

The Company has received governmental research grants from the Bundesministerium für Bildung, Wissenschaft, Forschung und Technologie (Ministry for Education, Science, Research and Technology) for the support of research and development projects. These grants are linked to specific projects and reports detailing the progress of these projects are sent to the respective government or funding organization. The grants are recognized as a reduction of expense to the extent they are earned, the related expenses qualify and have been incurred. Most of the governmental research grants are not refundable. The amounts recognized as reduction to the Company's research and development expense totaled TDM 2,331 and TDM 1,681 in 1999 and 1998, respectively. Under the terms of the grants, the governmental agencies generally have the right to

audit the use of the payments received by the Company. In 1998, non-qualifying expenses of TDM 219 had to be returned to the respective governmental agencies as a result of such audits.

Income Taxes

The Company applies the Statement of Financial Accounting Standards No. 109, Accounting for Income Taxes (SFAS 109). Under the asset and liability method of SFAS 109, deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases and operating loss tax credit carryforwards. Deferred tax assets and liabilities are measured using enacted tax rates that are expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. In assessing the realizability 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 realized.

Research and Development

Research and Development costs are generally not capitalized by the Company. Software development costs are to be capitalized beginning when a product's technological feasibility has been established and ending when a product is made available for general release to customers. To date, the establishment of technological feasibility of the Company's products has occurred shortly before general release, and accordingly no costs have been capitalized.

Use of Estimates

The preparation of consolidated financial statements in conformity with U.S. GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Fair Value of Financial Instruments

Cash and cash equivalents, trade accounts receivable, trade accounts payable, and accrued liabilities are reflected in the consolidated financial statements at fair value due to the short-term maturity of these instruments. The fair value of the long-term loan and liabilities closely approximates their carrying values on December 31, 1999 and 1998. The going concern value is determined on the basis of discounted cash flows. Negotiable securities are already valued at their market value.

Foreign Currency Denominated Transactions

All foreign currency gains and losses on transactions denominated in currencies other than the Company's functional currency have been included in the consolidated statement operations as other non-operating income (expense). The Company's functional currency is the Deutsche Mark. The Company recorded a net loss on foreign currency denominated transactions of TDM 417 and TDM 202 during 1999 and 1998, respectively.

Long-Lived Assets

In accordance with Statement of Financial Accounting Standards No. 121, Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to Be Disposed Of (SFAS 121), the Company's long-lived assets and certain identifiable intangibles must be reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Recoverability of assets to be held and used is measured by a comparison of the carrying amount of an asset to future net cash flows expected to be generated by the asset. If such assets are considered to be impaired, the impairment to be recognized is measured by the amount by which the carrying amount of the assets exceed the discounted net cash flow. Assets to be disposed of are reported at the lower of the carrying amount or fair value less costs to sell.

»Comprehensive Loss«

Effective January 1, 1998, the Company adopted Statement of Financial Accounting Standards No. 130, Reporting Comprehensive Income (SFAS 130), which requires that all components of comprehensive income (loss), including net income (loss), be reported in equity in the period in which they are recognized. Net income (loss) and other comprehensive income (loss), including unrealized gains and losses on investments, shall be reported, net of their related tax effect, to arrive at comprehensive income (loss). The Company did not hold any financial investments as of December 31.

Stock Option Plan

The Company has elected to follow the provisions of Accounting Principles Board Opinion No. 25, Accounting for Stock Issued to Employees (APB 25). Employee compensation from the issuance of employee stock options is recognized up through the first possible exercise date. Pro forma data required by the Statement of Financial Accounting Standards No. 123 (SFAS 123) are provided in the appendix.

New Financial Reporting Standards and Principles

In June 1998 the Financial Accounting Standards Board SFAS No. 133 published »Accounting for Derivative Instruments and Hedging Activities«. SFAS 133 prescribed the accounting standards for derivatives. According to SFAS 133 all derivatives shall be recorded as assets or liabilities in the balance sheet and should be valued at their fair value. In June 1999 the Financial Accounting Standards Board SFAS No. 137 published »Accounting for Derivative Instruments and Hedging Activities – Deferral of the Effective Date of FASB Statement No. 133, an Amendment of FASB Statement No. 133«. This postponed the effective date of SFAS 133. SFAS 133 in its current form now applies to all calendar quarters of all financial years which start after June 15, 2000. The Company, which reports no derivatives, as of December 31, 1999, refers to the effects of applying SFAS 133 in its appendix data.

