Evotec

Licensing deal, collaborations and milestones

Edison investment research

Advances in Action Plan 2016

Pharma & biotech

Evotec is making good progress to achieving its Action Plan 2016 goals following a flurry of activity since the middle of November. It has out-licensed its NMDA antagonist portfolio (including EVT100 family) to Janssen Pharmaceuticals (J&J), formed three new drug discovery alliances and begun a collaboration with Yale, and achieved two milestones. The Janssen licensing agreement should result in Evotec having another product in clinical development by the end of the year. Despite this progress, we have lowered our estimates following the reduction in guidance in October to be more conservative. So, our valuation is reduced by €55m to €430m.

Year end	Revenue (€m)	PBT* (€m)	EPS* (c)	DPS (c)	P/E (x)	Yield (%)
12/10	55.3	4.5	3.8	0.0	N/A	N/A
12/11	80.1	7.5	5.6	0.0	N/A	N/A
12/12e	88.0	2.3	0.9	0.0	N/A	N/A
12/13e	97.5	6.6	4.9	0.0	N/A	N/A

*PBT and EPS are normalised, excluding intangible amortisation, exceptional items and share-based payments.

NMDA agonists out-licensed

Evotec's NMDA antagonist portfolio has been out-licensed to Janssen for the treatment of depression in a deal worth €175m and double-digit royalties, a proportion of which is payable to Roche. Janssen is expected to initiate a Phase II trial in H213 once certain preclinical properties of the portfolio have been confirmed. This family of products includes the EVT100 series, which Evotec had previously been developing in collaboration with Roche for treatment-resistant depression.

Milestones and new alliances to maintain growth

Evotec has formed three new collaborations with biotech companies and the achievement of milestones with Ono Pharmaceuticals and MedImmune have laid the foundations for Evotec to continue its double-digit growth. The programme with Ono has reached preclinical development, so the drug candidate could enter clinical development in 2014.

New academic collaboration with Yale University

Evotec and Yale have entered into an open innovation alliance, in which Evotec will assist Yale in converting research in the fields of metabolism, neurology, immunology and oncology into highly innovative treatments. Evotec has formed two alliances with Harvard University (as part of its CureX strategy), the first of which has already led to a major strategic alliance with Janssen in diabetes.

Valuation: DCF valuation of €430m

Evotec lowered its guidance in Q412, and so we have lowered our estimates to be more conservative, despite its recent newsflow. Thus, we have lowered our valuation by €55m to €430m (€3.64 per share), compared to the current market cap of €331m. The main catalysts in 2013 are expected to be the formation of a second CureX collaboration with a major pharmaceutical company and possible upgrades to sales and profit guidance.

Evotec is a research client of Edison Investment Research Limited

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Price	€2.79
Market cap	€331m

Shares in issue	118.5m
Free float	70%
Code	EVT
Net cash FY12e (€m)	42.5
Primary exchange	Frankfurt
Other exchanges	N/A

Share price performance

%	1m	3m	12m
Abs	1.5	(0.7)	8.7
Rel (local)	3.4	(2.9)	(3.7)
52-week high/low		€3.0	€2.0

Business description

Evotec is a drug discovery business that provides outsourcing solutions to pharmaceutical companies, including Boehringer Ingelheim, Pfizer and Roche. It has operations in Germany, India, the UK and US. It has two partnered products, EVT302 and DiaPep277, in late stage clinical trials.

