

Group Management Report

CORPORATE DEVELOPMENT 2006

As a globally present research-based biotechnology company, MorphoSys operates in an ever-changing environment that presents both opportunities and challenges for its business. A strong fundamental demand for new therapeutics and research tools underpins the Company's future growth prospects. With Group revenues of € 53.0 million and an operating profit of € 6.2 million, MorphoSys surpassed its financial goals set at the beginning of the year 2006. This positive development was attributable, first and foremost, to the strong demand for MorphoSys's proprietary antibody technology HuCAL, as well as the industry-wide need for therapeutic antibodies and research tools.

The MorphoSys Group operates in two corporate segments, with headquarters based in Martinsried, near Munich, Germany. The corporate segments are responsible for business operations and represent the segments required for the purposes of International Financial Reporting Standards (IFRS).

THERAPEUTIC ANTIBODIES SEGMENT

The Therapeutic Antibodies segment comprises MorphoSys's activities in the area of therapeutic antibodies, which includes its therapeutic antibody collaborations with pharmaceutical and biotechnology companies, as well as its proprietary antibody development programs. In 2006, MorphoSys was able to sign new partnerships with Daiichi Sankyo, OncoMed, and Schering-Plough, and existing partnerships with Novartis, Pfizer, and Roche were expanded. After Bayer AG's acquisition of Schering AG, the collaborations with the two companies were consolidated under the existing contract with Schering AG. At the beginning of 2006, the second HuCAL antibody entered phase 1 clinical trials, and the Company ended the year with 43 active partnered therapeutic antibody programs. The proprietary antibody programs MOR103 and MOR202 are well on track. For MOR202, a formal preclinical development candidate was selected by the end of 2006, and for MOR103, MorphoSys expects to file for an IND (investigational new drug) in the second half of 2007. Total revenues of the Therapeutic Antibodies segment increased by 19% to € 34.7 million, thus representing 65% of total Company revenues.

ABD – RESEARCH ANTIBODIES SEGMENT

In 2006, MorphoSys continued to build its Research Antibodies business segment, or AbD, by acquiring the UK- and US-based Serotec Group. The segment comprises the former brands “Antibodies by Design”, “Biogenesis”, and “Serotec”. During 2006, all brands were renamed and all products of the segment are now marketed under AbD – Antibodies Direct. AbD is active in the field of research antibodies, and distributes research antibodies through a comprehensive sales catalog. Furthermore, AbD offers custom monoclonal antibodies, and provides contract manufacturing services. The Research Antibodies segment contributed revenues of € 18.3 million, representing about 35 % of total Company revenues.

MANAGEMENT OF THE GROUP

MorphoSys provides its proprietary antibody technology HuCAL for national and international customers for therapeutic, research and diagnostic applications. The Therapeutic Antibodies segment operates under the Company’s name MorphoSys, the Research Antibodies segment under the brand name AbD – Antibodies Direct. The Company operates globally and is represented with offices in Germany, in the UK and the United States as well as in Norway and in France. Furthermore, MorphoSys has established a distribution network with more than 100 distributors, to serve customers in more than 70 countries, including all major economic regions.

MorphoSys has a dual management and supervisory structure. The Group is managed by the Management Board. The Supervisory Board advises the Management Board and monitors its management activities. The Management Board is responsible for all operational activities of both segments of the Company. The subsidiaries are managed by managing directors, who report to the Management Board of MorphoSys AG.

MACROECONOMIC DEVELOPMENT

ECONOMIC DEVELOPMENT IN 2006

The world economy continued its growth track in 2006. World gross domestic product (GDP) increased by approximately 5%, compared with about 4% in 2005. In 2006, economic growth focused on the rapidly developing countries of Asia, Latin America as well as Central and Eastern Europe. In the developed industrial nations, economic conditions remained positive. The exchange rate of the US dollar and the euro remained largely stable, with an upwards trend for the euro towards the end of the year. By contrast, energy and raw material prices again rose sharply.

Growth rates in the United States slowed slightly during the year with economic growth in Q3 2006 being the lowest since 2003. In the United States, signs of inflationary pressures and labor market tensions as well as higher interest rates, rising gasoline prices and signs of weakening in the property sector were offset by continued strong consumer spending.

The economy in the Eurozone is experiencing the strongest upturn since the year 2000. In 2006, growth in the Eurozone was above its multi-year average at around 2.5%. The German GDP grew by approximately 2.5% in 2006, the strongest rate in five years. As a result of the economic upswing, unemployment in Germany has fallen below the 10% threshold for the first time in several years.

The Asian economic region again experienced sustained growth during 2006. The Chinese economy grew by approximately 11%, driven by high exports and a strong rise in capital spending. In Japan, the moderate upward trend continued thanks to an increase in domestic demand.

DEVELOPMENT WITHIN THE PHARMACEUTICAL AND BIOTECHNOLOGY SECTOR

Global pharma growth rate in the sector has slowed significantly during the last years, but according to IMS Health, future growth rates are expected to stabilize at 5% to 8% until 2010. During 2006, pharmaceutical companies faced several industry challenges, including pipeline and pricing pressure, government regulations, major blockbuster drugs such as the cholesterol-lowering drug Zocor® (Merck & Co.) and anti-nausea drug Zofran® (GlaxoSmithKline) going off patent, and the appearance of biosimilars on the horizon. Additionally, the FDA continued its cautious stance, adding risk warnings and low number of approvals. Nevertheless, there were also positive developments. European authorities have speeded up the approval procedures, and it is widely hoped that the recent appointment of a new FDA commissioner will result in shorter approval time and less risk aversion. Additionally, several product approvals and the label extensions of successful drugs such as Avastin® and Herceptin® had a positive impact on the industry.

To maintain growth rates, pharmaceutical companies are under pressure to acquire innovative products and technologies, resulting in increased M&A activity between pharmaceutical and biotechnology companies. Abbott Laboratories' acquisition of Kos Pharmaceuticals for approximately US\$ 3.7 billion is one example of this trend, the primary motive for the transaction being Abbott's goal of obtaining access to the cholesterol drug market. Other examples in 2006 include Pfizer's acquisition of PowderMed to strengthen the company's entrance into the vaccine market, and Merck & Co.'s purchase of Sirna Therapeutics to get access to RNAi, a technology for the regulation of gene activity. M&A activity in the biopharmaceutical industry often comes

in waves based on the changing strategic needs of pharmaceutical companies and the developments in the capital markets for biotechnology companies. In contrast to the recent past, when pharmaceutical companies were predominantly interested in license agreements and partnerships, today acquisitions appear to have greater strategic importance.

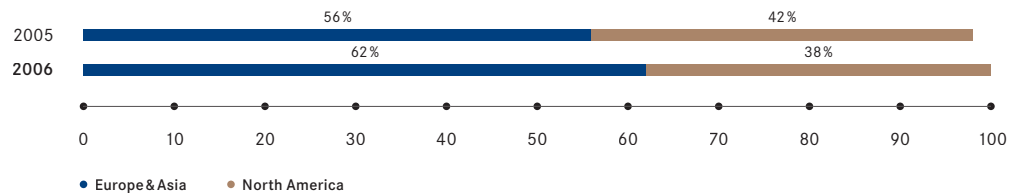
Antibody- and protein-based technologies and companies have been particularly sought after. The year 2006 saw a further decreasing of competition in the antibody industry. This was predominantly attributable to the acquisition of two main competitors of MorphoSys, namely the acquisition of Abgenix by Amgen at the end of 2005, and the takeover of Cambridge Antibody Technology (CAT) by AstraZeneca in May 2006. In addition, Merck & Co. announced the acquisition of two antibody technology companies, Abmaxis and GlycoFi, and Novartis bought NeuTec Pharma, a biotechnology company developing antibodies for infectious diseases. Finally, in September 2006, Amgen acquired Avidia, a privately held biopharmaceutical company that discovers and develops a new class of human therapeutics known as Avimer™ proteins.

At the end of 2006, 20 therapeutic antibodies were approved. In June 2006, Tysabri®, marketed by Biogen Idec and Elan, was reintroduced as a monotherapy treatment for relapsing forms of multiple sclerosis (MS). Tysabri® had been recalled in 2005 after cases of rare and fatal neurological disease occurred in connection with the use of the drug. In June 2006, Lucentis® (Genentech) received approval for the treatment of neovascular (wet) age-related macular degeneration (AMD). And in September 2006, Amgen's Vectibix™, developed by Abgenix to treat metastatic colorectal cancer, was approved by the FDA, thus becoming the 20th antibody drug on the market.

FINANCIAL ANALYSIS

REVENUES

In the fiscal year 2006, revenues increased by 58% to € 53.0 million year-on-year (2005: € 33.5 million). Reasons for the increase included revenues arising from extended deals, the inclusion of success-based payments from existing collaborations, as well as the inclusion of Serotec Group revenues, contributing 23% of total revenues. Revenues arising from the Therapeutic Antibodies segment accounted for 65% or € 34.7 million of total revenues, while the AbD segment generated 35% (€ 18.3 million) of the total. Total Company organic growth amounted to 22% compared to the same period in 2005. Approximately 42% of total Group revenues resulted from MorphoSys's three largest alliances with Novartis, Centocor and Roche (2005: 64% from Novartis, Centocor and Schering). Geographically, 62% of MorphoSys's commercial revenues were generated with biotechnology and pharmaceutical companies located in Europe and Asia, compared to 38% in North America (see also Notes to the Consolidated Financial Statements – section 2). This compares to 56% and 42% respectively, in the year 2005.

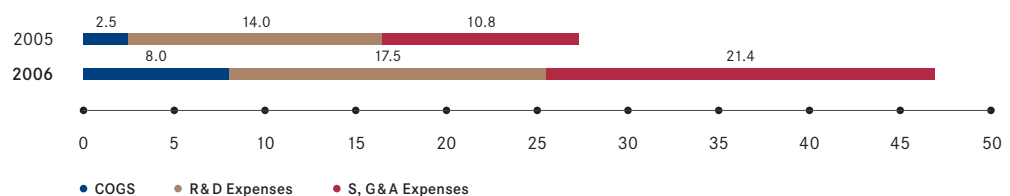
REVENUE SPLIT (in %)**THERAPEUTIC ANTIBODIES SEGMENT**

The Therapeutic Antibodies segment comprises all collaborations with a strong therapeutic and licensing aspect to them. In 2006, this segment generated its revenues with the following antibody collaborations: Bayer, Boehringer Ingelheim, Bristol-Myers Squibb, Centocor (Johnson & Johnson), Daiichi Sankyo, Eli Lilly, F. Hoffmann-La Roche, ImmunoGen, Merck & Co., Novartis, Novoplant, OncoMed, Pfizer, Schering, Schering-Plough, and Shionogi. The Therapeutic Antibodies segment also includes all activities in the area of proprietary product development. Its total revenues enclose € 27.2 million funded research and paid license fees, as well as € 7.5 million success-based payments (which include clinical milestones).

