Evotec AG

Close Brothers Seydler Research AG

Recommendation:	Risk:	Price Target:	
BUY (BUY)	Medium (Medium)	EUR 3.60 (3.70)	14 June 2011

A wave of news in the last weeks

Trial termination/ Acquisition/ Milestone Payment/ New alliances

- Over the last month Evotec has released a few announcements that had a mixed influence on our valuation. The most important news are related to the termination of Phase II trial with EVT 101 (partnered with Roche) and the acquisition of Compound Focus Inc from Galapagos.

- **Trial termination with EVT 101:** On 18 May Evotec announced voluntary termination of Phase II trial with EVT 101 due to difficulties in recruiting patients. We reduced the value of this compound in our rNPV-SOP valuation. This case demonstrates that it was the right decision for Evotec to distant itself from the development of proprietary projects.

- **Acquisition of Compound Focus:** For the acquisition of all shares in Compound, Evotec will pay Galapagos an immediate cash payment upfront of EUR 10.25m and an additional EUR 2.25m earn out component. With EUR 10.25m initial purchase price Evotec pays ~1.3x of Compound sales in FY 2010 (or ~1.6x with EUR 2.25m earn out component). Comparing the trailing sales multiple with the one of Evotec's (EV/Sales of ~4.8x for FY 2010), the deal does not seem overvalued.

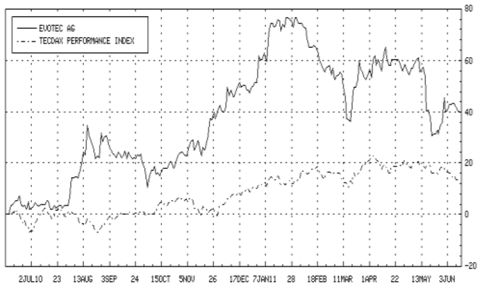
- We have adjusted our valuation model. The most considerable changes pertain to a decrease of rNPV of EVT 101 (rNPV before adj.: EUR 0.62/share; after adj.: EUR 0.31/share; -50%) due to the voluntary termination of trial and the increase of PV of Discovery Alliance Business (PV before adj.: EUR 1.85/share; after adj.: EUR 2.14/share; +15%) as a result of the acquisition of Compound Focus from Galapagos. All in all the negative setback resulting from the termination of trial with EVT 101 was to a large extent offset by the acquisition of Compound. Thus, now the core business Drug Discovery Alliance represents higher value contribution to the entire rNPV-SOP valuation (before adj. 50%; after adj.: 59%). Having conducted all necessary adjustments we decreased our price target from EUR 3.70/share to EUR 3.60/share, but retain a BUY recommendation.

Key data

Y/E 31.12., EUR m	2008	2009	2010	2011E	2012E
Revenues	39.6	42.7	55.3	69.8	84.6
Gross profit	17.6	18.4	24.3	33.2	41.5
EBITDA	-68.4	-38.2	6.5	8.1	10.3
EBIT	-73.2	-42.3	1.7	3.5	6.1
Net income/loss	-78.3	-45.5	3.0	3.5	4.9
EPS	-0.82	-0.43	0.03	0.03	0.04
CPS	-0.43	-0.20	0.00	0.02	0.06
Gross margin	44.5%	43.2%	44.1%	47.5%	49.0%
EBITDA margin	-172.7%	-89.6%	11.7%	11.6%	12.2%
EBIT margin	-184.8%	-99.1%	3.1%	5.0%	7.2%
EV/Sales	6.5	6.0	4.7	3.7	3.0

Source: Evotec AG; CBS Research AG;

Share price (dark) vs. TecDAX



Source: CBS Research AG, Bloomberg

Change	2010 new	2010 old	2011E new	2011E old	2012E new	2012E old
Revenue	-	55.3	69.8	66.0	84.6	75.9
EBIT	-	1.7	3.5	2.2	6.1	2.9
EPS	-	0.03	0.03	0.02	0.04	0.03

Internet: www.evotec.com
WKN: 566480
Reuters: EVTG.DE
Sector: Biotechnology
ISIN: DE0005664809
Bloomberg: EVT GY

Short company profile

Evotec is a drug discovery alliance and development partnership company focused on rapidly progressing innovative product approaches with leading pharmaceutical and biotechnology companies.

