



MorphoSys AG – Q1 2009 Conference Call Text

April 28, 2009

The spoken word shall prevail

Dr. Claudia Gutjahr-Löser, Head of Corporate Communications & IR, MorphoSys AG

Good afternoon and welcome, this is Claudia Gutjahr-Löser, Head of Corporate Communications & IR of MorphoSys. With me is Simon Moroney, our CEO, and Dave Lemus, our CFO.

First, we would like to welcome you to our Q1 conference call and thank you for participating. During the call, we would like to talk about the Company's financial results for the first quarter of 2009. Simon will begin by giving you an overview of the quarter. Then Dave will review the financial results for the first three months of 2009. Afterwards, we will open the call to your questions.

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.

I would now like to hand over to Simon Moroney.

Dr. Simon E. Moroney, CEO, MorphoSys AG

Thank you Claudia, and also from me a warm welcome to this call.

We're delighted to report on a successful start to 2009. As you will hear during this presentation, we have made excellent progress in all areas, and overall, we're on track to meet our goals for this year. We continue to have a very solid financial foundation, with respect to both balance sheet and P&L, which secures our ability to invest for future growth. The strength of our business model is very apparent in our financial results. Particularly noteworthy is the fact that we increased our investment in R&D by roughly two thirds over Q1 last year, and were nevertheless still able to report a higher operating profit. The Company is very well positioned to invest in value creation.

As usual, we'll start our operational review with the therapeutic segment of our business. The partnered discovery business continues to be our biggest source of revenues, which grew 19% over the same period last year. All of the ongoing partnerships continue to run smoothly, and we're excited about the potential of this business to deliver innovative, new HuCAL-based medicines.

In total, our partnered pipeline now comprises 58 antibody programs, up from 55 at the beginning of the year. This 58 breaks down into two programs in phase 2, two in phase 1, 31 in pre-clinic, and 23 in discovery. Please note that we count the Centocor antibody only as one compound but two programs. We reiterate our expectation that, until year-end, our partners will commence up to 20 new programs with us, and that between 2 and 4 partner programs should commence clinical trials.

Turning to our proprietary pipeline, development of both MOR103 and MOR202 remains on track. We will report on the phase 1 trial for MOR103 this quarter, as previously announced, and continue to expect the commencement of a phase 1b/2a trial in the second half of this year. Pre-clinical development of MOR202 also continues according to plan to support entry into clinical trials next year.

During the first quarter, we started an additional cancer program, MOR203, and we will start a fourth proprietary program, also in oncology, named MOR205, in the second quarter. We will, for the time being not disclose additional information on these programs, mainly for competitive reasons. Our team has selected two very interesting target molecules, and, as per our criteria for new programs, we are confident that within these programs we can generate unique drug candidates with clearly differentiated scientific, medical, and commercial features. Notwithstanding these new programs, I would like to emphasize that the majority, namely two thirds, of our investment in proprietary drug development for this year is earmarked for our two most advanced programs, MOR103 and MOR202.

While on the subject of proprietary development, I would like to point out that investment will increase significantly in the second half of this year. This is a consequence of the fact that costs will start to rise more rapidly as both programs advance, particularly as we expect to commence the phase 1b/2a trial of MOR103. Therefore, we urge you not to extrapolate from the Q1 figures for expense and profit, but direct you rather to the guidance we issued in February.

Turning to the AbD segment, we're delighted with the unit's first quarter performance. Revenues increased by 14 % over the same quarter of the prior year. Growth was driven by lucrative orders in the diagnostics space and a European academic institute as well as by a very good performance from the catalog segment. According to our estimates, the market for research antibodies is currently growing at rates in the low to mid single-digit percentage range. On this basis, we are out-

growing the market by about threefold, and therefore gaining market share. The unit is also comfortably profitable, confirming the breakthrough that we made into profitability last year.

That concludes my operational review – I'd now like to hand over to Dave for his review of the quarter's financials.

Mr. Dave Lemus, CFO, MorphoSys AG

Thank you, Simon.

