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West Pharmaceutical Services, Inc. (WST)

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CORPORATE PARTICIPANTS

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OTHER PARTICIPANTS

Luke Sergott
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MANAGEMENT DISCUSSION SECTION

Luke Sergott
Analyst, Barclays Capital, Inc.

Hi everybody. I'm Luke Sergott, I cover Life Sciences Tools and Diagnostics here at Barclays. It's my pleasure to have with me, West, we have CFO and COO, Bernard Birkett and Quintin Lai, who heads up everything else outside the CEO role. So I guess, we just got it.

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

Yeah, that's true.

Luke Sergott
Analyst, Barclays Capital, Inc.

Yeah, that's true.

QUESTION AND ANSWER SECTION

Luke Sergott
Analyst, Barclays Capital, Inc.
Q

So let's talk about the Annex-1 regulatory shifts, can you give us a high level of what's going on there and how you guys see that impacting your business over the next three years – three months to the rest of the year?

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

Well, first of all, Luke, thank you and thank you to Barclays for inviting us here. Really appreciate the opportunity. Annex-1 is just one of several things that have been talked about in the industry. And in the past, we've talked about how global regulators continue to look for ways to improve the quality and delivery of drugs, especially injectable drugs for the patients in their region. In this case, Europe has been taking a look at parenteral drugs and looking at the quality. And it's going to affect a lot of the manufacturing, including elastomers and Seals, as well as other areas that are in the primary packaging and delivery, and looking to reduce the particulate load that patients are exposed to.

It's gone through several comment periods, they are starting to formalize some of the regulations and some of the implications and requirements are going to come out over the next few years, starting at different times this year, next year, et cetera. And as we look at it, we think that that given that the exposure that we have and the sales that we have to customers in that region, that there are some legacy products that we sell that could benefit from moving to a higher value product that we offer and to the tune of several billion components over the next few years.

Luke Sergott
Analyst, Barclays Capital, Inc.
Q

And so is it a – so you're talking about taking a deeper look into the particulate matter. Does that require anything from your – any investment on your side on the manufacturing [indiscernible] (00:02:36) step up, QA, QC?

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

Well, we already cover it by the products that we offer through our high value product range. So there's various levels of – higher levels of quality that will take care of the Annex-1 issues or the problem that's trying to be solved with it. So it's really having customers convert their standard product to HVP product. And then even within the HVP product portfolio itself, customers may move further up that and curve over time. And we expect this to – it's going to take time for that to happen. We believe it's a multiyear process, we don't see one big large event happening, so it'll bleed in over time.

But it helps support our mix shift strategy and links back into our long-term construct 7% to 9% growth, which will be focusing on that mix shift element. And that in itself drives higher levels of profitability. So it's not really a volume play for us, it's converting volume that exists already and then any growth that comes from that.

Luke Sergott
Analyst, Barclays Capital, Inc.
Q

Have you already started to see – I know you talked about in the quarter 1 point of revenue headwind from a conversion towards this. So give us a sense of early demand or early conversations that you're having, timing and how that kind of is going to shake out?

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

A

Yeah. So the one that we called out when we gave guidance earlier this quarter was really that customer was ready to convert, they had the work actually done. But given some things that were happening internally with them, they decided to postpone this. So it's not, if but when, is the question on that. So to get there, we've been working with that customer probably for over a year to get them prepared and making sure that we have the infrastructure in place to support that.

For future customers who want to convert, we have been layering in capacity around our HVP processing, particularly around Envision and Pharma Wash to be able to support that incremental demand. And so, there's a number of conversations ongoing and as we said, we haven't baked a whole lot in this year, but when we move past 2024, we will see more of those conversions take place.

Luke Sergott
Analyst, Barclays Capital, Inc.

Q

All right. Do you think that the FDA [ph] follows through (00:04:59)?

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

A

If you look at – we're not going to comment on specific regulatory agencies, it's easier for us to talk about things that have been implemented or codified. But one thing, global regulators, they all look at each other, they get information from each other, there's a lot of information sharing. And so I think from our perspective, our expectation being in this industry is, we expect general regulations to continue to raise the bar over time.

Luke Sergott
Analyst, Barclays Capital, Inc.

Q

Yeah, makes sense. You talked about your February order coverage being higher than the pre-pandemic levels. Give us a sense of how this trended, let's say, from November, December through January, just to kind of get an idea of the momentum that you guys are seeing?

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

A

Well, it's not that our February coverage was greater than pre-pandemic, and what we called out again when we gave guidance to say that we were going to see most of the destocking event take place here in Q1 and then we would expect to see progress from a revenue perspective as we move through the rest of the year with incremental step ups each quarter.