Share data:

Share price (last closing price, EUR):	**2.71**
Shares outstanding (m):	115.60
Market capitalisation (EURm):	313.16
Enterprise value (EURm):	257.20
Ø daily trading volume (3 m., no. of shares):	489,909

Performance data:

High 52 weeks (EUR):	3.48
Low 52 weeks (EUR):	1.91
Absolute performance (12 months)	40.9%
Relative performance: (vs. TecDAX)	
1 month	-5.8%
3 months	-5.3%
6 months	-8.7%
12 months	22.8%

Shareholders:

Roland Oetker/ROI	13.5%
TVM V Life Science Ventures	10.5%
Free float	76.0%

Financial calendar:

AGM	16 June 2011
2Q/2011 Figures	11 August 2011

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Termination of Phase II trial with EVT 101

Termination of Phase II trial with EVT 101

On 18 May 2011 Evotec AG announced that the first proof-of-concept study in treatment-resistant depression (TRD) with EVT 101 (financed by Roche) was voluntarily terminated due to difficulties in recruiting patients.

According to Evotec, the company retains all rights in the EVT100 series, especially the back-up compound EVT103, and will enter into partnering discussions for these assets in another clinical development partnership.

The termination of the trial has not influenced our estimates, as we have not projected any potential milestones and sales in our financial forecast. However our rNPV sum-of-the-parts valuation included the risk-adjusted NPV of EVT 101. Therefore we have reduced the value of this compound in our rNPV-SOP valuation (for more details see section “Adjustments in rNPV-SOP valuation”). This case demonstrates that it was the right decision for Evotec to distant itself from the development of proprietary projects.

Acquisition of compound management business from Galapagos

Acquisition of Compound Focus from Galapagos

Following its strategy to strengthen the company’s core business, Drug Discovery Alliance, Evotec announced the acquisition of Compound Focus, Inc. (Compound), the compound management business of BioFocus, a Galapagos Company. The strategic rational of the acquisition is to expand its integrated drug discovery alliance solutions with best in class, profitable offering in compound management.

For the acquisition of all shares in Compound, Evotec will pay Galapagos an immediate cash payment upfront of EUR 10.25m and an additional EUR 2.25m earn out component payable over next two years depending on revenues and certain corporate milestones. Compound will be renamed into “Evotec (San Francisco) inc.” as US entity within the Evotec group. Business will be fully integrated into the company’s global operating structures.

The deal is favourably valued

With EUR 10.25m initial purchase price Evotec pays ~1.3x of Compound sales in FY 2010 (or ~1.6x with EUR 2.25m earn out component). Comparing the trailing sales multiple with the one of Evotec’s (EV/Sales of ~4.8x for FY 2010), the deal is not overvalued. Furthermore, the expected synergies make this acquisition even more valuable for Evotec. Therefore we positively assess the transaction and increase the value estimation of the core business Drug Discovery Alliance. This has resulted in an increase of value contribution of the company’s core business to the entire rNPV-SOP valuation (for more details see section “Adjustments in rNPV-SOP valuation”).

Multiple synergies are expected

The acquisition of Compound should among others:

Multiple synergies are expected

1) Strengthens Evotec’s market position and expands into new market niche with significant potential; 2) Benefits on cross selling synergies. Government organisations and existing Compound’s customers can access other Evotec services and vice versa (Cross selling synergies); 4) Increase revenues and profitability. In 2010 Compound’s top line amounted to ~EUR 7.8m with an operating profit of EUR 2.6m (operating margin is ~33%).

Adjustemtnt in rNPV-SOP valutaion

rNPV SOP valuation decreased due to the termination of EVT 101 trial

In view of numerous events over the last weeks we have adjusted our valuation model. The most considerable changes pertain to a decrease of rNPV of EVT 101 (rNPV before adj.: EUR 0.62/share; after adj.: EUR 0.31/share; -50%) due to the voluntary termination of trial and the increase of PV of Discovery Alliance Business (PV before adj.: EUR 1.85/share; after adj.: EUR 2.14/share; +15%) as a result of the acquisition of Compound Focus from Galapagos.

