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West Pharmaceutical Services, Inc. (WST)

Q1 2017 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Good day, ladies and gentlemen, and welcome to West Pharmaceutical's First Quarter 2017 Earnings 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 follow at that time. [Operator Instructions]

As a reminder, this conference call is being recorded. I would now like to turn the conference over to Quintin Lai, Vice President of Investor Relations. Sir, you may begin.

Quintin John Lai

Vice President-Corporate Development, Strategy & Investor Relations, West Pharmaceutical Services, Inc.

Thank you, Takia. Good morning. And welcome to West's first quarter 2017 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.

This morning, CEO, Eric Green; and CFO, Bill Federici will review our results, give you an update on our business, and provide an updated financial outlook for the full year 2017. There is a slide presentation that accompanies today's conference call and a copy of that presentation is also available on the Investor section of our website.

On slide two is the Safe Harbor statement. Statements made by management on this call and in the presentation contain forward-looking statements within the meaning of U.S. Federal Securities Laws. These statements are based on management's beliefs and assumptions, current expectations, estimates and forecasts. There are many

factors that can influence the company's future results that are beyond the ability of the company to control or predict.

Because of these known or unknown risk or uncertainties, actual results could differ materially from past results and those expressed or implied in any forward-looking statements. For a non-exclusive list of factors which could cause actual results to differ from our expectations, please refer to today's press release, as well as any further disclosures the company makes regarding the risks to which it is subject to 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, organic sales, adjusted operating profit, adjusted operating profit margin 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.

I will now turn the call over to West's CEO and President, Eric Green. Eric?

Eric Mark Green

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

Great. Thank you, Quintin, and good morning, everyone. We are pleased that you could join us today for our Q1 call. We are off to a good start to 2017. In the first quarter, we generated solid organic sales growth of 8.7%, with good contributions from both segments. We expanded growth and operating profit margins in the quarter. We launched new products and increased capacity with our Dublin Contract Manufacturing expansion, which is now online. And we continue to invest in the future with the first phase at our Waterford, Ireland facility on track to be operational and delivering validated customer samples in 2017.

We generated a record high diluted earnings per share of \$0.81 for the quarter. Excluding the benefit from the new accounting rules for tax deductions related to stock based comp expense; we would have grown adjusted diluted EPS by 13%.

On slide four, we present organic sales growth over the last five quarters. As you can see, our overall organic sales growth has been in the 8% to 10% range over this period. But when we look at the individual market units, as we previously discussed, there is more quarter-to-quarter variability. Our ability to serve these market groups despite these changes in demand, demonstrates the strength of our scale and the depth of our capabilities. In aggregate, the long-term dynamics across our end markets remain robust and we are uniquely positioned to serve these diverse customer groups.

Let me review our Q1 performance in the context of our end markets. Our strategy for growth remains focused on increasing the adoption rate of our high-value products. We are also working to secure more opportunities for our customers to use multiple West products for each dose delivered and we see customers responding positively to this strategy.

In our Pharma market unit, we had strong double-digit sales performance. The growth was a result of very strong high-value product sales, coupled with favorable year-over-year comparison due to inventory adjustments by our customers. There was also some favorable pricing adjustments made in certain regions impacted by inflation. We expect Pharma to return to more typical mid single-digit sales growth resulting in high single-digit growth for the full year.

As we saw last quarter, our Generics market unit declined mid-single digits as customers continue to work out safety stock accumulated in the first half of 2016. We have improved lead times for many of our high-value products and, in turn, our customers have been able to reduce their inventory levels.

For Generics, we expect to see increased momentum as the year goes on. We have already seen some large customers place meaningful high-value product orders for second half delivery. We expect Generics to return to high single-digit growth in the latter part of 2017, which will result in mid single-digit growth for the full year.

In the Biologics market unit, we saw mid single-digit growth as we cycled against the strongest growth quarter of last year due to inventory builds in support of commercial drug launches. In this quarter, we experienced some destocking by customers, but not at the same level as Generics and we expect to return to double-digit growth in Q2 and for the remainder of the year.

