

This is how you do it

European Life Sciences

15 July 2019, 08:27

Gilead and Galapagos entered a collaboration granting Gilead options for ex-EU rights for anything coming from Galapagos' pipeline for the next 10 years in exchange for \$3.95b upfront, \$1.1b equity investment plus multibillion future milestones. In all, the deal seems like a total win-win for both parties where Gilead finally gets the late-stage pipeline and exciting R&D engine, and Galapagos gains a strong and committed commercial partner, who will help build Galapagos' own infrastructure, and desired independence from takeover attempts and financial markets, while further expanding the R&D to discover novel targets. Just reflecting the upfront, equity investments and the nearterm milestones and royalties on the proprietary pipeline in our model, without a potential commercial advantage from having Gilead as a partner, our PT goes to €180 (\$160 for ADR) from €135 (\$120). Galapagos continues to feature on our favorites list.

A bargain on rich terms

With \$3.95b upfront, ~\$1b in nearterm milestones (GLPG1690, GLPG1972, 1-2 Toledo compounds) and a 20-24% royalty rate for ex-EU rights (~60-70% of total drug sales), the deal values Galapagos' early stage pipeline beyond our wildest dreams (our est. €14/share or €710m ex-filgo) and the consensus (€5-30 per share) estimates for the pipeline. However, considering the depth of Galapagos' pipeline (e.g. ~10 compounds for fibrosis at different stages and at least 5 Toledo compounds) and the prolificity of the R&D engine (e.g. R&D in osteoarthritis, Hep B, NASH), and the plan to double the R&D platform, Gilead got a bargain in the long term.

- **Equity investment:** Gilead will invest \$1.1b for 12.4% of Galapagos' shares at €140.59 (20% premium to 30d VWAP). In addition, Galapagos intends to grant Gilead 2 warrants to increase the stake to 25% at €140.59 for 1 year and to 29.9% at 30d VWAP+20% premium for 10 years. In return, Gilead agrees to 10-year standstill not to increase the stake beyond 29.9%. Gilead will appoint 2 Board members to Galapagos, including Dan O'Day.
- **\$3.95bn upfront** to be recognized over 10 year period.
- **General terms:** For the next 10 years, Galapagos will develop programs till the end of phase II, after which Gilead has an option to in-license the compound ex-EU. The further development cost will be shared equally. Galapagos will be entitled to \$150m milestones per compound and 20-24% royalty rate, which is rather a rich term considering that most of the programs in question have not reached proof of concept.
- **GLPG1690 in IPF:** Full rights on the compound ex-EU, 50/50 cost split on the ongoing phase III + \$325m milestone on the approval in the US.

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Rating	BUY
Price Target	€180.00
Closing price (12 Jul 2019)	€128.15

Previous rating and Price target

Change	Revision	Old
PT	29 Mar 2019	€135.00

Company data

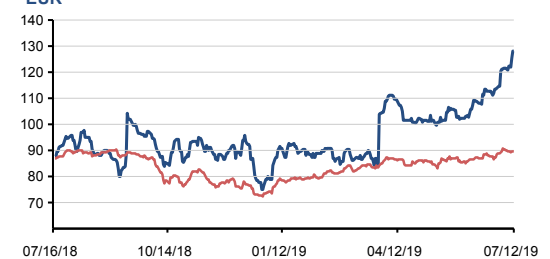
Market Cap	€7,025.6m
52-week range	€74.48 - €128.15
Number of shares	54.8m
Free float	61.6%
Avg. daily volume (20d)	387,875
Avg. daily turnover (20d)	€45,621,235
Daily turnover	€83,173,660
Next announcement date	25 July 2019
Reporting Period	H1'19 results

FY 31-Dec, EUR

	2019E	2020E
Total revenues	704.9	796.5
EBITDA	202.0	134.1
EBIT	202.0	134.1
Net profit	202.0	134.1

Source: Kempen estimates

EUR



- **GLPG1972 in osteoarthritis:** Option on US rights (n.b. Servier owns ex-US rights), 20-24% royalties, \$250m licensing milestone, a \$200m milestone on data in phase IIb (H2'20, our guess some effect on pain and function) + \$550m in regulatory and commercial milestone. Given the commercial potential of the disease-modifying drug in osteoarthritis (could be easily \$4b+), the extra milestones seem just.

More of filgo

While the general terms of the filgo agreement remained unchanged: 20-30% royalties ex-EU and 50/50 revenue split in EU5 plus the Benelux, Galapagos will now participate on more equal grounds in European commercialization (exclusive in 3 countries in RA and 2 on IBD), thereby creating the platform and infrastructure for the following pipeline assets (GLPG1690 in 2023, GLPG1972 in 2025). The cost-sharing shifted to 50/50 from 80/20, but with large RA trials completed and IBD approaching completion, the remaining trials in AS and PSA should not be too much of a burden for Galapagos and could be covered by filgo revenues coming in from 2020.

