Company: **Eurofins Scientific**

Event: **Eurofins 2018 Full-Year Results Conference Call Transcript**

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Operator:

Good day and welcome to the Eurofins Scientific 2018 Annual Results Conference Call. Today's conference is being recorded. At this time, I would like to turn the conference over to Gilles Martin, Chief Executive Officer. Please go ahead, Sir.

Gilles Martin:

Thank you very much. Good day everybody and thank you for joining our 2018 conference call. I will give a short introduction and Laurent Lebras, our CFO, will add a couple of words on finance. We'll keep that short to leave enough time for questions.

So 2018, 2018 is our third year of our five-year programme to build a global infrastructure and to build the leading laboratory group in our key markets, which are food testing, environmental testing and testing for the pharma industry.

In 2018, we have made massive progress towards this objective. Actually, we grew much faster than we expected due to the opportunity to buy some leading companies that we didn't expect to be for sale. Among others, we bought the food testing activities of LabCorp which had inherited them from buying Covance after they decided that they wouldn't be able to basically build a global leader in that market and we were actually winning a lot of clients from that company as we saw in the rest of 2018. And also we were able to buy TestAmerica, the leading environmental testing laboratory group in North America.

Also, in 2018 we expanded the different business lines. I assume you have access to our slide show which is online. I am looking at page eight of our slide show. We expanded our leadership in Europe in Genomics services, including a lot of next generation genomics testing and genetic sequencing. We expanded our leadership position in agro science testing and we also added activities to help seed companies registering new seeds. We expanded

our leadership in discovery pharmacology. We built a number one global position in cosmetics testing. We haven't talked a lot about cosmetics testing over the years, but cosmetics also can have an impact on health. Anything we put on our skin, of course can end up in our body or part of it. And we have been in that activity for a while but we added a few more companies, especially one in North America, which made us a global leader.

So we have done a lot to build the Group and the reason we are doing that, we can find them on page nine again. We think we are in extremely attractive markets which have strong potential for secular growth, due to our desire to live healthy and be protected from risk, due to innovation. For example bio-pharmaceutical products, antibodies, vaccines etc., have much more biological risk than small molecules used traditionally in pharma and therefore the testing requirements are much higher for registration than they can be for traditional pharmaceutical products. So innovation is adding to the growth of our market as well as outsourcing of our client's internal laboratories. That happened in Japan last year with Astellas outsourcing their internal laboratory to us.

So we are in extremely good markets and if you turn to slide 10, in those markets, scale matters. So if we are big in those markets, and if we then build a structure that makes us very efficient, then that creates lasting high barrier to entry and very high profitability, as we can see in many of the markets where we have done that already. So in 2018 we have just been continuing that programme. In fact, we were a little bit faster than expected in terms of deploying our laboratory network; some of the buildings we are working on we're moving faster towards completion. So we will be on plan by 2020 to finish our network which includes very large central laboratories, the hubs of our model, and many start-ups, which are local laboratories, where required, where we need to do the testing close to our clients for the simple tests. And then those local laboratories collect samples, carry out the simple tests locally and send the complex and rare tests to our large platforms. So we made massive progress to do that, both by building the platforms and sometimes also spending money to consolidate redundant facilities – we did a lot of that in the UK for example – so that we only

have as many sites as we need and no more than exactly what we need. So this is a programme that we should finalize throughout our network by 2020 as planned.

On page 12, you can see the change of the company; we achieved a lot in the last six years. We were only €1 billion company in 2012 present in 34 countries. At the end of last year, we were present in 47 countries with pro forma more than €4.2 billion revenues basically multiplying by four and with many more global leadership positions. So we have been moving very fast, both in terms of acquisitions and internal investments, to really take advantage of the potential of our market. It is a bit of a land grab in a way, because those positions, once we have them, is going to very, very difficult for anybody to reach, in those markets, the economies and scale that we are generating.

So you can see some of that again on slide 15 that you have seen. On slide 16 you see that we have now reached a global leadership position in activities that represent 70% of our revenues, so that is quite high, and we have achieved that in record time. You will note that we are not number one in clinical diagnostics and we don't want to be. Our interest in clinical diagnostics is more the esoteric advanced clinical diagnostic testing, the new methods based on genetics, molecular testing, genomic testing. And in some of those niches, we are doing quite well. We have for example the best non-invasive, prenatal testing portfolio that there is. Unfortunately, the reimbursement of those tests is very slow. France is just going to start reimbursement this year for non-invasive prenatal testing. Germany is planning to do it in 2020, so it hasn't been as fast as we hoped, but it is still on the horizon. And we see also in our portfolio quite some opportunities for very interesting things that could get reimbursement this year or next year.

