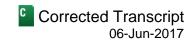


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# West Pharmaceutical Services, Inc. (WST)

Jefferies Global Health Care Conference



### CORPORATE PARTICIPANTS

#### Eric Mark Green

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

William J. Federici

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

## OTHER PARTICIPANTS

**David Howard Windley** 

Analyst, Jefferies LLC

# MANAGEMENT DISCUSSION SECTION

### **David Howard Windley**

Analyst, Jefferies LLC

All right. Good morning, everybody. I'm Dave Windley with Jefferies Healthcare Equity Research. I appreciate you coming to our 2017 Global Health Care Conference here in New York. It is a conference that we've put a lot of energy into and is built every year, and we're again very pleased to have you support the conference and join and come and hear what the companies have to say.

Here presenting in my coverage at 8:30 this morning is West Pharmaceutical Services, and here with them is the company's CEO to my immediate right, CEO Eric Green, and the company's CFO, Bill Federici.

So our agenda here this morning is we are going to do basic fireside chat, but I'm going to let Eric kick off with a few, broad opening comments.

#### Eric Mark Green

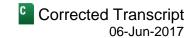
President, Chief Executive Officer & Director, West Pharmaceutical Services, Inc.

Great. Well, David, thank you, first of all, for the invitation to join you and your colleagues here at the Jefferies Health Care Conference. I know this is day one in the morning and the turnout looks quite strong. So, thank you for the invitation.

And also, thank you for the opportunity to talk about West. For those that are new to the West story, it is a tremendous company that has been in existence since 1923. Our focus is really around the primary containment of injectable drugs, all the way up to delivery devices; and this has been our focus and our passion for the last 90-plus years.

Today, West is an integral part of healthcare industry. When you look at the sheer number of components we produce per annum, it's about 41 billion components. That equates to about over 100 million injections a day that West components are used in administering drugs throughout the world.

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If you take a look at our criticalities in the healthcare space, on the top 50 biologics in the marketplace today, either West or our partner out of Tokyo, Daikyo, are on all top 50 of those drugs. The top 75 pharma and biotech firms across the globe in the injectable medicine space, West is currently working side by side with those firms. Today, we have a business that's quite diverse. The largest customer makes up approximately 7% of our business, and the largest product group is approximately the same and slightly less.

When you look at from a market perspective, we reorganized our company to be market-led. And that means that we've have broken our commercial organization into four clear groups: Pharma, which consists of the small molecule customers, branded pharma, approximately 35% of our business; the Biologics, our fastest-growing business, roughly a little over 20%; the Generic space, where we have a strong presence, again about 20%; and in Contract Manufacturing, where we do the design and mass manufacturing of components, medical devices, in the pharmaceutical space, which is about 20%.

And the performance of the business has been consistent with growth over the last five years. On a constant currency basis, the business grew just slightly less than 7%. And the adjusted diluted EPS is approximately a little over 12%, in double-digits. Obviously, last year, performance is a little bit stronger with a little over 9% top line growth and close to 20% in an adjusted diluted basis for EPS.

We do believe that the direction that we have embarked on in the last year-and-a-half is gaining traction, as I talked about, being more market-led. It really drives our behaviors and our operations. And, today, we have 28 manufacturing sites that we've consolidated as one entity, which allows us to leverage our capital, our asset base and our position in the marketplace.

The second major change is around our innovation engine. While we have a pretty robust pipeline of standard products moving to high-value product portfolio, we're continuously looking at working with our customers to broaden that portfolio, not just on the primary containment side, but also on the delivery side.

I think the last comment I'll just make is the diversity of the business. From a geographic point of view, roughly 50% of our business is in North America, about 40% in Europe and the balance is in Asia and South America.

First quarter, a couple of months ago, we came out with our results. The organic growth was around 8.7%. And we're able to drive margin expansion through efficiencies through our operations and also shift to the high-value products at least about 60 basis points in the gross margin.

So I think we have the right strategy. We have a healthy customer base that we work with each and every day. We have a tremendous product portfolio that we're continuously expanding and strengthening. And we have an asset base that we're utilizing and will continue to fully utilize to really position us well uniquely in the marketplace. And that's why, today, we can sit here and say that we are the market leaders in the primary containment of injectable drugs.

So it's a quick summary. Dave, if we could get started?

## QUESTION AND ANSWER SECTION

### **David Howard Windley**

Analyst, Jefferies LLC

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Thank you for that. I wanted to start, you mentioned 7% CAGR over the last five years and last year higher than that. I think fair to say that through that five-year period, you've kind of seen growth step up a little bit and I think driven by adoption of high-value components. So I wanted to start there around maybe you could describe where those penetration rates stand, what the attractiveness is, and maybe some of the surprises as it relates to, for example, generic adoption or some [indiscernible] (05:47).

