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HOLX - Hologic Inc at Canaccord Genuity Growth Conference

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CORPORATE PARTICIPANTS

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Mark Anthony Massaro *Canaccord Genuity Limited, Research Division - Senior Analyst*

PRESENTATION

Mark Anthony Massaro - *Canaccord Genuity Limited, Research Division - Senior Analyst*

All right. Good afternoon, everyone. Welcome to the 37th Annual Canaccord Genuity Growth Conference. My name is Mark Massaro. I'm the lead analyst on the diagnostics and life sciences team. I'm very pleased to have Hologic back again this year.

For those of you who are not familiar, Hologic is a global leader in women's health testing. We'll be diving through some of the certain businesses today.

With me today is Mike Watts, Head of Investor Relations and Justin Gaudreau, also in Investor Relations.

Guys, thank you very much for joining me today.

Michael J. Watts - *Hologic, Inc. - VP of IR & Corporate Communications*

Thank you for having us. Thanks to Canaccord as well.

QUESTIONS AND ANSWERS

Mark Anthony Massaro - *Canaccord Genuity Limited, Research Division - Senior Analyst*

Great. So I know that some of the folks in the audience are kind of generalist growth investors, so I figured maybe we'd start talking at a high level about some of your leadership areas, and areas like Breast Health imaging, Diagnostics, and just at a high level, if you could share what you're most excited about at Hologic today.

Michael J. Watts - *Hologic, Inc. - VP of IR & Corporate Communications*

Sure, and thanks again for having us, and appreciate all you guys sticking around until the end of the day as well.

So in a couple of words, if you're not familiar with the story, Hologic is an innovative medical technology company. We're primarily focused on improving women's health and well-being, primarily through early detection and early intervention. And maybe I'll try to answer your question, Mark, in a couple of different ways. One, from a product perspective, we have a handful, probably 4 primary businesses. Our 2 largest businesses are our Breast Health franchise, which is mainly a mammography franchise, and our Diagnostics business. Both of those in the last quarter represented about 35% of sales or so. And then we have 2 smaller businesses, our Surgical business and our Cynosure business, each of which are 12% or 13% of sales, and then a small scalable franchise as well.

And I think what really unites those businesses across the portfolio is really best-in-class products and large competitive moats in leading market positions. And I don't think I'll walk through all of them. We'll probably get into that in some of the conversation. But in our Breast Health business,



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for example, market leadership position there, mainly based on our Genius 3D Mammography systems. So these are the most advanced mammograms that provide better cancer detection and fewer recalls than traditional 2D, and we lead that market relative to some pretty big players.

Similar thing is true in Diagnostics. In Diagnostics, we're the leader in women's health testing, so these would be infectious disease assays for chlamydia; gonorrhea; human papillomavirus, which causes cervical cancer; Trichomonas; and we're really leading that market on the back of a fully automated platform, which is called the Panther system. I'm sure we'll get into that a little bit later.

So the business is really characterized by top products, and that includes in our Cynosure franchise and also Surgical. I think from a corporate perspective, if I could maybe take the question a different way, the company is evolving from what used to be a turnaround story now into a sustainable growth story. And if you're familiar with the back story, Steve MacMillan joined the company very late in 2013, spent most of his career at Stryker, proceeded to bring on [an entirely new] management team and really stabilized some businesses early on that had been declining through better commercial execution in the United States. That has continued over time, but we are supplementing that commercial execution with some new growth drivers.

And I think as we go forward, the next chapter of the story will come more from the maturation of an R&D pipeline that is now emerging for the first time from the use of our strong cash flows in terms of capital deployment, I'm sure we'll get into Cynosure a little bit later. And third from an expansion of our international business, which we're -- where we had previously been significantly underrepresented. So I'm sure we'll get into some of those points as we get into it.

Mark Anthony Massaro - *Canaccord Genuity Limited, Research Division - Senior Analyst*

Perfect. I wanted to talk about a couple of the highlights of your quarterly results from just a week ago. The first is your international business. Can you share with us maybe what surprised you in the quarter both in the Breast Health and Diagnostics divisions, and if you have any high-level thoughts about how sustainable international growth rates like that can continue?

