West Pharmaceutical Services: What Opportunities Await With GLP-1s?

Former Executive | Moderated Call | Moderator: Shane Sullivan | May 12, 2023 | 35 Min Read

Relevant Companies: WST | GLW | Schott AG | STVN | Daikyo Seiko, Ltd. | Gxi | ATR | Datwyler Ag

Heino Lennartz, Former Vice President and General Manager, Global Pharma - West Pharmaceutical Services

AGENDA

- Where do components manufactured by West Pharmaceutical Services fit within the value chain for pharmaceutical packaging in injectable drugs? Who are West's closest competitors?
- Which of West's components are incorporated into the primary packaging of GLP-1 drugs? Are GLP-1 drugs likely to utilize a similar proportion of high-value components as COVID-19 vaccines?
- What are the other post-COVID-19 headwinds and tailwinds for West's Proprietary Products and Contract Manufactured Products segments? What will drive future demand for West's high-value components?
- What is the current status of available capacity among primary pharmaceutical packaging providers? What is West's likely post-COVID-19 trajectory of margins and capital allocation priorities?

HIGHLIGHTS

On Stevanato and Gerresheimer:

"Stevanato for me is the company very close to the market and really looking to what the market needs are... Gerresheimer, I think – first of all, I don't know whether they have reached in the meantime already a stability level from its management... I think when you look into the capability from a glass perspective, from my point of view, Corning, with Valor, is best-in-class at the moment, then Schott, and then comes already Stevanato. I think from my perspective, Gerresheimer is a little bit behind here."

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Shane Sullivan: Hello everyone. Good morning and thanks for joining us on today's call concerning West Pharmaceutical Services. Before we get started, just one reminder for those in the audience listening in. If you have any questions that arise over the course of the conversation that you'd like me to relay anonymously to the Advisor on your behalf, feel free to email us at Ask@Guidepoint.com and I would be glad to do so. With that Heino Lennartz, I'd like to thank you once more for taking the time to join us today. It should be a very interesting discussion. To begin, would you mind introducing yourself and providing us with an overview of your background, please?

Heino Lennartz: Thanks, Shane Sullivan. You're welcome. I'm happy to join that call and hopefully help some people to better understand the West business. My name is Heino Lennartz, and I was at West more than 12 years in different roles. I started there as the European head for all the business affairs with a responsibility of nearly a third of that entire business, manufacturing business. Then as we went forward, we have seen that a lot of changes were going on in the market, specifically through globalization and the three presidents, at that point of time, three regional presidents came together and made a proposal to the board of directors that we should change our regional business into a more global business from a customer perspective. I ran then the so-called pharma business unit, and I was the vice president and general manager of the pharma business unit, representing also roughly a third of the proprietary business of West Pharma. I left West in 2018 to become a self-employed consultant and coach for a lot of people and companies.

Shane Sullivan: You referenced some relevant points just now, but what are the highlights from West's recent operating history? How has West evolved strategically over the past decade?

Heino Lennartz: I think when you look into West's business, West is predominantly really focused on primary packaging components plus the contract manufacturing part. When you see the markets are growing year over year tremendously, West was faced with a lot of capacity constraints over the last decades, and West has managed quite well to increase the capacity based on the market demand. To a certain extent, the market demand was suddenly higher than the capacity established, and it takes a while in order to go forward to establish new capacity, roughly when you make the decision to increase, for example, manufacturing capabilities, it takes you normally 1-1.5 years in order to really ramp up capacities.

Then the important thing is you measure that with the business going forward. Otherwise, your fixed cost base is just increased and you're not able to manage your margin levels. That's sometimes the margin pressure you see in the financial results. At this point in time, we are just coming out of that COVID crisis to a little bit of the surprise quite rapidly now. West was really faced with COVID as a huge demand, and everybody was pressing for capability specifically in primary packaging. We have seen also some changes in regulatory environments, fast track approvals and West was really benefiting on that in order to get up capacities much steeper than originally planned.

