WEST PHARMACEUTICAL SERVICES INC
Form 10-Q
August 03, 2015

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
FORM 10-Q

(Mark One)
þ QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15 (d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended June 30, 2015
or
.. TRANSITION REPORT PURSUANT TO SECTION 13 OR 15 (d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the transition period from to

Commission File Number 1-8036
WEST PHARMACEUTICAL SERVICES, INC.
(Exact name of registrant as specified in its charter)

Pennsylvania	23-1210010
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification Number)
530 Herman O. West Drive, Exton, PA	19341-0645
(Address of principal executive offices)	(Zip Code)

Registrant's telephone number, including area code: 610-594-2900

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15 (d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes þ No o

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).
Yes þ No o

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer	þ		Accelerated filer	o
Non-accelerated filer	o	(Do not check if a smaller reporting company)	Smaller reporting company	o

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).
Yes o No þ

As of June 30, 2015, there were 72,003,711 shares of the Registrant's common stock outstanding.

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PART I. FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

CONDENSED CONSOLIDATED STATEMENTS OF INCOME (UNAUDITED)
West Pharmaceutical Services, Inc. and Subsidiaries
(In millions, except per share data)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2015	2014	2015	2014
Net sales	$359.7	$368.9	$695.6	$715.7
Cost of goods and services sold	241.5	247.1	467.7	487.5
Gross profit	118.2	121.8	227.9	228.2
Research and development	8.1	9.9	15.6	19.9
Selling, general and administrative expenses	60.8	57.5	116.0	113.9
Other expense (Note 11)	10.2	0.3	9.4	1.0
Operating profit	39.1	54.1	86.9	93.4
Interest expense	3.4	4.2	7.5	8.2
Interest income	0.4	0.5	0.8	0.9
Income before income taxes	36.1	50.4	80.2	86.1
Income tax expense	9.2	14.0	21.7	23.8
Equity in net income of affiliated companies	0.9	1.2	2.2	2.4
Net income	$27.8	$37.6	$60.7	$64.7
Net income per share:				
Basic	$0.39	$0.53	$0.84	$0.92
Diluted	$0.38	$0.52	$0.83	$0.89
Weighted average shares outstanding:				
Basic	72.0	70.8	71.9	70.7
Diluted	73.7	72.4	73.5	72.4
Dividends declared per share	$0.11	$0.10	$0.22	$0.20

See accompanying notes to condensed consolidated financial statements.

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CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (UNAUDITED)
West Pharmaceutical Services, Inc. and Subsidiaries
(In millions)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2015	2014	2015	2014
Net income	$27.8	$37.6	$60.7	$64.7
Other comprehensive income (loss), net of tax:				
Foreign currency translation adjustments	11.8	(1.5)	(44.5)	(3.3)
Defined benefit pension and other postretirement plan adjustments, net of tax of $0.1, $0, $0.9 and $0.2 respectively	(0.2)	0.1	1.6	0.3
Net (losses) gains on derivatives, net of tax of $(0.4), $0.2, $0.8 and $0.4, respectively	(1.5)	0.5	1.9	0.7
Other comprehensive income (loss), net of tax	10.1	(0.9)	(41.0)	(2.3)
Comprehensive income	$37.9	$36.7	$19.7	$62.4

See accompanying notes to condensed consolidated financial statements.

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CONDENSED CONSOLIDATED BALANCE SHEETS (UNAUDITED)
West Pharmaceutical Services, Inc. and Subsidiaries
(In millions)

