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West Pharmaceutical Services, Inc. (WST)

Q3 2023 Earnings Call

CORPORATE PARTICIPANTS

Quintin John Lai
Vice President-Strategy & Investor Relations, West Pharmaceutical Services, Inc.

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

OTHER PARTICIPANTS

Paul Richard Knight
Analyst, KeyBanc Capital Markets, Inc.

Larry S. Solow
Analyst, CJS Securities, Inc.

Jacob Johnson
Analyst, Stephens, Inc.

John Newton Sourbeer
Analyst, UBS Securities LLC

Matt Larew
Analyst, William Blair & Co. LLC

David Windley
Analyst, Jefferies LLC

Justin Bowers
Analyst, Deutsche Bank Securities, Inc.

Derik de Bruin
Analyst, BofA Securities, Inc.

MANAGEMENT DISCUSSION SECTION

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

I would now like to hand the conference over to your speaker today, Quintin Lai, VP of Investor Relations. Please go ahead.

Quintin John Lai
Vice President-Strategy & Investor Relations, West Pharmaceutical Services, Inc.

Thank you, Michelle. Good morning and welcome to West third 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 we 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 is 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 it over, the call to our CEO, Eric Green.

Eric Mark Green

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

Great. Thank you, Quintin and good morning, everyone. Thanks for joining us today. Due to an unexpected family emergency back in Ireland, Bernard cannot participate today. I appreciate your understanding. Quintin will step in for Bernard.

We'd like to begin by addressing the ongoing situation in Israel, our top priority and focus remains on the safety and well-being of our team members and their families that live and work in the region.

Now, let's turn to slide 5 and the Q3 performance. I am pleased to report that our team delivered a solid third quarter. Our ongoing success can be attributed to a well-established, market-led growth strategy, which allows us to take full advantage of our solid base customer demand and recent capacity expansions. And it is the strength of our One West Team, who I'd like to thank, that make us a – make a meaningful difference to ensuring our customers have reliable supply of components necessary to deliver drugs to patients.

In the third quarter, we had solid organic net sales growth of 5.7%, with an approximate $78 million year-over-year decrease in COVID-19-related sales. Our base organic sales growth exceeded 20% for both the enterprise and our Proprietary Products segment.

Shifting to slide 6, in Proprietary Products, we had strong base demand of HVP components and devices. We continue to see certain customers experiencing strong uptake of their drugs as they accelerate and increase their replenishment orders with us. The greater than 20% growth in our base business was again led by our Biologics market unit, which had very strong double-digit growth in the quarter, excluding the impact of COVID-19-related sales.

And as we have seen through much of the year, we also had accelerated growth from restocking long lead time HVP components that we've been able to produce through our capacity expansions. This fueled growth in our Generics and Pharma market units.

During September and October, we have started to see an increase in inventory management trends by certain large Pharma and Generic customers, especially for our standard products as they manage their safety stocks for the remainder of the year. These issues have led us to temper our fourth quarter organic sales growth to 2% to 3%. Excluding COVID-related sales, we expect double-digit overall organic sales growth and double-digit Proprietary Products sales growth over the quarter.

And we continue to monitor the situation in Israel, and currently do not expect any impact on our ability to manufacture and ship out of the country.

As in prior years, we will provide our formal 2024 guidance on our upcoming February Q4 call. In a bit of a preview, despite the inventory management we are seeing by some of our large customers, we continue to expect to deliver our financial construct of 7% to 9% organic sales growth and 100 basis points of operating margin expansion. In addition, we anticipate that our pandemic-related sales are at a point, where we will no longer have to separate our base performance in 2024.

Lastly, a key aspect of our growth strategy and market leadership is West team of scientific thought leaders and technical experts. They continue to advance the care for patients with our customers through valuable insights to address the changing needs of more complex molecules and combination products. For example, at the recent PDA Conference and CPHI Worldwide Conference, several of our West experts delivered insightful presentations about the revised regulatory standards and emphasis on the development of sustainable products.

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

Quintin John Lai

Vice President-Strategy & Investor Relations, West Pharmaceutical Services, Inc.

Thank you, Eric, and good morning. Let's review the numbers in more detail. We'll first look at Q3 2022 revenues and profits, where we saw a mid-single digit increase in organic net sales growth, an increase in diluted EPS, and a decline in operating profit compared to the third quarter of 2022.

I will also take you through the drivers impacting sales and margin in the quarter as well as some balance sheet takeaways. And finally, we'll provide an update to our 2023 guidance.

First up, Q3, our financial results are summarized on slide 7, and the reconciliation of non-US GAAP measures are described in slide 16 to 20. We recorded net sales of $747.4 million, representing organic sales growth of 5.7%. COVID-related net revenues are estimated to have been approximately $80 million in the quarter, a decline of $78 million compared to the same period last year.

Looking at slide 8, Q3 Proprietary Products organic net sales increased 3.2%. High-value products, which made up approximately 76% of Proprietary Products segment sales, grew by mid-single digits, led by customer demand for HVP components and devices.

Taking a look at the performance of the market units, including the negative impact from a reduction of COVID-19-related sales, the Generics market unit delivered high-single-digit growth, and the Pharma market unit experienced low-single-digit growth, both led by Westar components and Admin Systems.