Next events

FY12 results	26 March 2013
Q113 results	14 May 2013
AGM	12 June 2013

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Evotec datasheet

Exhibit 1: Updated clinical R&D pipeline

Product	Development stage	Indication/ partner	Notes
DiaPep277	Phase III	Type I diabetes/ **Andromeda (Teva)**	A synthetic peptide of 24 amino acids derived from human Hsp60. Successfully completed the first pivotal Phase III study, DIA-AID (n=457): significant reduction in the decline in C-peptide levels (marker for endogenous insulin secretion, primary endpoint) compared to placebo (p=0.0374) and more patients maintained good glucose control (HbA1c levels of ≤7% after two years; p=0.035, 45.5% vs 35.7%). Enrolment for second pivotal study, DIA-AID2 (n=450), is complete and data is expected in H214. The product is licensed to Andromeda Biotech, which has sub-licensed the marketing rights to Teva. Evotec earned €3.9m from the successful completion of DIA-AID, and could earn significant mid-term milestones and single-digit royalties, 30% of which are payable to original shareholders of DeveloGen. Potential launch in 2015.
EVT302/ RG1577	Phase II	Alzheimer's disease/ **Roche**	Monoamine oxidase-B (MAO-B) inhibitor, initially licensed from Roche in 2006. Evotec licensed EVT302 back to Roche in 2011 for development in Alzheimer's disease (AD). Evotec was paid $10m upfront and could receive $170m in development milestones, $650m in commercial milestones and tiered double-digit royalties on sales. The Phase IIb MAORAD trial was initiated in September 2012 in moderately severe AD (n=420), trial due to be completed in March 2015. Potential launch 2019.
EVT201	Phase II	Insomnia/ **Jingxin Pharma**	$GABA_A$ receptor modulator, shown efficacy in two Phase II trials. In one trial, 75 adults, doses 1.5mg and 2.5mg, increased total sleep time (TST, 33.1, 45.0 min; both p<0.0001) and reduced wake after sleep onset (-16.7, -25.7min; p<0.0001) in a dose responsive manner. In second trial, 149 elderly pts, doses 1.5mg and 2.5mg, TST increased (30.9, 56.4min; p=0.0001, p<0.0001). No serious or unexpected adverse events. Jingxin Pharma in-licensed the exclusive rights to the drug in China and is due to initiate Phase IIb trials imminently; Evotec received a small upfront payment and could receive milestones and significant royalties. Development outside China is on hold.
NMDA antagonists	Phase II expected to start in H213	Depression/ **Janssen (J&J)**	NR2B-selective NMDA antagonists, originally discovered by Roche. A Phase II trial in depression should start in H213 after certain preclinical properties are confirmed. Evotec terminated a Phase II PoC trial for EVT101, a member of the portfolio, in May 2011 because of difficulty recruiting patients. Janssen in-licensed the portfolio of antagonists for $2m upfront, $6m if preclinical properties are confirmed, up to $67m in development milestones, up to $100m in commercial milestones, up to double-digit royalties, and additional milestones if other indications are pursued (eg schizophrenia or AD). Any payments are shared with Roche. Potential launch in 2019.
EVT401	Phase I/II	Rheumatoid arthritis, inflammatory diseases/ **Conba Pharmaceutical**	Antagonist of P2X7 ATP-gated ion channel, thought to be involved in the inflammatory process. Phase I trial: 96 healthy males with ascending doses, no serious adverse events or withdrawals occurred. A pharmacodynamic assay demonstrated that EVT401 blocked ATP-stimulated IL-1ß release in whole blood samples taken from the volunteers. Conba Pharmaceutical in-licensed the exclusive rights to the drug in China and is planning a Phase II trial. Evotec received a small upfront payment and could receive milestones in excess of €60m and tiered double-digit royalties. Further development in the rest of the world is on hold until the drug is partnered.
-	Phase I	Neuropathic pain/ **Boehringer Ingelheim**	Boehringer Ingelheim initiated a Phase I trial in May 2011 with a back-up compound. The development of a different compound, which had started Phase I in May 2010, has been stopped.

Exhibit 2: Academic collaborations

	Notes
Havard University/Howard Hughes Medical Institute (HHMI)	Formed as part of CureBeta initiative in 2011 to develop novel treatments for diabetes. Evotec is working with Prof Doug Melton. 16 months after the start of the collaboration, a strategic alliance was established with Janssen with an upfront payment of $8m; milestones up to $200-300m per product and royalties could be paid to Evotec, HHMI and Harvard University.
Harvard University/Brigham and Women's Hospital	Formed as part of CureNephron initiative in 2012 to discover and develop new biomarkers and treatments for kidney disease. Evotec is working with Prof Andy McMahon and Prof Ben Humphreys.
Yale University	An open innovation alliance formed in 2013, in which the two organisations collaborate to development treatments in the fields of metabolism, neurology, immunology and oncology.

Source: Edison Investment Research

Update: Good progress towards Action Plan 2016

Evotec has recently made good progress towards the ambitious goals in Action Plan 2016. The objectives include building a more mature pipeline, doubling revenues by 2016 at the latest and increasing the operating margin to c 15%. It has re-licensed its NMDA family of products (including the EVT100 series) to Janssen for development in the field of depression and potentially other indications. New drug discovery collaborations have been formed with Haplogen, Probiodrug and Apeiron Biologics. An innovation alliance has also been formed with Yale University so Evotec can continue developing first- and best-in class drug candidates. Important milestones in Evotec's collaborations with MedImmune and Ono Pharmaceuticals have been achieved as well. However, we have decided to be more conservative about Evotec's growth prospects following the reduction in guidance in Q412. So, we have reduced our estimates and lowered our valuation by €55m to €430m, but this still compares favourably with the current market cap of €331m.

