HILLIARD LYONS

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J.J.B. Hilliard, W.L. Lyons, LLC
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COMPANY UPDATE / ESTIMATE CHANGE/
PRICE TARGET CHANGE

Key Metrics

LDR - NYSE (as of 08/08/17)		$56.85
Intraday Price		$61.10
Price Target		$46.00
52-Week Range		$41.35 - $57.65
Shares Outstanding (mm)		9.6
Market Cap. ($mm)		$548.0
1-Mo. Average Daily Volume		10,279
Institutional Ownership		87.1%
Total Debt / Total Capital		84.1%
ROE (TTM)		81.8%
Price / Book Value		18.6x
Indicated Dividend / Yield	$1.10	1.9%
TTM Operating Margin		19.1%

Figures may not add up due to rounding

Operating EPS FY 9/30

	2016A	Prior 2017E	Curr. 2017E	Prior 2018E	Curr. 2018E
1Q	$0.40		$0.45A	$0.41	$0.36
2Q	$0.44		$0.55A	$0.55	$0.45
3Q	$0.50		$0.60A	$0.52	$0.54
4Q	$0.37	$0.26	$0.21	$0.34	$0.35
Year	$1.71	$1.72	$1.82	$1.83	$1.70
P/E	33.3x		31.3x		33.5x

Multiples based on yesterday's close

Revenue ($mm)

	2016A	Prior 2017E	Curr. 2017E	Prior 2018E	Curr. 2018E
1Q	$36.5		$37.6A	$37.6	$37.5
2Q	$38.1		$39.1A	$38.5	$39.0
3Q	$37.9		$39.9A	$39.3	$39.7
4Q	$36.8	$36.5	$36.8	$38.0	$37.9
Year	$149.2	$151.4	$153.4	$153.4	$154.2

***Company Description** – Based in Glenwood, IL, Landauer, Inc. is the world's largest provider of personnel radiation monitoring services. The dosimetry badges are sold to health care providers, energy producers, and military customers. The company also provides medical physics services for customers with diagnostic imaging equipment and radiation oncology operations.*

Landauer, Inc.

LDR – NYSE – Underperform – 4

Solid Quarter but Weak Quarter Ahead; Trends Positive but Shares Remain Expensive, Reiterate Underperform

- **3Q17 Results:** Landauer reported revenue of $39.9 million, above our estimate of $38.2 million and the Street consensus estimate of $39.8 million. Operating EPS were $0.60, well above our estimate of $0.46 and the Street consensus of $0.49; GAAP EPS were $0.67. Non-GAAP EBITDA were $11.3 million versus our estimate of $9.6 million.
- **Positive Highlights:** Radiation Measurement revenue was higher than expected due to strong domestic service growth. Additionally, the operating margin in the segment exceeded our estimate. The gross margin increased year-over-year, even in the face of more normalized comps regarding military revenue.
- **Negative Highlights:** The Medical Physics segment posted solid growth led by imaging physics, but the segment fell short of our estimate yet again. Corporate expenses were about $800K higher than we expected, although some of this was due to professional fees that management described as a one-time event.
- **FY17 Guidance:** Management increased guidance due to the strong quarter but effectively decreased 4Q17 guidance, at least relative to our previous estimate. Revenue is still expected to be between $149 million and $154 million but GAAP EPS is now expected to be between $1.81 and $1.87 versus $1.65 - $1.71 previously.
- **Outlook, Estimates, & Rating:** Our outlook for Landauer continues to improve. For FY18, our total company estimates are now $154.2 million in revenue, $36.1 million in adjusted EBITDA, and $1.70 in EPS. Our FY18 adjusted EBITDA estimate was $37.6 million previously. We are also unveiling FY19 estimates: revenue of $160.6 million, adjusted EBITDA of $41.6 million, and EPS of $2.12. We are maintaining our Underperform rating but raising our price target to $46 from $37. See pages 4 and 5 for valuation discussion and price target derivation.

