WEST PHARMACEUTICAL SERVICES INC
Form 10-Q
November 05, 2010

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 September 30, 2010

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 (State or other jurisdiction of incorporation or organization)	23-1210010 (I.R.S. Employer Identification Number)
101 Gordon Drive, PO Box 645, Lionville, PA (Address of principal executive offices)	19341-0645 (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 October 31, 2010, there were 33,298,173 shares of the Registrant’s common stock outstanding.

Table of Contents

TABLE OF CONTENTS

Table of Contents

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 September 30,		Nine Months Ended September 30,	
	2010	2009	2010	2009
Net sales	$ 271.4	$ 258.9	$ 827.9	$ 762.3
Cost of goods and services sold	196.7	187.2	587.8	542.6
Gross profit	74.7	71.7	240.1	219.7
Research and development	5.9	5.1	17.0	14.1
Selling, general and administrative expenses	44.9	44.3	137.2	132.3
Restructuring and other items (Note 3)	(1.4)	(3.6)	1.1	(2.5)
Operating profit	25.3	25.9	84.8	75.8
Interest expense	4.2	3.8	12.1	11.1
Interest income	(0.1)	(0.3)	(0.3)	(0.6)
Income before income taxes	21.2	22.4	73.0	65.3
Income tax expense	4.5	6.0	17.3	14.6
Equity in net income of affiliated companies	1.1	0.8	3.6	1.6
Net income	$ 17.8	$ 17.2	$ 59.3	$ 52.3
Net income per share:				
Basic	$ 0.53	$ 0.52	$ 1.78	$ 1.60
Diluted	$ 0.51	$ 0.50	$ 1.70	$ 1.53
Weighted average shares outstanding:				
Basic	33.4	32.9	33.3	32.8
Diluted	36.7	36.4	36.7	36.3
Dividends declared per share	$ -	$ -	$ 0.32	$ 0.30

See accompanying notes to condensed consolidated financial statements.

Table of Contents

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

	September 30, 2010	December 31, 2009
ASSETS		
Current assets:		
Cash, including cash equivalents	$ 97.1	$ 83.1
Accounts receivable, net	142.8	138.7
Inventories	148.4	129.2
Deferred income taxes	8.3	7.8
Other current assets	44.6	38.4
Total current assets	441.2	397.2
Property, plant and equipment	1,070.7	1,062.1
Less accumulated depreciation and amortization	514.0	485.0
Property, plant and equipment, net	556.7	577.1
Investments in affiliated companies	43.8	38.2
Goodwill	113.8	114.2
Deferred income taxes	67.9	69.4
Intangible assets, net	55.9	55.6
Other noncurrent assets	20.3	19.3
Total Assets	$ 1,299.6	$ 1,271.0
LIABILITIES AND EQUITY		
Current liabilities:		
Notes payable and other current debt	$ 1.4	$ 0.5
Accounts payable	56.3	68.4
Pension and other postretirement benefits	2.3	2.1
Accrued salaries, wages and benefits	51.1	46.8
Income taxes payable	9.6	5.7
Taxes other than income	11.4	8.1
Other current liabilities	26.1	39.5
Total current liabilities	158.2	171.1
Long-term debt	369.3	379.1
Deferred income taxes	23.1	22.9
Pension and other postretirement benefits	83.1	85.1
Other long-term liabilities	33.8	33.7
Total Liabilities	667.5	691.9
Commitments and contingencies (Note 14)		
Total Equity	632.1	579.1
Total Liabilities and Equity	$ 1,299.6	$ 1,271.0

See accompanying notes to condensed consolidated financial statements.

Table of Contents

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

	Common Shares Issued	Common Stock	Capital in Excess of Par Value	Number of Treasury Shares	Treasury Stock	Retained earnings	Accumulated other comprehensive loss	Total
Balance, December 31, 2009	34.3	$ 8.6	$ 72.9	(1.3)	$ (52.1)	$ 569.4	$ (19.7)	$ 579.1
Net income						59.3		59.3
Stock-based compensation			4.9					4.9
Shares issued under stock plans			(4.1)	0.3	11.7			7.6
Shares repurchased for employee tax withholdings				(0.1)	(2.0)			(2.0)
Excess tax benefit from employee stock plans			2.0					2.0
Cash dividends declared						(10.7)		(10.7)
Other comprehensive income, net of tax							(8.1)	(8.1)
Balance, September 30, 2010	34.3	$ 8.6	$ 75.7	(1.1)	$ (42.4)	$ 618.0	$ (27.8)	$ 632.1

See accompanying notes to condensed consolidated financial statements.

