# Breaking *through*

Galápagos

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# **Annual** Financial Report 2012

This document, Galapagos' Annual Financial Report 2012, contains all required information as per the Belgian Code of Companies.

**LANGUAGE OF THE ANNUAL FINANCIAL REPORT 2012**

According to Belgian law, Galapagos must publish its Annual Financial Report in Dutch. The Company also provides an English translation. In case of differences in interpretation, the Dutch version will take precedence. Galapagos is responsible for the translation and conformity between the Dutch and English versions.

**AVAILABILITY OF THE ANNUAL FINANCIAL REPORT 2012**

This document is available to the public free of charge and upon request:

Galapagos NV
Investor Relations
Generaal De Wittelaan L11 A3
B-2800 Mechelen, Belgium
Tel: +32 15 34 29 00
ir@glpg.com

An electronic version of the Annual Financial Report 2012 is available on the website of Galapagos, www.glpg.com.

Galapagos will use reasonable efforts to ensure the accuracy of the electronic version, but does not assume responsibility if inaccuracies or inconsistencies with the printed document arise as a result of any electronic transmission. Therefore, Galapagos considers only the printed version of the Annual Financial Report 2012 to be legally valid. Other information on the website of Galapagos or on other websites does not form a part of this Annual Financial Report.

**FORWARD-LOOKING STATEMENTS**

The Annual Financial Report 2012 may contain forward-looking statements, including, without limitation, statements containing the words "believes," "anticipates," "expects," "intends," "plans," "seeks," "estimates," "may," "will," "could," "stands to," and "continues," as well as similar expressions. Such forward-looking statements may involve known and unknown risks, uncertainties and other factors which might cause the actual results, financial condition, performance or achievements of Galapagos, or industry results, to be materially different from any historic or future results, financial conditions, performance or achievements expressed or implied by such forward-looking statements. Given these uncertainties, the reader is advised not to place any undue reliance on such forward-looking statements. These forward-looking statements speak only as of the date of publication of this document. Galapagos expressly disclaims any obligation to update any such forward-looking statements in this document to reflect any change in its expectations with regard thereto or any change in events, conditions or circumstances on which any such statement is based, unless required by law or regulation.

# **Report** of the Board of Directors

BOARD OF DIRECTORS' REPORT TO THE SHAREHOLDERS FOR THE FINANCIAL YEAR ENDING 31 DECEMBER 2012

Ladies and gentlemen,
Dear shareholders,

We present to you our report relating to Galapagos' consolidated and non-consolidated results during the financial year ended on 31 December 2012.

Throughout this report the term "Galapagos NV" shall refer solely to the non-consolidated Belgian company. "Galapagos" or "Group" or "Company" shall refer to the consolidated group of companies.

The companies included in the consolidated results are: Galapagos NV (Mechelen, Belgium); Galapagos BV (Leiden, The Netherlands); BioFocus DPI (Holdings) Ltd. and its subsidiaries BioFocus DPI Ltd., Cambridge Drug Discovery Holding Ltd., Cambridge Genetics Ltd., Cambridge Discovery Ltd. (Saffron Walden, UK); BioFocus, Inc. and its subsidiaries, BioFocus DPI LLC, and Xenometrix Inc.; BioFocus DPI AG (Basel, Switzerland) and its subsidiary Discovery Partners International GmbH (Heidelberg, Germany); Inpharmatica Ltd. (Saffron Walden, UK); Galapagos SASU (Romainville, France), Argenta Discovery 2009 Ltd. (Harlow, UK) and Galapagos istraživački centar d.o.o. (Zagreb, Croatia).

## 1. OVERVIEW OF DEVELOPMENT, RESULT AND POSITION OF THE GALAPAGOS GROUP

Galapagos made a strong claim on leadership in the JAK1 space in 2012. The Company announced the AbbVie (formerly Abbott) agreement for GLPG0634 in February 2012, delivering substantial shareholder value and reducing overall risks for the Company. GlaxoSmithKline (GSK) announced the initiation of Phase 2 studies in lupus and psoriasis with GSK2586184, a selective JAK1 inhibitor which was in-licensed from Galapagos in February 2012.

Under the leadership of newly appointed Chief Scientific Officer Dr Piet Wigerinck, Galapagos went on to deliver significant alliance milestones and make solid progress in its proprietary pipeline in 2012. Today Galapagos stands resolutely among the top European biotechnology companies, with one of the most promising new drugs in rheumatoid arthritis in its development portfolio, prospects for more clinical Proofs-of-Concept before end 2014, and substantial financial resources to bring other potential breakthrough drugs further toward the clinic in the coming years.

**R&D division gains momentum in 2012, expands opportunities beyond GLPG0634**

Galapagos increased the momentum of its R&D pipeline by the end of 2012, ending the year with 4 clinical, 6 pre-clinical, and more than 30 discovery programs. Galapagos is on track to have a mature pipeline of three programs in Phase 2 studies and multiple Phase 1 programs by end 2013.

On 29 February 2012, Galapagos and AbbVie announced a global collaboration to develop and commercialize GLPG0634 to treat autoimmune diseases. Under the terms of the agreement, AbbVie made an upfront payment of $150 million for rights related to the global collaboration. This upfront payment will be recognized over 30 months and will contribute to Galapagos' revenues over the coming three years. Upon successful completion of the rheumatoid arthritis Phase 2 studies by Galapagos, AbbVie will license the program for a one-time fee of $200 million. AbbVie will assume sole responsibility for Phase 3 clinical development and will have global manufacturing rights. Pending achievement of certain developmental, regulatory, commercial and sales-based milestones, Galapagos will be eligible to receive additional milestone payments from AbbVie, potentially amounting to $1 billion, in addition to tiered double-digit royalties on net sales upon commercialization. Furthermore, Galapagos retains co-promotion rights in the Benelux.

GLPG0634 is the first selective JAK1 inhibitor in Phase 2 to potentially treat multiple autoimmune diseases, such as RA. After the excellent results of the single center Proof-of-Concept study with GLPG0634, Galapagos proceeded with a Phase 2, dose-range finding study over multiple study centers. This trial confirmed the safety and clinical benefit of the drug to rheumatoid arthritis (RA) patients within 4 weeks. Statistically significant improvements were seen for DAS28, HAQ-DI, ACR and CRP for the 300mg dose. Galapagos will initiate Phase 2b clinical studies in RA in the second quarter of 2013.

In view of future Phase 2b studies in the US, Galapagos opened an Investigational New Drug (IND) application for GLPG0634 with the US Food and Drug Administration. Galapagos initiated a Phase 1 drug interaction study in the United States. Acceptance of the IND was based on a review by the FDA of the GLPG0634 data package, including chemical/pharmaceutical data, preclinical data up to the formal 13-week toxicology studies, and currently completed clinical studies.

In February 2012, GSK exercised the exclusive option to license GLPG0555 and GLPG0778 and recently announced the initiation of Phase 2 studies with GLPG0778 in psoriasis and lupus. Galapagos is eligible to receive up to €34 million in downstream milestones plus up to double-digit royalties on commercial sales arising out of these in-licensed programs.

In October 2012 Galapagos started its second Phase 1 clinical study with GLPG0974, a GPR43 inhibitor being developed to treat chronic neutrophil-driven inflammatory conditions such as inflammatory bowel disease (IBD). GLPG0974 is the first ever clinical compound directed against GPR43. In a First-in-human study, GLPG0974 showed excellent safety and pharmacokinetics, as well as up to 90% inhibition of a relevant biomarker. In the second Phase I study, the safety and tolerability of multiple ascending doses of GLPG0974 was evaluated for 2 weeks in 32 healthy volunteers. Aim of the study was also to confirm the strong biomarker signal. Galapagos intends to initiate and complete a Phase 2 Proof-of-Concept study with GLPG0974 in ulcerative colitis patients in 2013.

In the field of oncology, GLPG0187, an integrin receptor antagonist, was tested in a Phase 1b, maximum tolerated dose study including cancer patients. This study was extended at investigator request, in order to confirm an early sign of activity.

GLPG0492, an orally available selective androgen receptor modulator (SARM) was tested in a Phase I Proof of Mechanism study to assess the effect on muscle function in healthy volunteers. A biomarker effect similar to that of Oxandrolone was observed, but the data were insufficient for Galapagos to pursue GLPG0492 further in cachexia, and further development of the compound was discontinued.

The R&D division delivered progress in both alliances and proprietary programs, strengthening the depth of the pipeline beyond the success with GLPG0634. Three pre-clinical candidates and other milestones were announced in the alliances in 2012. Today, Galapagos is progressing 14 different novel target-based programs within the alliances, including five pre-clinical candidates. Galapagos aims to have at least two of these alliance candidates move into Phase 1 before end 2013.

In 2012, a number of new proprietary opportunities emerged and progressed in 2012. In an antibiotic program proprietary to Galapagos, a candidate drug CAM-1 was selected. This newly discovered antibiotic works by inhibiting the target DNA pol IIIα (DnaE), an enzyme present in all bacteria and essential for their growth; this target is absent in humans. This candidate shows strong activity against all tested drug resistant *Staphylococcus aureus*, including hospital and community acquired MRSA strains. Galapagos aims to enter the clinic in the first quarter of 2014, with a Proof of Concept study thereafter. Galapagos was also awarded a grant from the Flemish agency for Innovation by Science and Technology (IWT) to exploit the Company's know-how in DNA pol IIIα (DnaE) to discover new antibiotic treatments against additional bacterial species beyond what has been developed thus far.

In cystic fibrosis, an area in which Galapagos intends to progress medicines all the way to the market, the Company identified a potentiator series which showed potency higher than that of Kalydeco™ in both the GD551 and delF508 mutations in Ussing chamber assays. Galapagos will continue to work on lead optimization of this series, with the aim to nominate a pre-clinical candidate before year end.

**Good performance of the service division**

Both companies in our service division, BioFocus and Argenta, performed well in 2012. They were able to grow their external revenues by 10% and generated a segment result in line with 2011. BioFocus and Argenta continue to provide the kind of scientific quality and timely execution that clients in drug discovery need when looking to resource work on their pipelines. In 2012, the service division announced significant collaboration deals with partners such as Ono Pharma, AstraZeneca, Almirall, ANTABIO, and the University of Cambridge. Within BioFocus, the decision was taken to close the Basel site and move the high-throughput screening activities from Basel to Chesterford Park in the UK.

**Personnel**

At the end of 2012, the total number of employees working within the Group amounted to 796.

## Environment

All companies of the Group continue to hold the necessary permits for their exploitation, and to respect the applicable environmental rules.

## Group financial results

### Revenues

Galapagos' revenues for the full year 2012 amounted to €153 million, an increase of 36% compared to 2011. The service division focused efforts on growing their external business in 2012, with external revenues of €65.8 million growing +10% over 2011, despite closure of BioFocus' Basel operations and the resulting transfer of the high-throughput screening activities to Chesterford Park in the UK. The R&D division reported total revenues of €87.2 million, reflecting considerable milestone achievements in the alliances and €37.2 million in revenue recognition from the $150 million AbbVie payment.

### Result

The Group incurred a net loss for the full year 2012 of €5.7 million, or €0.22 loss per share, compared to a loss of €30.1 million, or €1.13 loss per share in 2011.

The R&D division incurred a segment loss of €3.5 million in 2012, compared to €40.5 million last year. R&D expenses were €80.3 million, compared to €84.5 million last year.

The BioFocus and Argenta Service division reported a gross margin of 33.7% (2011: 31.7%) on external revenues and a segment result of €8.2 million, compared to €9.0 million last year. Included in the reported segment result for 2012 were one-off investments to build up the high-throughput screening business in the UK, following the transfer from Basel. Corrected for these factors, the profitability of the running business in 2012 was in line with 2011.

General and administrative costs from continuing operations increased to €24.5 million, reflecting expenses related to the now-completed implementation of a company-wide ERP system to achieve better cost control and purchasing efficiencies of scale and one-off payroll expenses related to closing the AbbVie deal. General and administrative expenses as a share of group revenues decreased to 16.0% compared to 19.6% in 2011.

Restructuring and integration expenses of €2.5 million relate to the closure of Basel and reorganization costs. Result on divestment of €2 million is the net of the liquidation costs of dormant legal entities and an earn-out payment received from Evotec connected with the sale of Compound Focus, Inc. in 2011.

### Liquid assets position

Cash on balance was €94.7 million on 31 December 2012. The Company's liquid asset position of €115.4 million at year end 2012 (€48.5 million at year end 2011) included €20.7 million in alliance related receivables for which revenues were recorded in 2012 and payment is expected in Q1 2013. The liquid asset position was negatively impacted by pulled-forward preparations for the Phase 2b study with GLPG0634, amounting to €10 million spending earlier than planned in 2012, while total external spend expected for the Phase 2 studies in rheumatoid arthritis remains unchanged.
In addition, Galapagos' balance sheet holds an unconditional and unrestricted receivable from the French government (Crédit d'Impôt Recherche)[1] amounting to €25 million, payable in three yearly tranches starting in early 2014. A significant

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

portion of this receivable could be transferred into cash if needed.

**Outlook for 2013**

The Phase 2b clinical study for GLPG0634 will start in the second quarter of 2013, on track to delivering the full Phase 2 package to AbbVie in late 2014. The Company expects to make significant progress in both partnered and non-partnered R&D programs as the pipeline continues to mature across a broad range of therapeutic areas, resulting in three Phase 2 and multiple Phase 1 programs by end 2013. Management guides for €160 million in Group revenues in 2013.

## 2. OVERVIEW OF DEVELOPMENT, RESULT AND POSITION OF GALAPAGOS NV

**Chapter 2 only concerns the non-consolidated statutory results of Galapagos NV. These results are part of the consolidated results as discussed above.**

Galapagos NV's operating income in 2012 amounted to €133.7 million compared to €96.7 million in 2011. This increase is mainly due to increased external revenues of €20.1 million. As a result of capitalization of intangible assets for a third consecutive year, this increase in operating income was further enhanced by income from capitalized R&D expenses. The other operating income amounts to €13.3 million, including €1.1 million in grants recognized for R&D projects, €5.8 million in recharges to subsidiaries and €4.3 million recognized in tax incentives for investments in intangible fixed assets.

The operating costs of 2012 amounted to €133.7 million compared to €118.7 million in 2011. Material purchases decreased to €3.4 million compared to €3.9 million in 2011. Services and other goods increased to €71.3 million compared to €69.2 million in 2011, mainly as a result of increased software costs related to the ERP system and increased outsourcing for development of our products.

Personnel costs in 2012 amounted to €11.8 million compared to €9.8 million in 2011. The number of employees at Galapagos NV at the end of 2012 amounted to 113.

Depreciation increased to €45.5 million in 2012, compared to €33.7 million in 2011. This is due to amortization booked on the internally generated intangible assets capitalized in 2010, 2011, and 2012.

Galapagos NV's 2012 financial income increased to €3.1 million compared to €1.8 million in 2011, which can be explained mainly by interest earned on the $150 million upfront payment received from AbbVie in 2012. Financial costs amounted to €0.9 million compared to €1.6 million in 2011. This is due to lower cost of unrealized translation differences on the outstanding receivables and loans in foreign currency.

Extraordinary costs were recorded in 2012 and amount to €29.5 million, of which €28.4 million relates to the extraordinary write-off of capitalized R&D costs with regard to alliances which have ended or programs which have been placed on hold.

Galapagos NV is capitalizing its incurred R&D expenses to the extent that the costs capitalized do not exceed a prudent estimate of their value in use or their future economic benefits for the entity. The ability to recover the capitalized amounts

takes into account assumptions (i.e. future peak sales, market share, sales price, attrition rates regarding the successful completion of the different R&D phases) which have a highly judgmental nature and depend on the outcome of uncertain factors which are beyond the control of the entity (i.e. test results). The achievement of these assumptions is critical and may impact the recoverability of the amounts capitalized. Capitalized R&D expenses amount to €90.4 million compared to €84.6 million last year.

Investments in fixed assets in 2012 totaled €1.6 million, excluding the internally generated assets. They consisted mainly of investments in intangible assets, being software and licenses for implementation of a company-wide ERP system.

Galapagos NV's cash position at the end of 2012 amounted to €71.6 million.

The non-consolidated annual accounts of Galapagos NV which we submit for your approval were prepared in accordance with Belgian accounting rules as well as with the legal and statutory requirements. They show a negative result. The financial year 2012 closed with a loss of €27.2 million compared to a loss of €32.5 million in 2011. The result of Galapagos NV is largely affected by the fact that, as from financial year 2010, Galapagos NV capitalizes some of its R&D expenses and revenues, that are eligible for such capitalization under Belgian GAAP. This capitalization negatively impacted the net result of Galapagos NV by €10.4 million in 2012, compared to a positive impact of €15.0 million in 2011.

In 2012, neither Galapagos NV nor its affiliates made direct or active use of financial instruments such as hedging.

## 3. ACTIVITIES IN THE AREA OF RESEARCH AND DEVELOPMENT

For a description of Galapagos' Research & Development activities in 2012, we refer to what is set forth above in section 1, topic "R&D division gains monumentum in 2012, expands opportunities beyond GLPG0634."

## 4. SHARES AND CAPITAL

### Capital increases and issue of shares

On 1 January 2012, the share capital of Galapagos NV amounted to €142,928,662.81 represented by 26,421,441 shares. In the course of 2012 there were four capital increases resulting from the exercise of warrants, resulting in the issuance of 349,306 new shares, an increase of the share capital by €1,886,925.46 and an increase of the issuance premium account by €854,697.81. At the end of 2012, the total share capital of Galapagos NV amounted to €144,815,588.27 represented by 26,770,747 shares.

On 3 September 2012, the Board of Directors issued 481,140 warrants (after acceptances) within the framework of the authorized capital, for the benefit of the Directors and certain independent consultants of Galapagos NV, and of employees of the Group under a new warrant plan ("Warrant Plan 2012"). The offer of warrants to the Company's Directors under Warrant Plan 2012 was approved by the Extraordinary General Shareholders' Meeting of 22 August 2012. The warrants issued under Warrant Plan 2012 have a term of eight years and an exercise price of €14.19.

**Shares and rights attached to the shares**

Of the 26,770,747 shares of Galapagos NV outstanding at the end of 2012, 1,652,271 were registered shares, 25,117,716 shares were dematerialized shares and 760 shares were bearer shares. All shares are issued and fully paid up and are of the same class.

Each share (i) entitles its holder to one vote at the Shareholders' Meetings; (ii) represents an identical fraction of the capital and has the same rights and obligations and participates equally in the profit of Galapagos NV; and (iii) gives its holder a preferential subscription right to subscribe to new shares, convertible bonds or warrants in proportion to the part of the share capital represented by the shares already held. The preferential subscription right can be restricted or cancelled by a resolution approved by the Shareholders' Meeting, or by the Board of Directors subject to an authorization of the Shareholders' Meeting, in accordance with the provisions of the Belgian Company Code and Galapagos NV's articles of association.

**Authorized capital**

In accordance with the articles of association, the Extraordinary General Shareholders' Meeting of Galapagos NV authorized the Board of Directors to increase the share capital of the Company, in one or several times, and under certain conditions set forth *in extenso* in the articles of association of Galapagos NV. This authorization was renewed and is valid for a period of five years from the date of this renewal, i.e. 23 May 2011. The Board of Directors may increase the share capital of Galapagos NV within the framework of the authorized capital for an amount of up to €142,590,770.44. In 2012, Galapagos NV's Board of Directors made use of the right to increase the capital in the framework of the authorized capital on one occasion: on 3 September 2012, in connection with the issuance of Warrant Plan 2012 under which a maximum of 481,140 new shares can be issued for a total maximum capital increase of €2,602,967.40 (plus issuance premium).

When increasing the share capital within the limits of the authorized capital, the Board of Directors may, in Galapagos NV's interest, restrict or cancel the shareholders' preferential subscription rights, even if such restriction or cancellation is made for the benefit of one or more specific persons other than the employees of the Company or its subsidiaries.

**Changes in share capital**

In accordance with the Belgian Company Code, Galapagos NV may increase or decrease its capital by decision of the Extraordinary General Shareholders' Meeting taken with a majority of 75% of the votes cast, at a meeting where at least 50% of the share capital of Galapagos NV is present or represented. If the attendance quorum of 50% is not met, a new Extraordinary General Shareholders' Meeting must be convened at which the shareholders may decide on the agenda items, irrespective of the percentage of share capital present or represented at such meeting. There are in this respect no conditions imposed by the Company's articles of association that are more stringent than those required by law.

Within the framework of the powers granted to it under the authorized capital, the Board of Directors may also increase Galapagos NV's capital as specified in its articles of association.

**Purchase and sale of own shares**

At the Extraordinary General Shareholders' Meeting of 23 May 2011, the Board of Directors was authorized to approve the

acquisition, subject to the provisions of the Belgian Company Code, of Galapagos NV's own shares representing up to 10% of Galapagos NV's capital at a price which may not be lower than €0.05 and not higher than 110% of the price at which such shares were quoted on the Brussels stock exchange on the day preceding the day of the purchase. This authorization was granted for a period of 18 months after the publication of such decision in the Annexes to the Belgian State Gazette. The authorization is also applicable to the acquisition of shares of Galapagos NV by its affiliates. The conditions for the purchase and sale of own shares are set forth *in extenso* in the articles of association of Galapagos NV.

On 31 December 2012, neither Galapagos NV nor any subsidiary of Galapagos NV held any shares in Galapagos NV nor did any third party hold any shares in Galapagos NV on their behalf.

**Anti-takeover provisions in Galapagos NV's articles of association**

The Board of Directors is expressly authorized during a period of three years as of the date of the General Shareholders' Meeting which granted this authorization, i.e. 23 May 2011, to increase Galapagos NV's share capital within the context of the authorized capital by contributions in kind or in cash with restriction or cancellation of the shareholders' preferential subscription rights, even after the FSMA has notified Galapagos NV of a public take-over offer for the Company's shares, provided that the relevant provisions of the Belgian Company Code are complied with, including that the number of shares issued under such capital increase does not exceed 10% of the shares issued by Galapagos NV prior to such capital increase. The authorization referred to above may be renewed.

The articles of association explicitly authorize the Board of Directors to acquire and dispose of any shares of Galapagos NV, without prior approval by the Shareholders' Meeting, if this is necessary to avoid a serious and imminent harm to the Company. This authorization was granted for a period of three years from the publication of such decision in the Annexes to the Belgian State Gazette (i.e. 10 June 2011). This authorization applies under the same conditions to the acquisition of the shares of Galapagos NV by its subsidiaries.

**Anti-takeover provisions under Belgian laws**

Under Belgian law, public takeover bids for all the outstanding voting securities issued by the issuer are subject to the supervision of the FSMA. If the latter determines that a takeover violates Belgian law, it may lead to suspension of the exercise of the rights attached to any shares that were acquired in connection with the envisaged takeover. Pursuant to the Belgian law of 1 April 2007 on public takeovers, a mandatory takeover bid must be made when, as a result of its own acquisition or the acquisition by persons acting in concert with it, a person owns, directly or indirectly, more than 30% of the securities with voting rights in a company with registered office in Belgium whose securities are admitted to trading on a regulated or recognized market. The acquirer must offer to all other shareholders the opportunity to sell their shares at the highest of (i) the highest price offered by the acquirer for shares of the issuer during the 12 months preceding the announcement of the bid or (ii) the weighted average price of the shares on the most liquid market of the last 30 calendar days prior to the date on which the obligation of the acquirer to offer the takeover of the shares of other shareholders starts.

**Change of the articles of association**

Pursuant to the Belgian Company Code, any amendment to the articles of association such as an increase or decrease in

the capital of Galapagos NV, and certain other matters such as the approval of the dissolution, merger or de-merger of Galapagos NV may only be authorized with the approval of at least 75% of the votes validly cast at an Extraordinary General Shareholders' Meeting where at least 50% of Galapagos NV's share capital is present or represented. If the attendance quorum of 50% is not met, a new Extraordinary General Shareholders' Meeting must be convened at which the shareholders may decide on the agenda items, irrespective of the percentage of share capital present or represented at such meeting.

**Agreements with and between Shareholders**

On the date of this report, Galapagos NV had no knowledge of the existence of any shareholders' agreements between Galapagos' shareholders. Throughout 2012 there were no lock-up agreements in effect between the Company and any of its shareholders.

**Shareholders' structure**

Based on the transparency notifications received by the Company, the shareholders owning 5% or more of the Company's shares on 31 December 2012 were Delta Lloyd Asset Management N.V. (3,000,000 shares), Johnson & Johnson (2,350,061 shares), Baker Bros. Advisors, LLC (1,722,066 shares) and The Capital Group Companies, Inc. (1,554,438 shares).

