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# West Pharmaceutical Services, Inc. (WST)

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## CORPORATE PARTICIPANTS

**Bernard J. Birkett**

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

**Eric Mark Green**

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

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## OTHER PARTICIPANTS

**David Windley**

*Analyst, Jefferies LLC*

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## MANAGEMENT DISCUSSION SECTION

**David Windley**

*Analyst, Jefferies LLC*

We're ready to get started. Hi. I'm Dave Windley with Jeffries healthcare equity research in the US, cover contract manufacturing, contract research related to the pharma industry to – pick and shovel players into the branded pharma and biotech industry. West Pharmaceutical Services is one of the companies that I cover, WST is the ticker, very interesting company with a very powerful growth algorithm that a lot of folks are probably familiar with now. We'll get into that a little bit. I'm glad to have Eric Green, the company's President and CEO; and Bernard Birkett, the company's CFO and Head of Operations now, do I understand?

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**Bernard J. Birkett**

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

Yeah.

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**David Windley**

*Analyst, Jefferies LLC*

Yeah. Okay. Yes. So sorry if I was a little belated on that, but yes, I know him as the CFO of West. That's my primary interaction. So, glad to have you guys with us. Really appreciate your being here again.

## QUESTION AND ANSWER SECTION

**David Windley**

*Analyst, Jefferies LLC*

Q

Eric, I want to start off and just talk about sales trends. Your HVP product portfolio has continued to grow, both in the breadth of products but also in the dollars of sales. Maybe you could talk about what the last couple of years' experience has been in terms of the growth of the company's HVP sales line and kind of how that has been the same or different between COVID and non-COVID.

**Eric Mark Green**

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

A

Well, first of all, thanks for having us here in London. It's good to be back this year. You're absolutely correct to each. The high-value product portfolio of West continues to be the key thesis of growth. When we think about the space that we operate in, the injectable medicine space is very attractive within the healthcare sector. And the fastest segment of that sector is the biologic space, and our participation in biologic continues to be extremely strong, roughly lower 90% participation rate on new molecules that have been approved. And that success has been really driven by the technology and the capabilities and scale that we currently have within our high-value product portfolio.

If you think about the thesis we talk about is the kind of financial construct is 7% to 9% top line growth organic and 100-basis point operating margin expansion each and every year, and that held true if you take out COVID. Obviously, COVID was an accelerant over the last couple of years for West in the tune of about \$380 million of revenue in the last year. And if you take that out, the growth of HVP continues to be well in the double digits.

When we think about the opportunity of further growth is, put it in perspective, high-value products from a unit consumption perspective is roughly around 23% of volume, but it's over 70% of the revenue within proprietary. It basically is about 100-basis point expansion each year on volume, gets you strong double-digit growth on the revenue line for West. So, that's been the key driver of the business.

The last comment I'll make is if you strip out COVID, you look at the whole core business in the last couple years, it's been growing well above our construct of double-digit growth, which is very attractive base when you think about the biologics, the pharma and the generic marketplaces that we serve.

**David Windley**

*Analyst, Jefferies LLC*

Q

So in recent quarters, you've talked about the biologics segment having grown to from what was kind of an even four quarters across the four end markets that you identify to biologics now 40%-plus, and then you mentioned your participation rate in new biologics is 90%. I'm not surprised by that. In some cases, I wonder who your competition is. I'm sure they're out there but they don't show themselves very often. Do you expect on an ex-COVID basis that the biologics business will continue to be 40%-plus? And is that something that can continue to drive growth at or above that 7% to 9% construct? How do we need to think about the kind of the navigation through this, what's been kind of the volatile COVID period?

**Eric Mark Green**

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

A

Yeah, absolutely. If you strip out the COVID element of the revenue at West, we do strongly believe that the biologics business will continue to be the strongest growing market unit at West, well in the double digits. And the key drivers around it, as we just talked about, is the pipeline of new approvals and getting prepared for drug launches.

We also have a very healthy committed order book with our customers. In fact, in certain aspects, particularly around our highest part of high-value products, the NovaPure plungers, we currently have some constraints that we're laying in new capital in our facilities so that we can alleviate those constraints over the next several quarters to start getting ahead of the demand curve. But as you can imagine, our customers' success of newly launched biologics is resulting in increased demand that has been outsized of the current capacity that we're currently mitigating over the next few quarters. So, we're – we continue to feel that biologics will be growing in the double digits without COVID. Our pharma business will be probably around mid to low-single digit. And then, our generics business is about mid- to high-single digit.