Note Important Disclosures on pages 8 and 9
Note Analyst Certification on page 8

ADDITIONAL COMMENTARY

Performance Review

- The **Radiation Measurement** segment recorded revenue of $29.6 million, exceeding our estimate of $27.6 million. Management stated military sales increased $0.7 million to roughly $3.3 million. Domestic service growth was strong, although management noted about $0.5 million was from customer badge loss that is non-recurring in nature. Operating income in the segment was $12.1 million, representing an operating margin of 41.0% versus the segment's 3Q16 operating margin of 37.4% and our estimate of 35.2%. The increased military sales, which carry a higher operating margin boosted margins more than we expected. Based on our estimates, when excluding military deliveries and the divested Medical Products segment, product sales declined ~4% year-over-year. We estimate service revenues in this segment increased 6.7%.
- The **Medical Physics** segment generated year-over-year growth of 7.7% to achieve revenue of $10.3 million. This fell short of our estimate of $10.5 million. The imaging physics piece of the business expanded 15% year-over-year, showing continued execution on regulatory tailwinds. However, this is a slowdown from the FY16 imaging growth rate of ~28%. We do note this business can be lumpy but believe investors should keep an eye on it as the most impactful regulations have now anniversaried. Management stated they pulled in a contract worth $1 million annually that should start hitting the income statement in the next few months. The other piece of the business (therapy and commissioning) was up ~4% year-over-year, as therapy revenue growth offset a commissioning revenue decline. The operating margin in the segment declined to 7.7% from 7.9% in 3Q16; we estimated a 7.0% margin. While we still expect operating margins in this segment to expand over time, we continue to taper our expectations for the speed at which this occurs. Management acknowledged this issue with discussion about additional software and remote services that should help margins over time.
- Corporate operating expenses were $4.3 million for the quarter, coming in above our estimate of $3.5 million. Excluding $0.6 million in professional fees, corporate expenses were up modestly versus 3Q16.
- The company-wide gross margin of 52.9% was a strong improvement over 3Q16 and greatly exceeded our estimate of 49.6%. Total Selling, General, & Administrative expenses were $12.5 million, resulting in an operating margin of 21.5% versus the 3Q16 operating margin of 20.4% and our estimate of 18.1%.
- Our non-GAAP EBITDA calculation, which excludes Equity in Income of JVs and Other Income resulted in $11.3 million for the quarter, easily surpassing our $9.6 million estimate. We believe this is the key metric to watch, as EPS can swing significantly due to a volatile tax situation and small number of shares outstanding.
- Equity in Income of JVs was $1.2 million, a jump of 394% from a year ago. That compares to our estimate of $0.5 million. Management noted in the call the unusually large amount was the result of capital shipments that had been delayed somewhat. Management noted the historical run rate was around or a little below $2 million.
- Net interest expense was $0.7 million, even with last year. The company has paid down approximately $11.7 million in debt from this time last year using the proceeds from the sale of a business and monetized tax assets. The company paid down $5.1 million in debt this quarter.
- The effective tax rate was 27.5% versus our estimate of 31.0%. We remind investors this will likely be volatile over the next couple of years, as the company noted the Medical Products divestiture enabled Landauer to monetize approximately $20 million in tax assets over the next four years or so. Management elected to monetize a large amount this quarter, roughly $7.3 million.
- Net income was $6.6 million. Our calculation of operating net income was $6.0 million, an increase of 20% year-over-year. GAAP EPS were $0.67 versus $0.76 a year ago. Operating EPS were $0.60 versus $0.50 a year ago. Our estimate was $0.46 and the Street consensus was $0.49. Although we typically include Equity Income in our operating estimate, we note a normalized amount ($0.5 million) for that line item would have led to an operating EPS of $0.53.

