



## **MorphoSys AG – Conference Call Strategic Alliance with Novartis**

December 3, 2007

*The spoken word shall prevail*

### **Dr. Simon Moroney, CEO, MorphoSys AG**

Good morning and welcome, this is Simon Moroney, CEO of MorphoSys. With me is Dave Lemus, our CFO.

First, we would like to welcome you to this conference call and thank you for participating. We've arranged this call to talk about yesterday evening's announcement of our new strategic alliance with Novartis. For the participants in the conference call, you can view the accompanying slides on our corporate website. I will describe the deal and we will then open the call up for your questions.

### **Slide 2: Safe Harbor**

Before I start, I want to remind you that during this conference we will present and discuss certain forward-looking statements concerning the development of MorphoSys's core technologies, the progress of its current research programs and the initiation of additional programs. Should actual conditions differ from the Company's assumptions, actual results and actions may differ from those anticipated. You are therefore cautioned not to place undue reliance on such forward-looking statements, which speak only as of the date hereof.

### **Slide 3: New Strategic Alliance to Establish Innovative Therapeutic Antibody Pipeline**

The deal we have announced is of massive significance for MorphoSys and for the pharmaceutical industry. This is by far the largest deal MorphoSys has ever signed; it exceeds by many times all other agreements you have seen from us in the past in terms of value generation for our Company.

### **Slide 4: Deal Among Largest Pharma-Biotech R&D Alliances in Industry's History**

In fact it is, by our estimate, one of the largest pharma-biotech R&D Alliances forged in the history of the pharmaceutical industry, with a total volume in excess of \$1 billion. This figure is based on committed payments plus a realistic scenario of the number of products that will be developed, and uses probability-weighted success-based payments to derive the dollar value. In this regard, the number should be contrasted with several other so-called billion dollar deals in the industry, which often calculate total value assuming no attrition. Our figure conveys an

accurate view of the scope of this deal. Looking beyond the dollar volume, this deal will enable us to grow faster and generate more value than ever before and positions MorphoSys as a true global player in the pharmaceutical industry.

### **Slide 5: Financial Highlights**

Two highlights will quickly give you a sense of the size of the deal:

- First, the total potential volume of payments to MorphoSys exceeds USD 1 billion, before royalties;
- Second, committed payments alone, in the form of research and development funding plus technology access fees, exceed USD 600 million.

### **Slide 6: Joint Discovery & Development Program Builds on Excellent Existing Relationship**

Those are just two of the highlights; now I'd like to describe in some detail the scope of the collaboration. The objective is for MorphoSys and Novartis to work together to build a broad portfolio of therapeutic antibodies in a range of indications. It will combine our extensive antibody know-how plus innovative new technology developments with the biological, medical, developmental, and commercial power of Novartis.

### **Slide 7: Industry's Most Comprehensive Antibody Alliance**

This will be a truly joint effort, building on the excellent relationship that already exists between the two companies. We at MorphoSys will expand the team that is cooperating with Novartis on antibody discovery in line with the increased number of projects that will be pursued. Discovery will focus, as previously, on generating optimized human antibodies using proprietary MorphoSys technologies against targets provided by Novartis. This work will be fully funded by Novartis.

Once leads are identified, Novartis will, for most of the programs, be responsible for formal pre-clinical and clinical development plus marketing of the final product. In this respect, the new deal resembles our existing relationship, albeit considerably greater regarding the number of projects that will be pursued. Indeed, over the duration of the collaboration, MorphoSys and Novartis will pursue a substantial number of new human antibody discovery and development programs. Thus, based on publicly available information about the activities of pharmaceutical companies, this will be the industry's most comprehensive antibody effort. We expect to start a triple digit number of partnered programs over the next 10 years, from our existing partnerships as well as within the Novartis collaboration.

