



COMPANY UPDATE Galapagos NV (GLPG.AS)

Buy

Equity Research

Still positive post outperformance; 12m PT to €96, remain Buy

What's changed

We update our Galapagos estimates after 2016 results and the latest news. Incorporating the latest Phase 2 trial announcements, our 12-month target price increases to €96/share (16% upside) from €81 and we remain Buy rated. We also introduce an M&A component into our target price as Galapagos now ranks as 2 in our M&A framework (15% weighting). This is because we believe that there is increasing appetite for M&A acquisitions in biotech, and Galapagos has rapidly developing partnerships.

Implications

Galapagos and partner Gilead have announced Phase 2 trials for lead asset filgotinib in psoriatic arthritis, ankylosing spondylitis, Sjögren's disease, small bowel Crohn's and fistulizing Crohn's. We now incorporate forecasts for all these diseases into our model. Before a probability adjustment, we believe that the total sales opportunity for filgotinib in these diseases could be \$5.7 bn. We apply a 20% probability of success due to the early stage of the trials. Incorporating potential royalties from these sales adds €14/share to our DCF-based model.

Valuation

Our 12-month target price of €96 is composed of a SOTP DCF-based value of €91/share (85% weighting), and a potential M&A valuation of €123/share (15% weighting). Our M&A valuation is calculated by: (i) applying a 7.5% WACC to our stand-alone DCF (assumed WACC of a larger potential acquirer), rather than the 10% WACC we assume for Galapagos, and (ii) assuming 90% cost synergies (as we believe an acquirer would acquire Galapagos for its IP rather than the infrastructure).

Key risks

Key downside risks to our view and price target are outcomes of clinical trials, ability to recruit patients into later-stage cystic fibrosis trials, and potential value-destructive M&A.

INVESTMENT LIST MEMBERSHIP

Pan-Europe Buy List

Coverage View: Neutral

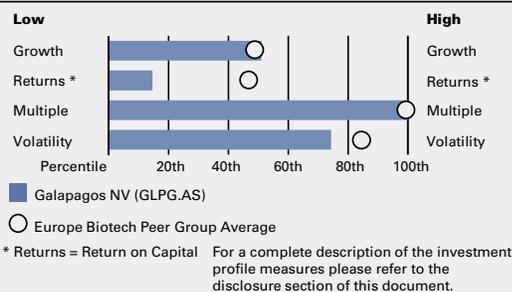
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Investment Profile



Key data	Current			
Price (€)	82.51			
12 month price target (€)	96.00			
Upside/downside (%)	16			
Market cap (€ mn)	3,770.4			
Enterprise value (€ mn)	2,935.0			
	12/16	12/17E	12/18E	12/19E
Revenue (€ mn) New	151.6	63.4	66.4	191.8
Revenue revision (%)	28.8	0.0	0.0	0.0
EBIT (€ mn) New	(11.5)	(100.8)	(103.5)	18.1
EBIT revision (%)	NM	(14.4)	(20.7)	(73.8)
EPS (€) New	1.18	(1.59)	(1.68)	0.74
EPS (€) Old	1.58	(1.57)	(1.52)	1.63
EV/EBITDA (X)	NM	NM	NM	141.7
P/E (X)	41.1	NM	NM	111.5
Dividend yield (%)	0.0	0.0	0.0	0.0
FCF yield (%)	10.6	(3.1)	(3.6)	(2.7)
CROCI (%)	99.1	660.8	653.5	(496.9)

Price performance chart



Share price performance (%)	3 month	6 month	12 month
Absolute	26.9	41.7	121.5
Rel. to FTSE World Europe (EUR)	22.1	29.0	94.6

Source: Company data, Goldman Sachs Research estimates, FactSet. Price as of 4/05/2017 close.