But however, we had the disappointment in clinical diagnostic in 2018, especially unexpectedly in the last quarter with the French single payer, the *Caisse Primaire d'Assurance Maladie,* which cut massively reimbursement in Q4, in the last part of Q4, to stay within its national spending. And they overestimated volume growth, so they overcut in a way. And therefore the reimbursement in France dropped 1% in 2018 as a whole while in the year

before, they grew 1%. And in 2019, they have a planned growth of 1.4% and that was all concentrated in Q4, which gives us unfortunately a hit. And this combined with our company Boston Heart Diagnostics in North America, which is facing very strong reimbursement headwinds for a variety of reasons that I can comment on later if necessary.

So those two things had an impact on our Q4 organic growth and our annual organic growth. It is about €15 million revenues that we are missing towards our 5% objective. We believe that impact to be largely one-off. The rest of our activities have an organic growth of more than 6% so everything is very dynamic and the outlook is quite good.

I will give the microphone to Laurent who will comment on slide 21 with our results for 2018 for financial terms.

Laurent Lebras:

Good afternoon everybody. Yes, we had a very solid 2018 result, like Gilles mentioned, on the top-line growth but also on the profitability. Before going into the details I would like to mention that this was a strong year for investment for us with €1.2 billion spent on acquisition, €360 million spent on CAPEX and €68 million on SDIs due mostly to start-up costs and restructuring costs. It is to be noted that our operating cash flow was quite strong at €540 million, a plus 34% evolution versus prior year, which enabled us to self-finance our CAPEX and SDI and still leave €120 million of free cash flow to equity after service of the debt.

In terms of profitability, our EBITDA recorded a growth of plus 27% in line with our growth of revenue and our adjusted EBITDA posted an improvement of 30 basis points at €720 million. It is to be noted that these two improvements were, despite dilution caused by our start-ups, and the clinical impacts that Gilles mentioned.

If I focus a bit more on the mature scope, which now represents about 93% of the revenues of the group, we can see that the profitability - adjusted EBITDA, of the scope was 20.5%, in line with profitability last year. But when we break it down by sub scope, that is to say for the

companies which were present in that scope before 2017, we note a significant improvement because this scope posted a 21.2% profitability, an improvement of 50 basis points year on year. Whereas the acquisitions from 2017 posted an adjusted EBITDA of 19.5% which is still dilutive compared to the total profitability of the mature scope, but which is a serious improvement of 160 basis points versus last year, mostly due to the accretion brought by EAG. And when we talk about 2018 acquisitions, they were still dilutive as a whole, as they posted a profitability of 16.5%.

If you focus a bit on our leverage, our leverage at the end of the year was 3.38x on a pro forma basis which is below our 3.5x self-imposed limit. And we have communicated clearly on strong objectives to deleveraging in the coming years, starting in 2019. We are posting an objective of generating €350 million of free cash flow for 2019, which is going to come thanks to self-imposed envelopes of €300 million each on M&A and CAPEX for 2019, but also for 2020. So overall this was a strong year in line with our objectives and our effort to build a unique platform.

Gilles Martin:

Okay, yes, so this is a short introduction on everything that happened last year. In the slide show, we added slides on other aspects regarding governance, etc. We listened to comments from investors. We had quite a few questions in the last few months, following a lot of short selling activity. We also did our best in our 2018 (annual report) to disclose as much as possible and take into account our investors' suggestions on all governance aspects. And if you read our annual report– and the slide show in addition to the press release, you will see a lot of improvement there. But this is not for us to talk, you've had a lot to read, so I would like to now turn the microphone over to you for questions and answers.

Operator:

If you would like to ask a question, please signal by pressing star one on your telephone keypad. If you are using a speakerphone, please make sure your mute function is turned off

to allow your signal to reach our equipment. Again, press star one to ask a question. We will now take the first question from Will Kirkness from Jefferies. Please go ahead.

