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West Pharmaceutical Services, Inc. (WST)

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MANAGEMENT DISCUSSION SECTION

Derik de Bruin
Analyst, Bank of America Merrill Lynch

Welcome to the 2017 Bank of America Merrill Lynch Healthcare Conference. I'm Derik de Bruin, the Life Sciences and Diagnostics Tools Analyst here at Bank of America. It's a pleasure to welcome our next company, West Pharmaceutical Services. We have Eric Green, President and CEO, with us, and Bill Federici, CFO. We're just basically going to do a fireside chat and do a Q&A and everything and get up from there, but thanks, everybody, for coming. And here's my shameless plug for the II vote for this year. Thank you in advance.

So anyhow, now that that disgusting thing is out of the way, so we're one of the longest covering teams on the sell side of West. I mean, we've been covering it, I think, longer but certainly the first large banks to do it. I think a lot of people are still very new to the story but can you sort of give us like a nickel sketch of like what West is in terms of where you fit into the pharma supply chain.

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

Great, Derik. Well, first of all, thank you and Bank of America Merrill Lynch for the invitation to participate in this year's healthcare conference here in Las Vegas, and we'll be pleased [indiscernible] (01:05) address some of the questions.

West is an organization that's been around for many, who may not know, but over 90 years. It started off really focused on manufacturing rubber to enclose injectable medicines back in the 1923 and beyond. The company has matured, obviously, since then, but you look at our position today, we are clearly working with most, if not, all the major biopharma, pharmaceutical companies around the world on their injectable medicines.

And what does West do? It's a $1.5 billion company today. Approximately $1.2 billion of that is what we'd call proprietary products. These are products that are elastomers, seals, septas and – I'm sorry, seals that could be used for vials, prefilled syringes. They could be used for cartridges.

We produce, in this particular space, 32 billion components a year, which is the largest supplier in this space by the order of magnitude of 2x or 3x.

And also, we have a part of our business around contract manufacturing. That business is roughly 20% of our company and what we produce there are devices specifically in line with our customers' requirements. To give you an example, insulin pens, continuous glucose monitoring devices. These are long-term agreements that we have with our customers we're able to help design, mass manufacture for several years ahead of us.

If I take – give you a picture about which type of customers have we served, we recently reorganized our company early last year in 2016. As I mentioned, the company has a deep rooted history of manufacturing, over 28 manufacturing sites that are really product-focused. But I think we reorganized our company to become more market-led.

And what does that mean? 35% of our business today goes to the pharma sector, tends to be small molecules. About 21% of our business or 22% of our business goes to the generic space. Another 21%, 22% goes to the biologic space, the large molecules. They're innovative, been launched in the marketplace. And the balance is the 20% going into contract manufacturing.

And you can imagine with over 2,000 customers and not one customer exceeding 7% of our sales, were somewhat agnostic. Our focus is to be on every molecule that comes out of the pipeline to ensure that there's continuity of West going forward.

Last thing I want to comment about is around this phenomenal of us moving our customers from standard product to high-value products. That portfolio, the differentiation in the marketplace, it allows us to have the highest level quality on components that are able to be used with biologics. Of the top 50 biologics in the marketplace today, West, or our partner in Tokyo, Daikyo, are on all 50 of those molecules.

It's important to mention because as we talked about in our first quarter earnings call, there were five molecules biologics approved in the first quarter. Four were monoclonal antibodies and one was a peptide. All five, West and our partner, Daikyo, are in all five.

So, our full focus is really the high growth area, providing high value products in the really maturing area of the biologics while maintaining a very strong foothold in pharma and also the generic space.

So Derik, that's a quick summary.

Derik de Bruin

Analyst, Bank of America Merrill Lynch

That's great.

Eric Mark Green

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

Hopefully, that's a good overview.

Derik de Bruin
Analyst, Bank of America Merrill Lynch

No. That's actually – that's a truly good overview.

QUESTION AND ANSWER SECTION

Derik de Bruin
Analyst, Bank of America Merrill Lynch

Q

So, just a couple of basic questions to start. You're – you've been in the CEO job now almost three years?

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

A

Two years.

