

Consolidated Statement of Operations

	12/31/2003 €	12/31/2002 €
Revenues	15,308,464	16,757,097
Operating Expenses		
Research and Development	8,998,012	19,591,834
Sales, General and Administrative	7,601,078	18,742,819
Stock-based Compensation	2,175,430	3,940,412
Total Operating Expenses	18,774,520	42,275,065
Loss from Operations	(3,466,056)	(25,517,968)
Interest Income	212,461	445,859
Interest Expense	874,415	687
Impairment of Marketable Securities	753,768	-
Other Income, Net	733,767	713,586
Loss before Taxes	(4,148,011)	(24,359,210)
Foreign Income Tax Expense	21	18,084
Net Loss	(4,148,032)	(24,377,294)
Basic and Diluted Net Loss per Share	(0.96)	(6.35)
Shares Used in Computing Basic and Diluted Net Loss per Share	4,332,438	3,838,670

See accompanying notes

Consolidated Balance Sheets

	12/31/2003 €	12/31/2002 €
Assets		
Current Assets		
Cash and Cash Equivalents	6,652,456	842,082
Marketable Securities	16,508,575	18,274,338
Accounts Receivable	2,111,710	8,732,790
Prepaid Expenses and Other Current Assets	948,575	1,684,729
Total Current Assets	26,221,316	29,533,939
Property and Equipment, Net	1,907,895	2,097,796
Patents, Net	6,103,675	6,898,990
License Fees, Net	10,898,904	3,352,604
Other Assets	627,130	509,984
Total Assets	45,758,920	42,393,313
Liabilities and Stockholders' Equity		
Current Liabilities		
Accounts Payable	258,732	2,273,539
Current Portion of License Payable	677,060	5,569,291
Current Portion of Deferred Revenue	4,272,249	4,378,995
Accrued Employee Benefits	949,122	1,468,907
Other Accrued Expenses and Liabilities	1,524,439	2,029,608
Total Current Liabilities	7,681,602	15,720,340
Non-Current Liabilities		
License Payable, Net of Current Portion	1,651,360	2,275,347
Deferred Revenue, Net of Current Portion	6,086,205	3,707,360
Convertible Bonds Due to Related Parties	157,200	74,800
Total Non-Current Liabilities	7,894,765	6,057,507
Stockholders' Equity		
Common Stock, € 3.00 Par Value; 8,626,344 and 7,345,582 Ordinary Shares Authorized; 4,901,332 and 3,949,706 Ordinary Shares Issued; 4,841,570 and 3,889,944 Ordinary Shares Outstanding; for 2003 and 2002, respectively	14,703,996	11,849,118
Treasury Stock (59,762 and 59,762 Shares for 2003 and 2002, respectively), at Cost	(21,934)	(21,934)
Additional Paid-In Capital	68,623,807	59,193,912
Accumulated Other Comprehensive Income/(Loss)	912,755	(517,591)
Accumulated Deficit	(54,036,071)	(49,888,039)
Total Stockholders' Equity	30,182,553	20,615,466
Total Liabilities and Stockholders' Equity	45,758,920	42,393,313

See accompanying notes

Consolidated Statement of Changes in Stockholders' Equity

	Common Stock	
	Shares	€
Balance at January 1, 2002	3,591,331	10,773,275
Exercise of Stock Options	495	1,485
Compensation Related to the Grant of Stock Options	-	-
Capital Increase for Euro Conversion	-	718
Capital Increase against Cash, Net of Issuance Cost of € 25,249	357,880	1,073,640
Other Comprehensive Loss:		
Change in Unrealized Losses on Available-for-Sale Securities	-	-
Foreign Currency Gain from Consolidation	-	-
Net Loss	-	-
Comprehensive Loss	-	-
Balance at December 31, 2002	3,949,706	11,849,118
Compensation Related to the Grant of Stock Options	-	-
Capital Increase against Contribution in Kind (XOMA), Net of Issuance Cost of € 23,314	363,466	1,090,398
Capital Increase against Contribution in Kind (CAT), Net of Issuance Cost of € 150,000	588,160	1,764,480
Other Comprehensive Loss:		
Change in Unrealized Gain on Available-for-Sale Securities	-	-
Foreign Currency Gain from Consolidation	-	-
Net Loss	-	-
Comprehensive Loss	-	-
Balance at December 31, 2003	4,901,332	14,703,996

See accompanying notes

Treasury Stock		Additional Paid-In Capital €	Accumulated Other Comprehensive Income/(Loss) €	Accumulated Deficit €	Total Stockholders' Equity €
Shares	€				
59,762	(21,934)	32,452,966	37,047	(25,510,745)	17,730,609
-	-	7,177	-	-	8,662
-	-	3,940,412	-	-	3,940,412
-	-	(718)	-	-	0
-	-	22,794,075	-	-	23,867,715
-	-	-	(557,178)	-	(557,178)
-	-	-	2,540	-	2,540
-	-	-	-	(24,377,294)	(24,377,294)
-	-	-	-	-	(24,931,932)
59,762	(21,934)	59,193,912	(517,591)	(49,888,039)	20,615,466
-	-	2,175,430	-	-	2,175,430
-	-	3,110,896	-	-	4,201,294
-	-	4,143,569	-	-	5,908,049
-	-	-	1,418,156	-	1,418,156
-	-	-	12,190	-	12,190
-	-	-	-	(4,148,032)	(4,148,032)
-	-	-	-	-	(2,717,686)
59,762	(21,934)	68,623,807	912,755	(54,036,071)	30,182,553

Consolidated Statement of Cash Flows

	12/31/2003 €	12/31/2002 €
Operating Activities		
Net Loss	(4,148,032)	(24,377,294)
Adjustments to Reconcile Net Loss to Net Cash Used for Operating Activities:		
Depreciation	851,743	890,034
Amortization of Intangible Assets	1,637,863	1,236,457
Net Gain on Sales of Marketable Securities	(326,270)	(276,872)
Unrealized Net Gain on Derivative Financial Instruments	(315,929)	-
Impairment of Marketable Securities	753,768	-
Gain on Sale of Property and Equipment	(2,652)	(3,940)
Net Gain from Accounting Estimate Change	(2,272,053)	-
Net Expense from Share Issuance (XOMA)	417,608	-
Recognition of Deferred Revenue	(7,930,121)	(6,416,412)
Stock-Based Compensation	2,175,430	3,940,412
Changes in Operating Assets and Liabilities:		
Accounts Receivable	6,621,080	(4,168,422)
Prepaid Expenses and Other Assets	1,098,937	(654,141)
Accounts Payable	(2,014,807)	2,020,599
Licenses Payable	89,612	3,847,910
Deferred Revenue	10,202,220	7,570,741
Accrued Employee Benefits	(519,785)	286,364
Other Accrued Expenses and Liabilities	(505,169)	858,768
Net Cash Provided by/(Used in) Operating Activities	5,813,443	(15,245,796)

	12/31/2003 €	12/31/2002 €
Investing Activities:		
Purchases of Marketable Securities	(12,075,587)	(39,552,408)
Proceeds from Sales of Marketable Securities	14,832,008	29,054,127
Purchases of Property and Equipment	(682,077)	(921,770)
Proceeds from Disposals of Property and Equipment	22,887	25,508
Additions to Patents	(58,746)	(496,630)
Net Cash Provided by/(Used in) Investing Activities	2,038,485	(11,891,173)
Financing Activities:		
Proceeds from the Issuance of Common Stock, Net	-	23,876,377
Proceeds from the Issuance of Convertible Bonds to Related Parties	82,400	74,800
Purchases of Derivative Financial Instruments	(164,000)	-
Payment of Financed License Payable	(1,798,830)	-
Cost of Share Issuance	(173,314)	-
Net Cash Provided by/(Used in) Financing Activities	(2,053,744)	23,951,177
Effect of Exchange Rate Differences on Cash	12,190	2,540
Increase/(Decrease) in Cash and Cash Equivalents	5,810,374	(3,183,252)
Cash and Cash Equivalents at the Beginning of the Period	842,082	4,025,334
Cash and Cash Equivalents at the End of the Period	6,652,456	842,082
Supplemental Disclosures of Cash Flow Information:		
Cash Received During the Year for Foreign Income Taxes	-	38,472
Unrealized Gain/(Loss) on Marketable Securities	1,418,156	(557,178)
Interest Paid	201,170	-
Non-Cash Settlement of License Payable (XOMA)	4,224,608	-
License to be Settled in Equity	-	3,160,386
Non-Cash Settlement of License Payable (CAT)	8,330,102	-
Capital Increase for Euro Conversion	-	718

See accompanying notes

Notes to the Consolidated Financial Statements

1 Organization and Summary of Significant Accounting Policies

Business and Organization MorphoSys AG (“the Company”) is a biotechnology company using combinatorial biology in drug discovery with the principal objective of developing and commercially exploiting new enabling technologies across a broad scientific spectrum. The Company was founded in July 1992 as a German limited liability company. In June 1998, MorphoSys AG was transformed into a German stock corporation. In March 1999, the Company went public on Germany’s *Neuer Markt*, the stock exchange designated for high-growth enterprises. On January 15, 2003, MorphoSys AG was admitted to the Prime Standard segment of the Frankfurt Stock Exchange.

