

# Condensed Consolidated Financial Statements for the Three Month Periods



March 31, 2004

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## MorphoSys Group: Three Months' Financial Report 2004

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## Dear Shareholders,

The year 2003 proved to be very successful for MorphoSys and I am pleased to report this progress continues in the first quarter results of 2004.

Following the Company's first-ever profitable quarter last year, MorphoSys was again able to report a net profit in 2004. With a first quarter profit of EUR 0.5 million, MorphoSys has posted its second consecutive profitable quarter. This achievement represents an important step towards the goal of a positive EBITDA for the year 2004.

Progress from new and existing partnerships also continued in the first quarter of 2004. As an example, in January 2004, GPC Biotech made a payment to MorphoSys in order to extend its license from MorphoSys for a HuCAL<sup>®</sup> antibody to treat certain types of leukemia. GPC Biotech has stated they expect to commence clinical trials of this antibody in the second half of 2004 - potentially the first MorphoSys-generated antibody to go into human clinical trials.

Also in January, MorphoSys and Bayer Healthcare signed a cross-licensing agreement. Under the agreement, MorphoSys obtained rights to use Bayer's human cell line HKB 11 for the production of HuCAL<sup>®</sup> antibodies for use in research projects, with an option to use the cell line in commercial antibody production. In exchange, Bayer will switch over from its existing HuCAL<sup>®</sup> library, to the newer HuCAL GOLD<sup>®</sup> version.

In March 2004, Centocor Inc., a subsidiary of the U.S. based pharmaceutical group Johnson & Johnson, commenced a new therapeutic antibody program in the indication area of auto-immune diseases. Additionally, the fourth milestone from the cooperation with Centocor was reported. Under the two companies existing collaboration, Centocor presently has three exclusive licenses from MorphoSys to develop therapeutic antibodies.

During the first quarter MorphoSys also announced the formation of a new antibody business unit, "Antibodies by Design". The unit was launched with the aim of leveraging the Company's proprietary HuCAL<sup>®</sup> technology into other, non-therapeutic applications. With more than one hundred orders since its foundation in May 2003, the unit is well on its way to contributing to MorphoSys' growth, and provides some indication of the significant potential inherent in this market segment.

On the back of these good news, the Company's share price has risen by 70% during the first quarter, and we hope the strong operational progress being made continues to be reflected in our share price development looking ahead.

Thank you for your continued confidence and support in our Company.



Dave Lemus  
Chief Financial Officer  
MorphoSys AG

# Group Management Report Q1 2004

## Industry Overview

Higher oil prices and a partial deterioration of consumer sentiment have recently cast a slight pall over the economic outlook in the Euro zone. The EU Commission's spring economic forecast assumes economic growth in Germany of 1.5% in 2004. This picture of a moderate recovery in the German economy is not entirely out of step with the slightly disappointing first quarter actually experienced. Growth is predicted to continue to stagnate in the first half of the year, and then begin to accelerate in the second half of the year.

For the biotechnology industry however, the picture was somewhat different. Namely, the first quarter of 2004 was the best quarter in several years. The initial public offering of Basilea, a Swiss biotech company, is the first IPO of a continental European biotechnology company for at least two years, and may be a harbinger that financial conditions are now gradually improving again in Europe. As a result, other IPOs for European biotechnology companies could take place during the course of 2004. Outside of Europe, the first quarter witnessed eight IPOs for biotechnology companies in the USA, one in the U.K., and another in India.

The share price of MorphoSys improved considerably during the first quarter. In tandem with positive company news, the Company's share price rose by 70% in the first quarter. This performance compares favorably to other benchmarks such as the FSE Prime Pharma & Healthcare Index, which rose by 2%, and an international peer group of antibody companies, whose average rise amounted to 43%.

## Financial Analysis

### Operating Revenues

Compared to the same period in the previous year, revenues in the first quarter of 2004 increased by 14% to EUR 4.2 million (March 31, 2003: EUR 3.7 million). Reasons for the increase included a milestone achievement in the first three months of 2004. Revenues arising from therapeutic antibody collaborations accounted for 85% of total revenue, while target research collaborations generated 11% of the total. The Antibody by Design unit generated 3% of total revenues.

Geographically, 70% of MorphoSys' commercial (non-grant) revenues in the amount of EUR 3.0 million were generated with biotechnology and pharmaceutical companies located in the United States and 30% in Europe. This compares to 79% and 21%, respectively, for these percentages in the same period of the prior year.

Approximately 70% of revenues projected for the full year 2004 are currently covered by payments committed under existing contracts.

**Operating Expenses**

For the first quarter of 2004, total operating expenses including stock-based compensation expense decreased by 20% to EUR 4.4 million (March 31, 2003: EUR 5.5 million), resulting in a slight operating loss of EUR 0.2 million (March 31, 2003: EUR 1.7 million). The reduction in operating expense levels of EUR 1.1 million was mainly due to lower personnel related costs and external consultancy costs, which included external lab funding costs.

**Research and Development Expenses**

Costs for research and development decreased by EUR 0.1 million to EUR 2.6 million (March 31, 2003: EUR 2.7 million). The decrease resulted mainly from lower spending for personnel and external lab funding, which was partly offset by higher amortization expense resulting from the CAT license acquired in 2003.