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Galapagos NV: Summary Financials

Profit model (€ mn)	12/16	12/17E	12/18E	12/19E	Balance sheet (€ mn)	12/16	12/17E	12/18E	12/19E
Total revenue	151.6	63.4	66.4	191.8	Cash & equivalents	973.2	881.5	771.0	681.7
Operating costs	(23.5)	(24.2)	(25.0)	(25.7)	Accounts receivable	9.7	6.9	7.2	20.7
R&D	(139.6)	(140.0)	(145.0)	(148.0)	Inventory	0.3	0.0	0.0	0.0
Lease payments	0.0	0.0	0.0	0.0	Other current assets	24.0	24.0	24.0	24.0
Other operating profit/(expense)	0.0	0.0	0.0	0.0	Total current assets	1,007.2	912.4	802.1	726.4
EBITDA	(7.3)	(96.5)	(99.7)	22.1	Net PP&E	15.0	16.2	17.5	18.7
Depreciation & amortisation	(4.2)	(4.3)	(3.8)	(4.0)	Net intangibles	1.0	0.6	1.0	1.3
EBIT	(11.5)	(100.8)	(103.5)	18.1	Total investments	0.0	0.0	0.0	0.0
Net interest income/(expense)	8.3	13.8	12.2	10.7	Other long-term assets	60.1	56.1	56.1	56.1
Associates	0.0	0.0	0.0	0.0	Total assets	1,083.3	985.3	876.7	802.5
Profit/(loss) on disposals	0.0	0.0	0.0	0.0	Accounts payable	31.3	40.8	42.2	0.0
Others (recurring)	57.5	8.0	8.0	8.0	Short-term debt	0.0	0.0	0.0	0.0
Pretax profits	54.2	(79.0)	(83.3)	36.7	Other current liabilities	72.5	71.5	71.5	71.5
Income tax	(0.2)	5.4	5.7	(2.5)	Total current liabilities	103.8	112.3	113.7	71.5
Tax rate (%)	0.4	6.8	6.8	6.8	Long-term debt	0.0	0.0	0.0	0.0
Minorities	0.0	0.0	0.0	0.0	Other long-term liabilities	220.8	173.6	126.3	79.1
Preferred dividends	0.0	0.0	0.0	0.0	Total long-term liabilities	220.8	173.6	126.3	79.1
Net income (pre-exceptionals)	54.0	(73.6)	(77.7)	34.2	Total liabilities	324.6	285.9	240.0	150.6
Other non-recurring items post tax	0.0	0.0	0.0	0.0	Preferred shares	0.0	0.0	0.0	0.0
Net income	54.0	(73.6)	(77.7)	34.2	Total common equity	758.7	699.5	636.7	651.9
EPS (underlying) (€)	1.18	(1.59)	(1.68)	0.74	Minority interest	0.0	0.0	0.0	0.0
EPS (basic, reported) (€)	1.18	(1.59)	(1.68)	0.74	Total liabilities & equity	1,083.3	985.3	876.7	802.5
Weighted shares outstanding (mn)	45.7	46.3	46.3	46.3	Capitalised leases	0.1	0.1	0.1	0.1
Common dividends declared	0.0	0.0	0.0	0.0	Capital employed	758.7	699.5	636.7	651.9
DPS (€)	0.00	0.00	0.00	0.00	Adj for unfunded pensions & GW	0.0	0.0	0.0	0.0
Dividend payout ratio (%)	0.0	0.0	0.0	0.0	Adj capital employed	758.7	699.5	636.7	651.9