Out-licensing of EVT100 series

Evotec has licensed its NR2B subtype selective NMDA-antagonist portfolio of products to Jansen for the treatment of depression and possibly other neurological indications. Evotec has received an upfront payment of $2m and should receive a further $6m in 2013 if certain properties of candidates are confirmed in preclinical studies. It could receive milestone payments up to $67m linked to various clinical, regulatory and launch events, commercial milestones up to $100m and double-digit royalties. Additional milestones are also payable if Janssen decides to develop more than one product in the portfolio or if it develops a product for indications other than depression, such as schizophrenia and Alzheimer's disease (AD). All payments received by Evotec will be shared with Roche, which originally developed the product.

The portfolio of products includes the EVT100 family, which Evotec had been developing EVT101 for treatment-resistant depression. The product had been in a Phase II study run by Evotec, after which Roche had an option to re-license the drug for $65m, but the trial was voluntarily terminated because of recruitment issues and issues associated with EVT101's toxicology profile. This led to the ending of the collaboration with Roche on this programme.

Janssen is expected to start a Phase II trial in depression in H213, once the preclinical properties of the candidates (presumably toxicology studies to confirm that some of the compounds have a better safety profile than EVT101) have been confirmed. Assuming that the studies demonstrate that at least one candidate has suitable characteristics, Evotec will have six products in clinical trials that are being developed by partners (Exhibit 1).

New collaborations and milestones

Evotec's growth aspirations depend on it entering more collaborations and achieving milestones. In the last three months it has formed alliances with Haplogen for infectious disease drugs, Probiodrug for a drug to treat AD and Apeiron Biologics for cancer immunotherapies. It has achieved a milestone as part of its MedImmune alliance in diabetes, resulting in receipt of €0.5m and an expansion of the collaboration in 2013. Also a compound (presumed to be an ion channel blocker for the potential treatment of cardiovascular, CNS and urological diseases) has been selected to enter preclinical development as part of its alliance with Ono Pharmaceuticals; this event has triggered an undisclosed milestone payment and could result in another product entering the clinic in 2014.

Evotec also formed an open innovation alliance with Yale University, in which the two organisations will work together in a broad range of therapeutic areas to develop innovative ways of addressing high

unmet medical needs. Essentially, Yale will provide the underlying science and Evotec its infrastructure and expertise in drug discovery to devise novel assays, screens and models required to develop innovative drugs. The alliance covers diseases related to metabolism, the central nervous system (CNS), immunology and oncology. It follows two collaborations with Harvard University for the CureBeta and CureNephron initiatives within EVT Innovate (Exhibit 2), to ensure that Evotec continues to offer the most advanced drug discovery solutions. The first alliance in the field of diabetes has already proved to be very successful; it began in March 2011 and the two organisations formed a strategic alliance with Janssen in July 2012 with an upfront payment of $8m and potential milestone payments of $200-300m per product.

Valuation and financials

We have lowered our valuation by €55m to €430m (€3.64 per share), despite Evotec's recent progress. This is primarily because we have reduced our estimates to be more conservative, following the company's lowering of guidance in October (see below). The other changes to our model related to the licensing deal, the removal of EVT401 in animals from the valuation (previously valued at €8m, the major animal pharmaceutical company stopped development of the product for commercial reasons) and changes to discount factors to reflect the progression of time. A summary of the risk-adjusted DCF valuation is shown in Exhibit 3.

Exhibit 3: Summary of risk-adjusted DCF valuation

	Value (€m)	Value per share (€)	Notes
Drug alliance business	169.3	1.43	Three stage DCF valuation, terminal growth rate: 2.5%
EVT 302	88.8	0.75	Expected launch: 2019; peak sales: $3.2bn; risk adjustment: 20%; royalties: 12.5% (excludes potential commercial milestones)
DiaPep277	68.7	0.58	Expected launch: 2015; peak sales: $1.2bn; risk adjustment: 65%; royalties: 5%
NMDA antagonists	27.1	0.23	Expected launch: 2019; peak sales: $1.0bn; risk adjustment: 25%; royalties: 7.5% (excludes potential commercial milestones)
EVT 401	12.1	0.10	In China in humans – expected launch: 2018; peak sales: $200m; risk adjustment: 30%; royalties: 12%.
EVT 070, EVT 770 milestones	21.7	0.18	Estimated milestones risk-adjusted by industry standards
Net Cash	42.5	0.36	Net cash position at FY12
Total	**430.2**	**3.64**	

Source: Edison Investment Research

We have significantly lowered our estimates to be more conservative following the reduction in guidance by Evotec in October 2012, despite of its recent progress (Exhibit 4). Since our note dated 25 September, we had lowered our estimates slightly in our Edison Insight publication in October. Our estimates do not include the impact of the recent weakening of the dollar against the euro or potential impairment charges.). The relatively small reduction in sales estimates results in a larger lowering of earnings forecasts because of operational gearing. Evotec is still expecting to increase R&D by 10% in FY13 to strengthen its technology platforms and expand its CureX initiatives.

