S&P Global
Market Intelligence

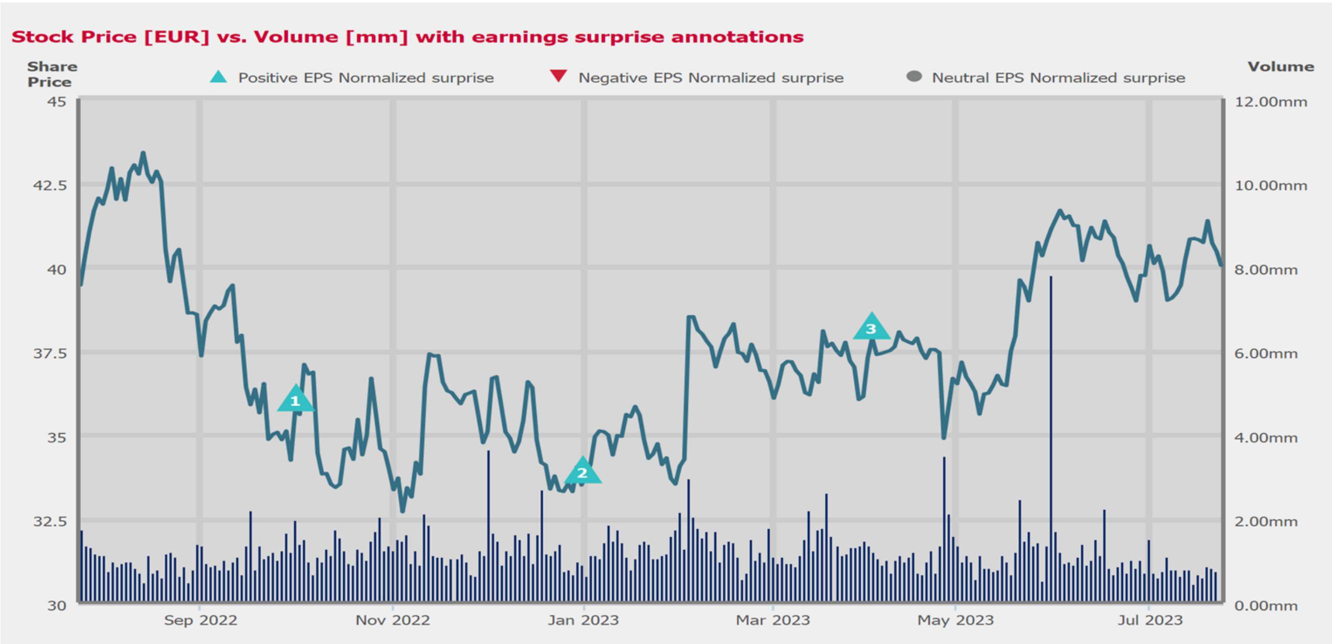
# Dassault Systèmes SE ENXTPA:DSY
# FQ2 2023 Earnings Call Transcripts

## Tuesday, July 25, 2023 8:00 AM GMT

## S&P Global Market Intelligence Estimates

| | -FQ2 2023- | | | -FQ3 2023- | -FY 2023- | -FY 2024- |
|---|---|---|---|---|---|---|
| | CONSENSUS | ACTUAL | SURPRISE | CONSENSUS | CONSENSUS | CONSENSUS |
| **EPS Normalized** | 0.27 | 0.28 | 0.27 | 1.19 | NA | NA |
| **Revenue (mm)** | 1457.54 | 1449.10 | 1430.11 | 5985.59 | NA | NA |

Currency: EUR
Consensus as of Jul-25-2023 8:42 AM GMT




| - EPS NORMALIZED - | | | |
|---|---|---|---|
| | CONSENSUS | ACTUAL | SURPRISE |
| **FQ3 2022** | 0.25 | 0.26 | 4.00 % |
| **FQ4 2022** | 0.33 | 0.34 | 3.03 % |
| **FQ1 2023** | 0.27 | 0.28 | 3.70 % |
| **FQ2 2023** | 0.27 | 0.28 | NA |

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# Call Participants

## EXECUTIVES

**Beatrix Martinez**
*Vice President of Investor Relations*

**Bernard S. Charles**
*Chairman & CEO*

**Pascal Daloz**
*Deputy CEO, COO & Director*

**Rouven Bergmann**
*CFO & Executive VP*

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# Presentation

### Operator

Good day, and thank you for standing by. Welcome to the Dassault Systèmes 2023 Q2 and First Half Earnings Presentation Call and Webcast. [Operator Instructions] Please, note that today's conference is being recorded. I would now like to hand the conference over to your speaker, Beatrix Martinez, Vice President, Investor Relations. Please go ahead.

### Beatrix Martinez
*Vice President of Investor Relations*

Good morning, everyone. This is Beatrix Martinez speaking, Dassault Systèmes VP, Investor Relations. From the company, we have Bernard Charles, Chairman and CEO; Pascal Daloz, Deputy CEO and COO; and Rouven Bergmann, CFO.

I would like to welcome you to Dassault Systèmes Second Quarter and Half Year 2023 Webcast Presentation. [Operator Instructions] Later today, we will also hold a conference call. Dassault Systèmes results are prepared in accordance with IFRS. Most of the financial figures in this conference call are presented on a non-IFRS basis, with revenue growth rates in constant currencies, unless otherwise noted. For an understanding of the differences between the IFRS and the non-IFRS, please see the reconciliation tables included in our press release.

Some of the comments we will make during today's presentation will contain forward-looking statements, which could differ materially from actual results. Please refer to our risk factors in our 2022 document d'enregistrement universel published on March 17.

I will now hand over to Bernard Charles.

### Bernard S. Charles
*Chairman & CEO*

Hello, everyone. This is my 106th quarter, not bad as a record. While we are pleased with this second quarter 2023 with a strong quarter from 2 perspectives, broad-based, and we see a momentum, may be strange for some of you provided the current indicators of the economy, but we see -- we do see a momentum and Rouven and Pascal will talk about it.

So the total revenue was up 8%, most importantly, double-digit for the new license when you add the upfront on the subscription. The operating margin was to 31%. On the headcount, remember, we continued to invest last year, at the end of year, and we have, again, invested, is up 7%. So we are investing for the future. The EPS up 7%. Excluding exchange rate, it's 15%. So what can we say. Pascal will have wonderful illustration about the next comments that I want to share with you. First, the move from things to live are working for us on opening up significant perspective. By the way, I'm sure you have noticed that at our CMD, Capital Market Day, in June, more to be discussed in years to come, but it's also a foundation for the next 5 years. The virtual twin discipline, the twin of the real is creating a new milieu where you can experiment and provide experiences when you connect the virtual twin in the real world.

