16-Feb-2023

West Pharmaceutical Services, Inc. (WST)

Q4 2022 Earnings Call

CORPORATE PARTICIPANTS

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

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

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

OTHER PARTICIPANTS

Larry S. Solow
Analyst, CJS Securities, Inc.

Matt Larew
Analyst, William Blair & Co. LLC

Jacob Johnson
Analyst, Stephens, Inc.

Paul Richard Knight
Analyst, KeyBanc Capital Markets, Inc.

Derik de Bruin
Analyst, BofA Securities, Inc.

John Newton Sourbeer
Analyst, UBS Securities LLC

David Windley
Analyst, Jefferies LLC

Justin Bowers
Analyst, Deutsche Bank Securities, Inc.

MANAGEMENT DISCUSSION SECTION

Operator: Good day, and thank you for standing by. Welcome to West Pharmaceutical Services Fourth Quarter 2022 Earnings Conference Call. At this time, all participants are in a listen-only mode. After the speakers' presentation, there will be a question-and-answer session. [Operator Instructions] Please be advised that today's conference is being recorded.

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

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

Thank you, Shannon. Good morning and welcome to West fourth quarter and full-year 2022 conference call. We issued our financial results this morning, and the release has been posted in the Investors section on the company's website located at westpharma.com.

This morning, Eric Green and Bernard Birkett will review our financial results, provide an update on our business, and present an update on our financial outlook for the full year 2023. There's a slide presentation that accompanies today's call, and a copy of that presentation is available on the Investors section of our website.

On slide 4 is our Safe Harbor statement. Statements made by management on this call and in the accompanying presentation contain forward-looking statements within the meaning of US Federal Securities Law. These statements are based on our beliefs and assumptions, current expectations, estimates, and forecasts.

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

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

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

Eric Mark Green

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

Thank you, Quintin, and good morning, everyone. Thanks for joining us today. We will start on slide 5. For over 100 years, the West name has come to mean so much to so many people. We've grown and expanded from manufacturing primary containment components to designing and manufacturing delivery systems. This remains the same today. As a global market leader who continues to define the evolution of our industry, our 10,000-plus team members are motivated by improving patient lives.

The past few years have been a reminder that the world doesn't stand still, and the needs of the healthcare industry are evolving and growing in complexity, with shifting treatment options from the hospital to home setting. We remain committed to the pursuit of scientific innovation and partnerships to address the changing needs of today and into the future.

Moving to slide 6. Looking back at the year, I'm pleased to report that West delivered overall organic sales growth of approximately 8%. This growth was generated despite a rapidly shifting pandemic landscape. We started 2022 expecting COVID-19 volume growth, but instead declining orders and demand from our customers actually resulted in a 15% decline in pandemic-related sales.

Excluding COVID-19, we estimate that our base organic sales growth was low-double digit, with mid-teens growth in proprietary products. And driving this base growth is demand for our high-value product offerings for both legacy as well as recently launched drugs. And we ended the year with a return to growth in Q4 in Contract Manufacturing.

This performance is the result of the dedication and relentless focus of our team members across the globe. We are connected by a strong responsibility and shared values that continue to help us succeed each day. I want to acknowledge these efforts and say thank you.

Looking ahead, we remain well-positioned with the right growth strategy around execute, innovate, and grow. Our solid order book of committed orders reinforces the criticality of West components and devices to address our customers' growing injectable drug demand, and we continue to deploy capital investments to support the increase in demand driven by the attractive end markets.

Turning to slide 7. In addition to our financial momentum, there were several other notable accomplishments in 2022. We shipped close to 47 billion components, touching billions of patient lives. As scientific and technical leaders in the industry, our customers expect us to help solve their problems. We continue to broaden insights with our expertise through our webinars, published articles, and technical presentations.

We partnered with Corning to build the next-generation leading elastomer-glass systems. We launched Daikyo CZ 2.25 ml insert needle syringe to support the biologics market, and secured three additional FDA-approved drugs using our SmartDose technology as we continue to bring additional value to our customers.

Lastly, we donated $2.75 million, but, more importantly, our team members continue to volunteer their time to help our local communities with the greatest needs. Our heartfelt thoughts are with all those impacted by the devastating earthquake in Turkey and Syria, where we have provided aid through UNICEF.