ANTIBODIES DIRECT - ABD SEGMENT

The AbD segment, embracing the Serotec Group, MorphoSys's Antibodies by Design unit and the Biogenesis Group, generated 35% (€ 18.3 million) of total revenues. The Serotec Group, newly acquired in January 2006, contributed € 12.3 million in revenues, or 67% of the total segment revenues. The Group also recorded grant revenues of € 0.2 million (2005: € 0.4 million) during the reporting period.

As of December 31, 2006, orders in the amount of € 2.5 million were classified as back orders in the segment.

OPERATING EXPENSES (in million €)

OPERATING EXPENSES

In the fiscal year 2006, operating expenses increased by 72% to € 46.9 million (2005: € 27.3 million), with operating profit remaining almost unchanged at € 6.2 million (2005: € 6.2 million). The total increase in operating expenses of € 19.6 million was mainly due to the inclusion of the Serotec Group in the consolidated accounts with an impact of € 13.8 million, due to higher personnel-related costs in conjunction with new collaborations, and increased expenses for proprietary product development.

Stock-based compensation expenses amounting to € 1.2 million are embedded in cost of goods sold, sales, general and administrative expenses as well as research and development expenses, and changed little in comparison to the previous year, remaining as a non-cash charge.

Applying IFRS 3 “Business Combinations” under IFRS accounting, a purchase price allocation (PPA) is currently carried out for the Serotec acquisition. The resulting preliminary values were retroactively recognized to the purchase date, and amortization as well as depreciation of assets identified were included in total operating expenses during the year 2006. Total PPA effects on operating profit including the Serotec acquisition amounted to € 1.5 million (2005: € 1.0 million).

COST OF GOODS SOLD (COGS)

COGS is composed of the AbD segment’s cost of goods sold during the year 2006 and includes the amortization of assets identified in connection with the Biogenesis and Serotec PPAs. In 2006, COGS rose significantly to € 8.0 million compared to € 2.5 million in the year 2005, which resulted mainly from the € 5.5 million inclusion of Serotec COGS in the consolidated Group accounts and the inclusion of € 0.7 million depreciation of inventories resulting from the purchase price allocation exercise in conjunction with acquired companies.

RESEARCH AND DEVELOPMENT (R&D) EXPENSES

In 2006, research and development expenses increased by € 3.5 million to € 17.5 million (2005: € 14.0 million). This was mainly the result of expenses for product and technology development amounting to € 3.0 million. The impact on R&D through the amortization of intangibles of acquired companies amounted to € 0.8 million.

SALES, GENERAL AND ADMINISTRATIVE (S, G&A) EXPENSES

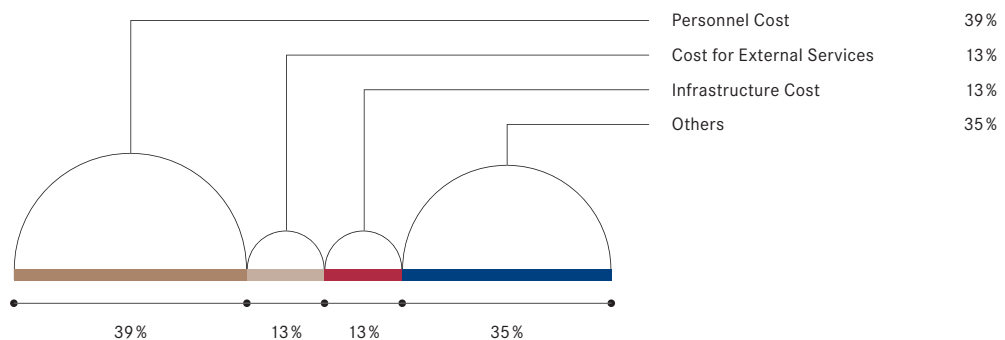
Sales, general and administrative expenses amounted to € 21.4 million compared to € 10.8 million in the previous year. The increase is mainly derived from the inclusion of the Serotec Group in the amount of € 8.3 million, higher S, G&A personnel costs at MorphoSys AG in Munich, and integration costs associated with acquired companies.

COST BY EXPENDITURE TYPE

For the year 2006, personnel costs (excluding expenses arising from stock-based compensation) amounted to € 18.1 million (2005: € 10.8 million) or 39% of total operating expenses, thus representing the largest cost block within operating expenses in the year 2006. The higher personnel costs arose mainly from the increased head count resulting from the inclusion of Serotec Ltd. and its affiliates and from the Group's expanded overall operational activity.

External services, representing the second-largest cost block by cost type and mainly consisting of marketing expenses, legal costs, costs for tax, auditing and accounting as well as general consulting, amounted to € 6.1 million (2005: € 2.9 million) or 13% of total operating expenses in 2006. Most heavily impacting these costs in 2006 were proprietary drug development and the inclusion of marketing costs from the Serotec Group.

Infrastructure costs included rent costs as well as depreciation of property and equipment and impacted operating expenses by € 5.9 million (2005: € 3.0 million) or 13% in 2006. Increased infrastructure costs were primarily the result of the inclusion of the acquired Serotec Group of companies. The Company leases for facilities on a group level amounted to € 1.7 million and € 0.9 million for the full years ended December 31, 2006 and 2005 respectively.

COST BY EXPENDITURE TYPE

NON-OPERATING ITEMS (NON-TAX)

Non-operating expenses excluding taxes amounted to € 0.9 million compared to non-operating expenses of € 1.0 million in the year 2005. Losses on foreign exchange totaled € 1.2 million and resulted mainly from contracts with commercial partners who share such foreign gains and losses. Bank fees and interest expenses (€ 0.3 million) were more than offset by gains from available-for-sale securities (€ 0.7 million).

TAXES

Income tax expenses of € 1.2 million were partly offset by amortization of deferred tax liabilities resulting from the Biogenesis and Serotec PPAs (€ 0.5 million). Furthermore, tax expenses comprised withholding tax (€ 0.2 million) retained from payments made by foreign customers.

As a result of the forecast for taxable income in 2007, a deferred tax asset on tax loss carry-forwards has been capitalized, which further reduced tax expenses by € 1.2 million.

OPERATING PROFIT/NET INCOME

For the full fiscal year 2006, Group operating profit remained almost unchanged at € 6.2 million compared to 2005. Earnings before interest and taxes (EBIT) amounted to € 5.4 million, compared to an EBIT of € 5.3 million in the same period of the previous year. Earnings before interest, taxes, depreciation and amortization (EBITDA) amounted to € 10.3 million compared to € 8.6 million in the previous year.

A net income after taxes of € 6.0 million was achieved for the year 2006, compared to € 4.7 million in the same period of 2005. The resulting basic net profit per share for 2006 amounted to € 0.94 (2005: € 0.84).

LIQUIDITY/CASH FLOWS

Cash flow from operations amounted to € 16.3 million in 2006 (2005: € 4.4 million). The Company's total cash flow was impacted by MorphoSys's successful private placement offering in March 2006, resulting in a total cash inflow from financing activities of € 19.6 million (2005: € 18.4 million). Net cash used in investing activities was primarily impacted by the acquisition of Serotec in January 2006 (€ 21.2 million), and amounted to a total of € 36.2 million (2005: € 31.4 million).

ASSETS

Total assets increased by € 47.7 million to € 127.8 million in the year 2006, compared to € 80.1 million in the year 2005. This was primarily a result of the acquisition of the Serotec Group's assets, including acquired goodwill in the amount of € 30.2 million, and due to cash inflows from a capital increase and cash generated from operations. For a more detailed split of the impact of the Serotec acquisition, see also Notes to the Consolidated Financial Statements – section 11.

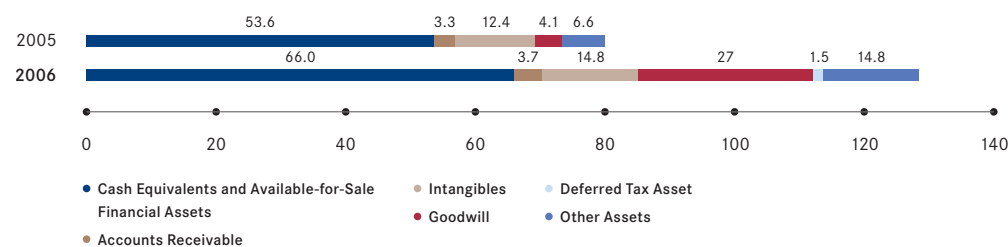
The value of inventories at year-end 2006 has sharply increased from € 0.5 million to € 3.5 million, reflecting the higher stocks through the acquisition of the Serotec Group. Many research antibodies are held in stock, to allow immediately shipping upon ordering by the customers.

At the end of 2006, MorphoSys's accounts receivable increased by € 0.4 million to € 3.7 million (2005: € 3.3 million).

With the restructuring and concentration of almost all US activities as well as UK activities of the AbD segment in Raleigh, North Carolina, USA, and Oxford, UK, land and building owned by the Company in New Hampshire, USA, as well as Oxford, UK, are held for sale and have been reclassified in the amount of € 0.7 million from non-current assets to current assets, accordingly.

On December 31, 2006, the Company held € 66.0 million in cash, cash equivalents and available-for-sale financial assets, compared to a balance at year-end 2005 of € 53.6 million.

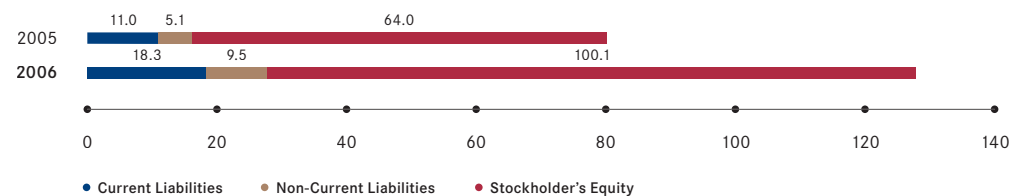
TOTAL ASSETS (in million €)*



* Differences due to rounding up/down, see consolidated balance sheets

LIABILITIES

In the fiscal year 2006, current liabilities increased by € 7.3 million to € 18.3 million from € 11.0 million at the end of 2005. This change primarily arose from the increase of accounts payable by € 6.2 million to € 10.5 million (2005: € 4.3 million) and was mainly a result of the inclusion of the Serotec entities into the consolidated financial statements as well as from increased operational activity involving higher short-term accruals. The growth in non-current liabilities was significantly impacted by the rise of non-current deferred revenues by € 2.5 million due to payments arising from new contracts signed in 2005 and 2006, in addition to an increase in deferred tax liability in combination with the Company's Serotec PPA exercise.

LIABILITIES (in million €)*

* Differences due to rounding up/down, see consolidated balance sheets

EQUITY

Total stockholders' equity amounted to € 100.1 million on December 31, 2006, or an equity ratio of 78%, compared to € 64.0 million on December 31, 2005.

As of December 31, 2006, the total number of shares issued amounted to 6,715,322, of which 6,686,160 were outstanding, compared to 6,025,863 and 5,996,701 on December 31, 2005, respectively.