Derik de Bruin
Analyst, Bank of America Merrill Lynch

Q

Two years, okay. Sorry, I'm aging quickly. The – so, I mean, it's just that we covered West for a long time. It's always a very well-run company. It's like – what's been your sort of imprint on the company as you've come? What has sort of changed about the business in terms of the way you sort of talk to the Street and sort of the way you just organize the business? What have you done to refocus West?

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

A

Derik, it's a very good question because two years ago when I arrived at West, I left a firm that was deep rooted into operational excellence but migrated towards becoming more customer centric. I would argue that West, the organization, all 7,300 employees, have really embraced this transition of being site-specific and/or product-specific to more market-led, and I believe that is driving the performance that we're seeing at West.

I'll give you an example. We formalized our commercial organization, again, around those four distinct units that we've talked about. We have dedicated sales professionals, technical customers service professionals that are interacting with that specific group each and every day around generics or around biologics or around pharma. I think that creates differentiation and has the lens of going into what do we need to innovate and how do we align our operations globally to be more effective.

I think the second area that we're seeing traction on is really in our operations. It's the first time we've globalized the operations. We've – it's under one umbrella and we have a new leader on site that has done this before at another medtech company and we're seeing positive trends so early on. It's asking the question, what is our manufacturing strategy footprint? We have 28 manufacturing sites. How do we leverage what we have and create more centers of excellence? How do we drive a global supply management program which we haven't had in the past?

So, we can look at our leverage spend, our leverage supply base. We're looking at lean programs. We have pockets of phenomenal lean programs throughout West. To give you an example, case in point, contract manufacturing. We simply have taken leadership out of that group and gone global and the initial impact has been quite positive. You'll see it in the first quarter results of about 1% efficiency gain just in the first quarter and this is just early innings.

I think the third area is that we had 20 – we had 12 R&D locations, really phenomenal deep science knowledge around polymer science, around proteomics, around engineering, around organic chemistry. By bringing all that together on one umbrella, we're now cross-pollinating really truly aligned to our customers when you look at primary containment all the way to delivery devices, looking at that holistically. And I believe these are the changes that we, as a leadership team, have made that gives us a sustainable platform to work off of, to continue to drive top-line growth organically but also margin expansion going forward.

Derik de Bruin
Analyst, Bank of America Merrill Lynch

Q

So, the – when I first started – when I first entered the company years ago, one of the questions I had with Bill and I ask, this is like – and it's like what doesn't the Street really appreciate about a story like this. And your answer to me at the time was the Street doesn't appreciate how long somebody's – how long this process takes. It's like the timing issues have been there or always been an issue because it takes so long for customers to build [indiscernible] (08:23).

I think what's been surprising as we've looked at the growth – I mean, some of the things like the wearables and sort of like [indiscernible] (08:32), it taken a little bit longer to come through, but you've seen this massive growth on their high-value products business coming up on this. So, can you sort of talk about what sort of shifted in the industry to sort of drive the higher value up?

And then, can we also sort of talk about the timelines on the newer products are coming through in sort of like how does it sort of fit into your long-term operating plans? I guess, there's a concern that when I talk to investors that there's a going to be a slowdown in the high-value products business, and then, it's still going to take some time for the new products to sort of ramp up, and so, there's going to be a potential for an air pocket in the growth. I mean, that's one of the major concerns I hear.

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

A

Yeah. Let me start, Bill, and then you can have from the perspective of the financial side. When you look at high-value products, this is the [indiscernible] (09:12) for you, within our proprietary business, which is about $1.2 billion. And again, from a component perspective, it's 32 billion components we manufacture per year. Of which, about 59% of the revenue in that business is high-value products. But more importantly, the way we look at our business is around number of units, its usage.

And so, it's roughly last year and 2016 is roughly around 2017, so 17% of the volume of units we produce out of the 32 billion is around the high-value products. We know clearly the biologics market unit customers require high-value products. Roughly all of our components go to biologic customers and the future in the pipeline that's – whether it's Phase 1, 2 or getting to commercial stage, are using high-value products. So, that's a very attractive marketplace.

And again, just so I'm very clear, is that we don't look at the market from a revenue perspective of our customers because we're looking at the units used. And so, if you look at biologics, they tend to be more about high-single digit. Well, obviously, the revenue of those firms are – can be well in the double-digits.