And of course, as everyone is now speaking about AI for text on Symantec and grammar, we are applying for a long time, more than 10 years, AI on science. So AI will play a role, not only for text on grammar, but it will play a big role for science, too. And I'm going to show you 2 illustrations about that in a moment.

So we are basically combining modeling, how you represent the world; simulation, how you experiment the world; on AI, how you learn from this new milieu, which is the addition of the replica of reality at a certain level. We call it virtual twin, connecting it to the data you collect, which are what we call real-world evidence, whether you are in manufacturing industries, energy or life science. So that's the core of the future of Dassault Systèmes. There is a second aspect of it, which is really the evolution of the world for a more sustainable industry. And virtual twin is a very key set of capabilities for that on multiple fronts, material transition, process transition and providing virtual twin as a service is a key for anything to rebuild and redefine the move from value chain to -- from supply chain to value chain. And of course, it calls for a new workforce, new type of training.

All our customers are talking about the workforce of the future at this point in time. So it's really an expansion where progressively the virtual world to help to design -- imagine, design, create, produce and operate is connected. And of course, you have seen it already. We are confirming our full year 2023 objectives, which I'm pleased with the team because we committed for the 5 years' plan. I'm supposed to be in charge of the -- this conclusion of the 5 years plan, doubling the EPS reaching EUR 1.20. So we said EUR 1.18 to EUR 1.20. I hope the team will deliver EUR 1.20.

This being said, coming back to the journey, there are a few things which are important. I think I illustrated to you very precisely why virtual twin of human is changing life, is changing a lot of things in life science. Not only that, bioscience is going to play a very big role in food, nutrition, substitution, as you can imagine, as well as even for manufacturing industries. So we are really seeing, on a longer term, a true metamorphosis of the entire industry of the world.

Let me come back on 2 illustrations. One, launching this video to show you, please look at the people, how they live in an environment, which is both real and virtual because I was touched. I was moved with this video that you are going to see in the French hospital Saint-Louis, please run the video.

[Presentation]

**Bernard S. Charles**
*Chairman & CEO*

It's always a special moment when you see these kind of capabilities in the real world, and when you see the face of those people helping to improve the life of others, really taking advantage of those technologies. So I think this echoes very well. What happened in Boston a few weeks ago, where we had the science in the age of experience. And we had an amazing conference with prestigious scientific scientists as well as Nobel Prize awarded people talking about the revolution that this will represent. And I think their presence -- their presentation confirmed that it's becoming very important. Big event, 300-plus number of the global scientific communities. And of course, this is key because this powerful network is helping us to qualify and define the priorities for this sector.

Another example, because everyone is talking AI, so we want to make sure that people understand that we have been doing it for years in multiple sectors. That is one example that you know that we have talked about already, which is AI for clinical trial. I will not come back on that. But as you know, the [indiscernible] arm in clinical trial is really AI-driven, AI-generated for precision medicine clinical trial.

Here is another example, which is -- I hope the video is running, Beatrix, thank you. This is an example of generative therapeutics design. What's the problem? You have a target, and you are trying to invent new type of molecules, biologics that could solve -- the target is of course the disease, that could solve the problem of killing the target or reducing the problem. And with AI, with generative therapeutic AI, Dassault Systèmes, with the BIOVIA brand, which is really a deep science, has really demonstrated that we can generate an incredible number of possible options.

Now the next question is, how do you select them? How you reduce the selection field when you have generated so many of those things?

So do we do simulation? So when you connect data science modeling simulation with AI, you get the new world. And I believe that what we're presenting here for generative therapeutics is as big as when -- and as important as when Google demonstrated the unfolding of -- that they did a few years ago, which has not been very much used, but all this is coming to create a new milieu for the science that will be useful. So generative AI is used widely on very specific domains at Dassault Systèmes, and we know how to build learning machine on science and data to make it happen. Remember, we also had the showcase a few months ago, I think second quarter, Pascal, with Renault predicting cost of the vehicle based on material cost volatility on market, and it worked very well.

So this is what I wanted to illustrate. It is an opportunity for us, and we are leveraging it. You are familiar for those of you who have followed us for numerous years, about this, what we call multiphysics multiscale, starting from atoms going to the end product, whether it's a plane or car or battery, brain or a heart, you name it, human cell or whatever. So we continue, and we will continue to invest to do multi-scale multi-discipline with not only material science chemistry but also biology. And we are even redefining the mass foundation of biology to make sure we have comprehensive models on all those things. And that's really core for Dassault Systèmes.

So in summary, virtual twin is not the shape of a human. Virtual twin is about representing all aspects, revealing the invisible for brain, heart, lungs, cells, and we do those things today. We have tangible program on each of them. Skin as well as microbiota, which are very, very key for the future, by the way, and when you think about the virtualization of this, and you connect it to the real data connection, you create a new world for partition. You create a new milieu to invent new type of practices and redefine the search. This is what Dassault Systèmes is doing.

And I could use the same illustration for object flying for Hi-Tec, for energy grid, for moving vehicles, for robots and the similarity with this architecture will be very, very alike. So this is why I think we have solid foundations for the future, and we will continue to invest to really make this a reality and value for the world. The purpose is guiding us. It's a generic statement, but I think no one can debate the fact that since February 9, 2012, we have spent a lot of money to make this happen, and we will continue to do so and I think with the right investment. With that, Pascal, it's your turn.

**Pascal Daloz**
*Deputy CEO, COO & Director*

Thank you, Bernard. Good morning, everyone. Always a pleasure to be with you at this time of the year. Before to dig a little bit into the customer example and the split by product line, by geo, let me give you some flavor of what is our perception of what is going on. My first comment is we saw the renewed focus on investment in innovation from a customer's standpoint.

And this positive shift in the market was relatively evident in our strong performance driven by the broad-based momentum in both large enterprises, but also in the mid-market across all the geos. And you will see Rouven will give you a lot of numbers to confirm this.

The second takeaway is the conversions between the experience economy and the circular economy is really driving a deep transformation across all the sectors. All the businesses, all the industries continue to evolve, and we saw growing demand from our customers to address those critical issues of sustainability, but also environmental responsibility, maintaining a competitive edge through rapid innovation and optimizing operational efficiencies.