Due to the regulatory environment and the pressure, West was able to absorb nearly 100% capacity now because in some of the facilities, the third shift or even the weekend shift were suddenly brought upward and have increased the capacity levels so could somehow have no surge capacity left, and particularly in that consolidation phase where we are now, we need to see how the capacities are moving forward and we come to that potentially later. The investments into new facilities take a while and West has done I think there quite good job in order to grow with the markets and have also the margin levels in their background.

When you look into the regional businesses, West was coming out of a regional remit and has changed in the years 2015, 2016, to a more customer focused organization. As we have seen globalization going forward, it was absolutely adamant that t

he customers are really getting a global service, and West has shifted from a regional based business into a customer and market led organization with three business units - biologics, pharma, generics for the proprietary business, and then the contract manufacturing bit. The contract manufacturing bit was in some of the occasions also led by the proprietary guys when it comes to global contracts in, for example, diabetes care.

Shane Sullivan: To round out this introductory piece, what exactly does West offer customers on the Proprietary products and Contract Manufactured products sides? In that respect, where does the company fit into the primary packaging ecosystem for injectable drugs?

Heino Lennartz: I think we need to understand that primary packaging in itself describes every component which touches the ingredient, the active ingredient, so the drug, and primary packaging for liquid drugs or freeze-dried drugs or lyophilized drugs, that's West business. Everything which you need to capture or to pack a liquid drug is normally a vial or a syringe or a cartridge system, and the proprietary business then of West is all components out of rubber and aluminum, which is then a secondary seal in order to close the cartridge, a syringe or a vial. The vial means stoppers, depending on lyo or serum stoppers, syringes, plungers and needle shield or tip cap. a cartridge system is a plunger in the backward of the cartridge. Then on top of that, there's a specific West designed double rubber layer closure system with a cap on top of it. That's the proprietary part.

When it comes to the contract manufacturing business, the difference here is West is manufacturing non IP business of West, so the IP is owned by the customer, and that's a completely other business model like in the automotive sector, a little bit comparable, but the norms are quite, quite different. The contract manufacturing piece is normally driven by concepts of the customer. West is then converting the idea of the customer into a manufacturing process. It's selling the manufacturing knowhow plus the efficient manufacturing. The margin levels are also quite different. As you can imagine, a non-IP based business has lower margin levels.

Shane Sullivan: On the Proprietary Products side, West's management team has talked about high value components, which of course present an outsized margin opportunity. What exactly separates component brands like FluroTec and NovaPure from standard components like Westar? Why are biologic drugs viewed as a growth driver for high value component uptake?

Heino Lennartz: You need - I think there are two things. One is the process, and one is the product feature. Let's start with the product feature. A FluroTec stopper or a FluroTec plunger is coated in a specifically coated rubber, which is per nature quite dirty. You avoid any contact because you the FluroTec or the foil face is to the active ingredient, so you avoid any contact with the dirty rubber or any interaction. The people who are talking, or the specialists are talking, so-called leachables or extractables profiles. You avoid any contact over the lifetime of the product and the shelf time of the product. That's a specific product feature, and that is a high value product because compared to standard components, you don't have that foil on top, so you have a much lower valued product and the additional product steps in order to get the foiled product are quite extensive.

The second thing is process know how. Process means when you look into what West is doing in the entire value chain of getting, let's say, components together with the drug in a container technology. Normally, for example, a lot of cleaning step like sterilization processes were done by the pharmaceutical customers themselves. West has taken over, because of capacity constraints of the customers, a lot of steps of their cleanliness in order to provide now stoppers in a different format, not just rinsed with a water environment. It's now the entire components are rinsed with WFI - water for injection - and this is much cleaner. You can think about the whole process steps which have been prior done by the customers are now under the umbrella of West. That drives the value add into the products you are now serving to the customers. That's the difference between bulk production from a product feature perspective - think about FluroTec coating - and the process feature, like I explained in the sterilization or in the water treatment.

Shane Sullivan: When it comes to biologic drugs, why are those shipped or manufactured disproportionately with high value components?