**Sales, General and Administrative Expenses**

Sales, general and administrative expenses amounted to EUR 1.5 million compared to EUR 2.2 million in the same period of the previous year. The higher cost in 2003 resulted mainly from lower personnel costs in 2004, and higher legal and auditors fees in 2003, associated with the two capital increases executed during the year.

**Stock-Based Compensation**

Stock-based compensation in the amount of EUR 0.3 million for the first three months of 2004 was recorded as a non-cash charge (March 31, 2003: EUR 0.5 million), resulting from application of SFAS No. 123 "Accounting for Stock Based Compensation" under U.S. GAAP accounting. The decrease in stock-based compensation was mainly due to declining expenses from options and convertible bonds granted in prior periods and lower numbers granted in 2004.

**Cost by Expenditure Type**

For the first three months of 2004, personnel costs (excluding expenses arising from stock-based compensation) amounted to EUR 1.4 million (March 31, 2003: EUR 1.9 million) or 32% of total costs representing the largest cost block within operating expenses in the first three months of 2004.

Intangible costs, which include patent litigation costs and amortization of licenses and patents, amounted to EUR 0.9 million (March 31, 2003: EUR 0.6 million), or 20% of the total in the first three months of 2004. Infrastructure cost, mainly representing rent and depreciation of property and equipment, amounted to EUR 0.6 million (March 31, 2003: EUR 0.6 million), or 14% of total costs, and remained unchanged compared to the same period last year.

**Non-Operating Items**

Non-operating income amounted to EUR 0.6 million compared to a non-operating loss of EUR 0.1 million on March 31, 2003, a change of EUR 0.7 million. The improvement largely stems from MorphoSys sale of marketable securities in the first quarter of 2004, which resulted in a realized gain of EUR 0.6 million. Higher interest income as a result of higher cash balances, and lower losses resulting from adverse exchange rate effects also served to improve the result in the first quarter of 2004.

### Net Income

For the quarter ended March 31, 2004, MorphoSys generated a net profit. The achievement of quarterly net income profitability was the second such consecutive achievement in a row; the first being in the fourth quarter of 2003.

The Company's net income amounted to EUR 0.5 million compared to a loss of EUR 1.8 million at March 31, 2003. EBITDA (Earnings before Interest, Taxes, Depreciation, Amortization and Stock-Based Compensation) amounted to EUR 1.5 million (2003: loss of EUR 0.7 million). The resulting earnings per share for the three months ended March 31, 2004 amounted to EUR 0.10 (loss per share on March 31, 2003: EUR 0.46).

### Liquidity / Cash Flows

On March 31, 2004, the Company held EUR 23.8 million in cash, cash equivalents and marketable securities compared to a EUR 23.2 million balance at December 31, 2003. Cash provided by operating activities amounted to EUR 0.5 million, continuing the positive trend established in 2003.

In the first three months of 2004, the Company's current assets decreased by EUR 0.4 million to EUR 25.8 million compared to EUR 26.2 million at December 31, 2003.

### Assets

Total assets decreased by EUR 0.9 million to EUR 44.9 million in the first three months of 2004, compared to EUR 45.8 million at December 31, 2003. The difference was mainly attributable to the decrease in accounts receivable of EUR 0.8 million arising from collections of the same from collaboration partners.

### Liabilities

During the first three months of 2004, total non current liabilities fell by EUR 1.1 million principally due to a decrease in the non-current portion of deferred revenues. Total current liabilities remained almost unchanged in the first three months of 2004.

### Equity

At March 31, 2004, the total number of shares issued was 4,901,332, of which 4,841,570 were outstanding, and these numbers remained unchanged from the levels at year-end 2003.

### Capital Expenditure

In the first three months of 2004, there were only very insignificant capital expenditures on patents or licenses, as was the case in the same period of the prior year. Amortization of existing capitalized intangibles for the first three months of 2004 was EUR 0.5 million compared to EUR 0.3 million in the same period of the previous year. The increase of EUR 0.2 million resulted from revaluation of the CAT license acquired in 2003.

Investment in property and equipment amounted to EUR 0.5 million for the three month period ended March 31, 2004, compared to EUR 0.1 million for the same period of the previous year. Depreciation for the first quarter 2004 accounted for EUR 0.2 million and remained unchanged from the same period last year.

## Human Resources

### Number of Employees

On March 31, 2004 the MorphoSys Group employed 101 employees (December 31, 2003: 95). On average for the quarter, the MorphoSys Group employed 100 employees for the first three months of 2004 (Q1 2003: 87).

Of the 101 employees, 77 worked in research and development and 24 in sales, general and administration. On March 31, 2004, 36 of MorphoSys' employees had a Ph.D. degree (December 31, 2003: 35).

On March 31, 2004, MorphoSys employed 3 apprenticeship positions (December 31, 2003: 2).

## Research & Development / Partnered Research

### Proprietary Product Development

No significant changes in the development of the Company's proprietary product pipeline have occurred since the publication of the annual report 2003.

### Partnered Product Development

#### *Bayer AG*

In January, MorphoSys signed an agreement with Bayer HealthCare for the cross-licensing of certain technologies. Under the agreement, MorphoSys received the human cell line HKB 11 for the production of HuCAL® antibodies. MorphoSys also received the right to use the cell line for its own research and an option for the commercial production of antibodies. As partial consideration, Bayer switched its in-house R&D programs to the MorphoSys HuCAL GOLD® antibody technology. Additionally, MorphoSys received an installation fee from Bayer HealthCare.