Shifting to slide 8. We continue to factor environmental considerations into every aspect of our business. Over the past five years, we have made tremendous strides across the six priority areas and newly defined performance indicators. I'm pleased that we're on target with 90% of our operational waste not being sent to landfills. Our pursuit of renewable energy alternatives has aided in a positive impact in emission reduction. These efforts have been recognized with numerous ESG accolades in 2022. We look forward to sharing more detail in our Corporate Responsibility Report to be published in the spring.

Turning to slide 9. We continue to address the growing market needs with today's complex and sensitive molecules. At the recent Pharmapack meeting, we introduced several new products for large volume delivery and complete vial containment solutions. One available product is our West Ready Pack with Corning's Valor ready-to-use vials. This will be the first of many products from our Corning partnership.

The combination of these products eliminates the risk of delamination and reduces glass particulate and bulk filling lines. It is drug delivery innovations like this that ensures best-in-class performance with a value proposition to meet the increased regulatory expectations with a complete vial containment solution.

Moving to slide 10, we are introducing full year 2023 financial guidance. This guidance is based on demand trends, as well as our current capacity levels. It's also reinforced by our strong West and Daikyo participation rate in drug approvals, especially in biologics and biosimilars. We expect full year overall organic sales growth of approximately 3% to 4%, which includes a $303 million year-over-year decline in pandemic-related sales. Excluding this impact, we expect mid-teens overall base organic sales growth with proprietary products growth in the high teens, and high-single digit growth in contract manufacturing.

2023 will represent a transition year for our margin profile as we see a headwind from COVID-19 HVPs. That said, our expected margins for this year are significantly above pre-pandemic 2019 levels. This underscores the strength of our financial construct with annual margin expansion of 100 basis points or more per year. In 2019, we posted operating margin of 16.1%. In 2023, we expect operating margin of 23% to 24%, which would represent an increase of approximately 800 basis points over a four-year period.

Also, today we announced that the board of directors has authorized a new share repurchase plan as our prior plan was completed last year. This program is authorized for up to $1 billion of share repurchase. We note that this new program does not have a specified end date. As comparison, in 2022, our 12-month program was completed at $203 million of buybacks; and in 2021, our 12-month program was completed $137 million of buybacks. This new $1 billion program will provide for a continuation of our share count-neutral strategy which is assumed in our 2023 full-year financial guidance. We believe this program will also provide flexibility for incremental share repurchases, depending on various factors such as economic and market conditions.

Turning to slide 11, as you can see from our guidance, we see continued base momentum in 2023, and we're planning for further additional growth as our customers are preparing for expanded success of their current biologics portfolio and drug launches. As such, we continue to drive forward to complete the installation of our capital expansion plans for additional HVP capacity. The picture shows the progression of our ongoing efforts. On my recent visit to Kinston, it was impressive to see the additional space added to accommodate the installation of new manufacturing equipment to address the growth of HVPs and plungers. Together with other site expansions, this will support future demand across our global manufacturing network.

Now, I'd like to turn the call over to Bernard.

Bernard J. Birkett

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

Thank you, Eric, and good morning. We'll first look at Q4 2022 revenue and profit where we saw low single-digit organic sales growth and a decline in operating profit and diluted EPS. 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 review our 2023 guidance.

First up, Q4. Our financial results are summarized on slide 12 and the reconciliation of non-US GAAP measures are described in slides 20 through 23. We recorded net sales of $708.7 million in the quarter, representing organic sales growth of 2.6%. COVID-related net revenues are estimated to have been approximately $55 million in the quarter, an approximate $69 million reduction compared to the prior year. These net revenues include our assessment of components associated with vaccines, treatment, and diagnosis of the COVID-19 patients, offset by lower sales to customers affected by lower volumes due to the pandemic.

Looking at slide 13, Proprietary Products sales grew organically by 1.8% in the quarter. High value products, which made up approximately 72% of Proprietary Products sales in the quarter, were flat compared to the prior year due to the reduction in COVID-related net revenues. Looking at the performance of the market units, the generics market unit delivered double-digit growth led by Envision components and Admin Systems, while the pharma market unit experienced high single-digit growth led by NovaPure and Westar components. And the biologics market unit saw a mid-single-digit decline due to a reduction in sales related to COVID-19 vaccine.

