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West Pharmaceutical Services, Inc. (WST)

Morgan Stanley Healthcare Conference

CORPORATE PARTICIPANTS

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Chairman, President & Chief Executive Officer

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Chief Financial Officer & Senior Vice President

MANAGEMENT DISCUSSION SECTION

Unverified Participant

All right. Good afternoon. Welcome to the final – one of the final sessions of Morgan Stanley Healthcare Conference. We have with us today West Pharmaceutical Services, Don Morel and Bill Federici.

Before we start, obviously, I will be remiss not to mention the relevant disclosures which you can find at www.morganstanley.com/researchdisclosures.

And I guess before we start, Don, if you would like to give us maybe a quick five-minute intro into the company and maybe talk a little bit about the most recent trends, that would be great.

Donald E. Morel
Chairman, President & Chief Executive Officer

No, I'd be glad to. For those that aren't familiar with the company, West's principal business lies in packaging and administration systems for injectable drugs. We're founded in 1923 in Philadelphia, fundamentally have grown with the pharmaceutical industry since that time. Very broad geographic footprint. We operate 30 manufacturing facilities around the globe. Very fortunate to have a wonderful customer base. We serve every vertically integrated multinational pharma company, every biotech company, almost every med device company and all of the major generics.

The spread of the business is roughly about 52% overseas in terms of our total $1.4 billion in revenue, the rest domestic. And over the past couple of years, we've had a very, very nice growth trajectory. We benefited from the industry's growth in biologics, the shift from the regulatory agencies in terms of cleaner packaging components.

The growth strategies for our business are actually quite simple. We operate two divisions: the first of which is Packaging, that's about $1 billion and three principles guide our work there. One is increasing the value we sell per unit in terms of our high value products, operating our manufacturing facilities in the leanest possible manner and then expanding geographically in regions where we don't have a large market share currently but we see selective opportunities principally in China and India.

On the other side of the business, we have been working our way into assembled devices. We have about a $375 million business at the end of 2013 in devices for administration. That is roughly about 80% contract manufacturing for our customers where we actually provide engineering and automation services to manufacture their products at high volume and about 20% less proprietary products.

Our goal for this group is quite simple. Again, it's conversion of that 20% proprietary revenue base to about 50% within a five-year timeframe and to commercialize a number of new product opportunities we've launched which take advantage of the trends at our marketplace for patient self-infusion either through auto injectors, through patch pumps or other devices. And also, a new containment system to replace glass in drugs that tend to be a bit active in the vial. There are problems with glass containment modalities, prefilled syringes and vials and whatnot with certain biologics where the silicone which used as an aid often results in decreasing the potency of the drug in the vial. So we see very, very good market opportunities for those products in the years ahead.

We had a terrific 2013 in the three major strategic areas. Our high-value products grew just under 10%. Our geographic aims grew just on the order of about 15% to 16%. And on the proprietary products side, although off of a small base, sales were up about 20% as well. So, we're getting the right stride. We've got great opportunities, great customer base. Be glad to answer any questions you might have.

QUESTION AND ANSWER SECTION

Q

Fantastic. Let's dig in a little bit into the proprietary products part of the business and delivery systems. On your second quarter conference call, you had mentioned that a customer with a drug product currently on the market will file for your custom CZ container before the end of 2014 with approval expected in first half 2015 and kind of commercialization shortly thereafter.

Can you just talk a little bit about whether that time line still holds and can you, in particular, show what was it about the CZ container that really appeal to the customer in this case and why CZ and not other formulation?

Donald E. Morel
Chairman, President & Chief Executive Officer

A

So in this particular case, the customer had an issue with packaging the diluent for their drug in a glass vial and the diluent happen to actually cause delamination of the inner surface, resulting in glass flakes floating in the vial. Clearly, a big regulatory concern.

So, one of our principal thesis behind the development of CZ has been a container that's compatible with some of these very, very aggressive diluents and drug solutions. The driver was solely from the standpoint of eliminating the delamination.