The last comment is the contract manufacturing is coming back into growth. We have that planned this year to being slightly down, and we're seeing that returning to growth definitely as we get into 2023.

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**David Windley***Analyst, Jefferies LLC*

Q

Okay. On the NovaPure plungers, I want to pause on that topic for just a second. You highlighted the capital, both the constraints and the activities that you're undertaking to put capacity in place to alleviate that. Can you help us to understand a little bit where you stand on that? You're talking about a couple of quarters. I think the guidance that you gave for the balance of this year was trying to be conservative around the timing of that capacity being available. But what steps operationally need to be completed to have that available to you for production?

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

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Yeah. So, the guidance for the remainder of this year really was centered around layering on some capacity. We already have the equipment in place. We had some challenges in Q3 making that equipment operational and we've been working through that. And we would expect, by the end of the year, that to be fully resolved. We've made a lot of progress as we've moved through probably the last four to eight weeks on that. And so, that element will be resolved and fully functional, we believe, early 2023.

Then there is other capacity specifically around plungers which has been planned to be layered in at the back end of Q1 2023, early Q2 2023, and that's to meet existing demand that's already there to give us some uplift for incremental demand that we expect to see here as we move through 2023. So just apart from the issue that we had in Q3 of this year, everything else is on track.

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**David Windley***Analyst, Jefferies LLC*

Q

So just to clarify, you mentioned you layer – the point that you made about layering in some additional capacity. Was that in 2022 or that's yet to come in 2023?

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

A

Yet to come in 2023, particularly around the plungers, yeah.

**David Windley***Analyst, Jefferies LLC*

Q

Okay. On the standard products, one of the things that, Bernard, when you first arrived, had been an issue around kind of seeing into your client's supply chains, what their order patterns were really reflecting relative to their own inventory levels, things like that, had been a cycle prior to your arrival. You invested a lot in greater insight into client pipelines and understanding that a lot of the tools, peers are talking about this inventory destocking in COVID that needs to happen. You guys have a different view. Maybe you could talk to what gives you the confidence that your products in the channel are not stocked in the way that Thermo and others have talked about?

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

A

Yeah. There's two parts to that. One, on the COVID side, we do see potentially an element for destocking around COVID-related business. On our core related business, we're actually seeing the opposite in certain instances, and that's driven by the increase in lead times that we've seen within our business and our ability to deliver to customers based on the challenges that we had during COVID and meeting the response to COVID itself. So, we've had customers who placed orders and want a product delivered in 2022 that we've had to push out into 2023 just based on the capacity.

Now, what we have tried to do during that period is prioritize production and delivery to customers. So, they did not get stocked out but they didn't get the full volumes that they requested. So as we move into 2023, that's something that we will be able to address by having this extra capacity on place – or in place that we're layering in, plus some of the COVID business dropping off, that allows us to respond and actually replenish inventories for some customers.

**David Windley***Analyst, Jefferies LLC*

Q

Got it. And on these – coming back to the NovaPure plungers before I leave that topic, the capacity that you're putting in place, is this the first iteration of producing plungers at a NovaPure quality level or you are already making that and this is adding to it?

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

A

We're already making it, and this is additional based on the demand we're seeing.

**David Windley***Analyst, Jefferies LLC*

Q

Got it. Okay. Thinking, I guess, a little bit beyond that – the arc that you show, your product arc that you show in your slide deck, how are you thinking about your R&D activities and product development activities to continue to extend your high-value product portfolio?

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

A

Yeah. There's two areas that we're looking at. One is we continuously look at challenging ourselves on what is the next generation of NovaPure. When you think about the premise of NovaPure, it's quality by design, and that was launched in roughly around 2015, 2016. It takes about two to three years to see the market, and now, it's quite

meaningful and quite significant to our portfolio. So we're looking at new technologies that can extend from a components perspective to drive even higher performance, particularly around the challenges in the areas of biologics.

The second area that the team is focused on is the concept of moving from components to systems. And this is an area that our company has been involved with with several drug companies in the analytical testing and the – clutching the technical data to be able to support the decision of what components to be used on a particular molecule when they launch.

Since we don't provide all the components, the most recent relationship we struck with Corning with the glass technology gives us the ability to start putting together a system approach which will drive ultimately a better product for our customers and implementation as a drug launch as they go – as they move forward. So that's the second wave that we're looking at, is moving again from a components system direction, and the investments we're making are definitely moving us aggressively in that direction.

