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Earnings Call

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Call Participants

EXECUTIVES

Maxwell Krakowiak

Senior VP & CFO

Prahlad R. Singh

CEO, President & Director

Stephen Barr Willoughby

*Senior VP of Investor Relations &
Head of ESG*

ANALYSTS

**Catherine Walden Ramsey
Schulte**

*Robert W. Baird & Co.
Incorporated, Research Division*

Daniel Anthony Arias

*Stifel, Nicolaus & Company,
Incorporated, Research Division*

Daniel Louis Leonard

*UBS Investment Bank, Research
Division*

Douglas Anthony Schenkel

Wolfe Research, LLC

Michael Leonidovich Ryskin

BofA Securities, Research Division

Patrick Bernard Donnelly

Citigroup Inc., Research Division

Puneet Souda

*Leerink Partners LLC, Research
Division*

Subhalaxmi T. Nambi

*Guggenheim Securities, LLC,
Research Division*

Tycho W. Peterson

Jefferies LLC, Research Division

Vijay Muniyappa Kumar

*Evercore ISI Institutional Equities,
Research Division*

Presentation

Operator

Ladies and gentlemen, thank you for joining us, and welcome to the Q3 2025 Revvity Earnings Conference Call. [Operator Instructions]

I will now hand the conference over to Steve Willoughby, SVP, Investor Relations. Steve, please go ahead.

Stephen Barr Willoughby

Senior VP of Investor Relations & Head of ESG

Thank you, operator. Good morning, everyone, and welcome to Revvity's Third Quarter 2025 Earnings Conference Call. On the call with me today are Prahlad Singh, our President and Chief Executive Officer; and Max Krakowiak, our Senior Vice President and Chief Financial Officer.

I'd like to remind you of the safe harbor statements in our press release issued earlier this morning and those in our SEC filings. Statements or comments made on this call may be forward-looking statements, which may include, but may not be limited to, financial projections or other statements of the company's plans, objectives, expectations or intentions. The company's actual results may differ significantly from those projected or suggested due to a variety of factors, which are discussed in detail in our SEC filings.

Any forward-looking statements made today represent our views as of today. We disclaim any obligation to update these forward-looking statements in the future, even if our estimates change. So you should not rely on any of today's statements as representing our views as of any date after today.

During this call, we'll be referring to certain non-GAAP financial measures. A reconciliation of the measures we plan to use during this call to the most directly comparable GAAP measures is available as an attachment to our earnings press release.

I'll now turn it over to our President and Chief Executive Officer, Prahlad Singh. Prahlad?

Prahlad R. Singh

CEO, President & Director

Thank you, Steve, and good morning, everyone. I'm glad you're able to join us this morning to discuss our third quarter results and our updated outlook for the rest of the year.

We continued to perform well during the third quarter and achieved our objectives during what continued to be a dynamic end market environment. We are consistently executing at a high level on those items, which are more fully within our control, such as our margins, cash flow generation, opportunistic capital deployment and a strong and consistent pipeline of bringing meaningful new innovation to the market, which I will touch on more in a bit.

While the current demand environment continues to remain stable, I'm increasingly optimistic that some of the larger industry overhangs we and others have been impacted by so far this year appear to be starting to gain clarity, which should continue to improve customer confidence levels and lead to more robust levels of investment into science.

Our third quarter results overall were in line with our expectations with 1% organic growth being slightly offset by less favorable FX tailwinds due to the changes in currency throughout the quarter. Our Signals software business continued to perform extremely well, growing 20% organically in the quarter, which again included even stronger SaaS performance and conversion.

Our reproductive health business also continued to perform exceptionally well and grew in the mid-single digits year-over-year with newborn screening again growing in the high single digits in the quarter. We anticipate continued strong performance in this business as we bring additional novel products and workflows to the market.

A recent example of this is our new NeoLSD 7-plex kit, which recently received IVDR approval in Europe and is awaiting FDA clearance expected early next year. This expanded assay will complement our existing capabilities to now also include screening for MPS-II, otherwise known as Hunter's (sic) [Hunter] syndrome.

We also remain diligent with our expenses in the quarter and generated 26.1% adjusted operating margins, which were modestly above our expectations. With some additional favorability below the line, we generated adjusted earnings per share of \$1.18, which was \$0.05 above the midpoint of our guidance. Additionally, we continue to have a strong focus on cash flow generation and our capital deployment priorities.

In the third quarter, we generated free cash flow of \$120 million and also received the final \$38 million brand payment related to our large divestiture from 2 years ago. This free cash flow continued to represent approximately 90% of our adjusted net income, solidly above our longer-term expectations.

Given our strong balance sheet position and disciplined M&A criteria, we again actively redeployed this cash by repurchasing our shares. In the third quarter, we spent \$205 million repurchasing approximately 2.3 million shares. This brings our total buyback activity since we've completed the divestiture 2.5 years ago to 12.5 million shares or 10% of the total shares we had outstanding at the end of the first quarter of 2023.

Given our commitment to disciplined capital deployment, we recently received a new \$1 billion share repurchase authorization from our Board, which will replace what was left on our existing program. This new share repurchase program will provide us plenty of capacity to continue to meaningfully deploy capital in this area over the next 2 years.

As we look ahead to the fourth quarter and into next year, although end markets have continued to remain relatively stable, I'm increasingly optimistic on our future performance given recent signs that the impact from certain larger industry overhangs are becoming more transparent.