It is a custom vial for this particular customer. It's going into a package for an approved drug. The time line still holds. We should be seeing commercial revenues off of that product in 2015 and basically it proves out the thesis that contamination is going to be an issue in the future and where CZ can eliminate that, we think we've got some good opportunities.

Q

And so, if you had to guess, I guess, that CZ penetration of the overall addressable market, can you talk about where you think they are and how fast you think we can get to a better level, what your targets are?

Donald E. Morel
Chairman, President & Chief Executive Officer

A

Sure. The industry historically moves very slow and what folks have to remember is that the entire infrastructure in place for fill/finish right now is all built around glass and it's built around high-volume dosing in prefilled syringes and in vials.

But the one thing I'd encourage people to remember is that CZ is actually a platform. It's not a single product; it's the base material that goes into the container. But because of its molding flexibility, you can make it into a range of vial sizes. You can make it everything from a [ph] leader (05:49) to contain biologic concentrate to a 1 mL prefilled syringe to a very small 2 mL vial and cartridges that go into some of the devices such as auto-injectors and patch pumps.

The real driver behind the uptake I think will be the need for cleaner containment systems. These biologic drugs are so expensive in their final dosage form. Anything that's a contaminant that acts either to degrade the potency of the drug or creates particulates like we had in the case of the vial that's [ph] plain (06:21) to market, our customers want to eliminate that at every step possible.

CZ is not a solution to all of those problems but by eliminating silicone, tungsten residue from glass manufacturing, it has much higher break resistance, and the fact that it's compatible with a broad range of pHs we think will give it a leg up in the marketplace. But it's a very flexible platform depending on the customers' needs.

William J. Federici
Chief Financial Officer & Senior Vice President

A

And in terms sizing, we don't expect a majority of glass to convert to plastic. We've heard estimates anywhere from 25% to 33% of prefilled syringes converting in the high-value space. So, in biologics and high-end vaccine space, converting over to a plastic format, but that's the kind of sizing that you can start to think about. We don't expect to get all of that. We think there will be multiple winners in this space. But clearly, CZ is an important part of that solution.

Donald E. Morel
Chairman, President & Chief Executive Officer

A

And based on what we know about where our customers are at in their formal stability process, our belief is that some time in the 2016-2017 timeframe, depending on completion of the stability trials and then the subsequent filings would be the point where we start to see uptake.

Q

Can you maybe share with us some of the conversations you're having with customers around your SmartDose platform and in particular, maybe talk about – I guess I want to talk about the synergies between the CZ platform as well that platform and how you can use both or one or the other to drive sales of the other?

Donald E. Morel
Chairman, President & Chief Executive Officer

A

Sure. SmartDose is actually a patch pump that the user will wear on their skin for as long as it takes to infuse the drug. One of the challenges in biologics is that the molecules are quite large and in-solution can be quite viscous. Getting an adequate infusion subcutaneously can be somewhat painful for the patient in that situation.

The SmartDose was really aimed at meeting an unmet need in the marketplace. We're delivering something above 1.5 mL. In some cases, we've got inquiries as much as 5 mL slowly over a period of 30 minutes, 1 hour, 2 hours, whatever the customers need would be but to be done by the patient in a home setting comfortably without having to go to the doctor's office or into the hospital. Patients simply puts it on, activates it with a button, the infusion begins. And then at the end, there's an audible alarm, they take it off, put it in a bag and dispose of it in the sharps.

Tremendous interest in this because of the flexibility it gives our customers in terms of formulation. As you point out, very important that the container, because of its geometry, is actually made of CZ. So, many years ago, we decided to invest in platforms and in the CZ seeing it for biologics in particular. One of the trends is to what I call combination devices where the primary container is in fact integrated into the delivery system as a single product. And indeed, that's happening. There's an awful lot of interest in these types of products. The auto-injector market has begun to take off.

Again, we've seen many opportunities for that and knock on wood, based on where our development programs are, could potentially see commercialization sometime in that 2016 timeframe.

Q

And you're already shipping, I think, at a run rate of, what, 10,000 units or something at the end of 2Q?