Heino Lennartz: When you now think about the cost of a product. We're talking about biologics like, say, a cancer or an oncology drug syringe, which is the market value of that is roughly $1,000, $1,200, or even more. You want to avoid that you have any cross-contamination, you have any issues with the packaging component, so you go for the lowest risk profile in order to package your product. If you have a lower cost product, like an insulin cartridge, which is sold for less than a comparable price of a can of Coca-Cola - once Novo Nordisk told me - then you need to take under consideration different economics.

Going back to biologics, biologics have, from a packaging component perspective, enough leeway in their final selling price that they can go for the best packaging component and then they will reduce the risk profile. They go for the top-notch packaging components in order to package oncology products. That's why FluroTec or NovaPure products come to fruition into these products. Does that make sense?

Shane Sullivan: Absolutely. Perfect. What is West getting up to when it comes to containment solutions - the Crystal Zenith brand with Daikyo vials, syringes, cartridges, as well as their self-injection platforms like SmartDose and SelfDose?

Heino Lennartz: I think here also a lot of product features we need to take and to take under consideration. Let's start about the container technology. Crystal Zenith. It's a, if you will, plastic syringe compared to a glass syringe. In some of the products you have, from an injectable perspective, they have a high problem, if you will, with silicone oil. The interaction with silicone oil is potentially reducing the shelf life of the product or diluting the product or give them any problem with the final drug, means in a glass syringe, in order to move a plunger forward, you need a siliconization or oil that the plunger is moving. Otherwise, the rubber is stuck in the glass. That's different in a Crystal Zenith syringe. Crystal Zenith is a, like I said already, a plastic environment where these features of glass doesn't really occur, and you can move plungers if you design that potentially adequately without any siliconization, that means you don't have a dilution effect.

The second thing is you can directly glue to a certain extent or bind a needle, if you have a staked needle syringe together with the plastic Crystal Zenith, whereas in normal glass syringes, there is a specific glue you need to put into glass that the needle stick to the glass, and that can cause also interaction or leachables into the product, into the final ingredient. That's the number one, Crystal Zenith.

Number two, with large molecules, a different problem came into the market. This is that you have longer injection times in order to bring large molecules, especially biologics or biosimilars, into the individual's body, subcutaneous tissues, and some of the injection time is more than 10 minutes or 12 minutes, whatever. Think about holding an autoinjector 12 minutes steady and then get your injection. That's nearly impossible, and you potentially have a lot of pain with that SmartDose platform West has developed this problem was managed in order to administer a longer injection time and then take off the SmartDose patch pump from your body and you got your injection less with pain, easier to administer, and with a full dose control.

Shane Sullivan: You talked about one format shift towards autoinjectors given the factors you just outlined. In framing future capacity investments, West's management team has also discussed a shift in format mix from vials to prefilled syringes. What's driving that?

Heino Lennartz: I think when we come to a lot of liquid drugs going from vial to syringes, we have different active ingredients in mind, potentially, when we think about customer designed oncology products. This is not a bulk production anymore when you have thousands of doses directly manufactured. It's more or less custom designed or disease designed syringes or drugs, and they are captured then in syringes because you are administering not that huge mass of people anymore, so you then can have also homecare capabilities that people are able to administer themselves. Two things - one is more custom designed drugs. The second thing is home care. I think a third is the less you are going, or you need to go into hospitals, and you can do that also in your home care doctors, and they have a much better administration capability that's driving then some of the drugs into prefilled syringe.

Shane Sullivan: Can you talk a bit about West's partnership with Corning and the Ready Pack solution that the partnership provides to customers? Do you think the pharmaceutical packaging industry is moving towards all-in-one containment and stopper combinations?

Heino Lennartz: I think also here we need to distinguish the markets a little bit. When it comes to biologics and biosimilars, I would say yes, but when we're talking about big mass production, I would say that's not the case. Let's take the first one here, specifically West, Corning, and also the Stevanato Group are coming with a novel concept, which is in a vertical concentration, if you will. That's one of West's targets to look into vertical capabilities, but not to demolish the market and have problems with some of their today customers when they are going that route too far, like, for example, the Stevanato Group, they are buying also a lot of West components.

