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Waters Corporation (WAT) CEO Chris O'Connell on Q3 2019 Results - Earnings Call Transcript

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Q3: 10-29-19 Earnings Summary

Press Release SEC *10-Q*

EPS of $2.13 beats by $0.00 | Revenue of $577.28M (-0.13% Y/Y) misses by $-11.07M

Earning Call Audio

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Waters Corporation (NYSE:WAT) Q3 2019 Results Earnings Conference Call October 29, 2019 8:00 AM ET

Company Participants

Chris O'Connell - Chairman and CEO

Sherry Buck - SVP and CFO

Bryan Brokmeier - Senior Director, IR

Conference Call Participants

Doug Schenkel - Cowen

Tycho Peterson - JPMorgan

Derik De Bruin - Bank of America

Dan Brennan - UBS

Stephen Beuchaw - Wolfe Research

Steve Willoughby - Cleveland Research

Vijay Kumar - Evercore

Jack Meehan - Barclays

Operator

Good morning, and welcome to the Waters Corporation Third Quarter 2019 Financial Results Conference Call. All participants will be in a listen-only mode until the question-and-answer session of the conference call. This conference call is being recorded. If anyone has any objections, you may disconnect at this time.

It is now my pleasure to turn the call over to Mr. Bryan Brokmeier, Head of Investor Relations. Please go ahead, sir.

Bryan Brokmeier

Thank you, operator. Good morning, everyone, and welcome to the Waters Corporation's third quarter earnings conference call. Before we begin, I will cover the cautionary language.

During the course of this conference call, we will make various forward-looking statements regarding future events or future financial performance of the company. In particular, we will provide guidance regarding possible future results of the company for the fourth quarter and full year 2019.

We caution you that all such statements are only our present expectations that actual events or results may differ materially. For a detailed discussion of some of the risks and contingencies that could cause our actual performance to differ significantly from our present expectations, see the risks factors included in our annual report on Form 10-K for the fiscal year ended December 31, 2018, in Part 1 under the caption, Risk Factors, and the cautionary language included in this morning's press release and 8-K.

We further caution you that the company does not intent to update its -- any of its predictions or projections, except during our regularly scheduled quarterly earnings release conference calls and webcasts or as otherwise required by law. The next earnings release call and webcast is currently planned for February 04, 2020.

During today's call, we will be referring to certain non-GAAP financial measures. Reconciliations of the non-GAAP financial measures to the most directly comparable GAAP measures are attached to our earnings release issued this morning and available on the company's website.

In our discussions of the results of operations, we may refer to non-GAAP results, which exclude the impact of items such as those outlined in our schedule titled Reconciliation of GAAP to Adjusted Non-GAAP Financials included in this morning's press release.

Unless stated otherwise, references to quarterly results increasing or decreasing are in comparison to the third quarter of fiscal year 2018. In addition, unless stated otherwise, all year-over-year revenue growth rates, including revenue growth ranges given on today's call, are given on a comparable constant currency basis.

Now, I'd like to turn the call over to Chris O'Connell, Waters' Chairman and Chief Executive Officer. Chris?

Chris O'Connell

Thanks, Bryan, and good morning, everyone. Thank you for joining us today. Along with Bryan Brokmeier, joining me on this morning's call is Sherry Buck, Waters' Chief Financial Officer.

During today's call, I will provide an overview of our third quarter operating results, as well as some broader commentary on our business. Sherry will then review our financial results in detail and provide comments on our fourth quarter and full year 2019 financial outlook. We will then open up the phone lines to take your questions.

Briefly reviewing our operating results for the third quarter, revenue grew 1%, while adjusted earnings per share grew 11%. With one meaningful exception, the third quarter played out largely as we expected. That exception was the U.S. where we saw unanticipated late quarter softness, which led to a shortfall against our overall revenue expectations for Q3.

At the time of our last earnings call, the strength of our U.S. performance in Q2 as well as the growth we saw during the first month of Q3 reinforced our prior expectation that we would see positive second half trends in the U.S. market. However, that momentum yielded to a more cautious tone from our U.S. pharmaceutical customers as the quarter developed, resulting in inconsistent capital purchasing in the second half of the quarter.

Outside of the U.S. Q3 played out largely as we expected, with a continuation of mixed market conditions in China and Europe that we’ve seen throughout the year.

Stepping back to look at 2019 through the first three quarters, it is clear, the challenges in the global macroeconomic environment, including market effects of government policy changes in China, lingering European political uncertainties, and mixed sentiment in the U.S. have led to a more variable set of end market conditions than we expected coming into the year.

Customers in key markets we serve have simply been more cautious in their capital purchasing during 2019 and more willing to delay spending quarter-to-quarter. One particular market impacted by these global macroeconomic challenges during 2019 has been small molecule pharmaceutical LC applications. This market where Waters has unique focus appears to be in a slower growth environment with ongoing stability and recurring revenue while simultaneously seeing modest pressure in instrument systems sales.

Certainly recent trends in India and China play a central role in this dynamic as does U.S. and European volatility in recent quarters.

That said, we are confident in our leading technology portfolio and strong market position as well as the long-term growth prospects of the small molecule LC market.

Aside from the macro environment, Waters has been diligently focused in 2019 on an exciting series of new product introductions that is positioning the company for a robust multiyear product cycle. While the impact of these new products has not been highly visible on the revenue line yet, market development activities are progressing well. And we are very pleased with early customer reactions.