The announcement builds on the existing agreement between the two companies, entered into in December 1999. In July 2001, the collaboration was extended to run through the end of 2005. The collaboration focuses on the use of human antibodies for application in the areas of therapy, diagnostics and target research.

#### *Centocor, Inc.*

In March 2004, MorphoSys announced that within the scope of its collaboration with Centocor Inc., a Johnson & Johnson company, Centocor had elected a new target molecule involved in auto-immune diseases, against which MorphoSys will generate antibodies using its proprietary HuCAL GOLD® technology. Centocor will carry out pre-clinical and clinical development and subsequent marketing of resulting products. In exchange, MorphoSys stands to receive licensing and milestone payments, in addition to royalties.

Early in April 2004, MorphoSys announced the achievement of the fourth milestone in its therapeutic antibody collaboration with Centocor. In meeting the milestone, MorphoSys developed several highly optimized fully human IgG antibodies against a disease-associated target provided by Centocor. As part of the collaboration milestone, MorphoSys applied its proprietary HuCAL GOLD® antibody library in order to generate antibodies which passed nine different pre-defined criteria.

In December 2000, MorphoSys and Centocor entered a collaboration to develop fully human antibodies in a wide range of therapeutic indications. Within the scope of the collaboration, Centocor has an option on up to 30 therapeutic target molecules against which MorphoSys will make optimized fully human antibodies using its proprietary HuCAL<sup>®</sup> technology. In March 2002, the existing partnership was expanded when Centocor ordered AutoCAL<sup>™</sup>, the MorphoSys-developed system for automated screening of the HuCAL<sup>®</sup> antibody library. Since the start of the collaboration MorphoSys has generated three HuCAL<sup>®</sup> antibodies meeting pre-agreed success criteria.

#### *GPC Biotech AG*

With payment of a license fee to MorphoSys, GPC Biotech AG extended its exclusive license for HuCAL<sup>®</sup> antibodies directed against an MHC class II target molecule in January 2004. The aim of the collaboration between GPC Biotech and MorphoSys, which began in 1999, is to develop a new generation of therapeutically active substances for the treatment of autoimmune diseases and certain forms of cancer. The most advanced project is aimed at the selective recognition and destruction of activated, reproducing MHC class II positive tumor cells - including those in B-cell and T-cell lymphomas. In the context of the partnership between MorphoSys and GPC Biotech, the fully human antibody against the GPC Biotech target molecule was selected and optimized by MorphoSys using its HuCAL<sup>®</sup> technology. GPC Biotech reported promising pre-clinical anti-tumor data around the antibody, called 1D09C3, in 2003. GPC Biotech has recently reported that it expects to enter 1D09C3 into human clinical trials in the second half of 2004.

#### **Antibodies by Design**

MorphoSys announced in February 2004 the formation of its new business unit "Antibodies by Design", which aims to market HuCAL<sup>®</sup> antibodies in non-therapeutic applications. The range of products and services offered by Antibodies by Design targets primarily industrial and academic institutions requiring custom-generated antibodies for use in research applications. The HuCAL<sup>®</sup> technology is currently employed at MorphoSys in a number of therapeutic antibody collaborations with renowned pharmaceutical and biotechnology company partners. The Antibodies by Design unit was conceived in order to expand the market for MorphoSys' core competence in the generation of fully human antibodies using its well-established HuCAL<sup>®</sup> technology. Using the HuCAL<sup>®</sup> technology, novel research antibodies can be generated within 8 to 10 weeks - a significant speed improvement over the current market standard of 6 to 9 months using animal-based technologies.

#### **Intellectual Property**

The U.S. Patent & Trademark Office granted two new patents to MorphoSys in March 2004, which further strengthen the Company's intellectual property portfolio. These patents provide an extended protection of the MorphoSys HuCAL<sup>®</sup> (Human Combinatorial Antibody Library) technology and enlarge the potential area of application for MorphoSys' technologies. The first new patent (US 6,696,248) entitled "Protein/(Poly)Peptide Libraries" relates to MorphoSys' proprietary HuCAL<sup>®</sup> technology. The patent covers the genetic constitution of synthetic, fully modular human antibody libraries based on in silico consensus sequences. A first HuCAL<sup>®</sup> patent, which is now complemented by the new patent, was issued by the U.S. Patent Office in 2001.

In addition, the U.S. Patent & Trademark Office granted a patent (US 6,692,935 B1) entitled "Targeted Hetero-Association of Recombinant Proteins to Multi-Functional Complexes". The patent covers certain methods for the development of multi-functional protein complexes, such as the combination of antibody fragments with different specificities.

## Outlook

As communicated during the year-end press conference in February 2004, Company revenues are expected to achieve double-digit percentage increase over the previous year. Expenses are anticipated to rise in 2004 slightly over 2003 levels. As a result of these developments, MorphoSys believes it can achieve an EBITDA-positive result for the fiscal year 2004. As such, the Company presently believes it remains on track to achieve its goals for the year.