The Biologics market unit also saw low-single-digit growth, driven by sales of FluroTec components and self-injection delivery devices. Our Contract Manufacturing segment experienced double-digit net sales – organic sales growth, led by an increase in components and sales of components related to injection-related devices and healthcare diagnostic devices.

Our adjusted operating profit margin of 24.2% was a 290-basis-point decrease from the same period last year. Finally, adjusted diluted EPS increased 6.4% for Q3. Excluding stock-based compensation, tax benefit, adjusted diluted EPS increased by 1% compared to last year.

Now, let's review the drivers in both our revenue and profit performance. On slide 9, we show the contribution to organic sales growth in the quarter. Sales price increases contributed $46.2 million, or 6.8 percentage points of growth in the quarter. Foreign currency tailwind was approximately $25.1 million, or 3.7 percentage points of growth. Overall mix and volume negatively impacted sales by $7.3 million. This includes an approximate $78 million reduction in COVID-19-related net demand, partially offset by positive volume and mix contribution from our non-COVID base business.

Looking at margin performance, slide 10, shows our consolidated gross profit margin of 38.6% for Q3, down from 39.0% in the same period last year. Proprietary Products' third quarter gross profit margin of 43.4% was 20 basis points lower than margin achieved in the same period last year. The key driver for the decline in Proprietary Products' gross profit margin was an unfavorable mix from a reduction in sales related to COVID-19 vaccines, offset by sales price increases that offset inflationary cost pressures in our plants.

Contract Manufacturing third quarter gross profit margin of 18.6% was a 130 basis points higher than the margin achieved in the third quarter of last year, due to a favorable mix of products sold and increased sale prices offset by 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 for the business. On slide 11, we have listed some key cash flow metrics. Operating cash flow was $537.4 million for the first nine months of 2023, an increase of $44.2 million compared to the same period last year, a 9% increase primarily due to improvement in working capital.

Our third quarter 2023 year-to-date capital spending was $253.3 million, $63.6 million higher than the same period last year. We continue to leverage our CapEx to increase our high-value product manufacturing capacity. Working capital of approximately $1.44 billion at September 30, 2023, increased by $38.3 million from December 31, 2022, primarily due to growth in our current assets, offset by an increase in our current portion of long-term debt.

Our cash balance at September 30, 2023 was $898.6 million, and was $4.3 million higher than our December 2022 balance. The small increase in cash is primarily driven by positive operating results, offset by increased repurchases under our share repurchase program and higher CapEx.

Turning to guidance, slide 12 provides a high-level summary. We're updating our full year 2023 net sales guidance and expect net sales to be in a range of $2.95 billion to $2.96 billion compared to our prior guidance range of $2.97 billion to $2.995 billion. There is an estimated full year 2023 tailwind of $20 million based on current FX rates, unchanged from prior guidance. We expect organic sales to be approximately 2% to 3% for the full year compared to the prior guidance range of 3% to 4%.

We are raising our full year 2023 adjusted diluted EPS guidance to be in a range of $7.95 to $8 compared to a prior range of $7.65 to $7.80. Also, our CapEx guidance is $350 million for the year, unchanged from prior guidance.

There are some key elements I want to bring to your attention. We have lowered our revenue guidance to reflect the recent trend with certain Pharma and Generic customers slowing their restocking of inventory and increased inventory management as we head into the end of the year. We expect full year COVID-19-related sales to be approximately $68 million compared to prior guide of $60 million.

Net sales guidance also includes reduction of $8 million resulting from a divestiture of a European facility that produced standard Proprietary Products. And this is unchanged from prior guidance. Full year 2023 adjusted diluted EPS range includes an FX tailwind of approximately $0.07 based on current FX exchange rates, compared to prior guidance of a tailwind of $0.05.

The updated guidance also includes EPS of $0.41 associated with year-to-date 2023 tax benefits from stock-based comp. Our guidance excludes future tax benefits from stock-based compensation.

I would like to highlight that over the last five years, our base business growth, excluding COVID-19, has been within or above our construct of annual organic revenue growth of 7% to 9%. And over the same time period, we've averaged annual operating margin expansion of over 100 basis points.

As Eric mentioned earlier, we are providing a preliminary look to 2024. Based on current trends in demand, we anticipate that West will again be within our long-range financial construct of organic sales growth and operating profit margin expansion. As usual, we'll provide more detailed guidance on 2024 on our February call.

I'd like to turn the call back over to Eric.

Eric Mark Green

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

Thank you, Quintin. To summarize, slide 13, we had a solid Q3 performance and are on track for double-digit base organic sales growth in Q4. Our base business remains strong, which is a testament to the durability of the foundation we have built over time. We are proud to serve as a valuable, trusted partner for customers to support patient health and look forward to continue to play a critical role in delivering healthcare well into the future.

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

QUESTION AND ANSWER SECTION

Operator: Thank you. [Operator Instructions] Our first question is going to come from the line of Paul Knight with KeyBanc Capital Markets. Your line is open. Please go ahead.

Paul Richard Knight
Analyst, KeyBanc Capital Markets, Inc.

Q

Hi, Eric. Hi, Quintin. You mentioned this stocking issue was kind of in the standard products category, which leads to the question of in the high-value product category, are you – obviously, we know you're supplying GLP-1 products, but are you capacity constrained on that side of the business? If you could talk to that issue and how big is GLP-1, if you can or will? And then lastly, these CapEx numbers, what facilities open next year? Thanks.