Conference Call Discussion

- Verifii continues to be a topic of conversation. CEO Mike Kaminski once again made a special point to remind investors that it will be a controlled commercial launch. The launch is still on schedule for some time before calendar year-end, which we have modeled into fiscal 1Q18. When discussing the expense ramp for launch, management was vague, but we point to 4Q17 guidance as a hint. Importantly, Verifii has passed the National Voluntary Laboratory Accreditation Program (NVLAP), which is a third-party accreditation program, and Landauer has submitted Verifii for regulatory approval.
- The press release stated there are currently no open contracts or purchase orders for the company's military products. When asked about military prospects on the call, management remained optimistic but pushed back hopes for securing a contract to early FY18. Thus, we believe investors should write off military business for FY18, and this will provide a roughly $8.3 million revenue and gross margin headwind.

Balance Sheet and Cash Flow Review

- Total debt-to-equity decreased to 5.4X from 6.6X last quarter. Long-term debt to EBITDA decreased to 2.9X from 3.1X last quarter.
- Free cash flow interest coverage increased to 22.3X from 7.8X last quarter due to tax asset monetization. EBITDA interest coverage decreased to 16.2X from 17.2X in 2Q17. Free cash flow dividend coverage increased to 5.8X from 1.8X last quarter due to the tax asset monetization.
- Cash flow from operations has increased 44% year-to-date compared with the same time frame a year ago, while free cash flow growth was 63%. The gains were driven largely by tax asset monetization with noticeable contribution from operational improvements.

ESTIMATES UPDATE

Our top line estimate changes largely reflect the results of this quarter. Within Radiation Measurement, we increased our FY17 revenue estimate to $112.1 million from $109.8 million previously, as a result of the ex-military beat and less concern about competitive pressure. We also increased our segment operating margin estimate higher to 37.2% from 36.2%. However, this reflects the positive surprise this quarter and does not fully capture the significant downward revision in 4Q17. Due to management guidance, we believe operating margin compression will begin next quarter and will be substantial. We remain uncertain about how long the margin compression will last but think this quarter's guidance gives investors some idea about magnitude. Our assumption is the increase in spending for Verifii will pick up substantially in 4Q17 and 1Q18 before tapering off. We still expect margin compression in 2Q18 and 3Q18, but not as severe. We expect spending to start to normalize in 4Q18 before margin expansion begins in FY19. We note the time frame is up for debate as management has been fairly vague in this regard but appears committed to a controlled launch, which should give investors an idea of revenue expectations. Our FY18 Radiation Measurement revenue estimate is now $110.8 million with a 34.8% operating margin versus $109.6 million with a 35.7% operating margin previously.

In Medical Physics, we decreased revenue estimates marginally. For FY17, we estimate $41.3 million in revenue (versus $41.6 million previously) and increased our operating margin estimate to 7.1% versus our prior estimate of 6.9%. We still expect Medical Physics margins to expand but continue to increase our time horizon for the company to realize efficiencies. Looking ahead to FY18, our updated estimate for Medical Physics is $43.3 million in revenue with an 8.7% operating margin versus $43.7 million with a 9.5% operating margin previously. We increased Corporate Expense assumptions for both FY17 and FY18, largely reflecting this quarter and updated run rate assumptions going forward. For FY17, our total company estimates are now $153.4 million in revenue, $37.9 million in adjusted EBITDA, and $1.82 in operating

EPS. This compares to previous estimates of $151.4 million, $36.9 million, and $1.72, respectively. We note our 4Q17 operating and GAAP EPS estimates are much lower now. We also point out to investors our FY17 GAAP EPS estimate of $1.87 matches the top end of updated guidance. For FY18, our total company estimates are now $154.2 million in revenue, $36.1 million in adjusted EBITDA, and $1.70 in EPS. This compares to previous estimates of $153.4 million, $37.6 million, and $1.83, respectively.