BioAccord made solid incremental progress in Q3 relative to demo, quoting and sales pipelines. And the third quarter launches of the Cyclic IMS, SYNAPT XS and our two new tandem quad mass spectrometers have all been very well received. We expect to see an increasing sales contribution from all of these key products in Q4 2020 and beyond.

We remain very positive on the long-term attractiveness and durability of the markets we serve. In particular, our recurring revenue, consisting of precision chemistries in servicing of our instruments has remained steady, indicating consistent underlying utilization of our strong installed base of instruments.

Taking a closer look at the business starting with a review of our market categories at the corporate level, sales to our broadly defined pharmaceutical category increased 3% for the quarter and year-to-date, with strong growth in China and India, partially offset by weakness in the U.S. and Europe. As I stated earlier, the global market for small molecule pharmaceutical applications is currently experiencing a more modest growth environment.

Conversely, the global large molecule market remained robust in Q3 and year-to-date. And we have sustained consistently positive results supported by our focused investments in this category, across LC, LC-MS and chemistries.

Sales to our worldwide industrial category, which includes the material science, food and environmental markets, were flat in the quarter with strength in material science offset by global weakness in food testing markets.

Furthermore, our industrial category remained solid in the U.S., but soft in Europe. Year-to-date, our worldwide industrial category sales were down 2%.

Sales to our academic and governmental category were down 3% in Q3 as strong growth in European biomedical research and materials research applications is offset by weakness in the Americas and China markets, most notably the China food segment. Year-to-date, our academic and governmental category was flat as growth in Europe and the U.S. has been offset by declines in China.

Next, I will review our sales performance by geography at the corporate level. Asia, our largest region in terms of revenue grew 7% in the third quarter. China grew 2%, which as I noted earlier, was driven by strong pharmaceutical growth, partially offset by food market weakness, and has been further influenced by the broader economic slowdown in China.

Looking specifically at the China pharmaceutical market, generic customers were cautious at the beginning of the year, while they digested the impact of the 4+7 program. However, this caution has given a way to a return of capital investment. Bidding in the second phase of the 4+7 program occurred in September and we're closely following the subsequent developments.

We continue to be encouraged by the pragmatic tone of our customers through this process, as well as the program's increasingly stringent quality requirements, which together support our initial observations that the larger pharma companies with higher market shares will be the most likely to benefit from 4+7.

Furthermore, we're well positioned in this regard, because within the Chinese generic pharmaceutical market, we have a higher concentration of sales to these larger companies than we do to smaller companies.

As mentioned last quarter, we believe that 4+7 will result in rising generic prescription volume in China over time, creating a positive tailwind for instrument demand. In India, solid growth was driven by the continued strength in the pharmaceutical market partially offset by industrial softness. Elsewhere in Asia, we continue to be pleased with our business in Japan and Korea, where we expect ongoing stability.

Turning to the U.S., we are disappointed with the 4% decline in the third quarter. U.S. pharma reversed the improving trend we saw in Q2 as our largest pharmaceutical customers, as well as generics companies slowed spending across both LC and LC-MS instruments during the second half of the third quarter.

On the other hand Q3 sales to our U.S. industrial customers grew 5% year-over-year. Overall, the Americas declined 5% in the third quarter, including expected weakness in Latin America, due to the ongoing political instability in both Mexico and Brazil.

Year-to-date, the U.S. grew 2% slightly ahead of 2018's Q3 year-to-date results, while total Americas in 2019 year-to-date have been flat, influenced by weakness we've seen in Latin America throughout the year as well.

In Europe, sales were flat in the quarter with a nice rebound in Eastern Europe that we expected offsetting a slight decline in Western Europe. Overall European results continue to be impacted by cautious Big Pharma capital spending as well as weakness in food and environmental markets.

Finally, I will review product line dynamics within our Waters and TA brands. Waters branded instrument sales declined 5% in the quarter. LC instruments declined slightly, and system with broader market LC trends that we spoke about earlier in our commentary. In LC-MS, our Q3 business was impacted by the weak Chinese food market as this market has a high concentration of our tandem quad LC-MS systems.

Outside of the China food market, our tandem quad portfolio performed well in biopharma R&D, followed -- following the early third quarter launch of our Xevo TQ-S cronos and the next generation version of the popular Xevo TQ-S micro. We are also off to a good start with the launch of our Cyclic IMS and SYNAPT XS systems.

Commercialization of our BioAccord system continues to track positively as market development activities support a meaningful multiyear revenue ramp. Overall in LC-MS systems we are excited about our investments over the past several years in new instruments, chemistries and informatics targeting high growth applications, such as biopharma and we believe that we are now poised for improving results driven by our enhanced and extended portfolio.

Waters branded recurring revenues which reflect the combination of service and precision chemistries grew 5% in the quarter. Chemistry strength in our pharmaceutical business was partially offset by softness in our industrial and academic and governmental categories. In particular, growth is strong and consistent within our application kits, UPLC columns and bioseparation columns. And we are seeing good uptick of our focused branded HPLC columns.

Turning to our TA product line, sales grew 5% in the third quarter with TA instrument system sales up 7% and service sales up 1%. We are encouraged by solid ongoing growth in our thermal and microcalorimetry product lines. I am proud of our TA team which has maintained great focus through a period of leadership transition. Our new President of TA, Jon Pratt, has brought great new energy and leadership that will enable TA to build on its historic success to make even more significant contributions to Waters over time.

