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West Pharmaceutical Services, Inc. (WST)

Q3 2024 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Good day and thank you for standing by. Welcome to the Q3 2024 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, John Sweeney, VP of Investor Relations with West Pharmaceuticals. Please go ahead.

John Sweeney
Vice President-Investor Relations, West Pharmaceutical Services, Inc.

Good morning and welcome to West's Third Quarter 2024 Earnings Conference Call. We issued our financial results earlier this morning and the release has been posted in the Investors section on the company's website located at westpharma.com.

On the call today, we will review our financial results, provide an update on our business and present an updated financial outlook for the full year 2024. There is a slide presentation that accompanies today's call and a copy of the presentation is available on the Investors section of the website.

On slide 4 is the Safe Harbor statement. Statements made by management on the 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 statements 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'll now turn the call over to our CEO, Eric Green. Eric?

Eric Mark Green

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

Thank you, John, and good morning, everyone. Thanks for joining us today. Prior to discussing our quarterly performance, I would like to take a moment to express our heartfelt thoughts and support to all our team members and communities affected by the recent hurricanes and weather-related issues. For precautionary measures and to ensure the safety of our team members, we closed our Florida manufacturing site ahead of Hurricane Milton.

I want to extend my thanks to those team members who were affected by this storm as they truly represent our One West culture. While there was no damage to our St. Pete plant, many of our team members have faced personal challenges. I'm truly proud of their efforts that enabled West to seamlessly serve our customers without disruption.

Now, let's turn to slide 5 and the Q3 performance. We had a solid third quarter with revenues and adjusted EPS coming in at the higher end of our expectations. Our West team across the globe continues to execute at a high level, motivated by our purpose of improving patient lives. The strong quarter performance was a result of our solid execution and close collaboration with our customers.

This allowed us to meet our customers' demand requirements, in some cases, ahead of schedule. As a result of Q3, we are increasing our adjusted EPS guidance for the full year. This reinforces my confidence in West's execution capabilities as we continue to deliver a proven market-led strategy and attractive long-term growth potential.

Turning to slide 6, West continues to have a strong position in Biologics, the fastest-growing segment within injectables, not only for current drugs in the market, but also for new drug launches, where our participation rate remains very high. Our HVP components are addressing the most critical therapeutic areas, including immunology, oncology, rare diseases and obesity. We expect to see some improvement in Biologics in Q4, driven by the continued ramp in wearable self-injection devices.

A key aspect to our growth strategy and market leadership is West team of scientific thought leaders and technical experts. Through valuable insights, they continue to address the evolving needs of the complex development process and regulatory requirements to meet the needs of our customers. As the market leader in the containment and delivery of injectable medicines, we continue to have productive dialogs with our customers at key industry conferences.

For example, at the recent CPHI Worldwide Conference, our West experts held a podium presentation about contamination control strategy in primary packaging as part of the EU GMP Annex 1. We know that a drug manufacturer's contamination control strategy is only as strong as its weakest link, making the quality and control of materials from third-party suppliers critical factors to their process. We remain well-positioned with our HVP capabilities to support our customers' pipelines for the future.

In addition, we're starting to see early traction with our long-term growth initiatives, particularly with GLP-1s and how we serve our long-standing customers. With our market leadership and proprietary products, and continued strength in contract manufacturing, we are making meaningful investments to drive increased capacity to address these new opportunities. We are also making significant progress in ramping up production of HVP delivery devices.

The strong increase with on-body's self-injection devices during the quarter was driven by a combination of capital investment, improved utilization and the implementation of a new production line. We anticipate this ramp-up to continue into the fourth quarter as we execute on our expansion plans. We have initiatives in place to improve the margin, including optimizing our manufacturing process, driving efficiency through automation and scaling to fill customer demand.

Now, let me shift to destocking as this remains a factor with our customers. We are starting to see signs of stabilization within our business. And in recent customer discussions, we have observed a positive shift, with some customers showing interest in increasing their near-term order levels. This gives us confidence that we're getting closer to a turning point in the destocking trend. We now expect continued signs of normalization in our Pharma business, improving trends in Biologics, driven by the ramp-up in delivery devices, and continued destocking with some generic customers into 2025.

