

Consolidated Statements of Operations (IFRS)

	in €	Note	12/31/2004	12/31/2003
Revenues		1p	21,978,796	15,308,465
Operating Expenses				
Research and Development			12,391,295	8,998,012
Sales, General and Administrative			7,522,188	7,202,206
Stock-Based Compensation		14 & 15	1,423,907	2,163,707
Total Operating Expenses			21,337,390	18,363,925
Profit/(Loss) from Operations			641,406	(3,055,460)
Interest Income			285,695	212,461
Interest Expense			338,469	884,957
Impairment of Marketable Securities			-	136,769
Other Income/(Expenses), Net			(306,520)	733,766
Profit/(Loss) before Taxes			282,112	(3,130,959)
Foreign Income Tax Expense		17	-	21
Net Profit/(Loss)			282,112	(3,130,980)
Basic Net Profit/(Loss) per Share		18	0.05	(0.72)
Diluted Net Profit/(Loss) per Share		18	0.05	(0.72)
Shares Used in Computing Basic Net Profit/ (Loss) per Share		18	5,131,467	4,332,438
Shares Used in Computing Diluted Net Profit/ (Loss) per Share		18	5,169,965	4,332,438

Consolidated Balance Sheets (IFRS)

	in €	Note	12/31/2004	12/31/2003
Assets				
Current Assets				
Cash and Cash Equivalents		3	12,531,198	6,652,456
Available-for-Sale Financial Assets		4	24,698,532	16,508,575
Accounts Receivable		5	2,304,778	2,111,710
Other Receivables		6	392,035	479,929
Prepaid Expenses and Other Current Assets		7	430,608	468,646
Total Current Assets			40,357,151	26,221,316
Non-Current Assets				
Property and Equipment, Net		8	2,330,995	1,502,403
Patents, Net		9	2,790,091	3,203,540
License Fees, Net		9	9,671,131	10,898,904
Software, Net		9	288,115	405,492
Other Assets		10	358,210	647,212
Total Non-Current Assets			15,438,542	16,657,551
Total Assets			55,795,693	42,878,867
Liabilities and Stockholders' Equity				
Current Liabilities				
Accounts Payable		11	3,838,144	2,732,293
Current Portion of License Payable		11	910,243	677,060
Provisions		12	600,607	-
Current Portion of Deferred Revenue		1p	4,757,249	4,272,249
Total Current Liabilities			10,106,243	7,681,602
Non-Current Liabilities				
Licenses Payable, Net of Current Portion		11	880,015	1,651,360
Deferred Revenue, Net of Current Portion		1p	5,100,646	6,086,205
Convertible Bonds Due to Related Parties		14	109,692	157,200
Deferred Tax Liability		17	220,611	-
Total Non-Current Liabilities			6,310,964	7,894,765
Stockholders' Equity		13		
Common Stock, € 3.00 Par Value; 9,597,400 and 8,626,344 Ordinary Shares Authorized; 5,438,852 and 4,901,332 Ordinary Shares Issued; 5,408,790 and 4,841,570 Ordinary Shares Outstanding; for 2004 and 2003 respectively				
Treasury Stock (30,062 and 59,762 shares for 2004 and 2003 respectively), at Cost			16,305,523	14,682,062
Additional Paid-In Capital			78,646,377	68,632,990
Accumulated Other Comprehensive Income/(Loss)			452,782	295,756
Accumulated Deficit			(56,026,196)	(56,308,308)
Total Stockholders' Equity			39,378,486	27,302,500
Total Liabilities and Stockholders' Equity			55,795,693	42,878,867

Consolidated Statements of Changes in Stockholders' Equity (IFRS)

	Common Stock	
	Shares	€
Balance at January 1, 2003	3,949,706	11,849,118
Compensation Related to the Grant of Stock Options and Convertible Bonds	-	-
Equity Components of Convertible Bonds Granted to Employees	-	-
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 for the Year	-	-
Comprehensive Loss	-	-
Balance at December 31, 2003	4,901,332	14,703,996
Compensation Related to the Grant of Stock Options and Convertible Bonds	-	-
Equity Components of Convertible Bonds Granted to Employees	-	-
Exercise of Options and Convertible Bonds Issued to Related Parties	47,387	142,161
Exercise of Options from Treasury Stock Issued to Related Parties	-	-
Conversion of Convertible Bonds, net of Issuance Cost of € 126,583	490,133	1,470,399
Other Comprehensive Income:		
Change in Unrealized Gain on Available-for-Sale Securities, Net of Deferred Tax Asset	-	-
Foreign Currency Loss from Consolidation	-	-
Net Profit for the Year	-	-
Comprehensive Income	-	-
Balance at December 31, 2004	5,438,852	16,316,556

Treasury Stock		Additional Paid-In Capital €	Translation Reserve €	Revaluation Reserve €	Accumulated Deficit €	Total Stock- holders' equity €
Shares	€					
59,762	(21,934)	59,197,248	(556,227)	38,636	(53,177,328)	17,329,513
-	-	2,163,707	-	-	-	2,163,707
-	-	17,570	-	-	-	17,570
-	-	3,110,896	-	-	-	4,201,294
-	-	4,143,569	-	-	-	5,908,049
-	-	-	801,157	-	-	801,157
-	-	-	-	12,190	-	12,190
-	-	-	-	-	(3,130,980)	(3,130,980)
-	-	-	-	-	-	(2,317,633)
59,762	(21,934)	68,632,990	244,930	50,826	(56,308,308)	27,302,500
-	-	1,423,908	-	-	-	1,423,908
-	-	7,405	-	-	-	7,405
-	-	715,476	-	-	-	857,637
(29,700)	10,901	508,850	-	-	-	519,751
-	-	7,357,748	-	-	-	8,828,147
-	-	-	158,299	-	-	158,299
-	-	-	-	(1,273)	-	(1,273)
-	-	-	-	-	282,112	282,112
-	-	-	-	-	-	439,138
30,062	(11,033)	78,646,377	403,229	49,553	(56,026,196)	39,378,486

Consolidated Statements of Cash Flows (IFRS)

	in €	Note	12/31/2004	12/31/2003
Operating Activities				
Net Profit/(Loss)			282,112	(3,130,980)
Adjustments to Reconcile Net Profit/(Loss) to Net Cash Used for Operating Activities:				
Depreciation			656,805	544,584
Amortization of Intangible Assets			1,980,243	1,540,452
Net Gain on Sales of Marketable Securities			(109,748)	(326,270)
Unrealized Net Gain on Derivative Financial Instruments			(233,459)	(315,929)
Impairment of Marketable Securities			-	136,769
Gain on Sale of Property and Equipment			(562)	(2,652)
Net Gain from Accounting Estimate Change			-	(2,272,053)
Net Expense from Share Issuance (XOMA)			-	417,608
Recognition of Deferred Revenue			(11,515,191)	(7,930,121)
Stock-Based Compensation			1,423,907	2,163,707
Changes in Operating Assets and Liabilities:				
Accounts Receivable			(193,068)	6,621,080
Prepaid Expenses and Other Assets			202,488	1,098,937
Accounts Payable and Provisions			1,381,447	(3,240,931)
Licenses Payable			(538,162)	89,612
Deferred Revenue			11,014,632	10,202,220
Cash Generated from Operations			4,351,444	5,596,033
Interest Paid			325,011	201,170
Net Cash Provided by Operating Activities			4,676,455	5,797,203

	in €	Note	12/31/2004	12/31/2003
Investing Activities:				
Purchases of Marketable Securities			(16,638,219)	(12,075,587)
Proceeds from Sales of Marketable Securities			9,055,420	14,832,008
Purchases of Property and Equipment			(1,505,102)	(540,284)
Proceeds from Disposals of Property and Equipment			20,267	22,887
Additions to Intangibles			(221,644)	(194,841)
Net Cash Provided by/ (Used in) Investing Activities		19	(9,289,278)	2,044,183
Financing Activities:				
Proceeds from the Issuance of Convertible Bonds			8,954,730	-
Proceeds from the Exercise of Options and Convertible Bonds Granted to Related Parties			1,377,388	-
Interest Expense Due to the Issuance of Convertible Bonds			13,458	10,542
Net of Proceeds and Payments from the Issuance of Convertible Bonds Granted to Related Parties			(47,508)	82,400
Purchases of Derivative Financial Instruments		6	(186,647)	(164,000)
Proceeds from the Disposal of Derivatives		6	508,000	-
Payment of Financed License Payable			-	(1,798,830)
Cost of Share Issuance			(126,583)	(173,314)
Net Cash Provided by/ (Used in) Financing Activities		19	10,492,838	(2,043,202)
Effect of Exchange Rate Differences on Cash			(1,273)	12,190
Increase in Cash and Cash Equivalents			5,878,742	5,810,374
Cash and Cash Equivalents at the Beginning of the Period			6,652,456	842,082
Cash and Cash Equivalents at the End of the Period			12,531,198	6,652,456

Notes to the Consolidated Financial Statements

1 Organization and Summary of Significant Accounting Policies

Business and Organization MorphoSys AG (“the Company, MorphoSys Group”) 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 Martinsried near Munich, 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.

General Information The consolidated financial statements for the year ended December 31, 2004, were authorized for issue in accordance with a resolution of the Management Board on February 13, 2005. The Management Board is represented by: Dr. Simon E. Moroney (Chief Executive Officer) and Dave Lemus (Executive Vice President and Chief Financial Officer).

The Supervisory Board is represented by: Dr. Gerald Möller (Chairman, Remuneration & Nomination Committee), Prof. Dr. Jürgen Drews (Deputy Chairman, Remuneration & Nomination Committee), Dr. Daniel Camus (Audit Committee), Prof. Dr. Andreas Plückthun, Dr. Metin Colpan Remuneration & Nomination Committee and Dr. Geoffrey N. Vernon (Audit Committee).

The registered offices are located at Lena-Christ-Str. 48 in 82152 Martinsried/Planegg, Germany.

