

WEST PHARMACEUTICAL SERVICES INC
Form 10-Q
August 05, 2013

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

(Mark One)

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15 (d) OF THE SECURITIES EXCHANGE ACT
OF 1934

For the quarterly period ended June 30, 2013

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)

530 Herman O. West Drive, Exton, 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 No

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 No

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

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

As of July 31, 2013, there were 34,892,542 shares of the Registrant's common stock outstanding.

Table of Contents

TABLE OF CONTENTS

	Page
<u>PART I. FINANCIAL INFORMATION</u>	
<u>ITEM 1.</u>	FINANCIAL STATEMENTS (UNAUDITED)
	<u>Condensed Consolidated Statements of Income for the Three and Six Months ended June 30, 2013 and 2012</u>
	<u>3</u>
	<u>Condensed Consolidated Statements of Comprehensive Income for the Three and Six Months ended June 30, 2013 and 2012</u>
	<u>4</u>
	<u>Condensed Consolidated Balance Sheets at June 30, 2013 and December 31, 2012</u>
	<u>5</u>
	<u>Condensed Consolidated Statement of Equity for the Six Months ended June 30, 2013</u>
	<u>6</u>
	<u>Condensed Consolidated Statements of Cash Flows for the Six Months ended June 30, 2013 and 2012</u>
	<u>7</u>
	<u>Notes to Condensed Consolidated Financial Statements</u>
	<u>8</u>
<u>ITEM 2.</u>	MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS
	<u>23</u>
<u>ITEM 3.</u>	QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK
	<u>35</u>
<u>ITEM 4.</u>	CONTROLS AND PROCEDURES
	<u>36</u>
<u>PART II. OTHER INFORMATION</u>	
<u>ITEM 1.</u>	LEGAL PROCEEDINGS
	<u>36</u>
<u>ITEM 1A.</u>	RISK FACTORS
	<u>36</u>
<u>ITEM 2.</u>	UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS
	<u>37</u>
<u>ITEM 6.</u>	EXHIBITS
	<u>38</u>
<u>SIGNATURE</u>	<u>39</u>
<u>INDEX TO EXHIBITS</u>	<u>F-1</u>

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		Six Months Ended	
	June 30,		June 30,	
	2013	2012	2013	2012
Net sales	\$344.5	\$324.8	\$683.9	\$641.1
Cost of goods and services sold	233.6	226.1	461.3	441.3
Gross profit	110.9	98.7	222.6	199.8
Research and development	9.5	8.2	18.6	16.5
Selling, general and administrative expenses	59.7	54.4	118.7	105.7
Restructuring and other items (Note 2)	(0.8) 0.5	(0.6) 0.3
Operating profit	42.5	35.6	85.9	77.3
Loss on debt extinguishment	—	11.6	0.2	11.6
Interest expense	4.1	4.6	8.7	8.8
Interest income	0.4	0.6	1.0	1.0
Income before income taxes	38.8	20.0	78.0	57.9
Income tax expense	10.3	6.5	18.9	16.4
Equity in net income of affiliated companies	1.7	2.1	2.8	3.3
Net income	\$30.2	\$15.6	\$61.9	\$44.8
Net income per share:				
Basic	\$0.87	\$0.46	\$1.79	\$1.32
Diluted	\$0.86	\$0.45	\$1.76	\$1.27
Weighted average shares outstanding:				
Basic	34.7	34.0	34.6	33.9
Diluted	35.4	36.6	35.3	36.9
Dividends declared per share	\$0.19	\$0.18	\$0.38	\$0.36

See accompanying notes to condensed consolidated financial statements.

