December 13, 2022

Zacks Small-Cap Research

Sponsored – Impartial - Comprehensive

M. Marin
312-265-9211
mmarin@zacks.com

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

Societal CDMO (NASDAQ:SCTL)

SCTL: Refinancing Measures Reduce Leverage Substantially

To reduce debt, extend maturities and lower interest cost, SCTL raised about $36M of gross proceeds yesterday, negotiated a new credit facility & entered into a sales-leaseback agreement. Proceeds will fully repay existing debt that carries interest of roughly 13% & was set to mature at YE 2023. The new credit facility matures at YE 2025 & implies roughly 9% interest. SCTL expects annual interest costs to be reduced by about $6.0M or 50+%.

OUTLOOK

All else equal, once all these steps (including a separate sale and purchase agreement signed in 3Q22) are consummated, pro forma debt and net debt balances would be roughly $31.3M and $20.6M respectively, down from $104.4M and $92.8M earlier. SCTL's leverage ratio, as measured by net debt to LTM EBITDA, would be 1.5x, down from 6.6x prior to the balance sheet measures, effectively reducing the leverage ratio by about five EBITDA turns.

Current Price (12/12/22)	$1.27
Valuation	**$4.00**

SUMMARY DATA

52-Week High	**$2.19**
52-Week Low	**$0.62**
One-Year Return (%)	**-15.43**
Beta	**0.68**
Average Daily Volume (sh)	**67,593**
Shares Outstanding (mil)	**89**
Market Capitalization ($mil)	**$113**
Short Interest Ratio (days)	**N/A**
Institutional Ownership (%)	**58**
Insider Ownership (%)	**8**
Annual Cash Dividend	**$0.00**
Dividend Yield (%)	**0.00**
5-Yr. Historical Growth Rates	
Sales (%)	**N/A**
Earnings Per Share (%)	**N/A**
Dividend (%)	**N/A**
P/E using TTM EPS	**N/A**
P/E using 2022 Estimate	**N/A**
P/E using 2023 Estimate	**N/A**
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	22 A	25 E	91.1 E
2023					96.5 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	-$0.06 A	-$0.04 E	-$0.23 E
2023					-$0.04 E

Quarters might not sum due to rounding & share counts

Disclosures on page 9

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

KEY POINTS: RECENT INITIATIVES

Refinancing efforts expected to reduce leverage ratios substantially…

- Yesterday Societal priced concurrent public offerings that raised gross proceeds of about $35.6 million. At the same time, the company negotiated a new credit facility and entered into a sales-leaseback agreement. These measures are steps to refinance and reduce debt, extend maturities and lower financing costs.

- Proceeds are earmarked to fully repay existing debt with Athyrium Capital Management that carries a combined interest rate of roughly 13% and was set to mature on December 31, 2023. The new Term A loan facility (for up to $37.5 million) matures in December 2025 and implies a roughly 9% interest rate. The net impact of these measures is expected to reduce SCTL's annual interest expense by about $6.0 million, or by about 50+%.

- Another important step towards strengthening the balance sheet and capital structure includes monetizing non-core real estate assets to pare debt. SCTL also entered into a sale and leaseback agreement for its Gainesville, Georgia manufacturing facility. The transaction is expected to produce $39 million in non-dilutive gross proceeds that will also go towards the elimination of the Athyrium Capital Management debt.

- An earlier sale and purchase agreement signed in 3Q22 for the sale of roughly 121 acres of non-core real estate to David Weekley Homes is expected to garner approximately $9.1 million and to close in 2H23. The proceeds are earmarked to reduce the aggregate Term A loan by $10 million.

- All else equal, once all these steps are consummated, the company's pro forma debt and net debt balances would be roughly $31 million and $21 million respectively, down from about $104 million and $93 million. SCTL's leverage ratio, as measured by net debt to LTM EBITDA, would be 1.5x, down from 6.6x prior to the balance sheet measures, effectively reducing the leverage ratio by about five EBITDA turns.

… While record quarterly new business & solid pipeline of new business support positive outlook

- We expect the refinancing measures to enable management to fully focus on its growth strategy. The apparent success of this strategy (in our view) can be seen in the many new contracts the company has closed, with a quarterly record number of new agreements signed in 3Q22. The company believes that its 2022 win-rate on new business exceeds the industry average.