The second area around high-value products, because we have a long runway ahead of us with the HVP, is the generic sector. As you move into injectable space, the generic sector has a decision to make and one of the value propositions of why we segmented that group differently outside of biologics and pharma is that it is about speed to market. There's a short window of opportunity to innovate our product and move it into generics and to launch and to get that six-month window of opportunity.

For them to replicate what has been done, and as you know, were written into the regulatory filings, and so, the primary container used for a particular molecule is well-known in the industry. And so, when they're moving into – a generic moves it into their process, they're asking themselves a question, do I just simply take the standard product or do I leverage West's high-value products where it will do washing, it will do vision inspection, it will do sterilization, the bagging and send it to the customer. That is a value proposition they like because it allows them to get to market faster.

The economics for us, obviously, the revenues grow 5 or 10 times more per unit and the margins are 2x. So, that's what we're seeing as the dynamics around the high-value products, the reason why we feel this is a very attractive space.

Let me be very clear though. We launched NovaPure, which is our in-process design portfolio, which is very small right now but that's the next wave of high-value products. So, we're continuously moving out that curve of that value proposition. So, we continuously move up per perspective per unit price on NovaPure is roughly $0.52 to $1 and the reason why is because all the additional benefits and features we had for our customers. So, you can see we want to continue to move it down the spectrum.

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

I think, I agree with what Eric said. I think the biggest change that we've seen, Derik, is that quality has been the big driver.

Derik de Bruin
Analyst, Bank of America Merrill Lynch
Q

Yeah.

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

What we're seeing both from the regulators and the customers in this marketplace is the drive towards cleaner product. Particulate is not a friend to the drug industry. And as customers move towards that demand for cleaner product, the product itself is – needs to be cleaned. It needs to be sterilized. Those are things that they can do themselves or that they can give to West, and hopefully, we do it better, faster, cheaper, et cetera.

So from the perspective, we always knew that high-value products – we've had high-value products. Westar and FluroTec have been out in the marketplace for more than a decade. But it's the acceleration. It's the pull from the industry from both a regulatory and a customer demand side, demanding these higher value, higher quality components that's really been the big change that I've seen.

Derik de Bruin
Analyst, Bank of America Merrill Lynch
Q

Great. And so, sort of like the generics blip [indiscernible] (13:28) last quarter and this quarter that's just – you think that's just sort of a temporary in sales and it's going to continue on?

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

Yeah. So, if you look at the generic, in particular, against around 20-ish, 21% of our business, first half of last year, one of the changes we made in our operations is to drive down lead times. We're – we make to order. So, a client will ask us, we need an X quantity and we'll produce over the next three to four months.

What we've identified is that we have a bottleneck in our high-value product portfolio and that was because of we're just coming online with the Kinston, North Carolina plant and some other alterations that we've made in Jersey Shore and other locations. And so, we caught – got caught with the fact that our delivery times were extended. So, our customers decide to order in advance. I think we were clear on the first half of last year, generics business growing on 20%. That's not the market.

Derik de Bruin Q
Analyst, Bank of America Merrill Lynch

Yeah.

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

So, what has happened is because of the operations team is able to drive down – in fact, a generics customer today had contact us, in just a matter of weeks, we can deliver them the product, and that is the level of confidence and service that we're looking for and that's one of the reasons why. And there's multiple reasons, but that's the main reason why we're seeing a destocking of our generic customers.

Roughly around five, and I mentioned this in our earnings call, about five – top five customers in generics is about 40% of that business. Therefore, they have a meaningful impact when they start to destock, and that's why we said this first half of this year would be soft in generics. We truly believe this year, we're looking at mid single-digit with generics and we believe, going forward, mid single to high-single is what you should expect for that particular part of the business.

Derik de Bruin Q
Analyst, Bank of America Merrill Lynch

Got it. So, let's talk a little bit about the capacity expansion. I mean, not to pick on the company but I'm going to. But once again, just sort of saying one of the knocks I hear from investors is that the free cash flow of the company is – if we try to value, let's say, on free cash flow right now, it's really tough, right?

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

Yeah.

Derik de Bruin Q
Analyst, Bank of America Merrill Lynch

So, can you talk about some of the capacity expansion plans and what there goes on? And I guess, you're clearly building capacity into [indiscernible] (15:40) of products that are going to come in demand that's going to be there.