Table of Contents

CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (UNAUDITED)

West Pharmaceutical Services, Inc. and Subsidiaries

(In millions)

	Three Months Ended		Six Months Ended	
	June 30,		June 30,	
	2013	2012	2013	2012
Net income	\$30.2	\$15.6	\$61.9	\$44.8
Other comprehensive (loss) income, net of tax:				
Foreign currency translation adjustments	(0.8)	(29.4)	(19.1)	(17.2)
Defined benefit pension and other postretirement plan adjustments, net of tax of \$0.7, \$0.8, \$1.8 and \$1.4, respectively	1.1	1.5	3.2	2.3
Net gains (losses) on derivatives, net of tax of \$0.5, \$(1.5), \$0.1 and \$(1.5), respectively	0.7	(2.4)	0.4	
Stable value fund	–	188,281,212	–	–
Total assets at fair value	\$ 946,746,778	\$ 188,281,212	\$ –	\$ 1,135,027,990
				– 418,655,951

Participant loans are the only investments specific to the Plan. Fair value of the Plan's participant loans balance of \$17,204,321 is classified as a Level 3 investment.

Level 3 Gains and Losses:

The table below sets forth a summary of changes in the fair value of the Plan's Level 3 assets for the year ended December 31, 2009.

	Participant loans
Balance at beginning of year	\$15,856,806
Issuances and settlements (net)	1,347,515
Balance at end of year	\$17,204,321

ADM 401(k) and Employee Stock Ownership Plan for Salaried Employees

Notes to Financial Statements

4. Investment Contract

The Master Trust invests in security-backed investment contracts through the Galliard Stable Value Fund (the Fund). The Fund is considered a security-backed investment contract and primarily invests in common collective trusts as well as wrapper contracts. The wrapper contracts provide assurance that future adjustments to the variable crediting rates of investments in the common collective trust cannot result in a crediting rate less than zero.

The wrapper contracts are investment contracts issued by an insurance company or other financial institution, backed by the portfolio of bonds that are owned by the common collective trusts in which the Fund is invested. The portfolio underlying the contract is maintained separately from the contract issuer's general assets, by a third party custodian. The interest crediting rate of the wrapper contracts is based on the contract value, and the fair value, duration, and yield to maturity of the underlying portfolio. These contracts typically allow for realized and unrealized gains and losses on the underlying assets to be amortized, usually over the duration of the underlying investments, through adjustments to the future interest crediting rate, rather than reflected immediately in the net assets of the Fund. The issuer guarantees that all qualified participant withdrawals will be at contract value.

Risks arise when entering into any investment contract due to the potential inability of the issuer to meet the terms of the contract. In addition, security-backed investment contracts have the risk of default or the lack of liquidity of the underlying portfolio assets.

The primary variables impacting the future crediting rates of security-backed investment contracts include the current yield of the assets underlying the contract, the duration of the assets underlying the contract and the existing difference between the fair value and contract value of the assets within the contract.

The Fund uses a compound net crediting rate formula, which reflects fees paid to security-backed contract issuers.

The security-backed investment contracts are designed to reset their respective crediting rates on a quarterly basis and cannot credit an interest rate that is less than zero percent.

The crediting rate of security-backed investment contracts will track current market yields on a trailing basis. The rate reset allows the contract value to converge with the fair value of the underlying portfolio over time, assuming the portfolio continues to earn the current yield for a period of time equal to the current portfolio duration.

ADM 401(k) and Employee Stock Ownership Plan for Salaried Employees

Notes to Financial Statements

4. Investment Contract (continued)

To the extent that the underlying portfolio of a security-backed investment contract has unrealized and/or realized losses, a positive adjustment is made to the adjustment from fair value to contract value under contract value accounting. As a result, the future crediting rate may be lower over time than the then-current market rates. Similarly, if the underlying portfolio generates unrealized and/or realized gains, a negative adjustment is made to the adjustment from fair value to contract value, and the future crediting rate may be higher than the then-current market rates.