Coming back to your question, in combination with the packaging component, with the superior glass, so you have a superior packaging component from West, you have a superior glass from Corning, and then you have the best in class engineering capability for small batch production, because that's different than a huge production, which is really the Stevanato Group because they can offer filling capability. They have easy fill capability, so fast track filling and they have a lot of engineering capability to help, for example, more specifically, smaller customers. They are coming now up to the forefront. Look into the situation which we had with the COVID crisis. There was somebody who has developed an mRNA drug but was not able to get it into the market, so they needed to liaise with Pfizer. If you had a one stop shop. In that combination, you could do it yourself. That's, I think, the future for biologics, for smaller batch production, and for smaller batch production in biosimilars.

Shane Sullivan: How sticky are West's customers when it comes to Proprietary Products? If a customer wants to switch primary packaging component vendors for an FDA approved injectable drug, is that a long and costly process?

Heino Lennartz: Yes, I think I only can quote you what I was told by a lot of customers, and I give you some ballpark figures. Think about the whole registration process. We have learned new registration timing with the COVID crisis, but I think that's not potentially the normal environment. You are thinking about a three year, potentially five-year, registration procedure with all the different phases a pharmaceutical company goes through. When it comes to the real registration of profiles, once you are in phase 3, you're talking about a change of a production, in that phase, it takes you a year for all the efficacy studies, for all the aging studies, for all the different data packages and potentially causes. That's a number I've heard from our customers, roughly or approximately up to $5 million in order to change all the registration profiles.

That is quite costly and that takes time and effort, and nobody has that time and effort just to change a packaging component. Your question - how sticky is it? West is selling components which they have started to sell in the late 80s, and they are still selling the same even, that they are potentially with the knowledge of the customers cleaner formulations in place in order to change that, because that would also raise material changes, new registration profiles. The market wants to avoid such issues and reregistration. There is no real benefit for the customers.

Shane Sullivan: West's management team has talked about taking above-trend pricing increases this year. I think the historic trend has been 1% or 2%. What is the continued pricing power of West? Do West products tend to be priced at a premium relative to competitors?

Heino Lennartz: I think also here we need to look into that with different lenses. One is the natural oil price related to elastomeric price increases. We have seen due to the oil price increasing, a lot of raw material cost increasing, and West is trying to match that with their price increase. A lot of contracts in that environment, particularly in the packaging component parts based on elastomers or on plastic have index related pricing, so the benefit goes to both sides. If the oil price and the elastomer is going down, the price is going down in the next year. That's why you see a leveling of that 1% and 2% historically. Now we are in a phase from where the index is going upwards and that drives some of the 5% price increase.

The second thing is the price clauses are based on, for example, value-based pricing. Means if you have a chance to take over more manufacturing steps or increase the capability of the customers, like service offerings in packaging component optimization, in supply chain optimization, West is selling a lot of services besides its particular product. Specifically in the last couple of years, West has changed also the pure product pricing into a more value-based pricing, and you see now some of the benefits here.

Shane Sullivan: On the topic of competition, estimates suggest that West's market share in plungers, stoppers, and the like, is very high. What are the competitive moats for West's Proprietary Products business right now? How durable is that competitive advantage against competitors like Aptar and Dätwyler?

Heino Lennartz: That's a good question. I think beside that, you need to take into consideration also new Chinese competitors coming because in the generics field, a couple of new Chinese players are coming also into the market. We will see some shifts I think in the generic field where really cost plays a major role, so especially for new products. Like I explained, a change in a given established packaging component is most likely not the case. West has a huge production capacity in place and a lot of customers are really now looking more and more into risk mitigation.

Even in my times, we had a lot of discussions with customers thinking about if a tsunami hits this plant, if a plane hits this plant, so what are you going to do then? When you look to primary packaging components capacities and you look into Aptar, they have quite small capacity. Aptar is potentially the lowest risk if you're really talking about global players as customers. Dätwyler has, I think an issue internally and focusing instead of just of primary packaging component and contract manufacturing for the pharma world, they have still a business which is going into different branches like automotive or electronics, so they are not that focused.

