Interview with Onno van de Stolpe, Chief Executive Officer, Galapagos NV

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Since its founding Galapagos has operated with a hybrid business model which has combined its internal discoveries with service activities. This model has worked quite well as it has now pushed the company into profitability. Would you say that everything has turned out according to plan or have you exceeded even your own expectations when first starting Galapagos?

Admittedly, everything has not completely worked out as originally planned. We started in 1998 before the human genome was unraveled. The initial idea was to develop a platform to rapidly identify and market novel targets. Although Galapagos today is still based around the identification of novel targets, the marketing of the targets got somewhat derailed when the human genome project was revealed; suddenly the market became flooded with novel targets. Although those targets were of a different validation level than ours, the market was somewhat spoiled and our targets were almost contaminated. It became pretty clear after the first two years that we needed to take the next step and develop our drugs against those targets in order to build a sustainable business model. That required becoming more integrated than the initial plan. When starting off we thought that we would be a functional genomics company, and in fact the original company was Galapagos Genomics. But after a couple of years we eventually dropped the “Genomics” and became an integrated player that acquired and built chemistry capabilities to bring a product to at least the clinic, though not necessarily to the market. Essentially, that has been our only change from the original business plan.

With regards to expectations, when we celebrated our 10 year anniversary I went back to our original 10 year plan and compared our revenue projections with performance. Except for €1-2 million, we were spot on. The expectations were clearly there but the mix of revenues was quite different from what we originally thought up in the first 10 year plan.

There has been a torrid pace of activity throughout the company's 10 year history. It seems that every two years there was either another round of financing, a new alliance forged, or a different company acquired. What have been the core consistencies amongst these many moving parts that have guided your strategy?

We have not necessarily deviated from the original direction when we first incorporated the company which was to use a functional system to identify novel targets. The only thing is we now develop drugs against those targets which required obtaining additional capabilities in the field of medicinal chemistry. We acquired BioFocus and later the assets of Discovery Partners International. We then bought a unit from Aventis which also had chemistry and bone biology capacities that fit well with our current activities. This year we also bought Argenta, a drug services company. All the acquisitions that we have done have not changed strategy or focus; rather, they have enabled us to execute the goals that we have set at the time. Do we surprise the market every time that we acquire another company? To some extent, yes. I am not the type of person who sits back and wonders what others think. We go when we think it is appropriate. Acquiring companies has its advantages by preventing others from looking too closely at your company and therefore minimizing the possibility that you yourself get acquired. We are not for sale. I once heard that by pursuing acquisitions you buy yourself six more months of time because the market first has to assess and understand your move. Then when those six months have expired we will likely have had another big move.

In 2005 you hit the market with your initial public offering (IPO). I can imagine that you did your road show going to many financial centers explaining why this company has a promising future. You had to communicate your vision and your deep familiarity of this field to others who are not experts in this type of industry. How did you do that?

That was the main problem since nobody understood what we were doing. We had taken a presentation and hired a consultant to simplify it. We changed the presentation back and forth trying to make it understandable for the laymen because with no clinical pipeline at the time we would not get the specialty investors – the traditional biotech investors. We would pitch to a generalist audience and that was what happened. The vast majority of the shares we placed went to generalist investors, which is still the case today. We are an ideal biotech holding for pension

funds, insurance companies, and investors who want to be in biotech but do not want to run the typical risks of traditional biotech. The hybrid business model helped quite a bit in our pitch. But we also had a service stream of revenues and therefore pitched the upside of new mode of action drugs as a free add-on to what we do from the service side. Nowadays that balance has shifted since our pipeline is more important than the service division.

Throughout your various rounds of financing how did your presentation of the main drivers of shareholder value evolve?

The main focus for shareholder value has clearly shifted away from service activities, especially after we bought BioFocus since it was a bigger company than Galapagos. In the initial years after the IPO the main topic was our service business whereas nowadays when presenting the company I only show one slide about the services division; the rest is on our alliances and pipeline.

Galapagos struck its first alliance with Big Pharma one year after the IPO. This was also around the time when the Dutch health insurance system was going through its reforms, cost-containment policies began to gain traction, and price pressures engendered more risk-sharing strategies from traditional pharma companies. In this respect, while the 2006 healthcare reforms were discouraging for pharmaceutical firms, was it a blessing in disguise for Galapagos?

I do not think it was the driving force. We were sort of a special case. If you are going to develop drugs from novel targets, you need to start in parallel in a disease area with quite a large number of targets; otherwise, there is minimal chance that you will hit the market. We just had limited funds. We had a modest IPO raising approximately €22 million and there just was not that much money to go very broadly in the disease area, with enough programs in parallel. We had moved three targets in Rheumatoid Arthritis into drug discovery. For the rest, we had a whole shelf of products in osteoporosis and osteoarthritis for which we could never finance the move into drug discovery ourselves. If we wanted to advance those targets we needed to seek alliances that would help us finance that.