Dividend cover (X)	NM	NM	NM	NM	Gross cash invested	(17.8)	(24.3)	(20.0)	41.3
Growth & margins (%)	12/16	12/17E	12/18E	12/19E	Ratios	12/16	12/17E	12/18E	12/19E
Revenue growth	150.3	(58.2)	4.7	188.7	CROCI (%)	99.1	660.8	653.5	(496.9)
EBITDA growth	91.5	(1,220.1)	(3.4)	122.2	CROCI/WACC (X)	--	--	--	--
EBIT growth	87.2	(777.3)	(2.7)	117.5	ROIC (%)	29.0	158.8	150.1	(47.6)
Net income growth	145.6	(236.3)	(5.5)	144.1	ROIC/WACC (X)	--	--	--	--
EPS growth	135.6	(234.6)	(5.5)	144.1	ROA (%)	6.0	(8.4)	(9.6)	2.9
DPS growth	NM	NM	NM	NM	WACC (%)	--	--	--	--
EBITDA margin	(4.8)	(152.1)	(150.1)	11.5	Inventory days	0.8	0.9	--	--
EBIT margin	(7.6)	(158.9)	(155.9)	9.4	Asset turnover (X)	10.5	4.1	3.9	10.6
Cash flow statement (€ mn)	12/16	12/17E	12/18E	12/19E	Net debt/equity (%)	(128.3)	(126.0)	(121.1)	(104.6)
Net income	54.0	(73.6)	(77.7)	34.2	EBITDA interest cover (X)	0.9	7.0	8.2	(2.1)
D&A add-back (incl. ESO)	4.2	4.3	3.8	4.0	Valuation	12/16	12/17E	12/18E	12/19E
Minority interest add-back	0.0	0.0	0.0	0.0	EV/sales (X)	8.2	46.3	45.8	16.3
Net (inc)/dec working capital	235.0	11.6	1.1	(55.7)	EV/EBITDAR (X)	NM	NM	NM	141.7
Other operating cash flow	(53.7)	(57.1)	(59.4)	(81.5)	EV/EBITDA (X)	NM	NM	NM	141.7
Cash flow from operations	239.4	(114.7)	(132.2)	(98.9)	EV/EBIT (X)	NM	NM	NM	173.4
Capital expenditures	(4.8)	(5.2)	(5.4)	(5.6)	P/E (X)	41.1	NM	NM	111.5
Acquisitions	(2.8)	0.0	0.0	0.0	Dividend yield (%)	0.0	0.0	0.0	0.0
Divestitures	0.0	0.0	0.0	0.0	FCF yield (%)	10.6	(3.1)	(3.6)	(2.7)
Others	0.2	0.0	0.0	0.0	EV/GCI (X)	--	--	--	75.8
Cash flow from investing	(7.3)	(5.2)	(5.4)	(5.6)	EV/adj. capital employed (X)	NM	NM	NM	NM
Dividends paid (common & pref)	0.0	0.0	0.0	0.0	Price/book (X)	3.7	5.5	6.0	5.9
Inc/(dec) in debt	0.0	0.0	0.0	0.0	Note: Ratios are adjusted for leases where appropriate. Only separately disclosed where significant and ongoing.				
Other financing cash flows	396.0	28.2	27.1	15.2	Note: Last actual year may include reported and estimated data.				
Cash flow from financing	396.0	28.2	27.1	15.2	Source: Company data, Goldman Sachs Research estimates.				
Total cash flow	632.9	(91.7)	(110.5)	(89.3)					
Capex/D&A (%)	114.5	119.7	142.1	137.9					
Reinvestment rate (%)	107.7	(4.1)	(4.1)	(12.9)					
Cash flow cover of dividends (X)	NM	NM	NM	NM					
Free cash flow cover of dividends (X)	--	--	--	--					