Exhibit 4: Summary of changes to estimates

	Sales			PBT			EPS		
	Old	New	% chg.	Old	New	% chg.	Old	New	% chg.
2012e	89.4	88.0	(1.6)	3.8	2.3	(42.1)	2.8	0.9	(67.9)
2013e	105.8	97.5	(7.8)	10.8	6.6	(38.8)	8.3	4.9	(42.0)

Source: Edison Investment Research; Note: Figures in €m except per share data.

Exhibit 5: Financial summary

€'000s	2010	2011	2012e	2013e	2014e
Year end 31 December	IFRS	IFRS	IFRS	IFRS	IFRS
PROFIT & LOSS					
Revenue	55,262	80,128	88,026	97,496	108,193
Cost of Sales	(30,916)	(45,143)	(57,416)	(63,197)	(68,612)
Gross Profit	24,346	34,985	30,610	34,299	39,581
EBITDA	6,480	11,971	8,875	13,899	18,316
Operating Profit (before GW and except.)	2,387	7,467	3,548	7,963	11,823
Intangible Amortisation	(672)	(1,703)	(2,675)	(3,471)	(3,434)
Other	113	(3,878)	(2,064)	0	0
Exceptionals	0	(557)	0	0	0
Operating Profit	1,715	5,207	872	4,493	8,390
Net Interest	(625)	(1,445)	(1,495)	(1,351)	(1,296)
Other	2,777	1,494	208	0	0
Profit Before Tax (norm)	4,539	7,516	2,261	6,613	10,527
Profit Before Tax (FRS 3)	3,867	5,256	(414)	3,142	7,093
Tax	(676)	(1,153)	(1,208)	(877)	(974)
Deferred tax	(206)	2,548	6,590	(0)	(0)
Profit After Tax (norm)	3,863	6,363	1,053	5,735	9,553
Profit After Tax (FRS 3)	2,985	6,651	4,967	2,264	6,120
Average Number of Shares Outstanding (m)	109.0	116.0	117.4	117.5	117.5
EPS - normalised (c)	3.8	5.6	0.9	4.9	8.1
EPS - FRS 3 (c)	3.0	5.8	4.2	1.9	5.2
Dividend per share (c)	0.0	0.0	0.0	0.0	0.0
Gross Margin (%)	44.1	43.7	34.8	35.2	36.6
EBITDA Margin (%)	11.7	14.9	10.1	14.3	16.9
Operating Margin (before GW and except.) (%)	4.3	9.3	4.0	8.2	10.9
BALANCE SHEET					
Fixed Assets	105,167	137,253	144,565	145,133	144,403
Intangible Assets	83,594	109,854	110,305	108,034	104,600
Tangible Assets	18,487	24,946	28,575	31,414	34,117
Other	3,086	2,453	5,686	5,686	5,686
Current Assets	86,692	80,960	81,163	83,790	94,576
Stocks	2,819	3,556	3,933	4,329	4,699
Debtors	11,841	10,393	10,853	12,020	13,339
Cash	67,394	62,428	60,378	61,442	70,538
Other	4,638	4,583	6,000	6,000	6,000
Current Liabilities	(32,802)	(42,833)	(41,050)	(42,681)	(47,318)
Creditors	(24,446)	(29,659)	(27,427)	(29,058)	(33,695)
Short term borrowings	(8,356)	(13,174)	(13,623)	(13,623)	(13,623)
Long Term Liabilities	(26,420)	(28,135)	(28,696)	(27,496)	(26,296)
Long term borrowings	(3,500)	(2,359)	(4,223)	(4,223)	(4,223)
Other long term liabilities	(22,920)	(25,776)	(24,473)	(23,273)	(22,073)
Net Assets	132,637	147,245	155,982	158,746	165,366
CASH FLOW					
Operating Cash Flow	1,759	10,659	8,105	13,399	20,526
Net Interest	(299)	(38)	(354)	(1,351)	(1,296)
Tax	(561)	(475)	(371)	(1,010)	(937)
Capex	(2,432)	(7,577)	(10,848)	(8,775)	(9,196)
Acquisitions/disposals	1,202	(12,196)	0	(1,200)	0
Financing	123	231	510	0	0
Dividends	0	0	0	0	0
Other	0	(1,700)	0	0	0
Net Cash Flow	(208)	(11,096)	(2,957)	1,064	9,096
Opening net debt/(cash)	(57,750)	(58,545)	(46,895)	(42,532)	(43,596)
HP finance leases initiated	0	0	0	0	0
Exchange rate movements	(510)	531	(631)	0	0
Other	1,513	(1,085)	-775	0	0
Closing net debt/(cash)	(58,545)	(46,895)	(42,532)	(43,596)	(52,692)

Source: Edison Investment Research, Evotec

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