Let's start the financial analysis with revenues.

Operating Revenues

In the first three months of 2009, Group revenues increased by 17% to € 19.1 million compared to last year's € 16.3 million. This increase is mainly due to higher levels of Therapeutic Antibodies segment revenues as well as stronger revenues in the AbD segment. Using constant foreign exchange rates at the average rate for 2008, Group revenues would have remained more or less unchanged.

Revenues of the therapeutic segment increased by 19% to a total of € 14.3 million, including success-based payments in the amount of € 2.8 million, a significant increase over last year's € 1.3 million.

Revenues of the AbD segment increased in the three months period by 14% to € 4.9 million. The largest part of revenues - approx. 82% or € 4.0 million - was generated with catalog and industrial customers, while custom manufacture antibodies contributed 18% or € 0.9 million. Of the three lines of business within AbD, the custom business grew the fastest with growth exceeding 25% year-on-year.

Operating Expenses

Compared to the first three months of 2008, total operating expenses increased in 2009 by approximately 22% to € 14.9 million.

Cost of Goods Sold

COGS is composed of the AbD segment's cost of goods sold in the first three months of 2009 and remained unchanged at € 1.7 million, due in part to favorable exchange rates in our cost base.

Research and Development Expenses

In the first three months of 2009, expenses for research and development increased by € 3.2 million to € 8.5 million. This was mainly due to higher costs for increased personnel costs and external lab funding, both associated with our increased proprietary drug development activities.

In the first three months of 2009, the Company incurred costs for proprietary product development and technology development in the amount of € 3.8 million, in comparison to € 1.2 million in the same period of the previous year. We expect our expenses to ramp in the second half of the year in particular, relating to increased costs for our phase 1b/2a study for MOR 103.

Sales, General and Administrative Expenses

Compared to the same period of the previous year, sales, general and administrative expenses decreased by €0.4 million to €4.8 million.

Operating Profit

Group operating profit amounted to €4.2 million in the first three months of 2009 compared to an operating profit of €4.1 million for the same period of 2008. The AbD segment showed an operating profit of €0.6 million on a segment basis.

In the first three months of 2009, net income amounted to €3.5 million. The diluted net profit per share for the first quarter amounted to €0.16 compared to €0.15 in the same period of the previous year.

Liquidity / Cash Flows / Balance Sheet

On March 31, 2009, MorphoSys's liquid funds comprised €136.1 million compared to €137.9 million on December 31, 2008. Cash outflow from operations in the first three months of 2009 amounted to €1.7 million, compared to a cash inflow of €4.0 million in the same period of 2008. This decrease in cash flow in 2009 is mainly attributable to a reduction in deferred revenues positions over the prior year and buildup of accounts receivable.

Outlook

As is typical during these conference calls, we will take the opportunity to update our financial guidance.

Today we can confirm the guidance given at the beginning of the year, namely we expect Group revenues to come in between €80 million to €85 million. We expect operating profit between €8 and €11 million. Additionally, continue to expect our investment in proprietary product development at somewhere between €18 million and €20 million. The majority of these expenses is linked to our more advanced programs MOR103 and MOR202. As mentioned previously, the phase 2 trial for MOR103 will start in the second half of 2009, and correspondingly expect proprietary R&D expense to ramp up in the last two quarters of 2009 in particular.

With that, I would like to conclude the financial analysis and hand back now to Claudia for the Q&A session.

Dr. Claudia Gutjahr-Löser, Head of Corporate Communications & IR

Thank you. We will now open the call now for your questions.

Question & Answer Session:

Operator: The first question is from Mrs. Cornelia Thomas, WestLB.

Dr. Cornelia Thomas, WestLB: Hello, good afternoon. I've got three questions. One is regarding your guidance; I'm particularly looking at the costs or the operating expenses you're guiding for. If I look at my model it looks as if not only your R&D expenses need to increase substantially over the rest of the year if you want to make your 36 million to 40 million, but also your SG&A expenses need to increase quite substantially. Could you explain to me why that would be? And yes, I guess that's the main question.