What we looked at, to give us a level of confidence around that, is looking at the order patterns, particularly in the back half of the year, where we're seeing as a percentage of forecast the number of orders that we have in place today versus pre-pandemic levels. And so that percentage of forecast is covered by actual orders in our system is greater than what we would have seen pre-pandemic. So we know that cover is there and we're seeing that strength. And what we also commented on was that, over the last month or two, we've seen the cadence of orders coming in, and a little bit ahead of where we originally predicted. Now, when that product gets delivered, it could be – some could be Q1 into Q2 or Q3.

But we are seeing that, which gives us confidence that at this point, we believe, we've ring-fenced that destocking event based on these data points that we're seeing. And that's given us that level of confidence around our guidance.

Luke Sergott
Analyst, Barclays Capital, Inc.
Q

Is there a particular – is this orders starting to recover quicker? Is this particular customer or is this a group now, [indiscernible] (00:07:32) is this wholesale?

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

It's across the board. Again, it's really a data point, it's not as if it's a huge number and what we are a little bit ahead of where we expect it to be. So we felt it was important to share that information as soon as we started to see that materialize, just to support the narrative that we had given around the guidance.

Luke Sergott
Analyst, Barclays Capital, Inc.
Q

Okay. And then I guess let's turn to the Biosecure Act here. I mean, we're kind of jumping around all over the regulatory areas, but – so are you – how do you think about with [indiscernible] (00:08:04) and the manufacturing and the impact on them? Like, how do you guys see that shaking up near term for you? Is that like a disruption for you or I mean, obviously, the work is probably going to get taken up by somebody else. Is this more of like a push out like how do you guys think about that?

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

Yeah, I'm not quite sure how that fits in. All right, we'll go to next one.

Luke Sergott
Analyst, Barclays Capital, Inc.
Q

So on the – let's go through your guide for the year. So 2% to 3% for the full year, you just talked about your LRP being 7% to 9% and then give us the underlying assumptions [indiscernible] (00:08:47)?

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

So around the 7% to 9% is really made of three components. You've got volume really 2% to 3% price, again 2% to 3%, and then the rest is made up with mix shift. And those three components have been fairly constant as we've been looking at the LRP and the volume with that's typically what we see on an annual basis. But the volume does vary between our market units, so biologics will be higher than that. And then generics and pharma, around that range or a little bit lower.

As we see it progressing through the year, as I mentioned, in Q1, we're going to see the major impact of the destocking. And as we move into Q2, we do see some improvement and getting back into construct as we exit the year.

Luke Sergott
Analyst, Barclays Capital, Inc.

Q

All right. And then the HPV device manufacturing headwind to start kind of walk through what's going on there?

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

A

Yeah. So that's really around an event. We're onboarding an automated line to support our delivery device business and that's taken a little bit longer than we would have anticipated given the complexity involved. So we have a lot of demand for the product, our issue is actually meeting that demand right now. So we're capacity constrained, so when that comes in towards the back end of the year, it will actually free up that capacity and we'll be able to start beating customers' expectations. I'd say that's more of a right at the back end of the year early into 2025.

Luke Sergott
Analyst, Barclays Capital, Inc.

Q

And as you think about this new volumes coming through that that new line or the process, is that going to – have you made any operating efficiencies versus your legacy business? Or is it just really a one to one?

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

A

Well, there will be some operating efficiencies given the level of investment we've made, but it's really can we get the throughput and meet that demand? And then you get a more, I think, sustainable and robust manufacturing process when that's in place.

Luke Sergott
Analyst, Barclays Capital, Inc.

Q

Yeah. And then you also – and you guys talked about you had a customer upgrading to the higher tier, high-value products and that kind of being a little bit of a speed bump, if you will. What's going on with – how long does it typically take for a customer to switch? Is there like do they have FDA submission? Like what goes on?

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

A

It depends, so if you're looking at, let's say, a customer that is using a formulation of ours that has been around for quite a long time and there's been grandfathered in, because it was approved years ago. If they were to move to a new formulation, you're going to have to do full stability testing. And so, it's going to be time, effort, cost in order to show that it can be – that you can move to that.

If it is something that is already using what we would call a modern formulation, but they right now, just by unwashed, then it's more of a process. So because of our processes of washing, sterilizing in vision, you're not really doing anything to the native rubber, you're just making it cleaner. Those are much easier kind of addendums and so, depends on what the customer is looking to upgrade. And we think that there's opportunity for both, for both legacy formulations as well as those that may be using the modern formulations, but at an unwashed level to move up.

Luke Sergott
Analyst, Barclays Capital, Inc.

Q

All right. And then so, on your guide, can you give us the underlying assumptions for proprietary products in the contract manufacturing?

