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West Pharmaceutical Services, Inc. (WST)

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MANAGEMENT DISCUSSION SECTION

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Hey, everyone. Our next session is West Pharmaceutical Services. I'm John Kreger, the Interim Director of Research at William Blair; and I'm also the Analyst that covers the stock. Thank you all for coming. This is the last session of the day in this room, which just means, when we get to Q&A after the presentation, we'll just take it. So, that's the one thing I will flag for you guys.

By way of disclosures, please feel free to check williamblair.com for any conflicts. We've got doing the presentation, the CEO, Eric Green. Thanks, Eric, for the time. We also have Bernard Birkett, CFO; and also Quintin Lai, Head of IR. So, they will certainly take part in Q&A as well.

So, we're thrilled to have West back. I think we've covered you guys for maybe five years. It's been a fantastic name to cover. If you don't know it, Eric will walk through the presentation, but it's a really cool kind of biologic containment, a fairly niche application, but they've done a really great job in a sort of mission-critical area for any biotech company trying to bring in a new drug to market.

So, with that, I will shut up. Over to Eric.

Eric Mark Green

President, Chief Executive Officer & Chair of the Board, West Pharmaceutical Services, Inc.

Yeah. John, thank you very much. And it's great to be with you here in Chicago, be part of the investor conference. And it's good to see everyone. I know it's the last event of today, so we'll make it a great story about West. You're right, John, we have a phenomenal history. But before I get started, I do need to, if that worked [indiscernible] (00:01:47). There we go. Okay. Just to remind everybody about the Safe Harbor statement. It's up here, but that's also available at our website, if you would like to download that and take a read, but it's pretty consistent.

And let's talk about West. It's a great organization. In fact, it started in 1923. So that means next year is going to be our 100th year event for West as an organization. And I think, if you will ask our 10,000 team members across

the globe, it's more about looking to the future, very exciting about where we're going. You think about purpose, as organizations are always looking at ways, what is our value in society? And I got to tell you, in the last 2 years, 2.5 years, it really became pointed on the criticality of West in healthcare, particularly around the vaccines focused on COVID, and we're more than just that. But it really came home to our role in our organization's ability to respond quickly to support our customers, and ultimately, the patients across the globe.

You think about the vision to be the world leader in primary containment and delivery devices, injectable medicines, and we're pretty bold by saying that we have a very strong stake in a very exciting part of the healthcare market. And the strategy around Execute, Innovate and Grow, I'll go in a little bit greater detail throughout the next 20 minutes, but I'm excited because it's the laser focus our organization has on continuously driving growth here at West to really impact all stakeholders; whether that's shareholders; our customers and jointly the patients; our team members across the globe; and also really important, the communities where we operate, live and play is very important to us here at West.

What do we do? We produce about 45 billion components a year that are coming in contact with patients across the globe. Really, if you think it from a product point of view portfolio, it comes down to vial containment administration systems, and also drug delivery and devices. So, as we think about the continuum that we play in is the primary containment and delivery for injectable medicines. That's our focus. We've been on the interesting journey, yes, for the last 99 years, but let's hone in the last five or six years. We took a look at the organization and we changed it to be more market-led, and we'll get into examples, what does that really mean in context of West and the markets that we serve?

We also started to look at our global operations. We had 29 manufacturing sites. Today, we have 25. We've doubled our size of the business, but less physical footprint across the globe, but that's a whole globalization of our global network. Frankly, without that step in our operations, we would not have been able to respond to the demand surge that we had in regards to COVID. The other aspects that we're driving is really exciting this whole digital journey. Everybody talks about digitization. But I truly believe, if you walked through one of our plants years ago, very analog mentality. Today, we've really driven a digital mentality, building the core competency within West by building a Digital Technology Center in Bangalore, and also another site in Taiwan.

We're also very excited about our ESG goals. We set goals back in 2017, five-year goals, and after a few years, we realized that we're going to blow past them. So, we reset our goals for our ESG back in 2019, which were well on the path to achieve. The business has expanded. It's a different business than it was in the last five or six years. But what we're excited is about the future and where this is going. It's a diverse business. When you think about the portfolio, from a geographic point of view outside the United States, it's greater than 55%. From a portfolio perspective, we talked a lot about high value products over the last several years. That is roughly around 63% as the end of 2021. And most importantly, the injectable medicine space is very exciting with the growth, but the sub-segment and the Biologics is the fastest growing segment with injectable medicines, and our position there at the end of 2021 is slightly greater than 40%. Not too long ago, that was sub-20%, so the continued growth in this area. We have a very diverse business portfolio that we can leverage and continue to grow quite nicely into the future.

