Athenex – Financial Situation

Ahead of earnings, Viceroy provide an insight of what’s to come.

November 4, 2019 – This report provides a deep dive on Athenex’s significant revenue declines and capital over-commitment that investors can expect in the coming months. We believe revenues from the second half of 2019 will fall ~40% against the first half of 2019.

- Athenex best seller, Vasopressin, has been pulled due to FDA ruling brought about by a lawsuit against Athenex by its largest customer, AmerisourceBergen.
- COO Jeffrey Yordon is on record as stating the Vasopressin ban “did not come unexpected”.
- Almirall licensing payments in 2018 were non-recurring, and 2019 milestones appear to have been delayed as Almirall redefine Athenex deliverables.
- Per management’s guidance, we expect product sales revenue to fall approximately 40% in the second half of 2019 against the first half of 2019.
- Athenex have not only committed $1.5b expenditure at their Dunkirk site across the next ten years but are also on the hook for excess development costs for the facility, whose floorplan has expanded by 28% on-the-fly and falling significantly behind schedule.
- Athenex’s new China-funded plant must also generate unrealistic revenues of almost US$1b within 5 years of opening, despite turning over only $160m across the last 5 years combined.
- Athenex must also pay RMB 10b in taxes over 10 years at its China Site, according to project commitments. Strangely, Athenex’s own tax projections do not meet the required sum from these commitments by over 30%.
- To manage its cash burning commitments to major facilities and accelerated R&D, Athenex has issued dilutive equity, and incredulously borrowed US$50m from major investor, Perceptive, at a punitive rate of 11%.

Considering the quantum of issues Viceroy have highlighted, it is alarming to shareholders that Athenex have not addressed a single point of our work. Opting instead to simply state we have published “inaccurate information”. Other commentators have begun to back-test our work1.

Where are the inaccuracies, Athenex?

We have already highlighted management’s involvement in Sino Forest, GCL Silicon/Poly, Suntech, Chelsea Therapeutics, the world’s largest illegal taxol smuggling operation, and now LyphoMed, Gensia and Sagent. It is mind blowing that Athenex investors would continue to associate with any one of these farces, let alone a collection such as this.

Viceroy reiterate our view that Oraxol is obsolete in the modern medicine, and that Athenex will be effectively bankrupt by mid-2020 with no profitable operations given management’s overenthusiastic spending habits.

Viceroy remain short Athenex, and are in the process of obtaining a compiled, detailed report by industry specialists pertaining to Oraxol and its inability to be commercialized.

In considering the above, Viceroy estimate that Athenex’s risks of a highly discounted and dilutive capital raise is all but guaranteed.

https://seekingalpha.com/instablog/38002746-denniskneale/5369151-cancer-conflicts-interest

1 Blog entry-Dennis Kneale:https://seekingalpha.com/instablog/38002746-denniskneale/5369151-cancer-conflicts-interest
Viceroy Research Group
Report 1: https://viceroyresearch.org/2019/10/22/athenex-too-little-too-late/
Report 3: https://viceroyresearch.org/2019/10/24/athenex-no-integrity/
Report 5: https://viceroyresearch.org/2019/10/28/athenex-rehash/

Other Coverage: https://seekingalpha.com/instablog/38002746-denniskneale/5369151-cancer-conflicts-interest

Attention: Whistleblowers

Viceroy encourage any parties with information pertaining to misconduct within Athenex, its affiliates or any other entity to file a report with the appropriate regulatory body. We also understand first-hand the retaliation whistleblowers sometimes face for championing these issues. Where possible, Viceroy is happy act as intermediaries in providing information to regulators and reporting information in the public interest in order to protect the identities of whistleblowers. You can contact the Viceroy team via email on viceroy@viceroyresearch.com.

About Viceroy

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1. Non-recurring revenue

A “pressin” issue

The judgement banning the sale of Vasopressin has destroyed Athenex best sales prospect to date:

![Figure 1 Athenex Q1 2019 Earnings Call Transcript](https://www.fool.com/earnings/call-transcripts/2019/05/09/athenex-inc-atnx-q1-2019-earnings-call-transcript.aspx)

Financial Results for the First Quarter Ended March 31, 2019

Athenex is on track to achieve its revenue guidance on products sales issued in March 2019. Product sales for the three months ended March 31, 2019 were $25.2 million, compared with $12.6 million for the three months ended March 31, 2018, an increase of $12.6 million or approximately 100%. The increase was attributable to a $5.0 million increase in specialty product sales, a $5.0 million increase in 503B product sales driven significantly by Vasopressin, and a $2.1 million increase in API product sales.