Now we come to a new feature, namely co-development and certain co-commercialization activities. This is an important feature that helps us move up the value chain. We have secured a number of co-development options on programs emerging from our joint discovery efforts. Under these options, MorphoSys may elect joint development with Novartis on a selection of the

collaboration's programs. In each case, we may co-develop all the way to market. For co-developed products we have the right to build up our own sales force in specific territories. We see these two options as an extremely valuable component of the deal. Most important of all, the co-development option gives us the opportunity to build our development capability in conjunction with one of the strongest and most experienced companies in the world.

## **Slide 8: Financial Details**

Let's now look at the financial details of the deal.

The collaboration will extend for 10 years. Novartis has the option to prolong the collaboration for a further two years or to terminate the collaboration after 7 years, but this latter option can only be triggered if certain precisely defined technology developments are not achieved, which we consider very unlikely. The license deal we announced with Dyax last week underpins much of the necessary technology development.

Novartis will pay annual technology access fees over the next ten years. These committed payments comprise roughly half of the USD 600 million I mentioned earlier. Included is one contingent component in the double digit million dollar range, associated with the internalization of the HuCAL suite of technologies at Novartis, which Novartis now commits to. Although this payment is dependent on successful installation of the technology, its achievement is essentially completely in our hands.

Novartis will fund a team of scientists at MorphoSys. We have defined a minimum size for this team, for which Novartis will pay the other half of the USD 600 million in committed payments over 10 years. It is important to note that this is a guaranteed minimum level of funding. It may increase in two ways – first, if Novartis chooses to pursue even more programs, and second, when MorphoSys exercises its co-development option for a particular program, the work at MorphoSys involved in defining the development candidate will be also funded by Novartis.

As is always the case, we stand to receive milestones and royalties on all programs based on our technology.

For those programs that we elect to co-develop, once the development candidate is defined, we may elect how much of the subsequent costs we carry. If we co-develop all the way to market, we will share profits in the same ratio as we have shared development costs. We may elect to withdraw from each program at pre-defined development stages. In this case, we will receive milestones and royalties.

One last note regarding the financial magnitude of this deal – in contrast to many deals in the industry, the very large numbers that we mentioned, USD 1 billion in total potential revenues, excluding royalties, of which USD 600 million is committed funding, include no equity component. This number is probability weighted, using industry standards for the success-rates of drug development, and may give you a feeling for the real size and value of the collaboration. Novartis is an existing shareholder of ours, and may increase their stake in the future, but none

of the payments defined in the deal comprise a purchase of equity. If you compare this with other R&D alliances, the significance of the level of committed payments we will receive becomes even more dramatic.

### **Slide 9: New Deal is Transforming for MorphoSys**

I'd like to turn now to the implications of this deal for MorphoSys.

We see this new alliance with Novartis as the culmination of almost ten years of successful commercialization of our proprietary HuCAL technology. It will also bring to closure our broad partnering model: we will not pursue further fee-for-service discovery deals of the type we have been pursuing for the last years. There continues to be demand for our antibody capabilities across the industry, but we feel our strategic interests are best served with a single large deal with a highly committed partner. With this single deal, we lock in the committed cash flows and the new programs that we would otherwise have attempted to secure across multiple partnerships over the coming years if we had continued our past model.

Through the substantial increase in partnered programs, which, as before, carry no risk for MorphoSys, we retain one of the biotech industry's most favorable risk/reward profiles. The Company's future is not dependent on the success or failure of any one drug. And even more than before, we will benefit from a growing pipeline of promising drug candidates.

But this deal is much, much more than just a replacement for many other potential deals, for two key reasons. One, the free cash flow from the deal of more than USD 30 million per year, before research funding, milestones and royalties, gives us unprecedented strategic flexibility to drive the future growth of the company. And two, the co-development options give us the opportunity to be an equal partner on several programs with one of the giants of the industry.

