PODCAST TRANSCRIPT

Talking Research: Digging Deeper – Understanding Lonza

First published: 21 April 2026

Murdo MacLean: It's 1897, in the valley of Gampel in the Swiss Alps. Engineers have channelled the river Lonza into a new electric works, turning mountain water into power, enough power to drive early electrochemical processes and produce calcium carbide for the modern age of industrial gas lighting. The company responsible is named after the river that made it possible: Lonza.

As time moves on, so does the business. From a single power station to a diversified industrial conglomerate. A decisive shift comes in the 1980s, when it takes its first steps into the nascent industry of biotechnology.

Today, Lonza is the world's leading provider of development and manufacturing services to the pharmaceutical industry. From its state-of-the-art facilities in Switzerland, it sits at the nexus of two of the most powerful long-term trends in global healthcare: outsourced drug production and the rise of biologic therapies.

My name is Murdo MacLean, I'm a Client Investment Manager at Walter Scott and I'm delighted to be joined today by Tom Miedema, the stock champion for Lonza. Tom is going to walk us through the inner workings of Lonza and the markets in which it operates. What gives the company its edge in such a complex and demanding industry? How durable is its market position? And in a world of geopolitical upheaval, how does it continue to serve the needs of a global and diverse customer base?

Before we get started, a reminder that the podcast is intended for investment professionals only and should not be construed as investment advice or a recommendation. Any stock examples discussed are given in the context of the theme being explored, and the views expressed are those of the presenters at the time of the recording.

Tom, maybe a good place to start here is telling us a little bit about what Lonza actually does.

Tom Miedema: Most people talk about Lonza being a CDMO. So that would be a contract development and manufacturing organisation. They would actually talk about being a CRDMO, so they would sneak in research in the middle there as well. Basically, that means that they will support their customers in the development of drugs from the research and the development stage all the way through to commercial manufacturing.

MM: I'm curious for someone who's spent so much of your career deep in the weeds of the semiconductor manufacturing supply chain – how on earth did you happen upon Lonza?

TM: To be honest, it was a bit of a Covid period thing. So early Covid lockdown and I ended up reading a lot around biology and synthetic biology, as you do. We did a lot of strange things in Covid.

And the more I read about the companies in this space, I just saw all these different parallels to what I'd seen in semiconductors. Both in the tools side in companies like Sartorius and Merck, that to me looked a lot like semiconductor tool makers, like an ASML. So that really got me into the space. And I started looking at the entire supply chain, and I just saw these similarities.

Also, just reading about the technology, so much has been changing in biotechnology. There are all these different modalities. There are so many scientific breakthroughs that have happened over the last couple of decades, and a lot of these are moving towards commercial reality and new drug products. And it just made me really curious to figure out who's going to bring these to market. How is this going to impact the world? Felt like a really interesting growth area.

MM: And I think you mentioned previously – and certainly we've discussed this with clients – that Lonza, specifically its role in this whole supply chain sort of mirrors that of TSMC, a company that's obviously very close to your heart. One that we've invested in for many years. So, could you just talk a little bit about what the parallels are that you see between those two companies and the industries?

TM: It's probably the closest parallel I would draw, is those two companies – they are remarkably similar. Now clearly what they make is completely different. The manufacturing process is completely different – maybe not entirely – but very, very different. But the parallels are stark. They take incredibly complicated products and take them on from their customer from the very beginning, from a concept – an early design of a new chip or a new drug.

They then take that product all the way through that design process and development process – super complicated – all the way through to commercial reality. And then at the end, they have to ramp it up at massive scale and bring those products to market. So, there are a lot of parallels in terms of what you're trying to do on behalf of a customer base.

MM: Well, that makes a lot of sense in terms of the skill sets required. But presumably there's also some differences between what it takes to be an outsourced manufacturer in the semiconductor space and in the drug space. Perhaps you could give us a feel of what the differences are between the two?

TM: Maybe some key differences to think about: there's no Moore's law in biology. To manufacture, it's more iterative: how do I increase the yield? It's much more experimentation. A lot of science in terms of delivering higher yields, but you're not going to get a doubling every 18 months. This is something that moves more gradually. A benefit however, is that your products last for a long time. Once you launch a drug, it's going to be in the market, potentially for decades. Some drugs just stay in the market – are useful for a very long time – you have very long cycles.

