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West Pharmaceutical Services, Inc. (WST)

Q2 2023 Earnings Call

CORPORATE PARTICIPANTS

Quintin John Lai
Vice President-Corporate Development, Strategy and Investor Relations, West Pharmaceutical Services, Inc.

Eric Mark Green
Chairman, President & Chief Executive Officer, West Pharmaceutical Services, Inc.

Bernard J. Birkett
Senior Vice President & Chief Financial and Operations Officer, West Pharmaceutical Services, Inc.

OTHER PARTICIPANTS

Larry S. Solow
Analyst, CJS Securities, Inc.

Jacob Johnson
Analyst, Stephens, Inc.

Paul Richard Knight
Analyst, KeyBanc Capital Markets, Inc.

Derik de Bruin
Analyst, BofA Securities, Inc.

Matt Larew
Analyst, William Blair & Co. LLC

David Windley
Analyst, Jefferies LLC

John Newton Sourbeer
Analyst, UBS Securities LLC

Justin Bowers
Analyst, Deutsche Bank Securities, Inc.

MANAGEMENT DISCUSSION SECTION

Operator: Thank you for standing by and welcome to the West Pharmaceutical Services Q2 2023 Earnings Conference Call. At this time, all participants are in listen-only mode. After the speakers' presentation, there will be a question-and-answer session. [Operator Instructions] Please be advised today's conference call is being recorded.

I would now turn the call over to Mr. Quintin Lai, Vice President of Investor Relations. Please go ahead.

Quintin John Lai
Vice President-Corporate Development, Strategy and Investor Relations, West Pharmaceutical Services, Inc.

Thank you, Valerie. Good morning and welcome to West's second quarter 2023 conference call. We issued our financial results this morning and the release has been posted in the Investors section on the company's website located at westpharma.com. This morning, Eric Green and Bernard Birkett will review our financial results, provide an update on our business, and present an update on our financial outlook for the full year 2023. There's a slide presentation that accompanies today's call and a copy of that presentation is available on the Investors section of our website.

On slide 4 is our safe harbor statement. Statements made by management on this call and in the accompanying presentation contain forward-looking statements within the meaning of US federal securities law. These statements are based on our beliefs and assumptions, current expectations, estimates and forecasts.

The company's future results are influenced by many factors beyond the control of the company. Actual results could differ materially from past results, as well as those expressed or implied in any forward-looking statement made here. Please refer to today's press release as well as any other disclosures made by the company regarding the risks to which it is subject, including our 10-K, 10-Q and 8-K reports.

During today's call, management will make reference to non-GAAP financial measures, including organic sales growth, adjusted operating profit, adjusted operating profit margin, and adjusted diluted EPS. Reconciliations and limitations of the non-GAAP financial measures to the most comparable financial results prepared in conformity to GAAP are provided in this morning's earnings release.

I now turn the call over to our CEO, Eric Green.

Eric Mark Green

Chairman, President & Chief Executive Officer, West Pharmaceutical Services, Inc.

Thank you, Quintin; and good morning, everyone. Thanks for joining us today. We will start on slide 5. I'm pleased to report that we delivered a solid second quarter, which has us positioned for an even stronger performance in the second half of the year. The continued success is a result of our proven growth strategy as we capitalize on the robust customer demand and ongoing capacity expansion projects. And proudly, the strength of the One West Team and unwavering commitment to our purpose continues to set us apart as the trusted market leader. I want to acknowledge team members across the globe and say, thank you.

The second quarter performance was driven by our base Proprietary Products business, which grew mid-teens. As expected, COVID-19 sales continued to drop as the second quarter last year was the peak of our pandemic-related sales. With respect to our base business, the Biologics market unit again grew double digits with stable demand. Our Generics market unit continued to benefit from HVP capacity expansions, as the base grew strong double digits. And the Pharma market unit base grew high single digits. In addition, Contract Manufacturing experienced significant momentum in the quarter with delivery of components for injection-related devices.

Turning to slide 6, the key levers of growth in Q2 were primarily driven by HVP components and delivery systems. Our participation rate in recently approved new molecular entities in the US and Europe remained strong. The components developed by West or our partner, Daikyo, are addressing some of the most critical therapeutic areas around immunology, oncology, including gene therapy applications, cardiovascular, neurology, diabetes and obesity. This is also reflected in the solid order book across our Biologics, Generics and Pharma customers, a clear reflection of the needs of the market. And we continue to make good progress on bringing down lead times for certain HVPs. We're seeing our order book patterns reverting to a more normal pre-pandemic cadence.

In addition, we continue to work closely with customers to update demand trends for the near and long term. These trends underscore the importance of our capacity investments which are making a significant impact across West's global operations. For example, at our West Kinston plant, we have installed, validated and brought online additional HVP capacity for NovaPure plungers. Although it is early days, we are pleased with the initial output as operations ramp up.