Is there a situation that where if you build it, they won't come? The market won't be there? I mean, do you – yeah, I mean, is there some sort of risk that it's not going to be able to fill the capacity once you get it all built?

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

A

Yeah. I'll start and Bill, if you'd like to add.

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

A

Yeah. Sure.

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

A

I think, when you look at our investments around capital expenditure, last year is about $170 million. This year, we have set between $150 million to $175 million, and I would argue that in the last several years, we've been building in advance, staying ahead of the curve for the demand that's coming in for high-value products. But I would say a little bit differently is that the way we reorganized our company, the capital that we're deploying in our 28 plants is now looked at differently.

We're looking at how do we create centers of excellence such as in Kinston, North Carolina or Waterford. To give you an example, Waterford. That's over $100 million investment we're making but the concept there is we're building this so we could – the size that we could do is quadruple through a modular approach, allow us to instead buy more land and building more facilities. We can continuously add on to existing facility, leveraging capital at different level that we've done before.

So, I think those two factors are important. We're staying ahead of the curve. The demand is there. The risk of [audio gap] (16:59) being there is really more of an industry sector change...

Derik de Bruin
Analyst, Bank of America Merrill Lynch

Q

Right.

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

A

...versus the competitive landscape. And I think, far as our discipline on capital deployment was – has historically been pretty tight. It's even more pronounced now with more of a global approach. So, I think you're going to see more conversation around free cash flow at West than we've had historically.

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

A

So, let me give you a couple of extra points there. So, the first one is we talked about the regulatory process and how demanding that is...

Derik de Bruin
Analyst, Bank of America Merrill Lynch

Q

Yeah.

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

...and the long timeframes that are involved. It's the same thing on our capital side. It'd be great, Derik, if we could just flick a light switch on and be able to manufacture their...

Derik de Bruin
Analyst, Bank of America Merrill Lynch Q

Yeah.

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

...biologic product from plan A to plan B. Because of the regulated nature of our products, it doesn't work that way. We have to work very closely with the customers in terms of revalidating those – their products on that new facility, so that it's proven that the product is effective and sterile in that – coming out of that new facility. But it also creates a huge barrier to entry from the competition by doing that.

So we are – yes, you're absolutely right. We're investing ahead of the curve. I think when we look at the kind of macro drivers that Eric talked about earlier that are driving the demand, we don't see that slackening any time soon. So, we believe that demand really is there, so, i.e., we build it, they will come.

But in addition to that, we believe that we're building a portfolio of places where the – where, like Waterford, where these are centers of excellence where we'll be able to finish the product at a very, very high level of quality that customers will be demanding because of regulators and they are pushing us in that direction, and we'll be able to satisfy that demand well into the future.

Derik de Bruin
Analyst, Bank of America Merrill Lynch Q

And also, I assume Waterford is also, just because you've obviously – you supply a lot to the European...

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

Yes.

Derik de Bruin
Analyst, Bank of America Merrill Lynch Q

...manufacturers.

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

Yes.

Derik de Bruin
Analyst, Bank of America Merrill Lynch Q

They wanted something closer...

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

A

Sure.

Derik de Bruin
Analyst, Bank of America Merrill Lynch

Q

...there like that. Is there a tax advantage that sort of goes on with there?

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

A

Of course. Of course, and that's not the primary benefit of why we do these things, but, yeah, it's a huge benefit. If you're manufacturing in the U.S., you're taxed at a much higher rate than the 12.5% in Ireland.

Derik de Bruin
Analyst, Bank of America Merrill Lynch

Q

Yeah. So, you've mentioned the – I'm sorry.

Q

I have a quick question on the biologics business. When you kind of think about what's driving the acceleration on the volumes, how many years that you have visibility for that? And then, what the kind of range of outcomes are there based on how biosimilars do, based on how certain classes of drugs do? How do you kind of view that and how much visibility do you have?

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

A

Yeah. This is a good question. So, when you look at the biologic market, obviously, we're working with our clients in early phase as they determine what primary container will be used and/or a delivery device will be used in conjunction. But when you look at it from a biologic point of view or a biosimilar point of view, again, we go back to the number of units. So, there might be economical differences between the end molecule. At the end of the day, it's the number of units. And the requirements for the type of primary packaging is very similar. So, the physical characteristics of the molecule interacting with the materials doesn't really change. So, that's where we can differentiate. And again, as I mentioned earlier, we're somewhat agnostic. Well, we might be working with the biopharma space with their innovative biologics. We're also looking at how do we provide primary packaging for the biosimilar space.