On the chips side, that's extremely rare. The cycles are very short. I launch a chip and my product might last for a year, two years, three years. That's the kind of cycle that TSMC faces. So, a big benefit on that side.

Maybe the last thing to think about is regulation. Pharma manufacturing – and rightly so – is highly regulated. These facilities have to be checked all the time by different regulators from different countries to make sure they're up to standard. Any problems with manufacturing, clearly a massive issue for patients' health considerations.

Far less so for semi. Clearly semi has to be right. But it's not like some external body is constantly checking exactly what you do and you have to write down your process so that everyone understands exactly how you work it. In fact, they [the semi manufacturers] want to keep that as secret as possible. Whereas Lonza has to say at every step, "this is exactly what we do" to the FDA or the European authorities, etc.

MM: I guess if a chip malfunctions it's an inconvenience, whereas a drug – if a drug goes wrong, the potential ramifications are a lot more severe.

I've heard you talk a lot about the parallels. We've discussed it with clients at length as well, about your experience in looking at TSMC and how that's led you to looking in a totally different industry at a much earlier stage in that outsourcing journey. Have you ever put that to the company? Is that something that they think about? Do they see those parallels?

TM: They're coming around. I've been trying to push this on them as well, because I think TSMC is probably one of the best… probably the best manufacturer in the world. And I think that's more and more recognised by people. So, I think it's a great company to aspire to be like. I've definitely had this debate with the company, and they see that, of course.

With the chairman – I was speaking to him a few months ago – and really pressing this. We're having this debate and I was sending an email just to explain my reasoning for why the similarity is relevant and what they can learn from TSMC over time. Lonza is a great business, but I think if they got to the TSMC level, they'd be even better.

I think there's a recognition that there's another level that they could step up. Because it's earlier. Semiconductors have really gone that way for a very long time. And it is now the de facto model for how semi operates. But it's not yet quite the case in this industry [pharma and biotechnology], which is the opportunity. But also means they have some way to go to perfect that.

MM: That's fascinating. I guess just playing devil's advocate maybe for a second: is outsourcing of these highly complex processes to the likes of Lonza – is it really cheaper for pharma and biotech companies to go that way than to do it in-house? I know in the semiconductor space, it's allowed both sides to specialize in what they're good at. But is it demonstrably cheaper, or are there other reasons why pharma companies might choose to outsource to Lonza?

TM: I mean, cost is one thing. It's definitely cheaper to do it, but it's really just only one consideration. When you're looking at drug manufacturers: the cost of manufacturing just isn't that big an issue in terms of the overall COGS [cost of goods sold] of a pharma product. But quality is incredibly important. Trust is incredibly important. You have to deliver on time. You have to support that product being launched. It's a massive issue. So those will be higher in the order of what management teams are thinking about when they're selecting what to do: insource - keep it internal; or outsource and who to go with.

Things to think about are, what is it that you're in business for? You know, Jeff Bezos likes to talk about it when you think about AWS. He talks about what makes your beer taste better. And the example they're using is: a long time ago when you're looking at brewers, they all used to have their own electricity production. It's funny how it's a little parallel with Lonza's history there as well; being an electricity producer. And they all used to manage power plants. And over time they go "why are we managing a power plant? We could be really good at that, but it doesn't make our beer taste better. Why don't we just have a large power plant that serves everyone

and we'll focus on the beer?" And that's the concept that runs through these big outsourcing operations and Lonza is a bit the same.

A biotech or a pharma company – why should they have expertise in manufacturing? Now they could develop that. They've done that very successfully for a long time, but it's more because they had to than they really thought they had some great expertise.

Why not have somebody who can build these massive plants – and it is getting more expensive, and it is getting more technologically challenging – for some of the new modalities that are coming through. Why not let someone else build that expertise? Someone else put that capital down and build the scale in manufacturing? And we'll focus on the science. We need to focus on developing and finding great drugs. And that's a great and very challenging task in itself.

And then ultimately bringing those drugs to patients. So, focus on marketing, the channels beyond that and let someone else manufacture. And that's been the direction of things. And for these small biotechs, they never even started with manufacturing. Because if you have one drug, do you really want to build a factory for that? That's a big question mark.

MM: I guess they're more interested in just the science and then potentially looking for a big company to come along and buy them, right? That seems to be what happens in biotech with the smaller companies.

