WEST PHARMACEUTICAL SERVICES INC
Form 10-Q
May 05, 2011

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 March 31, 2011

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 April 30, 2011, there were 33,487,904 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 March 31, 2011	Three Months Ended March 31, 2010
Net sales	$ 295.4	$ 274.7
Cost of goods and services sold	207.4	192.5
Gross profit	88.0	82.2
Research and development	6.9	5.4
Selling, general and administrative expenses	50.6	46.6
Restructuring and other items (Note 2)	1.7	1.3
Operating profit	28.8	28.9
Interest expense	4.7	4.0
Interest income	(0.2)	(0.1)
Income before income taxes	24.3	25.0
Income tax expense	6.1	6.2
Equity in net income of affiliated companies	1.4	1.0
Net income	$ 19.6	$ 19.8
Net income per share:		
Basic	$ 0.59	$ 0.60
Diluted	$ 0.56	$ 0.57
Weighted average shares outstanding:		
Basic	33.4	33.1
Diluted	36.8	36.5
Dividends declared per share	$ 0.17	$ 0.16

See accompanying notes to condensed consolidated financial statements.

Table of Contents

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

	March 31, 2011	December 31, 2010
ASSETS		
Current assets:		
Cash, including cash equivalents	$ 94.6	$ 110.2
Accounts receivable, net	161.2	126.4
Inventories	157.1	147.0
Deferred income taxes	11.3	10.5
Other current assets	56.9	42.5
Total current assets	481.1	436.6
Property, plant and equipment	1,127.4	1,077.2
Less accumulated depreciation and amortization	552.9	522.4
Property, plant and equipment, net	574.5	554.8
Investments in affiliated companies	48.9	48.2
Goodwill	115.2	112.5
Deferred income taxes	68.4	64.5
Intangible assets, net	55.1	55.1
Other noncurrent assets	22.9	22.6
Total Assets	$ 1,366.1	$ 1,294.3
LIABILITIES AND EQUITY		
Current liabilities:		
Notes payable and other current debt	$ 6.3	$ 0.3
Accounts payable	66.2	63.2
Pension and other postretirement benefits	2.1	2.1
Accrued salaries, wages and benefits	48.6	48.3
Income taxes payable	6.6	5.0
Taxes other than income	12.1	10.0
Other current liabilities	40.9	40.8
Total current liabilities	182.8	169.7
Long-term debt	364.7	358.1
Deferred income taxes	21.0	20.0
Pension and other postretirement benefits	91.2	87.2
Other long-term liabilities	43.3	33.6
Total Liabilities	703.0	668.6
Commitments and contingencies (Note 12)		
Total Equity	663.1	625.7
Total Liabilities and Equity	$ 1,366.1	$ 1,294.3

See accompanying notes to condensed consolidated financial statements.

4

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, 2010	34.3	$ 8.6	$ 77.3	(1.0)	$ (41.5)	$ 612.6	$ (31.3)	$ 625.7
Net income						19.6		19.6
Stock-based compensation			2.2					2.2
Shares issued under stock plans			(6.6)	0.2	8.1			1.5
Shares repurchased for employee tax withholdings				(0.1)	(2.1)			(2.1)
Excess tax benefit from employee stock plans			1.2					1.2
Cash dividends declared						(5.5)		(5.5)
Other comprehensive income, net of tax							20.5	20.5
Balance, March 31, 2011	34.3	$ 8.6	$ 74.1	(0.9)	$ (35.5)	$ 626.7	$ (10.8)	$ 663.1

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)

	Three Months Ended March 31, 2011	Three Months Ended March 31, 2010
Cash flows from operating activities:		
Net income	$ 19.6	$ 19.8
Depreciation	18.3	16.6
Amortization	1.2	1.1
Other non-cash items, net	2.1	1.4
Changes in assets and liabilities	(31.7)	(27.4)
Net cash provided by operating activities	9.5	11.5
Cash flows from investing activities:		
Capital expenditures	(19.4)	(17.7)
Acquisition of business, net of cash acquired	-	(1.3)
Acquisition of patents and other long-term assets	(0.4)	-
Purchases of investments, net	(9.6)	(0.7)
Other, net	0.3	-
Net cash used in investing activities	(29.1)	(19.7)
Cash flows from financing activities:		
Borrowings (repayments) under revolving credit agreements, net	6.0	(2.2)
Changes in other debt	(0.3)	(0.3)
Dividend payments	(5.4)	(5.3)
Excess tax benefit from employee stock plans	1.2	2.0
Shares repurchased for employee tax withholdings	(2.1)	(2.0)
Issuance of common stock from treasury	0.7	1.9
Net cash provided by (used in) financing activities	0.1	(5.9)
Effect of exchange rates on cash	3.9	(3.1)
Net decrease in cash and cash equivalents	(15.6)	(17.2)
Cash, including cash equivalents at beginning of period	110.2	83.1
Cash, including cash equivalents at end of period	$ 94.6	$ 65.9

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 Securities and Exchange Commission (“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 months ended March 31, 2011 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, 2010 (“2010 Annual Report”). The results of operations for any interim period are not necessarily indicative of results for the full year.

