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West Pharmaceutical Services, Inc. (WST)

Q2 2021 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Good day and thank you for standing by. Welcome to the West Pharmaceutical Services Second Quarter 2021 Earnings Conference Call. At this time, all participants are in a listen-only mode. After the speakers' presentation, there will be a question-and-answer session. [Operator Instructions] Please be advised that today's conference is being recorded. [Operator Instructions]

I would now like to hand the conference over to Quintin Lai, Vice President of Investor Relations. Thank you. Please go ahead.

Quintin John Lai

Vice President-Corporate Development, Strategy & Investor Relations, West Pharmaceutical Services, Inc.

Thank you, Erica. Good morning and welcome to West second quarter 2021 conference call. We issued our financial results this morning and the release has been posted in the Investors section on the company's website located at westpharma.com.

This morning, CEO, Eric Green; and CFO, Bernard Birkett, will review our financial results, provide an update on our business and present an update on our full-year 2021 financial guidance. There is a slide presentation that accompanies today's call, and a copy of that presentation is available on the Investors section of our website.

On slide 4 is our Safe Harbor statement. Statements made by management on this call and in the accompanying presentation contain forward-looking statements within the meaning of US federal securities law. These statements are based on our beliefs and assumptions, current expectations, estimates and forecasts. The company's future results are influenced by many factors beyond the control of the company. Actual results could

differ materially from past results, as well as those expressed or implied in any forward-looking statement made here. Please refer to today's press release, as well as any other disclosures made by the company regarding the risk to which it is subject, including our 10-K, 10-Q and 8-K reports.

During today's call, management will make reference to non-GAAP financial measures including organic sales growth, adjusted operating profit, adjusted operating profit margin and adjusted diluted EPS. Reconciliations and limitations of the non-GAAP financial measures to the most comparable financial results prepared in conformity to GAAP are provided in this morning's earnings release.

I now turn the call over to West CEO and President, Eric Green.

Eric Mark Green

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

Thank you, Quintin, and good morning, everyone. Thank you for joining us today.

Starting on slide 5, I am pleased to report that we delivered another solid quarter of growth. This was driven by strong organic sales in both our base business and the accelerating demand for products associated with COVID-19. Our high-value products coupled with productivity gains continue to fuel expanding growth in operating margins. Together, this has resulted in significant EPS growth for the second quarter.

The strong performance demonstrates the criticality of our business as the market leader in primary packaging of injectable drugs and as a testament to the foundation we have built over time with our market-led strategy, globalization of our manufacturing network and our One West Team approach, which is bringing meaningful benefits to our customers to support patient health.

We continue to manage through the challenges of the pandemic with focus on our key priorities of team member safety and ensuring uninterrupted supply of high quality containment and delivery devices. I am proud of our team across the globe for their dedication to customers, patients and most importantly to each other as we have met the demands of our business.

Another highlight this quarter is the release of our 2020 Corporate Responsibility Report. The core values of West are well aligned with our environmental, social and governance goals with a great year of achievement and accolades. And in the future, we expect even more progress as we continue to raise our ESG expectations. I encourage you to get the report which is on our corporate website. And as for guidance, we're well-positioned with the right strategy, strong core business and the incremental pandemic opportunities. With this momentum and the strong execution by the team, we're raising our sales and EPS guidance for the full-year 2021. Bernard will go into greater detail shortly.

Turning to slide 6. We continue to deliver the key drivers of growth in Q2 with strong customer demand of HVP components, including Westar, FluroTec, Envision and NovaPure offerings, as well as Daikyo's Crystal Zenith. It is clear that our unique value propositions and technical expertise resonates with our customers. As quality requirements continue to rise, we have seen growing demand each year for HVP products. Our industry-leading portfolio of film-coated components, Daikyo, FluroTec and NovaPure, are sought by our biologic and pharma customers as an effective barrier against organic and inorganic extractables and minimizing the interaction between the drug and closure while maintaining container closure integrity.

