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**Arch Therapeutics (OTCqb: ARTH) -Neutral Rated**

March 6, 2023

**Getting Closer to Reimbursement – CMS Codes**

*We believe Arch is getting close to finalizing its CMS reimbursement for the company’s lead product AC5. We know that the Centers for Medicare and Medicaid Services (CMS) made a preliminary recommendation to establish a dedicated Healthcare Common Procedure Coding System (HCPCS) Level II billing code specific to the AC5 Advanced Wound System. The preliminary recommendation was discussed at CMS’ First Biannual 2022 HCPCS Public Meeting, (held on November 30, 2022).*

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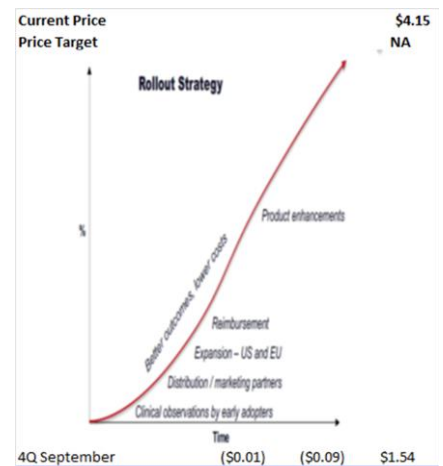
**CMS is Likely to Finalize its Reimbursement for AC5 Soon.** The “public” commentary is concluded (Nov. 2022), typically we see finalization 60-90 days later. Finalization of the HCPCS code better enables providers to bill third-party payors for AC5 that is used in doctors’ offices, supporting commercialization efforts.

**What’s Next? Capital.** The company is capital constrained. Badly needed capital allows the company to begin generating sales and paves the way for an uplisting. Fundamentally we believe in AC5 and that hasn’t changed. The stock remains at what we consider to be a deeply distressed valuation which we think corrects once the cash crunch is alleviated. We anticipate revising our rating, post-raise.

**An Effective Barrier and Scaffold that Promotes Healing.** The company's flagship product is based on its AC5 self-assembling peptide (SAP) technology platform. The platform includes AC5 Advanced Wound System and AC5 Topical Hemostat, which have received marketing authorization as medical devices in the United States and Europe, respectively, and which are intended for skin applications, such as the management of complicated chronic wounds or acute surgical wounds. The AC5 platform is a biocompatible peptide that is synthesized from proteogenic, naturally occurring L-amino acids. Unlike products that contain traditional peptide sequences, when applied to a wound, AC5-based products intercalate into the interstices of the connective tissue and self-assemble into a protective physical-mechanical nanoscale structure that can provide a barrier to leaking substances, such as blood, while also acting as a biodegradable scaffold that enables healing. Self-assembly is a central component of the mechanism of action.

**Valuation:** We have lowered our rating from Buy to Neutral and for the moment removed our price target. We have updated our revenue assumptions in our model. We assume a royalty model – 30% net to Arch. We apply a 30% risk rate in our Free Cash Flow to the Firm (FCFF), discounted EPS (dEPS), and Sum-of-the-Parts (SOP) models, which are then equal-weighted and averaged and rounded to the nearest whole number to derive our target valuation.

**Risks to our thesis** include: (1) commercial; (2) financial; (3) intellectual property; and (4) OEM and/or manufacturing. We review these risks in the Risks Analysis section of this report.



Source: Arch			
52-Week Range	\$2.02	-	\$20.70
Shares Outstanding (mil.)			1.3
Market Capitalization (mil.)			\$5
Enterprise Value (mil.)			\$5
Debt to Capital			0%
Book Value/Share			\$2.90
Price/Book			-
Average Three Months Trading Volume (K)			2
Insider Ownership			14.6%
Institutional Ownership			0.0%
Short interest (mil.)			-



## Risk Analysis

**Commercial risk.** The focus of the company is on successfully developing its products and bringing them to the market. Competition may be intense from external players as well as customers who choose to “build it themselves”.

**Financial risk.** The company may need to raise capital in the marketplace relatively soon. There can be no assurance that the company will be able to raise capital and do so on favorable terms successfully.

**Intellectual property risk.** The company may have to defend its patents and technical know-how, and there can be no assurances that the patents will not be infringed or will be held as valid if challenged, and the company may infringe on third parties' patents.

**OEM and or manufacturing risk.** Original Equipment Manufacturers (OEMs) may decide to make products themselves, and, as such, terminate production contracts before completion, creating revenue shortfalls. Manufacturing risks include the ability to produce and do so in a competitive, timely, and efficient way.