Note 2: Restructuring and Other Items

Restructuring and other items consisted of:

	Three Months Ended March 31,	
($ in millions)	2011	2010
Restructuring and related charges:		
Severance and post-employment benefits	$ 1.5	$ 0.4
Impairments and asset write-offs	0.2	0.1
Other restructuring charges	0.2	0.1
Total restructuring and related charges	1.9	0.6
Foreign exchange (gains) losses and other	(0.2)	0.7
Total restructuring and other items	$ 1.7	$ 1.3

Restructuring and Related Charges

In December 2010, our Board of Directors approved a restructuring plan designed to reduce our cost structure and improve operating efficiency. The plan involves the closure of a plant in the U.S. and a longer-term reduction in operations at a manufacturing facility in England. This plan will also result in the elimination of certain operational and administrative positions at various other locations. We expect to incur total restructuring and related charges of approximately $21.0 million through the end of 2012, which consists of approximately $15.0 million in cash expenditures for employee severance benefits and plant closure and asset relocation costs, and $6.0 million in non-cash asset impairment and disposal charges. To date, we have incurred $16.4 million in total charges as part of this plan, including $14.5 million in December of 2010 and $1.9 million during the three months ended March 31, 2011. The balance of the anticipated charges will be recognized as incurred during 2011 and 2012.

During the first quarter of 2010, we incurred $0.6 million in restructuring and related charges in connection with the 2009 restructuring program.

Table of Contents

The following table presents activity related to our restructuring obligations during the three months ended March 31, 2011:

($ in millions)	Severance and benefits	
Balance, December 31, 2010	$	10.2
Charges		1.5
Cash payments		(1.2)
Balance, March 31, 2011	$	10.5

Note 3: Income Taxes

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

For the three months ended March 31, 2011, our effective tax rate was 24.9% compared with 24.7% for the same period in 2010. Discrete tax items did not have a significant impact on our effective tax rate for either of the periods presented.

It is reasonably possible that due to the expiration of statutes and the closing of audits during the next twelve months, the total amount of unrecognized tax benefits may be reduced further by approximately $0.8 million, resulting in a favorable impact on the effective tax rate. The balance of accrued interest and penalties was $0.4 million at both March 31, 2011 and December 31, 2010.

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 2007 through 2010. We are also open for examination in various state and foreign jurisdictions for tax years 2005 through 2010.

Note 4: 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

On February 25, 2011, we exercised an option to purchase our new corporate office and research facility. Refer to Note 12, Commitments and Contingent Liabilities, for additional details. In conjunction with this, we anticipate that during January 2013, we will borrow $43.0 million under a five-year term loan with a variable interest rate. In anticipation of this debt, we entered into a forward-start interest rate swap in order to hedge the variability in cash flows due to changes in the applicable interest rate over the five-year period beginning January 2013. Under this swap, we will 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 the forward-start interest rate swap as a cash flow hedge.

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 March 31, 2011, 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 LIBOR in return for making quarterly fixed rate 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 the first quarter of 2011, we entered into several foreign currency hedge contracts that were designated as cash flow hedges of forecasted transactions denominated in foreign currencies. These contracts are described below.

We entered into a series of foreign currency contracts intended to hedge the currency risk associated with a portion of our forecasted Japanese Yen (“JPY”) denominated purchases of inventory from Daikyo Seiko Ltd. made by certain European subsidiaries. As of March 31, 2011, there were nine monthly contracts outstanding at ¥95.0 million each, for an aggregate notional amount of ¥855.0 million (approximately $10.3 million).

We have entered into a series of foreign currency contracts to hedge the currency risk associated with a portion of our forecasted U.S. dollar (“USD”) denominated inventory purchases by certain European subsidiaries. As of March 31, 2011, there were nine monthly contracts outstanding at $0.8 million each, for an aggregate notional amount of $7.2 million.