Through the first half of 2021, our participation rate in recently approved new molecular entities in the US and Europe remains strong. Our components by West or our partner Daikyo are spec'd on almost all of the biologics

and biosimilars approved so far in 2021 and a large majority of small molecules approved. And for the most part, these new drugs are using our highest level of HVPs including NovaPure, FluroTec and Westar.

This has translated into robust double-digit growth for our Biologics and Pharma segments both including and excluding COVID-19-related sales. Altogether, we continue to see sustainable, consistent growth and momentum in revenue growth and margin expansion. And we have increased visibility into customer demand as our book of committed orders continue to significantly expand and grow not only for the second half of this year but also for sales into 2022 and beyond.

Moving in slide 7 and speaking of visibility into future demand, we continue to increase the capacity of our global manufacturing network to support our growth trajectory to keep pace with the demand increase. At the outset of the pandemic crisis, we responded by accelerating our plans to expand HVP capacity, especially for FluroTec and NovaPure components. This is above our typical annual CapEx spend of approximately 7% of sales. That first tranche of capacity expansion began in May of last year. Our teams did a fantastic job of procuring, installing and validating the equipment. And all of it is now producing commercial product at our sites in the US, Ireland, Germany and Singapore.

In December, we began another tranche of investment based on increased visibility of vaccine development success and our growing base business. We expect this portion to be completed and in production during the second half of this year. Of note, these capacity expansions are within existing HVP sites and coupled with higher margins of HVP components, provide shorter paybacks and higher returns on invested capital than greenfield investments. This was made possible through the multi-year strategic transformation that our operations is currently executing, moving from a site or regional model to a global operating supply chain network.

As we discussed in the last earnings call, we have been contemplating an additional tranche as we are working with our customers to evaluate the need for even more volume production to stay ahead of both base and pandemic demand. Today, we are announcing that we have begun to execute that part, which is approximately \$80 million to support future demand of NovaPure [indiscernible] (00:08:41) as well as other HVP finishing capabilities. We expect to start in the second half of this year and be online towards the back half of 2022.

Now, I'll turn it over to our CFO, Bernard Birkett, who will provide more detail on our financial performance. Bernard?

Bernard J. Birkett

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

Thank you, Eric, and Good morning. Let's review the numbers in more detail. We'll first look at Q2 2021 revenues and profits where we saw continued strong sales and EPS growth led by strong revenue performance primarily in our Biologics and Pharma market units. I will take you through the margin growth we saw in the quarter, as well as some balance sheet takeaway. And finally, we will provide an update to our 2021 guidance.

First up, Q2. Our financial results are summarized on slide 8 and the reconciliation of non-US GAAP measures are described in slide 16 to 20. We recorded net sales of \$723.6 million, representing organic sales growth of 30.6%. COVID net related revenues are estimated to have been approximately \$117 million in the quarter. These net revenues include our assessment of components associated with vaccines, treatments and diagnosis of COVID-19 patients offset by lower sales to customers affected by lower volumes due to the pandemic.

Looking at slide 9, Proprietary Products sales grew organically by 39.3% in the quarter. High-value products, which made up more than 70% of Proprietary Products sales in the quarter, grew double-digit and had solid

momentum across Biologics and Pharma market units throughout Q2. Looking at the performance of the market units, the Biologics market unit delivered strong double-digit growth. We continue to work with many biotech, biopharma customers who are using West and Daiyo high-value product offering. The Generics market unit experienced low-single digit growth led by sales of FluroTec components. Our Pharma market unit saw strong double-digit growth with sales led by high-value products including Westar and NovaPure components and contract manufacturing had low-single digit organic sales growth for the second quarter led once again by sales of diagnostic and healthcare-related injection devices.

We continue to see improvements in gross profit. We recorded \$315.1 million in gross profit, \$120 million or 61.5% above Q2 of last year, and our gross profit margin of 43.5% was a 650-basis-point expansion from the same period last year. We saw improvement in adjusted operating profit with \$211.2 million recorded this quarter compared to \$106 million in the same period last year for a 99.2% increase. Our adjusted operating profit margin of 29.2% is a 910-basis-point increase from the same period last year. Finally, adjusted diluted EPS grew 97% for Q2. Excluding stock-based compensation tax benefit of \$0.09 in Q2 2021 and 2020, EPS grew by approximately 104%.

