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West Pharmaceutical Services, Inc. (WST)

Q3 2015 Earnings Call

CORPORATE PARTICIPANTS

John R. Woolford
Managing Director, Westwicke Partners LLC

Eric M. Green
Chief Executive Officer & Director

William J. Federici
Chief Financial Officer & Senior Vice President

OTHER PARTICIPANTS

Larry S. Solow
CJS Securities, Inc.

Derik De Bruin
Bank of America Merrill Lynch

David H. Windley
Jefferies LLC

MANAGEMENT DISCUSSION SECTION

Operator: Welcome to the West Pharmaceutical Services, Inc. Third Quarter 2015 Results Conference Call. At this time, all participants are in a listen-only mode. Later, we will conduct a question-and-answer session and instructions will be given at that time. [Operator Instructions] This call is being recorded on behalf of West and is copyrighted material. It cannot be re-recorded or re-broadcast without the Company's express permission. Your participation in this call implies your consent to our taping. If you have any objection, you may disconnect at this time.

And now I'd like to turn today's meeting over to Mr. John Woolford, from Westwicke Partners. Sir, you may begin.

John R. Woolford

Managing Director, Westwicke Partners LLC

Thank you, operator. Good morning, everyone, and welcome to West's third quarter 2015 results conference call. We issued our financial results this morning, and the release has been posted in the Investor Section on the Company's website, located at www.westpharma.com. If you have not yet received a copy of this announcement, please call Westwicke Partners at 443-213-0500 and a copy will be sent to you immediately.

Posted on the Company's website under Investors on the Presentation Materials tab is a slide presentation that management will refer to in their remarks today. The presentation is in PDF format.

I remind you that statements made by management on this call and in the presentation will contain forward-looking statements within the meaning of U.S.Federal Securities Law and that are based on management's beliefs and assumptions, current expectations, estimates and forecasts. Many of the factors that will determine the Company's future results are beyond the ability of the Company to control or predict. These statements are subject to known or unknown risks or uncertainties, and therefore actual results could differ materially from past results and those expressed or implied in any forward-looking statement.

For a nonexclusive list of factors which could cause actual results to differ from expectations, please refer to today's press release as well as any further disclosures the Company makes on related subjects in the Company's 10-K, 10-Q and 8-K reports.

In addition, during today's call management will make reference to non-GAAP financial measures, including sales at constant currency, adjusted operating profit and adjusted diluted EPS. Reconciliations and limitations of the non-GAAP financial measures to the most comparable financial results prepared in conformity to GAAP are provided in this morning's earnings release.

At this time, I'd like to turn the call over to Eric Green, West's Chief Executive Officer. Eric?

Eric M. Green

Chief Executive Officer & Director

Thank you, John, and let me welcome you to our third quarter 2015 earnings call. I'd like to start by apologizing for the technical difficulties for those that are dialing in. Today I'm joined on the call this morning by Bill Federici, our Chief Financial Officer, and Mike Anderson, our Treasurer and primary Investor Relations contact.

During our commentary today, Bill and I will review our third quarter results, discuss our expectations for the remainder of 2015 and highlight our long-term business plan. We will then open up the call for your questions.

Starting with the results on slide three, I am pleased to report that we delivered another solid quarter, and we are on track to finish the year strong. This is an exciting time at West. Not only are we achieving strong financial results, we're also executing on our high-value product growth strategy and making steady progress on our major drug delivery programs.

Let me start with some additional detail on the financials. Third quarter reported revenues of $344.5 million increased 5.2%, excluding a significant 8% currency headwind. Similarly, adjusted diluted EPS of $0.44 equaled the 2014 quarter, overcoming $0.06 of adverse currency translation, and grew 13.6% on a constant currency basis. This is primarily a result of strong sales performance for our high-value products.

Turning to slide four and starting with the Pharmaceutical Packaging Systems segment, sales at constant currency grew at 8.5% on higher than market growth across all regions. Customer demand for high-value packaging components continues to be strong, led by Westar RS, coated components and distribution of Daikyo products. Envision and NovaPure product lines also had a strong demand in the quarter.

This consistent performance reflects the unique value proposition West's high-value components provide for our customers, particularly those focused, or facing an increase in stringent regulatory environments. In fact, we are experiencing robust growth in our backlog of firm customer orders, particularly for Westar RS, which we are actively addressing. This underscores the importance of continuing to free up and build capacity for these products in our current and future operations footprint.