Will Kirkness:

Thanks, hi there. I have got three questions if that's alright. Firstly, just on that French Diagnostics cut, you said it came in the backend of the 4th quarter, and then thinking about the guidance around organic growth. Will that not be an impact for the remaining – well, I guess three quarters at least of this year, until it annualises out?

Second question, perhaps for Laurent, around the free cash flow. The guidance. If I look at the EBITDA going up by 130, CAPEX coming down about 60, maybe SDIs coming down as well, so I get the free cash flow number more than the guidance for 2019. I just wonder whether there is something going against you the other away, perhaps around working capital?

And then my last question is on the margin guidance. It looks like you're effectively guiding for – your EBITDA margin is 18.9%, which is sort of down year on year. I wonder if you could talk about the moving parts into fiscal 2019. I know sometimes you are just – you are using round numbers here, so maybe I am being too precise on the guidance. But if you can just split out maybe the underlying versus the M&A impact from a margin perspective, that will be great.

Gilles Martin:

Yeah, the French Clinical Diagnostics, it is a single payer market and there are normally two revisions, one in April and sometime one at the end of the year. And it is based on the negotiation between all market participants and the state, the state health insurance. It is really exactly hard to predict on a quarter-by-quarter basis, but yes, there is a small impact of last year's cut, although the cut of Q4 was a one-off cut. So we are starting this year with the result of the prices set in April of 2018 if I understand correctly, there will be another adjustment in April 2019 and they try to adjust at the end of the year to stay within their budget, which as I understand, they are planning for a growth of the total spend by 1.4% in

2019. But that's, of course, based on volume growth adjustments because the state sets the budget and they don't exactly know the volume ahead of time, so they try to adjust. And then they will do another agreement for three years with the suppliers for the next year three-year period, presumably by the end of 2019. The good news in France is there will be reimbursements of non-invasive prenatal testing for at-risk patients in 2019.

On the free cash flow, yes, I will let Laurent answer. On the margin, we do have of course a pro forma effect because we have lower – the acquisitions of 2018, especially TestAmerica have lower profitability. Laurent.

Laurent Lebras:

Yeah, on the free cash flow, I mean we didn't factor any adverse effect. I mean, you are right that we have an increase in our EBITDA and we have also reduction in our CAPEX. The rest is mostly the variation of the net working capital due to the growth of the Group, but we intend to keep it under 5% as usual, so we don't have any other elements in that guidance, or objective.

Will Kirkness:

Okay, thanks very much.

Laurent Lebras:

And on the margin objective for 2019, which seems a bit too low, it is mostly the effect of a rounded figure; I mean, we tried to give rounded figures as objectives. And also we have to take into account that the 2018 acquisitions were quite dilutive so we should not underestimate the time it takes to put them back at the level of the profitability of the Group, especially for TestAmerica, which we acquired only at the last months of last year, so it does not show so much in the accounts of 2018, but will show fully in 2019.

Will Kirkness:

Okay, that's great, thanks.

Operator:

We will now take the next question from Tom Burlton from Berenberg. Please go ahead.

Tom Burlton:

Hi, thank you. I have got a couple of questions if that's okay. So the first I have a follow up on Will's question regarding the free cash flow. The target you have given €350 million today is very helpful, I think, particularly combined with the CAPEX guidance you have given. And I appreciate maybe a bit early for this, but looking out into 2020, obviously CAPEX as percentage of sales will be falling further, profitability should be improving. Do you have a sense of what sort of free cash flow range you'd be hoping for in 2020? And if not, then when you would be prepared to give guidance on that. I will go with that one first and then I will come back for the second, if that's okay.

Gilles Martin:

Yeah, we haven't given a detailed guidance of 2020, we prefer to do that early 2020 when we know exactly what we have acquired, if anything in 2019 and what is likely to happen in 2020. But obviously if our EBITDA increases as planned and our CAPEX as percent of revenue would fall then close to 6%, that should have a positive impact on free cash flow in 2020 obviously. But frankly, all those results by 2020 stay pretty bad compared to what our labs are really earning, so there is still a huge dilution effect from all the things we are working on. We have so many – we have hundreds of programmes all over the Group to open labs, to develop new IT solutions, to deploy them.

When we deploy an IT solution, like we do in Biopharma at the moment, the productivity for the first three to six months is much lower than with the previous older system. We get the benefits of a new IT solution typically 12 months after deployment, so all those things, we have got lots and lots of things which are hurting our profitability and cash flow at the moment. And I run the group for really long-term benefits. We will see it trickling little by little but beyond 2020, I think we should continue to see significant improvements.