The projections – again, I would really caution on – as you have various sources of projections of biologics, the marketplace tends to be more on the end selling price. It is really around number of units. So, that's how we monitor our business and we do believe biologics will – they are and will continue to be the highest growth area when you look at it on an annual basis going forward for West.

Derik de Bruin
Analyst, Bank of America Merrill Lynch

Q

I mean – but along those lines, I mean, there certainly is a big push to stop overfilling of vials and just sort of reduce waste. In theory, if you're going to get – if people go to smaller dose – [indiscernible] just smaller dose, so (21:09) it's good for you, guys. You're just going to basically sell more product.

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

It is. But also remember, as we look at our portfolio, we're expanding to like quality by design with NovaPure, while the economics for West is much more attractive.

Derik de Bruin
Analyst, Bank of America Merrill Lynch Q

Yeah.

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

And it goes back to what you're referring to is that, our clients are able to reduce waste. Overfill, rejected lots at the end of the fill-finish process. And so, that's where we are adding that value, then we will capture...

Derik de Bruin
Analyst, Bank of America Merrill Lynch Q

Got it.

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

...through our technology and know-how.

Derik de Bruin
Analyst, Bank of America Merrill Lynch Q

So, a question that commonly comes up when I talk with investors about West is like, geez, you guys have such high moats around your business. It's like why don't you just raise prices through the roof and do it, because it's – at the end of the day, what they're paying for biologic, what they're paying for your products is small.

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

Yeah. I think it's a valid question. So, if you look at our history at West, we've historically, on an annual basis, net price contribution about 1%. It varies. If you really get into the details, there's some pockets a little bit higher, some pockets a little bit less. But on an aggregate, it's about 1%.

I think, as a firm, we are – because of the segmentation that we have created and the ways to address the sub-segments within the segments, such as emerging biotech versus biotechs are opportunities for us. But I think you'll see West continue to be disciplined on our pricing. We want to drive – the main drive growth – growth driver of this business is around volume and mix shift. And we will, if opportunities present themselves, to capture more price going forward. But it's not going to be the main driver of the performance of this company.

Derik de Bruin
Analyst, Bank of America Merrill Lynch Q

And just as a reminder, who are your major competitors? I think you have 70% share maybe of this market. Maybe, who are your other...

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

Yeah. The – in the elastomer space for West and Daikyo, our main competitor would be Datwyler, which is out of Europe. We believe, and based on our own knowledge is there – we're about 70-ish-plus percent of the marketplace and they're less – about 20% or less.

We know that Aptar Stelmi, which is the third largest, it's roughly less than 10%. Both firms are very good companies, very well run. We respect them. But I think when we look at the position that we've taken where we put in our investments and our technology and our capabilities really is the higher end portfolio. And we are always moving that bar up because we realize that competition wants to gain it's attractive space. But we are very focused on the high end.

Derik de Bruin
Analyst, Bank of America Merrill Lynch Q

So, you're looking for, if you sort of look at the model, high-single digit organic revenue growth, 7% to 9% organic revenue growth in the next couple of years. You've got significant operating margin expansion. You've got – and I mean, even at the low end of your op margin targets, you're looking at high-teens EPS growth numbers, and if you go to higher end of your margin opportunities, it certainly is north of 20%. Are you – it's a great business. It's like what goes wrong? What are the big risk factors of doing that? I mean, what are the pressure points?

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

Well, the number one pressure point is the industry itself and how healthcare continues to – what changes occur in healthcare, especially around injectable medicines. And like I said, though, is that if there's more price pressure in the industry, which could happen, I think when we look at how we are supporting our customers, we're less than 1% of the value of the drug that goes into the market. I think the pressure on us, as long as we continue to drive total cost of ownership with our customers and work side by side, I believe we'll be in a good position. So, the industry is one.

I think, the second area is that quality standards continue to rise. And frankly, that is one of our biggest opportunities as a differentiated company. We have, I think, industry-leading technical customer services, the content, the ability to analyze the – not just the elastomer but the entire primary container on behalf of our customers, is what differentiates us from the competition. But as quality standards rise and the regulatory bodies expect lower levels in particulate levels, that's where we need to continuously raise the bar. We can't be complacent.

