

April 24, 2002
Health Care Research

Compugen Ltd.

Compugen Reports In-line 1Q:02 Results.

Investment Conclusion: *Compugen remains a leading supplier of post-genomics data and bioinformatics tools, particularly focused on the transcriptome and splice variants. In our view, Compugen is having its most successful year ever, with recent collaborations with Millennium Pharmaceuticals^{a,b}, Gene Logic^{a,b} and diaDexus focused on creating long-term value from target discovery research.*

Key Points

- Compugen^{ab} reported in-line 1Q:02 revenues this morning of \$2.8 million. Product, service and collaborative revenues have been trailing off for three quarters in a row. Nonetheless, strong grant revenues in 1Q:02 made up for the shortfall and improved corporate gross margins to 78.8% from our expectation of 70%. We expect to see grant revenues contribute roughly 15% of total revenue of \$12 million in 2002.
- Due to weakness in the Israeli Shekel, R&D expenses of \$3.4 million were below our \$3.8 million budget. In addition, as a result of a reduction in the company's advertising budget, SG&A expenses of \$1.3 million came in below our forecast of \$1.6 million. As a result, the company reported a better-than-expected 1Q:02 net loss per share of (\$0.12) vs. our estimate of (\$0.17).
- Compugen is also making progress on the proprietary front with the discovery of two splice variants of the gene for prostate specific antigen (PSA) and human kallikrein-2 (hK2). These proteins were predicted by the LEADs platform and validated in Compugen's labs. We expect the company will continue to develop and eventually partner these potential diagnostic and therapeutic targets.
- We expect Compugen to have several additional announcements this year, including the licensing/partnering of its first novel genomics targets, additional GenCarta subscribers and potential target discovery collaborations.
- **We reiterate our Buy rating with a 12-month price target of \$6 per share.**

CGEN: \$2.82 Rating: Buy

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Change In...	Yes/No	Was	Is
Rating:	No		BUY
EPS F2002E:	Yes	\$(0.76)	\$(0.72)
EPS F2003E:	Yes	\$(0.80)	\$(0.82)
Rev F2002E:	No		\$12.0
Rev F2003E:	No		\$15.0
12-Month Price Target:	No		\$6.00
52-Week Range (NASDAQ)			\$19.38-3.13
			26.1 MM
Market Cap			\$73.6 MM
Avg Daily Volume (000)			NA
Book Value/Share 3/02			\$2.95
5yr Hist. EPS Growth Rate			NM
5yr Proj. EPS Growth Rate			25%
ROA 2002E:			NA
Dividend/Yield			NONE/ NA
Price/Book Value 3/02:			1.0x
LTD/Total Cap 3/02:			NM
Net Cash/Share 3/02:			\$2.82
Cash 3/02:			\$73.6 MM
Burn Rate 3/02:			\$20.0 MM
Yrs of Cash 3/02:			4
FY December	F2001 A	F2002 E	F2003 E
EPS:			
1Q	\$(0.14)	\$(0.12) A	NA
2Q	\$(0.15)	\$(0.19) E	NA
3Q	\$(0.18)	\$(0.20) E	NA
4Q	\$(0.16)	\$(0.21) E	NA
Year	\$(0.63)	\$(0.72)	\$(0.82)
P/E	NM	NM	NM
Rev (MM):	F2001 A	F2002 E	F2003 E
1Q	\$2.2	\$2.8 A	NA
2Q	\$2.9	\$3.0 E	NA
3Q	\$3.1	\$3.0 E	NA
4Q	\$3.1	\$3.2 E	NA
Year	\$11.4	\$12.0	\$15.0
Mkt Cap/Rev	NM	6.1x	4.9x

In-line 1Q:02 Results from Compugen; Maintaining Forecast Going Forward

Compugen reported in-line 1Q:02 revenues this morning of \$2.8 million. Product, service and collaborative revenues of \$2.4 million in 1Q:02 have been trailing off for three quarters in a row. Nonetheless, strong grant revenues in 1Q:02 made up for the shortfall and also improved corporate gross margins to 78.8% from our expectation of 70%. We expect to see grant revenues contribute roughly 15% of total revenue of \$12 million in 2002.

Due to weakness in the Israeli Shekel, R&D expenses of \$3.4 million were below our \$3.8 million budget. In addition, as a result of a reduction in the company's advertising budget, SG&A expenses of \$1.3 million came in below our forecast of \$1.6 million. Amortization of deferred compensation of \$80,000 was significantly below our forecast and last year's levels due to the forfeiture of options by some employees. As a result, the company reported a better-than-expected 1Q:02 net loss per share of (\$0.12) vs. our estimate of (\$0.17).

We are maintaining our forecast for the remainder of the year.