With a substantially lowered outlook for profitability and uncertainty about the duration of margin compression for FY18, we are unveiling FY19 estimates. We believe FY19 will provide a mostly normalized base from which investors can evaluate the promise of Verifii. We expect almost full uptake of Verifii in the hospital customer base but note it will happen throughout the year, so the pricing power won't be fully reflected. We anticipate more modest uptake in the industrial and professional office setting. We expect operating leverage to take hold but still believe most of that potential will be on display in 2020. For FY19, we anticipate revenue of $160.6 million, adjusted EBITDA of $41.6 million, and EPS of $2.12.

OUTLOOK & VALUATION

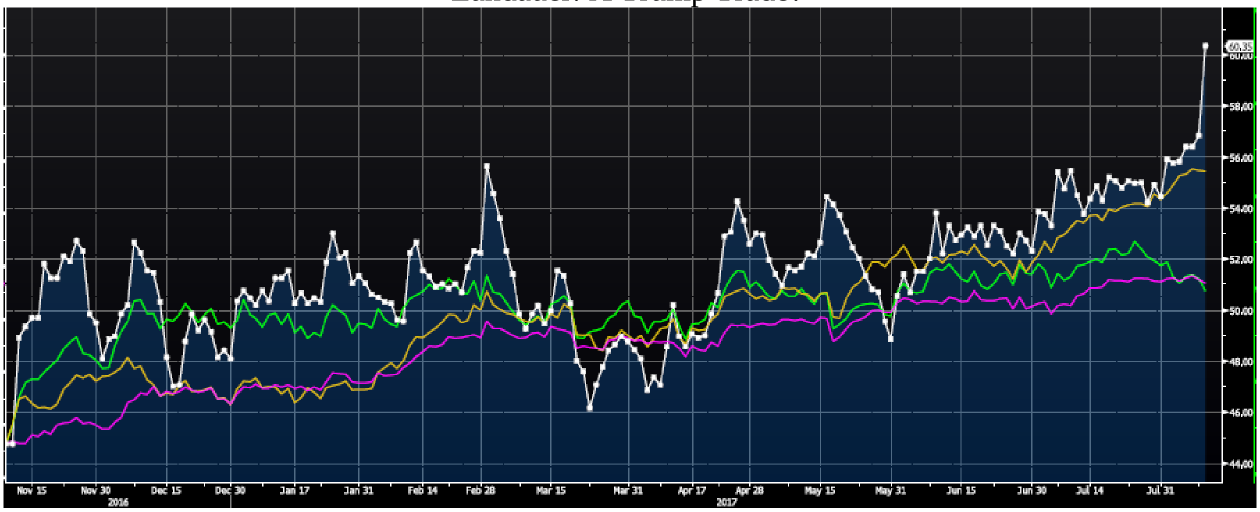
Outlook

Our outlook for Landauer continues to improve as it appears competitor Mirion Technologies has not been able to materially capitalize on a new and improved product offering, and any customer losses have been masked by strong international results. Despite lower FY18 estimates, we are excited about Verifii progress and continue to be impressed by the (relatively) new management team. At this point, our concern for the stock has less to do with company fundamentals than what is baked into the share price.

Valuation: the Trump trade that won't deflate?

The stock is trading intraday around 16.5X trailing EV/EBITDA and 19.2X our forward 12 month EBITDA estimate, both of which are significantly above historical norms around ~13X. We had viewed the extended valuation of late as a product of the "Trump trade," particularly revolving around tax reform. However, it appears the Trump tax reform trade has faded, which we view as the Russell 2000 small cap index (green line) converging with the S&P 500 index (pink line). For those viewing the report in black and white, the bottom two lines represent the Russell and S&P indicies. The only Trump trade that appears in tact is the defense spending trade, represented by the iShares U.S. Aerospace & Defense ETF (yellow line; ITA - $168.35). Outside of some moments of volatility for the thinly traded stock, LDR shares have neatly tracked the ETF until the spike today. Yet, we remind investors FY17 military revenue is expected to be around 5% of total revenues, and we believe FY18 military revenues will be approximately 0%. Thus, it perplexes us that some investors may view this as a military Trump trade rather than a tax reform Trump trade.