The increase in 2006 stockholders' equity compared to the prior year arose largely from the issuance of 208,560 new shares following a capital increase as consideration for the Serotec acquisition. The issuance of 384,338 shares stemming from the capital increase against cash successfully placed in March 2006 also contributed to the higher number of total shares. An additional increase of 96,561 shares resulted from the conversion of bonds issued to employees as well as exercised options. Furthermore, the grant of new stock options impacting equity amounted to € 1.2 million.

CAPITAL EXPENDITURE

In the fiscal year 2006, MorphoSys's investment in property, plant and equipment amounted to € 3.5 million, resulting in an increase of € 2.9 million compared to the same period of the prior year. Concentrating the Group's UK activities into one new UK headquarters in Oxford contributed € 1.2 million to the same. Depreciation of property, plant and equipment for 2006 accounted for € 1.5 million, compared to € 0.9 million in 2005. The increase was mainly due to an additional depreciation of € 0.5 million recognized as a result of the depreciation of stock in connection with the PPA exercises of the Serotec acquisition. In 2006, the Company invested € 0.4 million in intangible assets. Amortization of intangibles amounted to € 3.4 million and increased by € 0.7 million year on year, mainly due to the amortization of intangible assets acquired in the Serotec deal.



Dr. Bernhard Erning, Head of Treasury & Corporate Development • Dr. Claudia Gutjahr-Löser, Head of Corporate Communications • Christopher Stift, Head of Controlling & Accounting

FINANCING

During 2006, two capital increases were carried out. As part of the acquisition of the Serotec Group in January 2006, one-third of the purchase price was paid by means of a capital increase against contribution in kind. The 208,560 new shares from the capital increase (3.5% of the share capital) went to the former owners of the Serotec Group and are subject to a graded holding period.

In March 2006, MorphoSys successfully placed 384,338 shares (6.5% of the share capital) in a private placement to international institutional investors at a price of € 44.50 per share. The issue was oversubscribed several times. The Company raised gross proceeds of approximately € 17.1 million. The proceeds from the cash capital increase are intended to be used for general purposes, including further acquisitions in the field of research antibodies.

SUBSIDIARIES/CORPORATE ACQUISITIONS/DIVESTITURES

ACQUISITION OF THE SEROTEC GROUP

In January 2006, MorphoSys's Research Antibodies segment was further strengthened through the acquisition of the Serotec Group. The acquisition of Serotec, a renowned and internationally active supplier of research antibodies, more than tripled MorphoSys's existing Research Antibodies segment revenues and established the Company as one of the leading suppliers of research antibodies and antibody research technologies in Europe. Serotec provides MorphoSys with a strong distribution network including subsidiaries and sales offices in the United States



James Bernard, Managing Director, AbD Serotec • Tim Bernard, Head of Global Sales, AbD Serotec • Dr. Achim Knappik, Head of R&D, AbD Serotec • Joanne Crowe, Head of Marketing, AbD Serotec • Dieter Lingelbach, Division Head, AbD Serotec

and in the United Kingdom as well as in Germany, France and Scandinavia. Serotec (Serotec Ltd., Serotec, Inc., Serotec GmbH and Oxford Biotech Ltd.) has become a wholly owned subsidiary of MorphoSys AG and is being integrated within MorphoSys's existing Research Antibodies segment represented at that time by the Biogenesis and Antibodies by Design brands.

The purchase price of approximately £ 20 million (roughly € 29.3 million) has been paid via approximately £ 14 million (roughly € 20.5 million) cash and through the issuance of 208,560 new MorphoSys shares from a capital increase against contribution in kind.

INTEGRATION

During 2006, the newly acquired Serotec Group was integrated in MorphoSys's existing Research Antibodies segment. All products were combined in one sales catalog, and all offerings and marketing activities have been consolidated. The existing websites were integrated, and will be further expanded as an e-commerce platform.

In August, a new US office in the technology cluster Research Triangle Region near Raleigh, North Carolina, USA, was opened. The new 500-square-meter facility will provide additional space for new staff, increased stock levels for the expanded product range, and the expansion of sales for the custom monoclonal antibodies provided by AbD. All US activities of the AbD segment were concentrated in Raleigh, but another sales representation was kept in Brentwood, New Hampshire, USA.

By the end of 2006, all UK-based activities of AbD were centralized in a new building in Oxford, UK. The 2,200-square-meter facility acts as new UK headquarters for the MorphoSys Group of companies.

For 2007, a streamlining of corporate structure in order to increase administrative efficiency is planned.

BUSINESS DEVELOPMENT

Customer satisfaction determines MorphoSys's success. We strive to establish long-term partnerships and customer relationships, bringing lasting success to both sides. In the Therapeutic Antibodies segment, MorphoSys has shown an outstanding track record in establishing and expanding existing partnerships over the years, and more recently also in the AbD segment.

THERAPEUTIC ANTIBODIES SEGMENT

In 2006, the Company expanded several existing partnerships and signed new collaborations in the Therapeutic Antibodies segment. The following partnerships were either established or expanded in the 2006 fiscal year (in alphabetical order). For a detailed description of other partnerships, please refer to the Notes to the Consolidated Financial Statements – section 25.

DAIICHI SANKYO – SECOND PARTNERSHIP IN JAPAN

In March 2006, MorphoSys announced a license agreement and therapeutic antibody collaboration with Japan's pharmaceutical group Daiichi Sankyo for an initial two-year term with the option of an extension of up to three more years. For the Company, it is the second commercial partnership with a top 10 pharmaceutical company in Japan. MorphoSys's HuCAL GOLD library was installed at Daiichi Sankyo's research site in Tokyo.

Daiichi Sankyo committed to start one therapeutic antibody program with MorphoSys and received an option for further programs. MorphoSys will apply its proprietary HuCAL GOLD technology to generate antibodies against a target provided by Daiichi Sankyo. Subsequently, Daiichi Sankyo will be responsible for preclinical and clinical development as well as the ensuing marketing of resulting products. If extended beyond the initial two-year period, the contract provides Daiichi Sankyo with access to additional MorphoSys capabilities, such as target validation, antibody optimization and preclinical development. Such an extension would trigger an additional up-front payment and result in increased research funding for MorphoSys.

NOVARTIS – LARGEST ALLIANCE FURTHER EXPANDED

In June 2006, MorphoSys announced an expansion of its existing collaboration with Novartis. The collaboration, which is currently MorphoSys's largest partnership, will now go through May 2011. Novartis committed itself to increase the number of new therapeutic antibody projects annually – resulting in increased levels of Novartis's funding for research and development at MorphoSys. In addition, Novartis will have the option to gain access to the MorphoSys HuCAL GOLD library at an additional research site and will have access to the newly developed RapMAT quick-affinity optimization technology at the HuCAL library installation sites for optimization of non-therapeutic antibodies. Furthermore, the agreement also provides for increased annual license fees, with commercial license fees, research and developmental milestones, and royalties on marketed antibody products remaining unchanged. The non-exclusive option on internalization of the entire MorphoSys HuCAL technology platform, offered to Novartis under the terms of the initial collaboration in 2004, remains in place.

ONCOMED PHARMACEUTICALS – UNIQUE APPROACH IN CANCER THERAPY

The US-based biopharmaceutical company OncoMed Pharmaceuticals, Inc., has acquired a license to use MorphoSys's HuCAL technology in the research and development of human therapeutic antibodies for the treatment of various cancers, including breast, lung, colon and prostate cancer by targeting cancer stem cells. The two-year contract includes an option for OncoMed to develop HuCAL-derived therapeutic antibodies. The agreement includes an up-front payment and annual user fees.

PFIZER – EXPANSION DOUBLES POTENTIAL DEAL VOLUME

In December 2006, MorphoSys announced an early expansion of its collaboration with Pfizer until the end of 2011. Under the extended agreement, Pfizer has the option to begin new therapeutic antibody projects with MorphoSys resulting in an increased level of programs to be performed within the collaboration. As a result, the potential value for MorphoSys in research funding and potential developmental milestone payments increased to more than US\$ 100 million, not including royalties. Additionally, the extension triggered a one-off payment from Pfizer to MorphoSys.

SCHERING-PLOUGH – INCREASED MARKET SHARE AMONG BIG PHARMA

In May 2006, MorphoSys signed an initial two-year license agreement with the Schering-Plough Corporation for the use of its HuCAL GOLD technology in the research and development of human therapeutic antibodies. Under the terms of the agreement, MorphoSys grants access to its proprietary antibody library to Schering-Plough for use in its drug discovery programs at one research site. Schering-Plough has the option to develop HuCAL-derived therapeutic antibodies against up to ten disease-related targets.

The initial two-year term of the agreement also provides Schering-Plough with the option of an extension of up to three more years. The HuCAL GOLD antibody library was installed at Schering-Plough's research site in Palo Alto, California, USA, the location of Schering-Plough Biopharma, an affiliate of the Schering-Plough Research Institute.

COLLABORATIONS WITH ACADEMIC INSTITUTES

In addition to the commercial partnerships with pharmaceutical and biotechnology companies, MorphoSys has forged two relevant collaborations with leading academic institutes which offer potential benefits for both business segments.

THE BURNHAM INSTITUTE

In November 2006, MorphoSys signed a broad alliance with the Burnham Institute for Medical Research in La Jolla, California, USA, covering the use of fully human recombinant research antibodies and the commercialization of resulting products. The Burnham Institute will receive access to novel HuCAL GOLD-based research antibodies from AbD to identify and validate target molecules with potential medical implications. MorphoSys retains the commercialization rights for all antibodies emerging from the collaboration both as research antibody tools distributed via the AbD sales catalog as well as in therapeutic or diagnostic applications.

COLLABORATION WITH LEADING RESEARCH INSTITUTE IN JAPAN

MorphoSys and its partner the GeneFrontier Corporation have expanded their existing marketing alliance in Japan. The collaboration now also covers the generation of HuCAL-derived antibodies for proteome research and target validation together with a leading Japanese research organization as well as the commercialization of resulting antibody products. GeneFrontier will utilize MorphoSys's HuCAL GOLD antibody library to generate novel HuCAL antibodies against targets provided by the research institute. For this purpose, the HuCAL antibody technology was installed at GeneFrontier's research laboratories within a research facility in Tokyo. GeneFrontier will provide MorphoSys with financial compensation for access to the technology. Both companies agreed to share the commercialization rights for all antibodies discovered in this project. Similar to the contract with the Burnham Institute, this contract offers significant new product potential for the AbD division, but also a potential long-term benefit for MorphoSys's therapeutic business.

RESEARCH ANTIBODIES SEGMENT

In the Research Antibodies segment, several agreements were signed in 2006. The common aim of these activities is to support the central goal of the Company in this segment, namely, to make HuCAL the industry standard for research antibody generation.



