Market and Strategy – Value Added from Research to Clinical Development

During the fiscal years 2005 and 2006, MorphoSys successfully expanded its business by opening new markets geographically and by enabling broader use of its HuCAL technology. In the Therapeutic Antibodies segment, in which MorphoSys is developing drug candidates for both its own pipeline and for its partners, the company has achieved growth in all of the largest pharmaceutical markets: the USA, Europe and, increasingly, Asia. The second operating segment, AbD Serotec, markets research antibodies to meet the growing needs of universities, institutes and companies worldwide.

DEMAND FOR ANTIBODY DRUGS REMAINS DRIVER FOR GROWTH

Therapeutic antibodies continue to be one of the fastest-growing segments of the pharmaceutical industry. In 2006, the 20 approved antibody drugs on the market achieved total sales of approximately US$ 15 billion – representing a revenue increase of 25 % over the prior year's growth. Six of these antibodies achieved blockbuster status, each with annual sales in excess of US$ 1 billion. During 2006, two new antibody-based drugs, Lucentis® for the treatment of age-related macular degeneration (AMD*) and Vectibix™ for the treatment of metastatic colon cancer, received FDA* approval. In addition, after being withdrawn in 2005 by Biogen Idec and Elan due to side effects, the multiple sclerosis drug Tysabri®, was again approved for marketing with amended safety instructions.

LIST OF THE BLOCKBUSTER PRODUCTS

In 2006 six therapeutic antibodies achieved blockbuster status, each with annual sales in excess of US$ 1 billion.

DRUG	MARKETED BY	INDICATION	REVENUES 2006 IN US$ BILLION
Remicade®	Centocor/J&J/ Schering-Plough	Inflammation	3.0
Rituxan®	Genentech/ Biogen Idec/Roche	Oncology	2.2
Humira®	Abbott	Inflammation	2.0
Avastin®	Genentech/Roche	Oncology	1.9
Herceptin®	Genentech/Roche	Oncology	1.3
Synagis®	MedImmune	Virus infection	1.1

Due to the success of therapeutic antibodies, the pharmaceutical industry is continuing to intensify its activities with this class of drug. In 2006, numerous companies publicly announced their intention to invest more heavily in biologicals, in some cases explicitly stating a focus on antibody-based drugs. MorphoSys therefore anticipates a further increase in the already high demand for antibody-based technologies and products.

In addition to a growing commitment to internal antibody drug research and development, in 2006, several pharmaceutical companies gained access to antibody technologies or advanced antibody-based drug candidates through acquisition. On the technology side, US-based pharmaceutical company Merck, Inc., acquired GlycoFi and Abmaxis, and the British firm AstraZeneca bought MorphoSys's direct competitor, Cambridge Antibody Technology. Examples of drug candidate acquisition include Novartis's purchase of the biopharmaceutical company NeuTec, pharmaceutical giant Pfizer's acquisition of Rinat, and Genentech's takeover of Tanox, Inc. These transactions alone represent direct investment in the antibody sector in excess of € 3 billion.

LIST OF ACQUISITIONS AND DEAL VOLUMES

Acquisitions of antibody-based biotech companies by big pharma proof that the industry is convinced by antibodies as a class of drugs.

DATE	BUYER	TARGET	DEAL VOLUME IN € MILLION
07/2005	Roche	Glycart	150
08/2005	Pfizer	Bioren	not disclosed
12/2005	Amgen	Abgenix	2,200
04/2006	Pfizer	Rinat	not disclosed
05/2006	Merck	GycoFi, Abmaxis	480
05/2006	AstraZeneca	CAT	1,000
07/2006	Novartis	NeuTec	440
11/2006	Genentech	Tanox	720
12/2006	GlaxoSmithKline	Domantis	350

THE FUTURE BELONGS TO FULLY HUMAN ANTIBODIES

Until recently, therapeutic antibodies were produced in mice and partially, but not completely, adapted for humans. Current state of the art has enabled the development of fully human antibodies, which are accepted as the next generation and represent the majority of therapeutic antibodies currently in development. The antibody Vectibix™, which was approved for marketing in September 2006, is the second fully human antibody to be used as a therapeutic. Vectibix™ focuses on the same target* molecule and follows the same therapeutic strategy as the chimeric, or murine-based, cancer antibody Erbitux®, which reached the market in 2004. This approval demonstrates that fully human antibodies can replace even successfully marketed antibody drugs.