Our Contract Manufacturing segment experienced net sales growth of 7% in the fourth quarter, primarily driven by sales of healthcare-related medical devices.

Our adjusted operating profit margin of 22.4% was a 350-basis point decrease from the same period last year. Finally, adjusted diluted EPS declined 13.2% for Q4. Excluding stock-based compensation tax benefit of $0.06 in Q4, EPS declined by approximately 13.6%.

Now let's review the drivers in both a revenue and profit performance. On slide 14, we show the contributions to sales growth in the quarter. Sales price increases contributed $28.1 million or 3.8 percentage points of growth. Offsetting price was a foreign currency headwind of approximately $41.3 million and a negative mix impact of $8.9 million, primarily due to a reduction in COVID-19-related net demand.

Looking at margin performance, slide 15 shows our consolidated gross profit margin of 37% for Q4 2022, down from 41.1% in Q4 2021. Proprietary Products fourth quarter gross profit margin of 41.6% was 470 basis points lower than the margin achieved in the fourth quarter of 2021. The key drivers for the decline in Proprietary Products gross profit margin were unfavorable mix from a reduction in sales related to COVID-19 vaccine, and continued inflationary pressures on our plant costs, including raw materials, labor, and overhead. The headwinds were partially offset by sales price increases.

Contract manufacturing fourth quarter gross profit margin of 15.4% was 110 basis points below the margin achieved in the fourth quarter of 2021. The decrease in margin is largely attributed to mix of products sold.

Now let's look at our balance sheet and review how we've done in terms of generating more cash. On slide 16, we have listed some key cash flow metrics. Operating cash flow was $724 million for the year, an increase of $140 million compared to the same period last year, a 24% increase. Operating cash flow in the period benefited from our working capital improvement. In 2022, we spent over $284 million on capital expenditures, a 12% increase over 2021. We continue to leverage our CapEx to increase our high value product manufacturing capacity within our existing facilities in the US, Germany, Ireland and Singapore. Working capital of approximately $1.4 billion, increased by $252.6 million from 2021, primarily due to higher accounts receivable from our increased sales, higher inventory levels and an increase in our cash position.

Our cash balance at December 31 of $894.3 million is $131.7 million higher than our December 2021 balance. The increase in cash is primarily due to our operating results in the period, offset by our share repurchase program and higher CapEx.

Turning to guidance, slide 10 provides a high level summary. Full year 2023 net sales guidance will be in a range of $2.935 billion and $2.96 billion. There is an estimated headwind of $30 million based on current foreign exchange rates. We expect organic sales growth to be approximately 3% to 4%. We expect our full year 2023 adjusted diluted EPS guidance to be in the range of $7.25 to $7.40. Also, our CapEx guidance is $350 million for the year.

There are some key elements I want to bring your attention to as you review our guidance. Estimated FX headwind on EPS has an impact of approximately $0.11 based on current foreign currency exchange rates. We expect full year COVID-19 related net sales to be approximately $85 million compared to $388 million in 2022. And our guidance excludes future tax benefits from stock-based compensation.

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

Eric Mark Green

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

Great. Thank you, Bernard. To summarize on slide 17, the solid financial performance shared today continues to reaffirm that our growth strategy is working. We have a durable base business proven by a market-led approach, which is delivering unique value to our customers.

Our global operations team is efficiently manufacturing and delivering products in this complex environment with a focus on service and quality. And we're continuing to progress capital spending across our operations to meet current and anticipated future growth.

We realize that our products in pursuit of scientific innovations are critical to healthcare across the globe, which is why we're so committed to support patient health today and well into the future.

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

QUESTION AND ANSWER SECTION

Operator: Thank you. [Operator Instructions] Please stand by while we compile the Q&A roster. Our first question comes from the line of Larry Solow with CJS Securities. Your line is now open.