Recently, I had the opportunity to visit West's site in Singapore where we have enhanced the capabilities to meet growing HVP demand from our commercial customers in the APAC region. It was excited to see the facility fully equipped with industry-leading coating, pharmaceutical washing, sterilization and automated vision inspection capabilities for elastomers. This marks another exciting milestone on our journey towards meeting the industry's increasing emphasis on Biologics.

Shifting to slide 7, at the end of June we published our 2022 ESG report on the company website. I am proud of the progress the organization has made towards the new five-year targets with even greater scientific rigor and quantitative focus on environmentally based targets. We know to fulfill our purpose effectively together as One West, we must continue to progress the sustainability goals, diversity and inclusion, and success around our charitable endeavors. These collective efforts from last year were recognized by several organizations, including being named as one of America's Climate Leaders by USA Today.

Moving to slide 8, our full year 2023 organic sales growth outlook remains unchanged at approximately 3% to 4%, and we're raising the 2023 financial outlook for overall net sales and adjusted diluted EPS.

Now, I'll turn the call over to Bernard, who'll go into more detail from the quarter. Bernard?

Bernard J. Birkett

Senior Vice President & Chief Financial and Operations Officer, West Pharmaceutical Services, Inc.

Thank you, Eric, and good morning. Let's review the numbers in more detail. We'll first look at Q2 2023 revenues and profits, where we saw a low single-digit decrease in organic net sales and a decline in operating profit and diluted EPS compared to the second quarter of 2022. I will take you through the drivers impacting sales and margin in the quarter as well as some balance sheet takeaways. And finally, we will provide an update to our 2023 guidance.

First up, Q2. Our financial results are summarized on slide 9 and the reconciliation of non-US GAAP measures are described on slides 17 to 21. We recorded net sales $753.8 million, representing an organic sales decline of 2.5%. COVID-related net revenues are estimated to have been $20 million in the quarter, an approximate $106 million reduction compared to the prior year.

Looking at slide 10, Proprietary Products organic net sales declined 5.5% in the quarter. High-value products, which made up approximately 74% of Proprietary Product sales in the quarter, declined due to the reduction in COVID-related net revenues.

Looking at the performance of the market units, the Generics market unit delivered high-single-digit growth led by sales of Westar components and self-injection-related devices, while the Pharma market unit experienced mid-single-digit growth led by Envision and Westar components as well as Admin Systems. And the Biologics market unit saw a double-digit decline due to a reduction in sales related to COVID-19 vaccine.

Our Contract Manufacturing segment experienced a double-digit net sales growth, primarily driven by an increase in sales of components related to injection-related devices. Our adjusted operating profit margin of 24.5% was a 490-basis-point decrease from the same period last year. Finally, adjusted diluted EPS declined 14.6% for Q2. Excluding stock-based compensation tax benefits, EPS decreased by approximately 18%.

Now let's review the drivers in both our revenue and profit performance. On slide 11, we show the contributions to organic sales decline in the quarter. Sales price increases contributed $43.1 million or 5.6 percentage points of growth in the quarter, as did a foreign currency tailwind of approximately $4.4 million. Offsetting price was a negative mix impact of $61.9 million, which includes an approximate $106 million reduction in COVID-19 related net demand.

Looking at margin performance, slide 12 shows our consolidated gross profit margin, 38.7% for Q2 2023, down from 41.7% in Q2 2022. Proprietary Products second quarter gross profit margin of 43.9% was 230 basis points lower than the margin achieved in the second quarter of 2022. The key driver for the decline in Proprietary Products gross profit margin was primarily unfavorable mix from a reduction in sales related to COVID-19 vaccines, offset by sales price increases and production efficiencies. Contract Manufacturing second quarter gross profit margin of 15.4% was 90 basis points below the margin achieved in the second quarter of 2022, primarily due to inflationary pressures on our plant labor costs.

Now let's look at our balance sheet and review how we've done in terms of generating cash. On slide 13, we have listed some key cash flow metrics. Operating cash flow was $307.3 million for the six months ended June 2023, a decrease of $17 million compared to the same period last year, a 5.2% decrease, primarily due to a decline in operating results. Our second quarter 2023 year-to-date capital spending was $157.5 million, $25.6 million higher than the same period last year. We continue to leverage our CapEx to increase our high-value products manufacturing capacity.

Working capital of approximately $1.36 billion at June 30, 2023 declined by $37.9 million from December 31, 2022, primarily due to reductions in our cash balance. Our cash balance at June 30 of $796.3 million was $98 million lower than our December 2022 balance. The decrease in cash is primarily due to our share repurchase program and higher CapEx, offset by our operating cash flow in the period.

