

# BIOTECHNOLOGY

A Research Publication by DZ BANK AG

## Evotec<sup>6)</sup>

Reuters: EVTG.DE

Bloomberg: EVT GY

Year *	Sales		Adj. IFRS- Earnings per sh.		Cash flow per share		PER	PCF	Dividend per share
	EUR m		EUR		EUR				
2010	55.3	(55.3)	0.03	(0.03)	0.07	(0.07)	97.6	39.7	0.00
2011	80.1	(78.6)	0.06	(0.06)	0.10	(0.10)	40.2	24.1	0.00
2012e	89.5	(86.5)	0.07	(0.07)	0.11	(0.12)	41.9	25.8	0.00
2013e	98.5	(96.8)	0.09	(0.09)	0.13	(0.14)	32.7	21.9	0.00

\* Fiscal year end December – In brackets: Figures from the last publication

### 2012 action plan followed by 2016 action plan – fair value increased to EUR 4

- » **2011 results:** sales growth of 45% to EUR 80.1m exceeded market forecasts (EUR 78.8m) and the company's own outlook (EUR 77-79m) which had been raised twice in 2011. As a result of an unexpected impairment (EUR 2.1m), despite an increase of 204% to EUR 5.2m, operating profit was also lower than expected (EUR 9.4m) as was net profit (+123% to EUR 6.7m/consensus EUR 8.6).
- » **2012 outlook:** Evotec expects at least two major new research alliances in 2012 and double-digit sales growth to EUR 88-90m. Operating profit is set to improve further and liquid funds to exceed EUR 60m (DZ BANKe: EUR 67m). We regard this outlook as easily achievable and would not be surprised by an increase at mid-year.
- » **2016 action plan:** following the successful completion of the 2012 action plan, the company is now targeting double-digit annual sales growth and "strong" profitability by 2016 with its 2016 action plan.
- » **Valuation and investment recommendation:** we have adjusted our model and our new fair value is now EUR 4.0 per share; we still recommend buying this stock.

While the results for the 2011 financial year were in some instances slightly lower than expected as a result of an unexpected impairment, the outlook for 2012, and particularly for subsequent years, was convincing within the framework of the 2016 action plan. We expect a continuing newsflow relating to the company's externally financed and thus risk-free pipeline, a large number of other customer projects and from strategic transactions. We are raising our fair value to EUR 4.0 and further recommend this stock as a long-term buy.

Selected Companies	Price on 22 Mar 2012	PER		EV / EBITDA		EV / Sales 12e	Re- com.
		12e	13e	12e	13e		
Evotec	2.83 EUR	41.9	32.7	16.4	13.2	3.12	↑
Galapagos Genomics	12.23 EUR	62.9	47.0	20.1	17.9	1.67	–
WuXi Pharmatech	14.39 USD	11.6	9.9	6.6	5.5	1.87	–
Abcam	3.43 GBP	23.1	20.4	15.4	12.2	6.13	–
MorphoSys	19.12 EUR	n/a	60.2	71.6	22.9	3.92	↑
<b>Median for all peer group companies</b>		<b>11.6</b>	<b>20.4</b>	<b>16.4</b>	<b>17.9</b>	<b>3.87</b>	–

↑ = Buy, → = Hold, ↓ = Sell, ● = not rated, n/a = not appropriate  
Source: DZ BANK, I/B/E/S, FactSet

## EQUITIES

Flash  
23 Mar 2012

Buy (prev. Buy)

Closing price 22 Mar 2012

(in EUR): 2.83

Fair value: 4.00 (prev. 3.80)

Risk classification: 4

Financial ratios 2012e:

Book value per share (in EUR):	1.31
Equity ratio (in %):	67.9
Net margin (in %):	8.9
ROE (in %):	5.1
Dividend yield (in %):	0.0
Free cash flow (EUR m):	10.0
Net debt (EUR m):	-54.9

Number of shares

(million units): 118.4

Market cap

(in EUR m): 334.52

Free float (in %):

76.0

SIN: 566480

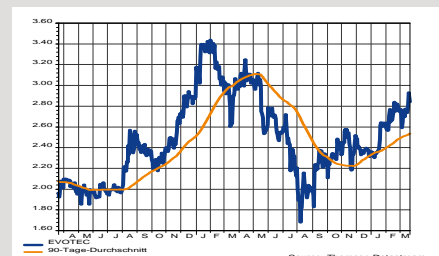
ISIN: DE0005664809

Datastream: D:EVTX

Next Newsflow:

Q1 Report 10.05.2012

AGM 16.04.2012



Author: Dr. Elmar Kraus, Analyst

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Bank on Germany

## 2012 ACTION PLAN FOLLOWED BY 2016 ACTION PLAN

### 2011 results

Sales growth of 45% to EUR 80.1m exceeded market forecasts (EUR 78.8m) and the company's own outlook which had been raised twice (EUR 77-79m). As a result of an unexpected depreciation of EUR 2.1m for project EVT201, despite an increase of 204% to EUR 5.2m, operating profit was also lower than expected (EUR 9.4m) as was net profit (+123% to EUR 6.7m/consensus EUR 8.6m).