However, for the time being, we want to remain prudent in our assumptions until we see sustained improvements in broader industry demand trends. While Max will provide more color on our updated guidance in a moment, at a high level, we are reiterating our 2% to 4% organic growth expectation for this year while raising our adjusted earnings per share guidance to a new range of \$4.90 to \$5 to account for our outperformance in the third quarter.

As we view our markets today, our best and most prudent assumption for next year is that organic growth continues to remain similar to what it has been over the last several years in the 2% to 3% range, but we see opportunity for improvements once customers consistently return to more historically normal levels of spending.

While we have started to see some promising signs with customer activity levels in October, we want to see how the remainder of the year plays out before factoring in potentially more robust levels of growth for next year. Within the 2% to 3% growth scenario, we also remain confident with our 28% adjusted operating margin baseline expectation for next year given the restructuring activities that are already well underway.

I'd now like to take a moment to share some perspective on how we've been executing at a high level, both scientifically and commercially as a number of the key initiatives we've highlighted publicly over the last year are now beginning to come to fruition. While the following are all great achievements on their own, I'd note our near-term pipeline is even more exciting and potentially impactful for the company overall.

First, let me start with AI. While much has been said about how AI is being used or sometimes not used in the corporate world, at Revvity, we are bringing real-world AI-based solutions to market for our customers at a rapid pace. This is not just automated notetaking or digital image creation, but rather through productivity improvements for our customers, in addition to new solutions which are changing and advancing how science is being done.

In the past year alone, we have commercially launched new AI-focused software offerings such as Signals One in our Signals business, Transcribe AI in reproductive health and Phenologic.AI in a high-content screening franchise. We have also entered into a new collaboration with Profluent Bio to offer novel AI-engineered enzymes with our Pin-point based editing system.

And only a month ago, we announced the introduction of our new Living Image Synergy AI software platform for use with our in vivo imaging instruments. This new offering helps reduce the time needed for scientists to manually review and highlight images of potential interest for further evaluation from several hours to a few minutes, freeing up significant capacity for these scientists to focus more of their time on uncovering even higher level insights.

While these are all great examples of how we are rapidly embedding AI's capabilities into new offerings for our customers, our development pipeline for additional new AI-based products is even more robust. We believe some of the novel solutions we are currently working on, which are not all that far away from coming to market have the potential to truly change scientific paradigms and how preclinical discovery is done.

I know that is a bold statement, but I could not be more excited about how our teams are embracing the power and potential of AI internally, but even more so what we are working on externally for our customers and the advancement of science. I look forward to sharing more on this with you in the coming months.

In addition to delivering on our own innovation commitments, we are also making strong progress in bringing our strategic partnerships to fruition. Many of these collaborations have been years in the making and were first highlighted externally at our Investor Day last November. One recent example includes our sequencing partnership with Genomics England and its large generation study announced earlier this year with work beginning in the third quarter.

When I visited our new lab in Manchester earlier this month, I learned about a powerful real-life example that's already come out of the study, which was recently featured by the BBC. Baby Freddie was among the first infants screened through the program. Within his first month of life, clinicians were able to identify a genetic condition linked to a rare form of eye cancer because of his participation in the study.

Although he showed no symptoms and had no family history, follow-up testing confirmed he had a tumor on his eye. Thanks to the early detection, Freddie received laser and chemotherapy treatment, greatly improving his chances of normal vision as he grows up.

While Freddie story reflects the broader impact of the study, it highlights why our collaboration with Genomics England matters so deeply, enabling transformative discoveries that can change and even save lives before families know there's a problem.

Our second key partnership was just announced earlier this month in collaboration with Sanofi. In this new relationship, we are developing and seeking global regulatory approvals for a new 4-plex assay for the early screening of type 1 diabetes, while at the same time, working to expand availability of our existing RUO assay within our global clinical lab network.

With Sanofi's disease-modifying therapy for delaying the onset of type 1 diabetes, TZIELD now approved in many jurisdictions around the world, including the U.S. and with recent regulatory advancements such as Italy's new requirement to screen all children in the country for the disease, we believe this new assay has the potential to be a meaningful contributor to our Diagnostics franchise once it receives regulatory approvals.

While these are 2 recent examples of our strategic partnership efforts coming to fruition, our pipeline of additional projects continue to remain very active. And I expect you will hear more from us on these opportunities quite soon.

I also wanted to take a moment to highlight the recent publication of our annual impact report, which showcases how our work is not only advancing science and health care, but is doing so in a sustainable way that keeps the best interest of our employees and communities we serve front and center.

Highlights from this year's report include the company having a 6% reduction in our Scope 1 and 2 emissions in 2024, and how we were able to divert 47% of our waste from landfills last year ahead of our multiyear goal. We achieved a 77% employee satisfaction rate in our recent all-employee survey, which was above our target, and were able to expand our STEM Scholarship initiatives to 2 additional universities in China and the U.K.

These efforts are being recognized as we recently received a AAA rating from the well-known ESG rating agency, MSCI, which is its highest possible rating and is above most of our peers. I couldn't be more proud of our efforts in this area.

Overall, we are making tangible progress on some of our key strategic partnerships and new product launch initiatives with even more significant announcements hopefully coming very soon. We have done a good job navigating the dynamic market environment so far this year and are managing the business appropriately to continue to deliver on our earnings expectations for the year while setting us up for even stronger financial performance in the future.