(3) Investment Securities

Investment securities are comprised of the following:

Deutsche Mark in thousands/TEUR

	31/12/1998	31/12/1999	TEUR
5.25 % International Finance Corporation notes due April 1999	2,503	–	–
7.00 % Hamburg Anleihe 1998 due May 1999	1,872	–	–
Total	**4,375**	**–**	**–**

(4) Inventories

Inventories consist of the following:

Deutsche Mark in thousands/TEUR

	31/12/1998	31/12/1999	TEUR
Raw materials	688	3,537	1,808
Work-in-progress	93	4,086	2,089
Total	**781**	**7,623**	**3,897**

Raw materials consist of biological materials and substances, chemicals, and components of research instruments. Work-in-progress primarily consists of EVOscreen® systems which are earmarked for delivery to partners in collaborative agreements and laboratory equipment.

(5) Other Current Assets

Other current assets consist of the following:

Deutsche Mark in thousands/TEUR

	31/12/1998	31/12/1999	TEUR
Receivables from tax authorities	779	1,153	590
Interest receivable	539	363	186
Shareholder interest receivable	312	–	–
Prepayments to third party contractors	82	595	304
Receivables from QE-Diagnostiksysteme	–	573	293
Others	160	297	151
Total	**1,872**	**2,981**	**1,524**

The claims against the tax authorities relate essentially to capital gains tax and value-added tax claims. Prepayments to third-party contractors consist of prepayments for the production of EVOscreen® systems on the Company's behalf.

(6) Investments in Affiliates

EVOTEC Analytical Systems has a 50 % investment in an affiliated company, QE-Diagnostiksysteme, which is accounted for using the equity method. At December 31, 1999, QE-Diagnostiksysteme had not yet generated any revenue. The Company's ownership interest in the share capital of QE-Diagnostiksysteme amounts to TDM 25 at December 31, 1999 and 1998. The Company's share of the net loss QE-Diagnostiksysteme amounted to TDM 689 and TDM 17 at December 31, 1999 and 1998, respectively. The value of the investment was reduced to zero by the loss for the year. The excess amount (TDM 206) was set off against receivables due from QE-Diagnostiksysteme.

(7) Fixed Assets, net

Fixed assets are comprised of the following:

Deutsche Mark in thousands/TEUR

	31/12/1998	31/12/1999	TEUR
Machinery and equipment	6,309	10,951	5,599
Leasehold improvements	1,627	1,699	869
Assets under construction	1,165	2,967	1517
Office equipment	4,591	5,884	3008
Computer software	636	1,333	682
Fixed assets, at cost	**14,328**	**22,834**	**11,675**
Less accumulated depreciation without software	4,526	7,488	3,829
Less accumulated amortization of software	259	559	286
Total	**9,543**	**14,787**	**7,560**

In 1999 assets under construction relate mainly to development of one EVOscreen® system and laboratory equipment which will be used by the Company internally. Once the EVOscreen® system and laboratory equipment is complete, these costs will be reclassified into machinery and equipment. Amortization expense associated with leasehold improvements is included in depreciation expense. Depreciation expense amounted to TDM 3,728 and TDM 2,893 in 1999 and 1998, respectively.

(8) Other Non-current Assets

Other non-current assets, consist of the following:

Deutsche Mark in thousands/TEUR

	31/12/1998	31/12/1999	TEUR
Intangible assets, net	430	996	509
Other non-current assets	52	58	30
Total	**482**	**1,054**	**539**

Intangible assets are stated net of accumulated amortization of TDM 1,509 and TDM 1,416 at December 31, 1999 and 1998, respectively. Amortization expense amounted to TDM 93 and TDM 152 in 1999 and 1998, respectively. The essential additions for the financial year involved the patent applications by a minority shareholder which were exchanged for equity in EVOTEC NeuroSciences.

(9) Segment Information

The Company has adopted Statement of Financial Accounting Standards No. 131, Disclosures about Segments of an Enterprise and Related Information (SFAS 131), which requires disclosure of certain financial information about operating segments, products, services and geographic areas in which they operate. The Company has not reported segment information because the Company operates in only one business segment. The Company's reporting on the financial year did not include any segment results as their significance was still immaterial.