Michael J. Watts - *Hologic, Inc. - VP of IR & Corporate Communications*

Sure. So let me give you a little bit of the history there. I mean, you'll remember this, Mark, but if we look back so much as 6 quarters ago, I think it was, international was an area of focus on the negative side for Hologic. I think it was our first quarter of our fiscal 2016 where that business turned negative. I think probably led to the downside by our Breast Health business. And at the time, we said hey, there's -- this looks a bit like a start-up. We've got some building to do, and we think we're going to make some progress as soon as 2017, so this fiscal year. I think 2 quarters ago, that business changed from being down to being basically flat. Last quarter, that business was up mid-single digits. This quarter, that business was up I think 10.5% on a constant currency basis. So probably a little bit ahead of schedule there. To be clear, we still have some work to do. We're not going to declare victory after 2 quarters of success. But we think over time, we are building the foundations for that to be a high single-digit, low double-digit grower for a long, long period of time. We are significantly underrepresented internationally, and even in our product categories, and this will get to the heart of your question in breast and in diagnostics, despite the fact that we saw the same products as we do in the U.S., despite the fact that we compete against the same large players, our market shares in most international markets are probably half what they are domestically. So we think that is a matter of focus and execution, and we now have a leadership team in place in those regions to help drive that business. In breast specifically, I think people always make a huge difference. About 1.5 years ago, we moved Kevin Thornal over to fix our relationships with our Breast distributors. We have a mix of direct sales OUS with distributor sales. And frankly, we were not managing those relationships well. Kevin did a terrific job of putting those deals on better footing, executing the blocking, tackling on a day-to-day basis. And as a result, this quarter, OUS Breast I think was up 13%. Something like that? On a constant currency basis, so nice progress there. In Diagnostics, the story is a little bit different. It is built on Panther, as I've mentioned in the introductory remarks, but it is catching up from a Panther placement perspective, catching up from an assay approval perspective and then driving utilization on those systems. So we continue to place more Panther instruments. We have now received CE marks for our viral load assays, so these are quantitative tests for HIV, hepatitis C and hepatitis B. Those almost double our addressable market in molecular testing, and those are beginning to contribute to growth. And then finally, we're working with customers to drive utilization on those systems. So some really nice progress, both in Breast Health as well as international. Having said that, we still got some work to do, and we're certainly not relaxing there.



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Mark Anthony Massaro - *Canaccord Genuity Limited, Research Division - Senior Analyst*

Got it. Well, I know many of the folks in the audience might have listened to your earnings call last week, and there was a little bit of surprises. I think the first is that you moved Kevin Thornal to run your Cynosure business. So the stock fell about 10%. This could be a pretty attractive opportunity to buy Hologic here.

Michael J. Watts - *Hologic, Inc. - VP of IR & Corporate Communications*

Would you like to repeat that, Mark?

Mark Anthony Massaro - *Canaccord Genuity Limited, Research Division - Senior Analyst*

Yes, it could be an attractive opportunity to buy Hologic here. And so I was wondering if you could just walk me through a little bit about the guide down for the full year fiscal '17 revenue guide, down \$10 million to \$25 million. How much of that was related to the new leadership versus any other dynamics in terms of like some salespeople that may have defected in there?

Michael J. Watts - *Hologic, Inc. - VP of IR & Corporate Communications*

Sure. So unfortunately, there's no direct quantitative answer to that, and there's not a regression that will tell us how that split out. But we have put in place new leadership at Cynosure, as I mentioned, Kevin Thornal, who turned around the OUS Breast business is now running that Cynosure business. And then another guy, who is the former Head of Marketing for Surgical business is now in charge of Surgical Marketing as well, a fellow named Bill Fruhan. And I think they're going to do a great job with that franchise. And really their focus in the near term is on stabilizing the U.S. commercial organization and optimizing the U.S. commercial organization.

