August 17, 2022

# Zacks Small-Cap Research

*Sponsored – Impartial - Comprehensive*

Elizabeth Senko, CFA
312-265-9484
esenko@zacks.com

scr.zacks.com
10 S. Riverside Plaza, Chicago, IL 60606

## Societal CDMO (NASDAQ:SCTL)

### SCTL: Reaping benefits from realignment

Our initial valuation for SCTL is $4.13 per share. The value is based on a 10-year DCF model building to sales of $201 million by 2031. We model terminal sales with an EBIT margin of 14% and a 15% tax rate. We use a terminal growth rate of 2% and an 11% discount rate. We believe the gap between current and our valuation is based on SCTL's less-familiar profile among CDMOs and its relatively high debt burden.

| | |
|---|---|
| Current Price (08/16/22) | $1.51 |
| **Valuation** | **$4.13** |

### OUTLOOK

Societal CDMO is an established small-molecule CDMO taking steps to position itself as alternative to the big industry players for established and emerging drug companies. In the past year, Societal has expanded its capabilities, capacity and diversified its customer base. Societal has a very specific business plan -- built on wisdom, experience, constant operating assessment, and establishing long-term customer relationships – which we believe will mitigate many of the challenges of carving out a bigger share in an industry dominated by large, deep-pocketed companies.

### SUMMARY DATA

| | |
|---|---|
| **52-Week High** | **$2.55** |
| **52-Week Low** | **$0.64** |
| **One-Year Return (%)** | **-41.33** |
| **Beta** | **1.13** |
| **Average Daily Volume (sh)** | **63,607** |
| **Shares Outstanding (mil)** | **57** |
| **Market Capitalization ($mil)** | **$75** |
| **Short Interest Ratio (days)** | **N/A** |
| **Institutional Ownership (%)** | **59** |
| **Insider Ownership (%)** | **8** |
| **Annual Cash Dividend** | **$0.00** |
| **Dividend Yield (%)** | **0.00** |
| **5-Yr. Historical Growth Rates** | |
| **Sales (%)** | **-1.3** |
| **Earnings Per Share (%)** | **N/A** |
| **Dividend (%)** | **N/A** |
| **P/E using TTM EPS** | **N/A** |
| **P/E using 2022 Estimate** | **-5.1** |
| **P/E using 2023 Estimate** | **-7.8** |
| **Zacks Rank** | **N/A** |

| | |
|---|---|
| **Risk Level** | **Above Avg.,** |
| **Type of Stock** | **Small-Blend** |
| **Industry** | **N/A** |

### ZACKS ESTIMATES

**Revenue**
(in millions of $)

| | Q1 (Mar) | Q2 (Jun) | Q3 (Sep) | Q4 (Dec) | Year (Dec) |
|---|---|---|---|---|---|
| 2020 | 22 A | 16 A | 19 A | 10 A | 66.5 A |
| 2021 | 17 A | 18 A | 18 A | 22 A | 75.4 A |
| 2022 | 21 A | 23 A | | | 90.4 E |
| 2023 | | | | | 104.0 E |

**Earnings per share**

| | Q1 (Mar) | Q2 (Jun) | Q3 (Sep) | Q4 (Dec) | Year (Dec) |
|---|---|---|---|---|---|
| 2020 | -$0.33 A | -$0.25 A | -$0.09 A | -$0.48 A | -$1.16 A |
| 2021 | -$0.23 A | -$0.06 A | -$0.07 A | -$0.04 A | -$0.35 A |
| 2022 | -$0.08 A | -$0.06 A | | | -$0.24 E |
| 2023 | | | | | -$0.13 E |

Zacks Projected EPS Growth Rate - Next 5 Years % **N/A**

© Copyright 2022, Zacks Investment Research. All Rights Reserved.

## COMPANY UPDATE

On August 16, Societal CDMO announced it has taken the first step to reduce its debt, with the pending sale of 121 acres of lakefront land to a developer for ~$9.1 million. Subject to due diligence, Societal expects this transaction to close in the second half of 2023. Separately, Societal continues discussion for the sale/leaseback of its Gainesville Georgia facility/land, which it hopes to close by the end of 2022. Combined, the company expects proceeds of $40 million - $50 million, which would reduce the company's indebtedness by up to half, as well as enable the company to secure lower-cost financing.