TM: I think another interesting aspect to think about is just the whole nature of the model in pharma. It's this kind of shot-on-goal-type thing: you find this great molecule or this great antibody that you think is going to have a massive impact in the world, but there's always risk. Most products fail at the end of the day. You got to go through phase one, two, three trials. And then there's an incredibly low chance ultimately that you get the whole way through and you hit the jackpot and get a successful product.

However, if you want to do it yourself, you've got to start building that factory capacity in anticipation of a product launch. If you get the phase three approval, you want to go, you want to bring that product to market. So you need to invest in a factory before you know if it's actually been successful. Then if you fail, which is unfortunately really common in the industry, you're left with an empty factory.

That might be okay, if you're a pharma company and you have 20 molecules in your pipeline. But it's a massive risk if you're a biotech with two or three. So, if a company like Lonza can serve hundreds of different customers with their own pipelines, it makes massive sense from a risk-sharing perspective that you can say: "okay, I don't need to take that risk and put the capital down, because I know I have this chance of failure."

MM: Interesting. Just out of interest, how early on does Lonza get in the room with its customers? At what stage? Because I think in the semi space, again, they're there in the room, they know what the designs are going to be, the next chips, etc. and then they plan accordingly, right? Does that same thing happen in this space as well?

TM: Absolutely. Lonza are desperate to get in the room as early as possible. They want to be there in the clinic when they're looking at which products we're going to bring into development. So which products are we going to start putting in through trial? Because they know that once they get that product, they're probably going to keep it the whole way through. 99% of the time the customer will stick with Lonza the whole way through.

Now you're going to get a high chance of failure in phase one and phase two. You've got thousands of products in the early pipeline. And that'll whittle down as we get through this natural success/failure mechanism that you have in pharma. But they want to be in that clinic. They want to be talking to the R&D guys and saying, "okay, put that product with us. We'll manufacture it in small quantities first. We're going to help you with that first trial, and then we'll scale up as you go." That's their strategy.

MM: Obviously, much that determines the success of a drug through the clinical trial process is the drug itself. How does Lonza guard against the risk that they get the blame for something failing in phase two? I mean does that ever happen? You know, "oh you did that step wrong. It's not our drug. It's you guys." Does that ever happen?

TM: There's a massive partnership here, so there is risk. I think it's less the risk that Lonza gets it wrong. It could happen – they could just fail to deliver the quality. They can have issues with batches and things like that. But I think that's extremely rare. I think what is critical is timing. A lot of what Lonza has to do – all this procedure, all this regulation – exists the whole way through; in setting up, in making sure that even small-scale production is done correctly. And so you have to do things by the book.

If you make a mistake, usually that means a delay. And speed is critical. It's very rare that you have a drug where other people haven't seen that science or have had a similar idea as well. Pharma's often a race to get the products to trial and get first to market with something. And Lonza is part of that race.

So, it's about trust that you won't mess it up – although I'm not saying that can't happen. But that speed element is also really critical. Can you trust your partner to deliver, as fast as possible, in that race to get a commercial product.

MM: A real partnership, I suppose. It sounds like a fantastically exciting space with a lot of growth ahead of it. Given how early it is in the whole trend of outsourcing, presumably Lonza is not the only company that wants to try and capture a piece of this pie. What does the competitive landscape look like for Lonza?

TM: Unfortunately, not. It'd be nice if they were a monopoly, but, they're not TSMC yet. They have about 15-20%* market share in outsourced manufacturing of biologic drugs. It's probably about 20% market share if you took all pharma manufacturing outsourcing. But the biologic piece is where they're really focused. And they've got higher market share in certain specialised modalities, like ADCs…

MM: What does ADC stand for?

TM: Antibody drug conjugates: where you're effectively starting to combine different bodies together and you have to produce things like linkers and make more… I was going to say 'fancy' – but you know – more sophisticated constructs.

The more challenging it gets typically means higher market share for Lonza. The other players – interestingly again a semi comparison, because the countries are similar. You've got a Korean champion: Samsung Biologics is a big player. Fujifilm in Japan have become a big player. And they really came into the market strongly through Covid. And then WuXi Biologics in China. These are probably the three biggest competitors that are going to hang around. There are also players in Europe and the US. But Lonza is clearly the big leader in the West.

MM: Interesting. And competing with so many Asian-based competitors; is there a labour-cost advantage that the Asian players can somehow leverage to lower their costs to boost their margins that Lonza maybe doesn't possess being based – let's face it – in a very expensive part of Europe?