I am increasingly optimistic that several key market uncertainties are beginning to ease, positioning us to benefit as demand eventually returns to more normalized levels. We are performing well, and the future is extremely bright for Revvity as we help shape how drug discovery and development is done in new ways in the years to come, while also driving advancements in specialty clinical diagnostics, which are having a meaningful impact on human health.

With that, I will now turn the call over to Max.

Maxwell Krakowiak

Senior VP & CFO

Thanks, Prahlad, and good morning, everyone. As Prahlad highlighted, our teams performed well in the quarter as was evident in our operating margins coming in slightly above our expectations, delivering another strong quarter of cash flow generation and opportunistic capital deployment.

Given this performance, potentially improving signs of customer activity and solid progress on our productivity initiatives, it positions us well to have a strong finish to the year with positive momentum as we head into 2026. While Prahlad highlighted how we are delivering new AI-driven solutions for our customers commercially, I wanted to provide you some perspective on how we are currently leveraging AI capabilities internally.

Our use of AI in our operations is already delivering significant value for both our employees and our customers, but also our financial performance. First, earlier this year, we deployed RevvityAI for all of our 11,000 employees. This custom-built, fully secure environment leverages leading large language models to drive both efficiencies and increased commercial opportunities across our business.

For example, we have now deployed over 30 custom AI agents, which are being used in areas such as commercial sales, customer care, technical service and repair, software development, HR and financial operations, and we expect to have over 50 agents in place by the end of the year.

By leveraging our platform, our sales reps are now seeing a 3 to 4x improvement in their lead generation conversion rates. In our software businesses, we're already seeing a 5% to 10% reduction in overall development time lines by leveraging our AI capabilities, allowing us to bring new offerings to market even faster than what was previously possible. Within finance, our new custom-built AI agents are having a fairly immediate and material impact on our collections, directly improving our cash flow generation.

While these are just a few specific examples of how we are already harnessing the potential of AI in our day-to-day operations, they represent just a small sample of how AI is transforming our business, and I believe we are just scratching the surface on its ultimate impact. As Prahlad mentioned, AI at Revvity is not just a theory or a long-range goal, but has become part of our operating model that we are actively leveraging both internally with our employees and externally in our products on a daily basis.

Now turning to the specifics of our third quarter performance. Overall, the company generated revenue of \$699 million in the quarter, resulting in 1% organic growth. FX was an approximate 1% tailwind to growth, a modest headwind compared to our assumptions 90 days ago, and we again had no incremental contribution from acquisitions.

As it relates to our P&L, we generated 26.1% adjusted operating margins in the quarter, which were down 220 basis points year-over-year, but modestly above our expectations. Margins were pressured on a year-over-year basis from tariffs, FX and lower volume leverage, particularly as it pertains to the weakness from our Diagnostics business in China. This was partially offset by a modestly better-than-expected impact from recently implemented cost-containment initiatives.

Looking below the line, our adjusted net interest and other expenses were \$22 million in the quarter, which was modestly impacted by the increased share repurchase activity year-to-date, resulting in lower interest earnings on our cash balances. Our adjusted tax rate was 15% in the quarter, and we continue to remain active with our share repurchase program as we averaged 115.5 million diluted shares in the quarter, which was down over 2 million shares sequentially and was down nearly 8 million shares year-over-year. This all resulted in our adjusted EPS in the third quarter being \$1.18, which was \$0.05 above the midpoint of our expectations.

Moving beyond the P&L. We generated free cash flow of \$120 million in the quarter, resulting in 88% conversion of our adjusted net income. On a year-to-date basis, our \$354 million of free cash flow equates to a solid 89% conversion of our adjusted net income.

Regarding capital deployment, we continue to remain active with our buyback program as we repurchased another \$205 million worth of shares in the third quarter. This brings our repurchase activity through September to nearly \$650 million, which allowed us to buy back 7 million shares so far this year overall.

As it relates to our balance sheet, we finished the quarter with a net debt to adjusted EBITDA leverage ratio of 2.7x, with 100% of our debt being fixed rate with a weighted average interest rate of 2.6% and weighted average maturity out another 6 years. As we evaluate capital deployment, we will continue to remain both flexible and disciplined in order to capitalize on the highest return opportunities while ensuring we maintain our investment-grade credit rating.

I will now provide some commentary on our third quarter business trends, which are also highlighted in the quarterly slide presentation on our Investor Relations website. The 1% growth in organic revenue in the quarter was comprised of flat performance in our Life Sciences segment and 2% growth in Diagnostics. Geographically, we grew in the low single digits in the Americas, grew in the mid-single digits in Europe, while Asia declined in the mid-single digits, with China declining in the low teens.

From a segment perspective, our Life Sciences business generated revenue of \$343 million in the quarter. This was up 1% on a reported basis and roughly flat on an organic basis. From a customer perspective, sales to pharma and biotech customers were up low single digits, whereas sales into academic and government customers declined in the low single digits in the quarter.

Our Life Science Solutions business declined in the low single digits in the quarter overall, which was in line with our expectations. Our Signals software business was up 20% year-over-year organically in the quarter, and as Prahlad mentioned, continues to be a bright spot of the Revvity portfolio. The business also continued to perform exceptionally well with an ARR of over 40%, an APV of 12% and net retention rate of more than 110% with all metrics solidly above levels from last year.