The portfolio that has gotten to where we are today is taking the standard products that we historically have produced for several biopharma companies and pharma companies across the globe, and started to add different services, technologies and capabilities to create, what we call, the high value product continuum, and you can see, it goes all the way from the Westar ready-to-use, ready-to-sterilize all the way up to NovaPure, which I'll talk about in a moment. And also, delivery devices, such as SmartDose, which is gaining traction, particularly when you think about some biologics going from IV to subcu.

But this portfolio is what has delivered these type of results. The results, when you think about from a revenue growth perspective, is roughly around 15% constant currency growth since 2017 to 2021. And when you think about the growth engine, we underline that as Proprietary Products, and it's growing very strong double digits, and what's driving that is high value products. You think about the Contract Manufacturing, which is less than 20% of our business today; back in 2017, it was roughly around 30% of our business. It continues to become a smaller portion of our overall portfolio as sub-10% growth. In Q1, what you notice is the growth continues with our Proprietary area, driven by high value products. And we'll talk more about why that's the case, but tremendous growth over the last five years of the business.

From a profit point of view, when you think about the growth thesis of West, it's not just the top line. It's top line plus the margin expansion or profit growth. You take a look at, the driver behind that really is the high value product portfolio. Think about 2016 when we embarked in this market-led journey, roughly 15% of our products produced – units produced was in high value products. Last year, it was 19%. So, you can see that it's roughly slightly less than 100 basis points a year expansion on units. From a revenue perspective, on the far right, it was roughly 45% of the revenues of total consolidated sales at West. And at the end of 2021, it was 59%. So, more than 2x double the unit growth.

More importantly, if you think about the middle section, it says, 41.5% gross margins at the end of last year, consolidated. Back in 2016, it's roughly around 33%. So, what you're seeing there is, doesn't take a lot of unit expansion in high value products, let's call it, 100 basis points per year, to drive significant double-digit growth of the high value product portfolio, which is growing to be a more significant factor of the entire portfolio, and it had over 800-basis-point of gross margin expansion at the same time period. Again, it's a mix growth thesis for the business.

And you ask the question, is there a runway ahead of us? Can this high value product portfolio continue to grow? While we need to continue to expand, we'll talk a bit about how we're going to expand the portfolio, but when you think about the fastest growing part of the market – or the market that's growing is Biologics. In Biologics, most of the transactions are high value products. So, you can see where the real engine and accelerant is with the business. That resulted in, obviously, strong EPS growth of over 30% and outpaced the market from a valuation point of view.

I'm going to talk about a couple of highlights last year which is kind of the foundation of what we're doing going forward. What's important is that there was a lot of activity focused around COVID, but the business didn't just stop and focus on COVID. It focused on our core business, it focused on expanding our market penetration, it focused on our pipeline. We think about the new products approved in 2021, our participation rate, it was equal or greater than prior years. In the Biologics space, it's well over 90%. We launched new technologies that allowed our customers to solve complex problems with DeltaCube. We received some awards recently at some trade shows. And we're clearly on this digital journey on leveraging our assets more effectively [indiscernible] (00:11:40) from a network perspective how to level load our demand that is on the organization.

While we're doing this, we're expanded capacity, touching 13 facilities over 400 pieces of equipment that were installed, not just installed, but validated and now commercially operating. And what's exciting about this part is that, instead of, historically, our capital expenditures used to be around buildings and land; today, we're more about equipment and processes on existing infrastructure. So, when you think about rate of return, it's much faster. We're talking in over a couple of years versus a new facility takes 7 to 10 years to get up, and start seeing some type of return. So, I'm really excited about the momentum that we had in 2021 that's going to carry us into this year and the years beyond.

Also, purpose. I said earlier about how we support the local communities, how does West play in the market and be a strong global citizen? In all our ESG metrics, they're all going in the right direction, and we're hitting our targets that we've established. And if you want to see more detail in this particular space, our Corporate Responsibility Report will be published – the 2021 Report will be published later this month. You can go to our website and download and see the richness of the detail behind our metrics and what we're doing to support.