Sales in Pharmaceutical Delivery Systems segment were comparatively lower due to the sale of a contract services business late in third quarter of last year and a decline in both reconstitution devices and SmartDose sales. We expect the category to recover in Q4. CZ and SmartDose sales continue to be uneven, or lumpy, because of the inherent nature of drug development. However, these programs are moving in the right direction, and we are certainly encouraged by the progress in the quarter.

To that point, the development of our SmartDose wearable injector continues to gain momentum in the marketplace, with multiple active development programs in place, including a recently submitted application to the U.S. Food and Drug Administration for Amgen's Repatha. The application is for a 420-mg monthly dose to administer it as a single injection utilizing the SmartDose injector, which features a silicone-free CZ cartridge and a FluroTec-coated piston containment system.

We are also aware that another product employing a CZ vial as the primary container has been recently approved by the FDA, and this is in addition to the Q2 approval by the FDA of a previously marketed product that we expect to be reintroduced in a CZ vial in 2016. These developments demonstrate the value propositions behind these proprietary technologies, and we expect to build on the momentum.

With regard to the plant expansions, we've previously reported our Kingston, North Carolina plant is now taking orders from customers for high-value products and will serve as a critical additional capacity as we manage the increase in demand for these products. Our expansion in Waterford, Ireland is proceeding to plan.

As a reminder, Phase I is designed to increase capacity for our proprietary rubber sheeting, which is used in insulin pen packaging. The plant is expected to be commercial production in early 2018. In addition, we are increasing our capacity in Dublin to service the increase in demand for our contract manufacturing capabilities for the diabetes market.

Turning to our outlook for the remainder of the year on slide five, we estimate 2015 sales at constant currency to grow at a low end of the 7% to 8% range. We expect a favorable product mix from stronger demand and throughput for our high-value products, which will drive margin expansion. Therefore, we're raising our adjusted EPS guidance range for the full year to be between $1.79 and $1.84, which represents a 15% to 19% growth on a constant currency basis over our results in 2014.

On our last call, I stated that I would update you on our five-year plan. Our plan is based on the same strategic imperatives that underline our success. It focuses on delivering high-quality primary packaging and proprietary delivery systems for injectable medicines. Those markets are growing and in broad terms present the best opportunities for continued growth.

We will continue to focus on our core strategic objectives while servicing our key market segments, among them, biologics, generics and branded pharma, to drive demand for our high-value products and proprietary delivery systems. We will grow by being responsive to the different needs within each segment knowing that their particular priorities differ in important ways and delivering the right products in the right way to each.

While our current long-term outlook is entirely organic based, we will remain open to opportunities to augment our growth through partnerships and bolt-on acquisitions to strengthen our packaging container and delivery system offerings.

Finally, we will accelerate efforts throughout our global supply chain to drive operational excellence by aligning capabilities to support key end markets and optimizing the utilization of our existing asset base as well as new investments. In doing so, we believe we can improve service, quality and profitability.

As a result, we expect we can attain fiscal year 2020 sales of $2.2 billion to $2.4 billion, operating margins in the range of 19% to 23%. Organic growth will continue to be driven by our proprietary technologies, which consist of high-value packaging components and delivery systems, and by geographic expansion. Margin growth will be fueled by supply chain enhancements and product mix.

I would like now to turn the call over to Bill Federici for a more detailed discussion on our financial results. Bill?

William J. Federici
Chief Financial Officer & Senior Vice President

Thank you, Eric, and good morning, everyone. We issued our third quarter results this morning, reporting net income of $1.5 million or $0.02 per diluted share. Our reported results this quarter include a $0.42 one-time non-cash charge associated with the settlement of approximately 40% of our U.S.pension obligations. Excluding this charge, our adjusted earnings per diluted share are $0.44 this quarter, equal to our adjusted third quarter 2014 earnings per diluted share.

Our 2015 earnings have been adversely impacted by the decline in the value of the euro and other currencies versus the U.S. dollar. The translation of our international results into U.S. dollars for reporting purposes has reduced our reported earnings by approximately $0.06 per share as compared to the prior-year third quarter, and by $0.24 per share through nine months.

