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West Pharmaceutical Services, Inc. (WST)

Barclays Capital Health Care Conference

CORPORATE PARTICIPANTS

Donald E. Morel, Jr.

Chairman, President & Chief Executive Officer

William J. Federici

Chief Financial Officer & Senior Vice President

MANAGEMENT DISCUSSION SECTION

Unverified Participant

Good afternoon, everyone. It's our great pleasure to host Mr. Don Morel and Mr. Bill Federici from West Pharmaceutical Services with us here at Global Healthcare Conference this afternoon. So we're going to start by a brief ARS system to [ph] gauge (00:22) the investors in the audience and then we proceed with our fireside chat. And after that, we will proceed to [ph] Pontiana 3 (00:31) room for the breakout session.

So the first question is, will the impact of healthcare reform be larger or smaller than the impact seen in 2015 for the company? So one, for significantly more impact and 5 for significantly less impactful. Okay. So I think the response seem to be neutral.

For the second question, what will utilization trends look like in 2015 for the company, one for significant increase and five for significant decrease? So we have a bias towards the positive, more on the increase side from the audience today.

Question three, how would you like to see the company deploy capital in 2015? The first option, M&A; second one, share repurchase; three, increase the dividend; repay debt; or the last option invest in core growth. Ok ay. So I think the top two priorities that people like to see for the company are M&A and investing in core growth.

Question four, do you think the company will grow earnings in 2016 faster than 2015? One for significantly faster and five for significantly slower. Okay. So I think we have a lot of expectations building in for 2016.

Question five, do you currently own shares in the company? One for yes, and two for no. Okay. So we have 50-50 audience, half of them are [ph] new to the name (03:09) and a lot of opportunity for you today.

Question six, what is your current bias on the stock? One, for positive; two for neutral; and three for negative? So we have a positive bias on the stock, 40% of the audience and 60% neutral.

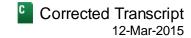
Okay. So I think that's it for our ARS questions for today. We will turn to the fireside chat section. So I think with 50% of the audience being new to West, I would like to ask Don and Bill to give overview of the company and the direction that you want to see the company going forward?

Donald E. Morel, Jr.

Chairman, President & Chief Executive Officer



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Sure. The company is a manufacturer of components used in disposable medical devices and injectable drug packaging and, more recently, the development and commercialization of fully as sembled devices for drug delivery. So we operate two divisions. Our revenues last year were about \$1.4 billion. The largest of those divisions is our pharmaceutical packaging systems group which is about \$1 billion in sales, global serving all of the major multinational pharma, biologic, generic customers, as well as the largest med device customers.

The device delivery systems group is about \$400 million. It also serves the global med device and pharma base. It's about 75% contract manufacturing right now and about 25% proprietary. So we're very fortunate and that we enjoy substantial market shares in our core business, especially in markets like diabetes, oncology, autoimmune disease, vaccines, generics, dental products, veterinary products. In the Western markets, seven out of 10 injectable drugs are packaged using West components. We enjoy a very strong position in biologics where the world's top 35 biologic drugs are all packaged using either West components or Daikyo components.

Our gross strategy is quite simple. We've enjoyed fairly robust growth over the last three to four years. In our core packaging business, we are focused on what we call our high value products given the pressures on the industry for particulate-free, ultra clean dosage forms on the device delivery side. We're going to ship that business from contract to proprietary. We drive higher margins of our business when we have proprietary content either through our manufacturing processes or through intellectual property that we own. If we're successful in doing those simple things, we within the next five years, hope to grow our business north of \$2 billion and our operating margins should be in the high teens in the 19% range.

So that's kind of a long range picture. The drivers of our growth pipelines and biologics are very strong. Last year, we had 41 new molecular entities approved in United States, 17 of those are injectables. We expect to take advantage of the growth in biologics expansion and indications as well as growth in emerging markets in the core business to drive our revenues for the future. So we think we're in a very good position right now.

QUESTION AND ANSWER SECTION

Q

Okay. Thank you, Don. So now that you mentioned the biologic markets and the growth and the pipeline that you're seeing, could you talk a little bit more about how lever your growth is may be in the packaging system segment to the growth of the overall biologic market growth. If we think about 10% growth in the biologics market given your unique offerings and the fact that some products will have to cycle through from the low value to high value packaging system, should we think that you will be able grow faster than the overall biologic market?

Donald E. Morel, Jr. Chairman, President & Chief Executive Officer

Well, I think our revenues are on a comparative unit basis will increase very nicely. We have to be careful to separate out revenue growth in the biologic space where the drugs are quite expensive from the unit growth rate.

