

## Schrodinger, Inc.

## 2023: one step forward, 2024: one step back

Reiterate Rating: NEUTRAL | PO: 32.00 USD | Price: 31.37 USD

## 4Q sales 6% below Street on lower DD contribution

Schrodinger (SDGR) reported 4Q revenues of \$74mn (+30% y/y) below BofAe/Street ests of \$81/79mn. Software revenue came in at \$69mn vs BofAe \$68mn, benefiting from several large multi-year contract renewals. Drug Discovery (DD) revenue of \$5.5mn was below BofAe \$12.9mn. Gross Margins came in at 78% (vs BofA/Street ests of 69/62%) with Software Gross Margins of 87% vs BofAe of 82%. On the bottom line, a net loss of -\$31mn was steeper than BofAe/Street -\$14/- \$29mn.

## FY24 guide disappoints, Software sales seen ~7% below

SDGR's FY24 guidance came in below expectations. While Mgmt. had signaled earlier in Jan. that DD sales would be "similar to or lower than 2022 levels" of ~\$45mm ([see our Jan 8 note for details](#)), they are now seen as \$30-\$35mn in the formal guide. More concerning, SDGR's outlook calls for Software sales growth of 6-13% (vs BofAe 16%). Mgmt. attributed the muted Software growth range to the challenging comp created by the large renewals seen in 4Q23 and ongoing weakness among smaller customers. While we acknowledge these dynamics, we highlight that FY23 Software was only marginally above the midpt of guidance and likely would have fallen short if not for the multi-year renewals. Considering this, the 2yr stack for Software implies a meaningful slowdown.

## Balance sheet remains healthy; OpEx growth moderating

Mgmt. expects FY24 OpEx growth of 8-12% (vs 28% in 2023) as SG&A functions are seen as nearing the appropriate scale for SDGR's customer base. Although somewhat surprising given SDGR's commercial ambitions, we see potential that this may be an early indicator of an inflection in operating leverage for the company. While operating cash burn is expected to increase y/y, mgmt remains comfortable with their runway and unrealized value in their equity stakes and proprietary portfolio.

## Lower estimates; PO to \$32; Reiterate Neutral

Overall, it was a disappointing update, with FY24 guidance coming in materially worse than most expectations. The change in DD guidance methodology is understandable, but we're left with lingering questions on how much of the weak outlook for Software growth (even on a stacked basis) is a function of conservatism versus a change in underlying markets. We lower our estimates and our DCF-based PO to \$32 (was \$38, still ~12.5% WACC and ~4.5% terminal growth). We reiterate our Neutral rating as while we continue to see SDGR's platform as having significant promise, 4Q23 was another reminder that there is still a long path to the company's full potential and value.

Estimates (Dec) (US\$)	2022A	2023A	2024E	2025E	2026E
EPS	(2.10)	0.54	(2.69)	(2.69)	(2.85)
EPS Change (YoY)	-47.9%	NM	NM	0%	-5.9%
Consensus EPS (Bloomberg)			(2.11)	(1.32)	(0.54)
DPS	0	0	0	0	0
Valuation (Dec)					
P/E	NM	58.1x	NM	NM	NM
Free Cash Flow Yield*	-5.5%	-6.5%	-7.8%	-6.8%	-7.2%

\* For full definitions of *IQmethod*<sup>SM</sup> measures, see page 4.

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Timestamp: 28 February 2024 11:20PM EST

28 February 2024

## Equity

## Key Changes

(US\$)	Previous	Current
Price Obj.	38.00	32.00
2024E Rev (m)	228.1	205.0
2025E Rev (m)	290.0	245.0
2026E Rev (m)	350.3	300.0
2024E EBITDA (m)	-188.0	-214.2
2025E EBITDA (m)	-173.9	-211.2
2026E EBITDA (m)	-163.3	-220.9

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## Stock Data

Price	31.37 USD
Price Objective	32.00 USD
Date Established	28-Feb-2024
Investment Opinion	C-2-9
52-Week Range	20.76 USD - 59.24 USD
Mkt Val (mn) / Shares Out (mn)	2,316 USD / 73.8
Free Float	97.5%
Average Daily Value (mn)	24.05 USD
BofA Ticker / Exchange	SDGR / NAS
Bloomberg / Reuters	SDGR US / SDGR.OQ
ROE (2024E)	-38.8%
Net Dbt to Eqty (Dec-2023A)	-29.4%
ESGMeter <sup>TM</sup>	Medium

ESGMeter is not indicative of a company's future stock price performance and is not an investment recommendation or rating. ESGMeter is independent of BofA Global Research's equity investment rating, volatility risk rating, income rating, and price objective for that company. For full details, refer to "BofA ESGMeter Methodology".

