eurofins

Morgan Stanley
Equity Research Department
Attn: Mr Edward Stanley, CFA
20 Bank Street | Canary Wharf | Floor 06
London, E14 4AD
UK

26th November 2018

Coverage Initiation Report

Dear Edward,

Firstly, we would like to start by stating that we very much appreciate and value that Morgan Stanley has initiated coverage of our stock. We are mindful that you recently joined Morgan Stanley from a competitor and that your firm's initiation on Eurofins was at least in part thanks to your direct support. We view this as a positive for Eurofins, even more so in times where banks and brokers carefully review their coverage universe. We trust that you and your team will continue to cover us in the future and at the same time, we hope that you are open to learn more about our company. We are always happy to exchange and arrange a call or meeting with analysts who cover us.

Secondly, let us clearly state that we respect and value analysts and investors' opinions. We value listening to their views and delving into their analysis in our efforts to consider a range of stakeholder positions in our decision-making processes and in the fine tuning of our investor relations and public communications work. That is one of the reasons why we have spent time reviewing your Initiation report and Initiation Feedback note dated 13th and 16th November respectively.

Thirdly, we would like to point out, in the enclosed document, some specific passages of your Initiation report where some of your core assumptions have, in our view, lacked background information and led to erroneous conclusions, notably regarding historic organic growth of our group. The outcome of your analysis with the additional insight may or may not have been different; however, we would like to provide feedback on some of your key assumptions that appear to form the basis of your analysis.

Having to write such letter is very unusual for us. As mentioned, we fully respect and accept that an analyst's opinion can be that Eurofins share should be worth X or that the company's organic growth should be Y and the profits Z in a given future year. Anyway, no one can tell with certainty what the future will be. However, to justify these opinions with facts or core hypotheses concerning past years that were not verified with the company and are blatantly wrong and contrary to any prior communication made by the company has forced us to write this letter. Indeed, despite our exchanges with you and our constant communication that, in our experience, acquisitions have no material impact on the Group's overall organic growth, we regret that your false hypothesis regarding this core aspect of your note, that acquisitions would have boosted Eurofins reported organic growth, was not clearly corrected in your Initiation Feedback note dated 16th November (see end of 3rd paragraph on page 5). Upon investors' requests now we unfortunately feel obliged to respond publically. Indeed, some factually wrong estimates in your note, not clearly corrected after feedback by the company, may have misled some or created confusion that may be damaging for some market participants.

Following the request from several of our shareholders and in order to provide information parity, we have disclosed the not yet public part of our response in a press release that we issued today on another topic and we will make this letter available on our website. In our press release and in the enclosure to this

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letter, we refrained to comment on all aspects of your note, which we may agree or disagree with, but just pointed out some areas that we see as factually wrong and/or where we found no corroborating data or evidence. We note, for example, that based on the true data on organic growth impact of acquisitions, the core hypothesis of your note, and following the logic of your note, you may have had to come to different conclusions regarding future growth of Eurofins but of course as previously stated, as no one can predict the future with certainty, we fully respect your right to express any opinion on this aspect as on any other future matter. Eurofins is run with the long term interests of its investors in mind and we also fully accept plurality of views on potential outcomes of our strategy and differing preferences between short term and long term prospects.

We hope that our comments and additional insights can be seen as constructive. We can only reiterate our openness to intensify our communication with you and to provide you with explanation of any public information before you issue a revised report.

Finally, we would like to thank you for your time analysing our stock and hope that we can work well together for the benefit of proper shareholder information.