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

A

That's great. Thank you for the question, Paul, and good morning. Let's start with the GLP-1 question. If you look at, we serve that space in both areas of our business, Proprietary Products with our elastomer components, specifically in that space, you'll see HVP plungers; and then in the Contract Manufacturing space, we support that – our customers in the GLP-1s with auto-injectors.

So, I would say, today, from our perspective, we're not capacity constrained. We're able to re-leverage some of the assets that we had, that we put in place for COVID, and a lot of that technology. And we also are leveraging our global network. And so, we'll see – we'll be able to continue to ramp, particularly on the elastomer space, HVP plungers, we'll support our customers as new drug molecules are approved and launched across the globe.

And on CM side, we have – we are currently producing auto-injectors into the market and we've been asked to expand capacity, which we've actually put expansions in place and they're ongoing. It'll take several quarters to get completed and validated throughout – let's call it throughout 2024. And particularly those sites that we're referring to, Paul, is Dublin and also Grand Rapids, Michigan. So, significant investments in those two areas.

On the – and from a market size perspective of GLP-1, we don't – we haven't commented, we still will not, we would say that from a volume perspective, I would focus from our customers and how they communicate their expectations. But [ph] it is true (00:20:11) that we're working with them to ensure that we are not and will not be the bottleneck as we continue to grow in that space for a number of years to come.

In regards to the restocking, you're absolutely correct. It's not as much in the HVP area, it tends to be – it is really around our standard products. It's in categories around disposable medical devices, tends to be the standard elastomer components. And we're being asked to divert some of those orders into 2024. So, that's the cadence, it's not a [ph] loss (00:20:49) of share. And we continue to have a very healthy win ratio of new approved molecules, particularly in Biologics. And so, our position from a market position hasn't changed, but it is just a timing of inventory management with a few select customers.

Operator: Thank you. And we'll move on to our next question. One moment, please. Our next question is going to come from the line of Larry Solow with CJS Securities. Your line is open. Please go ahead.

Larry S. Solow
Analyst, CJS Securities, Inc.

Q

Good morning, guys. Thanks for taking the questions and wish all luck for Bernard. I guess, first question, Eric, it's just – a little bit of a slowdown in Proprietary Products, just seasonally. And I know you guys were increasing capacity. So, I'm just curious, I thought we were going to kind of trend up. Is there just a little bit more of a return to some seasonality you're seeing? I know Q3 historically, pre-COVID was kind of a little bit slower. And the last few years have obviously been kind of – I think that's been throughout the window.

But are we kind of getting back to some of that and maybe that kind of goes in hand with the inventory management too, where now supply chains are maybe somewhat normalized, some of the larger customers have that ability to manage their inventory better as well?

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

A

Yeah, Larry, thanks for the question. First of all, I'll pass on your remarks to Bernard a little bit later. In regards to the inventory management, what we're seeing, it's not really – it's not seasonality or it's more around timing of orders. So, if we think about the investments we're making, and I know Paul earlier asked about specific capital investments in different plants. And most of our investments, about two-thirds, let's call it, two-thirds of our CapEx is around growth orientation. Right now, there's a heavy emphasis around HVP, particularly on plungers and also – and the CM side has been a little bit larger than typical because of the supporting some of the new drug launches coming down the road.

But we're seeing some of the – and so those investments are going to be at our major HVP sites and I already commented on which sites for CM.

In regards to timing of the orders, and it's not seasonality, it also is kind of customer action schedules. So, what I would look at is Q3 with the 20% base organic growth and that the comment to that Biologics, I won't give the number, but was – led that, so it's obviously above. That is really new molecules in the market and success of those existing components – I'm sorry, molecules in the market already. And so, the demand continues to be layered on top.

We play – and Kinston site as an example, we installed new capacity for NovaPure plungers. We've been ramping that up through Q3 and we'll also do that through Q4. And we should be able to relieve the bottle – the backorder situation by the end of this year, and we'll be in a very good position to be able to service our customers effectively throughout 2024 in the fastest area of growth. So, hopefully that gives you some context, Larry, of what we're seeing...

Larry S. Solow
Analyst, CJS Securities, Inc.

Q

Yeah. Helpful.

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

A

[indiscernible] (00:24:22) product, standard products in the market.

Larry S. Solow
Analyst, CJS Securities, Inc.

Q

Got you. Great. And just shifting gears, just want to follow up just on the high-value solutions [indiscernible] (00:24:32) into that, obviously, that continues to be the driver. And it sounds like there hasn't been much slowdown [indiscernible] (00:24:38) there. Well, just in terms of just – I think you said it was greater than 75% in the quarter for revenue. Can you remind us, approximately what it was last year? And more importantly, just I know it's a lot lower on volume. Can you just give us a kind of a guesstimate on where it is on a volume basis? And I imagine NovaPure still remains a minority piece of that. And that sounds like that's – potentially be the fastest-growing piece going forward. So, any color there would be great. Thanks.

Quintin John Lai
Vice President-Strategy & Investor Relations, West Pharmaceutical Services, Inc.