Now let's zoom on some specific cases. The first 1 is Unilever, and you remember, the circularity is more just than a concept for our clients. They recognize the tangible benefits of what we bring on the concrete projects. And we are driving forward the sustainability innovation in manufacturing using AI, as Bernard said, in combination with our virtual twins to minimize the waste and recycle the raw materials. Remember, 2 quarters ago, I was -- we were speaking about PepsiCo. Now we are speaking about the case of Unilever, and it's almost the same things. Unilever, they have the bold ambition to reduce the plastic waste with a target of reducing the virgin plastic by up 50% by 2025.

So to make it happen, and to support these ambitions, they are using the 3DEXPERIENCE platform to drive the material efficiency through an automated optimized -- optimization processes, which are leveraging the real-world evidence, the combination against of the AI and the virtual twin. And additionally, with those new plastic bottle design, we are right for the first time.

That's for the manufacturing space. If we zoom in the life sciences, the significant time required and the level of upfront costs and potential risk involved in clinical development provide barriers, in fact, to innovations in life sciences industry. And we aim to help to reduce and break down those barriers across the sectors to enable greater innovation. Last quarter, Novartis was expanding its trust to MEDIDATA. And you know Novartis, we have a long-standing relationship with them. And I think when they are selecting their partner, they select not only on the value-added, but also the trust and their domain expertise. And I think this is also something which is unique.

If you look at the landscape, we are one of the few having the therapeutic domain expertise.

So what does it mean? It means we will continue to assist them in achieving a reduction of 50% of the cycle time. But at the same time, we are also standardizing. We help them to standardize their clinical trial on one unified cloud platform to ensure the comprehensive life cycle management. And this is key because we are preparing the fact that they will connect the dots to the entire drug life cycle development. So our commitment to Novartis' success is stronger than ever, and it's evidenced by the expanded partnership with a new 5-year commitment, and we are dedicating, obviously, to support Novartis in enhancing the patient experience and driving unprecedented clinical outcome.

Now let's move on infrastructure and cities. The importance of the clean, safe and sovereign energy has always been mission-critical. And in the recent year, the topic has gained significant attention worldwide, particularly as we transition toward the global carbon-free energy. While we have frequently showcased the success in energy production, this time, I really want to emphasize how we can drive the innovation in the domain of the grid. Red Electrica, the sole operator of the Spanish electricity system, has adopted the 3DEXPERIENCE platform on the cloud, not only to design but also to operate the virtual twins of the energy network for the Spanish generation smart grid.

Operating the virtual twin of their network will ensure a few things. The first one is the highest grid availability while we are managing various energy sources, but also enable easy grid connections. We are also supporting them in designing the next generation of reversible hydropower plant for energy storage, which is obviously critical because when you have a lot of renewal, you need to find a way to store energy. And producing hydrogen and being able to recreate energy from them is extremely powerful.

And last, but not least, we are also assisting them in managing the construction program for the power lines, for the substations and for the storage facilities at the same time. So with one single platform, with the virtual twin experience, we cannot only help them to transform the traditional network into a grid, develop the new breakthrough technology, especially in the storage -- in the energy storage, but also operate real-time this network. So we are really delighted to support Red Electrica and further our partners for the sustainable energy.

Now let's move to the performance of the Q2. The key trend across the geo and product line I want to highlight. First, let's look at it by the geos. In Americas, the revenue growth accelerated sequentially to 10%, driven by a strong performance, mainly in Aerospace & Defense as well as High Tech and well supported by Life Sciences. In Europe, momentum continued, with a revenue growth of 9%, and the region benefited from a strong strength in Germany and France, mainly driven by consumer-packaged goods and retail and also transportation and mobility.

In Asia, the revenue growth was 4%, thanks to the rebound in China, with a growth up high single digits and continued high double-digit growth in India and strength in Mainstream Innovation.

Now turning to the product line performance for the second quarter. Industrial Innovation software revenue saw 7% growth in Q2. Within that, CATIA delivered double-digit growth in both upfront license and subscriptions, thanks to a strong cyber system adoption. And you have seen in Bernard's presentation, the cyber system adoption is not only for all the connected objects, but it's also meaningful for the rest of what we do, including Life Sciences.

SIMULIA also performed well this quarter, with the software revenue growing high single digits during the quarter. And ENOVIA also delivered a good subscription result during the period. In Life Sciences software, the revenue increased 7%. So MEDIDATA delivered a high single-digit growth, lower than in the previous quarter, and driven by an industry-wide reduction in study starts when compared to the very high post-COVID levels as well as on a very strong baseline effect when you compare the second quarter of last year. And Rouven will come back to this and will give you a lot of details.

But at the same time, and this is where I want to emphasize, we are experiencing a strong performance in the top pharma companies, including several multiyear renewals such as Novartis, but not only I could mention this quarter also Gilead. Importantly, we plan to return to double-digit growth before the end of the year for MEDIDATA at large.

Zooming now in Mainstream Innovation. Software revenue increased 12%, and this performance has been achieved with a strong double-digit growth with a broad-based expansion across all the geo for SOLIDWORKS. Notably in China, where the software revenue increased by 25%, and remember, it's really a significant rebound because this has to be compared by minus 22% in the first quarter.

Centric PLM also reported an excellent performance driven by the consumer-packaged goods retail and saw a continued business momentum across all the core business verticals. And zooming more on the Centric PLM, it's a brand -- it's a collection of solutions, which is used by 12,500 brands today, has a significant footprint in the market. However, the potential opportunity we see is much larger. We are progressively moving from fashion and apparel to new markets, including food and beverage, cosmetics, personal care, home and furniture, consumer electronics, just to name a few of them.

We are also moving from brands, which are the core, to retailers. And remember, one of the largest transactions for this quarter is with one of the large retailers in Europe, manufacturers, but also more and more consumer. Finally, we are -- from a solution standpoint, we are also expanding from the collection management to establish a business platform that will serve as a backbone for e-commerce.

I think we are well positioned to continue to execute our strategy and become a global leader in the consumer industries, and we believe that Centric PLM has the potential to become a $1 billion plus business in the coming years.

Now having said that, it's time for me to hand over to Rouven. Rouven, you have the floor.

**Rouven Bergmann**
*CFO & Executive VP*

Thank you, Pascal, and thank you, Bernard. As you can see, Q2 was a strong quarter. We delivered on all our key objectives, encompassing revenue growth, margin and EPS, driven by broad-based strength across pretty much all geographies and a healthy contribution from picking up large deal activity. As a result, we wrapped up a good first half of the year, which puts us on trajectory to achieve our full year objectives.

