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Certara Third Quarter 2021 Earnings Call Transcript

November 9, 2021

David Deuchler (Investor Relations):

Good afternoon, everyone. Thank you all for participating in today's conference call. On the call from Certara, we have William Feehery, Chief Executive Officer; and Andrew Schemick, Chief Financial Officer. Earlier today, Certara released financial results for the quarter ended September 30, 2021. A copy of the press release is available on the company's website.

Before we begin, I'd like to remind you that management will make statements during this call that include forward-looking statements within the meaning of federal securities laws, which are made pursuant to the Safe Harbor provisions of the Private Securities Litigation Reform Act of 1995. Any statements contained in this call that relate to expectations or predictions of future events, results or performance are forward-looking statements. Actual results may differ materially from those expressed or implied in the forward-looking statements due to a variety of factors. For a list and description of the risks and uncertainties associated with Certara's business, please refer to the Risk Factors section of our Form 10-K filed with the Securities and Exchange Commission on March 15, 2021. We urge you to consider these factors and you should be aware that these statements should be considered estimates only and are not a guarantee of future performance.

Also, in their remarks or responses to questions, management may mention some non-GAAP financial measures. Reconciliations of adjusted EBITDA, adjusted net income, adjusted EPS, and certain other non-GAAP financial measures to the most directly comparable GAAP measures are available in the recent earnings press release which is available on the Company's website.

This conference call contains time-sensitive information and is accurate only as of the live broadcast today, November 9, 2021. Certara disclaims any intention or obligation except as required by law to update or revise any financial projections or forward-looking statements whether because of new information, future events, or otherwise.

And with that, I will turn the call over to William.

William Feehery (CEO):

Thank you, David. Good afternoon, everyone. Thank you for joining Certara's third quarter earnings call. Andrew and I will start with prepared remarks, and then we will take questions.

I am very pleased with how the Certara business performed in the third quarter of 2021, as we continued to successfully execute on our strategic and financial objectives.

In the third quarter, we continued to grow our position as a global leader in biosimulation by delivering strong financial results. Revenue grew 23% compared with the third quarter of 2020. Adjusted EBITDA grew 28% compared with the same period a year ago.

In the third quarter, we set a new record for the number of new customers. We experienced strong double-digit revenue growth across all geographic regions, including North America, Europe, and Asia Pacific. Overall, we are pleased with our year-to-date performance, which has been ahead of our expectations forecasted earlier in the year.

In early October, we announced the closing of the Pinnacle 21 acquisition, consistent with our previous expectations for a fourth quarter closing. The integration is going smoothly, and early feedback from employees and customers has been positive. As a reminder, Pinnacle 21 is an industry-leading data standardization software platform, used by the biopharmaceutical industry and regulatory agencies, for managing compliance with the CDISC standards. Pinnacle 21's advanced SaaS-based solutions are used by the US FDA and Japan's Pharmaceutical and

Medical Devices Agency to validate all incoming clinical submission data. The FDA recently awarded a 5-year contract to Pinnacle 21 for software and related services for the DataFit program.

The Pinnacle 21 team is now part of our biosimulation and regulatory software business. As a newly combined entity, we see opportunities for expansion within existing customers and landing new customers worldwide. The Pinnacle 21 Enterprise software is complementary to Certara's existing software and technology-driven services, and we are optimistic about cross-selling opportunities over time.

As we look to the future with Pinnacle 21, we are confident that the technology's solid position in a growing market will lead not only to increased revenue and profitability but also an advancement of our shared goal to innovate tools to accelerate life-saving therapies for patients.

In other exciting news, we received our fourth FDA grant to verify and expand biosimulation models for assessing virtual bioequivalence for development of generic dermal drugs.

Bioequivalence studies ensure that the rate and extent of absorption of the investigational drug are not significantly different from those of the comparable reference product, which is often a branded drug. Demonstrating bioequivalence is a regulatory hurdle for generic drug approvals, and biosimulation can significantly enhance the efficiency of generic drug development by streamlining or even waiving some clinical studies. For example, Certara's Simcyp™ MechDermA model, was used to demonstrate virtual bioequivalence for a topical gel, classified as a complex generic.

We are also very pleased to share that Certara's Simcyp COVID-19 Vaccine Model was named a winner of an R&D 100 Award! Certara's COVID-19 Vaccine model uses biosimulation to optimize dosing regimens and helps inform the design of clinical studies involving COVID-19

vaccine candidates. For example, the model can be used to investigate potential differences in vaccine responses associated with age and ethnicity, or to optimize the time interval between doses by predicting the expected duration of antibody response. It was also named a finalist in the Informa Pharma Intelligence's 2021 Citeline Awards for its contributions to COVID-19 clinical activities. Citeline winners will be announced next spring.