The yield earned by the Fund at December 31, 2009 and December 31, 2008 was 3.80% and 6.20%, respectively. This represents the annualized earnings of all investments in the Fund divided by the fair value of all investments in the Fund at that date. The yield earned by the Fund with an adjustment to reflect the actual interest rate credited to participants in the Fund at December 31, 2009 and December 31, 2008 was 3.09% and 4.16%, respectively. This represents the annualized earnings credited to participants in the Fund divided by the fair value of all investments in the Fund at that date.

Security-backed investment contracts generally provide for withdrawals associated with certain events which are not in the ordinary course of Fund operations. These withdrawals are paid with a market value adjustment applied to the withdrawal as defined in the investment contract. Each contract issuer specifies the events which may trigger a market value adjustment.

At this time, the Fund does not believe that the occurrence of any such market value event, which would limit the Fund's ability to transact at contract value with participants, is probable.

Security-backed investment contracts generally contain termination provisions, allowing the Fund or the contract issuer to terminate with notice at any time at fair value, and providing for automatic termination of the contract if the contract value or the fair value of the underlying portfolio equals zero. The issuer is obligated to pay the excess contract value when the fair value of the underlying portfolio equals zero. In addition, if the Fund defaults on its obligations under the security-backed contract (including the issuer's determination that the agreement constitutes a non-exempt prohibited transaction as defined under ERISA), and such default is not corrected within the time permitted by the contract, then the contract may be terminated by the issuer and the Fund will receive the fair value as of the date of termination.

ADM 401(k) and Employee Stock Ownership Plan for Salaried Employees

Notes to Financial Statements

5. Master Trust Investment Information

The Plan's investments are held in the Master Trust. Investments and the income therefrom are allocated to participating plans based on each plan's participation in investment options within the Master Trust. At December 31, 2009 and 2008, the Plan's interest in the net assets of the Master Trust was approximately 77% and 76%, respectively.

The following table presents the investments for the Master Trust:

	December 31	
	2009	2008
Assets		
Investment securities at fair value:		
ADM common stock	\$525,028,572	\$506,439,622
Mutual funds	418,655,951	271,513,255
Investment contract	188,281,212	156,933,894
Other common stock	3,062,255	2,762,029
Cash and equivalents	221,691	-
	1,135,249,681	937,648,800
Adjustment from fair value to contract value for fully responsive investment contract	2,563,693	13,658,695
	\$1,137,813,374	\$951,307,495

Summarized financial information with respect to the Master Trust's investment income is as follows:

	Year Ended December 31	
	2009	2008
Net realized and unrealized appreciation (depreciation) in fair value of investments:		
ADM common stock	\$42,425,141	\$(268,008,531)
Mutual funds	77,602,398	(157,954,275)
Investment contract	5,606,614	6,483,745
Other common stock	189,817	(821,382)
	\$125,823,970	\$(420,300,443)
Dividend and interest income	\$19,591,387	\$25,517,084

ADM 401(k) and Employee Stock Ownership Plan for Salaried Employees

Notes to Financial Statements

6. Plan expenses

Brokerage commissions, transfer taxes, and other charges and expenses in connection with the purchase or sale of securities are charged against the trust fund and added to the cost of such securities or deducted from the sale proceeds, as the case may be. The stable value fund and mutual funds incur expenses in the course of their operations and distribute returns to shareholders based on the funds' net income. Accordingly, these costs are not shown in plan expenses. Participants are charged check processing fees in certain circumstances. Costs of administering the Plan, including the trustee, record keeper, audit and actuarial fees are currently paid by the Plan's sponsor, ADM. While it is anticipated that ADM will continue to pay these costs, the Plan permits the reasonable expenses of administering the Plan to be paid from the trust fund.

7. Plan Termination

Although it has not expressed any intent to do so, the Company has the right to discontinue its contributions at any time and to terminate the Plan subject to the provisions of ERISA. In the event of plan termination, participants will be 100% vested in all their accounts.