Table of Contents

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

	Nine Months Ended September 30, 2010	Nine Months Ended September 30, 2009
Cash flows from operating activities:		
Net income	$ 59.3	$ 52.3
Depreciation	50.4	46.7
Amortization	3.3	3.1
Other non-cash items, net	1.4	5.5
Changes in assets and liabilities	(23.3)	(22.5)
Net cash provided by operating activities	91.1	85.1
Cash flows from investing activities:		
Capital expenditures	(49.8)	(76.4)
Acquisition of businesses, net of cash acquired	(3.7)	(16.9)
Acquisition of patents and other long-term assets	(0.1)	(2.8)
(Purchases) redemptions of investments, net	(2.8)	4.2
Other, net	1.0	0.1
Net cash used in investing activities	(55.4)	(91.8)
Cash flows from financing activities:		
Borrowings under revolving credit agreements, net	21.9	4.9
Repayment of former credit facility	(26.6)	-
Debt issuance costs	(1.7)	-
Changes in other debt	0.1	(0.5)
Dividend payments	(16.0)	(14.8)
Excess tax benefit from employee stock plans	2.0	2.1
Shares repurchased for employee tax withholdings	(2.0)	(1.1)
Issuance of common stock from treasury	2.9	4.3
Net cash used in financing activities	(19.4)	(5.1)
Effect of exchange rates on cash	(2.3)	4.1
Net increase (decrease) in cash and cash equivalents	14.0	(7.7)
Cash, including cash equivalents at beginning of period	83.1	87.2
Cash, including cash equivalents at end of period	$ 97.1	$ 79.5

See accompanying notes to condensed consolidated financial statements.

Table of Contents

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 ("GAAP") for interim financial reporting and SEC regulations. The year-end condensed balance sheet data was derived from audited financial statements. Certain information and footnote disclosures normally included in annual financial statements prepared in accordance with 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 presentation 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 nine month periods ended September 30, 2010 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 2009 annual report on Form 10-K. The results of operations for any interim period are not necessarily indicative of results for the full year.

Business Segments: Effective January 1, 2010, our business operations were reorganized into two new divisions, Pharmaceutical Packaging Systems ("Packaging Systems") and Pharmaceutical Delivery Systems ("Delivery Systems"), in order to further align our business units with the underlying markets and customers they serve. All historical periods have been restated accordingly for the changes to our segment reporting structure to provide comparative information. Refer to Note 13, Segment Information, for further details.

Note 2: Acquisition

In July 2010, we acquired 100% of the outstanding shares of an Israel-based company that developed a subcutaneous drug delivery system using pre-filled cartridge technology. This acquired technology will be integrated into the Delivery Systems segment. The purchase price included cash paid at closing of $2.5 million and contingent consideration with an estimated fair value of $1.5 million. The preliminary purchase price allocation consisted of $3.3 million of in-process research and development intangible assets, $1.4 million of goodwill and $0.8 of deferred tax liabilities. We will continue to evaluate the fair value of the contingent consideration obligation at each reporting date, with any increases or decreases recorded within restructuring and other items in our consolidated statements of operations. The contingent consideration is payable to the selling shareholders based upon a percentage of product sales over the next seventeen years with no cap on total payments. Given the length of the earnout period and the uncertainty in forecasted product sales, we do not believe it is meaningful to estimate the upper end of the range over the entire period. However, our estimated probable range which could become payable over the next five years is between zero and $4.1 million. Operating results for the acquired business were included within the Delivery Systems segment from the date of acquisition. Pro forma results were not presented as this acquisition was not considered material to our consolidated balance sheets or results of operations.

Note 3: Restructuring and Other Items

Restructuring and other items consisted of:

	Three Months Ended September 30,		Nine Months Ended September 30,	
($ in millions)	2010	2009	2010	2009
Restructuring and related charges:				
Severance and post-employment benefits	$ 0.1	$ -	$ 0.4	$ 0.3
Asset write-offs	0.1	-	0.6	0.5
Other	-	-	0.2	0.3

Total restructuring and related charges	0.2	-	1.2	1.1
Acquisition-related contingencies	(1.8)	-	(1.8)	-
Brazil tax amnesty benefit	-	(3.9)	-	(3.9)
Foreign exchange losses and other	0.2	0.3	1.7	0.3
Total restructuring and other items	$ (1.4)	$ (3.6)	$ 1.1	$ (2.5)

Table of Contents

Restructuring and Related Charges

During the nine month period ended September 30, 2010, we incurred $1.2 million in restructuring and related charges in connection with the restructuring program announced in November of 2009.

