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West Pharmaceutical Services, Inc. (WST)

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David Windley
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MANAGEMENT DISCUSSION SECTION

David Windley
Analyst, Jefferies LLC

Hi. Welcome, everybody. I'm Dave Windley with Jefferies Healthcare Equity Research. I want to thank you for your interest in Jefferies' Virtual Global Healthcare Conference. I know folks who've probably been through a multitude of these, and we look forward to the opportunity to do conferences in person at some point in the not too distant future. But for the time being, we're still conducting virtual. I do cover pharma services, contract manufacturing, contract research and related for Jefferies, and one of the key companies in that space is West Pharma Services, WST is the ticker there. We are going to have a fireside chat with their management. CEO, Eric Green, is with us, as well as Bernard Birkett, the company's CFO. So, we welcome you two and thank you for your time today.

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

Thank you, Dave. It's good to be here.

QUESTION AND ANSWER SECTION

David Windley
Analyst, Jefferies LLC

Q

Sure. So, let's just start right in. Your business has performed really well. You've benefited from being involved in some key programs that are helping with global health. But certainly, there's some underlying trends that were already in place [ph] in that bad – in that (01:19) the pandemic has served to accelerate, one of those being the shift toward high-value products. So, as a general question before I dive into little bit more detail, maybe you could talk about the conversations you're having with clients at the development stage and how the selecting of your high-value products is increasing in those conversations?

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

A

Dave, that's the current momentum that we're seeing, it's from the adoption of our high-value product portfolio and particularly around FluroTec and all the way up to our NovaPure platform. And we are having discussions early on in their phase of development that enables them to think about using a – particularly like a NovaPure as a platform for a number of biologics that are going through their pipeline. I would say that we're really – it's not just the small firms that are looking at the highest level of HVPs at West as the entire portfolio of customers. We're seeing the adoption. As you recall, we launched NovaPure back in 2016/2017, it takes a couple of years for development. Our customers get comfortable with this, the data pack, making sure that is the right primary packaging containment for their solution. And it has – the growth that we're seeing is very, very attractive, as we speak now. So, we believe there's good runway ahead of us on HVP, but the – as you said earlier, the conversation starts early on their journey and we're seeing it through the approvals that are coming through, as we speak.

David Windley
Analyst, Jefferies LLC

Q

So, maybe to flip the question on its head, are there or what would be the examples of client products that don't choose a high-value product these days? It seems like the selection has gotten pretty high percentage, a percentage of new, I should say.

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

A

Yeah. Yeah, right, Dave. That's exactly the point to say and the most of the new products being launched are leveraging a vast array of the high-value product portfolio at West. We came out with a targeted line around the Generics segment with AccelTRA and that was strategic in regards to addressing speed, quality, reproducibility, and a technical data pack that is ready to go. And therefore, it is a high adoption rate in that particular area for ANDAs. And in the Biologics and Biosimilars space, it really is, well, the key differentiator of the technologies is the FluroTec coating. So, the interaction between the barrier coat between the elastomer and the drug molecule continues to be the industry standard.

So to get back to your point, a lot of the standard components which we still produce billions of components every year across the globe is needed in the marketplace. These are like needle shields, blood collection stoppers, disposable plungers in the marketplace. But if you think about new molecules coming in the market, HVP is the target area.

David Windley
Analyst, Jefferies LLC

Q

Okay. So then drilling into that a little bit, your Proprietary Products segment grew a little over 8% in 1Q ex-COVID. Your high-value products, so including COVID and non-COVID, your high-value products are now up to like 70% of revenue in the segment, that's continued to march higher. Is there – I think the answer is going to be no, but is there an upper limit to that? How should we think about that continuing to trend?

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

A

Yeah. There's just a couple drivers there. First of all, I just want to reiterate that the Proprietary business without or ex-COVID for 2020 was double digits, in the first quarter is also double digits. So that's a very strong healthy core base business growth in the organization. It's being led by our Biologics' growth frankly. In Biologics, the key components that are being used are FluroTec, NovaPure, and Crystal Zenith, the alternate to glass solution for the most complex biologics being approved. We think – if you think about longer term of the Biologics, we see double digits in that business, very robust. Again without COVID, we believe they'll continue to grow nicely, high-single to low-double digits for a number of years ahead of us, Generics from mid-single, and Pharma, the small molecule around low-single to mid-single. So you blend that all together, it continues to be very attractive growth here at West. And the Biologics piece is becoming more meaningful.

