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West Pharmaceutical Services, Inc. (WST)

Q3 2020 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Contract Manufacturing Operator: Ladies and gentlemen, thank you for standing by, and welcome to the Q3 2020 West Pharmaceutical Services Earnings Conference Call. At this time, all participants are in a listen-only mode. After the speaker presentation, there will be a question-and-answer session. [Operator Instructions] Please be advised that today's conference is being recorded. [Operator Instructions]

I would now like to hand the conference over to your speaker today, to Mr. Quintin Lai, Vice President, Corporate Development, Strategy and Investor Relations. Thank you. Please go ahead, sir.

Quintin John Lai

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

Thank you, Dylan. Good morning and welcome to West's third quarter 2020 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, CEO, Eric Green; and CFO, Bernard Birkett will review our financial results, provide an update on our business, and present our updated outlook for the remaining year of 2020. There's a slide presentation that accompanies today's call, and a copy of the presentation is available on the Investors section of our website.

On slide 2 (sic) [3] is the 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 risk 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 the GAAP are provided in this morning's earnings release.

I now turn the call over to West's CEO and President, Eric Green.

Eric Mark Green

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

Great. Thank you, Quintin. And good morning, everyone. Thank you for joining us today. Before we dive into our Q3 results and raise 2020 guidance, I'd like to make clear the importance of our mission at West and the values that form the pillars in which we operate. In today's uncertain environment and what seems like a new set of challenges each day, we remain focused on two key priorities: keeping our team members safe and ensuring uninterrupted supply of high-quality containment and delivery devices required by our customers and the patients we jointly serve.

Moving to slide 5. West is uniquely positioned to satisfy increasing market demand by leveraging our global operations scale and resources. Our team recognized, at the outset of the pandemic, the need to increase production capacity. We were already supporting the growth trajectory of our base business and the future demand for our products [ph] required (00:03:42) for COVID-19 vaccines and therapeutics meant that we needed to act quickly and decisively.

To address the increase in demand, we brought forward planned capital investments in production capacity. Earlier this month, we installed new manufacturing equipment at one of our HVP sites to prepare for the future demand of Flurotec and NovaPure. As of this week, that capacity is operational and we have additional equipment being installed at a second HVP site with more installations planned in the coming months at other global sites. The strength of our performance this past quarter demonstrates the forward momentum we have built over time with our market-led strategy and the One West Team approach to satisfy market demand.

Now turning to slide 6, the disruption caused by the pandemic has impacted the way all of us conduct business and our daily lives. West is no exception. Thankfully, the changes we have been making over the past several years of the way we do business have enabled us to address these disruptions from a position of strength. Customers come to West for a scientific and technical expertise, and this differentiates us in the market.

Despite the pandemic, we continue to share our expertise through our enhanced knowledge center, webinars, published articles and technical presentations at virtual conferences. We have been investing in digital technology and automation with two objectives in mind: bringing new connected products to market as well as enhancing the productivity of our operations at every level of the organization.

While we're early in our digital journey, I would like to share a few examples of our recent success, starting with our manufacturing automation strategy. We made great strides over the past year in helping us achieve continuous improvements in quality, safety, service and cost. For example, our St. Petersburg, Florida site has

developed an automation process for robotically loading and unloading molding presses. This has considerably reduced idle production time associated with product changeovers and improved operating efficiency. And our Kinston site has automated molding, trimming, rinsing processes, which will drive higher quality in final product and greater efficiency gains.

And I'm especially pleased with the team's agility in bringing forward the production capacity expansion I mentioned earlier. A great deal of planning and engineering went into this initiative to help us meet our customers' requirements. On the digital front, we have just introduced West Virtual, the future of customer interactions with a truly immersive, fully interactive online experience. We expect this tool to be a primary customer interface even beyond the current pandemic.

Turning to slide 7 and our performance in the third quarter, our financial results remain strong. I'm pleased to say that the growth trends we have experienced over the past several quarters continued in the third quarter, and the outlook for the fourth quarter remains positive. We had over 18% organic sales growth in the third quarter driven again by robust high-value product sales, as well as sales in Contract Manufacturing. And we experienced solid growth in operating profit margin expansion. This resulted in a strong adjusted EPS and free cash flow for the third quarter.

