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MANAGEMENT DISCUSSION SECTION

Dana Flanders
Analyst, Goldman Sachs & Co. LLC

Okay, great. Well, why don't we go ahead and get started? Thanks everybody for joining us. Big thanks to West Pharmaceutical Services for being here this year and speaking with us. I'm Dana Flanders, one of the senior healthcare analysts here at Goldman. And with us from West, we have Eric Green, CEO; and Bill Federici, the CFO, so thanks both of you for being here.

Eric, I don't know if you want to make maybe some opening remarks and then we can dig into Q&A.

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

Yeah, absolutely. So, first of all, Dana, thank you for the invitation for West to participate. Today, it's been a great day so far here in California, and thank you also for the opportunity to tell you a little bit about West.

Just to start off, West is a fantastic story if you haven't – if you're not familiar with West. It's a 95-year history that we just celebrated last month that has been really true to this core for the last 95 years of producing elastomer components used in primary containment of the injectable medicine space. We believe we are the leader in this particular space as we participate on majority of the drug molecules that are in the marketplace today whether it's in the biologic space, generics or in the branded pharmaceutical arena.

We're excited about our future. We have a strong platform to work off of. We have 28 manufacturing sites around the globe that produces approximately about 41 billion components per annum. If you look at a unit volume perspective, that's over 100 million injectable medicines introduced into the market each and every day that we participate on. I think when you start thinking about our opportunities from a market-led perspective, we reorganized the company into distinct areas around pharmaceutical generics and in the biologics area. It's roughly a third, a third, a third of these particular businesses of our proprietary businesses.

The generics provides a great opportunity for us to continue to create value propositions that allows us to move our customers from standard products to high value products. In the pharmaceutical space, we participate on drug molecules that have been in the marketplace for a number of decades, and we will continue to do so going forward. In the biologics space, we continue to have a very high participation rate of new molecules being approved and introduced into the market, whether it's in the North America, Europe or even in Asia. So we're very well-positioned in all areas in the proprietary.

But I'm excited about also on our contract manufacturing business, it's roughly around 23% of our business and that business is growing well in the high-single, low-double digits consistently. And we're very much well-positioned to produce auto-injectors, continuous glucose monitoring devices and also pens used for injectable medicines around the world. So, again, on all fronts, we're very well-positioned for continued growth.

I think, if you start thinking about the innovation engine, we're really focused on what's the next generation of high value products, whether it's expanding existing portfolio or moving into new adjacent areas that allows us to have more of a system or solution approach.

So, again, Dana, just a quick introduction. When we start thinking about West, we're very well-positioned. We have a very attractive marketplace that we're participating in, and we have a footprint that allows us to continue to grow for several years ahead of us.

QUESTION AND ANSWER SECTION

Dana Flanders
Analyst, Goldman Sachs & Co. LLC

Q

Great. Great. And that was a great intro. And maybe as we just think about big picture top down, I know you've laid out kind of a 6% to 8% long-term organic growth target, and you've laid out the pieces that kind of build-up to get there. But maybe from a top down perspective as we think about the tailwinds supporting your business whether it's outsourcing the regulatory and quality pressures that your customers face, I mean, how do those tailwinds play into that growth rate and what are you seeing right now relative to those trends? I mean, where do you see those trends going?

Dana Flanders
Analyst, Goldman Sachs & Co. LLC

A

Yeah, sort of looking at the trends, the macro trends, absolutely there's more movements within the injectable medicine space, really we started thinking about some of the most complex molecules for therapies to treat very complex disease states, tends to be more in the biologics space and injectables space, we're very well positioned in that particular area to continue to partner with our customers and have innovative solutions that enables to get them drug molecules into the market safely and efficiently for patients.

If you start thinking about the aging population and the more increasing demand on injectable medicines, we believe the market from an injectable medicine perspective in a unit, thinking about from a units perspective is roughly around 3% to 5%, so the volume component of our business. And that is, we believe, sustainable for a number of years to come. We also started thinking about the geographic growth of patient population and increasing usage of injectable medicines, particularly in Asia and in Eastern Europe. And again, we're very well positioned in those particular markets to capture those opportunities as the demand increases.