Substantially all operations are located in Germany. The Company has two wholly owned subsidiaries:

- MorphoSys U.S.A., Inc., which was incorporated in the United States on February 16, 2000. The subsidiary’s purpose was to assist the Company in the sale and licensing of MorphoSys AG products. MorphoSys U.S.A., Inc. substantially ceased its operations in November 2002.
- MorphoSys IP GmbH, which was incorporated in Munich, Germany, on November 6, 2002. The subsidiary’s purpose is to purchase, maintain and administer certain intangible assets of the MorphoSys Group. The Company’s operations are physically located at the premises of MorphoSys AG, and the operations of MorphoSys IP GmbH commenced on December 31, 2002.

The accompanying consolidated financial statements reflect the application of certain significant accounting policies as described in this note and elsewhere in the accompanying consolidated financial statements and notes.

Basis of Financial Statement Presentation The accompanying financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America (U.S. GAAP). In accordance with German law, the Company is required to publish its financial statements in accordance with the German Commercial Code, which represents generally accepted accounting principles in Germany (“German GAAP”). German GAAP varies in certain significant respects from U.S. GAAP. Accordingly, the Company has recorded certain adjustments, principally relating to revenue recognition and the recording of certain costs, in order to present the accompanying financial statements in accordance with U.S. GAAP.

Use of Estimates The preparation of the consolidated financial statements in conformity with accounting standards generally accepted in the United States requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Actual results could differ from those estimates.

Cash and Cash Equivalents	The Company considers all highly liquid investments with an original maturity of three months or less to be cash equivalents. The Company invests its cash in deposits with two major German financial institutions.
Consolidation	The accompanying financial statements consolidate the financial position, results of operations, and cash flows of MorphoSys AG and its subsidiaries. All intercompany transactions and balances have been eliminated.
Marketable Securities	The Company accounts for its marketable securities using Statement of Financial Accounting Standards (“SFAS”) No. 115, “Accounting for Certain Investments in Debt and Equity Securities.” Management determines the proper classifications of securities at the time of purchase and reevaluates such designations as of each balance sheet date. At December 31, 2003 and at December 31, 2002, such securities that we are classified as available-for-sale we are carried at market value, with unrealized gains and losses reported in accumulated other comprehensive income, which is a separate component of stockholders’ equity. Realized gains and losses on sales of investments, as determined on a specific identification basis, are included in the statements of operations when the investment is sold or matures. On a regular basis, the Company tests for impairment. If a decline in the fair value of available-for-sale securities is judged to be other than temporary, the cost basis for the security is written down to fair value as new cost basis. The written-down amount is included in earnings as an impairment charge. The Company considers a decline in the market value of a marketable security which is longer than six months in duration to be deemed other than temporary unless specific facts and circumstances indicate otherwise.
Derivative Financial Instruments	The Company accounts for its derivative instruments using SFAS No. 133 “Accounting for Derivative Instruments and Hedging Activities” and its corresponding amendments under SFAS No. 138. SFAS No. 133 requires the Company to measure every derivative instrument at fair value and record them as either an asset or liability. Changes in fair value are recorded in other income (see note 5).
Property and Equipment	Property and equipment is stated at cost, less accumulated depreciation and amortization. Major replacements and improvements are capitalized while general repairs and maintenance are charged to expense as incurred. Assets are depreciated over three to ten years using the straight-line method. Leasehold improvements are amortized over the estimated useful lives of the assets or the related lease term, whichever is shorter.

Revenue Recognition The Company's revenues include technology access fees; fees earned from research and development collaboration agreements predominately with companies based in the United States.

Revenue related to non-refundable technology access fees, subscription fees and license fees is deferred and recognized on a straight-line basis over the relevant periods of the agreement, generally the research term or the estimated useful life of the collaboration for those contracts without a stipulated term unless a more accurate means of recognizing revenue is available. Research and development collaboration service fees are recognized in the period that the services are provided. Milestone revenues are recognized upon achievement of certain criteria.

Investment grants from governmental agencies for the support of specific research and development projects are recorded as revenue to the extent the related expenses have been incurred: under the terms of the investment grants, the governmental agencies generally have the right to audit the use of the payments received by the Company.

For revenue arrangements with multiple deliverables the Company tests for separate units of accounting based on the criteria stated in EITF 00-21. If certain criteria are met, the consideration will be allocated among the separate units based on their respective fair values, and the applicable revenue recognition criteria will be considered separately for each of the separate units.

Deferred revenue represents revenues received but not yet earned per the terms of the contracts. At December 31, 2002, deferred revenue included € 2.8 million, for which cash was not received until January 2003. At December 31, 2003, cash was received for all deferred revenue recorded.

Segment Reporting The Company operates primarily in one business segment related to the development of antibody therapeutics within the biotech industries. Accordingly, the Company does not disclose significant additional segment information under the definition of segment reporting, defined by the standards of SFAS No. 131, "Disclosure About Segments of an Enterprise and Related Information."

Research and Development Research and development costs are expensed as incurred.

Stock-Based Compensation	The Company applies the provisions of SFAS No. 123 "Accounting for Stock-Based Compensation," which requires the Company to record the estimated fair value of stock options and other awards at the grant date as compensation expense over the period in which the employees render the services associated with the award.
Foreign Currency Translation	The financial statements of foreign subsidiaries have been translated into euros in accordance with SFAS No. 52, "Foreign Currency Translation." All balance sheet accounts have been translated using the exchange rates in effect at the balance sheet date. The statement of operations amounts has been translated using the average exchange rate for the year. The gains and losses resulting from the changes in exchange rates from year to year have been reported in accumulated other comprehensive income.
Net Loss per Share	<p>Basic and diluted loss per share is calculated in accordance with SFAS No. 128, "Earnings per Share." Basic loss per share is based upon the number of weighted-average shares of common stock outstanding for the respective years.</p> <p>The Company's outstanding stock options and convertible bonds were excluded from the above calculations of dilutive net loss per share, as the effect of their inclusion would have been anti-dilutive.</p>
Impairment of Long-Lived and Identifiable Intangible Assets	The Company evaluates the carrying value of long-lived assets and identifiable intangible assets for potential impairment whenever events or changes in circumstances indicate that the carrying amount of such assets may not be recoverable. Recoverability is determined by comparing projected undiscounted cash flows associated with such assets to the related carrying value. An impairment loss is recognized when the estimated undiscounted future cash flows are less than the carrying amount of the asset. An impairment loss would be measured as the amount by which the carrying value of the assets exceeds the fair value of the asset.
Patent Costs	The Company capitalizes costs related to obtaining patents and protecting granted patents from infringement. Capitalized costs principally relate to the costs of legal counsel. Patent costs are amortized on a straight-line basis over the lesser of their estimated economic life or remaining patent term (10 years). Amortization commences at the time the patent is issued. The Company's patents covering its proprietary HuCAL [®] technology were granted in Australia in October 2000, in the United States of America in October 2001 and in Europe in June 2002. Further patent applications are pending in Canada and Japan.

