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Zacks Small-Cap Research

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Societal CDMO (SCTL-NASDAQ)

SCTL: Adding Customers, Expanding Customer Relationships

SCTL continues expanding the customer base, deepening relationships with existing customers & strengthening its balance sheet. SCTL also continues to expand its core capabilities & recently received U.S. FDA approval for the manufacturing of commercial tablet at its Gainesville location. This represents the first commercial tablet that SCTL has been approved to manufacture, wh

Current Price (05/11/23)	$0.68
Valuation	**$1.20**

OUTLOOK

SCTL believes it has substantial opportunities to continue cross-marketing and cross-selling the broad range of services it offers. Societal signed $4.8 million in new and expanded projects in 1Q23, including adding four new customers and expanding project agreements across 12 existing programs. We view it as a positive when existing customers expand and / or renew or extend agreements. Importantly, SCTL owns the NDA and drug master file for Verapamil & expects that if it becomes necessary, it could shift to a different marketing partner from Lannett with limited disruption to Verapamil PM and Verelan SR sales.

SUMMARY DATA

52-Week High	**$1.84**
52-Week Low	**$0.64**
One-Year Return (%)	**-31.50**
Beta	**0.72**
Average Daily Volume (sh)	**212,659**
Shares Outstanding (mil)	**85**
Market Capitalization ($mil)	**$58**
Short Interest Ratio (days)	**N/A**
Institutional Ownership (%)	**49**
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-Value**
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	22 A	24 E	26 E	26 E	98.2 E

Earnings/Loss 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	-$0.06 A	-$0.03 E	-$0.01 E	-$0.01 E	-$0.11 E

Quarters might not sum due to rounding & share counts

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KEY POINTS

- Societal CDMO continues growth initiatives such as expanding the customer base, deepening relationships with existing customers, boosting capacity utilization and strengthening its balance sheet. The company believes it has created a 'concierge' type offering leveraging a broad and growing range of services and capabilities, while concurrently maintaining an agile operating structure that enables strong and speedy interaction with customers. These steps are expected to produce strong adjusted EBITDA expansion over the next few years.

- The company continues to expand its core capabilities in order to offer end-to-end solutions from early-stage development to scaled commercial production. For example, SCTL recently received U.S. FDA approval for the manufacturing of commercial tablet at its Gainesville, Georgia location. This represents the first commercial tablet that SCTL has been approved to manufacture, which broadens the offerings it can provide to customers.

- The company believes it has a substantial opportunities to continue cross-marketing and cross-selling the broad range of services it offers. Societal signed $4.8 million in new and expanded projects in 1Q23, including adding four new customers and expanding project agreements across 12 existing programs. We view it as a positive when existing customers expand and / or renew or extend agreements.

- Importantly, SCTL owns the NDA and the drug master file for Verapamil. Lannett, which has been its marketing partner for Verapamil since 2014, filed Chapter 11 bankruptcy earlier this month. Nevertheless, Lannett continues to perform under the terms of the company's agreement and SCTL has collected the majority of Lannett receivables. The company expects that if it needs to, it could shift to a different marketing partner with limited disruption to Verapamil PM and Verelan SR sales.

- The company expects margins to expand over 2023, as capacity utilization ramps and the revenue mix shifts towards higher margin services and projects and reiterated full year 2023 guidance; the company expects to generate revenue ranging from $94 to $100 million and adjusted EBITDA ranging from $15 to $18 million.

- As the company expands its overall customer base, SCTL added 15 new development customers in 2022 and continues to build on this momentum. Specifically, SCTL was selected by Xequel Bio to provide CDMO services to support ongoing clinical development efforts, including manufacturing the compound and placebo for upcoming Phase 2 clinical trials of iNexin™, and also signed a new customer agreement with Longboard Pharmaceuticals to support clinical development of LP352.

- In 2022, SCTL took several steps to strengthen its balance sheet and reduce debt and extend maturities. These measures are expected to reduce SCTL's annual interest expense by about $6.0 million, or by about 50+%. The company expects an additional $9+ million in proceeds from divestiture of non-core land in 2H23 that is earmarked to further pare debt.

1Q23 HIGHLIGHTS

Extending programs with existing customers; expanding & diversifying overall customer base

Societal CDMO (NASDAQ: SCTL), an established small-molecule CDMO, reported 1Q23 results that appear to trump a challenging industry backdrop. Revenue of $21.5 million was up slightly compared to 1Q22's $21.2 million. The company believes actions taken in 2022 laid the groundwork to position Societal for growth. The company has created a 'concierge' type offering leveraging a broad range of

services and capabilities, while concurrently maintaining a more agile and relatively smaller operating structure that provides customers access to top management.

