14-Nov-2023

West Pharmaceutical Services, Inc. (WST)

Jefferies London Healthcare Conference

CORPORATE PARTICIPANTS

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

OTHER PARTICIPANTS

David Windley
Analyst, Jefferies LLC

MANAGEMENT DISCUSSION SECTION

David Windley
Analyst, Jefferies LLC

Okay. All right. Good morning, everybody. Can you hear me? Yes?

Hi. Good morning. Welcome to Jefferies 2023 London Healthcare Conference. I'm pleased that you're able to be here and appreciate your attendance. My name is Dave Windley. I'm with Jefferies Equity Research in the States. I run our small national research office. And we do a fair amount of health care research out of that office.

Here with me today is West Pharmaceutical Services and management team, CEO, Eric Green, and Head of Corporate Development and IR, Quintin Lai. We're very pleased to have you guys here. You're regular attenders at this meeting. And so, thank you very much for being here and giving us your time.

QUESTION AND ANSWER SECTION

David Windley
Analyst, Jefferies LLC

Q

Eric, I thought I'd just start us off with kind of a perspective question. West is kind of a pure play on the injectable drug space. The injectable drug space keeps getting hotter in general. But there have been a couple of really big bangs of COVID and now GLP-1s that have come along that have added to what is otherwise still a fairly steady growth environment. So maybe talk about what the experience has been in making that transition.

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

A

Yeah. Great. Thank you, Dave. And first of all, thank you for the invitation. Enjoy the meetings here today. So far, they've been very productive. And my colleague, Quintin Lai, will be here also to assist in the questions.

But it's been an interesting journey the last couple years, Dave. And it really kind of shows the criticality of West in the injectable medicine space. We're in a very fortunate position. When you think about the marketplace itself, it's one of the fastest growing spaces within health care, the injectable medicine space.

If you go one level below that, you'll find that the biologic space is even – is the fastest growing subsegment of the injectable medicine space. And we're very fortunate to be positioned very well from our scale, our quality, and our technology to be the market leader in global containment and delivery devices in the injectable medicine space. So clearly, we have a very strong position.

And the COVID pandemic really challenged the organization in multiple ways. But I couldn't be more proud and humbled in how they responded. They're really driving a 24/7 mentality to make sure that we were able to support close to 8 billion doses of COVID vaccines across the globe, while our core business without COVID continued to grow double digits over the pandemic period.

And what that tells us is the durability and resiliency of our business model allows us to react to these mega or these large changes that could occur with new launches of new molecules.

So we're very well positioned, Dave. Fortunately, we've made enough investments, that we're optimistic about our investments, to be able to continue to stay ahead and support our base business, our core business. But also if there is any surge of demand of any particular new drug launch that could occur, whether near term or more long term. So it's a very good position to be in at West. And we're ready for the next challenge.

David Windley
Analyst, Jefferies LLC

Q

Excellent. So you've talked in public environments about the escalating interest in your highest value products. So part of function of the biologic growth that you just described, part of push in the regulatory environment toward quality. But maybe talk about how the demand uptake has intensified in FluroTec and NovaPure, your very highest of high-value products. And how you put capacity in place to be able to address that.

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

A

Yeah. So we're really good at seeding in the market. As you know, we are working with customers early on and from development all the way up to clinical through commercialization.

In those early phases, we've been seeding in the market, whether large, medium, or small firms – customers with NovaPure, particularly in the biologics space. And that launch was literally 2016, 2017. As you know, it takes a few years to get adoption in the marketplace. And we're seeing that become realized today.

And so when we think about new approvals, particularly in the biologics space and biosimilars, the residence or the consistency of using NovaPure has allowed us to see significant demand increase of that part of our portfolio, which is the highest end of our high-value products today. Not for the future, we have more work to expand that. But, today, NovaPure is the most – the highest quality product that we provide in the Elastomeric area of our business.

