West Pharmaceutical Services (WST)

Updated July 4th, 2018 by Nick McCullum

Key Metrics

Current Price:	$99	**5 Year CAGR Estimate:**	-4.7%	**Quality Percentile:**	65.0%
Fair Value Price:	$51	**5 Year Growth Estimate:**	7.0%	**Momentum Percentile:**	44.0%
% Fair Value:	194%	**5 Year Valuation Multiple Estimate:**	-12.3%	**Valuation Percentile:**	0.5%
Dividend Yield:	0.6%	**5 Year Price Target**	$72	**Total Return Percentile:**	0.8%

Overview & Current Events

West Pharmaceutical Services manufacturers packaging and components involved in the distribution and application of pharmaceuticals. The company's products include *Zenith Crystal*, a medical glass alternative, and *SmartDose*, an automatic medication delivery system. West Pharmaceutical was founded in 1923, is headquartered in Exton, Pennsylvania, and trades with a market capitalization of $6.3 billion.

In late April, West Pharmaceutical Services announced (4/26/18) financial results for the first quarter of fiscal 2018. Net sales grew 7.2% on a reported basis, with the majority of this growth coming from currency fluctuations. At constant currency, West Pharmaceutical's organic sales growth was just 0.2%. On the bottom line, adjusted earnings-per-share of $0.62 fell noticeably from the $0.81 reported in the prior year's period. This was largely due to the timing and magnitude of taxation events. More specifically, West Pharmaceutical Services recorded tax benefits associated with share-based payment transactions of $0.03 in the quarter, below the $0.21 impact in the same quarter last year. This $0.18/share difference explains all but $0.01 of the decline in the company's earnings-per-share. Still, West Pharmaceutical Services shares fell following the announcement, although they recovered all of these gains later in the quarter.

More recently, West Pharmaceutical Services announced (6/21/18) that it had appointed Bernard J. Bickett as Senior Vice President, Chief Financial Officer, and Treasurer, effective immediately. The company's prior CFO, William J. Federici, had announced in March his intention to retire this year. The incoming CFO is an outside hire, joining West Pharmaceutical Services from Merit Medical Systems, Inc., where he had served as the CFO.

Growth on a Per-Share Basis

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2023
EPS	$1.19	$1.06	$1.05	$1.17	$1.38	$1.57	$1.75	$1.30	$1.91	$2.78	***$2.85***	***$4.00***
DPS	$0.29	$0.31	$0.33	$0.35	$0.37	$0.39	$0.41	$0.46	$0.50	$0.54	***$0.58***	***$0.95***

With the release of first-quarter earnings, West Pharmaceutical Services reaffirmed its full-year 2018 financial guidance. The company continues to expect net sales between $1.72 billion and $1.73 billion, with 2018 organic sales growth anticipated to be in the range of 6% to 8%. On the bottom line, West Pharmaceutical Services continues to expect adjusted diluted earnings-per-share to fall between $2.80 and $2.90. Because of this, we are leaving our 2018 earnings estimate unchanged at $2.85/share.

Beyond that, West Pharmaceutical projects long-term organic sales growth of 6% to 8%. As we mentioned in our last quarterly update, we believe this rate is overly optimistic – the company's revenue has grown at 4.8% per year over the last 9 years. On the bottom line, West Pharmaceutical has compounded its adjusted earnings-per-share at a rate of 10.0% per year between 2008 and 2017, although this includes a significant 46% jump in 2017. Moreover, the company is expecting earnings growth of just 2.5% this year. Revenue growth and a more favorable product mix will be the source of this growth. More specifically, West Pharmaceuticals is focused on increasing revenues in the Proprietary Products segment, which has much higher margins than the Contract-Manufactured Products equivalent.

Valuation Analysis

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	Now	2023
Avg. P/E	18.0	17.1	18.1	17.8	17.2	23.7	26.1	43.8	38.1	18.3	***34.7***	***18.0***
Avg. Yld.	1.4%	1.7%	1.7%	1.7%	1.6%	1.0%	.9%	0.8%	0.7%	0.6%	***0.6%***	***1.0%***

Using the midpoint of West Pharmaceutical Services' recently-reaffirmed guidance band ($2.85), the company is trading at a price-to-earnings ratio of 34.7. This is an extremely high valuation multiple for any security. More importantly, this is also well above the company's long-term average price-to-earnings ratio, which has trended around 18 during the last decade (using the median). We believe a price-to-earnings ratio of 18 is justified given West Pharmaceutical Services' historical valuation and comparable valuations within the healthcare sector. Reversion to a price-to-earnings ratio of 18 over 5 years would impair future returns by 12.3% per year.

Safety, Quality, Competitive Advantage, & Recession Resiliency

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2023
GP/A	25.9%	23.9%	24.6%	24.3%	24.8%	26.0%	26.8%	26.9%	29.2%	27.5%	***28%***	***28%***
Debt/A	58.3%	54.4%	51.7%	53.2%	53.4%	45.8%	42.7%	39.6%	34.9%	31.3%	***30%***	***40%***
Int. Cov.	8.6	6.8	5.6	6.6	8.4	10.9	14.3	10.4	28.3	35.4	***30***	***20***
Payout	24.4%	29.2%	31.4%	29.9%	26.8%	24.8%	23.4%	35.4%	26.2%	19.4%	***20.4%***	***25.0%***
Std. Dev.	43.3%	29.6%	24.4%	27.6%	22.8%	18.9%	23.0%	21.9%	22.2%	22.3%	***22.0%***	***22.0%***

From a financial perspective, West Pharmaceutical is well-positioned to endure any business volatility in the near-term due to its conservative balance sheet. West Pharmaceutical's quality metrics have steadily improved over the years.

Final Thoughts & Recommendation

West Pharmaceutical Services has an entrenched position in a niche part of the healthcare industry. The company's business model of manufacturing unglamorous medical components is appealing because it captures the recession resiliency of the healthcare industry without attracting the competition of its more exciting sector counterparts.

With that said, we cannot stomach the company's current valuation. Healthcare stocks – even healthcare stocks *of the highest quality* – are trading around 18x earnings right now. West Pharmaceutical's earnings multiple is above 30. Accordingly, we recommend that investors sell this security and reinvest the proceeds into more compelling opportunities in the healthcare space.

Total Return Breakdown by Year