The company continues to expand its core capabilities in order to offer end-to-end solutions from early-stage development to scaled commercial production. For example, SCTL recently received U.S. FDA approval for the manufacturing of commercial tablet at its Gainesville, Georgia location. This represents the first commercial tablet that SCTL has been approved to manufacture, which broadens the offerings it can provide to customers. Concurrently, SCTL has focused on strengthening its financial position. The company is also building upon existing relationships to increase programs and revenue from many current customers. The company has identified several growth opportunities that it intends to pursue in 2023 and beyond and believes it has both sufficient excess production capacity and staff bandwidth to extend its service offerings into complementary areas.



Source: Company presentation

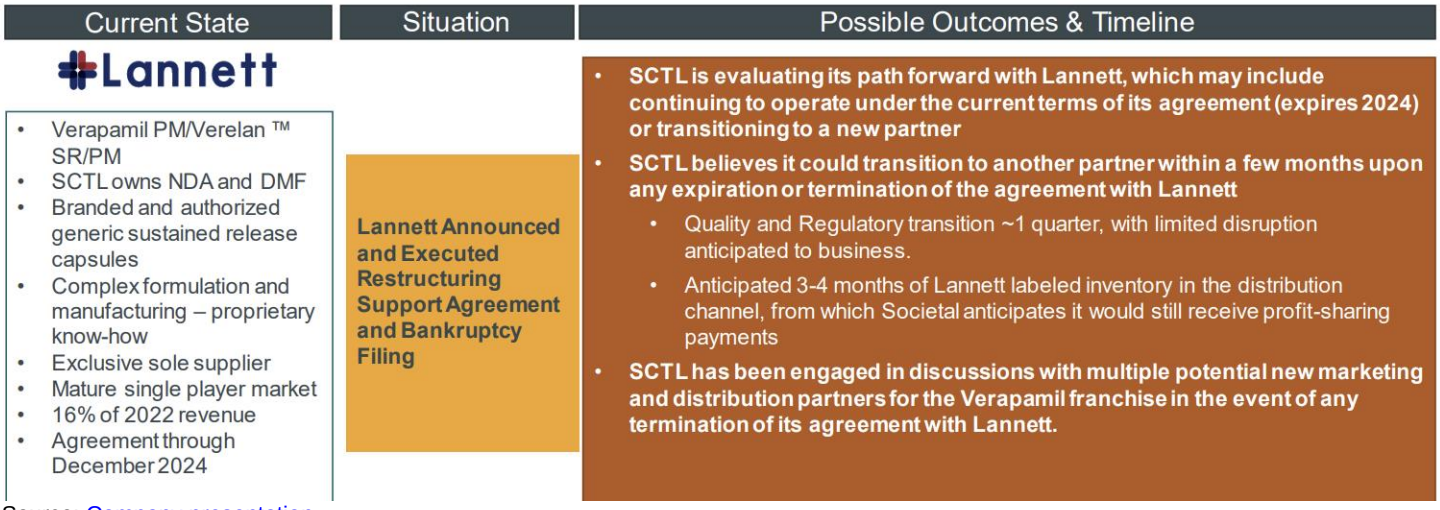
Societal was awarded several expansion agreements from existing customers in 1Q23. We view it as a positive when existing customers expand and / or renew or extend agreements. New projects span clinical trial services, tech transfer and formulation development, among other services. Gaining expansion projects from current customers is a core objective for the company. Moreover, the expansion agreements were for a range of services the company provides, including analytical, manufacturing, product encapsulation and packaging.

The company believes it has a substantial opportunities to continue cross-marketing and cross-selling the broad range of services it offers. Societal signed $4.8 million in new and expanded projects in 1Q23, including adding four new customers and expanding project agreements across 12 existing programs. The new business includes formulation and analytical method development, cGMP manufacturing, stability studies, packaging and logistics services. Societal believes that 1Q23 continued the 2022 momentum, with win-rates on new business exceeding the industry average. The company attributes this, in part, to its high-touch, customized service offerings that appeal to clients who seek to partner over the full drug development lifecycle.

SCTL's 1Q23 revenue increase largely reflected higher revenue from Teva, Societal's largest commercial customer. This increase was partially offset by lower revenue from Lannett's commercial sales of Verapamil PM products, reflecting the timing of customer orders. Lannett is one of Societal's largest customers.

