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MANAGEMENT DISCUSSION SECTION

David Howard Windley
Analyst, Jefferies LLC

All right, good morning. Welcome to Jefferies' 2018 Global Healthcare Conference. We appreciate your attendance. I'm Dave Windley with Jefferies' Healthcare Equity Research. Here to kick off day one and first presentation slot for our healthcare conference is West Pharmaceutical Services. And here with them is the company's CEO, Eric Green; the company's CFO, Bill Federici and the company's IR representative VP, Quintin Lai, is along with us as well. So I'm going to let Eric give some preliminary remarks and then we're going to launch into Q&A.

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

Great. Well, good morning, David. And thank you for the invitation to the Jefferies healthcare conference. It's great to be able to kick if off for the week. I'll just start off by saying that – give you a little bit of background about West for those who might be new to the story. West, we just celebrated the 95th history of the company. It's been formed back in 1923.

And we have been really true to our core focus as being the leader of primary containment of injectable medicines. And it started with producing of elastomeric products used for containment of injectable drugs around the world. We are a very diverse organization. Over 50% of our business is outside the United States, roughly 10% is in Asia and Latin America and about 40% is in EMEA.

When you think about our customer profile, we reorganized our company a couple of years ago to really be more market-led to be focused on the customer segments that we serve. And today, the way we are aligned, we have about 20% of our business is in the Generics space. We have roughly around 23%, 24% in the Biologics, about 30% in our Pharma which is really small molecule and then the balance, a little over 20% in our contract manufacturing business. Like I said, we have 28 manufacturing facilities around the world and we're able to service our customers from a geographic and from a customer segment point of view.

We have been on a very healthy growth trajectory for the last several years. And the main driver of that growth is our high-value product portfolio. And these are products that have been designed and manufactured at the highest level of quality in the industry. And these products – we're migrating our customers from standard packaging to high-value products, which has given us a more favorable economic return, obviously, to [ph] West's

(00:02:34) shareholders but also higher performance for our customers, we're looking at the more complex molecule especially in the areas of the Biologics.

So just to summarize on the business at West, we have a very strong platform of assets that are on the ground. We're continuously innovating new products that we're able to introduce into the marketplace based on our customers' expectations and needs. And we have globalized our operations to actually give us a better footprint to be able to service our customers more long term. So I appreciate the time, David.

David Howard Windley
Analyst, Jefferies LLC

Thank you.

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

We'll get into the Q&A.

QUESTION AND ANSWER SECTION

David Howard Windley
Analyst, Jefferies LLC

Q

Super. So thank you for that. We've been through a period over a couple of years where your high-value products that you just described and kind of your market-led strategy led to a pretty significant upsurge in orders that then led to kind of a lengthening of your lead times. And I think you've largely fixed that now. So perhaps you could describe to us your confidence level that – and we've been through this inventory correction and order patterns are kind of returning to normal. And then after that, let's talk about some of the steps you've taken to kind of get inside the client and get that information and confidence.

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

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Absolutely, David. So back in 2015, a few years ago, we had a very focused approach specifically in the Generics space to move our customers from standard packaging to high-value products. By doing so, that puts additional pressure on our operations specifically around the Westar washing capabilities and our Envision inspections. And we were in this flux of adding capacity in our Kinston, North Carolina, plant and also building out our Waterford, Ireland, facility which has just recently completed.

That's a bottleneck that occurred increased lead times for our customers significantly. Our customers reacted in a way of putting more orders into the system to ensure that they had adequate supply for their own supply chain. That was alleviated in early 2017 when we started to demonstrate a significant reduction in cycle time for our customers from anywhere between 30 to 40 weeks down to less than 10 weeks. We have been able to -- with the investments that we made in the facilities that I'd mentioned but also applying lean principles in some of our facilities, we're able to debottleneck and been able to provide better service and faster turnaround times for our customers. We are made to order. We don't make stock. So each and every order that comes in is a custom design for our customers for that particular molecule. We have put, as I mentioned, assets on the ground to alleviate that bottleneck and very comfortable as we continue to grow our high-value product portfolio high single,

low double digits, we can handle the volume or the capacity through our existing facilities for a number of years to come.

David Howard Windley
Analyst, Jefferies LLC

Q

Okay. So that answers kind of the next question on the capacity to handle growth. So you say you've got a number of years of growth in the buildings today.

