March 7, 2023

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: 2022 Underscores Success of Diversification & Growth Initiatives

SCTL has grown & diversified its customer base and expanded its service offerings and production capabilities. 4Q22 represented the second consecutive quarter of highest signed business in SCTL's operating history. SCTL signed $9.5M in new and expanded project agreements in the period, including $6+M in business with existing customers. We view it as a positive when existing customers expand and / or renew or extend agreements.

Current Price (3/6/23)	$1.25
Valuation	**$4.05**

OUTLOOK

Per its diversification / growth strategy, SCTL added 15 new development customers in 2022 and generated a record $19M in revenue from this vertical, compared to $12M and about $5.1M in 2021 and 2020, respectively. SCTL ended 2022 with about 45 active customers in this vertical compared to only four in 2020. SCTL believes this business line could reach revenue of $25M to $28M in 2023. Overall, the company also believes it has both sufficient production capacity and staff bandwidth to extend its service offerings into complementary areas & has identified several growth opportunities that it intends to pursue in 2023 and beyond. Notably, backlog was about $24M at year-end 2022.

SUMMARY DATA

52-Week High	**$2.19**
52-Week Low	**$0.62**
One-Year Return (%)	**-31.7**
Beta	**0.70**
Average Daily Volume (sh)	**211,013**
Shares Outstanding (mil)	**85**
Market Capitalization ($mil)	**$105**
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 2023 Estimate	**N/A**
P/E using 2024 Estimate	**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	24 A	90.2 A
2023	20 E	24 E	26 E	26 E	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	-$0.15 A	-$0.34 A
2023	-$0.05 E	-$0.02 E	-$0.01 E	-$0.01 E	-$0.08 E

Quarters might not sum due to rounding & share counts

Disclosures on page 9

© Copyright 2023, Zacks Investment Research. All Rights Reserved.

KEY POINTS: 2022 HIGHLIGHTS INCLUDE STRONG REVENUE / CUSTOMER GROWTH

- Societal CDMO registered a roughly 20% year-over-year revenue increase in 2022 (to $90.2 million), as it has grown and diversified its customer base and expanded its service offerings and production capabilities. The company recognized higher revenues from its clinical trial materials business and also benefitted from the first full year of revenue from IriSys, which it acquired in 3Q21.

- During 4Q22, SCTL signed $9.5 million in new and expanded project agreements, including more than $6 million in business agreements with existing customers. We view it as a positive when existing customers expand and / or renew or extend agreements. The quarter represented the second consecutive quarter of highest signed business in SCTL's operating history.

- The company added 15 new development customers in 2022 and generated a record roughly $19 million in revenue compared to $12 million and about $5.1 million in 2021 and 2020, respectively. SCTL ended 2022 with about 45 active customers from this vertical compared to only four in 2020. SCTL believes this vertical could reach revenue of $25 million to $28 million in 2023.

- The company has identified several growth opportunities that it intends to pursue in 2023 and beyond. The company believes it has both sufficient excess production capacity and staff bandwidth to extend its service offerings into complementary areas. For the full year 2023, the company expects to generate revenue ranging from $94 to $100 million. Notably, backlog was about $24 million at year-end 2022.

- We are optimistic about the benefits of the company's strategy leading to positive new business wins. 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 exceeded the industry average.

- In 2022, SCTL took several steps to strengthen its balance sheet, including refinancing and reducing debt. An important step towards the goal of strengthening the balance sheet and capital structure includes monetizing non-core real estate assets to pare debt. Such measures alleviate balance sheet concerns, we believe, and enable management to focus on its growth strategy as SCTL positions itself as an alternative to larger industry players for established and emerging drug companies.

