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Americas/United States
Equity Research
Specialty Pharmaceuticals

Galapagos NV (GLPG)

COMPANY UPDATE

R&D Day Highlights Progress With Filgo, Modest Delay With CF Triplet

Rating	**NEUTRAL [V]**
Price (20-Jun-17, €)	70.66
Target price (€)	84.00
52-week price range (€)	85.10 - 45.04
Market cap (€ m)	3,590.63

Target price is for 12 months.
[V] = Stock Considered Volatile (see Disclosure Appendix)

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- **Bottom Line:** We attended GLPG's R&D Day this morning in NYC. Investor interest was mainly on the cystic fibrosis (CF) franchise (partnered with ABBV) and the start of studies with the triplet being pushed back to 4Q 2017 (from mid-2017). We acknowledge this was disappointing, but we had anticipated there might be some delays along the way with the CF franchise given the relatively aggressive timelines the company had laid out previously. With filgotinib (partnered with GILD) the company laid out a compelling case for why they have a potential best-in-class asset with a broad development program well underway and likely to expand further. Following the recent pullback in the stock we find it somewhat more compelling, but we remain Neutral-rated for now as we see other SMID cap names in our coverage as more compelling based on their near-term catalyst profiles.

Financial and valuation metrics

Year	12/16A	12/17E	12/18E	12/19E
EPS (CS adj.) (€)	1.14	-1.17	0.57	-1.85
Prev. EPS (€)	-	-	-	-
P/E (x)	61.9	-60.5	124.8	-38.3
P/E rel. (%)	302.4	-365.5	841.7	-291.9
Revenue (€ m)	151.6	157.4	293.6	187.6
EBITDA (€ m)	-6.0	-48.0	32.0	-82.1
OCFPS (€)	5.06	-2.04	-0.91	-3.46
P/OCF (x)	12.0	-34.7	-77.6	-20.4
EV/EBITDA (current)	-440.0	-55.0	82.3	-32.1
Net debt (€ m)	-973	-883	-837	-672
ROIC (%)	5.33	34.41	-40.51	-239.18

Number of shares (m)	50.82	IC (current, € m)	-214.48
BV/share (Next Qtr., €)	15.7	EV/IC (x)	-15.0
Net debt (Next Qtr., € m)	-907.3	Dividend (current, €)	-
Net debt/tot eq (Next Qtr.,%)	-124.6	Dividend yield (%)	-

Source: Company data, Thomson Reuters, Credit Suisse estimates

- **Multiple options within CF portfolio, although initial triplet start pushed out:** With three potentiators, two C1 correctors and two C2 correctors in development, GLPG clearly has many options available in developing a triplet combination. The company is wisely taking its time with its regulatory strategy, with a focus on the UK regulators first and then expanding out to other countries from there. A long half-life for the active metabolite of the potentiator '2451 was surprising information revealed today that is leading to the need for additional follow-up before regulatory meetings next quarter and the potential start of Phase 2 studies with '2451 (in combination with the correctors '2222 and '2737) in 4Q. If the metabolite continues to cause issues going forward, GLPG has the potentiator '3067 also in mid-stage development, with studies beginning in triplet combinations in patients by early 2018. Preclinical assays of GLPG combos show the potential for added efficacy over what has been seen with VRTX, although we wait to see how this plays out in clinical trials, with several reading out over the next 12-18 months. Following the R&D Day we hosted a lunch with a CF expert who suggested a 5% improvement over placebo is likely needed for data from a triplet to be clinically meaningful. She was less familiar with the work GLPG has done to date, but sees an opening for GLPG if they can effectively enroll their studies and at least show equivalence to VRTX. She also sees a potential place for a new player on the market given the increased flexibility it will give patients and physicians both in terms of enrolling patients in new clinical trials and prescribing the medications once they are available commercially. In regards to one of the main side effects of interest, our doctor felt a teratogenicity risk would be an issue for enrollment of clinical trials but less of an issue post-approval since only half of her practice is female patients and a relatively low rate of her female patients (~10%) are actually trying to conceive.
- **Recent data highlights filgotinib's strong clinical profile:** GLPG continues to highlight the selectivity of filgotinib for JAK1 over JAK2 and the potential impact this may have on infection rates, red blood cell counts and platelet counts. Based on cross-trial comparisons highlighted by the company today, filgotinib exhibits a strong efficacy profile and potentially more attractive safety profile than the other main oral JAKs either on the market or in development (PFE's Xeljanz, LLY/INCY's baricitinib and ABBV's upadacitinib). The product is already in phase 3 in three potentially large indications (rheumatoid arthritis, Crohn's disease, ulcerative colitis), with six other indications in Phase 2 and additional proof of concept studies planned. The 60-week data presented at EULAR adds increased confidence on filgotinib's long-term safety profile, with additional longer-term follow-up data possible at ACR later this year. We assume $3.5Bn in peak sales for filgotinib given its potential best-in-class profile but also limited somewhat by the fact that generic versions of Xeljanz will likely enter the US market in the 2025 timeframe.
- **Other pipeline assets less of focus now, but provide areas of additional possible upside:** Most of the focus at the R&D Day was on filgotinib and the CF franchise, with very little focus on the other, earlier-stage assets. This is understandable given the limited data we have on the rest of the pipeline to date, although that may change over the coming months, potentially driving additional upside in the stock. GLPG1690 is GLPG's most advanced fully-owned asset in development for the treatment of IPF with topline Phase 2a data in 3Q 2017. GLPG1972 (partnered with Servier) will have its initial Phase 1b study in osteoarthritis recruited by the end of the year while MOR106 (with Morphosys) is focused on atopic dermatitis and with Phase 1 data expected in 2H 2017.
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Figure 1: GLPG Triplet Patient Studies