Accounting for Acquired License Rights	The Company acquired license rights by making upfront licensing payments, annual maintenance fees and sublicensing payments to third parties. The Company amortizes up-front licensing payments on a straight-line basis over the estimated useful life of the acquired license (10 years). Annual maintenance fees are amortized over the term of each annual agreement. Sublicensing payments are amortized on a straight-line basis over the life of the contract or the estimated useful life of the collaboration for those contracts without a stipulated term.
Concentration of Credit Risk	Financial instruments that potentially subject the Company to concentrations of credit risk consist primarily of cash, cash equivalents, marketable securities and accounts receivable. The Company's cash and cash equivalents are principally denominated in euros and U.S. dollars. Marketable securities are placed in high-quality securities. Cash, cash equivalents and marketable securities are maintained principally with two high-quality financial institutions in Germany. The Company continually monitors its positions with, and the credit quality of, the financial institutions, which are counter parties to its financial instruments, and does not anticipate non-performance. The Company's revenues and accounts receivable are subject to credit risk as a result of customer concentrations. One customer individually accounted for approximately 88% of the Company's 2003 accounts receivable balance. In addition, three customers individually accounted for 40%, 27% and 15% of the Company's total revenues in the year 2003. On December 31, 2002, two customers accounted for 50% and 46% for the prior year's accounts receivable balance and three customers individually accounted for 39%, 25% and 13% of the Company's revenues in 2002.
Accounts Receivable	For accounts receivable, the allowance for doubtful accounts is based on the management's assessment of the collectibility of specific customer accounts and the aging of the accounts receivable. If there is a deterioration of a major customer's credit worthiness or actual defaults are higher than the historical experience, management's estimates of the recoverability of amounts due the Company could be adversely affected. Based on management assessment, no allowance was necessary on December 31, 2003 and 2002. The company does not require collateral from customers for accounts receivable. On December 31, 2003 and 2002, accounts receivable included unbilled amounts of approximately € 119,360 and € 265,000 respectively.
Income Taxes	The Company accounts for income taxes under SFAS No. 109, "Accounting for Income Taxes" using the liability method. Income taxes and credits are provided at statutory rates for taxable items included in the statements of operations, regardless of the period in which such items are reported for income tax purposes. Deferred income taxes are recognized for temporary differences between the financial statement and income tax bases of assets and liabilities for which income tax benefits will be realized in future years. Deferred tax assets are reduced by a valuation allowance if, based upon the weight of available evidence, it is more likely than not that some portion or all of the related tax asset will not be realized.

Fair Value of Financial Instruments The carrying value of financial instruments such as cash and cash equivalents, accounts receivable and accounts payable approximate their fair value based upon the short-term maturities of these instruments. The fair value of marketable securities is based upon quoted market prices (see note 3). The fair value of license payables are determined by the effective interest method. Convertible bonds are recorded at their accreted values, which approximate the cash outlay that is due upon the note settlements.

Reclassifications Certain amounts in the prior year's consolidated financial statements have been reclassified to conform to the current year's presentation.

Effects of New Accounting Standards and Regulations In November 2002, the Emerging Issues Task Force (EITF) of the FASB issued EITF 00-21, "Revenue Arrangements with Multiple Deliverables," which addresses certain aspects of the accounting for arrangements that involve the delivery or performance of multiple products, services and/or rights to use assets. Under EITF 00-21, revenue arrangements with multiple deliverables should be divided into separate units of accounting if certain criteria are met, including whether there is objective and reliable evidence of the fair value of the undelivered items. In addition, the consideration should be allocated among the separate units based on their respective fair values, and the applicable revenue recognition criteria should be considered separately for each of the separate units. EITF 00-21 is effective for the Company's revenue arrangements entered into beginning July 1, 2003. Our adoption of EITF 00-21 did not have a material impact on our results of operations or financial position.

In July 2003, the FASB issued Interpretation No. 46, "Consolidation of Variable Interest Entities" ("FIN 46"), an interpretation of Accounting Research Bulletin No. 51, "Consolidated Financial Statements." FIN 46 prescribes how to identify variable interest entities and how an enterprise assesses its interests in a variable interest entity to decide whether to consolidate that entity. In October 2003, the implementation date of FIN 46 was deferred until the end of the first interim or annual period ending after December 15, 2003. On December 24, 2003, the FASB issued a revision to Interpretation 46 ("46R") to clarify some of the provisions of FASB Interpretation No. 46, "Consolidation of Variable Interest Entities," and to exempt some entities from its requirements.

Under the new guidance, special effective date provisions apply to enterprises that have fully or partially applied Interpretation 46 prior to issuance of this revised interpretation. Our adoption of FIN 46 did not have a significant effect on our results of operations or financial position.

In April 2003, the FASB issued SFAS No. 149, "Amendment of Statement 133 on Derivative Instruments and Hedging Activities," which amends and clarifies accounting for derivative instruments, including certain derivative instruments embedded in other contracts, and hedging activities under FAS No. 133. The amendments set forth in SFAS No. 149 improve financial reporting by requiring that contracts with comparable characteristics be accounted for similarly. The provisions of SFAS No. 149 are effective for contracts entered into or modified after June 30, 2003. Our adoption of SFAS No. 149 did not have a significant effect on our results of operations or financial position.

In May 2003, the FASB issued SFAS No. 150, "Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity." This statement establishes standards for how an issuer classifies and measures certain financial instruments with characteristics of both liabilities and equity. The provisions of SFAS No. 150, which also include a number of new disclosure requirements, are effective for instruments entered into or modified after May 15, 2003 and pre-existing instruments as of the beginning of the first interim period that commences after June 15, 2003. The adoption of SFAS No. 150 did not have a significant effect on our results of operations or financial position.

On December 17, 2003, the Securities and Exchange Commission ("SEC") published Staff Accounting Bulletin (SAB) No. 104, "Revenue Recognition." SAB No. 104 updates portions of the SEC staff's interpretive guidance provided in SAB No. 101 and included in Topic 13 of the Codification of Staff Accounting Bulletins. SAB No. 104 deletes interpretive material no longer necessary, and conforms the interpretive material retained, because the pronouncements issued by the FASB's EITF on various revenue recognition topics, including EITF 00-21. SAB No. 104 also incorporates the codification of certain sections SAB No. 101's frequently asked questions and answers. The adoption of SAB No. 104 did not have a significant effect on our results of operations or financial position.

2 Restructuring

In November 2002, MorphoSys announced restructuring measures. These measures included the discontinuation of clinical drug development and the refocusing of the Company's commercial strategy. These measures were implemented in 2003 with the aim of strengthening the Company's financial position by significantly reducing its cost base.

In November 2002, the Company took actions to reduce its headcount by 24% from 120 to 91 employees, thereof 26 in Germany and 3 in the U.S.A. The total amount of expenses relating to the restructuring plan amounted to € 731,837. Of this total amount, € 387,415 were part of the sales, general and administrative costs (of which € 268,610 are related to MorphoSys U.S.A., Inc.), and € 344,421 were allocated to Research & Development expenses. The € 268,610 include leasehold improvements, cancellation fees, and severance payments. At December 31, 2002, € 47,449 of the total termination benefits had been paid and € 684,388 were included in accrued expenses, of which € 415,778 were included in accrued employee benefits. Payments made in 2003 related to restructuring activities from 2002, approximated the estimated accrual at December 31, 2002. In August 2003, the last remaining liability related to the early termination of leased office space in the U.S. was settled. No significant further expenditures are currently anticipated. Therefore, the restructuring accrual at December 31, 2003 was zero.

3 Marketable Securities

Marketable securities consist of the following as of December 31, 2003 and 2002 (in thousands €):

in 000's €	Maturity	Cost	Gross Unrealized Holding		Market Value
			Gains	Losses	
12/31/2003					
HVB Euro Bond	06/07/2011	3,268	456	–	3,724
HVB Debentures	12/06/2009	2,562	161	–	2,723
DB Money Market Funds	daily	10,181	245	–	10,426
		16,011	862	–	16,873
Restricted Cash					364
					16,509
12/31/2002					
HVB Euro Bond	06/07/2011	3,794	–	(526)	3,268
HVB Debentures	12/06/2009	2,789	–	(269)	2,520
DB Money Market Funds	daily	12,611	239	–	12,850
		19,194	239	(795)	18,638
Restricted Cash					364
					18,274

The net unrealized holding gains of € 861,929 for the year ending December 31, 2003 and net unrealized holding losses of € 556,228 for the year ending December 31, 2002 were recorded as a separate component of stockholders' equity. The unrealized losses in 2002 were due to a decline in the market value of marketable securities placed with HypoVereinsbank, as a result of a downgrading of the bank.

The Company invested an aggregate amount of € 3.8 million in a silent partnership of HypoVereinsbank Luxembourg and € 2.8 million in securities of the HypoVereinbank AG. Under SFAS No. 115 "Accounting for Certain Investments in Debt and Equity Securities," both investments are designated as available-for-sale and are reported at fair value on the Company's balance sheet. Under the Company's accounting policy, marketable securities are presumed to be impaired if their fair value is less than their cost basis for more than six months, unless specific facts and circumstances indicate otherwise. If the Company deems these investments further impaired at the end of any other period, an additional impairment may occur. During 2002/2003, MorphoSys' HypoVereinsbank investments had traded below their original cost basis for more than six months, and therefore the Company deemed that an impairment of these investments had occurred. Accordingly, impairment charges from January 2003 to June 2003 of € 753,768 were recognized in June 2003. Since June 30, 2003, the two impaired investments have recovered, and at December 31, 2003, the two investments had regained € 617,000 in market value.

For further details of restricted cash items, see note 4.