Turning to sales, slide seven shows the major components of our consolidated sales increase. Excluding $30 million of exchange effects, our consolidated third quarter sales increased by 5.2% versus our third quarter 2014 sales. Excluding currency, Packaging System sales increased 8.5% versus the same quarter 2014. Sales price increases accounted for 1.7 percentage points of the increase, and the favorable mix of products sold and volume contributed the remainder of the increase.

Sales of our high-value products rose 14% versus the prior-year third quarter. HVP sales represent 45.9% of Packaging Systems' Q3 2015 sales, versus 43.8% a year ago. We continue to see strong demand for our product offerings that meet our customers' high quality expectations.

Delivery Systems' net sales decreased by 2.6% versus the prior-year quarter ex-currency. Sales of our proprietary products were $22.5 million, or 22.4% of the segment's revenues in the quarter, versus $28.4 million, or 27.5%, in the prior-year quarter. The majority of the decrease in proprietary sales occurred in our reconstitution products following strong second quarter 2015 sales for those products.

CZ and SmartDose were a combined $7.5 million in the current quarter, approximately $1 million less than the combined Q3 2014 sales of those products. Contract manufacturing sales increased by 4% at constant exchange rates.

As provided on slide eight, our consolidated gross profit margin for Q3 2015 was 31.4%, versus the 30.9% margin we achieved in the third quarter of 2014. Packaging Systems' third quarter gross margin of 37% is 1.7 margin points higher than the 35.3% achieved in Q3 2014. The increase in gross margin is due to continuing favorable sales mix, modest price increases and lower raw material costs, offset by normal inflationary increases in labor costs and volume-related increases in overhead costs.

Delivery Systems' third quarter gross margin declined by 3 margin points, to 17.3%, primarily due to the weaker product mix of sales and increased overhead costs associated with new capacity.

As reflected on slide nine, Q3 2015 consolidated SG&A expense decreased by $1.4 million versus the prior-year quarter. Our favorable exchange effect offset higher incentive comp expense and merit increases. As a percentage of sales, third quarter 2015 SG&A expense was 15.8%, versus 15.7% in Q3 2014.

Slide 10 shows our key cash flow and balance sheet metrics. Our year-to-date operating cash flow is $7.5 million higher than the first nine months of 2014, despite the negative impact of exchange rates and the higher level of pension funding in 2015. Our year-to-date results include noncash charges of $10.9 million in Q2 for executive retirement and the $49 million pension settlement charge in the third quarter.

We have made a $15 million voluntary contribution to the pension plan in Q4 in order to restore the asset funding level of the plan to what it was before the annuity purchase.

Our capital spending was $86.8 million for the first nine months of 2015, approximately the same as in the prior-year period. We expect to spend approximately $145 million to $155 million in capital in 2015, and approximately 50% of our planned capital spending is dedicated to new products and expansion activities, including approximately $26 million for the construction of our new Waterford facility.

Our balance sheet continues to be strong, and we're confident that our business will provide necessary future liquidity. Our cash balance at September 30 was $256.8 million, $1.5 million more than our December 2014 balance. Foreign exchange reduced our September 2015 overseas cash balances by approximately $17 million.

Debt at September 30 was $302.5 million, $34 million less than at year-end. Our net debt-to-total-invested capital ratio at quarter end was 4.4%.

Working capital at September 30 totaled $381 million, roughly $26 million lower than at year end. The majority of the decrease is due to the reclassification to current liability of our euro notes which mature in February of 2016.

Looking ahead, our current backlog of committed Packaging Systems orders stands at $397 million, 23% higher than at the prior year end, excluding exchange. In addition to new business, our backlog growth includes an increase in longer dated orders due to the longer lead times we are experiencing for high-value products in one of our facilities. Many of those orders are scheduled for 2016 delivery.

Excluding the impact of those advance orders, we estimate that our backlog would have increased 10% to 15% versus the prior year end. We expect our order backlog will decrease as a result of the actions we have taken, increased throughput in that facility and as customers validate recently added HVP capacity.

Based on our year-to-date 2015 results and our analysis of the orders on hand and the continuing unfavorable currency effects, we have raised the lower end of our full-year 2015 earnings guidance in this morning's release. That guidance is summarized on slide five.