Let's review the growth drivers in both revenue and profit. On slide 10, we show the contributions to sales growth in the quarter. Volume and mix contributed \$152.2 million or 28.9 percentage points of growth, including approximately \$117 million of volume driven by COVID-19-related net demand. Sales price increases contributed \$9 million, a 1.7 percentage points of growth and changes in foreign currency exchange rates increased sales by \$35.2 million or an increase of 6.7 percentage points.

Looking at margin performance, slide 11 shows a consolidated gross profit margin of 43.5% for Q2 2021, up from 37% in Q2 2020. Proprietary Products second quarter gross profit margin of 49.8% was 700 basis points above the margin achieved in the second quarter of 2020. The key drivers for the continued improvements in Proprietary Products gross profit margin were favorable mix of products sold driven by growth in high-value products, production efficiencies and sales price increases partially offset by increased overhead costs inclusive of compensation. Contract manufacturing second quarter gross profit margin of 16.7% was 230 basis points below the margin achieved in the second quarter of 2020. The 2020 margin included approximately 180 to 200 basis points of positive impacts from one-time benefits.

Now let's look at our balance sheet and review how we've done in terms of generating more cash. On slide 12, we have listed some key cash flow metrics. Operating cash flow was \$233.1 million year-to-date, an increase of \$27.9 million compared to the same period last year, a 13.6% increase. Operating cash flow in the period was adversely impacted by our working capital increase as well as timing of tax payments. Our 2021 year-to-date capital spending was \$111.6 million, \$42.4 million higher than the same period last year. Working capital of approximately \$1 billion at June 30, 2021, increased by \$134.1 million from December 31, 2020, primarily due to higher accounts receivable from increased sales. Our cash balance at June 30 of \$576.2 million was \$39.3 million less than our December 2020 balance. The decrease in cash is primarily due to our share repurchase program and higher CapEx in the period offset by our positive operating results.

Turning to guidance, slide 13 provides a high level summary. Full-year 2021 net sales are expected to be in a range at \$2.76 billion and \$2.785 billion compared to prior guidance range of \$2.63 billion to \$2.655 billion. This guidance includes estimated net COVID incremental revenues of approximately \$430 million. There is an estimated benefit of \$80 million based on current foreign exchange rate. We expect organic sales growth to be approximately 24% to 25%. We expect our full-year 2021 reported diluted EPS guidance to be in a range of \$8.05 to \$8.20 compared to a range of \$6.95 to \$7.10. As we continue to expand our HVP manufacturing capacity at our

existing sites to meet anticipated core growth and COVID vaccine demand, we are raising our CapEx guidance to \$265 million to \$275 million compared to our prior guidance of \$230 million to \$240 million of CapEx.

There are some key elements I want to bring your attention to as you review our guidance. Estimated FX benefit on EPS is an impact of approximately \$0.27 based on current foreign currency exchange rates compared to a prior estimated benefit of \$0.23. And our guidance excludes future tax benefits from stock-based compensation. So, to summarize the key takeaways for the second quarter, strong top line growth in Proprietary, gross profit margin improvement, growth in operating profit margin, growth in adjusted diluted EPS and growth in operating cash flow, delivering in line with our pillars of Execute, Innovate and Grow.

I'd now like to turn the call back over to Eric.

Eric Mark Green

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

Thank you, Bernard. To summarize on slide 14, our mission to improve patient lives drives our passion to provide leading-edge, primary containment and delivery technology for our customers. Our market-led strategy is delivering as evident in our leading participation rate in new approvals and our role in support of COVID-19. Our global operations team is executing with efficiencies and improvements in service and quality to meet increased demand and we're continuing to accelerate capital spending across our operations to meet current and anticipated future growth.

In summary, the first half of the year has been exceptional. We remain well-positioned with the strength of our core business and are confident in the long-term horizon of continued organic sales growth and margin expansion. We are proud to be the trusted partner for our customers across the globe and ensure the safe delivery of treatments to patients.