Why did we choose Novartis? As many of you know, we have been working closely with them since the middle of 2004. The ongoing collaboration is our largest, and is promising to be extraordinarily productive – the first program entered the clinic 3 years after work started. The relationship between the two companies is outstanding. It is our impression that Novartis is deeply committed to building an industry-leading portfolio of antibody products. For these reasons, as we evaluated potential partners for the competitive process that led to this new deal, Novartis was at the top of our list. I want to emphasize that although we are making a large commitment to this one partner, we retain our ability to build MorphoSys outside of the deal. For example, we remain committed to pushing forward our two in-house programs MOR103 and MOR202. While we certainly intend to keep Novartis informed about the progress of these programs, we are under no obligation that they be our partner for their further development or commercialization. We are also free to pursue other new programs independent of Novartis.

Another key consideration was size. The magnitude of the deal we were aiming to close could only be sustained by one of the world's very largest pharmaceutical companies. Knowing this, we did not offer it to companies outside of the very top tier.

What will we do with the strategic flexibility we have won? We are committed to further growth. In addition to MOR103 and MOR202, we are now evaluating a number of other attractive opportunities. These include re-acquiring or co-developing ongoing HuCAL programs with existing or new partners, or *de novo* programs. To emphasize what I said before, future pipeline building will not comprise new fee-for-service discovery deals.

While this is the last in the series of our discovery partnerships, it goes without saying that we will continue to work closely with our existing partners to ensure those collaborations are as successful and productive as possible. The collaborations will run their respective courses, but will not be subsequently renewed or expanded. Several of our partners still have the potential to initiate new HuCAL-based antibody development programs and we expect our partnered pipeline to be further strengthened this way.

Finally, I'd like to put this deal in the context of the pharmaceutical and biotech industries. Those of you follow our industry know the enormous challenges that the big drug developers face in filling their pipelines with the products of tomorrow. With this deal, MorphoSys becomes a major part of the solution to this problem. There should now be no doubt that our proprietary HuCAL technology will be the source of a range of future drugs. With this deal, we have secured our immediate future, and created unprecedented optionality to catalyze our growth as an independent company for the benefit of our shareholders.

In closing, I would like to thank the entire team here at MorphoSys who have worked very hard over many months to make this important deal a reality.

We'd now like to open the call up to your questions.

## **Slide 10: Q&A**

### **Questions & Answers**

**Operator:** We have our first question from Mr. Patrick Fuchs from DZ Bank.

**Dr. Patrick Fuchs, DZ Bank:** A fantastic deal, very elegant financially and strategically. I have a question first on the impact on P&L in the next year as you mentioned free cash flow resulting of 30 million per year from the deal. Does this mean that from the roughly 60 million in tech access and research funding you would have a profitability of about 40-50% on an EBIT level on that? Then another question regarding again to make sure with the co-development options, do you have options on all programs that are developed with MorphoSys, with the HuCAL technology or is there any selection that your partners will decide on and then does it have an impact on your strategy to develop MOR103 maybe even further than you planned originally and also do you have the intention of doing something strategically with your AbD unit as this was the unit to basically feed your technology business? Thank you.

**Dr. Simon Moroney:** Let me start with the latter three questions and then I'll hand over to Dave for the financial question. We're not able to disclose the number of programs on which we have options. We have this co-development option on a selection of programs, by no means the majority of the programs. That's about as far as I can go on that point. Regarding your question on MOR103, MOR103 is completely independent of this deal as is MOR202 so we're free to continue to develop those programs as and how we see fit. Obviously, we can talk to Novartis about co-developing those but we don't have to, we can also go elsewhere.

**Dr. Patrick Fuchs:** The question is not the partnering or the choice of partner, the question is until now you said ok, the value driving step is Phase II, would you go beyond that with the financial resources that you have now?

**Dr. Simon Moroney:** We haven't made a decision on that point yet. Of course, with the primary indication we're developing MOR103 in rheumatoid arthritis is a very big indication and the Phase III trial in such an indication would be very large and very expensive and we haven't, at this stage at least, changed our intentions to look for a partner at the end of Phase II for that program. However, as I said we haven't reached a final decision on that point yet. Regarding your third or fourth question on AbD, we continue to see AbD as we have in the past which is an interesting trigger to access new targets and so the type of deal that we did for example with the Burnham Institute whereby they get preferred access to HuCAL antibodies and we get access to the discoveries they make continues to be an attractive option for us and we continue to be in discussions with other academic institutions about similar kinds of deals to source targets that could then feed our own pipeline. But again that's something that's really quite independent of this deal.