Larry S. Solow
Analyst, CJS Securities, Inc.
Q

Good morning, guys. Thanks for taking the question, and congrats on a good quarter, better than obviously we expected. Eric, maybe you could just discuss sort of the long-range outlook. HVP, I know you mentioned 72% of revenue in the quarter. But can you speak to it more on a volume basis, and particularly some of the faster-growing and much higher-margin NovaPure and as you kind of ascend up the HVP curve, if you will, I mean, the opportunities over the next several years?

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

Yeah. Thanks, Larry, and good morning. No, you're right. So if you think about HVP right now, the amount of units produced from our manufacturing sites is roughly around 23% of the total volume. But as you rightly pointed out, it was about 72% of our sales in the last quarter. And the higher growth part of that high-value product spectrum of the portfolio is coming from our FluroTec, all the way up to NovaPure.

So NovaPure is becoming more meaningful. Obviously, it was a major element of the COVID-19 response. But with the number of biologic launches, the NovaPure is becoming a very attractive solution for our customers.

So I would say it's early, the investments that we're making. Particularly, in our HVP plants in Kinston, Jersey Shore, are around NovaPure plungers and other types of plungers to address future launches. So that's where the growth is really – a portion is coming from the higher end of HVP as we speak.

Larry S. Solow
Analyst, CJS Securities, Inc.
Q

Okay. And how about just – yeah, go ahead. I'm sorry.

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

If you look at the CapEx and guidance as well there, approximately 70% of that CapEx number is really to support growth initiatives and productivity improvements. And much of that is around high-value products. So that ties in with the outlook that we would see for the next number of years putting that capacity in place.

Larry S. Solow
Analyst, CJS Securities, Inc.
Q

And what about just generally in the industry? I know the trends in biologics are obviously growing faster than overall drugs. Has that trend, like, accelerated over the last few years, or what's the outlook there on a general macro level?

Eric Mark Green

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

A

Yeah. We believe the biologics and the biosimilars space is going to be the fastest growing area for new drug launches. If you think about the last year though, however, it was interesting to see the number of ANDAs and also small molecules approved into the market. And fortunately, we have a strong position in those areas also. But I think if you kind of fast forward, you'll still see biologics and biosimilars be the fastest growth area in our space.

Larry S. Solow

Analyst, CJS Securities, Inc.

Q

Got it. And then, just lastly, can you just give us sort of just a brief update. On the call, I am not sure if you've talked a little bit about Corning at all, but just sort of where we stand there. I know I think last year you had even called out how much you're spending on R&D. I'm sure it's a pretty incremental piece this year as well. But I don't know what you could speak to on the R&D side and the cost, but maybe just sort of where we stand qualitatively, the revenue outlook, and how big this could be over the next few years? Thanks.

Eric Mark Green

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

A

Yeah. Larry, it's a really strong partnership. And we're really pleased that earlier this month, we were able to announce our first product launch of combining our West NovaPure stopper and Corning's Valor vials, which – what we label as our ready-pack solution.

And just to remind everyone that this is kind of a seeder or a seed program that we use in the development of new molecules. So this has been very successful for us in the past. We're leveraging this channel to introduce this combination going forward. It's a great testament of the focus between the two firms on really bringing the products together as a complete solution.

And so, while this is early, we still have more work to do. We have number of launches that we have scheduled, whether it's in 2023, 2024. Ultimately, where we want to get to is a complete solution with the one drug master file. So it's a complete, fully-characterized system. And so, that will continue required investments. And so, if you look at our R&D spending, 2023 will be slightly up, and a good portion of that incremental piece will be around the West-Corning partnership.

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

Matt Larew

Analyst, William Blair & Co. LLC

Q

Hey. Good morning. Thank you for taking my questions. Eric, I just wanted to ask, just you referenced sort of the committed order book. And I'm curious maybe if you compare the composition of that order book today versus pre-COVID, obviously, on the non-COVID part, maybe just in terms of what NovaPure and FluroTec demand looked like. I guess the question is, out of the potential FluroTec customers who you start engaging with, what does the conversion look like? Excuse me – on the NovaPure side, what does the conversion look like in terms of folks who ultimately end up choosing to go with NovaPure perhaps versus a few years ago?

