

WEST PHARMACEUTICAL SERVICES INC
Form 10-Q
August 01, 2014

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, 2014

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 June 30, 2014, there were 70,764,711 shares of the Registrant's common stock outstanding.

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PART I. FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

CONDENSED CONSOLIDATED STATEMENTS OF INCOME (UNAUDITED)

West Pharmaceutical Services, Inc. and Subsidiaries

(In millions, except per share data)

	Three Months Ended		Six Months Ended	
	June 30,		June 30,	
	2014	2013	2014	2013
Net sales	\$368.9	\$344.5	\$715.7	\$683.9
Cost of goods and services sold	247.1	233.6	487.5	461.3
Gross profit	121.8	110.9	228.2	222.6
Research and development	9.9	9.5	19.9	18.6
Selling, general and administrative expenses	57.5	59.7	113.9	118.7
Other expense (income) (Note 11)	0.3	(0.8	) 1.0	(0.6
Operating profit	54.1	42.5	93.4	85.9
Loss on debt extinguishment	—	—	—	0.2
Interest expense	4.2	4.1	8.2	8.7
Interest income	0.5	0.4	0.9	1.0
Income before income taxes	50.4	38.8	86.1	78.0
Income tax expense	14.0	10.3	23.8	18.9
Equity in net income of affiliated companies	1.2	1.7	2.4	2.8
Net income	\$37.6	\$30.2	\$64.7	\$61.9
Net income per share:				
Basic	\$0.53	\$0.44	\$0.92	\$0.90
Diluted	\$0.52	\$0.43	\$0.89	\$0.88
Weighted average shares outstanding:				
Basic	70.8	69.5	70.7	69.2
Diluted	72.4	70.8	72.4	70.6
Dividends declared per share	\$0.10	\$0.10	\$0.20	\$0.19

See accompanying notes to condensed consolidated financial statements.

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CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (UNAUDITED)

West Pharmaceutical Services, Inc. and Subsidiaries

(In millions)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2014	2013	2014	2013
Net income	\$37.6	\$30.2	\$64.7	\$61.9
Other comprehensive (loss) income, net of tax:				
Foreign currency translation adjustments	(1.5	) (0.8	) (3.3	) (19.1
Defined benefit pension and other postretirement plan adjustments, net of tax of \$0, \$0.7, \$0.2 and \$1.8, respectively	0.1	1.1	0.3	3.2
Net gains on derivatives, net of tax of \$0.2, \$0.5, \$0.4 and \$0.1, respectively	0.5	0.7	0.7	0.4
Other comprehensive (loss) income, net of tax	(0.9	) 1.0	(2.3	) (15.5
Comprehensive income	\$36.7	\$31.2	\$62.4	\$46.4

See accompanying notes to condensed consolidated financial statements.

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CONDENSED CONSOLIDATED BALANCE SHEETS (UNAUDITED)

West Pharmaceutical Services, Inc. and Subsidiaries

(In millions)