Erica, we're ready to take questions. Thank you.

QUESTION AND ANSWER SECTION

Operator: [Operator Instructions] Your first question comes from the line of Paul Knight with KeyBanc.

Paul Richard Knight

Analyst, KeyBanc Capital Markets

Q

Hi, Eric. Congrats on the quarter. The – what's your view on COVID vaccine demand in the year 2022 and is the technical requirements on containment as high as other high-value products?

Eric Mark Green

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

A

Yeah, Paul, good morning and thanks for joining. Yes, we have good visibility into 2022 and some of the recent comments regard capital expansion is driven – a portion of that's driven by future demand. What you're seeing with our portfolio, the chosen configuration for a lot of these vial configuration [indiscernible] (00:19:29) are NovaPure or FluroTec solutions. So, tend to be mid to higher end of our HVPs. There is – obviously we're in discussion with customers as they are determining if there's going to be less dose per vial or move towards a prefilled syringe and also the conversation around potential boosters. So, there's many still moving parts, but when you think about the next 12, 18, 24 months we have clear visibility what we need to deliver to support the demand on hand.

Paul Richard Knight

Analyst, KeyBanc Capital Markets

Q

And secondly if you look in the – you obviously with your stability trials have a look into other biologics, would it be fair to say we continue to see acceleration in potential biologic approvals?

Eric Mark Green

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

A

Yes. What's exciting there is that not only the pipeline is rich, if you think about the more recent approvals that have been granted around the biologics, biosimilars participation remains extremely high. And the other indicator that gives us great confidence is we when you start thinking about our confirmed order book, if you think about the incremental, which is significantly up, it's really broken in, in different areas and the Biologics leading the charge for majority of that and it's around HVP. So we're quite confident of the future growth of the pipeline.

Paul Richard Knight

Analyst, KeyBanc Capital Markets

Q

Thank you.

Eric Mark Green

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

A

Thanks Paul.

Operator: Your next question is from Juan Avendano with Bank of America.

Juan E. Avendano*Analyst, BofA Securities, Inc.*

Hi. Good morning and congratulations on the quarter.

Q

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

Thank you, Juan.

A

Juan E. Avendano*Analyst, BofA Securities, Inc.*

My first question is, given the COVID revenue that is embedded in your guidance and we know that about a – more than 3.5 billion doses have been administered – vaccine doses year-to-date, it seems – and also knowing what the ASPs are for the packaging components, it might seem like the NovaPure mix perhaps is higher than or is greater than a majority by FluroTec, would you agree with that notion or not? And also on the COVID therapeutics, are you seeing more NovaPure than FluroTec?

Q

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

Yeah. So what you're seeing – Juan, thanks for the question. So if you think about the COVID solutions that we're providing, from a unit perspective, FluroTec is actually much higher than the NovaPure but we're seeing good growth in that area. But if you think about the new therapeutics that have been approved or in process through approval, it tends to be more towards the NovaPure. But when you translate from a revenue perspective, yes, NovaPure is becoming one of our top drivers of growth in our Proprietary business.

A

Juan E. Avendano*Analyst, BofA Securities, Inc.*

Thank you. Yes. That's the way the math seems to point. Okay. My second question is can you talk about the ordering patterns that you're seeing from customers? Some bioprocessing tools companies such as Sartorius have noted that they're seeing customers place orders further in advance. And so, are you seeing the same dynamic and are you concerned at all that this might create a demand gap sometime in the future when business trends normalize?

Q

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

Yeah, so Juan, one of the major pushes that we've had in the last couple years is really the visibility into our customers' supply chain and we've done a really good job leveraging some of our digital tools we deployed here within West. And that gives us confidence that the demand that we are seeing is more in line with what the demand – the pull within the marketplace. So, said differently is, yes, we're seeing more confirmed orders that are further out, but that also – we're also seeing that the increase on the number of orders more near term is also increasing. So, the confirmed order book has grown significantly, but the combination of more longer term visibility but also pure organic growth more near term.

