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West Pharmaceutical Services, Inc. (WST)

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CORPORATE PARTICIPANTS

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MANAGEMENT DISCUSSION SECTION

Unverified Participant

Good morning, everyone. Welcome to day three of the 2018 JPMorgan Healthcare Conference. I'm [ph] Julia Chin (00:00:14), I work in a Life Science Tools and Diagnostic team here at JPMorgan. It's my great pleasure to introduce you to our next company presentation this morning with West Pharma. Just a reminder, after this presentation, there will be a breakout session in the Sussex room, right down the hallway.

And with that, I'd like to turn it over to Eric Green, CEO of West Pharma. Welcome.

Eric Mark Green

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

Great. Thank you, [ph] Julia (00:00:33). And thank you for the invitation for us to participate this year at the JPMorgan Healthcare Conference. It's always great to start the year here in San Francisco and continue to progress and giving update on how we are doing at West. Before we get started, I do just need to state about our Safe Harbor statement and any forward-looking statement that may be made in this discussion today. This is visible obviously in the slide deck. And if you want further information, you can go to our website, westpharma.com.

I'm excited to tell you a little bit about West. For those who are not familiar with the organization, West has been around for 95 years, so it's a 95th year of celebration in 2018. We're quite proud of what we do and we have been doing this for a long time. We are providing the products and components used for injectable drug containment and delivery across all of the sector within the healthcare and med device companies.

Just a couple of quick comments about where we play, if you look at the top 50 biologics in the marketplace today based on IMS data and also based on revenue, we're on all top 50 plus our partner Daikyo. And just a quick comment about Daikyo, that's over a 40-year relationship of our partners in Tokyo that have done a – we have partnered and done a great job working together, bringing new technologies into the global marketplace and we couldn't be more proud to have our partners, Daikyo, out of Japan.

We're also working with the top 75 healthcare pharma and biotech injectable companies around the world. And what we do is, we produce components and we produce many components. Over 41 billion components were produced and distributed to our customers directly around the globe.

First, the business is diverse. Take a look at from a geographic or a product portfolio, even a customer segment, market segment portfolio, we are a diverse business. And specifically around the geographic, over 50% of our revenues are outside of the United States. We do have a large portion in the European market, roughly around

40%. And if you look at Asia-Pacific and Latin America combined, it's roughly around 12%. I'm going to go a little more detail in that particular region in just a moment.

What I'm really proud about is the growth that we're seeing really around our high-value components. So, if you look at our business, it's really bucketed into two areas. One is proprietary products. It's roughly 80% of our business and the balance is our contract manufacturing, which is roughly around 20% of our business.

Within the proprietary business, over 50%, was 42% of our consolidated revenues is high-value products and that is our highest profitable business in our fastest growing sector. In a market unit perspective, we are touching over 2,000 customers globally.

The pharma is our largest. No surprise in the small molecule domain when started thinking about the even distribution between generics, biologics and really our contract manufacturing area, with our generics and the biologics are fastest growing market units, based on user consumption of injectable medicines.

Let's go a little deeper into proprietary business. Again as I mentioned earlier, it's about 80% of our revenues and approximately 32 billion of that 41 billion components are in this particular part of our business in the proprietary. What do we do? From a product perspective, we are producing components used for vial containment, pre-filled syringes and also in cartridge systems. And we also look at, we have alternative to glass with our partnership with Daikyo, with Crystal Zenith technologies, which is a tremendous opportunity when you started thinking about the biologics space and the requirements outside of a glass containment.

We do have reconstitution devices, which is growing quite nicely at West. We anticipate further growth. And that was – the catalyst of that portfolio was from an acquisition, 10 years ago with Medimop out of Israel. And we look at our patent contribution today, Israel is one of our top leading locations of driving new innovations of that particular sector.

And last but not least is our self-injection devices. We talked about SmartDose, we talked about SelfDose, with other variations that are really from our future deliveries with our customers through development agreements. What's important about this slide is and we've been talking about this for the last couple years, is the transition of our customers from standard product portfolio to more of the high value products.

Our standard products, while it looks little growth, there's two drivers of that. One is primarily standard products are going into the pharma sector, small molecules. These molecules have been in the industry, in the market for many years, 5, 10, 15, 20 years and there's not a lot of change in that particular domain.