Steve Yoder, Head of Licensing & IP • Dr. Barbara Krebs-Pohl, Head of Business Development • Dr. Harald Watzka, Head of Alliance Management

CHEMICON – HUCAL ANTIBODIES POSITIONED IN LEADING MARKETING CHANNEL

In January 2006, MorphoSys and Chemicon International, Inc., a unit of the Millipore Corporation, signed a three-year agreement for the distribution of HuCAL-based recombinant research antibodies through Chemicon's worldwide sales network. Chemicon may market the licensed HuCAL-based research antibodies for use in *in vitro* research as stand-alone products or as components of reagent kits and may, in addition, also market the antibodies for clinical diagnostic applications. MorphoSys receives payment for antibody generation, optional additional fees, and royalties on all products.

CHIMERA BIOTEC – CO-MARKETING AGREEMENT WITH ANTIGEN SERVICE PROVIDER

In February 2006, AbD and Chimera Biotec GmbH announced the start of a co-marketing agreement. The parties agreed to co-market the rapid generation of monoclonal HuCAL antibodies by AbD and Chimera Biotec's complementary Imperacer™ assay technology for ultrasensitive antigen detection. Each partner will offer the other partner's services to its customers throughout the worldwide market.

HUCAL ANTIBODIES IN BIODEFENSE-RELATED PROJECTS

In September 2006, AbD was able to secure a contract as the sole source on a biodefense-related project by USAMRIID, an organization of the US Army Medical Research and Materiel Command and lead medical research laboratory for the US Biological Defense Program. USAMRIID has ordered fully human recombinant research antibodies against five bacteria-derived toxins. AbD generated these antibodies successfully within five weeks using the HuCAL GOLD antibody library and delivered the requested products to USAMRIID.

Biological toxins derived from living organisms, such as bacteria and other microorganisms or plants, are biological agents with potential implications in bioterrorism. HuCAL-derived antibodies may support the development of countermeasures against such biological toxins or act as therapeutic agents themselves.

RESEARCH AND DEVELOPMENT/ALLIANCE MANAGEMENT

MorphoSys uses its own HuCAL technology for the development of therapeutic antibodies and research applications. Its technology has been thoroughly tried and tested in numerous partnerships. The following represents the progress made in proprietary product and technology development as well as existing collaborations throughout the year:

THERAPEUTIC ANTIBODIES SEGMENT

MOR103 AS NEW LEAD PRODUCT ON TRACK TO CLINIC

At the beginning of 2006, MorphoSys rearranged the further development of its proprietary therapeutic antibody programs. As a result of a strategic review process initiated in 2005, MorphoSys decided to focus the majority of its efforts on its anti-inflammatory compound MOR103 as new lead compound in the indication of rheumatoid arthritis. MOR103 is a fully human HuCAL antibody against an undisclosed target. The Company intends to evaluate clinical efficacy of the compound. As a next development step, MorphoSys will provide all necessary information to regulatory authorities and ethics committees within the second half of 2007 to start human clinical trials.

In regard to MorphoSys's cancer-related MOR202 antibody program, the Company generated additional preclinical data around this project, and a preclinical candidate was selected.

MorphoSys discontinued further development of its anti-ICAM-1 program, which consisted of the MOR101/MOR102 therapeutic antibody projects.

ACCESS TO FULLY HUMAN CELL LINE FOR MOR103

In August 2006, MorphoSys AG signed a second PER.C6® license agreement with Dutch biotechnology company Crucell N.V. and a biopharmaceutical manufacturing agreement with its technology partner DSM Biologics. The license agreements allow MorphoSys to use the PER.C6® cell line in the production of clinical-grade material for the development of its proprietary MOR103 therapeutic antibody program. Production of clinical-grade material is a relevant step to keep to the timeline for this project.

BOEHRINGER INGELHEIM STARTS NEW CANCER PROGRAM

In November 2006, MorphoSys and Boehringer Ingelheim expanded their existing collaboration with a new antibody program. Boehringer Ingelheim exercised an option for optimizing a therapeutic HuCAL antibody and acquired an exclusive license for this project. The antibody identified by Boehringer Ingelheim at its research site in Vienna, Austria, is directed against a cancer disease-related target molecule. As a result, the collaboration now includes three areas of disease – the development of new therapies against cancer, inflammatory and cardiovascular diseases.

FURTHER PROGRESS IN CENTOCOR COLLABORATION

In February 2006, MorphoSys AG announced the achievement of a fourth therapeutic milestone within the scope of its collaboration with Centocor, Inc. In meeting the milestone, MorphoSys developed several highly optimized fully human IgG antibodies against a Centocor target involved in inflammatory and autoimmune diseases. The HuCAL GOLD antibodies passed pre-defined criteria. Achievement of the milestone triggered a payment from Centocor to MorphoSys.

FIRST CLINICAL DATA WITH HUCAL ANTIBODY 1D09C3

In December 2006, MorphoSys's partner GPC Biotech presented preliminary clinical data for the HuCAL-derived anticancer antibody 1D09C3 at the 48th Annual Meeting of the American Society of Hematology. 1D09C3 is currently in a phase 1 clinical program that is evaluating the antibody in patients with relapsed or refractory B-cell lymphomas, who have failed prior standard therapy. The objectives of the phase 1 program are to determine the maximum tolerated dose and to establish a recommended dose for a phase 2 efficacy trial. The preliminary data from 25 patients suggest that the HuCAL-antibody is well tolerated in this heavily pretreated patient population. A maximum tolerated dose had not yet been reached. Hints of antitumor activity were observed in two patients.

PROGRESS IN COLLABORATION WITH MERCK & CO., INC.

In December 2005, MorphoSys signed a license agreement with the US pharmaceutical company Merck & Co., Inc., for the use of its HuCAL GOLD and AutoCAL technologies in research and development of human therapeutic antibodies. During the course of 2006, installation of the Company's proprietary AutoCAL technology was successfully completed at two of Merck's research sites, Rome, Italy, and West Point, Pennsylvania, USA, and milestone payments were received.

ALZHEIMER ANTIBODY ENTERED CLINICAL TRIALS

In January 2006, MorphoSys's partner Roche filed all necessary applications to commence a European phase 1 clinical trial with a HuCAL-derived antibody to treat Alzheimer's disease. This clinical trial is currently underway in patients.

The HuCAL antibody targets are intended to remove abnormal build-ups of amyloid beta protein in cerebral tissue, which are typical to Alzheimer disease progression. The applications filing to commence clinical trials triggered a clinical milestone payment from Roche to MorphoSys.

FIRST HUCAL USER DAY

In December 2006, MorphoSys held its first HuCAL GOLD User Day in San Diego, California, USA, on the back of the international IBC's Antibody Engineering Conference. The meeting was intended to support and intensify the interaction between MorphoSys and its partners, and to increase the partners' knowledge of the HuCAL technology and handling.

RESEARCH ANTIBODIES SEGMENT ABD

Due to the activities of the Research Antibodies segment, HuCAL antibodies have found their way into many new areas of application. In 2006, the following research-related items arising from the AbD business were announced.

PARTNERSHIP WITH JAPANESE KAZUSA DNA RESEARCH INSTITUTE

In May 2006, AbD concluded a research and development program with the Japanese Kazusa DNA Research Institute. The two parties have jointly developed and characterized a series of recombinant research antibodies from MorphoSys's HuCAL GOLD antibody library. The antibodies are directed against proteins sourced from Kazusa's mKIAA cDNA cloning and expression project, which aims at identifying and characterizing previously unidentified genes and their corresponding proteins. Both parties share distribution rights and have made these HuCAL antibodies available via the sales catalogs of the Kazusa Institute and AbD.

HUCAL ANTIBODIES IN PARKINSON AND ALZHEIMER RESEARCH

In December 2006, AbD presented results from one of its customers at Japan's renowned Hokkaido University obtained by using HuCAL-derived antibodies. A set of monoclonal and fully human mini-antibodies was selected that specifically recognize the DJ-1 protein oxidized at a single amino acid. The analysis demonstrated that the HuCAL-based antibody fragments provide a set of useful probes for studying the DJ-1 protein. DJ-1 was initially identified by researchers at Hokkaido University as a novel cancer target and has recently been linked to certain forms of Parkinson's and Alzheimer's disease. As with other HuCAL-based antibodies generated for customers, AbD has made a DJ-1-specific antibody available via its sales catalog and customer website.



Dr. Robert Friesen, Head of Preclinical Development • Dr. Ralf Ostendorp, Senior Director, R&D • Dr. Markus Enzelberger, Senior Director, R&D • Dr. Armin Weidmann, Director, R&D • Dr. Margit Urban, Senior Director, R&D

PROPRIETARY TECHNOLOGY DEVELOPMENT AND IMPROVEMENTS

LAUNCH OF NEW TECHNOLOGY PLATFORM

In December 2006, MorphoSys presented a new technology platform called RapMAT, a new antibody optimization system. The RapMAT approach improves MorphoSys's capabilities to generate antibodies using the proprietary HuCAL GOLD antibody library and reduces the time until promising lead candidates can be isolated. The new system works hand in hand with the established HuCAL GOLD technology and builds on its advantageous features, such as its modular design with unique restriction sites flanking all important segments of the antibody genes. Resulting antibodies remain of fully human composition.

INTELLECTUAL PROPERTY

Securing and exploiting intellectual property (IP) remains a core focus of MorphoSys. In line with this philosophy, MorphoSys is active in seeking, when appropriate, IP protection for its proprietary drug candidates and its drug discovery platforms. Thus, at times, the Company pursues trade secret protection in lieu of filing patent applications when it believes the former will bring more value to the Company. In 2006, the Company filed numerous patent applications, including those covering its proprietary antibody programs and advances to its robust discovery platforms. IP continues to play a key role in the Company's successful partnering track record. For example, MorphoSys filed for IP protection on its RapMAT technology, access to which was a feature of the expansion of its collaboration with Novartis in June 2006.

HUMAN RESOURCES

MorphoSys's future success relies on having an expert and committed workforce. One of the key management tasks is to attract and maintain highly qualified and motivated employees for all areas of the Company.

LONG-TERM PERFORMANCE-RELATED REMUNERATION

All employees participate in the operational and financial success of the Company. In order to strengthen and expand the reward system for individual contribution, MorphoSys offers a performance-based bonus to all employees. This bonus supplements the existing remuneration system and opens up an additional performance incentive. Employee bonuses are based on the success of the Company and on personal performance. By setting personal goals, department goals and Company goals, each employee has the chance to contribute to the successful development of MorphoSys and to participate in its success.

In addition to the performance-related compensation, all employees have the chance to participate in a stock option or convertible bond program as part of a long-term equity incentive scheme. The aim of this program is to give employees a long-term stake in the success of the Company.

QUALIFICATION AND TRAINING

Supporting science and management education is a priority for MorphoSys. The Company offers career opportunities in the areas of research and product development as well as a variety of management positions. All employees enjoy a wide range of professional and personal development programs as well as a working environment that encourages enthusiasm and collaboration among departments and between the Company's different locations.