We have based our guidance on an exchange rate of $1.10 per euro, the same assumption we used in our prior guidance. As a reminder, each $0.01 strengthening of the dollar versus the euro results in approximately a $0.01 decrease in full-year forecasted EPS as a result of translation. Going forward we expect a $0.03 to $0.04 currency translation headwind in quarter four.

In addition, our 2015 guidance excludes any impact from a devaluation of the Venezuelan bolivar, as we continue to operate primarily under the official exchange rate that excludes executive retirement and pension settlement charges. Also, in Q4 we intend to repatriate approximately $128 million of cash held by non-U.S. subsidiaries. We do not expect to incur any additional tax costs associated with this repatriation.

I'd now like to turn the call back over to Eric Green. Eric?

Eric M. Green
Chief Executive Officer & Director

Thank you very much, Bill. In summary, we had a great quarter. I'm very pleased with our continued strong execution of the high-value product strategy and our steady progress with key drug delivery development programs. This concludes our prepared remarks for today, and now we look forward to answering your questions. Operator?

QUESTION AND ANSWER SECTION

Operator: Thank you. [Operator Instructions] And our first question comes from the line of Larry Solow of CJS Securities. Your line is open.

Larry S. Solow
CJS Securities, Inc.

Q

Hi. Good morning, guys.

Eric M. Green
Chief Executive Officer & Director

A

Good morning, Larry.

Larry S. Solow
CJS Securities, Inc.

Q

Just maybe starting from the 2020 goals and then working my way back to just a couple of current questions, when you look out at those goals, I don't know if you want to give any more color on the difference between PPS and PDS, but how do you look at PPS in particular? Do you look at particular categories like the PD-1 inhibitor category, for instance, is one, and multiple categories? Or do you do it more as a top-down looking, just to sort of get how you get your growth rates and assumptions?

Eric M. Green
Chief Executive Officer & Director

A

Yes, Larry, good morning. Great question. So, we actually went through a pretty detailed process over the last three months, and it's one of the actions that I wanted to take as I step into the role here at West. And we pulled in a number of our colleagues around the world, different disciplines, different expertise in the industry.

And the process we used was I want to refer to as a bottoms-up approach. We took a look at the end markets. We took a look at where it's attractive to play, such as we mentioned earlier about the biologics, the branded pharma, the generic space.

And we have identified that our portfolio and the high-value products portfolio plays very nicely on the trend of the marketplaces. So when we pulled these numbers together to represent and present to you today we did take a look at what we currently have, the pipelines and also where the market's going and took advantage of that opportunity.

Now, I'll turn it to Bill to talk a little bit about how we got to the $2.2 billion to $2.4 billion, because there is a currency impact when you look at prior-year guidance.

William J. Federici
Chief Financial Officer & Senior Vice President

A

Yes, thank you, Eric. And, yes, as Eric mentioned, we, when we looked at our long-term plans last year the value of the euro was a lot higher. It was

Larry S. Solow
CJS Securities, Inc.

Q

Right

William J. Federici
Chief Financial Officer & Senior Vice President

A

$1.25 per euro, whereas now we're using an assumption of $1.10.

Larry S. Solow
CJS Securities, Inc.

Q

Right

William J. Federici
Chief Financial Officer & Senior Vice President

A

That on order of magnitude was about $175 million worth of sales difference in and of itself.

Larry S. Solow
CJS Securities, Inc.

Q

Right

William J. Federici
Chief Financial Officer & Senior Vice President

A

In terms of the makeup, the other part of your question about what is included, just as a reminder, of the top 35 biologics by IMS data, we or Daikyo components are on each of those top 35.

Larry S. Solow
CJS Securities, Inc.

Q

Right. So, again, the theme, it doesn't matter who wins, I guess you guys will participate. And as you look back, ex-currency, changes in currency, do you feel that your 2019 goals are, as you're now a year later – are you running relatively close to those plus or minus?

William J. Federici
Chief Financial Officer & Senior Vice President

A

Yes. Yes, absolutely. They're still in line with those ranges we gave.

Larry S. Solow
CJS Securities, Inc.