Donald E. Morel
Chairman, President & Chief Executive Officer

A

That is right.

Q

Okay. I guess move for a second to the packaging business. You broke up the packaging business into roughly, I think, three segments. The first being the disposable medical devices that are governed by the 510(k) process and – which is about like $100 million in revs and not really growing with margins below the corporate average. Can you just talk a little bit about your strategic thinking around this segment and how you plan to address some of the lagging margins going forward?

Donald E. Morel
Chairman, President & Chief Executive Officer

A

Yeah. The segment is composed of three different sales buckets for us, the first of which is disposable medical device. Historic customers like Becton, Dickinson, [ph] Cognate (10:19) and Baxter, Abbot, infusion components, components that go into disposable syringes and whatnot. It's about $100 million. The margins tend to be lower, as you indicated, because it's a 510(k) and one-offs should try to keep your cost down.

The second part is what we called standard product. This is the historical West business in packaging, principally aimed at bulk antibiotics, very large volume vaccines, things like veterinary application, dental applications, diagnostic applications come in gross margins in the 20%, 25% range. It's about $475 million to $500 million of our overall business.

The final part is the most important, and that's what we called the high-value product category. This is where we do much of the post-processing and a lot of the analytical work necessary to support the customers' filings. And

that business is about $425 million to $450 million currently. But the margins come in that are north of 50%, and it is the driver for our business.

If you look at our sales pattern in this category for the last three, four, five years, we've got periods of more than 20% growth in the quarter to our first quarter of this year where it was down a little bit because of inventory adjustment. But it levels out at a growth rate that is in the high-single and low-double digits. Strategically, that's why our focus is on that market.

One of the real strengths of West is in packaging biologics. Of the 35 top-selling biologic drugs, either West or our partner, Daikyo, packages those products. If you look at the pipelines that are coming through, I think there's more than 70 monoclonal antibodies currently under development in various phases. You have strength in cancer in terms of some of the new PD-1 molecules coming out. You have innovative therapies in cholesterolemia, hypercholesterolemia like the PCSK9 drugs.

In diabetes, you have things like the GLP-1s. West packages all of these in one way or another so we're very, very high on that segment. Strategically, it's all about efficiency in the way we do centers of excellence in our factory.

Bill, maybe you want to talk about the manufacturing footprint and how we handle that.

William J. Federici
Chief Financial Officer & Senior Vice President

A

Sure. These are the high-value product segment that Don is talking about. There are certain manufacturing locations globally that are specifically developed to be able to handle those very, very clean manufacturing products that Don talked about. So we've got a plant in the United States in Pennsylvania. We've got one and we're converting down in North Carolina. We've got a plant in Germany, one in France and one in Singapore that will be – that are able to handle those very, very high-end biologic components.

Strategically, when we think about the disposable medical device segment that you talked about, that less than $100 million, it really is a function of history that we've worked with these customers for a long period of time. These are important drugs and important products that we're making for all of these customers. So, while strategic import is something you could – and margins you could question whether it's less than the average, but we tend to look at these things on a more global basis of servicing the customer and making sure we're able to service all of their needs.

Q

I guess moving a little bit more deeper into the high-value products part of the packaging business, can you give us a sense as to like what you think your competitive advantages here in terms of technological advantage? I'm thinking specifically FluroTec? And also how sustainable you see these double-digit growth rates being over the near to medium term?

Donald E. Morel
Chairman, President & Chief Executive Officer

A

So the competitive advantages are several. One of the really interesting characteristics of our business is that when the customer goes to file their new drug application, they have to prove the package is stable when in contact with the drug. That takes two years of work and very expensive. But it effectively locks the West component into the production of that drug for its lifetime. And indeed when a competitor comes in, we're often on a generics as well.

Our competitive advantage comes from what is called Drug Master File 1546, it's the single most referenced document in the FDA's archives. So when the customer files, the FDA comes to us for a permission to review the technical data in that document, so one mode there. The second mode comes from the technical knowhow and how we mold these products and how we process them. All technical knowhow built up over 40 years, very unique when compared to our competitive set.

