BGNE Update Call Transcript -- SEPTEMBER 8, 2019 / 7:00PM ET

Howard Liang, Ph.D., CFO & Chief Strategy Officer

Thanks very much. Good evening and good morning. Thank you for joining us for the update call to address allegations made in a short-seller's report late last week. Before we begin, as a reminder, we'll be making forward-looking statements during today's call, and our business carries certain risks. Some of these are discussed in our filings with the SEC and Hong Kong Stock Exchange, as noted in our forward-looking statement slide. To the extent that we do not address all of the items in the short-seller's report today, we are not implying that other parts of the report are correct. We do not intend to provide further public comment on this subject.

Join me today are John Oyler, our co-founder, Chairman and CEO, Dr. Xiaobin Wu, our General Manager of China and President of BeiGene. In addition, Scott Samuels, our General Counsel and Dan Mall, our vice president of finance and accounting would join us in Q&A. With that, I'd like to turn over to John to start the call. John?

John V. Oyler, Co-Founder, Chairman & CEO

Good evening or good morning. As you know, we started BeiGene in 2010 with a goal to develop novel innovative oncology medicines and to distribute these medicines as broadly as possible around the world to patients in need. We started from day-one aiming to be global in scope and we always sought to hold ourselves and our efforts to the highest global standards.

Our commitment to quality, compliance and transparency touches everything we do from the work in our research labs to our clinical development, manufacturing, and our financial controls and compliance.

Fighting cancer globally requires substantial efforts. Our company now employs over 2,700 people working in 10 offices on four continents. We're running clinical trials in over 30 countries including 26 Phase 3 or potentially registration-enabling studies across a portfolio of 13 assets, six of which were developed by scientists at BeiGene. We expect as many as 10 Phase 3 readouts through the end of 2020.

Turning to the recent events, we are here today to address false and misleading claims and statements circulated in a recent report by a short-seller, J. Capital. While I don't know them, I do know the team that I've built. My co-founder Xiaodong Wang is one of the most respected people I know – both as a scientist and as a person. I have the highest regard for him. I do know Dr. Xiaobin Wu. When we contemplated hiring him, the references I received were like none I'd ever heard before. There is overwhelming respect for him, for his integrity across this industry. Some of the most often used words to describe him are open, honest, and transparent. And most of you know Dr. Howard Liang, our CFO. He is honest, conservative, and understated. Get to know him if you

don’t. Or ask someone else on this call. I am fortunate to be surrounded by not only great leaders, but people of tremendous integrity. All of these people have no need to be part of BeiGene. All of them have spectacular options anywhere they want to be. Yet they choose to be at BeiGene because they feel that we are in a unique time and a unique place where we can have a tremendous impact for cancer patients. The same can be said at the other folks that you see on this page and also for the entire BGNE team. I am more than willing to stake my personal reputation on the integrity of the team.

We intend to have a lasting impact on treating cancer, and we know there are no shortcuts. We have, and we will continue to, conduct our business based on the highest standards of quality and integrity.

It is regrettable this distraction is taking even one minute away from our primary focus – that’s patients. We are using this forum to address claims raised in the short-seller’s report. It's relatively easy to see it for what it is: a collection of misleading statements with malicious assumptions. We welcome your questions at the end of this call as well as in follow-up. In addition, Howard and I will be at the Morgan Stanley conference in New York this Tuesday, and we hope to see many of you there.

I’ll turn the call over to my esteemed colleague, Xiaobin.

Dr. Xiaobin Wu, Ph.D., General Manager of China and President of BeiGene

Thank you, John, and hello to everyone on the line. Thank you for joining us for this discussion. I’m going to address the nonsensical allegations made about our product sales.

But first, I’d like to take a minute to talk from a more personal perspective.

At BeiGene we have a relentless commitment to quality and compliance. I see this company as being the first of its kind, taking exceptional and globally relevant new medicines to patients – regardless of their locations. I am honored by the opportunity to do the work we do at BeiGene, and to collaborate with the exceptional team here.