Independence from capital markets and takeover

While the collaboration implies close scientific collaboration between the company, Galapagos retains complete independence in the selection of target and disease area and development till phase III. Moreover, all compounds not picked up by Gilead would revert to Galapagos in full with no ties. With ~\$6b cash inflow in the coming years and the 50/50 R&D split, Galapagos is sufficiently funded to accelerate the pipeline (e.g. 8 trials for Toledo planned next year, more fibrosis compounds going to POC) for the next 5-7 years. Whereas, Gilead's involvement and the standstill would preclude any takeover attempts.

PT to €180/share

We update our model for: i) the initial equity investment (ex-warrants), ii) the upfront recognized over 10 year, iii) higher R&D split for filgo R&D, iv) milestones and royalties for GLPG1690 and GLPG1972, and iv) higher unallocated (i.e. excl. phase II programs) R&D spend from €250m/yr to €400m for the next 10 years. As a result, our PT increases to €180 mainly driven by cash infusion and better than expected terms for GLPG1972 (to €12/sh from €3) that compensates the decrease in valuation of GLPG1690 (to €6/sh from €12).

Galapagos - Company Profile

Company description

Galapagos is a biotechnology company that carries out small molecule drug discovery in a number of therapeutic areas. The company's research and development activities are based on novel drug targets identified using Galapagos' unique proprietary target discovery technology.

SWOT analysis

Strength

Filgotinib is potentially best in class JAK inhibitor with a strong partner in blockbuster indications

Broad proprietary pipeline

Unique, proprietary target discovery and validation capabilities

Opportunities

Initiation and progress of new drug discovery programs against first in class targets

New partnering deals

Weakness

Early-stage product pipeline focused on novel targets results in high risk drug candidates

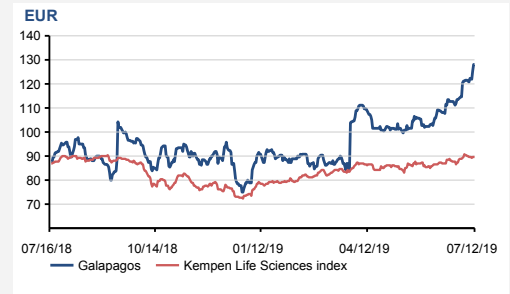
High competition in inflammatory indications

Threats

Clinical failures

Litigation/Infringement

Rating	BUY
Price Target	€180.00
Closing price (12 Jul 2019)	€128.15
Date	15 July 2019, 08:27



Source: Bloomberg

Company data

Bloomberg	GLPG NA
Market Cap	€7,025.6m
52-week range	€74.48 - €128.15
Number of shares	54.8m
Free float	61.6%
Avg. daily volume (20d)	387,875
Avg. daily turnover (20d)	€45,621,235
Daily turnover	€83,173,660
Next announcement date	25 July 2019
Reporting Period	H1'19 results

Major shareholders

	38.4%
Gilead	12.4%
van Herk	9.4%
Sands Capital	5.5%
Federated	5.2%
Capital Research	4.0%
Oppenheimer	1.9%

Source: Company data, Bloomberg

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Source: Kempen estimates

Income Statement (FY 31-Dec, EUR m)	2016A	2017A	2018A	2019E	2020E
Total revenues	151.6	155.9	317.8	704.9	796.5
COGS	0.0	0.0	0.0	0.0	-4.2
Gross profit	151.6	155.9	317.8	704.9	792.3
SG&A	-23.5	-27.2	-39.8	-44.9	-96.2
R&D	-139.6	-218.5	-322.9	-458.0	-562.0
Other operating expenses/income (net)	4.2	4.3	0.0	0.0	0.0
EBITDA	(7.3)	(85.5)	(44.8)	202.0	134.1
Depreciation and amortization	-3.3	-3.6	0.0	0.0	0.0
EBIT	-11.5	-89.8	-44.8	202.0	134.1
Interest expense	8.3	-25.7	15.6	0.0	0.0
Taxes	-0.2	-0.2	-0.1	0.0	0.0
Other financial items	57.5	0.0	0.0	0.0	0.0
Net profit	54.0	-115.7	-29.3	202.0	134.1
Balance Sheet (FY 31-Dec, EUR m)	2016A	2017A	2018A	2019E	2020E
Cash and cash equivalents	979.8	1,151.2	1,290.8	1,294.4	1,523.9
Receivables	9.7	28.0	18.6	25.1	28.4
Inventories	0.3	0.3	0.0	3.0	3.1
Deferred tax assets	2.0	2.0	2.5	20.1	22.7
Financial assets and other current assets	11.2	9.9	16.2	46.5	51.6
Tangible fixed assets	15.0	16.7	23.1	18.2	21.7
Intangible fixed assets	1.0	2.5	3.6	3.6	3.6
Goodwill	--	--	--	--	--
Other non-current assets	64.3	75.8	84.6	84.6	84.6
Total assets	1,083.3	1,286.3	1,439.5	1,495.7	1,739.6
Payables	31.3	47.1	68.9	68.9	98.2
Other current liabilities	289.7	223.5	152.6	6.8	87.3
Provisions	3.6	3.6	3.8	3.8	3.8
Long-term liabilities	--	--	--	--	--
Total liabilities	324.6	274.3	225.2	79.4	189.3
Total liabilities and shareholder's equity	1,083.3	1,286.3	1,439.5	1,495.7	1,739.6
Cash Flow Statement (FY 31-Dec, EUR m)	2016A	2017A	2018A	2019E	2020E
EBITDA	-7.3	-85.5	-44.8	202.0	134.1
Cash interest income/expenses	65.7	-25.7	15.6	0.0	0.0
Cash taxes	-0.2	-0.2	-0.1	0.0	0.0
Changes in provisions	0.8	0.1	0.1	0.0	0.0
Changes in working capital	-4.0	-2.4	31.4	-9.6	25.9
Changes in deferred revenue (milestones)	--	--	--	--	--
Other cash adjustments	-99.5	-443.5	-345.3	-184.2	47.0
Cash flow from operating activities	-44.4	-557.3	-343.0	8.3	207.0
Cash flow from investments	5.7	-1.6	-5.6	0.0	0.0
Proceeds from equity issues	339.7	369.0	231.5	0.0	0.0
Debt drawdowns/(repayments)	-0.1	-0.0	0.0	0.0	0.0
Cash flow from financing activities	339.6	369.0	231.5	0.0	0.0
Ratios	2016A	2017A	2018A	2019E	2020E
EV/revenues	8.3x	14.7x	8.6x	6.5x	5.5x
EV/EBITDA	nm	nm	nm	22.8x	32.7x
P/E	41.5x	nm	nm	29.2x	44.0x
Net debt / EBITDA (x)	134.3x	13.5x	28.8x	-6.4x	-11.4x
Metrics	2016A	2017A	2018A	2019E	2020E
Total revenue growth	nm	2.8%	nm	nm	nm
COGS as % of revenue	0	0	0	0	0.5%
SG&A as % of revenue	-15.5%	-17.5%	-12.5%	-6.4%	-12.1%
R&D as % of revenue	-92.1%	-140.1%	-101.6%	-65.0%	-70.6%
EBITDA margin (%)	-4.8%	-54.8%	-14.1%	28.7%	16.8%
EBIT margin (%)	-7.6%	-57.6%	-14.1%	28.7%	16.8%
Net profit margin (%)	35.6%	-74.2%	-9.2%	28.7%	16.8%
Cash as % of market cap	43.7%	33.5%	32.1%	21.9%	25.8%