	June 30, 2014	December 31, 2013
ASSETS		
Current assets:		
Cash and cash equivalents	\$226.7	\$230.0
Accounts receivable, net	209.6	185.7
Inventories	187.9	176.9
Deferred income taxes	16.8	15.9
Other current assets	44.4	42.2
Total current assets	685.4	650.7
Property, plant and equipment	1,402.3	1,369.0
Less accumulated depreciation and amortization	693.1	657.3
Property, plant and equipment, net	709.2	711.7
Investments in affiliated companies	60.4	60.9
Goodwill	114.0	114.2
Deferred income taxes	65.5	61.8
Intangible assets, net	46.1	48.3
Other noncurrent assets	24.1	24.0
Total Assets	\$1,704.7	\$1,671.6
LIABILITIES AND EQUITY		
Current liabilities:		
Notes payable and other current debt	\$2.2	\$2.2
Accounts payable	94.5	108.0
Pension and other postretirement benefits	2.2	2.2
Accrued salaries, wages and benefits	51.7	59.1
Income taxes payable	15.0	14.3
Other current liabilities	55.6	51.1
Total current liabilities	221.2	236.9
Long-term debt	359.3	371.3
Deferred income taxes	19.6	18.9
Pension and other postretirement benefits	79.1	83.1
Other long-term liabilities	52.9	55.0
Total Liabilities	732.1	765.2
Commitments and contingencies (Note 13)		
Equity:		
Preferred stock, 3.0 million shares authorized; 0 shares issued and outstanding	—	—
Common stock, \$0.25 par value; 100.0 million shares authorized; issued: 70.9 million and 70.4 million; outstanding: 70.8 million and 70.2 million	17.8	17.6
Capital in excess of par value	138.2	120.0
Retained earnings	855.5	805.0
Accumulated other comprehensive loss	(34.7)	(32.4)
Treasury stock, at cost (0.1 million and 0.2 million shares)	(4.2)	(3.8)
Total Equity	972.6	906.4

Total Liabilities and Equity	\$1,704.7	\$1,671.6
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See accompanying notes to condensed consolidated financial statements.

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CONDENSED CONSOLIDATED STATEMENT OF EQUITY (UNAUDITED)

West Pharmaceutical Services, Inc. and Subsidiaries

(In millions)

	Common Stock		Capital in Excess of Par Value	Treasury Stock	Retained earnings	Accumulated other comprehensive loss	Total
	Shares	Amount					
Balance, December 31, 2013	70.4	\$17.6	\$120.0	\$(3.8)	\$805.0	\$ (32.4)	\$906.4
Net income					64.7		64.7
Stock-based compensation			9.0	(0.4)			8.6
Shares issued under stock plans	0.6	0.2	9.6				9.8
Shares repurchased for employee tax withholdings	(0.1)		(4.1)				(4.1)
Excess tax benefit from employee stock plans			3.7				3.7
Dividends declared					(14.2)		(14.2)
Other comprehensive loss, net of tax						(2.3)	(2.3)
Balance, June 30, 2014	70.9	\$17.8	\$138.2	\$(4.2)	\$855.5	\$ (34.7)	\$972.6

See accompanying notes to condensed consolidated financial statements.

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CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED)

West Pharmaceutical Services, Inc. and Subsidiaries

(In millions)

	Six Months Ended	
	June 30,	
	2014	2013
Cash flows from operating activities:		
Net income	\$64.7	\$61.9
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation	42.6	39.1
Amortization	2.3	2.1
Loss on debt extinguishment	—	0.2
Stock-based compensation	8.9	10.4
Other non-cash items, net	(1.9)	(2.7)
Changes in assets and liabilities	(43.6)	(12.6)
Net cash provided by operating activities	73.0	98.4
Cash flows from investing activities:		
Capital expenditures	(56.2)	(83.8)
Purchases of short-term investments	(9.3)	(8.8)
Sales and maturities of short-term investments	8.3	13.7
Other, net	0.2	(3.0)
Net cash used in investing activities	(57.0)	(81.9)
Cash flows from financing activities:		
Borrowings under revolving credit agreements	182.9	178.3
Repayments under revolving credit agreements	(192.9)	(171.6)
Issuance of long-term debt	—	43.3
Repayments of long-term debt	(1.1)	(29.3)
Dividend payments	(14.1)	(13.1)
Excess tax benefit from employee stock plans	3.7	1.1
Shares repurchased for employee tax withholdings	(4.1)	(5.2)
Proceeds from stock option exercises	5.2	10.7
Employee stock purchase plan contributions	1.5	1.1
Contingent consideration payments	(0.1)	—
Net cash (used in) provided by financing activities	(19.0)	15.3
Effect of exchange rates on cash	(0.3)	(3.1)
Net (decrease) increase in cash and cash equivalents	(3.3)	28.7
Cash and cash equivalents at beginning of period	230.0	161.9
Cash and cash equivalents at end of period	\$226.7	\$190.6

See accompanying notes to condensed consolidated financial statements.