Q

Okay. And then just coming in a little closer to your guidance for next year, just on your top line, your 6% to 8%, do you expect that to be carried more by PPS, and would maybe PDS at least slow down, at least the SmartDose portion of that slow down perhaps in the first half of the year as some of the later-stage trials – obviously the one with Amgen has stopped, and, I guess, you'll get maybe some commercial sales in the back half of the year, but how you look at sort of the PPS versus PDS? Are you ready to give any more color on that?

Eric M. Green
Chief Executive Officer & Director

A

Yes. Larry, when you look at the high-value products portfolio and the continued growth that we've seen in strong double digits this year, we believe that will carry into 2016. When it comes to the proprietary technologies around SmartDose and CZ, while we believe that there's attractive growth in that area, and, in fact, we're looking at about a 50% growth on that portfolio, but again, that's a small piece of our entire business at this point.

With the recent announcement with Amgen, and it was discussed on their call last night, we're in a good position with when you talk about the wearable injector being part with Repatha going forward, but it's too premature to start talking about volumes and revenues at this point.

Larry S. Solow
CJS Securities, Inc.

Q

Okay. And just a couple more quickly, the longer lead times and the PPS backlog of 23%, have you requested that for your customers? Is it because there is a high-class problem? I mean, is demand accelerating to the point where you need to do this? Is there production issues that you have come into and that's why you're expanding capacity or is it really just a high-class demand problem that will work itself through?

Eric M. Green
Chief Executive Officer & Director

A

Yes, Larry, it's a good question, and the way you phrased that, high-class problem, is a good way to describe it. We've had an increase in demand a little greater than we anticipated when it comes to specifically around the Westar RS portfolio, which is primarily driven out of one plant where the backlog started to increase and that's our Jersey Shore facility in Northern Pennsylvania.

Now, what we have done is obviously we're in direct communication with our customers on a constant basis, but what we have done is we've employed strong lean manufacturing principles at that site, and we've already seen significant benefits on throughput in the last several weeks in our facility. So we believe this is an issue driven by customer demand that we're able to contain and to work through over the next number of months.

Now, I do want to comment that in addition to improving the productivity of our Jersey Shore facility, the Kingston, North Carolina investment that we've made is coming online right now with validation with customers so we can alleviate some of that bottleneck through our new facility in North Carolina.

So, we're managing through this. We believe we have our hands firmly around this situation. We're working with our customers and we believe we will continue to be able to support the growth that we're seeing with that portfolio.

Larry S. Solow
CJS Securities, Inc.

Q

Okay. And just lastly, what were your thoughts on with the pension settlement? What the impact will be on a go-forward basis on the P&L?

William J. Federici
Chief Financial Officer & Senior Vice President

A

Sure, Larry. The pension expense will go up a little bit versus the current year, approximately $2 million. And, again, that depends on what happens with discount rates.

Larry S. Solow
CJS Securities, Inc.

Q

Right, right.

William J. Federici
Chief Financial Officer & Senior Vice President

A

And the reason that it's counterintuitive is that you have – the way pension accounting works, you've had a whole bunch of unamortized losses in the past that have been accumulated on the balance sheet. So that charge that you see is basically the acceleration of some of that unamortized loss. It's a noncash charge, and you set that aside.

So, going forward though, you've used assets to pay for that for the annuity purchase.

Larry S. Solow
CJS Securities, Inc.

Q

Right.

William J. Federici
Chief Financial Officer & Senior Vice President

A

And therefore earning the rate of return in the assumptions that are used by the actuaries to set the pension expense. And there's a rate arbitrage there between the rate that you're earning, which is roughly rough order of magnitude 7% versus the discount rate, which is 4.5%. So that difference you're losing on all of those assets. So, going forward, your pension expense increases a little bit.

Larry S. Solow
CJS Securities, Inc.

Q

Got it, but...

William J. Federici
Chief Financial Officer & Senior Vice President

A

The reason – go ahead, Larry.

Larry S. Solow
CJS Securities, Inc.

Q

No, I was just going to say, it's essentially a small price to pay for – you reduce your volatility on almost half of your pension. So in terms of -

William J. Federici
Chief Financial Officer & Senior Vice President

A

And we reduce the amount of PBGC premiums from the fact that we have 1,700 less retirees in the plan.

Larry S. Solow
CJS Securities, Inc.

Q

Got it. Great, thanks. Thanks, Bill. I appreciate it.