During the first nine months of 2009, we incurred $1.1 million in restructuring and related charges as part of a 2007 plan to align the plant capacity and workforce of our former Tech Group segment with its revised business outlook and as part of a longer-term strategy of focusing the business on proprietary products.

The following table details activity related to our restructuring obligations recorded within other current liabilities:

($ in millions)	Severance and benefits	Other Costs	Total
Balance, December 31, 2009	$ 1.9	$ 0.1	$ 2.0
Charges	0.4	0.2	0.6
Cash payments	(1.9)	(0.3)	(2.2)
Balance, September 30, 2010	$ 0.4	$ -	$ 0.4

We expect all restructuring activities associated with the plans to be completed by the end of 2010.

Other Items

In July 2009, we acquired the ErisTM safety syringe system and other intellectual property and business assets from a France-based developer and manufacturer of drug delivery devices. The purchase price included contingent consideration with an initial fair value of $2.6 million which was recorded as a liability at the acquisition date. During the third quarter of 2010, we reduced the contingent consideration by $1.8 million to reflect a reduction in the probability of attaining certain milestones over the next four years. As of September 30, 2010, the liability balance representing the fair value of the contingent consideration was $0.6 million.

During 2009, the Brazilian government issued regulations which provided taxpayers the opportunity to settle certain tax-related debts under less stringent conditions. In September 2009, we enrolled in this tax amnesty program, which entitled us to a reduction in penalties, interest and other costs previously deposited in escrow accounts with the federal bank of Brazil in exchange for our irrevocable declaration of all specified obligations. As these costs were previously accrued, we recognized a gain of $3.9 million in the third quarter of 2009.

Note 4: Income Taxes

The tax provision for interim periods is determined using the estimated annual effective consolidated tax rate, based on the current estimate of full-year earnings before taxes, adjusted for the impact of discrete quarterly items.

For the nine months ended September 30, 2010, our effective tax rate was 23.6% compared with 22.3% for the same period in 2009. During 2009, we recorded a $2.1 million tax benefit resulting from the expiration of open tax audit years in certain jurisdictions, as well as the completion of a foreign tax audit which resulted in a reduction of liabilities for unrecognized tax benefits. Discrete tax items incurred during the first nine months of 2010 did not have a significant impact on our effective tax rate.

It is reasonably possible that due to the expiration of statutes and the closing of audits during the next 12 months, the total amount of unrecognized tax benefits may be reduced by as much as $0.9 million, resulting in a favorable impact on the effective tax rate. Accrued interest related to unrecognized tax benefits was $0.4 million and $0.5 million at September 30, 2010 and December 31, 2009, respectively.

Table of Contents

Because we are a global organization, we and our subsidiaries file income tax returns in the U.S. Federal jurisdiction and various state and foreign jurisdictions. We are subject to examination in the U.S. Federal tax jurisdiction for tax years 2006 through 2009. We are also open for examination in various state and foreign jurisdictions for tax years 2005 through 2009.

Note 5: 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

As a result of our normal borrowing activities, we have entered into long-term debt obligations with both fixed and variable interest rates. As of September 30, 2010, we have two interest rate swap agreements outstanding which are designated as cash flow hedges to protect against volatility in the interest rates payable on our $50.0 million note maturing July 28, 2012 (“Series A Note”) and our $25.0 million note maturing July 28, 2015 (“Series B Note”). Under both of these swaps, we will receive variable interest rate payments based on three-month London Interbank Offering Rates (“LIBOR”) in return for making quarterly fixed payments. Including the applicable margin, the interest rate swap agreements effectively fix the interest rates payable on the Series A and B notes at 5.32% and 5.51%, respectively.

Foreign Exchange Rate Risk

In 2010, we entered into a series of foreign currency hedge contracts, designated as cash flow hedges, to eliminate the currency risk associated with a portion of our forecasted Yen (“JPY”) denominated purchases of finished goods from Daikyo Seiko Ltd. and other JPY purchases made by West in the U.S. As of September 30, 2010, there were three monthly contracts outstanding at ¥91.0 million ($1.0 million) each, for an aggregate notional amount of ¥273.0 million ($3.0 million). The contracts fix the U.S. dollar (“USD”) to JPY exchange rate for a portion of our anticipated needs at a maximum of 91.00 JPY per USD while allowing us to benefit from any currency movement between 91.00 and 96.75 JPY per USD. As of September 30, 2010, the USD was equal to 83.67 JPY. The last contract matures on December 28, 2010.