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

Note 1: Summary of Significant Accounting Policies

Basis of Presentation: The condensed consolidated financial statements included in this report are unaudited and have been prepared in accordance with U.S. generally accepted accounting principles (“U.S. GAAP”) for interim financial reporting and Securities and Exchange Commission (“SEC”) regulations. The year-end condensed consolidated balance sheet data was derived from audited financial statements, but does not include all disclosures required by U.S. GAAP. Certain information and footnote disclosures normally included in annual financial statements prepared in accordance with U.S. GAAP have been condensed or omitted. In the opinion of management, these financial statements include all adjustments, which are of a normal recurring nature, necessary for a fair statement of the financial position, results of operations, cash flows and the change in equity for the periods presented. The condensed consolidated financial statements for the three and six months ended June 30, 2014 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, 2013 (“2013 Annual Report”). The results of operations for any interim period are not necessarily indicative of results for the full year.

Stock Split: On August 1, 2013, our Board of Directors approved a two-for-one stock split of our outstanding shares of common stock, effected in the form of a stock dividend. The record date for the stock split was September 12, 2013, and the share distribution occurred on September 26, 2013. All share and per share amounts presented in the accompanying condensed consolidated financial statements and related notes have been retroactively adjusted to reflect the impact of this stock split.

Note 2: New Accounting Standards

Recently Adopted Standards

In July 2013, the FASB issued revised guidance to address the diversity in practice related to the financial statement presentation of unrecognized tax benefits when a net operating loss carryforward, a similar tax loss, or a tax credit carryforward exists. We adopted this guidance as of January 1, 2014, on a prospective basis. The adoption did not have a material impact on our financial statements.

In March 2013, the FASB issued guidance that clarifies the application of U.S. GAAP to the release of cumulative translation adjustments related to changes of ownership in or within foreign entities, including step acquisitions. This guidance, which we adopted as of January 1, 2014, will be applied prospectively if and when changes of ownership related to foreign entities occur.

Standards Issued Not Yet Adopted

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

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In May 2014, the FASB issued guidance on the accounting for revenue from contracts with customers that will supersede most existing revenue recognition guidance, including industry-specific guidance. The core principle requires an entity to recognize revenue to depict the transfer of goods and services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. In addition, the guidance requires enhanced disclosures regarding the nature, timing and uncertainty of revenue and cash flows arising from an entity's contracts with customers. This guidance is effective for interim and annual reporting periods beginning on or after December 15, 2016. Entities can choose to apply the guidance using either the full retrospective approach or a modified retrospective approach. Management is currently evaluating the impact that this guidance will have on our financial statements, if any, including which transition method it will adopt.

In April 2014, the FASB issued guidance for the reporting of discontinued operations, which also contains new disclosure requirements for both discontinued operations and other disposals that do not meet the definition of a discontinued operation. This guidance is effective for fiscal years, and interim periods within those years, beginning after December 15, 2014. Management believes that the adoption of this guidance will not have a material impact on our financial statements.

Note 3: Net Income Per Share

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

(In millions)	Three Months Ended		Six Months Ended	
	June 30, 2014	2013	June 30, 2014	2013
Numerator:				
Net income	\$37.6	\$30.2	\$64.7	\$61.9
Denominator:				
Weighted average common shares outstanding	70.8	69.5	70.7	69.2
Dilutive effect of stock options, stock appreciation rights and performance share awards, based on the treasury stock method	1.6	1.3	1.7	1.3
Assumed conversion of convertible debt, based on the if-converted method	—	—	—	0.1
Weighted average shares assuming dilution	72.4	70.8	72.4	70.6

Under the "if-converted" method, the after-tax effect of interest expense related to convertible debt is added back to net income. During all periods presented, the add-back amount was immaterial.