There is an increase in regulatory scrutiny on drug molecules going into the marketplace today. And that is one of the premise of our high value product value proposition to really de-risk the number of defects or potential issues our customers would face when they introduce these molecules in the marketplace. By going with our high value products, we are reducing the number of particulates significantly from our drug molecule, enabling our customers to increase their yield. So you start thinking about regulatory scrutiny and more complexity that's being introduced. We're very well-positioned with our portfolio and thought leadership to enable us to be successful in that area.

Dana Flanders
Analyst, Goldman Sachs & Co. LLC

Q

Okay, great. And within the offerings you provided and I know you lay out a really nice chart of the high value products that you can offer your customers, I mean, where is that within that ladder that your customers say the incremental investment isn't worth it to do it in-house? And I know that can vary depending on size and footprint, but I mean generally what are you seeing relative to that aspect of the business?

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

A

Sure. So, Dana, when you think about it, in the primary containment of injectable drugs, the primary drug container that is the thing that houses the drug while it's in the supply chain, so whether it's with the pharmacist or the patient or in somebody's warehouse, that has to meet very strict requirements as part of that drug's approval. And so, we will manufacture the product by molding it, trimming it. And if it's going to a legacy large company that is an innovator in the small molecule space, they probably have the infrastructure in place to then wash with water-for-injection and do the sterilization that's required under the regs.

So, we will sell them, what we call, standard product and very – the quality is very good, but that finishing part of it, the washing with water-for-injection and the sterilization is something they do, they have their own infrastructure. And so, the price of RASP is much lower on a product like that because they're doing the downstream processing. If it's a generic customer, for instance, or a biologic customer that doesn't have that capacity themselves, someone has to do that for the regulatory process. So when we do it, the washing we call Westar RS, washing and sterilizing is Westar RU, and those are attributes rightly as you said that are downstream outsourced processing that we do. And we gain more ASP for each unit and a better margin profile for each unit. So, when you think about that continuum of product quality that we have with those customers, the high value product curve that you're describing, Westar is something that's applicable to a vast majority of our product. If it's got to be in the marketplace, someone has to wash it and someone has to sterilize it.

Vision – and that product Westar was introduced in late-1990s and is very well penetrated amongst our customers. The Westar where we're doing sterilization of those products is something that's a little newer for us and less penetrative. Something like vision inspection are what we call in our ambition process is very important. Eric mentioned earlier that yield is very important to customers, and making sure that they don't have risk of – downstream risk of either having a product recall or some other problems with their products throwing out the API if they find out in the fill-finish process that that there is a problem with the product either particular or some other problem. We will – our Envision product is designed to inspect the quality at the component stage, so that if there is a defect, we catch it when it's a couple of cents per piece as opposed to when the API has still been the product it has to be thrown out there.

So there's economic compulsion. That was introduced in the 2013-2014 timeframe Envision and has very little penetration, less than 10% of our units today. All the way up to our highest quality, quality by design product what we call NovaPure, which is again an addressable market you wouldn't use that for everything. It's mostly for the high end biologics, but very, very low penetration at this stage. It was introduced in 2016 and we're less than 1% penetrated.

Dana Flanders
Analyst, Goldman Sachs & Co. LLC

Q

Okay.

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

A

Gives you some sense.

Dana Flanders
Analyst, Goldman Sachs & Co. LLC

Q

Okay. And that's helpful. And as we think about your sub-segments, I mean, where is the greatest opportunity for further high value product conversion? Is there a natural ceiling for something like generics and pharma or is that still a lot of room to go?

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

A

Yeah. I think if you – that's a great question because there are – when we look at the runway for high value products just to put it in context as we talked about previously is roughly, less than 20% of our volume today that we manufacture is high value products, and obviously the sales aspect of that is a little over 40% of revenue. And when you break it down, you're right about the biologics, it's mostly transactions of biologics go directly into the high value products, especially with FluroTec-coating and Envision and sterilization – washroom sterilization.