And along with that, we've been adding capacity at our centers of excellence of our high-value products, particularly one that we just recently finished. It was with Kinston in North Carolina in the US. We have significantly added capacity around NovaPure plungers, because as we think about the future growth, speaking with our customers, it is around the HVP plungers. And NovaPure plunger is one of the premier offerings that we have. So we feel good about the investments.

We continue to invest. About 70% of our capital investments is around growth. And which – if you think about it a little bit further, most of it is around the mid to higher end of HVP, as you alluded. Most, if not all, of the approvals that we are on, particularly in biologics, is using FluroTec technology, all the way up to our NovaPure product offering. So that we're very well positioned today. And with the recent expansions, we can handle additional demand growth over the next few years.

David Windley
Analyst, Jefferies LLC

Q

So I'm going to linger on this for a moment. During COVID, the conversation in terms of high-value uptake was, I'd call, balanced between FluroTec and NovaPure. And over time, your comments have increasingly kind of migrated toward NovaPure. Are clients – I mean, I think FluroTec is maybe, more often than not, incorporated into NovaPure. So I know it's in there. But are clients kind of jumping over FluroTec and going all the way to NovaPure now?

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

A

Yeah. The technology itself of FluroTec is embedded in NovaPure. But it's the entire quality of the design concept that the product offering offers. And therefore, we're seeing more adoption at this point leveraging our NovaPure portfolio. So that's a correct statement.

David Windley
Analyst, Jefferies LLC

Q

Yeah. Okay. And the – I'm going to bet you're going to beg off on the specifics. But the economics for NovaPure over FlureTec are an increment higher. Yes?

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

A

Yes.

David Windley
Analyst, Jefferies LLC

Q

I'd love for Quentin to put numbers on that.

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

A

Yes.

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

A

Well, I mean the thing is is that when you're talking about NovaPure, you're talking about quality by design. And so we're putting in checks and balances on every stage of the manufacturing process. And then what comes out is a product that has tighter tolerances, lower defect rates, higher performance.

And so because of that, we do get a value proposition to the customer, as well as for ourselves. So in some cases, NovaPure gross margins can be 70% and even higher.

David Windley
Analyst, Jefferies LLC

Q

Right. Great. Segues really nicely into my next question, which was going to be around pricing. So the company – I've covered you for 12 years or more. And pricing for the vast majority of that time was in 1%, 1% to 2% region. And in this last year, I think, year to maybe year and a half, the price component – so separating -leaving mix aside, the price component of your increase has steadily stepped up. So maybe talk about the pricing posture and as your thinking has evolved there.

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

A

Yeah. I'll start here, Quintin. You're right, Dave. I think – just kind of looking back when we started, Quintin, it was probably a sub-1% net price contribution at West. And we've steadily increased that.

But I think it's been more of a strategic focus in the last few years, where we're looking at different parts of the portfolio, more of a strategic approach versus just across the board of leveraging opportunities to increase prices more in line with what we see inflationary costs. And also to cover the additional benefits that we're providing with the product.

So this year, we're between the 5% to 6% corridor. I think last quarter was about 6.5% or so net price contribution. Year prior, we're roughly about 3% to 4%.

So I do believe the way that we've structured and the way we're looking at our portfolio today and see the opportunities, whether it's geographic, whether it's certain customer segments, certain product segments, we do believe that we'll be north of the 1% to 2% that you were accustomed to years ago going forward.

It will be modified as we think about various inflationary costs. I mean, obviously, this year, we were – several industries were hit with additional inflationary costs we were able to pass on to our customers. And that will be kind of the lever as we think about going forward if there needs be more. And we have the capacity to put more into pricing.

I do want to just reiterate, though, Dave, when we talk about net price contribution, this does not include – as we move customers up of our high-value product curve, we consider that mix. So any time we're able to get a better ASP, better margin on the same number of units, we do not categorize that within our waterfall charts as price. We consider that mix. So this net price contribution is truly a reflection of year-over-year price.