# iQprofile<sup>SM</sup> Schrodinger, Inc.

## iQmethod<sup>SM</sup> – Bus Performance\*

(US\$ Millions)	2022A	2023A	2024E	2025E	2026E
Return on Capital Employed	-20.7%	-22.7%	-28.4%	-26.3%	-22.9%
Return on Equity	-29.7%	8.2%	-38.8%	-35.3%	-29.6%
Operating Margin	-81.1%	-81.9%	-107.7%	-89.3%	-76.5%
Free Cash Flow	(128)	(150)	(180)	(157)	(167)

## iQmethod<sup>SM</sup> – Quality of Earnings\*

(US\$ Millions)	2022A	2023A	2024E	2025E	2026E
Cash Realization Ratio	NM	-3.4x	NM	NM	NM
Asset Replacement Ratio	1.8x	2.4x	2.2x	2.0x	1.9x
Tax Rate	NM	5.1%	NM	NM	NM
Net Debt-to-Equity Ratio	-21.4%	-29.4%	-16.3%	-34.3%	-44.5%
Interest Cover	NA	NA	NA	NA	NA

## Income Statement Data (Dec)

(US\$ Millions)	2022A	2023A	2024E	2025E	2026E
Sales	181	217	205	245	300
% Change	31.2%	19.7%	-5.4%	19.5%	22.4%
Gross Profit	101	141	134	155	183
% Change	53.9%	39.3%	-4.9%	16.1%	18.1%
EBITDA	(142)	(172)	(214)	(211)	(221)
% Change	-31.2%	-20.7%	-24.6%	1.4%	-4.6%
Net Interest & Other Income	(2)	220	18	16	14
<b>Net Income (Adjusted)</b>	<b>(149)</b>	<b>41</b>	<b>(203)</b>	<b>(203)</b>	<b>(216)</b>
<b>% Change</b>	<b>-48.6%</b>	<b>NM</b>	<b>NM</b>	<b>0%</b>	<b>-6.2%</b>

## Free Cash Flow Data (Dec)

(US\$ Millions)	2022A	2023A	2024E	2025E	2026E
Net Income from Cont Operations (GAAP)	(149)	41	(203)	(203)	(216)
Depreciation & Amortization	4	6	7	8	9
Change in Working Capital	(21)	(23)	(20)	0	0
Deferred Taxation Charge	NA	NA	NA	NA	NA
Other Adjustments, Net	47	(160)	51	54	57
Capital Expenditure	(8)	(13)	(14)	(15)	(16)
<b>Free Cash Flow</b>	<b>-128</b>	<b>-150</b>	<b>-180</b>	<b>-157</b>	<b>-167</b>
<b>% Change</b>	<b>-64.1%</b>	<b>-17.6%</b>	<b>-19.9%</b>	<b>12.8%</b>	<b>-6.1%</b>
Share / Issue Repurchase	2	9	0	0	0
Cost of Dividends Paid	NA	NA	NA	NA	NA
Change in Debt	0	0	0	0	0

## Balance Sheet Data (Dec)

(US\$ Millions)	2022A	2023A	2024E	2025E	2026E
Cash & Equivalents	96	161	81	224	357
Trade Receivables	56	66	62	75	91
Other Current Assets	382	341	340	342	345
Property, Plant & Equipment	14	23	31	39	47
Other Non-Current Assets	140	212	212	212	212
<b>Total Assets</b>	<b>689</b>	<b>803</b>	<b>727</b>	<b>892</b>	<b>1,052</b>
Short-Term Debt	0	0	0	0	0
Other Current Liabilities	109	134	109	118	128
Long-Term Debt	0	0	0	0	0
Other Non-Current Liabilities	132	121	121	121	121
<b>Total Liabilities</b>	<b>241</b>	<b>254</b>	<b>230</b>	<b>239</b>	<b>249</b>
<b>Total Equity</b>	<b>448</b>	<b>549</b>	<b>497</b>	<b>653</b>	<b>803</b>
<b>Total Equity &amp; Liabilities</b>	<b>689</b>	<b>803</b>	<b>727</b>	<b>892</b>	<b>1,052</b>

\* For full definitions of iQmethod<sup>SM</sup> measures, see page 4.

## Company Sector

Healthcare Technology & Distribution

## Company Description

Schrodinger provides a physics-based software platform that can be used by pharmaceutical and biotech companies to more efficiently design and optimize novel drug candidates. Via Schrodinger's software as a service platform, drug discovery can potentially be faster, cheaper, and more efficient than by traditional methods. Schrodinger is also leveraging its software platform to support internal drug discovery projects.