Now, I'll turn the call over to Bernard. Bernard?

Bernard J. Birkett

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

Thank you, Eric, and good morning. Let's review the numbers in more detail. We'll first look at Q3 2024 revenues and profits, where we saw a low-single-digit decline in organic sales as well as declines in operating profit and diluted EPS compared to the third quarter 2023. I will take you through the drivers impacting sales and margin in the quarter as well as some balance sheet takeaways. And finally, we will provide an update to our 2024 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 $746.9 million, representing an organic sales decline of 0.5%.

Looking at slide 8, Proprietary Products' organic net sales decreased 0.5% in the quarter. High-value products, which made up approximately 75% of Proprietary Products sales in the quarter, declined by low-single digits, primarily due to destocking of our FluroTec, NovaBrand and Westar products, offset by an increase in sales of our drug delivery devices.

Looking at the performance of the market units, the Pharma market unit saw a mid-single-digit increase, driven by an increase in the sales of NovaBrand products and Administrative Systems. The Biologics market experienced a low-single-digit decline, primarily driven by destocking of FluroTec, NovaPure and Westar products, offset by an increase in our drug delivery devices. And the Generics market unit declined mid-single digits, primarily due to lower volumes in NovaBrand products.

Our Contract Manufacturing segment revenue, on a constant currency basis, was consistent with our performance for the third quarter of last year. Our adjusted operating profit margin of 21.5% was a 270-basis-point decrease from the same period last year. Finally, adjusted diluted EPS declined 14.4% for Q3. Excluding stock-based compensation tax benefit, EPS decreased by 10%.

Now, let's review the drivers in both the revenue and profit performance. On slide 9, we show the contribution to organic sales decline in the quarter. Sales price increases contributed $34.2 million, a 4.6 percentage points of growth in the quarter, as did a foreign currency tailwind of approximately $2.9 million. Included in sales price is a $19 million customer incentive associated with achieving volume levels.

More than offsetting price and FX was a negative volume and mix impact of $37.6 million, primarily due to lower sales volume caused by customer inventory management decision in the period and the mix shift from HVP components to drug delivery devices based on customer demand.

Looking at margin performance, slide 10 shows a consolidated gross profit margin of 35.4% for Q3 2024, down from 38.6% in Q3 2023. Proprietary Products' third quarter gross profit margin, 39.2%, was 420 basis points lower than the margin achieved in the third quarter of 2023. The key drivers for the decline in Proprietary Products' gross profit margin were lower production volumes in our high-margin HVP components and a mix shift to lower-margin drug delivery devices, which we expect to increase over time with yield improvements from automation. These margin reductions were partially offset by increased sales price, inclusive of the previously mentioned customer incentive.

Contract Manufacturing third quarter gross profit margin of 19.9% was 130 basis points greater than the margin achieved in the third quarter of 2023, primarily due to production efficiencies.

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 $463.3 million for the nine months ended September 2024, a decrease of $74.1 million compared to the same period last year, a 13.8% decrease, primarily due to a decline in operating results. For the third quarter 2024 year-to-date capital spending was $272.1 million, $18.8 million higher than the same period last year. We continue to leverage our CapEx to increase both our high-value product and contract manufacturing capacity.

Working capital of approximately $1.034 billion at September 30, 2024 decreased by $230.5 million from December 31, 2023, primarily due to a reduction in our cash balance. Our cash balance at September 30, 2024 of $490.9 million was $363 million lower than our December 2023 balance. The decrease in cash is primarily due to $506.5 million of share repurchases and our capital expenditures, offset by cash from operations.

Turning to guidance, slide 12 provides a high-level summary. We are increasing our full-year 2024 net sales guidance to a range of $2.875 billion to $2.905 billion from a prior range of $2.87 billion to $2.9 billion, reflecting the impact of foreign exchange. There is an estimated full-year 2024 headwind of approximately $1 million based on current foreign exchange rates. We expect an organic sales decline of approximately 1.5% to 2%. We are raising our full-year 2024 adjusted diluted EPS guidance to be in a range of $6.55 to $6.75, compared to a prior range of $6.35 to $6.65. Also, our CapEx guidance remains at $375 million, which is unchanged from prior guidance.