I want to be clear with kind of our perceptions of Cynosure post the deal, absolutely nothing has changed about the tailwinds that are benefiting that aesthetics market, the medium and long-term growth rates. Absolutely nothing has changed about our perceptions of Cynosure's ability to play a leadership role in that market. As evidence of that, the international business did well in the quarter, some of the franchises did well, the skin franchise, for example, consumable sales ticked up nicely as we would expect. But we have seen some challenges in the U.S. sales force, and that is sales force attrition that was primarily related to, of course, the rumor that Cynosure was going to be sold and then the actual sale to us. So we had some sales force attrition, most of it occurred in the March quarter, some of that continued to a lesser extent in the June quarter. So the guide -- the change in the guidance was really to allow for some of that disruption in the sales force. And also to at least allow for the possibility that as we get in and begin to change things that, that would have a near-term effect on sales.

So we did lower our guidance for our fiscal fourth quarter, which is the September year-end, and obviously that created a bit of controversy in the stock.

Now having said that, I think what's important to realize is that we do believe that the issues at Cynosure are very well identified and characterized at this stage. We think they are infinitely fixable. And in fact, as we move into our fiscal 2018 year, which starts in October, there's a lot of stuff working in our favor. The December quarter, as you know, is typically seasonally strong for aesthetics. There are 2 new product launches that Cynosure is planning around that time. One is a new indication for what's called submental fat, so this would be chin fat, where we think we have some nice competitive advantages there. That's in with the FDA. They're also launching a new platform, a radio frequency platform, around that time frame as well, either by the end of the calendar year or maybe in the first quarter of the next calendar year.

In addition, by that point, the reps who we have rehired, over time, will have had about 6 months or so to be in the Hologic system, get trained and be up to speed.



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So we think as we move into 2018, that we've got some nice growth to look forward to from Cynosure. So things should improve as we move into our next fiscal year.

Mark Anthony Massaro - *Canaccord Genuity Limited, Research Division - Senior Analyst*

Great. And maybe just a clarifying comment. I know there are -- you hinted to the initial disruption around sales force departures right around the time that the Hologic-Cynosure rumor surfaced, and then there was kind of a second wave in the prior quarter. Can you maybe just directionally share with us if the magnitude of the departures were of a similar level the first go-round versus what we've seen in the last 3 months?

Michael J. Watts - *Hologic, Inc. - VP of IR & Corporate Communications*

Yes. I mean, the majority of them were in the first go-round. Probably don't want to get too much into the specifics for competitive reasons, but certainly, enough attrition in the market -- in the field force to make a difference in the marketplace. I mean, this is a business where reps calling on doctors and knocking on doors makes a difference. And when those positions are vacant, you see the effect on the revenue.

Mark Anthony Massaro - *Canaccord Genuity Limited, Research Division - Senior Analyst*

Okay. And you also indicated on the call that part of the guide down was driven by summer seasonality, right?

Michael J. Watts - *Hologic, Inc. - VP of IR & Corporate Communications*

Right, of course. The quarter that ends in September included July and August. Those are seasonally a little bit weaker for the aesthetics industry, probably even more so for us this time around because the European business has continued to do well and therefore, makes up a bigger portion of sales. So clearly, August in Europe is not a terribly busy time for anything except holidays, so we try to factor that in as well.

Mark Anthony Massaro - *Canaccord Genuity Limited, Research Division - Senior Analyst*

Got it. So is there anything you're seeing competitively in the marketplace that might have changed in the last couple of quarters relative to, say, Zeltiq and other, whether it's commercial marketing initiatives that maybe Zeltiq has done that has changed how you guys think about the aesthetics market?

Michael J. Watts - *Hologic, Inc. - VP of IR & Corporate Communications*

Yes. So obviously, Zeltiq has a new owner. They were acquired by Allergan. It's a company that we know and have a lot of respect for. I think a big, I don't know if it's a change, but certainly the magnitude of some of the things they're doing from a direct-to-consumer advertising standpoint is probably one thing I would highlight. Maybe many of us in the room have seen ads for their body sculpting system. Now -- and I think they probably capitalized a bit on the disruption that has occurred at Cynosure in recent quarters. Now having said that, there are a lot of things underway that we think will put us more on equal footing and get us back to our rightful position in the marketplace. I did mention some new indications for SculpSure, which is our noninvasive body contouring product. Some of them have already been received, so we now have a labeled approval to use the product on the back and on the thighs in addition to the flanks and the abdomen. And as I mentioned, we have filed for an approval for what's known as a submental indication, where we think we're going to have some nice advantages and be comparable to the areas that can be treated with the competing products. So as that get approved -- if that gets approved later this year, we think that's going to help. In addition, we are just now getting our own DTC program off the ground as well. We think we can be fairly efficient and targeted with that, and I think that will help support demand in the marketplace as well.



