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Sinovac Biotech Ltd.

Fourth Quarter 2014 Earnings Conference Call

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CORPORATE PARTICIPANTS

Katherine Knight, *ICR*

Dr. Weidong Yin, *Chairman, President and Chief Executive Officer*

Helen Guang Yang, *Investor Relations Director*

CONFERENCE CALL PARTICIPANTS

Isabella Zhao, *Morgan Stanley*

Frank Yu, *Heng Ren Investments*

PRESENTATION

Operator:

Greetings and welcome to the Sinovac Biotech Limited Fourth Quarter and 2014 Whole Year Earnings Conference Call. At this time, all participants are in a listen-only mode. A brief 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.

I would now like to turn the conference over to your host, Ms. Katherine Knight of ICR. Please go ahead.

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 under 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 call over to Helen Yang. Go ahead, Helen.

Helen Yang:

Thank you, Katherine, and hello everyone. Thank you for joining us today. On today's conference call, I will provide an update on Sinovac's business and operations during the fourth quarter, and discuss our operational highlights from 2014. Then I will review our fourth quarter and full-year financials for last year, on behalf of our CEO and CFO.

The total sales in 2014 were $63.1 million, a decrease of 13% from $72.5 million. Excluding impacts from one-time H5N1 sales in 2013, the Company's annual sales of regular products increased by 1.8% year-over-year.

As we discussed over the past few quarters, 2014 was a challenging year in China's private pay vaccine market, due to the negative impact of the investigation into GSK and the effect of the hepatitis B vaccine incident. For Sinovac, since over 80% of our sales are in the private pay market in China, our performance was negatively impacted for the year.

With that said, however, we did see the private pay market pick up in the second half of the year and we also achieved a double-digit growth in our sales to the public pay market in 2014.

Overall sales generated from the private pay market decreased by 1% year-over-year, or $0.53 million, while, sales to the public pay market increased by 24.3% or $2 million, which offset a decrease in the private pay market.

The increase in sales to the public market was driven by several tender awards. We were selected by the Tianjin Centers of Disease Control to be the sole supplier of inactivated hepatitis A vaccine in prefilled syringe to the CDC Expanded Immunization Program for 2015 through 2017.

We were also selected, again, to be a supplier of the seasonal influenza vaccine in Beijing and we were able to increase our shares of this tender, as well.

Now, looking at the sales by product; for the full-year, we were able to maintain our regular sales levels from 2013, even saw a slight decrease of 1.8% year-over-year. This increase was mainly due to sales from Bilive, our hepatitis A&B combo vaccine in the private pay market, which contributed $21.9 million into the total revenue. This represents a 5.5% increase the Bilive sales year-over-year.

For our hepatitis A vaccine, Healive, overall sales remained stable from 2013 to 2014. A decrease in sales in the private pay market was offset by the increase of sales into the public market. Sales of our seasonal flu vaccine Anflu, also remained consistent with 2013 levels.

Revenue from the (inaudible) vaccine increased by 28% in 2014, contributing $2.2 million to total sales for the year.

Turning to the progress we've made on our EV71 vaccine, we have submitted supplementary documentation to the China Food and Drug Administration or CFDA, at the end of January this year, as required following the review of the new drug application by an expert panel in November last year. The CFDA has begun its review of the supplementary document we submitted and we maintain regular communication with the CFDA, so that we are able to be prepared for the next steps as soon as we receive the notification of an onsite inspection.

Once the onsite inspection and sample testing are successfully completed, we will receive the New Drug Certificate Production License and GMP License to begin commercial production of the EV71 vaccine.

While there is still some uncertainty on the exact timing of commercialization of our EV71 vaccine, we wait on the final stages of the approval processes, we're confident that it will be a significant growth catalyst for Sinovac, once it is on the market. The target market in China for EV71 is about 80 million children, with each child required two doses. While full market penetration may take about five-years and we estimate that we could see a demand of up to 10 to 20 million doses eventually.

