



West Pharmaceutical Services (WST)

Updated August 4th, 2020 by Jonathan Weber

Key Metrics

Current Price:	\$273	5 Year CAGR Estimate:	-11.7%	Market Cap:	\$20.5B
Fair Value Price:	\$92	5 Year Growth Estimate:	9.0%	Ex-Dividend Date:	10/16/20 ¹
% Fair Value:	295%	5 Year Valuation Multiple Estimate:	-19.5%	Dividend Payment Date:	11/01/20 ²
Dividend Yield:	0.2%	5 Year Price Target	\$142	Years Of Dividend Growth:	26
Dividend Risk Score:	A	Retirement Suitability Score:	C	Last Dividend Increase:	6.7%

Overview & Current Events

West Pharmaceutical Services manufactures 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 and is headquartered in Exton, PA. The company has increased its dividend for 26 consecutive years, which qualifies it to be a Dividend Champion.

West Pharmaceutical Services reported its second quarter earnings results on July 23. The company reported that its revenues totaled \$527 million, which represents a revenue growth rate of 12.2% compared to the prior year's quarter. West Pharmaceutical Services' revenues were higher than what the analyst community had expected, by \$31 million. Revenues were negatively impacted by adverse currency rate movements. Adjusted for that, West Pharmaceutical Services' organic revenues were up by an even stronger 14.3% year over year.

West Pharmaceutical Services generated adjusted earnings-per-share of \$1.25 during the second quarter, which represents a very appealing increase of 40% compared to the prior year's quarter. West Pharmaceutical Services increased its revenue guidance midpoint to ~\$2.05 billion for 2020, while the earnings-per-share guidance midpoint has been raised to \$4.20, from a previous level of \$3.57. The coronavirus crisis does not have a negative impact so far.

Growth on a Per-Share Basis

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2025
EPS	\$1.05	\$1.17	\$1.38	\$1.57	\$1.75	\$1.30	\$1.91	\$2.78	\$2.81	\$3.24	\$4.20	\$6.46
DPS	\$0.33	\$0.35	\$0.37	\$0.39	\$0.41	\$0.46	\$0.50	\$0.54	\$0.57	\$0.61	\$0.64	\$0.94
Shares³	67	67	67	70	71	72	73	74	74	75	76	78

West Pharmaceutical grew its earnings-per-share at an attractive pace of 12% annually between 2009 and 2019. This included the recovery from the last financial crisis, though, when West Pharmaceutical Services' earnings-per-share growth rate was at an above-average level, during 2010 – 2014. During the last financial crisis, West Pharmaceutical Services' earnings-per-share declined by roughly 15%, which was a very solid performance versus most other companies.

West Pharmaceutical projects a long-term organic sales growth rate in a range of 6% to 8%. We believe that this could be too optimistic, as West Pharmaceutical's revenues have grown at a slower pace of slightly less than 5% over the last 10 years, which is why we believe that this is a more realistic long-term organic sales growth estimate. West Pharmaceutical Services' organic revenue growth rate during 2018 was also slightly lower than management's revenue growth target range, although 2019's sales growth came in ahead of the forecast, at 10%. Thanks to tailwinds for the industry, such as rising healthcare spending, we believe that the company should not have any problems in growing its revenues. Revenue growth will be one source for higher earnings, but a more favorable product mix will positively impact West Pharmaceutical's earnings growth as well. The company seeks to increase its revenues in the Proprietary Products segment, which has significantly higher margins than the Contract-Manufactured Products business.

¹ Estimated date

² Estimated date

³ In Millions

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Valuation Analysis

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	Now	2025
Avg. P/E	18.1	17.8	17.2	23.7	26.1	43.8	38.1	36.0	34.9	46.3	65.0	22.0
Avg. Yld.	1.7%	1.7%	1.6%	1.0%	0.9%	0.8%	0.7%	0.6%	0.6%	0.4%	0.2%	0.7%

West Pharmaceutical Services has never been valued at an especially low valuation throughout the last decade, but in the 2009-2012 time frame, its valuation was at least moderate, although shares still traded at a premium valuation relative to the broad market. More recently, West Pharmaceutical Services' valuation has risen to a very high level, which is neither justified by the company's earnings growth record during the last couple of years, nor by the company's growth outlook over the coming years. We forecast huge downside potential for the company's shares.

Safety, Quality, Competitive Advantage, & Recession Resiliency

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2025
Payout	31.4%	29.9%	26.8%	24.8%	23.4%	35.4%	26.2%	19.4%	20.3%	18.8%	15.2%	14.6%