So, when the upper balance is hard to define because our challenge in our R&D group is to continuously evolve that high-value product portfolio. We don't believe NovaPure is the end result. It's an element of the portfolio. And so, we want to continue to convert new customers towards high-value products and our new molecules. And we also want our customers, in particular in Biologics, if they're using a particular configuration for the platform like Westar, move up to Envision, all the way up to NovaPure. So, there is a conversion even with high-value products that we're focused on which will give us that effect of more attractive economics for us, but a better product, a better end result for our customer.

David Windley
Analyst, Jefferies LLC

Q

Got it. On that conversion point that you made, that's an area where I think the acknowledgement has always been. But the good news is once it's tracked in, it's really sticky. The bad news is once it's tracked in that it's really sticky, they don't necessarily want to change. Is the attitude toward doing the validation work and changing to, moving up the ladder of high-value products, is that – is there a more accepting attitude of that? And if so, do the clients do that in portfolios or groups of products, or is it really kind of one-at-a-time decision?

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

A

It's both. It depends on the client. A few clients will do one at a time particularly in the new pipeline. We have other clients who are looking at doing a platform approach. So, as they approve it, not just on new molecules, we're looking to convert existing, and so when they re-file for those particular drug molecules, so that when they're in lifecycle management process. So, it's a combination of both and we're taking the opportunity to work with our customers in both scenarios.

David Windley
Analyst, Jefferies LLC

Q

Do those changes for them require machining changes in their manufacturing lines or is that not really required for the rubber part of their filling?

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

For the most part, no. There's this calibration and minor modifications. For us, there's alteration, obviously. But for them, it's minimal.

David Windley
Analyst, Jefferies LLC
Q

Got it. So coming back, you mentioned, I want to make sure I understand the point you're making about continuing to expect double-digit growth. Is that in total or do you think about that as ex-COVID? And if the latter, let's also talk about what – kind of what visibility do you have for continuation of a certain level of COVID work beyond the current year?

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

I'll start off and then I'm going to pull Bernard into the conversation also. But if I look at long-term, we still believe in the construct of 6% to 8% organic growth in our business – core business. And you're right, we've been producing higher than that over the last couple of years, and entering into 2021, we see a key driver that is continuation of high participation rate in Biologics, and also a continuation of growth in HVP. But I don't know, Bernard, if you want to add a comment about the 6% to 8% and the long-term growth [ph] curve (09:50).

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

Yeah. So, there is a couple of things. With the 6% to 8%, as Eric said, that's over the long-term and that's where we've seen our base business and how profound that through probably to 2020 and into early 2021. The one thing that I would say is that the growth profile of our business is shifting a little bit. We're – now we're seeing a lot of the growth come in Biologics. Generics and Pharma are still pretty close to where we would expect them to be, with Pharma low-single-digit to mid-single-digit; in the Generics, mid-single to high. And where we have seen a shift is the growth in our Contract Manufacturing business, which was growing fairly double digits; now, it's probably normalized at about a mid-single-digit growth rate.

So, the 6% to 8%, even though people would say, oh, it's still the same thing, it's – the mix is much better for us. And so, it is a stronger type of growth. And then, when you look at the numbers that we're growing off. So, from each year, the comp gets a lot more difficult. So, 8% or 9% next year isn't the same as 8% or 9% this year. So that's what we got to kind of be cognizant of as well as to – the numbers are getting a lot bigger. So, 6% to 8% means a lot more now than it did in the past.

So, when we look at it, we want to be relatively confident about the guidance we're giving. Now, if we can beat that and if there's more demand there or we're in a position to be able to satisfy them and grow faster. But we are reasonably – we're confident around that 6% to 8% trajectory over the long-term.

David Windley
Analyst, Jefferies LLC
Q

Got it. And then, when you think about the – I guess, I'll call it the intermediate term, the contribution from COVID, what's your longer-term visibility on that? Certainly, we and others have identified and published commitments by the major manufacturers of vaccine into the 12 billion doses next year. I mean, certainly if they continue with those commitments, it looks like 2022 will grow, but what visibility might you have to the persistency of the COVID supply?

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

A

Yeah, there is....

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

A

Yeah.

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

A

You go ahead, Eric.

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

A

No, no. Take it, Bernard, please.

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

A

Yeah. And so, we're continuous – continuously reviewing this. And you can see how we've approached the incremental layering in of extra CapEx since May of 2020 where we're doing it in phases based on the growth and demand that we're seeing both for responding to COVID, particularly on the vaccine side, and then also on our core growth – our business core growth. And so, we had our CapEx, we had incremental investments in May, June of last year. That's coming online probably throughout the first half of 2021. Some of it was online at the back end of 2020. We did a second phase that signed off in December of 2020 and we expect that equipment to layer in, in late 2021 and through 2022, and we'll continue to review those CapEx requirements based on demand.