And then question number two is, the operating margin in the AbD segment, that is 12% of the first quarter. Just looking at what it was like over the quarters last year that was much, much lower and just wondering if that is sustainable? If you could comment on that, that would be great.

And then the third question is MOR103. As far as I was aware, you were still planning to publicize some more data on the Phase I trial, the results of that. Are you still planning to do so? And if so, when do you think they could become available?

Dr. Simon Moroney: Okay, Cornelia, thanks for that. And let me start with actually the last bit of those three questions and then I'll ask Dave to take the questions regarding guidance and the impact of SG&A expense and also the margin for AbD.

We did indeed say early this year that we would publish the Phase I results for MOR103 in the second quarter, and we still intend to do that. Obviously we're early in that quarter at this stage but we still intend to be absolutely on track to give you full transparency on the results of that Phase I trial before the end of this quarter.

Dr. Cornelia Thomas: Okay.

Dave Lemus: With regard to the question on the AbD margins, last year you have to recall that the business was facing significant headwinds as a result of unfavorable foreign exchange rates. That seems to have reversed itself this year and in fact they're profiting somewhat to the extent that they are having the cost base in pound which is favorable versus sales that they're making in euro and dollar.

So from that perspective they did enjoy not only a strong quarter but also some favorable effects as it relates to their COCS on their margin.

Is the 12% sustainable for the year? We have given guidance that by the end of the year we expected that that margin could come down to what it was approximately last year which was closer to 3% or so. I think perhaps what we might be seeing before the end of the year is a delta as it relates to that number in particular as it relates to investments that we intend to make in the infrastructure of the unit to grow it further which would lead us to believe that potentially that 12% that you're seeing in Q1 would come down somewhat during the year.

So to answer your question, subject to foreign exchange effects and subject to that investment, we would expect the margin to come down somewhat by the end of the year.

Dr. Cornelia Thomas: Okay.

Dave Lemus: Regarding the S,G&A expense, I think I don't anticipate a massive increase in the expense. I expect as a result of the fact that we intend to occupy further infrastructure here in Munich, in particular, we are currently split across two sites. We have the potential of being split across three sites due to the increase that we expect in personnel and having to accommodate that will lead to a rise in SG&A. I probably wouldn't characterize that as a massive expense but I think that's probably the only thing I could say at this point. We see an increase but not a massive one.

Dr. Cornelia Thomas: Okay. If I could just follow up on that, do you think that COCS is going to increase then as well?

Dave Lemus: COCS?

Dr. Cornelia Thomas: Yes.

Dave Lemus: Yes, absolutely. COCS will increase and recall that COCS is solely attributable to the AbD segment and of course as sales go up, COCS correspondingly goes up also so if you're doing that calculation you'd also have to take that into account also.

Dr. Cornelia Thomas: Okay. Thank you very much.

Operator: The next question is from Mr. Thomas Schiessle, EQUI.TS.

Thomas Schiessle, EQUI.TS: Thanks for taking my question. This is Thomas Schiessle from Frankfurt speaking. Actually two questions to Dave. Concerning the tax rate it's still a little bit above 30%, right. Could you give us some flavor for the whole year? Maybe this will go down a little bit because of the investments you are intending to do?

And then next question is on the AbD business. You indicated some months ago that you are heading for approximately EUR20 million in sales in '09. Is this still valid? And is this within including so to speak, including the stimulus programs for the NIH or other academic institutions in Europe or in the US? And what is your general view on the mood of the pharmaceutical and biopharmaceutical companies concerning investments and R&D efforts? Thank you.

Dave Lemus: Okay. Perhaps I'll start off with the answer. Simon, perhaps you might be able to jump in with the tail-end of one of the answers as it relates to the mood. Maybe I'll take the tax question first. You asked whether or not the approximately 30% tax that we saw is something that we could expect for the balance for the year. I think the simple answer is yes. Recall that that tax rate is a blended tax rate and in fact includes not only the tax rate that we have in Germany which is sub-30% obviously but also as well tax that we pay on our profits now, and increasing profits I would mention, emerging from our US and UK subsidiaries where you have tax rates beyond 30%.