*ABC

SHRINKING COMPETITION INCREASES MARKET OPPORTUNITIES

Over the last few years, MorphoSys has solidified its international leadership position in antibody technologies and achieved one of its main objectives, namely to establish itself as the antibody partner of choice for the pharmaceutical industry. Not only has the HuCAL technology gained increasing acceptance as best-in-class, demonstrated by the partnerships MorphoSys has signed with the majority of the 20 largest pharmaceutical companies, but also worldwide there is only a small number of companies capable of providing fully human therapeutic antibodies to the pharmaceutical industry. Due to the acquisition of its two direct competitors, Cambridge Antibody Technology, or CAT, in March 2006, and Abgenix in December 2005, MorphoSys anticipates an increasingly improved market position in the future. Simply stated, the Company should benefit directly from market growth and from the increasing demand for antibody technologies. As an indicator of MorphoSys's 2006 performance in this area, the Company signed three new partnerships and significantly extended three existing contracts, the latter being as financially attractive as the new partnerships.

BREAKTHROUGH IN THE JAPANESE MARKET

In May 2006, MorphoSys signed a cooperation agreement with the Japanese pharmaceutical group Daiichi Sankyo*, the second long-term alliance with an Asian drug developer after the agreement with Shionogi from the previous year. This second deal thereby met one of the stated goals for fiscal 2006 in the first half of the year and represented what the Company regards as a breakthrough in the Japanese market. Japanese pharmaceutical company interest in innovative technologies continues to be high and as a result, MorphoSys will be looking to further increase its share in this market over the coming years.

*P.58

LIST OF TOP 10 JAPANESE PHARMACEUTICAL COMPANIES

In 2006 MorphoSys was able to sign a second contract with a Top 10 Japanese pharma company.

COMPANY	TURNOVER IN BILLION US$	R&D COSTS IN BILLION US$
1. Takeda	8.5	1.3
2. Astellas	8.0	1.3
3. DAIICHI SANKYO	**7.3**	**1.3**
4. Esai	4.8	0.73
5. Otsuka	3.3	0.5
6. Chugai	2.8	0.43
7. Mitsubishi Pharma	1.9	0.47
8. SHIONOGI	**1.6**	**0.28**
9. Tanabe	1.5	0.26
10. Kyowa Hakko	1.4	0.27

*P.59
*P.32

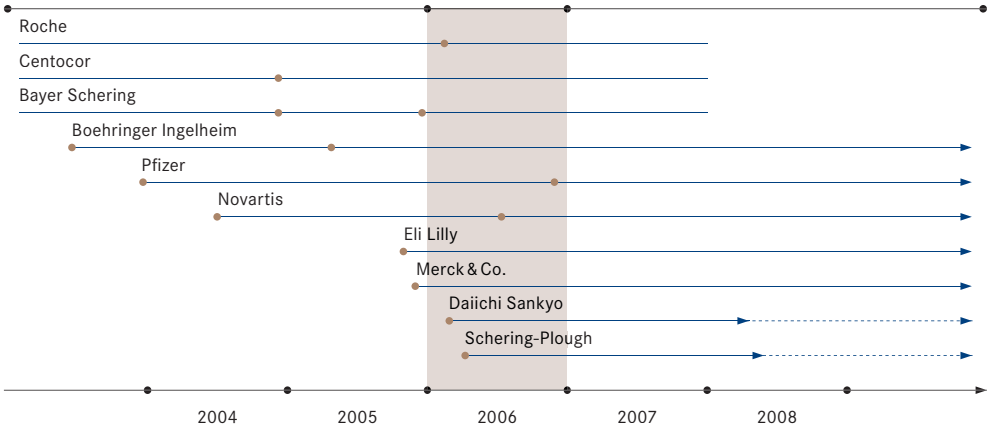
MorphoSys's agreement with the US pharmaceutical company Schering-Plough* marked its twelfth partnership with one of the twenty largest pharmaceutical companies. The third new partner in 2006, US-based start-up OncoMed Pharmaceuticals*, Inc., also provides a positive outlook for the future. First, it indicates that there are significant business opportunities beyond large pharmaceutical companies and second, it demonstrates that MorphoSys's technology is applicable for completely new therapeutic approaches.