During 2009, we entered into a series of foreign currency hedge contracts, designated as cash flow hedges, to eliminate the currency risk associated with a portion of our forecasted USD denominated inventory purchases made by certain European subsidiaries. As of September 30, 2009, there were three monthly contracts outstanding at $0.9 million each, for an aggregate notional amount of $2.7 million. The contracts effectively fixed the Euro to USD exchange rate for a portion of our anticipated needs at a maximum of 1.28 USD per Euro while allowing us to benefit from any currency movement between 1.28 and 1.46 USD per Euro. As of September 30, 2009, the Euro was equal to 1.46 USD. The last contract in this series matured on December 15, 2009.

We had also entered into a series of similar hedge contracts, designated as cash flow hedges, to eliminate the currency risk associated with a portion of our forecasted JPY denominated inventory purchases made by certain European subsidiaries. As of September 30, 2009, there were three contracts outstanding at ¥33.5 million each, for an aggregate notional amount of ¥100.5 million. The contracts effectively fixed the Euro to JPY exchange rate for a portion of our anticipated needs at a maximum of 131.00 JPY per Euro while allowing us to benefit from any currency movement between 131.00 and 145.75 JPY per Euro. As of September 30, 2009, the Euro was equal to 131.30 JPY. The last contract in this series matured on December 15, 2009.

Table of Contents

In addition, we periodically use forward exchange contracts, designated as fair value hedges, to neutralize our exposure to fluctuating foreign exchange rates on cross-currency intercompany loans. As of September 30, 2009, there was one contract outstanding, with a notional amount of €3.0 million that settled on October 15, 2009. Changes in the fair value of this derivative were recognized within restructuring and other items and were offset by changes in the fair value of the underlying exposure being hedged. During the nine month period ended September 30, 2009, we recognized a $0.1 million loss, in restructuring and other items, related to these fair value hedges. As of September 30, 2010, there were no contracts outstanding.

We have also designated our €81.5 million Euro-denominated notes as a hedge of our net investment in certain European subsidiaries. A cumulative foreign currency translation loss of $10.8 million pre-tax ($6.6 million after tax) on this debt was recorded within accumulated other comprehensive income as of September 30, 2010. We have also designated our 1.7 billion JPY denominated note payable as a hedge of our net investment in a Japanese affiliate. At September 30, 2010, there was a cumulative foreign currency translation loss on this JPY denominated debt of $6.0 million pre-tax ($3.7 million after tax) which was also included within accumulated other comprehensive income.

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 changes in crude oil prices. We periodically enter into call options for crude oil and other hedges in an attempt to mitigate our exposure to such oil-based surcharges. As of September 30, 2010, we held call options for a total of 16,000 barrels of crude oil with a fair value of zero.

Effects of Derivative Instruments on Financial Position and Results of Operations

Refer to Note 6, Fair Value Measurements, for the balance sheet location and fair values of our derivative instruments as of September 30, 2010 and December 31, 2009.

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

($ in millions)	Amount of Gain (Loss) Recognized in OCI for Three Months Ended September 30, 2010	2009	Amount of Gain (Loss) Reclassified from Accumulated OCI into Income for Three Months Ended September 30, 2010	2009	Location of Gain (Loss) Reclassified from Accumulated OCI into Income
Cash Flow Hedges:					
Foreign currency hedge contracts	$ (0.2)	$ -	$ 0.3	$ -	Cost of goods and services sold
Interest rate swap contracts	0.4	0.3	(0.8)	(0.8)	Interest expense
Total	$ 0.2	$ 0.3	$ (0.5)	$ (0.8)	
Net Investment Hedges:					
Foreign currency-denominated debt	$ (7.7)	$ (6.2)	$ -	$ -	Foreign exchange losses and other
Total	$ (7.7)	$ (6.2)	$ -	$ -	

Table of Contents

($ in millions)	Amount of Gain (Loss) Recognized in OCI for Nine Months Ended September 30, 2010	2009	Amount of Gain (Loss) Reclassified from Accumulated OCI into Income for Nine Months Ended September 30, 2010	2009	Location of Gain (Loss) Reclassified from Accumulated OCI into Income
Cash Flow Hedges:					
Foreign currency hedge contracts	$ (0.1)	$ 0.2	$ 0.3	$ -	Cost of goods and services sold
Interest rate swap contracts	1.2	3.0	(2.4)	(1.9)	