In our Diagnostics segment, we generated \$356 million of revenue in the quarter, which was up 3% on a reported basis and 2% on an organic basis. From a business perspective, our immunodiagnostics business declined in the low single digits organically during the quarter, which was in line with our expectations. China immunodiagnostics declined in the mid-20s with the impact from DRG playing out as we had expected. Excluding China, the other 80% of our immunodiagnostics business continued to perform very well and grew in the high single digits with mid-teens growth in the Americas.

Our reproductive health business grew mid-single digits organically in the quarter. Newborn screening continued to perform well and grew high single digits globally, which was again driven by fantastic operational and commercial execution and the initial contribution from our work with Genomics England.

As it pertains to China specifically overall, we incurred a low teens organic decline in the third quarter, driven by our Diagnostics business being down over 20% as it continues to face the impact of the DRG-related declines in volume. This was partially offset by low single-digit growth in our Life Sciences business in China, where we continue to see solid year-over-year growth in reagents.

Now moving on to guidance. As Prahlad mentioned, we are reiterating our organic revenue growth outlook of 2% to 4% for the full year with the fourth quarter expected to play out largely as we had previously expected. We continue to expect both our Life Sciences and Diagnostics segments to each grow in the low single digits for the full year, and we now see the tailwind from FX being slightly less than a 1% benefit to our full year revenue. We expect this to result in our full year total revenue to be in the range of \$2.83 billion to \$2.88 billion overall.

Moving down the P&L. We continue to expect our adjusted operating margins to be in the range of 27.1% to 27.3%, unchanged from our prior outlook and assumes the tariff environment as of today. Below the operating line, we now expect our net interest expense and other to be approximately \$83 million, up slightly from our prior outlook due to lower expected interest income due to recent rate cuts and the impact from our continued share repurchase activity.

We now expect a full year adjusted tax rate of approximately 17%, down 100 basis points from our previous assumption and an average diluted share count of a little under 117 million for the full year. This all results in our adjusted earnings per share for the year to now be expected in a range of \$4.90 to \$5, up \$0.05 from our prior outlook. Overall, our third quarter organic growth results were in line with our expectations, and our outlook for the full year remains largely unchanged.

As Prahlad highlighted, we are making great progress with a number of our key new product launches and strategic partnership initiatives while taking appropriate cost actions to achieve our goals for next year. We will continue to have a strong focus on our operational and commercial execution as we navigate the dynamic end market while remaining opportunistically disciplined with our capital deployment. This all positions us extremely well heading into next year and in the years to come.

With that, operator, we would now like to open up the call for questions.

Question and Answer

Operator

[Operator Instructions] Your first question comes from the line of Patrick Donnelly with Citi.

Patrick Bernard Donnelly

Citigroup Inc., Research Division

Prahlad, maybe to start on the '26 commentary. I appreciate the preliminary thoughts there. It sounds like maybe 2% to 3%. Can you just talk about the moving pieces? Obviously, you have the China Diagnostics piece. I think a lot of focus is on that. I think Max hit on that being down somewhere in the teens there, this quarter or maybe even 20%.

I guess how do you think about that piece into '26? Obviously, software has been a big growth driver for you, up 20% in the quarter. You're going to come up against those comps. Do you mind just high level, talk about those moving pieces into '26? And then Max, just the confidence on a low single-digit 2% to 3% type growth rate to be able to hold that 28% margin and the key levers there?

Prahlad R. Singh

CEO, President & Director

Sure. Patrick, let's -- just starting with 2026. When our assumption around the 2% to 3% is being prudent, we've started seeing signs of activity, especially around the instrument side. And if that customer behavior continues to normalize, that is only going to get better, especially around the China piece that you pointed out.

Now if you look at the trend starting with 3Q, while China was down mid-20s, ex China, it continues to be up in the high single digits. So overall, the Diagnostics business is performing very well, whether it's in reproductive health or immunodiagnosics ex China.

On the Life Sciences side, you pointed out to the software piece. And in the instruments side, as Max said in his prepared remarks, we are starting to see signs of increasing activity with customers, especially in September and October. And we expect that to start to result in actual demand coming into 2026. So I feel really good and confident about what we have put out there and only see signs of that going -- getting better as customer behavior continues to be more normalized.

Max, do you want to talk on the 28%?

Maxwell Krakowiak

Senior VP & CFO

Yes. Patrick, so look, I think as we think about the margins for next year, as we've previously commented, a 28% operating margin baseline for 2026, we're feeling very good about that target. We've got actions already underway that are going to help us achieve that 28% baseline. I think there's even been some of them out there in the publications as you look at some of the Northeast consolidation actions we've already taken. And so again, I think we're feeling very confident as a company in our ability to hit the 28%.

I think your subsequent question on how do you think about organic growth and the impact to the 28%, I would say the 28% baseline is tied to the 2% to 3% organic growth. Should there be additional tailwinds to that organic growth, we would expect to be able to then start generating additional operating margin expansion off of that baseline. But obviously, that is dependent on exactly how much further up the organic growth curve we would achieve.

Patrick Bernard Donnelly

Citigroup Inc., Research Division

Okay. Got it. That's helpful. And then maybe just inside the Life Sciences business this quarter, can you just talk about the reagents versus instruments piece? What did reagents do in the quarter, in particular? And then expectations for that moving forward. What are you hearing from the customers there would be helpful.

