Financial statements

Consolidated interim financial statements for the first quarter 2017

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Consolidated interim financial statements

Consolidated statements of income and comprehensive income
(unaudited)

Consolidated income statement

	Three months ended 31 March	
(thousands of €, except share and per share data)	**2017**	**2016**
Revenues	33,992	10,121
Other income	5,871	4,696
Total revenues and other income	**39,863**	**14,817**
Research and development expenditure	(44,930)	(27,818)
General and administrative expenses	(5,603)	(3,972)
Sales and marketing expenses	(556)	(422)
Total operating expenses	**(51,088)**	**(32,212)**
Operating loss	**(11,225)**	**(17,395)**
Fair value re-measurement of share subscription agreement	–	57,479
Other financial income	894	626
Other financial expenses	(3,274)	(4,761)
Profit / loss (–) before tax	**(13,605)**	**35,950**
Income taxes	–	–
Net income / loss (–)	**(13,605)**	**35,950**
Net income / loss (–) attributable to:		
Owners of the parent	(13,605)	35,950
Basic income / loss (–) per share	**(0.29)**	**0.81**
Diluted income / loss (–) per share	**(0.29)**	**0.79**
Weighted average number of shares – basic (in thousands of shares)	46,256	44,425
Weighted average number of shares – diluted (in thousands of shares)	48,330	45,492

Consolidated statements of comprehensive income

	Three months ended 31 March	
(thousands of €)	**2017**	2016
Net income / loss (–)	**(13,605)**	**35,950**
Items that may be reclassified subsequently to profit or loss:		
Fair value adjustment of available-for-sale financial assets	(8)	
Translation differences, arisen from translating foreign activities	39	(382)
Other comprehensive income, net of income tax	**31**	**(382)**
Total comprehensive income attributable to:		
Owners of the parent	(13,574)	35,567

Consolidated statements of financial position
(unaudited)

(thousands of €)	31 March 2017	31 December 2016
Assets		
Intangible assets	963	1,023
Property, plant and equipment	15,064	14,961
Deferred tax assets	1,957	1,957
Non-current R&D incentives receivables	58,693	54,188
Non-current restricted cash	1,137	1,098
Other non-current assets	2,878	2,880
Non-currents assets	**80,692**	**76,107**
Inventories	324	300
Trade and other receivables	16,010	9,728
Current R&D incentives receivables	10,154	10,154
Cash and cash equivalents	953,385	973,241
Current restricted cash	4,034	6,570
Other current assets	8,215	7,239
Current assets	**992,122**	**1,007,232**
Total assets	**1,072,814**	**1,083,338**
Equity and liabilities		
Share capital	223,928	223,928
Share premium account	649,135	649,135
Other reserves	(1,008)	(1,000)
Translation differences	(1,051)	(1,090)
Accumulated losses	(122,854)	(112,272)
Total equity	**748,150**	**758,701**
Pension liabilities	3,592	3,520
Provisions	64	63
Finance lease liabilities	-	9
Other non-current liabilities	1,697	2,469
Non-current deferred income	191,328	214,785
Non-current liabilities	**196,681**	**220,846**

(thousands of €)	31 March 2017	31 December 2016
Finance lease liabilities	50	54
Trade and other payables	46,964	31,269
Current tax payable	1,023	1,022
Accrued charges	921	619
Deferred income	79,026	70,827
Current liabilities	**127,984**	**103,791**
Total liabilities	**324,665**	**324,637**
Total equity and liabilities	**1,072,814**	**1,083,338**

Consolidated cash flow statements
(unaudited)