4 Restricted Assets

The Company has classified as restricted cash certain cash and cash equivalents and marketable securities in other assets that are not available for use in its operations. At December 31, 2003 and 2002, the Company had commitments of € 364,000 for guarantees issued and € 157,200 and € 74,800 respectively for convertible bonds issued to employees.

5 Derivative Financial Instruments

In May 2003, MorphoSys entered into foreign currency options contracts to hedge foreign exchange exposure related to U.S. dollar accounts receivable. At December 31, 2003, options contracts in the notional amount of € 4,690,583 or US\$ 5,250,000 were outstanding and will mature between January 2004 and February 2004. The fair market value at December 31, 2003 was € 479,929 and recorded in other current assets on the balance sheet. The Company did not have any derivative financial instruments at December 31, 2002.

At December 31, 2003, the remaining contract premium for derivatives amounted to € 164,000.

For the period ending December 31, 2003, unrealized gains amounted to € 315,929, of which € 193,500 were realized in January 2004 and included in total foreign exchange gains of € 389,196 (2002: € 483,042).

6 Accumulated Other Comprehensive Income/(Loss)

Accumulated other comprehensive income/(loss) consists of unrealized gains or losses on marketable securities and translation adjustments from consolidation. For the period ending December 31, 2003 and 2002, the components of accumulated other comprehensive income/(loss) were as follows (in thousands €):

	12/31/2003 in 000's €	12/31/2002 in 000's €
Net Unrealized Gain/(Loss) on Available-for-Sale Securities	862	(556)
Foreign Currency Translation Adjustment	51	38
Accumulated Other Comprehensive Income/(Loss)	913	(518)

The impairment charge on the HypoVereinsbank investments of € 753,768 was recognized as an unrealized loss in the statement of operations and removed from accumulated other comprehensive income (loss).

7 Intangible Assets

The following sets forth the intangible asset classes as of December 31, 2003 and 2002 (in thousands €):

	12/31/2003 in 000's €	12/31/2002 in 000's €
Amortized Intangibles		
Patents	8,569	8,531
License Rights	12,140	3,810
Accumulated Amortization Patents	(2,571)	(1,717)
Accumulated Amortization Licenses	(1,241)	(457)
Unamortized Intangible Assets		
Patents	106	85
Net Intangible Assets	17,003	10,252

The changes in the carrying amount of unamortized patents for the period ending December 31, 2003 is as follows (in thousands €):

	12/31/2003 in 000's €
Unamortized Intangibles	
Balance on December 31, 2002	85
Additions for the Full Year 2003	21
Balance on December 31, 2003	106

Amortization is expected to commence on unamortized patents once the related patents are issued. Amortization expense on intangible assets totaled € 1,637,863 for the twelve-month period ending December 31, 2003 (December 31, 2002: € 1,236,457). Patents are amortized over 10 years starting from the date of the first patent grant. Licenses are amortized over 10 years from the date of the acquisition.

Future amortization for the years 2004 to 2008 and thereafter are as follows (in thousands €):

	12/31 in 000's €
2004	2,071
2005	2,071
2006	2,071
2007	2,071
2008	2,071
Thereafter	6,542
	16,897

8 Property and Equipment

Property and equipment consist of the following at December 31, 2003 and 2002 (in thousands €):

	12/31/2003 in 000's €	12/31/2002 in 000's €
Office and Laboratory Equipment	3,605	3,145
Furniture and Fixtures	1,267	1,260
Purchased Software	1,186	1,044
Total	6,058	5,449
Less Accumulated Depreciation	(4,150)	(3,351)
Net Property and Equipment	1,908	2,098

9 Commitments

The Company leases facilities and equipment under long-term operating leases. Total rent expense amounted to € 899,676 and € 983,908 for the years ending December 31, 2003 and 2002 respectively. In January 2004, MorphoSys amended the existing lease agreement of its facilities. The new lease agreement expires in September 2009. Future minimum payments under non-cancelable operating leases with initial terms of one year or more are as follows (in thousands €):

	12/31 in 000's €
2004	1,191
2005	968
2006	933
2007	897
2008	893
Thereafter	893
	5,775

The Company's total expenses under operating leases in the years ending December 31, 2003 and 2002 totaled approximately € 1,058,111 and € 1,280,221 respectively.

10 Contingent Liabilities

In June 2001, a lawsuit was filed against the Company by Applied Molecular Evolution, Inc., (“AME”) San Diego, U.S.A., at the United States District Court of Massachusetts in Boston, U.S.A., alleging that the Company infringes the Kauffman-Ballivet patent family. These patents cover the stochastic production of proteins and were granted in the late 1990s. A trial date has not yet been set, although in January 2003, MorphoSys confirmed that it had received a positive “Report and Recommendation” from the Magistrate Judge to the District Judge for the District Court in Boston, Massachusetts, U.S.A., in the legal action filed by Applied Molecular Evolution. The Magistrate Judge recommended that MorphoSys’ motion for summary judgment of non-infringement be allowed and that AME’s motion for partial summary judgment of infringement be denied. As a result, no provisions for contingent liabilities have been made in the Company’s financial statements.

In December 2002, the Company and Cambridge Antibody Technology (“CAT”) entered into a settlement agreement pursuant to which they agreed to settle all patent disputes between the two companies. Pursuant to the settlement agreement, the Company agreed to make annual payments of € 1.0 million over the next five years as well as issue 588,160 new shares of common stock and make certain ongoing royalty and milestone payments, and in return will receive a license under certain CAT patents with respect to the previous and future development of HuCAL[®] libraries. The Company has the option to buy out its cash obligations to CAT for a predefined fixed amount at any time during the duration of the agreement. The Company recorded an accrual for the settlement with CAT in the year 2002. In addition, the Company recorded a net present value discount of approximately € 1.2 million on the annual payments to record the liability at its estimated fair value of € 3.8 million. The discount of 13% on the cash payments is being amortized to interest expense over the period of the payments. For the full year 2003, € 0.2 million was charged to interest expense. The settlement agreement was finalized in July 2003 and the Company engaged an external valuation expert to complete a valuation, whose basis provided the necessary information to finalize the accounting.

Based on the valuation analysis, the Company determined the fair value of the different components of the agreement and allocated the total consideration paid for each component based on the fair values of the consideration received. The completion of the analysis resulted in an accounting estimate change which reduced Research and Development expense by € 2.3 million. Accordingly, a total of € 1.9 million was expensed for the release. The remaining € 8.3 million of consideration represents the value of the license received and has been capitalized as an intangible asset and will be amortized over its expected useful life of 10 years.

Management is not aware of any other matters that could give rise to any material liability to the Company that would have a material adverse effect on the Company’s financial condition or results of operations.

The change in accounting estimate had the following effect on net loss and net loss per share for the years ending December 31, 2003 and 2002 (in thousands €, except for per share data):

	12/31/2003 in 000's €	12/31/2002 in 000's €
Net Loss	(4,148)	(24,377)
Effect from Change in Accounting Estimate	(2,272)	2,272
Pro-Forma Loss	(6,420)	(22,105)
Basic and Diluted Net Loss per Share	(0.96)	(6.35)
Effect from Change in Accounting Estimate	(0.52)	0.59
Pro-Forma Net Loss per Share	(1.48)	(5.76)

11 Stockholders' Equity

Common Stock On December 31, 2003, the common stock of the Company was € 14,703,996. This represented an increase of € 2,854,878 compared to December 31, 2002 balance of € 11,849,118. The increase arose as a result of the issuance of 363,466 shares to XOMA for a capital increase against contribution in kind, which was registered on May 6, 2003 in the commercial register, and the issuance of 588,160 shares to CAT for a capital increase against contribution in kind, which was registered on August 26, 2003 in the commercial register.

On March 28, 2002, the Company's common stock increased by € 1,073,640 from € 10,773,275 to € 11,846,915 with new shares arising from Authorized Capital II, in conjunction with the Schering collaboration signed in December 2001. In addition, the Company's common stock increased by € 718 from € 11,846,915 to € 11,847,633 to avoid fractional common stock as calculated by its imputed nominal value per share. During the year 2002, 495 shares were raised from conditional capital through exercise of the same number of employee stock options, thereby increasing the amount of subscribed capital by € 1,485, to a total of € 11,849,118, or 3,949,706 shares.

Authorized Capital On May 6, 2003, 363,466 shares of Authorized Capital I were issued to XOMA for a capital increase against contribution in kind.

On May 16, 2003, shareholders' assembly authorized the Company to create a maximum of 431,317 new shares of Authorized Capital II and a maximum of 1,725,269 new shares of Authorized Capital I.