At the end of 2012, the CEO owned 325,348 shares of Galapagos and 655,000 warrants. The other members of the Executive Team held an aggregate of 48,402 shares and 690,000 warrants. The other members of the Board held an aggregate of 16,800 shares and 180,710 warrants. Each warrant entitles to one share of the Company.

## 5. RISK FACTORS

Risk management is embedded in our strategy and is considered important for achieving our operational targets (see section 1, topic 'Outlook 2013').

To safeguard the proper implementation and execution of the Group's strategy, we have an internal risk management and control system. The Board of Directors has delegated an active role to the Audit Committee members for designing, implementing and operating the Company's internal risk management and control systems. The purpose of these systems is to manage in an effective and efficient manner the significant risks to which the Company is exposed.

The internal control system is designed to ensure:

- the careful monitoring of the effectiveness of our strategy
- the Company's continuity and sustainability, through, for instance, consistent accounting, reliable financial reporting and compliance with laws and regulations
- our focus on the most efficient and effective way to conduct our business

We have defined our risk tolerance on a number of internal and external factors including:

- business performance measures; operational and net profitability
- financial strength in the long run, represented by revenue growth and a solid balance sheet
- liquidity in the short run; cash

- scientific risks and opportunities
- dependence on our alliance partners
- compliance with relevant rules and regulations
- reputation

The identification and analysis of risks is an ongoing process that is naturally a critical component of internal control. On the basis of these and the Company's risk tolerance, the key controls within the Company will be registered and the effectiveness will be monitored. If the assessment shows the necessity to modify the controls we will do so. This could be the situation if the external environment changes, or the laws or regulations or the strategy of the Company change.

**Scientific risks**

The Group operates adequate standard operating procedures to secure the integrity and protection of its research and development activities and results, and the optimum allocation of its R&D budgets. The progress of the most important research and development programs is continuously monitored by the Executive Committee; they are discussed with the Board at least once per quarter, and Board members with expertise in clinical and scientific matters occasionally attend meetings with scientific staff to discuss and assess such programs.

**Reliance on key staff and management**

Our ability to attract and retain highly skilled personnel on acceptable terms is limited by the competition for qualified personnel. The absence of professionals could have a material adverse effect on business, financial condition, results of operations and prospects. Adequate remuneration and incentive schemes and the sharing of the Company's knowledge amongst key employees mitigate this risk. In the recent past, Galapagos has continued to be successful in attracting and retaining qualified employees.

**Operational risk**

- This risk can take many forms including business interruption, inappropriate behavior, lack of performance. This risk has a high potential impact, but is mitigated by policies and procedures such as surveillance of the buildings, annual appraisals and bonuses, and monthly management meetings.

- Internal and external IT systems
  Continuing an uninterrupted performance of our IT system is critical to the success of our business strategy and operations. A recovery plan for data has been implemented, as well as a system for interception of power failures. Fire walls and virus scanners provide an additional and adequate protection. The Company's personnel should adhere to continuity plans and procedures regarding access rights and installation of different programs.

**Safety risk: handling materials potentially hazardous to health**

The very limited use of hazardous materials, the existence of stringent health and safety operation procedures, and regular inspections and safety days significantly decrease the potential impact as well as the estimated likelihood of the risk. Furthermore, the Group employs quality & environmental health and safety managers who closely monitor laboratory safety and continuously seek to improve quality and safety conditions.

**Finance risk**

- Accounting estimates – impairment of goodwill
  The Group constantly uses estimates and assumptions concerning the future, especially when performing impairment tests on goodwill and (in)tangible assets. These tests are performed on a realistic and regular basis.

- Credit risk
  Credit risk represents the risk of financial loss caused by default of the counterparty. This risk is within acceptable boundaries as clients are major, well-respected, creditworthy, international pharmaceutical companies, research foundations, and biotech companies.

- Taxation
  The Company may incur unexpected tax charges, including penalties, due to the failure of tax planning or due to the challenge by tax authorities on the basis of transfer pricing.

  Any changes to Belgian and international taxation legislation or the interpretation of such legislation by tax authorities may influence the Group's activities, financial situation and results. Such potential changes and their impact are monitored carefully by management and its advisors.

- Changes in accounting standards
  Any changes to the accounting standards may influence the Group's financial situation and results. Here as well, such potential changes and their impact are carefully monitored.

- Financial and liquidity risk
  Liquidity risk represents the risk that an entity will encounter difficulty in meeting obligations associated with its financial liabilities.
  The Company monitors its cash on a regular basis by means of cash forecasts and sensitivity analyses. The Group's net operating cash flow after investments was positive in 2012 (cash flow) as opposed to a negative cash flow (cash burn) in 2011, which was mainly due to the $150 million upfront payment received from AbbVie in 2012. To fund its operations, research activities, and acquisitions, the Group may need additional cash, which may not be available on acceptable terms when required, if at all. At the moment the Group has no financial debt except limited financial lease obligations.

- Foreign exchange risk
  As a large part of the revenues and costs are denominated in currencies other than the Euro, our functional currency, the Company has considerable potential exposure to foreign currency fluctuation. The effect of these fluctuations is recorded in the profit & loss statement or in the consolidated equity, in accordance with the applicable accounting standards. The Company makes efforts to limit the exposure by closing contracts in local currencies and by matching revenues and costs in a foreign currency. In order to further reduce this risk, Galapagos implemented a netting system within the group in the course of 2012, which restrains intra-group

payments between entities with a different functional currency.

Galapagos annually establishes a detailed budget that is submitted to the Board of Directors for review and approval. The Group's performance compared to the budget is continuously monitored by the Executive Committee and is discussed with the Board at least once per quarter. For the establishment of its financial information, the Group has processes and methods in place that enable the preparation of consolidated financial statements for its annual and mid-year reporting, and more often if required. The Group's management reporting systems secure the generation of consistent financial and operational information, allowing management to follow-up the Group's performance on a daily basis. In view of continuous improvement the Group has implemented a new and advanced integrated ERP system.

**Intellectual property risk**

The Company's commercial success depends in part on the ability to obtain, maintain and enforce adequate protection of the intellectual property rights, including patents, in technologies and products and this in a large geographical zone. The development of grantable patents is not obvious. The possession of patents increases the revenues and is an important tool when negotiating with potential partners. The outcome of legal disputes concerning patent infringement is difficult to predict. Legal proceedings over IP rights can be time consuming and expensive and should be avoided by constant monitoring of published patents and patent applications. Galapagos endeavors to protect its proprietary technologies and know-how by entering into confidentiality and proprietary information agreements with employees and partners, and by setting up special procedures (e.g. with respect to the handling of the laboratory books). Future changes in IP law also can substantially influence the Company's operations.

**Market risk**

- Possible volatility share price
  The market price of the shares might be affected by a variety of factors outside management control, such as the global economic situation, the business development of competitors, sector mergers and acquisitions; it is difficult to mitigate this risk.

- Economic risk due to failure in confidence
  General public confidence about future economic conditions or performance of Galapagos or its suppliers or customers may impact the ability or willingness of others to trade with the Company.

- Dilution through exercise of warrant plans
  The exercise of existing warrants can significantly increase the number of shares.

- Inability to distribute dividends
  The Group has a limited operating history and future profitability cannot be guaranteed. Galapagos NV has significant losses carried-forward and will thus not be able to distribute dividends in the near future. This can cause people to refrain from investing in the Company's stock.

- Acquisition / integration risk

The acquisition and integration of other companies, as part of the Company's strategy to expand its business through acquisition of other businesses, present challenges to Galapagos' personnel and operations. Specific risks are unanticipated costs, loss of key personnel, the inability to obtain the expected benefits and synergies of the merger. Galapagos makes sure that every acquisition is preceded by a thorough due diligence and sets up systems that allow a smooth integration of the acquired businesses and teams.

- Reputational damage
  High ethical standards are maintained throughout the entire organization at all levels. Laws and guidelines are complied with.

**Interrupted product supply - loss of key suppliers**

A reliable supply of materials is required in order to eliminate production delays.
Most goods and services are provided by several different suppliers, which mitigates the risk of loss of key suppliers. Expanding the suppliers' network can be time consuming as all source suppliers are subject to rigorous ethical and quality control standards. The suppliers should perform as contractually required or expected.

**Reliance on key clients**

Certain relationships represent significant sources of revenues. Loss or deterioration of these relationships can significantly impact the results of the Group. The weakness of the global economy and the ongoing financial crisis has adversely affected businesses. This risk can be mitigated through multiple alliances with different partners, and through strengthening relationships with existing clients.

**Competition: organizations providing similar contract research – price pressure in the contract research market**

The Group faces competition from contract research companies that may bring products and services to the market which are more competitive or affordable and which might hurt the position of the service operations.

**Legal risks**

- Possible litigations and claims – product liability
  Product liability cases and claims may give rise to adverse regulatory action and/or negative market perception of the Company and its products. In most cases damages can be controlled. The likelihood of claims increases with the increase in size and visibility of the Company. The company carries appropriate insurance policies to cover its risks, including for its clinical trials.

- Failure to comply with laws and regulations – penalties or cease operations
  The industry in which the Company operates is strictly regulated. If the Company fails to meet strict regulatory requirements, the Company may be required to pay penalties or even to close down certain facilities.

- Change in alliance strategy
  Current or prospective licensees and partners may use or develop alternative strategies, technologies or competing products, independently or in collaboration with others. This strategic shift in business focus can

seriously impact the Company's results.

- Compliance with Corporate Governance
  Galapagos has always in all material respects been compliant with the Corporate Governance Code. Members of the Executive Committee and of the Board are expected to conduct their duties according to the highest ethical and professional business standards.

**Product development**

Pre-clinical testing, clinical research and regulatory approval of a pharmaceutical or medical product is a very intensive and costly process, and is subject to a high degree of failure in every phase. In some cases regulatory approval might not be received, or might be restricted to certain geographical regions or indications, or later withdrawn or significantly delayed, which could impact the receipt of product revenues, if any.

**General statement about Galapagos Group risks**

According to our current assessment we consider the risks to be manageable and the going concern of the Company not to be endangered at the time of the current report. Assuming no further deterioration of the global business, financial and regulatory environment, the Group considers itself well prepared to meet all future challenges.

## 6. SIGNIFICANT EVENTS ANNOUNCED AFTER THE END OF THE FINANCIAL YEAR

Galapagos announced the following significant events after 31 December 2012:

- 9 January: Galapagos delivers candidate drug in GSK alliance and receives milestone payment (included in 2012 revenues
- 10 January: Galapagos receives €2.7 million IWT grant for antibacterial research (not included in 2012 revenues)
- 15 January: Galapagos creates Fidelta, a third Galapagos service division
- 15 January: Galapagos acquires Cangenix, a structure-based drug discovery company
- 16 January: Galapagos delivers candidate drug in its alliance with Janssen Pharmaceutica NV and receives €4 million milestone payment (included in 2012 revenues)
- 30 January: Galapagos receives €2.5 million IWT grant for IBD research (not included in 2012 revenues)
- 5 February: Galapagos announces GSK2586184 JAK1 molecule progresses to Phase 2 studies
- 4 March: Katrine Bosley appointed to Galapagos' Board of Directors as of 27 February 2013 and resignation of Ferdinand Verdonck effective 26 February 2013
- 6 March: Galapagos receives €7.5 million in Servier alliances (included in 2012 revenues)
- 8 March: Galapagos and Roche conclude strategic alliance and Galapagos receives a payment of €5.75 million for work completed in 2012 (included in 2012 revenues)

## 7. GOING CONCERN AND ACCOUNTING STANDARDS

The 2012 consolidated results are negative for Galapagos, and the balance sheet shows a loss carry-over. The Board has examined the statements and accounting standards. Taking into account the solid cash position, in particular after the conclusion of the GLPG0634 deal with Abbott in February 2012, and the favorable outlook of developments of Galapagos NV's drug discovery activities and its subsidiaries' activities including GLPG0634, the Board is of the opinion that it can submit the annual accounts on an ongoing concern basis.
The Board is also of the opinion that additional financing could be obtained, if required. Whilst Galapagos NV's cash position is sufficient for the Company's immediate and midterm needs, the Board points out that if the R&D activities continue to go well, Galapagos NV may seek additional funding to support the continuing development of its products or to be able to execute other business opportunities.

## 8. CORPORATE GOVERNANCE STATEMENT

### 8.1. General

Galapagos uses the Belgian Corporate Governance Code 2009 (which can be found on www.corporategovernancecommittee.be) as reference code. Galapagos' Board of Directors approved a Corporate Governance Charter. The Charter, which is available on the Company's website, is applicable in addition to the law, the Company's articles of association and the corporate governance provisions included in the Belgian Company Code and the Belgian Corporate Governance Code 2009.

The Company's Corporate Governance Charter includes the following specific rules and charters:

- Charter of the Board of Directors
- Charter of the Audit Committee
- Charter of the Nomination- and Remuneration Committee
- Charter of the Executive Committee
- Dealing Charter (which provides procedures and guidelines to prevent abuse of insider knowledge and to prevent insider trading and market manipulation).

The Board of Directors intends to comply with the provisions of the Belgian Corporate Governance Code at all times. Nevertheless, it is possible not to comply with certain corporate governance provisions when the specific circumstances are taken into account. In such cases, which are mentioned in this chapter, the Company applies the "comply or explain" principle.

### 8.2. Board of Directors

Galapagos' Board of Directors consists of minimum five and maximum nine members, including the Chairman and the CEO. The Chairman is a non-executive Director and does not hold the office of CEO. The Board of Directors consists of at least three independent Directors.

Except for Mr Onno van de Stolpe, all Board members are non-executive Directors.

In 2012, the following persons were members of the Board: Dr Raj Parekh (Chairman), Ir Onno van de Stolpe (CEO), Dr Harrold van Barlingen, Mr Ferdinand Verdonck, Dr Werner Cautreels, Mr Howard Rowe and Dr Vicki Sato; the latter four Directors were appointed as independent Directors within the meaning of article 526ter of the Belgian Company Code.

The Board's role is to pursue the long-term success of the Company by assuming the authority and responsibility of the Board set out in Belgian Corporate law and by providing entrepreneurial leadership and enabling risks to be assessed and managed. The activities exercised and offices held by each of the Directors reflect the expertise and experience of each of them.

In 2012, the Board of Directors held 4 regular meetings, 9 meetings by telephone conference to discuss specific matters and 1 meeting in the presence of a notary (the latter relating to the issuance of the Warrant Plan 2012).

The attendance rate (in person or by written proxy to a fellow Director) for the Board members in function at 31 December 2012 was as follows: Dr Parekh 100%, Mr Van de Stolpe 93%, Mr Verdonck 100%, Dr Van Barlingen 86%, Mr Rowe 100%, Dr Cautreels 100% and Dr Sato 79%. The overall attendance rate was 94%. In addition, certain Board members (including Dr Cautreels and Dr Sato) also attended a number of review meetings with scientific staff of the Group.

The Board of Directors acts as a collegial body. The Company does not have a formalized process in place to evaluate the Board, its Committees and its individual Directors; the Board is of the opinion that such evaluation can occur on an ongoing and informal basis within the framework of the meetings of the Board and its Committees.

In connection with the requirements of the Law of 28 July 2011 relating to certain changes to the Belgian Company Code, in particular with respect to gender diversification in the Board of Directors, the Board will continue to monitor the gender diversification requirements.

### 8.3. Committees

The Board of Directors has installed a Nomination and Remuneration Committee, an Audit Committee and an Executive Committee.

At the end of 2012, the Nomination- and Remuneration Committee consisted of the following three non-executive Directors: Dr Parekh (Chairman), Dr Cautreels and Mr Rowe, the majority of whom are independent Directors. The Committee has the necessary expertise in the area of remuneration policy.

The Nomination and Remuneration Committee's role is twofold: providing recommendations to the Board of Directors regarding the remuneration policy of Galapagos and the remuneration of Directors and members of the Executive Committee, and selecting the appropriate candidates and making recommendations to the Board of Directors in relation to the appointment of Directors and members of the Executive Committee.

The Nomination and Remuneration Committee meets at least twice per year. In 2012, the Nomination- and Remuneration

Committee made recommendations on 3 occasions, dealing with matters including grants of warrants and bonuses, new warrant plans, and salary increases. The Nomination and Remuneration Committee acts as a collegial body. The overall attendance (present or represented) at the Nomination and Remuneration Committee meetings in 2012 was 100%. The CEO attended the meetings of this Committee when the remuneration of the other members of the Executive Committee was discussed.

At the end of 2012, the Audit Committee consisted of the following three Directors: Mr Verdonck (Chairman), Dr Parekh and Dr Cautreels. All members of the Audit Committee are non-executive Directors, the majority of whom are independent. The Chairman is an independent non-executive Director and has extensive experience in financial matters (including general accounting and financial reporting) and in matters of audit, internal control and risk control. The other members are competent in these matters as well.

The role of the Audit Committee is to follow up on financial reporting and verification of financial data, verify and follow up on the internal control mechanisms, evaluate and verify the effectiveness of the risk assessment systems, and follow up on the internal and external audit activities.

In 2012, the Audit Committee held 4 meetings, in which it dealt with matters including audit review, authorities and procedures, risk management and the ERP system. The Audit Committee acts as a collegial body. The overall attendance (present or represented) at the Audit Committee meetings in 2012 was 100%. Some of the meetings were attended by the Statutory Auditor.

The tasks of the Executive Committee include the following matters: the research, identification and development of strategic possibilities and proposals which may contribute to Galapagos' development in general, the drafting and development of policy guidelines to be approved by the Board of Directors, Galapagos' management through, among other things, the implementation of policy guidelines, the supervision of the performance of the business in comparison with the strategic goals, plans and budgets, and the support of the CEO with the day-to-day management of Galapagos.

On 31 December 2012, the Executive Committee consisted of five people: Mr Van de Stolpe (CEO, also executive Director), Dr Andre Hoekema (Senior Vice President, Corporate Development), Dr Chris Newton (Senior Vice President, Galapagos Services), Dr Piet Wigerinck (Chief Scientific Officer) and Mr Guillaume Jetten (CFO).

The Executive Committee meets regularly, and in principle once per month.

## 8.4. Remuneration report

### 8.4.1 Procedure for establishing the remuneration policy and setting the remuneration for members of the Board of Directors and of the Executive Committee

The procedure for establishing the remuneration policy and setting remuneration for members of the Board of Directors and of the Executive Committee is determined by the Board of Directors on the basis of proposals from the Nomination and Remuneration Committee, taking into account relevant benchmarks from the biotechnology industry and, for the members

of the Executive Committee, also the Group's performance rating system.

The remuneration of the members of the Board and the grant of warrants to members of the Board are submitted by the Board for approval to the General Shareholders' Meeting, and are only implemented after such approval.

The fixed and variable remuneration of the CEO (who is a member of the Board) is established by the Board of Directors based upon an authorization from the General Shareholders' Meeting. The fixed and variable remuneration of, and grant of warrants to, the other members of the Executive Committee is established by the Board of Directors.

**8.4.2 Remuneration policy**

a) Principles

The objective of Galapagos' remuneration policy is to attract, motivate and retain the qualified and expert individuals that the Group needs in order to achieve its strategic and operational objectives. In light of the remuneration policy, the structure of the remuneration package for the Executive Committee is designed to balance short-term operational performance with the long-term objective of creating sustainable value within the Group, while taking account of the interests of all stakeholders.

The remuneration of the non-executive Directors consists of a fixed annual amount, irrespective of the number of Board meetings that are held during the year, with a correction principle that, in the event a Director's presence rate at Board meetings is below 75%, the annual remuneration will be proportionally decreased. The remuneration of the non-executive Directors does not contain a variable part. The Board fees are paid in quarterly installments at the end of each calendar quarter.

The remuneration of the CEO (who is an executive Director) and of the other members of the Executive Committee consists of a fixed amount and of a variable part (bonus). Remuneration increases and bonuses are merit-driven and based on the Group's performance rating system that is based on individual performance (including exceptional deliverables) in combination with the overall performance of the Group, compared to the level of achievement of individual and corporate objectives that are established annually. The corporate objectives and the CEO's objectives are established annually by the Board of Directors, and the objectives of the other members of the Executive Committee are established annually by the CEO and are in relation to the corporate objectives set by the Board. For 2012 the corporate objectives included elements of revenue, cash flow, operating profitability, clinical trial results and licensing; all of these objectives were considered to be of equal importance. The level of achievement of the objectives for the CEO is reviewed at the end of each year by the Remuneration Committee and discussed and finally established by the Board, and the level of achievement of the objectives of the other members of the Executive Committee is assessed by the CEO at the end of the year in connection with appraisal discussions, discussed by the Remuneration Committee and finally established by the Board of Directors.

Pursuant to the rules of the Senior Management Bonus Scheme established in 2006, 50% of the bonus is paid immediately around year-end and the payment of the other 50% is deferred for three years. The deferred 50% component is dependent on the Company's share price change relative to the Next Biotech Index (which tracks the Company's peers). The Company's share price and Index at the start and end of the 3-year period is calculated by the average price over the

preceding and last month of the 3-year period, respectively.

- If the Company's share price change is better than or equal to the change in the Next Biotech Index, the deferred bonus will be adjusted by the share price increase/decrease and paid out.
- If the Company's share price change is up to 10% worse than the change in the Next Biotech Index, 50% of the deferred bonus will be adjusted by the share price increase/decrease and paid out, and the remainder will be forfeited.
- If the Company's share price change is more than 10% worse than the change in the Next Biotech Index the deferred bonus will be forfeited.

To be entitled to any deferred payment under the bonus scheme the beneficiary must still be in the Company's employ.

b) Relative importance of the various components

The CEO's bonus can be maximum 100% of the fixed part of his annual remuneration of the year for which the bonus is awarded. The aggregate bonuses of the other members of the Executive Committee's remuneration can be maximum 60% of the total amount of the fixed part of their aggregate annual remuneration of the year for which the bonus is awarded. In addition, the CEO and/or the other members of the Executive Committee enjoy a number of benefits such as pension payments, insurances and other fringe benefits, the monetary value of which is, however, limited.

c) Performance-related premiums in shares, options or other rights to acquire shares

The Company does not provide for any performance-related premiums in shares, options or other rights to acquire shares. The warrants granted to members of the Board of Directors (including the CEO) are not considered as a (performance-related or otherwise) variable remuneration as defined by the Belgian Company Code.

d) Information on the remuneration policy for the next two financial years

The Company currently has no plans to substantially deviate from the remuneration policy used in 2012 and the years before, as described above, in the next two financial years.

**8.4.3 Remuneration of non-executive Directors**

Pursuant to the decision of the Annual General Shareholders' Meeting of 24 April 2012, each of the independent Directors (i.e. Mr Verdonck, Dr Cautreels, Mr Rowe and Dr Sato) received a fixed annual remuneration of €20,000 in 2012. In addition, the Annual General Shareholders' Meeting of 24 April 2012 authorized an additional compensation of €20,000 for Directors who provide actively and on a regular basis independent clinical and scientific advice to the Board of Directors. In 2012, this was the case for Dr Cautreels and Dr Sato. The Chairman of the Audit Committee (Mr Verdonck) received an additional fixed amount of €5,000 for performing his duties as Chairman. The non-executive Director who does not qualify as independent Directors and who does not represent a shareholder of the Company (Dr Van Barlingen) also received a fixed annual remuneration for his mandate as a Director of €20,000. In the event a Director has a presence rate at Board meetings that is below 75% , the amounts referred to above are proportionally decreased. Directors who represent a shareholder in the Board of Directors would only receive reimbursement of the expenses incurred for participating in the Board of Directors (there were no such Directors in 2012).

The remuneration of the non-executive Directors does not contain a variable part; hence no performance criteria apply to

the remuneration of the non-executive Directors.

The Chairman of the Board of Directors, Dr Parekh, does not receive remuneration like the other Directors. However, a consultancy contract was made with him several years ago, under which he receives an annual fee of £50,000 as compensation for giving strategic advice.

The Board of Directors resolved to issue the Warrant Plan 2012 for the benefit of the Directors and two independent consultants of Galapagos NV, and of employees of the Group. In accordance with the resolution of the Extraordinary General Shareholders' Meeting of 22 August 2012, the following warrants were offered under such Plan to the non-executive Directors: Dr Parekh and Mr Verdonck: each 3,780 warrants; Dr Van Barlingen, Dr Cautreels, Mr Rowe and Dr Sato: each 2,520 warrants. All beneficiaries accepted the warrants. These warrants have a term of eight years. The exercise price of the warrants is €14.19. As regards the Directors, the warrants vest over a period of 36 months at a rate of 1/36$^{th}$ per month. The warrants cannot be transferred and cannot be exercised prior to the end of the third calendar year following the year of the grant. The Board of Directors does not consider these warrants as variable remuneration as defined by the Belgian Company Code as they are not subject to any performance-related criteria.