The other driver is actually a transition of customers from standard products to high-value products. So, we are – if you want to call it cannibalizing ourselves a little bit, we're actually moving our customers up the value curve closer to higher-quality products with our high-value products, as we said here, which is actually having an effect on our standard product portfolio.

Our delivery devices, while they're very small in our portfolio today from a revenue perspective, we do feel this has great potential long-term, has again strong delivery of growth over the last few years of strong double digits.

Turning over to our second segment is what we call 20% of our business is contract manufacturing. Contract manufacturing, what we're really good at in this space is to design and prototype delivery systems for our customers, for the pharma, the biotechs, the medical device companies around the world. We are manufacturing these materials.

When we scale up with our customers, we engaged in long-term contracts, where we're investing the capital in dedicated facilities and production runs in order to support their future demands not just for the next couple of years, for many years down the road, is our long-term partnerships and we deliver final finished products going to our customers around the globe.

One quick comment is, we are one of the largest providers of auto injectors in the industry today and we believe there's great opportunity continuing with that momentum. And the graph on the right gives you that indication that about 12 years ago, we acquired a firm called the Tech Group and today, we call it West Contract Manufacturing.

At that time, a little over 50% of the revenues of contract manufacturing were really geared to the consumer products – type products going into that particular sector. If you see on this graph here, our focus – our strategic focus in contract manufacturing really isn't around the healthcare space, auto injectors, pen injectors, continuous glucose monitoring, systems for the large players in the world. That's why, you're going to see the healthcare continuing to grow strong in this sector, while consumer products will be soft. But that is strategic, that's our focus, our investments are going into healthcare sector.

While we'll support customers and consumer products as we're having today, we're de-emphasizing over the couple of years, you can see that in our results.

I want to spend a moment as I mentioned earlier around Asia-Pacific and Latin America, I think there's opportunity here, when you start thinking about West's presence. We do have operations in those locations. There's two aspects to that; we do have a direct go-to-market approach in countries like Brazil and Columbia; we work with our partnership, alliance partnership with a company in Mexico, West Mexico, that is direct to customers.

When you start thinking about Asia-Pacific, we've a very strong presence in China, India, Southeast Asia, out of Singapore, Australia, our partnership in Daikyo is for the Japanese marketplace. So, we are direct with customers in those areas, plus we have assets on the ground where we're manufacturing components today if our customers in the local region.

While it's only 12% today of our revenue, we do believe and we do have the asset infrastructure today to be able to carry that forward with strong double-digit growth, which we're seeing this year even with some of the headwinds with our customers in India in regards to some of the regulatory barriers that they're faced with to get products out the door.

One quick comment here is, obviously there is a heavy generics play in this particular part of the region and also our high-value products. In earlier slide, we said it was – high-value products is 42% of the entire consolidated. When you put this in perspective, it's – the high-value product contribution out of Asia-Pacific is actually underrepresented and that is the area of growth that we're having. Our customers in this region are demanding higher quality due to the regulatory pressures in those specific markets.

And we're able to support them whether we import or we produce locally for those particular markets. I believe that we are very well positioned for continued growth in these particular markets. And there is markets we can continue to move into and further expand that penetration.

We set out, of course, a strategy, and this is not new to anyone in the room, but the last – about 2.5 years ago, we made it very clear we're going to move the organization from a product-led to more of a market-led organization. Sounds easy on a paper, it's been a journey. I think the customer response has been very positive. I think our – actually the whole ecosystem that we play in has been very positive and the approach that we have taken. And I want to go a little bit deeper in these four areas, but I just want to reiterate our focus really is to be the world leader in integrated containment and delivery components and devices for the injectable medicines. That's where we're focused, and that's where we're delivering results today.

Let's talk a little bit about the first area. It's about being market-led as an organization. You've seen how we've organized our commercial organization into the four distinct areas. We're creating value today. Because of this orientation, we're able to identify our customer needs and start driving that conversation into our innovation group, our R&D group, [indiscernible] (00:11:17) global operations, which I will touch on in a moment here. This approach here continues to gives us a good penetration on new molecules coming through the pipeline. We need to be in conversations with customers in development of Phase 1 and Phase 2, and not in the commercial stage or trying to take somebody else's share after the market has been commercialized. We create the most value with our customers, engaging early on in the conversations and that's what we're doing in these particular areas.