In August 2003, 588,160 shares of Authorized Capital I were issued to CAT for a capital increase against contribution in kind. Unused Authorized Capital I equaled 1,137,109 and 1,431,529 shares at December 31, 2003 and 2002 respectively. Unused Authorized Capital II equaled to 431,317 and 394,921 shares at December 31, 2003 and 2002 respectively.

Conditional Capital No stock options or convertible bonds were exercised in the year 2003. During the year 2002, 495 shares were raised from conditional capital through exercise of the same number of employee stock options, thereby increasing the amount of subscribed capital by € 1,485.

On May 16, 2003, the shareholders' assembly authorized the Company to create additional shares for Conditional Capital III, IV and V in the maximum amount of 1,275,000, 450,269 and 111,447 shares respectively.

In 2002, previously authorized Conditional Capital I and II, consisting of € 97,875 and € 900,750 respectively, and arising from prior year resolutions, were retained. Conditional Capital III, to allow issuance of convertible bonds and consisting of € 2,625,000 (875,000 shares) was also retained. Conditional Capital IV, an authorization to issue convertible bonds to management and employees as part of an equity incentive scheme, was retained and consisted of € 900,000 (300,000 shares). The shareholder assembly authorized the creation of Conditional Capital V consisting of € 223,668 (74,556 shares), which authorizes the Company to issue additional share options to employees.

Dividends Dividends may only be declared and paid from the accumulated retained earnings (after deduction of certain reserves) shown in the Company's annual German statutory accounts. Such amounts differ from the total of additional paid-in capital and accumulated deficit as shown in the accompanying consolidated financial statements as a result of the adjustments made to present the consolidated financial statements in accordance with U.S. GAAP. As of December 31, 2003 and 2002, the Company's German statutory accounts reflected no accumulated earnings available for distribution and accordingly, the Company's ability to pay dividends would depend upon the future earnings of the Company.

Additional Paid-In Capital On December 31, 2003, additional paid-in capital amounted to € 68,623,807 (December 31, 2002 € 59,193,912). The increase of € 9.4 million is due to stock-based compensation provisions in the amount of € 2,175,430, € 3,110,896 as a result of the XOMA share issuance, and € 4,143,569 as a result of the CAT share issuance.

In 2002, the additional paid-in capital was increased by € 3,940,412 resulting from stock-based compensation provisions, premiums associated with the capital increase against cash from the agreement with Schering, and the exercise of employee stock options.

Treasury Stock Treasury Shares totaling € 21,934 (59,762 shares) at December 31, 2003, remained unchanged compared to December 31, 2002.

12 Stock Options

1998 Employee Stock Option Program Effective June 15, 1998, the Company introduced an incentive stock option plan (“1998 Plan”) which provides for the grant of options to purchase shares of the Company’s common stock to key employees and members of the Company’s Management Board. The 1998 Plan authorized the grant of options to personnel for 96,075 shares of the Company’s common stock in the form of 45,450 registered warrants, each equal to one share of common stock and 50,625 shares deliverable upon exercise of non-warrant option rights. The Company reserved 55,350 common shares plus 68,650 shares of treasury stock for stock options. All option rights granted under this 1998 Plan have a 10-year term.

Each warrant entitles the holder to receive one share. Upon exercise of a warrant, the exercise price, which equals the fair value of the shares on the date of grant, is due and payable. The holder of warrants can exercise up to the full amount of warrants 6 months after the date of grant. The holder of warrants also has the right to sell them. The warrants or shares obtained upon exercise vest annually on a graded basis over three years.

The non-warrant option rights are granted by way of an option agreement by the Company to the employee. For all grants commencing after June 1998, a two year holding period is required after the date of grant, after which the holder of non-warrant option rights can exercise up to the amount of vested option rights.

1999 Employee Stock Option Program Effective July 21, 1999, the Company amended the incentive stock option plan (“1999 Plan”) authorizing the additional grant of options to employees for up to 300,250 shares, arising from conditional capital, and deliverable upon exercise of non-warrant option rights. On October 31, 1999, a grant of 98,100 shares was made to Company employees, management and the Supervisory Board. The option rights are non-transferable, and have a maximum life of 5 years. Additionally, a two-year holding period is required after the date of grant, after which the holder of the option rights can exercise up to the amount of vested option rights, under the condition that the value of the underlying stock has appreciated 10% per annum, cumulatively, in the year of exercise.

In the year 2002, additional grants to employees were made under the 1999 Plan, with terms identical to the 1999 stock options grants. 5,500 options were granted on January 15, 2002, to employees of MorphoSys AG.

In the year 2003, additional grants to executive board members were made under the 1999 Plan, with terms identical to the 1999 stock options grants. 36,000 options were granted on July 7, 2003, to executive board members of MorphoSys AG.

**2002 Employee Stock
Option Program**

Effective June 6, 2002, the Company amended the incentive stock option plan (“2002 Plan”) authorizing the additional grant of options to employees for up to 74,556 shares, arising from conditional capital, and deliverable upon exercise of non-warrant option rights. On July 9, 2002, a grant of 7,500 shares was made to Company employees. The terms are very similar to those of “1999 Employee Stock Option Program.” On May 16, 2003, the stockholders’ assembly authorized the Company to grant additional 36,891 shares under the “2002 Employee Stock Option Program” with identical terms.

In the year 2003, grants to employees were made under the 2002 Plan, with terms identical to the 1999 and 2002 stock options grants. 2,500 options and 15,000 options were granted on January 15, 2003 and July 1, 2003 respectively to employees of MorphoSys AG.

On January 15, 2004, 35,000 options were granted to employees with terms identical to the 1999, 2002 and 2003 stock options grants.

A summary of the activity under the Company’s employee incentive stock option plans for the years ending December 31, 2003 and 2002 is represented as follows:

	Shares	Weighted- Average Price €
Outstanding at January 1, 2002	285,465	30.12
Granted	13,000	41.07
Exercised	(495)	17.50
Forfeited	(32,500)	31.71
Outstanding at December 31, 2002	265,470	30.48
Outstanding at January 1, 2003	265,470	30.48
Granted	53,500	10.89
Exercised	–	0.00
Forfeited	(47,225)	31.65
Outstanding at December 31, 2003	271,745	26.40

Stock options exercisable at December 31, 2003 and 2002 amounted to 179,295 and 133,720 shares respectively. The weighted-average exercise prices of stock options exercisable were € 27.91 and € 25.40 at December 31, 2003 and 2002 respectively. Furthermore, the weighted-average fair value of options granted during 2003 and 2002 is estimated to be € 7.57 and € 17.98 respectively.

The following table presents weighted-average price and information about contractual life for significant option groups outstanding at December 31, 2003:

Range of Exercise Prices	Number Outstanding	Remaining Contractual Life (in Years)	Weighted-Average Exercise Price	Number of Exercisables	Weighted-Average Exercise Price
€ 10.88–€ 20.00	101,470	4.55	€ 14.02	47,970	€ 17.50
€ 20.01–€ 58.00	161,150	1.68	€ 25.46	126,075	€ 23.98
€ 58.01–€ 217.00	9,125	1.86	€ 180.78	5,250	€ 217.60
	271,745			179,295	

The Company accounts for stock-based compensation in accordance with the provisions of SFAS No. 123. Compensation expense recorded in 2003 and 2002 in connection with stock options was € 1,864,722 and € 2,458,368 respectively. The fair value of the options issued in 2003 was calculated using the Black-Scholes option pricing model and the following assumptions: risk-free interest rates ranging from 2.96% to 3.61%, dividend yield of 0%, 115% expected volatility and an expected option life of 3.0 years. For option grants in 2002, the following assumptions were used: risk-free interest rates ranging from 4.50% to 5.14%, dividend yield of 0%, 60% expected volatility and identical option life as of 2003.

Option valuation models require the input of highly subjective assumptions. Because changes in the subjective input assumptions can materially affect the fair value estimate, in management's opinion, the existing models do not necessarily provide a reliable single measure of the fair value of its employee stock options.

Stock Option Repricing

On September 1, 2001, the Company reissued 94,100 options to employees, which were cancelled on July 5, 2001. The reissued options have similar characteristics and vesting provisions as the original options granted. In accordance with SFAS No. 123, the reissued options were revalued at the date of reissuance using the Black-Scholes option pricing model. A fair market value of approximately € 5,950,000 was assigned to the reissued options, which will be recognized over the vesting period of the reissued options. During the year ending December 31, 2003 and 2002, the Company recognized approximately € 1,650,000 and € 2,226,000 respectively of stock-based compensation expense relating to these reissued stock options.

13 Convertible Bonds

At the Company's shareholder assembly in July 2002, the Company was authorized until June 30, 2006 to issue up to 300,000 non-interest-bearing convertible bonds with a par/nominal value of € 1.00 each to employees and members of the Board of Management of the Company and its affiliates. The preemptive rights of the stockholders were excluded. On May 16, 2003, the stockholders' assembly authorized the Company to grant additional 150,269 shares.