The Board of Directors points out that provision 7.7 of the Belgian Corporate Governance Code 2009 stipulates that non-executive Directors should not be entitled to performance-related remuneration such as stock-related long-term incentive schemes. In deviation to this provision, the Board of Directors has decided to grant warrants to non-executive Directors. This way, the Company has additional possibilities to attract competent non-executive Directors and to offer them an attractive additional remuneration that does not affect the cash position of the Company. Furthermore, the grant of warrants is a commonly used method in the sector in which the Company operates. Without this possibility, the Company would be confronted with a considerable disadvantage compared to competitors who do offer stock-related incentive schemes to their non-executive Directors. The Board of Directors is of the opinion that the granting of warrants has no negative impact on the function of the non-executive Directors.

Except as set forth above, there are no other benefits granted to the non-executive Directors.

**8.4.4 Remuneration of members of the Executive Committee that are also a member of the Board of Directors**

Mr Van de Stolpe is an executive member of the Board of Directors. As managing Director and CEO, he acts as Chairman of the Executive Committee. Mr Van de Stolpe does not receive any specific or additional remuneration for his work on the Board of Directors, as this is part of his total remuneration package in his capacity as member of the Executive Committee.

**8.4.5 Criteria and methods to evaluate performance of the CEO and the members of the Executive Committee in connection with their performance based remuneration**

The executive Director (CEO) and the members of the Executive Committee are eligible for performance-based remuneration (bonus). The level of the achieved bonus is established annually by the Board of Directors on the basis of proposals from the Nomination and Remuneration Committee (whose proposals are based on recommendations by the CEO for the other members of the Executive Committee). The award of a bonus is merit-driven and based on the Group's performance rating system that is based on annual individual performance (including exceptional deliverables) in combination with the overall

performance of the Group, compared to the level of achievement of individual and corporate objectives that are established annually. The corporate objectives and the CEO's objectives are established annually by the Board of Directors, and the objectives of the other members of the Executive Committee are established annually by the CEO. For 2012 the corporate objectives included elements of revenue, cash flow, operating profitability, clinical trial results and licensing; all of these objectives were considered to be of equal importance. Each of the corporate objectives is clear and measurable so that it is easy to determine whether or not a specific objective has been achieved or not.

**8.4.6 Gross remuneration of the CEO (executive Director, Chairman of the Executive Committee) (Mr Van de Stolpe) for financial year 2012**

a) Base salary (fixed): €402,811

b) Variable remuneration (bonus): as 3 out of 5 criteria from the Senior Management Bonus Scheme to be entitled to a bonus (i.e. the corporate objectives for 2012) were achieved, a bonus of €253,000 (i.e. 60% of the 2012 base salary) has been awarded over 2012 of which 50% was paid early January 2013, and the other 50% was deferred for 3 years. The value of the 50% deferred part of the bonus awarded over 2009 was established at the end of 2012 and resulted in a payment in early January 2013 of an amount of €389,134 (a multiple of 1.96 of the deferred bonus, as a result of the share price performance over the period 2009-2012, see section 8.4.2). In connection with the major collaboration agreement relating to GLPG0634 entered into in February 2012 a special bonus has been awarded by the Board (upon recommendation of the Remuneration Committee) in the amount of €150,000 of which 50% was payable in April 2012 and the other 50% was deferred for 3 years.

c) Pension: €70,708.

d) Other components of the remuneration: company car and payments for invalidity and healthcare cover, totaling €25,398.

In its meeting of 18 December 2012 (in application of Article 523 of the Code of Companies without the CEO being present) the Board of Directors resolved to increase the CEO's salary by 3% as from 2013. The principles applied for such increase were in line with the Remuneration Policy described above.

**8.4.7 Total (aggregate) gross remuneration of the other members of the Executive Committee for financial year 2012**

a) Base salaries (fixed): €1,356,345.

b) Variable remunerations (bonuses): as 3 out of 5 criteria from the Senior Management Bonus Scheme to be entitled to a bonus (i.e. the corporate objectives for 2012) were achieved, an aggregate bonus of €319,250 (i.e. 60% of the aggregate bonus pot for the incumbents in function on 31 December 2012) has been awarded over 2012 of which 50% was paid early January 2013, and the other 50% was deferred for 3 years. The value of the 50% deferred part of the bonus awarded over 2009 was established at the end of 2012 and resulted in an aggregate payment of €428,781 (a multiple of 1.96 of the deferred bonus, as a result of the share price performance over the period 2009-2012, see section 8.4.2). The deferred bonus was paid in early January 2013. In connection with the major collaboration agreement relating to GLPG0634 entered into in February 2012 a special bonus has been awarded in the aggregate amount of €375,000 of which 50% was payable in April 2012 and the other 50% was deferred for 3 years.

c) Pensions: €51,838.

d) Other components of the remunerations: company cars, payments for invalidity and healthcare cover, and other fringe benefits, totaling €68,659.

The amounts in this section include normal payments for compensation and benefits made to the two members of the Executive Committee whose employment with the Group ended in 2012, until the date of cessation of their employment, i.e. until 14 March 2012 for Dr Graham Dixon and until 14 December 2012 for Dr Radan Spaventi; the numbers do not include their respective termination payments (see section 8.4.10 below).

In its meeting of 18 December 2012 the Board of Directors resolved to implement salary increases as from 2013 for the members of the Executive Committee generally in line with the increases awarded in previous years, based on individual performance and taking into account the relevant benchmarks. The principles applied for such increases were in line with the Remuneration Policy described above.

**8.4.8 Shares, warrants or other rights to acquire shares awarded to, exercised by or expired for the CEO and other members of the Executive Committee during financial year 2012**

In 2012, only warrants have been offered to the members of the Executive Committee, and no shares or other rights to acquire shares have been awarded. No warrants have expired for members of the Executive Committee in 2012 and, in aggregate, 45,000 warrants have been exercised by members of the Executive Committee in 2012. The Board of Directors does not consider the granted warrants as a variable remuneration, as they are not subject to any performance criteria. The following number of warrants have been offered to and accepted by members of the Executive Committee in 2012: under the Warrant Plan 2012, issued by the Board of Directors under the authorized capital, on 3 September 2012, to each of Dr Hoekema, Dr Newton, Mr Jetten and Dr Spaventi (who left the Group in December 2012): 20,000 warrants; to Dr Wigerinck: 50,000 warrants and to Mr Van de Stolpe: 100,000 warrants. The warrants issued under Warrant Plan 2012 have an exercise price of €14.19 per warrant, a life time of 8 years, vest only and fully at the end of the third calendar year after the year of the grant, except for Mr Van de Stolpe, whose warrants vest over a period of 36 months at a rate of 1/36$^{th}$ per month. The warrants cannot be exercised prior to the end of the third calendar year after the year of the grant; they are not transferable; and each warrant gives the right to subscribe to one share of the Company.

At the end of 2012, the CEO owned 325,348 shares of Galapagos and 655,000 warrants. The other members of the Executive Committee in function on 31 December 2012 held an aggregate of 48,402 shares and 690,000 warrants. The other members of the Board held an aggregate of 16,800 shares and 180,710 warrants. Each warrant entitles to one share of the Company.

**8.4.9 Contractual provisions regarding compensation for severance for the CEO and other members of the Executive Committee**

The contracts between the Company (or its relevant affiliates) and the CEO and other members of the Executive Committee do not provide for severance compensation. They do not contain notice periods that exceed six months. However, in the past the Company has entered into undertakings with the CEO and the other members of the Executive Committee, providing that in case their contract with the Group is terminated as a result of a change of control of the Company, they would be entitled to a severance compensation of 12 months' base salary for the CEO and 9 months' base salary for the other members of the Executive Committee.

**8.4.10 Severance payment for departing members of the Executive Committee in 2012**

In 2012, two members of the Executive Committee have left the Group: Dr Graham Dixon left effective 14 March 2012 and Dr Radan Spaventi left effective 14 December 2012. In connection with their departure, payments have been made as follows: (i) to Dr Dixon: a total payment of €214,961 (including a compensation in lieu of 6 months' notice and a compensation for the deferred parts of bonuses); and (ii) to Dr Spaventi: a total payment of €394,380 (including a compensation in lieu of 17 week notice, a compensation for the deferred parts of bonuses, and an additional compensatory payment). Since the additional compensatory payment to Dr Spaventi slightly exceeded the equivalent of 12 month salary, it was made after review and approval by the Remuneration Committee and the Board. The Board has also resolved to approve a deviation from the relevant warrant plan rules for the benefit of both Dr Dixon and Dr Spaventi, by waiving, for them, the application of the principles that a warrant holder can exercise vested warrants only during an exercise period that falls within six months from the termination of the employment relation, and that upon termination of the employment relation a part of the warrants may become null and void if the termination takes place before the end of the third calendar year following the year of the offer.

**8.4.11 Claw-back right of the Company relating to variable part of remuneration**

There are no contractual provisions in place between the Company and the CEO and the other members of the Executive Committee that give the Company a contractual right to reclaim from said executives the variable remuneration that would be awarded based on erroneous financial information.

**8.5. Conflict of interest and related parties**

In the event of a transaction where a Director's interest conflicts with the interest of the Company, the Director shall notify the Board of Directors in advance of the conflict and will act in accordance with the relevant rules of the Company Code (i.e. article 523 of the Company Code). In addition, the Company's Corporate Governance Charter includes a policy for transactions between the Company and its Directors and executive managers. Without prejudice to the procedure defined in article 523 of the Belgian Company Code, this policy provides that all transactions between the Company and its directors, its members of the Executive Committee or its representatives need the approval of the Board of Directors, whose approval can only be provided for transactions at normal market conditions. Such a conflict of interest, even in the event it is not a conflict of interest as provided for in article 523 of the Belgian Company Code, shall be written down in the minutes, and the Director or member of the Executive Committee shall not vote.

In 2012, three cases of conflict of interest between the Company and a Director were noted:

(i) In a meeting of the Board of Directors of 14 March 2012, the following was reported, in application of article 523 of the Belgian Code of Companies, in connection with an exceptional bonus of 150,000 euro for the CEO (an executive Director) as reward for the major transaction involving GLPG0634: the Chairman declared that Mr Van de Stolpe had informed the Board of Directors of a conflict of interest, concerning the proposed award to him of said exceptional bonus. It has been explained to the Board that said exceptional bonus is a justified reward for the major deal-making result achieved by Mr Van de Stolpe. The exceptional bonus will have no material impact on the financial position of the Company. The Board shared the opinion of the Remuneration Committee that the proposed bonus is justified and reasonable. Mr Van de Stolpe did not take part in the deliberation and the vote concerning this decision.

(ii) In a meeting of 13 June 2012, it was resolved that the Board would make a recommendation to the next General Shareholders' Meeting for a grant of warrants to the CEO and the other members of the Board under a proposed Warrant Plan 2012 as follows: Mr Van de Stolpe 100,000 warrants; Dr Parekh and Mr Verdonck: each 3,780 warrants; Dr Van Barlingen, Dr Cautreels, Mr Rowe and Dr Sato: each 2,520 warrants. In application of article 523 of the Belgian Code of Companies the following is reported in connection with the proposed warrant offer for the CEO: The Chairman declares that Mr Onno van de Stolpe has informed the Board of Directors of a conflict of interest, concerning the proposed award to him of 100,000 warrants. It has been explained to the Board that the said warrant offer is proposed upon recommendation of the Remuneration Committee and is a justified reward for the results achieved by Mr Van de Stolpe. The award of this benefit will have no material impact on the financial position of the company. The Board shares the opinion of the Remuneration Committee that the proposed benefit is justified and reasonable. Mr Van de Stolpe did not take part in the deliberation and the vote concerning this decision. Furthermore, as a warrant offer is proposed to each Director, the same procedure has been followed for each Director individually.

(iii) In a meeting of the Board of Directors on 18 December 2012 the following was reported, in application of article 523 of the Belgian Code of Companies, in connection with the salary increase and bonus for the CEO: the Chairman declares that Mr Onno van de Stolpe has informed the Board of Directors of a conflict of interest, concerning the proposed award to him of a salary increase and a bonus. The salary of Mr Van de Stolpe was increased with 3% as of 2013. As 3 out of 5 criteria from the Senior Management Bonus Scheme to be entitled to a bonus (i.e. the corporate objectives for 2012) were achieved, a bonus of €253,000 (i.e. 60% of his 2012 salary) has been awarded to Mr Van de Stolpe for 2012. It has been explained to the Board that said salary increase and bonus is a justified reward for the results achieved by Mr Van de Stolpe in 2012. The salary increase and bonus will have no material impact on the financial position of the Company. The Board shares the opinion of the Remuneration Committee that the proposed salary increase and bonus is justified and reasonable. Mr Van de Stolpe did not take part in the deliberation and the vote concerning this decision.

### 8.6. Other matters

For a description of the most important characteristics of the internal control and risk management systems of the Company we refer to Section 5 "Risk Factors" of this Report, which is incorporated by reference in this Corporate Governance Statement.

For information relating to anti-takeover provisions, the major shareholders of the Company and the shares and warrants held by the members of the Board of Directors and the members of the Executive Committee, we refer to Section 4 "Shares and Capital" of this report, which is incorporated by reference in this Corporate Governance Statement.

Based on the transparency notifications received by the Company, the shareholders owning 5% or more of the Company's shares on 31 December 2012 were Delta Lloyd Asset Management N.V. (3,000,000 shares), Johnson & Johnson (2,350,061 shares), Baker Bros. Advisors, LLC (1,722,066 shares) and The Capital Group Companies, Inc. (1,554,438 shares).

## 9. FURTHER INFORMATION

This report of the Board of Directors will also be made available on the Company website: www.glpg.com/investor/financial_reports.htm.

* * *

The Board of Directors of Galapagos NV, represented by all its members, declares that, as far as it is aware, the statutory accounts and consolidated financial statements, prepared according to the applicable standards for financial statements, give a true and fair view of the equity, financial position and the results of the Company and its consolidated companies as of 31 December 2012.

The Board of Directors of Galapagos NV, represented by all its members, further declares that, as far as it is aware, this report to the shareholders for the financial year ending on 31 December 2012, gives a true and fair view on the development, results and position of the Company and its consolidated companies and on the most important risks and uncertainties with which the Company is being confronted.

* * *

On behalf of the Management and the Board of Directors of Galapagos, we would like to thank our shareholders for their support in 2012, a good year for the Company. We aim to build on the momentum achieved in the pipeline last year, on track to delivering a mature and broad pipeline of three Phase 2 programs in four indications, multiple Phase 1 studies, and pre-clinical candidates in the alliances and our internal programs in 2013.

The Board of Directors will submit to you proposals of resolutions to approve the annual accounts for the financial year 2012, and to discharge the Directors and the Statutory Auditor, for the exercise of their mandate during the financial year that ended on 31 December 2012.

Mechelen, 22 March 2013

On behalf of the Board of Directors,

| | |
|---|---|
| (signed) | (signed) |
| Onno van de Stolpe<br>CEO | Raj Parekh<br>Chairman |

# **Consolidated** financial statements

## CONSOLIDATED INCOME STATEMENTS AND CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME FOR THE YEARS ENDED 31 DECEMBER

### Consolidated income statement

| Thousands of € | Notes | Continuing operations Dec 2012 | Continuing operations Dec 2011 | Discontinued operations Dec 2012 | Discontinued operations Dec 2011 | Group total Dec 2012 | Group total Dec 2011 |
|---|---|---|---|---|---|---|---|
| Services revenue | | 65,660 | 57,147 | | 2,418 | 65,660 | 59,565 |
| R&D revenue | | 70,608 | 36,322 | | | 70,608 | 36,322 |
| Other income | | 16,716 | 19,403 | | | 16,716 | 19,403 |
| **Total operating income** | 4 | **152,984** | **112,872** | | **2,418** | **152,984** | **115,290** |
| Services cost of sales | 5 | -48,179 | -39,091 | | -1,832 | -48,179 | -40,923 |
| R&D Expenditure | 5 | -80,259 | -84,460 | | | -80,259 | -84,460 |
| General and administrative costs | 5 | -24,511 | -22,121 | | -602 | -24,511 | -22,723 |
| Sales and marketing expenses | 5 | -2,134 | -2,273 | | | -2,134 | -2,273 |
| Restructuring and integration costs | 5 | -2,506 | | | | -2,506 | |
| Result on divestment | 34 | -2,006 | 5,197 | | -3,043 | -2,006 | 2,154 |
| **Operating profit/loss (-)** | 4/5 | **-6,610** | **-29,877** | | **-3,058** | **-6,610** | **-32,935** |
| Finance income | 7 | 3,820 | 831 | | 28 | 3,820 | 859 |
| Finance cost | 8 | -2,362 | -1,647 | | -4 | -2,362 | -1,651 |
| **Profit/loss (-) before tax** | | **-5,152** | **-30,693** | | **-3,034** | **-5,152** | **-33,727** |
| Taxes | 9 | -569 | 630 | | | -569 | 630 |
| **NET PROFIT/LOSS (-)** | 10 | **-5,721** | **-30,063** | | **-3,034** | **-5,721** | **-33,097** |
| **NET PROFIT/LOSS (-) attributable to:** | | | | | | | |
| Owners of the parent | 10 | -5,721 | -30,063 | | -3,034 | -5,721 | -33,097 |
| **Basic result per share (in €)** | 10 | **-0.22** | **-1.14** | | **-0.11** | **-0.22** | **-1.25** |

### Consolidated statement of comprehensive income

| | | | | | | |
|---|---|---|---|---|---|---|
| Exchange difference arising on translating of foreign operations | 959 | 1,333 | | -956 | 959 | 377 |
| **Other comprehensive income** | **959** | **1,333** | | **-956** | **959** | **377** |
| **Total comprehensive income attributable to:** | | | | | | |
| Owners of the parent | -4,761 | -28,730 | | -3,990 | -4,761 | -32,720 |

## CONSOLIDATED STATEMENTS OF FINANCIAL POSITION AT 31 DECEMBER

### Assets

| Thousands of € | Notes | 2012 | 2011 |
|---|---|---|---|
| **NON-CURRENT ASSETS** | | **102,602** | **95,493** |
| Goodwill | 12 | 37,667 | 38,880 |
| Intangible assets | 13 | 9,424 | 10,614 |
| Property, plant and equipment | 14 | 18,099 | 19,524 |
| Deferred tax assets | 23 | 1,705 | 2,166 |
| Non-Current tax receivables | 9 | 35,288 | 23,081 |
| Available for sale financial assets and other non-current assets | 16 | 419 | 1,228 |
| **CURRENT ASSETS** | | **132,727** | **65,561** |
| Inventories | 15 | 204 | 502 |
| Trade and other receivables | 17 | 32,494 | 30,010 |
| Current tax receivables | 9 | 188 | |
| Cash and cash equivalents | 18 | 94,647 | 32,555 |
| Other current assets | 17 | 5,194 | 2,495 |
| **TOTAL ASSETS** | | **235,329** | **161,055** |

### Equity and liabilities

| Thousands of € | Notes | 2012 | 2011 |
|---|---|---|---|
| **TOTAL EQUITY** | | **118,447** | **118,376** |
| Share capital | 19 | 139,347 | 137,460 |
| Share premium account | 20 | 72,876 | 72,021 |
| Translation differences | 21 | 994 | 35 |
| Accumulated losses | | -94,770 | -91,140 |
| **TOTAL LIABILITIES** | | **116,882** | **42,679** |
| | | | |
| **NON-CURRENT LIABILITIES** | | **7,868** | **7,319** |
| Pension liabilities | 29 | 2,035 | 1,426 |
| Provisions | 27 | 676 | 786 |
| Deferred tax liabilities | 23 | 2,624 | 2,403 |
| Finance lease liabilities | 24 | 165 | 451 |
| Other non-current liabilities | 26 | 2,367 | 2,253 |
| **CURRENT LIABILITIES** | | **109,014** | **35,360** |
| Provisions | 27 | 176 | 393 |
| Finance lease liabilities | 24 | 240 | 425 |
| Trade and other payables | 26 | 22,093 | 18,068 |
| Current tax payable | 9 | 3 | 616 |
| Other current liabilities | 26 | 86,501 | 15,857 |
| **TOTAL LIABILITIES AND EQUITY** | | **235,329** | **161,055** |

## CONSOLIDATED CASH FLOW STATEMENTS FOR THE YEARS ENDED 31 DECEMBER

| Thousands of € | Notes | 2012 | 2011 |
|---|---|---|---|
| **CASH AND CASH EQUIVALENTS AT BEGINNING OF YEAR** | | **32,555** | **40,397** |
| Result from operations | | -6,610 | -32,935 |
| **Adjustments for:** | | | |
| Depreciation of property, plant and equipment | 14 | 6,884 | 7,727 |
| Amortization of intangible fixed assets | 13 | 2,125 | 4,369 |
| Inventories write off | | 3 | |
| Exchange gain/loss (-) on translation of net assets of subsidiary | | -659 | 244 |
| Share based compensation | | 2,086 | 2,040 |
| Gain (-) / Loss (+) on disposal of business | | 3,004 | -2,154 |
| Increase/Decrease (-) provisions | | -359 | 296 |
| Increase/Decrease (-) pension liabilities (assets) | | 609 | 297 |
| Profit on disposal of fixed assets | | -17 | |
| **Operating cash flows before movements in working capital** | | **7,066** | **-20,116** |
| Increase (-)/Decrease in inventories | | 291 | 942 |
| Increase (-)/Decrease in receivables | 17 | -16,876 | 11,032 |
| Increase/Decrease (-) in payables | 26 | 74,249 | -3,265 |
| **Cash generated/used (-) in operations** | | **64,729** | **-11,407** |
| Interest paid and other financial costs | 8 | -471 | -603 |
| Taxes | | -153 | 19 |
| **NET CASH FLOWS GENERATED/USED (-) IN OPERATING ACTIVITIES** | | **64,104** | **-11,991** |

| Thousands of € | Notes | 2012 | 2011 |
|---|---|---|---|
| Purchase of property, plant and equipment | 14 | -5,896 | -4,396 |
| Purchase of and expenditure in intangible fixed assets | 13 | -940 | -1,437 |
| Proceeds from disposal of intangible assets | 13 | 20 | |
| Proceeds from disposal of property, plant and equipment | 14 | 379 | 44 |
| Acquisitions (-), disposals (+) of subsidiaries, associates or joint ventures, net of cash acquired | 34 | | 8,710 |
| **NET CASH USED IN INVESTING ACTIVITIES** | | **-6,437** | **2,921** |
| Repayment of obligations under finance leases and other debts | | -477 | -343 |
| Proceeds of Capital and Share premium increases, net of issue costs | | 2,742 | 553 |
| Interest received and other financial income | 7 | 1,769 | 423 |
| **NET CASH GENERATED/USED (-) IN FINANCING ACTIVITIES** | | **4,034** | **633** |
| **EFFECT OF EXCHANGE RATE DIFFERENCES ON CASH AND CASH EQUIVALENTS** | | **391** | **594** |
| **INCREASE/DECREASE (-) IN CASH AND CASH EQUIVALENTS** | | **62,092** | **-7,842** |
| **CASH AND CASH EQUIVALENTS AT END OF YEAR** | | **94,647** | **32,555** |

## CONSOLIDATED CASH FLOW STATEMENT FROM DISCONTINUED OPERATIONS

| Thousands of € | 2012 | 2011 |
|---|---|---|
| Net cash flows generated/used (-) in operating activities | | -1,582 |
| Net cash generated/used (-) in investing activities | | 9,291 |
| Net cash generated/used (-) in financing activities | | 2 |
| **Net change in cash and cash equivalents** | | **7,711** |

## CONSOLIDATED STATEMENTS OF CHANGES IN EQUITY

| Thousands of € | Share capital | Share premium account | Translation differences | Accumulated losses | Total |
|---|---|---|---|---|---|
| **Balance at 1 January 2011** | **137,122** | **71,806** | **-343** | **-60,079** | **148,506** |
| Net result | | | | -33,097 | -33,097 |
| Other comprehensive income | | | 378 | | 378 |
| **Total comprehensive income** | | | **378** | **-33,097** | **-32,719** |
| Share based compensation | | | | 2,040 | 2,040 |
| Exercise warrants | 338 | 215 | | | 553 |
| Other | | | | -4 | -4 |
| **Balance at 31 December 2011** | **137,460** | **72,021** | **35** | **-91,140** | **118,376** |
| Net result | | | | -5,721 | -5,721 |
| Other comprehensive income | | | 959 | | 959 |
| **Total comprehensive income** | | | **959** | **-5,721** | **-4,762** |
| Share based compensation | | | | 2,086 | 2,086 |
| Exercise warrants | 1,887 | 855 | | | 2,742 |
| Other | | | | 5 | 5 |
| **Balance at 31 December 2012** | **139,347** | **72,876** | **994** | **-94,770** | **118,447** |

The consolidated financial statements of Galapagos were approved by the Board of Directors and authorized for issue, on 22 March 2013. They were signed on its behalf by:

(signed)

Onno van de Stolpe
Executive Director
22 March 2013

# **Notes** to the Consolidated Financial Statements

## 1. GENERAL INFORMATION

Galapagos NV ("the Company" or "Galapagos") is a limited liability company incorporated in Belgium and has its registered office at Generaal De Wittelaan L11/A3, 2800 Mechelen, Belgium. In this document references to "the Group" include Galapagos together with its subsidiaries.