Company believes it is well-positioned regarding Lannett

Since 2014, Lannett has been the company's marketing partner for Verapamil, which is a calcium channel blocker to treat hypertension. In 2022, the company improved the terms of its 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 included scheduled increases in manufacturing prices and awards SCTL potential new manufacturing agreements for additional Lannett development projects. Lannett represented 16% of the company's total revenue in 2022 (down from 23% in 2021, in part reflecting SCTL's ongoing diversification and growth initiatives, as well as Lannett's decline in Verapamil PM sales).



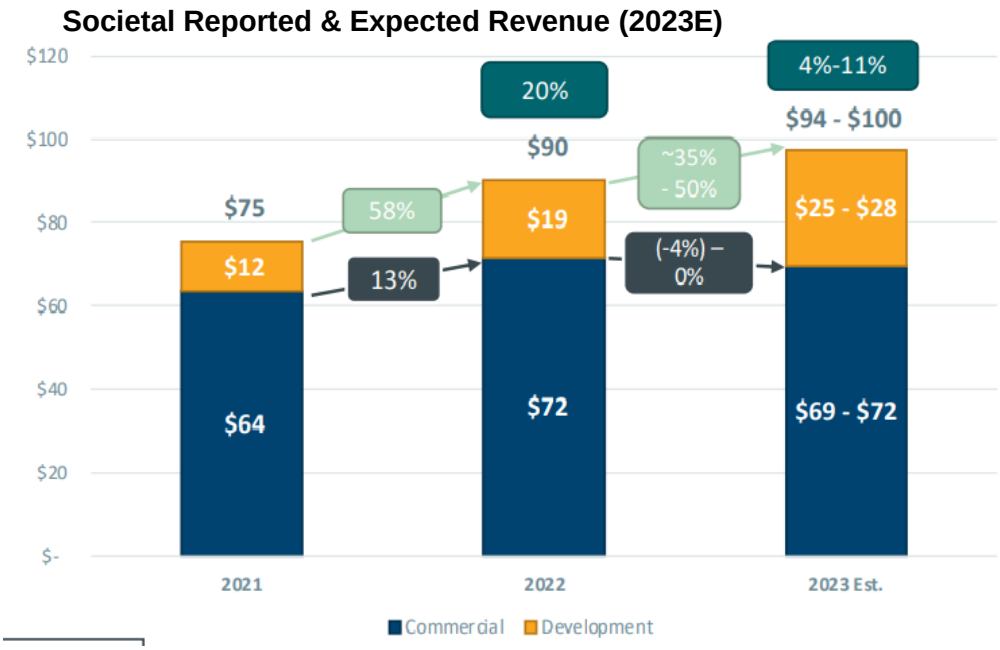
Source: Company presentation

Earlier this month, Lannett announced that it had filed Chapter 11 bankruptcy and proposed a plan of reorganization. Nevertheless, Lannett continues to perform under the terms of the company's amended agreement, according to SCTL. Lannett represented 17% of 1Q23 revenue and 19% of accounts receivable at the end of the quarter. SCTL has indicated that it had collected the majority of the Lannett receivables by May 8, 2023.

Moreover, Societal owns the NDA and the drug master file for Verapamil. The recent modifications to their agreement gives SCTL options to engage with other marketing partners under certain conditions and the company expects that if it needs to, it could shift to a different marketing partner with limited disruption to Verapamil PM and Verelan SR sales.

Expect margin expansion over 2023 …

The company's 1Q23 gross margin of 10.4% declined from about 24% in 1Q22, reflecting increased costs associated with a new aseptic fill/finish line and lower cost absorption, and the revenue mix. However, the company expects margins to expand over 2023, as capacity utilization ramps and the revenue mix shifts towards higher margin services and projects. Societal reported a net loss of $4.7 million, or ($0.06) per share, compared to a net loss of $4.3 million, or ($0.08) in 2Q22. Adjusted EBITDA was $0.6 million compared to $2.8 million, primarily reflecting the above-noted revenue mix and lower cost absorption, partially offset by lower S,G&A costs.



Source: Company presentation

SCTL reiterated full year 2023 guidance; the company expects to generate revenue ranging from $94 to $100 million and adjusted EBITDA ranging from $15 to $18 million. While the interest rate environment and uncertain economic backdrop could result in delays in initiating some customer programs in the near-term, the company expects the trend to outsource manufacturing to continue in the long-term, as biotech and pharma companies increasingly see the value of CDMO services.

As the company expands its overall customer base, SCTL added 15 new development customers in 2022 and continues to build on this momentum. Specifically, SCTL was selected by Xequel Bio to provide CDMO services to support ongoing clinical development efforts, including manufacturing the compound and placebo for upcoming Phase 2 clinical trials of iNexin™, and also signed a new customer agreement with Longboard Pharmaceuticals to support clinical development of LP352. Given its customer base, active projects and those in the pipeline and its ongoing discussions with current and prospective customers, SCTL believes the development vertical could reach revenue of $25 million to $28 million in 2023.

