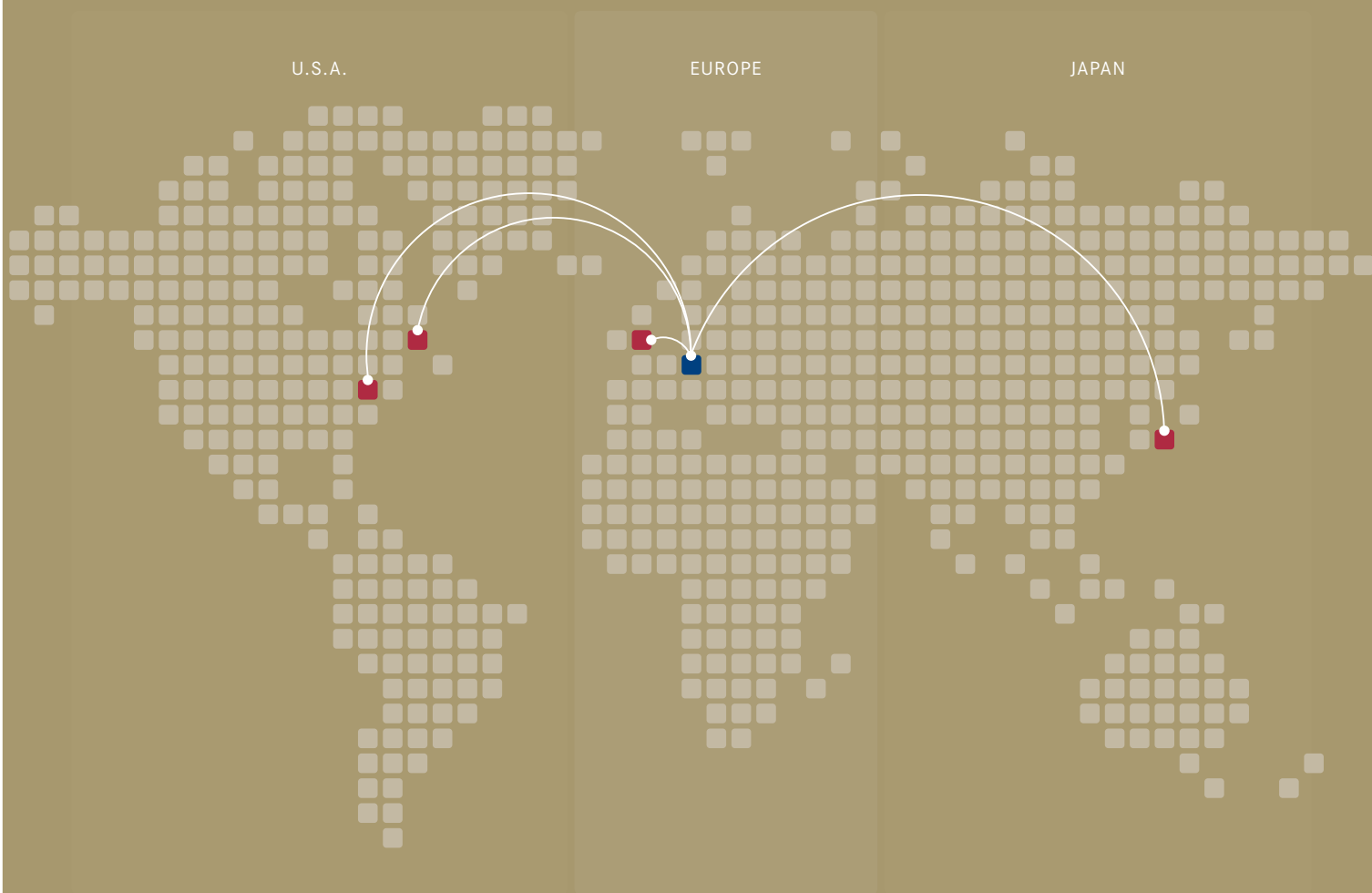


MorphoSys's Presence Worldwide



In 2005, MorphoSys made significant progress in establishing HuCAL GOLD as a worldwide industrial standard both for the development of therapeutic antibodies and as a key source of research tools. Having acquired and integrated the Biogenesis and Serotec Groups, the Company now has an established international presence, with sites in the United Kingdom and the all-important U.S. market. The combined customer and sales network of the therapeutic and research divisions of MorphoSys now spans the globe. As part of its strategy to penetrate new markets during the year, MorphoSys successfully entered into its first partnership with an Asian pharmaceutical group. MorphoSys's goal is to develop these attractive life sciences markets further and to more firmly establish its HuCAL technology as a recognized, high-quality approach for generating a wide range of antibodies.