Derik de Bruin
Analyst, Bank of America Merrill Lynch Q

Yeah.

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

So, that's probably more in internal control, but our quality standards are very high. I'm very proud to say, and I've said this before, somebody asked me, what's your quality metric, and we don't give a precise number because –

but we do say that's less than 100 defects per billion. And for those engineers out there, you realize that's better than Six Sigma and that does leave the industry. So, I think that's – those are the areas that we have to keep an eye on as we move forward.

Derik de Bruin
Analyst, Bank of America Merrill Lynch

Q

Any – yes. I was going to say any questions from the audience. Yeah.

Q

When you were discussing the go-to-market strategy, it seem that in the transition, you're maybe describing was one where the customer would come before to you and tell you what they wanted to now maybe you working with the customer more intimately to kind of design in early stage and that's higher value obviously. Can you talk about what percentage of your products today are those what the customer came to you, and then, what percent the products that were you kind of worked with them to earlier stage there?

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

A

That's – it's a good question but it's very hard to quantify it for you. I wish I could but I can't. I would say with this new structure we have in place today, I'll give an example, and we could use this as an example. I'll go back to the generics space. One of the issues with generics is that it's the value proposition [indiscernible] (26:54) to market. And when you look at the number of formulas – formulations we have that's in the marketplace today, it's difficult to be able to manage that transition.

So, what we have come out with the generics team is, again, just focus on that space. It's a program called [ph] the Seltra (27:12). It's out in the marketplace just recently and there's really a couple of key drivers. One is around service, so that we have, it's staged in our operations that we're able to get it out within a matter of a couple of weeks.

Secondly is that we've reduced the variability of the different formulas – the formulations that will be approved by the regulatory bodies. And that allows us, again, to be concentrated with these large million – multi-million component orders at a time.

And I think the third area – and by the way, this has all been designed by the voice of our customers, working with them, say, if you could do this for us, this would create this type of value. And by doing this, we're moving up the high-value product chain with our generic customers. We expect margin expansion of between 400 to 600 basis points with that particular segment. That's exciting because that will not have come from the way that we were organized versus where we are today. We are truly getting more insight of what we need to do with our innovation group and our engineering group to be more aligned to these customer needs. That's just one example of what's happening.

Q

[indiscernible] (28:26) are there other opportunities for M&A or how are you thinking about use of cash? And then, is there a distribution capability inside the company? And I guess, are there adjacencies that as you touch your customers more that you might go into that you're not in today?

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

A

Yeah. I think – I'll talk about M&A really quick and you is the use of cash. Number one about M&A is that we are – I would argue, last year, our focus really was to get the organization aligned, focused and deliver results for our customers. I think we've done that. I think at this point, we are looking at the industry, looking at opportunities for our tuck-in M&A opportunities to help us build out that portfolio of primary containment all the way to deliver devices, so we can be really truly differentiated with our customers. But that's our focus at this point.

The use of cash, why don't [indiscernible] (29:20).

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

A

Sure. First and most important from our perspective is investing back in the business, especially these – for the capacity for these high-value products. We think that's going to continue to drive the growth in a long time into the future. Once we get beyond that, we do have a dividend that we paid consistently over the last 24 years. We will continue to do so, we believe. Although that's a small number. That's $35 million, $40 million per year. Beyond that, if there are debt that is maturing, we have one that's coming up in 2018, we'll take care of that. We have a small buyback program through board authorized for about 800,000 shares this year. And Eric said, it's tuck-in opportunities on the M&A front.

So, we look at it as, we test it every year. We go through it and we look at where we're spending our capital, allocating it and what is the best and the most effective way to allocate that capital for a return for our investors and we believe we've got a very good mix at this point in time.

Q

[indiscernible] (30:24)?

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

A

Our distribution, basically, since we're made to order is tends – we're direct to our customers, so our channel to customer is direct. However, we actually ship from our manufacturing sites directly to our customers. So from the world I came from, West does not operate like that.

Derik de Bruin
Analyst, Bank of America Merrill Lynch

With that, we're out of time. Eric, Bill, thank you for being here.

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

Thank you very much, Derik.

Derik de Bruin
Analyst, Bank of America Merrill Lynch

Thank you, everyone.