**Dave Lemus:** Patrick, I guess in regards to your question about the free cash flow, yes, in very crude terms you're correct, namely the 600 million committed payments over ten years, roughly half of those are in the form of non-FTE based payments meaning there's no cost attached to them. So yes, you could roughly say that 50% EBIT is attached to the cash flows over those years.

**Dr. Patrick Fuchs:** And you're booking all this 600 million in the top line then, in the revenue line?

**Dave Lemus:** That's correct.

**Dr. Patrick Fuchs:** Ok, thank you.

**Operator:** Our next question comes from Holger Blum from Deutsche Bank.

**Holger Blum, Deutsche Bank:** First question, some clarification on the deal terms. What would be the risk adjusted milestone payment? You indicated those at €400 million? What would be the total amount without any risk adjustments? Then also on that term is the royalty still in the mid single digit range as before? The second question, maybe it relates a little bit to Novartis but in your discussions didn't you talk about an equity stake? At the end of the day

there are all the questions from investors why Novartis didn't buy the whole company while spending so much on it instead, maybe you could elaborate on that point as well. Finally, a question on the number of projects, could you remind us how many projects you have now with Novartis and how many you might have in three years' time? I think you mentioned in your presentation something like 100 projects. Was it with Novartis only or for the total duration? Could you give us some more details about what you have done with Novartis so far and expect it to be in the future? Thank you.

**Dr. Simon Moroney:** Ok, let me take those questions in order. First of all regarding the estimated volume of the deal based on expected milestones. What we did here is what we think is a fair thing to do which is to take industry standard probability assumptions for the transition from phase to phase and the overall success of a product coming to market and we applied those industry standard probabilities in estimating what the total milestone flow could be. We think it would be misleading and therefore we didn't do that just to assume that every single product makes it to market, that's as you know highly unlikely and we feel yes, we could generate a very large number if we did that but that would be rather misleading, so we feel that the number that we've communicated here is a reasonable one based on industry standard probabilities. The milestones and royalties continue to be broadly speaking in the kind of range that you've heard from us before, so there is no significant change in that regard, the royalties are still in the single digit range for example. Regarding the question about equity, Novartis is currently our largest shareholder and we anticipate that they will continue to be so and therefore there was - perhaps in contrast to some other deals - there was no urgent need for them to acquire equity in this transaction because they're already an existing shareholder. Perhaps this is an opportunity to point out that there will be no additional influence in the form, for example, of a board seat. Novartis will not take a board seat so we continue to have the same degree of independence and control over our future as we've had in the past in terms of management and board representation. Your last question regarding the number of projects, unfortunately we're not at liberty to speak about either the number that have gone on in the past with Novartis or the number that will go on in the future and during my presentation a few minutes ago you'll recall I used the term 'triple digit' and this concerns the number of programs in this Novartis collaboration and with our other partners and unfortunately we can't give you more precision around that but obviously triple digit implies that this is a significant number of additional new programs that will flow into the pipeline over the coming years.

**Holger Blum:** Ok, maybe with regard to timeline, when do you expect to have the number of projects at triple digits? In two years' time or later? Earlier?

**Dr. Simon Moroney:** You'll recall that the comment was over the duration of the collaboration that the number of starts will be triple digit, so the implication there is that over the total duration of ten years we expect that number to start. But I should caution here that you shouldn't interpret triple digit to mean precisely 100, triple digit means what it says, which is a number with three digits in it.