Turning to slide 8, provides a high-level summary – sorry, turning to guidance, slide 8 provides a high-level summary. We are updating our full year 2023 net sales guidance and expect net sales to be in a range of $2.97 billion and $2.995 billion, compared to our prior guidance range of $2.965 billion and $2.990 billion. There is an estimated full year 2023 tailwind, $20 million, based on current foreign exchange rates compared to prior guidance of a tailwind of $15 million.

We expect organic sales growth to be approximately 3% to 4%, unchanged from prior guidance. We are raising our full year 2023 adjusted diluted EPS guidance to be in a range of $7.65 to $7.80, compared to a prior range of $7.50 to $7.65. Also, our CapEx guidance of $350 million for the year, unchanged from prior guidance.

There are some key elements that I want to bring your attention to as we review our guidance. We expect full year COVID-19 related sales to be approximately $60 million, unchanged from prior guidance. Net sales guidance also includes a reduction of $8 million resulting from a divestiture of the European facility that produced standard Proprietary Product components, again, unchanged from prior guidance.

Full year 2023 adjusted diluted EPS guidance range includes an estimated FX tailwind of approximately $0.05 based on current foreign currency exchange rates, compared to prior guidance of a tailwind of $0.02. The updated guidance also includes EPS of $0.26 associated with year-to-date 2023 tax benefit from stock-based compensation. Our guidance excludes future tax benefits from stock-based compensation.

I would now like to turn the call back over to Eric.

Eric Mark Green

Chairman, President & Chief Executive Officer, West Pharmaceutical Services, Inc.

Thank you, Bernard. To summarize on slide 14, the solid financial performance in Q2 has us positioned well for the second half of the year. We continue to have a strong base business, which is a testament to the foundation we have built over time. As a global leader, we recognize the critical role our products play in health care across the globe, and that is why we're so dedicated supporting patient health both now and into the future.

Valerie, we're ready to take questions. Thank you.

QUESTION AND ANSWER SECTION

Operator: Thank you. [Operator Instructions] Our first question comes from the line of Larry Solow of CJS. Your line is open.

Larry S. Solow
Analyst, CJS Securities, Inc.

Q

Great. Good morning, guys. Thanks for taking the questions. Congrats on another good quarter. Eric, can you maybe just give us a little more color? You actually mentioned sort of a bunch of sort of areas where you guys are driving – seeing growth just on the product line. I know there's been a lot of talk about the GLP-1, diabetes and weight management and the growth there. But I'm just trying to get a sense.

I know, historically, you guys have never said obvious – one that's not to get too carried away with one group of products. But in this case, it seems like there's just been a lot of positive news and noise about the GLP-1. So can you just give us a sense of maybe – color how that's represented in your overall revenue mix today and where that could be in the future?

Eric Mark Green
Chairman, President & Chief Executive Officer, West Pharmaceutical Services, Inc.

A

Yeah. Good morning, Larry, and thanks for the question and thanks for joining us on the call. When we look at where the pipeline is being developed and our success, what we call a participation rate, continues to remain very high. As we look at year-to-date as an example and even from last year, I think we need to be clear that we are actually supporting many different therapeutic areas and not just one or two.

And that's what's really exciting about our portfolio, as we continue to evolve our offerings that we continuously be the company to support on their primary containment; again, across many different therapeutic categories. So, some will have higher demand in the market, some less such as gene therapy, as you think about the number of doses. But our focus is make sure that we are continuing to have that high participation rate in all different areas, have different type of growth trajectories over the next five-plus years.

Larry S. Solow
Analyst, CJS Securities, Inc.

Q

Got it. That's fair enough. A question on just margins in the Proprietary Products and for Bernard. A nice sequential improvement, a little bit higher sales and I think a lot – most of those sales look like drop to the gross margin line there. Anything unusual in this quarter compared to last quarter? Looks like COVID sales were about the same – COVID-related sales. So anything we should be aware of there that drove that sort of 150 bps sequential improvement in gross margin of Proprietary Products?

Bernard J. Birkett
Senior Vice President & Chief Financial and Operations Officer, West Pharmaceutical Services, Inc.

A

Yeah. It's really down to product mix. We're seeing that continued growth in high-value products ex COVID, and we're seeing that positive impact that's flown into margin. We're also improving the throughput within our facilities, getting better levels of efficiency, and we're seeing that partly because of the capacity that we're layering in. But again, improvements to our existing infrastructure and that combination is delivering to those improved margins.

And again, that's part of the overall construct that we've been talking about over the last number of years. So, we just continue to deliver on that.

Larry S. Solow
Analyst, CJS Securities, Inc.