2022 HIGHLIGHTS

Expanding & diversifying customer base

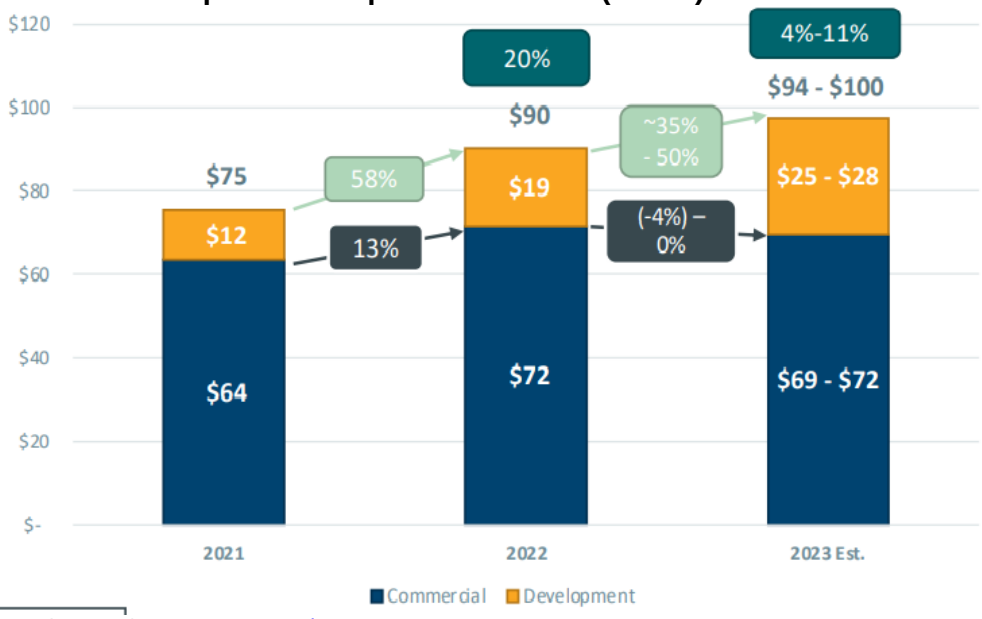
Societal CDMO (NASDAQ: SCTL), an established small-molecule CDMO, reported 4Q22 results last week, registering a 9% year-over-year revenue increase for the quarter (to $24.3 million) and roughly 20% for the year (to $90.2 million). Revenue for 4Q22 represents the highest revenue of any quarter over the past two years. The increase was driven primarily by an increase in European demand for Ritalin LA from a new customer, InfectoPharm, as well as an increase in revenue from Teva, which is Societal's largest commercial customer. Reflecting the timing of customer shipments, these increases were partially offset by lower year-over-year revenues from commercial product sales in San Diego. In 2022, Societal recognized higher revenues from its clinical trial materials business and also benefitted from the first full year of revenue from IriSys, which Societal acquired in 3Q21. These increases were partially offset by lower revenue from Lannett's commercial sales of Verapamil PM products.

Lannett is one of Societal's largest customers. It represented 16% of the company's total revenue in 2022 (which was down from 23% of total revenue in 2021, in part reflecting SCTL's ongoing diversification and growth initiatives and in part reflecting Lannett's decline in Verapamil PM sales). In 2022, the company improved the terms of its agreement with and a profit sharing partner. In 2022, 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.

Societal's non-legacy clinical trial business grew 58% year-over-year, as the company ended 2022 with a much larger and more diversified customer base compared to 2021. SCTL's customer base has grown about 3-fold over the past roughly two years. For example, during 4Q22, SCTL signed $9.5 million in new and expanded project agreements. The company signed more than $6 million in business agreements with existing customers during the quarter; we view it as a positive when existing customers expand and / or renew or extend agreements. The quarter represented the second consecutive quarter of highest signed business in Societal's operating history. New projects span clinical trial services, tech transfer and formulation development, among other services.

In terms of its development business, the company added 15 new development customers in 2022. SCTL generated a record roughly $19 million in revenue compared to $12 million and about $5.1 million in 2021 and 2020, respectively. SCTL ended 2022 with about 45 active customers from this vertical compared to only four in 2020. Given its customer base, active projects and those in the pipeline and its ongoing discussions with current and prospective customers, SCTL believes this vertical could reach revenue of $25 million to $28 million in 2023.

Societal Reported & Expected Revenue (2023E)



Source: Company presentation

The company's 2022 gross margin declined by about 66 bps to 25.6% -- as capacity utilization ramps, the company expects margins to expand over time. Including non-recurring charges, Societal reported a net loss of $19.9 million, or ($0.34) per share, compared to a net loss of $11.4 million, or ($0.26) in 2021. The 2022 net loss included refinancing costs, loss on extinguishment of debt and tax expense which aggregated just under $8 million, or $0.14 per share. Adjusted EBITDA was $16.2 million compared to $16.6 million in 2021 and was hurt by Lannett's lower Verapamil PM sales noted above.