In addition, we 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. As of March 31, 2011, there were nine monthly contracts outstanding at $1.2 million each, for an aggregate notional amount of $10.8 million.

As of March 31, 2011 and December 31, 2010, a portion of our long-term debt consisted of borrowings denominated in currencies other than the U.S. dollar. We 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 $14.8 million pre-tax ($9.1 million after tax) on this debt was recorded within accumulated other comprehensive loss as of March 31, 2011. We have also designated our 1.0 billion Yen-denominated note payable as a hedge of our net investment in a Japanese affiliate. At March 31, 2011, there was a cumulative foreign currency translation loss 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. We entered into the following economic hedges that did not qualify for hedge accounting treatment since they did not meet the highly effective requirement at inception.

In January 2011, we purchased a series of call options for a total of 77,900 barrels of crude oil, which are intended to mitigate our exposure to such oil-based surcharges and protect operating cash flows with regard to a portion of our forecasted elastomer purchases during the months of May through November 2011. With these option contracts, we may benefit from a decline in crude oil prices, as there is no downward exposure other than the $0.5 million premium that we paid to purchase the contracts.

Table of Contents

During the three months ended March 31, 2011, a gain of $0.9 million was recorded in cost of goods and services sold related to these outstanding call options. During the first quarter of 2010, a loss of $0.1 million related to crude-oil options was recorded in cost of goods and services sold.

Effects of Derivative Instruments on Financial Position and Results of Operations

Refer to Note 5, Fair Value Measurements, for the balance sheet location and fair values of our derivative instruments as of March 31, 2011 and December 31, 2010.

The following table summarizes 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 March 31, 2011	2010	Amount of Gain (Loss) Reclassified from Accumulated OCI into Income for Three Months Ended March 31, 2011	2010	Location of Gain (Loss) Reclassified from Accumulated OCI into Income
Cash Flow Hedges:					
Foreign currency hedge contracts	$ (0.3)	$ -	$ -	$ -	Net sales
Foreign currency hedge contracts	(0.7)	-	-	-	Cost of goods and services sold
Interest rate swap contracts	1.0	0.5	(0.8)	(0.8)	Interest expense
Total	$ -	$ 0.5	$ (0.8)	$ (0.8)	
Net Investment Hedges:					
Foreign currency-denominated debt	$ (4.1)	$ 4.5	$ -	$ -	Foreign exchange (gains) losses and other
Total	$ (4.1)	$ 4.5	$ -	$ -	

For the three months ended March 31, 2011 and 2010, there was no ineffectiveness related to our cash flow and net investment hedges.

Note 5: Fair Value Measurements

We define fair value as the price that would be received to sell an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date.

The following fair value hierarchy classifies the inputs to valuation techniques used to measure fair value into one of three levels:

- Level 1: Unadjusted quoted prices in active markets for identical assets or liabilities.

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Level 2: Inputs other than quoted prices that are observable for the asset or liability, either directly or indirectly. These include quoted prices for similar assets or liabilities in active markets and quoted prices for identical or similar assets or liabilities in markets that are not active.

- Level 3: Unobservable inputs that reflect the reporting entity's own assumptions.

Table of Contents

The following tables present the assets and liabilities that are measured at fair value on a recurring basis in our balance sheets:

($ in millions)	Balance at March 31, 2011	Basis of Fair Value Measurements Level 1	Level 2	Level 3
Assets:				
Short-term investments	$ 10.3	$ 10.3	$ -	$ -
Deferred compensation assets	3.6	3.6	-	-
Commodity contracts	1.3	-	1.3	-
	$ 15.2	$ 13.9	$ 1.3	$ -
Liabilities:				
Contingent consideration	$ 2.5	$ -	$ -	$ 2.5
Deferred compensation liabilities	6.0	6.0	-	-
Foreign currency contracts	1.4	-	1.4	-
Interest rate swap contracts	5.7	-	5.7	-
	$ 15.6	$ 6.0	$ 7.1	$ 2.5

($ in millions)	Balance at December 31, 2010	Basis of Fair Value Measurements Level 1	Level 2	Level 3
Assets:				
Short-term investments	$ 0.6	$ 0.6	$ -	$ -
Deferred compensation assets	3.6	3.6	-	-
	$ 4.2	$ 4.2	$ -	$ -
Liabilities:				
Contingent consideration	$ 2.3	$ -	$ -	$ 2.3
Deferred compensation liabilities	5.4	5.4	-	-
Interest rate swap contracts	6.1	-	6.1	-
	$ 13.8	$ 5.4	$ 6.1	$ 2.3