Significant Accounting Policies

a) Basis of Adoption

The preparation of the consolidated financial statements in conformity with International Financial Reporting Standards (IFRS) requires management to make certain estimates and assumptions that affect the amounts reported in the consolidated financial statements and accompanying notes. Actual results could differ from those estimates.

The accounting policies set out below have been applied consistently to all periods presented in these consolidated financial statements and in preparing an opening IFRS balance sheet at January 1, 2003, for the purposes of transition to IFRS.

The principal effects to this decision are discussed below.

IFRS 1 “First-Time Adoption of International Financial Reporting Standards”

IFRS 1 has been applied before its effective date in the preparation of the Group’s consolidated financial statements. As of December 31, 2004, the Group prepared its first consolidated financial statements in accordance with IFRS. The accounting policies have been applied in preparing the financial statements for the year ended December 31, 2004 (the reporting period), the comparative information presented in these financial statements for the year ended December 31, 2003 (the transition period), and in the preparation of an opening IFRS balance sheet January 1, 2003 (the date of transition), in accordance with IFRS 1.47. Those assets and liabilities not applicable for IFRS were eliminated from the opening IFRS balance sheet.

The Company made use of the following exemption following IFRS 1.13:

MorphoSys elected to use the initially measured fair value of certain licenses as deemed cost in accordance with IFRS 1.13 b. It is expected that revaluating respective license agreements had no significant impact on consolidated profits. Therefore, no adjustments were initiated for the accounts as at December 31, 2004.

IFRS 2 “Share-Based Payment”

IFRS 2 “Share-Based Payment” requires an expense to be recognized where the Group buys goods or services in exchange for shares or rights over shares (“equity-settled transactions”), or in exchange for other assets equivalent in value to a given number of shares or rights over shares (“cash-settled transactions”). The main impact of IFRS 2 on the Group is the expense associated with employees’ and directors’ share options and other share-based incentives by using an option-pricing model.

IFRS 2 is mandatory for reporting periods beginning on or after January 1, 2005. However, the Group resolved to adopt IFRS 2 early for the year ended December 31, 2004. In accordance with IFRS 2.54, the Group has applied IFRS 2 to equity-settled awards granted on or after January 1, 1999.

In accordance with IFRS 2.56, options granted prior to January 1, 1999, are therefore not expensed. All information is nonetheless disclosed in line with 2.44 and 2.45. Further details are given in notes 14 and 15.

IFRS 3 “Business Combination,” IAS 36 “Impairment of Assets” and IAS 38 “Intangible Assets”

IFRS 3 applies to accounting for business combinations for which the agreement date is on or after March 31, 2004.

The useful economic life of intangible assets is now assessed at the level of individual asset as having either a finite or indefinite life. The Company has identified no assets with indefinite life. Intangible assets with a finite life have been amortized over its useful life. Amortization periods and methods for intangible assets with finite useful economic lives are reviewed annually or earlier where an indicator of impairment exists.

IAS 21 “The Effects of Changes in Foreign Exchange Rates” (revised 2004)

The Group elected to adopt IAS 21 “The Effects of Changes in Foreign Exchange Rates early”.

Early adoption of other International Financial Reporting Standards

In addition to the standards referred to above, the Group has resolved to adopt the following revised standards early during the year; comparative figures have been amended as required:

- IAS 1 Presentation of Financial Statements (amended 2004);
- IAS 8 Accounting Policies, Changes in Accounting Estimates and Errors (revised 2004);
- IAS 10 Events after the Balance Sheet Date (amended 2004);
- IAS 17 Leases (amended 2004);
- IAS 24 Related Party Disclosures (revised 2004);
- IAS 27 Consolidated and Separate Financial Statements (amended 2004);
- IAS 32 Financial Instruments: Disclosure and Presentation (revised 2004);
- IAS 33 Earnings per Share (revised 2003 and amended 2004) and
- IAS 39 Financial Instruments: Recognition and Measurement (revised 2004).

IAS 38 “Intangible Assets” supersedes IAS 38 (issued in 1998) and will be applied for intangible assets acquired or obtained for which the agreement date is after March 31, 2004, in connection with the application of IFRS 3 and IAS 36 as revised in 2004. For all intangible assets acquired or obtained before March 31, 2004, IAS 38 (issued in 1998) is applied.

b) Statement of Compliance

The accompanying consolidated financial statements have been prepared in accordance with International Financial Reporting Standards (IFRS) adopted by the International Accounting Standards Board, London (IASB) in consideration of interpretations of the Standing Interpretations Committee (SIC) and the International Financial Reporting Interpretations Committee (IFRIC).

The consolidated financial statements of the Company for the year ended December 31, 2004, comprise the Company and its subsidiaries (together referred to as the “Group”).

c) Basis of Presentation

In preparing its opening IFRS balance sheet, the Group has adjusted certain amounts reported previously in financial statements prepared in accordance with U.S. GAAP. An explanation of how the transition from U.S. GAAP to IFRS has affected the Group’s financial position and financial performance is set out in the following tables and notes accompanying the tables.

The financial statements are presented in euros unless otherwise stated. They are prepared on the historical cost basis except that the following assets and liabilities are stated at their fair value: derivative financial instruments, available-for-sale investments and certain licenses (2004: Cambridge Antibody Technology PLC and XOMA Ireland Limited).

IAS 27 “Consolidated and Separate Financial Statements” shall be applied for annual periods beginning on or after January 1, 2005. The Company decided to adopt IAS 27 for all financial statements beginning January 1, 2003. The accounting policies have been applied consistently by Group entities following IAS 27.28.

Reconciliation of Equity in thousands of €

	Caption
Cash and Cash Equivalents	
Marketable Securities	
Accounts Receivable	
Other Receivables, Prepaid Expenses and Other Current Assets	
Property and Equipment, Net	ca
Patents, Net	cb
License Fees, Net	
Software, Net	ca
Other Assets	cc
Total Assets	
Current and Non-Current Liabilities	
Stockholders' Equity	
Additional Paid-In Capital	cc
Accumulated Other Comprehensive Income/(Loss)	cd
Accumulated Deficit	
Liabilities and Stockholders' Equity	

01/01/2003			12/31/2003			
U.S. GAAP	Adjustment	IFRS	U.S. GAAP	Adjustment from prior years	Adjustment from current year	IFRS
842	-	842	6,652	-	-	6,652
18,274	-	18,274	16,509	-	-	16,509
8,733	-	8,733	2,112	-	-	2,112
1,685	-	1,685	948	-	-	948
2,098	(571)	1,527	1,908	(571)	166	1,503
6,899	(3,299)	3,600	6,104	(3,299)	399	3,204
3,352	-	3,352	10,899	-	-	10,899
-	571	571	-	571	(166)	405
510	13	523	627	13	7	647
42,393	(3,286)	39,107	45,759	(3,286)	406	42,879
21,778	-	21,778	15,576	-	-	15,576
11,827	-	11,827	14,682	-	-	14,682
59,194	3	59,197	68,624	3	6	68,633
(518)	-	(518)	913	-	(617)	296
(49,888)	(3,289)	(53,177)	(54,036)	(3,289)	1,017	(56,308)
42,393	(3,286)	39,107	45,759	(3,286)	406	42,879

- ca) Software, Net Under U.S. GAAP, capitalized software with its net values of € 571,064 at January 1, 2003, and € (165,572) at December 31, 2003, was part of property and equipment. Under IFRS, software is separated on the consolidated balance sheet and therefore both amounts were reclassified.
- cb) Patents, Net Under U.S. GAAP, certain expenses (i.e. costs associated with obtaining and maintaining one's own patent) are capitalized as patents and amortized on a straight-line basis over their estimated useful economic lives. Under IFRS, all expenses relating thereto have to be recorded in the statement of operations after first assignation of the patent.
- In accordance with IAS 38.7, IAS 38.60 and IAS 38.54 (c), issued in 1998, costs for protecting granted patents from infringement of € 5,698 in 2003 (January 1, 2003: € 4,041,711) had to be reclassified as patent expenses which decreased the initial value of a certain patent. Depreciation for this patent had to be decreased by € 404,570 in 2003 (January 1, 2003: € 742,704). Accordingly, patents were adjusted with the net amount of € (3,299,007) as of January 1, 2003, and the net amortization of € 398,872 as of December 31, 2003.
- cc) Other Assets, Additional Paid-In Capital Under U.S. GAAP, the nominal value of € 1.00 for each bond was shown as liability. The fair value of the bond was expensed over the vesting period of one year and posted against equity.
- Under IFRS, the equity portion of the bond has to be separated and presented as additional paid-in capital in accordance with IAS 32.28. The equity component is deducted from the fair value of the bond. The remaining value is recognized as stock-based compensation. Therefore, deferred interest expense of € 13,054 as of January 1, 2003, and € 7,029 as of December 31, 2003, had to be reclassified as other assets.
- cd) Accumulated Other Comprehensive Income/(Loss) Under U.S. GAAP and IFRS, unrealized gains and losses on available-for-sale securities are recorded as a component of stockholders' equity. Unrealized losses are only recorded in the statement of operations, when the unrealized loss is deemed to be other than temporary (impairment). Under IFRS, unrealized gains and losses on available-for-sale securities can either be recorded in the statement of operations or as a component of equity. Accordingly, impairment charges from January 2003 to June 2003 of € 0.8 million were recognized in June 2003 and recognized as impairment of marketable securities in the statement of operations. Under U.S. GAAP, the amount recorded as impairment in prior periods may not be reversed, even if the reasons for the impairment are no longer applicable.
- Under IFRS and IAS 39.70, the amount recorded as impairment in prior periods should be reversed to the extent that the fair value of the investment has increased and if the increase in fair value can be objectively related to an event occurring after the loss was recognized. Therefore, the impairment of marketable securities was adjusted by € 616,999 in the statement of operations at December 31, 2003.