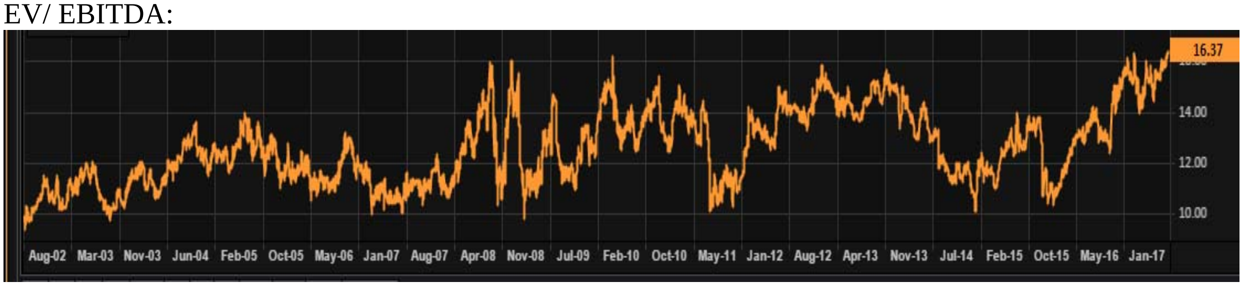
Landauer: A Trump Trade?



Source: Bloomberg

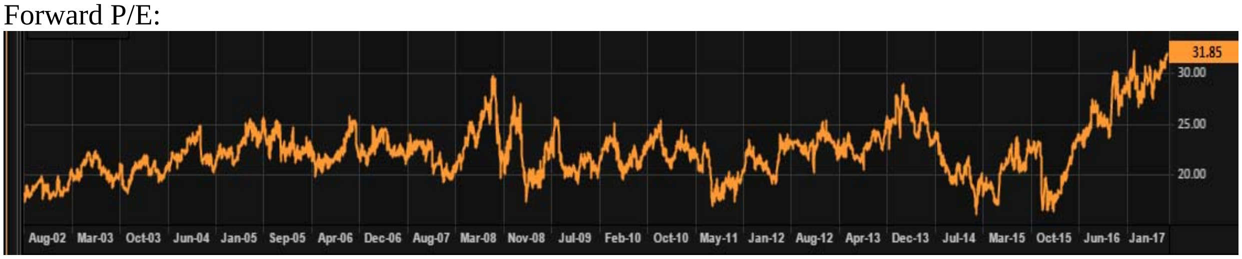
Regardless of how one may view Landauer as a trading proxy for politics, valuations are stretched, in our view. Multiple valuation metrics are at or near all-time highs.

EV/ EBITDA:



Source: Thomson Reuters

Forward P/E:



Source: Thomson Reuters

Even looking ahead to FY19, shares are trading intraday around 28.5X our FY19 estimates and 15.8X our adjusted EBITDA estimate.

Given the company's fairly high debt and the drastic swings in EPS resulting from a small number of shares outstanding and a volatile tax situation, we prefer an EV/EBITDA valuation approach. Due to an uncertain spending story in FY18, we are rolling our model forward an additional year to FY19. Even looking an additional year into the future makes LDR shares look expensive. We believe the market is focused on Verifii potential, which is appropriate in our view. However, shares appear ahead of themselves, in our opinion. Sticking with the historical median around 13X applied to FY19 EBITDA, we derive our price target of $46, well above our previous $37 price target but noticeably below current trading price. Thus, we believe LDR shares are overvalued and remain comfortable with our Underperform rating.