The third thing is in our supply chain. So we work very carefully with our suppliers, A, to establish long-term supply agreement. But B, where we do co-development, we have exclusive access to those proprietary materials that often are made solely for West or solely for Daikyo when they're run. So we are the only ones that can access them.

And then finally on the processing side, there's a second type of Drug Master File that governs our facilities. Within that Drug Master File, it describes our Westar processing and some of our other processes that again get locked in as part of the application. So the tighter we are with our customers in developing that data set in terms of not only the initial submission but also the validation runs, the more it ties us to them downstream and the more difficult it is for them to switch.

So, if you take our billion-dollar portfolio of business in packaging, as we begin a new year, roughly about 85% to 90% of that business is going to be repeat because those drugs are still in the market and, again, governed by the regulatory framework.

Q

I want to move to margins for a quick moment here. In 2Q, you attributed 80 bps of gross margin improvement to mix. Can you expand on that a little bit and discuss whether you see that as likely to persist over the next few quarters? And I know you had a particularly strong third quarter last year. And this year, you face – in addition to your regular seasonality, you lack the benefit of outsized demand on your high-value product line. So, how do you – what can we expect from you in this upcoming quarter?

William J. Federici
Chief Financial Officer & Senior Vice President

A

Talk about the margins first. When we look at the margin expansion you talked about and do the mix, you mentioned earlier and Don elaborated on this high-value product piece of our business, we will get roughly a double of the margin. We had about high 20%s margin on our standard components. And on these high-value components, we get historically around 55% margin. So, when we have a good quarter like we did, high-value product growth was about 8% in the second quarter. You're going to drop not only better throughput through the plants, but you're also going to drop additional margin for each of those units sold.

So, when we had the 80 basis point margin increase, it really was very tame underlying operating expenses, both raw materials, labor and overhead compared to this very high mix of products sold. And that's what basically generated the 80 bps of growth.

When you think about the third quarter, and we're not giving guidance on the third quarter, but when we think about the back half of the year, yeah, there is a tough comp that we have to deal with. But we believe that some of the specific items that had affected our comps last year is being very high due to some customer inventory management issues, a couple of changes that in our internal processes that customers had to buy some additional products more in 2013, those will be headwinds as we face the back half of the year.

And seasonality, as you mentioned also, is another headwind. But we believe what we're starting to see again over long periods of time is the underlying demographics in the markets, especially for biologics, the aging populations in the West and the increased incidence of chronic diseases all point to a favorable tailwind for us in terms of these mix issues. So, again, we're not going to give guidance here, but we do see a more normalizing of the growth patterns back to where we would expect.

Q

And then at your Analyst Day, you talked about operating efficiency measures, efforts at low-cost manufacturing and sourcing, some restructuring and facility rationalization. Can you maybe give us a bit more color on those initiatives especially, I think, on the feedback from customers as you look to optimize order management?

Donald E. Morel
Chairman, President & Chief Executive Officer

A

Well, the Analyst Day reference was to a project that we initiated last year to look at our total manufacturing footprint. And what we've done is, even a couple of years ago, been organizing what we call centers of excellence. And within that, as Bill said, the high-value products are being concentrated in certain facilities so that we have redundancy throughout the network; two in the United States, two in Europe, Asia and potentially, a future plant in India as we expand there. So, it gives us redundancy in the eyes of the regulatory bodies in risk mitigation in terms of our customer base, so that's the high-value part of the revenue stream.

The standard products tend to be in facilities that are shorter run, multiple changeover, not as high volume where the people there are experienced in running that kind of business model and know how to do it. We're getting better at it. We've got some room to run. That's where we think we can gain some margin improvement.

And then the third category is concentrating all of the med device work into just a couple of facilities. This is the disposable syringe, plunger, tips, IV components where you're basically running high volume 24/7. And we'll have a single plant, for example, in this category produce 8 billion pieces of saleable product in a single year. There, it's all about minimizing your labor cost, keeping your manpower down, optimizing your yield out of the presses and shortening your cure times as much as possible. All of that is ongoing. That will be an exercise that we continue to do over the next three to five years in order to optimize the footprints.