On January 15, 2002, pursuant to a Management Board decision, the Company issued 91,500 convertible bonds to the Management Board and employees of the Company.

The convertible bonds cannot be transferred or encumbered, other than through inheritance/death, or in the event of disability to work, the Board of Management can allow the transfer with good cause.

The conversion rights may only be exercised if a declaration of termination of the employment agreement with the owner of the convertible bonds has not been declared at the time of exercise and a mutual termination agreement has not been entered into. In the event of non-exercise of the conversion rights, beneficiaries are refunded amounts paid to acquire the convertible bonds (i.e. € 1.00 per bond/share).

The beneficiaries may exercise the conversion rights only after the expiration of a waiting period of one year of grant date. Each convertible bond with a nominal value of € 1.00 allows the exchange into one share of ordinary no-par value common stock of the Company against payment of the exchange price. The convertible bonds cannot be exercised beyond December 31, 2004.

The exchange price for the convertible bonds issued on January 15, 2002 was € 57.56, representing the average closing price of a share of the Company in the final XETRA auction at the Frankfurt Stock Exchange during the last five trading days preceding the resolution of the Board of Management on the issuance of the convertible bonds.

The exercise of the conversion rights is only possible if the stock exchange price on at least one day during the lifetime of the convertible bonds has amounted to € 63.31, or 110% of the average stock exchange price in the final XETRA auction at the Frankfurt Stock Exchange during the five trading days prior to the resolution of the Board of Management on the issuance of the convertible bonds.

Shares, which are issued by virtue of the conversion rights, may participate in the profits of the Company at the first time in the business year for which no stockholders' resolution on the distribution of profits has been passed at the time of the issuance.

In the year 2003, additional grants to employees were made under the 2002 Plan, with terms identical to the 2002 stock convertible bonds grants. 70,700, 8,500 and 14,000 convertible bonds were granted on April 1, 2003, May 17, 2003 and July 1, 2003 respectively to board members, executive board members and employees of MorphoSys AG. The exercise prices for the convertible bonds were € 11.69, € 10.00 and € 10.88 respectively.

The nominal value of € 5,400, relating to convertible bonds forfeited on December 31, 2003, was paid back to the respective people in January 2004.

	Convertible Bonds	Weighted- Average Price €
Outstanding at January 1, 2002	–	0.00
Granted	91,500	57.56
Forfeited	(16,700)	57.56
Outstanding at December 31, 2002	74,800	57.56
Outstanding at January 1, 2003	74,800	57.56
Granted	93,200	11.41
Forfeited	(16,200)	43.97
Outstanding at December 31, 2003	151,800	30.68

None of the convertible bonds granted in 2002 and exercisable in 2003 were exercised as of December 31, 2003.

Range of Exercise Prices	Number Outstanding	Remaining Contractual Life (in Years)	Weighted-Average Exercise Price	Number of Exercisables	Weighted-Average Exercise Price
€ 10.00–€ 20.00	88,400	2.00	€ 11.40	0	€ 11.40
€ 57.56	63,400	1.00	€ 57.56	63,400	€ 57.56
	151,800			63,400	

The Company accounts for stock-based compensation in accordance with the provisions of SFAS No. 123. Compensation expense recorded in 2003 and 2002 in connection with convertible bonds was € 310,708 and € 1,482,044 respectively. The fair value of the convertible bonds issued was calculated using the Black-Scholes pricing model using the following assumptions: risk-free interest rates ranging from 2.96% to 3.31%; dividend yield of 0%; 115% expected volatility; and an expected life of 2.0 years. For convertible bond issuance in 2002, the following assumptions were used: risk-free interest of 4.50%, dividend yield of 0%, 60% expected volatility and an option life of 2 years.

Option valuation models require the input of highly subjective assumptions. Because changes in the subjective input assumptions can materially affect the fair value estimate, in management's opinion, the existing models do not necessarily provide a reliable single measure of the fair value of its employee stock options.

14 Taxes

As a result of the net losses incurred by the Company each year since inception, no provision for income taxes has been recorded. At December 31, 2003, the Company has net operating loss carry-forwards of approximately € 31 million to offset future taxable income. Under current German tax laws, these loss carry-forwards have an indefinite life and may be used to offset the Company's future taxable income. Net operating loss carry-forwards are subject to review and possible adjustment by the German taxing authorities. Furthermore, under current German tax laws, certain substantial changes in the Company's ownership may limit the amount of net operating loss carry-forwards, which could be utilized annually to offset future taxable income. Subsequent significant ownership changes could further effect the limitation in future years.

Significant components of the Company's deferred tax liabilities and assets are as follows (in thousands €):

	12/31/2003 in 000's €	12/31/2002 in 000's €
Deferred Tax Liabilities:		
Intangibles	3,302	2,553
Other	373	(7)
Total Deferred Tax Liabilities	3,675	2,546
Deferred Tax Assets:		
Net Operating Loss Carry-Forwards	11,628	9,303
Deferred Revenue	230	360
Total Deferred Tax Assets	11,858	9,663
Valuation Allowance for Deferred Tax Assets	(8,183)	(7,117)
Net Deferred Tax Assets	3,675	2,546
Net Deferred Tax Liabilities / (Assets)	-	-

The Company has incurred losses since inception and has provided a full valuation allowance on its deferred tax assets at December 31, 2003 and 2002, since realization of these future benefits is uncertain. Income tax expense for the year ending December 31, 2003 amounted to € 21 compared to € 18,000 in 2002, which related to current foreign taxes.

Under German corporate tax law, taxes on income are composed of corporate taxes, trade taxes and an additional surtax. The Company's combined German statutory tax rate is 37%. A reconciliation between the income tax expense computed at the corporate statutory tax rate of 37% and the Company's effective tax rate for the years ending December 31, 2003 and 2002 is as follows (in thousands €):

	12/31/2003 in 000's €	12/31/2002 in 000's €
Tax Provision at German Statutory Rates	(1,535)	(9,013)
Change in Valuation Allowance	1,066	(1,951)
Change in Statutory Rates	-	233
Sale of Intangible Assets to Subsidiary	-	9,250
Stock-Based Compensation	805	1,458
Other	(336)	41
	1340	18

15 Directors' Dealings and Executive Compensation

The table below shows the shares, stock options and convertible bonds, and changes of ownership of the same, which were held by the Management and the Supervisory Board during the year 2003:

Shares

	01/01/2003	Additions	Sales	12/31/2003
Management				
Dr. Simon Moroney (held through a controlled entity)	113,461	-	-	113,461
Dave Lemus	-	-	-	-
Dr. Thomas von Rüden	-	-	-	-
Total	113,461	-	-	113,461
Supervisory Board				
Dr. Gerald Möller	-	-	-	-
Dr. Daniel Camus	-	-	-	-
Prof. Dr. Jürgen Drews	-	-	-	-
Prof. Dr. Andreas Plückthun	59,300	-	-	59,300
Dr. Jörg Reinhardt	-	-	-	-
Dr. Geoffrey N. Vernon	-	-	-	-
Total	59,300	-	-	59,300

Stock Options

	01/01/2003	Additions	Sales	12/31/2003
Management				
Dr. Simon Moroney	25,000	22,000	-	47,000
Dave Lemus	21,000	-	-	21,000
Dr. Thomas von Rüden	50,700	14,000	-	64,700
Total	96,700	36,000	-	132,700
Supervisory Board				
Dr. Gerald Möller	6,100	-	-	6,100
Dr. Daniel Camus	-	-	-	-
Prof. Dr. Jürgen Drews	5,930	-	-	5,930
Prof. Dr. Andres Plückthun	3,500	-	-	3,500
Dr. Jörg Reinhardt	3,500	-	-	3,500
Dr. Geoffrey N. Vernon	3,500	-	-	3,500
Total	22,530	-	-	22,530

Convertible Bonds

	01/01/2003	Additions	Sales	12/31/2003
Management				
Dr. Simon Moroney	12,000	12,000	–	24,000
Dave Lemus	10,000	24,000	–	34,000
Dr. Thomas von Rüden	10,000	10,000	–	20,000
Total	32,000	46,000	–	78,000
Supervisory Board				
Dr. Gerald Möller	–	2,500	–	2,500
Dr. Daniel Camus	–	1,500	–	1,500
Prof. Dr. Jürgen Drews	–	–	–	–
Prof. Dr. Andres Plückthun	–	1,500	–	1,500
Dr. Jörg Reinhardt	–	1,500	–	1,500
Dr. Geoffrey N. Vernon	–	1,500	–	1,500
Total	–	8,500	–	8,500

Compensation for the Management Board consisted of fixed and variable components. Fixed compensation for the Management Board in 2003 amounted to € 570,886, compared to € 533,541 in the year 2002. Variable compensation for the Management Board in 2003 amounted to € 232,780, compared to € 181,636 in 2002. Other compensatory benefits amounted to € 275,268 in 2003 and € 178,999 in 2002.