TM: Absolutely. They definitely have somewhat of a disadvantage based on location - particularly Switzerland, which is incredibly expensive. But if you look at cost, labour isn't a massive part. These are big, big factories. So, you have thousands of workers, but it's not a huge portion of the cost.

Where there is a bit of a differential – if you think about Korea or China – the prestige of working in drug manufacturing is really high. Actually getting master's level or even PhD level people to work on this type of work, particularly in the development side in the support of early-stage products – where Lonza is a real leader – those people are really expensive in the US and Europe. There's also a big call from pharma and biotech for those same people. [1]And that doesn't exist quite in the same way as in China and Korea, although that's changing a bit as well. But they have an advantage in that type of talent, I would say.

But if you really look at it, the market is much more moving towards manufacturing in close-to-end markets. It's much more important that you're competitive within Europe or competitive within the US.

Asia will highly likely be served by Asian players, although Lonza has got a presence in Singapore and it does very well there. But it's much more "ok, where do I want to have it manufactured?". And that will be the consideration of the end customer. And quite often, if I want to sell the product in the US, I'll be highly likely to produce it in the US, particularly these days. So that's the most relevant factor.

Again, as we talked about earlier, cost is a consideration, but it's probably more like fourth or fifth in the list, in terms of who do I trust to bring my incredibly valuable product to market?

MM: And I guess if you're a biotechnology company or a pharma company, you don't want one company manufacturing all your drugs. It feels like in the semiconductor space, we've kind of ended up in a scenario where TSMC controls almost all of the very high-end chips. I'm not sure if that was actually by design, or if that's just a consequence of the foresight that TSMC had.

Whereas perhaps in the pharma industry, in the biotechnology manufacturing space, it's considered healthy to have multiple manufacturers of your drugs. Do their customers carefully monitor that concentration risk?

TM: Definitely. I think Covid was a big wake up call on many different fronts. We're nowhere near that concentration in this space. But I think you're exactly right. TSMC is where it is… it is not what the customers wanted to happen. It's not actually that healthy for the world to be so concentrated in one company. And lots of people tried really hard to get Samsung and Intel to be a credible second source. And it's just the way the technology went and it's just the failure – frankly – on those companies' part that has led to where we are today. But they're still pushing, so we'll see where we go.

On drug manufacturing, we aren't at the point where the technology is so challenging that you can't have a credible second source. You definitely can. I think that's actually quite a healthy scenario. You can see the consolidation happening amongst

* Please note, this figure was corrected from "30–35% market share" to "15–20% market share" on 27 May 2026.

leading players. You want to have players that have a manufacturing footprint that has diversification. So if Lonza's plant in one location is having an issue, you can then move manufacturing to another location and you can have diversification within your supplier for a certain product.
But fundamentally, if you have a massive drug that is serving patients around the world, you want to make sure that you have multiple locations that you can produce that from, probably multiple suppliers.

The bigger the drug, the more suppliers you're going to have. That's great for patients. That's really important because if you do have a problem – and it does happen and we've seen it multiple times – that's a big issue.

So I think that's much more naturally the way the industry goes: that you typically don't give all of your drugs to one supplier. And even when a single drug gets really big, you'll start to look at a second source. You might even need a third source for the big drugs.

And that's a bit of Samsung's business, to be honest. Samsung is a competitor to Lonza, but its focus really is… it doesn't do the early-stage stuff. It waits for the big drugs to come out and says, "okay, I've now got a huge oncology drug. I'm going to be the second source for that drug, and I'm just going to do scale-manufacturing." And that's where cost is probably more of a consideration.

MM: Interesting. Going back a few years – possibly around Covid – there was a lot of focus on domestic manufacturing and creating national champions. That's obviously been continued under the Trump administration as well. Has that impacted or slowed the outsourcing journey, if you will, for the industry as a whole? Have you seen that have any significant impact in terms of that pace?

TM: Not really. There's quite a lot of headlines, particularly in the last while; big pharma companies being seen to make big announcements about investments, which creates a bit of noise. And clearly they're investing something in their own capacity. And I think the biggest companies are always going to want to have something internal. Just keep the secret sauce in certain areas internally. We'll see – maybe not. But generally, it just hasn't shifted things.