# Condensed Consolidated Balance Sheets (U.S. GAAP)

	03/31/2004 EURO (unaudited)	12/31/2003 EURO
<b>Assets</b>		
<b>Current Assets</b>		
Cash and Cash Equivalents	353,805	6,652,456
Marketable Securities	23,400,609	16,508,575
Accounts Receivable	1,279,983	2,111,710
Prepaid Expenses and Other Current Assets	740,175	948,575
<b>Total Current Assets</b>	<b>25,774,572</b>	<b>26,221,316</b>
Property and Equipment, Net	2,139,095	1,907,895
Patents, Net	5,906,515	6,103,675
License Fees, Net	10,581,661	10,898,904
Other Assets	501,585	627,130
<b>Total Assets</b>	<b>44,903,428</b>	<b>45,758,920</b>
<b>Liabilities and Stockholders' Equity</b>		
<b>Current Liabilities</b>		
Accounts Payable	158,789	258,732
Current Portion of License Payable	716,542	677,060
Current Portion of Deferred Revenue	4,917,676	4,272,249
Accrued Employees Benefits	411,113	949,122
Other Accrued Expenses and Liabilities	1,430,847	1,524,439
<b>Total Current Liabilities</b>	<b>7,634,967</b>	<b>7,681,602</b>
<b>Non-Current Liabilities</b>		
License Payable, Net of Current Portion	1,705,901	1,651,360
Deferred Revenue, Net of Current Portion	4,935,654	6,086,205
Convertible Bonds Due to Related Parties	151,800	157,200
<b>Total Non-Current Liabilities</b>	<b>6,793,355</b>	<b>7,894,765</b>
<b>Stockholders' Equity</b>		
Common Stock, EUR 3.00 Par Value; Ordinary Shares Authorized (8,626,344 and 8,626,344 for 2004 and 2003, respectively); Ordinary Shares Issued (4,901,332 and 4,901,332 for 2004 and 2003, respectively); Ordinary Shares Outstanding (4,841,570 and 4,841,570 for 2004 and 2003, respectively);	14,703,996	14,703,996
Treasury Stock (59,762 and 59,762 shares for 2004 and 2003, respectively), at cost	(21,934)	(21,934)
Additional Paid-in Capital	68,959,500	68,623,807
Accumulated Other Comprehensive Income/(Loss)	403,471	912,755
Accumulated Deficit	(53,569,927)	(54,036,071)
<b>Total Stockholders' Equity</b>	<b>30,475,106</b>	<b>30,182,553</b>
<b>Total Liabilities and Stockholders' Equity</b>	<b>44,903,428</b>	<b>45,758,920</b>

See accompanying notes

## Condensed Consolidated Statement of Operations (U.S. GAAP) - unaudited

	03/31/2004 EURO	03/31/2003 EURO
<b>Revenues</b>	<b>4,247,087</b>	<b>3,744,046</b>
<b>Operating Expenses</b>		
Research and Development	2,602,369	2,740,162
Sales, General and Administrative	1,490,376	2,248,421
Stock Based Compensation	335,693	461,095
<b>Total Operating Expenses</b>	<b>4,428,438</b>	<b>5,449,678</b>
<b>Loss from Operations</b>	<b>(181,351)</b>	<b>(1,705,632)</b>
Interest Income	103,810	20,066
Interest Expense	77,707	98,860
Other Income (Expense), Net	621,392	(3,086)
<b>Net Profit / (Loss)</b>	<b>466,144</b>	<b>(1,787,512)</b>
<b>Earnings / (Loss) per Share:</b>		
Basic	0.10	(0.46)
Diluted	0.10	(0.46)
<b>Shares Used in Computing Net Earnings / (Loss) per Share:</b>		
Basic	4,841,570	3,889,944
Diluted	4,843,040	3,889,944

See accompanying notes

# Consolidated Statement of Changes in Stockholders' Equity (U.S. GAAP)

	Common Stock		Treasury Stock		Additional Paid-in Capital EURO	Accumulated Other Com- prehensive Gain/(Loss) EURO	Accumulated Deficit EURO	Total Stockholders Equity EURO
	Shares	EURO	Shares	EURO				
<b>Balance at Jan. 1, 2003</b>	<b>3,949,706</b>	<b>11,849,118</b>	<b>59,762</b>	<b>(21,934)</b>	<b>59,193,912</b>	<b>(517,591)</b>	<b>(49,888,039)</b>	<b>20,615,466</b>
Compensation Related to the Grant of Stock Options	–	–	–	–	2,175,430	–	–	2,175,430
Capital Increase against Contribution in Kind (XOMA), Net of Issuance Cost of EUR 23,314	363,466	1,090,398	–	–	3,110,896	–	–	4,201,294
Capital Increase against Contribution in Kind (CAT), Net of Issuance Cost of EUR 150,000	588,160	1,764,480	–	–	4,143,569	–	–	5,908,049
Other Comprehensive Loss: Change in Unrealized Gain on Available-for-Sale Securities	–	–	–	–	–	1,418,156	–	1,418,156
Foreign Currency Gain from Consolidation	–	–	–	–	–	12,190	–	12,190
Net Loss	–	–	–	–	–	–	(4,148,032)	(4,148,032)
Comprehensive Loss	–	–	–	–	–	–	–	(2,717,686)
<b>Balance at Dec. 31, 2003</b>	<b>4,901,332</b>	<b>14,703,996</b>	<b>59,762</b>	<b>(21,934)</b>	<b>68,623,807</b>	<b>912,755</b>	<b>(54,036,071)</b>	<b>30,182,553</b>
Compensation Related to the Grant of Stock Options (Unaudited)	–	–	–	–	335,693	–	–	335,693
Other Comprehensive Gain/(Loss): Change in Unrealized Gain on Available-for-Sale Securities (Unaudited)	–	–	–	–	–	(509,914)	–	( 509,914)
Foreign Currency Translation Adjustment (Unaudited)	–	–	–	–	–	630	–	630
Net Income (Unaudited)	–	–	–	–	–	–	(466,144)	( 466,144)
Comprehensive Loss (Unaudited)	–	–	–	–	–	–	–	(43,140)
<b>Balance at March 31, 2004 (Unaudited)</b>	<b>4,901,332</b>	<b>14,703,996</b>	<b>59,762</b>	<b>(21,934)</b>	<b>68,959,500</b>	<b>403,471</b>	<b>(53,569,927)</b>	<b>30,475,106</b>