- Phase 1b: 1 month studies
- '2737 add-on to Orkambi
  - submission in July '17
  - start Q4 2017 – data H1 '18
- '2451 + '2222 + '2737
  - start of regulatory process in July '17
  - start Q4 '17 – data mid '18
- '3067 + '2222 + '2737
  - start early '18 – data H2 '18
- '3067 + '2222 + '3221
  - start mid '18 – data early '19

Source: GLPG Company data

Figure 2: GLPG Income Statement, 2015A - 2024E

Galapagos Income Statement														
(Euros in '000s, except per share amounts)	**2015A**	**2016A**	**Q1 2017A**	**Q2 2017E**	**Q3 2017E**	**Q4 2017E**	**2017E**	**2018E**	**2019E**	**2020E**	**2021E**	**2022E**	**2023E**	**2024E**
Royalty/Profit sharing Revenues	0	0	0	0	0	0	0	0	0	33,489	103,017	214,046	382,068	473,689
Product Revenues	0	0	0	0	0	0	0	0	0	16,403	79,570	170,753	272,300	339,088
R&D and Other Revenues	60,579	151,612	39,863	21,828	79,159	16,591	157,440	293,567	187,633	173,765	34,573	86,575	22,093	47,454
Total Revenues	**60,579**	**151,612**	**39,863**	**21,828**	**79,159**	**16,591**	**157,440**	**293,567**	**187,633**	**223,657**	**217,161**	**471,374**	**676,461**	**860,232**
Cost of Sales	0	0	0	0	0	0	0	0	0	0	7,957	15,368	21,784	23,736
Gross Profit	**60,579**	**151,612**	**39,863**	**21,828**	**79,159**	**16,591**	**157,440**	**293,567**	**187,633**	**223,657**	**209,204**	**456,006**	**654,677**	**836,495**
Research and development expenditure	129,714	139,573	44,930	43,542	45,439	50,541	184,452	237,984	238,363	192,679	156,230	141,923	129,111	117,650
SG&A	20,309	23,529	6,158	6,565	6,847	7,489	27,059	30,397	38,764	49,945	60,762	62,240	63,761	65,326
Restructuring and integration costs	0	0	0	0	0	0	0	0	0	0	0	0	0	0
Total Operating Expenses	**150,023**	**163,102**	**51,088**	**50,107**	**52,286**	**58,031**	**211,511**	**268,381**	**277,127**	**242,624**	**216,992**	**204,163**	**192,872**	**182,976**
Operating Income/(Loss)	**(89,444)**	**(11,490)**	**(11,225)**	**(28,279)**	**26,873**	**(41,440)**	**(54,071)**	**25,186**	**(89,494)**	**(18,967)**	**(7,788)**	**251,844**	**461,805**	**653,519**
Financial Income	1,916	67,429	894	762	725	740	3,122	2,666	2,527	2,031	1,884	1,919	2,726	3,992
Financial Expense	(32,100)	(1,692)	(3,274)	(0)	(0)	(0)	(3,275)	(2)	(2)	(2)	(2)	(2)	(2)	(2)
Net Finance Income	(30,184)	65,737	(2,380)	762	725	740	(153)	2,664	2,525	2,029	1,882	1,918	2,724	3,990
Pre-Tax Profit/(Loss)	**(119,628)**	**54,247**	**(13,605)**	**(27,517)**	**27,598**	**(40,700)**	**(54,225)**	**27,850**	**(86,969)**	**(16,937)**	**(5,906)**	**253,761**	**464,529**	**657,510**
Income Tax Expense	(1,218)	235	0	0	0	0	0	0	0	0	0	6,674	61,944	89,537
Effective Tax Rate	*1.0%*	*0.4%*	*0.0%*	*0.0%*	*0.0%*	*0.0%*	*0.0%*	*0.0%*	*0.0%*	*0.0%*	*0.0%*	*2.6%*	*13.3%*	*13.6%*
Net profit/(loss) from continuing operations	**(118,410)**	**54,012**	**(13,605)**	**(27,517)**	**27,598**	**(40,700)**	**(54,225)**	**27,850**	**(86,969)**	**(16,937)**	**(5,906)**	**247,087**	**402,585**	**567,972**
Net income from discontinued operations	0	0	0	0	0	0	0	0	0	0	0	0	0	0
Consolidated Net Income/(Loss)	**(118,410)**	**54,012**	**(13,605)**	**(27,517)**	**27,598**	**(40,700)**	**(54,225)**	**27,850**	**(86,969)**	**(16,937)**	**(5,906)**	**247,087**	**402,585**	**567,972**
Diluted EPS, Adjusted	**(3.32)**	**1.14**	**(0.29)**	**(0.59)**	**0.57**	**(0.88)**	**(1.17)**	**0.57**	**(1.85)**	**(0.36)**	**(0.12)**	**4.75**	**7.63**	**10.62**
Diluted EPS, GAAP	**(3.32)**	**1.14**	**(0.29)**	**(0.59)**	**0.57**	**(0.88)**	**(1.17)**	**0.57**	**(1.85)**	**(0.36)**	**(0.12)**	**4.75**	**7.63**	**10.62**