I think this move towards more localised manufacturing – that's already been happening since Covid. The big shock then was – particularly in the generic space, which is not something that Lonza does – the world woke up to the fact that almost all drug product eventually – at some level – comes from China and India. That's a high, high global concentration. And that's something that probably over time needs to be resolved. So there's much more region-for-region manufacturing; this has been a trend for a while, and I think this latest move further consolidates that direction of travel.

Now, the great thing for Lonza is that despite being a Swiss company, it's really the US manufacturing champion. It's got the biggest market share in the US and that's spread across mostly Portsmouth in New Hampshire and now a big site they acquired in 2024 and are really investing a lot in, in Vacaville in Northern California. So that's really exciting. Actually, it's been a support for Lonza because they want to fill that huge site that they now have in Vacaville in California. And so they're now winning a lot of business based on people looking to bring back manufacturing; or at least make sure the next generation of products are manufactured in the US.

MM: Interesting. I guess it's that whole tariff conversation. I think the market's initial response was to assume that all these companies were fairly local instead of very global, which is obviously something that we spend a lot of time on here: making sure that these companies have diversified manufacturing bases and are very global in their approach. But Switzerland particularly seemed to be at the sharp end of tariffs; not just in this space, but in luxury, watches, and all kinds of things. So is what you're saying – basically – that Lonza was able to overcome a lot of that given its historical global network? Or how do they handle those shifts in the tariff space?

TM: Interesting question. I have to admit when tariffs come out, you start thinking about those companies. So it wasn't comfortable in the beginning, but actually Lonza was one of the best positioned, as it turns out. The biggest benefit is that ultimately they don't export any of their products. Their customers will take the product at the factory gate and then move it on from there. So they were not tariff-exposed and were very resilient in that period.

But clearly there was a lot of noise around tariffs, a lot of noise around pharma, and the movement of those products. Because you're always going to have something in different places. It still makes a lot of sense to have, especially very specialised products, in certain locations, and then export some of that. So, they don't replicate everything in every different location. But for the big modalities, it's generally moving more local. I was happy to revisit the structure there.

MM: Perfect. So just switching to biotechnology – probably a considerable part of Lonza's future. At least my sense is that biotechnology can be extremely volatile, the whole space, the size of some of the companies, etc. How is Lonza able to remain resilient as a business, when you've got that customer base that's inherently potentially volatile? How do they manage those funding cycles within biotechnology?

TM: Again, maybe another semi parallel here. Semi is incredibly volatile – biotech, same thing – you're exactly right. The beauty of the business model here is that 70% of revenues are from launched

commercial products. In that setting these are products that are being used by patients. And that is one of the most stable growth businesses you can find anywhere. So 70% of the business is super stable and growing at a really nice clip. And then the rest of the business are these kinds of earlier stage products: phase one trial type molecules, phase two molecules.

Where you see the biggest cyclicality is early stage. When the biotechs have loads of money, they put lots of products into the clinic and start taking those bets on "maybe this will work" and start investing. And then when the money dries up and the VCs stop funding biotech or you have various different things – so we've had multiple cycles over the last couple of decades – then that pipeline dries up. And so there's a lot of cyclicality there. Luckily for Lonza the phase one piece is about 10% of revenues.

Big pharma tends to be far more consistent. And that's still a big chunk of the business. It's more about half of the business. It tends to be the other half, particularly the funnel into that 10%, that has some volatility. But ultimately it smooths out. Drug development is a very long cycle and with the structure that it has, you don't really see that volatility. It impacts sentiment a bit, to be fair. But actually in terms of business fundamentals, it's really pretty stable.

MM: Okay. I'm keen to just dig in a little bit into the financial profile of Lonza. And sorry to labor the point again on Taiwan Semiconductor, but certainly over our long association and investment in Taiwan Semiconductor, we've seen some really impressive margin expansion in that business. So is Lonza a margin story for you or is it some other metrics that you look at that are most important?

TM: We actually had the CFO of Taiwan Semiconductor in yesterday morning. So we were talking about profitability, which is getting pretty spectacular, as you said. Hopefully one day Lonza will be as profitable as TSMC but it might take a while. I mean, today Lonza is pretty profitable. But they're delivering about 32% EBITDA margin. They like to talk about EBITDA. So pretty good. But I think it could be a lot better. Actually they're not as profitable as their Asian peers yet. So they look at this themselves as well and they say, "okay, I have room to improve."