Tom Burlton:

Okay, perfect, thank you. And then just two more. The first one actually links to the comment you just made around the long-term view. I just wonder if you can clarify the comment in the statement around no plans to issue equity in the short term. Clearly, you obviously have a much longer-term horizon in the market and it seems, if I am reading it correctly, you are self-funded for your 2020 objectives. So can you just confirm that that is the case and we shouldn't be expecting any equity issuance during that period at least?

Gilles Martin:

Well, it makes no sense to issue equity, especially at the current share price. If we look at the value of our assets – and we could sell many assets, we have plenty of independent assets that we could sell – it would really make no financial sense whatsoever to issue equity at the current value. We don't need it. We are well funded. Our spending is discretionary, so there is no need to do that and we even have ensured our liquidity, we have lines of credit etc., so we are well sorted out in terms of that. Of course, all the time we review the different sources of funding and instruments. That's why last year we issued a Schuldschein at a record low interest rate and we are also using this commercial paper, things to reduce our cost of funding. So we are not a very sophisticated company, but we are getting better at managing our funding sources and managing the cost of our funding and optimising our balance sheet. We still had too much cash on average last year, but now that we have really clarified a commitment to strictly limit M&A and limit CAPEX, our treasurer will be even better able to optimise our cash balances. So we are trying to improve on those matters. As in many matters, we are trying to grow into the company size that we have now.

Tom Burlton:

Okay, perfect, thank you. And then just the last one which links into your comment you just made then actually regarding the future of the Clinical Diagnostics business or bits of that business. And there were comments on Bloomberg, or headlines mentioning that we may consider asset disposals. Under what circumstances would you consider disposals of parts of that Clinical Diagnostics business? It seems to be the one weak spot across your divisions

and selling it would seem to me it would get rid of some of the issues, such as the dilution of organic growth and it would completely redress the balance sheet in a more positive favour I guess. And just looking at the headline numbers, I mean French Clinical Diagnostics, correct me if I am wrong, is probably a €400 million revenue business. And if you were to sell that, at two times sales, you could conceivably raise in the order of €800 million, which I would have thought you could perhaps deploy at higher rates of return elsewhere. But maybe I am way out with those numbers. What would make you consider disposing parts of that business at least?

Gilles Martin:

Thank you very much. Well, that's a good observation. We have a number of assets which have high value. If I look at our Genomics business, €100 million revenues and there is one company called IDT that was sold to Danaher last year for something like ten times revenues which is very comparable to what we do. The Clinical in France, we have a clinical diagnostic testing, we have specialty testing which we like and where we can bring innovation to the market and we also have some local routine testing labs, couple of hundred million plus of that. Those things go for three or four times revenues when they are sold. So I am not saying that we will sell assets, I don't know where this rumour on Bloomberg comes from, we have made no decisions to sell anything. But this is something that indeed we mentioned in the press release that is making us very comfortable with our current leverage because we have plenty of assets that could be considered noncore and wouldn't prevent us from achieving our plans, that have a high value and that we could sell if we wanted.

But you know you don't build a group by buying and selling, of course that's what our shareholders do and some of them would like us to do that. I am not saying we will never do that. We will consider things at any moment, but it is true, you know we don't issue shares, we don't intend to issue shares, so our share price is not of immediate concern for us. But on the other hand we feel for our shareholders and the volatility and so on, and if the current leverage, which we are very comfortable with, is a cause for concern for some, we take that into account. And if there are excesses, we will consider what is the right course of action.

And we have all the peripheral assets which might be also highly valuable, outside of Clinical Diagnostics, we could look at.

You know buying and selling assets is not a thing that a company should normally do, but it is an option if we wanted to do that. I think, your analysis on Clinical Diagnostic is correct. The routine part of it could be worth quite a few hundred millions and is really hitting us in terms of market perception. While there are plenty of options – we could also distribute to our shareholders that division and there might be some people who like it and understand it very well and who would want to own that while others wouldn't. So we have plenty of strategic options we could follow, depending on how market goes.

Tom Burlton:

Okay, perfect, just one last quick one, if I could, relating to the redemption of the hybrid 2020 instrument. Are you able to clarify exactly what you have access to in terms of bank facilities when you are considering about redeeming that hybrid instrument?