BALANCE SHEET STRENGTHENING INITIATIVES

Extend maturities, lower cost of capital, reduce annual interest expense significantly …

Yesterday Societal CDMO (NASDAQ: SCTL), an established small-molecule CDMO, priced concurrent offerings of 27.8 million shares at $1.10 per share and 450,000 series A convertible preferred shares, raising gross proceeds of about $35.6 million. At the same time, the company negotiated a new credit facility and entered into a sales-leaseback agreement. These measures are steps in the company's strategy to refinance and reduce its debt, extend maturities and lower financing costs. In our view, these refinancing measures alleviate balance sheet concerns, enabling management to focus on its growth strategy as SCTL positions itself as an alternative to larger industry players for established and emerging drug companies.

Proceeds from the concurrent transactions are earmarked to fully repay an existing debt facility with Athyrium Capital Management, plus fees and expenses. This will extend maturities and lower aggregate financing costs. The Athyrium debt carries a combined interest rate of roughly 13% and was set to mature on December 31, 2023. SCTL entered into an agreement with Royal Bank of Canada (RBC) for a new Term A Loan debt facility for up to $37.5 million. The new facility matures in December 2025 and implies a roughly 9% interest rate. The net impact is expected to reduce SCTL's annual interest expense by about $6.0 million, or by about 50+%.

The new RBC credit facility consists of a three-year Term A Loan at SOFR (Secured Overnight Financing Rate) plus an initial base rate of 4.5% per annum that SCTL will immediately use to further reduce its outstanding debt balance with Athyrium. The company has extended debt maturities by two years through these measures.

Another important step towards the goal of strengthening the balance sheet and capital structure includes monetizing non-core real estate assets to pare debt. SCTL also entered into an agreement for a sale and leaseback of its Gainesville, Georgia manufacturing facility with Tenet Equity, a platform that provides capital for real estate transactions. The transaction is expected to produce $39 million in non-dilutive gross proceeds. The funds will also go towards the elimination of the outstanding debt balance with Athyrium Capital Management. In addition to entering into a 20-year lease agreement, Tenet has also provided a funding commitment of up to an additional $35 million for renovations and / or expansions in the future. The transaction with Tenet is for the Georgia facility alone and will not impact the company's other manufacturing facilities or development plans.

Earlier sales-leaseback transaction earmarked to reduce debt…

The sale and leaseback agreement noted above follows the sale and purchase agreement the company announced in 3Q22. In August 2022, the company signed a sales and purchase agreement to sell roughly 121 acres of non-core real estate to David Weekley Homes, an established homebuilder. The land is located adjacent to Societal's manufacturing facility in Gainesville, Georgia.

The transaction is expected to garner approximately $9.1 million. Societal expects the sale to close in 2H23 and has earmarked the non-dilutive proceeds from the sale to further strengthen its balance sheet by reducing a portion of its outstanding debt, specifically $10 million on the new term loan facility.

… Substantial improvements in net debt metrics & leverage ratio

All else equal, once these steps, including the $10 million term loan repayment, are consummated, the company's pro forma debt and net debt balances would be roughly $31.3 million and $20.6 million respectively, down from $104.4 million and $92.8 million. SCTL's leverage ratio, as measured by net debt to LTM EBITDA, would be 1.5x, down from 6.6x prior to the balance sheet measures, effectively reducing the leverage ratio by about five EBITDA turns. We have updated our projections reflecting the refinancing.

RECORD NUMBER OF CONTRACTS SIGNED TO-DATE

Positives of recent business trends

We expect the refinancing measures to enable management to fully focus on its growth strategy. The benefits of the company's strategy are illustrated by new business trends, in our view. Societal believes that its high-touch, customized service offerings will attract clients seeking to partner over the drug development lifecycle. Importantly, management believes that its 2022 win-rate on new business exceeds the industry average.