Q

Got it. While I got you, Bernard, just thoughts on CapEx and sort of – this year I think you're maintaining a $350 million number. As you look out over the next few years, do you feel like this number – and I guess, that would probably be a high-class problem, but do you feel like this CapEx level will remain at this area? Or do you see it may be coming down as you look out?

Bernard J. Birkett
Senior Vice President & Chief Financial and Operations Officer, West Pharmaceutical Services, Inc.

A

We would expect to see us normalize back to what we had been talking about pre-COVID of about 6% to 7% of revenues. But again, it's dependent on if there are other spikes in demand or investments that we need to make. We're willing to do that. We'll continue to invest in our business where it's needed. At the moment, we're investing in capacity around plungers across our high-value product network. So it's not just in one facility; it's right across the network to be able to meet the global demand from our customers.

We're seeing the results of that materializing as we speak. Our lead times are reducing significantly. So we're getting back to pre-COVID levels. And I think by the end of Q3, our lead times will be normalized across our business. We're also layering in some strategic flex capacity. So, we're able to respond to sudden increases in demands for customers. And then, that capacity kind of feeds into our long-term plan as well. So, it'll be utilized over the kind of five-year strategic horizon.

So with CapEx, we have made, as we said, that significant investment over the last number of years and maybe a little bit similar as we move forward to next year, but then maybe starting to tail off.

Operator: Thank you. One moment, please. Our next question comes from the line of Jacob Johnson of Stephens. Your line is open.

Jacob Johnson
Analyst, Stephens, Inc.

Q

Hey. Thanks. Good morning. Maybe following up on the last question and kind of the investments you've made in capacity recently. I think that the number one question we're getting, and I imagine you're getting as well from investors, kind of around the magnitude of the revenue opportunity from the NovaPure plunger capacity additions.

Is there any way to frame up or quantify the revenue potential of those capacity additions? And then, Eric, you also mentioned kind of early days in the ramp up at Kinston. Just curious kind of what the ramp there might look like as we think about the next 12 to 24 months?

Eric Mark Green
Chairman, President & Chief Executive Officer, West Pharmaceutical Services, Inc.

A

Yeah. I'll start with the ramp up just to address that quickly. As you know, we've been discussing how the installed capacity is coming in throughout 2023. In the second half, we're starting to ramp up. So we expect that to – it's occurring today. It will continue throughout Q3 and through the balance of the year. And it usually takes about two or three quarters to get to a pretty steady state.

And then, as Bernard mentioned a little bit earlier, is that we're always adding a little bit more capacity build flex. So anticipate Kinston, particularly on the NovaPure plungers, to be ramping up through the balance of the year.

Bernard J. Birkett
Senior Vice President & Chief Financial and Operations Officer, West Pharmaceutical Services, Inc.

A

Yeah. Just the way I would frame this is that when we look at the mix of our CapEx investments, I think we've said this before, pre-COVID it was like 50% of our CapEx deployment was around maintenance and then 50% on growth. Well, now what we're seeing is 70% of the CapEx deployment is around growth and specifically around growth in high-value products.

So it's not just the growth in the revenue, it's also the growth in operating margin given the areas that we're investing. So I think that's the way we would frame this. And that plays into our long-term construct of that 7% to 9%. And if opportunities take us above that, I think we'll be in a good position to respond.

Jacob Johnson
Analyst, Stephens, Inc.

Q

Okay. Thanks for that. And then maybe just a high-level question for you, Eric. You mentioned in your prepared comments kind of working closely with customers on demand trends. As I think about the Biologics end market, I know you're not very exposed to early-stage biotech, but there's been a lot of focus on the near-term dynamics there, given the funding and some prioritization we've seen in the pipelines there, which I suppose could maybe impact future commercializations at some point.

But I'm just kind of curious from the seat you have and your perspective where you kind of have a longer-term view and conversations with customers over the longer term, has there been any kind of change in their long-term planning, given the current macro we're in?

Eric Mark Green
Chairman, President & Chief Executive Officer, West Pharmaceutical Services, Inc.

A

Yeah. No, I don't see a long-term change to plans. You're absolutely spot on when you say that our exposure from a revenue and profit perspective in regards to biotech funding, preclinical or clinical, is extremely low, although we are active. As you know, the thesis of our growth is participating during the pipeline and then work through the whole commercialization. So we don't see any change long-term especially in the Biologics.

Very encouraged when I look at the first half of this year, a number of approved new biologics and how we're positioned. As you know very well that it takes a while for those to ramp and to get more into higher patient population. But we're positioned well and our exposure in the biotech funding is very low right now. But – and this whole discussion does not change our outlook for the Biologics long term.

Operator: Thank you. One moment, please. Our next question comes from the line of Paul Knight of KeyBanc. Your line is open.