Prior to BeiGene, I was the general manager for two of the top three multinational companies in China, for nearly 20 years. I led the China-pharmaceutical business at Bayer, a European company and at Pfizer, a US company. As a result, I have always made a focus on global quality, compliance, ethics, and operational excellence. And I have a great deal of experience ensuring the credibility of sales numbers in China.

In fact, the sales process in China is straightforward:

- Here’s a simple slide that shows how revenue recognition works in china for imported drugs. First, the foreign company, in this case Celgene, ships the product to BeiGene who takes possession and records this as inventory.
- Secondly, BeiGene sells the product to the distributor, in our case China Resources. China Resources is a reputable company. They are one of the top

three distributors in China, they are publicly listed in Hong Kong, and they work with many multinational companies. Once BeiGene sells the product to China Resources we recognize the revenue.

- The distributor network distributes the product to the hospitals and the drug stores and that is in-market sales.
- Our sales to distributors are final except for returns for product defects, with a value of less than US$ 200,000 since the fourth quarter of 2017.
- We have real-time access to product flow information in their distribution channel and we monitor it on an ongoing basis.
- The China Resources inventory for our product is generally one month, which was the case at the end of the second quarter of 2019, as confirmed again by the company.
- As is the standard practice across the industry, we also closely monitor information from distributors to the final destinations such as hospitals and drug stores. Those data have limitations as they do not cover every hospital and drug store, but they are very close to our reported company sales and provide good transparency down to a hospital and drug store level. The figures show a very consistent level of sell-through activities and are in line with what I'd expect to see.

We stand by our reported numbers.

We have been able to grow our revenue as a result of successfully executing our commercial strategies. We have also grown our commercial team in China to more than 600 people, which is a significant increase from when we took over Celgene's commercial operations. We have also expanded our reach to hospitals in China. We've also expanded our reimbursements and indications.

Again, I'm proud of the work we're doing and all we've accomplished. I will now turn the line over to my friend Howard.

Howard Liang, Ph.D., CFO & Chief Strategy Officer

Thank you very much Xiaobin.

I will address additional specific allegations in the report. There are so many false statements, factually wrong information, and wild speculations, including things as basic as having the wrong management stock sale data and the wrong square footage of our research building, that not only show a lack of understanding of our business but also a lack of basic equity research conduct and basic due diligence in verifying facts. For those of us who have done research and have done much bigger physician surveys but still had a hard time predicting sales, it is extraordinary to see someone claim that they can estimate our sales by purportedly interviewing 10 oncologists and use that as the basis to accuse company of falsifying 60% of its sales. There were many allegations and questions raised and there are very simple answers to all of these that were a phone call away, but instead they used their imaginations to come up with baseless accusations. Some are clearly serious which we will address, and some are just

laughable, such as alleging a related party transaction because of a similar sounding name to our co-founder Dr. Wang Xiaodong.

One of the more serious allegations of the short-seller's report center on the nature of BeiGene Guangzhou Co, or BGC. Before I get into the details of the role of BGC, I'd like to provide an overview of our investments and strategic collaborations in Guangdong, which as many of you know is one of the wealthiest provinces in China with more than 10% of China's GDP and a very significant market. We have collaborated with Guangzhou Development District to build a large, world-class biologics facility, with mostly external funding. This is a facility which we own 95% stake and our partner owns 5% stake of the manufacturing joint venture, as supposed to 5-10% of the economics of tislelizumab as alleged in the short-seller's report.

As many of you know, given the many years required to build a biologics manufacturing facility, the work must start long before commercialization. We intend to build significant operations in Guangzhou focused on biologics business. Our operations in Guangzhou are clearly real and we are having a grand opening ceremony for our Factory in three weeks.

Regarding BGC, this is our legal entity that is responsible for funding the significant tislelizumab development costs in China and distributing the drug once approved. In order to fund these expenses, we are required to make periodic capital increases. In contrast to the short seller's claim, BGC is audited by Ernst & Young.

