



Equity Research

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Compugen (NASDAQ - CGEN - \$1.48, TASE - $\lambda\text{פ}\eta\eta\eta$ - ₪ 7.56)

Company Update

Hold

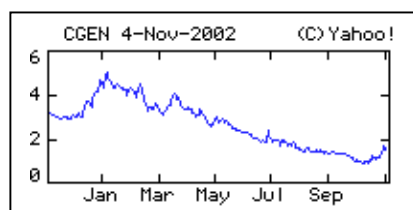
Company Data

| | |
|-------------------------------|---------------|
| Price (November 4, 2002) | \$1.48 |
| 12 Month High / Low | \$5.24-\$0.97 |
| IPO Price - 7/2000 | \$10 |
| Market Cap (November 4, 2002) | \$38.6MM |
| Shares Outstanding | 26.1MM |
| Float | 13MM |
| Daily Volume (3-month avg.) | 49.4K |
| P / E | NA |
| P / Revenue (2002E) | 3.51 |
| Net Cash 9/ 2002 | \$70.6MM |
| Net Cash per share 9/ 2002 | \$2.71 |
| Book Value per share 9/ 2002 | \$2.76 |

Estimates

| | 2000A | 2001A | 2002E |
|--------------|----------|----------|----------|
| EPS | (\$2.75) | (\$0.58) | (\$0.50) |
| Revenue (MM) | \$7.4 | \$11.4 | \$11.0 |

Stock Price History



Investment Summary

- Revenues (including R&D grants) for Q3 2002 came in at \$2.8 million, down from \$3.1 from the parallel period, 2001, and flat quarter over quarter. Net loss came in flat versus Q2 2002 at \$3.0 million or \$0.11 a share and down 14% from Q3 2002. Management has indicated that it expects a net loss of \$12-\$14 million for full year 2002 based on revenues of \$10-\$12 million.
- Compugen currently has a cash position of \$70.6 million (\$2.70 a share) that should be sufficient to last through 2006 while its market cap hovers around \$38 million. This reflects the market's low tolerance for companies without a clear timeline for profitability in a less than stable market environment.
- In July, it was announced that Pfizer renewed its collaboration with Compugen and will continue to use Compugen's LEADS platform. In addition, in September, Novartis announced that it was expanding its drug target discovery collaboration with Compugen. However, with flat revenues and a limited number of new collaborations, it is becoming clearer and clearer that functional genomics and bioinformatics will not carry Compugen to profitability.
- Compugen is looking to shift its business focus towards computational chemistry and medicine with a predictive medicine platform in early stages of development.
- Compugen will need to find the right business model for its predictive (computational) medicine platform to turn a technological winner into a financial success.
- While management has indicated that no business model has been finalized for its predictive medicine platform, it is likely that the platform will be primarily marketed to HMOs as a potential money saver. We hope that CGEN will make an announcement in the coming quarters regarding progress on the platform.
- While Compugen has \$70 million in cash and an excellent track record of developing first-rate technologies there are too many outstanding variables that prevent us from seeing any potential upside in the near term. The product that CGEN is depending on to become profitable is still in early stages with no clear timeline when it may even be launched and while management is considering a business model for the platform, nothing has been finalized.

While some promise may exist in the very long term, we see no significant upside potential in the near term and therefore we downgrade CGEN from *Market Perform* to *Hold*.



Business Developments

Collaborations

In July, it was announced that Pfizer has renewed its collaboration with Compugen to utilize the LEADS platform as well as a number of proteomics tools. The Pfizer collaboration represented 30% of Compugen's total revenues in 2001 and while we are pleased to see that this important collaboration is being maintained, management has noted that it does not expect as high a level of revenues from this renewed collaboration.

In September, Novartis announced that it would be expanding its collaboration with Compugen in identifying, prioritizing and validating new drug targets. As part of the collaboration, the two companies will co-develop a RNA interface platform. While this expanded collaboration attests to the excellent regard that the industry has for Compugen's technology, we do not see this collaboration resulting in a flood of revenues for Compugen.

With flat revenues over the last three quarters, Compugen's computational biology business seems to have hit a plateau and stalled. It is becoming clearer and clearer that Compugen cannot depend on its current technologies will not lead to profitability.

Technology Under Development

Compugen is currently trying to shift its focus towards the pharmaceutical industry and specifically, the area of predictive medicine. Using data from a pharmaceutical company, Compugen has begun testing a preliminary predictive medicine model with promising results. In addition, the company is currently negotiating with various HMOs to access patient data and samples in their databases. While, management hopes to be able to make an announcement regarding development progress in the coming quarters there is no indication when a marketable product will be ready.

Compugen will need to find the right business model for its predictive medicine platform in order to turn a technological winner into a financial success. Failure to do so will mean a slow and painful death for Compugen.

Management has indicated that no business model has been finalized for its predictive medicine platform. Compugen's LEADS platform for computational biology can only be used by a limited number of companies at any given time, as a dedicated staff from Compugen is needed for every project. While the LEADS platform has been recognized industry-wide as a superior technology for target discovery, the fact that it cannot be used leased in mass quantities has limited to its revenue generating ability.

***The Predictive
Medicine Platform***

***Finding the right
business model***



When the idea of building a predictive medicine platform was first discussed by Compugen, management had thought that pharmaceutical companies testing a drug candidate in clinical trials would use the platform on a project-by-project basis. However, management has realized that using a similar business model to that used for the LEADS platform would severely limit the predictive medicine platform's revenue generating potential.

Marketing the platform to HMOs as a money saver

Compugen will most likely try to market the platform primarily to HMOs. The platform, loaded on doctors' computers will help physicians pick the appropriate medications and treatments taking into account a patient's medical (and genetic) profile, thus preventing the wrong drugs from being prescribed. Compugen hopes that its platform will be recognized as a money saver by HMOs. A major obstacle preventing the financial success of the platform may be the fact there is always strong resistance from physicians when it comes to either learning a new technology or introducing a mechanism that interferes with a doctor's decision-making process.

In addition, Compugen will look to work with pharmaceutical companies in looking at drug candidates that have failed clinical trials. CGEN is hoping to develop its computational medicine platform in such a way that it will be able to identify population subsets for which the failed drug will be effective.

Conclusion

Compugen has \$70 million in cash that should be sufficient to last through 2006 as well as an excellent track record of developing top-notch computational technologies that have received industry acclaim. However, there are too many variables outstanding that prevent us from seeing any significant upside potential in the near term.

Too many variables

Compugen's base business, computational biology, has hit a plateau with flat revenue growth over the last three quarters. The technology that Compugen is depending on to become profitable is still in early stages of development and management has not finalized whom the platform is intended for. Should the project come to fruition, there is no guarantee that the market will embrace the technology making the product a financial success.

While some promise may exist in the very long term, we see no significant upside potential in the near term and therefore we downgrade CGEN from Market Perform to Hold.



About Compugen

Compugen is engaged in the fields of computational biology, chemistry and medicine. Compugen's currently marketed technologies combine the disciplines of mathematics and computer science with molecular biology to improve the understanding of genomics and proteomics, the study of genes and proteins. Computational chemistry and (predictive) medicine platforms are currently under development. The company provides products and services to pharmaceutical, biotechnology and other life science organizations. Compugen also hopes to commercialize some of its intellectual property (IP) with potential therapeutic and diagnostic use.

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