Market and Strategy - Sights Set on Profitable Growth

The pharmaceutical industry continues to show great interest in therapeutic monoclonal antibodies. In fact, the potential benefits, as well as the therapeutic success of this class of drugs, have, at times, exceeded even the pharmaceutical industry's expectations. In 2005, the 17 antibody drugs currently approved for the market generated total sales of approximately US\$ 12 billion—a year-on-year growth of around 20%. This growth has spurred numerous pharmaceutical companies to increase their investments in the sector, resulting in a higher profile for MorphoSys. For example, MorphoSys signed three new partnerships in 2005 and significantly extended four existing collaborations. Going forward, the Company will capitalize on the strength of its antibody partnership core business to take significant steps into new markets. In this way, MorphoSys should be able to leverage its longer-term growth opportunities, while also reducing overall risk.

In 2004, MorphoSys reached a financial inflection point, posting a net profit for the first time. In 2005, the Company's goal was to increase its profit significantly. MorphoSys subsequently reported a net profit of € 4.7 million on total sales of € 33.5 million, a 15-fold increase over 2004.

That said, MorphoSys continues to see itself as a technology-oriented, high-growth company. As such, the Company needs to explore new paths to exploit its potential for further growth. Lucrative opportunities—due to new regional markets as well as to new applications for proprietary technologies and products—exist in both main business segments in which MorphoSys currently operates: therapeutic antibodies and research antibodies. Thus while the Company's goal is to grow rapidly, and maintain profitability in order to remain independent of the capital markets, it also plans to reinvest a portion of this profit in order to grow.

Strength of Core Business with Therapeutic Agents



Barbara Krebs
Senior Director, Head of
Business Development

The successful development of MorphoSys's core therapeutic antibody business in 2004 continued unabated in 2005. During the year, the Company announced three new key licensing agreements with top pharmaceutical companies: Eli Lilly & Company, Merck & Company, Inc., and Shionogi & Co. MorphoSys also significantly expanded its existing collaborations with Bayer and Boehringer Ingelheim. Both have secured access to MorphoSys's HuCAL GOLD technology for the next five years, as well as the right to initiate new therapeutic projects, in addition to projects already in development.

New therapeutic antibody projects have already begun with existing partners, Schering AG, Centocor, Inc., and others. Overall, MorphoSys's drug pipeline grew from 24 to 29 active partner projects by the end of 2005—the third successive year of growth. At the time of writing, additional projects in our portfolio are nearing the clinical development stage—a point at which MorphoSys would benefit financially from substantial milestone payments. All in all, MorphoSys considerably raised its market share in the therapeutic sector during the past year, and ten of the 20 biggest pharmaceutical groups are currently working with our technologies.

As mentioned earlier in this report, the overall market for therapeutic antibodies developed positively in 2005. Even negative reports such as the withdrawal from the market of the multiple sclerosis drug Tysabri®—distributed by Biogen Idec and Elan—at the end of February 2005 cast no more than a fleeting cloud over the sector's prospects. Although no new therapeutic antibodies were approved in 2005, total sales for the 17 antibody drugs currently on the market increased by 20% over the prior year to approximately US\$ 12 billion. Six of these antibodies achieved blockbuster status, with annual sales for each in excess of US\$ 1 billion. Other antibodies are fast approaching this target.

