CREDIT SUISSE

30 July 2019
Americas/United States
Equity Research
Biotechnology

Galapagos NV (GLPG)

INCREASE TARGET PRICE

Strong balance sheet provides foundation for pipeline upside; Raising TP to €174

Rating	**OUTPERFORM**
Price (29-Jul-19, €)	159.30
Target price (€)	(from 113.00) 174.00
52-week price range (€)	168.85 - 75.60
Market cap(€ m)	8,733
Enterprise value (€ m)	7,562

Target price is for 12 months.

Research Analysts

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We are updating our model and raising our TP to €174, while maintaining our Outperform rating. Overall, we think Galapagos is well positioned to outperform over the next year, driven by:

- >€5B in cash, adjusted for the Gilead deal, providing valuation support
- Clinical updates of late-stage assets targeting large addressable markets in inflammation, idiopathic pulmonary fibrosis (IPF) and osteoarthritis (OA)
- Near-term revenue upside from undisclosed regulatory and clinical milestones related to filgotinib
- Potential to accelerate earlier stage programs such as the Toledo program (8+ assets with a currently undisclosed mechanism and target).

We think the recent Gilead transaction was a good deal for Galapagos, as the amount paid more-than-fully values the US opportunity for IPF and OA at this point in time, allowing GLPG to realize much of that value before further de-risking clinical trials. Beyond filgotinib, we think GLPG1690 has blockbuster potential in IPF (we conservatively model >$1B peak sales at ~35% PoS, launching in ~2022). GLPG1972 for OA could be an interesting asset as well, given the large addressable market, but we need additional clinical data before we assign more value to the program, (we model >1.1B peak sales at 15% PoS). **With a healthy cash position and an experienced collaborator in Gilead, we see favorable risk/reward, as updates for filgotinib, '1690, '1972 and Toledo expected in 2H19-2H21 are all potential drivers of upside.**

We are increasing our revenue and EPS estimates in our model, while making adjustments to reflect the Gilead transaction. Our €174 TP is based on a sum-of-the-parts DCF valuation, using a 1% terminal growth rate and 10% WACC, with cash flows forecasted through 2029 and terminal value assigned thereafter.

Risks: Clinical and developmental, regulatory, commercial and market.

Share price performance

On 29-Jul-2019 the AMSTERDAM EXCHANGE INDEX closed at 579.55
Daily Jul27, 2018 - Jul29, 2019, 07/27/18 = €94.9

Quarterly EPS	Q1	Q2	Q3	Q4
2018A	-0.73	-0.42	0.28	0.27
2019E	-0.89	-0.86	-1.94	0.90
2020E	-	-	-	-

Financial and valuation metrics

Year	12/18A	12/19E	12/20E	12/21E
EPS (CS adj.) (€)	-0.56	-2.45	0.87	3.09
Prev. EPS (€)	-	-4.85	-4.45	-4.11
Revenue (€ m)	317.8	108.5	341.8	590.6
EBITDA (€ m)	-39.7	-145.3	56.7	218.7
P/OCF (x)	-29.5	-90.0	132.8	45.0
EV/EBITDA (current)	-187.3	-52.1	133.2	33.6
Net debt (€ m)	-1,291	-1,171	-1,182	-1,394
ROIC (%)	58.64	206.52	-479.79	1602.43

Number of shares (m)	54.82	IC (current, € m)	-76.55
Net debt (Next Qtr., € m)	-	Dividend (current, €)	-
Net debt/tot eq (Next Qtr.,%)	-		

Source: Company data, Refinitiv, Credit Suisse estimates

Galapagos NV (GLPG)

Price (29 Jul 2019): **€159.3**; Rating: **OUTPERFORM**; Target Price: **(from 113.00) 174.00**; Analyst: **Evan Seigerman**

Income Statement	12/18A	12/19E	12/20E	12/21E
Revenue (€ m)	**317.8**	**108.5**	**341.8**	**590.6**
EBITDA (€ m)	**(40)**	**(145)**	**57**	**219**
Depr. & amort.	(5)	(8)	(16)	(24)
EBIT (€)	**(45)**	**(153)**	**40**	**195**
Net interest exp	16	17	18	18
PBT (€)	**(29)**	**(136)**	**58**	**213**
Income taxes	(0)	-0	(1)	(2)
Profit after tax	**(29)**	**(136)**	**57**	**211**
Minorities	-	-	-	-
Net profit (€)	**(29)**	**(136)**	**57**	**211**
Reported net income (€)	**(29)**	**(136)**	**57**	**211**
Other NPAT adjustments	0	0	0	0
Adjusted net income	**(29)**	**(136)**	**57**	**211**