And before I go to the details of the presentation, the numbers I want to also quickly recall, and I'm sure you do that when we introduced our objectives for Q2 back in April, we highlighted 3 main drivers to accelerate growth in the quarter: the first one was an acceleration in North America; the second was a continued momentum in Europe across key industries; and the third was the return to mid-single-digit growth in China. And in this quarter, all these elements were delivered as expected or with even better results. Now let's take a look at our Q2 results in more detail.

Total revenue and software revenue grew consistently 8%, while service revenue was up 7% at constant currency in line with our objectives. Upfront license revenue was up 6% year-over-year, ahead of our Q2 objectives, driven by the rebound in China and very good performance in mainstream innovation with SOLIDWORKS as well as a healthy contribution from large deal activity across Europe as well as North America.

Related to the performance in China, we highlighted during our Q1 call that we saw evidence of increasing activity in March. And in fact, this trend continued, driving 8% growth in China in Q2. We're confident that this progressive trend is further raising the potential for growth in the rest of the year.

Recurring revenue rose 9%, with subscription revenue up 13% year-over-year. Together, subscription upfront license revenue growth was up 10%, highlighting the improving momentum for Q2. For the first 6 months, the share of recurring revenue reached 81% of total software revenue. This represents a strong increase of 200 basis points versus last year.

While subscription revenue growth for SOLIDWORKS, Centric, CATIA and ENOVIA together was up over 30% and significantly above the average growth rate in the quarter, we experienced a temporary slower growth at MEDIDATA, as highlighted by Pascal earlier. So to complement what Pascal mentioned, I'd like to give you 3 points to explain what is driving the MEDIDATA performance in Q2, and what to expect for the rest of the year. First, we are facing the impact of lower clinical trial starts observed by global industry data. Second, the impact of COVID mega studies, which phased out during Q2 and Q3 of last year, which creates the baseline impact. And the third point is the momentum with top 50 pharma customers. So let's go through this one by one.

First, we are seeing a more deliberate investment environment in which CROs continuing to adjust volumes. Worldwide, in 2Q 2023, according to global industry data, clinical trial start decreased by around 10% year-over-year. Now while the study start volume was under pressure, our win rates remained strong on average at around 75%. Second, when we compare to Q2 last year, we had the benefit of the ending mega trial, which was started during the pandemic. Typically, at the end of such complex studies, we are entitled to true up revenue. This creates an unfavorable baseline effect with an impact of approximately 3 points to the growth rate. We expect a similar effect in Q3 before we are back to double-digit growth.

Third, we signed several multiyear renewals with top 50 pharma. This is evidenced by strong total quarter bookings up 17%. On top, we continued to see strong renewal rates, more than 20% above par level over the trailing 12-month period, as well as our revenue retention rate remains above 99.5%.

So to summarize, the lower subscription revenue growth contribution of MEDIDATA is temporary, and we are confident that growth will rebound towards the end of the year and further into 2024.

Looking at our strategic growth drivers of 3DEXPERIENCE and cloud. 3DEXPERIENCE revenue in the first 6 months grew 5% at constant currencies. This reflects a share of 31% of 3DEXPERIENCE addressable software revenue, which is flat year-over-year relative to a very strong comparison base last year. And as we highlighted before, our 3DEXPERIENCE deal road map is strengthening in the second half so we expect to see a share of increase in 2H.

Cloud revenue in the first 6 months rose 14%, now representing 24% of software revenue, which is an increase of 2 points. While MEDIDATA growth contribution was lower this quarter for the reasons mentioned, growth in 3DEXPERIENCE cloud remains at a healthy clip. We are well positioned to continue to capitalize on our leading position in key industries, capturing above-market growth in 3DEXPERIENCE and cloud.

Now let's review how we performed relative to the objectives we set for the second quarter. We reported total revenue of EUR 1.449 billion, and unlike in previous quarters, we had a currency headwind of 50 basis points, resulting in a negative FX impact of EUR 7 million. During this period, adjusted for currency, total revenue was EUR 5 million, higher than the midpoint of our target range due to the overperformance in software revenue by EUR 4 million and services by EUR 1 million.

We reported an operating margin of 31%, 50 basis points above the high end of the range and 80 basis points higher than the midpoint. This better revenue -- the better revenue performance and lower OpEx growth together contributed 110 basis points improvement versus the midpoint, which was partially offset by a negative currency impact of 30 basis points.

Now as you can see, it's clear from these numbers that we delivered on our profitability targets while continuing to invest. We added over 300 net new employees during the quarter and 650 for the first 6 months. Due to our disciplined investment approach, we are well on track to manage our OpEx growth in 2023, offsetting the carryover effect resulting from strong hiring last year. And this gives us the visibility to continue our focused investment in the second half of the year to address our long-term opportunities.

Now turning to the earnings per share. Very briefly, we reported EUR 0.28 as reported. And at the high end of -- we are at the high end of our range of EUR 0.27 to EUR 0.28, and we also offset a slightly negative currency impact of EUR 0.004 given the better performance.

Now turning on to the cash flow and balance sheet items. Cash and cash equivalents totaled EUR 3.345 billion compared to EUR 2.769 billion at the end of 2022. This reflects an increase of EUR 576 million. At the end of the quarter, our net financial position totaled EUR 352 million, an increase of EUR 579 million versus the net financial debt of EUR 227 million at the end of last year.

Now let's look at what is driving our cash position at the end of the second quarter. We generated EUR 1.026 billion in operating cash flow year-to-date. This was slightly lower by 2% or EUR 22 million when compared to the first 6 months of last year. There're 2 main insights here to share with you on what's driving this performance. First one, we continued to see good momentum in our working capital. The net change in operating working capital is up by 5%, driven mainly by strong collections, evidenced by sequentially improving DSOs. This is partially offset by a slightly unfavorable change in the nonoperating working capital due to higher tax rate.

Second, the net income adjusted for noncash items is lower versus last year because of 2 facts. First, as discussed, we decided to invest at higher levels in 2022 to accelerate top line growth. And as a result, we are absorbing the expense carryover effect now in 2023. At the same time, the progressive revenue growth acceleration is taking off. And the second fact is that the remaining gap is a result of an increase in social charges for share-based compensation due to the higher share price versus last year. And for more details, I refer you to the reconciliation table in our appendix.

Now to sum up, operating cash flow was mainly used for CapEx of EUR 67 million, payment of lease liabilities of EUR 42 million and the cash dividend paid in Q2 of EUR 276 million. And lastly, of note, we had a negative FX impact of EUR 56 million year-to-date 2023.