**Earnings slightly lower than expected**

### Strategic writedown for US market

As a result of the increasingly thin prospects in the American market, the company is writing off the remaining EUR 2.1m for the sleeping pill EVT201. Since the remaining valuation is based solely on market launch in the USA, the full value of the project has therefore been written off, irrespective of the fact that growth in China is continuing and that the start of a Phase IIb clinical trial is still planned for this year. With successful development and market launch by Jingxing Pharmaceuticals, Evotec then stands to receive milestone payments and shares of revenue.

**Sleeping pill for US market written off**

**Further growth in China for Asian market**

### Partnered projects

Of the partnered projects, the project relating to the diabetes drug DiaPep277 acquired with the takeover of Develogen is at the most advanced stage of development. Following the publication of summary data for the first Phase III trial, Teva drove forward recruitment for the second, approval-relevant Phase III trial. Data from this trial are expected in 2014 to 2015. Possible market launch would then be feasible in 2016.

**Risk-free, externally financed pipeline with DiaPep277 already in Phase III**

Two partnered projects are also in clinical Phase II and another two in Phase I (see table).

**More partnered projects in Phase I and II**

### PIPELINE PROJECTS AND THEIR STATUS

Project	Indication	Status	Partner	Next Newsflow
DiaPep277	Diabetes	clinical Phase III	Teva/Andromeda	Complete data for the first Phase III trial/ mid- 2012; data for second Phase III trial 2014/15
EVT201	Insomnia	clinical Phase II	JingXing Pharmaceuticals	Start of clinical Phase IIb 2012
EVT302	Alzheimers	clinical Phase II	Roche	Start of clinical Phase IIb 2012
VR-1	Pain	clinical Phase I	Pfizer	No starting time stated
Unnamed	Not specified	Clinical Phase I	Boehringer Ingelheim	Unnamed
EVT401	Inflammatory diseases	Test of efficacy	Unnamed	Not known
DG770	Diabetes	Lead structure optimisation	MedImmune (AstraZeneca)	Not known
Insulin Sensitiser	Diabetes	Lead structure optimisation	Boehringer Ingelheim	Not known
<b>Projects still unpartnered</b>				
EVT100	Depression	Clinical Phase II	/	Not known
EVT501	Alzheimer	Pre-clinical	/	Not known
P2X3	Pain/incontinence	Lead structure optimisation	/	Not known

Source: Evotec AG

<sup>1) - 9)</sup> Important: Please read the references to possible conflicts of interest and disclaimers/disclosures at the end of this report.

**Customer projects**

After declining slightly in 2010, the total number of customer projects/alliances increased by 35% in 2011, partly due to the recent acquisitions Kinaxo (e.g. cancer diagnostics) and Compound Focus (logistics services).

**Growth in customer projects and via acquisitions**

**CUSTOMER PROJECTS/ALLIANCES**

	2008	2009	2010	2011
Existing alliances	58	76	72	97(*)
Change		31%	-5%	35%
New alliances	21	29	22	45(*)
Change		38%	-24%	105%

**Growth from alliances and new acquisitions**

Source: Evotec AG; (\*) = of which 22 from new acquisitions Kinaxo and Compound Focus

**2012 outlook**

Evotec expects at least two major new research alliances in 2012 and double-digit sales growth to EUR 88-90m. Operating profit is set to improve further and liquid funds to exceed EUR 60m again (DZ BANke: EUR 67m). We regard this outlook as easily achievable and would not be surprised by an increase at mid-year.

**Positive outlook for 2012**

**2016 action plan**

Following the successful completion of the 2012 action plan, the company is now targeting double-digit annual sales growth and "strong" profitability by 2016 with its 2016 action plan.