Cash Flow	12/18A	12/19E	12/20E	12/21E
EBIT	(45)	(153)	40	195
Net interest	16	17	18	18
Change in working capital	(133)	11	(14)	(15)
Cash flow from operations	**(142)**	**(98)**	**79**	**241**
CAPEX	(10)	(22)	(68)	(30)
Free cashflow to the firm	**(153)**	**(120)**	**11**	**211**
Acquisitions	-	-	-	-
Divestments	-	-	-	-
Cash flow from investments	**(16)**	**(22)**	**(68)**	**(30)**
Net share issue(/repurchase)	288	0	0	0
Dividends paid	0	0	0	0
Changes in Net Cash/Debt	**140**	**(120)**	**11**	**211**

Balance Sheet (€)	12/18A	12/19E	12/20E	12/21E
Assets				
Cash & cash equivalents	1,291	1,171	1,182	1,394
Account receivables	19	6	20	34
Other current assets	19	20	20	21
Total current assets	**1,329**	**1,197**	**1,222**	**1,448**
Total fixed assets	23	37	89	95
Investment securities	-	-	-	-
Total assets	**1,439**	**1,321**	**1,398**	**1,630**
Liabilities				
Total current liabilities	**220**	**219**	**219**	**219**
Total liabilities	**225**	**225**	**225**	**225**
Shareholder equity	1,214	1,097	1,174	1,406
Total liabilities and equity	**1,439**	**1,321**	**1,398**	**1,630**
Net debt	(1,291)	(1,171)	(1,182)	(1,394)

Per share	12/18A	12/19E	12/20E	12/21E
No. of shares (wtd avg)	52	55	66	68
CS adj. EPS	(0.56)	(2.45)	0.87	3.09
Prev. EPS (€)	-	(4.85)	(4.45)	(4.11)
Dividend (€)	0.00	0.00	0.00	0.00
Free cash flow per share	(2.93)	(2.16)	0.17	3.11

Earnings	12/18A	12/19E	12/20E	12/21E
Sales growth (%)	103.9	(65.9)	215.0	72.8
EBIT growth (%)	50.1	(241.6)	126.3	383.4
Net profit growth (%)	74.7	(363.7)	142.3	267.1
EPS growth (%)	76.0	(336.2)	135.4	257.0
EBITDA margin (%)	(12.5)	(133.9)	16.6	37.0
EBIT margin (%)	(14.1)	(141.1)	11.8	33.0
Pretax margin (%)	(9.2)	(125.0)	17.0	36.0
Net margin (%)	(9.2)	(125.0)	16.8	35.6

Valuation	12/18A	12/19E	12/20E	12/21E
EV/Sales (x)	23.42	69.69	22.09	12.43
EV/EBITDA (x)	(187.3)	(52.1)	133.2	33.6
EV/EBIT (x)	(166.1)	(49.4)	187.4	37.7
P/E (x)	(283.7)	(65.0)	183.8	51.5
Price to book (x)	5.5	5.8	6.8	6.9
Asset turnover	0.2	0.1	0.2	0.4

Returns	12/18A	12/19E	12/20E	12/21E
ROE stated-return on (%)	(2.1)	(8.9)	3.7	13.5
ROIC (%)	58.6	206.5	(479.8)	1602.4

Gearing	12/18A	12/19E	12/20E	12/21E
Net debt/equity (%)	(106.3)	(106.8)	(100.7)	(99.1)
Interest coverage ratio (X)	2.9	8.8	(2.3)	(10.9)

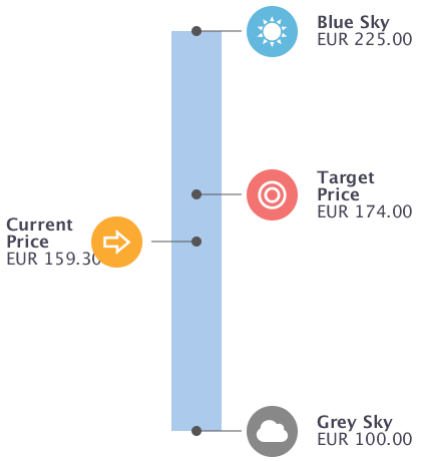
Quarterly EPS	Q1	Q2	Q3	Q4
2018A	-0.73	-0.42	0.28	0.27
2019E	-0.89	-0.86	-1.94	0.90
2020E	-	-	-	-

Source: Company data, Refinitiv, Credit Suisse estimates

Company Background

Galapagos is a clinical stage biotech company focused on developing novel treatments for rheumatoid arthritis, inflammatory bowel disease, idiopathic pulmonary fibrosis, and atopic dermatitis.