	Three months ended 31 March	
(thousands of €)	**2017**	2016
Cash and cash equivalents at beginning of year	**973,241**	**340,314**
Net income / loss (–)	(13,605)	35,950
Adjustments for:		
Other net financial expenses	2,380	4,134
Fair value re-measurement of share subscription agreement	–	(57,479)
Depreciation of property, plant and equipment	870	755
Amortization of intangible fixed assets	180	209
Net realized loss on foreign exchange transactions and net other financial expenses paid	(338)	(724)
Share-based compensation	3,023	1,902
Increase in pension liabilities	72	61
Gain on sale of fixed assets	–	(13)
Operating cash flows before movements in working capital	**(7,418)**	**(15,206)**
Increase in inventories	(24)	(23)
Increase in receivables	(11,586)	(5,209)
Increase in payables	11,092	928
Increase / decrease (–) in deferred income	(15,259)	270,926
Cash generated / used (–) in operations	**(23,196)**	**251,416**
Interest paid	(16)	(13)
Interest received	370	144
Net cash flows generated / used (–) in operating activities	**(22,843)**	**251,547**
Purchase of property, plant and equipment	(916)	(1,024)
Purchase of and expenditure in intangible fixed assets	(120)	(41)
Proceeds from disposal of property, plant and equipment	1	16
Decrease in restricted cash	6,531	–
Net cash flows generated / used (–) in investing activities	**5,497**	**(1,050)**

(thousands of €)	Three months ended 31 March 2017	2016
Repayment of obligations under finance leases and other debts	(14)	(17)
Proceeds from capital and share premium increases, net of issue costs	–	392,044
Net cash flows generated/ used (–) in financing activities	**(14)**	**392,027**
Effect of exchange rate differences on cash and cash equivalents	**(2,496)**	**(4,505)**
Increase / decrease (–) in cash and cash equivalents	**(19,856)**	**638,020**
Cash and cash equivalents at end of the period	**953,385**	**978,334**

Consolidated statements of changes in equity
(unaudited)

(thousands of €)	Share capital	Share premium account	Translation differences	Other reserves	Accumul. losses	Total
On 1 January 2016	**185,399**	**357,402**	**(467)**	**(18)**	**(177,317)**	**364,999**
Net loss					35,950	35,950
Other comprehensive income			(382)			(382)
Total comprehensive income			**(382)**	**–**	**35,950**	**35,567**
Share-based compensation					1,902	1,902
Issue of new shares	36,575	289,696				326,271
Share issue costs	(195)					(195)
On 31 March 2016	**221,779**	**647,098**	**(849)**	**(18)**	**(139,465)**	**728,545**
On 1 January 2017	**223,928**	**649,135**	**(1,090)**	**(1,000)**	**(112,272)**	**758,701**
Net income					(13,605)	(13,605)
Other comprehensive income			39	(8)		31
Total comprehensive income			**39**	**(8)**	**(13,605)**	**(13,574)**
Share-based compensation					3,023	3,023
On 31 March 2017	**223,928**	**649,135**	**(1,051)**	**(1,008)**	**(122,854)**	**748,150**

Notes

Basis of preparation

These condensed interim financial statements have been prepared in accordance with IAS 34 *'Interim Financial Reporting'* as adopted by the European Union. The condensed interim financial statements do not contain all information required for an annual report and should therefore be read in conjunction with Galapagos' annual report 2016.

The condensed interim financial statements were subject to a limited review by the statutory auditor, but have not been audited.

Details of the unaudited interim results

Revenues and other income

Revenues

The following table summarizes our revenues for the three months ended 31 March 2017 and 2016.

	Three months ended 31 March	
(thousands of €)	**2017**	**2016**
Recognition of non-refundable upfront payments	15,225	4,843
Milestone payments	16,564	–
Reimbursement income	104	3,950
Other revenues	2,099	1,327
Total revenues	**33,992**	**10,121**

Revenues (€34.0 million vs €10.1 million for the same period last year) were higher due to increased milestone revenues from AbbVie for our CF program and to an increase in revenue recognition of the upfront payment from Gilead related to the filgotinib program, which is recognized in function of the costs incurred.

The following table summarizes the upfront payments revenue recognition for the three months ended 31 March 2017 and 2016.

