

## Letter to the Shareholders

*Dear Shareholders,*

After a year of extraordinary success for our business, I'm delighted to present to you the MorphoSys Annual Report for 2007.

In this past year, the Company has reached a new stage of its development. The large-scale expansion of our corporate relationship with the Swiss pharmaceutical giant Novartis was the year's most important event. This new deal, signed in December, offers us unprecedented value-building opportunities and transforms our prospects for future growth. Nevertheless, the cornerstones of our business strategy remain exactly as before, namely the development of antibody-based medicines as well as the expansion of our proprietary HuCAL technology into the research tool market.

Our partnered therapeutic development business is at the heart of this strategy. Partnership deals form the basis of our current financial success and the programs pursued within these partnerships will deliver growth in the years ahead. The large number of programs in partnered development – 50 at year-end – is not only a great achievement in and of itself, but speaks also to the quality of our proprietary technology and broad antibody expertise. During the year, the partnered pipeline was substantially strengthened, as two further product candidates reached the clinic, bringing the total number of HuCAL-based therapeutic antibodies being tested in humans to four. One of these two programs emerged from our existing collaboration with Novartis, a clear illustration of the progress of the partnership, in that this drug candidate reached the clinic only three years after the original deal was signed.

Our partnerships with some of the world's leading pharmaceutical companies have produced a critical mass of HuCAL-based drug projects that is already generating a growing income stream in the form of milestone payments and, in the medium to long term, will provide lucrative royalty revenues. The extremely solid financial foundation that we have thereby created is now enabling us to focus on building value further via more creative corporate partnerships with pharmaceutical and biotech companies. The new deal with Novartis exemplifies this.

Why is the extended collaboration with Novartis so important? Our objective in entering this landmark deal was twofold: first, to generate enough free cash flow to finance our own drug development activities, and second, to lock in all the benefits of our partnered drug discovery model for the long term. We achieved both objectives in a deal that not only dwarfs our other relationships, but is also one of the biggest in the entire industry. The alliance will generate committed payments totaling over US\$ 600 million.



**“The large-scale expansion of our relationship with Novartis was the year’s most important event.”** Dr. Simon E. Moroney, Chief Executive Officer

A reasonable estimate of milestone payments takes the total deal value to over US\$ 1 billion. Equally importantly, the multitude of drug programs that will be pursued over the course of the collaboration means that our HuCAL product pipeline will expand substantially, and the potential for future royalty flows to MorphoSys will grow exponentially. It should not be forgotten that our other partnerships will continue as planned, thereby adding to the strength and depth of our pipeline. This strategy allows us to maintain one of the lowest risk profiles in the industry while simultaneously capturing a very high level of growth potential.

With our partnered drug discovery activities secure, we are now turning our attention to investing the free cashflow that the business is generating to create even more value. There is no dispute that the greatest value creation in the pharmaceutical industry is achieved by proprietary drug development. Armed with a powerful, proprietary technology for generating antibodies, the most proven class of biotherapeutics in the industry, MorphoSys is ideally positioned to build its drug pipeline. Our goal is to create an attractive, independent future for the Company in which we can continue to build value for all of our shareholders.

As planned, we filed a clinical trial application for our lead project, MOR103 for the treatment of rheumatoid arthritis, at the end of 2007. Because of the competitive therapeutic area that this program addresses, we have until recently released very few details about the compound. Early in 2008, we announced that the target molecule against which MOR103 is directed is GM-CSF. At the same time, we disclosed an exclusive license agreement on a fundamental US patent covering the blockade of GM-CSF as a means of treating inflammatory diseases. We expect this license to give MorphoSys an exclusive position on marketing rights for therapeutic antibodies targeting GM-CSF in the United States, which is by far the largest market for arthritis treatments.

Our AbD Serotec research antibody segment continues to be an important component of our business. Due to our activities in this market, recognition of the power of the HuCAL technology has increased dramatically. This has allowed us to sign key collaborations with medically focused research institutes, an example of which is our relationship with the Burnham Institute in the US, one of the most highly regarded organizations of its kind worldwide. Furthermore, our agreement with Genesis Research & Development, a New Zealand-based company, exemplifies an important synergy between AbD Serotec and our therapeutic antibody segment. Genesis sourced a research antibody from AbD Serotec, and subsequently showed that this antibody has potential as a therapeutic agent. When Genesis approached us for a license, we were able to negotiate a co-development option. In other words, what started as a normal customer relationship for AbD Serotec has been transformed into a potential joint development program for MorphoSys.

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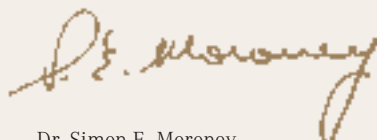
The Company's financial performance in 2007 was its best ever. Total revenue reached € 62 million, operating performance passed € 7 million and net profit exceeded € 11.5 million, all records for MorphoSys. The therapeutic segment showed particularly strong performance. Although the AbD Serotec segment fell somewhat short of its financial targets for the year, the unit was cash-generative, and continued to out-grow the market. Overall, with its secure cash flows and strong balance sheet, the Company is in better financial shape than ever.

Our share price benefited greatly from the announcement of our alliance with Novartis. Despite the recognition that this deal brought, over the entire year, the shares suffered against the backdrop of high-profile product development failures at other companies, which weighed heavily on market sentiment and affected all biopharmaceutical stocks. As a result, our shares underperformed in the market: on the last trading day of 2007, the stock was 12% down for the year, while the technology index of the Frankfurt Stock Exchange, the TecDAX, achieved 30% growth.

Nevertheless, the Company's achievements during the year enable us to look forward with confidence. The New Year brings with it a new era for MorphoSys. While we will continue to profit from the steady advance of our partnered drug development pipeline, we intend to devote more attention to our internal drug development efforts in the future. The primary example of this is the progress we foresee for our lead compound MOR103, which we expect to move through phase 1 clinical trials during 2008. We recognize that proprietary drug development requires increased investment, but that won't cause us to deviate from the disciplined financial management that has brought us to our current position of strength.

I am convinced that we have set the course for the Company's future in this last business year, more so than any year in our past. I extend my thanks to all our employees worldwide for their impressive contributions, their confidence and their creativity. I would also like especially to thank you, our shareholders, for your commitment and trust in our Company. I'm sure you'll join me in wishing the Company an even more successful year in 2008.

Sincerely yours,



Dr. Simon E. Moroney  
Chief Executive Officer