William J. Federici
Chief Financial Officer & Senior Vice President

A

Thank you, Larry.

Eric M. Green
Chief Executive Officer & Director

A

Thank you, Larry.

Operator: Thank you. Our next question comes from the line of Derik de Bruin with Bank of America Merrill Lynch. Your line is open.

Derik De Bruin
Bank of America Merrill Lynch

Q

Hey, good morning, everyone.

William J. Federici
Chief Financial Officer & Senior Vice President

A

Good morning, Derik.

Derik De Bruin
Bank of America Merrill Lynch

Q

So looking at your 2020 target, and just sort of like a question, so I'm going back, I'm looking at my model, I'm looking at some of the other forecasts you've made. And when I just sort of go back and look at your 2012 commentary for your Analyst Day and your 2014, in 2012 you were targeting $1.7 billion to $1.9 billion for 2016. It looks like where your guidance is sitting is somewhere around $1.5 billion, or a couple of hundred million dollars short, realizing about $100 million of that is FX.

Same thing when I look at the 2017 numbers. You were targeting somewhere in the $1.8 billion to $2 billion, also about $100 million light from the light end. So I'm just – I'm just once again just trying to get from you what's your confidence in that number to hit? Because the way I'm looking at it you've got to basically do mid-to high-single digit growth in PPS and then mid-to high-teens growth in the Delivery Systems business to sort of even get anywhere near the low end of your range. And given that things always seem to take a little bit longer with your business to mature for people to update products, I'm just wondering why you're so confident in the numbers?

William J. Federici
Chief Financial Officer & Senior Vice President

A

So let me take the first part of it, Derik. The one thing you have to remember, and we talked about it with Larry, is that there's a very large currency difference assumption in those models, whether you look at the prior year or prior years before that. We were operating in a much different currency environment versus the U.S. dollar. So they were – one year it was $1.33, another was $1.25.

So the – this year, if you just want to use the 2019 numbers we predicted last year versus this year, the currency impact alone is $175 million.

Derik De Bruin
Bank of America Merrill Lynch
Q

Okay.

William J. Federici
Chief Financial Officer & Senior Vice President
A

So your $100 million change is really not significant when you take the currency impact out from those years.

Derik De Bruin
Bank of America Merrill Lynch
Q

Okay.

William J. Federici
Chief Financial Officer & Senior Vice President
A

In terms of our confidence I'll let Eric speak to the confidence.

Eric M. Green
Chief Executive Officer & Director
A

Yes, Derik, and this is just to reiterate, and we spent a tremendous amount of time looking into the details about the markets and where we currently are and what are the expectations going forward. We are focused on the more attractive markets that are growing in the double-digits. And so our belief on the high-value products portfolio is that we'll continue to be able to service our customers globally to be able to continue with that market trend.

In addition, if you look at some of the geographic presence that we currently have today, it gives us another lever to continue to drive additional growth to West. It's particularly around the – what we call the PPS business today.

When you turn your attention towards more the PDS, the proprietary around CZ and SmartDose, those are really in smaller phases today. But we're seeing strong signals of acceptance and then the pipeline of going forward.

There could be some timing issues as we look over the next short term, i.e., one or two years. But the responses we're getting from customers give us confidence that we do have the right value proposition with those new innovations and technologies.

So that really focuses on the top line. When you look at the margin expansion, Derik, there's two levers that we have. Obviously price, let's put aside price at this point when we look at the operational excellence capabilities we have at West today.

We do have 28 manufacturing sites around the world. We do have the ability to leverage and start utilizing our existing assets a little differently than we've had historically. So I think there's an opportunity that clearly has been vetted on the margin expansion going forward.

Derik De Bruin
Bank of America Merrill Lynch
Q

Okay, thanks. That's helpful. So just as it stands today the impacts to FX in 2016, I mean, you're talking 6% to 8% constant currency growth, so is it – I'm looking about – where my calculations somewhere would be around a 1% to 2% FX headwind on the top line for next year, as well, where we're standing?

William J. Federici
Chief Financial Officer & Senior Vice President

A

We haven't done that math, Derik, but that doesn't sound unreasonable.

Derik De Bruin
Bank of America Merrill Lynch

Q

Okay. So, you're repatriating cash, any particular plans for that?