Similar to the second quarter, our base business had solid organic sales growth in the third quarter. We also had incremental sales associated with many COVID-19 development projects we are supporting for both therapeutics and vaccines. Specifically for vaccines, towards the back end of the quarter, we were asked by our customers to accelerate initial deliveries of components. This more than offset continued sales decline of products associated with injectable drugs and treatments such as dental and elective surgeries that have been impacted negatively by the pandemic.

As for guidance for the remainder of the year, we are confident that we're well positioned with the strength and resiliency of our core underlying business and the incremental opportunities being presented to support our customers with pandemic solutions. Therefore, we're raising our sales and EPS guidance for the remainder of the year.

And with that, I'll turn it over to our CFO, Bernard Birkett, who will provide more detail on our financial performance and guidance. Bernard?

Bernard J. Birkett

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

Thank you, Eric, and good morning. So, let's review the numbers in more detail. We'll first look at Q3 2020 revenues and profits where we saw strong sales and EPS growth led by strong revenue performance, primarily in our Biologics and Generics market units and Contract Manufacturing. I will take you through the margin growth we saw in the quarter, as well as some balance sheet takeaways. And finally, we'll review our updated 2020 guidance.

First off, Q3, our financial results are summarized on slide 8 and the reconciliation of non-US GAAP measures are described in slide 16 to 20. We recorded net sales of \$548 million representing organic sales growth of 18.2%. COVID-related net revenues are estimated to have been approximately \$32 million in the quarter. These net revenues include our assessment of components associated with treatment and diagnosis of COVID-19 patients offset by lower sales to customers affected by lower volumes due to the pandemic. Excluding net COVID impact, organic sales grew by approximately 11%.

Looking at slide 9, Proprietary Products sales grew organically by 20.3% in the quarter. High-value products which made up more than 65% of Proprietary Products sales in the quarter grew double digits and had solid momentum across all market units throughout Q3.

Looking at the performance of the market units, Biologics market unit delivered strong double-digit growth. We continue to work with many biotech and biopharma customers who are using West and Daikyo high-value product offerings.

The Generics market unit experienced high-single-digit growth led by sales of Teflon stoppers and Flurotec components. Our Pharma market unit saw mid-single-digit growth with sales led by high-value products and services including Westar and Flurotec components. And Contract Manufacturing had double-digit organic sales growth for the third quarter led once again by sales of diagnostic and healthcare-related injection devices.

We continued to see improvement in gross profit. We recorded \$194.6 million in gross profit, \$46.8 million or 31.7% above Q3 of last year. And our gross profit margin of 35.5% was a 310-basis-point expansion from the same period last year. We saw improvement in adjusted operating profit with \$103.9 million recorded this quarter, compared to \$70.1 million in the same period last year for a 48.2% increase. Our adjusted operating profit margin of 19% was a 360-basis-point increase from the same period last year. Finally, adjusted diluted EPS grew 46% for Q3. Excluding stock tax benefit of \$0.02 in Q3, EPS grew by approximately 53%.

Let's review the growth drivers in both revenue and profit. On slide 10, we show the contributions to sales growth in the quarter. Volume and mix contributed \$77.1 million or 16.9 percentage points of growth, including approximately \$32 million of volume driven by COVID-19-related net demand. Sales price increases contributed \$6.1 million or 1.3 percentage points of growth. And changes in foreign currency exchange rates increased sales by \$8.7 million or an increase of 1.9 percentage points.

Looking at margin performance, slide 11 shows our consolidated gross profit margin of 35.5% for Q3 2020, up from 32.4% in Q3 2019. Proprietary Products third quarter gross profit margin of 40.8% was 260 basis points above the margin achieved in the third quarter of 2019. The key drivers of the continued improvement in Proprietary Products gross profit margin were favorable mix of products sold driven by the growth in high-value products, production efficiencies and sales price increases, partially offset by increased overhead costs. Contract Manufacturing third quarter gross profit margin of 17.9% is 350 basis points above the margin achieved in the third quarter of 2019. This is a result of improved efficiencies and plant utilization.

Now, let's look at our balance sheet and review how we've done in terms of generating more cash. On slide 12, we have listed some key cash flow metrics. Operating cash flow was \$323.8 million for the year-to-date 2020, an increase of \$63 million compared to the same period last year, a 24.2% increase. Our year-to-date capital spending was \$116.7 million, \$27.9 million higher than the same period last year and in line with guidance.

Working capital of \$790.6 million at September 30, 2020 was \$73.5 million higher than at December 31, 2019, primarily due to an increase in accounts receivable due to increased sales activity and inventory mainly as a result of increasing safety stock. Our cash balance at September 30 of \$519.4 million was \$80.3 million more than our December 2019 balance, primarily due to our positive operating results. Our capital and financial resources including overall liquidity remained strong.