In addition, we are considering a variety of channels through which we could be able to tap into international markets for this vaccine, as well.

As for other vaccine pipeline programs, we have continued to make progress in other R&D projects, as well. We have obtained a Clinical Trial License for our pneumococcal polysaccharide vaccine, or PPV, as of May last year. We've begun our clinical trial for PPV this month.

For our pneumococcal conjugate vaccine, or PCV, we obtained the Clinical Trial License in January of this year and we also completed preclinical studies for our proprietary hepatitis B vaccine and filed a clinical trial application in December 2014.

Simultaneously, we are developing a new generation of hepatitis A&B combo vaccine based on our individual hepatitis A and hep B vaccines. The new generation of these combo vaccines will contain a higher level of dosage or hepatitis B component to enhance the vaccine's immunogenicity. The clinical trial application for the combined vaccine was also submitted in December 2014.

With that, I would now like to review our unaudited financial results for the fourth quarter and full-year 2014.

Quarterly sales were $20.3 million, a decrease of 11.4% from $22.9 million in the fourth quarter of 2013. Excluding revenue of the Company's H5N1 vaccine under the government's stockpiling program, regular sales were $20.2 million in the fourth quarter of 2014, an increase of 28.2% over $15.8 million in the prior year period. The increase was primarily driven by an increase in sales of the Company's hepatitis vaccines, due to increase of demand in the private pay market, as well as increase in average selling price.

Gross profit was $15.1 million, an increase of 2.9% from $14.7 million in the prior year period. Excluding the impact from H5N1 vaccine revenue, gross margin was 75.3%, compared to 60.4% in the prior year period. The increase in gross margin was primarily driven by the improved efficiency in the Company's manufacturing processes, which resulted in lower unit costs, as well as increased selling price of some of the Company's products.

Selling, general, and administrative expenses for the fourth quarter of 2014 were $9.9 million, compared to $7.9 million in the same period of last year—of 2013. The increase was primarily due to the trial production of EV71, as well as for exchange loss due to the appreciation of the US dollar against the Chinese Yen.

R&D expenses for the fourth quarter of 2014 was $3.5 million, a $1.1 million increase over the same period of 2013. This increase was attributable to the continued advancement of Sinovac's pipeline products, including preclinical development and milestone payment of sIPV, and trial production of PPV.

Net income attributable to common stockholders was $1.3 million, or $0.02 per basic and diluted shares, compared to $5.8 million, or $0.10 per basic and diluted share for the fourth quarter of 2013.

Now, turning to our full-year results. Total sales in 2014 were 6.3%—sorry, $63.1 million, a decrease of 13% from $72.5 million. Excluding the impact from one-time sales from H5N1 recognized in 2013, the Company's annual sales of regular products increased by 1.8% year-over-year. The growth was mainly due to the sales of hepatitis A&B vaccine to private pay markets, as well as the sales of hepatitis A vaccine and the seasonal influenza vaccine in the public pay market.

Gross profit of 2014 was $46.6 million, a decrease of 9.1% from $51.3 million in 2013. Gross margin was 73.9% compared to 70.7% in the prior year period. Excluding impact from H5N1 vaccine, gross margin was 74.2% in 2014, compared to 72.6% in 2013. The increase in gross margin was primarily driven by improved efficiencies in the Company's manufacturing processes, which resulted in lower unit costs.

Selling, general, and administrative expenses for 2014 were $34.8 million, consistent with the expense of $34.5 million in 2013.

R&D expenses for 2014 were $11 million, compared to $8.4 million in 2013. The increase in the R&D expenses was primarily related to the continued development of the Company's pipeline vaccine candidates, including the preclinical development and milestone payment for sIPV and trial production of PPV.

Net loss attributable to stockholders in 2014 was $0.9 million, or $0.02 per basic and diluted shares, compared to net income of $7.4 million, or $0.13 per basic and diluted shares in 2013.