I'm really pleased with insights we are gaining specifically in the areas of generics and biologics over the last two years, which will allow us to penetrate and actually create more capabilities which will service those customers more effectively. We always do look at which products are introduced since the market commercialized and is West and our partner Daikyo on those products. I can sit here and say that today we've had a very good hit rate on the – basically the whole portfolio, but biologics we continue to have a very strong hit rate with new molecular entities especially here in 2017, no different in 2016 and before.

One area we don't – I haven't personally talked about a lot in these conferences, but I really want to spend a few moments on because when you start thinking about what differentiates West, it gives us sustainability for long term, really comes down to the scientific affairs and technical customer services, regulatory affairs and quality. The statistics here are relative to us, they're pretty impressive, but in other industries, it might be a little bit different, it might be high, it might be different. But one thing I want to point here is, when you look at customer requests regulatory filing assistance. Majority of those are large customers have the infrastructure and the capabilities; we do provide the information for them. What was coming out of these conversations is more around the small pharma, the emerging biotechs, they have the desire, they have the competency, but they don't have the capability and that's where they look to West and we are partnering with our customers whether large, even the small emerging biotechs, resulting in over 1,700 requests just in 2017.

One area here, just to give you another perspective is that when you look at additional headcounts we added in 2017, taking away operations, production, manufacturing – as we built Waterford we're scaling up, we built on Dublin with contract manufacturing, we've been scaling up in 2017. We require resources in those locations. If you take those out of the equation, majority of our hires at West, as we've been growing the business in 2017 have in the areas of scientific affairs, technical customer services, regulatory and quality. We want to continue with this momentum because it, again, truly differentiates us from our competition. For those that attend technical seminars in this particular space, hopefully you've seen our colleagues, my colleagues on the podium, talking about the science. That's where it starts and I think we've been well accepted and requested to attend several of these sessions.

The second lever at West, strategic pillar, I would call, it is the global operations. And we literally, while we have 20 manufacturing sites globally, and we have been doing a pretty good job for 95 years, let's just say that. But there's a tremendous opportunity to start thinking about globalization. So, at the end of 2016, we put together, started to form a team. We brought a new gentleman to lead this global operations. And for the first time in the history of West, every manufacturing site, process, every location is now consolidated all under one team, and we're seeing tremendous opportunities and results even in this early-stage throughout 2017.

You'll continue to see productivity metrics we will share with you on our quarterly calls and how we are progressing with these activities. But just to give you a couple of pillars that we are focused on within our global operations, one is the manufacturing strategy. We have 28 manufacturing sites. How do we leverage our assets more effectively. How do we allow ourselves to be more aligned to our customers, level load and to build, manufacture, collocate with our customers without putting another spade in the ground for some years to come. So this is a focus that we have is to align our manufacturing and level load and have our customers look at the One West model versus looking at the sites specifically.

Last, on the right-hand side, yes, we're producing over 100 million components a day. In our space, in our competitors, there's a large differentiation between us and others. What I'm most impressed about is, when you walk through the halls and go to our sites, the employees are extremely engaged in the areas of quality. Yes, the metrics start with safety. We've done a really great job over the last couple of years to improve our safety record here at West. The second area is around quality. Third area is around service to our customers. And the fourth area is really the cost down model of continuously driving lean improvements throughout the organization. Those are the four key levers and metrics that we're looking at.

The one on the right-hand side of less than 0.08 defects per million is a conversation that we have at West. That's basically 8 per billion. And for those engineers in the room, when you think about Six Sigma, that's very impressive, but we're not stopping there, we're looking at continuously improving our quality metrics around defects – out-of-spec parts, I should say, with our customers, because one defect is too many, when you start thinking about injectable, medicines into the consumer healthcare system, whether it's our family members, our friends, our relatives, that's what we're serious about. And that's why we have a quality patient-first focus at West. This resonates really well and I would challenge anybody, if you want to attend one of our – come to one of our facilities and talk to our operators in the shop floor, and they're producing the hundreds of millions of components a year, will tell you each and every one of them has a name on it. And so that's the focus we have at West, we realize we have a lot of work to do, but I think we're in a very good position to start from.

The third lever is are on R&D, it's around innovation and it's driving growth in our business. And if you take a look at the last five years, products have been introduced in the last five years and you know in our industry, it takes – there's adoption curves and approvals and changes within our industry. If look at the last five years of products introduced by West into the marketplace, it's contributing a little over 100 basis points of incremental growth in 2017. So that to us is a good indicator, and we'll be continually monitoring and measuring that statistics as we continuously improve our contribution to the marketplace.