When you start thinking about the generics space and the pharmaceutical, we believe there's opportunity. There are two different distinct value propositions. Starting with the pharmaceutical, it tends to be more of a discussion around changing out a platform approach on the series of multiple molecules in the marketplace today to derive towards Zero-Defect. And really the drive around it is really total cost of ownership.

So, taking the processes that have historically been done by our customers and then bringing it to West and having West do it because of the amount of investments we made, the level of advancements we've made on our technology and capabilities to really deliver a product that has the highest quality to meet their needs.

So there is an economic compulsion to really move from standard high value products from a platform perspective and those type migrations tend to take multiple years, and that really is a true partnership on the technical sizeable firms making that happen.

In the generics space, what we're finding and our recently announced and launched portfolio, what we call, AccelTRA, which allows us really three components to that and really resonates well for generic customers. It's around speed, it's around simplicity, it's around documentation and quality. And so, we're sort of thinking about the short window of opportunity to introduce a new product to get approved, to get into the marketplace.

What we've been able to do is identify what particular formulations would be more suitable for a broader range of molecules for the generic customers. And through the washing and sterilization, we are able to deliver that product to our customer. We are able to reduce it from the several SKUs, let's say, over 100 SKUs down to a very short – small SKUs less than 10. What enables us to do is level order operations more effectively and efficiently and drive more velocity and manufacturing of products to get into our customers hands.

Give you a case in point, when we started the migration for standard high value products in generics, roughly to make the order demands roughly 25 to 40 weeks depending on the criteria to our customers now we're well less than 10 weeks. So you can see the dynamics there. It allows our customers to reduce their safety stocks but also have more real-time dynamic of fluid and materials into their operations.

The last part when I talked about documentation and the quality aspect is that we're able to provide all the necessary documentation in a format that allows them to file very quickly and gain approval. So, this is a program that we've developed from the inputs from our key customers in that particular space. It's really designed for the generic space, and we're very excited about the penetration opportunities there.

To summarize, the penetration opportunities in pharma and generics were less than 50% right now where revenues are [ph] classified (14:04) high value products, pharmaceuticals is much less than that. We believe there is runway ahead in that particular space definitely.

Dana Flanders
Analyst, Goldman Sachs & Co. LLC

Q

Okay, great. And on biologics, I know you talked about the ability to reduce error rates for expensive API. I mean, I guess, what are the statistics there and kind of the math that you can go to a biologics manufacturer and pitch this? I mean, what's your pitch to them to get them to want to move higher and higher up the value chain?

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

A

Sure. So it's exactly what you said, Dana. So, it's literally – we described it before, if you have a product, a very expensive API that takes a long time to manufacture, and you're waiting till the end of the process to inspect in the quality at the end and you find defects that's going to reduce your yield, and yield is extraordinarily important to our customers.

So, with things like Envision or even more importantly with NovaPure, where literally the product is designed specifically for that compound and you work with the customer to design a very, very rigorous inspection of that – of all the materials, the processes, the manufacturer and the ultimate delivery to the customer, we can help the customer reduce the level of defects and increase the yield, and it does depend on each individual customer. So, our sales forces have been trained to work with the customer and their technical people in looking at the compound and designing in, okay, well, what's the error – what are the yields now? What are some of the errors that you're finding? And then, how could we then help them upstream in the process deal with some of those things?

Now, it's with someone else's product, not much we can do about that. We can identify things for them and tell them how they might be able to reduce that. But as it relates to the primary drug package, we can help them reduce the defects when they're only in the component side, find them then and reduce that level, increase the level of quality of our component products, and therefore hopefully reduce their negatives and increase their yields.

Dana Flanders
Analyst, Goldman Sachs & Co. LLC

Q

Okay. And I know you had mentioned, Eric, I think working on kind of next-generation high value products and innovation in the space. I mean, where is your R&D team focused and, again, I know this is a very long cycle business, but what should we expect on the innovation and R&D front so you can continue to offer more and more value to your customers? What are you working on?