A

Yeah, Larry. I can't recall. I'll have to get back to you on what it was as a percent of sales last year, somewhere around 70% or plus or minus. We have seen growth year-on-year and it's a combination of volume, mix and price, that...

Larry S. Solow
Analyst, CJS Securities, Inc.

Q

Okay.

Quintin John Lai
Vice President-Strategy & Investor Relations, West Pharmaceutical Services, Inc.

A

...that have driven the year-on-year growth. And if you think about it when some of the new drugs that Eric has mentioned, that incremental volume of those drug successes, typically come at our higher end of HVP like NovaPure. And so, therefore, it has a bigger impact. So, it may not have as big a volume as much as a mix impact for us.

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

A

And one additional comment, the algorithm, Larry, of, if you think about the growth of HVP in the double-digits...

Larry S. Solow
Analyst, CJS Securities, Inc.

Q

Yeah.

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

A

...that requires about 100 basis points increase year-over-year of volume for HVP.

Larry S. Solow
Analyst, CJS Securities, Inc.

Q

Right.

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

A

So, we're still in the 23%, 24% corridor from a volume perspective. But as – but because the way that Quintin articulated the ASP margins, it's actually quite significant impact on the overall portfolio.

Larry S. Solow
Analyst, CJS Securities, Inc.

Q

Got it. Great. I appreciate the color. Thanks.

Quintin John Lai
Vice President-Strategy & Investor Relations, West Pharmaceutical Services, Inc.

A

Thanks, Larry.

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

A

Thanks, Larry.

Operator: Thank you. And one moment as we move on to our next question. And our next question is going to come from the line of Jacob Johnson with Stephens. Your line is open. Please go ahead.

Jacob Johnson
Analyst, Stephens, Inc.

Q

Hey, thanks. Good morning. And my best to Bernard as well. I guess I'll stick with the popular subject of the morning. Maybe just first, going back to the restocking dynamic, you call it out as a slowdown in restocking trends. I'm just curious kind of what surprised you about this. Is that a lack of restocking and customers not going to as high of safety stock as you would have expected? Or is it some destocking not to get too caught up in the vernacular here?

And then the other piece of that is just, Eric, you mentioned growing next year despite that inventory management. How should we – how long should we think about this dynamic persisting?

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

A

You want to cover the first part?

Quintin John Lai
Vice President-Strategy & Investor Relations, West Pharmaceutical Services, Inc.

A

Sure. So, Jacob, I'll give you an example. So, yeah, we – at the start of the year, we had customers putting orders in for Q4 that based on where we were in our capacity and our ability to deliver, we said we're going to have to get it to you next year. I mean, that's the lead time issue that we had and we had those types of discussions.

As our team have done a fantastic job of getting added and increasing the capacity, we got over the issues that we had last year in terms of some of the issues of installing that – some of the HVP processing capacity in one of our sites, we built on new facilities like in Kinston and in other areas, we were able to start to clear some of that backlog.

And then we were able to then to go to those customers and said, hey, we're going to be able to now deliver like you said originally for the end of the year. And what they came back to us and said, that now we're good. We've already reset our manufacturing schedules. We're going to just take it here in 2024 instead. And so, what – we thought we're going to be able to do and handle it because now we've got that additional capacity and help restock them, now it's just a matter of timing. So, that just gives you an example of some of the things that we've seen as the years progressed. Eric, [indiscernible] (00:29:20).

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

Absolutely. And I think the last aspect around this is that if you think about the dynamics of this long term, what we're speaking with customers on it is really it's the rescheduling of their production lines and the need of the products. So, that's why we are – we've given indication and we're not giving the full guidance today, but we're giving indication that 7% to 9% corridor, the top line growth is – and being led by HVP and it's been led by Biologics. And we're putting COVID into the number. So, it gives you kind of the dynamics that we're seeing right now. So, we should – this is a temporary situation.

Jacob Johnson
Analyst, Stephens, Inc.
Q

Okay. That's helpful. And then, Eric, you were just talking about the Kinston capacity ramping in 3Q and 4Q, and you kind of mentioned that you would catch up on maybe some back orders or something like that, if I heard you correctly. I'm just curious as it relates to that market, do you think containment solutions have been a bottleneck for the ramp of some of these drugs? And is this something that, as you get caught up on, we should expect Kinston to ramp pretty well in 4Q and maybe into early next year?

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

Yeah. I would say, no, we're not the bottleneck, I'll be clear, in some of these drug launches. We would state that we have been able to navigate and manage through. And I was just – before this call, we were just kind of doing another review of the customers that are coming out of that Kinston plant for particularly NovaPure plungers. And it's quite a few customers. So, it's not one molecule, it's not one customer, it's multiple and there's ramping up for 2024 campaigns.

So, we're excited about where we are. But I would say right now we're not a bottleneck. It's just – goes back to what we spoke about earlier is that we're – we would like to – they would like to see better, stronger safety stocks at their own – in their own pipeline. But we do know that there's some other issues that we see. But that's not for us to discuss from these launches.

But I would say we're not the bottleneck, we got the investments put in place, it's validated. Customers are very satisfied with the quality of the product from our Kinston facility, and we have capacity to continue to grow and support, frankly, the Biologic launches. And these are the areas around oncology, autoimmune, immunology. I mean, these are exciting areas for us. And I think we're well positioned for the future, particularly out of that plant.