It's really broken into three clear areas. One is advancing the core. Couple of great examples, I talked early about the generics and becoming more market-led. One of the key indicators we got from our generic customers is speed, is quality, and is service. And we created a new program called AccelTRA. We have products that have been produced. They're currently being validated, stability tests with a few customers at this point, to convert from standard products to AccelTRA which is now part of our high-value product portfolio. Our generics team has identified a value proposition that they've implemented, working with R&D, working with operations and that we're currently launching. It's a one example.

The second example is working on our NovaPure product portfolio, which is the highest level of quality, specifically designed for the biologic customer place. If you look at the second lever that we have is delivery devices. It's continuously identifying solutions with our customers through development agreements. We're continuously seeing increase with our customers looking at how do we take i.e., SmartDose, the next generation for their particular market and have another product that's approved as a combination device in the marketplace.

The third area is leveraging the acquisition we made with Medimop in Israel a few years ago, which is really gaining traction today with the products like Vial2Bag, a reconstitution of devices, that are really influential in the healthcare and the hospital marketplace. So, these are three levers that we're focused on at R&D at this point for execution to stay focused on what we introduce in the marketplace today to create value over the next several years here at West.

You can see our portfolio, how we're expanding it. It's moving from the standard from the bottom left, all the way up to this top-right is the increased value for our firm, but also most importantly, it's increased value for our customers and customer intimacy. We continue to expand the portfolio in all different areas. We're looking at new envision capabilities, looking at new technology in washing, sterilization, obviously looking at new opportunities around the NovaPure product portfolio. Stay tuned, we'll continue to update you on the progress there.

I'd like to just comment real quickly about the portfolio itself and what's driving the growth in the margin expansion. If you look at the high value product components, that business went 800 basis points from 34% in 2012 to where we are today. That is a little over 100 basis points per year and over an aggregate of few years as we noted here. And if you're really close to the story at West, you realize that the high-value products, the margins are quite considerably higher than what we have with our standard products.

We believe that again since 2016, we haven't updated the 2017 number, but 2016, 17% of our volume was in high-value products. So we feel that we have a runway that's quite attractive to continue with this momentum with that particular part of the portfolio. We're pleased with the gross margin expansion, but again, when we start thinking about layering on now the global operations strategy that I just articulated, we're pleased where we are, but we obviously want to continue to push forward, we're driving operational margin expansion [indiscernible] (00:21:59) the GM of 100 basis points per year.

Specifically, about the sustainable consistent growth, we have grown both the top line and our EPS nicely over the last several years. And obviously, our total return for our shareholders on the right-hand side compared to the S&P 500 and the S&P 400 has been relatively strong. We look at that as an opportunity to continue the momentum and stay focused on delivering for our customers and these graphs will take care of themselves.

I think when you look at our preliminary sales, long-term financial construct that we talk about, when you look at the core business for the components and contract manufacturing, we truly believe and this is without acquisitions, this is purely organic growth between 6% to 8% is the corridor for West. Showed geographical a bit earlier, we have done that consistently and we believe we have the markets, we have the product portfolio to continue with that trend.

The delivery systems, we believe, bring incremental growth to West. As you know, they are smaller portion today, but they will take time for adoption and penetration of the marketplaces. I'm really excited about our operational excellence and optimizing our footprint globally, and really a favorable mix shift going to high-value products, we still have pricing capabilities in our portfolio. And the construct includes continue to invest some capital, which is really around our organic growth story, roughly around 10% or a little bit less going forward.

Just to summarize, we've seen this slide – this is a staple for West, and the direction that we're going. We are a market-led organization. We do have more work to do to become even more market-led. We know that and we're working with our customers to make sure that we get closer to their supply chain, closer to their innovation groups, so that we're always at the table and designing and implementing new products to support them on their long-term growth.

We're driving innovation at West, our R&D team has been focused globally on our three key areas I mentioned, and now we have a global operations that has started to spur up great activities in 2017. We expect strong performance long term. At West, financially strong balance sheet and we've grown operating cash flow. Our focus is creating shareholder value. Our focus is on our customers and their patients and our focus is ensuring that we have the best environment for our people to and employees to thrive and flourish and really deliver value to our customers each and every day.

Thank you for our time. We'll see you at the Q&A breakout across the hall.