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

A

Yeah. Thank you for the question, Matt. So I – when I look at the order book versus pre-pandemic, and then strip out the COVID piece, overall, it's a net increase from where we were at that point in time. When you look at the composite of the growth of that order book, it is really driven by our high value products, and particularly, the higher end of HVPs. We're seeing a healthy growth in plungers, not just in the NovaPure sector but in other categories of HVP. But – so from a order – committed order book perspective, that's the kind of the characteristics we're seeing right now.

In regards to the adoption rate, it's actually quite high. So our participation rate, particularly in the biologics and biosimilars, is very, very strong. And what we are doing is we're seeding with the NovaPure portfolio. And once that is locked in, in the development phase as they go through into commercialization, that's the end result, better outcomes for our customers, obviously, better compatibility with the drug molecule.

So we're very excited to see the continuation of that adoption of NovaPure. And that's – hence the reason why we're putting these investments in place. And we're seeing more of a transition from vials to pre-filled syringes, which will require our plungers. So that's where we are. But it's a very healthy growth profile of the higher end of HVPs.

Matt Larew
Analyst, William Blair & Co. LLC

Q

Thanks, Eric. And then just maybe a cleanup one on the equipment issues you've referenced on the third quarter call. How did that end up impacting fourth quarter results relative to expectations, and where do things stand now halfway into the first quarter of 2023?

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

A

So those issues are resolved. The team did a really great job to resolve the issues and get our manufacturing facilities back up online, fully validated, characterized, and be able to support commercial production. That was done in, I'd say, mid part of Q4, a little bit later in that part of the quarter. So we're full out right now in Q1, and I'm excited that we have that at this point to allow us to get some of the backlog caught up in the early parts of this year.

Matt Larew
Analyst, William Blair & Co. LLC

Q

Thank you.

Operator: Thank you. Our next question comes from the line of Jacob Johnson with Stephens. Your line is now open.

Jacob Johnson
Analyst, Stephens, Inc.

Q

Hey. Thanks. Good morning, and congrats on a nice quarter. Maybe kind of following up on that last question, just, Bernard, as we think about how the year plays out, anything you'd highlight in terms of seasonality or kind of margin progression, revenue progression throughout the year? And maybe along those same lines, can you just remind us when you had the toughest comps from COVID that you'll be lapping from 2022?

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

A

Yeah. So I think, from a cadence perspective, going back to what we would have seen kind of pre-COVID where first quarter is usually a little bit lighter, picks up a bit in the second quarter, and then levels out in Q3 and Q4. And from a comp perspective, I think a lot of the COVID revenues we would have had would have been in the first half of 2022. So that's where, I won't say challenges, but that's where the biggest comps are going to be, from that perspective, and then some in Q3 and then, obviously, lighter in Q4.

Jacob Johnson
Analyst, Stephens, Inc.

Q

Got it. Thanks for that. And then on contract manufacturing, nice to see you return to growth there, uptick in revenue in the quarter, I think gross margin was down sequentially. Can you just hit on what drove both? And maybe related you're pointing to, I think pretty robust growth in 2023 where there's some investments you're making for this year and kind of again, along those same lines, what's driving the growth in that business in 2023?

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

A

Yeah, I think, as you'll remember when we were talking through 2022, a lot of the challenges we faced within contract manufacturing was really around one customer mainly, and a shift in their business. And so, as that kind of have tailed off towards the back end of the year, it allows us to be able to return to growth. Then we actually saw demand increase from our existing customer base, probably a little bit ahead of where we would have anticipated going into the fourth quarter. So that was again positive to see and what we would expect as we move into 2023 that we will be seeing mid-single-digit growth for our contract manufacturing on our existing business and then layering in with new business at the same time. So, we continue to make some investments in that area.

Jacob Johnson
Analyst, Stephens, Inc.

Q

Got it. Thanks for taking the question.

Operator: Thank you. Our next question comes from the line of Paul Knight with KeyBanc. Your line is now open.

Paul Richard Knight
Analyst, KeyBanc Capital Markets, Inc.

Q

Yeah. Thanks, Eric, and Bernard, and Quintin Lai. The question is, I – Paul touched on it, I guess, is COVID probably starts slow, then they manufacture more product, Q2, Q3, right? And then less in Q4, that's question one. And then the other would be regarding this pre-filled syringe market, is that really what you're seeing is biggest opportunity right now?