Turning to guidance, slide 13 provides a high-level summary. Full-year 2020 net sales guidance would be in a range of between \$2.1 billion and \$2.11 billion. This includes estimated net COVID incremental revenues of approximately \$85 million. There is an estimated headwind of \$4 million based on current foreign exchange rates.

We expect organic sales growth to be approximately 14% to 15%. This compares to prior guidance of \$2.035 billion to \$2.055 billion and growth of approximately 12%.

We expect our full-year 2020 adjusted diluted EPS guidance to be in a range of \$4.50 to \$4.55 compared to prior guidance of \$4.15 to \$4.25. As Eric discussed, we are expanding our HVP manufacturing capacity at our existing sites to meet anticipated 2021 COVID vaccine demand. CapEx guidance remains at \$170 million to \$180 million.

There are some key elements I want to bring your attention to as you review our revised guidance. Estimated FX headwinds on EPS has an impact of approximately \$0.02 based on current foreign currency exchange rates. The revised guidance also includes \$0.18 EPS impact from our tax benefits from stock-based compensation.

So, to summarize the key takeaways for the third quarter, strong top line growth in both Proprietary and Contract-Manufactured, gross profit margin improvement, growth in operating profit margin, growth in adjusted diluted EPS, and growth in operating and free cash flow. Our sales and EPS projections for 2020 and performance are in line with our long-term construct of approximately 6% to 8% organic sales growth and EPS expansion.

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

Eric Mark Green

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

Thank you, Bernard. Before I close, I'm pleased to share that, last evening, we received FDA clearance for West to market our 20-millimeter Vial2Bag Advanced product. The team is excited to bring this innovative product to the healthcare professionals.

To conclude, there are many challenges ahead of us, but we're resolute in our mission, focus, systems, and most importantly, the team to address these challenges. We see strength in our core business and we're confident in our long-term growth strategy, our market-led strategy is delivering unique value proposition to our customers. Our global operations network is able to flex and respond to the demand while driving market-leading service and quality. And our investments in digital technology and automation will continue to keep us on the forefront of the industry.

We remain focused on delivering value to all our stakeholders on a sustainable basis and doing our part to support the healthcare industry as it works to resolve this global pandemic. On behalf of the team members at West, we continue to wish you well in the days ahead.

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

QUESTION AND ANSWER SECTION

Operator: Thank you, sir. [Operator Instructions] I show our first question comes from the line of Juan Avendano from Bank of America. Please go ahead.

Juan E. Avendano

Analyst, BofA Securities, Inc.

Q

Hello. Thank you. Congratulations on the quarter, again, West and everybody. My first question is, it seems like the net COVID-related revenue, the benefit that you've been seeing over the last couple of quarters in 3Q and 4Q is anywhere between \$30 million and \$35 million per quarter. Why would you or would you not advise against annualizing this quarterly run rate in the out-years talking about 2021 and beyond?

Eric Mark Green

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

A

Yeah, Juan – well, first of all, thank you. And we look at Q2 was approximately \$19 million, Q3 was roughly around \$32 million net COVID impact, and a lot of that has been around our therapeutics and supporting therapies. And in Q3, we saw a little bit of demand regarding vaccines, to support the vaccines. But until we have visibility as our customers get product that's approved for human use, we are not able to guide any further particularly around the vaccines. So, Bernard did mention that, for the full year, we're looking at about \$85 million net impact of COVID-19. That's just based on what we know today and what we have visibility of.

Juan E. Avendano

Analyst, BofA Securities, Inc.

Q

Thank you. And would you be willing to give us the split in the third quarter between therapeutics and vaccines out of those \$32 million, how much was attributable to vaccines?

Eric Mark Green

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

A

Yeah. So, it was – the majority of it was around therapeutics and that's still what we're seeing. Now, we have seen towards the back end of the quarter some customers pull some of their demand for vaccines forward a little bit. And we have been responding to those demands, but primarily in Q3, mainly around therapeutics and some vaccine revenues.

Juan E. Avendano

Analyst, BofA Securities, Inc.

Q

Got it. And within the vaccine revenue, is this vaccine revenue associated with clinical trial activity or with at-risk manufacturing activity?

Eric Mark Green

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

A

Yeah, Juan, we won't comment on exactly what the stages or how our customers are ramping up. So, we just can't comment on exactly the use at this point in time.