I do expect that our dollar growth rate in terms of revenues will exceed the unit growth rate in the market. But the upside for us is not going to come from the packaging systems group there. We will get very nice growth driven by biologics and packaging. But one of the major trends in our business is the lifecycle management of some of these drugs in the emergence of biosimilars as well as platforms to enable the delivery of certain drugs that have to be formulated differently.

So we see the combination of the primary container where we do the packaging components and with the CZ technologies of the primary container. Plus the delivery device itself coming together in a combination product is one of the major trends that's going to drive our revenues. That will give us a bigger percentage of the sale of the product in terms of our own revenues and we think will help us grow our own units quite substantially. So the biologics segment is going to be a very good driver for us.

Q

Okay. Thank you. And moving on to biosimilars. It has been one of the biggest topics at our conference this year. Could you just give us a little more color on how would you capitalize on the biosimilars coming to the market now in the U.S. and may be give us a little bit of example of how you fit into the lifecycle of a biologic drug as it move and have biosimilar competition? Would a lot of biosimilars for the same originator drug be good for your business?

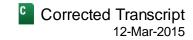
Donald E. Morel, Jr.

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Chairman, President & Chief Executive Officer

So if you take a biosimilar that would follow somewhat the traditional route of the small molecule going generic, when a small molecule goes, we will usually get a call from the generic company asking what the innovator used for the packaging materials. They don't want to introduce any additional risk into their process. So they're going to duplicate the formulation, they're going to duplicate the active. We normally pick up the generic business as well. It stays – it's a nice part of the stickiness of our business.

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We believe that behavior will follow with biosimilars. So many of the biologics today use our most advanced material formulations, coating technologies, processing technologies. And again, the biosimilar developer does not want any risk in their application process. So they will often look to use the same packaging used by the innovator. So in almost all cases that I can think of with one exception – the molecule that went commercial in India with a local producer – the biosimilars that have come to market have – that utilized West have stayed with West. So it's a good trend for us. We think we will pick up that volume.

Okay. Thank you. And moving on to the delivery system segment, which is also another important segment for West. You mentioned the revenue contribution from both the proprietary systems and the contract manufacturing. Right now, the proprietary system contributes about one-fourth of the revenue of the segment...

Donald E. Morel, Jr.

Chairman, President & Chief Executive Officer

About 25%.

...25%. Where do you see that percentage contribution going? Where would you like to see it going?

Donald E. Morel, Jr.

Chairman, President & Chief Executive Officer

So one of the strategic goals we've talked about for the business is to grow that ratio to about 50-50, and we believe we can do that with the products that are currently in our pipeline driven principally by our reconstitution systems and what was our Medimop group. The introduction of Crystal Zenith resin as a primary packaging material both for prefilled syringes and for vials and in a third category actually custom containers and then the introduction of the Smart Dose on body wearable injector. Everything we need to do to achieve that is in process right now and going through various clinical trials and regulatory filings. Those revenues almost likely manifest themselves in the outyears of the plan. But we do believe by the end of 2019 within our current plan that we will be at about 50-50 in terms of proprietary and contract.

And what would that contribute to the bottom line for the segment?

Donald E. Morel, Jr.

Chairman, President & Chief Executive Officer

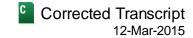
Bill?

William J. Federici

Chief Financial Officer & Senior Vice President

For the segment right now as you said it's 25% proprietary and 75% contract manufacturing. Obviously, with the contract manufacturing being the lion's share of the revenues, the margins are less and therefore the contribution is less. As we see, as Don said, migrating more towards a 50-50 split, those proprietary products carry a margin

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that's much closer to the 40% plus gross margin and therefore as it becomes 50-50, you'll have a much higher contribution margin coming from that segment to the point where we believe it will grow from an operating margin today of something around in the low to mid singles to something to the mid-to-high teens.

Q

Okay. Thank you. And what would be the driver of that – may be drive the 50-50 revenue split before 2019?

William J. Federici

Chief Financial Officer & Senior Vice President

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For 2019, as Don said, it will be — we will — in the device segment, we will be primarily looking to see growth coming from the contract manufacturing side. On the proprietary side, we do have two commercial products we have. The products that are in the Medimop portfolio of reconstitution products and we also have a safety portfolio. Those will continue to grow nicely. Where we'll see the growth near term is in CZ and SmartDose will be more in the sampling of those products as customers get familiar with them or through stability trials and regular clinical trials towards the development and ultimate commercialization hopefully of those products.