Jacob Johnson
Analyst, Stephens, Inc.
Q

Got it. Thanks for taking the questions.

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

Thank you.

Operator: Thank you. And one moment while we move to our next question. And our next question is going to come from the line of John Sourbeer with UBS. Your line is open. Please go ahead.

John Newton Sourbeer
Analyst, UBS Securities LLC

Q

Good morning and best to Bernard. I guess just starting off on GLP-1s, just any additional color or even maybe broader biologics, but how do you see this market evolving maybe between auto-injectors and multi-dose pens and maybe GLP-1s more specifically, just any thoughts on potential transition to more oral project – products there?

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

A

Yeah. No, it's – I don't want to be putting – speaking on behalf of my customers, I got to be careful here. So, what we're prepared to do for them is we'll continue to be the primary, the key manufacturer of elastomer components that go into several of these auto-injectors and other modalities. And so, from elastomer position, we're very encouraged with our HVP plunger portfolio and we're able to support them on the demand, and then actually stay ahead of the demand with our manufacturing capabilities. We mentioned a little bit earlier today that some of the assets we put in for COVID are actually fungible for this, not just for GLP-1, but for HVP in general.

I think in regards to multi-use pens, again, I would refer to our customers in that discussion. But from our point of view, we participate in all. And we are the market leader in injectable medicines. Now, we don't participate in oral, and that is the uptake of oral, the effects of this oral that – those are all discussions I would really encourage you to speak with our customers on directly.

But as the injectable space continues to grow on GLP-1 as new molecules are approved and launched, we're – and the investments we're making, both on the Proprietary and CM side, we have a good visibility of cadence of what we're being asked to build support through our global network to support the demand. I'll just be clear, one other aspect is that on the Proprietary side, we always enjoy a very high participation rate.

On the CM side, we've been very clear that our customers are looking at multiple suppliers to support them, and we're one of them. So, we're positioned very well on both sides of the business. Hopefully, that gives you some context of what we're seeing.

John Newton Sourbeer
Analyst, UBS Securities LLC

Q

Yes. Thanks. I appreciate the color there. And also just looking to the high-level framing around next year, you've had pretty strong pricing this year, I think, in the 5% to 6% range. Just any color on what you think pricing could look – [ph] shake (00:35:01) out to for 2024?

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

A

Yeah. I won't give exact at this point because we are still working through our details and we have been in discussions with customers. I think one thing to think about, you're right, this year we were communicating between 5% to 6% net price realization. I think we're clearly in that corridor, if not in the upper end, and which is positive when you think about the inflationary pressures that all of us around the world are faced with, and we're able to offset majority of that pressure.

We are taking consideration of additional inflation if, what that would look like next year, so just to give you a little context of how we look at this. And that will help us inform our decision about exactly what corridor we're going to be in. But I would say – I can say here that the [ph] store complexity years (00:36:00) ago when we were at sub-1% or between 1% and 2%, I believe that's behind us. We do think we're in a very – in a better position to capture more price going forward.

John Newton Sourbeer
Analyst, UBS Securities LLC

Q

Thanks, Eric. And then the last one just on my end, on COVID, it sounds like you're no longer going to break that out next year. There was an increase in the guidance for this year, anyway, just to think about what is the [ph] pandemic (00:36:22) level there on COVID going forward?

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

A

Yeah, I think the – just based on the guidance Quintin articulated, and I think both Bernard and Quintin have been clear on this, but we're looking at about $68 million for this year. So, with the [ph] base case (00:36:37) – if you do the delta, it's about $8 million in the [ph] fourth (00:36:40) quarter, just – and that means compare that to $388 million in prior year. And we're a little bit more than that of previous year to that.

It's hard to predict and – but we're – we've – in the last two quarters, we've been basically between $10 million and $20 million a quarter. And so, the way we look at it is, yes, that could potentially be a headwind. There's less doses that are administered or it could be a tailwind if there's more doses depending on how this pandemic evolves.

But we're just – we're going to – right now, our thinking is to put it into the base and run the business as a whole, because at this point, it's becoming a very small portion of overall West. So, yes, we'll be clear for the balance of this year, but then we'll give better clarity in February if we think we do need to still call it out, but our thinking right now is to eliminate that.

John Newton Sourbeer
Analyst, UBS Securities LLC

Q

Thanks for taking the questions.

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

A

Thank you.

Operator: Thank you. And one moment as we move on to our next question. Our next question is going to come from the line of Matt Larew with William Blair. Your line is open. Please go ahead.

Matt Larew
Analyst, William Blair & Co. LLC

Q

Good morning. Obviously the focus in terms of the Contract Manufacturing and auto-injector investments right now are around GLP-1s, but there's growing interest, I think, more broadly in new delivery modalities and obviously you have your SmartDose platform. So, just curious if you can maybe update us on either the interest on all pipeline or more generally what discussions with customers are like and more of the device category that you've invested in?

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

Matt, thank you for the question. Excellent question. Quintin, do you want to start?