Now let's turn to our fiscal year 2023 objectives. We are maintaining our guidance. The key takeaway is, as you heard from Bernard already, we are on a good trajectory to achieve our long-term financial objectives of EUR 1.20 earnings per share. Total revenue growth between 8% to 9% at constant currency remains unchanged. In absolute terms, we are offsetting the FX impact of minus EUR 7 million to the year by raising the performance to maintain the range as is of EUR 5.940 billion to EUR 5.990 billion. This assumes that we expect progressive growth acceleration throughout the remainder of the year, driven by an increasing contribution from large deal activity in the second half and mid- to high-single-digit growth in China, continuing the good Q2 trend. Finally, we reaffirm the operating margin range of 32.3% to 32.6%.

Before moving to the Q3 objectives, I would like to emphasize that this unchanged full year revenue guidance assumes that we maintain growth rates at constant currency for software revenue of 8% to 9%, service revenue of 5% to 7%. We continue to expect recurring revenue growth in the range of 10% to 11% with strong subscription revenue increasing in the range of 17% to 18%. Following the good trend of Q2 and upfront license revenue, we remain confident for the full year in the range of 2% to 5%.

Now let's turn to the Q3 objectives. We are targeting total revenue growth of 8% to 10% at constant currency, with recurring revenue increasing by 10%, driven by strong subscription growth of 17% to 19%. We are forecasting upfront license revenue growth of 6% to 10%. This reflects an acceleration in subscription revenue growth in Q3 versus Q2, and this is driven by an increasing share of large 3DEXPERIENCE subscription deals, continued momentum in adopting subscription-based pricing of the SOLIDWORKS customer base, and continued strong growth from Centric PLM. As mentioned, and for the reasons outlined before, MEDIDATA is expected to contribute mid- to high single digits in Q3 before returning to double-digit growth in Q4. For services revenue, we are predicting a normalized 2% to 5% growth.

In terms of profitability, we are forecasting operating margin of 30.2% to 30.5%, and diluted EPS of EUR 0.26 to EUR 0.27. For additional information and to review what we've discussed, please take a look at our earnings presentation.

In conclusion, we've had a good first half of the year with strong second quarter results. The growth is broad-based and the momentum is improving across all major geographies, driven by strength in industrial and mainstream innovation. We are on track to achieve our objectives for the year, which reflects an acceleration of growth in 2H. These results demonstrate that our platform strategy is well aligned with the priorities of our clients. We are focused on execution to deliver our sustainable growth throughout the year. And as such, we remain confident to achieve and advance towards our EPS objective of EUR 1.20 for the year.
And now with this, Bernard, Pascal and I are happy to take your questions.

# Question and Answer

**Operator**

[Operator Instructions] And the question comes from the line Michael Briest from UBS.

**Michael Briest**
*UBS Investment Bank, Research Division*

Just on the MEDIDATA performance. Can you talk about the mix of the business that you have between pharma and biotech and the CROs because clearly, the CRO change was quite dramatic. And then on Centric PLM, just looking at my notes, I think in 2020, the business had EUR 76 million in revenues. So when you're talking about EUR 1 billion, can we assume this is an area that you're actively looking for acquisitions in?

**Bernard S. Charles**
*Chairman & CEO*

Thank you, Michael, for the question. On MEDIDATA, the mix between biotech and pharma to CROs is about 60-40. And it has -- the CROs have picked up in terms of their growth over the years. It used to be 30-70, it's now more 40-60. And that's due to the very strong volume increase that we have experienced since 2019. And I think we are now in a period where this is going more back to the 30-70 we had before potentially.

**Pascal Daloz**
*Deputy CEO, COO & Director*

Michael, related to Centric PLM. You're right. I mean this year, we do expect to be close to EUR 200 million, which, to a certain extent -- yes, software. I'm saying, Rouven, telling me, it's higher than this. But anyway, my point is the next step is really EUR 0.5 billion and then after it's EUR 1 billion. To go to the EUR 0.5 billion, I think with what we have done until now, everything is set. As I was explaining, the diversification from a subsegment industry standpoint, moving from apparel and fashion to retail to consumer electronics to personal care, right?

The fact also that we are expanding from the brands to the retailers and to the manufacturers as well is really opening coverage expansions in order to nurture the growth. At the same time, we are evolving the concept of the collection management to the business platform. Because, at the end, Centric, PLM is a business platform for all the customers in the consumer industries.

And more and more, they are using this business platform as a way to enable, if you want, the online sales. And you noticed, we did some very small acquisitions to enhance the portfolio. One was related to the pricing, how we can integrate the pricing as part of the strategy in order, not only when you do the collections and you operate if you want the portfolio for the online sales to be able to modelize the performance of the business plan, but also to be able to do some real-time price adjustment, which is extremely important in the fast-moving goods because as you know, you have a lot of elasticity on price.

We are also expanding on the planning side, right? Because it's a complex chain. It's a complex value network. Having the ability to optimize the planning for all the different stakeholders is becoming something extremely important. Why we do this? Because you remember Centric is a subscription-based model for the vast majority of what we do. And each time we are renewing, we have exactly the same strategy that we have with MEDIDATA is not to renew at parity, of course, is to expand the share of wallets. And that's how we are complementing, if you want, by having additional modules to give reasons for the customer to expand with us and to consider Centric PLM a little bit more than the collection management systems.

That's, I think, the foundations to go to the EUR 0.5 billion. And I think it's probably too early to speak about how we will do the other half, and I will come back at the appropriate time on this.

**Operator**

The questions come from the line of Laurent Daure from Kepler Cheuvreux.

**Laurent Daure**
*Kepler Cheuvreux, Research Division*

I also have 2 questions. The first is back to MEDIDATA. I understand your comments for the coming quarters, but I was also interested in your views when, today, you discussed with your main clients their plans in terms of number of trials they have maybe

2 or 3 years from now, don't you think that there is a risk of really softness, not just for a few quarters, but in the longer term? So any granularity on this will be more than welcome.

And my second question is more for Rouven. On the margin side, when I look at your Q3, you need a much stronger margin in the fourth quarter. So we understand the wages are moderating and the headcount growth is also moderating. But do you also have other drivers to give us more comfort into your full year objectives?