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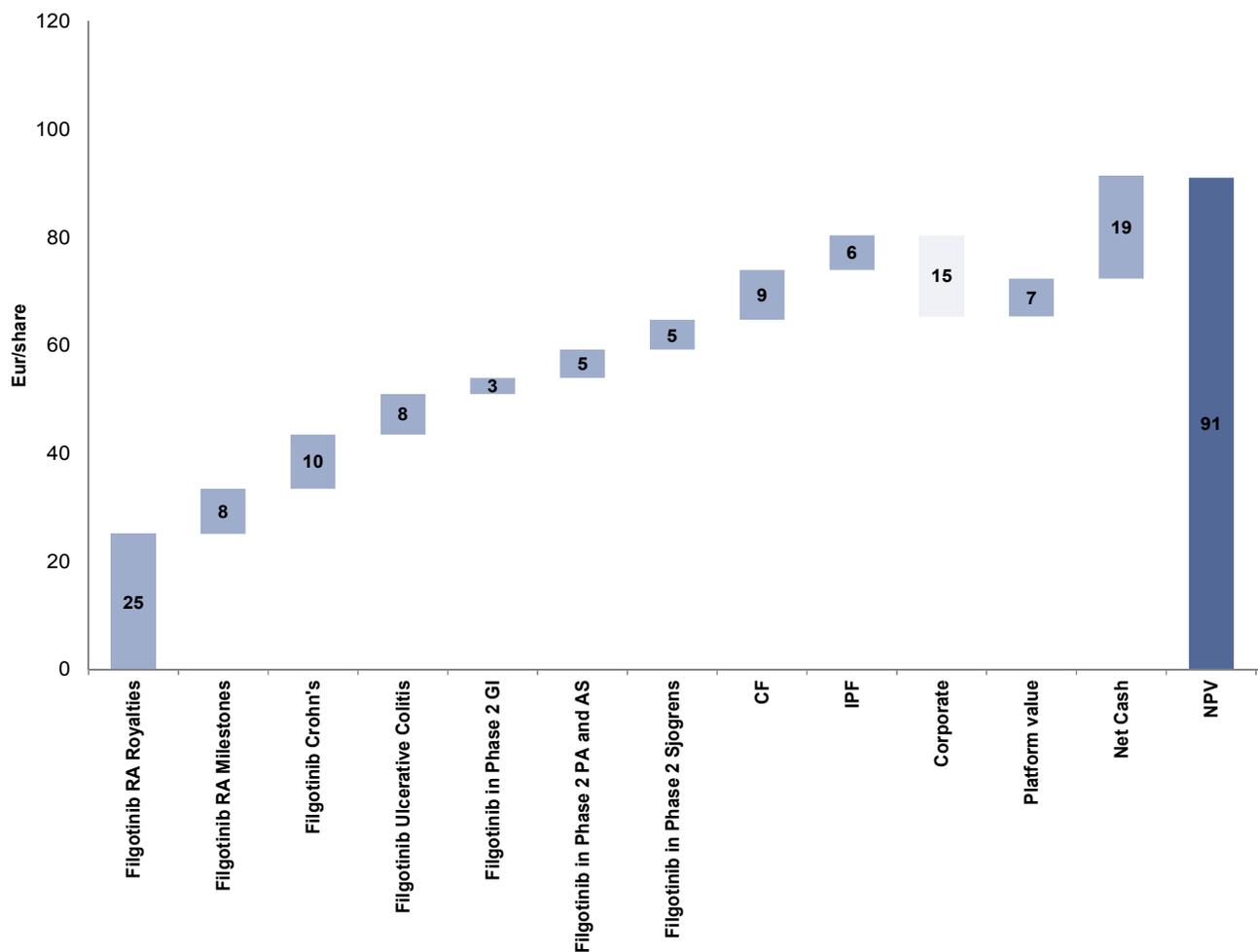
Valuation summary