This is where the GlaxoSmithKline (GSK) alliance came into the picture. GSK was looking for a risk sharing model where a company would take a drug from target to the clinic and we were looking for a way to fund a broader research portfolio. When we signed that first deal – our first deal over €100 million – it put us in a very elite league of companies to have that type of alliance partner. Afterwards it became much easier to interest other pharma partners since we had shown we had something valuable to offer. The first customer put us on the map and later the alliances allowed us to build up our revenue model as well as broaden our pipeline. Forging other alliances became

more and more valuable for year-to-year revenues from the milestones, while the GSK alliance was quite financially painful for us initially having to spend more than we were getting with milestones. Today all the Galapagos risk-sharing alliances with Big Pharma are quite profitable.

Do you think this company has reached critical mass? How many more areas do you believe Galapagos still needs to grow until you have reached the comfortable economies of scale for your capacities?

I think we have reached critical mass; 800 people is a lot. My ideal size is about 100-120 people in our scientific disciplines which is where you reach critical mass. You do not want to be too large, otherwise you become very bureaucratic and people do not really get to know each other anymore. The fact that Galapagos is spread over so many locations helps keep us somewhat lean. I prefer for Galapagos to be split over a number of different sites, each with a maximum of 100-150 people which is the direction we are heading in. I do not think we should acquire in order to reach critical mass. You should always explore opportunities in the market that might be a bargain or which might complement your current technologies. While there is nothing on the radar screen at the moment, that might change in a couple of months should we come across something.

With the current financing window being so tight and Galapagos being a company that so easily raises money on the basis of our success, you have to look at opportunities in companies who have basically run out of cash and have something good to offer.

Small and medium sized biotech companies are facing a very different financing environment today than when you founded Galapagos. The spillover from the financial crisis has perhaps dried up traditional venture capital flows and fiscal austerity could jeopardize public funding. How do you see the new window of financing facing biotechs today and what advice could you offer based on your own success?

Over the past two years we have been mentioned more and more as a role model in the way you can build a company. Relatively little investor money has gone into the company to reach a positive cash flow stage. However that is somewhat easier said than done because you need the technology platform that is applicable to many different disease areas to make it worthwhile. You need to have something absolutely unique. Our target discovery engine is absolutely unique in the world; there is no one who even comes close to it. That has helped us to build Galapagos to what it is today. The rest of our activities in chemistry and clinical research are very good, but they are not our unique selling point.

I do not have the answer as to how to start a biotech company today; it is extremely difficult. I find especially brave the early stage financiers. The route to the public market is very long and with so many IPOs and few mergers, how are you ever going to exit from your investment? The longer it takes you to exit the more it will cost as you wait for these companies turn profitable. It reaches a point where you will have to continually invest so as to not lose value.

The interesting question is “would I be able to do it again?” It would certainly be a challenge and I do not know if I could. We have been very lucky with the technology that we started with which we have built into an extremely valuable target discovery platform. The advice that I give to young entrepreneurs is to focus on generating revenues early on in your company’s development stage because it forces you to concentrate on technology that is sellable. In the past, especially in the genomics days, too many platforms were built that never generated any cash. It does not have to be a lot of money, but if a pharma or biotech company wants to pay for access to your technology then you are on track to create value. It also keeps you focused. The fact that you have revenues versus your costs is a constant focus here in this company. As you move towards profitability, like Galapagos, you will develop the thought process of asking if every Euro that you spend will eventually be made back. Companies that only spend money on research do not have that mindset; nor do they need to because they will never be profitable until they generate a product at the very end of the development stage or through a big licensing agreement.

How has your managerial strategy changed now that you are running a profitable company?

We discussed last year if we should try to turn the company profitable or perhaps pursue an extra investment that would hold off profits for another year. The whole management team and the Board were confident enough in our outlook this year and our sustainable profitability going forward, so we made the decision to go profitable last year.

Turning profitable definitely impacts your R&D spending. The moment you do become profitable, every decision on new programs that will cost, for example, two years of investment will eat into your P&L. This, of course, is not a problem that you have when you are not turning a profit. If not profitable, your losses will just further increase. But if you go from a €2 million profit to a €1 million loss, then you are essentially killing the company in the eyes of the financial markets.

It also has an effect on your acquisitions. We previously looked at acquisitions based on fit with the company; if it fit, then we went with it. Nowadays the third criterion is the acquisition’s impact on our P&L. Acquisition price is a balance sheet issue but P&L is more important because if the company has a burn rate of €5-10 million per year then you need to strategize how to make that

profit back somewhere else.

There were several new acquisitions just this year with Argenta and GSK’s former research center in Zagreb, Croatia. What do they bring to Galapagos?

You see already that Argenta is a profitable company so it was an easy acquisition that will add to profits. Although Zagreb does not have its own sales, the cost of running research there is 1/3 cheaper than in Western Europe. This can be an important factor if we outsource chemists, for example. You see through these acquisitions that we are looking at cost and income factors rather than a purely technological base. However, will we acquire more companies in the service base? It is unlikely, although possible, if we find another gem like Argenta. It is more logical for us to look at the technology space in the antibody market. The targets that we discover can be developed for small molecule drugs. We also find targets that are very well positioned to develop an antibody against, which at the moment we can only out-license. Presently we cannot forge alliances in antibodies because we simply do not have that technology. An antibody technology platform would therefore make sense to add to the company next to our small molecule technology.