HUMAN RESOURCES

One of the most important goals of the human resources department is to provide an optimal working environment for all employees. Flexible working hours and employment arrangements have a long tradition at MorphoSys; the goal being to help strike a better balance between professional duties and private needs, which in turn contributes to employee commitment to the Company. MorphoSys provides equal opportunities to women and men at their workplace. This tradition is based on the open and international corporate culture that has characterized the Company from the beginning and has remained strong up to the present day.

NUMBER AND QUALIFICATION OF EMPLOYEES

On December 31, 2006, the MorphoSys Group employed 279 people (December 31, 2005: 172). On average, the MorphoSys Group employed 265 people in 2006 (2005: 170).

Of the 279 employees, 98 people were employed by the Serotec Group on December 31, 2006, and on average 88 in the course of the year.

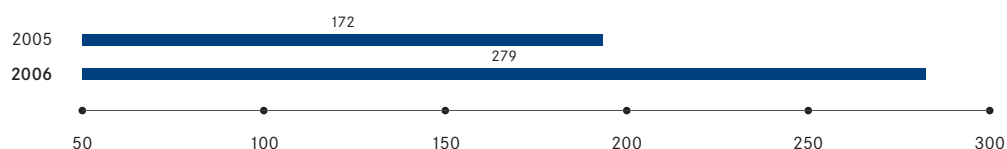
Of the 279 employees, 155 worked in research and development and 124 in sales, general and administration. On December 31, 2006, 59 of MorphoSys's employees held a Ph.D. degree (December 31, 2005: 46).

Of the 279 employees, 158 were engaged in the Therapeutic Antibodies segment and 121 in the AbD segment.

On December 31, 2006, MorphoSys had 1 apprenticeship position (December 31, 2005: 1).

	NUMBER OF EMPLOYEES
Germany	183
UK	78
USA	18
TOTAL	279

EMPLOYEES OF MORPHOSYS GROUP



SUPERVISORY BOARD

At the Annual Shareholders' Meeting held in Munich on May 17, 2006, MorphoSys's shareholders re-elected Prof. Dr. Jürgen Drews and Prof. Dr. Andreas Plückthun to the Supervisory Board.

JOB SAFETY

Regular medical checks are carried out for the MorphoSys employees. An initial medical check-up is performed for all new employees of the research and development department. In addition, the Company offers all employees in research and development the option to be vaccinated against hepatitis A and B.

MorphoSys conducts its research in safety level "Bio I" and "Bio II" laboratories under strict observance of all relevant legal guidelines. Internal standards are more stringent than those guidelines which are legally required.



Dr. Günter Wellnhof, Head of Technical Operations • Silvia Dermietzel, Head of Human Resources

As part of the expert team of employees responsible for work safety, biological safety and fire prevention, there is one designated employee dedicated to work safety alone. This person is responsible for providing employees with regular training and updates to inform them of the latest guidelines. MorphoSys employees are familiar with all requirements relating to job safety, handling of hazardous materials as well as accident and fire prevention. During 2006, there were no industrial accidents reported.

Due to regular maintenance by internal employees, all laboratory equipment adheres to the highest possible standard of safety.

REMUNERATION REPORT

REMUNERATION OF THE MANAGEMENT BOARD

The annual remuneration of the members of the Management Board consists of a fixed component, a performance-related bonus, a medium- and long-term performance-related component in the form of convertible bonds and stock options as well as of other fringe benefits. Each year, the appropriateness of the total compensation packages is subject to a review of the Remuneration & Nomination Committee. The complete compensation packages are compared to the outcome of the Annual German Biotechnology Industry Remuneration Study (GRS Study), and to other international benchmark sources. The adjustments to the compensation packages are adopted by the plenum of the Supervisory Board. The last date on which salaries were adjusted was in July 2006.

The total annual salary of the members of the Management Board comprises the fixed components plus additional other compensatory benefits, which encompass primarily the use of company cars, the reimbursement of travel and telephone costs, allowances for health, social care and invalidity insurances as well as special allowances and benefits received when working outside of the home country. Furthermore, all members of the Management Board participate in private pension funds. MorphoSys pays the monthly contribution to these funds. These payments are included here as other compensatory benefits and amount to 10% of the annual fixed salary of each Management Board member plus tax contribution.

Additionally, each member receives a performance-related cash bonus payment. Such payments are dependent on individual goals and company-related goals, which are determined by the Supervisory Board at the beginning of each fiscal year. The corporate performance targets reflect operating performance as measured by revenues and net income and other Company goals such as share performance or the successful integration of business units. At the end of the year, the Supervisory Board evaluates the level of attainment of these goals. The bonus is determined by the Supervisory Board on the basis of the Company's business development after due assessment of the circumstances. Approximately one-third of the bonus payment is dependent on personal goals, the other two-thirds depend on the extent to which the Company goals have been reached.

In the fiscal year 2006, the total cash remuneration paid to the members of the Management Board amounted to € 1,156,415 (previous year: € 887,964). The table below shows the detailed and individualized compensation for the Management Board in 2006:

in €	FIXED COMPENSATION	PERFORMANCE- RELATED COMPENSATION	OTHER COMPENSATORY BENEFITS	TOTAL COMPENSATION 2006
Dr. Simon E. Moroney	290,000	139,024	77,313 ²	506,337
Mr. Dave Lemus	204,750	104,973	99,456 ³	409,179
Dr. Marlies Sproll	181,500	13,052 ¹	46,347 ⁴	240,899

¹ Performance-related compensation for November and December 2005 (Dr. Sproll was appointed as member of the Management Board as of November 1, 2005)

² Includes € 68,913 annual contribution to private pension fund and allowances to insurances

³ Includes € 48,283 annual contribution to private pension fund and allowances to insurances

⁴ Includes € 40,088 annual contribution to private pension fund and allowances to insurances

The long-term performance-related remuneration consists of convertible bonds and stock options under the plans as resolved by the Annual Shareholders' Meeting. These are outlined in the "Equity-based Compensation*" for the Management Board" section below.

In 2006, 25,000 stock options were granted to Dr. Marlies Sproll in connection with her appointment as Chief Scientific Officer. Additionally, 14,248 convertible bonds were granted to members of the Management Board in 2006. The value of the stock options and convertible bonds granted to members of the Management Board under the 2002 option and convertible bond plan attributable to fiscal year 2006 totaled € 676,399 (2005: € 697,410).

During 2006, members of the Management Board exercised convertible bonds and subsequently sold the new shares. Further details are given in the schedule provided under “Directors’ Dealings” in MorphoSys’s Corporate Governance Report.

No credit or similar benefits were granted to members of the Management Board. In the year under review, the Management Board members received no benefits from third parties that were either promised or granted in view of their position as a member of the Management Board.

The service contracts for the Chief Executive Officer Dr. Simon E. Moroney and the Chief Financial Officer Mr. Dave Lemus have a term of three years each. Dr. Marlies Sproll was appointed as Chief Scientific Officer for the first time in November 2005; her respective service agreement has a term of two years. In the event of a non-reappointment and non-prolongation of the service agreement, each member of the Management Board is entitled to receive a severance payment in the amount of one annual fixed salary. If the service contract of a member of the Management Board is terminated by death, his/her spouse or partner for life is entitled to the monthly fixed salary for the month of death and the following twelve months. After a change of control transaction, each member of the Management Board is allowed to extraordinarily terminate his/her service contract and may demand the outstanding fixed salary for the remaining contractually provided term of contract, or two years, whichever is greater. Furthermore, in such a case, all granted stock options and convertible bonds shall be treated as immediately vested.

REMUNERATION OF THE SUPERVISORY BOARD

The compensation of the members of the Supervisory Board is specified by resolution of the Annual Shareholders’ Meeting. In accordance with the German Corporate Governance Code, members of the Supervisory Board receive fixed as well as performance-related compensation. It takes into account the responsibilities and scope of tasks of the members of the Supervisory Board as well as the economic situation and performance of the Company.

In the 2006 fiscal year, the members of the Supervisory Board received a total of € 259,000 (2005: € 190,500), excluding reimbursement of travel expenses, which was in accordance with the Annual Shareholders’ Meeting resolution of May 17, 2006. This amount consists of fixed remuneration and attendance fees.

The table below shows the detailed compensation for the Supervisory Board in 2006:

in €	FIXED COMPENSATION	VARIABLE COMPENSATION	TOTAL COMPENSATION
Dr. Gerald Möller, Chairman	40,000	24,500	64,500
Prof. Dr. Jürgen Drews, Deputy Chairman	30,000	11,000	41,000
Dr. Daniel Camus	25,000	20,000	45,000
Dr. Metin Colpan	25,000	7,500	32,500
Prof. Dr. Andreas Plückthun	23,500	7,500	31,000
Dr. Geoffrey N. Vernon	26,500	18,500	45,000

The German Corporate Governance Code proposes that remuneration of the Supervisory Board should also include components based on the long-term success of the Company. The Annual Shareholders' Meeting of MorphoSys AG decided on May 17, 2006, in favor of a revenues-related compensation program in the form of phantom stocks. In addition to the cash compensation, the Supervisory Board members will receive these phantom stocks, subject to a performance hurdle. A phantom stock is a claim on the Company to a cash payment of the difference between the stock exchange price at the end of the holding period and the exercise price. The holding period for phantom stocks is three years, beginning with the issue date on January 1, 2007, and ending on December 31, 2009. An amount will only be paid if the Company's consolidated revenues for the year show an average annual growth rate of at least 20%. In total, payments by the Company under this plan to the Supervisory Board as a whole must not exceed the amount of € 80,000 ("cap").

The Chairman of the Supervisory Board has received 2,500 phantom stocks, the Deputy Chairman 2,000 phantom stocks, and the members of the Supervisory Board 1,500 phantom stocks each.

In 2006, MorphoSys entered into consulting agreements with the member of the Supervisory Board Prof. Dr. Andreas Plückthun and another scientist of Prof. Dr. Plückthun's research team at the University of Zurich, Switzerland, ending December 2008. According to the agreements, the consultants shall provide consulting services in the antibody and scaffold fields. Under this agreement, Prof. Dr. Andreas Plückthun may receive payments of up to € 14,000 per year, depending on the extent to which the Company draws on his consultancy. Additionally, MorphoSys pays a yearly fee of SFr. 135,000 for its sponsored research agreement to the University of Zurich, represented by Prof. Dr. Andreas Plückthun. Both agreements were approved by the Supervisory Board plenum. No other consultancy agreements with members of the Supervisory Board are currently in place.

No members of the Management Board or the Supervisory Board were granted Company loans.

EQUITY-BASED COMPENSATION FOR THE MANAGEMENT BOARD**STOCK OPTIONS AND CONVERTIBLE BONDS**

The Supervisory Board also decides each year on the number of stock options or convertible bonds to be allocated to the Management Board members. Stock options are only granted in the event of a new appointment of a member of the Management Board or in the case of a renewal of a service agreement. Every year, all employees, including the Management Board, are offered convertible bonds as a mid-term performance-related compensation component.