So broadly, if I think about the overall fundamental case for Lonza going forward and what they target, the market they're operating in grows something like 8-10% annually. So a pretty healthy growth market for the CDMO industry. They want to beat the industry. So they're targeting 10-13% constant currency revenue growth, out to the medium term. A good growth clip. And they want to drive margin. They've got a new or new-ish CEO. He came in in 2024 and it's really clear that he wants to focus on execution. They've been investing a lot. The last five years they've invested a huge amount in terms of new facilities in the US, in Switzerland. And now it's really time to benefit from that. And that should drive margin healthily. So let's fill those facilities, really get them humming and drive margin every year. That's what we'll be looking for.

MM: When you say "a huge spend", can you quantify that in terms of percentage of sales? How elevated is it in relation to the long-run average that they spend on CapEx?

TM: Long-term they're targeting now 15% of sales in terms of CapEx. And that should be sustaining with the growth that we talked about a second ago. The last couple of years have been much higher; so they've been operating at more like 30% of sales. So really high – even moving into negative free cash flow. They've been spending and building up a bit of debt. And now we're going to see the other side of that. So a lot of investment – probably one of the more capital-intensive businesses that we own. Again, TSMC will be a comparison, which will be a bit higher. But yeah, really high levels of CapEx. So I think quite exciting to see those assets now being used.

MM: That's a pretty bullish statement from management – I suppose – on their confidence in the future.

TM: Absolutely. And there's no shortage of demand. So they're still investing in Vacaville. This is the US site we talked about. That's where some of that 15% is going. There's a lot of confidence that this can be delivered, but they have to operate and execute well.

MM: So obviously it's a significant investment. This sounds like a very costly industry to play in, let alone lead. Any idea what a new plant would cost to build greenfield today?

TM: It obviously depends on the size and what you want to manufacture. A big chunk of the business is the manufacturing of monoclonal antibodies or mAbs. A big plant – you're talking in the order of hundreds of millions of dollars. So you're not quite semi scale, but if you want to build multiple of those then you're in the billions. This is really expensive capacity that you're building.

MM: And just going back to the comparison with its peers. I'm not sure if Lonza is significantly more profitable or more cash generative than the Samsungs and the WuXIs, for example. But does Lonza – by virtue of its scale, its balance sheet size – does it have an advantage in terms of continuing to push the envelope on investment and others forcing them to follow?

TM: I don't think it's per se a financial advantage. So, you know – Samsung: there's no lack of

funding. They've got a very rich parent. Samsung's got plenty of money to spend. WuXi: real scale, the Chinese are very behind this; it's is a real high priority industry. To be clear, Wuxi is private, but Wuxi is well funded.
And Fujifilm, they've got a lot of cash flow from legacy. They know where the future is. We had the management of Fujifilm in a couple of months back. This is the area they're investing in; along with semi as well. They've got semi chemicals.

So, no lack of capital for the competitors. So, they're [Lonza] going to have to win on quality, trust, customer service, technology, being more digital, being more agile. But they have a massive advantage I think in being in Europe, in the US; that's really, really critical as well.

MM: Okay. You kind of touched on it before, but when you look at the pharmaceutical industry, it has a bit of a reputation for being quite defensive; kind of low growth, stable. Of course, they can go through periods of higher growth if they launch a fantastic new breakthrough drug. What sort of growth are you expecting from Lonza over the medium to long term? I mean, super-long term, where do you think this company can get to, maybe in terms of market share of the industry? Or what percentage of the industry becomes outsourced? And again, super-long term?

TM: It's an interesting question. Roughly the outsourcing rate today is about 50:50. CDMOs have outgrown the industry very significantly for the last decade, every single year. That's where we're kind of roughly at today. And I really see no change in that trajectory. I expect the outsourcing rate to get really pretty high.

There are occasionally accelerants to that as well. There have been quite a lot of deals to buy capacity from pharma. Actually the Vacaville deal that Lonza did – that was buying capacity from Roche. That was the original Genentech facility; kind of famous in biotech history. And you've seen other players do that, too. So I think that directionally feels very solid. And that's how you get to that kind of 8-10% CDMO market growth. Where the overall pharma market is probably more like – let's call it – 6%-ish, that kind of ballpark growth industry.

Because that outsource piece is moving steadily but relatively gradually; it takes time for the next drug and the next drug to being more likely to be outsourced than insourced. That can continue for decades until you get to that – who knows – 80%, 90%. But I think they [the outsourcers] will take the bulk of what's new. That's been the history. That's the beauty - this growth can sustain for a very long time.