William J. Federici
Chief Financial Officer & Senior Vice President

A

Yes, sure. We mentioned two things, Derik. The first one was that in February of 2016 we have our euro B, our Series B euro notes, rough order of magnitude $70 million, mature. And the second thing is that we have looked at this build that we have in Ireland, and we have a significant amount of CapEx that we're going to be going through. So we look at those, at the cash to be able to help those as well as other general corporate uses.

Derik De Bruin
Bank of America Merrill Lynch

Q

Great. So there is obviously a lot of stuff on the tape on consolidation. Obviously there's the Pfizer/Allergan news that's out, and some of the other companies are having some troubles in the news. I guess how does the sort of the consolidation environment, the changes there, does that have any impact on sort of how your outlook is thinking? I mean, could there be some sort of downturn in or changes in some of your packaging contracts with some of these players?

Eric M. Green
Chief Executive Officer & Director

A

Derik, when we look at the outlook of the impact of potential for the consolidation in the industry, for us at West it's a minimal impact because many of our products are already in the commercial phase, and therefore whether it's two firms or one firm coming together we are able to continue to supply and capture those revenues going forward.

I think where you see a little bit of potential delay is in the development arena when the two companies do consolidate, which could push out a couple of projects a little bit longer than we would anticipate. But overall if you look at our business it's very low impact for West.

Derik De Bruin
Bank of America Merrill Lynch

Q

Great. Thanks.

William J. Federici
Chief Financial Officer & Senior Vice President

A

Thank you Derik.

Eric M. Green
Chief Executive Officer & Director

A

Thank you Derik.

Operator: Thank you. [Operator Instructions] Our next question comes from the line of Dave Windley from Jefferies. Your line is open.

David H. Windley
Jefferies LLC

Q

Hi. Good morning gentleman. Thanks for taking my questions. I was hoping to get a little bit of insight into the sales progress for proprietary delivery products or devices that are not SmartDose and CZ, so reconstitution systems and things like that, the old Medimop and some of the other smaller things that you had acquired into that business a while back.

Eric M. Green
Chief Executive Officer & Director

A

Great.

William J. Federici
Chief Financial Officer & Senior Vice President

A

Yes, Dave, thank you. And they – we talked about the quarter being slightly down for those products. Medimop was slightly lower. We do expect that category, as Eric mentioned in his commentary, to rebound in Q4. We see strong growth coming out of those proprietary products.

Going forward beyond, we do see lots of opportunities for the Medimop reconstitution products and expect that that will continue to grow for us as we go forward. Just as with all of these proprietary device products, they're very small bases, Dave. So even Medimop, which has relatively been in the market for a long time, is still only a $50 million a year product line for us. Safety, which is the other commercialized proprietary product portfolio, is running around $20 million this year.

So they're small. They will continue to grow nicely. We believe that [ph] that (36:10) strategy, these are products that are needed by our customers who continue to work on development with us in those arenas and we don't expect these to be a major contributor to the kind of growth in Delivery Systems that we see for SmartDose and CZ but we do see them as being nice contributors and nice growers going forward.

David H. Windley
Jefferies LLC

Q

Thank you for that. And maybe sticking with that topic and moving out to the long-term planning, when you think about your PDS revenue contribution to your 2020 targets, what would you anticipate the mix of those proprietary devices – what percentage of the PDS sales will proprietary comprise by that point?

William J. Federici
Chief Financial Officer & Senior Vice President

A

Again, thanks, Dave. We have been talking in the past about it getting to a point – right now, it's about 75/25, 75% contract manufacturing, 25% proprietary. We've been talking for years about getting towards that 50/50 milestone of mix, proprietary versus contract manufacturing, and we still see that as being our guidepost for this 2020.

Now, all that being said, we have, as you see in the release and in Eric's comments, put a $200 million revenue range in the plan. And, to be honest, a lot of that is due to the fact that we do not control the timing of our customers' development and commercialization of CZ and SmartDose. So, we cannot put a single stake in the ground for you, but I can tell you that we still have high confidence that we will be marching consistently towards that 50/50 milestone that we've set for ourselves.