Importantly, commercial activity for both SmartDose and CZ remains high. We have multiple SmartDose programs at an early stage and [indiscernible] commercial programs in place for both SmartDose and CZ.

Developments for larger volume and preloaded versions of our SmartDose device platform, as well as connectivity features are raising interest from our customers, especially within our Biologics and the emerging biotech customer base.

In Contract Manufacturing, we achieved a second straight quarter of double-digit growth. Along with a favorable comparison from last year's first quarter, we are seeing the results as expected from the many tooling projects, which support new programs secured in the back-half of 2016. Because of the longer lead times of some of these projects, we have good visibility into the back half of the year, which should produce high single-digit growth in this segment.

On slide five, this shows our product portfolio and represents the value we bring to our customers with the value those products and services bring to West. We recognize that our long-term success depends on our ability to keep our product pipeline full of advanced containment and delivery solutions.

The product shown above the arrow represents some of the new products that have recently been launched or will soon be launched. I am pleased with the progress of our global innovation and technology team, and their work to expand our portfolio.

We do know it takes time for many of these products to achieve substantial commercial volumes, as our customers make their way through the drug development cycle, but we are pleased with our cadence of new product launches.

By working with our customers, particularly during Phase 1 or 2, we are able to support them from concepts to development to launch. As a result, we've seen high percentage of FDA approved injectables using either West or Dai-ichi components. In fact, we are pleased to report that our products are used in all five of the new biologic medicines approved by the FDA in the first quarter of this year.

Most recently, I got a chance to speak with some of our top customers at the March DCAT Conference in New York. It was a great pleasure to get their feedback and how West is successfully partnering with them to get their products to the market.

What I heard most frequently was how much they value and appreciate the deep technical insight that their teams offer. They also noted the importance of our collaboration to continuously improve so that together we can ensure we deliver the highest quality level each and every day.

It's not just about the products we make. To hear from our customers on how much they value our scientific affairs and technical services, as well as our regulatory affairs and assistance with filings, it underscores that West is the scientific destination for integrated containment and delivery of injectable medicines. We are striving to provide value at every possible touch point we have with our customers as part of our market-led strategy.

Turning to slide six, with a good start to the year, we remain focused on delivering critical high-value products to our customers, offering differentiating Contract Manufacturing services and further developing our growing self-injection platforms. We are maintaining a 7% to 9% organic sales growth guidance for the year and raising our adjusted EPS guidance.

I'll now turn it over to our CFO, Bill Federici, who will take you through the detailed financial results for the quarter. Bill?

William J. Federici

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

Thank you, Eric, and good morning, everyone. We issued our results this morning reporting first quarter 2017 earnings of \$60.9 million or \$0.81 per diluted share versus the \$0.30 per diluted share we reported in the first quarter of 2016. Those results are summarized on slide seven.

Our Q1 2017 reported results include a \$15.9 million or \$0.21 EPS tax benefit associated with our adoption of the new Accounting Standards regarding share-based payments. Our Q1 2016 reported results include a restructuring charge and the Venezuelan devaluation charge. Excluding those non-recurring items, our Q1 2016 adjusted diluted EPS was \$0.53. Those 2016 non-GAAP measures are described in slides 13 through 16.

Turning to sales, slide eight shows the components of our consolidated sales increase. Consolidated first quarter sales were \$387.7 million, an increase of 8.7% for the first quarter 2016 sales, excluding translation exchange effects.

Proprietary Product sales increased 8% versus the same quarter in 2016 excluding unfavorable translation exchange effects. Volume increases contributed 5.7% of the proprietary sales increase. Our high-value product components and system sales increased 8% versus the prior year first quarter.

As expected, the quarters – the current quarter's HVP sales were adversely impacted by customer inventory management, especially in our Generics and Biologics market units. The current quarter HVP sales as a percentage of total proprietary sales were constant versus the prior year quarter and represent more than 50% of our total Proprietary Product Q1 2017 sales.