SUITABILITY

Landauer reports approximately 90% recurring revenue and a 94% annual customer retention rate in Radiation Measurement. Further, competition has historically been weak in the Radiation Measurement and Medical Physics industries. However, the company's recent history has raised the risk profile of the stock. Ill-fated acquisitions and accounting issues are the primary sources. Further, the small-cap stock's low trading volumes, relatively weak liquidity, and leverage are also factors in our suitability rating. Finally, a new management team with limited experience at the company results in a risk rating of 4.

RISKS & CONSIDERATIONS

- **Competition and technological innovation** – The dosimetry business requires complex operations with many technological aspects. A competitor or new company could produce innovations that could displace Landauer as the industry leader.
- **Verifii failures** – Landauer is taking a major stride in deploying the Verifii platform, shifting the company to be as much a software company as a dosimeter manufacturer. The software business carries additional risks such as hacking or cloud disruptions. These issues could lead to customer dissatisfaction and financial disappointment.
- **Changing healthcare trends** – Diagnostic imaging utilization has experienced a massive increase over the past few decades. This has increased the value of the medical physics market. Significantly decreased utilization or innovation that enables ultrasounds to provide clarity on par with radiation-emitting imaging machines could reduce the need for medical physicists and harm the Medical Physics business.
- **Regulatory** – Landauer's growth opportunity in the Medical Physics business primarily revolves around new regulations. Should these regulations be reversed or altered, uncertainty may arise.
- **Legal** – Product lawsuits are common in the health care sector. An unfavorable court decision could hamper the ability to market a product.