In order to commercialize tislelizumab in China, we require a drug distribution license. We acquired a company holding a drug distribution license, which is a common practice, as the licenses today are nearly impossible to obtain through application. The name of the acquired company was changed before the acquisition by the selling party. Once the purchase was complete, the company's name was changed to BeiGene Pharmaceuticals Guangzhou. The temporary and then subsequent name change is common practice in China for acquisitions and the same occurred when we acquired Celgene's China business.

The short seller's report also speculated that the non-current asset balance of about $25 million on the books of BeiGene Pharmaceutical Guangzhou was used to repurchase Celgene inventory. It is actually a payment for production capacity expansion at our manufacturing partner, Boehringer Ingelheim. The industry practice is that you often have to pay for capacity expansion at the contract manufacturer, which is another reason in favor of building your own manufacturing. That said, that is a cost that we expect to recoup in a form of reduced product costs from BI in the future. Therefore, it is a noncurrent asset. Again, this is a specific payment that is easily verifiable and disclosed in our financial statements.

We do have employees in BGC, and there's an office space shown in the picture here on the slide. When the permanent location of a newly registered business has not been completed, it is common for a temporary registration address to be different from the

company's major assets or sites. Let me address a few other accusations and misstatements from the statements in the short seller's report.

Regarding inventory of the Celgene products. In contrast to the report and as described by Xiaobin, we do hold inventory of Celgene products in China. And because these are imported products, we order several times a month. However, at times, such as towards the end of second quarter, factors such as the timing and availability of product may result in increased purchase from Celgene. Inventory levels can fluctuate significantly from period to period as reported in our financial statements.

Regarding inventory in Suzhou, the report claims that it has high confidence that the locally reported inventory as Suzhou subsidiary relates to Celgene products. The inventory on the balance sheet of our Suzhou subsidiary is, in fact, zanubrutinib, our BTK inhibitor, and pamiparib, our PARP inhibitor, produced by the Suzhou facility.

When we consolidate our group financials, this pre-commercial product cannot be presented as inventory under U.S. GAAP accounting because we have not yet received approval to commercialize zanubrutinib and pamiparib. It is standard in our industry for local statutory financials to present inventory in this manner and standard for it to be adjusted in the global consolidation of the financial statements.

Our Suzhou facility began operations in the second half of 2017, and its operations only became significant after that. So until the end of 2017, it was audited by a local auditor. But in contrast to the short seller's report, it has been audited by EY since the beginning of 2018, and obviously, that's the period most relevant to the growth of the Celgene products.

Regarding gross margin trends. The short seller's report claims that our reported gross margin did not decline fast enough in connection with the price change, and this was taken as evidence to support their theory that we repurchased Celgene's products from a distributor. Of the three products, REVLIMID had the largest decline in price as a result of entering a national reimbursement list. However, this was already known that our acquisition of Celgene business and was reflected in our gross margin since the fourth quarter of 2017. So therefore, there was no further reduction.

Regarding our minimum purchase commitments. This was misunderstood to be our requirement to purchase our products from Celgene. We're not required to purchase a minimum amount of drug product from Celgene, but like all supply agreements, we are required to submit binding orders. Of the $135 million disclosed as commitments as of June 30, 2019, $114 million related to commitment to purchase PD-1 antibody from BI over the next 10 years. The remainder, or $21 million, represent a binding order for the inventory purchase from Celgene.

Regarding Celgene China cash balance at acquisition. The short seller's report claim that the cash acquired as part of Celgene business acquisition was misstated based on historical local statutory filings. As part of our accounting for the combination, a portion

of the cash upfront on the PD-1 collaboration was allocated to the Celgene business. This is all clearly disclosed in the acquisition footnote of our financial statements.

Before I turn it over to John, I would like to turn next to the claim that our insiders are "cashing out." The short seller's report states that our insiders have sold over $322 million worth of shares since company's IPO in 2016. However, this number appears to be double-counting, including both planned sales and actual sales. If you look at actual sales from publicly filed Form 4 reports, the sales by insiders are less than half of what short seller claims.