Galapagos NV was founded in 1999 as a joint venture between Crucell BV and Tibotec NV. Galapagos is an integrated drug discovery company with capabilities from target discovery to clinical proof of concept.

### R&D

Galapagos' R&D operations are specialized in the discovery and development of small molecules. Galapagos funds these programs through alliance payments from its pharma partners, cash generated by its profitable service operations, licensing agreements, and its cash reserves. Many of these programs are based on proprietary disease-modifying drug targets in disease areas for which there is a need for safe and effective medicines.

### Services

The Service operations comprise BioFocus and Argenta. Galapagos acquired BioFocus in October 2005 and added to this business through a number of acquisitions in 2006 and 2008. BioFocus offers a full suite of target-to-drug discovery products and services to pharmaceutical and biotech companies and to patient foundations, encompassing target discovery and validation, screening and drug discovery through to delivery of pre-clinical candidates.

Galapagos acquired Argenta in February 2010 and retained this company as a separate operation next to BioFocus. Argenta's contract research, which includes expertise in medicinal chemistry, computer-aided drug discovery, *in vitro* biology, analytics, *in vivo* pharmacokinetics, pharmacology and world-leading respiratory models, has a strong reputation for scientific excellence.

Galapagos acquired GlaxoSmithKline's research center in Zagreb, Croatia in September 2010, which became part of the R&D operations. In February 2013 this research center has been renamed Fidelta and will become part of the Service division once this site has made the operational transition to a services company.

### History of the Company since IPO

The shares of Galapagos NV have been listed on Euronext Brussels and Amsterdam since May 2005.

The Group has grown strongly over the last years, both organically and through acquisitions.

At the end of 2005, Galapagos acquired UK-based BioFocus plc. (and its affiliates). The shares of BioFocus were listed on the Alternative Investment Market (AIM) of the London Stock Exchange and the acquisition occurred through a public takeover bid in which Galapagos shares were offered in exchange for BioFocus shares. In connection with this acquisition the shares of Galapagos were then also listed on AIM.

In July 2006, Galapagos acquired the shares of the subsidiaries of Discovery Partners International, Inc. against cash

payment. As a result, US-based ChemRx Advanced Technologies, Inc. (later renamed into BioFocus DPI, Inc.) and the Swiss DPI AG (now called BioFocus DPI AG) and their respective affiliates, were added to the Group. In September 2006 Galapagos NV raised €11.1 million in a private placement on Euronext Brussels and Euronext Amsterdam amounting to a net cash contribution of €10.7 million. In December 2006, Galapagos acquired the UK-based Inpharmatica Ltd and the French ProSkelia SASU (renamed into Galapagos SASU). Both acquisitions were financed with Galapagos shares. Together with the acquisition of ProSkelia, Galapagos NV raised €31 million in a private placement, amounting to a net cash contribution of €29.6 million.

In March 2008, Galapagos' Level 1 American Depositary Receipt (ADR) facility in the United States became effective. In April 2008 Galapagos cancelled its quotation on AIM. In August 2008, Galapagos acquired the assets and ongoing service agreements of UK-based Sareum Limited against cash payment. These assets positioned Galapagos' service division BioFocus strongly in the growing field of structure-based drug discovery. In November 2008 Galapagos completed the sale of its San Diego based affiliate BioFocus DPI, Inc. to ChemVentures Pty Ltd.



On 21 October 2009, Galapagos raised €18.2 million in a private placement on Euronext resulting in a net cash contribution of €17.5 million.

On 1 February 2010, Galapagos acquired the service operations of Argenta Discovery for a €16.5 million cash payment. On 9 September 2010, Galapagos acquired GlaxoSmithKline's research center in Zagreb, Croatia. On 21 October 2010, Galapagos raised €28.7 million in a private placement with international institutional investors.

On 1 June 2011, Galapagos announced the sale of Compound Focus, Inc. to Evotec for €10.25M cash and an additional €2.25 in potential earn-out payments upon performance of the business in 2012/2013 depending on revenues and certain corporate milestones; in 2012 an amount of €1 million was received as earn-out payment.

On 29 February 2012, Galapagos and Abbott (now AbbVie) announced a global collaboration to develop and commercialize GLPG0634 to treat autoimmune diseases. Under the terms of the agreement, AbbVie made an initial upfront payment of $150 million for rights related to the global collaboration. Revenue recognition of this upfront over 30 months will contribute to profitability of Galapagos for the coming three years. Upon successful completion of the rheumatoid arthritis Phase 2 studies, AbbVie will license the program for a one-time fee of $200 million if the studies meet certain pre-agreed criteria. AbbVie will assume sole responsibility for Phase 3 clinical development and global manufacturing. Pending achievement of certain developmental, regulatory, commercial and sales-based milestones, Galapagos would be eligible to receive additional milestone payments from AbbVie, potentially amounting to $1.0 billion, in addition to tiered double-digit royalties on net sales upon commercialization. Galapagos retains co-promotion rights in Belgium, the Netherlands and Luxembourg.

A complete list of all companies directly or indirectly owned by Galapagos is detailed in note 33.

## 2. ACCOUNTING POLICIES

### Basis of preparation

These consolidated financial statements were prepared in accordance with International Financial Reporting Standards (IFRS) as adopted by the EU. The principal accounting policies used for the preparation of these consolidated financial statements are set out below.

### Standards and interpretations applicable for the annual period beginning on 1 January 2012

- Amendments to IFRS 7 *Financial Instruments: Disclosures – Transfers of Financial Assets* (applicable for annual periods beginning on or after 1 July 2011)

### Standards and Interpretations published, but not yet applicable for the annual period beginning on 1 January 2012

- IFRS 9 *Financial Instruments* and subsequent amendments (normally applicable for annual periods beginning on or after 1 January 2015)
- IFRS 10 *Consolidated Financial Statements* (applicable for annual periods beginning on or after 1 January 2014)
- IFRS 11 *Joint Arrangements* (applicable for annual periods beginning on or after 1 January 2014)
- IFRS 12 D*isclosures of Interests in Other Entities* (applicable for annual periods beginning on or after 1 January 2014)
- IFRS 13 *Fair Value Measurement* (applicable for annual periods beginning on or after 1 January 2013)
- IAS 27 *Separate Financial Statements* (applicable for annual periods beginning on or after 1 January 2014)
- IAS 28 *Investments in Associates and Joint Ventures* (applicable for annual periods beginning on or after 1 January 2014)
- Improvements to IFRS (2009-2011) (normally applicable for annual periods beginning on or after 1 January 2013)
- Amendments to IFRS 1 *First Time Adoption of International Financial Reporting Standards – Severe Hyperinflation and Removal of Fixed Dates for First-time Adopters* (applicable for annual periods beginning on or after 1 January 2013)
- Amendments to IFRS 1 *First Time Adoption of International Financial Reporting Standards – Government Loans* (normally applicable for annual periods beginning on or after 1 January 2013)
- Amendments to IFRS 7 *Financial Instruments: Disclosures – Offsetting Financial Assets and Financial Liabilities* (applicable for annual periods beginning on or after 1 January 2013)
- Amendments to IFRS 10, IFRS 11 and IFRS 12 – *Consolidated Financial Statements, Joint Arrangements and Disclosure of Interests in Other Entities: Transition Guidance* (applicable for annual periods beginning on or after 1 January 2014)
- Amendments to IFRS 10, IFRS 12 and IAS 27 – *Consolidated Financial Statements and Disclosure of Interests in Other Entities: Investment Entities* (applicable for annual periods beginning on or after 1 January 2014)
- Amendments to IAS 1 *Presentation of Financial Statements - Presentation of Items of Other Comprehensive Income* (applicable for annual periods beginning on or after 1 July 2012)
- Amendments to IAS 12 *Income Taxes – Deferred Tax: Recovery of Underlying Assets* (applicable for annual periods beginning on or after 1 January 2013)
- Amendments to IAS 19 *Employee Benefits* (applicable for annual periods beginning on or after 1 January 2013)

- Amendments to IAS 32 *Financial Instruments: Presentation – Offsetting Financial Assets and Financial Liabilities* (applicable for annual periods beginning on or after 1 January 2014)
- IFRIC 20 *Stripping Costs in the Production Phase of a Surface Mine* (applicable for annual periods beginning on or after 1 January 2013)

Management is currently investigating the impact of the initial application of these new and amended standards and interpretations on the Group's financial statements.

**Going concern basis**

The consolidated financial statements are prepared in accordance with the International Financing Reporting Standards (IFRS) published by the International Accounting Standard Board (IASB) and the interpretations issued by the IASB's International Financial Reporting Interpretation Committee, which have been endorsed by the European Commission.
The consolidated financial statements provide a general overview of the Group's activities and the results achieved. They give a true and fair view of the entity's financial position, its financial performance and cash flows, on a going concern basis.



**Group reporting**

The consolidated financial statements comprise the financial statements of the Company and entities controlled by the Company (its subsidiaries) established at 31 December each year. Together they constitute the Group. Control is achieved where the Company has the power to govern the financial and operating policies of another entity so as to obtain benefits from its activities.

The results of subsidiaries are included in the income statement and statement of comprehensive income from the effective date of acquisition up to the date when control ceases to exist.

Where necessary, adjustments are made to the financial statements of subsidiaries to ensure consistency with the Group's accounting policies.

All intra-group transactions, balances, income and expenses are eliminated when preparing the consolidated financial statements.

**Business combinations**

The acquisition of subsidiaries is accounted for using the purchase method. The cost of the acquisition is measured as the aggregate of the fair values, at the date of exchange, of assets given, liabilities incurred or assumed, and equity instruments issued by the Group in exchange for control of the acquiree.
The acquiree's identifiable assets, liabilities and contingent liabilities that meet the conditions for recognition under IFRS 3 are recognized at their fair value at the acquisition date, except for non-current assets (or disposal groups) that are classified as held for sale in accordance with IFRS 5 *Non Current Assets Held for Sale and Discontinued Operations*, which are recognized and measured at fair value less costs to sell. For each business combination, it is determined whether the non-controlling interest in the acquiree is measured at fair value or at the proportionate share of the acquiree's identifiable net assets.

**Business combinations and related goodwill/negative goodwill**

Goodwill arising on business combinations is recognized as an asset and initially measured at cost, being the excess of the cost of acquisition over the Group's interest in the fair value of the identifiable assets, liabilities and contingent liabilities of the acquired subsidiary less the value of the non-controlling interests at the date of acquisition. Goodwill is not amortized but tested for impairment on an annual basis and whenever there is an indication that the cash generating unit to which goodwill has been allocated may be impaired. Goodwill is stated at cost less accumulated impairment losses. An impairment loss recognized for goodwill is not reversed in a subsequent period.

In cases in which the acquirer's interest in the net fair value of the acquiree's identifiable assets, liabilities and contingent liabilities less the value of the non-controlling interests exceeds cost, all fair values and cost calculations are reassessed. In the event that an excess still exists, it is immediately recognized in the profit or loss statement.

**Intangible assets**

Expenditure on research activities is recognized as an expense in the period in which it is incurred.
An internally generated intangible asset arising from the Group's development activities is recognized only if all of the following conditions are met:

- Technically feasible to complete the intangible asset so that it will be available for use or sale
- The Group has the intention to complete the intangible assets and use or sell it
- The Group has the ability to use or sell the intangible assets
- The intangible asset will generate probable future economic benefits, or indicate the existence of a market
- Adequate technical, financial and other resources to complete the development are available
- The Group is able to measure reliably the expenditure attributable to the intangible asset during its development.

The amount capitalized as internally generated intangible assets is the sum of the development costs incurred as of the date that the asset meets the conditions described above.

Internally generated intangible assets are amortized on a straight-line basis over their useful lives. If the recognition criteria for accounting as an intangible asset are not met, development costs are recognized as an expense in the period in which they are incurred.

Intellectual property, which comprises patents, licenses and rights is measured internally at purchase cost and is amortized on a straight-line basis over the estimated useful life on the following bases:

- Customer relationships: 1-10 years
- In process technology: 3-5 years
- Software & databases: 3-5 years
- Brands, licenses, patents & know how: 5-15 years

In the event an asset has an indefinite life, this fact is disclosed along with the reasons for being deemed to have an indefinite life.

### Property, plant and equipment

Property, plant and equipment is recognized at cost less accumulated depreciation and any impairment loss. Depreciation is recognized so as to write off the cost or valuation of assets over their useful lives, using the straight-line method, on the following bases:

- Installation & machinery: 4-15 years
- Furniture, fixtures & vehicles: 4-10 years

Any gain or loss incurred at the disposal of an asset is determined as the difference between the sale proceeds and the carrying amount of the asset, and is recognized in profit or loss.

### Leasehold improvements

Leasehold improvements are depreciated over the term of the lease, unless a shorter useful life is expected.

### Assets held under finance lease

Assets held under finance leases are depreciated over their useful lives on the same bases as owned assets or, where shorter, over the term of the related lease agreement.

### Inventories

Inventories are valued at the lower of cost and net realizable value. The net realizable value represents the estimated sales price less all estimated costs for completion and costs for marketing, sales and logistics.

Cost of raw materials comprises mainly purchase costs. Raw materials are not ordinarily interchangeable, and they are as such accounted for using the specific identification of their individual cost.

The costs of work in progress comprise costs of materials, direct costs for personnel, and manufacturing overheads linked to transportation costs of inventory to the production location.

Molecule screening libraries are stated at cost on acquisition and written off over their useful economic lives, calculated by reference to utilization, but which in any event cannot exceed 5 years.

### Financial instruments

Financial assets and financial liabilities are recognized on the Group's balance sheet when the Group becomes a party to the contractual provisions of the instrument.

### Tax receivables

Non-current tax receivables are discounted over the period until maturity date according to the appropriate discount rates.

### Trade receivables

Trade receivables do not carry any interest and are stated at their nominal value reduced by appropriate allowances for irrecoverable amounts.

### Available for sale financial assets

Available for sale investments are measured at fair value, except for those equity instruments that do not have a quoted market price in an active market and whose fair value cannot be reliably measured. Those equity instruments are measured at historical cost.

Gains and losses arising from changes in fair value are recognized directly in equity until the security is disposed of or is determined to be impaired, at which time the cumulative gain or loss previously recognized in equity is included in the net profit or loss for the period. Impairment losses recognized in profit or loss for equity investments classified as available for sale are not subsequently reversed through profit or loss. Impairment losses recognized in profit or loss for debt instruments classified as available for sale are subsequently reversed if an increase in the fair value of the instrument can be objectively related to an event occurring after the recognition of the impairment loss.

### Cash and cash equivalents

Cash and cash equivalents are measured at nominal value. For the purposes of the cash flow statements, cash and cash equivalents comprise cash on hand, deposits held on call with banks, other short term deposits, highly liquid investments and bank overdrafts. Bank overdrafts are presented on the balance sheet as current liabilities.



### Trade payables

Trade payables bear no interest and are measured at their nominal value.

### Taxation

Income tax in the profit or loss accounts represents the sum of the current tax and deferred tax.

Current tax is the expected tax payable on the taxable profit of the year. The taxable profit of the year differs from the profit as reported in the financial statements as it excludes items of income or expense that are taxable or deductible in other years and it further excludes items that are never taxable or deductible. The Group's liability for current tax is calculated using tax rates that have been enacted or substantively enacted by the balance sheet date.

Deferred income tax is provided in full, using the liability-method, on temporary differences arising between the tax bases of assets and liabilities and their carrying amounts in the financial statements. However, the deferred income tax is not accounted for if it arises from the initial recognition of an asset or liability in a transaction other than a business combination that at the time of the transaction affects neither accounting nor taxable profit nor loss.

Deferred income tax is determined using tax rates (and laws) that have been enacted or substantially enacted by the balance sheet date and are expected to apply when the related deferred income tax asset is realized or the deferred income tax liability is settled. Deferred tax assets are recognized to the extent that it is probable that future taxable profit will be available against which the temporary differences can be utilized. As such, a deferred tax asset for the carry forward of unused tax losses will be recognized to the extent that is probable that future taxable profits will be available.

The amount of deferred tax provided is based on the expected manner of realization or settlement of the carrying amount

of assets and liabilities, using tax rates enacted or substantively enacted at the balance sheet date. Deferred tax assets relating to tax losses carried forward are recognized to the extent that it is probable that the related tax benefit will be realized.

### Foreign currencies

- **Functional and presentation currency**
  Items included in the financial statements of each of the Group's entities are valued using the currency of the primary economic environment in which the entity operates. The consolidated financial statements are presented in Euros, which is the Company's functional and presentation currency.

- **Transactions and balances in foreign currency**
  Foreign currency transactions are translated into the functional currency using the exchange rates prevailing at the dates of transaction. Foreign currency gains and losses resulting from the settlement of such transactions and from the translation at closing rates of monetary assets and liabilities denominated in foreign currencies are recognized in the income statement.

  Non-monetary assets and liabilities measured at historical cost that are denominated in foreign currencies are translated using the exchange rate at the date of the transaction.

- **Financial statements of foreign group companies**
  The results and financial position of all Group entities that have a functional currency different from Euro are translated as follows:
  - Assets and liabilities for each balance sheet presented are translated at the closing rate at the date of that balance sheet
  - Income and expenses for each income statement are translated at average exchange rates;
  - All resulting exchange differences are recognized as a separate component of equity
  - Such exchange rates are recognized in profit or loss in the period in which the foreign operation is disposed of.

### Revenue recognition

The Group generates revenues from providing research and development services, drug discovery and development activities, license or royalty agreements, the sale of products, various R&D incentives and from grants. The revenue recognition policies can be summarized as follows:

- Service business milestone payments are recognized as revenues when achieved
- Research milestone payments are recognized as revenues when achieved. In addition, the payments have to be acquired irrevocably and the milestone payment amount needs to be substantive and commensurate with the magnitude of the related achievement. Milestone payments that are not substantive, not commensurate or that are not irrevocable are recorded as deferred revenue. The Group believes that each substantive milestone payment represents a separate reasonable value for that phase of the collaboration agreement

- Non-refundable, up-front payments received in connection with research and development collaboration agreements are deferred and recognized on a straight-line basis over the relevant periods of continuing involvement, which is considered to be ended at the moment the first milestone is achieved
- Fees received from partners for options to license molecules or programs are recognized as revenue at fair value, over the option period unless the license is taken by the partner at an earlier moment than foreseen in the contract, in which case the remaining fees are recognized as license revenue at that point
- Sales from the BioFocus and Argenta business units typically comprise multiple elements combined in one or more license agreements. The elements in such multiple element arrangements are accounted for as follows:
    - Sales of molecule collections and reagents are recognized as product revenue when delivered
    - Contract research and development services are recognized as service revenues at fair value as such services are rendered. These services are usually in the form of a defined number of the Group's full-time equivalent ("FTE") at a specified rate per FTE
    - Upfront non-refundable license fees are only recognized as revenue at fair value when products were delivered and/or services were rendered in a separate transaction and the Group has fulfilled all conditions and obligations under the related agreement. In case of continuing involvement of the Group, the upfront fee would not be regarded as a separate transaction and the upfront non-refundable license fees will be deferred over the period of the collaboration
    - Molecule collections or viruses and technology access fees are recognized as license revenue over the period in which access is granted
    - Revenue under compound repository services is recorded as costs are incurred, which includes indirect costs that are based on provisional rates estimated by management. If actual costs are subsequently calculated to be greater than provisional rates, the additional income is recorded if there is a contractual right to submit updated claims. A reserve is provided against receivables for estimated losses that may result from rate negotiations, audit adjustments and/or lack of government funding availability if it is deemed necessary. To the extent that we incur adjustments due to rate negotiations or lack of government funding availability, revenue may be impacted
- The Group receives operational grants and tax credits from certain governmental agencies which support the Group's research and development efforts. These grants and tax credits generally aim to partly reimburse approved expenditures incurred in research and development efforts of the Group and are credited to the income statement when the relevant expenditure has been incurred and there is reasonable assurance that the grant or tax credit is receivable
- Revenues from term licenses are spread over the period to which the licenses relate, reflecting the obligation over the term, to update content and provide ongoing maintenance
- Revenues from perpetual licenses are recognized immediately upon sale to the extent that there are no further obligations, and only if the license imposes no further restrictions.

**Equity instruments**

Equity instruments issued by the Company are measured by the fair value of the proceeds received, net of direct issue costs.

### Defined contribution plans

Contributions to defined contribution pension plans are recognized as an expense in the income statement as incurred.

### Defined benefit plans

For defined benefit plans, the cost of providing benefits is determined using the "projected unit credit method," with actuarial valuations being carried out at each balance sheet date. Actuarial gains and losses that exceed 10 per cent of the greater of the present value of the Group's defined benefit obligation and the fair value of plan assets as at the end of the prior year are amortized over the expected average remaining working lives of the participating employees. Past service cost is recognized immediately to the extent that the benefits are already vested, and otherwise is amortized on a straight-line basis over the average period until the benefits become vested.

For defined benefits plans, the amount recognized in the balance sheet is determined as the present value of the defined obligations adjusted for the unrecognized actuarial gains and losses and less any past service costs not yet recognized and the fair value of any plan assets.



### Provisions

Provisions are recognized on the balance sheet when a Group company has a present obligation as a result of a past event; when it is probable that an outflow of resources embodying economic benefits will be required to settle the obligations and a reliable estimate can be made of the amount of the obligations. The amount recognized as a provision is the best estimate of the expenditure required to settle the present obligation at the balance sheet date. If the effect is material, provisions are determined by discounting the expected future cash flows at a pre-tax rate that reflects current market assessments of the time value of the money and, when appropriate, the risk specified to the liability.

### The Group as lessee

Leases are classified as finance leases whenever the terms of the lease substantially transfers all the risks and rewards of ownership to the lessee. All other leases are classified as operating leases.

Assets held under finance leases are recognized as assets of the Group at their fair value or, if lower, at the present value of the minimum lease payments, each determined at the inception of the lease. The corresponding liability to the lessor is included in the balance sheet as a finance lease obligation. The payments are divided proportionally between the financial costs and a diminution of the outstanding balance of the obligation, so that the periodic interest rate on the outstanding balance of the obligation would be constant. Interest is recognized in the income statement, unless it is directly attributable to the corresponding asset, in which case they are capitalized.

Rents paid on operating leases are charged to income on a straight-line basis over the term of the relevant lease. Benefits received and receivable as an incentive to enter into an operating lease are also spread on a straight-line basis over the lease term.

### Impairment of tangible and intangible assets

At each balance sheet date, the Group reviews the carrying amount of its tangible and intangible assets to determine whether there is any indication that those assets have suffered an impairment loss. If any such indication exists, the

recoverable amount of the asset is estimated in order to determine the extent of the impairment loss (if any). Where the asset does not generate cash flows that are independent from other assets, the Group estimates the recoverable amount of the cash-generating unit to which the asset belongs.

An intangible asset with an indefinite useful life is tested for impairment annually, and whenever there is an indication that the asset might be impaired. The recoverable amount is the higher of fair value less costs to sell and value in use.

If the recoverable amount of an asset or cash generating unit is estimated to be less than the carrying amount, the carrying amount of the asset is reduced to its recoverable amount. An impairment loss is recognized as an expense immediately.