But if you could think back a little bit, going to 2021, all the activity we were focused on running our plants 24/7. The organization still was able to – team members were able to still focus their attention on over 3,600 hours volunteered to support over 250 charities. And you think about the – everybody's talking about purpose, where are we focused as an organization? What I'm most proud about, doesn't show up in this chart at all is that, during the pandemic, a lot of the manufacturing facilities, roughly 75% of our team members work in a manufacturing plant across the globe, you have an absenteeism level. And our absenteeism level during the pandemic was less than pre-pandemic. And there wasn't a carrot-and-stick. There wasn't a requirement to come in. If you weren't feeling well, stay home, please. But the focus and understanding of what we do each and every day, not the 45 billion components, but each and every one of them has a patient name on it. And that is resonating throughout all 10,000 team members across the globe. That's why you can deliver results, as you see here.

So, that's a little bit about the past. And I think there's a lot of history. There's a lot of excellent foundation that has been established. We're working in diverse platform of a business, exciting growth markets that we're involved with, and our criticality is extremely high in healthcare. But I'm excited about and my colleagues are really excited about the future. We set on a course to be more market-led. That means, through all activities we have in our organization, we have to understand what the market is pulling us to do versus what we want to push to the market? And it resonates well within our commercial organization, the R&D innovation, and also, we think of our global operations, where we want to play, where we want to invest, and how do we support the demand that is continuously being put on the organization?

Let's go a little bit deeper in one area around the markets. We've broken up our business, to those who are not really familiar with the story, into really three discrete proprietary product markets with Biologics; we lump biosimilars in there, because the solution to customers is identical; the Generics, so small molecule generics; and then small molecule innovative Pharma; and we have our Contract Manufacturing business which, like I said before, it's a little bit less than 20% of our business. Each one of these units or segments has unique value propositions that we go to market with.

We have unique teams that are focused on executing on these initiatives. It was really exciting to see, as I mentioned earlier, the growth of Biologics; for the Q1 of 2021, where 43% of our total sales was Biologics. We don't see that slowing down. Why? Again, fastest growing area of the market, we're greater than 90% participation rate on all new approvals with BLAs and other jurisdictions around the world, and we also are driving our high value product portfolio into the Biologics space. A very attractive area for our growth long term.

This focus on market-led goes into our operations also when you start thinking about some of the key levers we've been driving. And we do think there's opportunity to continue to drive margin expansion. As you think about our global operations strategy, be able to level load our operations more effectively by leveraging the global supply chain and also, now, pushing harder on our automation strategy. If you have an opportunity to visit one of our facilities, particularly Waterford or in Kinston in the United States, what you'll see is that we have prototypes of automation from beginning to end that have no human interaction of the process to drive; one, quality; two is around obviously safety; but three is around productivity and yield.

And we're looking at ways to build, do this in a very cost-effective manner. So, it's really exciting we're on this journey. We're more early innings, as you think about where we are with the automation. We're also looking at different ways to look at supply chain maturity, and how do we become more robust globally. And so, this is an excellent area to see continued gross margin expansion, as we drive performance in our global operations.

Here's an example of some of the investments we have made recently. On the onset of the pandemic, we increased capital expenditures into our organization. And one thing that we did – I think the team did the right move was that, while our customers were working on vaccines, we focused them into the areas of our FluroTec [ph] barrier coating (00:18:13) technology and all way up to NovaPure. Why is that important? That is the clear sweet spot of where our Biologics growth is happening and that's the fastest growing area. So, as the investments roll into our organization, it is fungible from a [ph] COVID (00:18:32) vaccine production requirement all the way to a biologic.

So, the investments we made and installed to be able to respond during the pandemic is actually more than just the vaccine market itself. It was for the biologic market. And so, allowing us to continue to grow, particularly around the NovaPure portfolio and the West FluroTec technology. And this is not just [indiscernible] (00:18:56) site, but it's in multiple sites across the globe, so that our customers have a global assurance of supply and the consistency of supply from wherever location they want to operate.