Agreement	Upfront received	Upfront received	Date of receipt	Revenue recognized, three months ended 31 March 2017	Revenue recognized, three months ended 31 March 2016	Outstanding balance in deferred income as at 31 March 2017
	(thousands of $)	(thousands of €)		(thousands of €)		
Gilead collaboration agreement for filgotinib	300,000	275,558	January 2016	13,337	4,243	236,600
Gilead collaboration agreement for filgotinib	N.A.	39,003(*)	January 2016	1,888	600	33,488
Total recognition of non-refundable upfront payments				**15,225**	**4,843**	**270,088**

(*) deferred income of €39 million recognized upon signing of the share subscription agreement with Gilead as required under IAS 39.

For the three first months of 2017, €15.2 million of deferred income related to the Gilead collaboration agreement were recognized in revenue in function of costs incurred, applying the percentage of completion method. This revenue recognition consisted of €13.3 million related to the upfront license fee and €1.9 million related to the deferred income triggered by the accounting treatment of the share subscription agreement under IAS 39. The outstanding balance of deferred income from the Gilead collaboration agreement at the end of March 2017 amounted to €270.1 million of which €191.3 million reported as non-current deferred income.

Other income

The following table summarizes our other income for the three months ended 31 March 2017 and 2016.

	Three months ended 31 March	
(thousands of €)	**2017**	2016
Grant income	293	594
Other income	5,578	4,102
Total other income	**5,871**	**4,696**

Other income increased slightly (€5.9 million vs €4.7 million last year) in the first three months of 2017, mainly driven by higher income from R&D incentives.

Results

We realized a net loss of €13.6 million for the first three months of 2017, compared to a net profit of €35.9 million in the first three months of 2016. Last year's result was primarily driven by €57.5 million fair value gain from the re-measurement of the financial asset triggered by the share subscription agreement with Gilead.

We reported an operating loss amounting to €11.2 million for the first quarter of 2017, compared to an operating loss of €17.4 million for the same period last year.

Our R&D expenses in the first three months of 2017 were €44.9 million, compared to €27.8 million in 2016. This planned increase was due mainly to an increase of €11.7 million in subcontracting costs for our filgotinib and cystic fibrosis programs. Furthermore, personnel costs increased, explained by a planned increase in headcount, as well as higher costs for warrants and bonus plans as a result of the increase of our share price.

Our G&A and S&M expenses were €6.2 million in the first quarter of 2017, compared to €4.4 million in the first quarter of 2016. This increase mainly resulted from higher costs recognized in relation to the warrants and bonus plans as a result of the increase of the Galapagos share price, as well as a planned slight headcount increase.

Net other financial expenses in the first three months of 2017 amounted to €2.4 million compared to net other financial expenses of €4.1 million in 2016, and were primarily attributable to €2.5 million of unrealized exchange loss on our cash position in U.S. dollar as a consequence of the fluctuation of the U.S. dollar exchange rate in the first quarter of 2017.

Financial results in 2016 were primarily driven by the fair value re-measurement of the share subscription agreement.

Segment information

(thousands of €)	Segment information for the three months ended 31 March 2017			
	R&D	Fee-for-services	Inter-segment elimination	Group
External revenue	31,950	2,042	–	33,992
Internal revenue	–	1,005	(1,005)	–
Other income	5,859	12	–	5,871
Revenues & other income	**37,809**	**3,059**	**(1,005)**	**39,863**
Segment result	**(7,745)**	**(457)**		**(8,202)**
Unallocated expenses(1)				(3,023)
Operating loss				**(11,225)**
Financial (expenses) / income				(2,380)
Result before tax				**(13,605)**
Income taxes				–
Net loss				**(13,605)**

(1) Unallocated expenses consist of expenses for warrant plans under IFRS 2.

(thousands of €)	Segment information for the three months ended 31 March 2016			
	R&D	Fee-for-services	Inter-segment elimination	Group
External revenue	8,840	1,281	–	10,121
Internal revenue	–	1,310	(1,310)	–
Other income	4,636	60	–	4,696
Revenues & other income	**13,476**	**2,651**	**(1,310)**	**14,817**
Segment result	**(14,624)**	**(869)**		**(15,493)**
Unallocated expenses(1)				(1,902)
Operating loss				**(17,395)**
Financial (expenses) / income				53,345
Result before tax				**35,950**
Income taxes				–
Net income				**35,950**

(1) Unallocated expenses consist of expenses for warrant plans under IFRS 2.