The only thing that I would mention in addition to that is you may have noticed that the current tax within that total tax vis-à-vis deferred taxes has increased. Meaning that we are now slowly if not even by the end of this year going to completely amortize the deferred tax losses which we had capitalized back in 2007 so I think the one trend that you can anticipate as it relates to taxes is that the current tax or the amount of cash that we actually pay to the fiscal authorities will go up as a result of those net operating losses now coming to an end.

As it relates to the guidance for AbD, we continue to believe that the amounts that we have for the full year, the 20 million that you mentioned, are valid if you take the first quarter results and extrapolate that by four that tends to bear that out.

As to the mood within the pharma and biotech industry and as well the impact or potential impact of any fiscal stimulus within the context of for example the American fiscal stimulus and how that would impact sales, we believe there's room for optimism but Simon, perhaps you might want to comment on that.

Dr. Simon Moroney: Yes, I think we've been very encouraged so far with how the business has started this year. We weren't sure how the downturn would impact the various sub-segments of the AbD business and as of yet we've seen really no impact at all.

The catalogue business which you may expect would be most susceptible to that because it's heavily dependent on research budgets, actually performed very well in this first quarter. Whether that's a direct knock-on of the stimulus package in the US is very, very hard to say. But we know that the US performed particularly well in the catalogue business so I think it's a combination of things frankly. I think it is good performance by the team and as I said, we're seeing no negative impact at all of the overall economic downturn.

Thomas Schiessle: May I ask an additional question to that?

Dr. Simon Moroney: Sure.

Thomas Schiessle: Concerning potential acquisitions in the AbD business, is a new acquisition on the agenda once again? Or are you heading for internal extension and investments to beef up the business?

Dr. Simon Moroney: We've never taken an acquisition in that segment off the table. We continue to be potentially interested but as always it would depend on finding something that we think would comprise a very good fit for the business and really give us the ability to ramp the growth of that business significantly. We continue to survey and consider possibilities in that area but as of yet we haven't come across anything that we think makes a compelling sense to proceed with.

Thomas Schiessle: Is it more reaching the customers or is it more completing the technologies and so forth?

Dr. Simon Moroney: I think again I mean we would be interested in both of those aspects. The commercial, perhaps sales channel aspect, as you mentioned reaching customers and perhaps potential technical add-ons that would sense. But I think the key point here is that we don't feel that it's necessary or desirable to simply carry out an acquisition for the sake of it. We would have to be very convinced and it would have to make compelling sense for the business and until we identify that opportunity then obviously we're not going to carry out an acquisition.

Thomas Schiessle: Okay, thank you.

Operator: The next question is from Mr. Daniel Wendorff, Commerzbank.

Daniel Wendorff, Commerzbank: Yes, good afternoon. Maybe two follow-up questions, the first one on the AbD segment. And firstly regarding your guidance which you gave on the operating margin side, I was just curious to know if you could tell us about the underlying UK pound versus euro exchange rate which you assumed for that?

And relating to the revenue development in the first quarter, you already said that the US catalog business performed very well. Does this also relate to a change of your current offering or your redirection of sales and marketing efforts?

And then one question and last one on the therapeutic antibodies side, you mentioned that the number of partner programs increased to 58. The delta of three above the end of last year, is that solely related to the Novartis deal? Thank you.

Dave Lemus: Simon, perhaps you could start with the answer to some of those questions?

Dr. Simon Moroney: Sure, sure. Let me start with the again with the satisfying outcome of the revenue on the AbD side. We mentioned during the presentation that there were a couple of things. We had some rather larger orders out of the diagnostics space. We also had a larger order from a bigger academic institution and in addition the catalog business as a whole performed rather well. So it was really a combination of the things.

