Sinovac Biotech Ltd.
Second Quarter 2014 Earnings Conference Call
August 15, 2014

Operator: Greetings and welcome to the Sinovac Biotech Ltd. Second Quarter 2014 Earnings Conference Call. At this time, all participants are in a listen-only mode. A question-and-answer session will follow the formal presentation. If anyone should require operator assistance during the conference, please press star, zero, on your telephone keypad. As a reminder, this conference is being recorded.

It is now my pleasure to introduce your host, Katherine Knight from ICR. Thank you. You may begin.

Katherine Knight: Thank you, Operator, and good day, everyone.

Before we begin, I would like to remind everyone that this conference call contains forward-looking statements. These statements are made under the Safe Harbor Provisions of the US Private Securities Litigation Reform Act of 1995. These forward-looking statements can be identified by words or phrases such as will, expect, anticipate, future, intends, plans, believes, estimates, and similar statements. These statements that are not historical facts, including statements about Sinovac's beliefs and expectations are forward-looking statements. Forward-looking statements involve inherent risks and uncertainties. A number of important factors could cause actual results to differ materially from those contained in any forward-looking statements. Sinovac does not undertake any obligation to update any forward-looking statements except as required by applicable laws.

On the call today we have Mr. Weidong Yin, CEO; Ms. Nan Wang, CFO; Ms. Helen Yang, Investor Relations Director and Mr. Shuo He, Finance Director.

I will now turn the line over to Helen Yang. Go ahead, please, Helen.

Helen Yang: Thank you, Katherine, and hello, everyone, and thank you for joining us. On today's conference call, I will provide an update on Sinovac's business and operations during the second quarter, and then I will review our second quarter financial results on behalf of our CEO and CFO.

As we reported yesterday, in our earnings release, during the second quarter, we were operating in a challenging external market environment as demand for vaccines remained soft following an incorrect report related to hepatitis B vaccine late last year. While this situation was not directly

related to Sinovac's vaccines, it did soften overall vaccine demand in the private pay sector in China, which is where we generate the majority of our revenues.

During the second quarter, our total sales decreased by 30.7% to $12.1 million from $17.5 million during the same period in 2013. This decrease in year-over-year quarterly sales is accentuated by the record high sales that we experienced in second quarter last year relative to historical second quarter sales. For the first six months of 2014, our sales decreased by 6.8% year-over-year to $25.6 million from $27.5 million.

As we have discussed, there has been decreased demand for vaccines in private pay markets after a report late 2013 that incorrectly attributed that in Southern China to hepatitis B vaccine. While Sinovac's vaccines were not implicated in the report, and following an extensive investigation, China's Ministry of Health and World Health Organization concluded that the vaccine was not the cause of the deaths.

Nevertheless, there has still been a greater reluctance from parents to have their children vaccinated in the past six months. At the same time, the Centers for Disease Control across China took more conservative approach to their vaccination programs during these sensitive times than they have in the past.

As usual, revenue for the first six months of the year was driven primarily by sales of both of our hepatitis A vaccine, Healive, and our combined hepatitis A and B vaccine, Bilive.

Healive sales decreased by 27% in the second quarter and 12% for the first six months overall, which was mainly caused by these untrue reports. Bilive sales decreased by 33% in the second quarter from the same period last year and 1% in the first six months, because this year local CDCs shift their vaccination campaign from the second quarter to the first quarter. Consequently, revenue from sales for this campaign was largely recognized in the first quarter of 2014.

While our sales to the private market were lower in the second quarter, our sales to the public market remained stable on a year-over-year basis. As we have reported, we received two tenders in Beijing to supply Healive and the seasonal flu vaccine, Anflu, again this year. We will record a revenue of these tenders in the second half of 2014.

While we are currently facing short-term challenges in the Chinese vaccine market, we are still confident in our ability to execute our proven sales and marketing strategies and continue expanding our sales channels.

We expect year-over-year top line growth in the second half of 2014, and for the full-year 2014, we expect sales of our core products, including Healive, Bilive and Anflu, to be comparable to 2013 with potential for year-over-year growth.