Returning to the big picture, we remain steadfastly focused on executing on our five point value creation model. As we have consistently communicated, we aim to create shareholder value by: One, holding a leading specialty position in structurally attractive markets; two, executing a focused growth strategy driven by organic innovation; three, seeking opportunities for continuous operational improvement in innovation, channel and operations; four, maintaining capital discipline as we have shifted from being a capital accumulator to a capital deployer; and five, operating with a performance-oriented culture and management team.

To recap the third quarter, our assumptions in China and Europe played out as we expected, while we experienced volatility in the U.S., particularly among our largest pharma customers. While the macro environment in 2019 has been more challenging than we expected, our concerted investment in new product development is yielding a strong cadence of new products that should increasingly contribute to results over the coming quarters and years.

Looking to the fourth quarter, while we continue to focus on improving our sales growth and are prepared to fulfill higher demand, we are modeling our fourth quarter consistent with year-to-date trends. Sherry will cover the details of our guidance during her remarks.

With that, I'd like to pass the call over to Sherry Buck for a deeper review of the third quarter financials and our outlook. Sherry?

Sherry Buck

Thank you, Chris. And good morning, everyone. In the third quarter, we recorded net sales of $577 million, an increase of approximately 1% in constant currency. Currency translation decreased sales growth by approximately 1% resulting in flat sales as reported.

In the quarter, sales into our pharmaceutical market grew 3%, sales into our industrial market were flat, while academic and governmental markets declined 3%.

Looking at product line growth, our recurring revenue, which represents the combination of precision chemistry products and service revenue, grew 5% in the quarter, while instrument sales declined 3%. As we noted last quarter, there was no year-over-year difference in the number of calendar days during the third quarter but there is one additional calendar day in the fourth quarter of 2019 compared to 2018.

Breaking third quarter product sales down further, sales related to Waters branded products and services were flat, while sales of TA branded products and services grew 5%. Combined LC and LC-MS instrument platform sales were down 5% and TA's instrumentation system sales were up 7%.

Looking at our growth rates in the third quarter geographically and on a constant currency basis, sales in Asia were up 7% with China growing at 2%, sales in Americas were down 5% with U.S. down 4% and European sales were flat.

Now, I'd like to comment on our third quarter non-GAAP financial performance versus the prior year. Gross margin for the quarter was 58.2%, about flat compared to 58.3% in the third quarter of 2018.

Moving down the third quarter P&L, operating expenses were about flat year-over-year on a constant currency basis and benefited from lower variable expenses as compared to the prior year. In addition, foreign currency translation decreased operating expense growth by approximately 2% on a reported basis.

In the quarter, our effective operating tax rate was about 16%. Year-to-date, the tax rate is approximately 15%, which is in line with our full year guidance. Net interest expense was $8 million, an increase of about $6 million from the prior year as anticipated, as we shifted to a net debt position over the course of the year. Our average share count came in at 66.8 million shares, a share count reduction of approximately 13%, or about 10 million shares lower than in the third quarter of last year. This is a net effect of our ongoing share repurchase program.

Our non-GAAP earnings per fully diluted share for the third quarter increased to $2.13 in comparison to $1.92 last year, an increase of about 11% driven by our ongoing share repurchase program, and lower variable expenses as compared to the prior year.

On a GAAP basis, our earnings per fully diluted share increased to $2.07 compared to $1.83 last year. A reconciliation of our GAAP to non-GAAP earnings is attached to the press release issued this morning.

Turning to free cash flow, capital deployment and our balance sheet, I'd like to summarize our third quarter results and activities. We define free cash flow as cash from operations, less capital expenditures and excluding special items. In the third quarter of 2019, free cash flow came in at $124 million after funding $24 million of capital expenditures. Excluded from free cash flow was $21 million related to the investment in our Taunton precision chemistry operation. In the third quarter, this resulted in $0.22 of each dollar of sales converted into free cash flow and $0.25 year-to-date.

Now, I'd like to provide an update on our third quarter activities related to capital deployment, which we've categorized into three areas: Investing for growth; balance sheet strength and flexibility; and return of capital to shareholders.

In terms of returning capital to shareholders, we repurchased 2.7 million shares of our common stock for $580 million in the third quarter. These capital allocation activities along with our free cash flow resulted in cash and short-term investments of $405 million and debt of $1.4 billion on our balance sheet at the end of the quarter resulting in a net debt position of $951 million. Looking ahead, we remain committed to deploying capital against these three priorities.

Our current plans are to repurchase approximately $600 million in shares during the fourth quarter and consistent with our previous communications, about $2.5 billion for the full year. These assumptions are reflected in our full year 2019 guidance.

Turning to working capital, accounts receivable, day sales outstanding came in at 80 days this quarter, up slightly compared to the third quarter of last year. In the quarter, inventories increased by $55 million in comparison to the prior quarter, driven by planned inventory build related to Brexit contingency planning, and new product launches. Lower quarterly sales volumes also impacted inventory balances.

As we look forward to the remainder of the year, I'd like to provide some broader context on our Q4 and full year 2019 guidance. Given dynamics through the first three quarters of the year, we're expecting ongoing mixed end market conditions in China and Europe, improvement in the U.S. versus Q3, and increasing benefits from new product launches.

Our guide does not assume large end of year budget spending by pharmaceutical customers. As a result, we expect constant currency sales growth in the fourth quarter to be in the range of flat to 2%. At today's rates, currency translation is expected to decrease fourth quarter sales growth by about 1 percentage point. Fourth quarter non-GAAP earnings per fully diluted share is estimated to be in the range of $2.95 to $3.05. At current rates, a negative currency impact on fourth quarter earnings per share growth is expected to be 2 to 3 percentage points.