**Holger Blum:** Ok, thank you.

**Operator:** We'll take our next question from Mr. Hanns Frohnmeyer from LBBW.

**Hanns Frohnmeyer, LBBW:** Good morning, also congratulations from my side. I have a couple of quick questions. The first is the cash flow of \$600 million which you mentioned in your press release. Is it distributed equally over the ten year time course or you mentioned earlier that you are looking for backup loaded deals so are you getting the whole money over the whole period at the same level? The second is again I tried to find out that a selection of your co-development programs, what are the underlying decision making processes for that to take over the projects which were done in the beginning together with Novartis? The last question is you mentioned also in the press release that the Bayer and Centocor projects will end and will be not continued. Could you give us some reason? Is it a capacity reason? Could you give us an idea about the financial impact in the next two years? Thank you.

**Dr. Simon Moroney:** Let me start with the qualitative questions and then Dave will pick up on those two financial questions. Regarding the co-development, as I mentioned that concerns a few programs over the duration of the alliance and the way those programs will be picked will be a joint decision making process involving Novartis and MorphoSys and obviously factors that will feed into that will be indication, so we will obviously not spread our efforts over a number of different indications. We will try and focus in our selection onto those indications that we think make sense for us and where we think that we can perhaps add particular value.

**Hanns Frohnmeyer:** In addition it might also involve smaller indication fields which you could market by yourself.

**Dr. Simon Moroney:** Potentially, yes. Obviously we'll take that into account. We will think about what are the developmental aspects, how big and how long for example would a Phase III trial be and then we'll think about the commercial aspects, how realistic would it be that we could play a significant role in selling a resulting drug. So all of those issues will be taken into account and the decisions will be made on a case by case basis. Regarding Bayer-Schering and Centocor, those two deals were scheduled to run out this month, actually later this month and as I mentioned and you're correct, they will not be renewed. This speaks to the wider point that I mentioned during the talk that we feel that going forward our interests are better served by one single committed partner that we can work very closely with rather than multiple partnerships with multiple partners. It's easier to manage a single partnership. We have more ability to coordinate the activities that are going on here and we just feel that by signing this one partnership with Novartis we actually achieve everything that we could have achieved by renewing all of the deals that we have ongoing with everyone else.

**Hanns Frohnmeyer:** So does it mean that you also will not extend other contracts which are still running?

**Dr. Simon Moroney:** Correct. All the existing other partnerships that we have ongoing will run their lifetimes which are various as you know, some of them are longer, some of them are shorter, but at such time as those contracts come to an end they will not be renewed. Let's just make one important point here and that is that we expect that all of those partnerships that are generating drug candidates, that those drug candidates will continue to be developed by those partners irrespective of whether we have an ongoing, active collaboration with them or not.

**Dave Lemus:** With regard to the financial impact of losing those partners, currently we receive from those partners licensing fees and FTE funding, they are significant partners, obviously with the partnerships not renewing we will lose that however as Simon pointed out the milestones and royalties from programs which are ongoing are not endangered by that. That being said the size of this Novartis deal dwarfs what we will lose in terms of the deals falling away, so I want to stress that again. The size of the deal dwarfs what we lose. There was a question earlier on regarding the number of amounts of payments that we get whether or not we would ratively recognize them over time or do we receive them ratively over time. They're made of FTEs, internalization fees and licensing fees. The licensing fees are more or less rateable over time. The internalization fees are slightly lumpy and the FTEs are basically rateable over time with a slight ramp up towards the back end, so if you took the full 600 million and divided it through by 10 it wouldn't be roughly wrong.

**Hanns Frohnmeyer:** Maybe one follow-up to that, your decision not to extend the current partnership, was it part of this Novartis deal or was it an internal decision?

**Dr. Simon Moroney:** No, just to be clear how this deal came about, we set out to do such a deal. We decided earlier this year that it would be in our best interests to do something like this so the decision to switch from a broad array of partnerships to a single large partnership was our decision and ultimately Novartis was the partner that we chose to go forward with. That condition was something that we had already decided on previously.

**Hanns Frohnmeyer:** Ok, thank you very much.

**Operator:** Now we'll take our next question from Miss Alexandra Roche from Berenberg Bank.

**Alexandra Roche, Berenberg Bank:** I was just wondering quickly on the €6 million of costs that would be recognized in 2007, how come they're so high?