#### Eric Mark Green

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



Great. Thank you, David. So I think when you take a look at the high-value product portfolio today, let's dimension this. Within our Proprietary portfolio, it's roughly around 50% of our revenue. However, from a unit basis, last year in 2016, it was 17%, so 1-7 percentage of the number of units we produced on an annual basis. Clearly, we're looking at out of the 41 billion components we produce annually, about 32 billion are elastomers of which 17% is high-value products. The high-value products are – is a portfolio that's adding additional features and capabilities for our customers that basically brings from standard product up to the high-value product portfolio, you're looking at anywhere between 5 or 10 times the revenue per item and 2x the margin.

So, this mix shift phenomena is occurring for really two main reasons. One, in the Biologics space, when you take a look at the Biologics in the market, we already commented about the top 50, in the first quarter, five new approved molecules for the Biologics were introduced in the marketplace and West is on all five. And the reason for that is the high-value product portfolio offers the differentiated characteristics to ensure that there is no drug interaction between the biologic and the elastomer, the primary containment.

The second area that we are seeing on growth is, as we change into a more market-led approach, we're finding the value proposition of generics, which is really speed-to-market and it is around quality. We've been able to demonstrate with our generic customers that to switch from standard packaging, which may have been on a molecule for the last 10 to 20 years to high-value products if they switch to the generic form, gives them a competitive advantage to get to market faster with lower particulate levels, lower defect levels, and obviously, higher rate of approval by the authorities. So because of this transition, our customers working with them are migrating into the high-value products. The way to look at this is the high-value product growth, yes, it's in the Biologics space but also in the Generics, a little bit in the Pharma space.

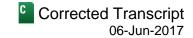
To address your question about penetration, we would say in the areas of the mature parts of the high-value product portfolio which is the FluroTec coating, the washing, those are probably in the areas between a third to about 40% penetration. Again, our market share, we believe, is around 70% across the whole elastomer space. This is early innings. But again, if you take a look at that whole portfolio of high-value products going all the way up to the NovaPure, the highest purity portfolio that we have, portfolio by design, those are very early, that's less than a couple of percentage points. So, we have a long runway ahead of us with these high-value products.

David Howard Windley

Analyst, Jefferies LLC



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Right. So maybe sticking with that topic, do you see clients, I think, so far largely because of your rollout, sequential rollout of those value-added services, clients have kind of followed that rollout and adopted in sequential pattern. Are clients continuing to follow that type of pattern or is there, for lack of better word, a leapfrogging from washing all the way up to NovaPure, just as an example?

Eric Mark Green

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

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Well, Dave, both. So certain clients who are finding – having difficulties with the quality in their drug to the market, they're actually taking that step forward from a standard all the way up to the highest level in NovaPure. We do have clients that are currently in the high-value product portfolio range, whether it's washing, in vision inspection, but they're also now migrating towards the NovaPure. So, it's a combination of both transitions that are occurring within the portfolio.

**David Howard Windley** 

Analyst, Jefferies LLC



Okay. And then, maybe before we leave it, is there – we touched on this a little bit last night, but is there a NovaPure prime? Is it – what happens after NovaPure? Stay tuned.

Eric Mark Green

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



I would tell you that what's really exciting is that the whole industry, including West, is focused on zero defects. So if you look at our quality levels today, we obviously measure that like any other firm. Our quality, our defect level is well below 100 per billion, significantly below that. And as you know, in the engineering world, the Six Sigma is considerably higher than that. So, we're considered best-in-class in this space but we will not stop until we get to the point of zero defect, zero particulate level with our clients. And that's – there's momentum not just from West but also from our customers. We will continue to look at innovations, new automations, new methodologies, producing and delivering the products to our customers that will drive it to that level. So, stay tuned on that.

David Howard Windley

Analyst, Jefferies LLC



Okay. One of the certainly beneficial aspects of this is, as I've talked to investors about this model compared to others, is your incremental opportunities for revenue growth also bring higher margin. Sometimes that's not the case for companies as they diversify out of or in addition add to core business. So this high-value product penetration is something that not only brings more price to you, but more margin. Maybe you could talk about, as I look at your financials for the last few years, you've been pretty steady and adding about 100 basis points of margin, and how high-value product contributes to that and what the forecast would be for that as well?

Eric Mark Green

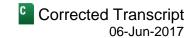


President, Chief Executive Officer & Director, West Pharmaceutical Services, Inc.