Total compensation for the Supervisory Board in 2003 amounted to € 193,839 (2002: € 163,466).

16 Corporate Governance

The Company issued its statement according to Section 161 of the German Stock Corporation Act (Aktiengesetz). This declaration was published and made accessible to stockholders accordingly on December 22, 2003.

17 Research and Development Agreements

The Company has a significant number of research and development agreements related to its discovery and development strategy. The following is a brief description of certain of these agreements, which have had, or may have, a significant financial impact (in chronological order).

**GPC Biotech AG, Munich,
Germany**

In April 1999, the Company signed a collaboration and license agreement with GPC Biotech AG (“GPC AG”), Munich. The objective of the collaboration program is to utilize the Company’s technologies to generate human antibodies against GPC targets and to deliver such antibody products to GPC for confirmation of achievement of predefined success criteria. The Company received from GPC upfront research and development funding/exclusivity payments as well as the potential for milestone and royalty payments.

**Bayer Corporation,
Berkeley, U.S.A.**

In December 1999, the Company announced a collaboration with Bayer AG encompassing a research collaboration and license agreement for the application of the Company’s proprietary technologies in a number of Bayer’s research and development programs. The agreement specified four areas in which the two companies apply the Company’s technologies. The Company’s HuCAL[®] (Human Combinatorial Antibody Library) technology is being used to generate fully human therapeutic antibodies against up to ten targets provided by Bayer. In addition, Bayer has an option to develop antibodies generated using the HuCAL[®] technology as *in vitro* diagnostics. Furthermore, HuCAL[®] is being used to identify antibodies for use in monitoring the progress of clinical trials with selected drugs. The fourth and last area of application is the use of MorphoSys’ technologies to identify and validate new targets emerging from Bayer’s genomics program, which will be used by Bayer in screens for new drug candidates.

Under the terms of the agreement, Bayer made an up-front payment to the Company upon signing the agreement, and pays in addition annual license fees and support for research and development funding at the Company. Furthermore, Bayer pays exclusivity fees for using the HuCAL[®] technology on up to ten potential targets, as well as milestone fees on antibodies delivered by the Company that meet preagreed success criteria. Any antibody-based products developed in the collaboration trigger development-related milestone and royalty payments by Bayer to the Company. In the course of the agreement, Bayer has thus far taken two exclusive licenses on antibodies from MorphoSys, and cross-licensed their HKB-11 cell line against installation of HuCAL[®] GOLD at selected Bayer sites.

**ProChon Biotech Limited,
Israel** In May 2000, the Company signed a cooperation and license agreement with ProChon, Rehovot, Israel. The firms will collaborate in the development of human therapeutic antibodies against a ProChon target. The fees payable to the Company include payments representing a license payment, as well as program-related milestones upon achievement of certain success-related criteria. ProChon will also pay royalties to the Company on marketed products derived from the collaboration. In May 2002, the two companies expanded their existing agreement, whereby MorphoSys acquired the rights to a portfolio of anti-cancer antibodies in development at ProChon. The agreement gave MorphoSys the exclusive right to develop and commercialize the antibodies for therapeutic applications in the field of oncology, and in particular against the target FGFR-3.

In July 2003, the agreement was amended. It is intended that MorphoSys continues with ProChon to develop up to 4 antibodies with MorphoSys' HuCAL[®] GOLD library, but MorphoSys will return all rights concerning FGFR-3 antibodies to ProChon.

**F. Hoffmann-La Roche,
Switzerland** In September 2000, the Company entered into a collaboration and license agreement for the development of human therapeutic antibodies against a Roche target. Under the terms of the agreement, the Company receives a license payment, development-related milestone payments, and royalties on marketed products. The Company will apply its (HuCAL[®]) Fab technology to the generation and optimization of antibodies for the Roche target. Roche will be responsible for the clinical development, regulatory approval and worldwide marketing of any resulting products.

ImmunoGen, U.S.A. In September 2000, the Company signed a collaboration and license agreement with ImmunoGen, U.S.A. The parties will collaborate in the discovery and development of human monoclonal antibodies against certain specified targets. ImmunoGen will be responsible for developing one or more antibodies generated by the Company into a marketable product. Under the agreement, the Company will receive a license payment, as well as development-related milestone payments and royalties on marketed products.

The existing agreement between the two companies was expanded in June 2001, whereby the expanded agreement provided for a research license from the Company to ImmunoGen for the Company's HuCAL[®] antibody library technology for the generation of research antibodies for use in ImmunoGen's functional genomics programs, in order to help validate new targets. The expanded agreement has a duration of four years.

Biogen, U.S.A. In December 2000, the Company signed a collaboration agreement with Biogen. Under the agreement, the two companies will collaborate in applying the Company's proprietary EST technology for generating antibodies against expressed sequence tags to validate drug targets in Biogen's genomics programs. The agreement includes an option for Biogen to develop selected antibodies identified during the collaboration as therapeutics. Biogen will pay MorphoSys a technology access fee, as well as research and development funding. In the event that any antibody-based therapeutics will be developed, Biogen will make milestone and royalty payments to the Company. In December 2001, Biogen expanded the agreement to include an additional amount of ESTs beyond those defined in the original agreement. In addition, the duration of the original license granted to Biogen was extended.

Centocor, U.S.A. In December 2000, the Company signed a subscription and license agreement with Centocor, Inc. ("Centocor"). The intention of the collaboration is to facilitate the research, discovery and development of novel antibody therapeutics. Centocor will have access to the HuCAL[®] technology at various sites; in addition, the Company will generate antibodies against Centocor targets. Under the agreement, the Company will receive committed technology license fees, exclusivity fees, research and development funding, and milestone payments. Should Centocor market any drugs as a result of the collaboration, the Company will receive royalty payments. The contract has a duration of 5 years unless otherwise extended. Centocor will be responsible for development and marketing of any potential drugs.

Oridis Biomed, Austria In September 2001, Oridis Biomed ("Oridis") and the Company entered into a wide-ranging agreement under which the Company gained preferred access to Oridis' tissue collection, residing at the Institute of Pathology, University of Graz, Austria.

The goal of the collaboration is the characterization and validation of new therapeutic targets. The Company will apply its HuCAL[®] technology to make antibodies to candidate targets, which Oridis Biomed will use to carry out high-throughput protein expression analysis on a range of human tissues. In return, Oridis received a license to the Company's HuCAL[®] technology, and will have access to certain antibodies from the Company. The Company received a first right of negotiation to all antibody products resulting from the collaboration. The Company receives and pays license fees from Oridis.

Schering AG, Germany In December 2001, the Company and Schering AG (“Schering”) formed a strategic alliance for the development of antibody therapeutics and *in vivo* diagnostics. As part of the agreement, Schering and the Company will combine their resources over the three-year collaboration term to exclusively pursue a minimum of five therapeutic and several *in vivo* diagnostic projects. Furthermore, the two partners will jointly undertake research to identify additional potential therapeutic and diagnostic targets emerging from Schering’s genomics program.

Over the lifetime of the agreement, the Company will receive license fees, milestone payments and royalties on any end products emerging from the collaboration. Additionally, Schering purchased 357,880 shares at an average price of € 66.79 per share in February 2002 as part of their strategic commitment to the partnership.

Pfizer, Inc., U.S.A. In December 2003, the Company announced a collaboration and license agreement with Pfizer, Inc. The intention of the collaboration is to facilitate the research, discovery and development of novel antibody therapeutics. The Company will apply its HuCAL[®] GOLD technology to the generation and optimization of antibodies for multiple Pfizer targets. Under the agreement, the Company received a committed upfront fee, research support, and depending on collaboration progress, milestone payments and royalties. Pfizer is responsible for the clinical development, regulatory approval and worldwide marketing of any resulting products.

18 Acquired License Agreements

The Company is party to license agreements covering certain patented technology.

Dyax Corporation, U.S.A. In October 1996, the Company signed a license agreement with Dyax Corporation, under which the Company received a royalty-bearing, non-exclusive, worldwide license to patents owned by Dyax covering certain technologies relating to the use and practice of phage display. The Company may use the licensed technologies for research and discovery of novel therapeutic agents and targets, and may sublicense the technology to its commercial partners. The Company paid an upfront technology access fee, in addition to annual maintenance and transfer fees.