Compugen Making Progress on the Collaborative Front

In our view, Compugen is having its most successful year, ever with recent collaborations with Millennium Pharmaceuticals (MLNM \$20.50, Strong Buy), Gene Logic (GLGC \$16.02, Buy) and diaDexus focused on creating long-term value from target discovery research.

Millennium Pharmaceuticals

Compugen entered into a software development collaboration with Millennium Pharmaceuticals to develop software to predict protein pathways. Millennium brings its genomics expertise and transcriptional profiling capabilities to the collaboration, which will greatly bolster Compugen's biological capabilities. Compugen, on the other hand, will do the heavy lifting required on the predictive biology/informatics side of the collaboration. Under the terms of the agreement, the companies will share costs for the development of the software and certain rights to the eventual technology or products. While we do not believe Compugen is getting paid for this research, the deal is a significant validation of Compugen's bioinformatics algorithms and capabilities.

diaDexus

Compugen also entered into a discovery alliance with diaDexus in 1Q:02. DiaDexus will employ Compugen's LEADs platform to analyze both genomic and proteomic databases to identify novel diagnostic markers and therapeutic targets. For its part, Compugen will receive cash milestones and a warrant to invest in diaDexus, a private company. Through early access to the Incyte and Human Genome Sciences^{ia} (HGSI \$17.03, Strong Buy) databases, diaDexus is working to develop novel diagnostic and therapeutic products. Importantly, this is Compugen's second collaboration this year centered on its expertise in computation transcriptome analysis and splice variants.

Gene Logic

Compugen announced a strategic collaboration with Gene Logic to offer the GencartaTM annotated genomic and proteomic information database through the GeneExpress database. We expect this alliance will dramatically increase the distribution effort currently focused on the Gencarta database. The alliance makes strategic sense for both companies, as it will present a novel marketing and commercialization venue for Compugen while providing GeneLogic's customers with novel, difficult-to-attain genes and transcripts derived using Compugen's proprietary algorithms, as well as genomic, transcriptomic and proteomic information necessary to the drug discovery process, including splice variants. We understand that GenCarta includes tens of thousands of genes, ~150,000 splice variants and the associated proteins, SNPs and alignment of ESTs to known mRNAs. Gene Logic intends to sell the customized human GencartaTM sequence data as an add-on component available to existing and prospective GeneExpress[®] Suite customers. Compugen will be responsible for continually updating the custom GencartaTM database with novel information.

Company Info

The Company

Compugen is a pioneer in the field of computational genomics and proteomics. Compugen's technology platforms enable scientists to automate and accelerate the process of analyzing the large amounts of fragmented genomic information being generated today by government, academic and commercial laboratories. Compugen links these web-enhanced products on LabOnWeb.com, offering molecular biologists additional analysis tools for genomic data. The company is also utilizing its proprietary technology to discover, develop and develop Novel Genomics with potential commercialization of targeted genes out of the 4,000 novel genes that the company has identified from the public domain data.

Investment Thesis

Compugen's advanced computational algorithms take a unique and completely orthogonal approach to the analysis of the human genome combining advanced mathematics, computer sciences and molecular biology to discover novel genes and proteins. Thus, Compugen can provide its customers with analysis tools and software solutions available nowhere else in the industry. In our opinion, these analysis tools will enable Compugen and its customers to better decipher the data pouring out of various genomics programs, and in the end, help better select those genes and proteins that will make the best drug targets. This unique analytical approach has spawned a multi-tiered business model, comprised of corporate solutions (LEADS), database information (GenCarta), discovery tools and Novel Genomic discoveries. Compugen has also introduced DNA array design tools, Z4000 for automated 2-D gel analysis technology for protein separation and ProtoCall for protein identification on mass spec systems. We also expect Compugen to leverage its technology platform for proprietary gene discovery.

Investment Risks

Among the risks are those related to most other early stage genomics enterprises. Specifically, although Compugen's computational and analysis capabilities have been tested and proven, so far its customers have not been able to produce new drugs or therapies using this technology. The company has only one main customer, Parke-Davis, accounting for a large portion of the company's revenues. In addition, the LabOnWeb.com site only has two corporate customers thus far and remains unproven. The biotechnology industry is characterized by rapid technological change, and the area of genomics research is a rapidly evolving field. There is intense competition among entities attempting to understand the molecular basis of life and to develop products and services based on their discoveries.

Our rating system is based upon 12-month price targets that assume a flat market.

For stocks with market cap of \$2 billion or greater:

Strong Buy describes stocks that we expect to appreciate by 25% or more.

Buy describes stocks that we expect to appreciate by 10-25%.

Market Perform describes stocks that we expect to change plus or minus 10%.

Market Underperform describes stocks that we expect to decline by more than 10%.

For stocks with market cap of less than \$2 billion:

Strong Buy describes stocks that we expect to appreciate by 50% or more.

Buy describes stocks that we expect to appreciate by 20-50%.

Market Perform describes stocks that we expect to change plus or minus 20%.