Juan E. Avendano

Analyst, BofA Securities, Inc.

Q

Okay. Got it. And my very last question, if I may. On the margin expansion – congratulations on the margin expansion, the gross margin expansion that you're seeing on the Contract-Manufactured Products segment. It's been two quarters of high-teens gross margin. My question is how sustainable is this? And given the comments that you had in your prepared remarks around the digital and automation improvements that you're making operationally, does this set up West to deliver more than 100 basis points of operating margin expansion in the upcoming years?

Bernard J. Birkett

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

A

So, to answer your first question on Contract Manufacturing, as we called out in Q2, we have seen significant improvement. Some of the Q2 bump in margins was related to some onetime engineering revenues and the associated profitability we saw with those. Again, we did see further improvements in Q3. If I was to look out between now and the end of the year, I would think the margin maybe a little bit lighter than that [ph] quarter (00:22:54) showing, again, significant improvements on previous years. And then as we roll forward into 2021 and beyond, I would start to see the 18%-plus being more sustainable over the long term. But when we're looking at Q4, I would dampen down expectations a little bit on that one.

Juan E. Avendano

Analyst, BofA Securities, Inc.

Q

Okay. Got it. And in the out-years, the 100 basis points upside to that given the digital transformation, the good trends on the high-value products, and obviously the increased utilization in the CMO segment?

Bernard J. Birkett

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

A

Yeah. On our long-term construct, we have continuously said that we're targeting 100 basis points plus improvement year-over-year. And we continue to make the investments to make sure that we can sustain that level of improvement over the long term, and digital is part of that.

Juan E. Avendano

Analyst, BofA Securities, Inc.

Q

Thank you. I'll leave it at that. I'll follow up offline. Thank you.

Bernard J. Birkett

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

A

Thank you.

Eric Mark Green

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

A

Thank you, Juan.

Operator: Thank you. Our next question comes from the line of Larry Solow from CJS Securities. Please go ahead.

Lawrence S. Solow

Analyst, CJS Securities, Inc.

Q

Great. Good morning. Thanks for taking my questions and congrats on a good quarter. Eric, you mentioned the Vial2Bag approval there at the end. Could you maybe just elaborate a little more on that. So, does that mean that the whole product line will be coming back in 2021 or...

Eric Mark Green

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

A

What's coming back is the 20-millimeter version of the Vial2Bag which is more – majority of the demand in the addressable market. So we are now, as we got the approval late last night, in the mode of ramping up and to reenter the market or enter the market with the new innovative product that we're very comfortable and confident on will be a really solid solution when you start to think about transferring drugs from vial into a bag situation environment at the bedside of a patient. So we're excited about this launch and we're ready to move forward. And thankfully the FDA has supported us on this journey.

Lawrence S. Solow

Analyst, CJS Securities, Inc.

Q

And obviously, just to follow up on Juan's questions and a very nice margin improvement. And you mentioned NovaPure and Envision. Could you just speak to – those are two of your highest-margin products, I believe – sort of give us like a global look at what penetration is of those two services compared to some of – Westar and Flurotec and how much room we got to run between the two?

Eric Mark Green

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

A

Yeah. Flurotec is really kind of a foundational element when you sort of think about – particularly in the biologics area, so the Flurotec coating that is used on both stoppers and plungers. And so, therefore, that's somewhat foundational and has been – the demand has obviously increased due to the current pandemic.

We started thinking about penetration of Envision which continues to grow nicely and then NovaPure, which is the highest level of quality of product that we provide in the marketplace, and that is – the adoption rate is starting to continue to – continues to accelerate. It is still less than 10% or frankly less than 5% of our sales in Proprietary but the highest growth that was seen. And what's really encouraging, as you know, we have good visibility what's in the pipeline and what our customers are looking to use for primary containment. NovaPure is now becoming quite a – I call it a staples in the biologics space.

So, we anticipate strong growth in NovaPure not just near term but more long term on the base business. And in addition to that, when you sort of think about some of – vaccines are being looked at and being developed for COVID, we are seeing interest levels around NovaPure.

Lawrence S. Solow

Analyst, CJS Securities, Inc.

Q

And you spoke to the increased capacities, particularly of NovaPure and Flurotec, and I realized that acceleration is partially driven by the vaccine demand in the short run. How about in the long run, the vaccines are not here forever or are there other options for these vaccine providers? Do you run the risk of overhead or unused overhead absorption with some of this increased capacity.