Paul Richard Knight
Analyst, KeyBanc Capital Markets, Inc.

Q

Yeah. Thanks, Eric. The impact, if any, is there from the Rocky Mount situation with Pfizer, does that kind of cause us to think about pacing on 3Q or what any impact, in your view, in the industry from that damage?

Eric Mark Green
Chairman, President & Chief Executive Officer, West Pharmaceutical Services, Inc.

A

Yeah. Paul, thanks for asking the question. First of all, we're always concerned about any of our customers' sites and their employees. And I know we have a site 60 miles from there at Kinston, North Carolina. So we've obviously reached out and offered any assistance, not just from a product perspective, but for a community perspective. And so a very longstanding relationship. And that's first and foremost in our mind when we were talking to them the day after the event.

In regards to us as product and revenue, we would not say there's any change in our trajectory for Q3, Q4. And we're really – specifically the organization West is ready to respond appropriately immediately to support them in any way. So – and that we'll leverage our global operations if necessary. So the two answers to your question, we're ready to support when needed and – but no change to our outlook for the next two quarters.

Paul Richard Knight
Analyst, KeyBanc Capital Markets, Inc.

Q

And I know Michigan was opening up in the first half of the year. What was that facility? And then the other capacity question, is Waterford under expansion yet?

Eric Mark Green
Chairman, President & Chief Executive Officer, West Pharmaceutical Services, Inc.

A

Yeah. I'll touch on the first one. I'll let Bernard touch the second one on Waterford. So in Michigan, we – it's a contract manufacturing site. It's one of our seven contract manufacturing sites throughout Europe and the United States. And it is – primarily the focus of the expansion has been around auto-injectors and that is up and running as we speak. And we're doing the ramp up with our customer at this time.

So really pleased on the progress and the output of the product, the high-quality product that's coming out of there. And that was kind of a transfer of knowledge from another site we have over in Europe. And so that whole global network approach in contract manufacturing is actually another benefit for our customer. So that's where we are with Michigan. Do you want to talk about Waterford, Bernard?

Bernard J. Birkett
Senior Vice President & Chief Financial and Operations Officer, West Pharmaceutical Services, Inc.

A

Yeah. In Waterford, we are looking at expansions of that facility, but it's not going to be here in 2023, probably start sometime in later in 2024. Right now we're working through Jersey Shore, Kinston and Singapore, as Eric mentioned. And then we have also expansion going on in our Eschweiler site. So it's coming.

Paul Richard Knight
Analyst, KeyBanc Capital Markets, Inc.

Q

Okay. And then, I guess, vaccine is waning – or is vaccine moving to dose vial and/or is it moving to syringe yet, Bernard?

Bernard J. Birkett
Senior Vice President & Chief Financial and Operations Officer, West Pharmaceutical Services, Inc.

A

We haven't seen any major shift in that at this point.

Paul Richard Knight
Analyst, KeyBanc Capital Markets, Inc.

Q

Okay. Thank you.

Eric Mark Green
Chairman, President & Chief Executive Officer, West Pharmaceutical Services, Inc.

A

Great. Thank you, Paul.

Operator: Thank you. One moment, please. Our next question comes from the line of Derik de Bruin of Bank of America. Your line is open.

Derik de Bruin
Analyst, BofA Securities, Inc.

Q

Hey. Good morning. Thanks for taking my questions. So I've got several, so I'm going to pop off on. You're getting really good pricing, it looked like 5% to 6% on the quarter. That's relative to your 1% to 2% historically. How sustainable is that going forward? Is it expected to [ph] fall back? (28:54)

Eric Mark Green
Chairman, President & Chief Executive Officer, West Pharmaceutical Services, Inc.

A

Well, I think – yeah. Yeah, Derik, it's a great question. So thanks for joining the call today. You're right. I mean, historically, we were in the 1% to 2% corridor all the way up to, let's say, 2021. When you think about 2022, we were roughly between 3% and 4% net price contribution. And this year, we're delivering on the high end what we stated earlier this year of 5% to 6%. We do – we intentionally built capabilities in the organization a couple of years ago that we were giving visibility of that believes we can be somewhere in between where we are today and where we were back in 2021.

And I won't give specific guidance right now, but our belief is that we have the ability to have more of a consistent, predictable price element, and we're focused on the mix also, which is a big driver of growth here at West. So while price is important, we'll continue to deploy the strategic pricing aspect. We're also very focused on mix and making sure we're bringing customers in at the higher end HVP versus the lower end. So those are two levers that we're focused on, Derik.

Derik de Bruin
Analyst, BofA Securities, Inc.