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**David Windley***Analyst, Jefferies LLC*

Q

The Corning Valor Glass deal is certainly is interesting. And what perked my eyebrows up in the last quarter was you talked about having at least an initial system version available for clients to begin to sample and do some development work around as early as, I think, early next year. Could you talk about a couple things on this front? One, how long should we think about the seeding process lasting before you start to get the uplift, like you described in the NovaPure example? And then – well, let me – let you answer that one first and I'll ask the second.

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

A

Yeah. Dave, I think if you look at the NovaPure case study, that's a typical cycle that we would see far as – from introduction to adoption and then into meaningful scale around commercialization. So, you're right. We are going to be launching a system, vial configuration system with NovaPure in the first quarter of 2023. So, that's just around the corner. And the initial discussions with several of our key customers has been extremely positive. So obviously, as many of our colleagues and peers in the market do voice of customer, we're very intent to make sure that we are making the right solution that really creates value. So, we do see this launch as critical as the first step of many sequential releases as we go forward from a vial to cartridge to a prefilled syringe environment.

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**David Windley***Analyst, Jefferies LLC*

Q

Okay. So the second question, which you touched on a little bit, but is based on kind of how the customer selects this. So, our understanding is that the customer would look at the variety of vials probably high – that high-value vials components, closure systems, elastomers and kind of go through a trial-and-error process of figuring out what is the best, I'm sure they have data that narrows that target down, but trial and error to figure out what the best individual selections are for them. How do you design a system that avoids that trial-and-error necessity? How do you do that?

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

A

That's fundamentally the principle of why we're driving this direction, is that we're taking that whole – we're reducing that cycle time to identify what is the right configuration for their drug molecule. And as I mentioned

earlier, we do that currently today for many of our clients, and at this point in time, we're actually providing a complete solution.

I should interject and say that one of the channels to market that has been very successful for us, and we've been doing this for a period of time with other components from other suppliers, is what we call Ready Pack. And this is a capability of seed in the market, and one of the attractive audiences of this program really is the smaller biotechs, the smaller pharma.

And so, as we see the market, we are seeing a little bit technical data with the products to be able to work with. And then, as they go through their process, they look to scale, and that's where we can come in and help them with the scalability. So it's one access to the market, access to the numerous customers we deal with, whether it's medium, small, large, anywhere in the geography that's providing all the technical data and support and it's providing material to be able to work with at that stage of their development up to clinical.

**David Windley**

*Analyst, Jefferies LLC*

Q

Okay. And then, if you're willing to share, how is the agreement struck with Corning? How do you share economics there? And how should we think about the price of a system versus the price of an elastomer to the client?

**Eric Mark Green**

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

A

Yes. So I'll start with the last part first, is that it's – we believe it's going to be incremental to just the segmentation of the components. The reason for that is we're de-risking, we're creating value that we're able to capture. It's the same concept when we launched NovaPure. There – if you think about the multiple that NovaPure is over other similar components but without that quality design element to it, it's the same concept to move up to the system. So we believe the economics and based on the discussions we've had with clients, we do believe there's value to be captured and move into that direction.

**David Windley**

*Analyst, Jefferies LLC*

Q

And then, how do you share...

**Eric Mark Green**

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

A

...oh, the economics. I apologize for that.

**David Windley**

*Analyst, Jefferies LLC*

Q

... [indiscernible] (17:50) Corning – excuse me, yeah, with Corning.

**Eric Mark Green**

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

A

So the way that the agreement is structured, we are exclusive. So, Corning is exclusive through West. We will still continue to work with the other manufacturers of glass components to be able to support our mutual customers. And we are embedding capital into their manufacturing operations where, therefore, they are going to be



manufacturing on our behalf. And it will be a similar arrangement that we have with other partners like Daikyo and acquiring the material from them. And then, obviously, as a complete system and the economic sense – system is greater than the sum of the two.

**David Windley**

*Analyst, Jefferies LLC*

Got it. Okay.

Q

**Bernard J. Birkett**

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

And I think it's important just on that as well, that there's – it's taken two DMFs right now that exist and bringing it to one, and then that DMF sits between West and the customer. So, we maintain the relationship with the customer and that's really important from taking risk off the table and actually making the whole process more efficient.

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**Eric Mark Green**

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

Yeah. Absolutely.

A

**David Windley**

*Analyst, Jefferies LLC*

Is the – Bernard, I think you and I have talked a little bit about Corning's – like there's a – there are two different types of pharmaceutical-grade glass in the market. There's, I think, borosilicate and aluminosilicate or something like that, if I pronounced those correctly, and that Valor incorporates that aluminosilicate. Are they in the market on pharmaceutical drugs today? Is that part of their product de-risked?