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

A

Yes. So the contract manufacturing, we would expect to be flat for the year. And then on our proprietary business, you're probably looking about just north of 3% growth, so that gives you the range of 2% to 3% on the guide.

Luke Sergott
Analyst, Barclays Capital, Inc.

Q

And then on the proprietary, can you dig in on what you guys are – your underlying assumptions were for the HPV components, devices and the bulk?

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

A

So the way to look at components, which is still the majority of our HVP, will be growing within [indiscernible] (00:13:22). And we think devices which are a much smaller portion of it right now, only 10% of our business we think will grow faster over the near term.

Luke Sergott
Analyst, Barclays Capital, Inc.

Q

All right. And on the devices side, as you guys think about that kind of scaling up and growing, it's helping, I understand, small portion but what's – give us a two- to three-year outlook for that, like how that growth is going to look like?

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

A

So devices is a little different, so when you compare to our component side, so the component side, we sell to thousands of customers. They sell too many drugs, it's a more of a portfolio. When you start looking at devices, in the case of things like our delivery device devices, there's only a handful of customers and it really is a function of the success of those customers have with their drugs. So it can be more drug dependent and so as our customers continue to gain traction, increase indications, perhaps move into new geographies, we have an opportunity to grow as they grow volume.

Luke Sergott
Analyst, Barclays Capital, Inc.

Q

All right. And then with the high level biologics approvals that we've had – last year, I think we crested over what we did in 2022 or 2021 and 2022. So how long typically does it take, you guys see that to scale up through your portfolio? Obviously, as soon as you manufacture, you're on it. But as you transition through that up to the scale of the HVPs.

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

A

So the recent approvals, especially biologic large molecule, they usually start up with modest volume. And now that incremental volume that does come in, usually is associated with our highest-value product. So FluroTec, for example, NovaPure. So that [ph] DeltaV (00:15:28) is multiplied by something that has got a pretty good price, which then generates that sales contribution. And then kind of like what I said with devices, as those customers get success, they see indications expansions as they move into new geographies, then the volume does increase.

So that has been the pattern that we've seen and so, newly approved Biologics, they start off modest, but then as they continue to gain traction and adoption, reimbursement, other drivers in the market, then it becomes a bigger and bigger portion for us. And so if you look at just our sales, I mean, 2016 of the three market units we had, Biologics was the smallest in terms of sales. Here we are now in – as of 2023, it is now the largest and that just shows you the impact of the growth of – especially, some of the drugs that have been introduced over the last eight, nine years.

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

And so typically what we see – and it's again, it's within that 7% and 9% construct that Biologics grows double-digits on an annual basis and then the vast majority of Biologics is HVP. And then in generics, you get mid to high single-digit growth and there is HVP participation there.

But again, it's at a lower level and there's still a market that we can capture. And then the lowest level of participation of HVP is in pharma. And again, that's the lowest – that's kind of low single-digit, mid single-digit growth for us. So the focus for us is really a lot of it is around Biologics and that leads back into that HVP conversion of growth and then leads into the operating margin expansion.

Luke Sergott
Analyst, Barclays Capital, Inc.
Q

And then within that 7% to 9% construct and Biologics at double-digits, like it's clear that the demand from the overall industry and the number of drugs coming out continues to increase. But, talk about the investments that you're making or you guys need to make to maintain that growth? You've talked about, I think, 70% of your [indiscernible] (00:17:41) CapEx going towards growth.

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

Yeah. So typically, pre-COVID, we were investing around 6% to 7% of revenues in CapEx. And at that time, we were probably seeing about 50% to 60% of the CapEx targeted towards growth. So what we have seen is, we've had to step up our CapEx deployment over the last number of years. I think last year we ended at about $360 million, this year we're targeting $350 million. So just over 10% of revenues, 10% to 12% of revenues. 70% of that capital is deployed against growth initiatives and much of that is targeted towards high-value products.

And again, so that was responding to COVID, putting the infrastructure in place for really pulling CapEx forward in a response to COVID. But knowing that we had that HVP growth coming, even if COVID went away, so we needed that capital in place. And it's for things like Annex 1 for just the normal growth rates we're seeing around Biologics. So this year the CapEx remains [ph] elevated (00:18:57). Over time, we expect it to normalize back to around that 6% to 7% of revenues.

But again, we have to make sure that we have the processes in place and a lot of it is the investment is around adding additional process capacity around Envision, Pharma Wash to support conversions and like the type of things that Annex 1 will drive.

So, on the HVP in the past what we would have seen, the conversion was really on people layering in new drugs, but with Annex 1, we'll actually be converting existing drugs to HVP or moving them up the HVP curve. So we will provide a little bit of acceleration to that over time. But again, it's not one standout event.