A

Juan E. Avendano*Analyst, BofA Securities, Inc.*

Thanks. And my last one before I get back in the queue, you alluded to this in the previous questions. But – I mean, would you feel at this point as customers and sponsors are evaluating the potential migration to COVID

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packaging configuration that is smaller, fewer dose vials or even prefilled syringes, do you think that that change is more imminent now than in the last quarter? How are those talks going and how feasible is that to happen?

Eric Mark Green

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

Yeah. That's still pending, but we're having these discussions with the customers and it does require us to prepare in advance in the event that these transitions do occur. As you rightly said, if it remains within the vial configuration, we're very well positioned and that – to be able to support the growth of NovaPure and FluroTec. If it transfers into a prefilled syringe, around our plunger solutions, that's where we're also investing, make sure that we're ahead of the curve. So, it is – it's ongoing discussions, Juan, and that will be – yet to be determined at this time.

Juan E. Avendano

Analyst, BofA Securities, Inc.

Thank you. I'll leave it there for now. Appreciate it. Congrats.

Eric Mark Green

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

Thanks, Juan.

Operator: Your next question comes from the line of Larry Solow with KJS Securities (sic) [CJS Securities] (00:25:47).

Larry S. Solow

Analyst, CJS Securities, Inc.

Good morning, guys. At CJS. Good morning, gentlemen. Congrats on a very great quarter actually. Just a couple of questions. Can you just help us sort of parse out on the gross margin, really impressive on the Proprietary side close to 50% and as you mentioned I think [indiscernible] (00:26:08) basis point improvement year-over-year totally. But if we just look sequentially I'm just trying to sort of bridge. You did 46% in Q1 and I think that had like a \$12 million benefit from some cancelled orders. So, just sequentially if we adjust for that, your gross margin was up like 500 bps on a little bit – just on Proprietary side. And I know sales were a little bit higher – COVID sales or vax-related sales were a little bit higher, but – I think my math is right and is there anything sort of unusual in there that drove that 500-basis-point sequential increase?

Eric Mark Green

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

[indiscernible] (00:26:46) unusual. What we're seeing is with product mix, we're seeing a strong pickup in gross margin. So, it's just obviously the profile of the products that are being sold around FluroTec and NovaPure. And what we're also seeing is improved levels of productivity in our plants. And you can tell last year we started to move toward 24/7 mode of operation within certain of our plants to increase production. And we have been able to generate a lot of efficiencies and increase levels of productivity as we went through the early part of the year, but particularly into Q2 as we got more streamlined and some of the products that we were producing to support COVID. So, it was really working on a couple of different elements. So, it's not just one driver. It's [indiscernible] (00:27:38)

Larry S. Solow*Analyst, CJS Securities, Inc.*

Right.

Q

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

It's the mix plus the increased levels of productivity.

A

Larry S. Solow*Analyst, CJS Securities, Inc.*

Right. And I fully [indiscernible] (00:27:45) unusual and then maybe there was some like one – little one-time item some that helped a little bit like last quarter [indiscernible] (00:27:52) but it sounds like – it sounds like no, right, sounds like this is maybe not fully sustainable but there's nothing really irregular. It's a lot of just the drivers of your growth in the last several years, right?

Q

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

Well, once you start running at those larger levels of volume through as well, you're going to get efficiencies and that's what we did see in Q2. And there was a small little increased levels of production towards the back-end of Q2 as we were preparing for Q3 because we do have a level of seasonality in our business. And when we get into Q3, we have plant shutdowns and scheduled maintenance that needs to take place and particularly in our European plants, so we wanted to get a little bit ahead of that. So we did build up a small amount of inventory but nothing overly material. And so, as we move into Q3, people have to take that into account when you're looking at the margin for the next quarter that we do have that level of seasonality. Didn't really appear as much last year but in previous years we do see a little bit of drop there, but again, it's planned.

A

Larry S. Solow*Analyst, CJS Securities, Inc.*

Right. Right. Okay. And not to split hairs, but a little bit of a – and this is – basically really gets lost in the shuffle. But on the contract manufacturing side, a little bit of a step back in margin, anything there unusual? I think we had thought that was going to sort of go the other way.