Since mid-October 2016 Galapagos has outperformed our European biotech coverage (Genmab, MorphoSys, Innate Pharma, indexed, excluding Actelion), gaining 40% vs. 18%, and SXDP of 8%. Part of this has been driven by a rerating across the board in European biotech.

However, we continue to remain positive on the Galapagos story as believe that the market will continue to recognize the potential upside in Galapagos' cystic fibrosis assets, as the development progresses and more data is shown. Galapagos aims to start testing the triple combination therapy in patients in mid-2017. For more details please see our note *Reassessing European Biotech - Galapagos, Innate top picks*, October 18, 2016.

Below shows our latest sum of the parts, DCF-based valuation model:

Exhibit 1: Sum of the parts DCF valuation of Galapagos



Source: Goldman Sachs Global Investment Research.

The new components to our valuation are the estimates for filgotinib in small bowel Crohns and fistulizing Crohns (€3/share, based on potential peak sales of \$1.1 bn and a 20% probability adjustment), psoriatic arthritis and ankylosing spondylitis (€5/share, based on potential peak sales of \$2.1 bn and a 20% probability adjustment), and Sjögren's disease (€5/share, based on potential peak sales of \$2.5 bn and a 20% probability adjustment).

The largest component of value is in Sjögren's disease, and this because we believe there is a greater unmet need in this disease. Sjögren's disease affects mucous membranes. In mild cases, this can manifest as dry eyes and dry mouth, and can be treated with drugs that address symptoms such as eye drops. However, for more severe cases there are no disease-modifying drugs approved.

M&A framework: Adding an M&A component to our price target

Where relevant, we assess the stocks in our coverage using an M&A framework, considering both qualitative factors (therapeutic areas targeted, phase of drug development, existing partnerships, upcoming clinical catalysts and quantitative factors (market potential of drugs) to incorporate the potential that certain companies could be acquired at a premium to current share prices. We assign an M&A score as a means of ranking companies under coverage from 1 to 4, with 1 representing a high (30%-50%) probability of M&A activity, 2 representing a medium (15%-30%) probability, 3 representing a low (10%-15%) probability and 4 representing minimal/zero probability (0%-10%). For companies ranked 1 or 2, in line with our standard departmental guidelines, we incorporate an M&A component into our target price.

We have attributed an M&A rank of 2 to Galapagos, and weight our M&A value by 15% (reflecting the probability implied by this ranking) within our price target methodology. In order to derive the M&A value, we: (1) applying a 7.5% WACC to our stand-alone DCF (assumed WACC of larger potential acquirer), rather than the 10% WACC we assume for Galapagos, and (2) assume 90% cost synergies (as we believe an acquirer would acquire Galapagos for its IP rather than the infrastructure).

Below we show our forecast P&L for Galapagos:

Exhibit 2: Galapagos forecast P&L

EUR (mn)	2011	2012	2013	2014	2015	2016	2017E	2018E	2019E	2020E	2021E	2022E
	FY	FY	FY	FY	FY	FY	FY	FY	FY	FY	FY	FY
Sale of goods	12.5	2.2	4.1	-	-	-	-	-	-	-	-	-
Services	51.8	66.9	58.7	-	-	-	-	-	-	-	-	-
Milestone payments	29.7	28.2	22.6	69.368	39.6	129.5	39.4	39.4	161.8	165.0	112.7	77.3
Royalties	-	-	-	-	-	-	-	-	-	30.5	85.0	168.2
CF Royalties	-	-	-	-	-	-	-	-	-	15.5	32.7	49.9
Other R&D Revenue	0.1	0.0	-	-	-	-	-	-	-	-	-	-
Upfront-payment	1.8	38.5	52.0	-	-	-	-	-	-	-	-	-
Other income	19.4	17.2	22.1	20.653	21.0	22.1	24.0	27.0	30.0	30.0	30.0	30.0
Revenues	115.3	153.0	159.5	90.0	60.6	151.6	63.4	66.4	191.8	240.9	260.4	325.4
Cost of sales	(40.9)	(48.2)	(41.3)	-	-	-	-	-	-	-	-	-
%	-35.5%	-31.5%	-25.9%	0.0%	0.0%	-2.0%	-3.0%	-4.0%	-4.0%	-4.0%	-4.0%	-4.0%
R&D	(84.5)	(80.3)	(99.4)	(111.1)	(129.7)	(139.6)	(140.0)	(145.0)	(148.0)	(150.0)	(150.0)	(150.0)
%	-73.3%	-52.5%	-62.3%	-123.4%	-214.1%	-92.1%	-220.7%	-218.3%	-77.2%	-62.3%	-57.6%	-46.1%
SG&A	(25.0)	(26.6)	(28.8)	(14.9)	(20.3)	(23.5)	(24.2)	(25.0)	(25.7)	(26.5)	(27.3)	(28.1)
%	-21.7%	-17.4%	-18.1%	-10.0%	-33.5%	-15.5%	-38.2%	-37.6%	-13.4%	-11.0%	-10.5%	-8.6%
Memo: cost base	(109.5)	(106.9)	(128.2)	(126.0)	(150.0)	(163.1)	(164.2)	(170.0)	(173.7)	(176.5)	(177.3)	(178.1)
Other operating income / costs	2.2	(4.5)	(1.0)	(0.7)	-	-	-	-	-	-	-	-
Operating profit	(32.9)	(6.6)	(11.0)	(36.6)	(89.4)	(11.5)	(100.8)	(103.5)	18.1	64.5	83.1	147.3
%	-28.6%	-4.3%	-6.9%	-40.7%	-147.6%	-7.6%	-158.9%	-155.9%	9.4%	26.8%	31.9%	45.3%
Net Financial Income/Expense	(0.8)	1.5	(0.2)	1.4	0.4	8.3	13.8	12.2	10.7	9.7	9.4	9.4
Other income	-	-	-	-	(30.6)	57.5	8.0	8.0	8.0	7.0	7.0	7.0
Net Income before tax	(33.7)	(5.2)	(11.2)	(35.2)	(119.6)	54.2	(79.0)	(83.3)	36.7	81.1	99.5	163.6
Corporate taxes	0.6	(0.6)	3.1	(2.1)	1.2	(0.2)	5.4	5.7	(2.5)	(5.5)	(6.8)	(11.1)
%	-1.9%	11.0%	-27.8%	6.0%	0.0%	-3.0%	-6.8%	-6.8%	-6.8%	-6.8%	-6.8%	-6.8%
Net Income	-33.1	-5.7	-8.1	-37.3	-118.4	54.0	-73.6	-77.7	34.2	75.6	92.7	152.5
Basic EPS	-1.25	-0.22	-0.28	-1.24	-3.32	1.18	-1.59	-1.68	0.74	1.63	2.01	3.30
Diluted EPS	-1.25	-0.22	-0.28	-1.24	-3.32	1.18	-1.54	-1.62	0.74	1.63	2.01	3.30

Source: Company data, Goldman Sachs Global Investment Research.

Disclosure Appendix

Reg AC

We, Tim Woodward, CFA, Keyur Parekh, Rebekah Yu, Ph.D. and Mick Readey, hereby certify that all of the views expressed in this report accurately reflect our personal views about the subject company or companies and its or their securities. We also certify that no part of our compensation was, is or will be, directly or indirectly, related to the specific recommendations or views expressed in this report.

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Tim Woodward, CFA: Europe-Biotech, Europe-Pharmaceuticals. Keyur Parekh: Europe-Pharmaceuticals.

Europe-Biotech: Actelion, Galapagos NV, Genmab, Innate Pharma SA, MorphoSys AG.

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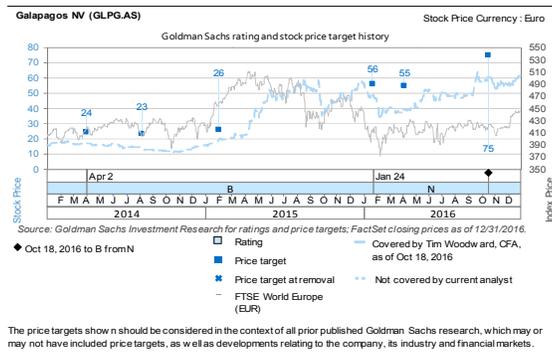
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Price target and rating history chart(s)



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