It is, therefore, no surprise that leading pharmaceutical companies are keen to invest in this class of drugs and related innovative technologies which offer such major benefits. This is illustrated by three industry acquisitions last year. In July 2005, pharmaceutical group Roche acquired the Swiss-based GlycArt Biotechnology AG for approximately € 150 million in an effort to develop its expertise in therapeutic antibody research. In August 2005, Pfizer paid an undisclosed sum to acquire the privately held Bioren, Inc. Pfizer described the acquisition as a step towards accelerating the development of targets for therapeutic antibodies as well as improving existing candidates which would strengthen Pfizer's commitment to the field of therapeutic antibodies. Both acquired companies had developed technologies that may further improve the effects of therapeutic antibodies. Last but not least, in December 2005, Amgen announced the acquisition of Abgenix for almost US\$ 2.2 billion.

These three transactions are solid indications of the pharmaceutical industry's interest in this class of drugs and the confidence placed in the future of this business segment. As a result, MorphoSys believes itself to be ideally positioned to participate in this trend on a long-term basis.

Foothold in Japanese Market

In 2005, MorphoSys achieved a major milestone toward its goal of expanding into Asia and the Japanese market in particular. At the beginning of September 2005, MorphoSys signed a three-year agreement with the Japanese pharmaceutical group Shionogi&Co. Currently the eighth most important pharmaceutical company in Japan based on annual sales, this is the first therapeutic partner in the Far East to use the HuCAL GOLD antibody library to support its own pharmaceutical research.

The inflection point for development of the Far East pharmaceutical market occurred in September 2004. At that point, MorphoSys had already received its first orders from Japan, thanks to its Antibodies by Design business unit. However, the Company had not managed to form a collaboration with an Asian pharmaceutical group. To do this, MorphoSys signed with a local partner—the Tokyo-based GeneFrontier Corporation. Approximately one year later, combined efforts to develop growth opportunities for MorphoSys in Japan and to establish HuCAL as a well-known brand for antibody development led to the agreement with Shionogi.

After the U.S., Japan is the second largest national pharmaceutical market in the world. In 2004, the country's ten most important pharmaceutical groups generated sales of approximately US\$ 38 billion. At the same time, they invested over US\$ 6.5 billion in internal research. However, in recent years, foreign companies such as Pfizer, Roche and Novartis have managed not only to obtain market share, but also to increase their influence in the Japanese market. The Japanese industry is currently in the process of liberating itself from this pressure. To do so, companies are merging to form larger entities, while also consolidating their own internal research efforts. Numerous groups, including Shionogi, have initiated programs to modernize the technology involved in the research and development of drugs. Based on this, MorphoSys recognizes a unique opportunity to expand its presence in Japan.

In addition to the pharmaceutical landscape, Japan's burgeoning life sciences market represents another opportunity for growth. While the number of biotechnology companies in Japan is still limited, industry sources estimate that the number will multiply quickly over the next five years. The fact that academic research organizations in Japan receive subsidies from the government is particularly significant. The ability for MorphoSys to forge new partnerships with Asian pharmaceutical and biotechnology companies is, therefore, increasing as is the number of potential customers for its research antibodies business.

List of Top Ten Pharmaceutical Companies in Japan (by Sales 2004)

	Turnover in billion US \$	R&D Cost in billion US \$
1. Takeda	8.2	1.2
2. Astellas ¹	6.9	1.4
3. Daiichi Sankyo ²	5.5	1.1
4. Esai	5.0	0.720
5. Otsuka	3.7	0.500
6. Chugai	2.6	0.450
7. Mitsubishi Pharma	1.8	0.480
8. Shionogi	1.6	0.280
9. Ono	1.3	0.250
10. Tanabe	1.3	0.230

¹ Merger between Yamanouchi and Fujisawa

² Merger between Sankyo and Daiichi Pharmaceuticals

Expansion in Research Antibodies Segment

In 2005, MorphoSys made its first ever company acquisition in the shape of the Biogenesis Group. Integration was effectively completed within nine months. The acquisition, an important and forward-looking step in terms of MorphoSys's company development, was instrumental in establishing a powerful research antibodies segment for the Company. For MorphoSys, the new Research Antibodies business unit is a strategically significant additional source of revenue that supplements the business with therapeutic antibodies. Going forward, MorphoSys plans further consolidation, while establishing the unit as a platform for continued growth. In line with this strategy, MorphoSys acquired the Serotec Group in January 2006. Serotec was one of the top three research antibody suppliers in Europe and the combined company can be considered one of Europe's leading dedicated supplier in this space.