Q

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

Yeah. And we have seen it improve as we've gone through 2021. But there were some one-time benefits that we did pick up in Q2 2020, much of it around engineering revenues that we were able to recognize last year. And I think at that time we called it out as well. So, that's the only kind of anomaly there.

A

Larry S. Solow*Analyst, CJS Securities, Inc.*

Okay. How about on the – on the CapEx outlook, it sounds like you certainly continue to pull things forward, which I think's a high-class problem and going to spend about, sounds like, close to \$250 million this year. As we look out over the next couple years, and I'm sure you still have further expansion opportunities and plans, do you expect the CapEx, the absolute dollar number to sort of continue to grow or since you've pulled forward some, do you think this could sort of level off at least?

Q

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

A

As a percentage of revenues, I would expect to see it level off and come back to close to that 6% to 7% of revenues. It may not be next year but I think after that, we'll start to see it normalize.

Larry S. Solow*Analyst, CJS Securities, Inc.*

Q

Okay. Just last question. On the Daikyo, obviously, you guys made a strategic investment – increased your investment a couple years ago and that certainly seems like the timing has turned out really well. And I think you put up like a \$9 million number this quarter, and obviously that reflects the strength of Daikyo's business as well. I know this number is little bit volatile from quarter-to-quarter but is that – I think run rate year-to-date were over \$20 million. Any color on that or the outlook there?

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

A

Yeah. That's – so that number just isn't Daikyo there. There's another element too. But they did have a very strong performance in Q2. I think in the first quarter we were probably \$5 million or \$6 million on income from affiliates. And I would expect it over time to come down to that level. I don't think it's going to run at what we experienced in Q2.

Larry S. Solow*Analyst, CJS Securities, Inc.*

Q

Okay.

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

A

I think it will step back a little bit.

Larry S. Solow*Analyst, CJS Securities, Inc.*

Q

Fair enough. Great. Appreciate the color. Thanks guys, and congrats again.

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

A

Okay. Thanks, Larry.

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

A

Thank you, Larry

Operator: Your next question comes from the line of Jacob Johnson with Stephens.

Jacob Johnson*Analyst, Stephens, Inc.*

Q

Hey. Thanks. Good morning. Maybe first, just a follow-up on something you alluded to, Eric, in Juan's last question. If we do go to smaller dose formats, I think the end – the product you're manufacturing is a bit smaller. Is there any downtime associated with switching over to a smaller format or is this something that's a pretty seamless process that it sounds like you're already preparing for?

Eric Mark Green

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

Yeah. It's a seamless process. We're just – obviously, we had to change some of the manufacturing equipment, the moles and so forth. But the process and facilities and our team members that are involved making these products are all consistent. So, it's a pretty quick transition.

Jacob Johnson

Analyst, Stephens, Inc.

Got it. Thanks for that, Eric. And then just on high-value products, obviously a lot of mix shift towards those with the COVID-related work. But I guess if we look at that portfolio ex-COVID, are you seeing – high-value product mix ex-COVID, it sounds like there's a lot of reasons you're excited about what's going on in Biologics, but just curious on that?

Eric Mark Green

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

Yeah. You got my excitement, Jacob. Absolutely. So, if you think about our – you go back to that confirmed order book, the one indicator for us is the mix of incremental within that portfolio is evenly distributed when you think about between COVID, new drug launches that, kind of, I mentioned that we're continuing to have a very high participation rate in new approvals and then the growth of the core business. And when you cut a little bit further, over half or majority, call it, over half of it is in the Biologics space. And the portfolio itself is all towards the high-end of HVP. So, you can see the momentum that is gaining. And when you think about the capital investments we're making because of the Biologics growth and some of the small molecule new entrants, these tranches that we spoke of a reference, it is really – it is all around HVP. We think about FluroTec, NovaPure in existing facilities. So, it's very high growth, I guess, in the HVP, and we expect that to continue on. I just want to preference the number of units that we are producing in HVP still is, let's call it, below 25% of our Proprietary portfolio. So, we have a long runway ahead of us to continue this momentum in – with our HVP portfolio.

Jacob Johnson

Analyst, Stephens, Inc.