The basis of accounting for any transactions between reportable segments is consistent with the valuation rules and with transactions with third parties.

Liquid assets position

Cash, cash equivalents and restricted cash totaled €958.6 million at 31 March 2017.

A net decrease of €19.9 million in cash and cash equivalents was recorded during the first three months of 2017, compared to an increase of €638.0 million during the same period last year. Net cash used in operating activities amounted to €22.8 million in the first quarter of 2017.

Furthermore, €5.5 million was generated in investing activities primarily driven by the release of restricted cash to cash and cash equivalents for €6.6 million, and finally €2.5 million of negative unrealized exchange rate differences were reported on cash and cash equivalents.

Restricted cash amounted to €7.7 million at the end of December 2016, and decreased by €2.5 million to €5.2 million at the end of March 2017. This decrease was explained by the full release of the escrow account containing the remaining €6.6 million of proceeds from the sale of the service division in 2014, as final agreement between the parties was reached. However, this was largely offset by an increase of €4.0 million from the proceeds received as a consequence of warrant exercises. This amount remained on a blocked bank account until 6 April 2017, being the date of the notary deed formally establishing the capital increase.

On 31 March 2017, restricted cash was composed of €0.5 million and €0.7 million bank guarantees on real estate lease obligations in Belgium and in the Netherlands respectively, and €4.0 million advances on capital increase from warrant exercises.

Cash and cash equivalents amounted to €953.4 million at the end of March 2017 and comprised cash and cash at banks, short term bank deposits and money market funds that are readily convertible to cash and are subject to an insignificant risk of changes in value. Our cash management strategy may allow short term deposits with an original maturity exceeding three months while monitoring all liquidity aspects. Cash and cash equivalents comprised €661.5 million of term deposits with an original maturity longer than three months but which are available upon one month notice period. Cash at banks were mainly composed of savings accounts and current accounts. We maintain our bank deposits in highly rated financial institutions to reduce credit risk. Cash invested in highly liquid money market funds represented €99.9 million and aim at meeting short-term cash commitments, while reducing the counterparty risk of investment.

(thousands of €)	31 March 2017	31 December 2016
Cash at banks	191,937	357,630
Term deposits	661,496	515,632
Money market funds	99,949	99,977
Cash on hand	3	2
Total cash and cash equivalents	**953,385**	**973,241**

On 31 March 2017, our cash and cash equivalents included $201.6 million held in U.S. dollar which could generate unrealized exchange gain or loss in our financial results in accordance with the fluctuation of the EUR/U.S. dollar exchange rate as our functional currency is EUR. We expect to use this cash held in U.S. dollar to settle our future payables in U.S. dollar which will be primarily linked to our global collaboration with Gilead for the development of filgotinib.

Furthermore, our balance sheet held R&D incentives receivables from the French government (*Crédit d'Impôt Recherche*[3]) amounting to €37.0 million as of 31 March 2017, to be received in yearly tranches from 2017 to 2021. Our balance sheet also held R&D incentives receivables from the Belgian Government amounting to €31.9 million as of 31 March 2017, to be received in yearly tranches from 2017 until 2027.

[3] *Crédit d'Impôt Recherche* refers to an innovation incentive system underwritten by the French government.

Contingencies and commitments

Contractual obligations and commitments

We entered into lease agreements for offices and laboratories which qualify as operating leases. We also have certain purchase commitments principally with CRO subcontractors.