See accompanying notes

# Consolidated Statement of Cash Flows (U.S. GAAP) - unaudited

For the Period ended March 31,	2004 EURO	2003 EURO
<b>Operating Activities</b>		
Net Income (Loss)	466,144	(1,787,512)
<b>Adjustments to Reconcile Net Loss to Net Cash Provided by Operating Activities:</b>		
Depreciation	218,594	220,444
Amortization of Intangible Assets	531,586	308,407
Net Gain on Sales of Marketable Securities	(652,418)	(115,948)
Unrealized Net Loss on Derivative Financial Instruments	72,700	–
Gain on Sale of Property and Equipment	–	(236)
Recognition of Deferred Revenue	(2,162,740)	(1,711,126)
Stock-Based Compensation	335,693	461,095
<b>Changes in Operating Assets and Liabilities:</b>		
Accounts Receivable	831,727	6,666,980
Prepaid Expenses and Other Assets	(198,684)	446,217
Accounts Payable	(99,943)	(595,135)
Licenses Payable	94,023	(1,159,560)
Deferred Revenue	1,657,616	374,999
Accrued Employee Benefits	(538,009)	(633,886)
Other Accrued Expenses and Liabilities	(93,592)	5,549
<b>Net Cash Provided by Operating Activities</b>	<b>462,697</b>	<b>2,480,288</b>
<b>Investing Activities:</b>		
Purchases of Marketable Securities	(13,236,692)	(7,927,080)
Proceeds from Sales of Marketable Securities	6,605,161	4,952,073
Purchases of Property and Equipment	(453,778)	(133,387)
Proceeds from Disposals of Property and Equipment	3,985	20,470
Additions to Patents	(17,183)	(14,940)
<b>Net Cash Used in Investing Activities</b>	<b>(7,098,507)</b>	<b>(3,102,864)</b>
<b>Financing Activities:</b>		
Proceeds from the Issuance of Convertible Bonds to Related Parties	(5,400)	(6,600)
Purchases of Derivative Financial Instruments	(138,000)	–
Proceeds from Disposals/Exercises of Derivative Financial Instruments	479,929	–
<b>Net Cash Provided by / (Used in) Financing Activities</b>	<b>336,529</b>	<b>(6,600)</b>
Effect of Exchange Rate Differences on Cash	630	6,524
Decrease in Cash and Cash Equivalents	(6,298,651)	(622,652)
<b>Cash and Cash Equivalents at the Beginning of the Period</b>	<b>6,652,456</b>	<b>842,082</b>
<b>Cash and Cash Equivalents at the End of the Period</b>	<b>353,805</b>	<b>219,430</b>
<b>Supplemental Disclosures of Cash Flow Information:</b>		
Change in Unrealized Gains on Marketable Securities	(509,914)	(243,666)
Reduction of Restricted Cash	118,000	–
License to be Settled in Equity	–	3,160,386

See accompanying notes

# Notes to the Condensed Consolidated Financial Statements -unaudited

## 1 Organization and Summary of Significant Accounting Policies

### **Business and Organization**

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

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

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

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

### **Basis of Financial Statement Presentation**

The accompanying financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America (U.S. GAAP).

### **Use of Estimates**

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

### **Cash and Cash Equivalents**

The Company considers all highly liquid investments with an original maturity of three months or less to be cash equivalents. The Company invests its cash in deposits with two major German financial institutions.

### **Consolidation**

The accompanying financial statements consolidate the financial position, results of operations, and cash flows of MorphoSys AG and its subsidiaries. All intercompany transactions and balances have been eliminated.

**Marketable Securities**

The Company accounts for its marketable securities using Statement of Financial Accounting Standards ("SFAS") No. 115, "Accounting for Certain Investments in Debt and Equity Securities." Management determines the proper classifications of securities at the time of purchase and re-evaluates such designations as of each balance sheet date. At March 31, 2004 and December 31, 2003, such securities that are classified as available-for-sale are carried at market value with unrealized gains and losses reported in accumulated other comprehensive income, which is a separate component of stockholders' equity. Realized gains and losses on sales of investments, as determined on a specific identification basis, are included in the statements of operations when the investment is sold or matures. On a regular basis, the Company tests for impairment. If a decline in the fair value of available-for-sale securities is judged to be other than temporary, the cost basis for the security is written down to fair value as new cost basis. The written down amount is included in earnings as an impairment charge. The Company considers a decline in the market value of a marketable security, which is longer than six months in duration, to be deemed other than temporary unless specific facts and circumstances indicate otherwise.