In 1999, sales are segregated into the following areas:

Deutsche Mark in thousands/TEUR

	1999	TEUR
Drug discovery technology		
– Technology transfer agreements	10,408	5,322
– Instruments	3,916	2,002
Drug discovery		
– Services	4,816	2,462
Total sales	**19,140**	**9,786**

All long-lived Company assets are located in the Federal Republic of Germany. All of the Company's sales were generated domestically.

(10) Collaborative Agreements

The Company's revenue has been generated from a limited number of collaborating partners in the pharmaceutical industry. The Company's collaborative agreements generally extend one to three years and have accounted for 64% and 92% of revenues in 1999 and 1998, respectively. As part of these long-term agreements, the collaborating partners acquire the right to purchase and internal use of the screening machines which are developed as a result of research and development activities. The Company retains the entire and exclusive right to commercialize these screening machines.

In the contract with SmithKline Beecham the total permitted volume of all research and development contracts is limited to DM 70 million. EVOTEC may use the results of the project for projects not related to pharmaceutical drug discovery, for internal projects in pharmaceutical drug discovery, including projects which may lead to a marketable product or pre-product, or in »external target collaborations«, provided that the number of molecular targets does not exceed 50 per year and does not exceed 5 per year with any one third party (increasing to 10 in the second year after delivery of the EVOscreen® system to SB and to 15 in the third year after delivery). These restrictions apply only until the end of the third year following completion of the Company's obligations under the agreement.
With regard to other so-called »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, the Company must pay royalties equal to 5 % of revenue to Novartis. These royalties are for a period of ten years from March 17, 1998.
EVOTEC is free of any restrictions concerning technologies arising in the course of its cooperation with Pfizer. The expenditure incurred under the research and development contracts was essentially incurred for all contracting partners as well as for EVOTEC so that no separate classification of the corresponding expenses was prepared.

(11) Income Taxes

German corporation tax law applies a split rate imputation system to the income taxation of a corporation and its shareholders. Upon distribution of retained earnings in the form of a dividend, shareholders subject to German tax receive an income tax credit for taxes paid by the corporation on such distributed earnings. In addition, the corporation receives a tax refund to the extent such earnings had been initially subjected to a corporation income tax in excess of 30 %. The tax refund is also distributed to the shareholders.

In general, retained German corporate income is initially subject to a federal corporation income tax of 40 % (1998: 45 %) plus a surcharge of 5.5 % on the federal corporate tax payable. After taking the solidarity surcharge into consideration, the federal corporate tax rate is 42.2 % (1998: 47.475 %). In addition, trade tax is applicable. Trade tax is deductible from the amount on which corporation tax is based, thus resulting in a reduction in the amount of corporation tax to be paid. For 1999 taxes are calculated using the effective corporate income tax rates of 53.2 % (1998: 57.47 %). The total loss before tax does apply to the business activity of affiliate companies which are liable for tax in the Federal Republic of Germany.

The following net deferred tax assets were:

Deutsche Mark in thousands/TEUR

	31/12/1998	31/12/1999	TEUR
Deferred tax assets			
Losses carried forward	13,150	24,950	12,757
Revenue recognition	1,400	2,489	1,273
Other	–	233	119
Total	**14,550**	27,672	**14,149**
Valuation allowance on deferred tax assets	(14,550)	(27,439)	(14,030)
Total deferred tax assets	**–**	**233**	**119**

	31/12/1998	31/12/1999	TEUR
Deferred tax liabilities			
Liquid assets	–	108	55
Other	–	125	64
Total deferred tax liabilities	–	233	119
Deferred tax, net	–	–	–

The tax losses do not expire and there are in principle no restrictions as to how they may be used. Since the Company did not achieve any taxable income in the past and the utilization of the losses carried over depends on the profit threshold being reached, an allowance has been recorded for the total net deferred tax asset.
The following differences between the effective income tax rate and the expected income tax rate of 53.2 % (1998: 57.47%) of the pre-tax profit, adjusted for pro rata losses from the equity valuation of investments and minority interests, resulted for the financial years 1999 and 1998.