Q

Got it. That's really helpful. Your competitor, Datwyler, called out some stocking issues, inventory issues going on with it. I mean, I know you haven't really – you've seen a little bit of this, but I'm just sort of wondering, has that had any impact on the business? Are you seeing any issues with that, that are sort of like [ph] popping up the unexpected (30:28)?

Eric Mark Green
Chairman, President & Chief Executive Officer, West Pharmaceutical Services, Inc.

A

Yeah, Derik, it's – all that's taken consideration as we kind of set the guidance for the balance of the year. Fortunately, we have a good lens with our customers. And there is some – when you think about the COVID vaccine, obviously, there's a stocking – destocking has been going on for the last couple of quarters.

And then we look at the base business, there's some inventory management here and there, but it's very low in amounts when you compare it to our order book, particularly last year. We have a good handle on it. And we're keeping an eye on and having conversations with customers, but a very low impact at West right now.

Derik de Bruin
Analyst, BofA Securities, Inc.

Q

Got it. So we, like a lot of other people, have done a bunch of work on the GLP-1s. And I think one of the questions we're constantly getting from investors is like, how do you sort of think about the impact to the injectables business if the oral GLP-1s sort of come out? I mean, what are your customers – how are your customers thinking about the impact of those in sort of like – I mean, you're obviously adding a lot of HVP capacity for GLP-1s and other products, but how are your customers sort of thinking about the impact of orals on that market?

Eric Mark Green
Chairman, President & Chief Executive Officer, West Pharmaceutical Services, Inc.

A

Well, I'm a little hesitant to go further on that conversation, Derik. I would ask you to – or anyone to speak to our customers directly. They have a good line of sight of the injectable market and capabilities versus the orals. I do know for a fact that, from our position we're working with the customers to make sure that we do have the focus on capacity, the timing of the capacity.

And as we ramp, it's actually touching both sides of our business, not just the HVP elastomers proprietary side. There's also a contract manufacturing and we're taking a very balanced approach to this. But again, we're really focused on that side and I would defer you, anyone to the customers on the oral conversation.

Operator: Thank you. One moment, please. Our next question comes from the line of Matthew Larew of William Blair. Your line is open.

Matt Larew
Analyst, William Blair & Co. LLC

Q

Hi. Good morning. I wanted to ask about the expansion in Singapore and maybe just to use that as maybe an opportunity, Eric, could you help us frame where Asia-Pac in general is from more of an HVP perspective? Are you seeing an acceleration in demand for HVP and NovaPure, particular in Asia-Pac, that's kind of driving the recent investment? And just kind of curious, given that you were just over there, what you're hearing.

Eric Mark Green
Chairman, President & Chief Executive Officer, West Pharmaceutical Services, Inc.

A

Yeah. Great question. Thanks, Matt. I'm excited about what I – or actually Bernard and I were able to see the progress in Singapore with our site. As you know, it's one of our five high-value product manufacturing sites on the globe. And so – and it supports some very exciting growth areas from a geographic perspective. I'll call out South Korea as an example – or Korea as an example. I'd also call out other parts of Southeast Asia. And in fact, some of the products are going into Japan. So I'm really excited about how we're able to leverage this site to really drive growth through Asia-Pacific.

What we're doing there is, we're making sure that our customers, particularly global customers, are getting the same quality product service out of any of the five HVP sites. And we expect Asia-Pacific to continue to be a high-growth area for us due to the amount of investments of our customers. And also, they're not just servicing the local market. You're finding a lot of our customers in that region are supporting the global market and/or working on behalf of some of the larger global drug companies.

And I'll end with this. While we were in Singapore, we had to meet with – several of our customers came together in Singapore throughout the region. And it was very informative in how we think about the demand of HVP in the future because customers are expecting high-level quality and benefits that they can truly represent the products on a global scale. And that's where we come in to be able to support them. So hopefully, that gives you some context of what we're trying to accomplish in Singapore.

Matt Larew
Analyst, William Blair & Co. LLC

Q

Okay. Thanks. And then, I just have two cleanups from earlier questions. One, if I'm interpreting your comments correct, Eric, should we think about full utilization of the new Kinston capacity not really occurring until 1Q 2024, just given that it takes a couple of quarters to ramp at the first half. And then the second, really stocking is still de minimis, but quarter-over-quarter is it fair to say that it's become a bit more of a headwind or a bit more of an unknown? And then, I'll jump off. Thanks.

Eric Mark Green
Chairman, President & Chief Executive Officer, West Pharmaceutical Services, Inc.

A

Yeah. No On the destocking comment, really it's all – majority of it is around the COVID-19 destocking. And so, we've been pretty clear on our quarterly cadence last year and what we're seeing this year. So that's probably the majority of it. From the base perspective, we're not seeing a material difference from quarter to quarter.