When an impairment loss subsequently reverses, the carrying amount of the asset is increased to the revised estimate of its recoverable amount, but so that the increased carrying amount does not exceed the carrying amount that would have been determined, had no impairment loss been recognized for the asset in prior years. A reversal of an impairment loss resulting from a sale of a subsidiary is recognized as income. In other cases impairment losses of goodwill are never reversed.



**Net earnings/loss per share**

Basic net earnings/loss per share is computed based on the weighted average number of shares outstanding during the period. Diluted net loss per share, if any, is computed based on the weighted-average number of shares outstanding including the dilutive effect of warrants.

**Share-based payments**

The Group uses equity-settled share-based payments as an incentive to certain employees, directors and consultants. Equity-settled share-based payments are measured at fair value at the date of grant. The fair value determined at the grant date of the warrants is expensed over the vesting period, based on the Group's estimate of shares that will vest eventually.

Fair value is measured by use of the Black & Scholes model. The expected life used in the model has been adjusted, based on management's best estimate, for the effects of non-transferability, exercise restrictions, and behavioral considerations.

**Discontinued Operations**

A discontinued operation is a component of the Group that either has been disposed of or is classified as held for sale and (a) represents a separate major line of business or geographical area of operations, (b) is part of a single coordinated plan to dispose of a separate major line of business or geographical area of operations, or (c) is a subsidiary acquired exclusively with a view to resale.

**Segment reporting**

Segment results include revenue and expenses directly attributable to a segment and the relevant portion of revenue and expenses that can be allocated on a reasonable basis to a segment.

Segment assets and liabilities comprise those operating assets and liabilities that are directly attributable to the segment or can be allocated to the segment on a reasonable basis. Segment assets and liabilities do not include income tax items. For further information, we refer to note 35 "Critical accounting estimates and judgments" and note 36 "Financial risk

management."

## 3. SEGMENT REPORTING

Segment reporting is represented in line with information presented to the CODM (Chief Operating Decision Maker). The CODM within Galapagos has been identified as the Executive Committee.
The Executive Committee assesses the performance of the operating segments by reviewing revenue, adjusted EBIT and gross margins by segment. Adjusted EBIT excludes the effects of share option compensation charges, impact of the impairment test of goodwill and restructuring costs from the operating segments. Interest income and charges and tax are not included in the results for the operating segments that are reviewed by the Executive Committee.

### Operating segments

For management purposes, the Group is divided into two operating divisions: R&D and Services. These divisions form the basis upon which the Group reports its primary segment information.

Principal activities are as follows:

### R&D operations

Galapagos' R&D operations are specialized in the discovery and development of small molecules. Galapagos funds these programs through alliance payments from its pharma partners, cash generated by its profitable service operations, licensing agreement from its proprietary pipeline, and its cash reserves. Many of these programs are based on proprietary disease-modifying drug targets in disease areas for which there is a need for safe and effective medicines.

### Service operations

Galapagos' service operations offer target-to-drug discovery products and services to pharmaceutical and biotech companies and to patient foundations, encompassing target discovery and validation, screening and drug discovery through to delivery of pre-clinical candidates. The service division has two operating units: BioFocus, which Galapagos has operated since 2005, and Argenta, which Galapagos acquired in February 2010. Galapagos operates these units in parallel, with both providing additional capacity and drug discovery capabilities to the Galapagos Group.

The operational results of these segments are evaluated monthly at the meetings of the Executive Committee for resource allocation and performance measurement. Intersegment sales are charged at prevailing rates based on a tax transfer pricing study.

Segment information about these businesses for the years ended 31 December 2012 and 2011 is presented below.

## 2012 SEGMENT INFORMATION

| | Thousands of € | Continuing operations | | | Discontinued operations | Unallocated costs | Galapagos Group total |
|---|---|---|---|---|---|---|---|
| | | R&D | Services | Intersegment eliminations | | | |
| MANAGEMENT REPORTING | R&D revenue | 65,959 | | | | | 65,959 |
| | Service revenue | 4,676 | 65,766 | | | | 70,442 |
| | Other Income | 10,639 | | | | | 10,639 |
| | Grant Income | 2,216 | | | | | 2,216 |
| | **External revenue** | **83,490** | **65,766** | | | | **149,256** |
| | Internal revenue | 4,145 | 3,201 | -7,347 | | | |
| | **Total revenue** | **87,635** | **68,967** | **-7,347** | | | **149,256** |
| | Cost of sales | -5,638 | -46,378 | 2,765 | | | -49,250 |
| | **Gross Margin** | **81,997** | **22,590** | **-4,582** | | | **100,006** |
| | **Opex** | **-85,528** | **-14,373** | **4,582** | | **-6,333** | **-101,653** |
| | **MR EBIT** | **-3,531** | **8,217** | | | **-6,333** | **-1,647** |
| | **MR EBITDA** | **896** | **11,652** | | | **-6,333** | **6,215** |
| IFRS - RECURRING | R&D Tax Credits | 4,294 | | | | | 4,294 |
| | Discounting of CIR receivables | -300 | | | | | -300 |
| | Reversal of Novartis revenue recognition | -197 | | | | | -197 |
| | Transfer Pricing Effect | 472 | -472 | | | | |
| | Warrants | -1,372 | -714 | | | | -2,086 |
| | IFRS Amortization | 415 | -1,694 | | | | -1,279 |
| | Other effects | -327 | -557 | | | | -884 |
| | **IFRS EBIT - RECURRING** | **-546** | **4,779** | | | **-6,333** | **-2,099** |
| IFRS - NON RECURRING | Loss on liquidation of Cambridge Drug Discovery Holdings Ltd | | -3,004 | | | | -3,004 |
| | Basel closing costs | | -1,136 | | | | -1,136 |
| | Restructuring costs | -1,369 | | | | | -1,369 |
| | Earn Out Income from Evotec | | 981 | | | | 981 |
| | Other Effect on IFRS Non Recurring Result | | 17 | | | | 17 |
| | **IFRS EBIT** | **-1,914** | **1,638** | | | **-6,333** | **-6,610** |

Service revenues within the R&D segment relate to fee-for-service work performed by the Zagreb site for GSK, as well as fee-for-service work for Servier.

Unallocated G&A costs relate to corporate costs which mainly consist of management services (i.e. corporate personnel such as CEO, CFO, investor relations, business development), IT services, legal services, finance services, HR services and IP costs (legal/patent protection). Depreciation charges and software costs related to the implementation of the company-wide ERP system also contribute in 2012 to corporate costs as opposed to previous year.

## 2011 SEGMENT INFORMATION

| | Thousands of € | Continuing operations | | | Discontinued operations | Unallocated costs | Galapagos Group total |
|---|---|---|---|---|---|---|---|
| | | R&D | Services | Intersegment eliminations | | | |
| MANAGEMENT REPORTING | R&D revenue | 36,306 | | | | | 36,306 |
| | Service revenue | | 59,575 | | | | 59,575 |
| | Other Income | 10,510 | 12 | | | | 10,522 |
| | Grant Income | 2,501 | 33 | | | | 2,534 |
| | **External revenue** | **49,317** | **59,619** | | | | **108,936** |
| | Internal revenue | 5,133 | 10,662 | -15,795 | | | |
| | **Total revenue** | **54,451** | **70,281** | **-15,795** | | | **108,936** |
| | Cost of sales | | -46,651 | 5,905 | | | -40,747 |
| | **Gross Margin** | **54,451** | **23,630** | **-9,891** | | | **68,189** |
| | **Opex** | **-94,962** | **-14,581** | **9,891** | | **-4,826** | **-104,479** |
| | **MR EBIT** | **-40,512** | **9,048** | | | **-4,826** | **-36,289** |
| | **MR EBITDA** | **-35,413** | **13,668** | | **156** | **-4,826** | **-26,415** |
| IFRS - RECURRING | R&D Tax Credits | 6,052 | | | | | 6,052 |
| | Reversal of Novartis revenue recognition | -197 | | | | | -197 |
| | Employee Profit Sharing Reserve | -107 | | | | | -107 |
| | Transfer Pricing Effect | 397 | -397 | | | | |
| | Warrants | -1,339 | -693 | | -8 | | -2,040 |
| | IFRS Amortization | 218 | -2,434 | | -2 | | -2,219 |
| | Other effects | -222 | -67 | | | | -289 |
| | **IFRS EBIT - RECURRING** | **-35,710** | **5,456** | | **-10** | **-4,826** | **-35,089** |
| IFRS - NON RECURRING | Result on divestment of Compound Focus | | 5,197 | | -3,043 | | **2,154** |
| | **IFRS EBIT** | **-35,710** | **10,653** | | **-3,053** | **-4,826** | **-32,935** |

The discontinued operation relates to the service division.

### Geographical information

In 2012 the Group's operations were located in Belgium, Croatia, France, Switzerland, The Netherlands and United Kingdom. The Group's R&D division is located in Belgium, Croatia, France and The Netherlands, with its service division operating in the remaining countries. The Swiss site was closed in the second half of 2012.

In 2012 the Group's top 10 customers represent 78% of the revenues. Our Group's client base includes 4 of the top 10 pharmaceutical companies in the world.

## 4. TOTAL OPERATING INCOME

| Thousands of € | 2012 | 2011 |
|---|---|---|
| Sales of goods | 2,205 | 12,548 |
| Services (selling FTE) | 66,885 | 51,762 |
| Milestone payments | 28,201 | 29,663 |
| License fees | 38 | 75 |
| Recognition of up-front non refundable fees | 38,493 | 1,839 |
| Other operating income | 17,162 | 19,403 |
| **Total** | **152,984** | **115,290** |

Sales of goods consist of the sale of chemical compound libraries on a non-exclusive basis.

Service revenues include the sale of biology and chemistry FTEs (full time equivalents) and related access fees under external contracts for the provision of target discovery and drug discovery services.

Milestone payments are mainly earned in the R&D business, as well as the recognition of up-front fees. The up-front fees are deferred and taken in revenue according to the accounting policies. Up-front fees increased significantly compared to 2011 because of the recognition in 2012 of €37.2 million of the $150 million (€112 million) up-front received from AbbVie for GLPG0634 in March 2012.

License fees cover the provision of chemistry based software and research tools under license agreements, which can also involve ongoing maintenance obligations.

Other income includes government grants received towards the cost of internal research and development programs. In many cases these carry clauses which require the Company to maintain a presence in the same region for a number of years and invest according to pre-agreed budgets. Failure to do so may result in the repayment of all or part of the grants received. In addition, other income also includes other incentives received from government agencies, and consists mainly of the French and Belgian tax credit for research companies and the Dutch and Belgian credit for salaries of research personnel.

## 5. OPERATING COSTS

Operating result has been calculated after charging (-)/crediting:

### Services cost of sales

| Thousands of € | 2012 | 2011 | 2011 Pro Forma |
|---|---|---|---|
| Personnel costs | -24,562 | -19,891 | -19,891 |
| Disposables and lab fees | -12,940 | -6,137 | -6,137 |
| Depreciation | -4,132 | -5,942 | -5,942 |
| Provisions | 376 | | -397 |
| Other operating expenses | -6,920 | -8,556 | -8,556 |
| **Total** | **-48,179** | **-40,526** | **-40,923** |

Compared to 2011, cost of sales increased significantly due to increased personnel costs and lab consumables because of increased laboratory staff. Also the fact that services performed less work for the R&D segment contributes to increased cost of sales, as less costs have been shifted to R&D expenditure as compared to last year. Other operational costs mainly contain travel expenses, consultancy costs and fees.

### R&D expenditure

| Thousands of € | 2012 | 2011 | 2011 Pro Forma |
|---|---|---|---|
| Personnel costs | -27,131 | -29,716 | -27,736 |
| Disposables and lab fees | -9,764 | -22,450 | -12,568 |
| Subcontracting | -25,393 | -20,481 | -24,538 |
| Premises costs | -9,013 | -7,573 | -8,908 |
| Depreciation | -3,535 | -3,002 | -3,002 |
| Impairment | | -576 | -576 |
| Provisions | -626 | 85 | 85 |
| Other operating expenses | -4,796 | -747 | -7,217 |
| **Total** | **-80,259** | **-84,460** | **-84,460** |

R&D expenses decreased from €84.5 million to €80.3 million, reflecting stringent cost control on disposables and lab fees, office expenses and maintenance costs.

## General and administrative costs

| Thousands of € | 2012 | 2011 | 2011 Pro Forma |
|---|---|---|---|
| Personnel costs | -9,445 | -6,569 | -6,569 |
| Premises costs | -4,590 | -5,218 | -5,218 |
| Professional fees | -2,708 | -2,527 | -2,527 |
| Director fees | -1,524 | -1,493 | -1,493 |
| Depreciation | -1,348 | -2,577 | -2,577 |
| Provisions | | -397 | |
| Other operating expenses | -4,896 | -4,339 | -4,339 |
| **Total** | **-24,511** | **-23,120** | **-22,723** |

General and administrative costs increased to €24.5 million, primarily due to increased personnel costs. In addition, the implementation of a company-wide ERP system to achieve better cost control and purchasing efficiencies of scale contributed more to G&A costs than last year. Premises costs include rent, service charges, property taxes and utility costs such as water, electricity and gas. Professional fees also include legal and tax fees related to the global collaboration agreement with AbbVie on GLPG0634 and the closure of the Swiss operations. Other operational costs mainly contain travel expenses, telephone, consultancy costs and fees.



## Sales and marketing expenses

| Thousands of € | 2012 | 2011 | 2011 Pro Forma |
|---|---|---|---|
| Personnel costs | -1,445 | -1,460 | -1,460 |
| Other operating expenses | -690 | -813 | -813 |
| **Total** | **-2,134** | **-2,273** | **-2,273** |

## Restructuring and integration costs and impairment

| Thousands of € | 2012 | 2011 | 2011 Pro Forma |
|---|---|---|---|
| Restructuring and integration costs | -2,506 | | |
| **Total** | **-2,506** | | |

Restructuring and integration expenses of €2.5 million relate to the closure of the operations in Basel and reorganization costs.

## 6. PERSONNEL COSTS

### The number of employees on 31 December was:

| | 2012 | 2011 |
|---|---|---|
| | 796 | 835 |
| **Total** | **796** | **835** |

### The average number of employees during the year was:

| | 2012 | 2011 |
|---|---|---|
| Key Management | 6 | 7 |
| Laboratory staff | 716 | 698 |
| Administrative staff | 94 | 96 |
| **Total** | **816** | **801** |

### Their aggregate remuneration comprised:

| Thousands of € | 2012 | 2011 | 2011 Pro Forma |
|---|---|---|---|
| Wages and salaries | -46,903 | -42,520 | -40,957 |
| Social security costs | -8,394 | -7,379 | -7,108 |
| Pension costs | -3,656 | -3,767 | -3,767 |
| Other costs | -3,641 | -3,970 | -3,824 |
| **Total** | **-62,594** | **-57,636** | **-55,656** |

The other personnel costs mainly relate to costs for meal tickets, canteen costs, travel expenses, costs for temporary personnel and costs for warrants granted of €2,086K (2011: €2,040K). For the costs of warrants granted, we refer to note 30.

## 7. FINANCE INCOME

| Thousands of € | 2012 | 2011 |
|---|---|---|
| Interest on bank deposits | 1,022 | 297 |
| Interest on short term deposits | 0 | 21 |
| Other financial income | 2,798 | 541 |
| **Total** | **3,820** | **859** |

Increased interest income on bank deposits mainly comes from interests on the $150 million upfront payment (€112 million) received from AbbVie in March 2012. The other financial income in 2012 mainly relates to translation differences coming from CHF. For 2011 this relates to translation differences coming from USD.

## 8. FINANCE COSTS

| Thousands of € | 2012 | 2011 |
|---|---|---|
| Interest on obligations under finance lease | -150 | -138 |
| Other financial costs | -2,211 | -1,514 |
| **Total** | **-2,362** | **-1,651** |

Increase in other financial charges can on the one hand be explained by available-for-sale financial assets which have been written off as management assesses these shares to be impaired as from 2012. On the other hand €0.6 million of goodwill for R&D was impaired and as such reversed because this goodwill was related to programs of ProSkelia SASU (now: Galapagos SASU) for which currently no more work is performed (on hold). More specifically, the largest part of this goodwill was allocated to GLPG0492 (SARM-Cachexia) for which the further development of the compound was discontinued in 2012. For 2011 the other financial costs mainly relate to exchange rate losses and translation differences arising from GBP.

## 9. TAXES

### Tax assets and liabilities

| Thousands of € | 2012 | 2011 |
|---|---|---|
| Tax assets | | |
| Non Current tax receivables | 35,288 | 23,081 |
| Current tax receivable | 188 | |
| **Total** | **35,476** | **23,081** |

The tax receivables relate to refunds resulting from tax credits on research expenses in France and Belgium. Non-current tax receivables are discounted over the period until maturity date.

| Thousands of € | 2012 | 2011 |
|---|---|---|
| Tax liabilities | | |
| Income tax payable | 3 | 616 |
| **Total** | **3** | **616** |

## Taxes recognized in profit or loss

| Thousands of € | 2012 | 2011 |
|---|---|---|
| Current tax | 150 | -553 |
| Deferred tax (note 23) | -719 | 1,182 |
| **Total** | **-569** | **630** |

Corporation tax is calculated at 34% (2011: 34%) - which is the tax rate applied in Belgium - of the estimated assessable profit for the year. Current group result before tax is a loss before tax as well as last year. The applied tax rate for other territorial jurisdictions is the tax rate that is applicable in these respective territorial jurisdictions on the estimated taxable result of the accounting year.

The tax of the year can be reconciled to the accounting profit/loss as follows:

| Thousands of € | 2012 | % | 2011 | % |
|---|---|---|---|---|
| Profit/loss (-) before tax | -5,152 | 34 | -33,727 | 34 |
| Income tax credit, calculated using the Belgian statutory tax rate on the accounting profit/loss (-) before tax (theoretical) | -1,751 | | -11,464 | |
| Tax expenses in income statement (effective) | 569 | | -629 | |
| Difference in tax expense to explain | 2,320 | | 10,835 | |
| Effect of tax rates in other jurisdictions | -325 | | 27 | |
| Effect of non taxable revenues | -4,520 | | -8,245 | |
| Effect of consolidation correction without tax impact | 157 | | 2,247 | |
| Effect of non tax deductible expenses | 1,840 | | 787 | |
| Effect of recognition of previous non recognized deferred tax assets | -14 | | -671 | |
| Effect of change in tax rates | -127 | | -49 | |
| Effect of tax losses (utilized) reversed | -1,496 | | -4,438 | |
| Effect from under or over provisions in prior periods | 102 | | 314 | |
| Effect of non recognition of deferred tax assets | 8,508 | | 20,863 | |
| Effect of R&D tax credit claims | -2,332 | | | |
| Effect of derecognition of previous recognized deferred tax assets | 527 | | | |
| **Total Explanations** | **2,320** | | **10,835** | |

The main difference between the theoretical tax and the effective tax is explained by the unrecognized deferred tax assets on tax losses carried forward for which the Company conservatively assesses that it is not likely that these will be realized in the foreseeable future, except for BioFocus DPI Ltd. and Galapagos Research Centre d.o.o (since 5 February 2013: Fidelta d.o.o.); and the investment allowances for research and development (tax credit (see note 23)). The non-taxable revenues, comprehending tax incentives like CIR, IWT, etc. in the different sites are also an important factor for the financial year 2012.

## 10. EARNINGS PER SHARE

Basic earnings per share is calculated by dividing the net result attributable to shareholders by the weighted average number of ordinary shares issued during the year.

| Thousands of € | 2012 | 2011 |
|---|---|---|
| Result for the purpose of basic result per share | | |
| - from continuing operations | -5,721 | -30,063 |
| - from discontinued operations | | -3,034 |
| **Group result for the purpose of basic result per share** | **-5,721** | **-33,097** |
| | | |
| **Number of shares (thousands)** | | |
| - Weighted average number of shares for the purpose of result per share | 26,545 | 26,403 |
| | | |
| **Basic result per share (Euros)** | **-0.22** | **-1.25** |
| - Basic result from continuing operations per share (Euros) | -0.22 | -1.14 |
| - Basic result from discontinued operations per share (Euros) | | -0.11 |

| Thousands of € | 2012 | 2011 |
|---|---|---|
| Result for the purpose of diluted result per share, being net profit/loss | | |
| - from continuing operations | -5,721 | -30,063 |
| - from discontinued operations | | -3,034 |
| **Group result for the purpose of diluted result per share** | **-5,721** | **-33,097** |
| | | |
| **Number of shares (thousands)** | | |
| - Weighted average number of shares for the purpose of basic result per share | 26,545 | 26,403 |
| | | |
| **Number of dilutive potential ordinary shares** | | |
| | | |
| **Diluted result per share (Euros)** | **-0.22** | **-1.25** |
| - Diluted result from continuing operations per share (Euros) | -0.22 | -1.14 |
| - Diluted result from discontinued operations per share (Euros) | | -0.11 |

As the Group is reporting a net loss, the outstanding warrants have an anti-dilutive effect rather than a dilutive effect. Consequently, basic and diluted loss per share are the same.

## 11. RIGHTS AND COMMITMENTS NOT REFLECTED IN THE BALANCE SHEET

For this subject matter we refer to note 28 "Contingent liabilities and assets".

## 12. GOODWILL

| Thousands of € | |
|---|---|
| **On 1 January 2011** | **42,380** |
| Disposal of subsidiaries | -3,500 |
| **On 31 December 2011** | **38,880** |
| Liquidation of subsidiaries | -620 |
| Goodwill impairment | -593 |
| **On 31 December 2012** | **37,667** |

As a result of the sale of Compound Focus, Inc. in 2011, the goodwill decreased to €38,880K.

The further decline in goodwill in 2012 can on the one hand be explained by the liquidation of Cambridge Drug Discovery Holdings Ltd and its subsidiaries Cambridge Genetics Ltd and Cambridge Discovery Ltd. On the other hand goodwill for R&D was impaired and as such reversed because this goodwill was related to programs of ProSkelia SASU (now: Galapagos SASU) for which currently no more work is performed (on hold). More specifically, the larger part of this goodwill was allocated to GLPG0492 (SARM-Cachexia) for which the further development of the compound was discontinued in 2012.

| Thousands of € | 2012 | 2011 |
|---|---|---|
| Services - BioFocus | 29,040 | 29,660 |
| Services - Argenta | 8,627 | 8,627 |
| R&D | | 593 |
| **Total** | **37,667** | **38,880** |

The recoverable amounts for the CGU's (Cash-generating units) were determined based on a value in use calculation. The most important assumptions for these calculations are the discount percentage, the growth rate and the expected changes in sales price and direct cost during the period. Management estimates the discount rate based on percentages that are applicable in the current market (before taxes) and that take into account the time value of money and the specific risks of the CGU's. The growth increase is based on the growth predictions for the industry. Changes in sales prices and direct costs are based on historical experience and expectations of future changes in the market.

The Company cannot predict whether events that trigger goodwill impairment will occur, when they will occur or how they will affect any asset values reported. Galapagos believes that all of its estimates are reasonable: they are consistent with the internal reporting and external market data, and reflect management's best estimates. However, inherent uncertainties exist that management may not be able to control. While a change in the estimates used could have a material impact on the calculation of the fair values and trigger an impairment charge, the Company is not aware of any reasonably possible change in a key assumption used that would cause a business unit's carrying amount to exceed its recoverable amount.

**Services**

The recoverable value for this CGU was determined based on a value in use calculation which uses input values from an annual budget and as projected until 2022 as approved by the Audit Committee. Management used growth assumptions of 6% for the first two years for BioFocus and 7% for Argenta, decreasing to 5% for both by 2022 with a perpetual growth of 2%. The EBIT-margin evolves to 15% for BioFocus and 16% for Argenta. The applied discount rate used was 15%. Only when the following assumptions are applied the recoverable amounts would fall below the current book values. For Argenta, a discount rate of more than 80%. For BioFocus, a discount rate of more than 18%. The cash flows for the following years were extrapolated on the basis of a prudent estimation of the growth of this segment.