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

A

Yeah. There's two areas that I'll focus on with our R&D efforts. If we look at – if you go back to what were our strategies around primary containment to delivery devices, and our customers are linking those two areas together. When you sit with the customers, you start to clearly understand that that linkage is now together versus historically has been somewhat segregated. We've done the same at West. So, we have aligned our R&D groups across the globe to that used to be some of our focus just on the elastomer and seal as the primary containment area, others were focused really on the delivery devices. We have brought that together to look at more holistic.

To look at where we spend our resources and our time, I would argue – if you split it down, it's roughly a little more than half is spent around the high value product portfolio around elastomers and seals. There's two aspects, one is, to improve upon the products we currently have.

One example would be around Envision inspection. We have pretty solid technology that's in place in our operations globally, but we're looking at the next-generation. And not just on the technology, the equipment itself but also the software component which is really what really differentiates West from others. And that technology allows us to get to subvisible particulate levels that have not been achieved before.

Again, raising the bar on expectations and tighten the tolerances and introduce that to our customers, which only enhances the high value product portfolio. The other area – within that area, we'll also look elongating – so, NovaPure, while it's new – relatively new over the last couple of years, and it will take as Bill explained, high value products has been around especially Westar RS and RU for a number of years, it does take a while for penetration and change in the industry. We're looking at what's the next level beyond NovaPure and identifying opportunities. Again, feedback from our market segments that we've developed.

The second area of spend and resource allocation really is around the delivery devices. We recently launched a new product what we call SelfDose. Just the other day, we won an award with our customer second place, I believe it was a Silver Award in New York for the innovation capabilities of this delivery device called SelfDose again. And I think when you start thinking about our portfolio, there is more and more need from our customers are pulling us into those conversations. We have primary containment, we're very confident and the stability of our molecule in that particular configuration.

How best can we deliver that now to the patient outside of a pre-filled syringe environment, or in a particular vial environment? And that's where we're been pulling the conversations. So we have that competency and capability from our engineering side to develop and to scale. Great case in point is, in our contract manufacturing side, which is about 23% of our business, if you walk through our plants in contract manufacturing, what attracts customers there is that we do – we have a strong capability of designing these delivery devices, whether it's auto injectors or pens or the type of delivery devices, and then doing scale into mass manufacturing. Again, that's where we're focused now with R&D what's the next generation of wearables into their devices.

Dana Flanders
Analyst, Goldman Sachs & Co. LLC

Q

Okay, great. And maybe moving on to numbers, I know there has been a lot of focus on near-term numbers. Last year, you had a lot of headwinds that are one-time, this year you have a big ramp to hit guidance as some of those headwinds start to fade. Maybe just talk about kind of the cadence of when a lot of these issues start to annualize and the confidence that you have, I think you grew flattish in Q1 that you can start to see that organic growth re-accelerate as we get into 2Q and then the back half of the year now?

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

A

So, absolutely [ph] end to end (21:00). So, we start with the end, our guidance, we believe we'll be able to grow in our 6% to 8% corridor with the headwinds that you described that have affected us specifically in the first quarter, and some of those will continue, I'll describe that in a minute. We'll be at the low-end of that 6% to 8% if you lead those in. But if you're taking some of those headwinds out, we'll be growing closer to the high end of that 6% to 8%. And we believe fundamentally that there has been no fundamental change in the underlying construct of the business.

The drivers that Eric described earlier and some of the things the annuity like revenue stream that we generate from the regulated nature of our product will continue to drive very nice growth long into the future. But as it relates to 2018 and some of the headwinds in the first quarter, obviously we were impacted by three primary headwinds, first one being the de-consolidation of our Venezuela operations in the second quarter of 2017. So in the first quarter of 2017, we had revenues and income that were not present in the first quarter of 2018. That was a significant headwind, that is gone. When you de-consolidate, it no longer is in your numbers. So, from the second quarter of 2017 now going forward, we will not have that as a comp to concern ourselves with.