Bernard J. Birkett

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

A

Right. Larry, the capacity that we've added was already baked into our five-year strat plan. So, really what we've done is accelerated that CapEx by probably two to three years so that...

Lawrence S. Solow

Analyst, CJS Securities, Inc.

Q

Yes.

Bernard J. Birkett

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

A

...this is capacity we were going to add in any case. And say a vaccine didn't happen, and we all want vaccines to be successful, but if it didn't, there won't be some costs to cover really in the short term. But that it's perfectly within our capability to do that. And we don't see any specific risk with it. It's...

Lawrence S. Solow

Analyst, CJS Securities, Inc.

Q

Right.

Bernard J. Birkett

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

A

...technologies that we already have in our business and that we are running today. So, it's really expanding the current technology base. So, from that perspective, there is not a huge risk and we would not see that capacity sitting there idle within the medium to long term, if vaccines were not successful.

Lawrence S. Solow

Analyst, CJS Securities, Inc.

Q

Got it. And then, just last question, just to clarify actually, a clarification. You mentioned – I think you said \$95 million now for COVID-related sales.

Bernard J. Birkett

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

A

\$85 million.

Lawrence S. Solow

Analyst, CJS Securities, Inc.

Q

\$85 million. Okay. So, up from \$60 million, so that's \$25 million. And I think you sort of reverted back a little bit on the FX impact by about another \$20 million or so. So, that's about three quarters of your increase on your guidance. And the rest I guess is the base business, fair to say?

Bernard J. Birkett

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

A

Yeah. And so, we are seeing strong growth across all the areas of our business, and with COVID and ex-COVID, if you look at the growth rates, excluding COVID, we're at double-digit growth rates.

Lawrence S. Solow

Analyst, CJS Securities, Inc.

Right.

Q

Bernard J. Birkett

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

So it's strong across all areas of the business. And we've been showing growth in each of the market units and contract manufacturing.

A

Lawrence S. Solow

Analyst, CJS Securities, Inc.

Got it. Great. Thanks very much. Appreciate it.

Q

Operator: Thank you. Our next question comes from the line of Jacob Johnson from Stephens. Please go ahead.

Jacob Johnson

Analyst, Stephens, Inc.

Hey. Thanks. Congrats on the quarter. Just maybe one question on COVID vaccines; in terms of customer demand, I don't think you experienced stocking earlier this year just generally. But as we think about the ramp-up of these vaccines, do you anticipate customers building up inventories ahead of a potential launch or should we anticipate this vaccine work being largely made to order?

Q

Eric Mark Green

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

A lot of our business is made to order. But we are in active discussion with several customers of if and when a vaccine is approved and how we can respond. So, I think, earlier in the prepared remarks, Bernard mentioned a little bit about inventory has increased and some of that is due to build on some components...

A

Bernard J. Birkett

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

That's our inventory.

A

Eric Mark Green

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

That's right.

A

Bernard J. Birkett

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

That's not inventory with the customer.

A

Eric Mark Green

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

A

Not with the customers, it's our own inventory as we prepare. So, we're well positioned to be able to react quickly and meet the requirements that the customers have – we have agreed upon with our customers. So, again, we're made to order, so we'll be able to respond if and when those approvals come.

Jacob Johnson*Analyst, Stephens, Inc.*

Q

Got it. And then maybe a bigger-picture question. In this COVID environment, we're seeing a lot of healthcare move into the home setting. Maybe it's too soon on the drug delivery side, but are you seeing any uptick in interest in products like SmartDose or SelfDose? And is this a trend you think that could maybe accelerate in coming years as we come out of COVID?

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

A

Yeah, Jacob, that's exactly one of the areas we're starting to have further discussions with our customers. And particularly a couple of the development agreements recently signed and we've commenced on with customers is exactly what you just referenced; ability to take it away from an infusion setting to a delivery device environment that SmartDose is capable of doing.

Now, it does take time to ensure that it's compatible and it obviously works as required. And we're confident in that area, but these development agreements do take time to get through over the line. We're seeing both mixture of new molecules in the pipeline, but also molecules that are already in the marketplace used in other types of modalities for delivery.

Jacob Johnson*Analyst, Stephens, Inc.*

Q

Got it. I'll leave it there. Thanks for taking the questions.

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

A

Thank you.

Operator: Thank you. Our next question comes from the line of John Kreger from William Blair. Please go ahead.