The external recognition of our Simcyp COVID-19 Vaccine Model is a testament to the utility of this product in the global effort to combat the COVID epidemic. More broadly, Certara's Vaccine Simulator covers a range of applications, and is now being used to help develop vaccines in oncology and respiratory syncytial virus.

As outlined in our strategy, we continue to invest in the business and add to our expert team worldwide. At the end of the third quarter, prior to Pinnacle 21 closing, we had more than 1000 employees, representing growth of nearly 14% year to date. Following the Pinnacle 21 closing, we have approximately 1,100 employees. We continue to expand our commercial footprint worldwide with a new chief commercial officer and additional business development hires worldwide. Nearly half of our new hires in the third quarter were scientists and subject matter experts, and now we have approximately 350 employees with doctorate degrees. In a recent study by Elsevier and Stanford University, seven of Certara's scientists were ranked in the top 2% based on standardized citation metrics. We are incredibly proud that these seven scientific leaders were featured on this list in the fields of pharmacology, toxicology, pediatrics, endocrinology and metabolism as well as microbiology and chemistry. It is the Certara culture and commitment to innovation and customer partnerships that attract top talent in a very competitive environment. We continue to prioritize making Certara a great place to work.

Yesterday, we announced that James Cashman will be our new Chairman of the Board of Directors. He is succeeding Sherilyn McCoy, who has decided to step down from our board to

focus on other professional commitments. On behalf of the Board, I would like to thank Sheri for her contributions and wish her all the best in her future endeavors. I am excited to continue working closely with Jim, who has been an independent board member at Certara since 2018. Jim has a proven track record as the previous CEO and Executive Chairman at Ansys, the global leader of engineering simulation software. His passion for simulation-driven product development will help continue to advance Certara's innovation and global expansion.

Finally, I am pleased that we will be hosting our inaugural investor day at the Nasdaq MarketSite in New York City on December 15th! Our investor day will feature presentations from Certara's leadership team, including our Business Unit Presidents, with a focus on our proprietary technologies and positioning to further grow the company. We are excited to meet you in person next month. If you cannot join in person, you can view the live stream of our Investor Day online on our investor relations website.

In summary, Certara had a strong third quarter, which demonstrated accelerated progress towards our goals and expectations. Looking forward, we are focused on delivering on our strategic and financial objectives.

I will now turn it over to our CFO Andrew to discuss third quarter financial results and the financial impact of Pinnacle 21.

Andrew Schemick (CFO):

Thank you, William. Hello everyone.

Before getting into the third quarter, I would like to touch on the financial highlights of our acquisition of Pinnacle 21.

As William stated earlier, we are excited to work with the Pinnacle 21 team, and the integration is off to a smooth start. Pinnacle 21 is a strong financial and cultural fit with Certara, and the

transaction is expected to be immediately accretive to our key financial metrics. As previously discussed, we are currently forecasting Pinnacle 21 2022 revenue to be in the range of \$30-\$32 million, exclusive of purchase accounting adjustments. We are currently forecasting revenue of approximately \$6 million in fourth quarter 2021 from Pinnacle 21 out of an expected FY pro forma revenue of \$23-\$24 million, exclusive of purchase accounting adjustments. To that point, we will have a purchase accounting adjustment in reported revenue related to Pinnacle's software deferred revenue in the fourth quarter, and throughout 2022. The impact of the deferred revenue valuation adjustment is expected to be in the range of \$4 million -\$5 million in the fourth quarter. We also expect the Pinnacle 21 acquisition to have adjusted EBITDA margins modestly higher than Certara corporate average in the fourth quarter of 2021 and look for them to expand in calendar year 2022.

Now to base Certara's results, total revenue for the three months ended September 30, 2021 was \$73.9 million, representing year-over-year growth of 23%. Year-to-date bookings were \$229.2 million, up 12% year-over-year and up 15% on a trailing twelve-month basis. The general business environment for bookings was slow during the first two months of the quarter, but the recent trends and pipeline for the fourth quarter position us well to achieve our guidance and maintain high visibility. After October results, the trailing twelve months bookings were up 18% versus the same period last year. As a reminder, I continue to look at trailing twelve months bookings as a predictor of forward twelve-month bookings, and on this metric, Certara is delivering in line with our long-term forecast of mid-teens organic revenue growth.

Software revenue was \$19.3 million, which increased 9% over the prior year period as a result of strong third quarter bookings, new logos and expansions on renewals. Software bookings were \$20.9 million, which increased 28% from the prior year period and the aggregate renewal rate was 87%. The aggregate renewal rate was below our target primarily due to re-timed

renewals. Year to date software bookings grew 19%, and the aggregate renewal rate was 90%. The growth in the quarter and year to date was driven by our biosimulation software - Simcyp and Phoenix, which are up 17% year to date.