I think about the research and development side. This is very exciting for us as we stand today. There's really three key elements of it, but one is around the product lifecycle management, and we continuously look at ways to evolve our portfolio to be able to support the unique challenges of our customers. As we think about SmartDose as example, we don't spend a lot of time talking about SmartDose, but it's a platform that's becoming more attractive in the Biologics space, as our customers are trying to solve a pretty complex problem of moving from an IV infusion environment to a subcu.

One of the drivers, one of the accelerants that has driven this shift is around the environment the last couple of years, where you want to have patients be able to receive their therapeutics, their treatments in the comfort of their home versus going to a hospital or a clinic setting. This is a driver that we're developing. We have many development agreements. We're excited over the next several years to see how these launches occur and to support, not just new molecules in the pipeline, but molecules already existing in the marketplace today, where they want to make this transition of modality and delivery.

The secondary is, we're looking at, as we think about containment and delivery in injectable medicine space, [indiscernible] (00:20:31) organization that we've built over the last year-and-a-half to really focus on, again, looking at the drug delivery, advanced materials, and additive manufacturing and biosensors. These are areas that are close to the core, but allow us to expand and provide more complete solutions to our customers. And the third area is, the level of science and technology evolves very quickly, and we're looking at ways to continuously drive new solutions to support the advanced therapies, and other areas of science that we are well able to support.

So, there was a communication recently about one of the changes or the focus we want to elongate high value products, and we call it the next rung within HVP. And it's moving from a component mindset to more of a system mindset as you think about systems. And so, therefore, what we did is, we have an agreement that has been signed with Corning in this collaboration, which we don't provide glass in the marketplace. We don't manufacture glass, but Corning does. And I would argue [ph] there's probably (00:21:44) 100 plus years of expertise around glass science and technologies, and we're excited about this opportunity to really move more towards a component – from components to a system.

And let's go in a little bit greater detail why. Why are our customers pulling us into this conversation? So, today, what we're engaged with customers on is that the regulatory changes are happening. There's more requirements to start looking at it from a combination product point of view versus simple components. As you step back a moment today, we provide components. And our customers are looking at ways to put these components together and have a solution, and they're filing that with the various regulatory authorities, and [ph] they're getting the data to support that (00:22:31). We do that already. So, by having this collaboration, we're able to now support the ever-changing of the regulatory requirements to continue the journey of high value packaging or products within the primary packaging arena.

What's exciting about this is, here's an example. Our customers historically would have two different work streams of elastomers and glass. And what you'll find here is that the number of Drug Master Files they point towards, whether it's us or some other glass company, it's multiple; three, four, five, six, depending on the configuration. What we're proposing here and the work has been launched between ourselves and Corning is to be able to have a complete system, a truly integrated system, fully characterized with one Drug Master File.

So, we're going to the customer. We're taking risk out of their – of the combination, if you think about integrated system with their drug molecule, we're taking risk out of the system, we're providing a complete solution, and we'll be able to manufacture that on behalf, working with Corning, but it's the West product going to the market. That is, when you think about what's the next generation of high value products, you think about systems, here's a step in that direction. [ph] We have, as you see in the (00:23:53) bottom, complete vial configuration, syringe configuration and cartridge configuration.

This lines up quite nicely when you think about device strategy, when you think about combination devices all way from the containment to the delivery to the injectable medicines. So, it's the area that we didn't have the manufacturing capability, the technology. We have that now, and we're able to now build for the future, particularly around the premium area, around the Biologics space.

So, I went through a lot of detail. But the fundamentals of the business are extremely strong. We're talking about our long-term construct, is 7% to 9% on the top line. We're looking at long-term construct of 100 basis points plus per annum of expansion of our operating margin. We believe the investment thesis from a capital, while we had in the last couple of years and this year, a little bit higher than we had historically, but we do believe [indiscernible] (00:24:56) 6% to 7% of revenue going forward.

We have a phenomenal foundation of work off of. Our continued success rate on new molecules remains high, if not higher than all time. And if you think about the economies of scale around quality and capabilities globally, West is well-positioned to continue to grow in a very formidable way. I'm excited about the future. We'll celebrate the past, but we're excited about the future, and we have tremendous assets in our possession. The number one, though, is trust of the customer, and that's been built over decades and we intend to continue to build that well into the future.

So, thank you for your time, and we will probably go into Q&A in a few minutes.

John Kreger

Analyst, William Blair & Co. LLC

Yes.

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