Quintin John Lai
Vice President-Strategy & Investor Relations, West Pharmaceutical Services, Inc.
A

Yeah. So, Matt, let me clarify. So, when we think about injection delivery platforms, we at West can participate in two ways. One, if the customer has the IP, then we can manufacture on behalf of that customer. And that's where our Contract Manufacturing is. We're really good at it. We're not the only one that will be there, though. As we've said in the past, the customers with the IP will typically outsource to two to three, and if it's a very big project, it could be up to five to six different players. So, that's how we participate. And very often, those customers also happen to be key proprietary product elastomer customers.

And then on the SmartDose side, there, that is proprietary to us. That is our design. And that's when customers come to us and work with us to spec in that device with their drug to make a drug device combination therapy. And there, we're seeing really active uptake. We are up to four now drug approvals using our SmartDose platform. And we have a very active pipeline of customers that are evaluating the platform.

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

Excellent. Thank you, Quintin.

Matt Larew
Analyst, William Blair & Co. LLC
Q

Okay. Thanks, Quintin. And then next on capacity, obviously, sort of Kinston is ramping to full capacity. I think you'd referenced maybe adding to the Waterford site in 2024. So, I guess just as we think about where capital is moving next from an investment perspective, is it Waterford, are there other sites or particular categories you have in mind? And as you're doing that, I know you've referenced building additional automation into newer builds, are those things that can help speed time to ramp, or more just benefit at steady state?

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

Yeah. That's – so, the two points, think about the first one in regards to our network and where we're investing our invest – capital, particularly on HVP, it's heavily concentrated between Kinston, a little bit in Jersey Shore up in Pennsylvania, but in Europe it's Waterford and Eschweiler. And we're also looking at additional expansion in Singapore to build support the Asia market. But the priority has been really around the US and Europe, and we'll continue to invest.

And it's interesting the growth that we're experiencing with HVP, to be able to support that, it is really around if you think about the pharma [indiscernible] (00:41:37) sterilization and Envision, that is helping us to drive the HVP conversion. So, I'm excited about where we are, but also the investments are in flight, what that will give us and also give us the ability to do uplift on additional demand that we expect.

The automation is ongoing and I actually am pleased with some of the recent progress we made our new technology for West that allows us to be more efficient, improve quality. In my mind, I'm always looking at ways to improve safety. And it also allows us to scale up faster when we start thinking about to support various areas, whether it's Biologics, I mentioned earlier about oncology, immunology or autoimmune, but it's also thinking about how do we support this scale up on GLP-1.

And so, this automation that we're working on with a couple of our external partners, I needed to get over to Europe recently to see some new investments that we put in place. I'm excited for what the engineering team has been doing and it's going to give us the ability to scale faster. But more importantly, I think the automation would provide a better product that continues to differentiate West in the marketplace. That's what I'm really excited about. Yes, we'll get efficiencies, yes, we'll get more throughput but reality is and main focus is higher quality product that differentiates in the market.

Matt Larew
Analyst, William Blair & Co. LLC

Q

Okay. Thank you.

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

A

Thank you.

Operator: Thank you. And one moment as we move to our next question. And our next question is going to come from the line of David Windley with Jefferies. Your line is open. Please go ahead.

David Windley
Analyst, Jefferies LLC

Q

Hi. Good morning. Thanks for taking my questions. And best to Bernard and his family. I wanted to start on stocking and just to understand some moving parts a little bit better. Understanding, I think, well that you're talking today that within elastomers or components, the destocking is mostly standard. I think early in the year, we had understood that you had some areas that post-pandemic – maybe Westar, for example, post-pandemic, had not gotten the capital allocation, the growth allocation and were understocked and catching up. And so, I guess, I wanted to try to understand better if those two factors were both at play and offsetting in the quarter or maybe the Westar was already done, and therefore, the standard destocking now is what we're feeling. I just – it feels like there have been through the year moving parts in both directions. And I just wanted to understand those and the cadence of them. Thanks.

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

A

It's a good question, David.

Quintin John Lai
Vice President-Strategy & Investor Relations, West Pharmaceutical Services, Inc.

A

Yeah. Hey, Dave. So, maybe it's just a definition or just maybe when you say destocking, we think of it more as customers that are having a demand issue like in COVID-19. And what they're doing is they're not reordering. And they're taking down their safety stock and consuming their safety stock, and that's certainly happening in COVID-19, which we're seeing year-over-year declines.

The other impact is the fact that we have been behind in terms of delivering because of our capacity constraints. And then as we've been able to restock, the base growth that you've seen in Generics and Pharma is well above the financial construct. So, well, that has been going on for the first part of this year. What we're seeing now is that that base growth is going to temper. It's not declining. It's just not going to be as high as we thought it was going to be in Q4.

That's why we're calling it a slowing of a restock. It's not necessarily a destock situation. And again, a lot of it happens, the fact that we've done a really good job of clearing the backlog. We've been – we've gone to our customers, we've said, hey, we have that capacity to deliver product. And they said, no, given where we are in the year, given where our manufacturing schedules are, we would rather be delivered next year instead of Q4.

David Windley
Analyst, Jefferies LLC

Q

Okay. Helpful. Thank you. And thinking about your initial comments on 2024 and admittedly, the – appreciate your answers to Paul's question to start on GLP-1s and I think we all know that the attention there is probably overwrought. But insomuch as there's a lot of enthusiasm for that particular class, I think your – folks that are paying attention to West believe that that can be a very strong driver for you, perhaps in excess of your long-term construct. Would you tell us that that is – that our assessment of that is too enthusiastic? Or is it that the pace at which that comes on is perhaps not as quick as we think? Or is it that other parts of the business are offsetting and those things net you into that 7% to 9% target range? Thanks.