## Investment Rationale

Schrodinger is well positioned to benefit from secular positive growth trends in pharma R&D spending, and the need for more efficient drug discovery methods. We believe SDGR has a substantial opportunity to grow in its core market, and while the drug discovery business offers additional upside, there is more limited visibility in the near term, capping upside and leaving us more cautious.

## Stock Data

Average Daily Volume 766,744

## Quarterly Earnings Estimates

	2023	2024
Q1	1.75A	-0.74E
Q2	0.06A	-0.75E
Q3	-0.86A	-0.78E
Q4	-0.39A	-0.42E

## Price objective basis & risk

### Schrodinger, Inc. (SDGR)

Our \$32 price objective is discounted cash flow (DCF)-based, with roughly 12.5% weighted-average cost of capital (WACC) and 4.5% terminal growth rate. This also equates to roughly 10x 2024E EV/Sales multiple, which is a premium to most names in the peer group, but reflects the additional long-term upside offered by the drug discovery business.

Downside risks are competition, drug development uncertainty, revenue volatility, and lack of profitability/potential need for further capital.

## Analyst Certification

I, Michael Ryskin, hereby certify that the views 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 specific recommendations or view expressed in this research report.

### US - Life Science, Diagnostic Tools and Animal Health Coverage Cluster

Investment rating	Company	BofA Ticker	Bloomberg symbol	Analyst
<b>BUY</b>				
	Avantor, Inc.	AVTR	AVTR US	Michael Ryskin
	Bruker Corporation	BRKR	BRKR US	Derik de Bruin
	Certara	CERT	CERT US	Michael Ryskin
	Charles River Laboratories	CRL	CRL US	Derik de Bruin
	Elanco Animal Health	ELAN	ELAN US	Michael Ryskin
	Exact Sciences	EXAS	EXAS US	Derik de Bruin
	Guardant Health	GH	GH US	Derik de Bruin
	ICON plc	ICLR	ICLR US	Derik de Bruin
	IQVIA Holdings Inc	IQV	IQV US	Derik de Bruin
	LabCorp	LH	LH US	Derik de Bruin
	Maravai	MRVI	MRVI US	Michael Ryskin
	Qiagen	QGEN	QGEN US	Derik de Bruin
	Qiagen N.V.	XQGNF	QIA GY	Derik de Bruin
	Quest Diagnostics	DGX	DGX US	Derik de Bruin
	Stevanato Group S.p.A.	STVN	STVN US	Derik de Bruin
	Thermo Fisher Scientific	TMO	TMO US	Derik de Bruin
	West Pharmaceutical Services	WST	WST US	Derik de Bruin
	Zoetis Inc.	ZTS	ZTS US	Michael Ryskin
<b>NEUTRAL</b>				
	10x Genomics, Inc.	TXG	TXG US	Michael Ryskin
	Agilent Technologies	A	A US	Derik de Bruin
	Danaher Corporation	DHR	DHR US	Michael Ryskin
	Evotec SE	EVO	EVO US	Michael Ryskin
	Hologic, Inc.	HOLX	HOLX US	Derik de Bruin
	IDEXX Laboratories	IDXX	IDXX US	Michael Ryskin
	Mettler-Toledo	MTD	MTD US	Derik de Bruin
	NeoGenomics Inc.	NEO	NEO US	Derik de Bruin
	Revvity Inc	RVTY	RVTY US	Derik de Bruin
	Schrodinger, Inc.	SDGR	SDGR US	Michael Ryskin
	Waters Corp.	WAT	WAT US	Derik de Bruin
<b>UNDERPERFORM</b>				
	Align Technology	ALGN	ALGN US	Michael Ryskin
	Fortrea	FTRE	FTRE US	Derik de Bruin



## US - Life Science, Diagnostic Tools and Animal Health Coverage Cluster

Investment rating	Company	BofA Ticker	Bloomberg symbol	Analyst
	Ginkgo Bioworks Holdings, Inc	DNA	DNA US	Derik de Bruin
	Illumina, Inc.	ILMN	ILMN US	Michael Ryskin
	Myriad Genetics	MYGN	MYGN US	Derik de Bruin
	Phibro Animal Health	PAHC	PAHC US	Michael Ryskin