In 2005, research antibodies generated sales of € 4.3 million, representing 13% of MorphoSys's total sales and up about 440% compared to 2005.

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MorphoSys UK Ltd.

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Senior Director Head of
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Senior Director,
Head of R&D, AbD



A Market in Upheaval

The research antibodies market is currently undergoing a period of technological and structural upheaval. MorphoSys views these developments as strong incentives to remain active in the market and as excellent opportunities for future growth.

Until recently, all research antibodies were developed using outdated, animal-based technologies—a method which has proven less than ideal from both an end-product and timing perspective. For today's customers, speed and diversity of the product range are becoming increasingly important, and these are both areas of particular advantage for MorphoSys's proprietary technology. Modern research is also constantly discovering new proteins, representing potential target molecules for scientists. New research antibodies are, therefore, needed if these proteins are to be characterized. MorphoSys is confident that the market as a whole is ready for a technological shift and that in the mid to long term, animal-based methods will be replaced by *in vitro* approaches such as the Company's HuCAL GOLD technology. MorphoSys is at the forefront of this change.

It is not only the technology, but also the structure of the heavily fragmented market for research antibodies that is evolving. Consolidations are expected in the next few years, whereby the currently large number of suppliers will merge to form a smaller number of larger entities. One example of such consolidation in 2005 was provided by Invitrogen Corp., based in the U.S., one of the largest suppliers of research tools of any kind. During the year, Invitrogen acquired three research antibody companies: BioSource International, Caltag and Zymed Laboratories. For these acquisitions, Invitrogen invested a total of US\$ 210 million.

Rebranding: AbD—Antibodies Direct

At the end of the third quarter of 2005 and only nine months after the acquisition, MorphoSys had largely completed the integration of the Biogenesis Group. The division now markets MorphoSys's core technology for research antibodies using a clear strategy targeting the main sectors of this market. The "Research Antibodies" combined business unit currently includes the three brands "Antibodies by Design", "Biogenesis" and "Serotec". Going forward, all three research antibodies business units will operate under the umbrella brand "AbD—Antibodies Direct".

Focus on Main Market Segment

The research antibodies market overall has posted growth rates of about 10–15% per year over the last years. Scientists around the world are currently spending more than US\$ 800 million annually on such tools.

MorphoSys's Research Antibodies business unit is currently active in three market segments. First, Biogenesis offers its customers ready-made **research antibodies in stock** via a sales catalog and a global distribution network. This catalog business is the largest segment in the research antibodies market. In addition to representing a growing branch of business, it is also a potential portal through which to access other business sectors in the future.

MorphoSys has also been active in the field of modern, customer-specific research antibodies since the founding of our Munich-based Antibodies by Design business unit in 2003. This business unit supplies **newly developed antibodies based on our HuCAL technology** to customers around the world who wish to investigate a novel protein using specific research antibodies that cannot be found in any sales catalog. Customers include scientists at universities and other research institutes, as well as scientists involved in pharmaceutical and biotechnology research. Existing Biogenesis customers interested in new research antibodies also have the opportunity to use services provided by the Antibodies by Design business unit. This new option has been well received and has resulted in new orders for MorphoSys's products from the Biogenesis sales network.

MorphoSys intends to use its HuCAL technology to introduce additional new products at Biogenesis. Over the last few months, Antibodies by Design and Biogenesis have worked together proactively to develop the first HuCAL-based antibodies against new target molecules, which have been incorporated into the sales catalog. Some of the recombinant research antibodies were identified as part of Antibodies by Design's active research partnerships with other companies.

The third market segment for this division is the **contract antibody manufacturing service** for major customers. In this segment, Biogenesis manufactures antibodies on a large scale, from 10 mg to 10 g, in accordance with customer specifications. Thanks to the acquisition of the Biogenesis Group, MorphoSys has added several key customers in this field to its customer base.