On the ramp up of Kinston, it is a ramp up and it's going to take several quarters to get to a very high utilization rate. So that will be sometime in 2024. I just want to be clear, we did add additional capacity to handle flexibility and future demand that we anticipate, particularly with some of the new approvals that are just coming through. So, yes, there will be some flex to that, but we expect it to be higher utilized throughout 2024.

Operator: Thank you. One moment, please. Our next question comes from the line of David Windley of Jefferies. Your line is open.

David Windley
Analyst, Jefferies LLC

Q

Hi. Thanks. Taking my questions. Good morning. I wanted to kind of extend a couple of earlier questions. First, on the growth CapEx, the 70% of CapEx that now represents growth, is there an algorithm we can think about as to how that – how a CapEx dollar translates either to revenue or, say, gross profit? Do you guys think about it in that way at all?

Bernard J. Birkett
Senior Vice President & Chief Financial and Operations Officer, West Pharmaceutical Services, Inc.

A

Yeah. That's not something that we share. We don't share that information. I think, David, the way we framed it is that the 70% is focused on growth. The growth is primarily in high-value products and it's to drive our long-term construct either to meet it or to create capacity to go above that. And then it's focused on higher margin products. So the return on investment is faster. So it's investing in it, particularly around the Biologics segment. I think that's the easiest way to frame it, rather than us giving specific dollars to revenue and profit. And that's not something we're willing to share.

David Windley
Analyst, Jefferies LLC

Q

Okay. I'll try it a slightly different way. So I've had some investors recall to me or recount to me that the Kinston NovaPure plunger expansion doubles that capacity. Would you be willing to comment on that or confirm that?

Eric Mark Green
Chairman, President & Chief Executive Officer, West Pharmaceutical Services, Inc.

A

The expansion that we put into Kinston specifically is significantly more than what we had there before. But on a global basis, it's adding more than 2x of capacity in the NovaPure portfolio. But that's about as far as we can go with giving the details there.

David Windley
Analyst, Jefferies LLC

Q

Okay.

Eric Mark Green
Chairman, President & Chief Executive Officer, West Pharmaceutical Services, Inc.

A

And it's supporting – I'll be very clear, though, David, and it's a very – it's a valid question. It's supporting multiple molecules, multiple customers and it's a network effect. So I got to be careful. It's not a particular product or a category, it's across multiple. It's been leveraged in multiple ways.

David Windley
Analyst, Jefferies LLC

Q

Right. Okay. Got it. In thinking kind of a similar question to Paul's, I think, about the Pfizer, North Carolina Rocky Mount facility, but thinking just more broadly about sterile fill-finish capacity, throughput, et cetera. So generally speaking, you hear that sterile fill-finish capacity is still quite tight.

In the case of some of the GLP-1s, some of those manufacturers have had some FDA-related issues that have caused shutdown of facilities or shutdown of a facility. That's certainly more in the past and I would think would have already impacted you if it was going to. But I guess I'm just wondering about how attentive we need to be to the capacity activities in the kind of the next downstream function from you, the folks that are using your elastomers to complete their work.

Bernard J. Birkett
Senior Vice President & Chief Financial and Operations Officer, West Pharmaceutical Services, Inc.

A

Yeah. That's part of normal supply chain management. And I think that our approach is that we are getting indications from our customers on what their demand is across a number of different therapeutics. Our job is to make sure that we have the capacity in place to be able to deliver when they need us. Sometimes that timing can flex. But we haven't seen no major impact on our business to this point.

And our focus, as we said, is layering in capacity. And back to Eric's point, it's not just in Kinston, we're leveraging capacity across our global network to be able to provide whatever response our customers need. And we've learned a lot from the last couple of years about having that capacity at a number of different facilities and that we're able to flex faster and we can meet any spike in demand. And that's what we're doing right now and that's where we have to remain focused. And what happens in the other parts of the supply chain, we're aware of it, which some of that is outside of our control.

David Windley
Analyst, Jefferies LLC

Q

Sure. So last question for me would just be to get your – take your temperature on the progress for your Valor Glass partnership, Ready Pack, seeding of the market and what you're seeing there. Thank you.

Eric Mark Green
Chairman, President & Chief Executive Officer, West Pharmaceutical Services, Inc.

A

Yeah. Dave, good question. I'm actually quite excited. I know we just had another review with our partner in the progress we're making. As you know, this is a multi-step journey. We have multiple launches right now. We're more focused on the vial launches. I think just a few weeks ago, we had Viridian vial technology launched through our channel. Customers are very excited about the opportunity to have a fully characterized complete system that the partnership with Corning gives us that flexibility and capability of representing a complete system with the one DMF to our customers.