In addition, during the three months ended June 30, 2014 and 2013, there were 0.6 million and 0.9 million shares, respectively, not included in the computation of diluted net income per share, because their impact was antidilutive. There were 0.4 million and 0.6 million antidilutive options outstanding during the six months ended June 30, 2014 and 2013, respectively.

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Note 4: Inventories

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

(\$ in millions)	June 30, 2014	December 31, 2013
Finished goods	\$80.5	\$80.0
Work in process	31.0	24.8
Raw materials	76.4	72.1
	\$187.9	\$176.9

Note 5: Debt

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

(\$ in millions)	June 30, 2014	December 31, 2013
Term loan, due 2014	\$—	\$0.1
Series B floating rate notes, due 2015	25.0	25.0
Euro note B, due 2016	83.4	84.1
Capital leases, due through 2016	0.3	0.4
Revolving credit facility, due 2017	43.6	53.7
Term loan, due 2018	40.3	41.3
Note payable, due 2019	0.3	0.3
Series A notes, due 2022	42.0	42.0
Series B notes, due 2024	53.0	53.0
Series C notes, due 2027	73.0	73.0
Convertible debt, due 2047	0.6	0.6
	361.5	373.5
Less: current portion of long-term debt	2.2	2.2
	\$359.3	\$371.3

Please refer to Note 10, Debt, to the consolidated financial statements in our 2013 Annual Report for additional details regarding our debt agreements.

At June 30, 2014, we had \$43.6 million in outstanding borrowings under our multi-currency revolving credit facility, of which \$4.9 million was denominated in Yen, \$28.7 million in Euro and the remainder in U.S. dollar ("USD"). The total amount outstanding as of June 30, 2014 and December 31, 2013, was classified as long-term.

At June 30, 2014, we had \$40.3 million outstanding under our five-year term loan due January 2018, of which \$2.1 million was classified as current. Please refer to Note 6, Derivative Financial Instruments, for a discussion of the interest-rate swap agreement associated with this loan.

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Note 6: Derivative Financial Instruments

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

Interest Rate Risk

At June 30, 2014, we had \$40.3 million of outstanding borrowings under our variable-rate five-year term loan related to the purchase of our new corporate office and research building. In anticipation of this debt, we entered into a forward-start interest rate swap to hedge the variability in cash flows due to changes in the applicable interest rate over the stated period. Under this swap, we receive variable interest rate payments based on one-month London Interbank Offering Rates (“LIBOR”) plus a margin in return for making monthly fixed interest payments at 5.41%. We designated this swap as a cash flow hedge.

In addition, we have a \$25.0 million interest rate swap agreement outstanding as of June 30, 2014, that is designated as a cash flow hedge to protect against volatility in the interest rates on our floating rate notes maturing on July 28, 2015 (“Series B Notes”). Under this swap, we 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 agreement effectively fixes the interest rate payable on the Series B Notes at 5.51%.

Foreign Exchange Rate Risk

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

We entered into a series of foreign currency contracts intended to hedge the currency risk associated with a portion of our forecasted Yen-denominated purchases of inventory from Daikyo Seiko Ltd. (“Daikyo”) made by West in the United States. As of June 30, 2014, there were six monthly contracts outstanding at ¥95.0 million (\$0.9 million) each, for an aggregate notional amount of ¥570.0 million (\$5.5 million).

We also entered into a series of foreign currency contracts to hedge the currency risk associated with a portion of our forecasted USD-denominated inventory purchases made by certain European subsidiaries. As of June 30, 2014, there were six monthly contracts outstanding at a monthly amount ranging from \$1.4 million to \$3.0 million, for an aggregate notional amount of \$14.1 million.

Lastly, 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 June 30, 2014, there were six monthly contracts outstanding at \$1.5 million each, for an aggregate notional amount of \$9.0 million.