**Exhibit 1. Income Statement**

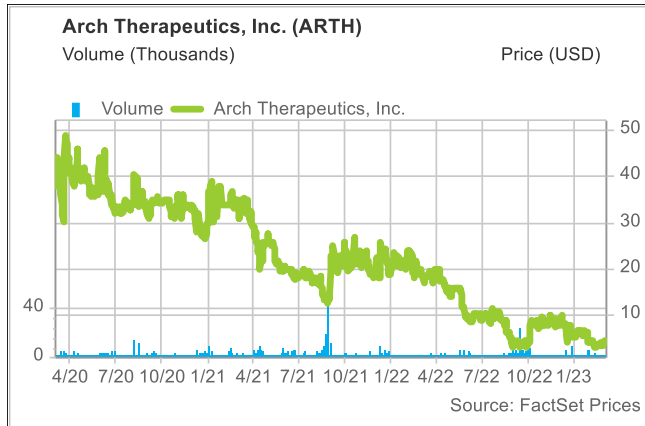
Arch Therapeutics, Inc.: Income Statement (\$'000)											
Arch Therapeutics, Inc.: YE September 30	2021A	2022E	2023E	2024E	2025E	2026E	2027E	2028E	2029E	2030E	2031E
<b>Product sales</b>											
AC5 Revenues	-	-	5,000	10,739	21,704	32,898	44,324	55,988	67,891	80,038	92,433
			-	-							
			-	-							
<b>Total Product Sales</b>	<b>12</b>	<b>-</b>	<b>5,000</b>	<b>137,998</b>	<b>221,950</b>	<b>328,879</b>	<b>44,324</b>	<b>55,988</b>	<b>67,891</b>	<b>80,038</b>	<b>92,433</b>
<b>Expenses</b>											
Cost of Goods Sold	26	-	500	13,800	22,195	32,888	4,432	5,599	6,789	8,004	9,243
	<b>%COGS</b>	<b>10%</b>	<b>10%</b>	<b>10%</b>	<b>10%</b>	<b>10%</b>	<b>10%</b>	<b>10%</b>	<b>10%</b>	<b>10%</b>	<b>10%</b>
Research and Development	1,353	1,421	1,492	1,939	2,521	3,277	4,261	4,474	4,697	4,932	5,179
	<b>%R&amp;D</b>										
General and Administrative	5,009	5,260	5,523	5,302	5,090	4,886	5,033	5,184	5,443	5,715	6,001
	<b>%SG&amp;A</b>										
<b>Total expenses</b>	<b>6,389</b>	<b>6,681</b>	<b>7,515</b>	<b>21,041</b>	<b>29,806</b>	<b>41,052</b>	<b>13,726</b>	<b>15,256</b>	<b>16,929</b>	<b>18,651</b>	<b>20,423</b>
Operating Income (Loss)	(6,377)	(6,681)	(2,515)	116,957	192,144	287,828	30,599	40,731	50,961	61,387	72,010
Interest expense											
Fair value of derivative liabilities in excess of proceeds											
Gain on exercise of warrants											
Loss on warrant derivative modification											
Loss on issuance of warrants											
Adjustments of fair value of derivative											
Other income											
<b>Total other income</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>
<b>Pretax Income</b>	<b>(6,240)</b>	<b>(6,681)</b>	<b>(2,515)</b>	<b>116,957</b>	<b>192,144</b>	<b>287,828</b>	<b>30,599</b>	<b>40,731</b>	<b>50,961</b>	<b>61,387</b>	<b>72,010</b>
Income Tax Benefit (Provision)	-	(133)	(201)	11,696	23,057	40,296	6,120	9,776	14,269	18,416	23,043
<b>Tax Rate</b>	<b>0%</b>	<b>5%</b>	<b>8%</b>	<b>10%</b>	<b>12%</b>	<b>14%</b>	<b>30%</b>	<b>34%</b>	<b>36%</b>	<b>38%</b>	<b>38%</b>
<b>GAAP Net Income (loss)</b>	<b>(6,240)</b>	<b>(6,548)</b>	<b>(2,313)</b>	<b>105,262</b>	<b>169,087</b>	<b>247,532</b>	<b>24,479</b>	<b>30,956</b>	<b>36,692</b>	<b>42,971</b>	<b>48,967</b>
<b>GAAP-EPS</b>	<b>(0.03)</b>	<b>(0.02)</b>	<b>(0.39)</b>	<b>14.47</b>	<b>23.15</b>	<b>33.76</b>	<b>3.33</b>	<b>4.19</b>	<b>4.94</b>	<b>5.77</b>	<b>6.55</b>
GAAP EPS (dil)	(0.03)	(0.03)	(0.03)	14.47	8.73	12.73	1.25	1.58	1.86	2.17	2.47
Wgtd Avg Shrs (Bas) - '000s	220,001	250,453	69,309	7,273	7,302	7,332	7,361	7,391	7,420	7,450	7,480
Wgtd Avg Shrs (Dil) - '000s	220,001	250,453	69,309	7,273	19,369	19,446	19,524	19,602	19,681	19,760	19,839

Source: Dawson James estimates

Companies mentioned in this report:

**Important Disclosures:**

**Price Chart:**



Price target and ratings changes over the past three years:

- Initiated – Buy – May 5, 2021 – Price Target \$3.00
- Update Report – Buy – December 17, 2021 – Price Target \$3.00
- Update Report – Buy – March 15, 2022 – Price Target \$3.00
- Update Report – Buy – June 24, 2022 – Price Target \$3.00
- Update Report – Buy – September 9, 2022 – Price Target \$3.00
- Rating Change – Buy to Neutral – January 18, 2023 – Price Target NA
- Update Report – Neutral – March 6, 2023 – Price Target NA

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- 2) **Neutral:** The analyst believes the price of the stock is fairly valued for the next 12-18 months.
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Current as of 3-Mar-23

	<b>Company Coverage</b>		<b>Investment Banking</b>	
<b>Ratings Distribution</b>	# of Companies	% of Total	# of Companies	% of Totals
Market Outperform (Buy)	24	69%	1	3%
Market Perform (Neutral)	11	31%	2	6%
Market Underperform (Sell)	0	0%	0	0%
<b>Total</b>	<b>35</b>	<b>100%</b>	<b>3</b>	<b>9%</b>

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