Services revenue was \$54.7 million, which increased 28% over the prior year period. The growth in services revenue was driven by the recognition of delayed tech-driven regulatory services as well as strong growth in biosimulation offerings. Services bookings were \$51.4 million, which decreased 10% from the prior year period. If you recall, Q3 of last year benefited from a bolus of bookings that were delayed from the first half of the year during the start of the COVID-19 pandemic. Year to date services bookings are up 10%, and we have seen services bookings pick up in September and October after a couple of slow months during the summer. Looking forward, the pipeline is strong, and Q3 performance is mostly reflective of timing.

Total cost of revenue for the third quarter of 2021 was \$28.8 million, an increase from \$23.0 million in the third quarter of 2020, primarily due to increases in employee-related costs resulting from billable headcount growth and stock-based compensation.

Total operating expenses for the third quarter of 2021 were \$45.9 million, an increase from \$26.9 million in the third quarter of 2020. The components of operating expenses are as follows:

Sales & Marketing expenses were \$5.1 million compared to \$3.1 million for the third quarter of 2020 due to a \$1.1 million increase in employee-related costs resulting from headcount growth and \$0.6 million in stock-based compensation.

R&D expenses were \$4.5 million compared to \$3.3 million for the third quarter of 2020. The increase in R&D expenses was primarily due to a \$0.9 million increase in employee related costs resulting from headcount growth and \$0.5 million increase in stock-based compensation both of which were partially offset by smaller reductions in other line items.

G&A expenses were \$26.2 million compared to \$13.4 million for the third quarter of 2020. The increase was primarily due to \$7.4M of acquisition costs, \$4.5 million increase in stock base compensation costs, and \$0.7 million increase in insurance expenses. Also contributing to the increase were public company costs which year to date have added approximately \$4 million to our cost structure.

Intangible asset amortization was \$9.6 million, and depreciation and amortization expense was \$0.5 million for the third quarter. There were no significant changes in either line item.

Continuing down the P&L, interest expense during the third quarter was \$3.3 million compared to \$5.9 million for the third quarter of 2021. The year over year reduction in interest expense is due to the repayment of our holdco loan last year.

Income tax benefit was \$1.6 million due to the tax effect of U.S. pre-tax loss, non-deductible items, the effects of tax elections made on UK earnings and the relative mix of domestic and international earnings and discrete tax items.

Net loss for the third quarter of 2021 was (\$1.8) million, compared to a net income of \$1.2 million in the third quarter of 2020 due primarily to the increase in stock-based compensation expense and acquisition costs which were partially offset by higher revenue and lower interest expense.

Diluted loss per share for the third quarter 2021 was (\$0.01), as compared to earnings per share of \$0.01 in the third quarter of 2020.

Adjusted EBITDA for the third quarter of 2021 was \$26.1 million compared to \$20.5 million for the third quarter of 2020, representing 28% growth. We continue to perform well against our plan and have made some upward adjustments to guidance based on the year-to-date performance, as well as the impact of Pinnacle 21.

Adjusted net income for the third quarter of 2021 was \$10.8 million compared to \$3.3 million for the third quarter of 2020.

Adjusted diluted earnings per share for the third quarter 2021 was \$0.07 compared to \$0.02 for the third quarter of 2020.

Now, moving to the balance sheet, we ended the quarter with \$416.8 million of cash and cash equivalents which includes net proceeds of \$133 million from our offering earlier in the quarter. \$250 million of the cash balance was planned for the Pinnacle 21 acquisition and post-closing our cash position and balance sheet remain strong after the effect of the acquisition.

As of September 30, 2021, we had \$301.2 million of outstanding borrowings on the term loan, and \$100 million of availability under the revolving credit facility under the Credit Agreement.

Regarding financial outlook, we are increasing our previously reported guidance for full year 2021 revenue, adjusted EBITDA, and adjusted EPS, including Pinnacle 21.

GAAP revenue in the range of \$288-\$291 million,

Adjusted revenue in the range of \$292-\$295 million, which excludes the P21 deferred revenue valuation adjustment of approximately \$4 - \$5 million

Adjusted EBITDA in the range of \$106-\$108 million, including \$2-\$3 million from Pinnacle 21

Adjusted EPS in the range of \$0.22 - \$0.26 per share

Fully diluted share in the range of 155-156 million, which includes the impact of the 4.5 million shares sold in our secondary offering in the third quarter and approximately 2.2 million shares relating the Pinnacle 21 acquisition.

Thank you.

Now I'll turn it back over to our CEO William Feehery.

William Feehery (CEO)

Thank you, Andrew. In summary, Certara had a strong third quarter, highlighted by our robust financial results, operational performance, and we hit the ground running in Q4 with the acquisition of Pinnacle 21. Our Certara team continues to focus on our commitments to customers and deliver strong growth for our shareholders.

We believe that our end-to-end platform is well-positioned to continue benefiting from solid market trends. We expect to capture a larger share of overall biopharmaceutical R&D spend as we continue to innovate, acquire, and add new solutions to our end-to-end platform.

At this point, we will open up the call for questions.

Operator, can you open up the line?