Since the implementation of equity-based compensation programs at MorphoSys AG, stock options or convertible bonds are only issued twice a year on the same predefined dates. The following overview shows the number of stock options and convertible bonds issued in 2006 to members of the Management Board (please see also 2002 Employee Stock Option Program and 2002 Employee Convertible Bond Program, see sections 15 and 16 of the Notes to the Consolidated Financial Statements) and their potential current value:

MEMBER OF MANAGEMENT BOARD	NUMBER OF CONVERTIBLE BONDS	STRIKE PRICE in €	GRANT DATE	EXPIRY DATE	FAIR VALUE OF ONE STOCK OPTION/CON- VERTIBLE BOND in €	FAIR VALUE AT THE TIME OF THE GRANT in €
Dr. Simon E. Moroney	5,699	44.12	Jan. 15, 2006	Dec. 31, 2008	14.03	79,957
Mr. Dave Lemus	4,749	44.12	Jan. 15, 2006	Dec. 31, 2008	14.03	66,628
Dr. Marlies Sproll	3,800	44.12	Jan. 15, 2006	Dec. 31, 2008	14.03	53,314
	NUMBER OF STOCK OPTIONS					
Dr. Marlies Sproll	25,000	44.12	Jan. 15, 2006	Dec. 31, 2011	18.66	466,500

STOCK OPTION PROGRAMS

The current stock option plan of 2002 provides for the issuance of nontransferable option rights to employees and to the Management Board. The option rights have a maximum life of five 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 number of vested option rights, on the condition that the value of the underlying stock has exceeded the stock price at the time of the grant by at least 20% on one trading day before the exercise.

CONVERTIBLE BOND PROGRAMS

The current convertible bond program of 2003 provides the issuance of non-interest-bearing convertible bonds with a par/nominal value of € 1.00 each to employees and to the Management Board. The beneficiaries may only exercise the conversion rights after the expiration of a waiting period of one year after the grant date. Each convertible bond with a nominal value of € 1.00 can be exchanged for one share of ordinary no-par value common stock of the Company against payment of the exchange price. Furthermore, the exercise of the convertible bonds is subject to the performance target that the value of the underlying stock has exceeded the stock price at the time of the grant by at least 10% on one trading day before the exercise.

For a more detailed description of the various stock option and convertible bond programs currently in operation, see sections 15 and 16 of the Notes to the Consolidated Financial Statements.

SUSTAINABILITY AND CORPORATE SOCIAL RESPONSIBILITY

The Company is active in the healthcare sector, and has developed new technologies for the generation of fully human antibodies for therapeutic applications, but also for research and diagnostics purposes. MorphoSys's technologies can help improve treatment options for life-threatening diseases within an aging population. The demand for innovative therapeutics, helping to ameliorate the quality of life of patients, is constantly increasing and allows the Company to grow its business globally.

MorphoSys is dedicated to sustainability and corporate social responsibility, as is clearly described in MorphoSys's credo. The management of the Company is convinced that responsible and effective environmental protection and good corporate citizenship are essential to entrepreneurial success. In 2003, MorphoSys introduced a code of ethics directed at the members of the Management Board and those persons of the Company responsible for finance, controlling and accounting at the Company. Senior Management and the Company's financial staff play an important and distinctive role within the Company's corporate governance in that these personnel are authorized and entrusted to ensure that accurate financial information is provided to investors quickly. The code of ethics – together with the related internal standards and policies, e.g. for safety, health and environmental protection – regulate corporate procedures and responsibilities.

MorphoSys is increasingly active in fulfilling its role as a socially responsible company. One of MorphoSys's main goals in regard to corporate culture and human resources is to secure a healthy work-life balance for its employees and their families. As a part of this effort, MorphoSys – together with other Munich-based biotechnology companies – founded a local kindergarten called "BioKids" in 2002 and has supported this both financially and in terms of active participation since that time. A member of MorphoSys has been consistently on the advisory board of the holding company Kita BioRegio e.V., which represents "BioKids."

Due to a change in the German education system, schools will be seeking closer collaborations with industry partners from 2007 onwards in order to prepare students for an earlier entry into working life. MorphoSys supports this program. As a part of its open-door policy, MorphoSys already presents itself on a regular basis to visitors at an annual open house and throughout the year.

MorphoSys offers wide-ranging employment opportunities, offering employment for school-leavers looking for vocational training, graduate students' diploma thesis as well as internships for students and technical assistants.

At the end of each year, the employees of MorphoSys AG support a local charitable non-profit organization with private donations. In 2006, MorphoSys's staff donated approximately € 1,000 to Lebenshilfe e.V. Schmalkalden, an organization supporting handicapped people.

INFORMATION TECHNOLOGY

MorphoSys continued its growth of head count and operations in 2006. For that reason, an IT infrastructure was introduced, in particular for server consolidation. All affiliates are members of the MorphoSys worldwide IT network, to improve business performance and ensure business continuity.

During 2006, all newly acquired affiliates were integrated into the corporate network to ensure the secure and reliable exchange of data and information. Administration of all affiliates is performed at the Company's headquarters in Munich. A global IT policy was implemented to introduce Group-wide security standards and worldwide use of data and applications.

All products from the former Biogenesis and Serotec units were merged into a new database. The launch of a new Web shop, which will be based on the new product database, is scheduled for the first half of 2007.

MorphoSys completed a relaunch of the corporate portal in June 2006. The relaunch was necessary to fulfill the increasing requirements of the two business segments of MorphoSys. It provides a comprehensive information platform of all business aspects for MorphoSys's customers, partners and shareholders.

The IT department of MorphoSys has developed a new business offer, supplying MorphoSys's partners with new bioinformatics software for sequence analysis of identified HuCAL antibodies. This system, named SAS, has already been installed at Merck & Co., and the installation for Novartis is scheduled for early 2007.

MorphoSys currently plans to implement a new ERP (enterprise resource planning) software for its S,G&A functions. Once established, it is anticipated that the new software system will be implemented across the MorphoSys Group (including its subsidiaries in the United States and the United Kingdom) after 2007.

In December 2006, MorphoSys received Microsoft's annual EMEA Customer Award at the Microsoft Convergence 2006 EMEA conference in Munich, Germany, for its innovative IT.

PROCUREMENT AND PRODUCTION

MorphoSys purchases raw materials and supplies from numerous suppliers. The Company procures all needed material from international suppliers, and tends to place its purchase orders with the most favorably priced suppliers, taking into consideration all relevant quality aspects. MorphoSys aims to secure strategic materials through medium- and long-term contracts, and has not experienced difficulties in obtaining sufficient amounts of raw materials and supplies in recent years. The price of raw materials and supplies may vary substantially.

MorphoSys produces human antibodies for research applications in the milligram to gram or more scale. For production purposes, MorphoSys has access to different expression systems, such as cell lines and expression vectors. For the expression of antibody fragments, MorphoSys uses bacterial expression systems, and has access to Wacker's secretion system for antibody fragment production. For the production of full IgGs, for example, MorphoSys uses the HKB.11 cell line in-licensed from Bayer and the PER.C6[®] cell line from Crucell.

For the production of clinical-grade material of MOR103, MorphoSys has signed a license agreement with Dutch biotechnology company Crucell N.V. and a biopharmaceutical manufacturing agreement with its technology partner DSM Biologics.

During 2006, MorphoSys achieved substantial discounts through global sourcing. As an example, all computer hardware is purchased from a global vendor, and the Company has established a global software license management system through its headquarters in Munich.

ENVIRONMENTAL PROTECTION AND QUALITY MANAGEMENT

Since high standards for quality, environmental protection and safety are critical success factors for MorphoSys, all relevant environmental issues are regularly monitored and assessed. The Company's entire waste disposal system is continually reviewed and evaluated with respect to the potential for improvement.

MorphoSys is not subject to direct regulation other than regulation generally applicable to businesses like itself. This includes various laws and regulations in effect in the different jurisdictions in which the Company operates, including laws and regulations applicable to environmental matters, such as the handling and disposal of hazardous wastes. In total, the Company's research and development activities involve only small amounts of hazardous materials and chemicals.

QUALITY MANAGEMENT

Within the framework of our quality management system, all business processes are continuously scrutinized and enhanced. Continuous improvement processes are an element of all of the Company's processes.

One of the areas of focus for the Therapeutic Antibodies segment was the establishment of new and innovative analytical methods and biological assays for in-depth characterization of the Company's antibodies. The innovation process was triggered to further improve the therapeutic antibody development process by applying efficient selection and quality filters in the antibody generation process early on. Quality management does not only mean ease of application, convenience and high product performance, but also comprehensive product safety and testing, which are mandatory parameters for entering clinical trials.

Within the AbD segment, quality is the key to delivering a market-leading solution, and ISO9001:2000 accreditation, the European quality standard, has been in place at Serotec Ltd. since December 1994, and at Serotec, Inc. as well as Serotec France since May 2003. This quality system provides a sound framework from which to operate.

AbD sells a group of "CE" marked products that conform to the directives of the *in vitro* Medical Device Regulations and can be sold and used by customers as *in vitro* Medical Diagnostic Devices. Serotec Ltd. is planning to implement ISO13485:2006, the European standard for businesses involved in medical devices and *in vitro* diagnostic medical devices in 2007, and is currently working towards the implementation of good manufacturing practice (GMP). AbD is dedicated to delivering customers a solution and not just a product, no matter what they order or where they work. This commitment to customer satisfaction is demonstrated by means of a global quality guarantee and a free antibody location service.

DECLARATIONS PURSUANT TO § 315 PARA. 4 OF THE GERMAN COMMERCIAL CODE

1. As of December 31, 2006, the Company's share capital amounted to € 20,145,966 and is divided into 6,715,322 no-par value bearer shares. With the exception of 29,162 own shares, all issued shares are exclusively common shares with voting rights. The Management Board is not aware of any restrictions of the voting rights or the right to transfer. This also applies to restrictions which may result from shareholders' agreements. The Company has not been notified of direct or indirect shareholdings in its share capital exceeding 10% of the voting rights pursuant to § 21 German Securities Trading Act ("WpHG"). There are no owners of shares with privileged rights or other rights giving a right to control votes.
2. Pursuant to § 6 of the Company's Articles of Association, the Management Board shall consist of at least two members, with the Supervisory Board defining the concrete number of the members of the Management Board. The Supervisory Board may appoint a Chief Executive Officer and one or several representatives of the CEO.
3. The shareholders have provided the Management Board with the following authorizations to issue new shares or conversion rights or to purchase own shares:
 - 3.1 Pursuant to § 5 para. 5 of the Articles of Association and with the approval of the Supervisory Board, the Management Board is authorized to increase the Company's share capital during the time period until April 30, 2011, in the amount of up to € 7,481,307 and by issuing 2,493,769 young bearer shares with no-par value for contribution in cash and/or in kind on one or several occasions (Authorized Capital I). The Management Board may, with the approval of the Supervisory Board, exclude the preemptive rights of the shareholders under the following conditions:
 - 3.1.1 in the case of a capital increase in cash, to the extent that such exclusion is necessary to avoid fractional shares; or
 - 3.1.2 in the case of a capital increase in kind, to the extent that the young shares are used for the acquisition of companies, shareholdings in companies, patents, licenses or other industrial property rights, or of assets which constitute a business in their entirety; or
 - 3.1.3 in the case of a capital increase in cash, to the extent that young shares shall be placed at a stock exchange in context with a listing.
 - 3.2 Pursuant to § 5 para. 6 of the Articles of Association and with the approval of the Supervisory Board, the Management Board is authorized to increase the Company's share capital in cash during the time period until April 30, 2011, by up to € 1,956,564 by issuing up to 652,188 young bearer shares with no-par value (Authorized Capital II). The preemptive rights of the shareholders may be excluded if (i) fractional shares are avoided and/or (ii) the issuance price of the young shares is not substantially below the stock exchange price of the listed shares of the same kind at the time of the final fixing of the issuance price.