Got it. I'll leave it there. Thanks for taking the questions.

Eric Mark Green

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

Great. Thank you.

Operator: And your next question comes from the line of John Kreger with William Blair.

John Kreger

Analyst, William Blair & Co. LLC

Hi. Thanks very much. Hey, Eric, you said you've got a great order book and it's getting longer. Do you have a decent picture yet about whether COVID-related work will be larger for you or smaller in 2023 compared to 2022?

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

It's a little bit too far out. We have good – conversations are ongoing. And as you know investments we need to make are 6 to 12, maybe sometimes 18 months in advance. So, we do have some visibility, but it's too premature to mention as we speak.

John Kreger*Analyst, William Blair & Co. LLC*

Okay. Sounds good. And then a non-COVID demand question for you. Have you been able to satisfy all that demand at this point or have you had to defer any of those orders as you've prioritized work relating to the pandemic?

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

Yeah. We're meeting our customers' demands so that – we may have to work with a few customers here and there to make sure that we're scheduled – scheduling their orders based on the commitments. But we're meeting all our customer commitments as we speak and we will continue to do so. One of the [indiscernible] (00:35:38) that we've been able to observe in the last several – couple quarters is the installed validated capacity that is going online. So if you think about some of the constraints that we may have had historically around HVP, those have been relieved as we speak, so – but the bottom line is that we are meeting our customer commitments.

John Kreger*Analyst, William Blair & Co. LLC*

Sounds good. And then one last one, can you give us an update on Crystal Zenith? I think last quarter you talked about some new commercial lines coming online in Arizona. Just give us a sense of where that stands now and what are the type of products that are driving demand for that newer category?

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

Yeah. Really, it's all around the Biologics space. So, it's from the prefilled syringes. We had – as you mentioned, we had a line that went on – that's up and running this quarter. Yeah, it's a CZ – one – it's a insert needle prefilled syringe line. We have another line that is starting installation later this year with the focus to having it delivered before the end of the year. So, it's – it is – it's a significant step-up for us around the CZ portfolio, particularly on the prefilled syringes. In addition to that, we are working with our partner, Daikyo, as they are continuously expanding their capacity, capabilities around CZ out of Japan to support with other configurations like Luer Lock, such as vials configurations. So, I'm pleased with the progress we're making, but there's more to come.

John Kreger*Analyst, William Blair & Co. LLC*

Sounds good. Thank you.

Operator: Your next question comes from Dave Windley with Jefferies.

David Windley*Analyst, Jefferies LLC*

Hi. Good morning. Very nice quarter and thanks for the updates and thanks for taking my questions. I wanted to start around productivity. You touched on this a time or two, Eric. The – and it seemed intuitive to me and you confirmed that as your volumes in some of these higher – call it higher tier high-value products have gotten to some level of critical mass that you would get some scale on that. I guess I'm wondering if you'd be willing to put say some rough percentage numbers on like have margins on a like-for-like basis improved by a material amount? Would you be willing to put numbers on that?

Eric Mark Green

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

Well, let me let me qualify, then I'll look to Bernard to quantify that. But you're right – Dave, you're right. What's happening is that we're gaining meaningful volumes over the last few quarters on the higher end of the HVP and there's a – and it's been driven by the Biologics and a few small molecules. So it is a lot easier for plants to run longer lot units in our facilities. And we're seeing that translate into better margins with those parts of the portfolio. And that – we believe that will continue because we're leveraging existing footprint. We are installing additional capacity, that's correct, but the payback is much shorter. And all this is translating to better outcomes of NovaPure and also parts of FluroTec. So, I don't know Bernard, if you want to add any comment to that?

Bernard J. Birkett

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

Yeah. I would say it's still – the vast majority of the margin expansion that we're seeing is coming from mix, but it is being supported by improvements in productivity and efficiencies. Now we did see a big spike in Q2, a bit lift there, but as I said when we move into Q3 because there are fewer production days that's – the level of absorption in Q3 will be a little bit less. So, I don't believe you're going to see as much margin expansion in Q3. And we typically see the most margin expansion in Q2 as we're running higher levels. And the quarter is actually longer for us, but it's still primarily driven by mix. And I would probably think 10%, 20% of the benefit is probably coming from efficiencies of productivity.