Reconciliation of Loss Reported for 2003 (in thousands of €):

	Caption	U.S. GAAP	Adjustment	IFRS
Revenues		15,308	-	15,308
Research and Development	cb	8,998	-	8,998
Sales, General and Administrative		7,601	(399)	8,998
Stock-Based Compensation	cc	2,175	(11)	2,164
Interest Income		212	-	212
Interest Expense	cc	874	10	884
Impairment of Marketable Securities	cd	754	(617)	137
Other Income, Net		734	-	734
Total Loss before Taxes		4,148	(1,017)	3,131

- d) Basis of Consolidation Intra-Group balances and transactions and any unrealized gains arising from intra-Group transactions are eliminated in preparing the consolidated financial statements following IAS 27.24. Unrealized losses are eliminated in the same way as unrealized gains.
- e) Foreign Currency IAS 21 (“The Effects of Changes in Foreign Exchange Rates”) prescribes how to include foreign currency transactions and how to translate financial statements.
- ea) Foreign Currency Transactions Transactions in foreign currencies are translated at the foreign exchange rate ruling at the date of the transaction. Monetary assets and liabilities denominated in foreign currencies at the balance sheet date are translated into euros at the foreign exchange rate ruling at that date following IAS 21.23a. Foreign exchange differences arising on translation are recognized in the income statement. Non-monetary assets and liabilities denominated in foreign currencies that are stated at fair value are translated into euros at foreign exchange rates ruling at the dates the values were determined following IAS 21.23c.
- eb) Financial Statements of Foreign Operations The Group’s foreign operations for perpetuation of MorphoSys U.S.A., Inc. are not considered an integral part of the Company’s operations. Accordingly, the assets and liabilities of foreign operations are translated into euros at foreign exchange rates ruling at the balance sheet date following IAS 21.44. The expenses of foreign operations are translated into euros at the average exchange rate for the year. Foreign exchange differences arising on translation are recognized directly in equity.

Any differences that have arisen since January 1, 2003, the date of transition to IFRS, are presented as a separate component of equity.

- f) **Interest** MorphoSys uses interest rates to calculate fair values and discount certain liability. For stock-based compensation calculation, MorphoSys uses the interest rate of a German government bond with duration of two years at grant date.
- To discount certain obligation in connection with the settlement agreement with CAT, the Company uses a 13% interest rate to discount its liability.
- g) **Derivative Financial Instruments** The Group uses derivative financial instruments to hedge its exposure to foreign exchange rate risks. In accordance with IAS 39.9, all derivative financial instruments are held for trading and recognized initially at cost. Subsequent to initial recognition, derivative financial instruments are stated at fair value, which is their quoted market price at the balance sheet date. Since the derivatives were not tested for hedge accounting, any resulting gain or loss is recognized in the income statement. According to the Company's foreign currency hedging policy, receivables which are definite and collectable within a twelve-month period will be hedged.
- Following IFRS 1.28, all derivatives are stated with their fair values. Any resultant gain or loss is recognized in the income statement.
- h) **Cash and Cash Equivalents** The Company considers all cash at bank, in hand and short-term deposits with an original maturity of three months or less to be cash and cash equivalents. The Company invests its cash in deposits with two major German financial institutions, mainly HypoVereinsbank Munich and Deutsche Bank AG.
- i) **Investments** All investments are initially recognized at cost, being the fair value of the consideration given and including acquisition charges associated with the investment.
- The Company accounts for its investments in debt and equity securities in accordance with IAS 39. Management determines the proper classifications of investments at the time of purchase and re-evaluates such designations as of each balance sheet date. At December 31, 2004, and at December 31, 2003, the investments held by the Group have been classified as available for sale. These investments are recognized or derecognized by the Group on the date it commits to purchase or sell the investments. Available-for-sale investments are stated at fair value, with any resultant gain or loss reported directly in the revaluation reserve within equity (IAS 39.55 b). After initial recognition, investments which are classified as available for sale are measured at fair value. Gains or losses on available-for-sale investments are recognized as a separate component of equity until the investment is sold, collected or otherwise disposed of, or until the investment is determined to be impaired, at which time the cumulative loss is reported in the income statement.

The Company considers a decline in the fair value of available-for-sale investments which is longer than six months in duration to be deemed other than temporary unless specific facts and circumstances indicate otherwise. If, in a subsequent period, the fair value increases, the impairment loss is reversed, with the amount of reversal included in net profit or loss for the period.

- j) **Accounts Receivable** Accounts receivable are stated at their cost less any allowance for doubtful accounts (see below) and impairment losses (see accounting policy m).

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 creditworthiness or actual defaults are higher than the historical experience, the management's estimates of the recoverability of amounts due the Company could be adversely affected. Based on management assessment, allowances in the amount of € 36,456 for December 31, 2004, and € 0 for December 31, 2003, were recognized. The Company does not require collateral from customers for accounts receivable.

- k) **Property and Equipment** Property and equipment is stated at cost, less accumulated depreciation (see note 7) and impairment losses (see accounting policy m). Replacements and improvements are capitalized while general repairs and maintenance are charged to expense as incurred. Assets are depreciated over their expected useful lives, which have been estimated to be three to ten years using the straight-line method. Leasehold improvements are depreciated over the estimated useful lives of the assets or the related lease term, whichever is shorter.

- l) **Intangible Assets** Research costs are expensed as incurred. Development costs were expensed as incurred in accordance with IAS 38.5 and IAS 38.11-38.23.

la) **Research and Development**

lb) **Patent Costs**

Patents obtained by the Group are stated at cost less accumulated amortization (see below) and impairment losses (see accounting policy m). 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 useful life (10 years) or the remaining patent term. 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.

- lc) License Rights** The Company acquired license rights by making upfront licensing payments, annual maintenance fees and sublicensing payments to third parties. The Company amortizes upfront licensing payments on a straight-line basis over the estimated useful life of the acquired license (10 years). The amortization period and method is reviewed at each balance sheet date (IAS 38.104). 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.
- ld) Software** Software is stated at cost less accumulated amortization (see below) and impairment losses (see accounting policy m). Amortization is charged to the income statement on a straight-line basis over the estimated useful lives of 3 years. Software is amortized from the date it is available for use.
- le) Subsequent Expenditure** Subsequent expenditure on capitalized intangible assets is capitalized only when it increases the future economic benefits embodied in the specific asset to which it relates. All other expenditure is expensed as incurred.
- m) Impairment** Management evaluates the carrying value of the Group's assets for potential impairment at each balance sheet date or whenever events or changes in circumstances indicate that the carrying amount of such assets may not be recoverable. If any indication of impairment exists, the asset's recoverable amount is estimated. An impairment loss is recognized whenever the recoverable amount is less than the carrying amount of an asset. Impairment losses are recognized in the income statement.

The recoverable amount of the Group's receivables is calculated as the present value of expected future cash flows, discounted at the original effective interest rate inherent in the asset. Receivables with a short duration are not discounted.

The recoverable amount of other assets is the greater of their net selling price and value in use. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset. For an asset that does not generate independent cash inflows, the recoverable amount is determined for the cash-generating unit to which the asset belongs.

An impairment loss in respect of a receivable is reversed if the subsequent increase in the recoverable amount can be related objectively to an event occurring after the impairment loss was recognized. In respect of other assets, an impairment loss is reversed if there has been a change in the estimates used to determine the recoverable amount. An impairment loss is reversed only to the extent that the asset's carrying amount does not exceed the carrying amount that would have been determined, net of depreciation or amortization, if no impairment loss had been recognized.

- n) **Trade and Other Payables** Trade and other payables are stated at their repayment amounts. Payables with repayment dates exceeding one year are discounted to their net present values.
- o) **Convertible Bonds** The Company issued convertible bonds to the Supervisory Board, Management Board and employees of the Company. In accordance with IAS 32.28, the equity portion of the bond has to be separated and presented as additional paid-in capital. The equity component is deducted from the fair value of the bond. The remaining value is recognized as stock-based compensation. The Company applies the provisions of IFRS 2 "Share-Based Payment" for all convertible bonds granted to Supervisory Board, Management Board and employees of the Company.
- p) **Revenue Recognition** The Company's revenues include technology access fees; fees earned from research and development collaboration agreements predominantly with companies based in the United States.

Revenue related to non-refundable technology access fees, subscription fees and license fees are 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 for which cash has been received 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.

In accordance with IAS 18.21, 18.25 and IAS 20.18, revenue arrangements with multiple deliverables the total consideration will be allocated among the separately identifiable components based on their respective fair values under application of IAS 18.20, and the applicable revenue recognition criteria will be considered separately for each of the separate components.

Deferred revenue represents revenues received but not yet earned per the terms of the contracts. Grant revenue in 2004 amounted to € 84,074 (2003: € 67,251).

- | | |
|------------------------------|---|
| q) Expenses | The Company applies the provisions of IFRS 2 “Share-Based Payment” which requires the |
| qa) Stock-Based Compensation | Company to record the estimated fair value for stock options and other awards at the measurement date as compensation expense over the period in which the employees render the services associated with the award. |
| qb) Operating Lease Payments | Payments made under operating leases are recognized in the income statement on a straight-line basis over the term of the lease. |
| r) Interest Income | Interest income is recognized in the income statement as it occurs, taking into account the effective yield on the asset. |
| s) Interest Expense | Borrowing costs are expensed when incurred. |
| t) Income Taxes | Income tax on the profit or loss for the year comprises current and deferred tax. Income tax is recognized in the income statement except to the extent that it relates to items recognized directly in equity, in which case it is recognized in equity. |

Current tax is the expected tax payable on the taxable income for the year, using tax rates enacted or substantially enacted at the balance sheet date, and any adjustment to tax payable in respect of previous years.

Deferred tax is provided using the balance sheet liability method, providing for temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for taxation purposes. The amount of deferred tax provided is based on the expected manner of realization or settlement of the carrying amount of assets and liabilities, using tax rates enacted or substantially enacted at the balance sheet date.