So when we look at that, in the near term, we're focused more on the growth and the profitability in line with what we have today. Once, as Don said, we get out into the later part of the five-year planning horizon, we believe we'll start to see some of those products in the CZ and SmartDose come to commercialization and that will be the ramp, the hockey stick, the inflection point that we'll start to see the growth on both revenues and profits.

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Okay. Thank you. Moving to the international opportunities, I understand that China and India are two very important international markets for West. Could you talk a little bit more about the revenue composition in these two markets that West has been able to achieve and what kind of competitive dynamics that you see locally?

Donald E. Morel, Jr.

Chairman, President & Chief Executive Officer



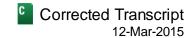
It's very different than the Western markets and we actually have to split the two. So China is two markets in one. It is the foreign multinationals that are establishing operations that already utilize West for their products. And then it's the local domestic markets and the state-owned pharmaceutical companies that are run principally by the Chinese.

So we have a dual branding strategy to attack both of those markets. We will have the traditional West brands for the multinationals and then a new brand that will be launched to serve more of the emerging market companies.

India also very different and the bulk of the business there is mostly for exports. So our tendency is to support the manufacturers whose business is dominated by European and United State's exports. Many of them, the U.S. multinational generic companies such as Hospira for example, building their facility in Vizag. So for us, the revenues there combined between China and India about \$80 million. They have grown at double digits for the past 10 years. We still see very attractive growth there.

We also see opportunities for our devices. We make closure system for a company called TrimTec which goes on to IV bottles. In the Chinese market, there are 4 billion IVs administered per year. Most of those in non-closed glass systems. They utilize a large rubber stopper. We think that our system on [indiscernible] (15:46) bottle offers a lot

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of opportunity. And we followed our customer into China, and built a facility to manufacture the TrimTec for them. So the growth opportunities will be from a combination of supporting our traditional Western customers, and then the local domestic producers as well.

Q

And in terms of the competition with locally in China and India, what kind of dynamics have you been experiencing?

Donald E. Morel, Jr.

Chairman, President & Chief Executive Officer

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So it is a very fragmented market in China. A number of years ago, the local Chinese stopper manufacturers, closure system manufacturers were using a great deal of systems based on natural rubber. And natural rubber was excluded from many Western systems prior to that because of the latex allergy question. We actually use dry processed natural rubber so the proteins that cause that reaction are actually taken out of the material.

But the Chinese government decided to issue licenses for synthetic closures, only issuing 33. That put a lot of the local firms out of business. The business began to consolidate within the remaining ones. But it's still extremely fragmented. So there's a couple of dominant players that are very, very strong, [indiscernible] (17:06) as well as a company [indiscernible] (17:08) both very good, both serving the bulk Chinese market mores o than the Western market.

From a Western standpoint, our competitor in Europe [indiscernible] (17:21) sells into China but does not have operations there. So we're the only Western supplier to my knowledge currently producing in Continental China.

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Okay. Thank you. And I would like to touch on the topic of the pricing power given the unique offerings that West has. Can you walk us through the dynamics of how you raise prices for certain products which you have a high level of stickiness with customers, what the push and pull of how you feel [ph] it would climb (17:57)?

William J. Federici

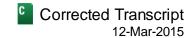
Chief Financial Officer & Senior Vice President

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Got it. On the packaging systems side of the business, about half of that business is covered by long-term contracts. And those contracts have a price escalation mechanism built into them based on either CPI or PPI or a combination thereof. So once a year on the anniversary of their contract, we will revisit the pricing power that we experienced in terms of that basket of goods over the last 12 months and that then becomes the basis for negotiating and increasing the prices going forward. So for that half of the business, it's pretty much contractually regulated.

For the other half of the business, it's better done on a purchase order basis. Once a year, usually around October, November timeframe, we go out with price increases for the customers. And again, it's based on a bunch of different factors taking in consideration, overheads, labors, and material input costs. And then those will be effective for the next year. That's generally how it works. The issue with a lot of the pricing pressures question is, gee, you're regulated into the product, why don't you just go ahead and raise prices?

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It's true. On the regulated product, we could certainly raise prices. And I don't think our customers will be too happy but certainly they'd have very little they could do about it other than if they wanted to change, they'd have to redo stability testing which takes a lot of time and a lot of money to effect that change. Where we see the problem with that is that, if you were to go ahead and basically disrupt the regular pricing mechanism you have by throwing something on top of that or asking for outsize price increase, where you really run into trouble is what you're trying to do, and especially in the biologic space, is to work with the customer on the next drug that's going to be coming out or the next product that's going to need our — both on the packaging side and on the device side. So we try to partner with our customers in terms of making sure that the pricing is — we get our fair pricing, but that we're not being considered to be abusive with that pricing power.