That is sometimes the feedback I got also from the customers of West in the past. And then look into the product portfolio. West has still unrivaled product features and services. For example, FluroTec, I think both of the others have also a coating developed, but they haven't reached, I think, the market traction or haven't really found customers where they really see, let's say, OmniFlex from Dätwyler as one of the similar coating structure like FluroTec from West. The track record is different, I think, and that's why when it comes really to high value products, West is the player in the market.

The other thing is a little bit of the business focus, like I mentioned. I don't know whether that's the case still, but Dätwyler, I have heard from our customers, that they wanted to do projects with Dätwyler, but due to their investments fights internally in their three different market segments - or two in the moment, I think they only have - is then potentially giving the customers a problem to really go forward with bigger investments. Think about the investment West has done in Waterford together with Novo Nordisk. I think this wouldn't be able to do that with Dätwyler. I think the investment situation is also important. I think when you look into the generics market, let me say that also from a fairness perspective, there is some movement potentially toward India and China because of purely cost. Like I said at the beginning, there are a couple of products in the market where really a couple of cent of the packaging components makes a major difference from their entire margin levels for their entire product.

Shane Sullivan: From a generics standpoint, with the emergence of these lower cost Chinese players - as you mentioned, it's more relevant to newer products - does that potentially hinder West's ability to grow in line with the market from that particular market group? Does that make sense?

Heino Lennartz: That makes sense. But I think West has also there, let's say, a kind of answer that West has started also in India and China to have that market advantage when you look into labor costs, and to a certain extent I think when you look into labor cost increases into China, I would say this is just a few years when that labor cost advantage is gone because they have still, I think, 10%-12% labor cost increases year over year, at least in my time. We are thinking about India is potentially the rock bottom where you should produce generics components and I think West is doing that.

Shane Sullivan: Let's shift gears and talk about the GLP-1 opportunity for West. We actually received a question from the audience a bit earlier on this, not specific to West, but actually Stevanato and Gerresheimer. Could you comment on Gerresheimer versus Stevanato's significance in GLP-1 delivery systems? How important/what is the value add for these companies? Between the two, is one meaningfully positioned better than the other?

Heino Lennartz: A personal opinion I need to disclaim - Stevanato for me is the company very close to the market and really looking to what the market needs are. I think they have a quite good management with Franco and his team to look into helping the organizations also around in the entire packaging space, like I said, looking into partnerships, looking into bringing upstream smaller customers, whereas Gerresheimer, I think - first of all, I don't know whether they have reached in the meantime already a stability level from its management. As you probably know, they had a lot of changes in the last couple of years, specifically in my times.

At the end of, let's say '15, '16, '18, a lot of customers told me the reliability of the management team is quite questionable, and I think at that point of time I think the market were looking into somebody will potentially acquire Gerresheimer at that point in time. It didn't take place. I think the stability level - is my question, is that regained in order to get into bigger programs from customers. I think when you look into the capability from a glass perspective, from my potentially point of view, Corning has, with Valor, are the best in class at the moment, then Schott, and then comes already Stevanato. I think from my perspective, Gerresheimer is a little bit behind here.

Shane Sullivan: Just to clarify one point, what is their participation in GLP-1 delivery systems? Is it the containment piece?

Heino Lennartz: Yes, it's the containment piece. It's the cartridge systems. All of the primary packaging components are, if I'm not mistaken, 99% coming from West. Because it's all cartridge based. I think I have not heard about GLP-1s going into syringes. They have a normal weekly injection. Potentially it will come into a syringe format, but all of the insulins and GLP-1s are a familiar structure with insulins, modern insulins as a peptide, and they are coming normally in autoinjector with a cartridge system.

Shane Sullivan: Similarly, what is West's involvement in these GLP-1 autoinjector formats? What components does West make that would be incorporated into such systems?