We do not plan to invest into rights capacity. We do plan to invest in high value capacity.

Q

We're about halfway through. Does anyone have any questions from the audience? It doesn't look like it.

William J. Federici
Chief Financial Officer & Senior Vice President

A

There's one up front over here. There you go.

Q

I think in your last quarter, you talked about basically sort of customers. As we get to October, they have sort of a September year-end that's a working capital or [ph] commission (20:52) inventories. Has that changed? Do you feel like it's changing that you're sort of kind of over that hump?

Donald E. Morel
Chairman, President & Chief Executive Officer

A

There's actually two parts to the answer and you're absolutely correct. Part of it is the seasonality in our business because our European plants and our European customers will shut down depending on country, mid-July really till the end of August. Combined with that, our med device customers usually have a September 30 as fiscal year-end. So, during the second quarter, they're working down inventories and not ordering, and then they start to reorder again as we get into their first quarter and our fourth quarter.

We think most of the inventory issues on the device side have worked their way through. We've certainly seen our orders uptick in North America. We've seen our orders uptick in Europe. That's pretty much what we've seen over the last couple of years in terms of seasonality.

The inventory builds that were done through the process change that Bill talked about are a little bit more difficult to predict. We've seen some uptick from those customers hasn't returned fully to historical order patterns from a year, year-and-a-half ago. But because we know we haven't lost any business there and the products are still in the market, it will return. We'll have a much better picture when we get to our Q3 call and then our end-of-the-year call in February.

Q

Maybe the one – the line of products overall. When I think about it, there's a standard RTF glass syringe is probably, I don't know, $0.26 to $0.27. How much more expensive would it be with CZ?

Donald E. Morel
Chairman, President & Chief Executive Officer

A

So, the category...

Q

The real potential for the market. So, you said about 30% as the high end.

Donald E. Morel
Chairman, President & Chief Executive Officer

A

Correct.

Q

And what would that mean in terms of sales?

Donald E. Morel
Chairman, President & Chief Executive Officer

A

So, we are targeting the biologic end of the space. We are not targeting where the bulk RTF syringes go for the generic heparins and things like that. You're absolutely correct that a standard prefilled syringe in that area is anywhere between $0.25 and $0.50 per unit, including the needle shield, the plunger rod.

For us, we've looked at the biologic end where with our system, we are the only ones that can offer a completely silicone-oil-free solution and that's because of the technology we have around the coating called FluroTec. Our expectation is in volume that those syringes will be probably in the $1.75 to $2 range. So, there's a big difference versus the bulk. But if the bulk guys want to put the attributes into the syringe, it will allow them to sell into that value segment. Their costs are going to be closer to $1.50. So, the gap is not as large as it would originally appear to be.

William J. Federici
Chief Financial Officer & Senior Vice President

A

And on – to answer the second part of your question about the size of the market, the addressable market, there are a lot of different estimates about how many prefilled syringes are being used in the biologic and high-end vaccine space. If you use an assumption of something like on the order of half of – 500 million to 600 million units and that continues to grow based on the growth of those underlying disease categories that support it, you're growing in the high singles to low doubles. You can start to see some of the size of the addressable market there if 25% or 33% of that market were to change.

Q

[Inaudible] (24:05-24:10) You know that [ph] IDT (24:10) will be the ultimate competitor since they're a leader in glass, dominating glass so much...

Donald E. Morel
Chairman, President & Chief Executive Officer

A

Sure.

Q

...80% to 85%. You don't see them at all working on plastics.

Donald E. Morel
Chairman, President & Chief Executive Officer

A

Oh, absolutely. This is a segment that almost two or three years ago, the glass guys would say would never develop. About a year ago, as Bill said, they came to the conclusion that roughly a third of the market could convert, and that would be 600 million units, so that's a 1.8 billion total.