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

A

Right. So one of the actions that we took with this organization is we globalized their operations. Historically, while the operation is running effectively, we had 20 sites that were somewhat independent and running regional from a site-specific perspective. We globalized the operation. So we're able to start level-loading our operations and start creating a what we call West network. So our clients that come into West and are looking for a particular process, we can design the process in multiple facilities. To give an example, we have created centers of excellence in our Kinston, North Carolina, facility and the Waterford, Ireland, facility that's coming onboard, Singapore and also in our Pennsylvania facility, Jersey Shore. And with those facilities, we're able to work with the customers to level-load and be more efficient.

With the Kinston expansion that took place, we validated the facility. We have roughly around capacity utilization of about 30% to 40%. So we have growth opportunities for the future growth in Kinston. In Waterford, that plant has just gone to commissioning as we speak right now. And that really gives us a confidence that we're able to handle high-value products finishing process for several years to come. So right today, the capacity is literally 100% available for us to leverage. So as we work through the global operations; we're able to right-size our facilities, bring into the centers of excellence concept that gives us multiple years of growth and gives our customers confidence that not only one plant but multiple plants can service them on an ongoing basis.

David Howard Windley
Analyst, Jefferies LLC

Q

And so to the prior question, you mentioned that your focus from an end market-led standpoint and moving clients to high-value product kind of focused at least initially on Generics. I think there has been kind of the cycle of, call it, inventory build and then inventory destocking across your end markets both – or all of Generic, Pharma and then Biologics. Talk about the subsequent impacts to order patterns in Pharma and Biologics.

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

A

Yeah. That's a great question. So while the backlog did occur, customers were taking inventory and having within their own facilities roughly around, call it, six months as an example. And today, because of the confidence level of our delivery times, we're able to have our customers reduce their own working capital to the areas anywhere between two to three months. So that effect happened – if you look at our Generics business in 2016, that business grew very strong double digits. And in 2017, there was a destocking effort by our customers. And that effort has brought down, again, the lead times roughly around two to three months for our customers as far as inventory holding. But that had an impact on our revenue for 2017. It was roughly around flat.

If you look kind of 24-month period, that business has grown mid to high single digits. The market in Generics space from a unit perspective, number of injections from a unit perspective, is roughly around mid single digit. And so our focus is to grow at slightly above the market, obviously. And we demonstrated that over a two-year

period for Generics. As we look at where we are today, demonstrated in the first quarter; we're confident. And looking at our backlog of orders that we have on hand that we need to deliver to our customers in the near term, the Generics business is back on track as expected. And that similar effect had occurred in our Pharma business segment and a little bit on the Biologics. So the efforts we put in place to truly globalize our operations, to get capacity available for our customers and to really reduce the lead times to be the best in the industry. And this is paying off. But we saw the impact of that normalization, I would call it, back in 2017.

David Howard Windley
Analyst, Jefferies LLC

Q

Right. And then one of the things that in prior conversations, Bill, you and I had spoken to was some of the investments the company has made in, and my sense was, people and relationships with Pharma to kind of get inside their supply chain and understand from a projection and predictability standpoint what the client's supply chain looks like so that you can have a better confidence going forward of when to expect their next order essentially. Can you guys talk about that a little bit?

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

A

Please go ahead.

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

A

Sure. So exactly what you said, Dave. So this industry is not known for its transparency generally in terms of supply chain. There's a lot of competitive forces. And as Eric described, we work with everybody. So one of our challenges has been trying to predict what the customers' orders are going to be. As Eric said, we're a make-to-order shop. So there is some lumpiness in terms of order predictability based on where the customers are in their own lifecycle of the drugs that they're selling, what's in the supply chain and also then what their holding patterns are, what do they carry themselves.

So in a less-than-transparent supply chain that we're working in, it makes it very difficult to predict and forecast. We brought in, almost two years ago now, a new global leader of our manufacturing process, Dave Montecalvo. And he brought with them decades of experience working in large environments where there was more transparency between the manufacturing side and the supply chain side of all of these organizations. So he set out and has done a great job of working with our customers directly in a win-win kind of situation. We offer them – if they let us see a little more transparency as it relates to what their holding patterns are and what they're seeing in the supply chain, we can better perform for them. We can reduce their working capital by level-loading our plants and being able to reduce our lead times to them. So there's a win-win here for both sides. It doesn't work with everybody. It started slow. We've got a number of our large customers in both the generic and the pharmaceutical markets who have opted onto this program and are working closely with us to alleviate excess capacity, excess product in the supply chain and be able to do more predictable manufacturing and supply. So, Dave, it doesn't work for everybody. But it is a good program with benefits for both sides. And we see that continuing as we continue the efforts to try to increase the transparency.