There are some key elements I want to bring your attention to as you review our guidance. Full-year 2024 adjusted diluted EPS guidance range includes an FX headwind of $0.02 compared to the prior year, which is a decrease from the prior guidance of the $0.03 headwind. The updated guidance also includes EPS of $0.26 associated with the first nine months of 2024 tax benefits from stock-based compensation. Our guidance excludes future tax benefits from stock-based compensation.

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

Eric Mark Green

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

Thank you, Bernard. To summarize on slide 13, we had a solid Q3 performance with a high level of execution focused on our purpose. We are the market leader in injectables, with an even stronger position in Biologics. We are investing in capital in higher-growth areas, with focus on execution, expanded margins and cash flow. And I'm confident that once the market demand normalizes, we will achieve our long-term financial construct with our proven market-led strategy and future growth drivers.

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

QUESTION AND ANSWER SECTION

Operator: [Operator Instructions] And our first question comes from Jacob Johnson with Stephens. Your line is open.

Jacob Johnson

Analyst, Stephens, Inc.

Q

Hey, thanks. Good morning, everybody. Congrats on the quarter. I guess just first on the organic growth guidance, you guys obviously had a really strong 3Q, but you did kind of narrow organic growth towards the lower end of the range. I realize we're talking about 25 bps there, but is there anything that got worse versus your prior expectations that you could call out? And then just along the lines of guidance, the $19 million fee you guys called out, was that something that was contemplated in prior guidance or was that a proverbial good guide this quarter? Thanks.

Bernard J. Birkett

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

A

Yeah, Jacob, I'll take that. On the second part of the question, yeah, the $19 million was contemplated. It was obviously based on volumes that we had to achieve in agreement with our customer and we achieved that. So, we – wasn't a surprise to us. On the guide itself, it's really just rounding the change for Q4. So, no real material change. The difference from Q3 to Q4 is really timing, when we delivered on customers' orders and some expectations. So, again, no real change to our outlook on the year.

Jacob Johnson

Analyst, Stephens, Inc.

Q

Got it. Thanks for that, Bernard. And maybe sticking with you, I think intra-quarter, you mentioned the potential for your margin profile to return to 2023 levels once you return to LRP growth. Can you just talk about your visibility into getting back to that kind of margin profile and kind of how quickly post destocking you could get back to those levels?

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

Yeah. So, it's really down to when demand normalizes and also that the mix within our business normalizes. When we get to that point and we get back to our LRP, then the margins adjust back to 2023 levels. So, it's really a mix impact and then that level of demand normalization.

Jacob Johnson
Analyst, Stephens, Inc.
Q

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

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

Thank you.

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

Thanks, Jacob.

Operator: Thank you. Our next question comes from Larry Solow with CJS Securities. Your line is open.

Lawrence Solow
Analyst, CJS Securities, Inc.
Q

Great. Thanks. Good morning, everybody. I guess, first question, just on the quarter itself, obviously a pretty solid quarter, especially relative to expectations. Was the higher end driven more on the just slower customer destocking or was it more on the demand side? Any way to kind of parcel that out? And it does sound like there's a little bit of, I guess, timing maybe was a little bit of a good guy in the quarter too?

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

Yeah. Larry, good morning. No, absolutely. What we observed in Q3 was really a couple factors. One is around execution, continued to deliver on the commitments that we made with our customers. And secondly is that, in a few cases, our customers are – they have accelerated some of their programs and asked us to deliver a little ahead of schedule. But they were contemplated and planned for already within the second half of 2024. So, it's really mostly around timing. That has given us additional growth in Q3.