	June 30, 2015	December 31, 2014
ASSETS		
Current assets:		
Cash and cash equivalents	$252.0	$255.3
Accounts receivable, net	198.8	179.0
Inventories	187.2	181.5
Deferred income taxes	8.2	7.8
Other current assets	33.7	35.7
Total current assets	679.9	659.3
Property, plant and equipment	1,380.3	1,390.8
Less accumulated depreciation and amortization	694.9	685.0
Property, plant and equipment, net	685.4	705.8
Investments in affiliated companies	59.8	60.6
Goodwill	105.3	108.6
Deferred income taxes	66.5	66.1
Intangible assets, net	39.4	42.0
Other noncurrent assets	27.4	28.5
Total Assets	$1,663.7	$1,670.9
LIABILITIES AND EQUITY		
Current liabilities:		
Notes payable and other current debt	$95.0	$27.2
Accounts payable	91.4	103.1
Pension and other postretirement benefits	2.5	2.6
Accrued salaries, wages and benefits	52.4	52.9
Income taxes payable	18.5	14.9
Other current liabilities	53.9	51.8
Total current liabilities	313.7	252.5
Long-term debt	231.7	309.5
Deferred income taxes	16.1	15.7
Pension and other postretirement benefits	63.0	83.7
Other long-term liabilities	49.8	52.6
Total Liabilities	674.3	714.0
Commitments and contingencies (Note 13)		
Equity:		
Preferred stock, 3.0 million shares authorized; 0 shares issued and outstanding	—	—
Common stock, $0.25 par value; 100.0 million shares authorized; issued: 72.1 million and 71.4 million; outstanding: 72.0 million and 71.3 million	18.0	17.8
Capital in excess of par value	188.6	160.2
Retained earnings	947.0	902.2
Accumulated other comprehensive loss	(160.2)	(119.2)
Treasury stock, at cost (0.1 million and 0.1 million shares)	(4.0)	(4.1)
Total Equity	989.4	956.9

Total Liabilities and Equity	$1,663.7	$1,670.9

See accompanying notes to condensed consolidated financial statements.

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CONDENSED CONSOLIDATED STATEMENT OF EQUITY (UNAUDITED)
West Pharmaceutical Services, Inc. and Subsidiaries
(In millions)

	Common Stock		Capital in Excess of Par Value	Treasury Stock	Retained earnings	Accumulated other comprehensive loss	Total
	Shares	Amount					
Balance, December 31, 2014	71.4	$17.8	$160.2	$(4.1)	$902.2	$(119.2)	$956.9
Net income	—	—	—	—	60.7	—	60.7
Stock-based compensation	—	0.1	19.2	0.1	—	—	19.4
Shares issued under stock plans	0.8	0.1	11.2	0.1	—	—	11.4
Shares repurchased for employee tax withholdings	(0.1)	—	(5.5)	(0.1)	—	—	(5.6)
Excess tax benefit from employee stock plans	—	—	3.5	—	—	—	3.5
Dividends declared	—	—	—	—	(15.9)	—	(15.9)
Other comprehensive loss, net of tax	—	—	—	—	—	(41.0)	(41.0)
Balance, June 30, 2015	72.1	$18.0	$188.6	$(4.0)	$947.0	$(160.2)	$989.4

See accompanying notes to condensed consolidated financial statements.

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CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED)
West Pharmaceutical Services, Inc. and Subsidiaries
(In millions)

	Six Months Ended June 30, 2015	2014
Cash flows from operating activities:		
Net income	$60.7	$64.7
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation	42.1	42.6
Amortization	2.1	2.3
Stock-based compensation	20.8	8.9
Other non-cash items, net	(1.6)	(1.9)
Changes in assets and liabilities	(48.5)	(43.6)
Net cash provided by operating activities	75.6	73.0
Cash flows from investing activities:		
Capital expenditures	(57.1)	(56.2)
Purchases of short-term investments	—	(9.3)
Sales and maturities of short-term investments	—	8.3
Other, net	1.0	0.2
Net cash used in investing activities	(56.1)	(57.0)
Cash flows from financing activities:		
Borrowings under revolving credit agreements	43.6	182.9
Repayments under revolving credit agreements	(43.6)	(192.9)
Repayments of long-term debt	(1.2)	(1.1)
Dividend payments	(15.8)	(14.1)
Excess tax benefit from employee stock plans	3.5	3.7
Shares repurchased for employee tax withholdings	(5.6)	(4.1)
Proceeds from exercise of stock options and stock appreciation rights	8.2	5.2
Employee stock purchase plan contributions	1.5	1.5
Contingent consideration payments	(0.1)	(0.1)
Net cash used in financing activities	(9.5)	(19.0)
Effect of exchange rates on cash	(13.3)	(0.3)
Net decrease in cash and cash equivalents	(3.3)	(3.3)
Cash and cash equivalents at beginning of period	255.3	230.0
Cash and cash equivalents at end of period	$252.0	$226.7