David Howard Windley
Analyst, Jefferies LLC

Q

Fantastic. So I've focused a little bit here to – at the outset on the short term on the tax code. Let's broaden that to more strategic. As you think about the macro drivers in the industry, more injectable drugs, kind of the percentage of drugs that are approved that are injectable is growing. And then kind of the potency or the aggressiveness of

those drugs then drives demand for high-value versus standard, I think. So without stealing all your thunder, talk about the factors that you see really favoring West play on the injectable drug market.

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

A

Yeah, and that's a great point. When you think about our high-value product portfolio, the thesis behind the portfolio is to be able to address some pretty complex configurations of new molecules coming to the marketplace. Let's focus on the Biologics particularly. When you think about the Biologics, the majority of the products require some type of coating on our elastomers. And that's where West is very good at.

You start thinking about our FluroTec coating technology and the capabilities. You start thinking about our washing, the technology that we have in-house built to wash to reduce the particulate levels to sub-visible levels that are industry standard. You start thinking about the Envision equipment that we put in place to be able to detect any particular defects so that we can alleviate those type of concerns when they get into our customers' hands. And that's why when you start thinking about the growth of the high-value product portfolio and the complexity of the new molecules coming into the marketplace, we're really positioned well to continue to participate on a very high percentage of the Biologics that are being [indiscernible] (00:14:58) through the pipeline today. Now, the acceptance of those drug molecules in the market could vary from one to the next like any other new product lifecycle. But the benefit for West is that we are participating on basically the entire array of products in the marketplace.

The high-value product value proposition isn't just for the Biologics space. If we turn our attention towards Generics as an example, we've launched a new campaign or program called AccelTRA. And what AccelTRA does – it's a program focused on three key areas, simplicity, it's about speed and it's around documentation and quality. When I say about speed and simplicity is that in the Generics space, as you know, is that there's a very short window of opportunity to get your drug molecule approved and into the marketplace. And you need to get a high acceptance and market share. For West, what we've identified through this market-led approach is that our customers in the Generics space, we were creating hundreds of SKU variations for our customers. And so we've actually simplified this through our AccelTRA program to a very few number of SKUs so they can create more of a platform concept.

So we're able to level-load our operations. Fewer SKUs through our plants like Kinston allows us to much more effective efficient runs for our customers and give it the highest level quality with the full suite of documentations required that our customer can simply go to the filing agencies and file for their drug molecule. So we're seeing a high level of acceptance and interest in that particular part of our portfolio. And again, that's the high-value product journey that we're on at this point. To put it into dimensions for you, to put it into context, think about our high-value products. We produce over 41 billion components a year. In our high-value products, less than 20% of the number of units that we produce are high-value products. And when you think about the revenues, the revenues of our entire consolidated business is slightly over 40%. So when you start thinking about the Generics, we see very high participation in the Biologics. And also the interest in some pharmaceutical companies to create a platform to drive for zero defects is driving our customers towards the high-value product portfolio.

The economics, as I mentioned earlier, is favorable for West because there is a higher-priced ASP. There's obviously a little more margin associated to that. But our customers are seeing the value for that service. And so they themselves are trying to do that internally within their own operations. So this journey, we've been on for a while. But when you start thinking about the road ahead of us and the opportunities with the new biologics coming into the marketplace, there's more interest in the Generics space. There's a very attractive growth opportunity with our high-value product portfolio for several years ahead of us.

David Howard Windley
Analyst, Jefferies LLC

Q

So we take that one step further. So I think the investor community understands fairly well. You've talked about the shift from standard to high-value for some time now. And I think we understand the opportunity to shift the 80% toward the 20%. But even within the 20%, it's my sense that an awful lot of the volume within the high-value products is in, say, the entry point, the entry high-level product, the washed. But there's an opportunity to move from washed to sterilized to Envision and inspected et cetera. What drives a client to move up that ladder?

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

A

Yeah, absolutely. So for our clients, it's easier to have that conversation to move up, obviously, than to move down. And when they're looking at their new pipeline going through R&D and into commercialization, they're looking at ways to – because the complexities of products is increasing. And so, therefore, they're looking at ways to drive even further defects at the end – finished process that they go through to get the drug molecule in the marketplace. Their particular cost of those molecules are only increasing over time because of the complexity. And the risk of having a defect at the end of the process increases if you're not introducing some of the steps to mitigate those defects. And that's where the interest level towards Envision all the way up to our highest offering of NovaPure, which is quality by design, is gaining traction with our customers.