Lawrence Solow
Analyst, CJS Securities, Inc.
Q

Got you. And Eric, I know it's too early to look out to 2025, but it does sound like – without putting an actual number on it, it does feel like you guys are perhaps a little more confident that we at least begin that recovery, maybe you don't get fully normalized for the full year but do you feel like, as you look out, we could have a relatively normal kind of demand year for you guys or not much inventory destocking, at least, going forward?

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

A

Yeah, Larry, there's a couple of factors around there. One is the underlying focus of our business is very, very strong and we continue to participate in very attractive areas. And a number of initiatives that are in place and the tractions are – the traction is very positive. We have been speaking about destocking particularly in the last quarter, we called – we kind of highlighted what we felt was going to kind of play out in 2024. And that's what's happening.

We're seeing the consistent – consistent to what we said earlier, which is basically we do believe in our Pharma business, that has mostly normalized as we speak. And so, you kind of can see that little bit of return to growth in that particular area. We've seen improving trends in Biologics, but we did say that that would be throughout Q3 and a little bit in Q4, so we do see that continue to play out as is.

And then we did call out and we still do destocking with some generic customers that go into 2025. So, my comment was around started seeing signs of stabilization with our business because it's consistent to the conversations we're having with customers today. And there tends to be a little more positive in those conversations but let's get through Q4 before we even comment about 2025 at this point in time.

Lawrence Solow
Analyst, CJS Securities, Inc.

Q

No, great. I really appreciate the color. Just if I can squeeze in one last question. Just CapEx plans going forward, does this feel like this is the peak year or could 2025 be sort of similar roughly? Any thoughts on that, Bernard?

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

A

Yeah, it's – I think, again, we'll give guidance on CapEx for 2025 in February, but it is something that we are looking at based on the demand, what we're seeing and where – the capacity increases that we need to add will continue to add where we see growth and we continue to review those programs. But over the next, I would say, 12 to 24 months, we'll be looking to get back to more normalized level of CapEx and that's the trend that we're starting to see, Larry.

Lawrence Solow
Analyst, CJS Securities, Inc.

Q

Got you. Great. Appreciate all the color. Thanks, guys. Thank you.

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

A

Thanks, Larry.

Operator: Thank you. And our next question comes from Paul Knight with KeyBanc. Your line is open.

Paul Richard Knight
Analyst, KeyBanc Capital Markets, Inc.

Q

Hi, Eric. The comment about wearable injection devices, does that mean Phoenix line is building, producing? And then kind of a follow-up is could we get an update on Grand Rapids, Michigan and the Dublin facility as well?

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

Yeah. Yeah. Good morning, Paul, and thanks for the question. Twofold. The first one on SmartDose, particularly our Phoenix facility, you're correct, that ramp-up started in Q3, where we did receive FDA approval for commercial manufacturing into the market. And we're really excited about that new team that's been put together and just the level of capability of the ramp-up. They're meeting expectations and I'm really proud of that team to really go from a brand new facility and now producing high-quality product that's going to the market.. So I'm very pleased with that.

As you know, a lot of these startups, these ramp-ups do take time. So, it's going to be – it's going to take several quarters to get to what I call peak throughput. But the initial results are very, very positive.

In regards to the facilities investments in Grand Rapids and Dublin, these are two contract manufacturing facilities that are really focused on the – to build, support our customers in GLP-1s. And Grand Rapids, Michigan, that is still ramping up as we speak. We are producing commercial product, but it is still in ramp-up phase. As you know, that takes probably a good three to five quarters to really get to the levels that we expect and what our customers expect as throughput.

On Dublin, it's little bit longer. This is kind of a two-stage approach. The first is the manufacturing of the devices for contract manufacturing, again, GLP-1s. And that will commence shortly, probably early 2025. And as that ramps up, we're also adding in that facility, already communicated before, but just to reiterate, drug handling, so we'll be taking a finished drug product, contained and put it with our – the device that we're going to manufacturer there. So, it's a complete solution for our customer.

We're really excited about that because that's playing out our high-value product or a high-value focus on contract manufacturing, adding services and capabilities that really help us expand not just revenue, but also margin in that particular business. So, there are different timelines. They're on us right now. Teams are executing within – as planned and I'm excited to see full production in the near future from both sides.