Societal CDMO is an established small-molecule CDMO taking steps to position itself as an alternative to the big industry players for established and emerging drug companies. Societal believes that its high-touch, customized service offerings will attract clients seeking to partner over the drug development lifecycle. In the past year, Societal has expanded its capabilities, capacity and diversified its customer base, focusing across the pharmaceutical development lifecycle from supplying product for clinical trials, through the regulatory process to commercial scale production. Barely a year into its transformation, Societal has a very specific business plan -- built on wisdom, experience, constant operating assessment, and establishing long-term customer relationships – which we believe will mitigate many of the challenges of carving out a bigger share in an industry dominated by large, deep-pocketed companies.

Our 10-year DCF model builds to sales of approximately $201 million by 2031. We model terminal sales with an EBIT margin of 14% and a 15% tax rate. We assume a terminal revenue growth rate of 2% and a 11% discount rate. Under these assumptions, we arrive at an intrinsic value of $4.13 per share.

## RECENT FINANCIALS AND VALUATION

SCTL reported $23.2 million in revenue in 2Q22, up 29% (YoY), with much of gain driven by higher demand for Ritalin LA from InfectoPharm, and inorganic gains from its FY21 acquisition of IriSys. These gains were partially offset by continued softness in the legacy Lannett business (Verapamil PM), which began in 1Q22.

COGs for the quarter totaled $17.5 million compared to $12.3 million for the year-earlier period. The increase was due to overhead costs for the IriSys facility as well costs associated with higher manufacturing revenue. Higher expenses also reflect the absence of employment tax credits, which lowered reported COGs in the year-earlier period.

SG&A rose $1.4 million to $5.2 million, compared to $3.8 million in the year-earlier period, driven primarily by higher headcount and relocation expense. Notably, the increase includes reallocation of certain employee expense from COGs to SG&A as of October 2021. Interest expense was $3.4 million in 2Q22, a decrease compared to $3.9 million in the year-earlier period. In 2Q22, SCTL recorded a net loss of $3.6 million or $0.06 per diluted share, compared to net income of $1.2 million or $0.03 per diluted share, for the comparable period of 2021.

The company maintains its 2022 guidance for revenue of $90 to $95 million, and EBITDA, as adjusted to be in the range of $16 to $18 million.

For the rest of 2022, we expect top-line improvement from SCTL's revamped segmented customer strategy. The company signed an amended contract with improved economics with Lannett through the end of 2022. Management reports that it inked six projects in 2Q22 from new customers as well as expanded agreements with existing customers. The company expects to double the number of proposals written in 2022 (vs. 2021) and a 40% increase in the number of signed proposals, roughly double the win rate in 2021.

Our model is based on SCTL's current business; it does not include any future acquisitions, moves outside of its core small molecule solid-dose oral formulation and injectables business, or the addition of adjacent services (e.g., cGMP consulting). We look for revenues of $90.4 million in 2022, up 20%, We forecast a net loss of $(13.4) million.

By 2026, we forecast revenues of $142.2 million, a 9.5% CAGR. We forecast operating income of $18.2 million in 2026, compared with $0.4 million in 2021. We expect SCTL to be breakeven on a GAAP basis in 2025, as operating income gains offset interest expense. For 2023 – 2031, we forecast top-line growth of 12% slowing to 7%, for a CAGR of 8.6%, slightly ahead of the ~6% top-line growth expected for the CDMO group as a whole

SCTL has generated positive operating cash flow in each of the past three years. we forecast SCTL will produce ~$6 million in free cash flow in 2022, growing to $25 million by 2027.

At June 30, 2022, SCTL had $15.5 million in cash and equivalents on its balance sheet, compared to $25.2 million at the end of 2021, and up $0.3 million at the end of 1Q22. The Company has $2 million in current related party debt, and long-term debt of $94.4 million in a term loan and $3.6 million in related party debt. As noted, Societal has signed an agreement to sell 121 acres of land to a developer for ~$9.1 million. The transaction is expected to close in the second half of 2023. Separately, the company is in discussions for a sale-leaseback of its land/facility in Gainesville Georgia, for an estimated $30 million - $40 million. Together, these transactions will reduce Societal's indebtedness by as much as half.