Blue/Grey Sky Scenario



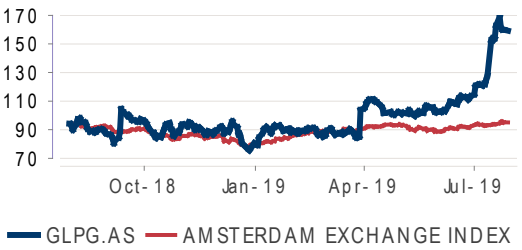
Our Blue Sky Scenario (€) (from 125.00) 225.00

Our blue sky valuation of €225 is based on 100% POS of filgotinib in rheumatoid arthritis, ulcerative colitis and Crohn's disease, as well as better-than-expected data from the pipeline drugs GLPG1690, and GLPG1972. Our blue sky valuation is based on a DCF driven by a 10% WACC and discounted cash flows through 2029, with 1% terminal growth rate thereafter.

Our Grey Sky Scenario (€) (from 75.00) 100.00

Our grey sky valuation of €100 is based on clinical failure of the developmental pipeline, but includes EUR 5.7B of value from cash-on-hand adjusted for the Gilead transaction.

Share price performance



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Gilead Deal: On July 14, 2019, Galapagos and Gilead announced a $5.1B+ deal meant to greatly expand the terms of the existing collaboration. Under the terms of the agreement, Gilead will make a $3.95B upfront cash payment to Galapagos, and make an additional $1.1B equity investment in Galapagos, increasing its ownership stake from 12% to 22%. Gilead will fund the deal with cash on hand. The proposed investment also includes warrants for Gilead to increase its stake to 25% at the original deal value within 1 year, and up to 29.9% during the 10-year revised collaboration agreement, subject to future trading prices and shareholder approval. In return, Gilead will receive from Galapagos:

- Ex-EU rights for GLPG1690 (in Phase 3 for idiopathic pulmonary fibrosis)
- Option to acquire US rights for GLPG1972 after Ph2b, currently in development for osteoarthritis
- Options to license ex-EU rights for Galapagos' other clinical programs, for 10 years
- Revision of filgotinib cost-sharing to a 50/50 split, royalty rate unchanged (tiered rate at 20-30%)

For all assets, development costs will be split 50/50 and Galapagos will receive milestones and tiered royalties of 20-24% after Gilead opts in. (See our Gilead initiation note for more detail on filgotinib and our recent U.S. Biotechnology note, dated 14 July, for our view of the deal from the Gilead perspective). While a takeout is less likely for Galapagos (given the 10-year agreement), we think that the additional capital will likely allow the company to accelerate R&D investment and also support commercialization of filgotinib (for which Galapagos is now responsible in more European countries).