Quintin John Lai
Vice President-Strategy & Investor Relations, West Pharmaceutical Services, Inc.

A

So, again, I understand your question. Here's – well, here's our philosophy. We need to be ready for whatever the customers need from us. And so, we have – that's why our teams have such great communication with customers. We have cited that we have customers that are doing really well and are increasing their reorders. In the event that those things change to the positive, that's where our global network is ready. We are – so we're in position for that. We've got the global network to do that. And so – now, what happens to that class of drug, that's really better addressed by our customers, all we can say is that we'll be ready and continuing to be ready. And that's why we've got so much capital projects going on right now. Eric?

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

A

So, in addition to that, Quintin is right, it's – when you think about the growth for – we're really confident with the growth of Biologics, continues to be strong. And when we speak about Biologics, we're not really bringing in GLP-1 conversations [ph] into that (00:49:00) mix. And so, the growth we're – talking about the 7% to 9% construct, it has to be led by HVP, it's to be led by Biologics. That really isn't part of the GLP-1 conversation.

As demand comes in for GLP-1s, when their drugs are approved [ph] and is – further (00:49:21) launches, and the whole supply chain is working effectively and efficiently, we'll be in a very good position to be able to support that scale-up. Exact timing, exact cadence of that aspect, I would probably [ph] turn (00:49:37) more to our customers on that, but we're positioned well to absorb the elastomer side and also the investments we're making. We'll take some time to [ph] build in and validate (00:49:47) up, in addition to what we have already, that will be [indiscernible] (00:49:50) longer term. But we're ready to address that, Dave.

David Windley
Analyst, Jefferies LLC

Q

I appreciate that answer. If I could just clarify, Eric, on what you just said. When you say you're not bringing GLP-1s in on that statement, does that mean that GLP-1s are categorized, say, in Pharma, not Biologics? Or are you just saying that you're enthusiastic about the Biologics pipeline notwithstanding whatever GLP-1s do to that pipeline?

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

A

Yeah. It's really, it's latter. It's...

David Windley
Analyst, Jefferies LLC

Q

Yeah.

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

A

...I tend to focus on what's approved or about to get approved in the market. And that's – and on the Biologics space, we have a diverse portfolio of customers, diverse portfolio of approved drugs in the market and about to be approved. And [ph] I'll mix (00:50:42) – yes, we as an organization are going to fully support and be ready and available to support the – any GLP-1 launches that are beyond what we see today.

And we're excited to be part of that participation and we'll lead in the front like we have and there's no reason why we can't deliver like we did around COVID, it's the same model, frankly. When you think about really the number of SKUs, number of assets that are – that we're leveraging their existing operations, we're very confident we can deliver. But I would say – I just want to be clear, I'm very excited about Biologics without saying that this growth is going to be driven by GLP-1.

David Windley
Analyst, Jefferies LLC

Q

Understood. Thanks for the clarification. Thank you.

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

A

Thanks.

Operator: Thank you. And one moment as we move on to our next question. And our next question is going to come from the line of Justin Bowers with Deutsche Bank. Your line is open. Please go ahead.

Justin Bowers
Analyst, Deutsche Bank Securities, Inc.

Q

Hey, good morning, everyone. Just a two-parter on the outlook for 2024, which, I think, we all appreciate. One, wanted to clarify that the 7% to 9% organic does include the $68 million of – it's on top of the COVID, the $68 million of COVID. And then number two, sort of can you help us understand the visibility that you have now into that growth. Is there a level of commitments from customers? Are you already talking about sort of like project planning and the pipeline for next year? Just investors in this space have been very skittish around visibility. So, any framing there would be helpful.

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

A

Yeah. No, great questions. The first one is pretty clear. Yes. The – when we talk about 7% to 9% top line and 100-basis-point margin expansion that is inclusive of the COVID $68 million that we guided for 2023 in that number. So – and if there's a drastic change between now and February, we'll communicate that. But based on what we're seeing, the answer is yes, it's part of that equation.

The second part about visibility, just, it's interesting our business is made to order for the most part. So, our customers are coming to us and giving us campaigns, whether it's three quarters, six quarters, five quarters, and we're able to support them on whether it's new drug launches or existing drug launches. And there's always going to be some variability on each and every molecule. And so – but on aggregate, we have pretty good lens what type of volume we need for our SKUs and what investments we need to make.

On the CM side, it tends to be very long contracts with specific assets in CapEx installed that will take a little time to ramp. But once we're operating, we pretty much know what the capacity and output will be day over day. The – on the elastomer side, there's [indiscernible] (00:54:08) more volatility, more variability, and again, it depends on how successful the drugs are in the marketplace. And so, therefore, we're able to move a little bit up and down quarter to quarter.

So, we do have visibility. Is it 100%? No, but this business has tremendous amount of, I'd call it, annuity like repeat year-over-year. It's not 100%, but it's very high. And that gives us confidence on how we can plan existing growth, but also future launches working with our customers. So, it's a little bit of both in there in that answer.

Justin Bowers
Analyst, Deutsche Bank Securities, Inc.