The apparent success of this strategy (in our view) can be seen in the many new contracts the company has signed. In fact, SCTL signed a quarterly record number of new agreements in 3Q22. Reflecting the company's growth and diversification initiatives, SCTL has more than 65 customers, up more than three-fold in just a few short years, with nearly 20 of those in 2022 to-date. The company's customer base includes legacy agreements, companies with early stage assets in development phase and others closer to commercialization implementing tech transfers. The company targets doubling the number of proposals in 2022 versus 2021 and believes that its 2022 win-rate on new business exceeds the industry average.

As noted, SCTL signed a quarterly record number of new business agreements in 3Q22. Specifically, SCTL signed $8.2 million in new and expanded project agreements in 3Q22, which marks the highest number of new contracts the company has signed in any quarter since becoming an independent dedicated CDMO. The agreements cover projects spanning clinical trial services, analytical method, tech transfer, formulation development, cGMP manufacturing, and packaging services.

For example, in early September, Societal announced two new contracts. The first contract supports development of novel immediate and extended-release capsule formulations on an investigational treatment for a range of neurodegenerative disease. Following completion of analytical methods and formulation activities, Societal will manufacture, package, and label the product for phase 1 clinical trials. If the investigational treatment moves ahead, we expect Societal will be well-positioned to continue providing developmental and manufacturing services through the regulatory process, and perhaps through commercialization.

Another contract is to provide developmental/manufacturing services for a topical gel drug candidate to combat hair loss. As with the first contract, Societal will provide analytical and formulation services, as well as clinical trial material manufacturing to support planned Phase 1/2a studies involving the investigational drug candidate. As the company continues to add new contracts, we expect further revenue growth.

Subsequent to 3Q22, the company has announced additional new deals. For example, Cingulate signed a MSA (Master Services Agreement) with Societal for Societal to manufacture all clinical, registration, and commercial batches of Cingulate's lead candidate CTx-1301, which is an investigational medication for the treatment of ADHD (Attention Deficit / Hyperactivity Disorder). Societal CDMO will dedicate a specific manufacturing suite within its Gainesville, Georgia facility to satisfying the Cingulate agreement. SCTL expects to close additional contracts per its segmented sales strategy, as well as to expand agreements with existing customers.



Source: Company presentation

Lannett Agreement: Terms Improved

The company also recently improved the terms of its agreement with Lannett. Lannett has been one of Societal's largest customers (representing 23% of total revenue in 2021) and a profit sharing partner. In 1H22, Lannett experienced a revenue shortfall. SCTL amended its license and supply agreement with Lannett for the marketing of Verapamil PM and Verelan products, including a 10% increase in the profit share on Verapamil PM sales in order to improve its economics. The modified agreement also now includes scheduled increases in manufacturing prices and awards SCTL potential new manufacturing agreements for additional Lannett development projects.

VALUATION

Given its anticipated higher growth than peers at this stage in its transformation, we would expect SCTL shares to command a multiple at the high end or even slightly above the roughly 16x to 18x EV/EBITDA average multiples peers in the CDMO space command. At a valuation of roughly $4 per SCTL share, based on our 2023 EBITDA forecast and reflecting the company's deleveraging, SCTL shares would trade at just under 19x on this basis.

As the company maintains growth initiatives such as expanding the customer base and boosting capacity utilization, these steps are expected to produce strong adjusted EBITDA expansion over the next few years. We therefore anticipate share price appreciation driven by improving adjusted EBITDA and some slight multiple expansion. We also believe there could be upside to our 2023 adjusted EBITDA estimate, as our forecast incorporates continued headwinds on mature legacy products such as of Verapamil PM and significant lead time during which revenue from new business ramps as the company brings on new agreements with Cingulate and others, as well as ongoing global supply chain challenges.

Thus, our valuation is based on the company's current state of development and could change with indications that 2023-24 revenue and adjusted EBITDA growth could beat our current forecast. We note that through 3Q22, Societal achieved cumulative revenue growth of 24% compared to the same period in 2021. We believe our 2023 forecast could be overly conservative in light of the many new contracts the company has signed and management's confidence in growing its pipeline of new business. We continue to see attractive potential for share price appreciation as the company's momentum continues.

RISKS

Risks to Societal achieving its objectives, and to our valuation, include the following.