Looking to the full year, assuming we perform within the guidance range for the fourth quarter, that would result in full year 2019 constant currency sales growth guidance of about 1% compared to our prior guidance range of 1% to 3%. At current rates, currency translation is assumed to decrease 2019 sales growth by 1 to 2 percentage points.

Gross margin guidance for the full year is now expected to be about 58.5% at the lower end of a prior guidance range of 58.5% to 59% due to less fixed cost absorption on the lower forecasted sales volumes. We will continue to exercise disciplined expense control for the balance of the year.

Our other key assumptions for full year guidance are unchanged. Net interest expense of $30 million to $32 million, full year effective tax rate of 14% to 15%; and lastly, an average diluted share count of 68.5 million to 69 million shares outstanding.

Rolling all this together and on a non-GAAP basis, full year 2019 earnings per fully diluted share are now projected in the range of $8.73 to $8.83, a decrease from our prior range of $8.95 to $9.10. At current rates the negative currency impacts on full year earnings per share growth is expected to be 2 to 3 percentage points.

Chris will now make a few summary comments. Chris?

Chris O'Connell

Thank you, Sherry. In summary, our third quarter saw continuation of market conditions influenced by a challenged global macroeconomic environment. We remain very positive on the ongoing durability and potential of our chosen market categories and we are excited about our increasing new product cadence for which our management team is focused on successful launch execution.

With that, we will now begin the question-and-answer session. As we are not always able to get to everyone's questions, please limit yourself to one question and one follow-up. And if you have additional questions, please contact the Waters Investor Relations team after the call. Operator?

Question-And-Answer Session

Operator

Thank you. Our first question is from Doug Schenkel, Cowen. Your line is open.

Doug Schenkel

Good morning and thank you for taking the question. So Chris, over the last five years, Waters' division recurring revenue has gone from over 8% in 2015 to now tracking to 5% or below this year. In the time we've been tracking Waters, which goes back to the early 2000s, we can't find anything that resembles this trend. And I can't find an annual recurring revenue growth number for the division as well as the one year tracking to this year other than in 2009. I think we can all understand why there might be periods where capital demand slows. But at the core of an investment in Waters, there's always been a belief that recurring revenue growth would be steady. Simply put this is your 5 of ongoing declines in this metric, and this year is the worst other than the great recession. And this is in the midst of what has been one of the golden periods for tools. This begs a number of questions. I'll limit it to three.

One, what can you point to that would demonstrate that there are not structural issues at Waters that are different from the peer group? Two, have competitive dynamics intensified, leading to share loss that you would now acknowledge? And three, why is a continuation of the share buyback, which has arguably depleted the company's rainy day funds with shares at historically high multiples, the best use of capital moving forward given aforementioned trends and amid concerns about structural and competitive dynamic issues? Thank you.

Chris O'Connell

Thanks, Doug. Good morning. Okay, you asked three questions there, so I'll try to take them in order. In terms of the recurring revenue and a reflection of the overall structure of our company relative to our peers, of course, Waters as you know is more concentrated in the pharmaceutical category, particularly the small molecule category. And as I mentioned on the call, we have seen a lengthening of equipment purchasing dynamics in that sector. We're currently in environment very much driven by macro and to some degree other noise that's in the environment that has affected the small molecule business of our overall pharma business, our small molecule business, which is LC intensive, is about 70% of our overall pharma business. And currently that's experiencing more modest growth and certainly there is some impact of recurring revenues that follow from the overall instrument sales. This particular market, which again we do have unique concentration in Doug, as you know, has been steady over time. And while it's hard to tease out individual cycles, I think there's no arguing that it's in the softer phase right now for a number of those reasons that are affecting participants, whether it's on the generic side or the large pharma side. Our pharma revenue -- our pharma recurring growth, while we don't break that out, was strong in Q3 and has also been strong throughout this year and last year. And certainly some of the recurring revenues on the industrial side of the business that's been in a difficult period with global macro has certainly explained that.

And as it relates to a competitive differentiation, our strongest competitive differentiation is in the pharma sector, particularly in the regulated laboratory environment and late stage development, and QA/QC. And so, there have been periods over time when the -- when that particular market segment has done very well and grown above the average of tool, other tool categories. And at this point in time, that sector of the market is growing below the average. But I think because of that, we do see the -- some evidence of pent up demand building and have confidence in that end market over the long-term.

Relative to share loss and your second question, we've certainly seen over an extended period of time pressure on our mass spec market share, and that's why we've invested so heavily to reverse that trend and we think we're really on at a bit of a pivot point relative to the new technology that's come into the market at both the high end of mass spec as well as in the core tandem quad portfolio, and with a totally new white space opportunity with BioAccord to really improve the mass spec market share position.

On the LC side, we've seen generally stable conditions over time and different dynamics within UPLC, HPLC and UHPLC. But as I mentioned earlier, the strong concentration of Waters and regulated laboratories has been an advantage in stabilizing in keeping that share stable and we continue to invest against that, and in other product categories that you didn't mention, TA instruments, chemistry informatics and service we've seen stable share trends as well. So overall, we're very focused on competing in a market that is very competitive. Certainly acknowledged strong competition but I like the position we have.

Relative to the buyback, as you know with U.S. tax reform that came through a year and a half ago or so, we had a one-time opportunity to really reset our balance sheet and work towards in appropriate capital structure that gives us flexibility but also optimizes our balance sheet and our overall weighted average cost of capital. And certainly feel like we have enough flexibility to make the investments we want to make, both capital investments as well as M&A.