The other two were there was – on our contract manufacturing business, there was a consumer product customer who decided they wanted to bring their manufacturing in-house. It's $23 million worth of sales for the entire year, the first quarter's impact was $5.1 million on the – that $5 million to $6 million a quarter is what we'll see each quarter as we go through the rest of this year, and then that will anniversary itself out in 2019.

The impact it had on the OP line was about $1.7 million in the first quarter. You'll expect – we expect to see between $1.5 million and $2 million impact in each subsequent quarter and through the rest of 2018. However, in the beginning of the year, we talked about a restructuring program that we've announced where we're going to – one of the pillars of that restructuring program is, we're going to take the two consumer product contract manufacturing plants that we have and consolidate them into one. The timing of when that happens, it will happen either in the late third quarter or early fourth quarter. And depending on when that happens, obviously then that will depend how much of the third and fourth quarter headwind there will be. It could be a little less than that $1.5 million to $2 million, but again depending on the timing of when we're able to consolidate those two operations.

The third headwind is really around the under-absorbed overhead in our Waterford, Ireland plant. As you know, that plant we started construction in the 2014 timeframe. We finished construction, have been working on validation protocols for the first piece of that program, which is for insulin sheeting for our customer's insulin products – injectable insulin products. We are now in the process of – we've sent validated samples to the customer. The customer is now in the process of doing their validation protocols on the samples we sent. We believe that in the second half of this year, we will start to actually sell commercial product to them, and that will reduce the amount of overhead under-absorption. So, it was about a $3.6 million impact in the first quarter. You'll see about that same amount in the second quarter.

In the third and fourth quarters, that number will abate a little bit based on what I've just described as the ability to sell some – to get some revenues to offset that under-absorbed overhead, so somewhere in the $1.5 million per quarter in the back half of the year, and then obviously in 2019 we believe that will be much less of an issue going forward.

Dana Flanders
Analyst, Goldman Sachs & Co. LLC

Q

Okay, great. That's helpful. And in terms of the, I guess, the organic growth ramp across sub-segments, I know generics has been very strong for you. Biologics, I think, you kind of lowered the outlook post-Q1. Talk about from

a sub-segment perspective, which one of those segments you have visibility into, which ones are going to be accelerating throughout the year and just the outlook, I guess, across each sub-segment?

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

A

Yes, so absolutely. From a proprietary products portfolio, which is about 80% of our business, we expect that business to sequentially strengthen quarter-over-quarter for the balance of the year and you are absolutely correct, the sub-segments have different dynamics through the next few quarters.

In the biologics space, we do believe that due to timing of particular launches with our customers and just the demand profile at this point of time, we believe that will be more of a second half strong growth. We expect the second half area to be around high-single, low-double digit type of growth in those particular quarters. The generics as you said earlier has come back and we expected that to occur and it is occurring. And that was really a dynamic of our supply chain shift that occurred a couple of years ago. We worked through that last year, and we're very confident on the performance of that particular segment.

When I think about the pharma, that is more of an incremental sequential improvement to the back half of the year. It was slightly down if you took Venezuela out of the discussion in the first quarter. We believe that will be continuously increasing through the end of the year to have us pretty strong mid-single digits, the growth that we expect out of that unit on an annual basis.

Two drivers of that, one is, some of the demand changes with our customers and, secondly, with their inventory profiles, but secondly is around the availability of our administration systems. We've added capacity both in Israel and also in Puerto Rico to help some demand pull that we're getting from customers who are not able to produce at this point. But we have demand – supply that's available now out of Israel in this month, and in October production lines will be available and validated in October out of Puerto Rico.

So, when you put that all together, there is a sequential build, I'd say, that Q2 is a little bit better than we had from previous quarter and then stronger than the second half. What's really encouraging is the adoption towards high value products, and that does across all three segments. We do believe, as we look, that will build over the balance of the year with very – quarterly very strong high single low-double digit growth expectations.