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Mark Anthony Massaro - *Canaccord Genuity Limited, Research Division - Senior Analyst*

That's great. I know in the past you've used celebrity spokespersons in your DTC, going back to Sheryl Crow a few years ago. Is there potentially like a celebrity that you think would be...

Michael J. Watts - *Hologic, Inc. - VP of IR & Corporate Communications*

Mark Massaro.

Mark Anthony Massaro - *Canaccord Genuity Limited, Research Division - Senior Analyst*

I mean, I guess...

Michael J. Watts - *Hologic, Inc. - VP of IR & Corporate Communications*

Celebrity body sculpting.

Mark Anthony Massaro - *Canaccord Genuity Limited, Research Division - Senior Analyst*

Maybe a little under here. But should we be thinking along those lines? Or are you thinking more traditional, any color on your DTC initiatives.

Michael J. Watts - *Hologic, Inc. - VP of IR & Corporate Communications*

Yes. So I think that the -- this is an area where Cynosure had not had a lot of capability in the past. They were beginning to dip their toe into these DTC markets that hadn't done it at any kind of scale. Now if you think back to what we have accomplished in our Breast business, that's where Sheryl Crow is used. But we've also done a lot of online targeted DTC marketing to help drive patients to centers that have a Genius 3D Mammography. And that has helped grow the business, and it's also helped grow the customer base for those mammography centers. And I think it's some of those same principles that we would intend to apply to Cynosure DTC, so targeted, online-based, work with the customer to help build their businesses.

Mark Anthony Massaro - *Canaccord Genuity Limited, Research Division - Senior Analyst*

Got you. Can you share -- provide a little more color on the radio frequency program? Are there new areas, new indications? Or should we think of it more as a new technology, similar indications?

Michael J. Watts - *Hologic, Inc. - VP of IR & Corporate Communications*

Sure. So this is a platform that before we acquired Cynosure, they had talked about as being in the pipeline. They do have a radio frequency product or an RF product today that's called Pellevé. It is typically used for aesthetic applications. So the new RF platform, which we have filed domestically for would be a replacement for Pellevé initially. And think of it as a new platform, and over time, we would look for it to play a role in at least 3 different areas. First, initially, would be aesthetic procedures, so this would be wrinkle removal, moles, skin tags, these kind of things. Second and over time would be some women's health applications that would be complementary to our MonaLisa Touch product. And then third and furthest down the road would be some general surgical applications as well. So we think this is a platform that over time will be a nice base [for which us] to grow in some different areas.



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Mark Anthony Massaro - *Canaccord Genuity Limited, Research Division - Senior Analyst*

Perfect. I will open it up to the audience, if there are any questions particularly related to the aesthetics business. All right. I'll come back to the audience later. So I want to move on to Diagnostics. Your molecular diagnostics business grew 20% internationally and high single digits in the U.S. So that was a very strong performance. I know in the call you talked a little bit about cross-selling and driving utilization. Was wondering if you could give us maybe an update on Panther utilization. Can you share with us what you're seeing driving the growth in the U.S., and at a high level, how should we be thinking about the growth profile for molecular diagnostics going forward?