## 13. INTANGIBLE ASSETS

| Thousands of € | Customer relationships | In process technology | Software & databases | Brands, licenses, patents & know-how | Total |
|---|---|---|---|---|---|
| **Acquisition value** | | | | | |
| | | | | | |
| **At 1 January 2011** | **4,090** | **6,051** | **5,144** | **16,585** | **31,869** |
| Additions | | | 1,431 | 6 | 1,437 |
| Sales and disposals | | | | -1,500 | -1,500 |
| Transfer | | | | | |
| Translation differences | 77 | 15 | 53 | 40 | 185 |
| **Balance at 31 December 2011** | **4,167** | **6,066** | **6,629** | **15,131** | **31,991** |
| Additions | | | 941 | | 941 |
| Sales and disposals | | | -3 | -375 | -377 |
| Transfer | -2,116 | -505 | -306 | 2,927 | |
| Translation differences | 4 | | -28 | 100 | 75 |
| **Balance at 31 December 2012** | **2,054** | **5,561** | **7,231** | **17,783** | **32,629** |
| | | | | | |
| **Amortization and impairment** | | | | | |
| | | | | | |
| **At 1 January 2011** | **2,069** | **5,908** | **4,922** | **5,435** | **18,335** |
| Charge for the year | 267 | | 585 | 2,942 | 3,794 |
| Impairment | | 143 | 12 | 421 | 575 |
| Sales and disposals | | | | -1,500 | -1,500 |
| Transfer | | | | | |
| Translation differences | 66 | 15 | 53 | 38 | 172 |
| **Balance at 31 December 2011** | **2,403** | **6,066** | **5,571** | **7,336** | **21,377** |
| Charge for the year | 102 | | 455 | 1,568 | 2,125 |
| Impairment | | | | | |
| Sales and disposals | | | | -357 | -357 |
| Transfer | -1,699 | -505 | -187 | 2,391 | |
| Translation differences | 4 | | -28 | 84 | 60 |
| **Balance at 31 December 2012** | **809** | **5,561** | **5,811** | **11,022** | **23,205** |
| | | | | | |
| **Carrying amount** | | | | | |
| | | | | | |
| At 31 December 2011 | 1,764 | | 1,057 | 7,795 | 10,614 |
| **At 31 December 2012** | **1,245** | | **1,420** | **6,760** | **9,425** |

The additions in software and databases relate to the implementation of a company-wide ERP system. The impairment and disposal recorded in previous year on licenses relate to the write-off with regard to the Enceladus assets, which were returned to Enceladus.

## 14. PROPERTY, PLANT AND EQUIPMENT

| Thousands of € | Land & building improvements | Installation & machinery | Furniture, fix-tures & vehicles | Other tangible assets | Total |
|---|---|---|---|---|---|
| **Acquisition value** | | | | | |
| | | | | | |
| **At 1 January 2011** | **13,473** | **51,710** | **1,470** | **6,561** | **73,215** |
| Additions | 231 | 3,820 | 272 | 72 | 4,396 |
| Sales and disposals | -4 | -544 | -174 | -9 | -730 |
| Variations in scope | -147 | -2,622 | -23 | | -2,792 |
| Transfer | | -340 | | 340 | |
| Translation differences | 122 | 490 | 2 | 34 | 648 |
| **Balance at 31 December 2011** | **13,675** | **52,514** | **1,547** | **6,998** | **74,735** |
| Additions | 300 | 5,060 | 539 | | 5,900 |
| Sales and disposals | -1,148 | -12,237 | -11 | -4 | -13,400 |
| Other increase/decrease (-) | | | 227 | | 227 |
| Transfer | 791 | 1,313 | 2,012 | -4,117 | |
| Translation differences | 93 | 364 | 35 | 8 | 501 |
| **Balance at 31 December 2012** | **13,712** | **47,015** | **4,350** | **2,886** | **67,962** |
| | | | | | |
| **Depreciations and impairment** | | | | | |
| | | | | | |
| **At 1 January 2011** | **8,660** | **35,789** | **705** | **4,175** | **49,328** |
| Charge for the year | 1,932 | 4,935 | 162 | 697 | 7,727 |
| Sales and disposals | | -512 | -174 | | -686 |
| Variations in scope | -93 | -1,682 | -23 | | -1,798 |
| Transfer | | -170 | | 170 | |
| Translation differences | 96 | 517 | 4 | 23 | 640 |
| **Balance at 31 December 2011** | **10,594** | **38,877** | **674** | **5,066** | **55,211** |
| Charge for the year | 1,477 | 4,402 | 312 | 692 | 6,884 |
| Sales and disposals | -1,124 | -11,902 | -7 | | -13,034 |
| Other increase/decrease (-) | | | 435 | | 435 |
| Transfer | 731 | 1,189 | 1,434 | -3,354 | |
| Translation differences | 75 | 268 | 21 | 3 | 368 |
| **Balance at 31 December 2012** | **11,753** | **32,834** | **2,869** | **2,408** | **49,864** |
| | | | | | |
| **Carrying amount** | | | | | |
| | | | | | |
| At 31 December 2011 | 3,082 | 13,637 | 873 | 1,932 | 19,524 |
| **At 31 December 2012** | **1,959** | **14,181** | **1,481** | **478** | **18,099** |

There are no pledged items of property, plant and equipment. There are also no restrictions in use on any items of property, plant and equipment.

## 15. INVENTORY

| Thousands of € | 2012 | 2011 |
|---|---|---|
| Raw materials and supplies (net) | 204 | 389 |
| Work in progress (net) | | 113 |
| **Total** | **204** | **502** |

The work in progress consisted of incomplete molecule collections in Basel for which the operations stopped in 2012.

## 16. AVAILABLE FOR SALE FINANCIAL ASSETS AND OTHER NON CURRRENT ASSETS

Available for sale financial assets have been written off in 2012 (2011: €805K) and represent an investment in common stock in an unlisted biotechnology company incorporated in the USA. The shares are not traded on the open market; management assesses these shares to be impaired as from 2012.

In 2008 a reclassification was done from cash and cash equivalents to available for sale financial assets. This reclassification relates to the CDO (for an amount of €2,000K), that was impaired fully in 2008, and as of 31 December 2012 remained at a fair value of €0.

| | Measurement at cost | | Measurement at fair value | |
|---|---|---|---|---|
| Thousands of € | 2012 | 2011 | 2012 | 2011 |
| Available for sale financial assets | | 1,037 | | 805 |
| Other non current assets | 420 | 191 | | |
| **Total** | **420** | **1,228** | | **805** |

## 17. TRADE AND OTHER RECEIVABLES

| Thousands of € | 2012 | 2011 |
|---|---|---|
| Trade receivables | 27,876 | 25,048 |
| Prepayments | 2,125 | 2,769 |
| Other receivables | 2,493 | 2,194 |
| Other current receivables | 5,194 | 2,495 |
| Accrued income | 2,685 | 1,616 |
| Deferred charges | 2,509 | 879 |
| **Total** | **37,688** | **32,505** |

The Group considers that the carrying amount of trade and other receivables approximates their fair value. The other current assets mainly include accrued income from subsidy projects and deferred charges.

## 18. CASH AND CASH EQUIVALENTS

| Thousands of € | 2012 | 2011 |
|---|---|---|
| Bank balances | 94,643 | 32,543 |
| Cash at hand | 4 | 12 |
| **Total** | **94,647** | **32,555** |

The bank balances and cash held by the Group and short-term bank deposits have an original maturity of maximum three months. The carrying amount of these assets approximates their fair value. The cash and cash equivalents have no restrictions upon them.

## 19. SHARE CAPITAL

The share capital of Galapagos NV, as included in the articles of association, reconciles to the 'Capital' on the balance sheet as follows:

| Thousands of € | 2012 | 2011 |
|---|---|---|
| Share capital Galapagos NV | 144,815 | 142,928 |
| Costs of capital increases (accumulated) | -5,468 | -5,468 |
| **Capital** | **139,347** | **137,460** |

Costs of capital increases are netted against the proceeds of capital increases, in accordance with IAS 32 Financial instruments: disclosure and presentation.

### History of Share Capital

The overview below represents the evolution of the share capital as included in the articles of association of Galapagos NV (rounded).

| Date | Share Capital Increase New Shares (in €) | Share Capital Increase Warrants (in €) | Number of Shares issued | Aggregate Number of Shares after Transaction | Aggregate Share Capital after Transaction (in €) |
|---|---|---|---|---|---|
| **1 January 2011** | | | | **26,358,984** | **142,590,770** |
| **31 December 2011** | | | | **26,421,441** | **142,928,662** |
| 5 April 2012 | | 740,590 | 137,414 | 26,558,855 | 143,669,252 |
| 29 June 2012 | | 101,162 | 18,699 | 26,577,554 | 143,770,414 |
| 14 September 2012 | | 116,688 | 21,569 | 26,599,123 | 143,887,102 |
| 17 December 2012 | | 928,486 | 171,624 | 26,770,747 | 144,815,588 |
| **31 December 2012** | | | | **26,770,747** | **144,815,588** |

As of 1 January 2011, the Company's share capital amounted to €142,590,770.44, represented by 26,358,984 shares. All shares were issued, fully paid up and of the same class.

On 30 March 2011, 52,496 warrants were exercised at various exercise prices under Warrant Plan 2005, Warrant Plan 2006 Belgium/The Netherlands, Warrant Plan 2006 UK, Warrant Plan 2007 and Warrant Plan 2007 RMV. The exercise resulted in a share capital increase of €284,003.36 (plus €185,260.31 in issuance premium) and the issuance of 52,496 new shares.

On 23 May 2011, the Board of Galapagos decided, within the framework of the authorized capital, to create a maximum of 802,500 warrants, for the benefit of certain employees and independent consultants of Galapagos and its subsidiaries under a new warrant plan ("Warrant Plan 2011"). After acceptances, the total number of warrants de facto created and granted under this plan is 619,000. These warrants have a term of eight years. The exercise price of the warrants is €9.95. As of 31 December 2012 no warrants were exercised under this plan and 569.000 warrants were still outstanding.

On 23 May 2011, the Extraordinary General Shareholders' Meeting of Galapagos decided to create a maximum of 131,740 warrants, for the benefit of the directors of Galapagos under a new warrant plan ("Warrant Plan 2011 (B)"). After acceptances, the total number of warrants de facto created and granted under this plan is 129,220. These warrants have a term of five years. The exercise price of the warrants is €9.95. As of 31 December 2012 no warrants were exercised under this plan and all warrants were still outstanding.

On 30 June 2011, 8,386 warrants were exercised under Warrant Plan 2006 Belgium/The Netherlands. The exercise resulted in a share capital increase of €45,368.26 (plus €26,835.20 in issuance premium) and the issuance of 8,386 new shares.

On 19 December 2011, 1,575 warrants were exercised under Warrant Plan 2006 Belgium/The Netherlands. The exercise resulted in a share capital increase of €8,520.75 (plus €2,693.25 in issuance premium) and the issuance of 1,575 new shares.

On 31 December 2011, the Company's share capital amounted to €142,928,662.81, represented by 26,421,441 shares. All shares were issued, fully paid up and of the same class.

On 5 April 2012, 137,414 warrants were exercised at various exercise prices under Warrant Plan 2002 Belgium, Warrant Plan 2005, Warrant Plan 2006 Belgium/The Netherlands, Warrant Plan 2006 UK, Warrant Plan 2007, Warrant Plan 2007 RMV and Warrant Plan 2008. The exercise resulted in a share capital increase of €740,589.74 (plus €359,072.53 in issuance premium) and the issuance of 137,414 new shares.

On 29 June 2012, 18,699 warrants were exercised at various exercise prices under Warrant Plan 2006 Belgium/The Netherlands, Warrant Plan 2006 UK, Warrant Plan 2007, Warrant Plan 2007 RMV and Warrant Plan 2008. The exercise resulted in a share capital increase of €101,161.59 (plus €59,091.48 in issuance premium) and the issuance of 18,699 new shares.

On 12 July 2012, the Board of Directors of Galapagos NV decided, within the framework of the authorized capital, to create

a maximum of 530,140 warrants, for the benefit of the Directors and certain independent consultants of Galapagos NV, and of employees of the Group under a new warrant plan ("Warrant Plan 2012"). After acceptances, the total number of warrants de facto created and granted under this plan is 481,140. These warrants have a term of eight years. The exercise price of the warrants is €14.19. As of 31 December 2012 no warrants were exercised under this plan and 456,140 warrants were still outstanding.

On 14 September 2012, 21,569 warrants were exercised at various exercise prices under Warrant Plan 2005, Warrant Plan 2006 UK, Warrant Plan 2007 RMV and Warrant Plan 2008. The exercise resulted in a share capital increase of €116,688.29 (plus €28,133.01 in issuance premium) and the issuance of 21,569 new shares.

On 17 December 2012, 171,624 warrants were exercised at various exercise prices under Warrant Plan 2002 Belgium, Warrant Plan 2005, Warrant Plan 2006 Belgium/The Netherlands, Warrant Plan 2006 UK, Warrant Plan 2007, Warrant Plan 2007 RMV and Warrant Plan 2008. The exercise resulted in a share capital increase of €928,485.84 (plus €408,400.79 in issuance premium) and the issuance of 171,624 new shares.

On 31 December 2012, the Company's share capital amounted to € 144,815,588.27, represented by 26,770,747 shares. All shares were issued, fully paid up and of the same class.

| Other information | **Ordinary shares** | **Total** |
|---|---|---|
| Par value of shares | 5.41 | 5.41 |

The Board of Directors is authorized for a period of 3 years starting from the date of the General Shareholders' Meeting that granted the renewed authorization, being 23 May 2011, to increase the share capital of the Company within the framework of the authorized capital through contributions in kind or in cash, with limitation or cancellation of the shareholders' preferential rights, even after notification by the FSMA (Financial Services and Markets Authority) of a public takeover bid on the Company's shares, provided that the relevant provisions of the Code of Companies are complied with, including that the number of issued shares cannot be more than one tenth of the number of shares issued prior to the capital increase and representing the share capital of the Company. Said authorization can be renewed.

The authorized capital as approved by the Extraordinary General Shareholders' Meeting of 23 May 2011 amounted to €142,590,770.44. As of 31 December 2012, €2,602,967.40 of the authorized capital was used, so that on the balance sheet date an amount of €139,987,803.04 still remained available under the authorized capital.

## 20. SHARE PREMIUM

| Thousands of € | 2012 | 2011 |
|---|---|---|
| On 1 January | 72,021 | 71,806 |
| Increase as a result of capital increase in cash | 855 | 215 |
| **On 31 December** | **72,876** | **72,021** |

## 21. TRANSLATION DIFFERENCE

| Thousands of € | 2012 | 2011 |
|---|---|---|
| On 1 January | 35 | -343 |
| Translation differences, arisen from translating foreign activities | 959 | 378 |
| **On 31 December** | **994** | **35** |

The increase in translation differences is mainly related to the translation of foreign operations in CHF.



## 22. DERIVATIVE FINANCIAL INSTRUMENTS

### Currency derivatives

The Group does not actively use currency derivatives to hedge planned future cash flows. On the balance sheet date, total notional amount of outstanding forward foreign exchange contracts that the Group has committed are nil (2011: nil).

On 31 December 2012 the fair value of the Group's currency derivatives is estimated to be nil (2011: nil).

The Group does not designate its foreign currency denominated debt as a hedge instrument for the purpose of hedging the translation of its foreign operations.

See note 36 for further information on how the Group manages financial risks.

## 23. DEFERRED TAX

| Thousands of € | | 2012 | 2011 |
|---|---|---|---|
| I | **Recognized deferred tax assets and liabilities** | | |
| | Assets | 1,705 | 2,166 |
| | Liabilities | -2,624 | -2,403 |
| II | **Deferred tax assets unrecognized** | **106,197** | **105,642** |
| III | **Deferred taxes** | **-719** | **1,182** |
| | Deferred tax expenses net relating to origination and reversal of temporary differences | -205 | 511 |
| | Tax benefit arising from previously unrecognized tax assets used to reduce deferred tax expense (+) | 14 | 671 |
| | Deferred tax expenses relating to write down of previously recognized deferred tax assets | -527 | |



The notional interest deduction for an amount of €2,624K (2011: €7,169K) and the investment deduction of €966K (2011: €1,916K) could give rise to deferred tax assets. The amount of notional interest deduction that has been accumulated in the past can be carried forward for maximum 7 years, the notional interest deduction of 2012 and following years will not be carried forward according to a change in the Belgian tax legislation. There is no limit in time for the investment deduction.

The unused tax losses carried forward at 31 December 2012 amount to €345,546K (2011: €350,650K), €41,594K relates to unrecognized tax losses with expiry date between 2013 and 2027.

The tax losses carried forward can be compensated with future profits of the Group for an indefinite period except for Switzerland, the US and Croatia. Because BioFocus DPI Ltd. was profitable in 2011 and 2012 and management expects that this situation is sustainable, a deferred tax asset was set up for an amount of €1,000K (2011: €1,493K). This amount was based on a conservative estimate of net profits for the next 5 years. For the same reasons a deferred tax asset for tax losses carried forward, which are limited in time (3 years), was set up for the Zagreb research center for an amount of €678K.
The deferred tax liabilities relate to timing differences on the value of fixed assets of BioFocus DPI Ltd, BioFocus DPI Holdings and Argenta.

## 24. FINANCE LEASE LIABILITIES

| | Minimum lease payments | | Present value of minimum lease payments | |
|---|---|---|---|---|
| Thousands of € | **2012** | **2011** | **2012** | **2011** |
| Amounts payable under finance lease | | | | |
| Within one year | 327 | 531 | 240 | 425 |
| In the second to fifth years inclusive | 298 | 667 | 165 | 451 |
| After five years | | | | |
| | **625** | **1,198** | **405** | **876** |
| Less future finance charges | 220 | 322 | | |
| **Present value of lease obligation** | **405** | **876** | | |
| Less amount due for settlement within 12 months | | | 240 | 425 |
| **Amount due for settlement after 12 months** | | | **165** | **451** |

| | Net book value | | Acquisition cost | |
|---|---|---|---|---|
| Thousands of € | **2012** | **2011** | **2012** | **2011** |
| **Leased assets** | | | | |
| Installation & machinery | 295 | 1,227 | 2,247 | 4,679 |
| **Total** | **295** | **1,227** | **2,247** | **4,679** |

The Group leases certain of its installation and machinery under finance leases. For the year ended 31 December 2012, the average borrowing rate was 8.29% (2011: 7.92%). The interest rates were fixed at the date of the contracts. All leases are on a fixed repayment basis and no arrangements have been entered into for contingent rental payments.

The fair value of the Group's lease obligations approximates their carrying value. Leased assets decreased because some assets are no longer classified as leased assets in 2012.

## 25. OPERATING LEASE OBLIGATIONS

### The Group as lessee

The Group has rental contracts for office and laboratories which qualify as operating leases as follows:

| Thousands of € | **2012** | **2011** |
|---|---|---|
| Minimum lease payments under operating leases recognized in the income statement for the year | 6,702 | 7,065 |
| **Total** | **6,702** | **7,065** |

On the balance sheet date, the Group had outstanding commitments for future minimum rent payments, which become due as follows:

| Thousands of € | 2012 | 2011 |
|---|---|---|
| Within one year | 6,056 | 6,927 |
| In the second to fifth years inclusive | 20,532 | 24,517 |
| After five years | 15,883 | 17,717 |
| **Total** | **42,472** | **49,161** |

## 26. TRADE AND OTHER PAYABLES

| Thousands of € | 2012 | 2011 |
|---|---|---|
| Trade payables | 22,093 | 18,068 |
| Other creditors | 2,367 | 2,253 |
| Other current liabilities | 86,501 | 15,857 |
| Accrued charges | 2,893 | 2,837 |
| Deferred income | 83,608 | 13,020 |
| **Total** | **110,962** | **36,178** |
| Included in current liabilities | 108,594 | 33,925 |
| Included in non-current liabilities | 2,367 | 2,253 |
| **Total** | **110,962** | **36,178** |

The increase in deferred income is due to the revenue recognition of the $150 million (€112 million) upfront payment received from AbbVie of which €37.2 million has been recognized in 2012. The balance of €74.4 million has been deferred and will be recognized as income in 2013 (€44.6 million) in 2014 (€29.8 million).

## 27. PROVISIONS

| Thousands of € | Post-employment benefits (non-current) | Other provisions (non-current) | Restructuring provision (current) | Total |
|---|---|---|---|---|
| **Balance per 1 January 2012** | **4** | **783** | **393** | **1,180** |
| Additional provisions | 6 | 14 | 760 | 780 |
| Provisions utilized amounts | | -3 | -1,136 | -1,139 |
| Transfer | | -141 | 141 | |
| Translation differences | | 13 | 18 | 31 |
| **Balance at 31 December 2012** | **10** | **666** | **176** | **852** |

Additional provisions contain a restructuring provision for the Basel site of €760K (2011: €388K) which has been fully utilized in the aftermath of the closing of the site in Basel.

## 28. CONTINGENT LIABILITIES AND ASSETS

As a result of the acquisition of ProSkelia SASU (now: Galapagos SASU) from ProStrakan in 2006, ProStrakan is entitled to earn-outs for a maximum amount of €14.5 million, in case of achievement of predetermined milestones in the research programs that were taken over by Galapagos. The achievement of these milestones will generate a net positive cash flow for the Group, but this is still too uncertain. Due to this uncertainty a contingent liability has not been recorded yet.

As a result of the acquisition of GlaxoSmithKline Research Centre Zagreb d.o.o. (as per 31 December 2012: Galapagos Research Centre d.o.o and since 5 February 2013: Fidelta d.o.o.) from Glaxo Group Limited in 2010, Fidelta is entitled to subsidy payments of €10.75 million over a period of three years from the acquisition until May 2013. In return, Fidelta is obliged to perform research services for GSK should such work be requested by GSK.

## 29. RETIREMENT BENEFIT SCHEME



### Defined contribution plans

The Group operates defined contribution systems for all of its qualifying employees. The assets of the schemes are held separately from those of the Group in designated pension plans. For defined contribution systems, the Group pays contributions to publicly or privately administered pension- or insurance funds. Once the contribution is paid, the Group does not have any remaining obligation.

The personnel of the Group in Belgium participate in a defined contribution plan (extra-legal pension). These arrangements are subject to a minimum guaranteed return in accordance with the Belgian legislation. These plans are financed through a group insurance policy for which the insurance company also guarantees a minimum return. Similar pension schemes apply to the Group entities in other countries, except for France.

The amounts due by the Group to these pension schemes for 2012 was €2,911,423 (2011: €2,543,460) of which €52,501 was paid after 31 December 2012 (2011: nihil). These amounts do not include the pension contributions of Galapagos SASU (see below).

### Defined benefit plans

The Group uses two defined benefit plans for Galapagos SASU France. The defined benefit plans are not supported by funds.

The first defined benefit plan is an addition to the French Social Security and requires Galapagos SASU to pay certain pension contributions, as under the French Social Security. In 2012 Galapagos SASU paid for this purpose €775,380 as employer social contributions (2011: €554,398).

In addition, the Chemical and Pharmaceutical Industry's collective bargaining agreements require that Galapagos SASU pays a retirement allowance depending on the seniority of the employees at the moment they retire. The benefit obligations for these retirement allowances amounted to €1,115,870 for 2012 (2011: €728,641). This increase is mainly due to a change in

actuarial assumptions (decrease of discount rate from 4.75% to 3.00%).
Additionally, there are also seniority premiums paid in France. The provisions for these premiums amounted to €919,591 in 2012 (2011: €697,322).

The revised IAS 19 standard is effective for accounting years beginning on or after 1 January 2013 with retroactive effect on accounting years beginning on or after January 1 2012 (the effects on 2012 are to be posted in 2013). Actuarial gains and losses are to be recognized in the balance sheet immediately, with a charge or credit to other comprehensive income (OCI). They are not recycled subsequently. Regarding the provisions for seniority premiums ('Gratifications') the revised IAS 19 standard will not trigger any changes. Regarding retirement allowances ('Indemnités de départ en retraite') €179.464 of unrecognized losses on January 1 2012 will have to be booked to retained earnings on January 1 2012. The actuarial loss of €274.065 which occurs during 2012 will have to be booked through OCI at the end of 2012. IAS 19R will have no impact on the income statement in this case.

### Obligations included in the balance sheet

| In € | 31/12/2012 | 31/12/2011 |
|---|---|---|
| Present value of funded defined benefit obligation | 1,115,870 | 728,641 |
| | | |
| Fair value of plan assets | | |
| Shortage | 1,115,870 | 728,641 |
| Actuarial gains or losses (-) not recognized | -453,529 | -179,464 |
| **Liability included in the balance sheet** | **662,341** | **549,177** |

### The present value of the gross obligation developed as follow

| In € | 31/12/2012 | 31/12/2011 |
|---|---|---|
| Opening balance | 728,641 | 517,421 |
| | | |
| Acquired through business combination | | |
| Current service cost | 78,554 | 75,568 |
| Interest cost | 34,610 | 29,673 |
| Benefits paid | | |
| Impact modification rights | | 107,274 |
| Actuarial gains (-) or losses | 274,065 | -1,295 |
| **Closing balance** | **1,115,870** | **728,641** |

### Amounts recognized in profit or loss for defined benefit plans are as follows

| In € | 31/12/2012 | 31/12/2011 |
|---|---|---|
| Current service cost | 78,554 | 75,568 |
| Interest cost | 34,610 | 29,673 |
| Actuarial gains or losses (-) | | |
| **Total expense** | **113,164** | **105,241** |

This expense is booked as pension cost within G&A personnel costs.