Next question, please.

Operator

Thank you. Next question is from Tycho Peterson with JPMorgan.

Tycho Peterson

Thanks, Chris, I want to follow up on the U.S. headwinds because obviously last quarter, you were up 7%, pharma up mid-single digit. So this is a pretty decent reversal. It seems like it caught up with you late in the quarter. Can you just give a little more color on how much was pharma, how much was generics. What really does give you confidence in a fourth quarter recovery? Is it the order book? Just curious as to what the drivers of the reversion here are in particular versus some of the comments we've heard?

Chris O'Connell

Yes, thank you, Tycho. Yes, just to confirm, your -- the first part of your question, this was -- in fact it happened quite late in the quarter, as you know more than half of our business comes in the third month of the quarter as just to give some color on where our head was at a quarter ago, we did comment on the fact that coming out of the chute in the beginning of the quarter we saw the continuation of trends we had seen in Q2, which as I mentioned in my prepared remarks reinforced the view we had on the U.S.

August is always a little bit variable with vacation periods and September ended up being a lot weaker than we expected. And really the only thing I can point to in general is just a lot of noise in the market right now, whether it's industry litigation or M&A, or certainly on the generic side some of the effects later in the government year on the generic user fee increase. There's just a bunch of different factors that make for a more noisy market than is expected.

I've had the chance to personally with the team evaluate a number of the large orders that we expected, that we had forecast internally within the third quarter and I'm confident that those orders which come from well known customers, strong customers, have been delayed and not lost or cancelled. And so that has given us confidence to suggest that the U.S. ought to be better in Q4 than it was in Q3 and year-to-date. But we're certainly also being pragmatic and cautious in assuming overall trends for the year continue. And therefore, our assumptions for Q4 do not include a large budget flush. Certainly if a large budget flush were to materialize, as it has in the past, that would represent upside to our numbers, but we're not forecasting that at this point.

Tycho Peterson

And then for the follow up I want to hone in a little bit on the China dynamics. Can you give us some color on how much China pharma grew? And then as we think about 4+7, you talked about the bidding process beginning in September. We've heard anecdotally, maybe a third of the labs will go away. So how do we get comfortable this isn't a bit of a false bottom here? And then also, it seems like some of the Indian generic companies are also participating in 4+7. I think Dr. Reddy's won a tender. So just curious how you think about the trade off in growth between China local generic and India pharma?

Chris O'Connell

Yes. We're certainly learning as we go. It's an interesting environment there. As we know, Q1, really the market went on hold and it came back in Q2 and Q3, it was solid as well. We had double-digit growth in China pharma in the third quarter. And what we've seen there is that even as 4+7 extends to a broader part of the market, the second phase of bidding in September was the same 25 drugs that we had seen in phase one extending to 27 provinces. About 60% of the participants in the phase two tender were the same companies that participated in the first round of the tender and about 40% were new. But just about all of the major bidders in the process were companies that you would consider to be in the top 100 within China.

To your point about foreign participation, the first phase was almost entirely local China companies, larger China companies in that larger category. In the second phase, we did see an increased participation of the non-Chinese companies, it was about an 85%, 15% mix between China and the non-Chinese companies. So, for example, the Indian company you referenced is an example of the type of companies that are making up that 15% in the second phase.

Like we've stated before, the big picture here is that this effort is being done to enhance the overall access of medications to the population and therefore volumes will be increasing. And so, these are long-term positive -- these initiatives are long-term positive for volume in the market and testing volume. And it does also lead to some change in the market. Some of the companies for example that have not won some of these tenders don't necessarily leave the industry altogether, they have focused on other things. So we have some examples of generic companies leaving the generic space and getting involved in new drug development for example.

So it is still a dynamic situation playing out but at least in the two quarters we've just reported most recently, Q2 and Q3, we've seen a stabilization of that demand.

Operator

Thank you. And our next question is from Derik De Bruin, Bank of America. Your line is open.

Derik De Bruin

So, a couple of questions. So first of all, I wanted to follow up on something that Doug asked. So in the HPLC, UPLC market, typically those instruments have a five to eight year life cycle, life span in them and the upgrade cycle we went through in LC ended in 2017. And clearly we're getting some changes in terms of the generic manufacturer in U.S. and China, Tycho referenced companies going out of business, essentially. I guess just what gives you confidence that we should see a rebound in LC instruments in 2020? Is the first question.

Chris O'Connell

Yes, thanks a lot, Derik. I want to do as much as I can to provide color on some of the market dynamic that we've seen year-to-date now that we're through three quarters. But I also want to balance that with the fact that fourth quarter is our biggest quarter and a lot can play out in fourth quarter. And so before we put too fine a point on the trends in the market that would underscore our guidance for 2020, we want to see the fourth quarter play out. As you know, in some markets, this business, the LC business in particular has become pretty backend weighted. And we've seen in some years a significant increase in business in the fourth quarter that creates an overall story for a kind of a rolling analysis. And so we want to see that play out.

Like I said earlier, we're not assuming a big flush at the end of the quarter. And that's why we put the guidance where it is just for caution and conservatism purposes, but we do want to see it play out before we say too much about what we expect out of LC instruments in 2020. But like I mentioned earlier, the LC, the small mol LC market has been reliable historically. We are currently seeing more modest growth and believe that to some extent demand is building for investment in that area as we step into the next several years. So, we're watching it closely. We want to see what fourth quarter trends look like. And also keep in mind that when you think about the LC business, and the increase of focus on mass spec based workflows that we're seeing in the market, particularly in large molecule that LCs are an important component and with just about every mass spec system we sell, LCs come along with it. So, we're looking at LC in both the standalone LC optical market, if you will, as well as the LC-MS market.