Michael J. Watts - *Hologic, Inc. - VP of IR & Corporate Communications*

Sure. Let me try to get all those questions sort of in order. If you're not that familiar with the company, our Diagnostics business is really a razor-razor blade model. So we will typically place a Panther system, the razor, with a lab customer, and oftentimes, it will do -- be on the reagent rental model. So they won't actually pay anything for it upfront, but then we recoup the cost of that instrument through assay sales over time. So when Mark talks about Panther utilization, what he's talking about is the pull-through on those systems, so the dollar amount of the assays that are run over some period of time. And we try to update that not every quarter but at least annually. So at the end of our last fiscal year, I think we said that utilization was about \$190,000 for each Panther instrument on an annual basis. So that's pretty unheard of in the diagnostics industry, and that number has been growing since that point. Probably don't want to give you a spot estimate, but that number has been growing since that point as our sales force does a much better job of helping the customer get their customer to test the guidelines. So despite the volume and testing that's done today for things like chlamydia, gonorrhea, most people who are sexually active or not, treat it according to the guidelines or test it according to the guidelines of the CDC and others. So it's working with our customers to help build their business in that way. And that's been quite successful from a market expansion perspective. Our market shares are already very high in Diagnostics, so there's probably not a ton of headroom to grow those further, but we can certainly work with customers to expand the overall market. Internationally, we touched on that a little bit before. That's more Panther placements that's driving utilization on those and adding the menu, and that's what's kind of netted out to that very healthy growth OUS off a small base, admittedly. Our OUS molecular business is probably a bit more than \$20 million, something like that, but growing very nicely. And I think that going forward, certainly, molecular diagnostics can and should be accretive to overall company growth rates. You're never going to be able to stay at that 20%, 30% level forever. Internationally, that will kind of come back to Earth a little bit with the law of big numbers, but certainly, it'll be accretive to growth going forward.

Mark Anthony Massaro - *Canaccord Genuity Limited, Research Division - Senior Analyst*

And then you've got Panther Fusion, which is the sidecar with PCR assays. I know last week in San Diego, you gave me a good view of the Panther. Can you just speak through what the new assay content might mean to reagent utilization and placements? And I'd be curious what inning you think you guys are in placing Panthers both U.S. and OUS?

Michael J. Watts - *Hologic, Inc. - VP of IR & Corporate Communications*

Sure. So let me do the baseball thing first. I think in the U.S., we are probably -- we placed a lot of Panthers. I mean, we probably have around 1,200 Panthers placed now globally. That probably splits something like 60-40, U.S. versus OUS. So we've come a long way in the U.S., still some headroom. But to use a baseball analogy, if it started raining, it would probably be a complete game at this point. But what's interesting about the U.S. opportunity is the utilization on those Panthers is still very low. Meaning if you just take the number of assays that are being run through on a daily basis, it's only about 1/3 or so of the overall capacity of the platform. So lots of opportunity to add additional menu like the viral load assays to the women's health menu that's on there today. OUS is greenfield. OUS, it's very early in the game and we look forward to a lot of continued Panther growth for a long time. In terms of the Fusion, we'd encourage you to look at the Fusion from a long-term perspective. As you saw last week at AACC, I mean, Fusion is a sidecar that attaches on to an existing Panther instrument in the field. It's kind of a 1-day upgrade in the field, and it does 2 very important things for us. One is it gives us the ability to run PCR-based test as opposed to TMA-based test onboard the system, so it's a different amplification technology that each of which has strengths and weaknesses. So as we're looking at developing a new test for a particular target, if it makes the most sense on PCR, we can do that. In our R&D labs, if it makes the most sense on TMA, we can do that as well. In addition, what Fusion offers us is the ability to do different kinds of tests, so the Panther side of the instrument is really good at doing super high volume tests that uses



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liquid reagents. The Fusion side has a different assay format. It's a little cartridge, about as big as your finger, that has reagents that are stable onboard for a much longer period of time, so much more conducive for tests that maybe don't have the volume of the chlamydia, gonorrhea but do still have higher price points. So the way to think about Fusion is to give customers the ability over time to consolidate the vast majority of their testing on one system, that being the Panther Fusion. So it enables us to knock out competitive boxes and they can just centralize their testing on Fusion. Now over time, the menu will expand. The first menu that we are developing, as you learned last week, is really the respiratory test. So that is 3 separate respiratory assays for things like flu, parainfluenza, rhino, things like that between these 3 tests. Those are not huge markets, and they're seasonal and largely based on flu testing. But over time, we think that Panther will really become the center of -- Panther Fusion will become the center of the clinical lab.

Mark Anthony Massaro - *Canaccord Genuity Limited, Research Division - Senior Analyst*

Got it. All right. So moving to Breast Health. We're more than halfway through here. So you grew 13% currency-neutral OUS. I think you declined about 2% in the U.S. Did you see anything one-time in nature last quarter? And I guess I'm just trying to figure out what kind of pathway for growth you have internationally. If you could, give us a sense for whether more is new to Hologic business or upgrades just 3D from 2D.