Now, I would like to turn over your attention to the balance sheet. As of December 31, 2014, cash, cash equivalents totaled $90 million, compared to $107.2 million as of December 31, 2013. Net cash used in operating activities was $8.6 million in 2014. Net cash used in investing activities was $12.5 million, which was primarily used for payment of property, plant, and equipment for the Company's PPV and varicella production facilities.

Net cash provided by financing activities was $5.2 million in 2014, including proceeds from loans of $17.8 million, which were offset by the repayment of loans of $16.6 million, as well as $3.5 million in government grants received.

As of December 31, 2014, the Company had $47.4 million of bank loans due within one-year. Sinovac's cash and cash equivalents and time deposit position of $91.5 million are sufficient to meet both these loan repayment obligations and the Company's operational requirements. When appropriate, the Company will seek new commercial bank loans to finance the commercialization of pipeline products.

With that, I would like to turn the call back to the Operator for questions. Operator?

Operator:

Thank you. At this time, we'll 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 the question queue. You may press star, two if you would 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 key.

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 my question to English. The first question is about the guidance for 2015. I would like to—if we can get more color from Mr. He and Mr. Weidong what our expectation for sales growth and net profit growth for 2015? If we can and can we get more color by the segment of the market (phon) between the public market and the private market? Also by the products segment? The second question is regarding the sales projection for the EV71; if we assume the successful launch of EV71 in 2015, what's the sales contribution we'll expect for 2016 and '17?

Dr. Weidong Yin:

(Chinese spoken).

Helen Yang:

I'll just briefly translate Mr. Yin's comments. He thinks it's a very good question. For the overall market, actually in 2014, we believe that we were facing a very big challenge in (inaudible), as well as the other vaccine market in China. We see some of their performance reported that some of them are maintaining very minimal sales growth or even had a decrease in sales.

However, under these external environment, Sinovac keeps executing its sales strategy to maintain sales into the private pay market. For example, for our Bilive sales which is 100% sold into the private pay, and these actually contributed a significant amount of revenue for 2014. Also, at the same time, we increased the sales into the public pay market, as well.

For the overall market environment for 2015, we think there won't be any significant changes from 2014, but the Company will keep executing our sales strategy, which has proved to be successful in the past years.

Dr. Weidong Yin:

(Chinese spoken).

Helen Yang:

So for 2015, we think there are some potential growth catalysts. For example, from the private pay market, we will keep penetrating into some central part of China in order to drive up the sales from the private pay. Also, for our public pay market, we have been making some efforts to enter into other provinces for the EVI (phon) market.

However, there are still some uncertainties for the achievement from these different—these new strategies. That's why we are not giving guidance for 2015 sales growth comparing to 2014.

Dr. Weidong Yin:

(Chinese spoken).

Helen Yang:

The other growth potential may come from the overseas market because the Company has already filed registration for our vaccines in over 10 countries, and also, we passed the (inaudible) inspection conducted by some countries that we are registering the vaccines. We believe that the Company has a very strong competitive advantage in terms of the vaccine price, as well as the good quality. So, the Company, we're still making effort in order to realize bigger sales from the overseas market.

Dr. Weidong Yin:

(Chinese spoken).

Helen Yang:

Also, the Company, all the Management Team are expecting the commercialization of our EV71 vaccine. So, to answer your second question, actually the Company was in regular contact with CFDA, particularly on the technical communication. We have been discussing with them various aspects of how to evaluate a vaccine, as well as how to set up the standards for the quality control for these vaccines, after it's commercialized. We believe we made a good progress on these and we're also making whatever effort it will be need in order to commercialize these vaccines as soon as we can.

Dr. Weidong Yin:

(Chinese spoken).

Helen Yang:

So, the Company will also keep updating the market and the (inaudible) about every significant progress we make during the process of registering these vaccines in China. Regarding to your question about the financial contribution of these vaccines, Mr. Yin is going to explain from a different aspect.

Dr. Weidong Yin:

(Chinese spoken).