We know that they're working on a solution. Gerresheimer is working on a solution. Terumo in Japan is working on a solution. Very good company in Germany, a plastic molder called Transcoject has a solution. But again, the market is going to segment very carefully along value lines here where for contrast media, you've got one value proposition for a standard injectable vaccine that may be in a prefilled.

It's not going to meet all the bells and whistles; the $0.75 solution may be absolutely acceptable. But at the high end for the biologics where the guys' dose is anywhere from $1,000 to $1,200, he's going to want the safest,

securest, silicone-oil-free, tungsten-free, glue-free, unbreakable or break-resistant syringe that he can get and that's where we think our product offering fits.

Q

Sir.

Q

Specialty business is growing rapidly, in general, in the pharmaceutical market because of biologics, et cetera. I'm trying to understand where that fits in in your business. Standard packaging, I would have thought, would be growing with that market high-single digit. Why is it not? If you can help me understand that.

Donald E. Morel
Chairman, President & Chief Executive Officer

A

Sorry. What's the first part of the question? I didn't understand it.

<Q >

Yeah, I think...

Donald E. Morel
Chairman, President & Chief Executive Officer

A

I couldn't hear the first part of your question.

Q

I think...

Q

[Inaudible] (25:54)

Q

Specialty pharma is growing fast and why are we only seeing a small growth in our standard products. These too aren't necessarily...

Donald E. Morel
Chairman, President & Chief Executive Officer

A

Yeah. This part of the question comes in that in some of specialty pharma areas, you've got controlled release formulations. You may have a single dose per month replacing what could have been a single dose per week. So we have seen some formulations go to longer controlled release which hurts our volume.

Q

I guess what [ph] I'm guessing (26:20) is Rituxan, Herceptin, Enbrel, all these things are growing rapidly even on an Rx basis. Are they showing up in your standard packaging?

William J. Federici
Chief Financial Officer & Senior Vice President

A

No.

Donald E. Morel
Chairman, President & Chief Executive Officer

A

No. They're still in the high-value...

William J. Federici
Chief Financial Officer & Senior Vice President

A

They're in the high-value space.

Q

So what differentiates high-value and what actually – what's the difference between those two...

Donald E. Morel
Chairman, President & Chief Executive Officer

A

So rubber manufacturing has not changed for 100 years. We take raw materials, we mix them, we roll them into a sheet and then we mold them into components and trim them. So think of standard products as kind of those four steps plus a washing step to clean the product up before we ship it to the customer.

The high-value products go through not only that process, but at the end stage of the molding, they can go through four to five additional steps, each one of which incrementally adds to the value of the product. The first of which is the FluroTec. This is a very thin layer of fluoropolymer which is molded onto the rubber surface which stops extraneous chemicals from coming out of the rubber formulation into the drug solution, and in the case of proteins, actually stops proteins in the drug solution from adhering to the surface to a large extent [ph] and, B, (27:26) creating the strength of the drug. So, FluroTec would be step one.

Step two, it goes to a process they would normally do with what we called Westar. This is where it's washed in water-for-injection and very carefully handled to get rid of endotoxins and decrease the bioburden, all of which we will measure and certify as part of the product. It will then go through a vision inspection step where every single one of the components is visually inspected for dimensional tolerance and for gross defects or contaminants on the surface.

The next step is really documentation necessary in helping support our customers with the FDA where we will ship it to them with a certificate of compliance that says we've done all the laboratory testing, the product meets specification, and that paper trail is available to the FDA. So, each one of those incrementally adds to the value. It takes the margin from 25% on a gross basis up to 60%, but the customers, depending on their needs, can pick and choose from a recipe of all of those depending on what they need.

Many of them now are asking for us to do all of those steps and at the end, bag them in a very special system called a ported bag which goes into the barrier isolator and basically introduces sterile product so that they can fill right away. And that is a huge sea change for the industry over the past 10 years. This category basically came about in the early to mid part of the 1990s driven by cleanliness requirements in the industry, and those cleanliness requirements continue to increase.

Q

Any others? Great. I guess, Don, if you can talk to us a little bit about capital deployment. I know you've clearly made some acquisitions in delivery systems that had worked out very, very well, Tech Group in 2005, Medimop and La Model in 2010. Can you talk a bit about what you look for in acquisitions and what strategic considerations or capabilities you're looking for today?