Deutsche Mark in thousands/TEUR

	31/12/1998	31/12/1999	TEUR
Calculated (expected) income tax	6,292	9,745	4,983
Other	17	22	11
Effect of change tax rate	–	(1,081)	(553)
Valuation allowance	(6,292)	(8,664)	(4,430)
Effective income tax	17	22	11

(12) Loan and Lines of Credit

In February 1998 the Company entered into a TDM 10,000 loan agreement with a bank. This loan carries an interest rate of 5 % per annum and is payable in semi-annual installments ending at September 30, 2006. This loan is secured by certain patents and equipment. The Reconstruction Loan Corporation »KfW Kreditanstalt für Wiederaufbau« guaranteed TDM 5,000 of the Company's indebtedness under this loan agreement. The annual maturities of this loan are as follows:

	TDM	TEUR
2000	1,250	639
2001	1,250	639
2002	1,250	639
2003	1,250	639
2004	1,250	639
Thereafter	2,500	1,278
Total	8,750	4,474

The Company maintains lines of credit totalling TDM 250 to finance its short-term capital requirements, of which the entire balance was available at December 31, 1999. These lines of credit provide for borrowing at various interest rates and have no stated maturity date.

(13) Other Current Liabilities

Other current liabilities consist of the following:

Deutsche Mark in thousands/TEUR

	31/12/1998	31/12/1999	TEUR
Accrued social costs	325	485	248
Taxes	193	437	223
Other current liabilities	106	44	22
Total	**624**	**966**	**493**

(14) Deferred Revenue

Deferred revenue is related to the following long-term collaborative agreements:

Deutsche Mark in thousands/TEUR

	31/12/1998	31/12/1999	TEUR
SmithKline Beecham	2,250	450	230
Novartis	1,085	787	402
Pfizer	–	5,133	2,625
Other deferred income	100	–	–
Total	**3,435**	6,370	**3,257**
Less current portion	2,985	5,641	2,884
Total	**450**	**729**	**373**

(15) Earnings per Share

The number of outstanding weighted average shares is calculated based on the retroactive consideration of the conversion of the share capital to the Euro in 1999 as well as the increase in capital from Company funds.

The potentially dilutive equity instruments include the stock options issued to employees outstanding as of December 31, 1999. Due to the loss situation of the Company, the stock options do not have a diluting effect on the earnings per share.

(16) Stock Option Plan

The shareholders' meeting on June 7, 1999 authorized the Supervisory Board to grant stock options to the members of the Management Board and authorized the Management Board to grant stock options to the employees. The maximum number of individual shares at a nominal value of Euro 1.00 which can be granted to the Management Board and the employees under the program is 733,300.
In each year up to 30 % of the total options available under the program can be granted to employees and Management Board. Under the program 20 % of the options are reserved for the Management Board, 20 % for key-employees and 60 % for other employees of the Company.
The terms of the stock option plan provide that the Management Board can only grant the employees options starting in financial year 2000, if the average closing price of the shares of the Company during the last three months of the financial year prior to the granting of options is at least 30 % higher than the corresponding average for the last three months of the previous financial year. Should the hurdle not be reached, the Supervisory Board can nevertheless authorize the granting of options to employees if it is considered necessary for the interests of the Company.

Each of the options entitles the holder to purchase one share of the Company within ten years of the option grant date with an imputed share in the share capital of Euro 1.00 at a predetermined strike price. For all options granted in the year 1999, the strike price will be the offer price as of the initial public offering. Options granted in the year 2000 and thereafter can be exercised at a strike price equal to the closing price of the shares of the Company on the trading day before the option was granted. Options can only be exercised, if at least two years have elapsed since the grant of the option. Options can only be exercised within certain exercise periods. Each exercise period lasts for two weeks and commences on the third day after one of the following events: 1. the publication of the quarterly results by the Frankfurt Stock Exchange, 2. the annual press conference on the financial statements of the Company, and 3. the ordinary Shareholders' Meeting of the Company.
Options can only be exercised if at the time of the exercise the price of the shares is at least 5 % above the strike price.

As part of the initial public offering on November 10, 1999, 178,269 options to purchase one share per option were issued to employees at a subscription price of Euro 13.00, a maximum of one-third of which could be exercised after two years at the earliest, a maximum of two-thirds after three years and after four years all of the options may be exercised. The options have a maximum term of ten years. They may only be exercised if the share price has reached at least 105 % of the strike price at the time of exercise.