**iQmethod<sup>SM</sup> Measures Definitions****Business Performance**

Return On Capital Employed

Return On Equity

Operating Margin

Earnings Growth

Free Cash Flow

**Numerator**

NOPAT = (EBIT + Interest Income) × (1 – Tax Rate) + Goodwill Amortization

Net Income

Operating Profit

Expected 5 Year CAGR From Latest Actual

Cash Flow From Operations – Total Capex

**Denominator**

Total Assets – Current Liabilities + ST Debt + Accumulated Goodwill Amortization

Shareholders' Equity

Sales

N/A

N/A

**Quality of Earnings**

Cash Realization Ratio

Asset Replacement Ratio

Tax Rate

Net Debt-To-Equity Ratio

Interest Cover

**Numerator**

Cash Flow From Operations

Capex

Tax Charge

Net Debt = Total Debt – Cash &amp; Equivalents

EBIT

**Denominator**

Net Income

Depreciation

Pre-Tax Income

Total Equity

Interest Expense

**Valuation Toolkit**

Price / Earnings Ratio

Price / Book Value

Dividend Yield

Free Cash Flow Yield

Enterprise Value / Sales

**Numerator**

Current Share Price

Current Share Price

Annualised Declared Cash Dividend

Cash Flow From Operations – Total Capex

EV = Current Share Price × Current Shares + Minority Equity + Net Debt +

Other LT Liabilities

Enterprise Value

**Denominator**

Diluted Earnings Per Share (Basis As Specified)

Shareholders' Equity / Current Basic Shares

Current Share Price

Market Cap = Current Share Price × Current Basic Shares

Sales

Basic EBIT + Depreciation + Amortization

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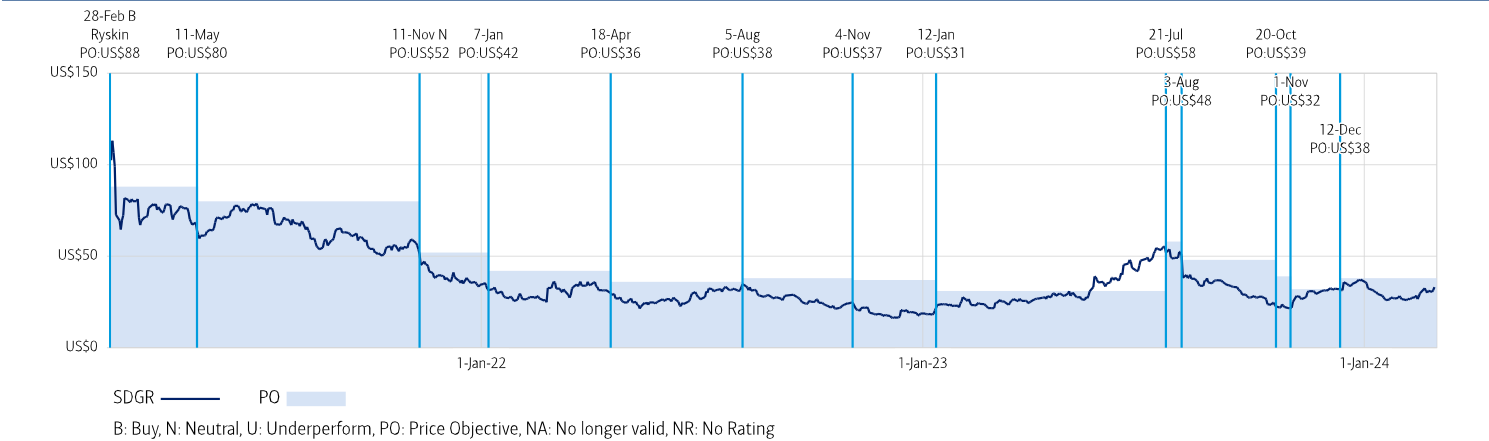
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Schrodinger (SDGR) Price Chart



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Equity Investment Rating Distribution: Health Care Group (as of 31 Dec 2023)

Coverage Universe	Count	Percent	Inv. Banking Relationships <sup>R1</sup>	Count	Percent
Buy	234	60.94%	Buy	115	49.15%
Hold	80	20.83%	Hold	36	45.00%
Sell	70	18.23%	Sell	29	41.43%

Equity Investment Rating Distribution: Global Group (as of 31 Dec 2023)

Coverage Universe	Count	Percent	Inv. Banking Relationships <sup>R1</sup>	Count	Percent
Buy	1895	53.62%	Buy	1083	57.15%
Hold	832	23.54%	Hold	454	54.57%
Sell	807	22.84%	Sell	383	47.46%

<sup>R1</sup> Issuers that were investment banking clients of BofA Securities or one of its affiliates within the past 12 months. For purposes of this Investment Rating Distribution, the coverage universe includes only stocks. A stock rated Neutral is included as a Hold, and a stock rated Underperform is included as a Sell.

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Neutral	≥ 0%	≤ 30%
Underperform	N/A	≥ 20%

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