**2016 action plan: double-digit annual growth and "strong" profitability**

**Service range now split in three**

Following the successful completion of the 2012 action plan, the company is now targeting market leadership for research into active substances with its new 2016 action plan. Double-digit annual sales growth and "strong" profitability by 2016 are to be secured by the "magic triangle" consisting of EVT Executive, EVT Integrate and EVT Innovate:

**"Magic triangle":**  
 - **Execute**  
 - **Integrate**  
 - **Innovate**

**"MAGIC TRIANGLE" FOR RESEARCH INTO ACTIVE INGREDIENTS FROM 2016 ACTION PLAN**

Action Plan 2016		
EVT Execute	EVT Integrate	EVT Innovate
<ul style="list-style-type: none"> <li>▶ Provide high tech functional solution tools and capabilities to optimise efficiency at any point of a drug discovery process</li> <li>▶ Achieve strong foundation of repeat business</li> <li>▶ Drive profitability via economies of scale and process optimisation</li> <li>▶ Deliver double-digit revenue growth</li> </ul>	<ul style="list-style-type: none"> <li>▶ Offer integrated drug discovery alliances that can start at any point in the drug discovery process</li> <li>▶ Deliver an increase in the number of integrated collaborations</li> <li>▶ Risk-shared arrangements, profitability dependent on project success, milestones and royalties</li> </ul>	<ul style="list-style-type: none"> <li>▶ Deliver unique target driven drug discovery initiatives for first in class novel drugs</li> <li>▶ Focused investments in research to drive higher returns</li> <li>▶ Achieve significant upfronts, milestones and royalty payments associated to projects</li> </ul>

Source: Evotec AG

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**Further expansion of the company**

The 2016 action plan includes the further medium-term expansion of the company to a workforce of around 700 (currently: 610). We expect a strengthening of the biological substances area (e.g. antibodies or antibody-related substances) but also of the range of services, for example contract production of effective substances in the pre-clinical or early clinical stages, to be financed - depending on the scale - from a combination of a cash component and a share component with performance-related elements.

**Summary and investment conclusion**

While the results for the 2011 financial year were in some respects slightly lower than expected as a result of an unexpected impairment, the outlook for 2012, and particularly for subsequent years, was convincing within the framework of the 2016 action plan. We have adjusted our model and are raising the fair value to EUR 4.0.

We expect a continuing newsflow relating to the company's externally financed and thus risk-free pipeline, the completion of, or further progress with a large number of customer projects, and strategic transactions within the framework of the further expansion of the company. We still recommend this stock as a long-term buy with a new fair value of EUR 4.0.

**Further expansion of the company feasible in the areas of biological substances and/or contract production**

**Model adjusted for 2016 action plan**

**Buy recommendation and fair value raised to EUR 4.0**

## AT A GLANCE

### Company profile

Evotec pursues a hybrid business model as a service provider and drug developer for the pharmaceutical industry. In addition to fees for contract work, the company also receives payments on reaching specific research milestones and a share of sales once a drug has reached the market. The company now only develops its own, self-funded projects up to a certain degree of maturity.

### Basis for investment recommendation

While the results for the 2011 financial year were in some respects slightly lower than expected as a result of depreciation, the outlook for 2012, and particularly for subsequent years, was convincing within the framework of the 2016 action plan. We expect a continuing newsflow relating to the company's externally financed and thus risk-free pipeline, a large number of other customer projects and strategic transactions. We are raising our fair value to EUR 4.0 and further recommend this stock as a long-term buy.

### Price sensitive current issues

- » Integration of newly acquired Develogen, Kinaxo and Compound Focus
- » Further expansion of customer base, in particular through the newly acquired companies
- » Publication of full data from the first Phase III study with DiaPep277 around mid year

### Opportunities and risks

Opportunities	Risks
Ongoing trend towards outsourcing of R&D activities	Growth restrictions through shortage of personnel
New customer contracts and milestone payments via recently acquired Develogen and Kinaxo	Let-up in outsourcing trend
Cross-selling via newly acquired Compound Focus	Development risks
Data from clinical development of diabetes drug DiaPep277	

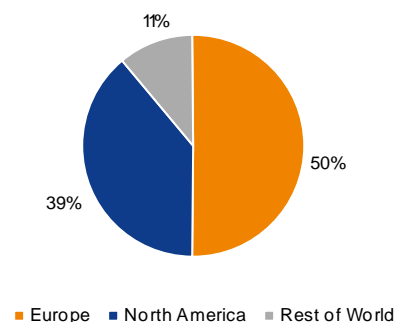
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**RATIOS**