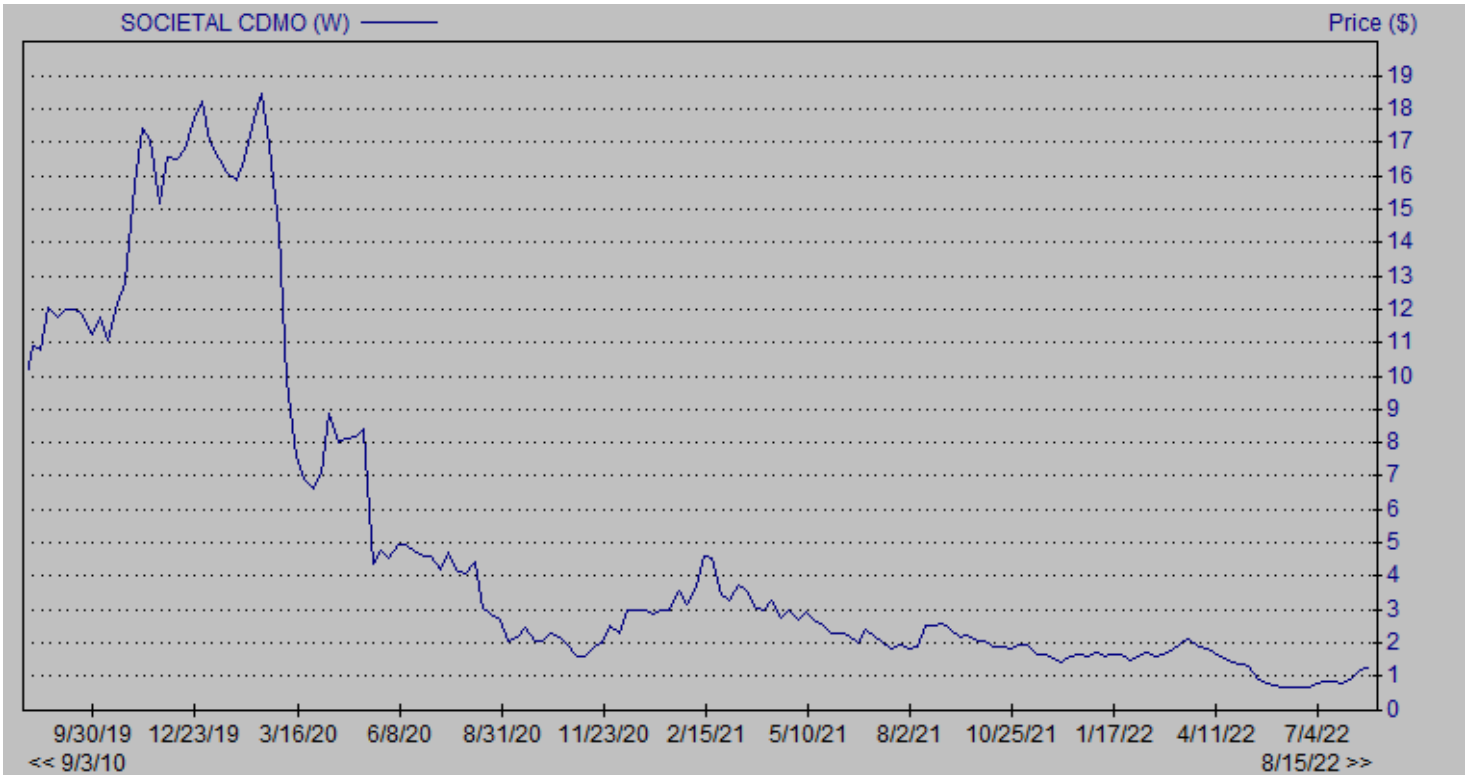
## Exhibit 1. Financial Summary

| INCOME STATEMENT | | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| Fiscal year (Dec) | 2020A | 2021A | 2022E | 2023E | 2024E | 2025E | 2026E | 2027E |
| Revenue | **66,499** | **75,360** | **90,432** | **103,997** | **117,516** | **130,443** | **142,183** | **153,558** |
| Cost of sales | (54,134) | (55,537) | (67,372) | (73,838) | (82,261) | (90,006) | (96,684) | (104,419) |
| **Gross Profit** | 12,365 | 19,823 | 23,060 | 30,159 | 35,255 | 40,437 | 45,499 | 49,138 |
| Selling, general & administrative | (18,124) | (18,374) | (20,528) | (21,760) | (23,283) | (24,913) | (26,407) | (27,992) |
| **Operating profit (EBIT)** | **(8,342)** | **412** | **1,547** | **7,473** | **11,092** | **14,645** | **18,211** | **20,267** |
| Total other income/(expense) | 0 | 3,352 | 0 | 0 | 0 | 0 | 0 | 0 |
| **Pretax profit** | **(27,501)** | **(11,370)** | **(13,436)** | **(7,210)** | **(3,297)** | **543** | **4,392** | **6,724** |
| Taxes | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| **Net income** | **(27,501)** | **(11,370)** | **(13,436)** | **(7,210)** | **(3,297)** | **543** | **4,392** | **6,724** |
| Basic shares outstanding | 23,744,313 | 44,117,473 | 56,681,453 | 56,681,453 | 56,681,453 | 56,681,453 | 56,681,453 | 56,681,453 |
| Diluted shares outstanding | 23,744,313 | 44,117,473 | 56,681,453 | 56,681,453 | 56,681,453 | 56,681,453 | 56,681,453 | 56,681,453 |
| **Basic EPS** | **($1.16)** | **($0.26)** | **($0.24)** | **($0.13)** | **($0.06)** | **$0.01** | **$0.08** | **$0.12** |
| **Diluted EPS** | **$0.00** | **$0.00** | **($0.00)** | **($0.00)** | **($0.00)** | **$0.00** | **$0.00** | **$0.00** |