The intrinsic value for these options on the appropriate qualifying date is TDM 104. This led in 1999 to an expenditure of TDM 5 and an accrued expenditure from the stock option plan of TDM 99.
If SFAS 123 were to be applied, the pro forma yearly loss for the Company would be TDM 18,554. In determining the compensation expenses the Company assumes a risk-free interest rate of 4.4 %, a dividend of zero and a volatility factor of 80 %. The percentage of subscription rights expected to be taken up is 95 %.

(17) Shareholders' Equity

In connection with the initial public offering in November 1999 the Company issued 4,100,000 shares with a par value of Euro 1.00 as well as additional 645,000 shares through the Greenshoe by the investment bank. The issue price was Euro 13.00 per share. Additional paid in capital was reduced by TDM 8,609 due to the costs of the offering. The part of the investment exceeding the nominal value on the shares issued under the Greenshoe was not yet at the Company's disposal on December 31, 1999 and was paid in after the end of the financial year.
In the general shareholders' meeting on May 14, 1999 the shareholders resolved to convert the share capital to Euro. In addition, the share capital was increased by TDM 13,609 from company funds. The capital was redivided into individual shares on the basis of Euro 1.00 per share so that the shareholders now have 50 shares at a nominal value of Euro 1.00 for every previously held share with a par value of DM 5. The effect of this conversion was reflected retroactively for all reported periods in the financial statement.
The Management Board of the Company was authorized by way of a shareholders' resolution to issue new shares for cash or in-kind contributions up to an amount of 3,500,000 shares as authorized capital. On December 31, 1999, after the capital increases presented, unauthorized but not issued shares totalled 1,355,000 shares. Under the German Stock Corporation Act, 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 passing of the resolution, in the form of conditional capital (bedingtes Kapital) or approved capital (genehmigtes Kapital). The authorization of the issuance of approved capital is limited to a period not exceeding five years from the date the shareholders' resolution becomes effective.

In December 1998 the silent partners and the Company agreed to dissolve the silent partnership. The silent partners contributions of TDM 12,400 were accordingly converted into shareholders' equity. The tax benefits associated with the Company's accumulated losses initially received by the silent partners, approximately TDM 9,996, were transferred to the Company.
In November 1998 the Company issued 234,993 shares of capital stock to an institutional investor for TDM 7,732. As these shares were not yet registered, these amounts were recorded as liability to shareholders as of December 31, 1998. The capital increase was recorded in the trade register on March 18, 1999.

(18) Commitments and Contingencies

(a) Operating Leases

The Company leases certain office space and other equipment under operating leases. The future minimum lease payments under non-cancelable operating leases are approximately as follows at December 31, 1999:

	TDM	TEUR
2000	1,826	934
2001	1,826	934
2002	1,826	934
2003	1,826	934
2004	1,826	934
Thereafter	11,656	5,960
Total	20,786	10,630

The rent expense for operating leases amounted to TDM 1,723 and TDM 1,222 for the years ended December 31, 1999 and 1998, respectively.

(b) Other Commitments

The Company has entered into long-term consultant contracts, some of which are with shareholders of the Company. During 1999 and 1998, payments under consultant contracts totaled TDM 611 and TDM 511, respectively. The future minimum payments associated with long-term consultant and other miscellaneous long-term commitments total approximately TDM 622 and TDM 918 at December 31, 1999 and 1998, respectively. Additionally, the Company has an open-ended purchase obligation to a supplier totalling U.S. dollar 522,190.00.

(19) Employees

The average number of persons employed by the Company in 1999 was 198 (1998: 126).

(20) Ownership Interest

Deutsche Mark/Euro

December 31, 1999	Total shareholders' equity	Company's ownership interest		1999 net loss	
	DM	DM	%	DM	EUR
1. QE-Diagnostiksysteme GmbH, Erkrath	(411,094.58)	24,250.00	50.0	(1,377,032.89)	(704,065.74)

(21) 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 totaled TDM 906. Under the employee stock option scheme, the members of the Management Board received 20,532 options of which one-third may be exercised after two years.

(22) Supervisory Board

The members of the Supervisory Board are listed at the end of this report. The remuneration paid to the members of the Supervisory Board in the financial year amounted to TDM 48 (1998: TDM 11).