### Obligation included in the balance sheet reconciles as follows

| In € | 31/12/2012 | 31/12/2011 |
|---|---|---|
| Opening balance | 549,177 | 443,936 |
| Total expense | 113,164 | 105,241 |
| Paid allowances and contributions by the employer | | |
| **Closing balance** | **662,341** | **549,177** |

### The most important actuarial assumptions are

| In € | 31/12/2012 | 31/12/2011 |
|---|---|---|
| Discount rate | 3.00% | 4.75% |
| Expected salary increase | 2.50% | 2.50% |

### Adjustments resulting from experience amount to

| In € | 31/12/2012 | 31/12/2011 |
|---|---|---|
| Present value of the gross obligation | 1,115,870 | 728,641 |
| Experience adjustments | 21,064 | -2,887 |

The expected contributions for next year amount to €146.690 of which €113.214 is related to service cost and €33.476 is related to interest cost.

## 30. WARRANT PLANS

Presented below is a summary of Warrant Plans activities for the reported periods. Various Warrant Plans were approved for the benefit of directors and independent consultants of Galapagos NV, and of employees of the Group. The warrants offered to employees and independent consultants vest according to the following schema: 10% of the number of warrants granted vest upon the date of the grant; an additional 10% vest at the first anniversary of the grant; an additional 20% vest at the second anniversary of the grant; an additional 20% vest at the third anniversary of the grant; and an additional 40% vest at the end of the third calendar year following the grant. This vesting mechanism does not apply to the warrants granted under the Warrant Plan 2011 and Warrant Plan 2012, for which all warrants vest at the end of the third calendar year following the year of the grant, with no intermediate vesting. The warrants offered to Directors vest over a period of 36 months at a rate of 1/36th per month. Warrants cannot be exercised before the end of the third calendar year following the year of the grant. Pursuant to a resolution of the Extraordinary General Shareholders' Meeting of 23 May 2011 an in principle provision has been incorporated in the Warrant Plans that in the event of a change of control of the Company all outstanding warrants vest immediately and will be immediately exercisable.
After the reverse 4:1 share split decided by the Shareholders' Meeting of 29 March 2005, 4 warrants of Warrant Plan 2002 Belgium entitle the warrant holder to subscribe to one share. For the Warrant Plans created from 2005 onwards, one warrant entitles the warrant holder to subscribe to one share. In the summaries and tables below, the numbers of warrants issued under Warrant Plan 2002 Belgium are divided by 4 to avoid a mixture of rights.

The table below sets forth a summary of warrants outstanding and exercisable at 31 December 2012, per Warrant Plan:

| Warrants | Allocation date | Expiry Date | Exercise Price (€) | Outstanding per 1 January 2012 | Granted during the year | Exercised during the year | Forfeited during the year | Expired during the year | Outstanding per 31 December 2012 | Exercisable per 31 December 2012 |
|---|---|---|---|---|---|---|---|---|---|---|
| 2002 B | 15/06/04 | 14/06/17 | 4.00 | 2,000 | | 2,000 | | | | |
| 2002 B | 09/07/04 | 08/07/17 | 4.00 | 31,250 | | | | | 31,250 | 31,250 |
| 2002 B | 31/01/05 | 30/01/17 | 6.76 | 105,000 | | 52,500 | | | 52,500 | 52,500 |
| 2005 | 04/07/05 | 03/07/18 | 6.91 | 145,000 | | | | | 145,000 | 145,000 |
| 2005 | 23/11/05 | 22/11/18 | 8.35 | 60,000 | | 25,000 | | | 35,000 | 35,000 |
| 2005 | 15/12/05 | 14/12/18 | 8.60 | 12,500 | | | | | 12,500 | 12,500 |
| 2005 | 22/11/06 | 21/11/19 | 8.65 | 21,445 | | 19,450 | | | 1,995 | 1,995 |
| 2006 BNL | 13/02/06 | 12/02/19 | 8.61 | 59,121 | | 6,372 | | | 52,749 | 52,749 |
| 2006 BNL | 22/11/06 | 21/11/19 | 8.65 | 7,000 | | | | | 7,000 | 7,000 |
| 2006 BNL | 04/05/07 | 03/05/20 | 9.22 | 7,500 | | | | | 7,500 | 7,500 |
| 2006 BNL | 28/06/07 | 27/06/20 | 8.65 | 735 | | | | | 735 | 735 |
| 2006 BNL | 21/12/07 | 20/12/20 | 7.12 | 11,355 | | 8,940 | | 315 | 2,100 | 2,100 |
| 2006 UK | 01/06/06 | 31/05/14 | 8.70 | 54,717 | | 37,026 | | | 17,691 | 17,691 |
| 2006 UK | 22/11/06 | 21/11/14 | 8.65 | 5,405 | | 3,570 | | | 1,835 | 1,835 |
| 2006 UK | 19/12/06 | 18/12/14 | 9.18 | 9,625 | | 9,625 | | | | |
| 2006 UK | 28/06/07 | 27/06/15 | 8.43 | 19,455 | | 11,565 | | | 7,890 | 7,890 |
| 2006 UK | 21/12/07 | 20/12/15 | 7.25 | 504 | | 504 | | | | |

| Warrants | Allocation date | Expiry Date | Exercise Price (€) | Outstanding per 1 January 2012 | Granted during the year | Exercised during the year | Forfeited during the year | Expired during the year | Outstanding per 31 December 2012 | Exercisable per 31 December 2012 |
|---|---|---|---|---|---|---|---|---|---|---|
| 2007 | 28/06/07 | 27/06/15 | 8.65 | 108,126 | | | | | 108,126 | 108,126 |
| 2007 | 28/06/07 | 27/06/20 | 8.65 | 187,445 | | 82,675 | | | 104,770 | 104,770 |
| 2007 RMV | 25/10/07 | 24/10/20 | 8.65 | 101,500 | | 39,725 | | | 61,775 | 61,775 |
| 2008 | 26/06/08 | 25/06/21 | 5.60 | 194,119 | | 50,354 | | | 143,765 | 143,765 |
| 2008 B | 26/06/08 | 25/06/13 | 5.60 | 55,000 | | | | 5,000 | 50,000 | 50,000 |
| 2009 | 01/04/09 | 31/03/17 | 5.87 | 506,000 | | | 16,000 | | 490,000 | |
| 2009 B | 02/06/09 | 01/06/14 | 7.09 | 56,670 | | | | | 56,670 | |
| 2009 B | 02/06/09 | 01/06/17 | 7.09 | 75,000 | | | | | 75,000 | |
| 2010 | 27/04/10 | 26/04/18 | 11.55 | 491,350 | | | 29,100 | | 462,250 | |
| 2010 B | 27/04/10 | 26/04/15 | 11.55 | 190,248 | | | | | 190,248 | |
| 2010 C | 23/12/10 | 26/04/18 | 11.74 | 75,000 | | | | | 75,000 | |
| 2011 | 23/05/11 | 22/05/19 | 9.95 | 619,000 | | | 50,000 | | 569,000 | |
| 2011 B | 23/05/11 | 22/05/16 | 9.95 | 129,220 | | | | | 129,220 | |
| 2012 | 03/09/12 | 02/09/20 | 14.19 | | 481,140 | | 25,000 | | 456,140 | |
| **Total** | | | | **3,341,290** | **481,140** | **349,306** | **120,100** | **5,315** | **3,347,709** | **844,181** |

| | Warrants | Weighted average exercise price |
|---|---|---|
| **Outstanding on 1 January 2011** | **2,719,653** | **8.37** |
| Exercisable on 31 December 2010 | 542,484 | |
| Granted during the period | 748,220 | |
| Forfeited during the year | -28,318 | |
| Exercised during the period | -62,457 | |
| Expired during the year | -35,808 | |
| **Outstanding on 31 December 2011** | **3,341,290** | **8.70** |
| Exercisable on 31 December 2011 | 949,683 | |
| Granted during the period | 481,140 | |
| Forfeited during the year | -120,100 | |
| Exercised during the period | -349,306 | |
| Expired during the year | -5,315 | |
| **Outstanding on 31 December 2012** | **3,347,709** | **9.51** |
| Exercisable on 31 December 2012 | 844,181 | |

The table below sets forth the valuation of the warrants.

| Belgian Plans | 2012 | 2011 | |
|---|---|---|---|
| | 3 September | 23 May | 23 May |
| Exercise Price | 14.19 | 9.95 | 9.95 |
| Current share price | 13.02 | 9.54 | 9.54 |
| Fair value on the grant date | 5.91 | 4.70 | 3.68 |
| Estimated volatility (%) | 39.91 | 39.49 | 39.49 |
| Time to expiration (years) | 8.00 | 8.00 | 5.00 |
| Risk free rate (%) | 2.24 | 3.50 | 3.50 |
| Expected dividends | None | None | None |

The method of determining the exercise share price is set up by the Board of Directors.

The estimated volatility is calculated on the basis of the historical volatility of the share price over the useful life of the warrants, validated by reference to the volatility of a representative biotech index.

The time to expiration of the warrant is calculated as the estimated duration until exercise, taking into account the specific features of the plans.

The warrants have been accounted for in accordance with International Financial Reporting Standard 2 on Share Based Payments. IFRS 2 takes effect for all warrants offered after 7 November 2002.

Warrants expense for warrants that vested in 2012 amounted to €2,086K (2011: €2,040K).

The following table provides an overview of the outstanding warrants per category of warrant holders at 31 December 2012.

| | Number of warrants | |
|---|---|---|
| Category | 2012 | 2011 |
| Non-executive Directors | 180,710 | 163,070 |
| Executive Team | 1,345,000 | 1,357,500 |
| Other | 1,821,999 | 1,820,720 |
| **Total warrants outstanding** | **3,347,709** | **3,341,290** |

The outstanding warrants at the end of the accounting period have an average exercise price of €9.51 (2011: €10,52) and a weighted average remaining useful life of 1,880 days (2011: 2,103 days).

## 31. RELATED PARTIES

Intercompany transactions between Galapagos NV and its subsidiaries, and amongst the subsidiaries, have been eliminated in the consolidation and are not disclosed in this note.

### Trading transactions

In 2012 and 2011, Galapagos NV and its affiliates had no trading transactions with parties that are considered as related parties as defined in IAS24.

### Potential conflicts of interest between the Company and its Directors

In 2012 and 2011 the Directors received an annual fee of €20,000 plus expenses. The chairman of the Audit Committee received an additional payment of €5,000 per year. In addition, the Annual General Shareholders' Meeting of 24 April 2012 authorized an additional compensation of €20,000 for Directors who provide actively and on a regular basis independent clinical and scientific advice to the Board of Directors. In 2012, this was the case for Dr Cautreels and Dr Sato. Dr Parekh, the Chairman of the Board, is compensated through a consultancy agreement only (see note 32).

There are no loans between Galapagos NV and the members of its Board of Directors or its Executive Committee.

The remuneration of key management (including the CEO) is set out in note 32.

In 2012 (as in 2011), there were no arrangements or understandings with major shareholders pursuant to which a representative of such shareholder became a Board Member or Executive Committee member of the Company.

In 2012, a total of 117,640 warrants were issued to the Directors, of which 100,000 for the CEO; this issue of warrants was decided by the Board of Directors within the framework of the authorized capital, in accordance with the resolution of the Extraordinary General Shareholders' Meeting of 22 August 2012. In 2011, the total number of warrants issued to Directors was 129,220 (of which 100,000 for the CEO) by decision of the Extraordinary General Shareholders' Meeting of 23 May 2011.

## 32. REMUNERATION OF KEY MANAGEMENT PERSONNEL

On 31 December 2012, the Executive Committee comprised five members: Mr Onno van de Stolpe, Dr Andre Hoekema, Dr Chris Newton, Dr Piet Wigerinck and Mr Guillaume Jetten. In the course of 2012, two individuals ceased to be a member of the Executive Committee: Dr Graham Dixon with effect from 14 March 2012 and Dr Radan Spaventi with effect from 14 December 2012. The remuneration package of the members of the Executive Committee who were in function in the course of 2012 comprises:

| Thousands of € (except for the number of warrants) | 31/12/2012 | 31/12/2011 |
|---|---|---|
| Short-term employee benefits(*) | 3,348 | 3,044 |
| Post-employment benefits | 123 | 88 |
| **Total benefits excluding warrants** | **3,470** | **3,132** |
| Number of warrants offered in the year | 230,000 | 225,000 |

***(*) includes: salaries, employer social security contributions, other short term benefits.***

The above table includes the normal payments for compensation and benefits made to Dr Dixon and Dr Spaventi up to the date of cessation of their employment. In addition, as compensation for the termination of their employment, the following payments have been made to them: (i) to Dr Dixon: a total payment of €214,961; and (ii) to Dr Spaventi: a total payment of €394,380; the aggregate social security contributions on these payments amounted to €74,235.

The members of the Executive Committee provide their services for the Group on a full-time basis. Their remuneration includes all costs for the Group, including retirement contributions.

The 230,000 warrants offered in 2012 to the members of the Executive Committee were offered under Warrant Plan 2012.

The retirement benefits to the members of the Executive Committee are part of the retirement benefit scheme to which all qualified personnel are entitled; the contributions are paid as a percentage of the gross annual salary. This does not apply to the members of the Executive Committee who render their services as an independent consultant and who make their own pension contributions.



The Executive Committee members, together with other senior managers, are eligible to receive bonuses under the Senior Management Bonus Scheme established in 2006. Pursuant to the rules of the Senior Management Bonus Scheme, 50% of the bonus is paid immediately around year-end and the payment of the other 50% is deferred for three years. The deferred 50% component is dependent on the Company's share price change relative to the Next Biotech Index (which tracks the Company's peers). The Company's share price and Index at the start and end of the 3-year period is calculated by the average price over the preceding and last month of the 3-year period, respectively.

- If the Company's share price change is better than or equal to the change in the Next Biotech Index, the deferred bonus will be adjusted by the share price increase/decrease and paid out.
- If the Company's share price change is up to 10% worse than the change in the Next Biotech Index, 50% of the deferred bonus will be adjusted by the share price increase/decrease and paid out, and the remainder will be forfeited.
- If the Company's share price change is more than 10% worse than the change in the Next Biotech Index the deferred bonus will be forfeited.

To be entitled to any deferred payment under the bonus scheme the beneficiary must still be in the Company's employ.

The seven members of the Executive Committee (including the CEO) who were in function in the course of 2012 were paid an aggregate amount of €1,759,156 in remunerations and received an aggregate amount of €1,366,470 in bonuses. The aggregate bonus amount was composed of 3 parts: (i) an aggregate bonus of €286,125, being 50% of the bonus for performance over 2012 (paid in early January 2013), with the other 50% being deferred for 3 years, (ii) an aggregate amount of €817,915 paid in early January 2013 as the 50% deferred part of the bonus over 2009; this deferred part was established at the end of 2012 using a multiple of 1.96 of the deferred part of the 2009 bonus, as a result of the share price performance over the period 2009-2012; and (iii) an aggregate amount of €262,430 paid in April 2012 as 50% of the special bonus in connection with the major collaboration agreement relating to GLPG0634 entered into in February 2012, with the other 50% being deferred for 3 years. For 2011, the members of the then Executive Committee (comprising 7 members including the CEO) were paid an aggregate amount of €1,770,663 in remunerations and an aggregate amount of €925,876

in bonuses (which was the 50% deferred part of the bonus for performance in 2008; no bonus was paid for performance in 2011 as not 3 out of the 5 corporate objectives had been met in 2011).

Other components of their remuneration included contributions to the Group's pension and health insurance schemes, company cars and certain fringe benefits of non-material value.

Only the CEO is a member of both the Executive Committee and the Board of Directors. The CEO does not receive any special remuneration for his work on the Board of Directors, as this is part of his total remuneration package in his capacity as member of the Executive Committee.

No loans, quasi-loans or other guarantees were given to members of the Board and of the Executive Committee.

**Transactions with non-executive directors**

In connection with the compensation of independent Directors, the Annual Shareholders' Meeting (AGM) of 24 April 2012 fixed the annual remuneration for independent Directors for the exercise of their mandate as a Director of the Company at €20,000 plus expenses and resolved to pay an additional compensation of €5,000 to the chairman of the Audit Committee of the Board of Directors for his activities as chairman of the Audit Committee. Said AGM also authorized an additional compensation of €20,000 for Directors who provide actively and on a regular basis independent clinical and scientific advice to the Board. In 2012, this was the case for Dr Cautreels and Dr Sato. In 2012, a total amount of €112,474 was paid to the independent Directors as Board fees (2011: €80,000) and €11,331 as expenses (2011: €3,798).

The aforementioned AGM fixed the annual remuneration for non-executive Directors who are not independent Directors and who do not represent a shareholder at €20,000 plus expenses. In 2012 an aggregate amount of €20,000 was paid to these Directors (2011: €28,111); they did not claim reimbursement of expenses.

The aforementioned AGM resolved that in case a Director attends less than 75% of the meetings of the Board of Directors, the annual amounts mentioned in the two paragraphs here above shall be reduced pro rata the absence score of such Director. This rule did not require implementation in 2012.

The aforementioned AGM resolved that the Directors who represent a shareholder on the Board of Directors will only receive reimbursement for the expenses they incur for attending meetings of the Board of Directors and no other compensation or fees for their Board membership. There were no such Directors in 2012 or 2011.

As of 1 August 2005, the Chairman of the Board Dr Parekh receives an annual consulting fee of £50,000 as compensation for his specific assignment to assist the Company in strategic positioning, financing and acquisitions, including, amongst others, the evaluation of several alternative corporate transactions, including potential company and compound acquisitions, as well as strategic alliance opportunities. Dr Parekh does not receive other cash compensation from the Company.

In 2012, 17,640 warrants were granted to non-executive Directors (2011: 29,220).

## 33. CONSOLIDATED COMPANIES AS OF 31 DECEMBER 2012

| Name of the subsidiary | Country | % voting right Galapagos NV (directly or indirectly through subsidiaries) | Change in % voting right previous period (2012 vs 2011) |
|---|---|---|---|
| Argenta Discovery 2009 Ltd | United Kingdom | 100% | |
| BioFocus DPI (Holdings) Ltd | United Kingdom | 100% | |
| BioFocus DPI AG | Switzerland | 100% | |
| BioFocus DPI Ltd | United Kingdom | 100% | |
| BioFocus DPI, LLC. | United States | 100% | |
| BioFocus, Inc. | United States | 100% | |
| Cambridge Discovery Ltd. | United Kingdom | 0% | (100%) |
| Cambridge Drug Discovery Holding Ltd. | United Kingdom | 0% | (100%) |
| Cambridge Genetics Ltd. | United Kingdom | 0% | (100%) |
| Discovery Partners International GmbH | Germany | 100% | |
| Galapagos B.V. | The Netherlands | 100% | |
| Galapagos istraživački centar d.o.o. | Croatia | 100% | |
| Galapagos SASU | France | 100% | |
| Inpharmatica Ltd | United Kingdom | 100% | |
| Xenometrics, Inc. | United States | 100% | |

**Notes:**
1. On 1 June 2011, BioFocus, Inc. sold the 100% of the shares of Compound Focus, Inc. to an affiliate of Evotec AG.
2. On 6 March 2012, the dormant legacy companies (acquired in the framework of the acquisition of BioFocus) Cambridge Discovery Ltd., Cambridge Drug Discovery Holding Ltd. and Cambridge Genetics Ltd, were dissolved.
3. On 5 February 2013, Galapagos istraživački centar d.o.o. was renamed into Fidelta d.o.o.

## 34. COMPANY ACQUISITIONS AND DISPOSALS

During 2012, no company acquisitions or sales were performed by the Group. Result on divestment of €2 million is the net of the liquidation costs of dormant legal entities and an earn-out payment received from Evotec connected with the sale of Compound Focus, Inc. in 2011.

| Thousands of € | 2012 |
|---|---|
| **Result on divestment** | |
| | |
| Net loss on liquidation of dormant companies | -3,006 |
| Earn-out income for disposal of Compound Focus Inc (sold in 2011) | 1,000 |
| **Total Result on divestment** | **-2,006** |



### Liquidation of dormant companies

| Thousands of € | 6/3/2012 |
|---|---|
| **Dissolution of fully consolidated companies** | |
| | |
| CTA effect on disposal of Cambridge Discovery Ltd | -4,758 |
| CTA effect on disposal of Cambridge Drug Discovery Holdings Ltd | 2,373 |
| **Total CTA effect** | **-2,386** |
| | |
| Reversal of goodwill recorded in Cambridge Drug Discovery Holdings Ltd | -620 |
| **Net loss on divestment** | **-3,006** |

During the year 2011, one company was sold.

### Disposal of Compound Focus, Inc.

| Thousands of € | 31/5/2011 |
|---|---|
| **Transfer of fully consolidated company** | |
| | |
| Fixed assets | 993 |
| Financial assets | 41 |
| Trade & other receivables | 761 |
| Prepayments | 2,544 |
| Cash | 57 |
| **Total assets** | **4,396** |
| | |
| Equity | 3,469 |
| Trade payables | 64 |
| Accrued charges | 175 |
| Deferred income | 688 |
| **Total equity and liabilities** | **4,396** |
| | |
| Total assets | 4,396 |
| Total liabilities | 927 |
| Translation differences | 355 |
| | |
| Net assets | 3,114 |
| Goodwill at acquisition | 3,500 |
| Costs associated to sale | 1,482 |
| **Sell price** | **10,249** |
| **Gain/loss on sale** | **2,154** |
| | |
| **Net cash from divestment** | **8,710** |

On 1 June 2011 Galapagos sold its facility in South San Francisco (Compound Focus, Inc.), the compound management business of BioFocus, to a subsidiary of Evotec AG. This facility has been part of BioFocus, the service division of the Galapagos Group, since the acquisition of the Discovery Partners International assets by Galapagos in July 2006. For the sale of all shares in Compound Focus, Galapagos received a cash upfront of €10.25M with an additional €2.25M in potential earn-out payments. An earn-out payment of €1.0 million has been received in 2012, contributing to 2012 result on divestment. No other earn-out payments will be received, so there is no longer a contingent asset related to the sale of Compound Focus, Inc. The realized gain on the sale of Compound Focus amounts to €2.2M. Due to debt restructuring resulting from the sale of Compound Focus, Inc., the service division reported a gain of €5.2M, whereas Compound Focus, Inc. realized a €3.0M loss as discontinued operation.

## 35. CRITICAL ACCOUNTING ESTIMATES AND JUDGEMENTS

Drafting financial statements in accordance with IFRS requires management to make judgments and estimates and to use assumptions that influence the reported amounts of assets and liabilities, the notes on contingent assets and liabilities on the date of the financial statements and the reported amounts of income and expenses during the reporting period. Actual results may differ from these estimates.

The most important assumptions concerning future developments and the most important sources of uncertainty for estimates on the balance sheet date are presented below.

### Share based payments plans

The Group determines the costs of the share based payments plans on the basis of the fair value of the equity instrument at grant date. Determining the fair value assumes choosing the most suitable valuation model for these equity instruments, by which the characteristics of the grant have a decisive influence. This assumes also the input into the valuation model of some relevant judgments, like the estimated useful life of the warrant and the volatility. The judgments made and the model used are specified further in note 30.

### Pension obligations

The cost of a defined pension arrangement is determined based on actuarial valuations. An actuarial valuation assumes the estimation of discount rates, estimated returns on assets, future salary increases, mortality figures and future pension increases. Because of the long term nature of these pension plans, the valuation of these is subject to important uncertainties. We refer to note 29 for additional details.

### Impairment of goodwill

Changes in management assumptions on profit margin and growth rates used for cash flow predictions, could have an important impact on the results of the Group. Determining whether goodwill is impaired requires an estimation of the value in use of the cash generating units to which the goodwill has been allocated. The value in use calculation requires the entity to estimate the future cash flows expected to arise from the cash generating unit and a suitable discount rate in order to calculate present value. The carrying amount of goodwill on the balance sheet date was €37.667 (2011: €38,880). An impairment loss was recognized during 2012 related to the goodwill for R&D, because this goodwill was related to programs for which currently no more work is performed (on hold).