| BALANCE SHEET | | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| Fiscal year | 2020A | 2021A | 2022E | 2023E | 2024E | 2025E | 2026E | 2027E |
| Cash & equivalents | 23,760 | 25,217 | 18,556 | 20,765 | 27,399 | 37,054 | 51,403 | 66,623 |
| Accounts receivable | 9,033 | 11,913 | 13,565 | 15,600 | 16,452 | 18,262 | 18,484 | 19,963 |
| **Total current assets** | **54,069** | **57,529** | **55,585** | **61,302** | **70,598** | **83,735** | **99,753** | **118,066** |
| Property plant and equipment | 43,841 | 51,708 | 49,372 | 47,371 | 45,687 | 43,618 | 41,681 | 39,071 |
| **Total Assets** | **103,415** | **160,317** | **155,237** | **158,154** | **164,965** | **175,233** | **188,681** | **204,385** |
| Accounts payable | 1,804 | 2,085 | 2,221 | 2,695 | 2,954 | 3,290 | 3,600 | 3,867 |
| **Total current liabilities** | **7,803** | **17,735** | **17,072** | **18,268** | **18,974** | **19,429** | **19,491** | **19,246** |
| **Total liabilities** | **117,515** | **118,253** | **121,335** | **126,203** | **130,506** | **134,486** | **138,003** | **141,144** |
| Common stock / APIC | 220,284 | 287,818 | 293,092 | 298,350 | 304,155 | 309,901 | 315,440 | 320,736 |
| Retained earnings / accumulated defici | (234,384) | (245,754) | (259,190) | (266,399) | (269,697) | (269,153) | (264,761) | (258,038) |
| Other comprehensive income / (loss) | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| **Total equity** | **(14,100)** | **42,064** | **33,902** | **31,950** | **34,458** | **40,748** | **50,678** | **62,699** |
| **Total liabilities and equity** | **103,415** | **160,317** | **155,238** | **158,153** | **164,964** | **175,233** | **188,681** | **203,842** |