Let me touch on this briefly. And, Bill, if you want to get into the details. I think if you take a look at, there's really a couple of levers that we're looking at. One is, you're absolutely correct, the mix shift towards high-value products, not just on the revenue because we're adding more features and services to our customers, but also the margins are close to 2x on average.

The second phenomenon that you're seeing on the margin expansion is this opportunity to drive our operations more globally. What I mean by that is, historically, while it was the right decision at the time, was we used to run

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the 28 manufacturing place globally, somewhat independent. So decision rights on where we produce products were really more collocate to our customer versus from a center of excellence point of view.

We reorganized our operations a little over a year ago with a mindset to shift our business to be global operations, where we start strategically placing our investments into certain locations so we can drive return on invested capital, we can drive inefficiencies, drive more automation which, again, will turn into additional margin expansion. So there's a combination of both levers that we're pulling at the time. You like to mention that?

William J. Federici

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

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Yeah. So when you think about the high-value products and the growth has been greater than 10% annually over the last five years. In fact, when we look back over the last 10 years, the growth of high-value products has been in excess of 10% per year. Associated with that, there is higher revenue associated with it, but also the margin differential as you mentioned is 2x.

So when we look at it and use 2016 numbers, on average, a standard product, one that's molded and trimmed and bagged for the customer to do all of the downstream processing like washing and sterilizing and vision systems, those things carry an average gross profit margin in about the high-20s. When a customer doesn't have that opportunity to do that themselves, either they don't have the infrastructure or we can do it better, faster, cheaper, total cost of ownership play there, we can then get – once we do the washing in Westar with very clean water called water for injection, which we call Westar. We may even sterilize it for them, which would be ready-to-use Westar.

We may provide them services of clean room, bagging in a clean room environment. And we also may provide vision systems, cameras trained on each individual product as it's manufactured, as Eric said, to meet the regulator and customer goals of zero defects. All of those downstream attributes that we're adding to the product add not only to the revenue, but also to the margin.

So again, using 2016 numbers, the average gross margin for a high-value product was about 55%, so roughly double what it was for the standard product. If you do just look at the math on those two areas, you have high-value products growing faster than average, carrying a higher margin associated with that, than the standard product which is growing slower and has a lower margin. Obviously, over time, that will increase your margins organically.

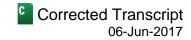
So we look at the growth rate of this business being somewhere in the 6% to 8% corridor over a long period of time driven by the phenomenons we just talked about. And we see margin expansion, as Dave said, at the gross margin line, about 50 basis points to 70 basis points for that mix shift phenomenon. We see a little bit of price helping that, very marginal amount of pricing. And then, the operational efficiencies, those things all combined, we see about 100 basis points on average per year from an operating perspective being able to expand margins.

David Howard Windley
Analyst, Jefferies LLC

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Super. Thanks. So shifting a little bit, the other part of the business, the Contract Manufacturing piece, is an area that maybe doesn't have as high a margin as we've discussed, but has some capability benefits to the business as you try to expand into some proprietary devices. So perhaps talk about those knock-on benefits skill set wise. And then, also, talk about how you've changed the client conversation to think more comprehensively about what West is bringing?

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#### Eric Mark Green

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

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Okay. Just to frame up Contract-Manufacturing, as I said earlier, it's about 20% of our business today. We have said that we believe this year it would be high-single digit growth from the top line of the business. And approximately 75% of business of Contract Manufactured is targeted in the pharma healthcare space; the other 25% is more consumer product goods. It's more of a legacy business. Our focus, our strategy is around the healthcare space and you'll continue to see us invest in those particular areas.

What do we produce? We produce products such as insulin pens, we produce continuous glucose monitoring devices, and such, those type of products for clients. It's a different business model and has different economics associated to it. So the margins are less than our traditional core business of the elastomers and seals.

What we're finding from a client perspective is actually becoming more and more important as we start looking at from an enterprise and enterprise discussion. To give you an example, historically, we ran the business somewhat independent. So we'd have discussions around developing the next-generation of insulin pen. While at the same time, we'd have discussions around the elastomers because every unit that goes out the door needs a primary container for the drug. That's where West plays in, historically. So you can see the combination coming together.

So what we've done is we reorganize into the specific segments and we're able to work with our customers from an enterprise discussion, not just doing the Contract Manufacturing, but also working on the primary containment as more fully-integrated solution for our customers. The knowledge and the capabilities that that group brings to West as of overall on the operations side is quite remarkable.