See accompanying notes to condensed consolidated financial statements.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

Note 1: Summary of Significant Accounting Policies

Basis of Presentation: The condensed consolidated financial statements included in this report are unaudited and have been prepared in accordance with U.S. generally accepted accounting principles (“U.S. GAAP”) for interim financial reporting and Securities and Exchange Commission (“SEC”) regulations. The year-end condensed consolidated balance sheet data was derived from audited financial statements, but does not include all disclosures required by U.S. GAAP. Certain information and footnote disclosures normally included in annual financial statements prepared in accordance with U.S. GAAP have been condensed or omitted. In the opinion of management, these financial statements include all adjustments, which are of a normal recurring nature, necessary for a fair statement of the financial position, results of operations, cash flows and the change in equity for the periods presented. The condensed consolidated financial statements for the three and six months ended June 30, 2015 should be read in conjunction with the consolidated financial statements and notes thereto of West Pharmaceutical Services, Inc. (which may be referred to as “West”, “the Company”, “we”, “us” or “our”) appearing in our Annual Report on Form 10-K for the year ended December 31, 2014 (“2014 Annual Report”). The results of operations for any interim period are not necessarily indicative of results for the full year.

Note 2: New Accounting Standards

Recently Adopted Standards

In April 2014, the Financial Accounting Standards Board ("FASB") issued guidance for the reporting of discontinued operations, which also contained new disclosure requirements for both discontinued operations and other disposals that do not meet the definition of a discontinued operation. We adopted this guidance as of January 1, 2015, on a prospective basis. The adoption did not have a material impact on our financial statements.

Standards Issued Not Yet Adopted

In July 2015, the FASB issued guidance regarding the subsequent measurement of inventory. This guidance requires inventory measured using any method other than last-in, first-out or the retail inventory method to be measured at the lower of cost and net realizable value. Net realizable value represents estimated selling prices in the ordinary course of business, less reasonably predictable costs of completion, disposal and transportation. This guidance is effective for fiscal years, and interim periods within those years, beginning after December 15, 2016. Management believes that the adoption of this guidance will not have a material impact on our financial statements.

In April 2015, the FASB issued guidance on the accounting for fees paid by a customer in a cloud computing arrangement. This guidance is effective for fiscal years, and interim periods within those years, beginning after December 15, 2015. Management is currently evaluating the impact that this guidance will have on our financial statements, if any.

In April 2015, the FASB issued guidance which changes the classification of debt issuance costs, from an asset on the balance sheet to netting the costs against the carrying value of the debt. This guidance is effective for fiscal years, and interim periods within those years, beginning after December 15, 2015. Management believes that the adoption of this guidance will not have a material impact on our financial statements.

In January 2015, the FASB issued guidance which removes the concept of extraordinary items from U.S. GAAP. This guidance eliminates the requirement for companies to spend time assessing whether items meet the criteria of being both unusual and infrequent. This guidance is effective for fiscal years, and interim periods within those years, beginning after December 15, 2015. Management believes that the adoption of this guidance will not have a material impact on our financial statements.

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In August 2014, the FASB issued guidance which defines management's responsibility to evaluate whether there is substantial doubt about an entity's ability to continue as a going concern and to provide related footnote disclosures. This guidance is effective for the annual period ending after December 15, 2016, and for annual periods and interim periods thereafter. Early adoption is permitted. Management believes that the adoption of this guidance will not have a material impact on our financial statements.

In June 2014, the FASB issued guidance that clarifies the accounting for share-based payments in which the terms of the award provide that a performance target that affects vesting could be achieved after the requisite service period. In this case, the performance target would be required to be treated as a performance condition, and should not be reflected in estimating the grant-date fair value of the award. The guidance also addresses when to recognize the related compensation cost. This guidance is effective for fiscal years, and interim periods within those years, beginning after December 15, 2015. Management believes that the adoption of this guidance will not have a material impact on our financial statements.