Michael J. Watts - *Hologic, Inc. - VP of IR & Corporate Communications*

Yes. So your numbers are right. We were down just fractionally in the U.S. in Breast Health in the quarter. We do not think that is a lasting state, to be 100% clear about that. We are in the process of launching several new products in Breast Health. One of them is already on the market, that's our Affirm Prone Biopsy system. That has been building nicely over the course of this year. It should be bigger still in 2018. Around the end of the year, we will also launch an entirely new and, we think, revolutionary closed-loop biopsy system called Brevera, which will be additive to next year's growth. And in our most recent call last week, we talked for the first time about 2 new -- 2 completely new mammography systems that help us better segment the market. One is a high-end system that provides a new detector, better detection capabilities, better 2D reconstruction, more comfort features for the patient, a new breast stabilization system, breast density software, so really the high-end system to extend our leadership position in that portion of the market. Then we also talked about kind of a defeatured 3D as well for that lower-volume segment of the market that perhaps doesn't need all the bells and whistles that we have on our current platforms, touchscreens and power controls and height adjustments and things like that. So we think with that refreshed product portfolio -- and I'll tell you, our Breast Health business deserves a lot of credit for developing and nurturing a pipeline that is just now coming to fruition, we do think the Breast business can improve from the level that you saw in the third quarter and continue to be not a -- it's not a double-digit grower, to be clear, but we think it can be a low single-digit grower going forward.

Mark Anthony Massaro - *Canaccord Genuity Limited, Research Division - Senior Analyst*

Got you. I know -- if I have this right, the lower-volume new product, I think, is 3D performance. The higher one is 3D Dimensions. Should we think of 3D Dimensions as a potential replacement of 3D tomo? Is that the natural progression? I guess I'm trying to understand if this is a replacement for 3D tomo both OUS and U.S.

Michael J. Watts - *Hologic, Inc. - VP of IR & Corporate Communications*

Well, it's still 3D tomo, to be clear. It's just better 3D tomosynthesis. So you get the same benefits that you're seeing today with our existing product, so much better cancer detection, fewer recalls, we're the only company with a specific claim to be better for women with dense breast. As you know, that's about roughly half the population, really important because about, I think, 35 states have enacted laws now where women have to be notified of their density -- breast density status. So it is an upgrade over what we are selling today, which is already the best in the market. And we think that for those customers who are really early adopters who might have gotten their original 3D system in the 2011, 2012 time frame and are just now beginning to think about their next system to stay on the cutting edge, that they would take look at this.



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Mark Anthony Massaro - *Canaccord Genuity Limited, Research Division - Senior Analyst*

Got it. We have 2 minutes left, and I want to focus on potential strategic opportunities. Obviously, you divested the blood screening business. You made a relatively a large deal in Cynosure. How should we be thinking about maybe some of the pipeline of deals you've looked at over the last year or so? And whether or not the recent, what I would call, blip at least on Cyno, does that impact some of the strategic rationale you make going forward?

Michael J. Watts - *Hologic, Inc. - VP of IR & Corporate Communications*

Yes. So we're a company that's blessed with really strong free cash flow, well in excess of \$500 million of free cash, so that gives us quite a bit of flexibility. The first priority for that cash in the near term, as you know, we've got some convertible debt that's callable in December and March of next year that we'd like off of our balance sheet. That's a face value of about \$530 million, I think. Cost us much more than that to take it out. So I think that's the first priority. But at the same time, we do continue to look for small tuck-in acquisitions in all of our businesses. We recently acquired, for example, the German distributor of our Breast Health products, I think that was about a \$20 million transaction. And certainly, we look for those kinds of opportunities as we go forward, we think we have more than enough capacity to do small tuck-ins. Certainly, nothing like the size of Cynosure, but rather opportunities to put in other products in our sales reps' bags to leverage an existing channel, those kinds of things.

Mark Anthony Massaro - *Canaccord Genuity Limited, Research Division - Senior Analyst*

Wonderful. I'm afraid we're out of time. But Mike, Justin, thank you very much for coming back.

Michael J. Watts - *Hologic, Inc. - VP of IR & Corporate Communications*

Thanks, Mark.

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