Source: Company data, Credit Suisse estimates

Companies Mentioned *(Price as of 20-Jun-2017)*
Galapagos NV (GLPG.AS, €70.66, NEUTRAL[V], TP €84.0)
Vertex Pharmaceuticals Incorporated (VRTX.OQ, $126.33)

Disclosure Appendix

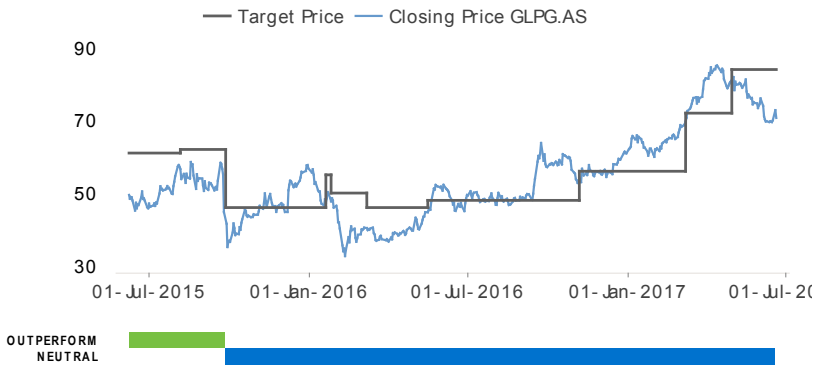
Analyst Certification

I, Vamil Divan, MD, 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
08-Jun-15	49.48	61.00	O *
06-Aug-15	56.60	62.00	
27-Sep-15	44.75	46.00	N
20-Jan-16	47.36	55.00	
26-Jan-16	47.70	50.00	
07-Mar-16	40.37	46.00	
16-May-16	44.72	48.00	
06-Nov-16	52.78	56.00	
08-Mar-17	69.75	72.00	
30-Apr-17	80.46	84.00	

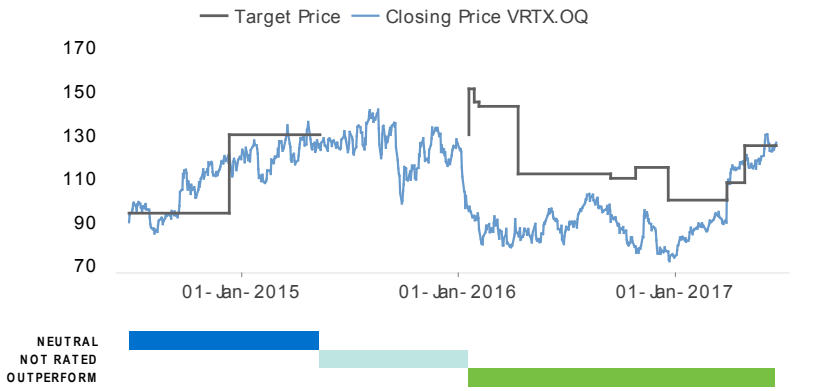
** Asterisk signifies initiation or assumption of coverage.*



3-Year Price and Rating History for Vertex Pharmaceuticals Incorporated (VRTX.OQ)

VRTX.OQ	Closing Price	Target Price	
Date	(US$)	(US$)	Rating
25-Jun-14	89.86	94.00	N
11-Dec-14	120.78	130.00	
13-May-15	125.52		NR
19-Jan-16	94.99	151.00	O *
28-Jan-16	92.76	145.00	
05-Feb-16	86.61	143.00	
11-Apr-16	84.47	112.00	
14-Sep-16	90.12	110.00	
26-Oct-16	78.71	115.00	
20-Dec-16	76.44	100.00	
29-Mar-17	108.01	108.00	
28-Apr-17	118.30	125.00	

** Asterisk signifies initiation or assumption of coverage.*



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

Method: Our €84 target price for Galapagos NV is based on a DCF (discounted cash flow) valuation. We use a 10% WACC (weighted average cost of capital) and forecast discounted cash flows through 2030, with terminal growth rate of -2% thereafter. We maintain our Neutral rating given the uncertainties ahead of the end of Phase 2 meeting with the FDA.

Risk: The risks to our €84 target price and Neutral rating for Galapagos NV include: 1. Clinical development setbacks of filgotinib most significant near-term risk 2. Remaining pipeline relatively early in development, providing clinical and commercial risk 3. Manufacturing issues as GLPG does not own or operate manufacturing facilities for the production of product candidates 4. Uptake of Filgotinib and other pipeline assets is lower than we expect 5. Collaboration issues

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