*P.59
*ABC

Of the expanded contracts, the most significant is the extension of the existing alliance with Novartis*. This cooperation was already the largest partnership in MorphoSys's portfolio, not least in terms of the number of antibody projects and research payments involved. From 2004 through 2006, this agreement represented the primary revenue driver in the Therapeutic Antibody business segment. In August 2006, MorphoSys announced the substantial expansion of the partnership in three major areas: more researchers will be dedicated to Novartis projects, resulting in higher research payments to MorphoSys; both companies will initiate more projects from which MorphoSys will benefit in the future through the established system of license payments, milestone payments and royalties*; and the contract has been extended until the end of 2011, increasing forecasting security.

MorphoSys has a strong track record to extend and potentially expand existing deals and forge new alliances.

TRACK RECORD OF NEW CONTRACTS AND CONTRACT EXTENSIONS WITH TOP 20 PHARMA



MAXIMIZING THE VALUE OF THE PIPELINE

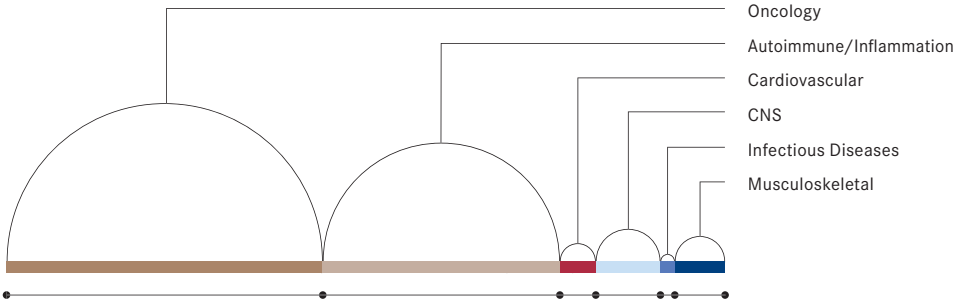
The current MorphoSys pipeline consists primarily of development projects with partners in addition to two of the Company's proprietary programs. MorphoSys seeks to maximize the value of its antibody pipeline in two ways: first, through a continuous increase in the number of therapeutic programs with partners and second, through targeted investment in the Company's proprietary projects.

One way to value the MorphoSys pipeline is to estimate the sales potential of products in development. In general, pharmaceutical companies do not initiate projects if the resulting products do not have significant sales potential, ideally in excess of US $ 500 million per year. MorphoSys will benefit from its partners' products via royalties which are a mid-single-digit percentage of net sales.

Another way of viewing the pipeline's value is to consider the diseases these potential products would address. By analyzing the distribution of partner projects over different therapeutic areas, it becomes clear that MorphoSys's pipeline is focused on the markets with the highest sales for antibody therapies. For example, approximately 45 % of partnered projects today target the treatment of cancer, currently the largest market for therapeutic antibodies. A further 30 % address autoimmune* illnesses and inflammatory diseases, which also account for a large market segment in terms of antibody therapies. In addition, MorphoSys and its partners are pursuing approaches for the treatment of cardiovascular conditions, diseases of the central nervous system, inflammatory diseases and illnesses of the musculoskeletal apparatus.

Two of the partnered projects are currently in clinical development and the number of preclinical drug candidates has risen from 7 to 14 during 2006. From this subset, several projects are expected to advance to clinical testing within the next two years. In total, MorphoSys has over 43 therapeutic antibody projects after the addition of fourteen new projects in 2006, and therefore has a broad basis for future performance-based success payments. These payments, also called milestone payments, represent pure profit for MorphoSys. The Company therefore believes that it has entered into a very exciting phase of its growth, characterized by an increase in performance-based success payments. This presents the opportunity for MorphoSys to invest in its proprietary projects using its own free cash flow in order to further increase the total value of the drug pipeline.

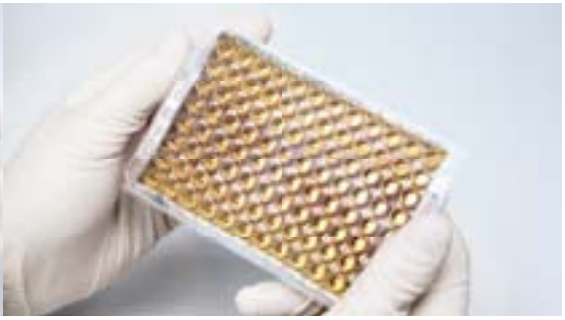
INDICATIONS OF PARTNERED PROGRAMS TODAY



MorphoSys is active in all indications where antibodies represent a successful class of drugs today.