Q

**Bernard J. Birkett**

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

Yes.

A

**Eric Mark Green**

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

Yeah.

A

**David Windley**

*Analyst, Jefferies LLC*

Okay. Easy enough answer. The next question I had, separate topic, is around your thoughts on capital allocation. The company cash flow is pretty well. You're talking about, I think, coming closer to, if not, at the back end of a pretty intensive CapEx cycle. How do you think about capital intensity of the business organically going forward, and then where you want to direct your free cash flow?

Q

**Bernard J. Birkett**

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

Yeah. So right now, we're – on the capital spend itself, we would expect 2023 to be another kind of heavy year around CapEx. And again, it's really driven by the growth opportunities we see in front of us. So in CapEx in the past, it was 50% maintenance and IT and then 50% growth. Right now, what we're seeing is that the CapEx is

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30% maintenance and IT and focus 70% on growth. So, the dynamic there has shifted. And again, within that, it's really focused on high-value products and more so on equipment. So, the payback is a lot better. So after 2023, we would expect it to normalize and come back to our normal rates. But again, that depends on what opportunities present themselves.

We continue with our dividend policy. We do a share buyback which really just offsets share creep on an annual basis. Then the other areas for us to look at are really on M&A, which is something that we haven't done in the recent past. But now that we're through COVID, it is something that we will take a much closer look at, particularly in the spaces around looking at delivery devices, wearables, hospital to home, and that area allows us to expand on our SmartDose portfolio.

Again, a lot of that would be tuck-in kind of acquisitions rather than anything that we would see as being transformative at this point. So, the main thing for us to do is to protect and not distract or detract from the organic growth story.

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**David Windley**

*Analyst, Jefferies LLC*

Q

Got it. And on the acquisition front, you've talked about this for several years, but as you said, haven't done deals in the recent past. I suspect particularly, say, 2020 and 2021 valuations were probably really high. Are you seeing any correction in that in terms of your targets?

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**Bernard J. Birkett**

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

A

I think there is some correction. There's probably a little ways to go in that. I don't think it's fully done at this point. But the valuations, when we looked at it from our own acquisition, our own M&A policy, it was really hard to see how would you – you would generate returns from a lot of those potential targets that we had at that time because the valuations were so high. So, we take a very disciplined approach to M&A. And we have certain hurdle rates and criteria that have to fit before we will do anything just to make sure that we're creating the best returns for our business and for shareholders.

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**David Windley**

*Analyst, Jefferies LLC*

Q

So before we end, I wanted to – I want to come back to the margin question, if I could. Do you – the business has tracked along through, if we go back to Eric, when you joined the business, generated a gross profit margin in the kind of low-30s, 32%, 33%. You implemented a couple of key things kind of dividing the end market, the customer segment, customer-led sales strategy that you implement, and then inwardly facing an operational globalization that was to drive efficiency. Some of those things showed – started to bear fruit prior to COVID, and then COVID layers on top and really skews your financials. How should we think – as COVID is coming back out about a normalized margin, should we go back to pre-COVID and draw 100-basis point line up into the write per year or is – are the benefits of COVID more – some of the benefits of COVID more durable than that?

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**Bernard J. Birkett**

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

A

Yeah. So right now, as we're looking through margin, there's a number of puts and takes, and there's a lot of volatility in the market out there. We're facing a number of different headwinds, obviously COVID being the primary one, and that business actually reducing and that was high-margin business. We're also looking at FX

and also a lot of the inflationary pressures that every business has seen today. But there are a number of levers that we can access to help offset many of those headwinds.

We're looking at our pricing strategy. So our pricing in 2022, we saw that we were able – currently tracking about 4% to 4.5%. About 100 basis points of that is based on surcharges and onetime price requests from customers. And then – so, we're about 3% to 3.5%. Prior to that, we were at 1% to 2%. So, we're getting more price than we've had in the past.

For 2023, we're currently assessing what should that price get be based on the cost pressures that we're facing. So, we're currently going through that with customers. We're looking at the – on our core business, the HVP shift, that mix shift and what we will get from that. And we're also looking at the cost structures within our business from a COGS perspective and from an OpEx perspective to make sure that they're aligned with the current climate that we're operating in so we can maximize margin here in the short term.

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## David Windley

*Analyst, Jefferies LLC*

Okay. I think we're at time. So, I will thank you very much for your attendance and thanks to the audience for your interest. I wish you all a good week. Thank you.

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## Eric Mark Green

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

Great. Thank you.

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