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

Just also on the Phoenix site, that's in two phases. What we've added currently is another kind of manual, semi-automated line and that's what we're ramping. And then, as we progressed through 2025, we'll be implementing a fully automated line to drive production efficiencies, greater levels of utilization, and also to meet the customer demand for that product. So, that will happen throughout 2025. So, we expect to see margin improvements in that product line over the next 6 to 12 months.

Paul Richard Knight
Analyst, KeyBanc Capital Markets, Inc.
Q

Thanks.

Operator: Thank you. Our next question comes from Michael Ryskin with Bank of America. Your line is open.

Michael Ryskin
Analyst, BofA Securities, Inc.
Q

Hey, thanks for taking the question, guys. Going back to some of your comments on 3Q benefiting from some timing, meeting some customers ahead of schedule. Just curious if you can dig into that. Was it one or two large orders, or was it a little bit broader in terms of the timing benefit? Was it in more of the Pharma customer where you talked about destocking normalizing or in Biologics? And are there – now that you've completed those orders and you delivered them in 3Q, are there others sort of behind them to fall into queue in terms of backlog? And is there other work behind that to backfill?

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

A

Yeah. Michael, thank you for the question and good morning. The work that we did with our customers is somewhat broad. I won't isolate it to one or two customers and it was primarily in the areas of Biologics and Pharma. And so, there's specific reasons behind it. But these are, obviously, requests we already had in our production plans or schedules to be able to support our customers on these specific products, but they were brought forward to meet their needs and their demand.

Now, obviously, we won't comment into 2025, but as we think about for the rest of the year, as our customers continue to replenish their orders, we will obviously be ready to respond if orders do come in later this quarter in Q4 for those particular customers. But as we speak right now, that's the reason why you see we call out a little bit earlier delivery of those particular products into Q3 versus Q4.

Michael Ryskin
Analyst, BofA Securities, Inc.

Q

Okay. Thanks. That's helpful. And quick follow-up on the – you talked through the changes on the top line for the guide. For EPS, I think you've raised the midpoint by $0.15, but $0.05 of that – $0.04 was incremental stock-based comp, $0.01 was FX. The $0.10 that's operational, is that driven by the mix, the one-time benefit, the $19 million you saw in the third quarter? Or just talk us through the $0.10 there.

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

A

It's driven by a number of things. Mix was part of this. Our operating margin was a little bit stronger than we would have initially anticipated. And so, it's really managing mix and also managing costs within our business on an ongoing basis to drive that margin improvement and improvement in EPS.

Michael Ryskin
Analyst, BofA Securities, Inc.

Q

Thanks.

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

A

Not just one thing.

Michael Ryskin
Analyst, BofA Securities, Inc.

Q

Appreciate it.

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

A

Thank you.

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

A

Thanks, Michael.

Operator: Thank you. And our next question comes from David Windley with Jefferies. Your line is open.

David Windley
Analyst, Jefferies LLC

Q

Hi. At the risk of asking a simple question, I noted, I guess, first, you've used the NovaBrand brand in commentary today and I know you also talked about that at a conference in the quarter, but I think that's the first time we had heard that. And I noted that in your comments today, you did also use NovaPure, so they seem to be distinctly different or maybe parts of the same broad category. Could you talk about what NovaBrand is, what it includes, how new is it and how is it that it is the source of growth in some and the source of headwind in others?

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

A

Yeah, Dave, that's a good question. Thanks for joining us this morning. So, NovaBrand encompasses the quality design principles of our highest quality product. One is NovaPure, which is the laminated version with FluroTec. And then the non-laminated version is NovaChoice. And what you'll find is NovaPure is highly adopted in the – it's called – in the Biologics area. And NovaChoice tend to be more adopted in the pharmaceutical area. That doesn't require the coding. And so, that's the nomenclature of the product.

Now, NovaChoice, it depends on the segment. So, as you know, NovaPure is, again, as I mentioned, really well adopted in the Biologics. And that's where we had some destocking occur throughout 2024. We called that out in Q3. We anticipate a little bit going into Q4.