A deferred tax asset is recognized only to the extent that it is probable that future taxable profits will be available against which the asset can be utilized. Deferred tax assets are reduced to the extent that it is no longer probable that the related tax benefit will be realized.

2 Segment Reporting

A segment is a distinguishable component of the Group that is engaged in providing products or services and that is subject to risks and returns that are different from those of other segments.

Segment information is presented in respect of the Group's business and geographical segments. The primary format, business segments, is based on the Group's management and internal reporting structure. Segment results and assets include items directly attributable to a segment as well as those that can be allocated on a reasonable basis.

The Group consists of the following main business segments:

Partnered Target Research	MorphoSys possesses one of the leading technologies in the generation of human antibody therapeutics and bespoke antibody research projects. The Company makes use of its technology in collaborations with internationally renowned pharmaceutical and biotech companies.
Reagent Business	The reagent business leverages MorphoSys's core technological capabilities in the design and manufacture of antibodies for research purposes. It commercializes HuCAL [®] technology focusing on the custom generation of research antibodies for partners on an individual basis.

In presenting information on the basis of geographical segments, segment revenue is based on the geographical location of the customers. Segment assets are based on the geographical location of the assets.

in 000's €	Partnered Target Research		Reagent Business		Unallocated		Consolidated	
	2004	2003	2004	2003	2004	2003	2004	2003
Revenues	21,194	15,276	784	32	-	-	21,978	15,308
Segment Result	9,874	6,941	(1,826)	(1,436)	(7,407)	(8,560)	641	(3,055)
Interest Income	-	-	-	-	-	-	286	212
Interest Expense	-	-	-	-	-	-	338	885
Impairment of Marketable Securities	-	-	-	-	-	-	-	137
Other Income, Net	-	-	-	-	-	-	(307)	734
Foreign Income	-	-	-	-	-	-	-	-
Tax Expense	-	-	-	-	-	-	-	-
Total Profit/(Loss)	-	-	-	-	-	-	282	(3,131)
Accounts Receivable	2,065	2,050	240	62	-	-	2,305	2,112
Property and Equipment, Net	1,090	938	878	251	363	313	2,331	1,502
Software, Net	210	299	8	7	70	99	288	405
Total Segment Assets	3,365	3,287	1,126	320	51,305	39,272	55,796	42,879
Deferred Revenue	9,815	10,321	43	37	-	-	9,858	10,358
Total Segment Liabilities	9,815	10,321	43	37	6,560	5,218	16,418	15,576
Capital Expenditure	728	283	777	257	-	-	1,505	540
Depreciation	461	400	145	6	51	134	657	540

Intangibles are included in unallocated segment assets and not split since they are the basis for both segments. Therefore, patents and license fees in the net amount of € 12.5 million remain unallocated.

The following table shows the split of the Company's consolidated sales by geographical markets:

	in 000's €	
	2004	2003
Germany	3,844	2,374
U.S.A. and Canada	12,043	12,379
Austria	376	520
Switzerland	5,458	-
Other Europe	186	35
Other	71	-
Total	21,978	15,308

Substantially, all assets were located in Germany.

3 Cash and Cash Equivalents

	in 000's €	2004	2003
Cash		-	-
Bank Balances		12,281	205
Term Deposits		250	6,447
Cash and Cash Equivalents		12,531	6,652

See note 1h.

4 Investments

Investments consist of the following as of December 31, 2004 and 2003:

in 000's €	Maturity	Cost	Gross Unrealized Holding Gains	Losses	Realized Holding Losses	Market Value
12/31/2004						
HVB Euro Bond	06/07/2011	-	-	-	-	-
HVB Debentures	12/06/2009	-	-	-	-	-
DB Money Market Funds	daily	24,320	624	-	-	24,944
		24,320	624	-	-	24,944
Restricted Cash						246
						24,698
12/31/2003						
HVB Euro Bond	06/07/2011	3,794	-	-	(70)	3,724
HVB Debentures	12/06/2009	2,789	-	-	(66)	2,723
DB Money Market Funds	daily	10,181	245	-	-	10,426
		16,764	245	-	(136)	16,873
Restricted Cash						364
						16,509

The net unrealized holding gains of € 623,840 for the year ended December 31, 2004, and € 244,930 for the year ended December 31, 2003, were recorded as a separate component of stockholders' equity (revaluation reserve). In 2004, the Group has recorded gains of € 109,748 in the income statement on the sale of investments, which had previously been recognized in equity (2003: € 198,463).

Under IAS 39, 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 2003/2004, MorphoSys's HypoVereinsbank investments had traded below their 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 and recognized as impairment of marketable securities in the statement of operations. Since June 30, 2003, the two impaired investments have recovered and at December 31, 2003, the two investments had regained € 616,999 in market value. This increase in market value was treated as reversal of the impairment losses previously recognized in the statement of operations. Therefore, an impairment loss of € 136,768 was recognized in the income statement for the financial year 2003. In January and February 2004, MorphoSys sold both investments.

For further details of restricted cash items and investments, see note 10.

5 Accounts Receivable

All accounts receivable are non-interest-bearing and are generally due on a 30- to 45-day term. On December 31, 2004 and 2003, accounts receivable included unbilled amounts of approximately € 116,037 and € 119,360 respectively.

6 Other Receivables

According to the Company's hedging policy, definite foreign currency receivables which are collectable within a twelve-month period are hedged and shown as other receivables with its fair values. Starting 2003, MorphoSys entered into foreign currency options and forward contracts to hedge foreign exchange exposure related to U.S. dollar accounts receivable.

At December 31, 2004, options contracts in the notional amount of € 3,846,155 (December 31, 2003: € 4,690,583) or US\$ 5,000,000 (December 31, 2003: US\$ 5,250,000) were outstanding, which mature in January 2005. The fair market value at December 31, 2004, was € 180,190 (December 31, 2003: € 479,929) and recorded in other receivables on the balance sheet and classified as held for trading. Changes in fair value were recognized as other income. At December 31, 2004, the contract premium for derivatives entered into in February 2004 amounted to € 138,000 (2003: € 164,000).

In June 2004, MorphoSys AG entered into foreign currency forward contracts with the notional amount of US\$ 3.8 million. The fair market value at December 31, 2004 was € 211,845 (December 31, 2003: € 0) and recorded as other receivables. Changes in fair value were recognized as other income.

In December 2004, the Company received cash in the amount of US\$ 1.25 million for the respective amount hedged by a forward contract due on January 03, 2005. Therefore, the Company entered into a foreign currency swap. The swap was included in the fair market value of foreign currency forward contracts as of December 31, 2004. For the period ending at December 31, 2004, unrealized gains amounted to € 233,459 and included in total foreign exchange losses of € 105,499 (2003: gains of € 315,929).

7 Prepaid Expenses and Other Current Assets

Prepaid expenses mainly include prepaid sublicense fees in the amount of € 0.1 million at December 31, 2004 and 2003, and other prepayments in the amount of € 0.3 million at December 31, 2004 (2003: € 0.2 million).

8 Property and Equipment, Net

	in 000's €	Office and Laboratory Equipment	Furniture and Fixtures	Total
Cost				
01/01/2004		3,605	1,267	4,872
Additions		1,427	78	1,505
Disposals		46	-	46
12/31/2004		4,986	1,345	6,331
Accumulated Depreciation				
01/01/2004		2,778	592	3,370
Depreciation Charge for the Year		523	134	657
Disposals		27	-	27
12/31/2004		3,274	726	4,000
Carrying Amount				
01/01/2004		827	675	1,502
12/31/2004		1,712	619	2,331

The depreciation charge is included in the following line items of the statement of operations:

	in 000's €	2004	2003
Research and Development		493	408
Sales, General and Administrative		164	137
		657	545

For more detailed information, see Appendix 1.

9 Intangible Assets, Net

	in 000's €	Patents	License Fees	Software	Total
Cost					
01/01/2004		3,725	12,140	1,185	17,050
Additions		41	-	181	222
12/31/2004		3,766	12,140	1,366	17,272
Accumulated Amortization					
01/01/2004		522	1,241	780	2,543
Amortization for the Year		454	1,228	298	1,980
12/31/2004		976	2,469	1,078	4,523
Carrying Amount					
01/01/2004		3,203	10,899	405	14,507
12/31/2004		2,790	9,671	288	12,749

The amortization charge is included in the following line items of the income statement:

	in 000's €	2004	2003
Research and Development		1,451	1,014
Sales, General and Administrative		529	526
		1,980	1,540

The Company has entered into the following license agreements covering certain patented technology which are capitalized (non-capitalized license agreements have not been disclosed in detail):

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 SCA Ventures's 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.

On December 31, 2004, the license had a remaining amortization period of 5 years.

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 terminated earlier, the term of this agreement shall be the later of 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.

On December 31, 2004, the license had a remaining amortization period of 5 years.

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.

On December 31, 2004, the license had a remaining amortization period of 6 years.

XOMA Ireland Limited

In February 2002, the Company concluded a cross-licensing agreement for antibody-related technologies with XOMA Ireland Ltd. Pursuant to the agreement, MorphoSys paid € 1.1 million to XOMA with a second payment of € 4.6 million due 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.

On December 31, 2004, the license had a remaining amortization period of 8 years.

Cambridge Antibody Technology 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's 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, WinterII 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.

On December 31, 2004, the license had a remaining amortization period of 8 years.

For further information, see Appendix 1.

10 Other 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, 2004 and 2003, the Company had commitments of € 245,500 and € 364,000 for guarantees issued and € 59,778 and € 157,200 respectively for convertible bonds issued to employees. € 49,914 for convertible bonds issued to employees were outstanding at December 31, 2004.

11 Accounts Payable

Accounts payable are non-interest-bearing and are normally settled within 30 days. License payables are partly settled within 30 days. License payables which are expected to be settled after more than 12 months are discounted to their net present value with an interest rate of 13%.