Gilles Martin:

Well, we have obviously enough. We are not publishing that because it varies, of course month by month, we get more and more lines and we get extended lines and so on, so it would be really permanent disclosure. But obviously we wouldn't have written that if we didn't have enough to buy back our hybrid. Now, of course we will look at a number of options and we could issue a new hybrid also, but what we wanted to say is we don't have to because there are so many strange rumours that are spread by some people who obviously have some interest of doing it. I even heard some people claiming that our cash on our balance sheet didn't exist, so all kinds of nonsense.

Of course, our auditors are checking that and asking the banks for reconciliation when the auditor comes. So we said this because we had to dispel any worries about our funding but we will of course review that type of funding when times come, looking at all the options we should follow at that time. And we will of course favour long-term funding so things that are

long term so we can spread our obligations to reimburse over the long period, is what we prefer to do.

Tom Burlton:

Perfect, thank you very much.

Operator:

We will now take the next question from Edward Stanley from Morgan Stanley. Please go ahead.

Edward Stanley:

Yes, thank you for taking my question. I have got a couple as well please. On the bank borrowing, it shows that you have increased bilateral credit lines by €490 million at the year-end; I wonder what is behind that. Secondly, you seem to have opened 15 new labs and yet in your CAPEX bridge, it shows that the lab equipment CAPEX looks like it has doubled year on year, with only 15 new labs, but there is probably something else going on with the existing labs. And thirdly, I am interested in Boston Heart because the growth has not been as good there as you might have expected. How much goodwill is there on that asset and why wouldn't it need impairments if the growth is below what you might have expected?

Gilles Martin:

Thank you. So I will answer on the last couple of questions and I will let Laurent answer on the bank lines. We put CAPEX not only in our new start-ups, we also added 64,000 square meters of additional labs. We have organic investments in our labs, in our large platforms which are not only the start-ups, and we do indeed gear up for growth in those labs. We do also invest in our IT infrastructure throughout our Group.

On Boston Heart, well, Boston Heart has unfortunately not performed as we expected. The company is smaller now. It has suffered because it is focused on more prevention testing

which is not enjoying very good reimbursement. And we are looking for synergies with the rest of our clinical activities in the US. And obviously this is one business we speak about it as an isolated business, but it is part of our overall clinical activity in the US and therefore the goodwill is considered as a whole so that's what we can say with that.

Overall, actually, if you look at the growth of our clinical business, excluding France and excluding Boston Heart, if you do the maths, you will see we have had good organic growth on the rest of that business. So some of our activities there are doing quite well. And we are quite optimistic that some of our assays that we are working on, or that we are working with other people in co-development will get reimbursements which could also bring some good surprises. But let's wait and see, so far we have had quite a disappointment with this Boston Heart investment. Others might make us more happy.

Laurent Lebras:

Yeah, and coming back to your first question, the bank borrowings have increased, indeed, at the end of 2018 because of comparison versus 2017 is not very comparable. At the end of 2017, we raised fresh equity and a hybrid towards the end of the year, so we didn't need to draw so much on our credit lines. And at the end of 2018, we drew a bit more on this credit line but it is to be noted that some of these amounts have been reimbursement already since the beginning of the year.

Edward Stanley:

Thank you.

Gilles Martin:

We had too much cash at the end of last year, I found out. I was not very pleased with our treasurer actually because we had about €500 million – we shouldn't have ended the year with €500 million cash.

Operator:

Once again, if you would like to ask a question, please press star one. We will now take the next question from Saul Casadio from M&G. Please go ahead.

Saul Casadio:

Hi, thanks for taking my questions. I have a couple, maybe a little bit more if I can. I will ask them one at a time, if that's okay. The first one is really easy. In terms of EBITDA, could you provide the EBITDA pro forma, taking into account the impact of acquisitions?

Gilles Martin:

Can you ask your other questions please, so we will look exactly for the number in the meantime?

Saul Casadio:

Okay, the other question is on the hybrid, this has been touched on in previous questions. When you say that you are funded for a redemption, are you effectively committing to redeem the 7% coupon hybrid at the first call?