LANDAUER, INC.									LDR: UNDERPERFORM
In millions	2015 A	2016 A	1Q17 A	2Q17 A	3Q17 A	4Q17 E	2017 E	2018 E	2019 E
Fiscal Period End	9/30/2015	9/30/2016	12/31/2016	3/31/2017	6/30/2017	9/30/2017	9/30/2017	9/30/2018	9/30/2019
Income Statement									
Radiation Measurement	106.0	104.2	27.6	28.7	29.6	26.2	112.1	110.8	116.4
Operating Margin %	*33.6%*	*36.3%*	*40.6%*	*39.8%*	*41.0%*	*26.2%*	*37.2%*	*34.8%*	*38.1%*
Medical Physics	35.4	39.2	9.9	10.4	10.3	10.7	41.3	43.3	44.3
Operating Margin %	*8.8%*	*8.2%*	*6.8%*	*6.4%*	*7.7%*	*7.5%*	*7.1%*	*8.7%*	*9.5%*
Medical Products	9.9	5.8							
Operating Margin %	*15.5%*	*18.3%*							
Total Revenue	**151.3**	**149.2**	**37.6**	**39.1**	**39.9**	**36.8**	**153.4**	**154.2**	**160.6**
Gross Margin %	*52.0%*	*50.6%*	*52.3%*	*51.9%*	*52.9%*	*50.1%*	*51.8%*	*52.8%*	*53.0%*
Gross Profit	**78.7**	**75.5**	**19.6**	**20.3**	**21.1**	**18.5**	**79.5**	**81.4**	**85.2**
SG&A Expenses	54.0	48.8	12.2	12.5	12.5	15.0	52.2	56.0	54.3
Non-GAAP Operating Income	**24.7**	**26.6**	**7.4**	**7.8**	**8.6**	**3.5**	**27.3**	**25.4**	**30.9**
Operating Margin %	*16.3%*	*17.9%*	*19.8%*	*20.0%*	*21.5%*	*9.5%*	*17.8%*	*16.5%*	*19.3%*
Adjusted EBITDA*	**37.1**	**37.7**	**9.7**	**10.7**	**11.3**	**6.2**	**37.9**	**36.1**	**41.6**
EBITDA Margin %	*24.5%*	*25.3%*	*25.9%*	*27.4%*	*28.3%*	*16.8%*	*24.7%*	*23.4%*	*25.9%*
Non-recurring Items**	(1.0)	0.0	0.4	(0.3)	0.0	0.0	0.0	0.0	0.0
Equity in Income of JVs	2.3	1.5	0.6	1.2	1.2	0.4	3.4	2.0	2.4
Interest Expense	(4.4)	(3.4)	(0.8)	(0.6)	(0.7)	(0.7)	(2.8)	(3.0)	(2.9)
Other Income	(0.3)	3.6	(0.3)	0.1	0.0	0.0	0.0	0.0	0.0
Pre-tax Income	**21.3**	**28.4**	**7.0**	**8.4**	**9.1**	**3.2**	**27.9**	**24.4**	**30.5**
Effective Tax Rate	*29.4%*	*34.9%*	*34.2%*	*36.6%*	*27.5%*	*31.0%*	*32.1%*	*30.0%*	*30.0%*
Net income attributed to noncontrolling interest	0.5	0.7	0.2	0.2	0.2	0.2	0.7	0.7	0.7
Net Income (attributed to LDR)	**14.5**	**17.8**	**4.4**	**5.2**	**6.4**	**2.0**	**18.0**	**16.4**	**20.6**
Non-GAAP Operating Net Income* **	**14.8**	**16.3**	**4.4**	**5.3**	**5.8**	**2.0**	**17.4**	**16.4**	**20.6**
Diluted Shares Outstanding	9.6	9.6	9.6	9.6	9.6	9.6	9.6	9.7	9.7
GAAP EPS Attributed to LDR Shareholders	**$1.52**	**$1.86**	**$0.46**	**$0.54**	**$0.67**	**$0.21**	**$1.87**	**$1.70**	**$2.12**
Non-GAAP EPS Attributed to LDR Shareholders* **	**$1.55**	**$1.71**	**$0.45**	**$0.55**	**$0.60**	**$0.21**	**$1.82**	**$1.70**	**$2.12**
Balance Sheet									
Cash and Equivalents	15.3	13.3	12.4	12.9	21.1	23.1	23.1	29.9	42.2
Other Current Assets	46.4	42.7	44.7	48.8	52.2	45.8	45.8	47.5	49.1
Total Current Assets	**61.8**	**56.0**	**57.1**	**61.7**	**73.3**	**68.9**	**68.9**	**77.3**	**91.2**
Net PP&E	46.4	46.4	46.1	46.6	47.2	58.2	58.2	58.1	57.9
Equity in Joint Ventures	24.0	26.2	25.0	25.3	26.5	26.5	26.5	26.5	26.5
Intangible Assets	48.1	43.1	42.3	42.3	42.5	33.9	33.9	33.9	33.9
Other Assets	28.5	19.1	17.3	14.7	8.7	5.3	5.3	2.1	6.0
Total Assets	**208.7**	**190.8**	**187.8**	**190.5**	**198.2**	**192.7**	**192.7**	**198.0**	**215.4**
Current Liabilities	38.5	34.5	33.1	33.4	36.3	36.9	36.9	37.6	39.2
Long-term Debt	133.4	109.1	107.6	105.1	100.6	98.6	98.6	90.1	88.5
Other Non-Current Liabilities	24.5	26.6	26.7	27.0	30.4	30.4	30.4	30.4	30.4
Total Liabilities	**196.4**	**170.2**	**167.3**	**165.4**	**167.3**	**165.8**	**165.8**	**158.1**	**158.1**
Non-controlling Equity Interest	1.1	1.4	1.2	1.3	1.5	1.5	1.5	1.5	1.5
Total LDR Shareholders' Equity	**11.2**	**19.2**	**19.2**	**23.8**	**29.4**	**25.5**	**25.5**	**38.4**	**55.9**

**We do not include Equity in Income of JVs and Other Income*

***Excludes impairment and restructuring charges and non-recurring items*

****Excludes non-recurring items and other income, with a constant tax rate of 35% applied to FY14 and 31% applied to 4Q16*

Source: Company Reports and Hilliard Lyons estimates

Additional information is available upon request.