Details of the assumptions used in testing goodwill for impairment are given in note 12.

## 36. FINANCIAL RISK MANAGEMENT

We refer to note 5 "Risk factors" of the Report of the Board of Directors for additional details on general risk factors.

### Capital management

The Group manages its capital to ensure that the Group will be able to continue as a going concern. At the same time, the Group wants to ensure the return to its shareholders through the results from its research activities. This strategy has not changed compared to 2011.

The capital structure of the Group consists of financial debt (which currently the Group barely has), cash at bank and in hand and cash equivalents, as mentioned in note 18, and equity attributed to the holders of equity instruments of the Company, such as capital, reserves and results carried forward, as mentioned in the consolidated statement of changes in equity.

The Group manages its capital structure and makes the necessary adjustments in the light of changes of economic circumstances, the risk characteristics of underlying assets and the projected cash needs of the current research activities. The most important parameters used in assessing the capital structure are the current cash situation and the expected cash generation rate: the cash generation is defined as the net result, corrected for depreciations and reduced by investments in fixed assets.

The Group wishes to maintain a capital structure that is sufficient to finance research activities for at least 12 months. For this, cash receipts from possible collaboration or other cash generating contracts, as well as the cash receipts from the services division BioFocus, are taken into account. To keep the capital structure at a certain level, the Group can issue new shares or enter into financing agreements.

The Group is not subject to any externally imposed capital requirements.

### Financial risk management

The financial department of the Company coordinates the access to national and international financial markets and considers and manages continuously the financial risks concerning the activities of the Group. These relate to the credit risk and the currency risk. There are no other important risks, such as liquidity risk or interest rate risk because the Group has nearly no financial debt and has a good cash position. The Group does not buy or trade financial instruments for speculative purposes. The Group primarily attempts to manage the currency risk by closing contracts in local currencies with the other party. These clients are for the most part large pharma groups that typically are better equipped to hedge against a possible exchange rate risk. For the remainder, the Group attempts to manage the currency risk for debt and receivables by matching the gains and costs in a foreign currency.

Categories of material financial assets and liabilities:

| Thousands of € | 2012 | 2011 |
|---|---|---|
| **Financial assets** | | |
| Cash at bank and in hand | 94,647 | 32,555 |
| Trade receivables | 27,876 | 25,048 |
| Other amounts receivable | 2,493 | 2,194 |
| Tax receivables (current and non-current) | 35,476 | 23,081 |
| **Financial liabilities** | | |
| Trade debtors | 22,093 | 18,068 |
| Other amounts payable | 2,367 | 2,253 |
| Leasing debts | 405 | 876 |
| Tax payable | 3 | 616 |



## Credit risk on receivables

The term "credit risk" refers to the risk that a counterparty will default on its contractual obligations resulting in financial loss to the Group. To limit the risk of financial losses, the Group has developed a policy of only dealing with creditworthy counterparties.

Galapagos grants credit to its clients in the framework of its normal business activities. Usually, the Group requires no pledge or other collateral to cover the amounts due. Management continuously evaluates the client portfolio for creditworthiness. All receivables are considered collectable, except for these for which a provision for doubtful debtors has been established.

The trade receivables consist of a limited amount of creditworthy customers, many of which are large pharmaceutical companies, spread over different geographical areas.

Four clients represented 77% of the trade receivables at the end of 2012. The large percentage at year-end was caused by important milestone payments that will be paid in 2013. Other clients with outstanding payables represented less than 10% of the total balance sheet of the Group at the end of 2012. The concentration of the credit risk within the group is influenced strongly by the size of the amounts in the partnering agreements.

The net book value of the financial assets in the financial statements represents the maximum credit risk.

Aging balance of receivables that are due, but that are still considered collectable:

| Thousands of € | 2012 |
|---|---|
| 60 - 90 days | 445 |
| 90 - 120 days | |

### Liquidity risk

The Group's consolidated balance sheet shows an amount of €94,770K as incurred losses. Cash needs are projected on a 3-year rolling forecast basis and are compared with expected available cash balances at the end of each period. These projections are based on realistic assumptions with regard to milestone and upfront payments to be received, taking into account the Company's past track record, including the assumption that not all new projects that are being planned will be realized. On the basis of these projections and sensitivity analysis the Company expects no need for additional external funding for its current operations for at least the next 3 years. The Company could also decide to disinvest from some of its present activities as a means of generating additional cash.

### Market risk: interest rate risk

The Group's financial performance is not subject to any significant interest rate risk. The Company has in its portfolio a CDO for which the "mark to model" value is zero, and which consequently has been fully impaired. Based on the latest information, the tranche in our portfolio of the CDO has not been impacted by settled credit events. Galapagos no longer receives interests on the CDO.

### Market risk: exchange rate risk

The Group's financial performance is subject to exchange rate risk, because part of its purchases is done in US dollars, Swiss Francs, GB Pounds and Croatian Kuna. To limit this risk, the Group attempts to align incoming and outgoing cash flows in currencies other than EUR. In addition, contracts closed by the different entities of the Group are mainly in the functional currencies of that entity. The exchange rate risk within the Group is therefore almost exclusively caused by the intra-group transactions between entities with a different functional currency. In order to further reduce this risk, Galapagos implemented a netting system within the group in the course of 2012, which restrains intra-group payments between entities with a different functional currency.

The exchange rate risk in case of a 10% change in the exchange rate amounts to:

| Net book value - Thousands of € | 31/12/2012 | 31/12/2011 |
|---|---|---|
| Euros - US Dollars | 507 | 503 |
| Euros - GB Pounds | 927 | 977 |
| Euros - CH Francs | 93 | 371 |
| Euros - HR Kunas | 1,146 | 682 |
| CH Francs - GB Pounds | 95 | 21 |
| HR Kunas - GB Pounds | 5 | 4 |
| US Dollars - GB Pounds | 807 | 808 |

The magnitude of the amounts on 31 December 2012 has increased mainly in the conversion Euros – HR Kunas, despite a decrease in the conversion Euros – CH Francs.

## 37. AUDIT FEES

The statutory auditor's fees for carrying out the statutory auditor's mandate on the level of the Group headed by Galapagos NV amounted to €88,850 in 2012 (2011: €80,250). The fees for exceptional services or special missions executed by the statutory auditor, in particular other control missions, amounted to €12,863 in 2012 (2011: €5,510). Fees for persons related to the statutory auditor for carrying out an auditor's mandate on the level of the group headed by Galapagos NV amounted to €111,150 in 2012 (2011: €119,750). The fees paid in 2012 for exceptional services or special missions executed in this Group by persons related to the statutory auditor for tax and consultancy amounted to €126,087 (2011: €76,328 for tax consultancy). The Audit Committee and the Board of Directors are of the opinion that these ad hoc activities do not affect the independence of the statutory auditor in the performance of his statutory duties. The majority of the abovementioned additional fees were approved in advance by the Audit Committee. The one to one rule was complied with.



## 38. EVENTS SUBSEQUENT TO THE BALANCE SHEET DATE

Galapagos announced the following significant events after 31 December 2012:

- 9 January: Galapagos delivers candidate drug in GSK alliance and receives milestone payment (included in 2012 revenues)
- 10 January: Galapagos receives €2.7 million IWT grant for antibacterial research (not included in 2012 revenues)
- 15 January: Galapagos creates Fidelta, a third Galapagos service division
- 15 January: Galapagos acquires Cangenix, a structure-based drug discovery company
- 16 January: Galapagos delivers candidate drug in its alliance with Janssen Pharmaceutica NV and receives €4 million milestone payment (included in 2012 revenues)
- 30 January: Galapagos receives €2.5 million IWT grant for IBD research (not included in 2012 revenues)
- 5 February: Galapagos announces GSK2586184 JAK1 molecule progresses to Phase 2 studies
- 4 March: Katrine Bosley appointed to Galapagos' Board of Directors as of 27 February 2013 and resignation of Ferdinand Verdonck effective 26 February 2013
- 6 March: Galapagos receives €7.5 million in Servier alliances (included in 2012 revenues)
- 8 March: Galapagos and Roche conclude strategic alliance and Galapagos receives a payment of €5.75 million for work completed in 2012 (included in 2012 revenues)

# **Report** of the statutory auditor

**Galapagos NV**
**Statutory auditor's report to the shareholders' meeting**
**on the consolidated financial statements for the year ended 31 December 2012**

To the shareholders
As required by law, we report to you on the performance of our mandate of statutory auditor. This report includes our report on the consolidated financial statements as defined below together with our report on other legal and regulatory requirements.

**Report on the consolidated financial statements – Unqualified opinion**
We have audited the accompanying consolidated financial statements of Galapagos NV ("the company") and its subsidiaries (jointly "the group"), prepared in accordance with International Financial Reporting Standards as adopted by the European Union and with the legal and regulatory requirements applicable in Belgium. These consolidated financial statements comprise the consolidated statement of financial position as at 31 December 2012, the consolidated income statement, the consolidated statement of comprehensive income, the consolidated statement of changes in equity and the consolidated statement of cash flows for the year then ended, as well as the summary of significant accounting policies and other explanatory notes. The consolidated statement of financial position shows total assets of 235.329 (000) EUR and the consolidated income statement shows a consolidated loss for the year then ended of 5.721 (000) EUR.

*Responsibility of the board of directors for the preparation of the consolidated financial statements*
The board of directors is responsible for the preparation and fair presentation of consolidated financial statements in accordance with International Financial Reporting Standards as adopted by the European Union and with the legal and regulatory requirements applicable in Belgium, and for such internal control as the board of directors determines is necessary to enable the preparation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

*Statutory auditor's responsibility*
Our responsibility is to express an opinion on these consolidated financial statements based on our audit. We conducted our audit in accordance with International Standards on Auditing. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the statutory auditor's judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the group's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the group's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by the board of

directors, as well as evaluating the overall presentation of the consolidated financial statements. We have obtained from the company's officials and the board of directors the explanations and information necessary for performing our audit.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

*Unqualified opinion*
In our opinion, the consolidated financial statements of Galapagos NV give a true and fair view of the group's net equity and financial position as of 31 December 2012, and of its results and its cash flows for the year then ended, in accordance with International Financial Reporting Standards as adopted by the European Union and with the legal and regulatory requirements applicable in Belgium.

**Report on other legal and regulatory requirements**
The board of directors is responsible for the preparation and the content of the directors' report on the consolidated financial statements.

In the framework of our mandate, our responsibility is to verify, for all significant aspects, the compliance with some legal and regulatory requirements. On this basis, we provide the following additional comment which does not modify the scope of our audit opinion on the consolidated financial statements:

- The directors' report on the consolidated financial statements includes the information required by law, is, for all significant aspects, in agreement with the consolidated financial statements and is not in obvious contradiction with any information obtained in the performance of our mandate.

Kortrijk, 25 March 2013

**The statutory auditor**

(signed)

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**DELOITTE Bedrijfsrevisoren / Reviseurs d'Entreprises**
BV o.v.v.e. CVBA / SC s.f.d. SCRL
Represented by Gino Desmet

# **Non-consolidated** Financial Statements

## CONDENSED NON-CONSOLIDATED (STATUTORY) ANNUAL ACCOUNTS

### GALAPAGOS NV STATEMENT OF PROFIT AND LOSS

| Thousands of € on 31 December | 2012 | 2011 |
|---|---|---|
| Turnover | 45,981 | 26,509 |
| Internally generated intangible assets | 74,450 | 61,380 |
| Other operating income | 13,282 | 8,818 |
| **Operating income** | **133,713** | **96,707** |
| Raw materials, consumables and goods for resale | -3,423 | -3,852 |
| Services and other goods | -71,304 | -69,205 |
| Remuneration, social security costs and pensions | -11,795 | -9,809 |
| Depreciation, impairment and other amounts written off on constitution costs, intangible and tangible assets | -45,490 | -33,710 |
| Other operating charges | -1,713 | -2,093 |
| **Operating profit/loss (-)** | **-12** | **-21,962** |
| Finance income | 3,117 | 1,760 |
| Finance cost | -860 | -1,558 |
| **Result on ordinary activities before taxes** | **2,245** | **-21,760** |
| Extraordinary income | | 3 |
| Extraordinary cost | -29,477 | -10,728 |
| **Result before taxes** | **-27,232** | **-32,485** |
| Taxes | | |
| **Result for the year** | **-27,232** | **-32,485** |
| Loss brought forward | -88,055 | -55,570 |
| **Result to be carried forward** | **-115,287** | **-88,055** |

## GALAPAGOS NV BALANCE SHEET ON DECEMBER 31

### Assets

| Thousands of € on 31 December | 2012 | 2011 |
|---|---|---|
| **Non-current assets** | **185,982** | **185,966** |
| Intangible assets | 100,553 | 98,314 |
| Property, plant and equipment | 3,233 | 3,306 |
| Financial Fixed Assets | 82,196 | 84,346 |
| **Current assets** | **110,482** | **62,055** |
| Inventories | 204 | 206 |
| Trade and other receivables | 38,652 | 55,162 |
| Cash and cash equivalents | 71,626 | 6,687 |
| **Total assets** | **296,464** | **248,021** |

### Equity and liabilities

| Thousands of € on 31 December | 2012 | 2011 |
|---|---|---|
| **Equity** | **98,600** | **122,627** |
| Share capital and reserves | 144,816 | 142,929 |
| Share premium account | 66,916 | 66,061 |
| Accumulated losses | -115,287 | -88,055 |
| Investment grants | 2,155 | 1,693 |
| **Liabilities** | **197,864** | **125,394** |
| **Non-current liabilities** | **573** | **855** |
| Obligations under finance lease (non-current) | 165 | 495 |
| Other liabilities | 408 | 360 |
| **Current liabilities** | **197,291** | **124,539** |
| Trade and other payables | 46,033 | 68,551 |
| Obligations under finance lease (current) | 204 | 188 |
| Tax, payroll and social security liabilities | 2,370 | 1,920 |
| Other liabilities | 148,684 | 53,880 |
| **Total equity and liabilities** | **296,464** | **248,021** |

# Glossary

**ACR20**
American College of Rheumatology 20% response rate signifies a 20% or greater improvement in the number of swollen and tender joints as well as a 20% or greater improvement in three out of five other disease-activity measures

**ADR**
American Depositary Receipt; Galapagos has a Level 1 ADR with ticker symbol GLPYY and CUSIP number 36315X101, which is traded over the counter on the Pink Sheets. One ADR is equivalent to one ordinary share in Galapagos NV

**Attrition rate**
The historical success rate for drug discovery and development, based on publicly known development paths. Statistically seen, investment in at least 12 target-based programs is required to ensure that at least one of these will reach a Phase 3 study. Most new drug R&D programs are discontinued before reaching Phase 3 because they are not successful enough to be approved

**Bioavailability**
Assessment of the amount of (candidate) drug that reaches a body's systemic circulation after administration

**Biomarker**
Substance used as an indicator of a biological state, particularly to monitor a biological response to a candidate drug

**Black & Scholes model**
A mathematical description of financial markets and derivative investment instruments that is widely used in the pricing of European options and warrants

**Cachexia**
Loss of appetite, weight and muscle mass in persons who are not actively trying to lose weight; it can be a symptom of underlying illnesses such as cancer, COPD and age-related disorders

**Candidate drug**
Substance that has satisfied the requirements of pre-clinical testing and has been selected for clinical testing for the treatment of a certain disorder in humans

**CDO**
Collateralized debt obligation; a type of structured asset-backed security (ABS) whose value and payments are derived from a portfolio of fixed-income underlying assets

**CGU**
Cash-generating unit; the smallest recognizable group of assets which generates entries of finance largely independent from entries of finance generated with the other assets or group of assets

**CIR**
Credit Impot Recherche, or research credit. Under the CIR, the French government refunds up to 30% of the annual investment in French R&D operations, over a period of three years. Galapagos benefits from the CIR through its operations in Romainville, just outside Paris.

**Clinical Proof of Concept (PoC)**
Point in the drug development process where the candidate drug shows efficacy in a therapeutic setting

**CODM (Chief Operating Decision Maker)**
Within Galapagos it has been identified as the Executive Committee

**Compound**
A chemical substance, often a small molecule with drug-like properties

**Compound repository services**
The selection, formatting, storage, processing and delivery of compounds, which are owned by government, academic and commercial organizations

**Contract research organization**
Organization which provides drug discovery and development services

**COPD**
Chronic obstructive pulmonary disease; chronic lung disease characterized by difficulty breathing and persistent coughing; includes the diseases commonly referred to as chronic bronchitis and emphysema

**CRP**
C-reactive protein is a protein found in the blood, the levels of which rise in response to inflammation

**Cystic fibrosis**
A life-threatening genetic disease that affects approximately 70,000 people worldwide. Although the disease affects the entire body, difficulty breathing is the most serious symptom as a result of frequent lung infections

**DAS28**
DAS28 is an RA Disease Activity Score based on C-reactive protein, tender and swollen joint counts of 28 defined joints and physician's global health assessment

**Development**
Process of bringing a new drug to the market. At Galapagos, this is the department which performs pre-clinical and clinical development research, clinical batch scale-up, and regulatory filings of Galapagos' drug candidates

**Discovery**
Process by which new medicines are discovered and/or designed. At Galapagos, this is the department that oversees target and drug discovery research through to nomination of pre-clinical candidates

**Disease-modifying**
Addresses the cause of disease and modifying the disease progression, not just the symptoms of the disease

**Downstream milestones**
The downstream milestones are for successes at key decision making points in the alliance, i.e. selection of a pre-clinical candidate, start of a clinical research study, regulatory filings and approvals, and achievement of commercial sales goals

**Drug development**
Process of bringing a new drug to the market; includes both pre-clinical development and human clinical trials

**Drug discovery**
Process by which a (potential) therapeutic is either discovered or designed

**Efficacy**
Effectiveness for intended use

**FDA**
The Food and Drug Administration is an agency responsible for protecting and promoting public health

**Fee-for-service**
Payment system where the service provider is paid a specific amount for each procedure or service performed

**FIH**
First-in-human clinical trial, usually conducted in healthy volunteers with the aim to assess the safety, tolerability and bioavailability of the candidate drug

**FSMA**
The Belgian market authority: Financial Services and Markets Authority, or Autoriteit voor Financiële Diensten en Markten

**FTE**
Full-time equivalent; a way to measure a worker's involvement in a project. For example, an FTE of 1.0 means that the equivalent work of one full-time worker was used on the project

**GLPG0187**
Galapagos candidate drug being developed for treatment of cancer metastasis; currently in a Phase 1b patient study

**GLPG0555**
First candidate drug from Galapagos' arthritis alliance with GlaxoSmithKline; inlicensed by GSK in 2012

**GLPG0634**
Small molecule selective JAK1 inhibitor which showed excellent efficacy and safety in rheumatoid arthritis patients in Phase 2 trials in November 2011 and November 2012, partnered with AbbVie in 2012

**GLPG0778**
Second candidate drug from Galapagos' arthritis alliance with GlaxoSmithKline, inlicensed by GSK in 2012. This program is now called GSK2586184 and is currently in Phase 2 studies in lupus and psoriasis

**GLPG0974**
Galapagos candidate drug targeting GPR43, which plays a key role in Inflammatory Bowel Disease: currently in a Phase 1 multiple ascending dose study in healthy volunteers

**GSK2586184**
Previously known as GLPG0778, GSK2586184 is a second candidate drug from Galapagos' arthritis alliance with GlaxoSmithKline, inlicensed by GSK in 2012. This program is currently in Phase 2 studies in lupus and psoriasis

**Infectious diseases**
Diseases that are caused by pathogenic micro-organisms such as bacteria, viruses, parasites or fungi

**Inflammatory diseases**
A large, unrelated group of disorders associated with abnormalities in inflammation

**In-/out-licensing**
Receiving/granting permission from/to another company or institution to use a brand name, patent, or other proprietary right, in exchange for a fee and/or royalty

**Intellectual property**
Creations of the mind that have commercial value and are protected by patents, trademarks or copyrights

**Intersegment**
Occurring between the different operations of a company

**Investigational New Drug (IND) application**
United States Federal law requires a pharmaceutical company to obtain an exemption to ship an experimental drug across state lines, usually to clinical investigators, before a marketing application for the drug has been approved. The IND is the means by which the sponsor technically obtains this exemption

**JAK**
Janus kinases (JAK) are critical components of signaling mechanisms utilized by a number of cytokines and growth factors, including those that are elevated in rheumatoid arthritis

**Metastasis**
Transmission of cancerous cells from a primary site (usually a tumor) to one or more sites elsewhere in the body

**Milestone**
Major achievement in a project or program; in Galapagos' alliances, this is usually associated with a payment

**Molecule collections**
Chemical libraries, usually consisting of drug-like small molecules that are designed to interact with to specific target classes. These collections can be screened against a target to generate initial "hits" in a drug discovery program

**MRSA**
Methicillin-resistant *Staphylococcus aureus* is a strain of *Staphylococcus aureus* that is resistant to methicillin. It causes a potentially life-threatening infection that occurs most frequently among patients in hospitals

**Oral dosing**
Administration of medicine by the mouth, either as a solution or solid (capsule, pill) form

**OTC**
"Over the Counter" which means trading directly between two parties. In the U.S., over the counter trading in stocks is carried out via market makers who use quotation services such as the OTC Bulletin Board (OTCBB) and the Pink Sheets. The US over-the-counter market is monitored by the NASD. Galapagos' Level 1 ADR is traded over the counter under ticker symbol GLPYY on the Pink Sheets in the US, www.pinksheets.com

**Outsourcing**
Contracting work to a third party

**Pharmacokinetics (PK)**
Study of what a body does to a drug; the fate of a substance delivered to a body

**Phase 1**
First stage of clinical testing of a potential new treatment designed to assess the safety and tolerability of a drug, usually performed in a small number of healthy human volunteers

**Phase 2**
Second stage of clinical testing, usually performed in 20-300 patients, in order to determine efficacy, tolerability and the most effective dose to use

**Phase 3**
Large clinical trials, usually conducted in 300-3000 patients to gain a definitive understanding of the efficacy and tolerability of the candidate treatment by comparing it to the "gold standard" treatment; serves as the principle basis for regulatory approval

**Pre-clinical**
Stage of drug research development, undertaken prior to the administration of the drug to humans. Consists of *in vitro* and *in vivo* screening, pharmaco-kinetics, toxicology, and chemical upscaling

**Pre-clinical candidate (PCC)**
A potential drug that meets chemical and biological criteria to begin the development process

**Psoriasis**
Psoriasis is an immune-mediated disease that affects the skin. It is caused by the immune system being mistakenly triggered, resulting in overproduction of new skin cells

**Rheumatoid arthritis (RA)**
A chronic, systemic inflammatory disease that causes joint inflammation, and usually leads to cartilage destruction, bone erosion and disability

**R&D operations**
Research and development operations; unit responsible for discovery and developing new candidate drugs for internal pipeline or as part of risk/reward sharing alliances with partners

**Screening**
Method usually applied at the beginning of a drug discovery campaign, where a target is tested in a biochemical assay against a series of small molecules or antibodies to obtain an initial set of "hits" that show activity against the target. These hits are then further tested or optimized

**Service operations**
Business unit primarily focused on delivering products and conducting fee-for-service work for clients. Since February 2010, Galapagos' service operations include the BioFocus and Argenta business units

**SilenceSelect®**
Galapagos' proprietary collection of arrayed adenoviruses, effective in knock-down human genes in primary cells to identify novel drug targets. This technology forms the basis of Galapagos' target

discovery engine

**Systemic Lupus Erythematosus**
*Systemic Lupus Erythematosus (SLE)* is an autoimmune disease characterized by inflammation of many parts of the body. This inflammation is caused by the immune system that mistakenly attacks healthy cells, leading to tissue damage

**Target**
Protein that has been shown to be involved in a disease process and forms the basis of therapeutic intervention or drug discovery

**Target discovery**
Identification and validation of proteins that have been shown to play a role in a disease process

**Technology access fee**
License payment made in return for access to specific technology (e.g. compound or virus collections)

**Ussing Chamber**
Ussing chamber is a scientific tool used to measure the current as an indicator of ion transport taking place across an epithelium

**Galapagos NV**
Generaal De Wittelaan L11 A3
2800 Mechelen
Belgium
Tel: +32 15 34 29 00
Fax: +32 15 34 29 01
E-mail: ir@glpg.com

**Careers**
E-mail: jobs@glpg.com
www.glpg.com/careers/jobs.htm

**www.glpg.com**