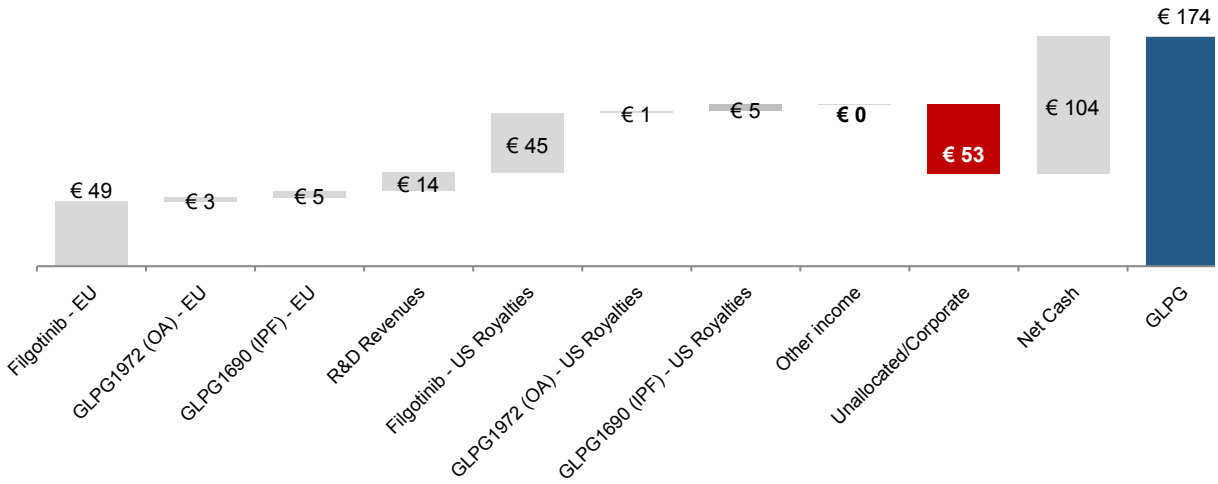
GLPG1690 in IPF has blockbuster potential: Galapagos has a small but rapidly advancing pipeline in idiopathic pulmonary fibrosis (IPF), a rare lung disease with high unmet need and large market potential. Current treatment options for IPF have limited efficacy and some significant side effects. Nonetheless, patient uptake of IPF therapy has been surprisingly strong with 2017 WW sales reaching $2B. Galapagos' lead IPF candidate GLPG1690 has a novel mechanism of action (MoA) with the positive Phase 2 (FLORA) trial setting the stage for the much larger 1,500 patient Phase 3 pivotal program (ISABELA 1 and ISABELA 2), with updates expected 2H20. Also in the pipeline for IPF is GLPG1205, currently in Phase 2 (PINTA). After the announced deal, Galapagos retains full EU rights, while Gilead will market the drug ex-EU. Phase 3 costs will be split 50/50, while Galapagos will receive a $325M milestone on US approval and 20-24% in tiered sales royalties.

GLPG1972 for osteoarthritis also promising: We believe GLPG's continued progress in osteoarthritis (OA) is relatively underappreciated, and see it as a potential contributor of meaningful growth in the mid-to-long term. We expect that the Phase 2 ROCCELLA trial for GLPG1972 in OA is likely to read out in early 2021, with potential approval in 2024. Should Gilead opt-in after the phase 2b, Galapagos will receive an upfront payment of $250M, up to an additional $750M in milestones and 20-24% in tiered sales royalties.

Other inflammation fibrosis programs are pre-clinical, but over 20 programs provide diverse optionality: Leveraging the company's high-throughput target discovery platform, Galapagos has been actively expanding their portfolio of preclinical programs across many therapeutic areas. The most recently disclosed program is called "Toledo" and at the October 2018 R&D Day the company showed data demonstrating robust disease activity control in several GI mouse models. The company initiated its Phase 1 trial in January 2019. We expect additional updates from this program at the R&D day in November 2019.

Valuation: Our €174 TP is based on a sum-of-the-parts DCF valuation. We forecast cash flows through 2029 to account for known or anticipated competition and patent expirations. Beyond 2029, we apply a 1% terminal growth rate to Galapagos cash flows. Galapagos is discovery-focused biotech company, and we expect that the company will be able accelerate its R&D efforts, replacing cash flows at a rate faster than what is lost to erosion. The collaboration with Gilead allows the company to monetize assets earlier than it would otherwise be able to, via opt-in payments and milestones, while allowing it to share phase 3 clinical risk and ex-EU commercialization risk with an experienced partner. We account for the risk-mitigation of the collaboration via a 10% discount rate.

Figure 1: Galapagos SOTP Valuation



Source: Company data, Credit Suisse estimates

Risks to our target price and rating:

- **Clinical and developmental:** Some of our valuation and share upside potential is based on outcomes from clinical trials. If any of Galapagos' late-stage assets are shown to be clinically ineffective or unsafe, we would expect negative pressure on shares.
- **Regulatory:** Food and Drug Administration (FDA), European Medicines Agency (EMA), and other regulatory body approvals are required for Galapagos to market and sell its therapeutics. Any delay or outright rejection of the approval of investigational assets could have a negative impact on the future cash flows and value of Galapagos shares. Furthermore, FDA or EMA could revoke the marketing authorization of any marketed product due to safety or efficacy concerns.
- **Commercial:** EU sales and US sales royalties drive the majority of our cash flow and earnings estimates. If sales are worse than our or consensus expectations, we could see a negative impact on shares.
- **External/Market Risk:** Biotechnology remains a volatile sector that can be affected by external factors, including drug pricing legislation, intellectual property law, healthcare policy, and the overall economy. Negative policy developments and/or a weakening of the economy could affect Galapagos' share price.