In the NovaChoice, that is one of the key solutions in the GLP-1s for us to support our customers. And so, as you can imagine, the ramp-up that we're starting to see in the GLP-1s, we're able to support them with their high participation rate of really NovaChoice and also Westar RU that we provide our customers in that area. So, that's how it's defined, Dave, between the two.

David Windley
Analyst, Jefferies LLC

Q

Very helpful. If I could ask, I'm going to squeeze two follow-ups. So, just on what you just answered, is the NovaChoice pricing similar to NovaPure? And then secondly, Eric, on your comments about participation rate remaining very high, which you've been very consistent about, would you be willing to talk about what you think your wallet share is? So, I think – I believe, your definition of participation rate is you're spec-ed in on the product. How does that look in terms of sole versus dual-sourced or otherwise in the participation rate? So, price on NovaChoice and then wallet share, please. Thanks.

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

A

Yeah, Dave, on NovaChoice, it's between $0.15 to $0.30 per unit on ASP, 50% to 60% margin to give you kind of perspective. So, the key differentiator again is the barrier code of FluroTec between that and NovaPure, which technically – I mean, from a user need basis is quite a significant difference between barrier and non-barrier.

And in regards to participation rate, you're right, we do look at are we spec-ed in in the filings of our customer – the drug companies of our product. And there is a few cases where you do see dual sourcing but what we are seeing and we continue to see is that we – in these particular examples, we are very high as far as the percentage of the – on a drug molecule. And that hasn't changed.

If you're talking about a particular area like GLP-1, where we're really a key player in that space from all – from a volume perspective. So – and that's pretty consistent as we look at Biologics in other areas. Yes, there is some testing for dual-sourcing capabilities, but that's more for – it's not as frequent and it's more on new launches, not on existing molecules in the marketplace.

David Windley
Analyst, Jefferies LLC

Q

Very good. I appreciate the answers. Thank you.

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

A

Great. Thank you

Operator: Thank you. Our next question comes from Matt Larew with William Blair. Your line is open.

Matt Larew
Analyst, William Blair & Co. LLC

Q

Hi. Good morning. I wanted to ask about Contract Manufacturing gross margins that were up nearly 400 basis points sequentially. You've referenced, obviously, scaling capacity at – in Dublin and Grand Rapids and also adding new capabilities with higher revenue margin potential. Most of the story over the last, call it, five or seven years has been margin expansion on the Proprietary Products side. Just wonder if you could maybe, using this quarter as a window into what the potential is for Contract Manufacturing moving forward?

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

A

Yeah, Matt, I think if we're looking out over the next, like, 12 to 24 months, we see slight uptake on the Contract Manufacturing as the drug handling business comes onboard because that is a very different margin profile for current Contract Manufacturing business. But for us to scale that, it's going to take a little bit of time. So, I would anticipate the margins around Contract Manufacturing to be relatively consistent with what they are now.

We get a little bit of variability between quarters depending on product mix and the level of kind of DA or engineering work that's involved, that's pretty consistent, within the high-teens.

Matt Larew
Analyst, William Blair & Co. LLC

Q

Okay.

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

So, it's more in the longer term where we would see a – like a significant step-up in the margins within CM.

Matt Larew
Analyst, William Blair & Co. LLC
Q

Okay. As a follow-up, you, again, a number of times today called out GLPs as an offset to some of the destocking and your strong share in that space. Sometimes it's hard from the outside to compare the cadence of benefit to you versus what we might see from some of the drug companies themselves in terms of their sales reporting. Could you guys give me sort of a state of the union as to where you see – to the size of your business today to the extent you can quantify that? And also any updated thoughts on go-forward growth and market opportunity? Thanks.

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

Matt, just to clarify, we're specifically focused on the GLP-1s, I didn't – I just wanted to make sure I heard that correctly, correct?

Matt Larew
Analyst, William Blair & Co. LLC
Q

Correct. Correct. Yeah. Thanks, Eric.