Expanding service offerings to leverage existing capacity and team bandwidth…

The company has identified several growth opportunities that it intends to pursue in 2023 and beyond. This includes potentially introducing a biologics capability related to fill finish capabilities to complement its existing offerings. The company believes it has both sufficient excess production capacity and staff bandwidth to extend its service offerings into complementary areas. For the full year 2023, the company expects to generate revenue ranging from $94 to $100 million. Notably, backlog was about $24 million at year-end 2022. The company believes that, depending on the interest rate environment, raising funding for development and other projects might be challenging for some of its customers in the near-term. Nevertheless, the trend to outsource manufacturing is expected to continue in the long-term, as biotech and pharma companies increasingly see the value of CDMO services. The company expects to generate adjusted EBITDA ranging from $15 to $18 million in 2023.

We are optimistic about the benefits of the company's strategy leading to positive new business wins. 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 exceeded the industry average.

Balance sheet strengthening measures - extending maturities, lowering cost of capital & interest expense

In 2022, SCTL took several steps to strengthen its balance sheet. The company 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 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.

Sales-leaseback transaction 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.

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

- SCTL reported 2022 results on March 1, 2023.
- On February 1, 2023, Societal announced that it had signed more than $6 million in work orders in 4Q22.
- 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

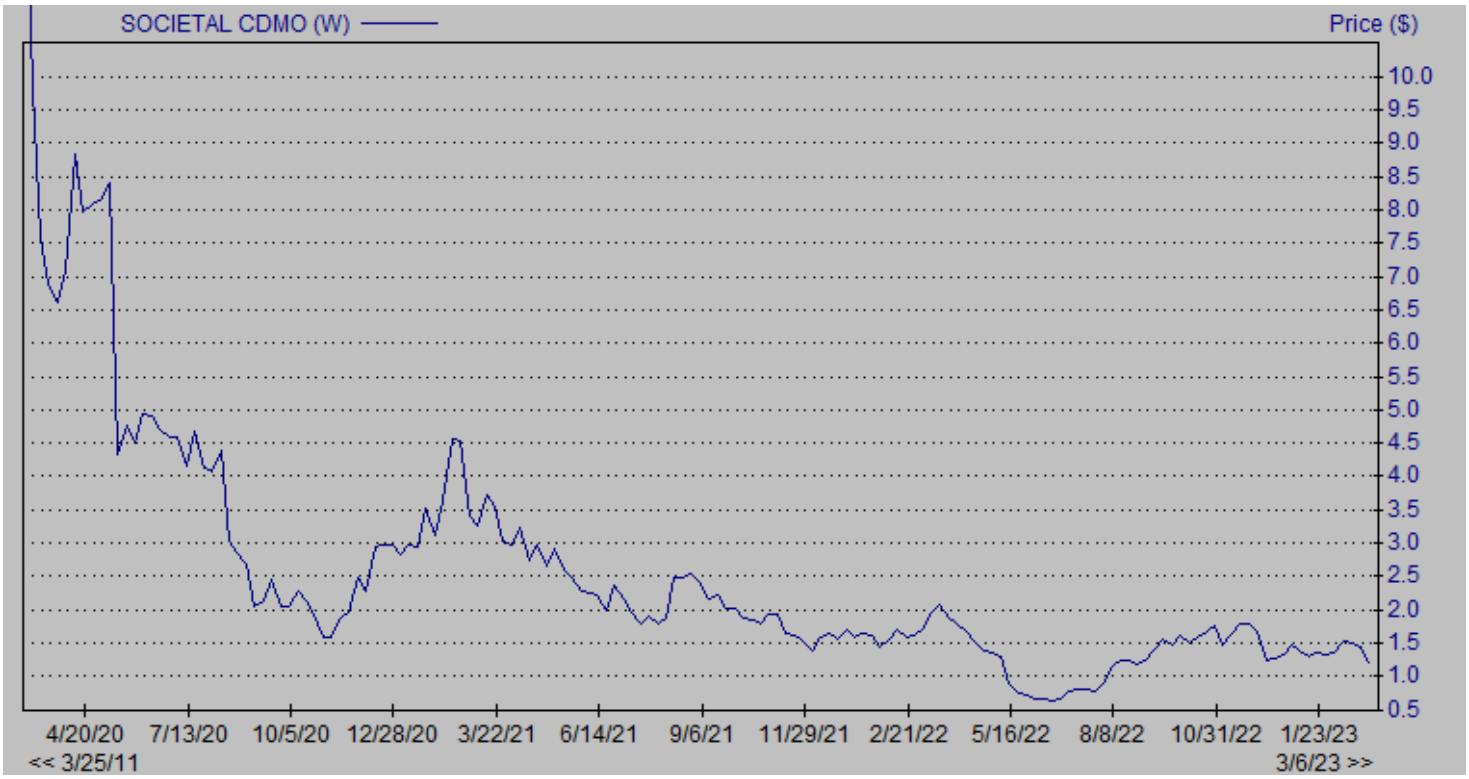
Societal CDMO Income Statement & Projections ($ thousands, except per share data)