Derik De Bruin

Great. And can you talk a little bit about the European markets, just maybe some comments on Eastern versus Western Europe food, environmental, academic, governant, just a little bit more color there? And the shift of the question being is, how much uncertainty you think Brexit has caused across the European markets? Thank you.

Chris O'Connell

Sure. Thanks. Yes, Europe has been a fairly challenging operating environment this year and just to recap the numbers overall for Europe, it was flat in the quarter and is down 2% for the year. That's -- that includes an overall European pharma number that is 1% up in the quarter and 1% up year-to-date with actually a pretty decent academic and government market up double-digits both quarter-to-date and year-to-date offsetting a similar range of declines for the industrial market. Some of the trends we've seen year-to-date -- quarter-to-date was actually a little better in Europe industrial at a mid single-digit decline versus a double-digit decline for the year-to-date. So even though the numbers are still negative in European industrial there, they've gotten incrementally better in the third quarter, and that's really a kind of a combination of the chemical materials market and TA being flatter, and the food and environmental market being down overall.

In terms of the overall environment, there's enough economic data including PMI that shows a kind of a flat to contracting economic growth environment. And certainly Brexit delays, as you mentioned, are front of mind. And we felt that through the Brexit process, much sentiment is on hold. And we do believe that in that process, there is some pent up demand building, particularly in the UK, in the Northern parts of Europe. And so we're really trying to look ahead and see when we might see an improving picture, but it's -- Europe has been kind of a flattish scenario all year long. And that said, we're super confident in our competitive position throughout Europe and believe that the concentrations we have in certain sectors are really -- provide the right context for what's happening there. But believe we're poised particularly with our new product flow to take advantage of improving market conditions when they come.

Okay, next question, please.

Operator

Thank you. Our next question is from Dan Brennan, UBS. Your line is open.

Dan Brennan

Great, thanks for thanks for the questions. So, Chris, I want to just look at China. Could you provide some color within China regarding food versus industrial versus pharma. You made some comments in your prepared remarks I think signaling kind of macros having an impact. And I know food has been a bigger drag for you. So anyway, if you could just separate out your key areas within China, kind of how they did and kind of what you're expecting going forward?

Chris O'Connell

Sure. Thanks, Dan. So China was up 2% for the quarter and it's up 1% year-to-date and the year-to-date obviously incorporates the decline we saw in Q1 with a bit more stability in Q2 and Q3, particularly on the pharma side. And like I mentioned earlier, the pharma business was up double-digits in China and has solidified in the -- as the 4+7 program as we talked about has matured a little bit at least and has more visibility. And really the rest of the business is flattish on the industrial side. It was flat in the quarter and is down 1%

for the year. And then on the academic and government side is where we've actually seen much more of the pressure, which is down double-digits. And that's really a function of the food market. As you know, the bulk of our food testing business has been in government-oriented labs, and that's as the market makes a transition from the government focus on food testing, where government labs are doing the bulk of the testing to one where they're in more of a supervisory role, that particular market has been somewhat disruptive. We do see a number of dynamics there. Even though the demand has been soft on the government side, we expect an increase in growth in the future on the private side and, and even to some degree a privatization of what previously were government labs.

And so, that process of privatization within the government testing environment as well as the uptake in the third-party testing lab sector has caused this disruption, and to your point, food, as the years played out has provided most of the pressure in our business there, while pharma has recovered. The industrial environment is a bit muted based on the overall economic conditions but it's really been in that government area and the food testing.

I will say in the food area another important comment though just looking at the market, it's a pretty mass spec heavy market with a focus on tandem quads. And we've really strengthened our portfolio in tandem quads this year with the introduction of the cronos and the TQ-S micro. And that gives us a lot more flexibility particularly in the mid and lower tiers of tandem quad testing. And I think we could argue that we have across the board the strongest or one of the strongest tandem quad portfolios in the industry and feel very good about our ability to compete in that market and to serve the different segments of the market as they develop. So we're glad with the investments we've made on the mass spec side and that will show through particular in the tandem quad business. And obviously we're working as hard as we can to understand when that demand might return and how to make sure we're well positioned to win a lot of it.

Dan Brennan

And then this is a follow-up. So on the new products side Chris I know in your prepared remarks you talked about meaningful revenue contribution. I know you're not going to give us a number right now. But at least could you just discuss with the fourth quarter kind of what assume from new products? And then is there any way to just kind of categorize how to think about what the potential of all these new products that you're rolling out could be since it's such a critical part I think of kind of your story and kind of strategy shift that you've made at Waters? Thank you.

Chris O'Connell

Yes. Thanks, Dan. And absolutely job one at Waters is new product innovation. And we're in the midst of a significant transformation of our R&D efforts and really the continued achievement of innovation leadership. I think a lot of those efforts are going really well. We're extremely encouraged by the products that have come through the pipeline already with a pretty heavy focus on mass spec, given the growth opportunities in the mass spec markets as well as competitive position that we needed to improve. That was clearly the case. But kind of furthermore on the innovation side with the increases in investment, we've built a really robust five year product roadmap that we have more clarity than we've ever had at Waters in terms of a cadence of new product introductions across instruments, chemistries. And of course, we'll be talking a lot more about informatics in the years to come with the Waters Connect platform.