With our best regards,

Victoire Spahn	Hugues Vaussy
Head of Investor Relations	Senior Finance Director

Enclosed: Log file of comments on Morgan Stanley Initiation Report dated 13/11/2018 and Feedback Initiation note dated 16/11/2018

Logfile of comments on Morgan Stanley Reports 13th/16th November 2018

Reference to section / page of the report	Statement	Eurofins View
Pg 1, Intro. "Is M&A boosting organic growth?"	"…an assumption of between 5-10% organic growth on average for the acquired businesses…"	This is simply false. We always communicated that acquisitions have generally no material impact on the Group's organic growth. In fact, as stated in today's press release, over the last full four years (2014 to 2017 where our M&A activity intensified), M&A resulted in a c.50bps drag on our reported organic growth and not a boost. The same applies to the last 6 years.
Pg 5, The Thesis, 3) Organic growth to determine valuation Pg 8, Organic growth guides valuation	"…organic growth in the core business may be slowing down (as per the analysis later)." "…What has the impact from M&A been on organic growth and if organic growth has been boosted by prior year M&A…"	Extract from today's PR: "Over the last 4 years (2014 to 2017), Eurofins' average reported organic growth was above 7%. During this period, on average for the accounts of each year N, acquisitions acquired in year N-1 grew organically 350bps less in year N than the rest of the Group. Excluding these acquisitions made during year N-1 from the organic growth calculation for year N, the average organic growth would have been over 7.5% over the period 2014-2017 instead of over 7% as reported. The same conclusions apply to the six years' period between 2012 and 2017.
Pg 7, Organic growth guides valuation	"…we estimate that on a comparable basis to TIC peers, Eurofins' organic growth rate over the past six years may in fact have been 5.5%..."	As also stated in today's PR, should we have used the 12-month rolling technique to calculate our organic growth (include acquisitions into organic growth after 12 months of ownership), average organic growth would also have been above 7.5% over the period 2014-2017 and the last 6 years i.e. higher than under our conservative organic growth definition (7%) and not lower (5.5%) as you note.
Pg 9, Organic growth guides valuation	"At the other end of the spectrum, Intertek's organic growth calculation is the most restrictive of any TIC company."	This would only be more restrictive or conservative if acquisitions were growing faster than the rest of the group immediately post acquisition, which, as stated above, was not the case for Eurofins over the 6 years you cited.
Pg 9, Methodology, Exhibit 9	"Exhibit 9: MS estimate for normalised organic growth"	Your "stated organic growth" shows 9.5% in 2015, 6.0% in 2016 and 5.0% in 2017. This is incorrect. Our organic growth was almost 7.5% in 2015, over 9% in 2016 and close to 6% in 2017. It looks like you have shifted everything by one year.
Pg 9, Methodology and Pg. 10, Exhibit 10	"… we estimate that prior year acquisitions may have boosted Eurofins' reported organic growth by 12.4% on average relative to the adjusted number under peers' methodology (Exhibit 10). In 2016 and 2018, we calculate M&A may have contributed ~27% of organic growth."	See above. This is factually wrong.

<table>
<tr>
<td>Pg 10, Methodology

Pg 1, Initiation feedback, 3. The company view</td>
<td>"…conclusion from our work and estimates above is that the organic growth rate for Eurofins on a comparable basis to TIC peers over the past six years is c5.5% and appears to be decelerating, compared to the 6.3% and more stable number under the company's definition."

"…little to no benefit to organic growth from M&A under its disclosure compared to peer definitions."</td>
<td>See above. Using the definition you consider more restrictive, organic growth would have been higher than reported by Eurofins, not lower. Any change from year to year is due to a mix effect (e.g. including clinical testing) and not to a deceleration in historically owned businesses.

We confirmed to you, as we did many times in the past, that our disclosure method does not lead to higher organic growth than if the calculation was done with the other methods mentioned in your note and that your hypothesis for acquisitions' growth was wrong. In spite of that, it may appear that you maintained your incorrect hypothesis on page 5 of your initiation feedback.</td>
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<td>Pg 5, The Thesis, 1) Leverage is high

Pg 6, Testing and Inspection Scorecard, 1) Leverage is high

Pg 13, All eyes on cash

Pg 15, Bridging to organic deleveraging</td>
<td>"…we forecast negative FCFE post-M&A beyond 2022e, assuming steady investment levels."

"…we think negative post-M&A equity free cash generation post FY22e should result in a discount to peers, all else equal."

"…we forecast negative FCFE post-M&A beyond 2022e…"

"…Capex: we assume 8% capex/sales in 2018e, a sequential step down from 8.7% at 1H18. This slowing capex trajectory has been guided by the company."