David Windley

Analyst, Jefferies LLC

Helpful. And specifically on that, beyond the crush of the pandemic, would you expect to continue to run plants three shifts a day, seven days a week into the foreseeable future or is that a treadmill that's kind of running unsustainably fast?

Eric Mark Green

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

Well, based on the current demand we have outside of COVID, which is higher than our typical run rates, we are going to need to continue to run our plants accordingly so we can level load them. So, I would say in many cases we will be continuing to run the 24/7 and the demand of new molecules that are being approved and also our current base business, would expect that. Think about the growth of our business today, yes, COVID has been a major impact to that, but the core is still growing around the double-digit range. So, it's a very strong robust foundation that we're working off of.

David Windley

Analyst, Jefferies LLC

Got it. And the CapEx that you've mentioned and you've talked about within existing plants, and you – I think you named a few relative to projects that are either in flight or already completed. Is Waterford win, the company built

it, was highlighted for its kind of flexibility and modularity, is that a target of a lot of this expansion or is it not exclusively – is it more balanced across the world than that?

Eric Mark Green

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

A

It's balanced across the world but I would tell you that Waterford – if you've visited Waterford two years ago, you would not recognize it. It has significantly increased throughput. Additional capital has been put into Waterford. We increased the number of team members in that site significantly. So, yes, we're – these investments we're making because we really created this network around HVP in multiple sites, so we're not dependent on a site. But we've raised the volume level quite significantly in Waterford and we intend to continue to do so because it's been designed exactly what you've articulated. It's a modular approach. We can keep on adding to it the infrastructure and continue to put more volume through it. But I want to be clear though, we still have that capability in Kinston. We're expanding Singapore. We have additional capabilities in other locations like Kivin and Eschweiler. So, it's not just one site of investment. It's multiple sites, but heavily weighted towards Waterford.

David Windley

Analyst, Jefferies LLC

Q

Got it. Okay. Yeah. Sorry?

Bernard J. Birkett

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

A

[indiscernible] (00:43:07) Waterford couple of weeks ago and it was my first time there in two years. And the level of activity in that plant compared to where it was two years ago, it's just transformational as to what's happening there and how we've been able to leverage that and that's really helped us in our response to COVID and also the core growth but it does kind of highlight to us that we have to have some of this infrastructure in place before we actually believe we need it. So – but I think as you said that it is on a modular basis that allows us to expand much faster in the future than we would have done in the past. And I think, as Eric said, that's the same for Kinston and Singapore sites as well.

David Windley

Analyst, Jefferies LLC

Q

Got it. Last one for me [indiscernible] (00:43:55) specific number again. Last couple of quarters on your high-value products, you've used the phrase or the terminology over 70% and I'm wondering does that mean 70.5% over or 75% over or 80% over like – it seems like the growth is so strong that it could be moving percentage points above 70% and I just wanted to get a more specific number if you'll give it? Thanks.

Eric Mark Green

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

A

No, I won't give it. I think it gives enough color and also you can – the trend is the important thing there is we can see significant improvement in that number quarter-over-quarter and it's forecast to continue to improve based on the demand that we're seeing particularly around the Biologics segment.

David Windley

Analyst, Jefferies LLC

Q

Got it. Okay. Thank you.

Eric Mark Green

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

Thank you, Dave.

Operator: And there are no further questions at this time. I'll turn the call back over to you, Mr. Lai, for closing remarks.

Quintin John Lai

Vice President-Corporate Development, Strategy & Investor Relations, West Pharmaceutical Services, Inc.

Thanks, Erica. And thank you for joining us on today's conference call. An online archive of the broadcast will be available on our website at westpharma.com in the Investors section. Additionally, you may access a replay through Thursday, August 5, by using the dial-in numbers and the conference ID provided by the – at the end of today's earnings release. That concludes the call for today. Thank you.

Operator: This concludes today's conference call. Thank you for participating. You may now disconnect.

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