- 3.3 Pursuant to § 5 para. 6 b of the Articles of Association, the Company's share capital shall be conditionally increased by an amount of up to € 5,488,686, divided into up to 1,829,562 bearer shares with no-par value (Conditional Capital III). The conditional capital increase shall only be accomplished (i) to the extent that owners of options and/or convertible bonds make use of their option and/or conversion rights issued by the Company until April 30, 2011, in accordance with the resolution of the Annual Shareholders' Meeting or (ii) to the extent that owners fulfill their duties to convert. The same shall apply to owners of options and/or convertible bonds issued by domestic or foreign affiliates, which are totally owned by the Company.
- 3.4 Furthermore, there exists a Conditional Capital I in the amount of up to € 46,785 (§ 5 para. 4 of the Articles of Association), a Conditional Capital II in the amount of up to € 644,325 (§ 5 para. 6 a of the Articles of Association), a Conditional Capital IV in the amount of up to € 1,393,761 (§ 5 para. 6 c of the Articles of Association) and a Conditional Capital V in the amount up of € 1,031,961 (§ 5 para. 6 d of the Articles of Association). These conditional share capitals may be used for the issuance of option and conversion rights to members of the Management Board and to employees of the Company or of its affiliates.
- 3.5 According to the resolution of the ordinary Annual Shareholders' Meeting 2006, the Company may purchase own shares in the amount of up to 10% of the share capital existing at the time of the said resolution. This authorization is valid until October 31, 2007. The Management Board may decide whether the shares shall be acquired as purchase order in the stock market or by virtue of a public offer. The acquired own shares may be used for the following purposes:
- 3.5.1 with the approval of the Supervisory Board, the shares may be redeemed; or
 - 3.5.2 the shares may be used in order to fulfill conversion rights or option rights which have been granted by the Company or an affiliate; or
 - 3.5.3 the own shares may be used as acquisition currency in context with the purchase of companies, shareholdings in companies, business assets, intellectual property rights or licenses.
4. After a change of control transaction, each member of the Management Board is allowed to extraordinarily terminate his/her service contract and may demand the outstanding fixed salary for the remaining contractually provided term of contract or for two years, whichever is greater. Furthermore, in such a case, all granted stock options and convertible bonds shall be treated as immediately vested. The same applies to some of the directors of the Company to whom options or conversion rights have been granted.

Additionally, the Company has commercial contracts with pharmaceutical partners, which may be affected in the event of a change of control and could affect future cash flows significantly.

RISK REPORT

MorphoSys AG operates on a global basis. Its business activities comprise different risks, which are relevant to many business functions. The business, financial condition and operating results of MorphoSys may be materially adversely affected by each of these risks. In line with the German “Corporate Sector Supervision and Transparency Act” (“Gesetz zur Kontrolle und Transparenz im Unternehmensbereich” – KonTraG), MorphoSys has established a comprehensive and effective system to identify, assess, communicate and manage risks across its functions and operations. Risk management has the goal of identifying risks as early as possible, limiting business losses by means of suitable measures, and avoiding risks that pose a threat to the Company’s existence. Regular risk analyses at a corporate level are carried out in the areas of Legal, Taxes and Insurance, Human Resources, Finance, Corporate Communications, Strategic Planning and Controlling, Business Development, Research and Development as well as Production.

GENERAL BUSINESS-RELATED RISKS

MorphoSys is subject to the typical industry and market risks inherent to the development of fully human antibodies for use in research, diagnostics and therapy. It is known that the development of drugs takes 10 to 15 years, with high attrition rates. MorphoSys is minimizing these risks by partnering its products with pharmaceutical and biotechnology companies, which are responsible for clinical development and marketing. In general, there is a risk that none of the antibody products in MorphoSys’s current antibody pipeline will be successfully developed. Within its second operating segment, the MorphoSys Group generates antibodies for research applications and diagnostics applications. There is a risk that those products will not fulfill the requirements of the customers, or that other products will be more favorably priced.

ACQUISITION RISKS

During 2006, MorphoSys acquired the Serotec Group, through which the Company has gained access to new distribution and sales channels. In the future, MorphoSys may acquire additional companies or technologies to increase market share and to complement existing business. Acquisition can expose the Company to risks associated with the assimilation of new technologies, operations, sites and personnel, the inability to generate revenues to offset acquisition costs, the issuance of dilutive equity securities, the inability to maintain relationships with employees and customers, and the incurring of additional expenses associated with future amortization or impairment of acquired intangible assets or potential business. The failure to address the aforementioned risks may prevent the Company from achieving the anticipated benefits from the acquisition within a reasonable time frame.

PRODUCT DEVELOPMENT RISKS

MorphoSys is committed to generating therapeutic antibodies for its commercial partners and, more recently, on its own account. Thus, the Company's product pipeline comprises both partnered and proprietary therapeutic antibody development programs. These programs are subject to a number of risks of failure inherent in the development of medical therapies. Product candidates require preclinical studies and clinical trials in humans as well as regulatory approval prior to commercialization. To date, none of the Company's licensees or partners has commercialized a product based on MorphoSys's HuCAL technology, and HuCAL-derived therapeutics are not expected to be commercially available for a number of years. In addition, none of the HuCAL-derived product candidates has successfully completed all stages of clinical testing and regulatory approval procedures. Preclinical and ongoing phase 1 studies may not predict and do not ensure safety or efficacy in humans, and are not necessarily indicative of the results that may be achieved in pivotal clinical trials with humans.

COMPETITION AND TECHNOLOGICAL CHANGE

MorphoSys's business environment is characterized by rapid change and intense competition. Its competitors include major pharmaceutical, chemical and biotechnology companies possessing greater financial, technical and marketing resources than those available to MorphoSys. In addition, certain biotechnology companies have formed collaborations with large established pharmaceutical companies to support the research, development and commercialization of products that may be competitive with those of MorphoSys. Moreover, certain research and academic institutions are also active in areas similar to those of MorphoSys. Some of MorphoSys's competitors are currently focusing their business efforts on gaining a share of the market and offer their technology at little or no cost to collaboration partners. The first pharmaceutical product to reach the market is often at a significant advantage to later entrants, particularly since subsequent potential entrants must prove an advantage of their product over products already on the market. There is a risk that MorphoSys's competitors could succeed in developing technologies and products that are safer, less costly and more effective than its technologies or products. In addition, there is a risk that these technologies could produce products that reach the market earlier and could be more successful than those developed by MorphoSys.

PRODUCT RISKS

The marketing and sale of antibody products and services for certain applications entails a potential risk of product liability, and there can be no assurance that product liability claims will not be brought against the Company. MorphoSys currently carries product liability insurance coverage. There can be no assurance, however, that the Company will be able to maintain such insurance at a reasonable cost and on reasonable terms or that such insurance will be adequate to protect MorphoSys against any or all potential claims or losses.

DEPENDENCE ON HEALTHCARE AND PHARMACEUTICAL SPENDING

MorphoSys is dependent on various sources of income, including, in particular, fees, milestone payments and royalties from licensees and partners, the financial condition of public treasuries and the financial markets, the government and governmental health authorities, research institutions, private health insurers and other organizations. Part of MorphoSys's revenues is derived from entering into collaborations with partners, including pharmaceutical companies. Many collaborative and/or out-licensing agreements provide for milestone payments and fees to be paid subject to the satisfaction of specific criteria. MorphoSys has no control over whether its partners or licensees will be able to meet such milestones, nor will MorphoSys be able to control whether products derived from its technology are being developed at all by its partners. Moreover, certain pharmaceutical companies may be more likely to seek to in-license products which have already reached a relatively advanced stage of development, such as phase 2 compounds, as opposed to less advanced product candidates still in preclinical stages. Consequently, the products in MorphoSys's pipeline may not reach a sufficiently advanced stage of development to be of interest to these pharmaceutical companies for some time. Therefore, the Company can offer no assurance that there will be a guaranteed revenues stream from current or future collaborations.

IP RISKS

MorphoSys has been involved in legal proceedings in Germany and certain foreign jurisdictions, including the United States. These involve claims brought by and against it for license or patent infringement, which arose in the ordinary course of business. After the settlement of the litigation with Applied Molecular Evolution/Eli Lilly in September 2005, no significant patent litigation is pending. However, the field of recombinant antibody libraries and phage display, in which the Company is active, is relatively new, and the intellectual property position of the various parties involved is complex and litigious. Therefore, MorphoSys can offer no assurance that further patent suits will not be brought by companies possessing existing patents or patents which have not yet been granted or which the Company is currently not aware of. Any such proceedings, if brought and subsequently decided against MorphoSys, could have an adverse material effect on the business, financial condition and operating results of MorphoSys.

ADDITIONAL FUNDING REQUIREMENTS

MorphoSys's future capital requirements will continue to be substantial and will be dependent on many factors, including its ability to find licensees and to enter into satisfactory collaboration agreements, as well as the success of such collaborations in generating revenues (e.g. licensing fees, milestone payments and royalties). The costs of the preclinical testing of MorphoSys's products and technologies and the costs associated with filing, defending and enforcing patent rights may exceed the returns from these products. MorphoSys may also need to raise additional funds in future years. The Company can offer no assurance that adequate funds will be available to MorphoSys when needed on satisfactory terms or at all. If adequate funds are not available or are not available on acceptable terms, MorphoSys may have to reduce its expenditures for research and development, production or marketing. Any such development could have an adverse material effect on MorphoSys's business, financial condition and results of operations. If additional funds are raised by issuing shares, stockholders are likely to experience a dilution of their interests.

CURRENCY RISKS

The Group accounts are administered in euros. A significant portion of revenues and expenses are earned and incurred in currencies other than the euro. Although the euro is the most predominant currency, others, especially the US dollar, and the British pound, and to lesser degrees the Swiss franc and the Japanese yen may experience fluctuations in the exchange rate to the reporting currency of euro, thus impacting financial results. The Company examines the necessity of hedging foreign exchange transactions to minimize the currency risk during the year and attempts to address these risks by regularly employing derivative financial instruments.