New rNPV-SOP reflects higher value contribution from the core business

All in all the negative setback resulting from the termination of trial with EVT 101 was to a large extent offset by the acquisition of Compound, which from our point of view should add to the overall value of Evotec. Thus, now the core business Drug Discovery Alliance reflects higher value contribution to the entire rNPV-SOP valuation (before adj. 50%; after adj.: 59%). Having conducted all necessary adjustments we have decreased the entire rNPV-SOP value from EUR 3.71/share to EUR 3.61/share.

We decrease our price target from EUR 3.70/share to EUR 3.60/share, but retain a BUY recommendation.

Adjustments in rNPV-SOP valuation

		Before Adjustement		After Adjustment	
	Valuation method	Sum of the parts valuation per share	Relative value contribution	Sum of the parts valuation per share	Relative value contribution
Discovery alliance business	DCF	1.85	50%	2.14	59%
EVT 101/103 (Partner: Roche)	rNPV	0.62	17%	0.31	9%
DiaPep277 (Andromeda/Teva)	rNPV	0.37	10%	0.37	10%
H3 antagonist	rNPV	0.13	4%	0.12	3%
EVT 201 (Partner: Zhejiang Jingxin Pharmaceutical)	rNPV	0.18	5%	0.18	5%
Cash and cash equivalents net of debt*		0.57	15%	0.48	13%
Total value		3.72	100%	3.61	100%

Adjusted figures are in red
* Cash and cash equivalents less EUR 10.25m of immediate payment for acquisition of Compound Focus

Source: CBS Research

Other recent events

13th clinical trial from Boehringer Ingelheim

13th milestone payment from Boehringer Ingelheim

At the end of May Evotec announced that a back-up compound in its strategic alliance with Boehringer Ingelheim (BI) has advanced into a Phase I clinical trial a milestone payment of EUR 2.0m. The compound, which was discovered and optimised within the alliance, is being developed as a novel treatment for neuropathic pain.

It is the 13th milestone payments achieved within the alliance with BI, which Evotec entered in 2004. Since the beginning of 2011 it is already the second milestone payment received from BI. Overall the total amount of milestone payments generated from Boehringer Ingelheim has increased over the last years. We expect that this growth trend will increase in the near future (See table below).

Furthermore, it is already the second milestone payment which is attributable to the advancement of compound into Phase I clinical trial, which also enhances the overall value of the alliance with BI.

Milestones payments from Boehringer Ingelheim since the beginning of the collaboration

	Year	Number of milestone payments from BI
Start of collaboration with BI	2004	0
	2005	1
	2006	1
	2007	0
	2008	3
Extension of the collaboration	2009	2
	2010	4
	1H/2011	2
	Total	**13**

Source: Evotec; CBS Research

Strategic Alliance with PsychoGenics

Strategic alliance with PsychoGenics

On 25 May 2011 Evotec announced that it has entered into a strategic alliance with PsychoGenics Inc. to provide integrated CNS drug discovery solutions to pharmaceutical and biotech companies. The two companies will work together in a seamless fashion to provide existing and new clients access to their complementary drug discovery platforms for the identification and development of new therapeutics to treat CNS disorders.

Medicinal Chemistry Collaboration with Active Biotech

Collaboration with Active Biotech

On 6 June the company announced that it has entered into a medicinal chemistry collaboration with Active Biotech AB, following the successful conclusion of a High Throughput Screening campaign to identify small molecule modulators of a priority biological target, selected by Active Biotech, involved in immune disorders and cancer.

Based on excellent progress made using its state-of-the-art Screening Platform in 2010, Evotec will now apply its integrated medicinal chemistry platform to optimise initial screening hits with the aim of progressing into a lead optimisation programme. No financial details are disclosed.