Helen Yang:

So, actually the Company has already made plans for the sales and marketing of EV71 vaccine and this plan was adjusted from time-to-time, depending on the dynamic factors from the external market. The Team has already lined up the actions, which of selling these vaccines including the price level and the—including for example, the price level because we have made a lot of analyzes from the existing vaccine market.

We have seen that there are some relationship between the price level and the sales volume, and the Company will adjust it—adjust the actual (phon) manufacturing price of EV71 depending on the size of volume that we can supply to the market, even though the price level is not fixed at this moment. Also, the Company's in contact with some of our customers, i.e. the Centers for Disease Control, to discuss about how to use this vaccine after it's launched into the market.

The Company's also making the plans, including the medical marketing plans, including how to conduct a Phase 4, the—i.e. the post (inaudible) studies after the vaccine is launched.

Dr. Weidong Yin:

(Chinese spoken).

Helen Yang:

Also, the Sales Team is very confident about selling this vaccine into the market. They believe that once the vaccine is approved, they will be able to create a market and create a demand, and also they believe that this vaccine will bring a very good cash flow after it's launched into the market, as well.

Dr. Weidong Yin:

(Chinese spoken).

Helen Yang:

Even though it's still very difficult to tell when this vaccine can be launched into the market, either this year or 2016, however, we think that the Sales Team is very confident that it believes the revenue from this vaccine will give a significant contribution to the Company's sales growth in the coming years.

Dr. Weidong Yin:

(Chinese spoken).

Helen Yang:

Is it okay?

Isabella Zhao:

Yes. Thank you for answering my question. Thank you, yes.

Helen Yang:

Thank you.

Operator:

Thank you. Ladies and gentlemen, as a reminder it is star, one to ask a question at this time.

Our next question comes from the line of Frank Yu with Heng Ren Investments. Please proceed with your question.

Frank Yu:

Yes. (Chinese spoken). Now, I'll translate my question. The first question is when will Sinovac come to the US and discuss the new exciting developments in the pipeline? The second question is if EV71 is approved, what is the timeline for commercial production and what is the volume? The third question is why is the fourth quarter financial results still unaudited? Thanks. (Chinese spoken).

Dr. Weidong Yin:

(Chinese spoken).

Helen Yang:

So, firstly, Mr. Yin said he's scheduled to visit US is not confirmed yet, but the Management team has been making plans to visit (inaudible) in the US in the coming months. Once we confirm it, we will disclose it to the market.

Dr. Weidong Yin:

(Chinese spoken).

Helen Yang:

For the EV71 vaccine, our maximum capacity is about 20 million doses and we think you can take that number as a guidance for your future forecasts.

So, to also answer your question about once the vaccine is approved, how long it will take to sell the first dose of the vaccine to the market. After we receive the approval, we need to first do the commercial production of the first batch of the vaccine, and then these vaccines need to be submitted to the National Laboratory for the loss release testing. Combining these two processes within the vaccine can be launched in about four to five months after the approval is received.

To answer your third question, why these numbers still unaudited? Actually, if you see our disclosure in the past years, we normally will disclose about fourth quarter and twelve year numbers as unaudited because the audited report is not finally signed off at this moment. But normally there won't be any significant change from these other numbers. It's also a market practice in order to provide investors with some data early on.

Frank Yu:

Okay, thank you. (Chinese spoken).

Operator:

Thank you. Ladies and gentlemen, we'll pause another moment to allow for any further questions. If you would like to ask a question at this time, please press star, one on your telephone keypad.

Thank you. There are no further questions. At this time, I'd like to turn the floor back over to Management for any final remarks.

Helen Yang:

Thank you, Operator, and we thank you all for participating in today's call, and we're looking forward to speaking to you in the following announcement of our fourth quarter results. Thank you.

Operator:

Thank you. This concludes today's teleconference. You may disconnect your lines at this time. Thank you for your participation and have a wonderful day.