Analyst Certification

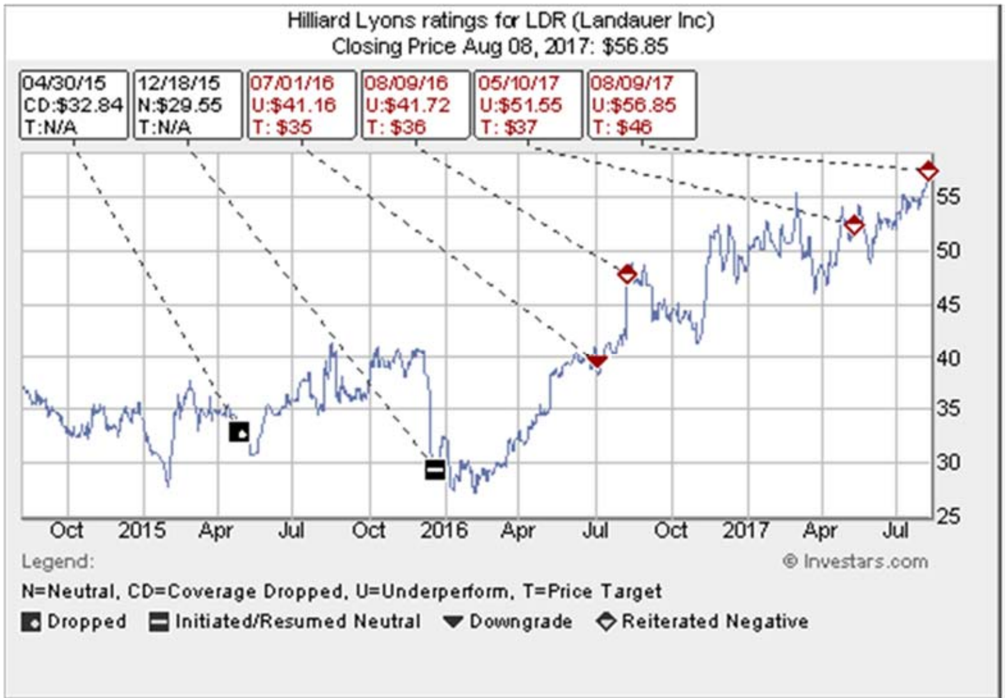
I, Kurt A. Kemper, hereby certify that the views expressed in this research report accurately reflect my personal views about the subject company(ies) and its (their) securities. I also certify that I have not been, am not, and will not be receiving direct or indirect compensation in exchange for expressing the specific recommendation(s) in this report.

Important Disclosures

Hilliard Lyons' analysts receive bonus compensation based on Hilliard Lyons' profitability. They do not receive direct payments from investment banking activity.

Investment Ratings:
Buy - We believe the stock has significant total return potential in the coming 12 months.
Long-term Buy - We believe the stock is an above average holding in its sector, and expect solid returns to be realized over a longer time frame than our Buy rated issues, typically 2-3 years.
Neutral - We believe the stock is an average holding in its sector, is currently fully valued, and may be used as a source of funds if better opportunities arise.
Underperform - We believe the stock is vulnerable to a price set back in the next 12 months.

Definitions of Suitabilities:
1. A large cap, core holding with a solid history.
2. A historically secure company which could be cyclical, has a shorter history than a "1" or is subject to event driven setbacks.
3. An above average risk/reward ratio could be due to small size, lack of product diversity, sporadic earnings or high leverage.
4. Speculative, due to small size, inconsistent profitability, erratic revenue, volatility, low trading volume or a narrow customer or product base



	Hilliard Lyons Recommended Issues		Investment Banking Provided in Past 12 Mo.	
Rating	**# of Stocks Covered**	**% of Stocks Covered**	**Banking**	**No Banking**
Buy	36	29%	14%	86%
Hold/Neutral	79	63%	5%	95%
Sell	10	8%	0%	100%

As of 7 July 2017

Other Disclosures

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