So, it's changing all the time. But what we're seeing is that there's more of a likelihood of vaccines being required for the short- to medium-term, if not long-term, where initially people may have thought it would be a one and done. Well, that doesn't appear to be the case. And we're still gathering information on that. So for 2021, [ph] it's got to what, it's (13:37) $345 million in our guidance. Our core base business growth is probably at the high end of our construct based on the guidance we've given. And so, again, still very growth, and we're getting visibility into 2022, but we're still pulling that together and assessing from a capacity point of view what we need to do to support that.

David Windley
Analyst, Jefferies LLC

Q

Got it. And then could you talk us through just maybe in theoretics how the economics change for West in a situation where the world moves from – changes formats for a drug, in this case, COVID, that changes from say a multi-dose vial to a single-dose vial, or over to a prefilled syringe, I'm thinking that the rubber that you supply from prefilled syringe is smaller and therefore price per unit maybe less or different, but if you could help us to understand some of the levers that are impacted by a change to a different format?

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

A

Yeah. I'll take this, [indiscernible] (14:50). So, you're right. If they're – the discussions – and actually, frankly, that's one of the third tranches of investments we're looking at if it's necessary to invest for that configuration of change that you referenced. So, right now, vial configuration to be between 5 to 14 doses per vial, as an example, depending on the vaccine itself. And if it is lower dose – it goes more like flu-like which you will see today in the market, it could be a single-dose vial, it could be a few doses, i.e., three to four doses per vial or it could be a prefilled syringe. And so, the benefit with what we have done is we're really focused on the FluroTec technology all the way up to the NovaPure capability. And the formulation in the configuration doesn't change except for the size. And therefore, the economics are relative, very close to one another. So, we will have to modify some of our production processes. But the fundamentals are still intact, no change. But the end product is either going to be little smaller and/or different configuration like a piston or plunger. So, that's where the conversation is, as we speak, but there's no guarantees until we get down to that path.

David Windley
Analyst, Jefferies LLC

Q

Interesting. So, just to reiterate back to you, so your formulation, the components of the rubber, the FluroTec coating, those kinds of things that you have invested in for a vial stopper would be fungible to a prefilled syringe tip, but the mold that you're pouring that material into and cutting out, that's the part that would really change.

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

A

Yeah, and that's the interchangeable piece components, so the fundamental equipment itself and the processes we have in our facilities stay intact. But you're correct, the molds would be modified accordingly to the requirements that are there. I do want to just articulate one thing though is that the patient population could be different. So, it really does depend on how individuals are going to be open to a booster. And so, it's on a clear mathematical equation for us at this point in time.

David Windley
Analyst, Jefferies LLC

Q

Yeah. Yeah.

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

A

But we're in discussions and we're planning accordingly, and so lifecycle management over time.

David Windley
Analyst, Jefferies LLC

Q

Got it. Bernard, you walked us through a minute ago the cadence of a couple of major CapEx investments and those coming online. How has capacity utilization increased or improved? Maybe not only focused on those investments, but just kind of across the network, where does the company stand in terms of room for growth in the current footprint and current equipment?

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

A

Yeah. So, particularly around FluroTec and NovaPure, they're the areas that we're focused on adding in incremental CapEx spend, because we are seeing accelerated demand for a lot of those products. So, we've taken a number of different ways to deal with this. When we run – we're now running a lot of our plants which are running those products, they are running 24/7. As we said, we have layered in. We're on our second phase of incremental capital. So, that tells your utilization rates are very, very high. And so, we've got to get ahead of it early, because you could take like 12 months-plus to get equipment in and lined up to meet that demand. So, we're trying to stay ahead of this and – as we speak. So, in all of the – many of the high-value product lines, our utilization has increased materially. And again, that leads to that incremental CapEx.

And from a footprint point of view, we've been able to do it all in the existing footprint with some minor modifications within plants. So, it's targeted on specific plants around COVID, so you're looking at Jersey Shore, Kinston, Waterford, Eschweiler, or in Singapore. So again, it's spread right across the globe and targeted into very specific plants to meet customer demand.

As we move out and if we had to add footprint, again, it would be on those specific sites. And I think for something like Waterford, we can do it relatively quickly given the design of that facility. It's done on a modular basis. So, all the services and everything are already in. So, it's just a matter of putting on the different extensions that we need and we can get into production a lot faster using that methodology rather than building a site right from scratch. So that was – it's – that's the way it was designed to allow us to respond quicker. And so, again, right now, we don't have anything where we need to add footprint. And – but that's going to come at some point. But, again, the way it's designed, I don't think it'll be at the same level of investment that we've seen in the past when we've done buildings and the length of time to get product through them will be a lot less.