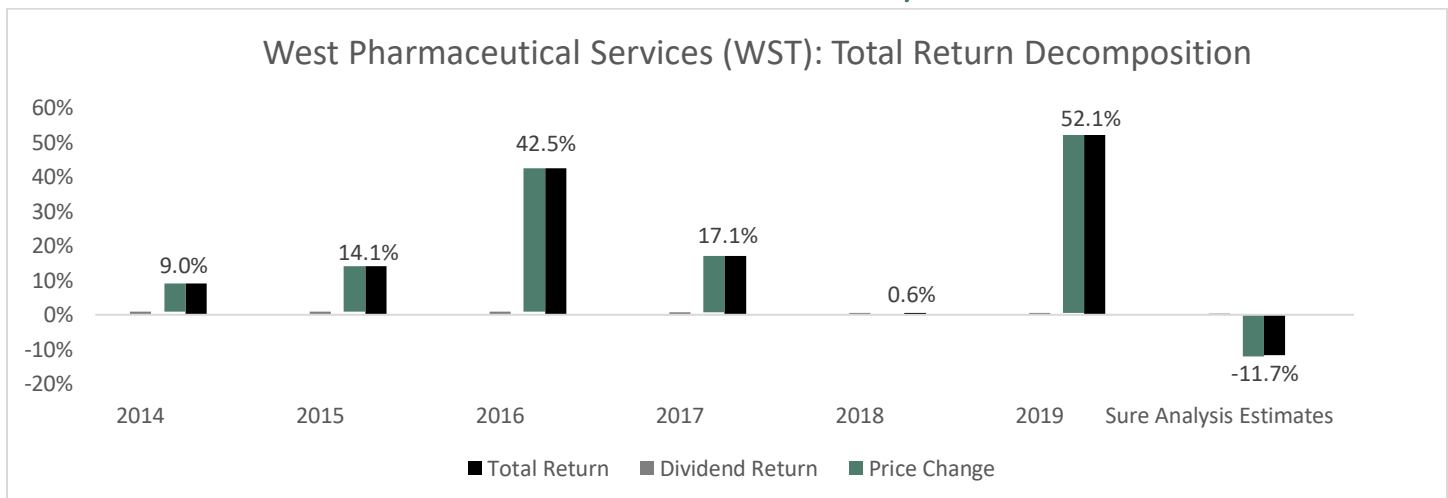
West Pharmaceutical Services' dividend payout ratio has never been high – the company has paid out less than one-third of its net profits in the form of dividends during each year of the last decade. Coupled with the fact that the company continued to raise its dividend during the last financial crisis, the payout appears to be very safe. At well below 1%, the yield is so low that the stock is still very uninteresting for income investors.

West Pharmaceutical is not active in a cyclical industry, as demand for medical items and pharmacologic products is not really dependent upon economic conditions. This explains why West Pharmaceutical was not impacted by the last financial crisis to a large degree, showcased by the fact that earnings-per-share declined by just 15% peak-to-trough.

Final Thoughts & Recommendation

West Pharmaceutical Services is active in an industry that is poised to generate solid growth rates over the coming years, and which is also not very vulnerable to recessions. The current coronavirus crisis is not a relevant headwind for the company, according to its management. West Pharmaceutical Services also has a solid dividend growth track record. We still do not think that the company is attractive for income investors due to the very low dividend yield. Due to an almost absurdly high valuation of around 65 times 2020's net profits, West Pharmaceutical Services earns a strong sell recommendation from us at the current price, although we would like the company around fair value.

Total Return Breakdown by Year



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Income Statement Metrics

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Revenue	1,105	1,192	1,266	1,368	1,421	1,400	1,509	1,599	1,717	1,840
Gross Profit	318	339	388	435	448	456	501	513	545	606
Gross Margin	28.8%	28.5%	30.6%	31.8%	31.5%	32.6%	33.2%	32.1%	31.8%	32.9%
SG&A Exp.	188	191	218	235	229	244	240	246	263	273
D&A Exp.	73	76	77	85	90	90	91	97	104	103
Operating Profit	107	119	143	164	183	180	227	235	248	297
Op. Margin	9.6%	10.0%	11.3%	12.0%	12.9%	12.9%	15.0%	14.7%	14.4%	16.1%
Net Profit	65	76	81	112	127	96	144	151	207	242
Net Margin	5.9%	6.3%	6.4%	8.2%	8.9%	6.8%	9.5%	9.4%	12.0%	13.1%
Free Cash Flow	65	34	55	65	71	81	49	133	184	367
Income Tax	14	24	33	40	47	26	54	81	41	59

Balance Sheet Metrics

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Total Assets	1,294	1,399	1,564	1,672	1,670	1,695	1,717	1,863	1,979	
Cash & Equivalents	110	92	162	230	255	275	203	236	337	439
Accounts Receivable	126	147	175	186	179	181	201	253	288	319
Inventories	147	152	162	177	182	181	199	215	215	236
Goodwill & Int. Ass.	168	164	163	163	151	142	126	129	126	
Total Liabilities	669	744	835	765	713	671	599	583	583	
Accounts Payable	63	90	103	108	103	120	122	138	130	157
Long-Term Debt	358	349	412	374	336	298	229	197	196	-
Shareholder's Equity	626	655	729	906	957	1,024	1,118	1,280	1,396	1,573
D/E Ratio	0.57	0.53	0.56	0.41	0.35	0.29	0.20	0.15	0.14	-

Profitability & Per Share Metrics

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Return on Assets	5.1%	5.6%	5.4%	6.9%	7.6%	5.7%	8.4%	8.4%	10.8%	
Return on Equity	10.8%	11.8%	11.7%	13.7%	13.6%	9.7%	13.4%	12.6%	15.5%	16.3%
ROIC	6.7%	7.6%	7.5%	9.3%	9.9%	7.3%	10.8%	10.7%	13.5%	15.3%
Shares Out.	67	67	67	70	71	72	73	74	74	75
Revenue/Share	15.05	16.11	17.64	19.17	19.52	18.97	20.12	21.10	22.78	24.40
FCF/Share	0.88	0.46	0.77	0.91	0.97	1.09	0.66	1.75	2.44	4.87

Note: All figures in millions of U.S. Dollars unless per share or indicated otherwise.

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