Now, I would like to update you on our progress related to the export market. As we have mentioned on the previous calls, we obtained our commercialization license of Anflu in Mexico late last year. In early July, we delivered our first order of 150,000 doses of Anflu to Mexico. These doses will be distributed in the second half of the year for the 2014 to 2015 flu season.

We will use these first order and shipment processes to identify and resolve any issues associated with long-distance shipping and Mexican custom procedures so that we are prepared to fulfill larger orders in the future. This is a solid milestone for the Company as it continues to expand in the international markets.

Additionally, there was a favorable change to our value-added tax rate in the second half of the year. The VAT rate was reduced from 6% to 3% as of July the first 2014. While this did not factor into our second quarter results, the reduced VAT rate will contribute to an improvement in the profitability of Sinovac's vaccine in the private pay market.

Now, turning to updates on our research and development. On June 18, we submitted supplementary statistical data from our EV71 vaccine clinical trial to China's Centers for Drug Evaluation. If the CDE does not require further documentation, the next step will be to organize an expert review panel followed by an on-site facility inspection from the CFDA if the expert review panel goes well.

During the first six months 2014, the incidence of hand, foot and mouth disease, a condition that can be caused by EV71 was unusually high. According to the Ministry of Public Health, there were 1.69 million cases of hand, foot and mouth disease reported in the first half of the year, and among which 334 cases were fatal. During the same period in last year, there were fewer than 910,000 reported cases and only 156 of which were fatal.

Although we have not been given a clear timeline for the approval of our EV71 vaccine, we have seen the CFDA working closely with China's National Centers for Disease Control to develop vaccination strategies for EV71 in light of the recent outbreak.

In July, we received RMB20 million out of the RMB60 million government grant we were awarded for construction of a dedicated EV71

vaccine production facility. The government will provide the remaining RMB40 million once specific construction and approval criteria are met.

Also, during the second quarter, we received the clinical trial approval for our pneumococcal polysaccharide vaccine, or PPV. This is Sinovac's first bacterial vaccine. The successful development of these vaccines will mark the expansion of the Company's technical capabilities to both viral and bacterial vaccines. We have already selected a site for the clinical trial and our drug proposal is currently under expert review. We expect the clinical trials to begin by the end of this year following approval by an ethics committee.

In summary, although we experienced a challenging market environment in the second quarter, we expect these conditions will be short term and our pipeline products to be significant driver for the growth as they are approved for commercialization.

With that, I would now like to review our unaudited financial results for the second quarter and first six months ended June 30th, 2014.

In the second quarter 2014, total sales were $12.1 million, a decrease of 30.7% from $17.5 million during the same period in 2013. Gross profit was $9.1 million in the second quarter 2014, compared to $13.6 million in the prior-year period. Gross margin decreased to 75% from 77.9% in the prior-year period.

Selling, general and administrative expenses for the second quarter 2014 were $8.6 million, compared to $8.8 million in the same period of 2013.

R&D expenses for the second quarter of 2014 were $3.3 million, a $1.2 million increase over the same period in 2013. These expenses are primarily related to the continued advancement of pipeline vaccine candidates, including Sabin Inactivated Polio Vaccine, EV71, PPV, and varicella vaccine.

Net loss attributable to common stockholders for the second quarter of 2014 were $2.2 million, or $0.04 per basic and diluted share, compared to net income attributable to common stockholders of $1.3 million, or $0.02 per basic and diluted share, in the period of last year.

Now looking at the first half of 2014, total sales for the first half of 2014 were $25.6 million, a decrease of 6.8% from $27.5 million in the same period of 2013.

Gross profit for the first half of 2014 were $19.3 million, a decrease of 6.4% from $20.7 million in the same period of 2013. Gross margin was 75.4% in the first half of this year, compared to 75.1% in the same period of last year.

Selling, general and administrative expenses for the first half of 2014 were $16.4 million, compared to $15.9 million for the same period of 2013.

R&D expenses in the first half of this year were $5 million, compared to $3.9 million in the same period of last year. These expenses are primarily related to the continued advancement of our pipeline vaccine candidates.