BALANCE SHEET MEASURES

Lowering net debt, 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 help 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 were earmarked to fully repay an existing debt facility with Athyrium Capital Management, plus fees and expenses. The Athyrium debt carried 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 roughly $39 million in non-dilutive gross proceeds were also earmarked for the elimination of the Athyrium Capital Management debt balance. In addition, Tenet 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

SCTL shares have come under increased pressure in 2023, reflecting (we believe) sector multiple compression, the Lannett bankruptcy and potential delays to the company's balance measures in this uncertain environment, among other factors. However, SCTL noted that it is conducting business as usual with Lannett and collecting its receivables. Moreover, we believe the balance sheet measures implemented in 2022 strengthen the company's capital position significantly and we also anticipate higher growth for SCTL than for peers at this stage in its transformation. In addition, the company has indicated that it expects to reach cash flow B/E by year-end 2024.

Our valuation is based on the company's current state of development and could change with changes to the 2023-24 outlook. At a valuation of roughly $1.20 per SCTL share, based on our 2023 EBITDA forecast and reflecting the company's deleveraging, SCTL shares would trade at just under 8x on this basis on a pro forma basis (for pending debt reductions).

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 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.

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.
- 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.
- If it needs to replace Lannett, SCTL might not find a replacement marketing partner as quickly as it anticipates.

RECENT NEWS

- SCTL reported 1Q23 results on May 10, 2023.
- On May 8, 2023, the company announced that it was selected by Xequel Bio to provide CDMO services to support the ongoing clinical development of iNexin™.
- On April 12, 2023, SCTL announced that it had signed multiple expansion agreements with existing customers.
- Societal announced its selection by Longboard Pharmaceuticals to provide CDMO services to support clinical development of LP352 on April 5, 2023.
- On March 20, 2023, SCTL announced that it had received U.S. FDA approval for the manufacturing of commercial tablet at its Gainesville, Georgia location.
- On February 1, 2023, Societal announced that it had signed more than $6 million in work orders in 1Q23.
- The company announced concurrent transactions focused on reducing debt and extending debt maturities on December 12, 2022.

FINANCIAL MODEL

Societal CDMO

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

	2020	2021	1Q22	2Q22	3Q22	4Q22A	2022A	1Q23A	2Q23E	3Q23E	4Q23E	2023E
Revenue	66,499	75,360	21,194	23,152	21,589	24,279	90,214	21,527	23,694	26,449	26,486	98,156
y/y chg (%)		*13.3%*	*26.1%*	*28.5%*	*18.4%*	*8.9%*	*19.7%*	*1.6%*	*2.3%*	*22.5%*	*9.1%*	*8.8%*
COGs	54,134	55,537	16,114	17,470	16,055	17,437	67,076	19,279	18,031	18,805	18,593	74,709
Gross profit	12,365	19,823	5,080	5,682	5,534	6,842	23,138	2,248	5,663	7,644	7,893	23,447
Gross margin	18.6%	26.3%	24.0%	24.5%	25.6%	28.2%	25.6%	10.4%	23.9%	28.9%	29.8%	23.9%
S,G&A	18,124	18,374	5,710	5,160	5,075	6,009	21,954	4,662	5,760	5,771	5,827	22,020
Amortization of intangible assets	2,583	1,037	221	220	244	220	905	184	184	184	184	737
Total operating expenses (incl COGs)	74,841	74,948	22,045	22,850	21,374	23,666	89,935	24,125	23,975	24,761	24,605	97,466
Operating income (loss)	(8,342)	412	(851)	302	215	613	279	(2,598)	(281)	1,688	1,881	690
Interest expense	(19,159)	(15,134)	(3,413)	(3,421)	(3,544)	(3,681)	(14,059)	(2,014)	(2,016)	(2,016)	(2,016)	(8,061)
Gain / other - debt extinguishment, refin'g	-	3,352	-	-	-	(4,996)	(4,996)	-	-	-	-	-
Pretax loss	(27,501)	(11,370)	(4,264)	(3,119)	(3,329)	(8,064)	(18,776)	(4,612)	(2,297)	(328)	(134)	(7,371)
Taxes						1,105	1,105	72			100	172
Net loss						(9,169)	(19,881)	(4,684)	(2,297)	(328)	(234)	(7,543)
EPS or loss per share	($1.16)	($0.26)	($0.08)	($0.06)	($0.06)	($0.15)	($0.34)	($0.06)	($0.03)	($0.01)	($0.01)	($0.11)
Avg shares out (FD)	23,744	44,117	56,351	56,599	56,666	61,895	57,878	84,800	87,792	89,692	89,992	88,069
Stock based comp	10,100	6,514	1,500	1,400	1,200	1,279	5,379	1,044	1,305	1,357	1,479	5,185
D&A	9,500	7,568	1,980	2,020	2,154	2,121	8,275	2,089	2,222	2,369	2,431	9,111
Other	2,700	2,222	(1,200)	900	1,200	2,221	2,868	74	-	-	-	74
Adj EBITDA	13,958	16,716	1,429	4,622	4,769	6,234	16,801	609	3,246	5,414	5,791	15,060
Adj EBITDA / share	$0.59	$0.38	$0.03	$0.08	$0.08	$0.10	$0.29	$0.01	$0.04	$0.06	$0.06	$0.17