**Pascal Daloz**
*Deputy CEO, COO & Director*

I take the first one, Rouven. You can complement whatever you want. So Laurent, again, if you look at the trend for the clinical trial, the average growth is between 6% to 8% for decades, right? And this is a normalized growth. When COVID happened, we had an extra. These numbers almost improved by 50%, right, exceeding 10%, 12% was the number. So I think on the long run, we are not making a mistake to assume that the underlying growth will stay what we have seen in the last decade. And we have evidence of this. And you could cross check with many, many studies. That's one piece.

The second piece, as Rouven was saying, our winning rate is extremely high for at least the Phase II and the Phase III where, as you know, this is the bulk of the market, is exceeding 75%, and we continue to improve the winning rates.

Last but not least, it's something also extremely important. I was making this comment when I was commenting why certain customers are selecting us. It's because we are bringing not only the solutions, the technical solutions, but also the therapeutic domain expertise. We could claim we have a significant presence in the oncology, but if I subsegment all the clinical trials in different domains, there are still areas where we could expand significantly, right? One of them is probably related to, for example, the Alzheimer. As you may know, you have a lot of new molecules coming on the market. It's a promising market in the coming years. And those clinical trials are extremely complex because not only you have to measure from a biology standpoint, from a medical standpoint what it means, but also you have to assess the behavior of the people. And this mix is a complex thing to do, against just as administration, how we could continue to expand.

So if you do the sum, the combination between the market growth plus the winning market share and the expansion to subsegment the market, I think we have enough to continue to maintain the rhythms and to continue to expand what you have experienced in the last years since MEDIDATA came to -- with us.

**Rouven Bergmann**
*CFO & Executive VP*

Okay. Laurent, I take the second question because I have nothing to add to the first. On the margin, we had very good margin performance in the second quarter, thanks to the measures we have taken and the disciplined approach to our investments. We have very good visibility into the second half of the year as it relates to OpEx. I remember, in Q1, the OpEx growth of around 13% year-over-year. Q2 was 8%. And it's right in Q4, in our plan, we've set the majority of -- we've essentially consumed the expense carryover by the end of Q3 to see the full benefit in Q4.

And I would say we are, in fact, a little bit ahead of the plan. So we have good visibility. Given the strong performance in Q2, we were able to risk adjust for the second half. I might not have -- we might not have reflected everything of this in the Q3 guidance, right, to give us just some room, but we have good visibility for the year on the margin. I hope that gives you the comfort that you're looking for.

**Operator**

The questions come from the line of James Goodman from Barclays.

**James Arthur Goodman**
*Barclays Bank PLC, Research Division*

Apologies to add 1 more just around the MEDIDATA situation, just maybe zooming out a little bit. Just wondered if you could -- you've talked a bit about the win rates. But just from a competitive situation, clearly, there's been quite a lot of noise in the market over the course of this year. One of your competitors is growing quite fast in R&D. And I wondered if you could talk about it from a product perspective. So a lot of top 50 deals, but is that primarily EDC or how successful is the business being cross-selling other main modules like CTMS into that base?

And has the competitive situation had any impact at all, and there's been some management change in that business over the course of this year as well.

Second question, just around the SOLIDWORKS strength. I think you've got some price rises due to come through in July. Just wondered if there's any one-off impact that you can defer in this quarter from any sort of form of customer behavior ahead of that or sort of early price rises that might have come in already.

**Pascal Daloz**
*Deputy CEO, COO & Director*

Okay. I will start with the first part, Rouven, and maybe you can take the SOLIDWORKS question.

**Rouven Bergmann**
*CFO & Executive VP*

Sure.

**Pascal Daloz**
*Deputy CEO, COO & Director*

So related to the competitive landscape. I think there are 2 ways to address your topic. The first one is, the environment, to a certain extent, is forcing certain customers also to consolidate their choice. At the COVID time, we saw a lot of startups coming promising sometime the moon and having hard time to deliver. It was extremely obvious, for example, in what we call the decentralized clinical trial, right, when you have to do the trial from home. Why I am saying this? Because we are rescuing right now some of those large studies using start-up solutions. And some of them are in bankrupt or close to.

Where I want to go with this? I think the platform concept is becoming more and more understandable by this industry. Because for a long time, they were putting, I think, more emphasis on the best-of-breed approach. Now they start to see the benefits of having the platform to connect the dots. And to a certain extent, if I want to make an analogy, what's happened in our manufacturing space, I don't know, 10 years ago, 15 years ago or maybe 20, when the market moved from the traditional PDM approach to the platform-based approach is happening also in this industry, moving from what we call the EDC approach, electronic data records, to a platform-based approach, which is much more data-centered, AI-based, modeling and simulation enabled.

And this is making the big difference because all the modules, whatever we call -- we speak about ECO, RTMS, CTMS, all this collection of very specialized modules will be redefined in a completely different manner because many of the functionality will be managed at the platform level and not anymore at the application level. This is happening. This is changing a lot of the way the landscape is structured and defined. And I think we are leading this transformation by far. Proof of what I'm saying. Obviously, the platform concept is extremely meaningful for the top 50 large companies because you know this industry is heavily concentrated.

And the bookings for this segment is almost growing 2x faster than the current performance of MEDIDATA, right? So the traction is there. And as you may know, this is where one of our competitors, probably the one you have in mind, they are focusing right now. So to a certain extent, if you look at the different elements, what is happening from reconfigurations of the system standpoint plus the market trend we are really experiencing right now, I think we are in a very good position.

The exposure we have on the small biotech does exist but mainly through the CROs, right? This is what we call the study-by-study business. And as you may know, what does it mean? It means they are not contractualizing with us on the global enterprise in order to have a capacity to run different studies. We are contracting one by one. The way to do it is usually through the CROs. And that's the reason why what Rouven was saying. This is where we are seeing the volume decreasing, but at the same time, our market share is increasing. Because from an efficiency standpoint, when the volumes are dropping, if you are big CROs, you need to improve your efficacy and your efficiency. And we have a lot of technology to make this happen. It's extremely visible with against the large contract we have with the largest CRO whatever it's PPD of IQVIA, just -- or Syneos, just to name a few of them. That's for the competitive landscape. Maybe, Rouven, you can take the question related to SOLIDWORKS.