"Capex: we assume 7% and 6.5% tangible capex/sales in 2019e and 2020e. This is fading down to the targeted 6% level but remains higher than company guidance due to our assumption that US M&A integration and the build out of the hub-and spoke network will take longer than expected."</td>
<td>As mentioned on 13th November, your initiation report's cash flow statement double-counted the hybrid coupons. This implies an incremental cash usage of EUR150m over the next 3 years, which may be partly why you concluded that we do not have the ability to pay down the hybrid with the cash we have on the balance sheet (see page 3 "Potential cash flow shortfall when the hybrid matures in 2020, which could result in a refinancing"). We note that you re-issued the revised model that evening but have not seen a new note clearly highlighting the revised FCF forecasts.

In addition, we noted the below capex assumption in your note (% of sales):

<table>
<tr><th>EUR mn
Year End: 31-Dec</th><th>FY to 2018 E</th><th>FY to 2019 E</th><th>FY to 2020 E</th><th>FY to 2021 E</th><th>FY to 2022 E</th></tr>
<tr><td>Tangible capex % sales</td><td>-8.0%</td><td>-7.0%</td><td>-6.5%</td><td>-6.5%</td><td>-6.0%</td></tr>
<tr><td>Intangible capex % sales</td><td>-1.5%</td><td>-1.5%</td><td>-1.5%</td><td>-1.5%</td><td>-1.5%</td></tr>
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Of course, you are free to use whatever assumptions you feel are appropriate for future M&A spend and capex, even if they contradict the company's objectives. However, we would like to bring to your attention that when we comment on our capex to sales ratio, it includes both tangible and intangible capex (as per slide 62 of our November 2018 Corporate Presentation).

In that context, we have said that we expect our capex to sales ratio to remain above 8% in 2018 and gradually go down towards c.6% by 2020. We have also said that maintenance capex levels in our industry stand at around 2-3% of sales and that we believe that Eurofins should be able to maintain 5% organic growth with c.4-6% capex to sales. That includes tangible and intangible</td>
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		capex.
Pg 23, Valuation	"Conversely however, we think negative post-M&A equity free cash generation past FY22e should result in a PE discount to peers, all else equal."	As previously communicated, our current capex levels are exceptionally high as we are in the middle of our 5 year (2015-2020) investment programme to build our unique state-of-the-art hub-and-spoke global laboratory network. Beyond real estate, this also includes significant one-off investments into our IT platforms. As you can also see on slide 62 of our November 2018 Corporate Presentation, most IT capex is related to the development and deployment of our proprietary electronic Laboratory Information Management Systems that are tailor made for each of our business lines. We are in the process of finalizing these and should have rolled out the system to a large part of our network by 2020. We expect significant productivity gains and improvement in the quality and speed of our services to result from these systems. Exceptionally high levels of capex also include significant one-off investments into a large number of greenfield laboratories: we have opened 37 start-up laboratories in the 18 months from January 2017. Each start-up laboratory requires exceptional, one-off capex and generates cash operating losses. We have largely finalized our current start-up programme and have said that we would not initiate another large start-up programme in the near future. We leave it to your readers to decide whether post M&A cash flow is a relevant metric when comparing to P&L and cash flow data not including M&A.
Pg 7, Organic growth guides valuation	"The removal of 69 federal-level environmental laws means c. 40% of predominantly government testing is no longer happening."	Firstly, we would like to understand your definition of "government testing". Are you referring to environmental testing conducted by Governmental agencies? Or to the environmental testing by the industry/commercial clients/households as a result of Governmental regulations? We checked with our US environmental testing leadership and they confirmed that there indeed appears to have been 69 laws repealed by the Trump administration. However, only a proportion of those laws impact the testing market. Others are related to Environmental matters, but have no relation to testing. Also, many are being challenged in the courts. More importantly, we cannot reconcile the "40%" impact you suggest. We can actually see significant positive growth momentum in this market at the moment that is being generated by: o *Regulated 'blue states' are advancing from a regulatory standpoint in opposition to the Federal level.* o *Class action lawsuits continue to gain strength as a powerful implied market driver.* o *Improving economic conditions and related infrastructure/commercial development, partially fuelled by Trump's USD 1.5tn spend programme on infrastructure over 10 years.*