Companies Mentioned *(Price as of 29-Jul-2019)*
Galapagos NV (GLPG.AS, €159.3, OUTPERFORM, TP €174.0)

Disclosure Appendix

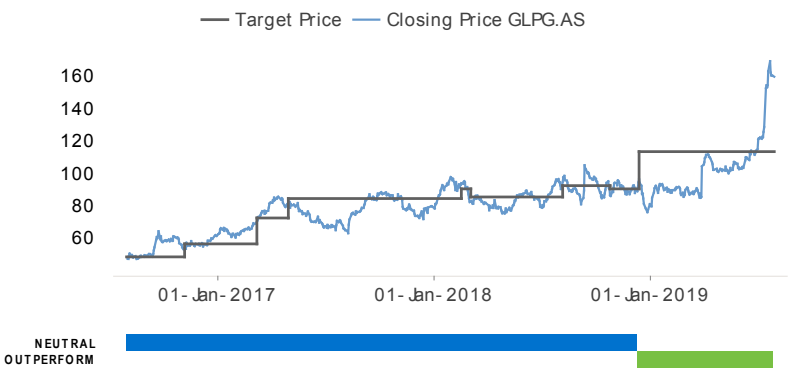
Analyst Certification

I, Evan Seigerman, certify that (1) the views expressed in this report accurately reflect my personal views about all of the subject companies and securities and (2) no part of my compensation was, is or will be directly or indirectly related to the specific recommendations or views expressed in this report.

3-Year Price and Rating History for Galapagos NV (GLPG.AS)

GLPG.AS	Closing Price	Target Price	
Date	(€)	(€)	Rating
31-Jul-16	48.71	48.00	N
06-Nov-16	52.78	56.00	
08-Mar-17	69.75	72.00	
30-Apr-17	80.46	84.00	
16-Feb-18	93.48	90.00	
04-Mar-18	81.84	85.00	
06-Aug-18	94.14	92.00	
25-Oct-18	86.04	90.00	
13-Dec-18	95.88	113.00	O
09-Jul-19	122.15	113.00	*

** Asterisk signifies initiation or assumption of coverage.*



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Outperform (O) : The stock's total return is expected to outperform the relevant benchmark* over the next 12 months.
Neutral (N) : The stock's total return is expected to be in line with the relevant benchmark* over the next 12 months.
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Neutral/Hold*	39%	(28% banking clients)
Underperform/Sell*	13%	(23% banking clients)
Restricted	2%	

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Target Price and Rating
Valuation Methodology and Risks: (12 months) for Galapagos NV (GLPG.AS)

Method: Our €174 target price and Outperform rating for Galapagos NV are based on a DCF (discounted cash flow) valuation. We use a 10% WACC (weighted average cost of capital) and forecast discounted cash flows through 2029, with terminal growth rate of 1% thereafter.

Risk: Risk to our €174 target price and Outperform rating: Clinical and developmental: Some of our valuation and share upside potential is based on outcomes from clinical trials. If any of Galapagos' late-stage assets are shown to be clinically ineffective or unsafe, we would expect negative pressure on shares. Regulatory: Food and Drug Administration (FDA), European Medicines Agency (EMA), and other regulatory body approvals are required for Galapagos to market and sell its therapeutics. Any delay or outright rejection of the approval of investigational assets could have a negative impact on the future cash flows and value of Galapagos shares. Furthermore, FDA or EMA could revoke the marketing authorization of any marketed product due to safety or efficacy concerns. Commercial: EU sales and US sales royalties drive the majority of our cash flow and earnings estimates. If sales are worse than our or consensus expectations, we could see a negative impact on shares. External/Market Risk: Biotechnology remains a volatile sector that can be affected by external factors, including drug pricing legislation, intellectual property law, healthcare policy, and the overall economy. Negative policy developments and/or a weakening of the economy could affect Galapagos' share price.

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See the Companies Mentioned section for full company names
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This research report is authored by:
Credit Suisse Securities (USA) LLC.....Evan Seigerman

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