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

A

Yeah. Definitely a good point of emphasis there. So you mentioned the inflation parts of that. So if I were to translate what I heard from you just there, 5% to 6% probably had some elevated inflation elements in it.

Go-forward price, maybe not necessarily as high as the 5% to 6%, presuming that the inflation has moderated, as it has, but certainly better than the 1% or 1% to 2% that has been in the more distant past. Is that the right interpretation?

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

A

Correct. That's the way to look at it.

David Windley
Analyst, Jefferies LLC

Q

Yeah?

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

A

Yeah.

David Windley
Analyst, Jefferies LLC

Q

Okay. And you mentioned more strategic and kind of targeted approaches. Are you – I mean, is it better pricing power at the highest end of your high-value products? And so taking more price there? Or in certain therapeutic categories? Or how do you – you mentioned not broad based anymore. So how should we think about the targets for that price increase?

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

A

Yeah. It's not – I would not classify it as the higher end of our portfolio. It's all parts of the portfolio. But it is very targeted to certain segments and certain parts of the portfolio. It doesn't – necessarily would translate to the HVP product portfolio.

I will say this, though, we do not have list price. And so when we engage with our customers, we look at the value proposition. And we set the price, the starting point, based on what we're providing the customer at that particular time. So the entry point may not be consistent with one customer to the next.

David Windley
Analyst, Jefferies LLC

Q

Interesting. Okay. And then thinking about your long-range growth targets, 7% to 9% revenue growth, kind of 100 basis points of margin expansion. Focused on the revenue growth part of that, I think when you first set that, would have been in the period where this price contribution would have been on the relatively low end. So if you're getting an extra couple points, couple – 3 points of price benefit to your top line, how does that incorporate within the 7% to 9% long-range plan?

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

A

Quintin?

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

A

Yeah. So there are a few ways to look at that long-range plan. I mean, yeah, 7% to 9%, typically, volumes are growing in the low single digit, 2% to 3%. It presume pricing at the 1% to 2% range. And then the balance of it being mix.

And as you go forward, again, if you affect any one of those components, price, volume, or mix, then we would probably go back and reevaluate.

But all those things put together is how we look – take a look at it. If you look at it from a market unit perspective that assumes Biologics growing low double digits, Generics growing kind of mid to high single digits, and Pharma growing low to mid single digits, and Contract Manufacturing growing kind of mid plus. So different ways to look at the 7% to 9%. It's a long-term construct, Dave, and that's how we kind of look at it.

David Windley
Analyst, Jefferies LLC

Q

Yeah. Very good. So certainly, the price element of those three contributors to growth hasn't gotten worse. We can say it's a net better benefiter, beneficiary of your long-range plan.

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

A

Yeah. I mean so, as Eric said, I mean, historically, we've been closer to the 1% for [ph] net price per range (14:11), and we think that we can do strategically more. And then depending on – and as we demonstrated over the last couple years – if we get inflationary issues on materials, shipping, energy, labor, all of those things, we believe we have a mechanism to also pass that through.

David Windley
Analyst, Jefferies LLC

Q

Got it. Okay. Getting a little more specific to the recent performance in the third quarter, you called out some weakness due to customer cadence around restocking. We kind of distinguish between restocking and destocking. I thought it might be a good opportunity to distinguish the difference, if it is important. And then what are those areas where you're seeing that stocking cadence change?

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

A

And there's three areas that we are seeing movement when it comes to order patterns with our customers. So just to level set, we're made to order. So we have visibility over the next, call it, four to eight quarters of demand of our customers. And there's some variability from quarter to quarter. But we do have that visibility.

And when you think about the three of them referenced. And one is there is a – there was a destocking effort this year around COVID. I think everybody understands that. So last year, we did about $388 million of COVID-related materials. This year, we're guiding about $68 million. So that's $320 million headwind. Hence, we're still growing this business in 2023. And so that's one of the three.