For the full year 2017, we expect double-digit sales growth in high-value products. CZ and SmartDose sales grew double digits in the current quarter versus the prior year quarter. Contract-Manufactured Products' net sales increased by 11.4% versus the prior quarter excluding exchange, a favorable mix of products sold, volume increases and pricing drove the increase in Q1 2017 sales.

This quarter's growth was favorably impacted by the ramping up of some customer's projects in our Dublin facility. We expect high single-digit sales growth in Contract Manufacturing for the full year 2017.

As provided on slide nine, our consolidated gross profit margin for Q1 2017 was 34.6% versus the 34% margin we achieved in the first quarter of 2016. Proprietary Products' first quarter gross margin of 39.2% was 40 basis points higher than the 38.8% achieved in the first quarter of 2016. The increase in gross margin is due to price increases and operational efficiencies offset by a slightly unfavorable mix of products sold and normal inflationary increases in labor and overhead costs.

Our Venezuelan operation's favorable currency impact in the current quarter was partially offset by yen currency losses on material purchases and an unfavorable currency translation effect in Europe.

Contract-Manufactured Products' first quarter gross margin increased by 160 basis points to 16.3% compared to the prior year quarter. The current quarter's higher gross margin is primarily due to the favorable mix of products sold and operational efficiencies, offset by normal material, labor and overhead cost increases.

As reflected on slide 10, Q1 2017 consolidated SG&A expense increased by \$3.5 million versus the prior year quarter. As a percentage of sales, first quarter 2017 SG&A expense was 15.9% versus 16% in the first quarter of 2016. Pension costs decreased by \$1 million in the quarter and were offset by higher compensation expense, including merit increases and increased IT costs. Foreign exchange had a favorable effect, reducing SG&A expenses by \$400,000.

Slide 11 shows our key cash flow metrics. Operating cash flow was \$20.7 million for the current quarter, \$17 million more than the prior year quarter, primarily reflecting the higher net income and the new Accounting Standards Classification of the excess tax benefit on share based payments as part of operating cash flows.

Our capital spending was \$37.5 million in the current quarter. We expect to spend approximately \$150 million to \$175 million in capital in 2017, more than half of our planned capital spending is dedicated to new products and expansion initiatives, including \$25 million in Waterford.

Slide 11 also provides some summary balance sheet information. Our balance sheet continues to be strong and we are confident that our business will provide necessary future liquidity. Our cash balance at March 31 of \$169 million was \$34 million less than our December 2016 balance. Approximately \$27 million of our cash was used to buy back 325,000 shares of our common stock under the Board authorized share buyback plan, and we made a \$20 million voluntary contribution to our pension plan.

While a large portion of our cash remains invested overseas and is generally not available to be repatriated to the U.S. without incurring tax consequences, we continue to pursue repatriation of certain offshore cash where possible.

Debt at March 31 of \$228 million is essentially the same level as at year end. Our net debt to total invested capital ratio at quarter-end was 4.8%. Working capital of \$396 million at March 31 was \$5 million lower than at year-end. The majority of the decrease was due to the reduction in cash and the reclassification of long-term debt to current offset by increases in inventories and receivables related to our growth in our business.

Our committed Proprietary Product orders of \$408 million at March 2017 were 8% higher than at year-end, but 5% lower than the March 2016 orders excluding exchange. The March 2016 committed orders were impacted by our extended lead times for certain high-value products.

Turning to slide 12, we are increasing our full year 2017 EPS guidance range by \$0.21 to reflect the Q1 excess tax benefit on stock transactions. We are reaffirming our other annual guidance provided previously.

We have based our guidance on an exchange rate of \$1.05 per euro, the same rate used in our prior guidance. Our 2017 guidance excludes any additional impact from further currency devaluations, including the Venezuelan bolívar as the company continues to operate primarily under the official exchange rate. It also excludes the expected additional expense associated with our restructuring program.

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

Eric Mark Green

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

Great. Thank you, Bill. In conclusion, we delivered a solid set of results for the first quarter of 2017. We are driving high-value product growth in our Proprietary Products segment and expanding our Contract Manufacturing services. Our global operations is driving more efficient production, higher quality and better service, delivering significant value to our customers and the patients they'd serve.