For those that are familiar with Contract Manufacturing realize that it's a very margin-tense environment. The lean principles out of those facilities and digitizing the processes are far more advanced than other parts of healthcare, even at West.

So we're able to migrate the activity out of our Contract Manufacturing to the rest of the business to drive more lean efficiencies and to drive more digital principles in our operations. So that's the benefit we see with Contract Manufacturing.

From a customer point of view, it's more of an enterprise discussion. This connectivity between the elastomers and the Contract Manufacturing, and from the internal operations point of view, we're leveraging some of the best practices that have been in place for over a decade into the rest of the operations globally.

#### David Howard Windley

Analyst, Jefferies LLC

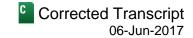
All right. So moving on to free cash flow and capital. I think as you've put a lot of capacity in the ground including some maybe heavier infrastructure spending on that upfront. You talked about your ability to modularize your expansion of those sites like Waterford as you go forward. So questions being, how does capital intensity look? What do you think your spending levels will be over the next few years? And then, as you do see, let's say, less consumption of operating cash flow going forward, where does the excess free cash flow get allocated?

#### Eric Mark Green

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

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I think we'll take on this. But I think the first part is that on the capital expenditure, there's been some heavy lifting over the last couple of years and particularly with our largest single investment in the history of West is in Waterford, Ireland. And just to remind everybody the first phase, which is the ability to have a second site for insulin sheeting, which West is close to the global demand in that particular product. Our primary facilities in Denmark and Waterford will be the first phase of that will be a secondary site, which is currently being validated by our customers today. So we'll be continuing to produce for the balance of 2017 and commercial results in 2018.

But when you start thinking about our capital expenditures, Waterford is a great example where there's tremendous investments upfront. But, as we go forward, we're taking more of a center of excellence approach. We will have finishing processes in place for high-value products in Ireland to allow us to support our customers in Europe.

And as we look forward, as we continue to invest our CapEx, we're able to start doing more a modular approach, as you mentioned, into Waterford or into Kinston, North Carolina, versus finding more land and more buildings to do the expansion. So we'll be able to leverage our efficiencies and capital more effectively as we go forward with our global footprint with 28 sites.

5, 10-plus years from now we may have to have another major investment to keep up with the demand. But what's really fascinating about our business, 60% of our capital that we spend today is on new growth. So we have tremendous operating facilities with a lot of moving parts in our equipment and our infrastructure that requires annual maintenance to keep the quality standards that we have at West. But 60% of that spend is truly on new growth for our business. We'll continue to do so as we go forward.

#### William J. Federici

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

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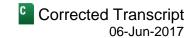
Yeah. So I think one thing to think about, CapEx range is in that \$150 million to \$175 million a year. We think that'll stay relatively constant in that range over that planning time period that we talked about through 2020. You've heard about the growth of our business. If you think about the growing revenues and the expanding margins, obviously, mathematically operating cash flow will continue to expand over that time period. So, mathematically, if you take an increasing operating cash flow, subtract that same dollar-wise corridor, you're going to drop more free cash flow out of that equation.

As a percentage of sales, our CapEx will continue to decline. It's roughly in the low teens today. We believe that it'll be in the high-single digits by the end of 2020. So all of those things portend towards having more "free cash flow" defined as the operating cash flow less the CapEx.

We see the opportunities every year. We take a look at it from a capital allocation perspective, Dave, your question. We look at those, all the different ways that we can allocate capital. And right now with the growing business and the type of organic growth and organic margin expansion opportunities that we have in this business, we believe the right thing to do and the most beneficial for the shareholder is to continue to invest that money back into the core of our business for these high-value product portfolios that we're developing.

We do pay a small dividend on an annual basis. It's somewhere in the \$35 million to \$40 million a year. We hope to continue to do so on an annual basis. We do have some debt left on a net debt basis. We have very little debt, but there is some debt still left. So as that debt matures over the next decade or so, we will obviously take care of either paying down or replacing that debt with cash flow as well.

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And then the last piece of it, oh, two last pieces, we have the board-authorized share buyback program which we look to try to keep the share count relatively neutral. And then we have tuck-ins, M&A activities in and around the device portfolio specifically, where we see technologies that will fit into our overall portfolio. So, that's how we view capital allocation.

### **David Howard Windley**

Analyst, Jefferies LLC

I'd love to ask one more question, but I don't think I can ask one that you can answer in 45 seconds. So we'll just wrap it here and move down to Carnegie Hall for the breakout session. Thanks, everybody.

#### Eric Mark Green

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

Great. Thank you, Dave.

### William J. Federici

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

Thank you, Dave.

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