| CASH FLOW STATEMENT | | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| Fiscal year | 2020A | 2021A | 2022E | 2023E | 2024E | 2025E | 2026E | 2027E |
| **Cash from operating activities** | **9,239** | **10,858** | **(1,339)** | **6,684** | **12,063** | **15,408** | **20,995** | **21,331** |
| Capital expenditures | (7,603) | (29,291) | (4,522) | (5,200) | (5,876) | (5,870) | (6,398) | (6,142) |
| **Cash from investing activities** | **(7,603)** | **(29,291)** | **(4,522)** | **(5,200)** | **(5,876)** | **(5,870)** | **(6,398)** | **(6,142)** |
| **Cash from financing activities** | **4,148** | **19,890** | **0** | **0** | **0** | **0** | **0** | **0** |
| **Net change in cash during period** | **5,784** | **1,457** | **(5,861)** | **1,484** | **6,187** | **9,538** | **14,597** | **15,189** |

## HISTORICAL STOCK PRICE



## DISCLOSURES

The following disclosures relate to relationships between Zacks Small-Cap Research ("Zacks SCR"), a division of Zacks Investment Research ("ZIR"), and the issuers covered by the Zacks SCR Analysts in the Small-Cap Universe.

ANALYST DISCLOSURES

I, Elizabeth Senko, Senior Analyst, hereby certify that the view expressed in this research report accurately reflect my personal views about the subject securities and issuers. I also certify that no part of my compensation was, is, or will be, directly or indirectly, related to the recommendations or views expressed in this research report. I believe the information used for the creation of this report has been obtained from sources I considered to be reliable, but I can neither guarantee nor represent the completeness or accuracy of the information herewith. Such information and the opinions expressed are subject to change without notice.

INVESTMENT BANKING AND FEES FOR SERVICES

Zacks SCR does not provide investment banking services nor has it received compensation for investment banking services from the issuers of the securities covered in this report or article.

Zacks SCR has received compensation from the issuer directly, from an investment manager, or from an investor relations consulting firm engaged by the issuer for providing non-investment banking services to this issuer and expects to receive additional compensation for such non-investment banking services provided to this issuer. The non-investment banking services provided to the issuer includes the preparation of this report, investor relations services, investment software, financial database analysis, organization of non-deal road shows, and attendance fees for conferences sponsored or co-sponsored by Zacks SCR. The fees for these services vary on a per-client basis and are subject to the number and types of services contracted. Fees typically range between ten thousand and fifty thousand dollars per annum. Details of fees paid by this issuer are available upon request.

POLICY DISCLOSURES

This report provides an objective valuation of the issuer today and expected valuations of the issuer at various future dates based on applying standard investment valuation methodologies to the revenue and EPS forecasts made by the SCR Analyst of the issuer's business.
SCR Analysts are restricted from holding or trading securities in the issuers that they cover. ZIR and Zacks SCR do not make a market in any security followed by SCR nor do they act as dealers in these securities. Each Zacks SCR Analyst has full discretion over the valuation of the issuer included in this report based on his or her own due diligence. SCR Analysts are paid based on the number of companies they cover. SCR Analyst compensation is not, was not, nor will be, directly or indirectly, related to the specific valuations or views expressed in any report or article.

ADDITIONAL INFORMATION

Additional information is available upon request. Zacks SCR reports and articles are based on data obtained from sources that it believes to be reliable, but are not guaranteed to be accurate nor do they purport to be complete. Because of individual financial or investment objectives and/or financial circumstances, this report or article should not be construed as advice designed to meet the particular investment needs of any investor. Investing involves risk. Any opinions expressed by Zacks SCR Analysts are subject to change without notice. Reports or articles or tweets are not to be construed as an offer or solicitation of an offer to buy or sell the securities herein mentioned.

CANADIAN COVERAGE

This research report is a product of Zacks SCR and prepared by a research analyst who is employed by or is a consultant to Zacks SCR. The research analyst preparing the research report is resident outside of Canada, and is not an associated person of any Canadian registered adviser and/or dealer. Therefore, the analyst is not subject to supervision by a Canadian registered adviser and/or dealer, and is not required to satisfy the regulatory licensing requirements of any Canadian provincial securities regulators, the Investment Industry Regulatory Organization of Canada and is not required to otherwise comply with Canadian rules or regulations.