And our innovation and technology team continues to fill our product pipeline with exciting new developments in primary containment and delivery. We are off to a good start, and I look forward making additional progress and executing our market-led strategy in 2017.

Takia, we're ready to take questions. Thank you.

QUESTION AND ANSWER SECTION

Operator: Thank you. [Operator Instructions] Our first question comes from Derik de Bruin with Bank of America Merrill Lynch. Your line is open.

Derik de Bruin

Analyst, Bank of America Merrill Lynch

Hi. Good morning.

Q

William J. Federici

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

Good morning.

A

Eric Mark Green

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

Good morning, Derik.

A

Derik de Bruin

Analyst, Bank of America Merrill Lynch

Great. So I got just a few housekeeping questions and I got a bigger one. Bill, the tax guide for 2017 is the bulk of the benefits in the first quarter. How does the rest of the quarter pace out? And what's the guide for the full-year tax rate?

Q

William J. Federici

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

Full-year tax rate is going to be right around 29%.

A

Derik de Bruin

Analyst, Bank of America Merrill Lynch

Okay. Great.

Q

William J. Federici

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

It excludes – as you know, it excludes that tax benefit that we picked up from the share based payments adopting that new accounting pronouncement.

A

Derik de Bruin

Analyst, Bank of America Merrill Lynch

Got you.

Q

William J. Federici

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

So that's why the first quarter is so low.

A

Derik de Bruin

Analyst, Bank of America Merrill Lynch

Got you. Okay. Great. And the top line impact from FX, you're looking for now?

Q

William J. Federici

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

Well, FX is, right now we are guidance to \$1.05 per euro.

A

Derik de Bruin

Analyst, Bank of America Merrill Lynch

Yeah.

Q

William J. Federici

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

Right now, obviously, it's a little higher than that, but we put a stake in the ground and we'll continue to monitor that and report on it on a quarterly basis. But right now it's a headwind for us from the euro.

A

Derik de Bruin

Analyst, Bank of America Merrill Lynch

Got it. Okay. Share count?

Q

William J. Federici

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

A

Share count, we are hoping that remain relatively flat, because we have that share buyback plan that we've – that the board authorized and we put in place. So we're hoping to keep it relatively flat.

Derik de Bruin

Analyst, Bank of America Merrill Lynch

Q

Great. A bigger question now. Could you just walk a little bit about the Biologics, I mean, you had a tough comp and in this quarter, you've also seen some drawdowns, you saw some drawdown in inventory that sounds like – just talk about what you are sort of seeing in that end market and then how, where – is there any update in terms of where your customers are adopting Crystal Zenith and then I'll shut up.

Eric Mark Green

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

A

Yeah. Derik, good question. We look at the Biologics similar to last year where we had a period of time was a little bit slightly less than the other three quarters, that's we are experiencing this year in 2017 and the markets themselves are still as far as the unit volume perspective mid to high single-digit and we expect to grow faster than that obviously. But working with our customers with the inventory management and again this leads to the high-value product focus of reducing cycle times just to put dimension slightly and in couple of our plants that produce mostly the high-value products, we saw a nice reduction about 20 – roughly around 20% reduction. That obviously is migrating back to our customers and there is again higher degree of confidence and therefore, they're pulling back on their inventories.

As we've said, we're pretty clear that we'll see an increase in growth rates over prior year to back to the double digits starting this quarter in Q2 and going forward. So we're feeling pretty good about that.

In regards to CZ, we've seen a little slight increase of the interest level, when you start to looking at pre-stability – stability and then getting ready for launch in those three buckets, we are seeing an increase which is favorable. As you know it does take time, it does depend on approvals and customers getting ready for launch, but we're still feeling pretty good about that portfolio at this time.

Derik de Bruin

Analyst, Bank of America Merrill Lynch

Q

Great. Thank you.

Eric Mark Green

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

A

Thank you, Derik.