Luke Sergott
Analyst, Barclays Capital, Inc.

Q

Yeah, I was just going to ask, like, do you have your existing – have you made the necessary investments for like the next one to two years of volumes expected from Annex 1?

Quintin John Lai
Vice President-Corporate Development, Strategy and Investor Relations, West Pharmaceutical Services, Inc.

A

Yeah. Those investments are done for the next one to two years. What we have to look out is past that nearly two to three, four-year horizon, given the time it takes to get that capital equipment ordered and then deliver it, so you're looking at 12 to 24 month timeframe. So we always have to be ahead of the curve.

What we've actually built in is some headroom and capacity to allow us to flex more in the future, rather than being so reactive to pretty large spikes in demand. We want to have the capacity in place, so we can maintain our lead times and maintain consistent supply to our customers.

I think over the last couple of years, we saw a spike in lead times to over 50 weeks in some instances. And we have brought that back down to more normalized lead time rates. But again, that's something that we were trying to avoid in the future. So we're not getting this whipsaw effect.

Luke Sergott
Analyst, Barclays Capital, Inc.

Q

Makes sense. On pricing, so you have I guess 5.5 points in 4Q, just what are your assumptions there and for 2024 and kind of walk through where are you able to get pricing. Obviously the HVPs versus more commoditized, but just any pushback in normalized rates?

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

A

Yeah. So we're – this year and it kind of ties in with what's in the long-term construct as well as like 2% to 3% on price. I think last year was a [ph] miss (00:21:24) The price gap was a bit elevated based on we were trying to cover a lot of inflationary costs as well.

So we're in a position to be able to pass some of that on to customers and be able to have those conversations. But on a kind of more normal operating model, we target that 2% to 3% and there are certain areas, it depends whether we have contracts in place with customers or if they're just going from purchase order-to-purchase order, you have to look at the ability to raise prices in different areas.

So for us, we don't operate a price list, so it's not a flat 2% to 3% across the business. And so we have greater flexibilities in some areas versus others.

Luke Sergott
Analyst, Barclays Capital, Inc.

Q

All right. And within that, that's 2% to 3% on Biologics or should we expect a little bit more for mix in that long – in that LRP construct?

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

Again, it depends on how much of that business is contracted and then how much of it is also coming like that's pure price. There's also the mix shift gain that we get when we move people up that high-value product curve. So we got to look at it in a couple of different ways.

Luke Sergott
Analyst, Barclays Capital, Inc.
Q

Yeah, so what I'm just trying to figure out is, the patient volumes – the patient populations are getting smaller, drugs are getting more complex. So like some of the offsets that you have available to offset those lower volumes and as you're thinking about that LRP and double-digit growth?

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

Yeah, but I think when we look at Biologics, there is the ability to get more price there versus in our pharma business, where we're dealing with a lot of standard products and it's a little bit more price competitive. So that makes it more challenging again. So it's really looking at where is the value capture versus what we're providing to the customer.

Luke Sergott
Analyst, Barclays Capital, Inc.
Q

Okay. Probably the last one here. So talk about the investment you guys made into the integrated systems in the wearables, as the drugs go from IV bags to subcu and expected at [ph] IO (00:23:29) patent cliffs and that like just give a sense of what you're doing there?

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

Well, so two different things. So on the integrated systems, I think that goes under an overall push in the industry and by regulators to continue to raise the bar. And so there is a lot more scrutiny on devices like prefilled syringes that they should operate like a [ph] true (00:24:02) integrated system as opposed to what it is now, which is a bit more piecemeal.

Customer picks an Elastomer, Seal, a glass supplier, et cetera, and then puts it all together and calls it a system. What we envision is that, that if you actually have it fit for purpose, where it's a dedicated Elastomer, a glass system that has been validated with higher specs and higher reproducibility and reliability, we think that we can provide incremental value.

With respect to the wearable side, that just follows the trend of, how can you make healthcare more accessible? Today, if you have a patient that has to travel to a clinic to an infusion center, that's just a barrier for patients to adhere to the regimen. But if you can enable them to go and get treatment at their own home to have more self-care, now you can open up better adherence and better applications.

And so as companies are able to reformulate and get it into volumes of 3 to 10 CCs, now it puts it within the realm of delivering devices like our [ph] SmartDose (00:25:31) device, which can do bolus or basal delivery in a variety of times. And again, just adds more value to the healthcare system.

Luke Sergott

Analyst, Barclays Capital, Inc.

Makes sense. All right. That's all I have. Thank you.

Bernard J. Birkett

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

Thank you.