The residual maturity of liabilities is listed in the table below:

	in €	12/31/2004	12/31/2003
Accounts Payable		335,464	258,732
Accrued Expenses		2,588,248	2,007,882
Other Liabilities		914,432	465,679
Of which Taxes		730,773	177,721
Of which Related to Social Security		156,897	117,933
Total		3,838,144	2,732,293

Accounts payable include accruals, which mainly contain accrued expenses for personnel payments of € 1.0 million (2003: € 0.9 million). Expenses for outstanding invoices include € 0.9 million mainly for license compensation (2003: € 0.5 million), € 0.1 million for Supervisory Board members' compensation (2003: € 0.1 million), € 0.0 million for audit fees and costs related there to (2003: € 0.1 million) and € 0.1 million for legal services (2003: € 0.1 million).

12 Provisions

At December 31, 2004 and 2003, the Company had provisions of € 600,607 and € 0 respectively.

13 Stockholders' Equity

Common Stock On December 31, 2004, the common stock of the Company was € 16,316,556. This represented an increase of € 1,612,560 compared to the December 31, 2003, balance of € 14,703,996. Each share of common stock is entitled to one vote. The increase arose mainly as a result of the issuance of the conversion of bonds issued to Novartis on May 19, 2004. The bond was converted into 490,133 MorphoSys shares on June 15, 2004. Through conversion and exercise of 47,387 convertible bonds and options issued to employees, common stock increased by an additional € 142,161 in 2004. In accordance with § 200 AktG, a contingent capital increase becomes effective with the issuance of new shares. At January 27, 2005, the application of the capital increase has not been filed. The registration has declaratory effect.

The increase of € 2,854,878 during the year ended December 31, 2003, 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.

Treasury shares totaling € 11,033 (30,062 shares) at December 31, 2004, compared to € 21,934 (59,762 shares) at December 31, 2003, were subtracted from the Company's common stock.

Authorized Capital On May 11, 2004, the Annual Shareholders' Meeting authorized the Company to increase Authorized Capital I by 823,424 shares to create a maximum of 1,960,533 new shares of Authorized Capital I (December 31, 2003: 1,137,109 shares). Also approved was an increase to Authorized Capital II of 58,816 shares to create a maximum of 490,133 new shares of Authorized Capital II (December 31, 2003: 431,317 shares).

Unused Authorized Capital I equaled 1,960,533 and 1,137,109 shares at December 31, 2004 and 2003, respectively. Unused Authorized Capital II equaled to 490,133 and 431,317 shares at December 31, 2004 and 2003, respectively.

Conditional Capital In 2004, 2,880 shares were raised from Conditional Capital I through exercise of the same number of options by employees, increasing the subscribed capital by € 8,640. Furthermore, 17,385 shares were raised from Conditional Capital II through exercise of the same number of options by employees, increasing the subscribed capital by € 52,155, and 27,122 shares were raised from Conditional Capital IV through exercise of the same number of convertible bonds by employees, increasing the subscribed capital by € 81,366. At December 31, 2004, the subscription notes for options and convertible bonds exercised were not signed. As of the end of January 2005 the application for the registration of the conditional share capital increase has not been filed.

On May 16, 2003, the Annual Shareholders' Meeting 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.

On May 11, 2004, the Annual Shareholders' Meeting authorized the Company to create an additional 58,816 shares for Conditional Capital V to create a maximum amount of € 510,789 (170,263 shares).

On May 19, 2004, MorphoSys issued a convertible bond (callable common shares) split into seven partial debentures to Novartis, convertible into a total of 490,133 shares. On June 15, 2004, Novartis converted all debentures into 490,133 common shares from the Company's Conditional Capital III.

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 IFRS. As of December 31, 2004 and 2003, 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, 2004, additional paid-in capital amounted to € 78,646,377 (December 31, 2003: € 68,632,990). The increase of € 10.0 million is due to stock-based compensation provisions in the amount of € 1,431,313, € 7,357,748 from Novartis's capital increase through the grant of callable common shares in May 2004 and € 1,224,326 through the exercise of options and convertible bonds in the year 2004.

In 2003, the additional paid-in capital was increased by € 9.4 million resulting from stock-based compensation provisions in the amount of € 2,181,277 including the equity component of convertible bonds, € 3,110,896 as a result of the XOMA share issuance, and € 4,143,569 as a result of the CAT share issuance.

14 Convertible Bonds

At the Company's Annual Shareholders' Meeting 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 Annual Shareholders' Meeting authorized the Company to grant an 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 by inheritance/death. 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 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 from the 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.

At December 31, 2004, all convertible bonds granted in 2002 expired. The nominal value of € 1.00 each was paid back to respective related parties.

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. In the year 2004, 27,122 bonds of the 2003 grant were converted into shares of ordinary no-par value common stock with the same amount by employees of the Company.

In the year 2004, an additional grant to board members and employees was made under the 2002 Plan, with terms identical to the 2002 stock convertible bonds grants. On December 9, 2004, 49,914 convertible bonds were granted to board members and employees of MorphoSys AG. The exercise price for the convertible bonds is € 38.40.

A summary of the activity under the Company's employee incentive convertible bonds plan for the years ended December 31, 2004 and 2003, is represented as follows:

	Convertible Bonds	Weighted- Average Price in €
Outstanding at 01/01/2003	74,800	57.56
Granted	93,200	11.41
Forfeited	(16,200)	43.97
Outstanding at 12/31/2003	151,800	30.68
Outstanding at 01/01/2004	151,800	30.68
Granted	49,914	38.40
Exercised	(27,122)	11.69
Forfeited	(24,200)	35.66
Expired	(50,700)	57.56
Outstanding at 12/31/2004	99,692	24.83

Convertible bonds exercisable at December 31, 2004 and 2003, amounted to 49,778 and 63,400 shares respectively. The weighted-average exercise prices of convertible bonds exercisable were € 11.22 and € 57.56 at December 31, 2004 and 2003, respectively. Furthermore, the weighted-average fair value of bonds granted during 2004 and 2003 is estimated to be € 16.52 and € 5.04 respectively.

The nominal value of 10,000 forfeited convertible bonds was not reimbursed to respective related parties by the balance sheet date.

The following table presents weighted-average price and information about contractual life for significant convertible's groups outstanding at December 31, 2004:

Range of Exercise Prices	Number Outstanding	Remaining Contractual Life (in Years)	Weighted-Average Exercise Price	Number Exercisable	Weighted-Average Exercise Price
€ 10.00–€ 38.10	49,778	1.00	€ 11.22	49,778	€ 11.22
€ 38.10–€ 38.40	49,914	2.00	€ 38.40	-	-
	99,692			49,778	

The Company accounts for stock-based compensation in accordance with the provisions of IFRS 2 and IAS 32.28. The equity portion of the bond has to be separated and presented as additional paid-in capital. The equity component is deducted from the fair value of the bond. The remaining value is recognized as stock-based compensation. Compensation expense recorded in 2004 and 2003 in connection with convertible bonds was € 184,327 and € 298,985 respectively. The fair value of the convertible bonds issued in 2004 was calculated using the Black-Scholes option pricing model using the following assumptions: risk-free interest rate of 2.74%; dividend yield of 0%; 78% expected volatility and an expected life of 2.0 years.

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

15 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 are vested 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.

For the full year 2004, 32,580 options from the 1998 Plan were exercised.

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 option 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 option grants. 36,000 options were granted on July 7, 2003, to executive board members of MorphoSys AG.

For the full year 2004, 17,385 options from the 1999 Plan were exercised.

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 the “1999 Plan” employee stock option program. On May 16, 2003, the Annual Shareholders’ Meeting authorized the Company to grant additional 36,891 shares under the “2002 Plan” 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 option 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 option grants.

A summary of the activity under the Company’s employee incentive stock option plans for the years ended December 31, 2004 and 2003, is represented as follows:

	Shares	Weighted-Average Price in €
Outstanding at 01/01/2003	265,470	30.48
Granted	53,500	10.89
Exercised	-	-
Forfeited	(47,225)	31.65
Outstanding at 12/31/2003	271,745	26.40
Outstanding at 01/01/2004	271,745	26.40
Granted	35,750	11.72
Exercised	(49,965)	21.11
Forfeited	(63,600)	21.30
Outstanding at 12/31/2004	193,930	26.70

Stock options exercisable at December 31, 2004 and 2003, amounted to 106,518 and 179,295 shares respectively. The weighted-average exercise prices of stock options exercisable were € 36.51 and € 27.91 at December 31, 2004 and 2003, respectively. Furthermore, the weighted-average fair value of options granted during 2004 and 2003 is estimated to be € 6.99 and € 7.57 respectively.

The following table presents weighted-average price and information about contractual life for significant option groups outstanding at December 31, 2004:

Range of Exercise Prices	Number Outstanding	Weighted-Average Remaining Contractual Life (in Years)	Weighted-Average Exercise Price	Number Exercisable	Weighted-Average Exercise Price
€ 10.88–€ 38.10	183,930	3.53	€ 19.06	97,518	€ 23.27
€ 38.11–€ 58.00	2,000	1.50	€ 44.96	1,500	€ 44.96
€ 58.01–€ 217.00	8,000	0.70	€ 197.84	7,500	€ 207.06
	193,930			106,518	

The Company accounts for stock-based compensation in accordance with the provisions of IFRS 2 “Share-Based Payment.” Compensation expense recorded in 2004 and 2003 in connection with stock options was € 1,239,580 and € 1,864,722 respectively. The fair value of the options issued in 2004 was calculated using the Black-Scholes option pricing model using the following assumptions: risk-free interest rate of 3.1%, dividend yield of 0%, 78% expected volatility and an expected option life of 3.0 years. For option grants in 2003, the following assumptions were used: risk-free interest rates ranging from 2.96% to 3.61%, dividend yield of 0%, 115% expected volatility and identical option life as in 2004.