Operator: Thank you. Our next question comes from Tim Evans with Wells Fargo. Your line is open.

Sara Silverman

Analyst, Wells Fargo Securities LLC

Q

Hi, guys. This is Sara Silverman on for Tim.

Eric Mark Green

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

A

Hi, Sara.

Sara Silverman

Analyst, Wells Fargo Securities LLC

Q

I've a margin – hi, guys. I've a margin question for you. You guys had pretty solid margin gains in the quarter and I'd like to look at some of the components. You guys call out about 100 basis points of efficiency gains but then volume and mix was about a 30 basis points headwind. Can you guys talk about kind of what exactly you're doing to gain the efficiencies and then also talk about why volume and mix was a negative contributor, since this is kind of the reversal of historical trend?

Eric Mark Green

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

A

Yes, Sara. Good morning. And let me start with the efficiencies. Last year we embarked on, as you know, a little over a year ago we embarked on a really a different focus around our operations. We globalized historically, rain it from a site and region perspective and it was effective at that time, but going forward, we felt we could bring more of a global approach. We've brought a leadership into the organization and frankly, we're starting to see good traction and looking at how we can move certain products being produced in certain regions and our locations more effectively truly balance our load.

When I look at the operations, there's really four key levers we are focused on. One, we're already a pretty high level on quality, but we wanted to actually move that bar even further north. The second is around service. The lead time focused on reducing it to a more than acceptable point by our customers is that we are definitely on that journey. The third is on global lean initiatives, they're starting to kick in, we are going more global operations, global mean, and our principles returning to see early traction. And the fourth one is going to take little more time, but it's really the global manufacturing strategy, and looking at capacity opportunities and leveraging scale. We spend, obviously, quite a bit on CapEx. We're looking at how we can leverage our assets more effectively going forward with this global approach.

I think Bill, do you want to talk a little bit about the mix effect?

William J. Federici

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

A

Sure. So mix, Sara, was slightly negative; it was slightly unfavorable. And it's directly tied to the lower growth rate in both Biologics and Generics.

Sara Silverman

Analyst, Wells Fargo Securities LLC

Q

Okay. So going forward, you think that mix will continue to be a positive contributor to margin?

William J. Federici

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

A

Exactly. Right. So let me, returning Biologics returning double-digit in the second quarter and then also seeing Generics ramp up by the end of the year, all of those will help with that the mix going forward.

Sara Silverman

Analyst, Wells Fargo Securities LLC

Q

Okay. Great. And then just a quick follow up on the CZ question. You guys had about \$27 million in CZ and SmartDose last year. Do you guys expect that line to grow materially this year?

Eric Mark Green

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

Yeah. We expect that to grow in the double digits.

A

Sara Silverman

Analyst, Wells Fargo Securities LLC

Okay. Great. Thanks for my questions.

Q

Eric Mark Green

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

Great. Thank you, Sara.

A

William J. Federici

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

Bye, Sara.

A

Operator: Thank you. Our next question comes from Larry Solow with CJS Securities. Your line is open.

Lawrence Solow

Analyst, CJS Securities, Inc.

Good morning. Thanks, guys.

Q

William J. Federici

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

Good morning, Larry.

A

Lawrence Solow

Analyst, CJS Securities, Inc.

Good morning. A Bunch of moving parts, obviously, with timing and what not. And just curious, I know we had expected a little bit more of backend loaded year. Is most of the difference there just a little bit of the pull forward in the Contract Manufacturing side or what's sort of – is there or is the quarter maybe a little bit better than your internal outside the timing?

Q

Eric Mark Green

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

Yeah. I think what we are going to see in the back half this year is more of the ramp up on the Generics space. As you recall that that we have a few large customers in that space that really moved the needle quickly.

A

Lawrence Solow

Analyst, CJS Securities, Inc.

Right.

Q

Eric Mark Green

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

A

And so, again, I'm very pleased with our operations really driving down cycle times, therefore a higher degree of confidence, but the demand in the Generics is still rather robust.