(23) Scientific Advisory Committee

Prof. Dr. Manfred Eigen, Göttingen
Prof. Dr. Günther Fuhr, Berlin
Prof. Dr. Roger Nitsch, Zürich, Switzerland
Prof. Dr. Norbert Riedel, Glendale, U.S.
Prof. Dr. Detlev Riesner, Düsseldorf
Prof. Dr. Rudolf Riegler, Stockholm, Sweden
Prof. Dr. Heinrich Schulte, Hamburg
Prof. Dr. Charles Weissmann, UK

(24) Concentration of Business Risks

Most of the Company's customers operate in the pharmaceutical and biotechnology industries. Aggregate revenue for the Company's three significant customers accounted for approximately 72 % and 92 % of total revenue for the years ended December 31, 1999 and 1998, respectively. Related receivables from these customers were approximately 18 % and 35 % of trade accounts receivable at December 31, 1999 and 1998, respectively.

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

The consolidated financial statements of the Company are prepared in accordance with United States Generally Accepted Accounting Principles (»U.S. GAAP«), which differ in certain respects from German accounting requirements as prescribed by the HGB. The following is a summary of the significant differences between applied U.S. GAAP and HGB requirements that may affect the Company's net income and equity for the periods presented.

Deferred tax assets — Under U.S. GAAP, deferred tax assets arising from a tax loss carry forward and temporary differences are generally recorded and must be analysed in light of whether realization of the assets is »more likely than not«. This means a level of likelihood that is greater than 50 %. As a result of this analysis, a deferred tax asset may be subject to a valuation allowance. Under the HGB, deferred tax assets generally may not be recognized with respect to a tax loss carryforward because expected future tax savings are not recognizable before the realization of such profits.

Revenue recognition — Under U.S. GAAP, more stringent revenue recognition criteria exist which can result in differences in the periods in which revenue is recognized under the HGB.

Private placement and initial public offering costs — Under U.S. GAAP, certain costs in connection with a private placement or an initial public offering of equity are recorded as a reduction of equity. Under the HGB, such costs are expensed as incurred.

Unrealized holding gains and losses on available-for-sale securities — Under U.S. GAAP, unrealized holding gains and losses on available-for-sale securities are recorded as a component of equity. Under the HGB, unrealized losses are recorded in the statement of operations. Unrealized gains would not be recorded until realized.

During the financial year 1999, the Supervisory Board obtained detailed information about business trends and the status of the Company in five meetings with the Management Board of EVOTEC BioSystems AG. The Management Board continuously informed the Supervisory Board as to the status of the Company through written and verbal reports.
The Supervisory Board paid special attention to the Company's strategic development. Extensive examination of the portfolio of research and development projects, their stage of development, the chances of launching new products and on their market potential was jointly conducted by the Supervisory Board and the Management Board. In addition to detailed sales analyses, the focus was on the results, the financial situation, and the initial public offering.
The Management Board presented a detailed forecast for the upcoming financial year to the Supervisory Board. The Supervisory Board approved the plans of the Management Board.

The accounting, the annual financial statements and management report of EVOTEC BioSystems AG for 1999 have been audited by KPMG Deutsche Treuhand-Gesellschaft Aktiengesellschaft Wirtschaftsprüfungsgesellschaft in Hamburg and received an unqualified opinion.

The annual financial statements were presented to the Supervisory Board for review. The Supervisory Board acknowledged the findings of the auditors, who were present at the meeting of the Supervisory Board on March 13, 2000, and who reported comprehensively their findings. The Supervisory Board reviewed the financial statements and it does not raise any objections.
The Supervisory Board approved the annual financial statements for the financial year 1999 as presented by the Management Board. With the approval by the Supervisory Board, the annual financial statements have been adopted.

The consolidated financial statements and the consolidated management report have been audited by KPMG Deutsche Treuhand-Gesellschaft-Aktiengesellschaft Wirtschaftsprüfungsgesellschaft in Hamburg and received an unqualified opinion. Moreover, the Supervisory Board reviewed the consolidated financial statements and the consolidated management report and it does not raise any objections.

The Supervisory Board approves the proposal of the Management Board to carry the retained deficit forward to the next year.

The Supervisory Board thanks the Management Board and the employees for their work during the year under review.