Q

Got it. And then just a quick follow-up on CM. Sort of the margins this year, or this quarter, is that sort of a good go forward rate just given sort of the commentary on the longer visibility in that business?

Quintin John Lai
Vice President-Strategy & Investor Relations, West Pharmaceutical Services, Inc.

A

Yeah. I think that this quarter we did have some benefit from some pricing that we did take through some of our contracts. And we think longer term, we're looking 16% to 17%.

Justin Bowers
Analyst, Deutsche Bank Securities, Inc.

Q

Okay. That's all for me. Thank you.

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

A

Yeah. Thank you.

Operator: Thank you. And one moment as we move on to our next question. And our next question is going to come from the line of Derik de Bruin with Bank of America. Your line is open. Please go ahead.

Derik de Bruin
Analyst, BofA Securities, Inc.

Q

Hey, thanks for taking my question. So, the margin guide that's implied for the fourth quarter, I mean, to get to your EPS number, that is basically, and sort of using your [indiscernible] (00:56:06) guides and everything you put in there, to get to that EPS number for the year, even if we don't assume you're going to get any of that stock-based compensation, it looks like you're going to take a pretty big step down sequentially Q3 to Q4. I'm just curious what's going on. Is it validation of lines? Why is there such – why is this sort of the implied margin step down so big between quarters? Thanks.

Quintin John Lai
Vice President-Strategy & Investor Relations, West Pharmaceutical Services, Inc.

A

Hey, Derik. Thanks. Thanks for the question. Really it's just utilization and absorption. Given that we're probably going to have lower volumes through our facilities in the fourth quarter, we're just – we just wanted to make sure that we have a reasonable swag at gross margin. And then, we're going to continue to manage our costs on the SG&A and R&D line. But – so, that's where the margin impact is really going to be reflected, especially in Proprietary Products margin for the quarter.

Derik de Bruin
Analyst, BofA Securities, Inc.

Q

Got it. So, gross margin on Proprietary Products, you expect to be down sequentially just given the...

Quintin John Lai
Vice President-Strategy & Investor Relations, West Pharmaceutical Services, Inc.

A

Yes.

Derik de Bruin
Analyst, BofA Securities, Inc.

Q

...utilization [indiscernible] (00:57:15).

Quintin John Lai
Vice President-Strategy & Investor Relations, West Pharmaceutical Services, Inc.

A

That's right. That's right.

Derik de Bruin
Analyst, BofA Securities, Inc.

Q

Got you.

Quintin John Lai
Vice President-Strategy & Investor Relations, West Pharmaceutical Services, Inc.

A

And then CM to get back down to kind of that 16%, 16.5% range.

Derik de Bruin
Analyst, BofA Securities, Inc.

Q

Got it. Okay. And so, how long does that sort of like – I mean, how long does that sort of like drag on Proprietary Products if we start thinking about building out our quarterly models or quarterly estimates for next year?

Quintin John Lai
Vice President-Strategy & Investor Relations, West Pharmaceutical Services, Inc.

A

No, no. I mean, as – look, I mean, we're in the process of formalizing kind of the plans for 2024. But as we look at it, next year, with the top line growth that we get led by HVP, you're going to see gross margins improve year-on-year.

Derik de Bruin
Analyst, BofA Securities, Inc.

Q

Got it. Okay. That's great. And just going back, I mean, I know we've talked about the guide, and it's – questions have been asked. But I mean, coming to stock for a while and you're right, I mean, you historically are doing better than your 7% to 9% construct. I mean, why wouldn't you do at least the high end of that range next year? I mean, given you've got pricing, you've got demand, you've got some orders that got pushed from this year to next year, I mean why wouldn't – and COVID is normalizing, why wouldn't that be just like – why wouldn't that be a reasonable 9% or better?

Quintin John Lai
Vice President-Strategy & Investor Relations, West Pharmaceutical Services, Inc.

A

Well, Derik, look, we're sitting here in October. We're putting our plans together. We're trying to give you kind of a preview of next year. And we're also doing it cognizant of the fact that we're hearing other life science tools companies upstream of us talk about softness and tougher times. We don't have some of the high exposure that they have in certain areas like emerging bio and pre-commercial companies and things like that. But still, we just want to be – again, we want to be – we acknowledge that there are uncertainties out there.

So, as we sit there and put all that in, and that's how we come up with that preliminary guide. And we'll provide a lot more detail in February because we'll have a lot more information then, and we're happy to come back and talk to you then.

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

A

Yeah. And I think we've been consistent on the message that, that's just – to us, we want to continuously hit or exceed. So, that's where we sit right now with the visibility we have.

Derik de Bruin
Analyst, BofA Securities, Inc.

Q

Great. Thanks a lot. Appreciate it.

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

A

Thanks, Derik.

Quintin John Lai
Vice President-Strategy & Investor Relations, West Pharmaceutical Services, Inc.

A

You bet. Good talking to you, Derik.

Operator: Thank you. And I would like to hand the conference back over to Quintin Lai for any further remarks.

Quintin John Lai

Vice President-Strategy & Investor Relations, West Pharmaceutical Services, Inc.

Thanks, Michelle. 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 a 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 the call. Have a nice day.

Operator: This concludes today's conference call. Thank you for participating. You may now disconnect.