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

A

Yeah. Good morning, Paul. That's a good question. So the first part is that when we think about the COVID, it's – we're looking about right now, approximately $85 million for 2023 is relatively kind of evenly spread, we can't get any more granular than that at this point. But as you know, we were much higher than that last year. So we do have the capability to manufacture accordingly.

In regards to the pre-filled syringe, when you think about our investments, particularly in the last couple of years and working with some of the launches and anticipation around plungers, which obviously supports the pre-filled syringe space, is actually we're anticipating higher growth in that area and that is, the equipment's coming online as we speak. I mentioned a little bit in my prepared remarks about Kinston, a lot of the additional equipment in there is really geared around plungers. And so I'm excited to build support that part of the market as we see the pre-filled syringe market continue to expand with high growth. So we're going to play in that and we're prepared for it and that's where our investments are really focused on today.

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

Okay. Thanks.

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

Thanks, Paul.

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

Derik de Bruin Q
Analyst, BofA Securities, Inc.

Hi. Good morning.

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

Morning, Derik.

Derik de Bruin Q
Analyst, BofA Securities, Inc.

So can you talk a little bit about sort of like pricing? You got about 4% in 4Q, how should we think about that in 2023? Are you – I know you were debating taking some higher pricing by looking through pricing dynamics, and things are going forward. And I guess, have you done that and have you seen any pushback from your customers?

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

Yeah. Thanks for the question. So you're right, we have implemented in the fourth quarter of 2022, obviously discussions with our customers about the 2023 calendar year. Our net price increase will go up in 2023, and that is obviously for all the right reasons, particularly with some of the inflationary challenges and so forth that I think all industries are being faced with.

So I think the team responded appropriately. I believe we took a really very well-balanced approach. We do have certain customers on contract, so we did have some limitations. However, overall, with the new pricing team and strategy we put in place a couple of years ago, we're starting to see that pay off. So that will be rolling out as we speak and already this quarter and be rolling throughout 2023. But, Bernard, do you want to provide more color on that?

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

Yes. I think, in the fourth quarter, we said if we did about 3.8% on pricing, we're targeting 5% to 6% on price as we move through 2023. So it is a bit of a step-up and part of that is to take into account the inflationary cost pressures that we're also seeing. But as Eric said, you can see the trajectory in our price increases over the last number of years, and how we're approaching that, that's also been on the increase.

Derik de Bruin
Analyst, BofA Securities, Inc.
Q

Great. Just a little bit of an accounting question. What was the tailwind from stock-based comp in 2022? And your initial tax rates are never what you end up being with for the full year. So is it comparable to think – is it reasonable to think you'd get a comparable benefit in 2023?

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

We guide without it because it's very hard for us to estimate this. If you look at last year, it was about $0.22, I believe. So we guide without it for a reason because it is so hard for us to predict that's kind of outside of our control.

Derik de Bruin
Analyst, BofA Securities, Inc.
Q

Got it. And if I can squeeze one more in, if you don't mind. How should we think about the economics on the pre-filled syringes? I mean, obviously, there's a lot of new drugs coming out for metabolic disease, for obesity. And how should we think about your potential profitability or the revenues associated with one of those units? And just give us some way to sort of, like, ballpark what your – I mean, what your revenue contribution could be on something like that?

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

Yeah. So if you think about the pre-filled syringe area and the plungers, it depends on – if it's NovaPure, it's pretty comparable to – we talk about the $0.80 to over $1 a unit. But if it's not the NovaPure, other types of HVPs, you have a very large range between, let's call it, $0.40 per unit. So you can see the range that we're operating in.

From a margin perspective, again, it is HVP. That could range anywhere between 55% to 80%. So I'm giving you a very broad range...

Derik de Bruin
Analyst, BofA Securities, Inc.
Q

Yeah.

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

...because not all molecules have the same requirements. But what's good around our investment thesis in our facilities, particularly around plungers, is that the equipment and the processes are somewhat fungible. So we can leverage these existing assets. We're putting them to the current drug launches, but also anticipated areas of potential growth. So we're positioned well.