- The sales and purchase agreement with David Weekley Homes might take longer than expected to close or might not close at all.
- The company might not diversify its customer base as quickly as management expects. Given the historical revenue concentration from a few customers with relatively mature legacy products, this could delay the company's ability to achieve certain operational and financial targets.
- Competition could increase and slow or hinder the company's growth initiatives
- If any of the company's development stage customers fail to obtain sufficient financing to advance their candidates, SCTL could lose customers and revenue.
- Rising cases of COVID-19 or other diseases could further impact global logistics challenges.
- The company might not be able to deleverage as quickly as management anticipates. Given the current interest rate environment, this could impact interest expense and earnings more than currently anticipated.
- SCTL might need to raise additional capital to finance its diversification and growth initiatives.

RECENT NEWS

- The company announced concurrent transactions focused on reducing debt and extending debt maturities on December 12, 2022.
- SCTL reported 3Q22 results on November 9, 2022.
- Societal announced the signing of multiple agreements with both new and existing customers on September 29, 2022.
- On September 7, 2022, Societal announced that it was awarded two new CDMO service contracts focused on supporting clinical development programs for novel therapeutic candidates.
- Societal signed a Sales and Purchase agreement with David Weekley Homes valued at more than $9 million on August 16, 2022.
- SCTL added three new customers on August 3, 2022, signing agreements to provide CDMO services to support clinical development of several novel therapeutic candidates.

FINANCIAL MODEL

Societal CDMO

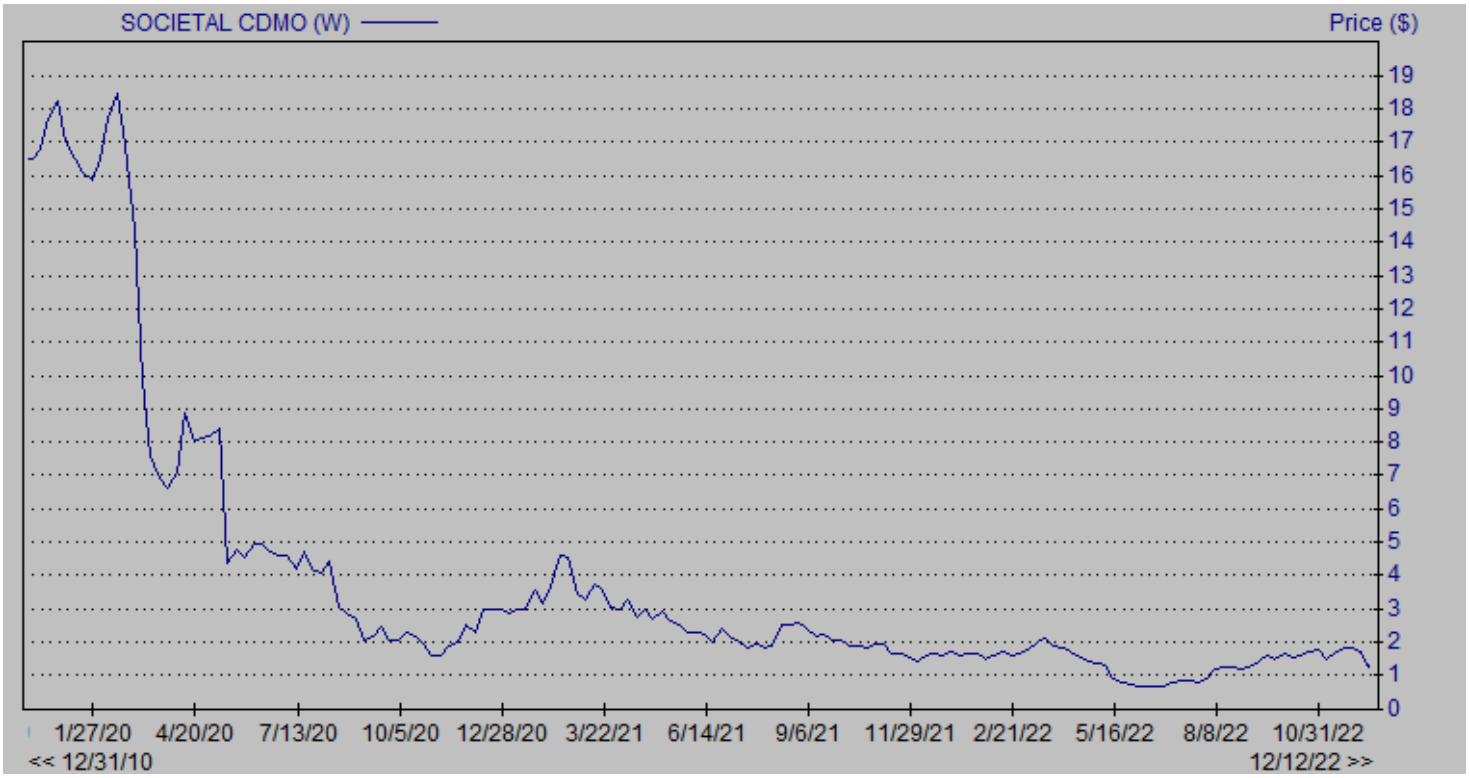
Societal CDMO Income Statement & Projections ($ thousands, except per share data)