At June 30, 2014, a portion of our debt consists of borrowings denominated in currencies other than the U.S. dollar. We have designated our €61.1 million (\$83.4 million) Euro note B and our €21.0 million (\$28.7 million) Euro-denominated borrowings under our multi-currency revolving credit facility as a hedge of our net investment in certain European subsidiaries. A cumulative foreign currency translation loss of \$4.7 million pre-tax (\$2.9 million

after tax) on this debt was recorded within accumulated other comprehensive loss as of June 30, 2014. We have also designated our ¥500.0 million (\$4.9 million) Yen-denominated borrowings under our multi-currency revolving credit facility as a hedge of our net investment in Daikyo. At June 30, 2014, there was a cumulative foreign currency translation gain on this Yen-denominated debt of \$0.5 million pre-tax (\$0.3 million after tax) which was also included within accumulated other comprehensive loss.

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The following table summarizes the effects of derivative instruments designated as hedges on other comprehensive income ("OCI") and earnings, net of tax:

(\$ in millions)	Amount of Gain (Loss) Recognized in OCI for		Amount of Loss Reclassified from Accumulated OCI into Income for		Location of Loss Reclassified from Accumulated OCI into Income
	Three Months Ended June 30,		Three Months Ended June 30,		
	2014	2013	2014	2013	
Cash Flow Hedges:					
Foreign currency hedge contracts	\$0.1	\$(0.1)	) \$—	\$—	Net sales
Foreign currency hedge contracts	0.2	(1.0)	) —	0.9	Cost of goods and services sold
Interest rate swap contracts	(0.2)	) 0.4	0.4	0.4	Interest expense
Forward treasury locks	—	—	—	0.1	Interest expense
Total	\$0.1	\$(0.7)	) \$0.4	\$1.4	
Net Investment Hedges:					
Foreign currency-denominated debt	\$0.5	\$(1.0)	) \$—	\$—	Other expense (income)
Total	\$0.5	\$(1.0)) \$—	\$—	

(\$ in millions)	Amount of Gain (Loss) Recognized in OCI for		Amount of Loss Reclassified from Accumulated OCI into Income for		Location of Loss Reclassified from Accumulated OCI into Income
	Six Months Ended June 30,		Six Months Ended June 30,		
	2014	2013	2014	2013	
Cash Flow Hedges:					
Foreign currency hedge contracts	\$—	\$0.2	\$—	\$—	Net sales
Foreign currency hedge contracts	0.1	(2.7)	) —	1.5	Cost of goods and services sold
Interest rate swap contracts	(0.3)	) 0.5	0.8	0.8	Interest expense
Forward treasury locks	—	—	0.1	0.1	Interest expense
Total	\$(0.2)	) \$(2.0)	) \$0.9	\$2.4	
Net Investment Hedges:					
Foreign currency-denominated debt	\$0.5	\$1.4	\$—	\$—	Other expense (income)
Total	\$0.5	\$1.4	\$—	\$—	

For the three and six months ended June 30, 2014 and 2013, there was no material ineffectiveness related to our hedges.

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Note 7: Fair Value Measurements

Fair value is defined 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.

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.

The following tables present the assets and liabilities recorded at fair value on a recurring basis:

(\$ in millions)	Balance at June 30, 2014	Basis of Fair Value Measurements		
		Level 1	Level 2	Level 3
Assets:				
Short-term investments	\$8.5	\$8.5	\$—	\$—
Deferred compensation assets	6.1	6.1	—	—
Foreign currency contracts	0.1	—	0.1	—
	\$14.7	\$14.6	\$0.1	\$—
Liabilities:				
Contingent consideration	\$4.9	\$—	\$—	\$4.9
Deferred compensation liabilities	7.7	7.7	—	—
Interest rate swap contracts	4.7	—	4.7	—
Foreign currency contracts	0.1	—	0.1	—
	\$17.4	\$7.7	\$4.8	\$4.9