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

Okay. Great. Thanks, Matt. Sorry, I just wanted to make sure I heard correctly. Yeah. No, absolutely. So, we will not talk about the demands of our customers. I would refer to them on the future demand of their – the GLP-1s in the market. But if we take a look at our – how we are positioned, the agreements we – are in place and where we play, we play in two areas, one in Proprietary, which is the elastomers and seals. And then the other area is Contract Manufacturing.

Let me just touch on Contract Manufacturing quickly, then I'll move back to Proprietary. In that area, we do participate, as I mentioned earlier, around, for example, the investments in Grand Rapids and also in Dublin to manufacture and assemble the auto-injectors and pens. So, we do participate there, but that is, as you can tell, it's highly competitive. We're selective on what projects or initiatives we want to take on because it's heavily capital intensive. And so, we're participating in that area and it does support us with our large customers, but it's very selective. On the Proprietary side – and that growth, by the way, will be dependent on end patient consumption. So, whether it's a pen or auto-injector.

On the Proprietary side, if it's a vial configuration, we're obviously there with our stoppers. We have been, we will continue to be. And then if it is in a pen or a auto-injector, we do provide the plungers and also insulin sheeting if needed on their configuration. And that is our – is very high as far as the volumes that we are producing. Going forward, we have forecast – we really haven't mentioned that – we haven't really called that out as a specific area, but it is starting to pick up with the investments we put in.

If we look forward, what we need to do to be able to support that growth, the capital that we require, a lot of it's already installed, which is very positive. We do need, over time, based on the forecast that we are working with our customers on, is looking at maybe some more HVP finishing similar to what we put in Kinston, we're putting into Jersey Shore and also in Eschweiler. But it's really the finishing area that we are looking at. As you know, that's fungible to other types of customers like Biologics run HVP. So, that's kind of where the investment thesis will be if and when needed. But fortunately, we have, because of our investments over the last few years, really supports the growth in this particular area going forward.

Matt Larew
Analyst, William Blair & Co. LLC

Q

Okay. Thanks a lot, Eric.

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

A

Thanks, Matt.

Operator: Thank you. Our next question comes from Justin Bowers with DB. Your line is open.

Justin Bowers
Analyst, Deutsche Bank Securities, Inc.

Q

Eric, can you, maybe at a high level, just talk about what inning you think we're in with respect to the destocking? And then, are there – amongst the different components, are you closer to the finish line versus others like, let's say, standard versus NovaPure versus FluroTec? And then part two would be just around the margins. You've had some pretty high decrementals this year. As volumes begin to normalize, is there any reason why you wouldn't have greater incrementals on the way back up and maybe above construct?

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

A

Yeah, Justin, let me take the first part and then Bernard, if you don't mind, on the second part. In regards to kind of where we are with the destocking area, I think the way that we've been consistently communicating is that it's not equal across the entire customer portfolio and/or product portfolio. But by the way, the product portfolio is really driven by the market segments. And so, we've been pretty clear that in the Pharma area, the small molecule, we've seen that more normalized. So, we feel, if you want to look at from the spectrum, it's closer to the end, let's say, and we're starting to see more normalization of order patterns and future outlook.

If we look at the Biologics, we – it is very clear with our customer conversations. If you take the drug delivery devices off the table from a discretion point of view, the [indiscernible] (00:42:08) products used for containment, that particular area, we continue to see destocking in Q3 and as we mentioned, we'll see a little bit more in Q4.

We do see that getting closer to the end, but let's go through our Q4 and as we think about our order book going forward, we'll update you the first part of the year about 2025. Biologics, so, we've been pretty consistent that, particularly a few customers, that we believe that while there're some positive conversations about future demand, it's – we do believe that's going to continue into the first part of 2025.

So, that's how we look at it from a destocking point of view. I didn't give you an aggregate total on that, but it is mixed based on the customer segments and it's pretty consistent – it's playing out as we started to communicate, let's call it, the last quarterly call. And we'll keep an eye on that and make sure that we deliver and we'll reassess as we think about going forward. So, the margin conversation, Bernard, can you...