**Rouven Bergmann**
*CFO & Executive VP*

Yes, happy to. James, on SOLIDWORKS. I think for you, the main key takeaway is that on a year-to-date basis, we are back to 7% growth. Q2, as we said, is 12%. On the license, Q2 was very strong with 15% while we were actually down 14% in Q1. So Q2 and Q1, you see the trend reversing. And if we look at the contribution from China, Pascal mentioned that, it's really a catch-up from the low level of consumption in Q4 and 2022, where the investment cycles are now geared towards innovation to retool and expand --

accelerate innovation cycles and scale. We see that clearly in China. The price increase in China was very, very marginal so there is no such thing than anticipation. In North America, the sequential growth in SOLIDWORKS is flat. So we have a similar performance. So do not expect there to be any anticipation. I think we are already on a kind of normalized trend. And so we expect now the 7% to 8% as the run rate go forward as we have seen in previous years.

**Operator**

The questions come from land of Nicolas David from ODDO BHF.

**Nicolas David**
*ODDO BHF Corporate & Markets, Research Division*

I have 2. The first one is regarding China. How should we see H2 after the very strong Q2? I mean, do you think that Q2 benefited from a catch-up after several quarters very low? Or is it a normal performance, and we can expect in the new world and expect growth to continue like that in H2? And you didn't mention China specific case of Industrial Innovation, larger contracts, where do you stand there?

And my second question is regarding 3DEXPERIENCE. Could you help us reconcile the difference of growth you have from 3DEXPERIENCE and Industrial Innovation, which is still pretty strong, while 3DEXPERIENCE are growing less? And does it have an impact all in all on your revenue growth because of a shortfall of revenue given that 3DEXPERIENCE tend to be higher in terms of pricing and cross-selling. Any color would be helpful.

**Pascal Daloz**
*Deputy CEO, COO & Director*

So I will start first. I'll just say, China, there are 2 trends. One was the catch-up on the mainstream market. That's what we were expecting to happen. And you have seen the result in Q2. And if I look at the pipeline for H2, it's normalized, right. The second one is the SOE, the state-owned company, where you remember, in the first half of the year, first, many of them, they were waiting for the elections to happen before to engage, commercially speaking. And, two, the geopolitics has, to a certain extent, slowed down a little bit the process because for many of them, right now, when they are buying a piece of software, they should almost justify why they are not buying Chinese software or what they want to do?

Why I'm saying this because in Q2, you have the benefit of the rebound of the Mainstream, but you do not have yet the full contribution of the large SOE transaction we have in our pipeline. They are expected to be closed in H2. Whatever it's in the aerospace or transportation and mobility and industrial equipment, this is where we have the largest one, and also in construction.

So to answer to your question, so we are relatively confident that you will see something similar happen for Q3. And I still expect to have certain accelerations happening probably between Q3 and Q4. But right now, I'm betting much more on Q4 than Q3. That's where we are.

Related to the 3DEXPERIENCE platform, it's almost the same story. Again, you have seen certain -- the last transaction was missing in Q1. They are coming back in Q2. And you will see the benefit of them in Q3 and Q4, and all of them are 3DEXPERIENCE related. So the contribution in the mix will improve, and you will see that at the end of the year, we will be aligned with what we were expecting for this year. We are relatively dependent on those large transactions, which is normal. And as you may know, usually, they are backloaded, and that's the reason why from a quarter to another one, we are giving this indicator, but the reality at the end, the most important is to be aligned on the trajectory on a yearly basis because it's a multiyear plan, right? If you want to add a few things, Rouven, feel free. If not...

**Rouven Bergmann**
*CFO & Executive VP*

No, no.

**Pascal Daloz**
*Deputy CEO, COO & Director*

No?

**Nicolas David**
*ODDO BHF Corporate & Markets, Research Division*

just regarding SOLIDWORKS in China, when you mentioned H2 should be normalized. It's normalize at the same level in Q2 or normalize at a more lower level.

**Pascal Daloz**
*Deputy CEO, COO & Director*

No, no. It will be the one it used to be. I mean, I do not expect to do a 20-plus percent growth in mainstream in China every quarter, overall, total software for mainstream. On a license standpoint, yes, right, which, again, is a double-digit growth. That's what we are targeting. And it's a good sign you remember because the mainstream market is usually the only indicator for the investment cycle, and Rouven and I, we were relatively careful. If you remember at the beginning of the year when we came with the guidance, some of you were pushing us to be more aggressive on China. And we say, no, no, this is what -- not what we are seeing in the pipeline. But to a certain extent now, I think it's almost the opposite. You have a lot of comments related to potentially a slowdown in China and, to a certain extent, we have a better visibility for the second half of the year than we have for the first half of the year.

Because, remember, the first priority for the Chinese economy was to relaunch the consumption. Now they are investing to relaunch the innovation cycle, and it's extremely visible on our side in all the different sectors we are touching.

**Operator**

The questions come from the line of Toby Ogg from JPMorgan.

**Toby Ogg**
*JPMorgan Chase & Co, Research Division*

A couple from me. Just firstly, on the guidance for Q3, just the subscription growth 17% to 19%. In the quarter, you've indicated MEDIDATA to be probably sort of mid-single to high single digit in Q3. So recovery on the subscription won't be from the MEDIDATA side. So just mechanically, where does that reacceleration come from on the subscription part of the business? And is there any upfront revenue recognition from SOLIDWORKS in there?

Then secondly, just on the MEDIDATA outlook into the second half. You mentioned the return to double digit by the end of the year and Q3 could be that mid- to high-single-digit. So I guess the question here is what would drive the mid- to high in Q3 versus the high-single-digit done in Q2? And then what have you assumed for the development of clinical trial starts through the second half of the year?

**Pascal Daloz**
*Deputy CEO, COO & Director*

Okay. Toby, I go -- I will take a run at your questions and, Pascal, please add. So the first one on the guidance. Yes, 17% to 19%, 13% in Q2 and 13% year-to-date. So the key drivers of the acceleration is, as Pascal mentioned before, we have significant 3DEXPERIENCE opportunities in our deal road map in Q3 in key industries, and they are well advanced at their expansion with the existing clients. They are going on an accelerated path to adopt 3DEXPERIENCE platform.

The second part, I mentioned in my prepared remarks, which is really an important message for you to take from this call is that the SOLIDWORKS customer base is increasingly adopting the subscription-based pricing. The subscription growth for SOLIDWORKS has been up 50% year-to-date, and the number becomes meaningful. And then we mentioned and talked about the strong growth of Centric. Centric is a subscription business. We transitioned that entirely to be subscription. And that's growing extremely nice, as Pascal mentioned, we had this large deal in Q2, and we have a good pipeline in 2H.