I think one thing I would like to highlight here is as you're aware we have appointed a new head to the unit, Dieter Feger, who joined us from Abbott Diagnostics at the beginning of this year and at the time we said that we were looking for a sharpened focus on sales and marketing efforts. We felt that those could be improved and what we may be seeing here is the first signs of that improvement in fact. So I'm sure that at least part of the effect is an improvement in our performance as a sales and marketing organization.

Turning to your third question, Daniel, about the therapeutic antibody number, indeed there is a delta of three. We have three more programs in comparison to the end of last year. What we don't do of course is we don't break out precisely the origin of those various programs so unfortunately I can't comment on who has provided those new starts. I think the important point here is that overall as I said during the presentation that we still see ourselves as on track for 20 new starts before the end of the year.

Dave Lemus: Okay, maybe Daniel, just to follow-up on your question about the assumption used for the British pound. I actually have two numbers in my mind and rather than give you my best guess of those two numbers, perhaps if I could just come back to you on it. I think as a generic comment I can say that the rate that we ended up using for the full year is not far off from the current rate between the pound and the euro. But then again, rather than give a false number here because I'm not 100% sure which number we have, perhaps I can get back to you on that.

Daniel Wendorff: Yes, that's fine. Thank you.

Operator: The next question is from Dr. Christian Peter, Sal. Oppenheim.

Dr. Christian Peter, Sal. Oppenheim: Yes, hello and good afternoon. Congratulations on these great results. I have two questions actually. First, on your newly announced programs, MOR203 and 205, I understand you don't want to give any details regarding indications but maybe you could give us a little more flavor on the timelines that we could expect?

Am I approximately correct to assume that we have to wait round about three years until these programs could reach an IND? And the second question regarding your plans for acquiring or in-licensing new products for your therapeutic antibody business. Could you comment on how the current slightly improved environment in the markets has affected your plans regarding that intention? Thank you.

Dr. Simon Moroney: Sure, let me take those two, Christian. First of all, regarding MOR203 and 205, recall that our code says that programs that start with a “2” are cancer programs. So remember MOR103 is obviously an inflammation program, MOR202 is a cancer program so these MOR203 and 205 given the first number is “2” are cancer programs. These are very new programs. Obviously, they've just started and therefore in terms of timelines, you're right that it would be unreasonable to expect that we could get these things into the clinic in less than three years from now.

And I think what we'd really like to be able to do, we wanted to give you clarity that these programs were ongoing but they are early stage programs and we'd like to kind of keep them under the radar screen and allow our colleagues in R&D here to get on with their work before talking too much about them. And also there's obviously a competitive element here that there's really nothing for us to gain from making the world aware of the details of these programs.

Dr. Christian Peter: Yes, I understand.

Dr. Simon Moroney: In terms of the acquisition in-licensing of new components for the pipeline, we continue to look at that very closely. You referred to the improvement in the market, that improvement doesn't seem to have reached through into the smaller biotech sector so I think that there are a lot of private and indeed public companies out there with prospects as bleak as they were perhaps six months ago.

So we don't think that the chances of being able to get our hands on potential new products have changed at all over the previous six months and we continue to be very busy in assessing potential opportunities there. But again as always with these kinds of transactions, acquisitions, very difficult to predict if and when a transaction may emerge and therefore we'd like to again continue that work quietly and see what emerges from it.

Dr. Christian Peter: All right. Thanks a lot.

Operator: There are no more questions at this time. I hand back now to Dr. Moroney for his closing remarks.

Dr. Simon E. Moroney, CEO, MorphoSys AG

If there are no further questions, I'd like to conclude by reminding you of the key take-home messages from the call. Our core partnered discovery business continues to perform well, as illustrated by an increase in the total number of partnered programs. This engine is driving increased investment in our proprietary pipeline, and here, development of MOR103 and MOR202 continues according to plan. And finally, the AbD unit has made a very solid start to the year. Overall, we are on track with all of our activities, and are confident of reaching the goals we have set ourselves for the year.

Dr. Claudia Gutjahr-Löser, Head of Corporate Communications & IR

That concludes the call. If any of you would like to follow up with us directly, we can be reached throughout the day. Thank you again for your participation and goodbye.

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