Maxwell Krakowiak

Senior VP & CFO

Yes. Look, I think as you look at the third quarter results, our Life Science Solutions business was mostly in line with our expectations. I would say there was a little bit of geography between the instrumentation and reagents. Reagents were modestly lower than what we had previously anticipated as the summer months were just a little bit lighter from a run rate perspective. But I would say the overall lab activity, we continue to see sort of continued progress as we had in the first half of the year.

I think as you look at the fourth quarter, just out of prudence, I think we are assuming a similar market environment to what we experienced in the third quarter, and we have also baked in some modest impact from the government shutdown, and we'll obviously have to see how that plays out over the quarter here.

Operator

Your next question comes from the line of Vijay Kumar with Evercore ISI.

Vijay Muniyappa Kumar

Evercore ISI Institutional Equities, Research Division

Prahlad, my first question is on your comments around October customer activity levels picking up. You're seeing some signs. Can you elaborate that on -- is it like pharma? Is it academic and government customer base? Is that showing up in reagents or instruments? Any color on the improvement that you're seeing. And was this -- I'm curious, was this tied to the Pfizer enhancement? Or was it just more anecdotal?

Prahlad R. Singh

CEO, President & Director

Vijay, when I mentioned the increasing signs of activities with customers as we are seeing it, it is more on the pharma/biotech side and not obviously on the academia and government side. And it's particularly in the pockets of instruments. I would say that it's not like broad change and a lot of actual demand coming through, but there is definitely increasing pockets of activity that is happening on the instrument side, and that's a clear trend that we have started seeing in the pharma/biotech.

Vijay Muniyappa Kumar

Evercore ISI Institutional Equities, Research Division

Understood. And then maybe, Max, one for you on your fiscal '26 comments were helpful. But should that 2% to 3% organic with 28% op margins translate to high singles EPS for '26? And then I know share repo has helped you guys. But how you're thinking about FX or below the line, et cetera, for next year?

Maxwell Krakowiak

Senior VP & CFO

Yes, Vijay. Yes, to answer your question, it would imply sort of a high single-digit EPS growth year-over-year at the 2% to 3% and the 28% operating margin baseline. I think in terms of below the line, if you think about some of the assumptions, interest and others should be relatively flat year-over-year.

From a tax rate perspective, we have mentioned that our tax planning has sort of created a new sort of 18% baseline from a company, which is significantly improved from where we previously were around 20%. And so I'd probably point you to that sort of starting point for 2026, and we'll see what happens with any discrete items for next year.

And then I think from a share count perspective, obviously, we've done a lot of progress this year and returned a lot of capital to the shareholders through our buyback programs. And so I think when you

factor in the lower share count for next year, all those below the line items should point you to a high single-digit EPS growth for 2026 based on those assumptions.

Prahlad R. Singh

CEO, President & Director

Yes. And just to add to that, Vijay, that high single-digit EPS growth is before assuming any additional capital deployment.

Operator

Your next question comes from the line of Michael Ryskin with Bank of America.

Michael Leonidovich Ryskin

BofA Securities, Research Division

Can you hear me now?

Maxwell Krakowiak

Senior VP & CFO

Yes.

Michael Leonidovich Ryskin

BofA Securities, Research Division

That works better. I want to drill into the 4Q quarter ramp specifically. I know you said 3Q kind of came in generally in line with expectations. But if you look at the both organic 3Q to 4Q and on the margins, it's still a pretty steep ramp, probably even steeper than it was before. So I know you talked about Genomics England coming online in the fourth quarter. There are some other moving pieces. There's some dynamics with the comps. Could you just give us the bridge again and sort of walk us through what gives you confidence in that? Especially given, like you said, you've got DRG still going on. Reagents came in a little bit softer in 3Q. So just give us confidence in that 3Q to 4Q ramp this year.

Maxwell Krakowiak

Senior VP & CFO

Yes, sure. So 2 pieces of that, one, you asked about the ramp on organic growth and then the ramp on margins. I'd say, first, from a margin standpoint, there's been no change to our previous assumption. It's still 30% operating margins. The fourth quarter is always the biggest margin quarter for us as a company as it's our highest volume quarter of the year. And so I'd say there was no real changes there, Mike. I mean, if you think about holding costs relatively flat and the higher volumes, you're going to get to the 30% margins.

I think when you look at it from an organic growth standpoint and the ramp between the third and the fourth quarter, I would say there's really a couple of key pieces of that ramp. One is on the IDx comps, as we've talked about, assuming the same sort of multiyear stack performance as we've seen through the first 3 quarters of the year. So that's one dynamic.

The second is software will have a ramp between the third and the fourth quarter, although we expect a step down in organic growth, we do expect a higher nominal dollar amount for software in the fourth quarter. And the third piece is you do see a little bit of seasonality just in terms of our instrument volumes between the third and the fourth quarter. So I would say those are probably the 3 biggest pieces, Mike.

Michael Leonidovich Ryskin

BofA Securities, Research Division

Okay. And then following up on the China DRG comments. I mean, if you look at China Dx, China ImmunoDx, I think it was down mid-teens or low teens in 2Q. It's down 20% or more in the third quarter. So by the time we exit this year, could you give us sort of a snapshot of what's left in the portfolio for

China ImmunoDx and what the incremental risk in -- risk or downside in 2026 is, just sort of frame how much further headwind there will be next year for that?