And so we are still on the path to be able to continue to launch various configurations ultimately to get to the point of a fully characterized prefilled syringe using the best technologies of both organizations, but that still is going to take some time to get there. I won't give you exact dates, but over the next couple of years you'll see various launches and penetration with our customers.

Operator: Thank you. One moment, please. Our next question comes from the line of John Sourbeer of UBS. Your line is open.

John Newton Sourbeer
Analyst, UBS Securities LLC

Q

Hi. Thanks for taking the question. Just maybe a modeling one here to start off. How do we think about the revenue cadence here in the second half with the different dynamics at play? You have the new capacity coming online, COVID roll-off and then some seasonality. Just any additional color you could provide us there?

Bernard J. Birkett
Senior Vice President & Chief Financial and Operations Officer, West Pharmaceutical Services, Inc.

A

Yeah. I would say that, Q2 – or Q3, like similar to Q2, plus/minus. And then we would expect to see a pickup in Q4 based on the capacity that we're implementing on in Kinston and at a couple of other facilities.

John Newton Sourbeer
Analyst, UBS Securities LLC

Q

Got it. And then just on biosimilars, I don't think you touched on that. There's a few that have been coming online. I guess, how is this playing into demand you have here, on revenue? And any changes around the competitive environment you're seeing on biosimilars, if branded switching to a competitor?

Eric Mark Green
Chairman, President & Chief Executive Officer, West Pharmaceutical Services, Inc.

A

Yeah. No, issue for us. Actually, when we look at biosimilars and work with those customers, has a very similar primary packaging configuration of others. And so it is the higher end of high-value products and we continue to participate very high. When we talk about a participation rate for Biologics, we're also inclusive of biosimilars. So we look at that as kind of holistically and feeling really good about where we are and where we're going.

John Newton Sourbeer
Analyst, UBS Securities LLC

Q

I appreciate the color there. And then just last one for me. I know you've commented on APAC, but would you be willing to say how much of your revenue is in China? And others have called out some issues there and headwinds. Have you seen anything in the China market to call out?

Eric Mark Green
Chairman, President & Chief Executive Officer, West Pharmaceutical Services, Inc.

A

Yeah. It's very little. It's a very low single-digit percentage of the overall West enterprise sales. If you – if we look at that business, we're pleased with where it's at. But if there's any headwinds, it's all around COVID-19. That's strictly where the issues are, which we – are characterized basically for the whole globe for us right now. But very low exposure right now in China.

John Newton Sourbeer
Analyst, UBS Securities LLC

Q

Got it. Thanks for taking the questions.

Eric Mark Green
Chairman, President & Chief Executive Officer, West Pharmaceutical Services, Inc.

A

Yeah. Thank you.

Operator: Thank you. One moment, please. Our next question comes from the line of Justin Bowers of Deutsche Bank. Your line is open.

Justin Bowers
Analyst, Deutsche Bank Securities, Inc.

Q

Hi. Good morning, everyone. Just a quick one on the margins. With revenue being flat sequentially, plus or minus, is it fair to think of operating margins being around the same level? And then as we think about 4Q and the step-up there in volumes, should there be some incrementals there with respect to the margins? And then part two, pardon if I missed this, but what was the C-19 contribution in the quarter?

Bernard J. Birkett
Senior Vice President & Chief Financial and Operations Officer, West Pharmaceutical Services, Inc.

A

So to answer the margin question, we would expect it to step down a little bit, and that's typically what we see coming off Q2. From a manufacturing point of view, it's usually our strongest quarter in the year. So given the various shutdowns that we have in Q3, Q4, there's typically a little bit of step down, and that will be normal for us. So it's just to bake that in. And that's embedded in the guidance. COVID-19, we did about $20 million in Q2 from a revenue perspective.

Justin Bowers
Analyst, Deutsche Bank Securities, Inc.

Q

Okay. Got it. That's it for me. Thank you.

Eric Mark Green
Chairman, President & Chief Executive Officer, West Pharmaceutical Services, Inc.

A

Yeah. Thank you.

Bernard J. Birkett
Senior Vice President & Chief Financial and Operations Officer, West Pharmaceutical Services, Inc.

A

Thanks.

Operator: Thank you. I'm showing no further questions at this time. I'd like to turn the call back over to Quintin Lai for any closing remarks.

Quintin John Lai
Vice President-Corporate Development, Strategy and Investor Relations, West Pharmaceutical Services, Inc.

Thanks, Valerie. And thank you for joining us on today's conference call. An online archive of the broadcast will be available on our website at westpharma.com in the Investors section. Additionally, you may access the replay for 30 days following this presentation by using the dial-in numbers and conference ID provided at the end of today's earnings release. That concludes this call. Have a nice day.

Operator: Thank you. Ladies and gentlemen, this does conclude the conference. You may now disconnect. Have a great day.