INTEREST RATE RISKS

Interest income earned on our available-for-sale financial assets is affected by changes in the relative level of market interest rates. The Company follows an investment policy which dictates that all investments must have at least an investment grade (BBB+) rating to qualify as an investment.

DEPENDENCE ON KEY PERSONNEL

MorphoSys has not experienced any difficulties in attracting or retaining key management or scientific staff, but the continued ability to recruit and retain qualified skilled personnel is critical to the Company's success. Due to the intense competition for experienced scientists from numerous pharmaceutical and biotechnology companies and academic and other research institutions, there can be no assurance that MorphoSys will be able to attract and retain such personnel on acceptable terms. Planned activities will also require additional personnel, including management, with expertise in different areas. The inability to recruit such personnel or develop such expertise could have an adverse material impact on the Company's operations.

OTHER RISKS

Further, MorphoSys continuously monitors applicable environmental, health and safety, operational as well as other applicable statutory or industrial guidelines, and has implemented functions to comply with all of these effectively at each of our business locations. To minimize the manifold tax, corporate, employment, competition, IP and other legal frameworks, the Company's management bases decision making and design of policies and processes on the advice of external as well as internal experts. There could be other risks beyond risks described here that MorphoSys currently either deems as insignificant or is not aware of at the time of this report.

OPPORTUNITIES

The growing demand for healthcare will be met not only by using existing therapies, but also by new ones originating from advances in the understanding of the biology of disease and the application of new technologies. Innovative new products have been launched in recent years, which are changing therapeutic approaches and are improving the quality of life for patients. In addition, due to fast-developing economies such as India and China, the number of patients who can benefit from medicines is expanding. Taken together, these factors represent a significant opportunity for the healthcare industry.

MorphoSys is providing a cutting-edge technology for the development of fully human antibodies. Human antibodies have proven to be an extremely successful class of drugs, with tremendous growth potential. The demand for antibodies and the interest of the industry in this class of drugs has sharply increased over the last 12 to 18 months, clearly underpinned by several acquisitions and large licensing agreements in this field. But not only the use of antibodies as therapeutics, but also for research purposes and diagnostics applications, represents future growth opportunities for MorphoSys.

THERAPEUTIC ANTIBODIES

MorphoSys has established itself as one of the leading providers of fully human therapeutic antibodies. During 2005 and 2006, the scope of competition substantially decreased through the acquisitions of two major competitors. Only a few companies offer technologies to develop fully human antibodies. During the last years, MorphoSys has built up a strong international patent portfolio, and has secured its freedom to operate and to commercialize its technologies worldwide. Today, MorphoSys owns several issued and pending patents on its core antibody technologies, which provide the Company with protection from competition. Due to high market entry barriers for new companies, an increasing demand for antibody therapeutics as well as a decrease in competition, MorphoSys expects an increasing number of antibody programs and partnerships over the coming years.

By participating in drug development with multiple partners, MorphoSys has effectively lowered its risk profile. With currently more than 40 active therapeutic antibody development programs ongoing with its partners, the chance that MorphoSys will participate financially in one or more marketed drugs is much higher than if fewer partnerships and fewer programs were ongoing. As time goes on and development projects advance, it is expected that both the number and the magnitude of success-based payments will increase.

MorphoSys is also developing therapeutic antibodies for its own account. Currently, two compounds, MOR103 and MOR202, are in preclinical development. The Company plans to increase its investments in its own development programs and intends to develop the antibody MOR103 for the treatment of rheumatoid arthritis at least as far as proof of concept in man (phase 2a). By taking its internal programs forward without a partner, the Company stands to benefit from more lucrative financial terms at such time when an alliance for further development is signed.

RESEARCH ANTIBODIES

Through the acquisitions of Biogenesis and Serotec, MorphoSys established itself within the top 20 of the worldwide leading providers of antibodies and antibody technologies for research and diagnostic applications. AbD is a full-service antibody company offering a unique custom monoclonal antibody technology, a huge selection of ready-made antibodies, large-scale antibody production from hybridomas, and a variety of other antibody services. The Company has established a strong base from which to commercialize HuCAL-derived antibodies in the research and diagnostics markets. These markets have traditionally been totally dominated by antibodies derived from animals. MorphoSys intends to lead the transition to new *in vitro* technologies for antibody generation. In contrast to animal-based methods, *in vitro* technologies, such as the HuCAL library, offer greater speed, throughput and flexibility in antibody generation.

The Company has demonstrated its ability to complete acquisitions in this segment of the industry and to use these transactions to accelerate its growth. MorphoSys intends to continue using a merger and acquisition strategy to augment strong organic growth as a means of increasing its market share and achieving its growth objectives. From its current position as a leader in the European market, the Company expects to become one of the leading global players in this field.

PERFORMANCE-BASED MANAGEMENT AND CONTROL

The Group is managed and controlled within the framework of a performance-based management system. Our objective is to systematically and continuously increase the value of the enterprise – through profitable growth and a focus on businesses which offer the best development opportunities in terms of competitiveness and performance. An integrated control concept, value-based performance indicators together with measures to enhance efficiency and growth as well as optimize capital employed are key elements of our management system.

Operational business performance is measured on the basis of revenues and profit from operations. On a quarterly basis, budget planning for the current fiscal year is reviewed and updated. Furthermore, a mid-term planning scenario covering the upcoming years is updated on an annual basis.

Key performance indicators for the two operating segments include:

in €	12/31/2005	12/31/2006	12/31/2007 (FORECAST)
MORPHOSYS GROUP			
Group revenues	33.5 million	53.0 million	60–65 million
Group profit from operations	6.2 million	6.2 million	7–10 million
THERAPEUTIC ANTIBODIES SEGMENT			
Revenues	29.1 million	34.7 million	2/3 of total Group revenues
Number of partnered therapeutic antibody projects	29	43	50
Number of proprietary therapeutic antibody projects	4	2	2
ABD SEGMENT (INCLUDING SEROTEC FROM JANUARY 12, 2006, ONWARDS)			
Revenues	4.3 million	18.3 million	1/3 of total Group revenues

The Company is presently reviewing additional key performance indicators beyond those listed above.

OUTLOOK AND FORECAST

Despite the slight weakening of the global economy, the market environment is anticipated to remain generally favorable. For 2007, MorphoSys anticipates that it will further increase its market share for the application of human antibodies in therapeutics, research and diagnostics. A growth-oriented strategy provides the road map for MorphoSys's future development.

DEVELOPMENT OF THE HEALTHCARE SECTOR

According to IMS Health, the healthcare sector is expected to grow with only 5% to 6% – the lowest growth rate in years. Reasons for the lower growth rates are patent expiries and the reform of the healthcare systems within the industrialized countries. During 2007, therapeutic products with an annual sales value of US \$ 16 billion are expected to lose patent protection. This will impact revenues and profits of pharmaceutical companies. For 2007, the approval of 25 to 35 new drugs is anticipated, e.g. GlaxoSmithKline's breast cancer drug Tykerb® or Novartis's Tasigna®, a new treatment for chronic myeloid leukemia. However, many of those new products target smaller niche indications, and will not contribute to stronger sales growth.

The trend towards consolidation through M & A activities will continue with even more deals than in 2006, especially between pharmaceutical companies and biotechnology companies with innovative drugs or technologies.

STRATEGY

Looking forward, MorphoSys will continue to conduct its business in two operating segments. Both segments are forecast to further grow and to increase market share within the antibodies industry. The Company aims to sign additional partnerships with leading international research institutions and to establish the proprietary HuCAL technology as an industry standard for antibody generation.

Additionally, the Company will continue to invest in proprietary drug development, as well as in technology development, to ensure its technological leadership. For its lead program MOR103, MorphoSys has planned to file all necessary applications to commence a phase 1 clinical trial in the second half of 2007. For MOR202, a preclinical candidate had been selected by the end of 2006. The Company intends to continue preclinical development of its second compound.

The Research Antibodies segment (AbD) is expected to keep expanding its market share. AbD will focus on Web-based commercialization of its products, with sophisticated technical services and customer support. One goal is to introduce novel research antibodies of high interest rapidly, and to increase the number of HuCAL-based products in the catalog. Additionally, the unit will seek to sign further strategic distribution agreements with large research antibody suppliers.

REVENUES

In line with growth expectations for a life sciences “growth” company, MorphoSys sees its long-term organic revenues growth averaging at at least 15% per annum. For 2007, MorphoSys anticipates total revenues of € 60 million to € 65 million and organic growth of 15% to 25% in comparison to 2006.

In 2007, the Therapeutic Antibodies segment will provide approximately two-thirds of total revenues. MorphoSys receives periodic license payments, funded research payments, performance-based success payments, and clinical milestones. In 2007, it is anticipated that milestones and success-based payments will contribute an increasing percentage of total revenues as compared to previous years. Such performance-based payments lend themselves to potentially higher upside, but also more volatility and unpredictability throughout the year.

Revenues from the Research Antibodies segment (AbD) are expected to further increase and account for approximately one-third of total 2007 revenues. Revenues from the AbD segment comprise revenues for ready-made antibodies from the antibody catalogs, revenues for custom monoclonal antibody services, and revenues for contract manufacturing services.

EXPENSES

In 2007, expenses are expected to continuously increase due to a higher full-year total average head count of the MorphoSys Group as compared to the previous year. Further increases in costs are likely to arise from new investment into proprietary product development and technology development.

PROFIT FROM OPERATIONS

The MorphoSys Group is committed to future growth on a profitable basis. On the Group level, MorphoSys intends to achieve a profit from operations of € 7 million to € 10 million.

RESEARCH AND DEVELOPMENT

As in the past, research and development is to remain the key focus in coming years. MorphoSys intends to continue its investments in technological improvement in the area of human antibodies. Additionally, the Company is developing proprietary therapeutic antibody candidates in the area of inflammation (MOR103) and oncology (MOR202). Expenses for product development will increase with the advancement of those programs.

HEAD COUNT

During 2007, increase in head count is mainly contingent upon new partnerships or expansions of existing business activities to support this.

FINANCING

MorphoSys has been cash flow positive since 2003, and the current business model is predicated on running operations independent of the capital markets. Free cash flow and profits from operations are intended to be reinvested into research and development as well as in future growth opportunities in order to secure the long-term growth of the Company. On this basis, additional financing required for the continuation of normal operations is currently not foreseen in 2007. However, financing of future acquisitions cannot be excluded per se on this basis.

FUTURE CORPORATE STRUCTURE AND ORGANIZATION

A streamlining of the Group's corporate structure is planned for 2007, in order to increase administrative efficiency and streamline reporting processes. In that vein, the two US companies were merged under the name MorphoSys US, Inc., in January 2007.

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. The Company's German statutory accounts showed taxable income in 2006; however, as of December 31, 2006, and 2005, they reflected no accumulated earnings available for distribution, and the Company's ability to pay dividends will therefore depend upon its future earnings.