Gilles Martin:

I can't answer this question. Of course, we don't commit to anything, I mean, we cannot like give a free lunch to the hybrid investors. We will, of course, review that when the time comes. We are just saying that should we decide to do that, which most people would think is quite likely, we are funded to do it. It doesn't prevent us from issuing a bond or a new hybrid, of course.

Saul Casadio:

What do you mean you are funded, do you have lines in place, some sort of backstop lines specifically negotiated for refinancing the hybrid? What do you mean exactly you have financing in line?

Gilles Martin:

Well, we have made a number of objectives and hypothesis for the development of the business in 2019 and 2020. And based on those hypothesis and the cash flow generated and our existing bank lines and facilities, we would have the cash at that time to pay it back, that's what it means.

Saul Casadio:

Okay, I understand. I can continue asking questions if that's okay, if you want to take time to answer the first one?

Laurent Lebras:

In terms of the first one, it is in the note 3.19 in our annual report. I mean, if you take our EBITDA of €651 million, you have to add €62 million so that would give you a pro-forma EBITDA published of €713 million.

Saul Casadio:

But I understand that's pro-forma for, let's say, nonrecurring items, it is not a pro-forma for the full year impact of acquisitions. I just want to give [inaudible] –

Laurent Lebras:

This is a full year pro forma.

Gilles Martin:

It is not adjusted.

Saul Casadio:

So the €719 million is actually pro-forma with acquisitions?

Gilles Martin:

Okay, I will move to the next question and Laurent will check the numbers and get back to you.

Saul Casadio:

Okay, fine. And this is a question I have asked in the past but it is just to check if there is any update in the way management is thinking. It seems the new plan is basically, M&A, it is fully funded through the cash flow. What are your thoughts in terms of evolution of the capital structure? As I said, I have asked this question before; I am wondering whether there is any update on your thinking on this point.

Gilles Martin:

No, we don't plan to change anything, I mean, definitely not to issue equity, as I mentioned earlier.

Laurent Lebras:

On the EBITDA, to come back to your question, so if you take the adjusted EBITDA which we published in 2018, which is €719 million, we can project that the adjusted EBITDA pro-forma would be around €785 million.

Saul Casadio:

€785 million, okay, thanks. That's helpful. And on IFRS 16, sorry, I didn't have a chance to go through the whole annual report. Have you published somewhere the adjustments that might be impact of the IFRS 16?

Laurent Lebras:

Yes, we did, we did it in the first section of the note with regards to our leases and we have made an estimate, but you have to be careful, this is made on the situation at the end of 2018. IFRS16 becomes enforceable on the 1st of January this year and we will have to re-

estimate these based on the leases at the end of June and then at the end of December. So if you look at this note, you will find an adjustment which is the following, which is probably €481 million of net debt in addition, and €105 million of EBITDA in addition as well.

Saul Casadio:

Okay, one last if I can. Otherwise, I will go back in the queue. Just what you mentioned in your cash balance that you think that the €500 million is too high and clearly the strategy is to have M&A basically fully funded through cash flow. I would agree with that. What are your plans in terms of ending cash balance for 2019?

Gilles Martin:

I don't know, I mean, I guess we would say maybe 5% of our revenues or something like that would be a reasonable amount. We will have a little bit here and there, I mean, it is not necessarily all in the holding. All right, thank you, I think we will take other questions so everybody can ask questions and then maybe at the end, you can come back with more questions, if you don't mind.

Saul Casadio:

Okay, sure.

Operator:

We will now take the next question from Matija Gergolet from Goldman Sachs. Please go ahead.

Matija Gergolet:

Yes, hello and good morning. A few questions from my side. First question is on the separately disclosed items, just to say clarify what is your guidance there for 2019. So, as you will have fewer start-up costs, presumably there are also, say, the start-up cost separately disclosed items will be lower in 2019; if you could confirm that? And then secondly also on the separately disclosed items on your page 22, just fairly large investments in IT which I think

was €33 million last year, I think that's internal IT. What was that exactly and should we expect that to step down?

Another question, which is a little bit of follow-up to the cash management, whether it will bring it to the working capital, it seems that quite a few of the other testing companies have been very successful in the recent years in reducing working capital to sales. You have been clearly very much focused on growth but how much room do you think that you have to reduce the working capital? Is it going to be a material focus for this year or not? I mean, previously, you actually mentioned that working capital will be a bit of net absorption for this year.