![Figure 2 Athenex Q1 2019 Earnings press release](https://www.globenewswire.com/news-release/2019/05/09/1820625/0/en/Athenex-Inc-Announces-First-Quarter-2019-Financial-Results-and-Provides-Corporate-Update.html)

Since its prospectus the company has only disclosed a complaint for declaratory judgement against Endo Par Innovation, Par Pharmaceutical and Par Sterile Products (the Par entities) regarding an infringement on their patents. This developed into a landmark case for the FDA based on Athenex’s use of “bulk” pharmaceutical ingredients.

Recently, a judgement in favor of Endo’s subsidiary Par Sterile Products, LLC entities was passed July 15, 2019 putting a stop to vasopressin revenue for Athenex. As a further blow, the FDA upheld their decision that vasopressin was not a viable use for bulk manufacturing as there was an FDA-approved product already on the market.

![Figure 3 Docket summary – Case 1:18-cv-00896](https://portal.unifiedpatents.com/litigation/New%20York%20Western%20District%20Court/case/1:18-cv-00896)

Vasopressin is no longer a source of income for the company. Since its prospectus the company has only disclosed a complaint for declaratory judgement against Endo Par Innovation, Par Pharmaceutical and Par Sterile Products (the Par entities) regarding an infringement on their patents. This developed into a landmark case for the FDA based on Athenex’s use of “bulk” pharmaceutical ingredients.
Athenex’s API arm, Athenex Pharma Solutions, was put under fire in September 2018 by PharMEDium Services (PharMEDium) for allegedly abusing the Drug Quality and Security Act of 2013 in their Amicus Curiae brief on the case. **What makes this more interesting is that PharMEDium is a subsidiary of AmerisourceBergen, Athenex's largest customer, accounting for 21% of revenues in Q2 2019.**

The brief filed September 20, 2018 by PharMEDium claims that Athenex intentionally misinterpreted section 503B to prepare its products from bulk pharmaceutical ingredients. This is likely to cut down on costs as bulk ingredients are generally cheaper and easier to procure.

Under the DQSA, bulks can only be used under direction from the FDA in the event of a shortage in the market or inclusion on a list; note that a shortage alone is not considered permission.

In response to this dismissal, Athenex COO, Jeffrey Yordon, stated the FDA’s decision “**did not come unexpected**”.

> Either this is a complete lie, or the Athenex had been selling as much Vasopressin as possible before the FDA undoubtedly came knocking.

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Viceroy’s projection of Athenex’s ongoing earning power treats vasopressin revenue as non-recurring revenue to reflect that the company is prohibited from selling it.

<table>
<thead>
<tr>
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</tr>
</thead>
<tbody>
<tr>
<td>Product sales</td>
<td>342</td>
<td>12,816</td>
<td>19,394</td>
<td>36,106</td>
<td>56,394</td>
<td>79,487</td>
</tr>
<tr>
<td>License fees &amp; consulting revenue</td>
<td>659</td>
<td>314</td>
<td>392</td>
<td>1,105</td>
<td>32,878</td>
<td>7,415</td>
</tr>
<tr>
<td>Grant revenues</td>
<td>210</td>
<td>814</td>
<td>765</td>
<td>832</td>
<td>319</td>
<td>274</td>
</tr>
<tr>
<td><strong>Total Revenues</strong></td>
<td><strong>1,211</strong></td>
<td><strong>13,944</strong></td>
<td><strong>20,551</strong></td>
<td><strong>38,043</strong></td>
<td><strong>89,100</strong></td>
<td><strong>87,176</strong></td>
</tr>
<tr>
<td>Cost of sales</td>
<td>558</td>
<td>13,153</td>
<td>19,718</td>
<td>25,122</td>
<td>47,005</td>
<td>63,080</td>
</tr>
<tr>
<td>SG&amp;A</td>
<td>5,392</td>
<td>27,036</td>
<td>25,956</td>
<td>46,112</td>
<td>49,008</td>
<td>55,468</td>
</tr>
<tr>
<td><strong>Total operating costs</strong></td>
<td><strong>5,950</strong></td>
<td><strong>40,189</strong></td>
<td><strong>45,674</strong></td>
<td><strong>71,234</strong></td>
<td><strong>96,013</strong></td>
<td><strong>118,548</strong></td>
</tr>
<tr>
<td>Operating income</td>
<td>(4,739)</td>
<td>(26,245)</td>
<td>(25,123)</td>
<td>(33,191)</td>
<td>(6,913)</td>
<td>(31,372)</td>
</tr>
<tr>
<td>R&amp;D</td>
<td>12,972</td>
<td>24,463</td>
<td>60,624</td>
<td>76,797</td>
<td>119,905</td>
<td>115,014</td>
</tr>
<tr>
<td><strong>EBIT</strong></td>
<td><strong>(17,711)</strong></td>
<td><strong>(50,708)</strong></td>
<td><strong>(85,747)</strong></td>
<td><strong>(109,988)</strong></td>
<td><strong>(126,818)</strong></td>
<td><strong>(146,386)</strong></td>
</tr>
<tr>
<td>D&amp;A</td>
<td>162</td>
<td>888</td>
<td>2,026</td>
<td>3,673</td>
<td>3,269</td>
<td>3,411</td>
</tr>
<tr>
<td>Significant non-recurring revenue</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Almirall license payment</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>30,000</td>
<td>-</td>
</tr>
<tr>
<td>Vasopressin*</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>15,637</td>
<td>19,191</td>
</tr>
</tbody>
</table>