The research antibodies market is currently undergoing a period of technological and structural upheaval.

Until recently, all research antibodies were developed using outdated, animal-based technologies. MorphoSys is confident that the market is ready for a shift towards new *in vitro* approaches such as HuCAL.



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In addition to the projects initiated through partnerships, MorphoSys has internally developed two antibody programs, MOR103* and MOR202, that will be out-licensed in the future to a partner for further clinical development and subsequent marketing. Generally, companies that advance antibody-based drug candidates into the clinic can expect attractive out-license agreements that reflect the program value through higher milestone payments and a greater share of future sales. In the last few years, biotechnology companies have had a much-improved negotiating position when seeking to partner projects with pharmaceutical companies, due primarily to pharma's increasing need for new agents and products.

RESEARCH ANTIBODIES AS A SECOND DRIVER OF GROWTH

MorphoSys began marketing research antibodies in 2003 under the brand "Antibodies by Design." The objective of this business was to open up the market for non-therapeutic applications. Within two years, MorphoSys consolidated this part of the business through the acquisition of the British-American Biogenesis Group in January 2005 and the Serotec Group* in January 2006. MorphoSys's AbD Serotec unit is today one of the leading suppliers of research antibodies in Europe and one of the twenty largest suppliers worldwide. With total sales in excess of € 18 million, the business has matured into a reliable second contributor to MorphoSys's top line.

*P.56

Scientists are currently investing approximately US$ 1 billion annually in research antibody tools. In past years, the market for research antibodies has recorded an average growth rate of between 10% and 15%. It is possible, with the right strategy, to exceed this growth. MorphoSys's goal is to achieve this in three ways: first, the company will increase the proportion of HuCAL-based antibodies by introducing new products into the Company's proprietary sales catalog. Second, MorphoSys will replace bestsellers with HuCAL antibodies with which there is the possibility of increasing the profit margin. And third, the Company will further consolidate the lucrative sub-business of producing research antibodies on behalf of customers – the so-called custom business. By following this approach in the past fiscal year, MorphoSys has exceeded the market growth rate.

In addition to organic growth, MorphoSys further improved the profitability of the segment. In 2006, AbD Serotec achieved a gross margin of approximately 60% and thus achieved the objective set at the start of the year. With further automation of antibody selection, MorphoSys aims to continue to improve the margin in the future.

The research antibodies market is currently undergoing a period of technological and structural upheaval. Until recently, all research antibodies were developed using outdated, animal-based technologies. MorphoSys is confident that the market as a whole is ready for a technological shift and that in the medium to long term, animal-based methods will be replaced by *in vitro* approaches such as the Company's HuCAL GOLD technology. Here, MorphoSys sees itself at the forefront. In structural terms, the market is very fragmented, with a large number of small providers, and a phase of consolidation has begun. MorphoSys's objective is to continue to be actively involved in this trend and it plans to look for suitable companies that could additionally strengthen the research antibodies AbD Serotec unit.

OPENING UP NEW APPLICATIONS FOR HUCAL ANTIBODIES

In August 2006, the AbD Serotec unit signed an agreement to become the exclusive supplier for a project in the field of biological weapons defense. As part of this relationship, USAMRIID*, an organization of the United States Army Medical Research and Materiel Command and the leading medical research institute for the United States' defense program against bioterrorism, requested research antibodies against five bacterial toxins*. AbD Serotec developed and supplied these within five weeks with the help of MorphoSys's HuCAL GOLD antibody library.

*P.61

*ABC

The successful signing of the contract with USAMRIID underlines the potential of the Company's HuCAL GOLD technology in the growing battle against biological weapons. The project benefited especially from one central advantage of recombinant antibodies technology, specifically the development of antibodies against toxic substances, which would be impossible with animal-based methods.