And then just lastly, still on the free cash flow generation, you mentioned that €300 million is a self-imposed limit on CAPEX. I mean, this will make your lowest CAPEX to sales I think since 2011. How rigid is that limit, on the CAPEX specifically, not on M&A? Thank you very much.

Gilles Martin:

Thank you very much. Well, on the SDI, it is a little bit hard to plan because half of it is our start-up cost. And start-ups, as they ramp, in the first year we have not so much cost because we are incurring the build-out cost but we have very little staff. Then we staff the lab to get the accreditations of all the tests we are offering so the peak year of spend is probably year two. Then we start to generate revenue. Our objective is to break even in year three. Year four is sometimes still dilutive to our 15% EBIT target and we usually hit our target of close to 20% EBITDA or 15% EBIT in year four or five. So of all those start-ups we did in 2017 and 2018, they still will be ramping up in terms of cost.

It is really hard to predict the ramp-up of revenues of the startups. That's why we don't give a specific guidance for that. And in our reorganizations it also depends a bit on how fast we are rationalising the sites that we acquired. We don't rationalise everything obviously, but there is some duplication here and there and those programmes are not really exactly easy to plan on a quarter by quarter. To be conservative – we got the question today at the analysts' meeting

in Paris and we said maybe the same order of magnitude that we had in 2018 could be a number for 2019. It is not a guidance, it is a best guess, not an objective.

Working capital to sales, we think 5% is not bad. I mean, others are higher and others are better, but we are quite conservative. Others are also doing things like factoring and all kinds of practices that can reduce their working capital which are expensive, so I think 5% is a reasonable objective. We have a mix of activities and TestAmerica was not as good as the rest of our group. Some of our 2018 acquisitions are not – it will take a couple of years, it takes a lot of work. But long term, yes, I mean, we are not focusing on it as much as we should. We are growing so fast that there are many things, many low-hanging fruits that we haven't yet addressed. Purchasing, we are making progress in rolling out our global purchasing platform, but we are still only halfway in Europe so we have quite some things to do.

And on CAPEX, again, the lab investment CAPEX, we normally can time because the time between order and delivery is max three to six months. Sometimes we are not exactly sure when certain large CAPEX item will be delivered by one or two months. Building is slightly harder to time, whether there will be delays or things will be done on time, but we think €300 million is good. And this clinical diagnostic business, for example, in France, has been a problem on growth, but it requires very little CAPEX. We did quite a bit of CAPEX last year to renew the equipment park to get better terms with the different vendor, but that is behind us. Beyond that, we are not going to spend so much, so we think the €300 million is achievable. And if we had to cut, we could cut further but that would not be a good thing, I think.

Matija Gergolet:

Thank you. Sorry, just to follow up on the IT spending, the €33 million that you have there, the €30 million per annum, is that expected to come to a completion in 2019 or 2020 or that we should assume zero after 2020?

Gilles Martin:

So what is there is development of our new IT platforms and indeed, for the core of our Group, our Biopharma Product Testing division, our Food Testing division, our Environment Testing division; we think those programmes will tail off by 2020. There will be a remainder because there's always need for new functionalities, but we believe that this would be at a significantly lower level than the spend that we have incurred in 2018 and we are still incurring since a couple of years.

Matija Gergolet:

That's internal, right?

Gilles Martin:

That's internal, yeah, well we have also some licenses that we buy and whenever we can buy software, we buy it, we don't try to reinvent the wheel. CRMs or accounting systems, of course we buy. But the systems to manage our laboratories, to manage our logistics, to make sure all our labs work together, the interpretation systems, the huge databases we develop and the genomics data management; all those things we have to develop ourselves because there is nothing that works for our scale.

Matija Gergolet:

Thank you very much. Very clear.

Gilles Martin:

Thank you.

Operator:

We will now take the next question from Mr Christophe Ganet from Oddo. Please go ahead.

Christophe Ganet:

Hello, good afternoon. Christophe from Oddo. Actually maybe three questions. One on M&A; when you say you will be more selective, can you be more precise? Should we understand that you will pay less in terms of multiples of your acquisitions? Should we understand that it will be less in total amounts so in total absolute value? Or should we consider that you will be more focused on high profitability targets? That's the first question.

The second question is related to diagnostics. And if I am not wrong, you mentioned that you were about to get the reimbursement for your prenatal tests, notably I understand in France. So how much could we expect and how much does it represent in the US, just to compare the things? And maybe it should compensate for the organic growth in your biological testing in France, medical testing?.