So yes, MEDIDATA will be back to double-digit growth in Q4. And -- because of 2 reasons. #1 is, we will be, through the baseline effect that I've explained in Q2, which will recur in Q3 as a result of the ramp-up of the large mega trials of 2020 that wrapped up in 2022, where we had the benefit of recurring up revenue at the end of this, which is kind of a onetime revenue when that be recognized in 2022 that creates an unfavorable comparison of about 3 points to the growth rate in 2023.

We will have that behind us in Q4, and we will also compare, I think, to have a more favorable comparison in Q4 versus in Q2 and Q3 overall also because of volume. We have seen that the lower volume growth already starting at the end of last year. While now as we had some renewals with bigger CROs that were lower for the reasons Pascal explained, where we see this trend now becoming a little bit more material. So we are starting to normalize that. And of course, a good performance in the enterprise, top pharma 50 companies bookings, they will translate into revenue in the following quarters. So that's the summary of the subscription performance and the explanation for MEDIDATA.

**Operator**

The questions come from the line of Frederic E. Boulan from Bank of America.

**Frederic Emile Alfred Boulan**
*BofA Securities, Research Division*

First of all, on Industrial Innovation, we had a nice acceleration this quarter on the '22 that was pretty strong. So we discussed some of the impacts on China, but is there anything more specific or additional you want to point out in terms of a driver of that? And to what degree you think this is sustainable.

Second question around free cash flow. So you -- we had a second quarter that was impacted by about EUR 150 million negative working cap. You flagged this impact on cash taxes. But can you discuss more broadly working cap, how you see that developing through the rest of the year, and how we think about this for cash flow for this year?

And then if I can, just a quick clarification on your commentary around growth. I think in Mainstream Innovation, you mentioned you expect 7% to 8% as gross run rate go forward. Is this a commentary for SOLIDWORKS in particular or for the whole segment? I think you did 12% in Q3. So I just wanted to clarify that.

**Pascal Daloz**
*Deputy CEO, COO & Director*

Okay. I'll take the first one. So again, the best way to answer to your question is to look at by industry subsegment. I think the trend is still extremely positive in aerospace across the board, Europe, U.S., Asia, not only for the large OEM, but also for the supply chain at large. And as you may know, almost the industry standardized on 3DEXPERIENCE platform. And this is triggering, to a certain extent, the expansion towards the simulations, the manufacturing and cyber system design, which are really the expansion we are bringing with the new set of solutions. So that's one thing. The transportation and mobility sector is also steady for us, mean same thing is happening across the board, driven by the electrification of the car, but also the new mobility experience. And we see more and more innovations coming.

You have this market trend, which is what we call the software-defined vehicles. And probably it's a topic on which we will come back to give you our perspectives and how we position ourselves on this, but it's a major trend touching this industry at large, and we are benefiting from this. The next segment is Industrial Equipment because industrial equipment, we -- the vast majority is coming from the mainstream, but we have a significant footprint with CATIA and [indiscernible] platform and ENOVIA specifically and also SIMULIA for the very complex equipment. And this market is also a good one where, I think, we have a good winning rate, and we are expanding our footprint.

So overall, if you look at -- and it's my echoing commentary as an introduction. We see -- we saw a rebound in the investments in the innovation cycle. It's happening in the industry. And again, when we are telling you the manufacturing industry, there is a convergence of the experience economy on one hand and the circularity on the other hand, it's really, really redefining the entire portfolio for all those companies. And the disruptions coming from the supply chain and the materials are still there.

But now there is also an opportunity if you want to rebuild in a different way. You cannot imagine, for example, in Aerospace & Defense how many time we spent to discuss about the new materials to choose certain existing materials, but each time you introduce a new material, this is changing everything. This is changing the design. This is changing the way you produce, the way you maintain. And this is impacting at large the cycle. So that's, to a certain extent, the reason why the -- you have seen this good trend in the manufacturing innovation board, driven specifically by the manufacturing industry, but not only. And it's touching almost all the different product lines we have, starting with CATIA, which is the largest one.

Beatrix, do we conclude here.

**Rouven Bergmann**
*CFO & Executive VP*

So we have -- I think the cash flow question...

**Pascal Daloz**
*Deputy CEO, COO & Director*

Oh, cash flow.

**Rouven Bergmann**
*CFO & Executive VP*

So on the cash flow, you wanted some assurance and explanation for Q2. I would encourage you to look at year-to-date because we always have some seasonality in the number. And when you look at the working capital, on a year-to-date basis, the operating working capital, in fact, is improving by EUR 49 million year-over-year. We've explained this in detail in the documents that we've provided you today. I want to highlight 1 or 2 things that are standing out in this. One, which is when you look at the decrease in trade accounts receivables and contract assets, this decrease was very strong in Q1 because of strong collections in Q1 and the extreme high level of activity in Q4.

Remember, Q1 this year was a softer quarter. As such, you would expect the collections from Q1 also be slightly lower than what our growth rate -- our growth trajectory certainly is. So there is a seasonality impact here between Q1 and Q2, where the decrease in trade receivables in Q2 is lower than what we had in Q2 of last year. So -- but the balance of Q1 and Q2 is still favorable, very much so, of EUR 151 million. And now you combine this with the contract liability -- the increase in contract liability, which is down year-over-year. Last year, we had a really strong impact in the increase of contract liabilities at the time when we increased -- when we did the pricing change for SOLIDWORKS. And there, lots of SOLIDWORKS customers bought multiyear subscription and multiyear deals.

And that elevated very much the contract liability as a deferred revenue. We didn't have that buying in advance in Q2 this time because it was more of a catch-up and less so multiyear. So that explains the difference in the -- the big difference in the contract liabilities. But the net of it is positive, keep that in mind. I think the unfavorability in the nonoperating is very marginal, minus EUR 13 million. This is a little bit of noise. This will balance out.

It's really due to the higher tax payments because of our growth, right? We simply see activity that's reflected in that. For the rest of the year, DSOs are improving. I think we have improved DSOs even though there's -- you could argue the difficult macro environment, but we're doing a good job in driving collections, and I see this trend to continue. And so for the full year, we are expecting our operating cash flow to grow in line with our operating performance.

**Bernard S. Charles**
*Chairman & CEO*

I think with that, thank you very much for participating this morning and for your questions. We will host another conference call at 3:00 Paris time. For our friends who are maybe on the West Coast, it will be more convenient for them. Enjoy your day and have a nice summer break for those of you who are taking a summer break and talk to you soon. Thank you very much. Have a good day.

**Operator**
Ladies and gentlemen, this concludes today's conference call. Thank you for participating. You may now disconnect your lines. Thank you.