Importantly, for our current executive officers and directors listed in the report, they have sold only approximately 18% of their total holdings. For our CEO, John Oyler, who has made a personal investment of over $10 million, he has sold only approximately 16% of total holdings and even after these sales still maintains a 10% interest in the company.

Clearly, our CEO and other insiders have a significant continuing financial stake in the company, and their interests are aligned with those of our shareholders. They're not cashing out.

Again, I'd like to reiterate the sentiment provided so far. We stand by our business practices and the opportunity we have ahead. With that, I'll turn over the call to John to talk about investment, but for our future.

John V. Oyler, Co-Founder, Chairman & CEO

Thank you, Howard. Now we'd like to address the short seller's claim that our burn rate and our development costs are unreasonable. BeiGene's R&D investments are indeed substantial. Our portfolio consists of six internally developed drug candidates, with another entering the clinic shortly. We're a leader in the China-inclusive global drug development. We have the largest oncology-focused clinical team in China.

To date, more than 7,000 subjects have been enrolled in BeiGene clinical trials, including costly head-to-head trials, such as our Phase III superiority trial of zanu versus ibrutinib in Waldenström's, which we expect to read out later this year. We're also conducting another Phase III head-to-head superiority trial against ibrutinib in CLL. These are large hematology trials that are generally more costly as we need to purchase ibrutinib to enable us to have a global label. We also, for that asset, are running a Phase III of zanu versus BR in CLL, which could read out in 2020.

In addition to this, we have a global comprehensive development program for our PD-1. It includes six globally enrolling registration studies. As most of you have heard me say over the course of the past several years, the PD-1 market in China is not about first approval, but it's about getting a broad label quickly. Only with a label in hand can a PD-1 be reimbursed, and only with reimbursement can a PD-1 affordably reach the vast number of patients in need in China.

This slide shows how our R&D spending compares to other peer companies on an active Phase III trial basis. The majority of our R&D expenses are related to clinical development. With 17 ongoing Phase III trials, our spending is actually below the global trend. We stand out from our Chinese peers because we're running a large number of global programs, and we ensure global quality in everything we do.

In addition to the clinical development, BeiGene also invests in manufacturing. We believe that this is an important strategic capability, and this is reflected in our R&D expenses until we receive approval. We also continue to fund an exceptional team of 300 in preclinical research. This is a group that continues to grow and has triggered the acquisition of additional space in Changping.

The short seller also implied that we overpaid in our purchase for the Changping research building in order to funnel money to Xiaodong's brother. First, for clarification, Xiaodong does not have a brother. Second, the short seller reported that the benchmark price at the time of the sale for similar real estate was RMB 30,000 per square meter. In fact, BeiGene paid RMB 21,000 *(correction)* per square meter. So based on the report statement, this was an exceptional deal for BeiGene.

Those of you who know me know I'm a jovial guy, and this is nonsensical to the point of being funny. But we're not joking today. We're very serious about what we do, and these were serious, malicious falsehoods.

The short seller's report also questions our disclosure of R&D costs. It claims we have poor internal controls because we don't allocate research expense by program. This is not something typically done in our industry. BeiGene does, however, disclose external expenses by R&D program.

And as a public company on both Nasdaq and Hong Kong Stock Exchanges, we're subject to significant scrutiny of our financial controls and our processes. We're audited by Ernst & Young, who provide an unqualified opinion on both our internal controls or our financial reporting and the consolidated financial statements of the company, and they've done this both for 2017 and 2018.

Furthermore, we're fully SOX compliant. We pride ourselves on having strong internal controls, and we completely disagree with the characterization of the report.

I'm confident in everything we do at BeiGene, and I stand by our financials, our commitment to quality and compliance, and the integrity of our team. I feel incredibly grateful every day for all that BeiGene has accomplished in a relatively short amount of time.

To echo Xiaobin, I'm honored to work with the great people in this company. Our strength is in the people, it's in our character, and it's in our devotion to our mission.

And with that, operator, I'd like to open up the line for questions.