**Derivative Financial Instruments**

The Company accounts for its derivative instruments using SFAS No. 133 "Accounting for Derivative Instruments and Hedging Activities" and its corresponding amendments under SFAS No. 138. SFAS No. 133 requires the Company to measure every derivative instrument at fair value and record them as either an asset or liability. Changes in fair value are recorded in other income (see note 4).

**Property and Equipment**

Property and equipment is stated at cost, less accumulated depreciation and amortization. Major replacements and improvements are capitalized while general repairs and maintenance are charged to expense as incurred. Assets are depreciated over three to ten years using the straight-line method. Leasehold improvements are amortized over the estimated useful lives of the assets or the related lease term, whichever is shorter.

**Revenue Recognition**

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

Revenue related to non-refundable technology access fees, subscription fees and license fees 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 are recorded as revenue to the extent the related expenses have been incurred: Under the terms of the investment grants, the governmental agencies generally have the right to audit the use of the payments received by the Company.

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

Deferred revenue represents revenues received but not yet earned per the terms of the contracts. At December 31, 2003 and March 31, 2004, cash was received for all deferred revenue recorded.

**Segment Reporting**

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

**Research and Development**

Research and development costs are expensed as incurred.

**Stock-Based Compensation**

The Company applies the provisions of SFAS No.123 "Accounting for Stock-Based Compensation," which requires the Company to record the estimated fair value of stock options and other awards at the grant date as compensation expense over the period in which the employees render the services associated with the award.

**Foreign Currency Translation**

The financial statements of foreign subsidiaries have been translated into Euro in accordance with SFAS No. 52, "Foreign Currency Translation." All balance sheet accounts have been translated using the exchange rates in effect at the balance sheet date. The statement of operations amounts have been translated using the average exchange rate for the year. The gains and losses resulting from the changes in exchange rates from year-to-year have been reported in accumulated other comprehensive income.

**Net Earnings/Loss Per Share**

Basic and diluted earnings/loss per share is calculated in accordance with SFAS No. 128, "Earnings per Share". Basic earnings/loss per share is based upon the number of weighted-average shares of common stock outstanding for the respective years. Diluted earnings per share at March 31, 2004 include the number of weighted-average shares of common stock outstanding and the number of weighted-average shares from stock options and convertible bonds exercisable.

**Impairment of Long-Lived and Identifiable Intangible Assets**

The Company evaluates the carrying value of long-lived assets and identifiable intangible assets for potential impairment whenever events or changes in circumstances indicate that the carrying amount of such assets may not be recoverable. Recoverability is determined by comparing projected undiscounted cash flows associated with such assets to the related carrying value. An impairment loss is recognized when the estimated undiscounted future cash flows are less than the carrying amount of the asset. An impairment loss would be measured as the amount by which the carrying value of the assets exceeds the fair value of the asset.

**Patent Costs**

The Company capitalizes costs related to obtaining patents and protecting granted patents from infringement. Capitalized costs principally relate to the costs of legal counsel. Patent costs are amortized on a straight-line basis over the lesser of their estimated economic life or remaining patent term (10 years). Amortization commences at the time the patent is issued. The Company's patents covering its proprietary HuCAL<sup>®</sup> technology were granted in Australia in October 2000, in the United States of America in October 2001 and in Europe in June 2002. Further patent applications are pending in Canada and Japan.

**Accounting for Acquired License Rights**

The Company acquired license rights by making upfront licensing payments, annual maintenance fees and sublicensing payments to third parties. The Company amortizes up-front licensing payments on a straight-line basis over the estimated useful life of the acquired license (10 years). Annual maintenance fees are amortized over the term of each annual agreement. Sublicensing payments are amortized on a straight-line basis over the life of the contract or the estimated useful life of the collaboration for those contracts without a stipulated term.

**Concentration of Credit Risk**

Financial instruments that potentially subject the Company to concentrations of credit risk consist primarily of cash, cash equivalents, marketable securities and accounts receivable. The Company's cash and cash equivalents are principally denominated in Euro and U.S. dollars. Marketable securities are placed in high-quality securities. Cash, cash equivalents and marketable securities are maintained principally with two high-quality financial institutions in Germany. The Company continually monitors its positions with, and the credit quality of, the financial institutions, which are counter parties to its financial instruments, and does not anticipate non-performance. The Company's revenues and accounts receivable are subject to credit risk as a result of customer concentrations. At March 31, 2004, three customers individually accounted for approximately 53%, 19% and 15% of the Company's accounts receivable balance. In addition, three customers individually accounted for 34%, 20% and 13% of the Company's total revenues for the first three months 2004. On March 31, 2003, three customers individually accounted for 42%, 26% and 16% of the Company's revenues. On December 31, 2003, one customer individually accounted for approximately 88% of the accounts receivable balance.

**Accounts Receivable**

For accounts receivable, the allowance for doubtful accounts is based on the management's assessment of the collectibility of specific customer accounts and the aging of the accounts receivable. If there is a deterioration of a major customer's credit worthiness or actual defaults are higher than the historical experience, management's estimates of the recoverability of amounts due the Company could be adversely affected. Based on management assessment, allowances of EUR 7,150 and EUR 0 were necessary on March 31, 2004 and December 31, 2003. The company does not require collateral from customers for accounts receivable. On March 31, 2004 and December 31, 2003, accounts receivable included unbilled amounts of approximately EUR 1,063,550 and EUR 119,360 respectively.