Lawrence Solow

Analyst, CJS Securities, Inc.

Okay.

Eric Mark Green

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

So we're pretty confident there. In the Biologics, again, that's more of a ramp up, back to double digits in Q2 and beyond. So when you have that effect of those two, which is about 50% of our business and most of that is our high-value product portfolio.

The Contract Manufacturing, just a quick comment. While it was double digits in last two quarters, we anticipate a similar type of growth going forward. However, when you look at the Q4 as far as the growth percentage, it's going against a very high comp. So we should look at the Contract Manufacturing as a very stable predictable revenue run rate for that business, especially after investing in the facilities in Dublin.

Lawrence Solow

Analyst, CJS Securities, Inc.

Okay. And just on the Contract Manufacturing side, just a quick aside there. I know the – on the gross margin of that segment, it did increase pretty nicely year-over-year and I assumed it's just timing related and still sort of Q1, I guess, normally is a little bit lower, but it still remains sort of lower probably than your full year outlook. You had a decent rebound in growth. Is there anything else in there that sort of impacted that, that should sort of wane as the year progresses?

William J. Federici

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

Yeah. So, Larry, as you remember, we had a bunch of tooling stuff going on in the fourth quarter that has actually now produced usable capacity and that capacity is filled by our customers. So that's obviously helping with the increase in the margins. And there is also some good operational efficiency going on in there as well. So those things we continue, as Eric said, we continue to think that that's going to continue to build for the year.

Lawrence Solow

Analyst, CJS Securities, Inc.

Got it. And then, just lastly on, it sounds like you guys are obviously improved your throughput and your capacity over the last two quarters, which is, I guess, comforting to your customers and that's led to some slowdown in orders, which were probably a little bit ahead of the game last year. Do you think what sort of getting closer to, I guess, I don't know about equilibrium, but less volatility in the order line going forward?

Eric Mark Green

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

Yeah. I would say, at this point, we are just going to see less volatility. I think we are more in a stable state, but I will keep on challenging the operations to find ways to even improve the cycle times that – so that it's uniquely in a new space. So as we go forward, you'll see that reflected in our committed orders. We do want to keep – continue to push the cycle times down to be more aligned with our customer expectations.

Lawrence Solow

Analyst, CJS Securities, Inc.

Got it. Great. Thanks guys. Appreciate it.

Q

Eric Mark Green

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

Thanks, Larry.

A

Operator: Thank you. Our next question comes from Dave Windley with Jefferies. Your line is open.

Jared Meggison

Analyst, Jefferies LLC

Hi, guys. This is Jared Meggison on for Dave this morning.

Q

William J. Federici

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

Hey, Jared.

A

Jared Meggison

Analyst, Jefferies LLC

I just had a couple quick ones. Can you guys elaborate a little a bit more on Waterford and kind of the impact you guys expect there in 2018? I don't want to jump forward too much, but just curious what kind of impact this could have kind of on a long-term basis?

Q

Eric Mark Green

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

Yeah. Well, we're in the process of – at the end of this year, we'll be working with our customers, especially in insulin space on validating samples. And once the validation process has been completed, we can start moving into commercial revenues. But as you know in this space, in this business, it does take a while to ramp up. So I would argue that 2018 while we will see ramp up in commercials, it's not going to be really significant. It's going to be in line with our expectations, but it's not going to be a significant hit to our top line in 2018.

A

Jared Meggison

Analyst, Jefferies LLC

Got you. And then just real quickly on the customer inventory management. I'm just curious to kind of dive into your guys' visibility on that and kind of ability to forecast?

Q

Eric Mark Green

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

Well, one of the – you're absolutely correct. And that's one of the reasons why we realigned our organization to the market-led. So our Generics team is just focus on the Generics customers. They are having discussions day in day out and they are working with their operations to translate that into capacity and utilization of our facilities.

A

We are getting better at it. Can we improve? I think, we can. But I would say we're getting better visibility. Some of it is a little bit of variability of our customers as they move in and out of ability to produce. Unfortunately some of

our customers are going through difficult times with FDA, but that translates into another location. So there is some moving parts for that business, but we are gaining better visibility. I do believe we have some room for improvement.