Market Underperform describes stocks that we expect to decline by more than 20%.

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Ted, a senior biotechnology analyst in the research department, has focused on covering the genomics sector for the last three years. Ted's coverage universe includes molecular biology equipment and consumables companies, as well as target discovery/drugdevelopment companies. Prior to joining Robertson Stephens, Ted was a junior research analyst at Lehman Brothers where he covered medical technology stocks. He received his BA from the University of Pennsylvania. Currently, Ted is attending Columbia University focusing on molecular biology and genetics.

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Compugen
Quarterly Earnings Estimates
(\$ in thousands except per share)

	<u>2000A</u>	<u>1Q</u>	<u>2Q</u>	<u>3Q</u>	<u>4Q</u>	<u>2001A</u>	<u>1QA</u>	<u>2QE</u>	<u>3QE</u>	<u>4QE</u>	<u>2002E</u>
Revenues:											
Revenues	\$6,891	\$2,003	\$2,777	\$2,902	\$2,684	\$10,366	\$2,350	\$2,550	\$2,550	\$2,750	\$10,200
<u>Research Grants</u>	<u>466</u>	<u>243</u>	<u>130</u>	<u>215</u>	<u>406</u>	<u>994</u>	<u>463</u>	<u>450</u>	<u>450</u>	<u>450</u>	<u>1,813</u>
Total Revenues	\$7,357	\$2,246	\$2,907	\$3,117	\$3,090	\$11,360	\$2,813	\$3,000	\$3,000	\$3,200	\$12,013
<u>Cost of Revenues</u>	<u>1,600</u>	<u>473</u>	<u>796</u>	<u>1,251</u>	<u>948</u>	<u>3,468</u>	<u>597</u>	<u>900</u>	<u>900</u>	<u>960</u>	<u>3,357</u>
Gross Income/(Loss)	\$5,757	\$1,773	\$2,111	\$1,866	\$2,142	\$7,892	\$2,216	\$2,100	\$2,100	\$2,240	\$8,656
Gross Margin	78.3%	78.9%	72.6%	59.9%	69.3%	69.5%	78.8%	70.0%	70.0%	70.0%	72.1%
Operating Expenses:											
R&D Expenses	9,744	3,520	3,803	3,900	3,485	14,708	3,429	4,000	4,250	4,500	16,179
M&S Expenses	3,150	1,553	1,733	1,800	1,496	6,582	1,337	1,750	1,800	1,850	6,737
% of Revenues	45.7%	77.5%	62.4%	62.0%	55.7%	63.5%	56.9%	68.6%	70.6%	67.3%	66.0%
G&A Expenses	3,396	946	930	950	1,150	3,976	1,064	1,200	1,300	1,400	4,964
<u>Amort. of Deferred Compensation</u>	<u>5,644</u>	<u>537</u>	<u>729</u>	<u>875</u>	<u>751</u>	<u>2,892</u>	<u>80</u>	<u>550</u>	<u>450</u>	<u>350</u>	<u>1,430</u>
Total Operating Expenses	21,934	6,556	7,195	7,525	6,882	28,158	5,910	7,500	7,800	8,100	29,310
Operating Income/(Loss)	(\$16,177)	(\$4,783)	(\$5,084)	(\$5,659)	(\$4,740)	(\$20,266)	(\$3,694)	(\$5,400)	(\$5,700)	(\$5,860)	(\$20,654)
Operating Margin	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM
Interest Income, net	2,772	1,228	1,134	1,000	616	3,978	541	500	450	400	1,891
Pretax Income/(Loss)	(\$13,405)	(\$3,555)	(\$3,950)	(\$4,659)	(\$4,124)	(\$16,288)	(\$3,153)	(\$4,900)	(\$5,250)	(\$5,460)	(\$18,763)
Pretax Margin	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM
Income Tax	0	0	0	0	0	0	0	0	0	0	0
Tax Rate	0.0%	0%	0%	0%	0%	0.0%	0%	0%	0%	0%	0.0%
Net Income/(Loss)	(\$13,405)	(\$3,555)	(\$3,950)	(\$4,659)	(\$4,124)	(\$16,288)	(\$3,153)	(\$4,900)	(\$5,250)	(\$5,460)	(\$18,763)
Net Margin	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM
Earnings per Share	(\$0.75)	(\$0.14)	(\$0.15)	(\$0.18)	(\$0.16)	(\$0.63)	(\$0.12)	(\$0.19)	(\$0.20)	(\$0.21)	(\$0.72)
Shares Outstanding	17,983	25,989	26,001	26,100	26,031	26,030	26,050	26,150	26,250	26,450	26,225

Source: Company reports and Robertson Stephens analysis.

Note: CGEN issued 500,000 options worth \$3 million in 3Q:00, to be recognized as Amortized Deferred Compensation with \$1.5 million in 2H:00, and the remainder recognized over the next 3 years.