Heino Lennartz: Irrespectively whether it's an autoinjector potentially used with a pen, with the syringe, sometimes they do that, but normally it's a cartridge based systems, and when it comes to cartridges, the predominant player in all cartridge system is West Pharma for insulin or diabetes care because they have a unique technology in order to - it's called lined seals, means the closure on top of the cartridge which is a double layer rubber component and then it's crimped to the surface of the cartridge with a crimped seal, and in the backwards you have the plunger moving forward in order to bring the liquid to the needle. West is producing nearly 100% of the entire market. This is the sole supplier in that market because of that unique technology.

The second thing is in combination with that, West has a huge stake in manufacturing of pen technologies and autoinjectors. In the diabetes space, West is the biggest manufacturer in the contract manufacturing environment of any autoinjector, even for Novo Nordisk, for Lilly, and also for all the other players in that market.

Shane Sullivan: From a Proprietary Products standpoint, GLP-1 delivery systems - do they incorporate primarily high value components?

Heino Lennartz: Again, high value is how you explain what is high value. In this case, high value is - a lined seal is a high value product per se in its definition, because it's a dual layer, it's a very high IP related system, and then high value to the customer because of also process related knowhow West is selling in order to manufacture the cartridges together with the closure systems. I give you one example. In order to help customers to reduce their output scrap, West has done tremendously service providing in order to bring that down to a level which is for the customers close to best in class. When you drive that service and get a system in place, including manufacturing support, packaging support, then you are also benefiting - and I said that at the beginning - not only by the component, you also process support and service support. Then you are getting a value-based pricing and that drives your value, high value, products.

Shane Sullivan: I'm also trying to figure out the true GLP-1 market opportunity for West. If you just look at what Novo Nordisk has put out in terms of their global GLP-1 sales from both a diabetes and obesity standpoint, along with the market share that they've estimated, it seems to be - this is back of the envelope math - a $14.7 billion category minimum, perhaps higher, and some of that is going to be oral in its dosage forms. For each unit of an injectable GLP-1 drug, how many dollars of COGS would West's participation capture if we think about the whole continuum of products that they offer for such systems? Are you able to estimate that?

Heino Lennartz: I would do a wild guess, and I think when you look into a pen for semaglutide, for example, I think the market value is around $200, round about. Sometimes I've seen different numbers depending on market. Let's say $200. I would guess that West has roughly 10% of that.

Shane Sullivan: Perfect.

Heino Lennartz: All the components - lined sealed, manufactured, autoinjector and plunger, so everything all in one.

Shane Sullivan: So, $20.

Heino Lennartz: Yes. Roundabout.

Shane Sullivan: During Q1 2023 earnings, West's management team noted higher than expected revenue growth for the Contract Manufactured Products segment, and they raised full year revenue growth guidance from, I think it was mid to high-single digits to low-double digits. I believe this was driven by GLP-1 autoinjectors. Is the Contract Manufactured Products business for West anywhere as sticky as the Proprietary Products business? As you said, they have very commanding share with this injection format - is that going to remain with West, do you think, long term? Are there any risks?

Heino Lennartz: Of course, there are risks. The risk here is higher because you have a non-IP related business, but West is really superior in its capability to manufacture specifically autoinjector and pen technologies. Otherwise, why would Novo Nordisk, for example, not invest into their own facilities either going with West in order to get their autoinjectors into the market? I think West is doing something very well in establishing the manufacturing concept and its related scrap into this organization.

On the other hand, West has invested into clean room technologies where a lot of customers or competitors are not manufacturing contract manufacturing bids in at least white rooms or even clean rooms. There is also, I think, West still best in class in order to your capability in the surrounding, and you can measure that directly in your related scrap at the end of the day, and the customers are paying the manufacturing scrap to a certain extent. Why would you change something which is much better to something which is worse, potentially for a couple of cents, and you don't know what you are gambling with?

Shane Sullivan: How do the gross margins compare between the Proprietary Products business and the Contract Manufactured Products business, just in terms about West's participation in GLP-1s? I know you said they were lower. Any way to frame that quantitatively?

