Galapagos

Optionality too large to ignore

European Life Sciences

Going into the new year, Galapagos' stock is in a holding pattern awaiting a catalyst to unlock the negative EV value. Given limited near-term pipeline newsflow and a gradual launch of Jyseleca in Europe, we look for the appointment of a new CEO (and management team) to restore investor confidence in the company. Even if we can't point to a specific catalyst, we find the negative ~€2b EV optionality too large to ignore and raise our rating to a BUY with a PT of €67 ($77 for ADRs).

Looking for a CEO with a strong R&D background

The most significant near-term catalyst, in our view, would be the announcement of a new CEO. Per the company's disclosure, the board is looking for a profile of a person with a "strong R&D background" but also someone that has experience in the commercial space, so an overall seasoned executive. Of note, a CSO candidate has already been identified, but they would naturally like to join after the CEO appointment. Given the search has been ongoing since August, we could see an announcement in early Q1'22. We will be particularly looking for any past working relationship the new CEO has with Gilead management which could clarify the next steps for the company, and its relationship with Gilead.

Gilead clearly signaling Jyseleca in the US is off the table

With the announcement of the completion of recruitment in the filgotinib phase 3 trial in CD in Oct, Gilead effectively walked away from commercializing filgotinib in the US. In a revised agreement, Gilead shifted operational and financial responsibility to Galapagos for the CD program in exchange for $15m. Additionally, upon EU approval in CD, the royalties payable by Galapagos to Gilead will be reduced by 30% across all Jyseleca indications to 5.6-10.5%, still as of 2024. The news came on the back of the announcement from the FDA to include additional safety concerns to the boxed warning for all the JAK inhibitors approved in immunology. A positive, however, is that with the reduced royalty burden we now see profitability for Jyseleca in Europe.

Scenarios for the future of the Gilead relationship

Given the early-stage pipeline of Galapagos and abandonment of Jyseleca in the US, we see a couple of scenarios for the future of Galapagos and its relationship with Gilead:

- **Preserving the status quo.**Galapagos and Gilead could continue as is, with the cash split between late-stage M&A/BD and internal R&D. In this scenario, we could see a conflict between assets that Galapagos should acquire to leverage its European commercial organization and assets that Gilead would want Galapagos to acquire.
- **Gilead acquiring Galapagos.** Gilead is already a 25.5% shareholder and still has a warrant (warrant B) to go to 29.9% by Aug'24 (can be extended to 2029). *Continued on the next page*

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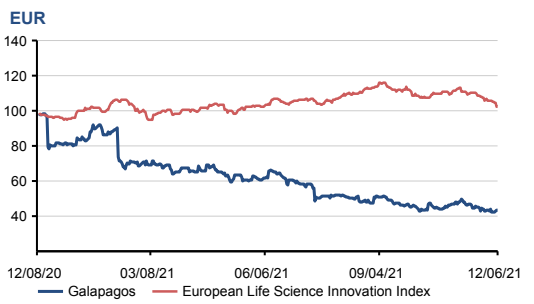
Rating	BUY
Price Target	€67.00
Closing price (06 Dec 2021)	€43.31

Previous rating and Price target

Change	Revision	Old
PT	1 October 2021	€50.00
Rating	1 October 2021	NEUTRAL

Company data

Market Cap	€2,837.8m
52-week range	€41.30 - €101.00
Number of shares	65.5m
Free float	50.0%
Avg. daily volume (20d)	319,091
Avg. daily turnover (20d)	€14,171,680
Daily turnover	€15,596,770
Next announcement date	24 February 2022
Reporting Period	FY'21 results



Source: Bloomberg

- Near-term however the exercise price could be a challenge as Gilead would have to pay at least €140.59/share. As part of the overall agreement, Gilead agreed not to dispose of any shares until Aug'24 but also not to go beyond 29.9% ownership until 2029. Thus, it would appear that the only outcome is the status quo, however, we believe that the standstill and exercise price could always be renegotiated (particularly under new management) if it is in the best interest of all shareholders.

- **Gilead (partially) walking away.** As highlighted above, Gilead can not just walk away at this point but could perhaps walk away from the current structure of Galapagos. While the board has previously committed to keeping the commercial organization and R&D together, with Gilead clearly not interested in launching Jyseleca in the US there could be a rationale for a transaction that keeps Gilead committed to the R&D part of Galapagos only.