Maxwell Krakowiak

Senior VP & CFO

Yes. Mike, look -- so I think, look, the DRG situation has been playing out as we had anticipated. We had sort of foreshadowed that IDx China would be down sort of mid-20s here in the third quarter. That's what played out in the third quarter. I think as you look for the impact into 2026 and even the fourth quarter here, we don't expect much change in DRG. We do expect that once we lap sort of the anniversary in the second quarter of 2026, we do expect that business to return to more sort of muted levels of growth in the back half of the year. And so I think, again, no real change from our previous communication on the DRG situation in China.

Operator

Your next question comes from the line of Dan Leonard with UBS.

Daniel Louis Leonard

UBS Investment Bank, Research Division

I was hoping you could talk a little bit about what type of growth outlook for your software business is embedded into your 2026 framework given the offsetting factors of difficult comps, but I think you also have a big new product launch coming before year-end.

Maxwell Krakowiak

Senior VP & CFO

Yes, absolutely. So look, as you look at software, to your point, 2026 will be coming off a challenging comp here in 2025 from an organic standpoint. In 2025, we expect the business to finish in the high teens, 20% growth. So it will be a significant comp. Two things I'd say of that, one, in '26, we probably expect organic growth to be more in the mid-single digits. I would say we expect some contribution from the NPIs. But as you know, software NPIs take a little bit longer to ramp as they get released and customers really start learning about the new tools and adopting them, et cetera. So there's some impact in there, but I wouldn't say it's a huge impact for '26. And if things pick up faster, that would be, I would say, upside to the mid-single-digit organic growth.

The second thing I'd say is organic growth is always not maybe the best metric to look at when you're evaluating a software business. And I think as you look at the performance around ARR, your APV, which again just normalizes for revenue recognition and then also our net retention rate, those metrics continue to perform extremely well for us as a business, and we are incredibly excited about the software business in 2026 and beyond.

Prahlad R. Singh

CEO, President & Director

Yes. And just to add to that, Dan, just as we saw previously, last year, we launched Signals Synergy and Signals Clinical. And it took some time for it to get traction, and now it started really contributing. Similarly, as we bring in lab design -- BioDesign and LabGistics NPIs, it takes a few quarters for it to start ramping up, and we start seeing contributions from that -- those new NPIs.

Daniel Louis Leonard

UBS Investment Bank, Research Division

Understood. And Prahlad, can you talk a little bit about your M&A thoughts in light of how big you're going with the share repo?

Prahlad R. Singh

CEO, President & Director

Yes. I mean, again, we continue to be disciplined in our approach around M&A deployment. We've -- we have an active pipeline, Dan, and we continue to look for opportunity. We will be in this environment pretty prudent in how we deploy. And honestly, the best opportunity right now from a return on capital investment is our share buyback. We think that's the most attractive opportunity in front of us, and we are fully taking advantage of that opportunity, while keeping a very fertile pipeline and looking for opportunity for doing acquisitions.

Operator

Your next question comes from the line of Tycho Peterson with Jefferies.

Tycho W. Peterson

Jefferies LLC, Research Division

I want to probe a little more on reagents. I know you said modestly below expectations. Did the reagents actually decline? I mean, if software was up 20%, instruments down mid-single, it would imply reagents were down low singles. So is that the right interpretation? And then how do we think about kind of go-forward incremental margins on the reagents business? I know you've previously talked about 60%, 70%. I guess, given the pricing backdrop and inflation, just talk a little bit about the margin profile for reagents going forward, too.

Maxwell Krakowiak

Senior VP & CFO

Yes, absolutely, Tycho. So look, I think as you look at the reagents performance in the third quarter, they were down very slightly year-over-year. I would say that, again, as I mentioned in the call, the summer months were a little bit lighter. We've taken a prudent approach to our fourth quarter guidance. But we still see, I would say, stronger levels of underlying lab activity when you look at things year-over-year. So again, I don't think we're saying that there's been some huge shift here really in lab activity.

The second thing I'll answer is on the margin side and the incrementals. I would also say there's no change in the power of our incremental margins in our reagents business. Yes, it is a little bit of a tighter pricing environment, but we are still holding in there from a pricing perspective. And I think as the lab activity continues to ramp here, we are going to see the margin benefit as we get upside from those incrementals.

Tycho W. Peterson

Jefferies LLC, Research Division

Okay. That's helpful. And then maybe just -- I know you've had a number of questions on instruments. I'm just curious, budget flush in the year-end from pharma, is that baked in or not? How are you thinking about that on the back of these announcements? I know you talked about activity picking up, but how do you think about near-term kind of budget flush here? Is that a call option on the fourth quarter?

Maxwell Krakowiak

Senior VP & CFO

Yes. I think, look, as you look at the budget flush and what's sort of assumed in guidance here, you do always have a modest seasonal step-up for instruments between Q3 and Q4. I wouldn't say it was back to all the way of historical levels of budget flush, but you do definitely see an increase between the third and the fourth quarter. And as Prahlad mentioned, there is -- we have definitely seen an uptick in the activity level in our instrumentation pipeline. It was a little bit better here in the third quarter, and we do believe that there's some opportunity here for us in the fourth quarter as well.