It's a very fine line we walk. We walk it every day. Our sales people are well verse in helping the customer understand the true value that West brings to their organization through our products and the technical support we offer them and the product support. But it is a - let's just say, it's interesting at times and it's something that we take very, very high responsibility for.

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And to follow up on that, how difficult it is for and your competitor per se to walk into your existing relationship, assuming you have a really good relationship, long-standing relationship, with a manufacturer of a 10-year-old drug?

Donald E. Morel, Jr.

Chairman, President & Chief Executive Officer

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On the pharmaceutical side, it's difficult. It's a very, very rare that a switch happens from one supplier to another unless there is a change in a specific raw material, no longer being available or a plant experiencing a mechanical shutdown or something like that. Their requirement is that they do the stability testing which normally takes a period of two years. And then they do a supplemental submission with the new compatibility data. Normally, that costs somewhere between \$350,000 and \$500,000 per drug. So even a single submission for a change can be quite costly.

Has it been a case in the past where this might happen once every few years or not really?

Donald E. Morel, Jr.

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Chairman, President & Chief Executive Officer

It is extraordinarily rare. Since I've been with West over the past 23 years, I can think of less than five where that's happened.

William J. Federici

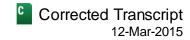
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Chief Financial Officer & Senior Vice President

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The competition is really for the next drugs that are being developed, right.

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For the next drugs coming in. Okay. That's helpful. And on your partnership with Daikyo, could you talk a little bit more about the history of the partnership and where you see the partnership going forward for the next three to five years?

Donald E. Morel, Jr.

Chairman, President & Chief Executive Officer

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Yeah. We engaged with Daiky o back in 1973. It was actually done by Bill West brother. They were looking to expand internationally. They had partners in Europe. They had partners in Central and South America. And for many years, the partnership was an equity ownership by West and Daikyo. In the mid 1990s, we began to get more involved with them in terms of exchange visits. We developed a distributorship arrangement where Daikyo would rep our products in Japanese and Asia-Pacific markets. We would rep the Daikyo products and support them in North America and in Europe.

And over the last 15 years, it's grown to be incredibly tight. We are probably Daikyo's number one customer now in terms of sale of their product in both Europe and United States. We do all the technical support for them. We've licensed in a number of technologies that Daikyo has developed. And Daikyo has licensed in a number of our technologies. So for example, our Westar processing and the post manufacturing treatment, Daikyo is all licensed in. We licensed the Daikyo FluroTec and B2 for the manufacturing of coating closures.

So it's become a very dynamic, very beneficial relationship for both parties. It's one that we see increasing in the future. Daiky o is the originator of the Crystal Zenith resin for example. They sell about \$60 million of that in Japan. We're beginning to develop that market in the United States. So I'm very confident in the relationship growing for the foreseeable future.

Q

Okay, thank you for that. And then another question I want to touch on is the industry practice of investing a few years ahead of the sales curve, because you have to work with the manufacturers before drugs become available in the market. Would that practice ever change where with the two or three year time frame that you have to invest ahead of the curve, the sales curve ever shorten or it might even actually expand now that we're talking more and more about biologic drugs and the longer lifecycle of the product?

Donald E. Morel, Jr.

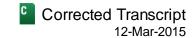
Chairman, President & Chief Executive Officer



So all of our products go through validation and verification. And when we produce a component to be used by our customers, we have to make the capital investment in the factory, in the equipment, in the clean rooms. We have to run the product. We have to do the validation and show the dimensional stability, the chemical extractable profile. And everything that meets our specification.

Once that's done then the customer has to take that product and run it on their own lines. And then they have to do initially for new drugs [ph] of course (25:18) the stability. So we often have to make capital decisions anywhere from three to five years in advance. In the example that we announced with Waterford last year, the new Irish facility that will not see sales until the early part of 2018 once all of the validation work is done and the customer testing work is done. So the capital decisions are pretty important. We have to get them right in terms of the capacity and the right location.

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Okay. That's all the time we have for the fireside chat session for today. We thank you so much Don and Bill for your time today. But we'll continue our discussion in the [ph] Pontiana 3 (25:59) room for the Q&A session. Thank you.

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