David Windley
Analyst, Jefferies LLC

Q

Got it. Okay. Okay. If I could kind of focus in on this year a little bit, maybe a little bit more of a micro question, but you got to a really strong start in the first quarter both from a Proprietary Products standpoint, and then, I guess, Contract Manufacturing was back at kind of a 4% level on some tougher comps, but has been at that level for the last couple of quarters. So, how should we think about the cadence of your progression through the year, over the remaining three quarters? Can you give us a sense for how – maybe COVID is the biggest influence there, but how we should think about revenue getting out of the remainder of the year?

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

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Yeah. So for COVID, we had $103 million in the first quarter. About $12 million of that was a one-timer. So you get about $90 million. Then you'd run that out over the year, you would kind of annualize, say at $360 million, we guided $345 million. And the reason for that is, typically in Q3, we have some plant shutdowns mainly in Europe for a couple of weeks. So, we're doing a lot of maintenance. And then, the fourth quarter is usually a bit shorter from the number of production days compared to the first half of the year. So, it's trying to strike that balance, and we didn't assume any business that isn't already approved, so vaccines that are approved. So, again, we'll see how that plays out for the remainder of the year and if there is incremental demand [indiscernible] (21:59). [ph] Does that help (22:02)?

David Windley
Analyst, Jefferies LLC

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Right. In light of the kind of commitments by the vaccine manufacturers to grow doses in 2022, is it logical for us to think perhaps with some lead time that your activity would also be on a – generally on an upward trajectory as we move toward 2022 and just kind of – that contrasts with what's baked in your guidance?

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

A

Yeah. So, we are layering in more equipment. So, if there is that incremental demand, as we said, our first phase is coming onboard in the first half of this year. The second phase of CapEx really will be – we'll be onboarding it late 2021, early 2022. So that will be a 2022 impact rather than 2021. But as I've said, we are layering in extra capacity. So if there's need, it should be there.

David Windley
Analyst, Jefferies LLC

Q

Okay, okay. You mentioned the change in the kind of the growth algorithm, 6% to 8% holds, but the contributors to that 6% to 8% are shifting a little bit and the Biologics piece of that is favorable to your margin. Is the 100-basis-point per year margin construct also is still applicable or do you think that benefits to the positive because of the contributions to growth?

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

A

It still applies because again you're growing 100 basis points each year off a bigger number. So, the – whatever – the low-hanging fruit isn't – there isn't as much of it as it may have been in the past. So, as we work through this, we need that conversion to high-value products to do that 100-plus basis points and together with the other initiatives that we have ongoing with our operations and the level of digitalization that's happening within our business. And, again, like if we can do better than 100 basis points, we will. We're not constraining this. But what we're saying is that our commitment is to grow 100 – at least 100 basis points each year and to deliver on that. And if we can do more, we will.

David Windley
Analyst, Jefferies LLC

Q

Got it. Last question, on the costs' side, seen some increase in commentary around inflation both from a commodity standpoint and from a labor standpoint. Are you seeing any of that show itself in your business and how able to pass that through is West?

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

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So, on the materials' side, we have seen some – that majority of it we can pass through, but it usually takes one or two quarters for that to happen. It doesn't happen in the quarter where we see the increase. But it's not overly material for us, so we can absorb it. And on the labor side, we have seen pressure on hiring, particularly around some of our facilities and that has impacted some of the rates that we've had to pay. But then to offset that, as I said earlier, we're running our plants 24/7. So, we're picking up efficiencies there to help absorb some of those cost increases. So, again, no impact, like we're not using that as a reason for us not to achieve any of our goals.

David Windley
Analyst, Jefferies LLC

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And is there – Bernard, on the last point, is the 24/7 operation, is that sustainable in the long run? Can you continue to do that?

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

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Yeah. Again, it's on certain product lines within certain plants. It's not right across the board. So, it is sustainable. And given we may get relief when we layer in this equipment that we've talked about for 2021 and 2022, so that may – that will help us reduce the reliance on 24/7. But right now, it's required.

David Windley

Analyst, Jefferies LLC

Got it. Got it. Very good. Gentlemen, thank you very much for your participation in the conference. Great to hear your insights. And I'll wish you the best in your meetings this afternoon. Thanks to the audience for your attention and I wish you a good day. Thank you.

Bernard J. Birkett

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

Thank you.

Eric Mark Green

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

Thank you.