Just a couple of quick notes on the products we've launched, there are different type of products, of course, we've made a number of different key line extensions on the LC side that are maybe a little bit below the radar screen, but really enhance our industry leading LC portfolio, particularly on the bio side with our Arc Bio and H-Class Bio and the binary pump and a number of other products we've put into the market this year, certainly the chemistries that go along with the LC portfolio. I mentioned a new family of HPLC chemistries, the focus family, and of course everything we're doing in bioseparations.

But mass spec has really been the headline this year, BioAccord is a game changer. It is really white space opportunity in the sense of bringing highly usable, high quality, very easy to use time-of-flight mass spectrometry into the regulated laboratory space in late development and ultimately QA/QC. I've had a chance to personally visit three or four customers this quarter who have bought BioAccord and the feedback is very positive. So, we're encouraged there.

The activities in the third quarter did not have as big of an impact in the third quarter. It should have a bigger impact in Q4. The tandem quads, I mentioned cronos and micro, but we did sell an encouraging number of the Cyclic IMSs in the quarter and have an even bigger order book for Q4. And then, the SYNAPT XS system which we announced the launch of in the third quarter, we did not ship in the quarter and we have communicated that -- we did communicate that to our customers. And so, we certainly have a bigger opportunity in Q4 than we had in Q3 relative to the high-res portfolio and we expect the SYNAPT XS, which is a dramatic enhancement in our well accepted SYNAPT QTOF platform. We certainly have an opportunity to ship that product this quarter that we didn't have last quarter.

So, that's some more color on all the new product launches. And again, I don't want to put too fine a point on a specific contribution in the fourth quarter, but we certainly expect it to increasingly be visible. And as we roll into next year with these launches under our belt, I think we'll be in a position as we guide for 2022 to put some more specificity around that.

Dan Brennan

Great, thank you.

Chris O'Connell

Thanks, Dan. Next question please.

Bryan Brokmeier

Operator, is there another question in the queue?

Operator

Our next question is from Stephen Beuchaw with Wolfe Research.

Stephen Beuchaw

First, I actually want to follow up on a point that the Doug alluded to, it has to do with capital deployment. If I think back to the beginning of the year, you -- well, it actually goes even into the fourth quarter of the prior year. You made a commitment to not just doing the

$2.5 billion but also to getting to a leverage target that implies that you continue to buy back stock beyond 2019. Are you still committed to going to that leverage target?

Sherry Buck

Hi Steve, this is Sherry. So yes, so just to go back a little bit with the availability of our cash, as a result of tax reform, we did a lot of work and analysis and wanted to our balance sheet to work. And we communicated our share buyback program for the year of $2.5 billion and we're working toward that as reflected in our guide. And then as we look at overall capital structure and optimizing that capital structure, 2.5 times net debt to EBITDA ratio is still a near-term goal. And I would say, as we end the year we'll probably be about 2 times with our guidance around the share buyback. So, we'll look at our 2020 plans and give some more details around what our specific guidance for next year, but that is still a goal we're working toward but not obviously for this year.

Stephen Beuchaw

Okay, perfect. And then, Chris, I should've opened the door in a different kind of way. There have been a lot of really good questions asked here in the Q&A with people focusing on customer demands, competitive demands, R&D, macro. These are all important parts of a sort of broader conversation around -- what do you own when you own Waters as a stock, right. If I talk to an investor who owns Waters, they're generally talking to me about how much appeal they see because of the likely sustainability of the growth of pill count. And that should mean that you get to mid-single digit growth. I'm sure you're going to get questions on this topic from a lot of investors in coming weeks and months.

So I guess now that we're at this point in the year and we've learned a few things, a few things we didn't know even six months ago, how do you talk to that investor about that path back to mid-single digit growth? Is that the right way to think about things? Thanks so much.

Chris O'Connell

Sure, yes. No, of course all efforts, Steve, are focused on returning to better -- much better growth. And we've certainly seen better growth in different instrument cycles within the specific categories we focus in. At the end of the day, I think a lot about the markets we participate in and want to make sure Waters is well positioned in structurally attractive markets. And even putting aside cycles and different macroeconomic conditions, we still fundamentally believe that the attractiveness of the pharma and biopharma space is very high, and furthermore that there is an accelerating innovation story in material science and food safety testing and some of the other markets we're in.

So, we're really focused on the fundamentals of those markets and believe that some of the things you mentioned around the sustainability of the pill count and prescription volume and patient access to medication on the small molecule, the generic side and also the innovation on the large molecule side are all very, very good markets to participate in.

And our ability proven over time and we believe we're in a new phase of proving it all over again in terms of the ability to lead the market with meaningful innovation in these spaces, which will then have a downstream impact on a strong recurring revenue stream with consumables. And service is a great place to be as the company that can generate very high returns on invested capital and over different cycles market leading organic growth.

I think the incremental opportunity we have since tax reform is to add to that with deploying capital to growth activities, whether it's a faster pace of capital investment in the company or tuck-in M&A as we see it, we've certainly been active in the M&A space in the recent past. And while we've not gone forward, given our level of discipline and focus on things that will make the biggest difference, that will be over time an added opportunity to generate returns of our capital that we generate in the business.

So, that's how I think about it. And ultimately, making sure we make the right investments, allocate our capital both internally and externally to earn the type of returns that Waters has so consistently delivered over time.