Tycho W. Peterson

Jefferies LLC, Research Division

Okay. And then just lastly, on the tax rate, 18% baseline for 2026. Is there an opportunity for more leverage there? And how sustainable? I mean, I think you're going to be at 15% here in the back half

of this year. I know you saw a step down in the back half of last year. So how do we think about maybe additional tax leverage beyond that 18% baseline?

Maxwell Krakowiak

Senior VP & CFO

Yes. Look, I'd say, look, our tax team has done a tremendous job, I think, in resetting what we even consider baseline from where we were a couple of years ago. Again, it was 20%, and now we're at sort of an 18% baseline here. I think just from a -- in terms of a forecasting and guidance approach, we don't really roll in any expected sort of onetime benefits. We kind of take our baseline and see how the year progresses, and that's how I would encourage you to think about '26 as well.

Operator

Your next question comes from the line of Doug Schenkel with Wolfe.

Douglas Anthony Schenkel

Wolfe Research, LLC

Two topics I wanted to ask about. The first is China Diagnostics. So I guess, 3 parts to this one. One, I believe China Diagnostics is down to about 5% of total sales exiting Q3. I want to make sure that's right. Two, it sounds like we should model that down 20% to 25% due to the changes in multiplex reimbursement, so down 20% to 25% year-over-year, and I think we should do that through Q2.

And then third, can we confidently model that returning to growth thereafter? Or is there any reason to be more cautious than that? There have been a few head fakes there in China, as we know, and you got folks like Abbott and Danaher, who are telling folks to model incremental headwinds in 2026. How do you see it from there?

Maxwell Krakowiak

Senior VP & CFO

Yes. Doug, yes. So a couple of different questions in there. So I think, look, as you look at the China as a percent of revenue, you had mentioned 5%, I think it's closer to 6%, which is probably what I would use as you think about exiting this year. I think, again, we've already kind of talked about the fact and what our expectations are for DRG is to continue to see the headwinds here from -- what we saw in the third quarter continuing until we anniversary in the second quarter. I think we've also talked about how we have in our LRP, the assumption of closer to low single-digit growth for IDx business in China. And so I would continue to have that sort of same thought process as you sort of think about the second half of 2026.

I'd also say, again, on the immunodiagnostic side, the business outside of China continues to perform incredibly well. Now I know there's a focus on China right now with DRG, but IDx ex China continued to grow high single digits. The Americas was up mid-teens. And so that business continues to perform incredibly well and one we are excited, it can keep performing well in '26 and beyond.

Operator

Your next question comes from the line of Puneet Souda with Leerink.

Puneet Souda

Leerink Partners LLC, Research Division

So first one on -- just wanted to clarify on the instrumentation side. The recovery of the improvement that you're seeing in this quarter, is it more of the China tariffs impacted situation from the last quarter? Or actually, are customers telling you that we're purchasing more this quarter and into the next quarter? Maybe just help us understand sort of what you're hearing versus a sequential improvement because of tariffs and other concerns between U.S. and China that happened in 2Q?

Prahlad R. Singh

CEO, President & Director

No, the answer is the latter part of your comment. What we are seeing is more of a broader activity, and it was not -- it is not specific to any China tariff-related opportunity, and specifically from pharma/biotech customers. So what we are really seeing is a broader level of activity and discussions on pharma/biotech on the life sciences instrument side.

Puneet Souda

Leerink Partners LLC, Research Division

Got it. Okay. And then just on the academic and government side, I know the reagent exposure is there. So just trying to understand if the grants are fewer next year just with the -- given the funding -- 5-year funding in some of the grants and the early funding that's happening. Maybe just help us understand how are you thinking about the overall reagent growth into '26. And then just one more question, if I may. Could you remind us how much of your manufacturing for China sales is in China? Localization is emerging as an important theme beyond the VBP and DRG. So if you could elaborate on that.

Prahlad R. Singh

CEO, President & Director

Yes. Sure. On the manufacturing side, all of our reproductive health and newborn screening is in China for China. Over the past decade, we have moved all of that. And on the IDx side, Puneet, more than half of it now is local in China for China. And the rest that we are shipping from Germany are specific and very unique assays where we have minimal local competition.

Maxwell Krakowiak

Senior VP & CFO

Yes. And I think, look, the other point I'll add to that, too, is we have the capacity and the availability to move that additional product into China if we need to from a competitive or local requirement perspective. So I think we remain confident in our ability to handle anything there from a localization standpoint. I think as you look at the -- your other question, Puneet, on the...

Puneet Souda

Leerink Partners LLC, Research Division

On the multiyear.

Maxwell Krakowiak

Senior VP & CFO

Yes, on the reagents and sort of how we think about 2026. Look, I think from a reagents perspective, again, as we've mentioned, the 2% to 3%, we're really anticipating, I would say, a similar-ish environment to what we're currently seeing. Obviously, we'll have to see what happens from an NIH and budget perspective. But our 2% to 3% organic growth guidance for next year is not expecting some huge ramp-up or change in the underlying market activity. If that were to change to the positive, we continue to see increasing momentum build, that's not necessarily something we factored in the 2% to 3%.

Operator

Your next question comes from the line of Dan Arias with Stifel.

Daniel Anthony Arias

Stifel, Nicolaus & Company, Incorporated, Research Division

Max, on the gel contributions, which I think you've kind of pointed to as being heavily weighted in 4Q for \$10 million or so, how should we model that sequentially in the quarters after that? Is there a drop down? Or do you think there's some level of stability into the front half of 2026?