- SCA Ventures, Inc., U.S.A.** In December 1999, the Company concluded a non-exclusive product-derived license agreement with SCA Ventures, Inc., U.S.A., in which the Company obtained a non-exclusive license from SCA Ventures in order to design, discover, develop, make, use, sell, offer for sale and import HuCAL[®]-derived products under SCA Ventures' patent rights in single-chain antibodies. The Company may use the SCA Ventures' licensed technologies for the research and discovery of novel therapeutic agents and targets, and may sublicense the technology to its commercial partners. The Company may terminate this agreement for any reason upon 6 months prior written notice to SCA Ventures. The Company pays an upfront license fee, annual maintenance and transfer fees.
- Biosite Diagnostics, Inc., U.S.A.** In January 2000, the Company signed a collaboration agreement with Biosite Diagnostics, Inc., under which the Company receives a royalty-bearing, non-exclusive, worldwide license to patents owned by Biosite and XOMA Corporation covering certain technologies relating to the display and screening of multi-chain antibodies. The Company may use the licensed technologies for research and discovery of novel therapeutic agents and targets, and may sublicense the technology to its commercial partners. Unless earlier terminated, the term of this agreement shall either be the expiration of the parties' respective obligations to pay royalties, or the expiration of the last patent right licensed by one party to the other. The Company pays an upfront technology access fee, in addition to annual maintenance and transfer fees.
- Genentech, Inc., U.S.A.** In May 2000, the Company concluded a license agreement with Genentech, Inc., granting the Company rights under Genentech patents relating to monovalent phage display screening technology. The Company may use the licensed technologies for research and discovery of novel therapeutic agents and targets, and may sublicense the technology to its commercial partners. The Company pays an upfront technology access fee, in addition to annual maintenance and transfer fees.
- XOMA Ireland Limited** In February 2002, the Company concluded a cross-licensing agreement for antibody-related technologies with XOMA Ireland Ltd. Under the agreement, the Company received a license to use the XOMA antibody expression technology for developing antibody products (including Fab and scFv formats) using MorphoSys' phage display-based HuCAL[®] antibody library. MorphoSys also received a license for the production of antibodies (including Fab and scFv formats) under XOMA patents. Under the agreement, XOMA obtained a license to use the MorphoSys HuCAL[®] antibody library for its target discovery and research programs. The agreements also provide for the release of the Company from any past activities using the Company's technology to the extent they also use XOMA's antibody expression technology.

Pursuant to the agreement, MorphoSys paid € 1.1 million to XOMA with a second payment of € 4.6 million due in September 2002. At the Company's option, the second installment could be paid in cash or with new shares of the Company's common stock equivalent to € 5.5 million. The Company recorded € 2.5 million as a charge to research and Development expenses in the year 2002. The remaining € 3.2 million represents the value of the license received, and has been capitalized as an intangible asset and will be amortized over its expected useful life of 10 years.

In October 2002, the Company exercised the option to pay the second installment with 363,466 new shares of its common stock, which was determined with reference to the market price of the Company's common stock at the time of the notice. The Company recorded a charge to interest expense related to this exercise of the option at the time the shares were issued in May 2003 which equaled € 0.7 million.

**Cambridge Antibody
Technologies PLC,
Cambridge, U.K.**

In December 2002 and effective July 2003, the Company entered into a licensing and settlement agreement with CAT. The settlement agreement covers MorphoSys' past, present and future use, the commercialization of all versions of its HuCAL[®] libraries, and all patents in the ongoing disputes between the two companies. This includes the litigation in the United States regarding CAT's Griffiths, McCafferty, Winter II and Winter/Lerner/Huse patents as well as oppositions launched by MorphoSys at the European Patent Office against CAT's Winter II and McCafferty patents.

The companies agreed to terms under which MorphoSys will be free to develop and commercialize its HuCAL[®] technologies. CAT undertook not to sue MorphoSys in relation to present HuCAL[®] GOLD libraries and all future derivatives thereof. In addition, MorphoSys received a license to the CAT patent estate in respect of previous HuCAL[®] libraries. CAT will receive an annual payment of € 1 million over the next five years. It will also receive other financial consideration from MorphoSys' activities related to its HuCAL[®] GOLD libraries for a defined period of time. CAT will receive milestone and royalty payments under the license for products developed using previous HuCAL[®] libraries. In addition, CAT received an equity stake of 588,160 ordinary shares in MorphoSys under the license agreement. MorphoSys retains the option to buy out its obligations to CAT for a predefined fixed amount at any time during the duration of the agreement.

Summary of Significant Differences between German GAAP and U.S. GAAP

The financial statements of the Company are prepared in accordance with accounting principles generally accepted in the United States of America (“U.S. GAAP”), which differ in certain respects from German generally accepted accounting principles (“German GAAP”) as prescribed by the German Commercial Code. The following is a summary of the significant differences between applied U.S. GAAP and German GAAP 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-forwards and temporary differences are generally recorded and must be analyzed 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 German GAAP, deferred tax assets generally may not be recognized with respect to a tax loss carry-forwards because expected future tax savings are not recognizable before the realization of such profits.

Intangible assets—Under U.S. GAAP, certain expenses (i.e. costs associated with obtaining one’s own patent) are capitalized as intangible assets and amortized on a straight-line basis over their estimated useful lives. Under German GAAP, such costs are expensed as incurred. The capitalization of certain acquired license rights is accounted for according to an expert valuation under U.S. GAAP. Under German GAAP, the splits are based on the net present value or acquisition cost.

Amortization life of acquired license rights—Under U.S. GAAP, these rights are amortized over their estimated useful economic life of 10 years. Under German GAAP, the amortization period of 8 years follows the rates used for tax purposes

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 German GAAP. In the fourth quarter of 2000, the Company implemented the U.S. Securities and Exchange Commission SAB 101, which requires non-refundable technology access payment revenue to be amortized over future periods of benefit. Although not required to do so, the Company will also use the same practice of revenue recognition in its German GAAP (HGB) accounts starting for the year 2001 and onwards.

Stock-based compensation—The Company accounts for stock option and convertible bond grants in accordance with SFAS No. 123 and recognizes compensation expense. Under German GAAP, compensation expense is not being recognized.

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 additional paid-in capital. Under German GAAP, 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. Unrealized losses are only recorded in the statement of operations, when the unrealized loss is deemed to be other than temporary. If the reasons for an impairment in prior years are no longer applicable, under German GAAP, the investment is written up to its net realizable value, and at most to its acquisition cost. Under German GAAP, unrealized losses are recorded in the statement of operations.

Unrealized holding gains and losses on derivative financial instruments—Under U.S. GAAP, unrealized gains and losses on derivatives are recorded as other income/expense. Under German GAAP, increased market value is not recorded.

Non-current liabilities—U.S. GAAP requires to record long-term liabilities with its present value of the future payments, using an interest rate commensurate with the risk involved. Under HGB, the long-term liabilities are recorded with their repayment amounts.

Roll-Forward of Fixed Assets

	Aquisition and Production Cost			12/31/2003 €
	01/01/2003 €	Additions €	Disposals €	
I. Intangible Assets				
Patents	8,616,089	58,746	0	8,674,835
License Rights	3,810,297	8,330,102	0	12,140,399
	12,426,386	8,388,848	0	20,815,234
II. Property and Equipment				
Purchased Software	1,043,890	141,793	0	1,185,683
Office and Laboratory Equipment	3,120,604	532,652	41,954	3,611,302
Furniture and Fixtures	1,259,429	7,632	0	1,267,061
	5,423,923	682,077	41,954	6,064,046

Accumulated Depreciation				Net Book Values		
01/01/2003 €	Depreciation €	Disposals €	12/31/2003 €	12/31/2003 €	12/31/2002 €	
1,717,099	854,061	0	2,571,160	6,103,675	6,898,990	
457,693	783,802	0	1,241,495	10,898,904	3,352,604	
2,174,792	1,637,863	0	3,812,655	17,002,579	10,251,594	
472,826	307,365	0	780,191	405,492	571,064	
2,390,651	414,649	21,719	2,783,581	827,721	729,953	
462,650	129,729	0	592,379	674,682	796,779	
3,326,127	851,743	21,719	4,156,151	1,907,895	2,097,796	

Chart of Consolidated Entity as of December 31, 2003

	Currency	Exchange Rate at December 31, 2003; One Unit of Foreign Currency in €	Share of Capital in %	Equity in Foreign Currency	Profit/Loss in Foreign Currency
MorphoSys U.S.A., Inc. Charlotte, North Carolina, U.S.A.	US \$	1.25800	100.00	269,101	24,221
MorphoSys IP GmbH	€	-	100.00	23,891	0