Donald E. Morel
Chairman, President & Chief Executive Officer

A

Sure. So, two questions there. Capital deployment's fairly easy. We're in a growth phase and we have been investing the majority of our operating cash flow back into the business. So, number one for us is to take a look at where we can deploy that cash flow in rapidly growing areas. And based on the growth of high-value products in the packaging side and devices on the device side, it's gone into capacity there. We do pay a dividend, which we have done historically. That takes up about $30 million with the recent increase. If we have cash flow [indiscernible] (30:01), we'd look at selectively paying down debt and/or share repurchases which we've done on occasion.

For the most part, our organic growth investments have really panned out and we'll continue to do that as long as we see opportunities there. Balance sheet is very strong, so we've got a lot of flexibility. Normally, those operating cash flows cover our gains.

On the M&A side, we've been very selective. We look for bolt-on acquisitions that support our injectable franchise and share the characteristics of our base business; strong IP content, either patents or knowhow, a B2B model where we can do the manufacturing and sell into our existing customer base. We'd love to have strong talent come along with it, technical and managerial. And where we can, the same kind of regulatory barriers around the product which implies drug material contact.

If you look at our technical expertise, what we understand is how these drug solutions interact with different kinds of materials, whether they're small molecule or whether they're proteins. And that's a substantial part of our competitive advantage. We look to add to that in terms of acquisition candidates.

Q

And then what metrics do you look at when assessing a potential target as in like ROIC, IRR?

Donald E. Morel
Chairman, President & Chief Executive Officer

A

The board surprises are usually [ph] the bottom or the start (31:15) of all of those things. So, yes, we look at them. We're mostly interested in strategic fit and is there a value that we can add to it and grow it faster than the innovator or the originator. We're very disciplined. We do not do well on competitive processes. We like to look for very good engineering talent with a good concept that's began to develop it and we can add to it. We've looked

at things anywhere from a couple of million of dollars up to as much as much as $1.5 billion in terms of size. Our sweet spot really, we think, is in the low millions to maybe up $200 million. It needs to be easily integratable. But the main thing is that you'd like them to accretive but there are situations where obviously you're going to invest strategically ahead of the curve...

Q

Right.

Donald E. Morel
Chairman, President & Chief Executive Officer

A

...and you look for cultural fit with the company to make sure that you can build on it. Bill, anything I missed?

William J. Federici
Chief Financial Officer & Senior Vice President

A

I think you've covered it all.

Q

I guess one last question from me for Bill. You reduced your growth expectations in the second quarter but kept your 2014 diluted EPS guidance. Can you walk through some of the reasons why top-line guidance was reduced? And I understand you attributed some of that to kind of shorter lead times and tough comps, obviously. As for the pacing of those revenues, can you confirm that it's more like a timing issue and we'll see that come back in 2015?

William J. Federici
Chief Financial Officer & Senior Vice President

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We absolutely – to the last point, we absolutely believe that there's a no-loss business. Our business is fairly predictable over long periods of time because, as we said in the regulatory process, once you're on those drugs, you're there for the life of the drug or until somebody does some other stability testing

We've seen some of these special one-off things that have occurred in 2013 that caused above-normal growth rate, so we're seeing the reverse of that as these excess inventories work their way through the systems. We thought that would be done a little quicker than it is. So some of that has left itself over into the second half of 2014. Thus, the slight decrease in the revenue guidance. But we're – our cost part of the equation remains fairly tame and the return of the high-value products and some of our lean initiatives are allowing us to maintain our – were allowing us to maintain our EPS guidance. So, that's kind of the story.

Unverified Participant

Great. Well, I guess we will end it there. I think we're just about out of time, and thank you all for all coming. And thank you, Don and Bill.

William J. Federici
Chief Financial Officer & Senior Vice President

Great. Thank you.

Donald E. Morel

Chairman, President & Chief Executive Officer

We appreciate your time.