So, it is a mixed discussion. But what's encouraging is since about a year ago in this industry, there is not a lot of transparency in the supply chain. And we have been working with some of our key customers, particularly in the generics and pharma, to align the supply chain teams of the two firms. And in the cases that we're working closely with, we're able to see higher predictability for both firms to determine demand profiles [ph] with like (28:38) several quarters, which is very encouraging. We expect to roll that out to more customers but that will take time. But I'm really encouraged by our supply chain what they're doing to really create better visibility with our customers.

Dana Flanders
Analyst, Goldman Sachs & Co. LLC

Q

Okay, great. And maybe on the margin side of things, I know you had originally given guidance for I think it was 100 bps or more expansion this year. I think you kind of backed off that a little bit in Q1 although it sounds like you are getting some good high value product growth. So what's changed, I guess, relative to 1Q versus guide that you had originally given?

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

A

I think, we didn't change our guidance. I think what we were talking about is that rough number of 100 bps is, if you take out the headwinds from the first quarter. So – and we still believe that we'll get close to that number for the full year. It's a – from all the things that Eric just described to you, the building obviously will be a momentum story. You're not going to see a whole lot of margin expansion in the second quarter, but sequentially it'll be a little better than the first. And then, in the back half of the year with all of the strong high value product growth, that's where we believe we'll start to see more robust margin expansion and get us in line with where we expect to be.

It is – we've talked about it, the correlation between highway product growth and margin expansion is very powerful. It's – the more we can expand [indiscernible] (30:05), the more we can grow our high value product portfolio are in that kind of high single to low double digit range, which is where it's been for the last five years and in fact the last 10 years, if we look back. We believe that that will generate somewhere on the GP line about a 50-basis point to 70-basis point margin expansion.

And then, Eric talked earlier about some of the operational efficiencies where we're working on and our operations looking at instead of 28 disparate plants looking at the network of productive capacity will help continue to drive more growth in margins there to get as close to that 100 basis points for the year, if you exclude out the first quarter headwind.

Dana Flanders
Analyst, Goldman Sachs & Co. LLC

Q

Okay. Okay. And in terms of geographic footprint, I know you touched on this before, maybe just talk to the ex-U.S. regions where you're seeing strong growth. What are you doing to invest ex-U.S. to continue that momentum that you've seen?

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

A

Yeah. We break it in two areas. I mean, just kind of to mention this, 10% of our business last year was roughly outside of U.S. and Europe, so talk about Asia-Pacific and Latin America. We believe that those businesses – those locations should be growing faster than the enterprise itself. And last year, we were faced with some headwinds and specifically in India with a few of our customers having some issues with some of our manufacturing processes, we're seeing that being worked through at this point. So we're seeing very strong growth coming out of Asia today. We continue to see very healthy growth coming out of Latin America.

We are continuing to invest in those regions. We've built a stronger, more robust go-to-market approach in China with dedicated direct sales professionals in the major markets. We have done the same in India. So, we're not heavily reliant on third parties to sell or to create demand for our products in those marketplaces.

We do have manufacturing capabilities in the three, I would say, high-growth markets in Asia. You're thinking about a China plant, we have an India plant, and we have a plant in Singapore that can service the region quite efficiently with high-value products. I think, in Latin America, we have a very robust and very well managed operations in Brazil that supports the South America region.

So, I would argue that we're very well positioned now. It's around driving execution and driving greater demand. We are seeing more CMOs that are working on behalf of our customers in regions like South Korea, in India that we're partnering with, along with our customers to build support them locally, so they can export the materials into

other markets. So, very exciting future ahead of us. We have a good platform. I think we have the right team on the ground today, and we should experience the higher growth as we go forward in those markets.

Dana Flanders

Analyst, Goldman Sachs & Co. LLC

Okay, great. Well, I know we're running up against time, so why don't we stop there. Thanks for joining us everyone today.

Eric Mark Green

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

Great. Thank you, Dana.

William J. Federici

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

Thank you, Dana.