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

A

Yeah. On the margin, what we would expect is when demand normalizes and our mix normalizes, that we will get back to our 2023 levels of operating margin, and then, through the long-term construct, grow 100 basis points per year off that. When we look at what's occurred this year in 2024, it's much of the destocking we've seen within Biologics and Generics, and that's where typically we would tend to see more HV product sales. And, obviously, then the margin impact has been greater than what we would have seen prior to that when we saw destocking within Pharma.

I would kind of – if you go back and look at our margin expansion over 2021 into 2022, a lot of that was driven by HVP growth and that mix shift. So, that shows you the power of the construct we have. And when that Biologics engine starts growing again and gets back to normalized levels of growth, we would expect to see that margin start to expand. And first thing is we need to get back to, like, pre-2024 levels of margin and then start growing off that. We're confident that will happen over time.

Justin Bowers
Analyst, Deutsche Bank Securities, Inc.

Q

Thank you. I'll hop back in the queue.

Operator: Thank you. Our next question comes from Thomas DeBourcy with Nephron Research. Your line is open.

Thomas DeBourcy
Analyst, Nephron Research LLC

Q

Hi. Thanks for taking the question. I just had a question around, I guess, generalized customer behavior in terms of orders. I guess, through kind of others in the bioprocessing market, they've seen the [ph] pharma (00:45:10) customers placing smaller orders more frequently versus maybe the typical sort of cadence that [indiscernible] (00:45:16). Just wondering if you've seen a change in how customers are also ordering or you expect to go back [indiscernible] (00:45:24)?

John Sweeney
Vice President-Investor Relations, West Pharmaceutical Services, Inc.

A

Tom, I apologize. We're having a little trouble hearing your question. Would it be possible just to maybe move a little closer to the microphone or speak up, please?

Thomas DeBourcy
Analyst, Nephron Research LLC

Q

Sorry. Can you hear me?

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

A

Yes, perfect.

John Sweeney
Vice President-Investor Relations, West Pharmaceutical Services, Inc.

A

Much better. Thank you.

Thomas DeBourcy
Analyst, Nephron Research LLC

Q

Okay. I apologize. Yeah. My question was, I guess around specifically kind of customer orders on a more general – in a more general way. We've heard from some companies in the bioprocessing supply chain that customers are ordering – doing smaller orders more frequently versus, I guess, their typical kind of cadence. And was wondering if you had seen any changes at all there and – or whether you expected to kind of go to back to historical kind of timing and cadence there?

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

A

Yeah. No, thank you for the question. And when we look at our order pattern right now, as we – with our customers, it's more in line with the pre-COVID time period. I think it is different than during the pandemic period of time and also in the last, call it, end of 2023, going into 2024. And there's two drivers to that. One, as I think you pointing out is more normalized – starting to get to more normalized or stabilized environment. But secondly is, as you recall, in our – during the pandemic time, our lead times were significantly higher because of the demand on not just the core business, but also on the materials used for the pandemic.

When I say that, I am very proud of the team and how they have, with the invested capital, with the – so with the capacity we have online, with multiple sites, particularly on the high-value products, we're able to build, support our customers in a much more timely fashion if not equal or better than we did pre-pandemic. And give you an idea, that's like 8 to 12 weeks to make the order highly customized. So – and during the pandemic, we were reaching 40 to 50 weeks. So, it is a significant difference.

So, I just want to highlight that because there's two factors why we're seeing order patterns change. One from a market pharmaceutical supply chain effect and the other one was really our lead times. And customers are much more comfortable today and confident in our ability to deliver their product from multiple sites on time each and every time that they requested. So, hopefully I addressed your question but we are seeing a change.

Thomas DeBourcy
Analyst, Nephron Research LLC

Q

Great. Thank you.

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

A

Thank you.

Operator: Thank you. I'm showing no further questions at this time. I would now like to turn it back to John Sweeney for closing remarks.

John Sweeney
Vice President-Investor Relations, West Pharmaceutical Services, Inc.

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

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