Hamburg, March 13, 2000

Prof. Dr. Heinz Riesenhuber
Chairman of the Supervisory Board

Supervisory Board

Prof. Dr. Heinz Riesenhuber
Chemist, Frankfurt am Main
Chairman of the Supervisory Board

Member of the Supervisory Board:
ALCAN Deutschland GmbH, Eschborn
Altana AG, Bad Homburg
Frankfurter Allgemeine Zeitung, Frankfurt am Main
Henkel KGaA, Düsseldorf
Mannesmann AG, Düsseldorf
Messer Griesheim GmbH, Frankfurt am Main
OSRAM GmbH, Munich

Peer Schatz
Business Executive, Düsseldorf
Vice Chairman of the Supervisory Board

Chief Financial Officer of Qiagen N.V.

Member of the Supervisory Board of companies of the Qiagen Group

Maximilian Graf Drechsel
(until May 14, 1999)
Business Executive, Düsseldorf

Director, HSBC Private Equity (Deutschland) GmbH, Düsseldorf

Member of the Beirat Moy'sche Privatstiftung, Anif/Austria

Prof. Dr. Freimut Leidenberger
(until May 14, 1999)
Doctor, Hamburg

Roland Oetker
(from May 14, 1999)
Business Executive, Düsseldorf

Managing Partner
ROI Verwaltungsgesellschaft mbH, Düsseldorf

Member of the Supervisory Board:
Volkswagen AG, Wolfsburg
CinemaxX AG, Hamburg

Member of the Verwaltungsrat:
Gamma Holding N.V., Helmond/NL
Pan-European Smaller Companies Fund, London/GB

Member of the Beirat:
Dr. August Oetker Gruppe, Bielefeld

President, DSW Deutsche Schutzvereinigung für Wertpapierbesitz e.V., Düsseldorf

Prof. Dr. Hans-Jürgen Quadbeck-Seeger
(from May 14, 1999)
Chemist, Bad Dürkheim

Former member of the BASF Executive Board for Research

Dr. Axel Schmidt-Hern
Lawyer, Düsseldorf

Partner of the law firm
Hengeler Mueller Weitzel Wirtz, Düsseldorf

Dr. Helmut Schühsler
(from May 14, 1999)
Business Executive, Munich

Director of TVM Techno Venture Management GmbH, Munich

Chairman of the Supervisory Board:
Cardiogene AG, Düsseldorf
MorphoChem AG, Munich
Ingenium AG, Munich

Member of the Supervisory Board:
Axxima AG, Munich (until February 14, 2000)
MediGene AG, Munich
GPC AG, Munich
HepaVec AG, Berlin

Prof. Dr. Heinrich Schulte
(until May 14, 1999)
Doctor, Hamburg

Chairman of the Supervisory Board of Aristogen GmbH, Ingelheim

Member of the Supervisory Board of Newlab GmbH, Erkrath

Timm Jessen, Jörn Aldag, Karsten Henco

Management Board

Dr. Karsten Henco
Biochemist, Erkrath
Chief Executive Officer

Karsten Henco is a co-founder of EVOTEC BioSystems AG. Prior to that he was co-founder and managing director of QIAGEN.

Member of the Supervisory Board:
Garching Innovation GmbH, Munich
QE-Diagnostiksysteme GmbH, Erkrath