The second one is what we – working with our customers. During the COVID period, our lead times as a made-to-order manufacturing process elongated. So going all the way out to, call it, 40 to 50 weeks. We were working with our customers. During that period of time, we had to identify which orders can we fulfill at that time, so we don't have these stock-outs for our customers. But also importantly, to be able to get materials out for the COVID vaccines.

As the COVID vaccines kind of come back or reduced, we're able to to rectify those, correct those lead times. And we're back down to the normal pre-COVID period of time, give or take.

And also with the capital investments we made, it allowed us to get more capacity in our facilities. Because again, the core business was growing double digits consistently quarter to quarter over last two-plus years and three years.

The third one, we're seeing working capital with a certain group of customers, particularly around disposable medical devices. This tends to be our standard products, lower margin, large volumes.

But that certain particular facilities we have around the globe, these particular products just – and these are like the nonregulated products that we are providing to our customers that are going into whether clinical or a hospital setting. And that particular portfolio, we're seeing more working capital management at this point in time.

So those are the three moving parts that we're dealing with today, and that's – hopefully that clarifies that...

David Windley
Analyst, Jefferies LLC Q

Yeah, it does.

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

...confusion.

David Windley
Analyst, Jefferies LLC Q

That's great.

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

Yeah.

David Windley
Analyst, Jefferies LLC

Q

Is it possible to have visibility into how long this lower order pattern will last before these clients have gotten their inventory levels to what they want them to be?

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

A

On the third bucket – the first bucket we know. But the third bucket, we are – that's unknown at this point of time. There's a little more variability. Again, it's a small piece of our business.

But when it's coming to restocking with our customers and just building up their safety stocks, that's why in the last call we had, we gave some indication that next year we'll be within – looking at our financial construct as intact, so the 7% to 9%.

So you can assume that goes back to kind of the traditional growth we're seeing with the low to mid for Pharma, mid to high for Generics, and double digits for Biologics, and mid to high for CM, that algorithm.

So that whole building up the safety stock, we're pleased. We feel that we're close to completion there for our customers. And now we'll probably be back to reordering patterns consistent what we've seen before.

David Windley
Analyst, Jefferies LLC

Q

Got it. And kind of relatedly, but maybe a broader version of the question. Beginning I think when Bernard joined you in the CFO seat, there was a pretty concerted effort around investments into visibility – connectivity with clients, visibility into client supply chains, and being able to kind of manage that cycle a little bit better. Maybe describe those efforts and what visibility they give you now.

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

A

Yeah, Quintin.

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

A

Yeah. A lot of that infrastructure that has been put in and continues to progress was instrumental in us being able to react appropriately when the COVID surge hit. Because as Eric said, we were able to manage supplying COVID vaccine manufacturers, COVID drug manufacturers, as well as make sure that all of our other customers got some product. Maybe they didn't get everything they needed in terms of safety stock. But to the best of our knowledge, we don't believe a drug got stocked out because they could not get product.

And I think that that was in part because of the team and the infrastructure, the analytics that our team has put together. And it's composed of not only looking at order patterns, but it's also composed of getting feedback from the customer. And we've increased that feedback loop.

Eric and I just talked with our – some of our commercial leaders last week. They were coming back from a large conference in Barcelona. Huge difference year over year. Last year, it was, West, when are you going to get our supply up again to more comfortable level? This year, West, okay, you're better now. And so that's the progress that we're making.

David Windley
Analyst, Jefferies LLC

Q

Yeah. Let's move on to capacity. So, Eric, you mentioned Kinston.

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

A

Yeah.

David Windley
Analyst, Jefferies LLC

Q

You mentioned 70% of CapEx is generally going toward growth investments. So maybe flesh out – Kinston's one that maybe people are more aware of, as top of mind, but may be the broader targets of that 70% of CapEx for growth.

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

A

Yes. So if you – so this year, we spent about $350 million in capital, CapEx. And it's really allocated, again, 70% towards growth-orientated investments versus maintenance and IT infrastructure.