Biding its time with GLPG3667

Following the publication of passable phase 1b results with GLPG3667 (TYK2 inhibitor) in Jul in PSO (note), Galapagos is taking a step-wise approach by running first an extended dose-escalation study in healthy volunteers. In 2022, the company is planning to start a phase 2b in PSO and a phase 2 in UC. As a reminder, post phase 2b data, Gilead can in-license any Galapagos compound ex-Europe rights for $150m and 20-24% royalty with phase 3 costs split evenly. Thus, for GLPG3667, Gilead will likely have to decide in 2023 at the earliest when the FDA's position will be clearer. BMS has a PDUFA date for deucravacitinib on 10 Sep'22 which will bring clarity on whether the FDA treats TYK2 inhibitors in line with other JAKs. Meanwhile, we noted Pfizer spinning off its phase 2 JAKK/TYK2 inhibitor, brepocitinib, as well as TYK2 inhibitor PF-06826647 to an undisclosed partner. While Pfizer retains upside in the assets, we believe this is another signal of big pharma losing interest in the TYK2 class.

Two new SIK inhibitors in the clinic in 2022

Following disappointing POC data with GLPG3970 (SIK2/3 inhibitor) in PSA, RA, and UC (note), Galapagos discontinued the development (though the Sjogren's trial still appears to be recruiting). Instead, Galapagos is starting a phase 1 trial with GLPG4399 (SIK3 inhibitor) by YE'21 and expects to move another SIK2/3 inhibitor into the clinic in 2022. Given the data so far, we remain skeptical about the class and do not reflect any upside in our model from the programs and not expect to have a more conclusive view until 2023.

Wild card AbbVie data in CF around YE'21

Galapagos divested the CF assets in 2018 with AbbVie assuming all responsibilities in exchange for $45m upfront and up to $200m in development and commercial milestones. Additionally, Galapagos remains eligible for single-digit to low teens royalties. AbbVie could be reporting phase 2 data with a potentiator/corrector doublet (incl.Galapagos originated galicaftor/ABBV222 and navocaftor/ABBV3-67) in Q1'22 (NCT03969888) as well as from a triple combo trial (incl. galicaftor and navocaftor) around YE'21 (NCT04853368).

Optionality too hard to ignore, raising to a BUY rating

While we have a hard time getting a conviction into the existing pipeline assets, we believe the optionality in the stock is too high to ignore and decrease our negative platform contribution in our valuation. Combined with a now positive contribution from Jyseleca in Europe, we raise our PT to €67 ($77 for ADRs) with a new BUY rating. Even so, our updated valuation is just about in line with our estimated YE'22 cash position.

Galapagos - Company Profile

Galapagos is a Dutch-based biotech company that carries out small molecule drug discovery and development. The company's lead drug, Jyseleca (JAK inhibitor), is being commercialized for RA and UC in Europe while in the US, partner Gilead discontinued development due to an unfavorable commercial prospect. In the pipeline, GLPG3667 (TYK2 inhibitor) is going into phase 2b in PSO and in phase 2a in UC in 2022 while in the SIK inhibition program, Galapagos will test new molecules in phase 1 through 2022.

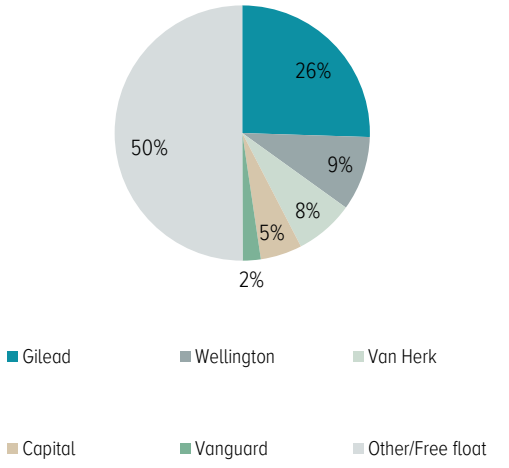
Key information

Bloomberg, Kempen estimates

Bloomberg ticker	GLPG NA	Cash YE'21 (€m)	4,682
Alternative listing	GLPG US	Cash YE'21/Mcap	155.4%
Market cap (€m)	3,014	Cash YE'22 (€m)	4,321
Shares outstanding (m)	65.5	Cash YE'22/Mcap	143.4%
Total FTE at YE'20	845	Runway guidance	N/A
Rating & PT	BUY, €67	WACC	12.5%
Upside/downside to PT	45.6%	Tax rate	3.8%