*Viceroy estimate

**Figure 8 Viceroy Revised EBITDA**

Per management’s guidance, we expect product sales revenue to fall approximately 40% in the second half of 2019 against the first half of 2019.

**Other historical non-recurring sources**

We have also removed several non-recurring revenue sources:

- Almirall’s US$30m payment for KX01 from 2018.
- PharmEssentia’s US$2m payment for KX01.

**Figure 9 – Extract Athenex 10-K**

Revenue
Revenue for the year ended December 31, 2018 was $89.1 million, an increase of $51.1 million, or 134%, as compared to $38.0 million for the year ended December 31, 2017. The increase was primarily attributable to the $30.0 million license fees related to the collaboration agreement with Almirall, S.A., and the $2.0 million upfront license fees related to our license agreement with PharmEssentia. Revenue from product sales also
Non-recurring future payments

Athenex have received $20m that is dependent on the results of clinical trials for Athenex’s KX01-AK-003 and KX01-AK-004 drug, being satisfactory.

Did Almirall catch on to the conflicts of interest in Athenex conducting its own research?

Alongside delays in this licensing contract fulfilment and drug development, it is increasingly concerning that Athenex appears to have been given a greater burden of proof in providing “satisfactory” data to Almirall. Athenex, as a Company, must now not only provide clinical trial data, but also “summary of the findings signed off by an executive member of Athenex with fully audited listings, tables and figures including SAS datasets.”

Original Contract: December 11, 2017

Second amendment change – June 18, 2019⁶

Athenex has received this cash, guaranteed against a bank deposit. We are unsure at this date as to whether Almirall has provided a notice that it is satisfied with KX01 results. I suppose we will find out at Q3 release.

It is astonishing how low Athenex’s risk management controls are, especially given the Board’s and Management’s history of fraud.

⁶ https://www.sec.gov/Archives/edgar/data/1300699/000156459019029706/atnx-ex10302_120.htm
2. Diving into commitment

Dunkirk’s Buffalo Billions

Athenex has committed to US$1.5bn in operational expenditure in Dunkirk over the course of 10 years at its allegedly soon-to-be-completed facility.

We are substantially dependent on our public-private partnerships and if we or our counterparties fail to meet the obligations of these agreements and we lose the benefits of these partnerships, it would materially impact our development, operations and prospects.

Our long term public-private partnerships with government and government agencies, including in certain emerging markets, include agreements to build and/or maintain manufacturing facilities for us. For example, we entered into an agreement with FSIMC, whereby FSIMC agreed to fund the costs of construction of a new manufacturing facility in Dunkirk, New York. FSIMC is responsible for the costs of construction and all equipment for the facility, up to an amount not to exceed $200 million plus any amounts not used under the prior $25 million grant to construct our North American headquarters and formulation lab in Buffalo, New York, and shall retain ownership of the Dunkirk facility and the equipment. To the extent the costs of constructing the Dunkirk facility exceed approximately $266 million, we will be responsible for those costs. We are entitled to lease the facility and all equipment at a rate of $1.00 per year for an initial 10-year term, and for the same rate if we elect to extend the lease for an additional 10-year term. We are responsible for all operating costs and expenses for the facility. In exchange, we have committed to spending $1.52 billion on operational expenses in the Dunkirk facility in our first 10-year term in the facility, and an additional $1.5 billion on operational expenses if we elect to extend the lease for a second 10-year term. We have also committed during 40 permanent employees within the first 5 years at the Dunkirk facility. In addition, in July 2017, we entered into a 20-year payment in lieu of tax agreement with the CCIDP for the construction of the Dunkirk facility, valued at approximately $51 million. We have also entered into similar arrangements with FSIMC relating to our headquarters, and Changqing Main Riverside Development & Investment Co., Ltd, relating to a plant in Chongqing, China, under which we have committed to achieving certain operating, revenue and tax generation milestones. If we are unable to comply with our obligations under these arrangements, including the milestones we have committed to achieve, we may lose access to the properties covered by such arrangements which could disrupt our operations and manufacturing activities, cause us to divert resources to finding alternate facilities, which would not have any subsidies, and would have a significant impact on our operations and financial performance. We may also be subject to lawsuits or claims for damages against us if we are unable to comply with our obligations under these arrangements. For example, our potential liability in connection with a failure to comply with the New York State partnership agreements could be as high as $225 million, depending on the amount of funding EBD had contributed to the Dunkirk project at the time of the claim.