Maxwell Krakowiak

Senior VP & CFO

Yes, Dan, so the \$10 million per gel was actually the initial sort of second half contribution -- full second half. So we did start to see the -- a little bit there in the third quarter as the contract and the lab came online. We do expect a little bit of sequential pickup here in the fourth quarter. I think as you look at sort of 2026, I wouldn't anticipate too much further ramp from what we currently have assumed in there in the fourth quarter, and that will sort of be a consistent quarterly number as we think about it for 2026.

Daniel Anthony Arias

Stifel, Nicolaus & Company, Incorporated, Research Division

Okay. And then maybe, Prahlad, on your pharma and biotech comments, can you elaborate a little bit on the biotech element and just how much of the incremental enthusiasm that you might be pointing to is due to some of the larger biotech companies versus some of the smaller and emerging players that might be getting a little bit more enthusiastic about what they might do?

Prahlad R. Singh

CEO, President & Director

Yes. I think that's a key differentiation. I mean most of the louder activity we are seeing is on the typical large and midsized biotech. While the conversations are ongoing with the smaller ones, Dan, it's not at the same level as you would see with the mid- and large-sized biotechs, who tend to be more of our traditional customers anyway.

Operator

Your next question comes from the line of Catherine Schulte with Baird.

Catherine Walden Ramsey Schulte

Robert W. Baird & Co. Incorporated, Research Division

Maybe first, just for the 2% to 4% organic for the full year and it creates a pretty wide range for the fourth quarter. So should we be anchoring more towards the lower end of that range? And how should we think about performance by segment for the fourth quarter?

Maxwell Krakowiak

Senior VP & CFO

Yes. Catherine, thanks for the question. Look, I think as you look at the full year range, the 2% to 4%, I don't think it's an uncommon practice to have sort of that range for the fourth quarter. I think as you kind of look at the midpoint, though, of what we have for the fourth quarter in terms of our full year guidance, that would sort of point you to a 2% to 3% organic growth for the fourth quarter in order to reach that midpoint for the full year.

Catherine Walden Ramsey Schulte

Robert W. Baird & Co. Incorporated, Research Division

Okay. Great. And then maybe how did U.S. academic and government perform in the quarter? And you mentioned baking in a government shutdown impact in guidance. Any way to size kind of how you're thinking about that?

Maxwell Krakowiak

Senior VP & CFO

Yes. So first, in terms of the academic and government performance in the Americas for the third quarter, it was down mid-single digits in the third quarter. Again, as we've talked about, most of the instrument activity pickup we're mostly seeing is on the pharma/biotech side versus academic and government. So that was a bit of a headwind for us in the period.

I think as you then look at the government shutdown, I think the bigger impact there right now that we're seeing is more so on the reagent side, which we have baked in some modest assumptions there for the fourth quarter. I would say, again, it's modest. It's not something that is a huge number to embed into the guidance.

Operator

Your next question comes from the line of Subbu Nambi with Guggenheim.

Subhalaxmi T. Nambi

Guggenheim Securities, LLC, Research Division

In your prepared remarks, you talked about how AI is improving your operating efficiency. As your customers implement AI, do you view this as a threat or as an opportunity? Meaning if AI improves their efficiency and reduces their risk, are you seeing any signs that this leads to more or less demand for Revvity products?

Prahlad R. Singh

CEO, President & Director

It's a great question, Subbu. I think if you were to look in the short to midterm, and by that, I define over the next 3 to 5 years, I think it will result in increased demand on the reagent and instrument side because I think not just traditional pharma/biotech companies, but also AI-focused companies on life sciences will want to correct and create more and more data in order to sort of look at what modeling capabilities that you need to have, what AI models that you need to build.

But I think over the second half of the decade, I would venture to say that the Signals business is very well positioned on the AI side of drug discovery. We are in every lab, every researcher in pharma -- big pharma/biotech has Signals at their fingertips. And if we are able to provide the capability and ability for pharma/biotech customers to use the Signals infrastructure and incorporate AI capability into that, it becomes a natural tool in the hands of researchers who don't need to be computer specialists to do drug discovery. And that's where we have the opportunity, both in the short to midterm with our reagents and instruments portfolio and in mid- to long term with our Signals business.

Subhalaxmi T. Nambi

Guggenheim Securities, LLC, Research Division

And just as a follow-up, you described some signs of instrument recovery in your prepared remarks. If that continues to take hold, what instruments would you expect to be the first to participate in that recovery? Would you consider providing book-to-bill data on instruments heading into 2026 as we get to year-end?

Prahlad R. Singh

CEO, President & Director

Yes. I think the benefit or the advantage that we have, Subbu, is most of the life sciences instruments that we provide are noncommoditized products. And the initial uptick that we start seeing is especially on the cellular imaging capabilities that we provide to our customers, looking at cellular imaging, our high-content screening platforms specifically. We've never provided book-to-bill ratio. And generally, that's not something that we look at either.

Operator

There are no further questions at this time. I will now turn the call back to Steve for closing remarks.

Stephen Barr Willoughby

Senior VP of Investor Relations & Head of ESG

Thank you, Nicole, and thank you for everybody joining us this morning. We look forward to catching up with more of you over the coming weeks and months and at conferences.

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