And third question, can you come back again on what you have said on the fourth quarter, notably on again French Clinical Testing activities? I don't really understand when you say that there won't be any remaining effect on 2019 because once you have got a security social new tariff, it should be the same for the next year. So can you come back on this? And again when you mix this growth plus lower pace of growth for TestAmerica, can you elaborate on what will be the initiative that helps you to bring the organic growth to this 5%? Thanks.

Gilles Martin:

Thank you. In M&A, when we say more selective, I think the main reason is we have done the acquisitions that there were to be done. There are very few large laboratories doing food testing or pharmaceutical product testing in the world. Covance was the big one with €150 million, but what else is around: maybe SGS does €200 million of food testing, pure testing, BV €100 million, Intertek €50 million. There are a very few players that do more than €50 million in that activity. There is not so much around to buy in biopharma product testing, there are a couple of more players, who have assets of size. The scale effects are bigger actually in food and environmental testing so we don't need to buy every biopharma product testing asset that moves.

So when I say more selective, we are focused on assets that really bring a strong advantage. We have time to go in more countries, we don't have to build our footprint – there are many countries where we are not yet market leader. We have time to become market leader in those countries, we can definitely take a pause of a couple of years to expand in some markets if we want to focus on getting the benefit of what we have. Doing all those acquisitions for two years, it also was much more than we expected, €700 million additional revenues in 2017, €700 million in 2018, that will also keep our teams busy to deploy our IT systems, to move their IT systems on our infrastructure, to transfer their accounting teams to our centralised national accounting service centre.

So it is not necessarily bad to take a bit of a pause there and do all that. So it is not really a matter of what we will focus on, more profitable, less profitable, it has to really fit and bring a strong benefit. The things that can be delayed, we can delay.

In France, we haven't really quantified the total market because the reimbursement at the moment is for at-risk patients only, not every mother. Germany is much more promising; in 2020, the reimbursement in Germany should be for all patients, so all pregnancies. And that will open a much bigger market, but it is meaningful, it is a few tens of millions in total. We will not be the only one, but obviously we think we are going to have a nice share. It also depends on the exact wording which test will exactly be reimbursed. Because we have a whole range of tests in our portfolio, some with a very broad genetic covering for all range of diseases, some just for trisomy 21, so it will depend on the fine print.

Your next question on the fourth quarter, in the French clinical market. What happened in the fourth quarter was a one-off cut, that lasted only for the last part of the fourth quarter. In addition there is each year a tariff cut in April and we had that, like every year, throughout the years, and the cut of April will continue. But the cut at the end of the year was a one-off and then we go back in January to the April 2018 prices. There would be another addition in April.

And TestAmerica has lower profitability. It is quite dilutive in profitability as you see our – the acquisitions from 2018 have a lower EBITDA than the rest of our Group. But in terms of growth, actually last year it grew at our average Group growth. So the market was dynamic in environmental testing last year in North America. Thank you.

Operator:

That concludes today's question and answer session. Mr Martin, at this time I will turn the conference call to you for any additional remarks.

Gilles Martin:

Right. Thank you very much to all of you for joining our conference call and thank you to all of you who are shareholders. We empathise with you, there has been quite some volatility on our shares over the last six months. There is nothing we can do to prevent short selling activity. We respect, of course, every opinion about what our share price should be. What we try to do is whenever we hear of information which is wrong or which is misleading or which is basically erroneous, we try to correct it. As you have seen, also, we have done our best in our annual report and press release to provide additional disclosure and we are listening to our investors' recommendations on those.

I think the market outlook is very good and things remain very exciting. And we think we will complete our five-year programme as planned by 2020 and that we will enjoy very strong barriers to entry in what we think is a very attractive market. The good thing about all the money we spent in all those acquisitions and the money we spent in building our labs, it has been spent now so we have the facilities. We are not going to have to spend again that money and therefore long term that should also show in our cash flow, and we will benefit for that for a long time.

So that's about it for today, we are welcoming questions and comments on one-on-one, you are welcome to call our IR team and I am looking forward to meeting some of you tomorrow in London. Thank you very much and have a good evening, bye-bye.

Operator:

This concludes today's call. Thank you for your participation. You may now disconnect.

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