That's unusual for West because, historically, we've been around 50%. So this is the new algorithm that we're working with. And I'm actually quite excited about that.

And you think about where it's being invested. So the five centers of excellence for HVP. You think about – we talk a lot about Kinston because we had some tours there. We opened up the doors and gave visibility of the types of investments we're making there. But that's consistent to what we're doing at Jersey Shore.

Here in Europe, it's in Germany and also in Ireland. And we do have some investments going on in Singapore. So that is to help continue to fuel the growth of high-value products, particularly around plungers is pretty much the primary area of focus and also HVP processing and finishing.

The secondary area that we have invested growth capital is around Contract Manufacturing, particularly around – and here in Europe is in Dublin and also in the United States is around Grand Rapids, Michigan, primarily. And this is really around autoinjectors. And we continue to invest capital in that space. We currently have major projects going on in both locations as we speak.

So it is again around growth. And it's spanning from HVP portfolio on the Elastomer side, but also touching our Contract Manufacturing business for the – particularly around the autoinjector space.

David Windley
Analyst, Jefferies LLC

Q

Yeah. On the Contract Manufacturing, are the economics of your participation – I think as a premise, you've described that in those cases, it's the customer's IP. And they're hiring you among a few other vendors to produce those devices, those – that molded plastic for you – or for them. Are the economics on those autoinjectors, say, better than your current Contract Manufacturing kind of margins, profitability?

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

Let's just say that they're within the range. I don't want to specify one way or the other. But they're within the framework that we've established with that business going forward.

As you think about Contract Manufacturing years ago, a few years ago, we were kind of a mixture of the Pharma health care space, but also in consumer products. We really deemphasized consumer products over the years. Focused on the Pharma segment, which is consistent to the customers that we are servicing in the proprietary side. So the economics are relatively consistent to what we see within Contract Manufacturing today going forward.

David Windley
Analyst, Jefferies LLC
Q

Yeah. Okay. I want to ask – I know we're getting toward the end here.

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

Yeah.

David Windley
Analyst, Jefferies LLC
Q

Let me just ask one more around, I'll call it, integrated delivery systems. So this is I think a long-term strategic evolution that you all are trying to pursue through things like SmartDose and partnerships with Corning on Valor Glass. Maybe just set the table on where you see the world going in terms of those integrated delivery systems. And how far along you are in terms of getting customer uptake.

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

Yeah. Quintin, start?

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

So twofold. On the area of wearables, Dave, that is a differentiated product. It is something that is relatively new for the marketplace. And it serves a purpose of enabling the transition from IV-based drugs to subcu-based drugs.

And so it really gives the health care provider, as well as the patient, different options to get the drug. And so we're seeing good traction there. We already have four approvals. We have an active pipeline.

On the other area of integrated systems, that is where you're combining elastomer with glass. This is again new to the industry. And it's being driven by a couple of things.

One, the regulators continue to push to see that when you assemble components together, that they work together as a system. And so they're pushing the drug companies to show that they're a system. And the drug companies push the suppliers to go into system. Regardless of the fact that, right now, it's all ad hoc. Everybody doing components just on a components basis. We think that by creating this true integrated system, we can help address some of those issues.

And then second, we believe that there's going to be a streamlining for the customer to be able to have one filing, one drug master file. Simplicity in their supply chain. And more transparency on how things work on their side.

So again, we – it's a long-term process. It's going to take some validation. But we believe that it could be the next rung for our HVP.

David Windley

Analyst, Jefferies LLC

Excellent. All right. I think I'm right up against time, so we'll call it there. Thank you for your attention and attendance.

Eric Mark Green

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

Great. Thank you, Dave.

David Windley

Analyst, Jefferies LLC

Thank you, guys.

Eric Mark Green

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

Thank you.

David Windley

Analyst, Jefferies LLC

Talk to you soon. Feel free to reach out.