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 the 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 re-issued 94,100 options to employees, which had been cancelled on July 5, 2001. The re-issued options have similar characteristics and vesting provisions as the original options granted. In accordance with IFRS 2 “Share-Based Payment,” the re-issued options were revalued at the date of re-issuance using the Black-Scholes option pricing model. An incremental fair market value of approximately € 5,950,000 was assigned to the re-issued options, which will be recognized over the vesting period of the re-issued options. During the years ended December 31, 2004 and 2003, the Company recognized approximately € 535,741 and € 1,650,000 respectively of stock-based compensation expense relating to these re-issued stock options.
- Extension of 1999 Options** On October 31, 1999, 98,100 options were granted under the 1999 options plan to employees, Supervisory Board members and Management Board members. The originally anticipated options term was five years. On October 14, 2004, the Management and Supervisory Boards decided to extend the exercise period of 54,900 options granted to employees and the Management Board respectively until October 31, 2009. In accordance with IFRS 2 “Share-Based Payment,” the extended options were revalued at October 14, 2004, using the Black-Scholes option pricing model. Stock-based compensation in the amount of € 518,585 was recognized at full in the fourth quarter of 2004.

16 Personnel Expenses

	in 000's €	2004	2003
Wages and Salaries		7,229	6,334
Social Security Contributions		1,077	929
Stock-Based Compensation Expense		1,424	2,164
Temporary Staff (External)		1	33
Other		757	218
		10,488	9,678

The average number of employees during the year ended December 31, 2004, was 117 (December 31, 2003: 93).

17 Income Taxes

The Company and its German subsidiary are subject to corporate tax, solidarity surcharge and trade tax. Since 2001, a corporate tax rate of 25% plus 5.5% solidarity surcharge applies. In 2003 only, the corporate tax rate amounted to 26.5% with regard to the one-off effect of the Flood Victims Solidarity Act applicable for 2003. Considering the multiplier rate of 300% for municipal trade tax, the trade tax rate amounts to approximately 13.04% of the taxable income and is deductible in the calculation of the corporate tax income.

The income tax of the current fiscal year comprises as follows:

in 000's €	12/31/2004	12/31/2003
Actual Tax Expense/Benefit for the Current Year	-	-
Actual Tax Expense/Benefit for Previous Years	-	-
Deferred Tax Expense/Benefit resulting from the Existence or the Reversal of Temporary Differences	(826)	(1,623)
Deferred Tax Benefit with Regard to the Recognition of DTA on Previously Unrecognized DTA with Regard to Future Reversal of Differences between IFRS and Tax Balance Sheet	826	1,623
Total Amount of Deferred Taxes Resulting from Entries directly Recognized in Equity	(221)	-

Deferred taxes are recognized only to the extent that it is more likely than not that the related tax benefits will be realized. Based on the income situation in the past and the business expectations for the foreseeable future, valuation allowances are reported if this criterion is not fulfilled.

Valuation allowances on deferred tax assets were reduced by € 826,000. The current assessment with regard to the usability of deferred tax assets can change depending on the income situation of future years and may result in higher or lower valuation allowances.

The following table reconciles the statutory income tax expense to the actual income tax expense presented in the financial statements. In order to calculate the statutory income tax expense, in fiscal year 2004, the combined income tax rate of 36% (2003: 36%) was applied to income before taxes. The tax rate applied in the reconciliation statement includes corporate tax and solidarity surcharge, and amounts to 26.38% plus the effective trade tax rate based on the multiplier rate of 300% for municipal trade tax which amounts to 9.60% taking into account that the trade tax is deductible in the calculation of the corporate tax income.

Reconciliation Statement	in 000's €	2004	2003
Profit Before Income Tax		282	(3,131)
Expected Tax Rate		36%	36%
Expected Income Tax		(102)	1,127
Tax Effects Resulting from:			
Deferred Income Tax Arising from the Recognition of DTA on Previously Unrecognized DTA with Regard to Future Reversal of Differences Between IFRS and Tax Balance Sheet		826	1,623
Non-Recognition of DTA on Current Year Tax Losses		(224)	(1,831)
Stock-Based Compensation (SBC)		(513)	(783)
Interest Expense and Gain XOMA		-	(150)
Expense of Cost/Capital Increase		46	62
Non-Tax-Deductible Items		(29)	(37)
Other Effects		(4)	(11)
Actual Income Tax		-	-

No deferred tax assets were reported for corporate tax loss carry-forwards in the amount of € 33,363 thousand and trade tax loss carry-forwards in the amount of € 32,115 thousand. The loss carry-forwards may be carried forward indefinitely and in unlimited amounts. From 2004, German tax law restricts the offset of taxable income against existing tax loss carry-forwards to an amount of € 1 million plus 60% of taxable income above € 1 million. Deferred tax assets on assets and liabilities were only reported to the extent of existing deferred tax liabilities. A valuation allowance for deferred tax assets with regard to future reversal of differences between IFRS and tax balance sheet in the amount of € 4,510 thousand exists.

Significant components of the deferred tax assets and liabilities are as follows:

in 000's €	DTA 2004	DTA 2003	DTL 2004	DTL 2003
Intangible Assets	5,789	6,760	1,242	1,272
Valuation Allowance on Intangible Assets	(4,510)	(5,336)	-	-
Inventory	79	65	-	-
Receivables and other Assets	870	523	121	155
Short-term Securities Investments	4	-	225	-
Other Accruals	6	6	-	-
Deferred Income	110	230	2	2
Liabilities	-	-	979	819
	2,348	2,248	2,569	2,248

18 Earnings Per Share

The calculation of basic loss per share is based on the net profit for the year of € 282,112 (2003: € (3,130,980)) and a weighted-average number of shares of common stock outstanding for the respective years (2004: 5,131,467; 2003: 4,332,438).

The weighted-average number of shares of common stock was calculated as follows:

	2004	2003
Shares Issued at January 1	4,901,332	3,949,706
Effect of Treasury Shares Held	(30,062)	(59,762)
Effect of Shares Issued in April	2,367	-
Effect of Shares Issued in May	5,671	238,272
Effect of Shares Issued in June	247,717	-
Effect of Shares Issued in August	250	204,222
Effect of Shares Issued in September	583	-
Effect of Shares Issued in October	164	-
Effect of Shares Issued in November	2,204	-
Effect of Shares Issued in December	1,241	-
Weighted-Average Number of Shares of Common Stock	5,131,467	4,332,438

The diluted profit per share is calculated taking into account the Company's potential common shares from outstanding stock options and convertible bonds. For the year ended 2003, these shares would have had an anti-dilutive effect.

The table below illustrates the reconciliation from basic to diluted earnings per share (in thousands of €, except per-share data):

	12/31/2004	12/31/2003
Numerator:		
Net Profit/(Loss)	282	(3,131)
Denominator:		
Weighted-Average Shares Used for Basic EPS	5,131,467	4,332,438
Dilutive Shares Arising from Stock Options	12,401	-
Dilutive Shares Arising from Convertible Bonds	26,097	-
Total Denominator:	5,169,965	4,332,438
Earnings/(Loss) per Share (in €):		
Basic	0.05	(0.72)
Diluted	0.05	(0.72)

As of February 7, 2004, EPS would be calculated as follows (in thousands of €, except per-share data):

	2004
Numerator:	
Net Profit/(Loss)	282
Denominator:	
Weighted-Average Shares Used for Basic EPS	5,131,467
Dilutive Shares Arising from Stock Options	15,105
Dilutive Shares Arising from Convertible Bonds	28,177
Total Denominator:	5,174,749
Diluted Earnings/(Loss) per Share (in €):	0.05

19 Financial Risk Management Objectives and Policies

The Group's principal financial instruments other than derivatives comprise debentures, convertible non-cumulative redeemable preference shares, cash and short-term deposits. The main purpose of these financial instruments is to raise finance for the Group's operations. The Group has various other financial instruments such as trade debtors and trade creditors, which arise directly from its operations.

The Group also enters into derivative transactions, principally forward currency contracts. The purpose is to manage the currency risks arising from the Group's operations, as the Company generates a substantial part of its revenues with U.S.-based companies.

Furthermore, the Company hedges its foreign exchange exposure only for receivables payments, which are definitive and are due or will be collected within a twelve month period. To the extent that foreign currency payables exist within the same time frame, they are to be netted against foreign currency receivables wherever possible, and the resulting net position hedged. The Company does not hedge the translation risk arising from the conversion of foreign affiliated companies into euros.

The main risks arising from the Group's financial instruments are interest rate risk, liquidity risk, foreign currency risk and credit risk. The Board of Management reviews and agrees policies for managing each of these risks and they are summarized below. The Group also monitors the market price risk arising from all financial instruments. The magnitude of this risk that has arisen over the year is discussed in note 4. The Group's accounting policies in relation to derivatives is set out in note 1.

Interest Rate Risk The exposure of the Group to changes in interest rates relates mainly to investments in available-for-sale debt securities. Changes in the general level of interest rates may lead to an increase or decrease in the fair value of these investments. With regard to the liabilities shown in the balance sheet, the Group is currently not subject to significant interest rate risks.

Credit and Liquidity Risk Financial instruments that potentially subject the Company to concentrations of credit and liquidity 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 counterparts to its financial instruments, and does not anticipate non-performance.

It is the Group's policy that all customers who wish to trade on credit terms are subject to credit verification procedures. However, the Company's revenues and accounts receivable are subject to credit risk as a result of customer concentrations. One customer individually accounted for approximately 52% of the Company's 2004 accounts receivable balance. In addition, three customers individually accounted for 28%, 26% and 17% of the Company's total revenues in the year 2004. On December 31, 2003, one customer accounted for 88% of the prior year's accounts receivable balance and three customers individually accounted for 41%, 27% and 14% of the Company's revenues in 2003. Based on the management's assessment, allowances of € 36,456 and € 0 in relation to the newly formed reagent business unit were necessary on December 31, 2004 and 2003.