Net loss attributable to stockholders in the first half of 2014 were $2.2 million, or $0.04 per basic and diluted share, compared to a net loss of $0.7 million, or $0.01 per basic and diluted share, in the same period of last year.

As of June 30th, 2014, cash and cash equivalents totaled $89.6 million, compared to $107.2 million as of December 31st, 2013. Net cash used in operating activities were $11.4 million during the first half of 2014, and net cash used in investing activities were $5.7 million, which was primarily used for the payment of property, plant and equipment for the Company's Changping facility.

Net cash provided by financing activities were $0.9 million during the first half of 2014, including loan proceeds of $8.9 million and loan repayment of $8.5 million.

As of June 30th, 2014, the Company had $36 million of bank loans due within one year. Sinovac's cash and cash equivalents position of $89.6 million is sufficient to meet both these loan repayment obligations as well as the Company's operational requirements.

With that, we conclude the management prepared remarks. Operator, we will now take questions. Thank you.

Operator: Thank you. Ladies and gentlemen, at this time, we will now be conducting a question and answer session. If you would like to ask a question, please press star, one on your telephone keypad. A confirmation tone will indicate your line is in question queue. You may press star, two if you'd like to remove your question from the queue. For participants using speaker equipment, it may be necessary to pick up your handset before pressing the star keys.

Our first question comes from the line of Isabella Zhao with Morgan Stanley. Please proceed with your question.

Isabella Zhao: Thank you for taking my question. (Chinese spoken).

I will translate that question into English. First one is for Mr. Yin and I want to ask the current market environment and also the competitive environment and how long it will last and what's the impact for the 3Q sales? The second question is for the R&D expenses. Given the fact that R&D has been—expenses increased a lot, I want to get a sense of what kind of ratio we are looking at in the second half of the year? The third question is on the EV71 progress. Can the management give us an update on when we will expect this gets approved and are we still looking for the end of 2014? Essentially those are my questions.

Weidong Yin: (Chinese spoken).

Helen Yang: So Mr. Yin answered your first question, because from Mr. Yin's perspective, the overall vaccine market this year didn't show a growing trend, and he thinks that this is due to an external environment and also due to the economic condition of entire China market. Actually for the government income, it was not increased as well. So we didn't see any increased spending on buying more vaccines.

As you mentioned, the hepatitis B vaccine incidents, actually Mr. Yin thinks that it's a short-term event. It will impact our sales in the second quarter, but he also believes that for the vaccine sales it's not proper to only evaluate a vaccine sales quarter-by-quarter, maybe we should be looking at the sales in the whole-year period.

So, for the overall market, Mr. Yin thinks that we would—we think that the vaccine market is still comparable to last year. So for our objective in the second half, we will be making additional efforts to drive up the growth with our hepatitis A and B vaccine, and at the same time we will maintain the sales of our hepatitis A Anflu vaccine at least comparable to last year.

Weidong Yin: (Chinese spoken).

Helen Yang: Regarding to the research and development, actually EV71 is one of the most important projects within the Company, and actually in the past month, the Company kept updating the progress in our research and development progress on these projects. Actually in this year we made a lot of efforts to assisting the Centers for Disease Control on setting out the vaccination strategies of using this vaccine to control the disease epidemic in China.

Also we keep a good dialogue with the CFDA on the approval processes and also answering the technical questions. Actually also due to the severity of this disease in this year, actually the MOH and CDC has the same expectation as what we have to commercialize the vaccine and start to use it to control the disease epidemic as soon as we can.

Regarding to the timeline that you asked, actually that's also our objective; however, right now this process is still out of our control. We will make the efforts towards that goal, but we cannot give a short answer whether that could be realized or not, but we will do whatever we can.

Weidong Yin: (Chinese spoken).

Helen Yang: So you asked about the R&D expenses, but Mr. Yin wants to highlight on our key projects in R&D programs. The first one is the sIPV program that we licensed from an entity with the support from WHO. Actually this is a—besides the EV71, this is another important project for the Company. We have already completed the execution of the agreement and also we obtained (inaudible). So the R&D team is working very hard right now on the preclinical study at the moment. Our objective is to have this vaccine enter into the clinical phase as soon as we can.