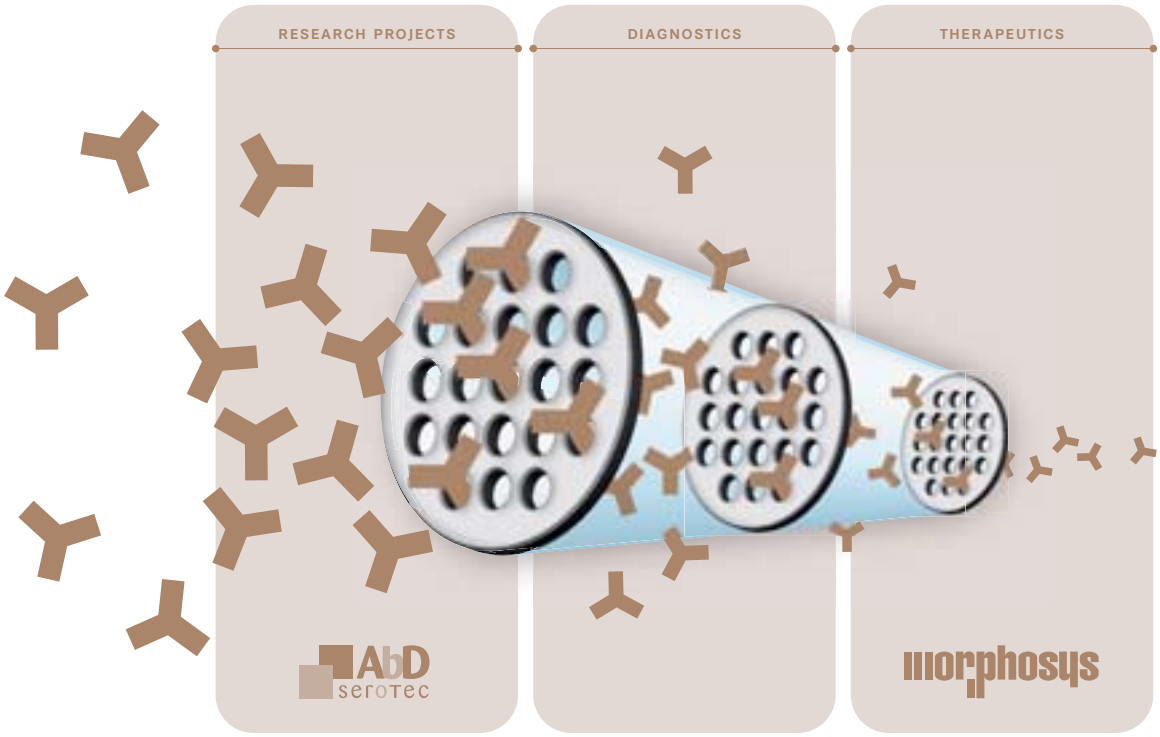
In addition, MorphoSys has entered into a research cooperation with the renowned Japanese Kazusa DNA Research Institute*. As part of this cooperation, both partners have jointly developed a series of research antibodies from MorphoSys's HuCAL GOLD antibody library. The antibodies detect proteins from the Kazusa mKIAA cDNA project, the objective of which is to identify and characterize previously unknown genes and the proteins encoded by them. Both partners share the marketing rights and therefore these antibodies are now included in both the Kazusa Institute and the MorphoSys Group sales catalogs.

*P.64

VALUE ADDED FROM RESEARCH TO CLINICAL DEVELOPMENT

One of the synergies of MorphoSys's business model is the potential for further development of existing customer relationships into higher-priced operating segments. It is highly possible that satisfied AbD Serotec customers, who thereby have initial exposure to MorphoSys's core technology, will decide to partner with MorphoSys for the development of their therapeutic or diagnostic projects. MorphoSys has seen at least one user in the pharmaceutical industry switch from being an AbD Serotec customer to a full therapeutic partner, based on satisfaction with the technology.

SYNERGY MODEL OF BUSINESS SEGMENTS



The AbD segment acts as a feeder for new diagnostic and therapeutic commercial applications, providing MorphoSys with access to new markets for the Company's technologies.

Antibodies used as research tools to identify and validate disease-related target molecules bear the potential to act as diagnostic or therapeutic agents. The more research is performed using HuCAL antibodies, the more likely it is that lucrative commercial opportunities for MorphoSys will result, whether in the therapeutic, diagnostic field or in wider research applications. For this reason, MorphoSys is actively promoting the uptake of its technology in the research community. In 2006, MorphoSys signed a contract with the renowned US research center, the Burnham Institute, that follows this rationale. The Burnham has access to novel HuCAL GOLD-based research antibodies from AbD Serotec to identify and validate target molecules with potential medical implications. MorphoSys retains commercialization rights for all antibodies emerging from the collaboration both as research antibody tools distributed via the AbD Serotec sales catalog as well as in therapeutic or diagnostic applications.