The facility is not only far behind schedule, but has also been upgraded in size:

Therefore, the risk for Athenex does not only lie in its commitment to expenditure in Dunkirk, but it is also liable for the thinly budgeted site’s excess costs over its budget of $200m.

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7 https://www.sec.gov/Archives/edgar/data/1300699/000156459019029706/atnx-10q_20190630.htm
8 https://www.sec.gov/Archives/edgar/data/1300699/000156459019029706/atnx-10q_20190630.htm
Chongqing

On September 23, 2019 – almost three years behind schedule – Athenex announced the completion of its new 440,000sqft facility in Chongqing. This government funded project does come with its caveats. For instance, Athenex must reach certain revenues and tax milestones:

![Figure 13 The Athenex Pharmaceutical Base Project Agreement](https://ir.athenex.com/news-releases/news-release-details/athenex-completes-construction-new-api-facility-chongqing)

Strangely, Athenex’s projections do not meet these caveats. Additionally, the sum of Athenex’s tax projections for the first 10 years sums to only RMB 6.8b, well below the required RMB 10b.

This is besides the ridiculous projection that the plant will operate at yearly sales of ~US$1bn within 5 years, while Athenex in its entirety is still doing sub-$90m at its peak, a figure which will now drop substantially, and while opening another major facility in Dunkirk!

<table>
<thead>
<tr>
<th>Plant Figures (RMB’000s)</th>
<th>1st Year</th>
<th>2nd Year</th>
<th>3rd Year</th>
<th>4th Year</th>
<th>5th Year</th>
<th>6th Year</th>
<th>7th Year</th>
<th>8th Year</th>
<th>9th Year</th>
<th>10th Year</th>
</tr>
</thead>
<tbody>
<tr>
<td>Manufacturing</td>
<td>465,000</td>
<td>1,560,000</td>
<td>3,200,000</td>
<td>4,320,500</td>
<td>4,958,720</td>
<td>5,706,700</td>
<td>5,875,500</td>
<td>6,049,370</td>
<td>6,228,450</td>
<td></td>
</tr>
<tr>
<td>API</td>
<td>450,000</td>
<td>630,000</td>
<td>810,000</td>
<td>910,000</td>
<td>930,000</td>
<td>930,000</td>
<td>930,000</td>
<td>930,000</td>
<td>930,000</td>
<td></td>
</tr>
<tr>
<td>Total Sales Revenue</td>
<td>915,000</td>
<td>2,190,000</td>
<td>4,010,000</td>
<td>5,230,500</td>
<td>5,888,720</td>
<td>6,636,700</td>
<td>6,805,500</td>
<td>6,979,370</td>
<td>7,158,450</td>
<td></td>
</tr>
<tr>
<td>Total VAT and surtax</td>
<td>56,000</td>
<td>187,000</td>
<td>384,000</td>
<td>585,000</td>
<td>653,000</td>
<td>685,000</td>
<td>705,000</td>
<td>726,000</td>
<td>747,000</td>
<td></td>
</tr>
<tr>
<td>Income tax</td>
<td>9,000</td>
<td>50,000</td>
<td>114,000</td>
<td>157,000</td>
<td>183,000</td>
<td>200,000</td>
<td>210,000</td>
<td>217,000</td>
<td>233,000</td>
<td></td>
</tr>
<tr>
<td>Total Tax</td>
<td>65,000</td>
<td>237,000</td>
<td>498,000</td>
<td>738,000</td>
<td>838,000</td>
<td>895,000</td>
<td>922,000</td>
<td>949,000</td>
<td>977,000</td>
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</tbody>
</table>

Dilution solution – Perceptive hedging their bet

To manage its cash burning commitments to major facilities and accelerated R&D, Athenex has issued dilutive equity, and incredulously borrowed US$50m from major investor, Perceptive, at a punitive rate of 11%, when banks are lending at approximately half of that rate.

In all fairness, Viceroy would have asked for a lot more.

![Figure XX – Extract from Athenex Q2 2019-10-Q](https://www.sec.gov/Archives/edgar/data/1300699/000156459019029706/atnx-10q_20190630.htm)

We estimate that Athenex, if lucky, may make it to HY 2020 before hats are out for a >10% equity dilution.