So second project—or the second progress we made is on the pneumococcal polysaccharide vaccine. As we reported, that we obtained a clinical license already, and also the Company made investments to build up the facilities right now. So, overall for the second half, we don't expect the R&D expenses will be a lot higher than the first half, probably comparable to what we have spent on R&D in the first half.

Did we answer your question?

Isabella Zhao: Yes, thanks for taking my questions. Thank you, yes.

Helen Yang: You're welcome.

Operator: Thank you. As a reminder, ladies and gentlemen, if you would like to ask a question, please press star, one on your telephone keypad at this time.

Our next question is coming from the line Yi Chen with Aegis Capital. Please proceed with your question.

Yi Chen: Hi. Thank you for taking my questions. First of all, Helen, can you remind me what you just said about recently there has been new data to CFDA regarding EV71, what date was that?

Helen Yang: It is the statistical data from our clinical study.

Yi Chen: When did you submit it?

Helen Yang: June 18.

Yi Chen: June 18?

Helen Yang: Yes.

Yi Chen: Also recently I think Hualan Bio announced that they have submitted a clinical trial application for their EV71 vaccine. So can you remind us how much time it took Sinovac from application for clinical trial to completion of the clinical trial?

Helen Yang: From application until the completion?

Yi Chen: Right.

Helen Yang: I think we submitted the application by the end of 2009, and we obtained the license to—actually the green light to start conduct the trial by the end of 2010, and then we took about two years to complete the three phases of clinical studies. So, basically at least three years I think.

Yi Chen: Okay.

Helen Yang: That's actually under fast-track approval processes.

Yi Chen: Right, right. Okay. Can you also comment on your pricing strategy in international markets? Are they priced the same?

Weidong Yin: (Chinese spoken).

Helen Yang: So Mr. Ying answered your question that actually for international expansion is always one part of our strategy, and we have—take years to register our vaccines in other developing countries. Like for example, as we mentioned for Mexico, we have obtained the license for commercializing Anflu, and we already shipped the first order even though it's not that big, but actually originally when we planned in the first half, we and our partner in Mexico are expecting a bigger order, but we think it's good to take a conservative approach for the first shipments that we can go through the entire processes to see is there any issues to stop us—to prevent any loss if we ship a big volume.

Also in first half we also had an opportunity to participate into the government tender for remittance (ph) of vaccines we can supply from other developing countries like in Turkey. Even though, we are new

to that market and we are not able to finalize the order in time, but we think for the overseas market there are demand over there, and our goal is to improve the utilization of our facilities with the expanded volume produced and supplied to the overseas markets and then we can lower down the costs and also that would be a good complementary market to our domestic sales. That's why for the overseas market we are looking at a mid-level of price and also we were looking at a higher volume.

Yi Chen: Thank you. About the 2014 revenue guidance, you said that you expect for your core products, which is hepatitis and influenza vaccines, you can—you expect to have a comparable or maybe a bit higher revenue numbers than 2013. Does that already include the VAT rate reduction effect?

Helen Yang: (Chinese spoken).

That is—it's already included. I think because this year is only half a year impact but—only half year.

Yi Chen: Right, right, I know. Okay, thank you.

Helen Yang: You're welcome.

Operator: Thank you. The next question is coming from the line of John Gregory with SJ Strategic Investments. Please proceed with your questions.

John Gregory: Good morning. My question is in regard to EV71 pricing. As you get closer to approval and commercial launch, do you expect the pricing to have gross margins similar to what hepatitis vaccine has, or more than that or less than that?

Weidong Yin: (Chinese spoken).

Helen Yang: I think for pricing of EV71, we think that these—the level price will be only finalized after we obtain the sales license. However that Mr. Yin explains that actually right now in Chinese market, we have seen some vaccines which is priced at a very high level and also with a very good demand like for the 7-valent PCV supplied by Pfizer and also the pentavalent vaccine supplied by Sanofi, they're all priced at more than $100 per dose in China, and actually with that price level, they can sell up to 1 million does.