		As stated in our press release, Eurofins' U.S. environment business grew over 5% organically in 10M18, showing that we see limited negative impact from the abovementioned issue.
Pg 7, Organic growth guides valuation	"Until there is movement here on reimbursement allowance, we estimate this ~13% of inert group revenue contributes to a c80-100bps drag on group organic growth, using 2017 group revenues as a base."	On a proforma basis, Eurofins' French clinical diagnostics business (c.EUR400m revenues) represents c.9% of group revenues (EUR4.3bn proforma in 2018). We cannot reconcile your calculation. What does it assume for organic growth for that business?
Pg 11, Organic growth guides valuation Pg 21, Valuation	"…previous occasions when Eurofins has underperformed TIC peers' organic growth such as in 2012. While we expect the relative organic growth underperformance to be less pronounced this time compared to last time we expect it to be more sustained." "While we expect the relative organic growth underperformance to be less pronounced this time compared to last time we expected it to be sustained."	We cannot comment on your opinion regarding future organic growth of other companies. Only time will tell. We feel our business has strong organic growth upside post completion of our 2015-2020 global investment programme. We would note that our EPS growth was lower then too. It may not just be about revenue growth. We have not found why you expect any potential future underperformance to be more sustained? In particular as we understand that you expect peers' organic growth to be partly boosted by cyclical factors. Eurofins' growth has proven to be non-cyclical and very defensive in times of crises.
Pg. 14, Exhibit 19	2017 ROICE PPE below 10%	We do not disagree with the calculation from a mathematical point of view. However, we would note the following points: - Using the reported EBITAS includes non-recurring SDIs and thus is distorted by the fact that we opened many new start-ups in 2017 and thus SDIs went up. The incremental ROCE (ex GW and financial assets) using adjusted EBITAS was 18% in 2017. - However, we understand that in your computation all acquisitions are included in the denominator but only partly in the numerator (in particular, only one month of EAG, only 4 months of Amatsi and DiscoverX). As per page 87 of our 2017 annual report, if all the acquisitions made in year 2017 had been consolidated in the P&L for the FY 2017, the adjusted EBITAS would have been EUR66m higher and the **incremental ROCE PPE (ex GW and financial assets) would have been more than 40% in 2017**.
Pg 29, Disclosure Section	MS discloses having provided IB services to Eurofins in the last 12 months and plans to provide them in the next three months	We were surprised to read that MS has provided investment banking services to Eurofins in the last 12 months. While we cannot comment on your intentions in the future, we cannot find evidence to confirm the first part of the statement.
Pg 4, Initiation feedback, Margins and synergies from	"We believe recent acquisitions such as Covance and TestAmerica will require higher capex than is implied in group	This is an opinion. Eurofins believes its capex objectives to come back towards 6% of revenues by 2020 consider these two acquisitions appropriately. We have made no statement regarding future margins of those two specific businesses.

acquisitions	guidance and could therefore take longer than expected to reach group margins."	
Pg 5, Initiation feedback, The Company's view	" Subsequent to acquisition however, the scale and network benefits can mean several points to organic growth in the year immediately following acquisition (per the illustrative example below), which is how we estimated our average Y+1 organic estimate of 10% for acquired businesses. "	This may be true over time but not in Y+1 as we previously shared with you. Eurofins typically needs 2 to 3 years to bring full benefits of its network to companies acquired.
Pg 5, Initiation feedback, The Company's view	"…therefore the immediate upside potential from that bolt-on effect could be lessened in coming years as the group scales back its M&A ambitions."	As the alignment to Eurofins' average organic growth level is generally delayed by 2 or 3 years, this could have the contrary effect; a positive impact on Eurofins organic growth post 2020. It may appear here that you are maintaining a false hypothesis despite the Company confirming to you that it was wrong.