	2020	2021	1Q22	2Q22	3Q22	4Q22A	2022A	1Q23E	2Q23E	3Q23E	4Q23E	2023E
Revenue	66,499	75,360	21,194	23,152	21,589	24,279	90,214	19,913	23,694	26,449	26,486	96,542
y/y chg (%)		*13.3%*	*26.1%*	*28.5%*	*18.4%*	*8.9%*	*19.7%*					
COGs	54,134	55,537	16,114	17,470	16,055	17,437	67,076	16,608	17,486	19,308	18,937	72,339
Gross profit	12,365	19,823	5,080	5,682	5,534	6,842	23,138	3,306	6,208	7,141	7,548	24,203
Gross margin	18.6%	26.3%	24.0%	24.5%	25.6%	28.2%	25.6%	16.6%	26.2%	27.0%	28.5%	25.1%
S,G&A	18,124	18,374	5,710	5,160	5,075	6,009	21,954	5,408	5,462	5,517	5,649	22,036
Amortization of intangible assets	2,583	1,037	221	220	244	220	905	222	224	227	236	910
Total operating expenses (incl COGs)	74,841	74,948	22,045	22,850	21,374	23,666	89,935	22,238	23,173	25,051	24,823	95,285
Operating income (loss)	(8,342)	412	(851)	302	215	613	279	(2,325)	521	1,398	1,663	1,257
Interest expense	(19,159)	(15,134)	(3,413)	(3,421)	(3,544)	(3,681)	(14,059)	(2,046)	(2,046)	(2,046)	(2,046)	(8,183)
Gain / other - debt extinguishment, refin'	-	3,352	-	-	-	(4,996)	(4,996)	-	-	-	-	-
Pretax loss	(27,501)	(11,370)	(4,264)	(3,119)	(3,329)	(8,064)	(18,776)	(4,370)	(1,525)	(648)	(383)	(6,926)
Taxes						1,105	1,105				100	100
Net loss						(9,169)	(19,881)	(4,370)	(1,525)	(648)	(483)	(7,026)
EPS or loss per share	($1.16)	($0.26)	($0.08)	($0.06)	($0.06)	($0.15)	($0.34)	($0.05)	($0.02)	($0.01)	($0.01)	($0.08)
Avg shares out (FD)	23,744	44,117	56,351	56,599	56,666	61,895	57,878	85,192	87,792	89,692	89,992	88,167
Stock based comp	10,100	6,514	1,500	1,400	1,200	1,279	5,379	1,292	1,305	1,318	1,331	5,245
D&A	9,500	7,568	1,980	2,020	2,154	2,121	8,275	2,178	2,222	2,369	2,388	9,158
Other	2,700	2,222	(1,200)	900	1,200	2,221	2,868	-	-	-	-	-
Adj EBITDA	13,958	16,716	1,429	4,622	4,769	6,234	16,801	1,145	4,048	5,085	5,382	15,660
Adj EBITDA / share	$0.59	$0.38	$0.03	$0.08	$0.08	$0.10	$0.29	$0.01	$0.05	$0.06	$0.06	$0.18

Source: Company reports & Zacks

© Copyright 2023, Zacks Investment Research. All Rights Reserved.

HISTORICAL STOCK PRICE



© Copyright 2023, 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.