And I think Lonza can continue to – and the other big players, to be fair – can continue to take market share gradually over time. But it's something that happens slowly because of – you know – we talked about how the drugs develop. You're not typically trying to poach a manufactured product. You might share, you might have multiple sources for those big, big products; but it's more about getting in early and then growing that base as new products are developed and commercialised.

MM: We talk a lot about culture here at Walter Scott. And certainly over the years, we've come across many companies who on paper analysed beautifully, but ultimately we haven't decided to invest on clients' behalf, perhaps because the culture doesn't align or we're not comfortable with it. Talk to us about your impression; your first impressions of the culture at Lonza when you went to visit headquarters.

TM: Headquarters is in Basel. I think the interesting thing about culture is that the culture kind of has to suit a little bit what you're trying to achieve, what you're doing. A lot of our companies are world-leading in what they do. World-leading in science or technology or they just have a certain culture which is engineering stars and new product breakthroughs or their sales organisations are really aggressive. So you have those kinds of cultures, which is very common in our portfolio companies.

But then when you have an outsourcing organisation, something more like a TSMC or more like an AWS at Amazon, those kinds of businesses – certainly for Lonza – I think you need a different culture. It has to be customer centric, and it has to have that humility aspect. What the customer is doing is the most important thing. Because you are entrusted with the most valuable thing that the customer is going to do. You have to deliver that product. No mistakes. It has to be perfect from a regulatory perspective.

So you have to be humble and say, "okay, this is most important; more important than us." I think that's a great culture to find. And that's certainly what I've come across so far at Lonza. Clearly we need to keep on digging, but that's what we look for in terms of the right cultural fit for that kind of outsourcing type business.

MM: Thinking about the businesses that we've invested in historically, we talk about the 'picks and shovels', if you will. Maybe not the household names that a lot of people would recognise. And Lonza probably falls into the category; no less important because it's not a household name. It feels like there's parallels with Lonza and lots of other companies that we've gone into historically.

TM: I agree. I have to admit that when I started reading about Lonza, I kind of had no idea really what it did. I'd heard the name many times. And it's a really big business. But I expect many people will be in the same boat. It is not a household name and possibly never will be, which is not a bad thing.

MM: So we can't have an investment conversation these days without referencing the topic of the day: AI. There's been plenty said already about the potential for AI to accelerate drug development and to perhaps address the high failure rates that you've already referenced in drug development as well. How do you see AI adoption over the medium to long-term impacting Lonza's business model, for better or for worse?

TM: I think there's maybe two areas that are obvious, but there are many things that come to mind. One is, they should be able to do more in automation. So actually, while there's not that many people, there are a lot of process steps which are not highly automated today within drug manufacturing. There's a lot of paperwork, FDA filings, etc., which is very laborious and a lot of things that are still kind of embarrassingly archaic, mostly because of the other side, not the Lonza side, but this is the way the industry operates. So there's a lot of room for efficiency and applying tech to the industry generally, and that should help speed things up and to just improve things massively and make things more flexible and more dynamic.

I think probably the most interesting piece, though, is AI drug discovery. If we do really realise that dream and reduce failure rates and have AI discover amazing new molecules, that'd be really exciting.

Biology is still going to be complicated – it's one of those massively complicated areas. So I don't think we get every shot to be a success. But let's say you increase success rates meaningfully. It's great for the world, great for patients – if we could find cures for some of those challenging conditions, that would be wonderful. And it'd be great for Lonza, too. They could be the manufacturer of those products. You still need a physical asset to bring those new molecules to the world. You'd have less failure rates, which means they'd lose something on the R&D side. But the real high value is getting those products to the commercial setting.

I had this discussion with management as well. I'd love to see Lonza as *the* place where these new AI drug discovery businesses go. And existing businesses are using these technologies, too, of course; the pharma companies that we invest in as well. Lonza, particularly in Vacaville – the location is perfect. You're sitting in Northern California. You're at the centre of AI globally. That should be where the next generation of drugs are produced.

MM: Thank you, Tom, so much for your time today. It's been fascinating listening to you explaining more about Lonza. And to everyone listening or watching: thank you for spending the time with us. We hope you found the discussion useful. If this format appeals, there are more *Digging Deeper* films available in our archive. We'll link them in the show notes and on our website. Thanks again, and until next time.

WALTER SCOTT

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