**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.

**Reclassifications**

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

**Effects of New Accounting Standards and Regulations**

For the effects of new accounting standards we refer to our published accounts as of December 31, 2003.

## 2 Marketable Securities

Marketable securities consist of the following as of March 31, 2004 and December 31, 2003 (in thousands EUR):

in 000's EUR	Maturity	Cost	Gross Unrealized Holding Gains	Gross Unrealized Holding Losses	Market Value
<b>December 31, 2003</b>					
HVB Euro Bond	June 7, 2011	3,268	456	0	3,724
HVB Debentures	Dec. 6, 2009	2,562	161	0	2,723
DB Money Market Funds	daily	10,181	245	0	10,426
		<b>16,011</b>	<b>862</b>	<b>0</b>	<b>16,873</b>
Restricted Cash					364
					<b>16,509</b>
<b>March 31, 2004</b>					
DB Money Market Funds	daily	23,295	352	0	23,647
		<b>23,295</b>	<b>352</b>	<b>0</b>	<b>23,647</b>
Restricted Cash					246
					<b>23,401</b>

Net unrealized holding gains of EUR 352,015 for the first three months 2004 and EUR 861,929 for the year ended December 31, 2003 were recorded as a separate component of stockholders' equity.

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

During the first three months of 2004, MorphoSys sold both investments - the silent partnership of HypoVereinsbank Luxembourg as well as held securities of the HypoVereinbank AG. Realized gains amounted to EUR 646,100.

For further details of restricted cash items see Note 3.

### 3 Restricted Assets

The Company has classified as restricted cash certain cash and cash equivalents and marketable securities in other assets that are not available for use in its operations. At March 31, 2004 had commitments of EUR 246,000 for guarantees issued compared to EUR 364,000 at yearend 2003. The reduction resulted from guaranties returned in connection with discontinued operations of MorphoSys US Inc. EUR 157,200 and EUR 74,800, respectively, were committed for convertible bonds issued to employees, management and supervisory board at March 31, 2004 and December 31, 2003.

### 4 Derivative Financial Instruments

In May 2003, MorphoSys entered into foreign currency options contracts to hedge foreign exchange exposure related to US Dollar accounts receivable. During the first quarter 2004, the remaining contracts were sold or exercised for EUR 479,929.

In February 2004, the Company entered into foreign currency options contracts in the notional amount of EUR 3,846,155 million or USD 5,000,000 million. At March 31, 2004, these options contracts remained unsold and were presented as other current assets.

For the first three months of 2004, amortization of the option premiums amounted to EUR 72,700.

### 5 Accumulated Other Comprehensive Income / (Loss)

Accumulated other comprehensive income consists of unrealized gains on marketable securities and translation adjustments from consolidation. For March 31, 2004 and December, 31 2003, the components of accumulated other comprehensive income were as follows (in thousands EUR):

in 000's EUR	03/31/2004	12/31/2003
Net Unrealized Gain / (Loss) on Available-for Sale Securities	352	862
Foreign Currency Translation Adjustment	51	51
<b>Accumulated Other Comprehensive Income / (Loss)</b>	<b>403</b>	<b>913</b>

## 6 Intangible Assets

The following sets forth the intangible asset classes as of March 31, 2004 and December 31, 2003 in thousands EUR):

in 000's EUR	03/31/2004	12/31/2003
<b>Amortized Intangibles</b>		
Patents	8,578	8,569
License Rights	12,141	12,140
Accumulated Amortization Patents	(2,786)	(2,571)
Accumulated Amortization Licenses	(1,559)	(1,241)
<b>Unamortized Intangible Assets</b>		
Patents	114	106
<b>Net Intangible Assets</b>	<b>16,488</b>	<b>17,003</b>

The changes in the carrying amount of unamortized patents for the period ending March 31, 2004 is as follows (in thousands EUR):

in 000's EUR	
<b>Unamortized Intangibles</b>	
Balance on December 31, 2003	106
Additions for the Year 2004	8
<b>Balance on March 31, 2004</b>	<b>114</b>

Amortization is expected to commence on unamortized patents once the related patents are granted. Amortization expense on intangible assets totaled EUR 531,586 for the three months period ended March 31, 2004 (March 31, 2003: EUR 308,407). Patents are amortized over 10 years starting from the date of the first patent grant. Licenses are amortized over 10 years from the date of the acquisition. The increase of amortization expense is mainly due to the acquisition of the CAT license in July 2003.

## 7 Property and Equipment

Property and equipment consist of the following at March 31, 2004 and December 31, 2003 (in thousands EUR):

in 000's EUR	03/31/2004	12/31/2003
Office and Laboratory Equipment	4,039	3,605
Furniture and Fixtures	1,267	1,267
Purchased Software	1,193	1,186
<b>Total</b>	<b>6,499</b>	<b>6,058</b>
Less Accumulated Depreciation	(4,360)	(4,150)
<b>Net Property and Equipment</b>	<b>2,139</b>	<b>1,908</b>

## 8 Contingent Liabilities

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

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

## 9 Stockholders' Equity

### Common Stock

On March 31, 2004, the common stock of the Company was EUR 14,703,996 and remained unchanged to December 31, 2003.