**Dave Lemus:** First of all I want to stress that that number is up to €6 million and it involves a variety of different fees, all of which are somehow related to closing this deal. We think in the face of the amount of total deal volume that we're talking about here and again it's a probability weighted amount to make this deal in excess of a billion, we think that the amounts that we spend to help us close this deal are minimal in that regard.

**Alexandra Roche:** Ok, so it's not just one advisory fee or something like this, it's numerous costs?

**Dave Lemus:** That's right.

**Alexandra Roche:** Ok, I just wanted to check. Thank you.

**Operator:** Now we'll take our next question from Thomas Schiessle from EQUI.TS.

**Thomas Schiessle, EQUI.TS:** Thank you for taking my question. Congratulations gentlemen, an impressive deal, indeed. A question on further production of the antibody fragments you are striving for to develop. Will this be managed in an initial contract you have to sign and will there be any restrictions in production capacity? This is the one; the other question is more from a strategic point of view. You didn't communicate that your arrangement with Novartis will be an exclusive arrangement but if it comes to the facts to me it looks like an exclusive arrangement so will you be open for similar treaties with third parties or is MorphoSys more or less capped with the activities for Novartis? Thank you.

**Dr. Simon Moroney:** Ok Thomas, thanks for that. Regarding the production issue, this is something that's not specifically regulated in this contract for the simple reason that I'm sure Novartis will address this on a case by case basis. As with many of the world's largest pharmaceutical companies of course they have more than adequate internal production capabilities and I would envisage that production of drug candidates will be done in house at Novartis, but as I said this is not something specifically that we discussed and frankly we don't see it specifically as being an issue. From the strategic point of view that's an important question and I want to be very clear on this, obviously by expanding the scope of our deal with Novartis and by pursuing more programs with Novartis it becomes less likely that we'll pursue programs with other people. What we'll continue to apply is our exclusive target model, that is first come, first served, whoever shows up and requests an option or an exclusive license on a particular target will get that target. We will for our own account have the ability to reserve certain targets and work exclusively for our account and also we'll continue to honor the other partnerships that we have with other pharmaceutical companies where they can do the same thing. Obviously the largest area of activity will be that that we conduct with Novartis because simply we've decided that that should be our biggest partnership. We also have defined and excluded for ourselves an area, namely infectious diseases which is completely excluded from this Novartis partnership so we will have the ability without competition from Novartis to pick targets in the infectious disease field which we can pursue either on our own account or with partners completely independent of Novartis. So let me put it this way, the partnership is very close, Novartis becomes our preferred partner by far but to describe it as an exclusive partnership would be misleading.

**Thomas Schiessle:** But on the other hand to put the finger on the point, what you are striving for is you will divide the market of antibody development into two parts, from the one hand the old generic driven development and your development with HuCAL antibody technology and that will divide the market. Is this impression correct?

**Dr. Simon Moroney:** The way we think about it from a technological point of view is that there is and there has been for a number of years a trend towards fully human antibodies and as you know our technology delivers fully human antibodies. We believe that the earlier technologies, chimerization which you mentioned and humanization belong to the past and that the future belongs to fully human antibody technologies such as HuCAL.

**Thomas Schiessle:** Ok, thank you.

**Operator:** We have no further questions at this time.

### **Slide 11: Concluding Remarks**

In closing, the three key take-home messages are:

First, we have just signed one of the biggest ever pharma-biotech alliances.

Second, with this one deal, we have locked in all of the benefits of our current broad partnering model for many years to come.

And third, the lucrative cash flow to MorphoSys from this one deal gives us unprecedented strategic flexibility to grow in the years ahead. Increased proprietary drug development and co-development of HuCAL-based programs will play a key role in this regard.

All in all, this is a transforming deal for us, and allows us to open the next chapter of the company's corporate development.

With that, we conclude the call. We are in the office for the rest of the day if you would like to follow up with us directly. Thank you again for your participation and goodbye.

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