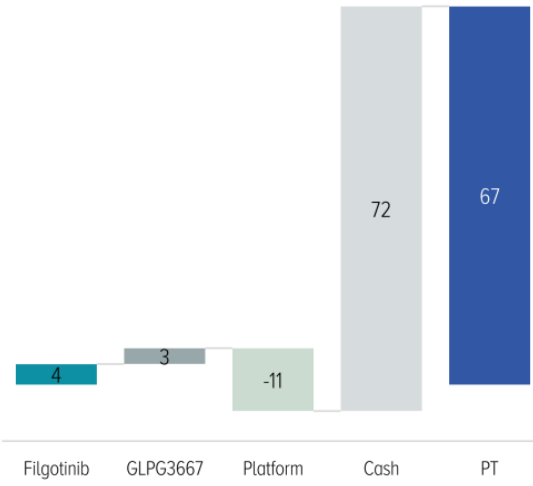
Major shareholders

Bloomberg



SOTP

Kempen estimates



News flow calendar

Company, Kempen estimates

Drug/product	Indication	Event	Timing	Up/Downside
Galicaftor, novacaftor (A	Cytstic fibrosis	Data phase 2 potentiator/corrector doublet	Q1'22	+/- 5%
Filgotinib	Ulcerative colitis	UK and Japan review process conclusion	Q1'22	-
Galicaftor, novacaftor (A	Cytstic fibrosis	Data phase 2 potentiator/corrector/corrector triplet	Q1'22	+/- 5%
Filgotinib	Safety (male toxicity)	Data phase 2 MANTA/MANTA-Ray trials - 52 weeks	H1'22	+20% / -5%
GLPG3667	Psoriasis	Start phase 2b	H1'22	-
GLPG3667	Ulcerative colitis	Start phase 2a	H1'22	-
GLPG0555	Osteoarthritis	Data phase 1/2 (JAK1)	H1'22	-
GLPG3970	Sjögren's syndrome	Data phase 2 GLIDER (SIK2/3)	H1'22	+/- 5%
GLPG2737	ADPKD	Data phase 2	H1'23	+/- 3%
Filgotinib	Crohn's disease	Data phase 3 DIVERSITY	H1'23	+/- 10%
GLPG3667	Psoriasis	Data phase 2a	H2'23	+/- 5%

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Income Statement (FY 31-Dec, EUR m)	2019A	2020A	2021E	2022E	2023E	2024E
Total revenues	**834.9**	**478.1**	**456.4**	**553.4**	**534.5**	**634.1**
COGS	0.0	0.0	-2.1	-6.7	-13.3	-26.0
Gross profit	**834.9**	**478.1**	**454.3**	**546.7**	**521.2**	**608.1**
SG&A	-24.6	-66.5	-80.0	-115.0	-147.0	-147.0
R&D	-420.1	-523.7	-500.0	-370.0	-358.5	-391.7
Other operating expenses/income (net)	-9.0	-47.9	-100.8	-64.3	-54.9	-65.7
EBITDA	**381.2**	**(160.0)**	**(226.5)**	**(2.6)**	**(39.2)**	**3.6**
Depreciation and amortization	-10.0	-14.0	-13.7	-16.6	-16.0	-19.0
EBIT	**368.8**	**-178.6**	**-241.1**	**-20.3**	**-56.3**	**-16.7**
Interest expense	-38.5	-134.2	52.1	47.3	43.5	40.2
Taxes	0.2	-1.2	0.0	0.0	0.0	0.0
Other financial items	-181.6	3.0	3.0	3.0	3.0	3.0
Net profit	**148.8**	**-311.0**	**-186.0**	**30.0**	**-9.9**	**26.5**

Balance Sheet (FY 31-Dec, EUR m)	2019A	2020A	2021E	2022E	2023E	2024E
Cash and cash equivalents	5,780.8	5,210.8	4,727.4	4,345.4	4,015.7	3,830.2
Receivables	169.4	334.1	250.1	227.4	131.8	121.6
Inventories	0.0	0.0	0.0	0.0	0.0	0.0
Deferred tax assets	4.2	4.5	4.3	5.2	5.0	5.9
Financial assets and other current assets	23.2	23.2	23.2	23.2	23.2	23.2
Tangible fixed assets	66.1	103.4	126.2	142.8	148.1	148.1
Intangible fixed assets	24.9	24.9	24.9	24.9	24.9	24.9
Goodwill	0.0	0.0	0.0	0.0	0.0	0.0
Other non-current assets	0.0	0.0	0.0	0.0	0.0	0.0
Total assets	**6,068.6**	**5,701.0**	**5,156.1**	**4,769.0**	**4,348.8**	**4,154.0**
Payables	143.4	172.4	125.0	121.3	102.5	104.2
Deferred revenue (milestones / pre-payments)	3,000.6	2,809.1	2,499.1	2,078.9	1,688.6	1,458.6
Other current liabilities	33.6	33.8	32.3	39.2	37.8	44.9
Provisions	8.3	8.3	8.3	8.3	8.3	8.3
Long-term liabilities	7.0	7.0	7.0	7.0	7.0	7.0
Total liabilities	**3,193.0**	**3,030.6**	**2,671.7**	**2,254.6**	**1,844.2**	**1,623.0**
Total liabilities and shareholder's equity	**6,068.6**	**5,701.0**	**5,156.1**	**4,769.0**	**4,348.8**	**4,154.0**