Therefore, we think for EV71, at least this is the first of this kind to be commercialized worldwide, and also we invest quite a lot in R&D and facilities. That's why at the beginning we would expect to price this vaccine at a (inaudible) level and to start expand the sales—start from the tier 1

areas. So that's the current thought and our teams keep assessing the market demand—actually the relation between the demand and the price levels, and they will keep updating their analysis to the senior management team, but only final decision will be made after the vaccine is commercialized.

John Gregory: Okay. In regards to approval of the EV71 vaccine, I know you made the filing in May of 2013, so it's going on 15 months. In the US, it usually takes 12 months to get a new NDA approved. Is the reason it's taking so long is because they're trying to approve all three manufacturers at the same time, or it would seem like because the disease is kind of serious that they would be—they would want to approve the vaccine as soon as possible, so I can't understand why it's taking so long?

Helen Yang: Well, firstly I'll translate your question to Mr. Yin.

(Chinese spoken).

Weidong Yin: (Chinese spoken).

Helen Yang: Actually Mr. Yin says he has the same expectations as you have, because we do see urgent demand for this vaccine to control the disease, however that also EV71, this is the first again—first of this kind and even for China's FDA, CFDA, it is the first time—almost the first time for them to evaluate a vaccine which never been approved and reviewed by any other country in the past.

Actually Mr. Yin is saying even in US, maybe for such a vaccine, it may take relatively long period of time for evaluating thoroughly about the research and development and analysis whether it's sufficient to approve the product.

Actually he refer an example for your information that when we're trying to publish our Phase 3 clinical study publication, it took us about one year for the New England Journal of Medicine to review and approve and then finally publish the publication, so compared to that for the FDA to take about 15 months or even longer to review entirely the—all technical aspect of the vaccine starting from pre-clinical studies and all the clinical research.

It really needs that long period of time, and also, of course, comparison among the three companies, is also one important part of their technical review because again this is the first of this kind. They don't want to do it very rush. That's why we think this is the—it's not abnormal for them to take such a long time, but still recently we see some good progress made by them, that's why we would expect to have some good news or good progress to be announced or shared with investors in the near future.

John Gregory: Well, I guess just a comment on that is that I can understand what you're saying, but you had excellent Phase 3 results, you did get the study published in the most prestigious journal in the world, I don't know how often that's ever happened by a Chinese company and you have a serious situation going on, it just seems like to me it would be something that the China FDA would want to get approved as quick as possible. But anyhow another question. In regards to the Anflu that you're selling to Mexico, is that because your distributor is bidding or has won a government tender or is he ordering Anflu just to sell to the private pay?

Helen Yang: Actually for Mexico market, we intend to participate into the government tender because that's the major market demand in Mexico for flu vaccines, but at the same time they also have a private pay sector which is a relatively small amount, but for this time the first order we supplied, that is only to the private pay sector because we want to take (ph) the processes and if anything happens we don't have to—having any bad relationship with the government, so we would take the private pay market first, but in the future our goal is to enter into the tender market.

John Gregory: I guess I would assume that if you win a tender in the government market, you will make that announcement. I mean you didn't make the announcement in July that you sold your first order to Mexico, which seems significant to me, but I would assume that if you do win a tender in Mexico, you'll put a press release out on that, won't you?

Helen Yang: Yes, he says winning a tender, that's when we'll put out a press release.

John Gregory: Okay. All right. Thank you very much.

Helen Yang: Thank you.

Operator: Thank you. As a final reminder, ladies and gentlemen, to ask a question, please press star, one on your telephone keypad. Please hold while we poll for any additional questions.

It appears we have no further questions at this time. I would now like to turn the floor back to management for any additional concluding comments.

Helen Yang: Thank you, Operator, and we thank you all for participating in today's call, and we are looking forward to speaking to you following the announcement of our third quarter results. Thank you.

Weidong Yin: Thank you.

Operator: Thank you. Ladies and gentlemen, this does conclude today's teleconference. We thank for your participation and you may disconnect your lines at this time.