Any transition isn't going to happen overnight. So if you think about the early stages of our high-value products had been in existence over a decade. And the acceptance rate or the penetration rate is roughly around at least about 40% at this point. And so thinking all the way up to the highest level of quality that we provide today, the NovaPure; that's less than 1% of our sales today and it's been introduced about a year and a half ago. Interest level is very high. But it takes time for our customers to validate, to look at which products they want to put the NovaPure on and then adapt over a period of time, one or two years later. So it's a long journey that's ahead of us. But the conversation really is the value proposition of really solving some complex issues they're faced with at the end of the line of their drug molecule before it gets launched into the channel.

David Howard Windley
Analyst, Jefferies LLC

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And I think people will probably intuit this. But just to confirm, you talk about standard versus high-value product margin contribution of high-value product in general is higher. But then we should also expect and believe that as you move up through high-value products; the average that you get, which I think is in the low 50s, that entry-level high-value product is lower than that. NovaPure is much higher than that.

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

A

Right, no, absolutely. So when you think about the high-value product portfolio, roughly around 55% is the average margin on that portfolio. The majority of the revenues and volume is on the early stages of high-value product; Westar as you mentioned, the washing capability, sterilization, getting into the Envision inspection. We move up to the higher end of that spectrum. It's obviously well north of the 55% average. And so you start getting into the 70%, 80% type of a margin perspective. But I have to be very clear though. The value proposition to our customers and the acceptance – if you're talking about a $100-, $500-, $1,000-dose drug molecule; to move it to a NovaPure, as an example, on average, let's call it a $0.70 to $0.80 to $0.90 solution is insignificant. We're still less than 1% of the COGS typically when our customers are making those decisions. So you're absolutely correct. The margin expansion occurs as we evolve our customers up the lifecycle of the high-value product curve. But

also, when you start thinking about the scale and the size of these orders especially in the Generics, we'll drive that adoption rate much faster.

David Howard Windley
Analyst, Jefferies LLC
Q

Great. And in the time we have left, probably one more question here. You are in-flight on the transition of a major injectable manufacturer from standard to high-value as a portfolio. As opposed to kind of the product-by-product decision, this client has decided to move...

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

Yes.

David Howard Windley
Analyst, Jefferies LLC
Q

...en masse. What are the milestones that you – I know you don't want to talk about the individual client. But as you think about the success steps for that individual client, what are some of the milestones that you need to deliver? And then as you do that successfully, does that then become an example for other clients to follow?

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

It is, absolutely. No, we do not discuss specific customers and nor we will discuss that amongst the customer base. But we are able to demonstrate that over – if a customer decides to create a platform of their products going through the high-value product portfolio at West. There is a journey that we are on. And it usually takes two to three years to make that conversion meaningful because, again, there's significant testing, validation done in the early stages. And then they evolve as material – that product needs to be introduced into the marketplace. Now, every customer is going to have a different dynamic. So smaller firms, it might be the new molecules coming through the pipeline. They made a decision across the board, we're only going to bring in NovaPure for those portfolios. And so those are the type of conversations we're having at this point. But once the decision is made; it does take a period of time to move from discussion, validation to commercialization. And that time tends to be measured in quarters and years versus days and weeks. So it does take some time to make that transition occur.

David Howard Windley
Analyst, Jefferies LLC
Q

It takes some time. To the last part of the question, are other clients kind of observing this process and kind of pending decisions are based on that?

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

Yes. Most of our clients are taking a look at how far do we want to move up that spectrum. And again it does vary based on their own portfolios so they do make decisions on segmentation in their portfolio, which area is more effective to drive with the high-value products at West. But the journey is pretty consistent conversation. Look, the regulatory hurdles are becoming more stringent. The quality standards in the industry are only increasing. The focus on reducing working capital of our customers is increasing. These are all areas that West is very well positioned to address for our customers. There isn't a company today that can handle the type of complexity of molecules that we are today with our customers. And when you start thinking about what's the next generation for

West? You're absolutely correct. We are continuously developing and focusing on broadening the pipeline of product offering to our customers but also extending it further so that these quality discussions in the industry are dissipated when you come to West. So that's our focus with that portfolio.

David Howard Windley

Analyst, Jefferies LLC

Super, appreciate that. So we'll wrap here and break out in the Broadway Room one level down. Thank you very much.

Eric Mark Green

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

Thank you, David.