Heino Lennartz: Yes, I think when it comes to margin levels, I'm very careful when you look into the MD&A sections of what is West disclosing their in their annual report, for example, there you can see the different margin levels of the segment reporting and I would like to refer to that.

Shane Sullivan: From a capacity standpoint in both Proprietary Products and Contract Manufactured Products, obviously on the Proprietary Products side, COVID demand has come down precipitously, but at the same time, GLP-1 drugs, especially for obesity, have been growing pretty explosively. Does West have the capacity to meet that growing demand right now?

Heino Lennartz: I think when you look into what West is investing into the different facilities, and I think the last earnings calls have given you a quite good understanding if you looked into that. I think in Americas, they from a proprietary product perspective, West is investing into Kinston, and Williamsport, and Jersey Shore, which is really the basis. Jersey Shore and Williamsport in the U.S. part are getting a lot of traction at the moment. Kinston is their best-in-class plant in the U.S. Then when you look into Europe, Waterford is the best-in-class plant beside Eschweiler in Germany, and they're investing also into a city called Kovin in Serbia, which is the lower production piece.

West is spreading their investments into proprietary environment, and then if it comes to the contract manufacturing environment, they have shells available where the customers normally pay for a lot of the investments into the manufacturing equipment, for example, when it comes to tools and things like that, and West, I think, is quite equipped with a lot of injection molding machines to absorb additional capacities. But I think what we need to look into - and I would like to frame that a little bit - in the COVID crisis, all the regulatory bodies worldwide were not looking into a lot of restrictions you have in labor time. Everybody wanted to have packaging components for COVID products, and West has really went into a nearly 100% capacity use.

Normally, the market needs some surge capacities for WHO campaigns or risk mitigation, and customers are asking for that. I think with the investment West is doing, they are, I think, on the right track in order to establish the new capacities for the market. Is that the right level at the moment? Big question mark, but I think for their advantage, the COVID capacity need is going down and going down. This can be directly converted to the GLP-1s because that's all high value stuff.

Shane Sullivan: Could you talk a bit about how the diminishment of COVID sales has impacted operating margins for West? I know that they've consistently driven down sales expectations for COVID related products in recent quarters. Do you think margins have bottomed out for West? What do you think are going to be the keys to driving that 100 basis points of operating margin improvement per year going forward per previous guidance from this juncture?

Heino Lennartz: As I tried to explain, you have all your established capacities now utilized - also over the weekends, it's a 24/7 operation in all of your facilities you have worldwide, and before the COVID crisis, you were not working in a lot of facilities like in France and Germany and some of the other jurisdictions over the weekends. So, without investing really in fixed assets, you have just increased your shift patterns, and that's directly giving you the bottom-line effect. Only by putting in labor and some material costs and a little bit of variable overhead, you have directly increased your output potentially by 20% over the year.

This is not a sustainable base going forward. We will potentially see a margin drop unless West is able to convert standard business into high value business where they increase their margin levels. I think that's a good chance in respect of GLP-1s, because GLP-1s are potentially a lot of products which have been used formerly for standard production can be converted into high value products. Here, the crux is, is the capacity established able to produce both standard or high value because of the cleanliness of the product?

Like I said at the beginning in one of my words, it depends a little bit to the surrounding. If you have a normal gray area where you produce it, or do you have a white room where you produce it, or is it a classified room that drives the difference in particular at the end in the final inspection? There's a lot of if and whens. I would guess that West can convert some of the standard components into high value components but will have a setback in margin levels due to the lower consumption rates in respect of their shift patterns.

Shane Sullivan: I think we've run the gamut on GLP-1s. Let's address a few more topics before we close out for today. Earlier in the call, Heino, you briefly referenced biosimilars. How do you view that opportunity for West when it comes to high value components? Of course, they're similar to their innovator predecessors, but given the presumably lower price point of these biosimilars versus their predecessor innovators, will they still be disproportionately packaged with high value components?