Foreign Currency Risk Although the Company has significant customers in the United States, the Group contracts the majority of transactions in euros. Part of the purchases and sales are denominated in U.S. dollars, Swiss francs and pounds sterling. Generally, the amounts involved are not significant or payment is effected within a short period, thus leading to no significant foreign currency risks (see also note 6).

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 is 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.

20 Operating Leases

The Company leases facilities and equipment under long-term operating leases. Total rent expense amounted to € 898,292 and € 899,676 for the years ended December 31, 2004 and 2003, 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 are as follows:

	in 000's €	2004	2003
Up to One Year		1,700	1,191
Between One and Five Years		3,668	3,691
More than Five Years		-	893
		5,368	5,775

The Company's total expenses under operating leases in the years ended December 31, 2004 and 2003, totaled approximately € 1,084,597 and € 1,092,953 respectively.

21 Contingencies

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. 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's motion for summary judgment of non-infringement be allowed and that AME's motion for partial summary judgment of infringement be denied. In September 2004, the District Judge issued a "Memorandum and Order" wherein he declined to adopt the recommendation and denied the summary judgment motions. Instead, he ordered that a Markman hearing for claim construction should be held. Thereafter, based on the facts at issue, it will be determined whether the case can be decided by way of summary judgment or has to go to trial. 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, the basis of which 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.

The management is not aware of any other matters that could give rise to any material liability to the Company that would have an adverse material 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 year ended 2003 (in thousands of €, except for per-share data):

	12/31/2004
Net Profit/(Loss)	(3,131)
Effect from Change in Accounting Estimate	(2,272)
Pro-Forma Loss	(5,403)
Basic and Diluted Net Profit/(Loss) per Share	(0.72)
Effect from Change in Accounting Estimate	(0.52)
Pro-Forma Net Profit/(Loss) per Share	(1.24)

22 Related Parties

The Group has related party transactions with its management and with members of the Supervisory Board. In addition to the cash remuneration, the Group has issued stock options and convertible bonds to the management and to members of the Supervisory Board.

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 2004:

Shares

	01/01/2004	Additions	Forfeitures	Expired	Sales	12/31/2004
Management						
Dr. Simon E. 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	-	2,500	-	-	-	2,500
Dr. Daniel Camus	-	-	-	-	-	-
Prof. Dr. Jürgen Drews	-	-	-	-	-	-
Prof. Dr. Andreas Plückthun	59,300	-	-	-	-	59,300
Dr. Jörg Reinhardt*	-	-	-	-	-	-
Dr. Geoffrey N. Vernon	-	-	-	-	-	-
Dr. Metin Colpan**	-	-	-	-	-	-
Total	59,300	2,500	-	-	-	61,800

Stock Options

	01/01/2004	Additions	Forfeitures	Expired	Sales	12/31/2004
Management						
Dr. Simon E. Moroney	47,000	-	-	-	-	47,000
Dave Lemus	21,000	-	-	-	-	21,000
Dr. Thomas von Rüden***	64,700	-	31,500	-	29,700	3,500
Total	132,700	-	31,500	-	29,700	71,500
Supervisory Board						
Dr. Gerald Möller	6,100	-	-	3,600	-	2,500
Dr. Daniel Camus	-	-	-	-	-	-
Prof. Dr. Jürgen Drews	5,930	-	-	2,000	-	3,930
Prof. Dr. Andreas Plückthun	3,500	-	-	2,000	-	1,500
Dr. Jörg Reinhardt*	3,500	-	1,750	-	-	1,750
Dr. Geoffrey N. Vernon	3,500	-	-	2,000	-	1,500
Dr. Metin Colpan**	-	-	-	-	-	-
Total	22,530	-	1,750	9,600	-	11,180

*) Retired 05/11/2004 **) Entered 05/11/2004 ***) No longer with the Company since 09/03/2004

Convertible Bonds

	01/01/2004	Additions	Forfeitures	Expired	Sales	12/31/2004
Management						
Dr. Simon E. Moroney	24,000	7,474	-	12,000	-	19,474
Dave Lemus	34,000	6,228	-	10,000	-	30,228
Dr. Thomas von Rüden***	20,000	-	20,000	-	-	-
Total	78,000	13,702	20,000	22,000	-	49,702
Supervisory Board						
Dr. Gerald Möller	2,500	-	-	-	-	2,500
Dr. Daniel Camus	1,500	-	-	-	-	1,500
Prof. Dr. Jürgen Drews	-	-	-	-	-	-
Prof. Dr. Andreas Plückthun	1,500	-	-	-	-	1,500
Dr. Jörg Reinhardt*	1,500	-	1,500	-	-	-
Dr. Geoffrey N. Vernon	1,500	-	-	-	-	1,500
Dr. Metin Colpan**	-	-	-	-	-	-
Total	8,500	-	1,500	-	-	7,000

Compensation for both the Management Board and Supervisory Board consisted of fixed and variable components. Total compensation for the Supervisory Board excluding reimbursements of travel expenses in 2004 amounted to € 169,500 (2003: € 152,500). The table below shows the detailed compensation for the Management Board and the Supervisory Board:

Management Board

in €	Fixed Compensation		Variable Compensation		Other Compensatory Benefits		Total Compensation	
	2004	2003	2004	2003	2004	2003	2004	2003
	Dr. Simon E. Moroney	227,052	212,100	63,630	94,500	59,051	60,261	349,733
Dave Lemus	170,824	166,650	74,993	57,750	101,072	140,145	346,889	364,545
Dr. Thomas von Rüden***	129,421	192,136	75,661	80,530	53,037	74,862	258,119	347,528
Total	527,297	570,886	214,284	232,780	213,160	275,268	954,741	1,078,934

Supervisory Board

in €	Fixed Compensation		Variable Compensation		Total Compensation	
	2004	2003	2004	2003	2004	2003
	Dr. Gerald Möller	25,000	25,000	20,500	15,000	45,500
Dr. Daniel Camus	13,500	13,500	13,500	9,000	27,000	22,500
Prof. Jürgen Drews	18,500	13,500	7,000	9,000	25,500	22,500
Prof. Andreas Plückthun	12,000	13,500	7,500	9,000	19,500	22,500
Dr. Jörg Reinhardt*	4,913	13,500	3,000	7,500	7,913	21,000
Dr. Geoffrey N. Vernon	15,000	15,000	15,500	9,000	30,500	24,000
Dr. Metin Colpan**	8,587	-	5,000	-	13,587	-
Total	97,500	94,000	72,000	58,500	169,500	152,500

* Retired 05/11/2004 ** Entered 05/11/2004 *** No longer with the Company since 09/03/2004

23 Corporate Governance

The Company issued its statement according to Section 161 of the German Stock Corporation Act (Aktiengesetz). This declaration has been published and made accessible to stockholders accordingly on December 9, 2004.

24 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 these agreements, which have had, or may have, a significant financial impact (in alphabetical order).

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



Bayer

In December 1999, the Company announced a collaboration with Bayer AG encompassing a research collaboration and license agreement for the application of the Company 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 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 upfront payment to the Company upon signing the agreement, and pays additional 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 pre-agreed 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.

Biogen Idec, Inc., U.S.A.

 The logo for Biogen Idec, featuring the words "biogen ideo" in a lowercase, sans-serif font. The text is contained within a stylized, light-colored rectangular frame that has a slight 3D effect with a shadow on the right side.

In December 2000, the Company signed a collaboration agreement with Biogen Idec, Inc. (Biogen Idec). Under the agreement, the two companies collaborated 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 included an option for Biogen to develop selected antibodies identified during the collaboration as therapeutics. In return, MorphoSys received a technology access fee, as well as research and development funding. 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. The research agreement was successfully concluded at the end of September 2004. Biogen Idec retains limited rights in certain HuCAL[®]-derived antibodies.

Boehringer Ingelheim GmbH

 The logo for Boehringer Ingelheim, consisting of a circular emblem on the left containing a stylized building or temple facade with columns and a pediment. To the right of the emblem, the words "Boehringer" and "Ingelheim" are stacked vertically in a serif font.

In February 2003, MorphoSys and Boehringer Ingelheim GmbH, entered into a therapeutic antibody collaboration and cross-license agreements. Under the terms of the agreements, MorphoSys received an exclusive, worldwide license to patents owned or controlled by Boehringer Ingelheim to develop, make and sell therapeutic and diagnostic antibodies targeting the ICAM-1 molecule. Boehringer Ingelheim will receive exclusive commercial licenses to therapeutic antibodies against two undisclosed targets, which MorphoSys will generate utilizing its HuCAL GOLD[®] antibody technology.

In November 2003, Boehringer Ingelheim exercised its first option for the development of a therapeutic antibody. As a result, MorphoSys will develop a therapeutic antibody for Boehringer Ingelheim against an undisclosed target molecule for the treatment of inflammatory diseases such as asthma and rheumatoid arthritis.

In August 2004, Boehringer Ingelheim exercised its second option for the development of a therapeutic antibody. Both parties initiated a new program for the development of a therapeutic antibody against an undisclosed target molecule involved in cardiovascular diseases. MorphoSys will generate this antibody using its proprietary HuCAL GOLD[®] technology. Boehringer Ingelheim will be responsible for the pre-clinical and clinical development and subsequent marketing of any resultant products on which MorphoSys could earn milestones and royalties.

IIO Bristol-Myers Squibb

In August 1998, the Company and Bristol-Myers Squibb Company (formerly DuPont Pharmaceuticals Company) entered into a cooperation agreement under which Bristol-Myers Squibb acquired a non-exclusive license to MorphoSys's HuCAL[®] antibody library technology. Under the agreement, Bristol-Myers Squibb applied HuCAL[®] technology in its pharmaceutical discovery programs for target characterization and validation. In July 2000, the parties extended this research license and agreed to collaborate in developing a system for fully automated high-throughput antibody generation, called AutoCAL[™]. The amended agreement provided for Bristol-Myers Squibb's continued use of the HuCAL[®] libraries and for the installation of AutoCAL[™] at Bristol-Myers Squibb's facilities in Wilmington (Delaware, U.S.A.). Milestones were achieved in 2000 and 2001 with the successful generation of research antibodies against target molecules provided by Bristol-Myers Squibb using AutoCAL[™].