Source: Company reports & Zacks

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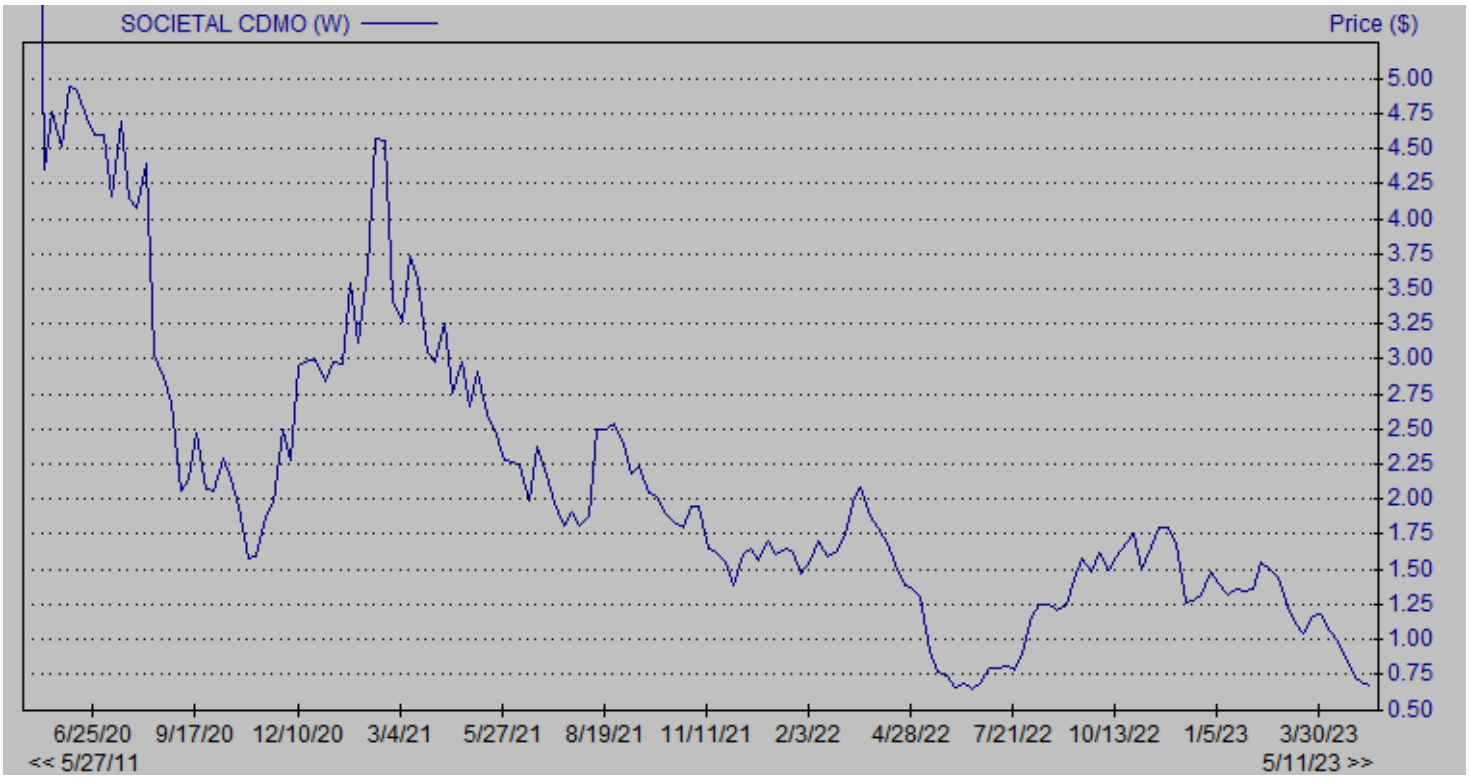

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