Amongst your many alliances and target discoveries, which one do you see as offering the most promise for this company?

Earlier this year we chose cystic fibrosis (CF) as the area where we will not partner with anyone and will take the drug all the way to the patient. We believe that a company like Galapagos should focus on orphan disease markets for a number of reasons: you get some regulatory and marketing advantages, there are more grants available, the road to the market is a little shorter, and you do not need large sales forces since the patients are well organized. We worked with the CF Foundation for years to find novel targets. What we found were so good and so exciting that my team decided to license them from the CF Foundation and develop them ourselves. We have announced that to the market and already have a couple of programs in drug discovery.

Was this go-it-alone approach done, in part, to brand Galapagos with its own identity that is independent from its alliances?

Yes, the company needs it own face which alliances and the service division do not give. If we get CF in the clinic with our programs then I think it will make a difference. Secondly, alliances are a fantastic way to build the company but they are also very difficult to manage because of the strategic shift in many pharmaceutical companies. People change all the time, heads of divisions switch, and mergers are quite frequent in the pharma industry. Every time something like that happens it has an impact on the alliance, most of the time not for the better. One public example is

our GSK alliance which started in osteoarthritis. GSK brought in a new head of their InflammationCEDD who wanted to shift the alliance focus to rheumatoid arthritis. That ultimately worked out well for us because we repackaged the osteoarthritis programs we got back from GSK, and sold them in an alliance with Servier. But there came a painful moment when we had that discussion with GSK. Inconsistencies are the biggest downside of the alliance model. Pharma does not have any continuity. They do not stick to any strategic vision; zero, zip. They go left one day and right the next. It is a disaster. They are dinosaurs at the end of the road.

Galapagos is spread out amongst many alliances and across various international locations. What is the unifying corporate culture that consolidates one common Galapagos identity?

You have to split the service side from the rest of the company. The service business is very much located in England with BioFocus and Argenta and has a culture of delivering quality to customers, much like any service company. It is a tightly run ship that closely watches costs and margins whereas the rest of Galapagos's business is extremely milestone driven. If there is one culture in this company that everyone needs to adhere to, it is that timelines are crucial for success. I keep telling the whole company, but especially our managers, that meeting timelines that people have for their programs is our only way for survival because we are so dependent on the milestones. If we do not meet them, we run out of funding very rapidly. It is all about meeting the timelines and getting the milestones, in contrast to the service division that is more cost driven.

Looking at the industry from a macro perspective, what do you see as the main contributions that Galapagos has made to the biotech sector in the Netherlands?

It is without question that companies such as Galapagos and Crucell have important flagship roles in this country. There have been some biotech failures in this country and other companies that have gone public after Galapagos have not done so well. Some have even been outright disasters. Having Galapagos and Crucell be successful helps the sector. It helps gain visibility and proves to the government that not everything goes wrong in this sector; there are actually companies that deliver. That is probably the biggest contribution that we have had.
If you look at what Galapagos is doing for the industry, we are a true, innovative, new mode of action discoverer. Galapagos, by sheer nature and the reason for its existence, focuses everything on novel modes of action and new targets that we discover. Hopefully our ultimate contribution will be that we can bring not one, but a number of new modes of action to the market together with our partners.

What is your unique management style that blends with the strategic vision that you have for this company?

Galapagos in general has a very informal management style. We do not like strong hierarchy, which I believe is very much influenced by my time in the US whose informal biotech culture I appreciate. A good anecdote about BioFocus is that I actually forbid managers from wearing suits. The company is determined by the success of our scientists so I want to keep the distance between management and scientists as small as possible.

Another element that we try to instill as much as possible is that it is okay to fail. We do not punish people if they do not have the right results. We want to move forward with innovation but with innovation comes failure. I accept that and I try to get my management team to implement that as much as possible.

We have a no-nonsense approach here. In my company presentation I refer to Nike's "Just Do It" slogan, which is a very strong message. People in general do not put their bar high enough or do not believe that they can put their bar high. At the end of 2008 we had an internal budget of €100 million for 2009. I went to my Board and asked them for approval of €100 million guidance to the financial markets for 2009 Group revenues. They thought I was crazy because setting financial guidance so close to your internal budget is usually a recipe for disaster. I urged them to set the €100 million target because not only is it a fantastic number, but it would be the first time in the history of the company that we could say that we produced €100 million in revenue. We eventually came out with €106 million. I believe this organization can do it. I am all about setting the bar high and giving people the tools to deliver the jump over that bar.

What would be your final message to our readers?

When talking to younger people at universities I often advise them to start their careers in smaller organizations such as a biotech company. The fun that you can have working in a biotech company, like I did at 25 person agricultural biotech firm in Leiden, is such an energetic experience. You get so much information and experience – both positive and negative – from working with a small company. The experience of the company becomes one in the same as your own experience. So, small is beautiful in that respect.

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