	2020	1Q21	2Q21	3Q21	4Q21	2021	1Q22	2Q22	3Q22A	4Q22E	2022E	2023E
Revenue	66,499	16,803	18,017	18,237	22,303	75,360	21,194	23,152	21,589	25,202	91,137	96,542
y/y chg (%)							*26.1%*	*28.5%*	*18.4%*	*13.0%*	*20.9%*	*5.9%*
COGs	54,134	14,337	12,334	13,160	15,706	55,537	16,114	17,470	16,055	18,499	68,138	71,213
Gross profit	12,365	2,466	5,683	5,077	6,597	19,823	5,080	5,682	5,534	6,704	23,000	25,329
Gross margin	18.6%	14.7%	31.5%	27.8%	29.6%	26.3%	24.0%	24.5%	25.6%	26.6%	25.2%	26.2%
S,G&A	18,124	4,683	3,787	4,606	5,298	18,374	5,710	5,160	5,075	4,669	20,614	21,335
Amortization of intangible assets	2,583	646	54	135	202	1,037	221	220	244	244	929	948
Total operating expenses (incl COGs)	74,841	19,666	16,175	17,901	21,206	74,948	22,045	22,850	21,374	23,412	89,681	93,496
Operating income (loss)	(8,342)	(2,863)	1,842	336	1,097	412	(851)	302	215	1,791	1,457	3,046
Interest expense	(19,159)	(3,898)	(3,960)	(3,822)	(3,454)	(15,134)	(3,413)	(3,421)	(3,544)	(3,260)	(13,638)	(6,956)
Gain / other - debt extinguishment, refin'	-	-	3,352	-	-	3,352	-	-	-	(1,000)	(1,000)	-
Net loss	(27,501)	(6,761)	1,234	(3,486)	(2,357)	(11,370)	(4,264)	(3,119)	(3,329)	(2,470)	(13,182)	(3,910)
EPS or loss per share	($1.16)	($0.23)	$0.03	($0.07)	($0.04)	($0.26)	($0.08)	($0.06)	($0.06)	($0.04)	($0.23)	($0.04)
Avg shares out (FD)	23,744	29,738	39,352	51,416	55,964	44,117	56,351	56,599	56,666	62,083	57,925	89,166
Stock based comp	10,100	3,100	2,000	1,300	100	6,500	1,500	1,400	1,200	1,207	5,307	4,883
D&A	9,500	2,146	1,554	1,685	1,902	7,287	1,980	2,020	2,154	2,132	8,286	8,369
Other	2,700	300	-	1,800	100	2,200	(1,200)	900	1,200	480	1,380	1,035
Adj EBITDA	13,958	2,683	5,396	5,121	3,199	16,399	1,429	4,622	4,769	5,610	16,430	17,333
Adj EBITDA / share	$0.59	$0.09	$0.14	$0.10	$0.06	$0.37	$0.03	$0.08	$0.08	$0.09	$0.28	$0.19

Source: Company reports & Zacks

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

HISTORICAL STOCK PRICE



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

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, M. Marin, 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.