West Pharmaceutical Services (WST)

Updated July 27th, 2018 by Nick McCullum

Key Metrics

Current Price:	$107	**5 Year CAGR Estimate:**	-6.5%	**Volatility Percentile:**	64.5%
Fair Value Price:	$51	**5 Year Growth Estimate:**	7.0%	**Momentum Percentile:**	68.5%
% Fair Value:	210%	**5 Year Valuation Multiple Estimate:**	-14.1%	**Valuation Percentile:**	0.2%
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 $7.3 billion. The company has increased its dividend for 25 consecutive years, which qualifies it to be a Dividend Champion.

In late July, West Pharmaceutical Services reported (7/26/18) financial results for the second quarter of fiscal 2018. In the quarter, reported net sales of $447.5 million grew 12.6% over the same period a year ago. Constant-currency organic sales growth was 9.0% in the three-month reporting period. On the bottom line, West Pharmaceutical Services generated adjusted diluted earnings-per-share of $0.70, which increased by 6.1% over last year's $0.66. West Pharmaceutical Services also reaffirmed its 2018 financial guidance. The company continues to expect net sales between $1.72 billion and $1.73 billion and adjusted diluted earnings-per-share between $2.80 and $2.90. The markets reacted very favorably to West Pharmaceutical Services' earnings release (which beat consensus estimates for both revenue and earnings), sending shares up by more than 12% on the first trading day following the earnings release.

Before that, 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***

West Pharmaceutical Services continues to expect 2018 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. We are maintaining our 2018 and 2023 earnings-per-share estimates following the release of the company's second quarter earnings report.

Beyond that, West Pharmaceutical projects long-term organic sales growth of 6% to 8%. We continue to believe that this 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. Unfortunately, the Contract-Manufactured Products segment delivered much stronger revenue growth in the most recent quarter (16.9% compared to 6.9%).

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	***38.5***	***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%***

West Pharmaceutical Services' already-high valuation surged further into nosebleed territory following the publication of its second quarter earnings release. The company is *currently trading for a price-to-earnings ratio of 38.5*. This is an extremely high valuation 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 a remarkable 14.1% 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%***

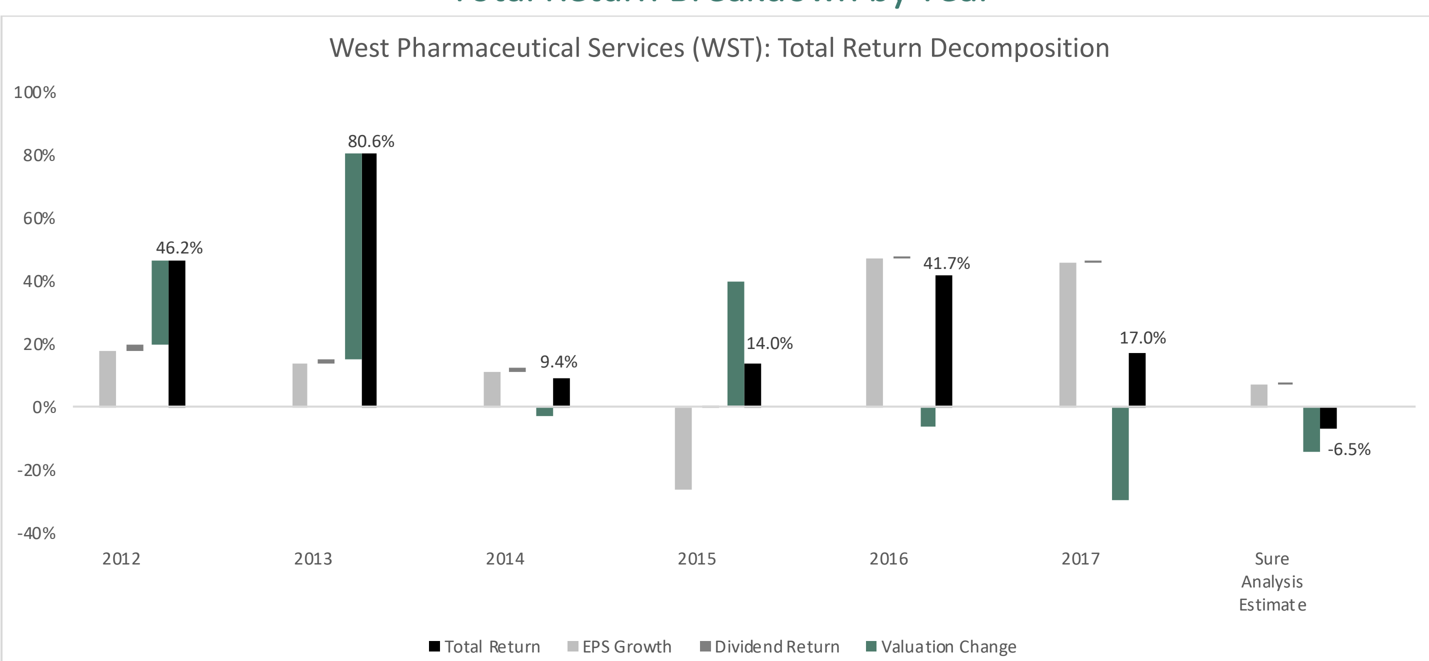
From a financial perspective, West Pharmaceutical is well-positioned to endure any business volatility in the near-term due to its conservative balance sheet. West Pharmaceutical's quality metrics have steadily improved over the years.

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.

As before, West Pharmaceutical Services' extraordinarily high valuation prevents us from even considering the company as a potential investment opportunity. We reiterate our strong sell rating on this healthcare component manufacturer.

Total Return Breakdown by Year



Disclosure: This analyst has no position in the security discussed in this research report, and no plans to initiate one in the next 72 hours.