Source: Kempen estimates

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Definitions	
Method	Company reports include a discussion of valuation methods used in order to determine Price Targets. The resulting conclusions lead to a Rating as below.
Sell	Expected negative total return of 0% or more on a 12 month basis.
Neutral	Expected total return between 0% and 10% on a 12 month basis.
Buy	Expected positive total return of 10% or more on a 12 month basis.
Under Review	Rating and/or Price Target are Under Review in case Kempen Research is actively reviewing its Rating and/or Price Target of the subject company. The previous Rating and/or Price Target, if any, are no longer in effect, may be subject to change and should not be relied upon.
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Drop Coverage	Kempen Research is no longer actively covering this specific stock. Any previous Rating and Price Target, if any, are no longer in effect for this stock and should not be relied upon.
Price target	Expected share price in 12 months.

Rating distribution

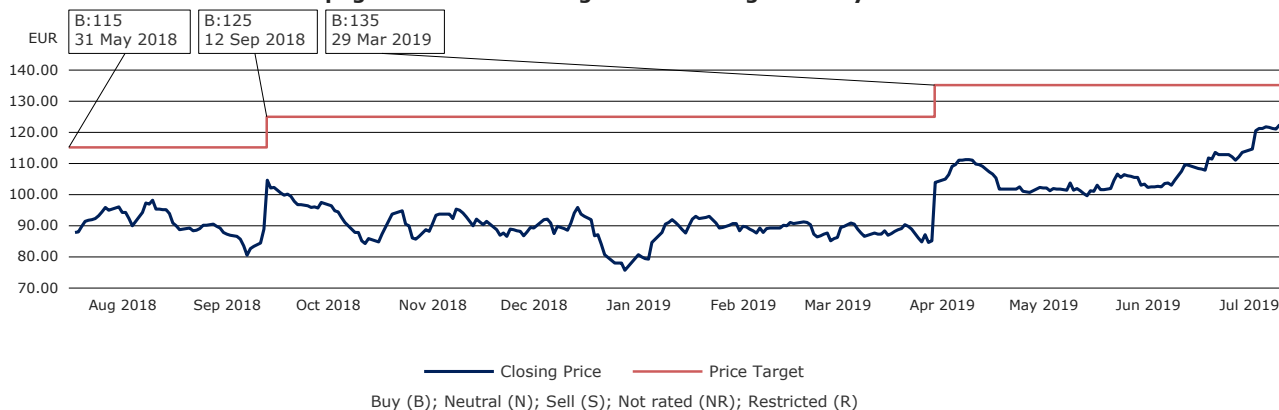
Rating	Count (% of total coverage)	% of investment banking clients
BUY	90 (49%)	62%
NEUTRAL	69 (38%)	33%
SELL	25 (14%)	4%
Total	184 (100%)	100%

Rating distribution based on data of 15 July 2019.

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Galapagos 12 Months Rating and Price Target history as of 12 Jul 2019



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