John Kreger*Analyst, William Blair & Co. LLC*

Q

Hi. Thanks. Bernard, could you just expand a bit more on your comments about accelerated CapEx. When would we expect that program to sort of come on line? I think you said one plant has come on line already. But can you just give us a little bit more detail about when the other accelerated programs are coming on. And I'm curious if that is impacting your expense levels as well. Obviously, it's impacting CapEx, but are you – to what degree are you running sort of elevated spending through the P&L, too?

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

A

Yeah. So we're onboarding the equipment as we speak. And each week and over the next coming weeks, we'll be layering in more. And as we move into 2021, we'll be layering in more capacity. There is some expense around it

regarding some engineering support, validation support, but it's not overly material as we've already commented that the equipment and the technologies we are onboarding are technologies and equipment that we have used in the past. So, it's not anything new for us. So, we have the systems and the people in place already to be able to do that. So, it's not overly material on our results at this point.

John Kreger*Analyst, William Blair & Co. LLC*

Q

Great. Thanks. And then, the net COVID benefit, can we assume that is mostly flowing through the Biologics segment?

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

A

That's correct, Biologics and then Generics have seen some.

John Kreger*Analyst, William Blair & Co. LLC*

Q

Got it. Okay. And curious – obviously you've gotten a really nice lift from the pandemic in terms of demand. Can you talk about sort of a non-COVID pipeline that you're seeing. And are you able to meet the underlying demand levels there? Are you having any capacity issues?

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

A

Yeah, no, you're absolutely right. In the last quarter, we had double-digit growth on the ex-COVID in Proprietary, which is really the area that were impacted the most, which [indiscernible] (00:35:02) probably supported the most. And when you think about the pipeline in our Biologics business, it is very robust. So, not just molecules that have been launched and continue to have higher uptake in the marketplace, but it's new molecules are being developed and we're – we have very high participation rate also in Biologics.

So, the underlying growth rate of the three market units continue to do quite well. And that does put, as you've referenced, additional capacity pressures on our capabilities, but that's for these investments we're bringing in and we're able to quickly install, validate and move it into operational productivity. So, the underlying business, we believe that will continue to go forward as is based on our current participation rate on new molecules coming to the pipeline.

John Kreger*Analyst, William Blair & Co. LLC*

Q

Great. Thanks. And just one last thing to clarify. Can you remind us at what point in a drug development process are you typically getting engaged by the innovator, is it preclinical or early-stage clinical?

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

A

It's preclinical. So, we're very early on. And in many cases, if they're not using – as you know, we have a pretty high participation rate on many of our customers' drug portfolio. So, if they're looking at moving away from an element or products that they're already using within other parts of their portfolio, then we will obviously alter and move to higher-value products like NovaPure. But it's very early on with our customers.

John Kreger

Analyst, William Blair & Co. LLC

Great. Thank you.

Q

Operator: Thank you. I show our next question comes from the line of Danlei Yan from Jefferies. Please go ahead.

Danlei Yan

Analyst, Jefferies LLC

Hi. Good morning. Thanks for taking my questions. I guess I just have one that hasn't been asked already. As cash builds, how are you thinking about prioritizing deployment of capital?

Q

Bernard J. Birkett

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

So right now, we're focusing on making sure that we're adding the additional capacity, the required capacity that's needed. You can see that we've increased or had increased our CapEx guidance, and that's in the short to medium term as we look at where we deploy capital in the future. We will look at M&A. But, again, we take a very disciplined approach to looking at that and how we deploy capital in that area based on what are the strategic objectives that we have and what incremental value can that bring to our customers and how we will create value from those acquisitions and add stakeholder value. And so, we have a pretty robust construct around the hurdle rates that we have to meet. But that is something that we have started to look at. And if we have any updates for you in the future, we'll obviously communicate those to you.

A

The one thing that we are cognizant of is that we have a very strong and robust organic growth story and strategic plan in place and our priorities to make sure that we continue to deliver on that and not get distracted. So hopefully that answers your question.

Danlei Yan

Analyst, Jefferies LLC

Great. Thank you. And yes, it does.

Q

Operator: Thank you. I show no further questions in the queue. At this time, I'd like to turn the call back over to Mr. Quintin Lai for closing remarks. Please go ahead.

Quintin John Lai

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

Thank you, Dylan. Thank you, everyone, 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 through Thursday, October 29, 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 concludes today's conference call. Thank you for participating. You may now disconnect.

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