On 31 March 2017, we had outstanding obligations for future minimum rent payments and purchase commitments, which become due as follows:

(thousands of €)	Total	Less than 1 year	1–3 years	3–5 years	More than 5 years
Operating lease obligations	26,386	4,186	6,202	5,512	10,485
Purchase commitments	44,617	41,877	2,740	–	–
Total contractual obligations & commitments	**71,003**	**46,063**	**8,943**	**5,512**	**10,485**

On 31 December 2016, we had outstanding obligations for future minimum rent payments and purchase commitments, which become due as follows:

(thousands of €)	Total	Less than 1 year	1–3 years	3–5 years	More than 5 years
Operating lease obligations	27,263	4,114	6,494	5,504	11,151
Purchase commitments	27,579	27,084	495	–	–
Total contractual obligations & commitments	**54,842**	**31,198**	**6,989**	**5,504**	**11,151**

Contingent liabilities and assets

On 13 March 2014, we announced the signing of a definitive agreement to sell the service division operations to Charles River Laboratories International, Inc., or CRL, for a total consideration of up to €134 million. CRL agreed to pay us an immediate cash consideration of €129 million. The potential earn-out of €5 million due upon achievement of a revenue target 12 months after transaction closing has not been obtained. Approximately 5% of the total consideration, including price adjustments, was being held on an escrow account. Four claims have been introduced by CRL, which all have been settled for a total amount of €1.3 million. In the first quarter of 2017, the remaining balance of €6.6 million was released in full as final agreement between the parties has been reached.

Following the divestment, we remained guarantor until early February 2017 in respect of the lease obligations for certain U.K. premises. Finally, following common practice, we have given representations and warranties which are capped and limited in time (since 1 April 2016, CRL can only introduce a claim covered by the Tax Deed (during a period of 5 years), other claims related to the sale cannot be submitted anymore).

In the course of 2008, a former director of one of the subsidiaries sued for wrongful termination and seeks damages of €1.5 million. We believe that the amount of damages claimed is unrealistically high. In 2014, the court requested an external advisor to evaluate the exact amount of damages. On 29 January 2016, the court made a 1st degree judgment, dismissing all claims in full. In appeal, the 2nd degree court instructed the 1st degree court to conduct a new trial, which is currently pending. So far, the first hearing is scheduled on 12 July 2017, no decisions have yet been made. Considering the defense elements provided, as well as the fact that so far the court has made no decision indicating that the claim would be sustained, our board and management evaluated the risk to be remote to possible, but not likely. Accordingly, it was decided not to record any provision as the exposure was considered to be limited.

Significant accounting policies

There were no significant changes in accounting policies applied by us in these condensed consolidated interim financial statements compared to those used in the most recent annual financial statements of 2016, except for the adoption of new standards and interpretations described below.

New standards and interpretations applicable for the annual period beginning on 1 January 2017

- Amendments to IAS 12 - Recognition of Deferred Tax Assets for Unrealized Losses
- Amendments to IAS 7 - Disclosure Initiative
- Annual Improvements to IFRS Standards 2014–2016 Cycle – Amendments to IFRS 12

The nature and the effect of these changes were taken into consideration, but the above amendments did not affect the interim condensed consolidated financial statements. We have not early adopted any other standard, interpretation, or amendment that has been issued but is not yet effective.

Seasonality

The impact of seasonality or cyclicality on our operations is not regarded as applicable to the unaudited interim condensed consolidated financial statements.

Events after the end of the reporting period

On 5 April 2017, we announced the dosing of the first patient in an additional Phase 2 study with filgotinib in psoriatic arthritis (EQUATOR), led by Galapagos, which triggered a $10 million milestone payment from Gilead to Galapagos.

On 6 April 2017, 247,070 warrants were exercised at various exercise prices (with an average exercise price of €16.33 per warrant) resulting in a share capital increase (including issuance premium) of €4 million and the issuance of 247,070 new shares. The closing price of the Galapagos share at this date was €84.60. The exercise price of these warrants was received from the warrantholders end of March 2017 and was classified as restricted cash.

On 21 April 2017, we announced the closing of our underwritten public offering of 4,312,500 American Depositary Shares ("ADSs"), at a price of $90.00 per ADS, before underwriting discounts, for gross proceeds of €363.9 million. This includes the full exercise of the underwriter's option to purchase additional ADSs. Each of the ADSs offered represents the right to receive one ordinary share. The estimated net proceeds of this public offering after underwriting discounts and offering expenses payable by us, amount to €348.0 million.

Approval of interim financial statements

The interim financial statements were approved by the board of directors on 25 April 2017.