In the year 2003, common stock increased by EUR 2,854,878. The increase arose as a result of the issuance of 363,466 shares to XOMA for a capital increase against contribution in kind, which was registered on May 6, 2003 in the commercial register and the issuance of 588,160 shares to CAT for a capital increase against contribution in kind, which was registered on August 26, 2003 in the commercial register.

### Authorized Capital

Unused Authorized Capital I equaled 1,137,109 shares at March 31, 2004 and remained unchanged to December 31, 2003.

In August 2003, 588,160 shares of Authorized Capital I were issued to CAT for a capital increase against contribution in kind.

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

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

Unused Authorized Capital II equaled to 431,317 shares and remained unchanged to December 31, 2003.

### Conditional Capital

No stock options or convertible bonds were exercised in the first three months of 2004.

**Additional Paid-In Capital**

On March 31, 2004, Additional Paid-in Capital amounted to EUR 68,959,500 (December 31, 2003 EUR 68,623,807). The increase of EUR 335,693 is due to stock based compensation provisions.

**Treasury Stock**

Treasury Shares totaling EUR 21,934 (59,762 shares) remained unchanged compared to December 31, 2003.

## 10 Stock Options and Convertible Bonds

On January 15, 2004, 35,000 options were granted to Company employees. In the first three months of 2004, no convertible bonds were granted.

## 11 Directors Dealings

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 first three months of 2004:

Shares	01/01/2004	Additions	Sales	03/31/2004
<b>Management Board</b>				
Dr. Simon Moroney (held through a controlled entity)	113,461	–	–	113,461
Dave Lemus	–	–	–	–
Dr. Thomas von Rüden	–	–	–	–
<b>Total</b>	<b>113,461</b>	<b>–</b>	<b>–</b>	<b>113,461</b>
<b>Management Board</b>				
Dr. Gerald Möller	–	–	–	–
Dr. Daniel Camus	–	–	–	–
Prof. Dr. Jürgen Drews	–	–	–	–
Prof. Dr. Andreas Plückthun	59,300	–	–	59,300
Dr. Jörg Reinhardt	–	–	–	–
Dr. Geoffrey N. Vernon	–	–	–	–
<b>Total</b>	<b>59,300</b>	<b>–</b>	<b>–</b>	<b>59,300</b>

**Stock Options**

	01/01/2004	Additions	Sales	03/31/2004
<b>Management Board</b>				
Dr. Simon Moroney	47,000	–	–	47,000
Dave Lemus	21,000	–	–	21,000
Dr. Thomas von Rüden	64,700	–	–	64,700
<b>Total</b>	<b>132,700</b>	<b>–</b>	<b>–</b>	<b>132,700</b>
<b>Supervisory Board</b>				
Dr. Gerald Möller	6,100	–	–	6,100
Dr. Daniel Camus	–	–	–	–
Prof. Dr. Jürgen Drews	5,930	–	–	5,930
Prof. Dr. Andreas Plückthun	3,500	–	–	3,500
Dr. Jörg Reinhardt	3,500	–	–	3,500
Dr. Geoffrey N. Vernon	3,500	–	–	3,500
<b>Total</b>	<b>22,530</b>	<b>–</b>	<b>–</b>	<b>22,530</b>

**Convertible Bonds**

	01/01/2004	Additions	Sales	03/31/2004
<b>Management Board</b>				
Dr. Simon Moroney	24,000	–	–	24,000
Dave Lemus	34,000	–	–	34,000
Dr. Thomas von Rüden	20,000	–	–	20,000
<b>Total</b>	<b>78,000</b>	<b>–</b>	<b>–</b>	<b>78,000</b>
<b>Supervisory Board</b>				
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
<b>Total</b>	<b>8,500</b>	<b>–</b>	<b>–</b>	<b>8,500</b>

## 12 Earnings Per Share

Basic and diluted earnings/loss per share (EPS) are calculated in accordance with SFAS No. 128, "Earnings per Share". The table below illustrates the reconciliation from basic to diluted earnings per share (in thousands EUR, except per share data):

Three Months Ended March 31,	2004 EURO	2003 EURO
<b>Numerator</b>		
Net Profit / (Loss)	466	(1,787)
<b>Denominator</b>		
Weighted Average Shares Used for Basic EPS	4,841,570	3,889,944
Dilutive Shares arising from Stock Options	1,470	–
Dilutive Shares arising from Convertible Bonds	–	–
<b>Total Denominator</b>	<b>4,843,040</b>	<b>3,889,944</b>
<b>Earnings / (Loss) per Share (in EUR)</b>		
Basic	0.10	(0.46)
Diluted	0.10	(0.46)

As of the reporting date, April 29, 2004, EPS would be calculated as follows (in thousands EUR, except per share data):

Three Months Ended March 31,	2004 EURO
<b>Numerator</b>	
Net Profit / (Loss)	466
<b>Denominator</b>	
Weighted Average Shares Used for Basic EPS	4,841,570
Dilutive Shares arising from Stock Options	1,470
Dilutive Shares arising from Convertible Bonds	63,400
<b>Total Denominator</b>	<b>4,906,440</b>
<b>Diluted Earnings per Share (in EUR)</b>	<b>0.09</b>

# Imprint

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