Cash Flow Statement (FY 31-Dec, EUR m)	2019A	2020A	2021E	2022E	2023E	2024E
EBITDA	381.2	-159.9	-226.5	-2.6	-39.2	3.6
Cash interest income/expenses	-220.1	-131.1	55.1	50.3	46.5	43.2
Cash taxes	0.2	-1.2	0.0	0.0	0.0	0.0
Changes in provisions	4.5	0.0	0.0	0.0	0.0	0.0
Changes in working capital	8.4	-135.8	36.7	18.9	76.8	11.9
Changes in deferred revenue (milestones)	2,850.8	-191.5	-310.0	-420.3	-390.3	-230.0
Other cash adjustments	36.2	-0.0	-1.3	6.0	-1.2	4.3
Cash flow from operating activities	**3,061.1**	**-619.7**	**-446.0**	**-347.6**	**-307.4**	**-167.0**
Cash flow from investments	**-30.8**	**-4.7**	**-0.9**	**-1.1**	**-1.1**	**-1.3**
Dividends paid	0.0	0.0	0.0	0.0	0.0	0.0
Proceeds from equity issues	1,512.6	105.7	0.0	0.0	0.0	0.0
Debt drawdowns/(repayments)	0.0	-0.0	0.0	0.0	0.0	0.0
Cash flow from financing activities	**1,512.6**	**105.7**	**0.0**	**0.0**	**0.0**	**0.0**

Ratios	2019A	2020A	2021E	2022E	2023E	2024E
EV/revenues	3.1x	10.6x	nm	nm	nm	nm
EV/EBITDA	6.8x	nm	8.3x	585.8x	30.1x	nm
P/E	71.0x	nm	nm	94.5x	nm	107.1x
Net debt / EBITDA (x)	-15.2x	32.6x	20.9x	1,687.0x	102.3x	-1,067.6x

Metrics	2019A	2020A	2021E	2022E	2023E	2024E
Total revenue growth	189.1%	nm	-4.5%	21.3%	-3.4%	18.6%
COGS as % of revenue	0	0	0.5%	1.2%	2.5%	4.1%
SG&A as % of revenue	-2.9%	-13.9%	-17.5%	-20.8%	-27.5%	-23.2%
R&D as % of revenue	-50.3%	-109.5%	-109.6%	-66.9%	-67.1%	-61.8%
EBITDA margin (%)	45.7%	-33.5%	-49.6%	-0.5%	-7.3%	0.6%
EBIT margin (%)	44.2%	-37.4%	-52.8%	-3.7%	-10.5%	-2.6%
Net profit margin (%)	17.8%	-65.1%	-40.8%	5.4%	-1.8%	4.2%
Cash as % of market cap	69.1%	50.6%	166.7%	153.2%	141.6%	135.0%
YE number of FTE	845.0	845.0	845.0	845.0	845.0	845.0

Source: Kempen estimates

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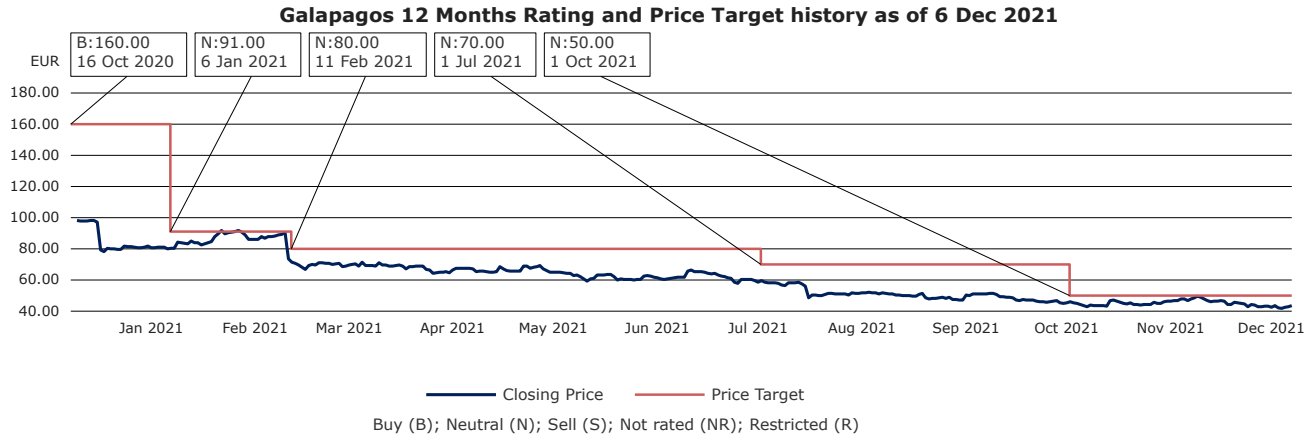

Buy (B); Neutral (N); Sell (S); Not rated (NR); Restricted (R)

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