In May 2014, the FASB issued guidance on the accounting for revenue from contracts with customers that will supersede most existing revenue recognition guidance, including industry-specific guidance. The core principle requires an entity to recognize revenue to depict the transfer of goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. In addition, the guidance requires enhanced disclosures regarding the nature, timing and uncertainty of revenue and cash flows arising from an entity's contracts with customers. This guidance is effective for interim and annual reporting periods beginning on or after December 15, 2017. Early adoption is permitted as of one year prior to the current effective date. Entities can choose to apply the guidance using either a full retrospective approach or a modified retrospective approach. Management is currently evaluating the impact that this guidance will have on our financial statements, if any, including which transition method it will adopt.

Note 3: Net Income Per Share

The following table reconciles net income and shares used in the calculation of basic net income per share to those used for diluted net income per share:

	Three Months Ended June 30,		Six Months Ended June 30,	
(In millions)	2015	2014	2015	2014
Net income	$27.8	$37.6	$60.7	$64.7
Denominator:				
Weighted average common shares outstanding	72.0	70.8	71.9	70.7
Dilutive effect of stock options, stock appreciation rights and performance share awards, based on the treasury stock method	1.7	1.6	1.6	1.7
Weighted average shares assuming dilution	73.7	72.4	73.5	72.4

During the three months ended June 30, 2015 and 2014, there were 0.8 million and 0.6 million shares, respectively, not included in the computation of diluted net income per share because their impact was antidilutive. There were 0.5 million and 0.4 million antidilutive shares outstanding during the six months ended June 30, 2015 and 2014, respectively.

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Note 4: Inventories

Inventories are valued at the lower of cost (on a first-in, first-out basis) or market. Inventory balances were as follows:

($ in millions)	June 30, 2015	December 31, 2014
Finished goods	$79.2	$76.0
Work in process	30.0	25.6
Raw materials	78.0	79.9
	$187.2	$181.5

Note 5: Debt

The following table summarizes our long-term debt obligations, net of current maturities:

($ in millions)	June 30, 2015	December 31, 2014
Series B floating rate notes, due July 28, 2015	$25.0	$25.0
Euro note B, due February 27, 2016	67.8	74.3
Capital leases, due January 1, 2016	0.1	0.2
Revolving credit facility, due April 26, 2017	27.4	29.7
Term loan, due January 1, 2018	38.2	39.2
Note payable, due January 1, 2020	0.2	0.3
Series A notes, due July 5, 2022	42.0	42.0
Series B notes, due July 5, 2024	53.0	53.0
Series C notes, due July 5, 2027	73.0	73.0
	326.7	336.7
Less: current portion of long-term debt	95.0	27.2
	$231.7	$309.5

Please refer to Note 8, Debt, to the consolidated financial statements in our 2014 Annual Report for additional details regarding our debt agreements.

At June 30, 2015, we had $27.4 million in outstanding borrowings under our multi-currency revolving credit facility, of which $4.1 million was denominated in Yen and $23.3 million was denominated in Euro. The total amount outstanding under this facility at June 30, 2015 and December 31, 2014 was classified as long-term.

In addition, at June 30, 2015, we had $38.2 million outstanding under our five-year term loan due January 2018, of which $2.2 million was classified as current. Please refer to Note 6, Derivative Financial Instruments, for a discussion of the interest-rate swap agreement associated with this loan.

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Note 6: Derivative Financial Instruments

Our ongoing business operations expose us to various risks such as fluctuating interest rates, foreign exchange rates and increasing commodity prices. To manage these market risks, we periodically enter into derivative financial instruments such as interest rate swaps, options and foreign exchange contracts for periods consistent with and for notional amounts equal to or less than the related underlying exposures. We do not purchase or hold any derivative financial instruments for speculation or trading purposes. All derivatives are recorded on the balance sheet at fair value.

Interest Rate Risk

At June 30, 2015, we had a $38.2 million forward-start interest rate swap outstanding that hedges the variability in cash flows due to changes in the applicable interest rate of our variable-rate five-year term loan related to the purchase of our corporate office and research building. Under this swap, we receive variable interest rate payments based on one-month London Interbank Offering Rates (“LIBOR”) plus a margin in return for making monthly fixed interest payments at 5.41%. We designated this swap as a cash flow hedge.