(\$ in millions)	Balance at December 31, 2013	Basis of Fair Value Measurements		
		Level 1	Level 2	Level 3
Assets:				
Short-term investments	\$7.5	\$7.5	\$—	\$—
Deferred compensation assets	5.7	5.7	—	—
	\$13.2	\$13.2	\$—	\$—
Liabilities:				
Contingent consideration	\$4.3	\$—	\$—	\$4.3
Deferred compensation liabilities	7.8	7.8	—	—
Interest rate swap contracts	5.6	—	5.6	—
	\$17.7	\$7.8	\$5.6	\$4.3

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Short-term investments, which are comprised of certificates of deposit and mutual funds, are included within other current assets and are valued using a market approach based on quoted market prices in an active market. Deferred compensation assets are included within other noncurrent assets and are also valued using a market approach based on quoted market prices in an active market. The fair value of our foreign currency contracts, included within other current assets and other current liabilities, is valued using an income approach based on quoted forward foreign exchange rates and spot rates at the reporting date. The fair value of our contingent consideration is included within other current liabilities and other long-term liabilities and is discussed further in the section related to Level 3 measurements. The fair value of deferred compensation liabilities is based on quoted prices of the underlying employees' investment selections and is included within other long-term liabilities. Interest rate swap contracts, included within other long-term liabilities, are valued based on the terms of the contract and observable market inputs (i.e., LIBOR, Eurodollar synthetic forwards and swap spreads). Refer to Note 6, Derivative Financial Instruments, for further discussion of our derivatives.

Level 3 Fair Value Measurements

The fair value of the contingent consideration liability related to our SmartDose™ electronic patch injector system ("SmartDose contingent consideration") was initially determined using a probability-weighted income approach, and is revalued at each reporting date or more frequently if circumstances dictate. Changes in the fair value of this obligation are recorded as income or expense within other expense in our condensed consolidated statements of income. The significant unobservable inputs used in the fair value measurement of the contingent consideration are the sales projections, the probability of success factors, and the discount rate. Significant increases or decreases in any of those inputs in isolation would result in a significantly lower or higher fair value measurement. As development and commercialization of SmartDose progresses, we may need to update the sales projections, the probability of success factors, and the discount rate used. This could result in a material increase or decrease to the contingent consideration liability.

The following table provides a summary of changes in our Level 3 fair value measurements:

	Six Months Ended	
	June 30,	
	2014	2013
Beginning Balance	\$4.3	\$3.3
Increase in fair value recorded in earnings	0.7	0.2
Payments	(0.1) —
Ending Balance	\$4.9	\$3.5

Refer to Note 11, Other Expense, for further discussion of our acquisition-related contingency.

Other Financial Instruments

We believe that the carrying amounts of our cash and cash equivalents, accounts receivable and short-term borrowings approximate their fair values due to their near-term maturities.

Quoted market prices are used to estimate the fair value of publicly traded long-term debt. The fair value of debt that is not quoted on an exchange is estimated using a discounted cash flow method based on interest rates that are currently available to us for debt issuances with similar terms and maturities. At June 30, 2014, the estimated fair value of long-term debt was \$359.2 million compared to a carrying amount of \$359.3 million. At December 31, 2013, the estimated fair value of long-term debt was \$365.8 million and the carrying amount was \$371.3 million.

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Note 8: Accumulated Other Comprehensive Loss

The following table presents the changes in the components of accumulated other comprehensive loss, net of tax, for the six months ended June 30, 2014:

(\$ in millions)	Losses on cash flow hedges	Unrealized gains on investment securities	Defined benefit pension and other postretirement plans	Foreign currency translation	Total
Balance, December 31, 2013	\$ (6.0)	\$ 4.3	\$ (47.0)	\$ 16.3	\$ (32.4)
Other comprehensive loss before reclassifications	(0.2)	—	(0.4)	(3.3)	(3.9)
Amounts reclassified out	0.9	—	0.7	—	1.6
Other comprehensive income (loss), net of tax	0.7	—	0.3	(3.3)	(2.3)
Balance, June 30, 2014	\$ (5.3)	\$ 4.3	\$ (46.7)	\$ 13.0	\$ (34.7)