Derik de Bruin
Analyst, BofA Securities, Inc.

Q

Great. Thank you very much.

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

A

Thank you.

Operator: Thank you. Our next question comes from the line of John Sourbeer with UBS. Your line is now open.

John Newton Sourbeer
Analyst, UBS Securities LLC

Q

Hi. Thanks for taking the questions. I guess maybe digging in a little bit more on the new capacity coming online and the CapEx. Any color just on pacing there for the year? And then, just a follow up on that equipment and the delays at 3Q. I think that was around a $30 million a month headwind. Can we assume now that this is off that that's contributing around $30 million a month as well?

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

A

Yeah. The impact in Q3 was about $30 million, and that may vary depending on volume mix as we go through each quarter. So it's hard to say it's $30 million each quarter. It would be difficult to commit to that at this point. But in saying that all of those problems that we had in Q3 have been resolved, as Eric kind of talked about earlier, and much of that happened as we progressed through Q4.

On the pacing of layering in new CapEx, that will happen as we move through 2023. So it's not all at once. And we'll see some of it as we get into the back end of the second quarter, particularly in Kinston, where we are getting new parts of our facility up and running with the equipment that we've installed there. And then, as we progressed through the year, there would be equipment layered in the other HVP sites.

John Newton Sourbeer
Analyst, UBS Securities LLC

Q

Got it. Appreciate it. And then, I guess just maybe on COVID, it looks like you lowered the guidance there slightly. I guess just any thoughts on just where endemic levels go from here? How much more further drops do you think that you see coming down from COVID beyond 2023?

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

A

It's hard to estimate that. We've tried to – well, we're giving our best estimate based on the information that we have today. If we thought it was going to drop any further, then we would have included that in the guidance. But based on what we see today, that's where we think it's going to play out.

John Newton Sourbeer
Analyst, UBS Securities LLC

Q

Right. Thanks for taking the question.

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

A

Thank you.

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

A

Thanks.

Operator: Thank you. Our next question comes from the line of David Windley with Jefferies. Your line is now open.

David Windley
Analyst, Jefferies LLC

Q

Hi. Thanks for taking my question. I hope you can hear me. I've got a couple of follow-ups, but I wanted to start with just asking if you would level set where the market units are, with kind of generics having a strong end of the year and biologics down, those are kind of opposite directions than is normal. What's the kind of relative sizing of your four segments of the business, so we have a base to work off of? Thank you.

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

A

Yeah. So if you look at biologics, as we go into 2023, the biggest impact of COVID revenues been reducing is within the biologics segment. So we do see a reduction there. But if you back that out, we're actually seeing very strong double-digit growth within the biologics segment for our core business.

And then, as we progress through 2023 on generics, again, we would be looking to see high-single digit, nearly double-digit growth; pharma, high-single digits; and then contract manufacturing, as we said earlier, mid-single digit growth.

David Windley
Analyst, Jefferies LLC

Q

Okay. And Bernard, so to apply those, so is it like, I think, biologics was 40% to 45%. I'm just looking for, should I think about with the kind of COVID correction that it's closer to the 40% and just looking for kind of the percentages to apply those growth percentages to?

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

A

Yeah. Biologics was, yeah, mid-40s. It's going to come back a slight bit. So you're probably 40% to 45%. And then, what was pharma – I think contract was about 17% or 18%.

David Windley
Analyst, Jefferies LLC

Q

That's fine. I can follow up offline. On the installation of the equipment, and Eric, we talked about in Kinston, the washing equipment in that process. I guess I was under the impression that that was specifically NovaPure and maybe even more specifically, NovaPure plunger equipment, but Bernard's answer to the last question that it kind of varies, that that $30 million a month will vary based on volume and mix. Maybe I misunderstood what – how fungible that equipment is across your product lines. And perhaps you could further elaborate on that? Please.

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

A

Yeah. No, absolutely. So specifically on the equipment that we discussed about Q3, that was ongoing operations that's specifically just NovaPure.

David Windley
Analyst, Jefferies LLC

Q

Okay.