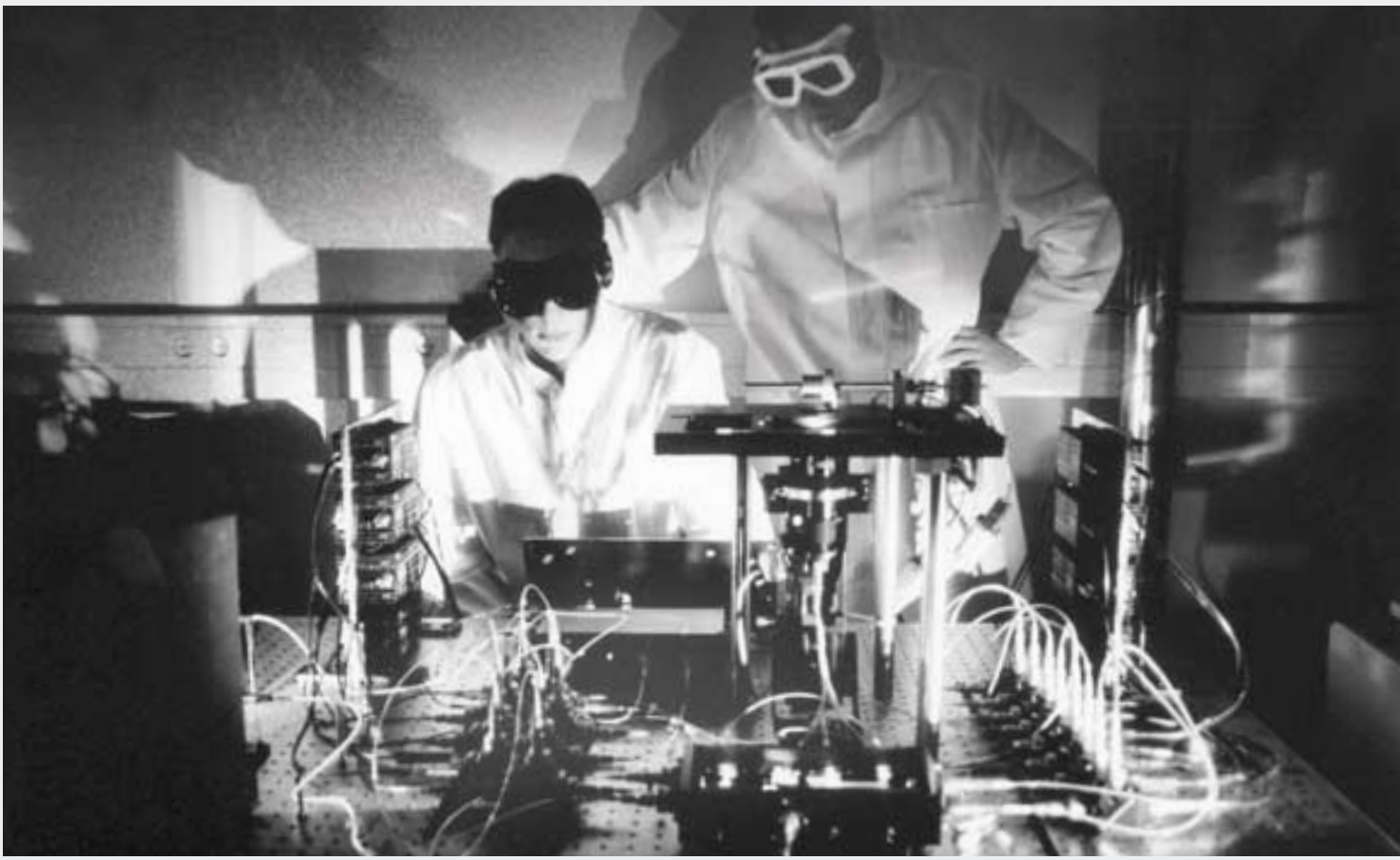
Joern Aldag
Business Executive, Hamburg
President, Chief Financial Officer

Jörn Aldag was previously CFO and managing director of MAN GHH, a multinational subsidiary of MAN AG.

Dr. Timm-H. Jessen
Chemist, Hamburg
Chief Scientific Officer

Timm Jessen held positions in drug discovery at Hoechst Marion Roussel and headed HMR's Biotech Group in Germany.

Fig. left: Dr. Elke Diekmann removes microtiter plates from the compound library.
Fig. top: Maren Köhler freezes cell cultures in liquid nitrogen.
Fig. center: Dr. Eloisa López-Calle labels a protein with a fluorescent dye.
Fig. right top: Dr. Nick Hunt examines the growth of cells to be used in a screening process.
Fig. right bottom: Heiko Mühlenfeld and Roland Stange develop a new detection unit in the laser laboratory.



EVOTEC's financial calendar

Apr. 4, 2000	Press conference, analyst meeting, annual report for 1999
May 15, 2000	First quarter report 2000
Jun. 26, 2000	Annual shareholders' meeting
Aug. 4, 2000	Second quarter report 2000
Nov. 8, 2000	Third quarter report 2000

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This annual report is also available in German.

Concept and graphic design: KMS Team, Munich
Photographs: Raffaella Schnell, Munich
Print: Aumaier GmbH, Munich
Lithography: Colorlux new, Verona, Italy

We are growing by miniaturizing.