8. Reconciliation of Financial Statements to Form 5500

The following is a reconciliation of net assets available for benefits per the Plan's financial statements to the Form 5500:

	December 31	
	2009	2008
Net assets available for benefits per the financial statements	\$892,183,860	\$746,457,318
Adjustments to contract value for fully responsive investment contract	(1,913,061)	(10,261,804)
Amounts allocated to deemed distributions	(41,437)	(40,620)
Amounts allocated to withdrawing participants	(7,775)	(183,946)
Net assets available for benefits per the Form 5500	\$890,221,587	\$735,970,948

ADM 401(k) and Employee Stock Ownership Plan for Salaried Employees

Notes to Financial Statements

8. Reconciliation of Financial Statements to Form 5500 (continued)

The following is a reconciliation of net realized and unrealized appreciation (depreciation) per the Plan's financial statements to the Form 5500:

	Year Ended December 31	
	2009	2008
Net realized and unrealized appreciation (depreciation) per the financial statements	\$99,736,449	\$(322,674,063)
Current year adjustments to contract value for fully responsive investment contract	(1,913,061)	(10,261,804)
Prior year adjustments to contract value for fully responsive investment contract	10,261,804	837,830
Net realized and unrealized appreciation (depreciation) included in the Master Trust investment income per the Form 5500	\$108,085,192	\$(332,098,037)

The following is a reconciliation of withdrawals per the Plan's financial statements to the Form 5500:

	Year Ended December 31	
	2009	2008
Withdrawals per the financial statements	\$38,258,251	\$73,367,228
Current year amounts allocated to deemed distributions	41,437	40,620
Prior year amounts allocated to deemed distributions	(40,620)	-
Current year amounts allocated to withdrawing participants	7,775	183,946
Prior year amounts allocated to withdrawing participants	(183,946)	(2,450,675)
Withdrawals per the Form 5500	\$38,082,897	\$71,141,119

Amounts allocated to withdrawing participants were recorded on the Form 5500 for withdrawal requests that have been processed and approved for payment prior to December 31, 2009 and 2008, but not yet paid.

9. Income Tax Status

The Plan received a determination letter from the IRS, dated July 27, 2007, stating the Plan is qualified under Section 401(a) of the Internal Revenue Code (the Code), and therefore, the related trust is exempt from taxation. Subsequent to this determination by the Internal Revenue Service, the Plan was amended and restated. Once qualified, the Plan is required to operate in conformity with the Code to maintain its qualification. The plan sponsor believes the Plan is being operated in compliance with the applicable requirements of the Code and, therefore, believes that the Plan, as amended, is qualified and the related trust is exempt.

ADM 401(k) and Employee Stock Ownership Plan for Salaried Employees

Notes to Financial Statements

10. Risks and Uncertainties

The Plan invests in various investment securities. Investment securities are exposed to various risks such as interest rate, market, and credit risks. Due to the level of risk associated with certain investment securities, it is at least reasonably possible that changes in the values of investment securities will occur in the near term and that such changes could materially affect participants' account balances and the amounts reported in the statements of net assets available for benefits.

Schedule

ADM 401(k) and Employee Stock Ownership Plan for Salaried Employees

EIN: 41-0129150

Plan 029

Schedule H, Line 4i – Schedule of Assets (Held at End of Year)

December 31, 2009

Identity of Issuer, Borrower, Lessor, or Similar Party	Description	Current Value
Participant loans* * Parties in interest.	Loans, interest rates from 4.25% to 10.50%, maturities through 2019	\$ 17,204,321

Signature

Pursuant to the requirements of the Securities Exchange Act of 1934, the Plan Administrator has duly caused this annual report to be signed on its behalf by the undersigned hereunto duly authorized.

ARCHER-DANIELS-MIDLAND COMPANY

/s/Steven R. Mills

Steven R. Mills
Executive Vice President and
Chief Financial Officer

Dated: June 17, 2010

Exhibit Index

Exhibit	Description
23	Consent of Ernst & Young LLP.