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

A

So you have washers that wash – pharmaceutical washing capability that supports really the high-value product portfolio, the vision that you sort of envision, equipment that you were able to see, that is for NovaPure, so some of the equipment is not fungible, but the core elements of the equipment is.

But the growth that we're having, based off of that equipment you looked at, was really around the heavy part of that is NovaPure. There's some mix effect to it. And then the future investments we're making that you saw in Kinston, that is – that's again, it's a wide range of high-value products, FluroTec, all the way up to NovaPure.

David Windley
Analyst, Jefferies LLC

Q

Okay. So where I wanted to go with that and I'll make this my last one is you're losing the year-over-year COVID, $300-ish million. Management's made the point that that has been very high gross margin, high incremental margin revenue and so that creates, I think – contributes to this transition year on margin, Eric, that you mentioned in your prepared remarks.

It seems like as you've put some of this equipment in place that was the hold up in 3Q, again, your last answer helps me to understand that better, but the revenue potential that that equipment unlocks is in the neighborhood of the revenue that you're losing from COVID. I guess, I now understand that maybe the margin on that revenue that's coming in is perhaps not quite as rich as COVID. You could confirm that for me.

But just thinking about that and any other factors that we should be keeping in mind that influenced that margin transition, you know that are not as rich as the COVID revenue that is coming off. Thanks.

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

A

Yeah. Dave, I'll take that. And just going back to your last question on the splits, just to clear that up, so the – as a percentage of proprietary sales, biologics is like mid-40s, generics mid-20s, and then pharma in the low 30% range. That'll get you to the split.

And with regard to your question on margin, it's not as simple as one product coming out and another product going in. So we're looking at as where there's a mix impact obviously with the COVID revenues falling off and they have been higher margin products. And we've also got the impact of inflation on our cost base. So you've got those two headwinds. And then as we alluded to – or we talked about earlier is the increase in price that we're seeing is above what we would normally see in our business. So that helps offset some of this margin pressure.

And then we have very specific cost initiatives within our business, both from an operations manufacturing perspective and then on SG&A and R&D, really looking at cost control and cost management, and that is delivering a number of efficiencies for us. So it helps us to overcome some of the margin challenges, but not all of them. And then that goes back to the point earlier where we're not actually – margin isn't stepping back to pre-COVID levels. We're maintaining or holding on to a lot of the improvements that we made or the gains that we made.

David Windley
Analyst, Jefferies LLC
Q

That's very helpful. Thank you.

Operator: Thank you. Our next question comes from the line of Justin Bowers with Deutsche Bank. Your line is now open.

Justin Bowers
Analyst, Deutsche Bank Securities, Inc.
Q

Hi. Good morning, everyone. Just piggybacking on Dave's question. Can you help us understand and maybe it's a range of sort of what the margin profile is on the C-19 business? And then with respect to the new capacity that's coming online in 2023, can you help us understand how that phases in? Is it ratable, or is it more second half loaded? Any color there would be helpful.

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

So the margin on the COVID products would have been at the higher end of our margin range because a lot of that was NovaPure. So you could have been looking at range of 60% to 70% plus. And then on the CapEx piece on that being layered in, a lot of it has been layered in and commissioned as we speak. But you see the impact of it will be more so in the back half of the year when it's fully operational and we're able to put a lot of volume through.

Justin Bowers
Analyst, Deutsche Bank Securities, Inc.
Q

Understood. And then just a quick one on China, maybe a status update on the two plants over there and any thoughts on how that impacts the progression of the year?

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

Yeah. In China, our business impact for West overall is quite low. A lot of the activity that or manufacturing we do in China is for China. And so we have a really strong team there in our facility in Qingpu that continues to capture more share within the market. But our reliance on our team there to export is very low. And again, overall value or revenues and profits to the corporation is very small.

So that's our impact in China. Our supply chain, if you think about procuring materials, is not heavily dependent on that part of the world. The team has done a really good job. Many of our products are co-located to our manufacturing sites. So that's how we've set up our procurement and supply chain of raw materials.

Justin Bowers
Analyst, Deutsche Bank Securities, Inc.

Q

That's helpful. Appreciate it.

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

A

Great. Thank you.

Operator: Thank you. I would now like to turn the conference back over to Quintin Lai for closing remarks.

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

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

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