A summary of the reclassifications out of accumulated other comprehensive loss is presented in the following table (\$ in millions):

Detail of components	Three Months Ended June 30,		Six Months Ended June 30,		Location on Statement of Income
	2014	2013	2014	2013	
Losses on cash flow hedges:					
Foreign currency contracts	\$—	\$ (1.4)	\$—	\$ (2.4)	Cost of goods and services sold
Interest rate swap contracts	(0.7)	(0.7)	(1.3)	(1.3)	Interest expense
Forward treasury locks	—	(0.1)	(0.2)	(0.2)	Interest expense
Total before tax	(0.7)	(2.2)	(1.5)	(3.9)	
Tax expense	0.3	0.8	0.6	1.5	
Net of tax	\$ (0.4)	\$ (1.4)	\$ (0.9)	\$ (2.4)	
Amortization of defined benefit pension and other postretirement plans:					
Transition obligation	\$—	\$—	\$—	\$ (0.1)	(a)
Prior service cost	0.3	0.3	0.6	0.7	(a)
Actuarial losses	(0.8)	(2.3)	(1.6)	(4.7)	(a)
Total before tax	(0.5)	(2.0)	(1.0)	(4.1)	
Tax expense	0.2	0.7	0.3	1.5	
Net of tax	\$ (0.3)	\$ (1.3)	\$ (0.7)	\$ (2.6)	
Total reclassifications for the period, net of tax	\$ (0.7)	\$ (2.7)	\$ (1.6)	\$ (5.0)	

(a) These components are included in the computation of net periodic benefit cost. Refer to Note 10, Benefit Plans, for additional details.

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Note 9: Stock-Based Compensation

The 2011 Omnibus Incentive Compensation Plan (the "2011 Plan") provides for the granting of stock options, stock appreciation rights, restricted stock awards and performance awards to employees and non-employee directors. The terms and conditions of awards to be granted are determined by our Board's nominating and compensation committees. Vesting requirements vary by award. At June 30, 2014, there were 3,875,996 shares remaining in the 2011 Plan for future grants.

During the six months ended June 30, 2014, we granted 597,093 stock options at a weighted average exercise price of \$47.26 per share based on the grant-date fair value of our stock to key employees under the 2011 Plan. The weighted average grant date fair value of options granted was \$10.35 per share as determined by the Black-Scholes option valuation model using the following weighted average assumptions: a risk-free interest rate of 1.57%; expected life of 6 years based on prior experience; stock volatility of 22.1% based on historical data; and a dividend yield of 0.8%. Stock option expense is recognized over the vesting period, net of forfeitures.

In addition, during the six months ended June 30, 2014, we granted 130,486 performance vesting share ("PVS") awards at a weighted grant-date fair value of \$47.27 per share to key employees under the 2011 Plan. Each PVS award entitles the holder to one share of our common stock if the annual growth rate of revenue and return on invested capital targets are achieved over a three-year performance period. The actual payout may vary from 0% to 200% of an employee's targeted award. The fair value of PVS awards is based on the market price of our stock at the grant date and is recognized as expense over the performance period, adjusted for estimated target outcomes and net of forfeitures.

Total stock-based compensation expense was \$4.6 million and \$8.9 million for the three and six months ended June 30, 2014, respectively. For the three and six months ended June 30, 2013, total stock-based compensation expense was \$5.0 million and \$10.4 million, respectively.

Note 10: Benefit Plans

The components of net periodic benefit cost for the three months ended June 30 were as follows (\$ in millions):

	Pension benefits		Other retirement benefits		Total	
	2014	2013	2014	2013	2014	2013
Service cost	\$2.5	\$2.5	\$0.1	\$0.3	\$2.6	\$2.8
Interest cost	4.3	3.7	0.1	0.3	4.4	4.0
Expected return on assets	(4.8)				