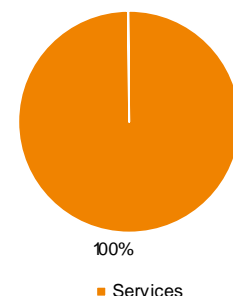
Euro	2010	2011	2012e	2013e	2014e
<b>Profit and loss ratios</b>					
Sales (m)	55.3	80.1	89.5	98.5	108.4
EBITDA margin	11.7%	12.1%	19.1%	20.6%	22.5%
EBIT margin	3.1%	6.5%	13.5%	15.5%	17.8%
Net margin	5.4%	8.3%	8.9%	10.4%	12.2%
Investment ratio	0.0%	0.0%	4.5%	4.1%	3.7%
R&D as % of sales	11.1%	10.5%	10.5%	10.0%	9.2%
Admin and sales costs as % of sales	28.9%	19.7%	18.0%	16.5%	15.0%
Net other operating costs as % of sales	1.0%	7.0%	3.0%	3.0%	3.0%
Net financial income as % of sales	3.9%	0.1%	-0.8%	-0.6%	-0.4%
Interest cover	2.7	3.6	17.6	24.2	48.3
Average sales growth next five years	16.7%	10.4%			
Average earnings growth next five years	35.6%	23.1%			
<b>Profitability ratios</b>					
ROE	2.3%	4.5%	5.1%	6.2%	7.4%
ROCE	1.7%	4.2%	9.8%	12.6%	16.1%
<b>Productivity ratios</b>					
Sales per employee ('000)	110.08	141.95	136.48	136.97	143.63
EBIT per employee ('000)	3.42	9.22	18.43	21.23	25.57
<b>Balance sheet ratios</b>					
Equity ratio	69.1%	67.5%	67.9%	68.6%	69.5%
Long term debt and equity / Fixed assets	157.6%	127.8%	134.7%	143.6%	154.9%
Liquidity (quick ratio)	318.6%	180.2%	196.0%	215.4%	238.9%
Receivables as % of sales	21.4%	13.0%	13.0%	13.0%	13.0%
Investment (net of GW) / Depreciation			80.3%	78.9%	77.7%
Working capital as % of sales	2.7%	-13.6%	-12.3%	-11.4%	-10.5%
Net debt (m)	-54.6	-45.6	-54.9	-66.7	-81.5
Net debt complete (m)	-35.9	-31.1	-40.3	-51.7	-66.3
<b>Figures per share</b>					
Earnings per share, diluted	0.03	0.06	0.07	0.09	0.11
Diluted cash earnings per share	0.07	0.10	0.11	0.13	0.16
Dividend per common share	0.00	0.00	0.00	0.00	0.00
Cash per share, diluted	0.18	0.15	0.23	0.33	0.45
Net debt per share, diluted	-0.47	-0.39	-0.46	-0.56	-0.69
<b>Valuation ratios</b>					
Enterprise value / Sales	5.1	2.9	3.1	2.7	2.3
Enterprise value / EBITDA	43.8	23.8	16.4	13.2	10.4
Enterprise value / EBIT	165.3	44.4	23.1	17.6	13.1
EV/Sales to sales growth	0.25	0.17	0.30	0.26	0.23
PEG ratio - common shares		1.13	1.81		
Fiscal year end December					

Source: Evotec, DZ BANK estimates

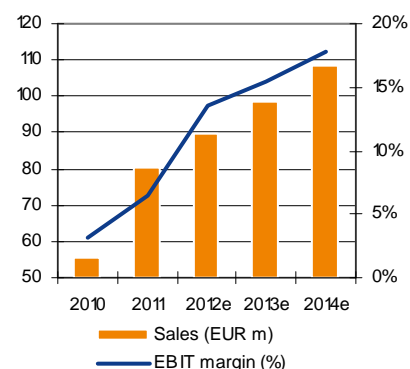
**SALES BY REGION 2011**



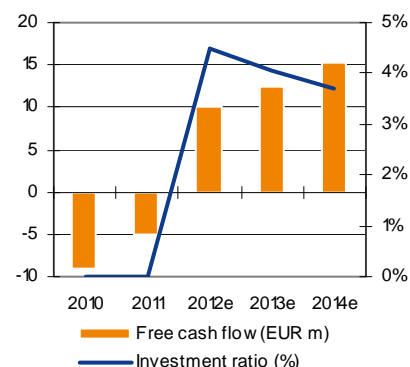
**SALES BY BUSINESS SEGMENT 2011**



**SALES AND MARGIN DEVELOPMENT**



**FREE CASH FLOW AND INVESTMENT RATIO**



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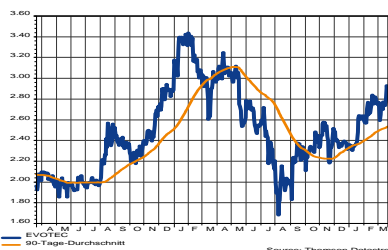
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**RATING HISTORY**

Recommendation	Date	Price
Buy	5 Feb 2010	1.96 EUR

<sup>1) - 9)</sup> Important: Please read the references to possible conflicts of interest and disclaimers/disclosures at the end of this report.

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