Operator

Thank you. Our next question is from Steve Willoughby, Cleveland Research.

Steve Willoughby

Hi, good morning. Thanks for taking my questions. I guess two things; first, Chris, if you could just -- I guess asking about new products in a different way, the company has had to guide down organic growth 3 times so far this year. And I'm just trying to get a feel for kind of what were you expecting the impact or contribution from new products this year at the beginning of the year as compared to now? And then I have a follow-up for Sherry.

Chris O'Connell

Yes, Steve, I think we were -- we always had modest expectations and that's why we didn't put too fine a point on a number. Certainly, we expected toward the back half of the year to see more of an impact on that. And obviously, with our largest quarter ahead of us, Q4 accounts for 30% of the year in terms of our historical averages of the third quarter. We want to make sure we see fourth quarter play out and do expect to see a bigger impact. But overall for the year, we expected a modest impact.

And so, in terms of what's played out, I don't think there's any question that the muted capital purchasing environment and some of the macro-dynamics we've spoken about probably had somewhat of a moderating effect on that impact, but that's why we focus on some of those underlying metrics of market development that I have continuously alluded to, to gauge our progress. And ideally what that adds up to here is strengthening in the fourth quarter and setting the stage for an even bigger impact in 2020.

Operator

Thank you. And our next question is from Vijay Kumar, Evercore. Your line is open.

Vijay Kumar

I had one China question and one guidance. Maybe I'll start with China. Chris, maybe -- you mentioned some comments on food. Is that end market graph maybe stabilizing, improving or maybe not better, worsened? And I'm also curious, we hear noise on this round two of 4 by 7. Should we think of that as incremental or is this already being accounted by customers, given that they knew the second round was coming?

Chris O'Connell

Yes, thanks, Vijay. I'm happy to take those, and welcome to coverage of the name. I know you're not new to the space overall but new to us, so welcome. And in terms of China, it's hard to say where to call the current short-term trend right now and we want to see another quarter or two. I don't think we have any expectation that food is going to jump back this quarter. There is a transition going on in the market.

If you look at the China food market from a bigger picture perspective, food had a really great run in China in the sort of '15 to '17 time frame in the relative recent past. And it's a market that, as I mentioned before, has been very oriented to government laboratories that's changing. It's changing for the right reasons because a lot of the testing infrastructure is being pushed out into the community. And there will be a privatization process underway there, which we think is ultimately going to lead to a return of really favorable growth conditions. And as I mentioned before, our improving tandem quad portfolio is going to be well timed for when that comes back, But again, it's -- don't have enough visibility to call a rebound in the immediate future here.

And just a small point on 4+7, then I'll let you ask your Sherry question since we're running a little low on time. But the -- we do learn more incrementally. We do have a pretty good feel for what the second phase has brought. And we see confidence on the part of the largest companies that are participating and doing well in those tenders. And as I believe Tycho asked earlier, beginning to see the participation of some major global companies as well in the process. But again, that process is all about growth and managing price through these tenders in a way that gives the government confidence that can support the growth that's being demanded by their population.

Was there a financial question?

Bryan Brokmeier

I think we have time for one last question.

Operator

Thank you. And our last question is from Jack Meehan, Barclays. Your line is open.

Jack Meehan

Chris, I guess just given some of the recent growth trends, I wanted to prod a little bit more on capital deployment. You've talked a couple of times about tuck-in M&A. Just curious, earlier this year, you changed the credit agreement to allow for increased leverage for deals over $400 million. If you did a deal that size, would you consider that additive to the buyback plan? And are you looking at assets of that size? I'm just curious if there is any additional color you could give around the pipeline. Thanks.

Chris O'Connell

Sure. Yes, Jack, let me take -- thanks for the question. And let me take the first part of that and have Sherry comment as well. Yes, we've been investing internally in a capability for M&A to add some -- to add to our portfolio in advanced and adjacent technologies with a very rigorous strategic financial and execution framework. And I would characterize the assets we're looking at as more in the small to mid size, more in the tuck-in category is -- we certainly have a lot of flexibility in our balance sheet to do everything we're looking at and obviously want to make sure that we can be opportunistic where it's appropriate. But I'll have Sherry comment a little further on the covenants and so forth.

Sherry Buck

Right. Yes, so we updated some of our agreements and with the recent offering that we made, it was just bringing all of them in line with language that we already had as far as what our leverage ratios are. So, it's maybe just a little bit of housekeeping on that. But as far as our overall capital structure, we've talked about working through a near-term leverage ratio of 2.5 times. And certainly, if there is a right asset that makes sense for us from our strategic goals and our strategy, we'd be willing and have the flexibility, as Chris mentioned, to lever up. And we've got the covenants in place to cover that.

Chris O'Connell

Good. Thanks. Sherry, and thanks everybody for your participation and questions. We're going to wrap up the call now. Just a note of conclusion here. Despite the more challenging capital purchasing dynamics that we've talked about this year, 2019 has been an important year for Waters in setting the stage for an exciting multiyear product cycle. We've begun to see the early outputs of our significant recent investment in R&D and are encouraged by early customer response. We expect to see increasing sales contribution from our newly commercialized products as well as those still to come over the coming quarters and years.

So on behalf of our entire management team, I'd like to thank you for your continued support and interest in Waters. We look forward to updating you on our progress during our Q4 2019 call, which we currently anticipate holding on February 04, 2020. Thank you, and have a great day.

Operator

And thank you. This does conclude today's conference call. You may disconnect your lines and we appreciate your business. Thank you.