Centocor, Inc., 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. Centocor will be responsible for the development and marketing of any potential drugs. Should Centocor market any drugs as a result of the collaboration, the Company will receive royalty payments. The original contract had duration of 5 years and was to end in December 2005. In December 2004, both parties extended their agreement until the end of 2007. The extension agreement provides for increased levels of research and development funding by Centocor to MorphoSys, and an upfront payment by Centocor to MorphoSys for the extension.

F. Hoffman-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.

GPC Biotech AG, Munich, Germany

In April 1999, the Company signed a collaboration and license agreement with GPC Biotech AG ("GPC AG"), Munich, Germany. The objective of the collaboration 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 upfront research and development funding/exclusivity payments from GPC as well as the potential for milestone and royalty payments.

IMMUNOGEN, INC.

ImmunoGen, Inc., U.S.A.

In September 2000, the Company signed a collaboration and license agreement with ImmunoGen, Inc., U.S.A. The parties will collaborate in the discovery and development of human monoclonal antibodies against certain specified targets. ImmunoGen, Inc. 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 functional genomics programs at ImmunoGen, Inc., in order to help validate new targets. The expanded agreement has duration of four years.

NOVARTIS

Novartis AG

In May 2004, MorphoSys AG and Novartis AG ("Novartis") announced a collaboration to discover and develop antibody-based biopharmaceuticals as therapeutic agents, in order to address unmet medical need across a variety of diseases. MorphoSys brings validated and robust human antibody technologies (HuCAL GOLD[®]) to Novartis's new strategic research directions, building a collaboration that will identify and develop novel therapeutic agents rapidly and efficiently. MorphoSys scientists will work directly with Novartis scientists across the global sites of the Novartis Institutes for BioMedical Research (NIBR), including the new world headquarters in Cambridge, MA, U.S.A. The MorphoSys HuCAL GOLD[®] technology will be an integral part of Novartis's drug discovery and development efforts. During the three-year term of the agreement, which may be extended up to a total of five years, Novartis will fund internal research at MorphoSys that will generate and optimize HuCAL GOLD[®] antibodies against targets identified by Novartis. In addition, Novartis will have access to the current MorphoSys HuCAL GOLD[®] library at two of its sites. Additionally, under the terms of this collaboration Novartis will be MorphoSys's first partner to receive a non-exclusive option on internalization of the entire MorphoSys technology platform, which would trigger an additional payment by Novartis to MorphoSys. Novartis made an approx. € 9 million investment in MorphoSys by purchasing non-interest-bearing convertible bonds from MorphoSys. In addition, MorphoSys will receive over US\$ 30 million in committed R&D funding and technology license fees over the first three years. MorphoSys also stands to receive technology license payments, research and developmental milestones, and royalties on marketed antibody products.

Novoplant GmbH

In July 2004, MorphoSys AG and Novoplant GmbH announced the signing of a collaboration for the development of therapeutic antibodies in animal health applications. Under the three-year agreement, Novoplant received a license for the development and commercialization of therapeutic antibodies as feed components for use in veterinary medicine. Novoplant will pay a technology access fee to MorphoSys in addition to annual licensing fees. Additionally, MorphoSys receives milestone fees and royalties for the subsequent development and marketing of any resulting products. In the context of the cooperation, Novoplant will use MorphoSys's HuCAL GOLD[®] technology to generate antibodies against viruses, parasites and pathogenic micro-organisms. The addition of such MorphoSys antibodies to animal feed stock may offer protection against infectious diseases in the respective animal's gastrointestinal tract. MorphoSys retains all rights in any human therapeutics or diagnostics emerging from the collaboration.

Pfizer, Inc., U.S.A.

In December 2003, the Company announced a collaboration and license agreement with Pfizer, Inc. ("Pfizer"). 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.

**ProChon Biotech Limited,
Israel**

In May 2000, the Company signed a cooperation and license agreement with ProChon Biotech Limited ("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 the MorphoSys HuCAL GOLD[®] library, but MorphoSys will return all rights concerning FGFR-3 antibodies to ProChon.

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's tissue collection, residing at the Institute of Pathology, University of Graz, Austria, and Oridis gained access to Company's HuCAL GOLD[®] technology. The goal of the collaboration was the characterization and validation of new therapeutic targets. The Company applied its HuCAL[®] technology to make antibodies to candidate targets, which Oridis used 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 gained 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 and Oridis paid each other license fees to access the other's technology. The research agreement ended at the end of 2004, and was not extended.

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.

In December 2004, both parties extended the collaboration agreement by at least two more years, until the end of 2006, with the option of a further extension period of one year beyond this time frame.

**XOMA Technology Ltd./
XOMA Ireland Ltd.**


In February 2002, MorphoSys and XOMA Technology Ltd./XOMA Ireland Ltd. (“XOMA”) concluded mutual license agreements for their antibody technologies. Under the terms of these agreements, MorphoSys received a license for itself and for its collaboration partners for the past and future use of XOMA antibody expression technology for the development of antibody products in connection with the phage display-based HuCAL[®] antibody library (the “XOMA license”). In return, XOMA received a five-year license from MorphoSys to use the MorphoSys HuCAL GOLD[®] antibody library, which XOMA will use for its own target molecule identification and for its research programs. Moreover, an option is included for the development of therapeutic antibodies. MorphoSys acquired the XOMA license by issuing 363,466 shares arising from a capital increase in 2003.

25 Subsequent Events

On January 20, 2005, MorphoSys acquired Biogenesis Ltd. (Poole, U.K.) and its sister company, Biogenesis, Inc. (NH, U.S.A.). The final agreements specified the purchase of 100% ownership of the two companies by MorphoSys AG for a total of GBP 5.25 million, less net debt of approximately GBP 700,000. The total cost for financial advisors, legal counsel and other cost was estimated to be at € 0.8 million. The two Biogenesis companies will become wholly owned subsidiaries of MorphoSys AG. Further information relating to the business combination including operational disposals, intangibles goodwill, and carrying amounts of assets and liabilities for disclosure purposes was deemed impracticable due to the closing of the transaction immediately after the Company’s year-end statutory accounts were closed for 2004.

Summary of Significant Differences Between German GAAP and IFRS

In accordance with § 292a HGB, the Company has an exemption from publishing its financial statements in accordance with the German Commercial Code, which represents generally accepted accounting principles in Germany (“German GAAP”). The accompanying financial statements are in conformity with principles of consolidated financial statement of the European Union (principle 83/349/EWG). German GAAP varies in certain significant respects from IFRS. 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 IFRS.

The financial statements of the Company are prepared in accordance with International Financial Reporting Standards (“IFRS”), 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 IFRS and German GAAP that may affect the Company’s net income and equity for the periods presented.

Intangible assets—Under IFRS, certain expenses (i.e. internal costs associated with obtaining patents) 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 are accounted for according to an expert valuation under IFRS. Under German GAAP, the splits are based on the net present value or acquisition cost.

Amortization life of acquired license rights—Under IFRS, 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 IFRS, more stringent revenue recognition criteria exist which can result in differences in the periods in which revenue is recognized under German GAAP.

Stock-based compensation—The Company accounts for stock option and convertible bonds grants in accordance with IFRS 2 and recognizes compensation expense. Under German GAAP, compensation expense is not recognized.

Private placement and initial public offering costs—Under IFRS, 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 derivative financial instruments—Under IFRS, unrealized gains and losses on derivatives are recorded as other income/expense. Under German GAAP, increased market value is not recorded.

Non-current liabilities—IFRS requires that long-term liabilities be recorded with the present value of the future payments using an interest rate commensurate with the risk involved. Under German GAAP, the long-term liabilities are recorded with their repayment amounts.

Roll-Forward of Fixed Assets (Appendix 1)

	Acquisition and Production Cost			
	01/01/2004 €	Additions €	Disposals €	12/31/2004 €
I. Property and Equipment				
Office and Laboratory Equipment	3,605,233	1,426,886	46,387	4,985,732
Furniture and Fixtures	1,267,327	78,216	-	1,345,543
	4,872,560	1,505,102	46,387	6,331,275
II. Intangible Assets				
Patents	3,724,871	40,885	-	3,765,756
License Rights	12,140,398	-	-	12,140,398
Software	1,185,682	180,759	-	1,366,441
	17,050,951	221,644	-	17,272,595

	Accumulated Depreciation			Net Book Values		
	01/01/2004 €	Depreciation €	Disposals €	12/31/2004 €	12/31/2003 €	12/31/2003 €
	2,777,510	523,749	27,706	3,273,553	1,712,179	827,723
	592,647	134,080	-	726,727	618,816	674,680
	3,370,157	657,829	27,706	4,000,280	2,330,995	1,502,403
	521,331	454,334	-	975,665	2,790,091	3,203,540
	1,241,494	1,227,773	-	2,469,267	9,671,131	10,898,904
	780,190	298,136	-	1,078,326	288,115	405,492
	2,543,015	1,980,243	-	4,523,258	12,749,337	14,507,936

Chart of Consolidated Entity as of December 31, 2004 (Appendix 2)

	Currency	Exchange Rate At 12/31/2004; One Unit of Foreign Currency in €	Share of Capital in %	Equity in Foreign Currency	Profit/Loss in Foreign Currency
Company Consolidated (Apart from Parent Company)					
MorphoSys U.S.A., Inc., Charlotte, North Carolina, U.S.A.	US\$	1.36100	100	24,050	(245,051)
MorphoSys IP GmbH, Munich, Germany	€	-	100	23,891	-