Appendix

rNPV-SOP Valuation

	Valuation method applied	Sum of the parts valuation in EUR m	Sum of the parts valuation per share	Relative value contribution
Discovery alliance business	DCF	247.3	2.14	59%
EVT 101/103 (Partner: Roche)	rNPV	36.3	0.31	9%
DiaPep277 (Andromeda/Teva)	rNPV	42.8	0.37	10%
H_3 antagonist	rNPV	13.7	0.12	3%
EVT 201 (Partner: Zhejiang Jingxin Pharmaceutical)	rNPV	21.1	0.18	5%
Cash and cash equivalents net of debt		55.5	0.48	13%
Total value		**416.7**	**3.61**	100%

Source: Evotec; CBS Research

Profit and loss account

IFRS EUR 1,000	2008	2009	2010	2011E	2012E
Total revenues	**39,613**	**42,683**	**55,262**	**69,824**	**84,614**
YoY growth	-27.2%	7.7%	29.5%	26.3%	21.2%
Cost of revenue	-21,977	-24,262	-30,916	-36,657	-43,153
as % of sales	-55.5%	-56.8%	-55.9%	-52.5%	-51.0%
Gross profit	**17,636**	**18,421**	**24,346**	**33,166**	**41,461**
as % of sales	44.5%	43.2%	44.1%	47.5%	49.0%
Research and development expenses	-42,537	-20,947	-6,116	-10,000	-11,846
as % of sales	-107.4%	-49.1%	-11.1%	-14.3%	-14.0%
Selling, general and administrative (S,G&A)	-19,950	-16,695	-15,956	-19,062	-22,846
as % of sales	-50.4%	-39.1%	-28.9%	-27.3%	-27.0%
Other operating expenses	-28,359	-23,078	-559	-632	-661
as % of sales	-71.6%	-54.1%	-1.0%	-0.9%	-0.8%
EBITDA	**-68,404**	**-38,234**	**6,480**	**8,129**	**10,337**
as % of sales	-172.7%	-89.6%	11.7%	11.6%	12.2%
Depreciation and amortisation	-4,806	-4,065	-4,765	-4,656	-4,229
as % of sales	-12.1%	-9.5%	-8.6%	-6.7%	-5.0%
EBIT	**-73,210**	**-42,299**	**1,715**	**3,473**	**6,108**
as % of sales	-184.8%	-99.1%	3.1%	5.0%	7.2%
Net financial results	-2,760	-2,520	2,152	1,102	271
EBT (Earnings before income taxes)	**-75,970**	**-44,819**	**3,867**	**4,575**	**6,379**
as % of sales	-191.8%	-105.0%	7.0%	6.6%	7.5%
Income taxes	**-2,317**	**-678**	**-882**	**-1,052**	**-1,467**
as % of EBT	3.0%	1.5%	-22.8%	-23.0%	-23.0%
Net income/loss	**-78,287**	**-45,497**	**2,985**	**3,522**	**4,912**
as % of sales	-197.6%	-106.6%	5.4%	5.0%	5.8%
Basic earnings per share (EUR)	**-0.82**	**-0.43**	**0.03**	**0.03**	**0.04**

Source: Evotec; CBS Research

Research

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Close Brothers Seydler Research AG uses a 3-level absolute share rating system. The ratings pertain to a time horizon of up to 6 months:

BUY: The expected performance of the share price is above +10%.
HOLD: The expected performance of the share price is between 0% and +10%.
SELL: The expected performance of the share price is below 0%.

Recommendation history over the last 12 months for the company analysed in this report:

Date	Recommendation	Price at change date	Price target
30 July 2010	BUY (Initiating Coverage)	EUR 2.00	EUR 2.80
12 August 2010	BUY (Company Update)	EUR 2.26	EUR 2.90
05 October 2010	BUY (Company Update)	EUR 2.22	EUR 2.90
28 October 2010	BUY (Company Update)	EUR 2.30	EUR 3.00
11 November 2010	BUY (Company Update)	EUR 2.49	EUR 3.00

15 December 2010	BUY (Company Update)	EUR 2.85	EUR 3.20
17 January 2011	BUY (Company Update)	EUR 3.33	EUR 3.70
11 February 2011	BUY (Company Update)	EUR 3.25	EUR 3.70
10 March 2011	BUY (Company Update)	EUR 3.00	EUR 3.70
24 March 2011	BUY (Company Update)	EUR 2.94	EUR 3.70
13 May 2011	BUY (Company Update)	EUR 3.00	EUR 3.70
14 June 2011	BUY (Company Update)	EUR 2.71	EUR 3.60

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Close Brothers Seydler Research AG uses a 3-level risk-scaling system. The ratings pertain to a time horizon of up to 6 months:

LOW: The volatility is expected to be lower than the volatility of the benchmark
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