Jared Meggison

Analyst, Jefferies LLC

Great. Thanks, guys.

Q

Eric Mark Green

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

Thank you.

A

William J. Federici

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

Thanks.

A

Operator: Thank you. Our next question comes from William March with Janney. Your line is open.

William March

Analyst, Janney Montgomery Scott LLC

Hey, guys. This is Bill on for Paul Knight. How you're guys doing?

Q

Eric Mark Green

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

Good. How are you doing?

A

William J. Federici

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

Good. Thanks, Bill.

A

William March

Analyst, Janney Montgomery Scott LLC

So first question just on the Generics business, obviously, customers have been working off of backlog over the past couple quarters, with the backlog also kind of flat year-over-year, are you starting to see more customers interested in high-value products and so some of them are maybe burning off standard products to upgrade, just what are you seeing from that customer segment?

Q

Eric Mark Green

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

Yeah. Bill, I wouldn't correlate that exactly to the transition from standard to high-value products. There is a transition occurring.

A

William March

Analyst, Janney Montgomery Scott LLC

Okay.

Q

Eric Mark Green

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

A

And we have discrete cases to point to. However, what we are seeing is as the – we've seen the momentum of new committed orders coming in, which is building on upon the backlog at this time. So as you recall, it's roughly around 8% increase as of end of last year. Last year because the pull-back in inventory is probably more of the latter part, it was after we had a discussion in October – it was the June, October and December. We knew it's going to be probably a good six months – roughly approximately about six months to work out. So we are – Q1 was right in the middle of that or in the beginning of that at this point. So, I would say, it's a combination of both transition from standard to high-value products but also destocking with some of our large customers.

William March

Analyst, Janney Montgomery Scott LLC

Q

Got it. And on CZ and SmartDose, could you just give us an update on the number of trials that are currently utilizing those two products?

Eric Mark Green

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

A

Yeah. So as I mentioned earlier, we're trying to get away from the exact number every time, but I would say that, when we're talking about CZ, there is an increase – a slight increase. SmartDose is relatively the same as last quarter we talk about, but there is more conversations. In fact, quite a bit more conversations happening right now around DAs and around sampling of discussions about variations of the product to support various drug therapies. So it's slightly better than what we talked about last quarter.

William March

Analyst, Janney Montgomery Scott LLC

Q

Got it. And just one quick one for Bill. Bill over the past six quarters or so return on invested capital has really been moving up about 400 basis points, 500 basis points. Could you just maybe highlight what's driving that?

William J. Federici

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

A

Well, certainly, the high-value product growth that we've seen over the last several quarters, in fact, over the last couple years has been very, very strong. And that drives the favorable mix shift. We're doing a great job of operational efficiencies. We're doing a great job of getting good leverage out of the other parts of the business.

So those things are all helping produce. At the same time, we continue to invest in the business and that will continue to be a drag on our return on invested capital. But we're doing in a prudent way, making sure we're investing in those things like high-value product capacity to be able to continue to grow at the rates that we've been able to grow. So yeah, I think the two biggest drivers our HVP growth and the operational efficiency.

William March

Analyst, Janney Montgomery Scott LLC

Q

Great. Thanks guys. Have a good one.

William J. Federici

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

A

Thank you, Bill.

Eric Mark Green

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

A

Thank you, Bill.

Operator: Thank you. I'm showing no further questions at this time. I would like to turn the conference back over to Quintin Lai, Vice President of Investor Relations for any closing remarks.

Quintin John Lai

Vice President-Corporate Development, Strategy & Investor Relations, West Pharmaceutical Services, Inc.

Thank you, Takia. Thank you for joining us on today's conference call. An online archive of the broadcast will be available on our website at westpharma.com in the Investor section. Additionally, you may access a telephone replay through Thursday, May 4, by dialing the numbers and conference ID provided at the end of today's earnings release. That concludes this call. Thanks, and have a good day.

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

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