David H. Windley
Jefferies LLC

Q

And so not to – I guess I'm just thinking a little along the lines of Derik's questions about we've – 50/50 is what you've said in the past. You're saying that again today. We've kind of rolled forward one more year on the long-term planning. Should I attribute the fact that you're not seeing, say, that number in 2020 being further than you might have seen it in 2019 just a matter of difficulty in sticking a flag in the ground type of thing and the uncertainty around this over that time period?

William J. Federici
Chief Financial Officer & Senior Vice President

A

Absolutely. Absolutely, that's exactly the way I would think about it.

David H. Windley
Jefferies LLC

Q

Okay. Is it possible to give for the two segments some type of – I'm hesitant to ask you to be too specific on this because I'm guessing you probably won't be but some type of sense of margin differential, as it stands today, between high-value products and standard in packaging and proprietary and contract manufacturing in delivery?

William J. Federici
Chief Financial Officer & Senior Vice President

A

Absolutely, can do that for you, Dave, easy, and it's consistent with what we've said in the past. High-value products are running gross margin over the last five years about 55% versus standard packaging, which is around just under 30% and those are not exact, but those are good mileposts for you going forward.

On the Delivery Systems side, contract manufacturing, we are slightly less than 20% on a contract manufacturing gross margin basis, whereas with proprietary today we're not that much better. We're probably in the high 20s, low 30s, but that's really volume related, not having as much throughput through those plants on a very lumpy, as we said, basis for those products.

When we go out further in the plan, we see our margins getting into those types of products, for the proprietary delivery system products, being in the high 30s. In fact, some of them, like Medimop, are 49% already as they're commercialized, but from the high 30s up to 50% gross margin.

David H. Windley
Jefferies LLC

Q

Okay. And my last question and I'll drop off. I apologize, Eric. So, I was reading through the press release and I've been unable to find the reference, but I thought there was a reference, it kind of sounded like changes in the global infrastructure of the business over the long-term planning period that would allow for greater efficiency, et cetera.

And I know in a previous conversation you and I had talked a little bit about that. I wondered if you could flesh that out a little bit for me.

Eric M. Green
Chief Executive Officer & Director
A

Yes, Dave, no, when we look at our global operations, and one of the areas that we're looking at is to implement more around lean manufacturing capabilities, because we do have tremendous assets on the ground today, and that has been one of the main reasons why West has been very successful. They refer to the moat around the business, right?

And so we will continue to leverage the assets on a global basis. And we do believe through lean manufacturing and continuing the direction around network optimization, which we've discussed in the past, are levers that we will continue to pull aggressively to make sure that we are expanding our margins beyond just price and product mix.

David H. Windley
Jefferies LLC
Q

Okay. So that sounds a little more direct-cost oriented. I guess I was thinking that you had an eye toward doing some things around perhaps global or regional SG&A support operations and things like that. Am I misreading, misremembering?

Eric M. Green
Chief Executive Officer & Director
A

No, Dave, I think there's a couple of areas that we have is we are starting to use the nomenclature of centers of excellence around our key product portfolios, like high-value products, for example. We're focusing in the future around three locations – Singapore; Waterford, Ireland; and Kingston, North Carolina – as the primary locations of centers of excellence.

I think secondly is we're also – we do currently have regional infrastructure in Asia, Europe, and obviously here in the U.S., and we're looking at how can we reinforce particularly markets where the attractiveness of growth is ahead of us, so, i.e., China. We have presence there, but how do we reinforce that and continue to have the strong double digits that we've been seeing this year?

Also India we have a very strong presence. You go down to South America, Brazil, we have a pretty strong presence there in addition. So those are the areas that we'll reinforce to make sure that we have the capabilities in the regions to be able to service the customers locally and to respond to their needs on a local basis.

David H. Windley
Jefferies LLC
Q

Okay. Thank you.

Eric M. Green
Chief Executive Officer & Director
A

Thanks, Dave.

William J. Federici
Chief Financial Officer & Senior Vice President
A

Thanks, Dave.

Operator: Thank you. [Operator Instructions] And I'm not showing any further questions at this time. I would now like to turn the call back over to Eric Green for any further remarks.

Eric M. Green

Chief Executive Officer & Director

Great. Thank you, operator, and thank you, everyone, for your time today. We look forward to speaking with you again on our fourth quarter call in February. Thank you very much.

Operator: Ladies and gentlemen, thank you for participating in today's conference. This does conclude the program and you may all disconnect. Everyone have a great day.