Heino Lennartz: My view on that is most of the newcomers into the market producing biosimilars will potentially copy just the packaging components they have seen in the originator packaging, just to avoid any risks because then they have a fast track in their registration profile. They have seen or they can use the same components very easily, and they have accelerated stability testing. I think the advantage, depending greatly on the price point for the final product, is to use the same components as the originator. I think that is the market trend we have seen, especially when it comes to smaller newcomers on the market out of India or China. They are then using the same components in order to have a fast to market there, which I think is the biggest gold nuggets you can earn from a pharmaceutical perspective. My belief is 60%-70% will stay with the packaging of the originator.

Shane Sullivan: In terms of opportunities and risks, West has not been a particularly acquisitive company, I think, but management has previously discussed drug delivery as one potential area where they could pursue acquisitions. Would such a move make sense for West? Are there any areas potentially where you could envision the company becoming more acquisitive?

Heino Lennartz: As I said already, I think when we look into a vertical concentration form, everything in that environment would make sense. What I mean by that is glass manufacturer, component manufacturer, like West, I said. The crux here is not to have your customers push back in some of your own behaviors. I think that was strategically every time important for the West management team, as I was part of, not to get your customer into a corner where he will potentially say - he or she say - is West still longer a partner for us, because they are now grabbing business from us? This is a little bit the problem when you are in that niche manufacturing environment.

The easiest way out is really going into contract manufacturing, but on the other hand, then you are getting into the challenge - you don't want to go just in contract manufacturing space without having the IP of the elements because then you are really gaining the margin levels. If you are still in a business environment without IP, then you better invest your money into the proprietary business. This is the small thin line West needs to find, and the product in that environment, which potentially nobody has. Like with the SmartDose, West came with a novel product none of the big pharmas had in their development, at least at that stage. I think that's the right level to look into in order to save the business discussions with your customers, and by potentially demolishing their business or taking their business, portion of their business. Can you follow me in my thinking?

Shane Sullivan: Yes, absolutely. To get a balanced viewpoint and really sum up everything we've discussed, what do you see as the key risks and challenges that one should consider when evaluating the future success of West as the business resets post COVID-19?

Heino Lennartz: I think a couple of things to summarize also what we have discussed in the last hour, roughly, the combination product, and combination product is, for example, a plunger, sorry, a cartridge system or a syringe system together with an autoinjector. And the regulatory environment is increasing for that, and West needs to monitor that very clearly and work with the customers closely together in order to be here ahead of the regulatory environment, and to be the partner of choice, number one.

Second thing out of my view is, like we also discussed, compared to the competitors, don't lose the focus on your core business, on your proprietary packaging components. This is the most important thing where you are really valued by the customers. What I think West has really done well, and is also going forward doing well hopefully, is the strong customer connection. West is, in most of the cases, well ahead in their information, in their market interest, together with the customers, very close linked up key account, global key account system, up to the highest level into the management teams of the pharmaceutical customers. That's important. It's joined to the hip to a certain extent in most of the cases.

I think the importance going forward, as we talked about, biosimilars and biologic companies, a lot of smaller customers are coming into the market. The markets are changing a little bit from big pharma to a smaller pharma environment. You need to have an answer to that. How can you help them? How can you grab that business and early being involved with these smaller companies? We have discussed now several times today high value products, means, again, from my perspective, how can you add value into the entire supply chain from starting the development of a product at our customers to finally deliver that into the patient, and how can you grab value out of that supply chain? That's not just a primary packaging component in itself.

Shane Sullivan: Well, Heino, that's it from me in terms of questions. I'm not seeing anything further from the audience either. Anything else you'd add before we close out?

Heino Lennartz: No, I just wanted to say thank you very much, and hopefully I could give you a little bit more insight, and I'm happy to talk to you again, Shane.

Shane Sullivan: Likewise. Thanks, Heino. It's been a very helpful discussion. For those in the audience listening in, if you're interested in scheduling a follow up call, please get in touch with your Guidepoint representative. Otherwise, I hope everyone has a good weekend, and Heino, thanks so much again. Always a pleasure.

Heino Lennartz: You're welcome. Have a nice weekend. Bye.

Shane Sullivan: Bye.