In addition, we had a $25.0 million interest rate swap agreement outstanding as of June 30, 2015, that was designated as a cash flow hedge to protect against volatility in the interest rates on our floating rate notes ("Series B Notes"), both of which matured on July 28, 2015. Under this swap, we received variable interest rate payments based on three-month LIBOR in return for making quarterly fixed rate payments. Including the applicable margin, the interest rate swap agreement effectively fixed the interest rate payable on the Series B Notes at 5.51%.

Foreign Exchange Rate Risk

During 2015 and 2014, we entered into several foreign currency hedge contracts that were designated as cash flow hedges of forecasted transactions denominated in foreign currencies, which are described in more detail below.

We entered into a series of foreign currency contracts intended to hedge the currency risk associated with a portion of our forecasted U.S. dollar ("USD")-denominated inventory purchases made by certain European subsidiaries, for a total notional amount of €9.7 million ($11.7 million).

We also entered into a series of foreign currency contracts to hedge the currency risk associated with a portion of our forecasted Euro-denominated sales of finished goods by one of our USD functional-currency subsidiaries for a total notional amount of €9.1 million ($11.0 million).

In addition, we entered into several contracts which involve both a written and a purchased option to hedge the currency risk associated with a portion of our forecasted Yen-denominated inventory purchases made by West in the U.S. The notional amounts of these contracts include ¥792.9 million of a derivative asset and ¥792.9 million of a derivative liability, or $6.7 million each.

Lastly, we entered into several contracts which involve both a written and a purchased option to hedge the currency risk associated with a portion of our forecasted Yen-denominated inventory purchases made by certain European subsidiaries. The notional amounts of these contracts include ¥457.7 million of a derivative asset and ¥457.7 million of a derivative liability, or $3.7 million each.

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At June 30, 2015, a portion of our debt consisted of borrowings denominated in currencies other than USD. We have designated our €61.1 million ($67.8 million) Euro note B and our €21.0 million ($23.3 million) Euro-denominated borrowings under our multi-currency revolving credit facility as a hedge of our net investment in certain European subsidiaries. A cumulative foreign currency translation gain of $16.2 million pre-tax ($10.3 million after tax) on this debt was recorded within accumulated other comprehensive loss as of June 30, 2015. We have also designated our ¥500.0 million ($4.1 million) Yen-denominated borrowings under our multi-currency revolving credit facility as a hedge of our net investment in Daikyo. At June 30, 2015, there was a cumulative foreign currency translation gain on this Yen-denominated debt of $1.3 million pre-tax ($0.8 million after tax) which was also included within accumulated other comprehensive loss.

Commodity Price Risk

Many of our Packaging Systems products are made from synthetic elastomers, which are derived from the petroleum refining process. We purchase the majority of our elastomers via long-term supply contracts, some of which contain clauses that provide for surcharges related to fluctuations in crude oil prices. The following economic hedges did not qualify for hedge accounting treatment since they did not meet the highly effective requirement at inception.

In November 2014, we purchased a series of call options for a total of 134,700 barrels of crude oil to mitigate our exposure to such oil-based surcharges and protect operating cash flows with regard to a portion of our forecasted elastomer purchases through December 2015. With these contracts we may benefit from a decline in crude oil prices, as there is no downward exposure other than the $0.1 million premium that we paid to purchase the contracts.

During the three and six months ended June 30, 2015, the loss recorded in cost of goods and services sold related to these call options was immaterial.

Effects of Derivative Instruments on Financial Position and Results of Operations

The following tables summarize the effects of derivative instruments designated as hedges on other comprehensive income (“OCI”) and earnings, net of tax:

	Amount of Gain (Loss) Recognized in OCI for Three Months Ended June 30,		Amount of (Gain) Loss Reclassified from Accumulated OCI into Income for Three Months Ended June 30,		Location of (Gain) Loss Reclassified from Accumulated OCI into Income
($ in millions)	2015	2014	2015	2014	
Cash Flow Hedges:					
Foreign currency hedge contracts	$(0.4)	$0.1	$(0.4)	$—	Net sales
Foreign currency hedge contracts	(1.1)	0.2	—	—	Cost of goods and services sold
Interest rate swap contracts	—	(0.2)	0.4	0.4	Interest expense