COMPANY UPDATE / ESTIMATE CHANGE

Health Care Services
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Key Metrics

LDR - NYSE (as of 02/09/17)		$49.55
Price Target		$36.00
52-Week Range		$53.45 - $27.10
Shares Outstanding (mm)		9.6
Market Cap. ($mm)		$475.9
Enterprise Value ($mm)		$571.2
1-Mo. Average Daily Volume		28,356
Institutional Ownership		94.6%
Debt / Total Capital		85.0%
ROE (TTM)		105.3%
Price / Book Value		24.7x
Indicated Dividend / Yield	$1.10	2.2%
TTM Operating Margin		18.5%

Operating EPS FY 9/30

	2016A	Prior 2017E	Curr. 2017E	Prior 2018E	Curr. 2018E
1Q	$0.40		$0.45A	$0.42	$0.44
2Q	$0.44	$0.46	$0.55	$0.49	$0.56
3Q	$0.50	$0.49	$0.45	$0.52	$0.51
4Q	$0.37	$0.33	$0.27	$0.36	$0.34
Year	$1.71	$1.67	$1.73	$1.80	$1.85
P/E	29.0x		28.7x		26.9x

Figures may not add up due to rounding

Revenue ($mm)

	2016A	Prior 2017E	Curr. 2017E	Prior 2018E	Curr. 2018E
1Q	$36.5		$37.6A	$37.1	$37.9
2Q	$38.1	$37.7	$39.1	$38.0	$38.8
3Q	$37.9	$39.2	$38.0	$39.5	$39.2
4Q	$36.8	$37.7	$36.5	$37.9	$38.1
Year	$149.2	$151.4	$151.1	$152.5	$154.0

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

Revenue Beat Delivered by Military Sales and Solid International Results

- **1Q17 Results:** Landauer reported revenue of $37.6 million versus our estimate of $36.7 million and the Street consensus estimate of $37.4 million. Operating EPS were $0.45 versus our estimate of $0.39 and the Street consensus of $0.45; GAAP EPS were $0.46. Non-GAAP EBITDA were $9.7 million versus our estimate of $8.9 million.
- **Positive Highlights:** Radiation Measurement revenue was higher than expected with an operating margin that was much higher than we projected. The revenue beat was partially due to higher military revenue and international product sales. The operating margin expansion was largely due to military revenue and a one-time credit for a real estate tax reimbursement.
- **Negative Highlights:** The Medical Physics segment posted solid growth led by imaging physics, but the segment fell ~$0.5 million shy of our estimate. Additionally, the Medical Physics operating margin contracted to 6.8% versus our expectations of 9.5%. Corporate operating expenses also exceeded our estimate, partially due to increased proxy expenses.
- **FY17 Guidance:** Management maintained previous guidance. Revenue is expected to be between $149 million and $154 million. Management expects GAAP EPS to be between $1.65 and $1.71.
- **Outlook, Estimates, & Rating:** Our outlook for Landauer has not changed materially. For FY17, our total company estimates are now $151.1 million in revenue, $36.9 million in adjusted EBITDA, and $1.73 in operating EPS. Our FY17 adjusted EBITDA estimate was $36.1 million. For FY18, our total company estimates are now $154.0 million in revenue, $37.7 million in adjusted EBITDA, and $1.85 in EPS. Our FY18 adjusted EBITDA estimate was $36.8 million. We are maintaining our Underperform rating. See page 4 for valuation and price target derivation.

Note Important Disclosures on pages 7 and 8
Note Analyst Certification on page 7

ADDITIONAL COMMENTARY

Income Statement Observations

- The **Radiation Measurement** segment recorded revenue of $27.6 million, exceeding our estimate of $26.2 million. Management stated military sales were $2.6 million in the quarter, which is an increase of $2.2 million from a year ago and $0.6 million higher than we had modeled. Management noted international growth was 7.3% due to product sales. Crudely assuming geographic distribution for the quarter equivalent to FY16, domestic revenue was likely flat or slightly up. Management noted the domestic service revenue increased ~2%. Operating income in the segment was $11.2 million, representing an operating margin of 40.6% versus the segment's 1Q16 operating margin of 36.0% and our estimate of 33.9%. The higher military sales and a one-time $600,000 tax refund related to a successful real estate tax appeal significantly boosted margins. We estimate margins outside of those items to be around 36.5%, which still represents expansion when we had anticipated higher spending for the Verifii development and launch preparation. Management now expects the National Guard contract to wrap up in 3Q17, and Japanese product sales from last year are expected to provide a tough comparison starting in 3Q17. Management reiterated Verifii launch guidance of second half calendar 2017.
- The **Medical Physics** segment generated year-over-year growth of 6.3% to achieve revenue of $9.9 million. This fell short of our estimate of $10.5 million. The imaging physics piece of the business expanded roughly 21% 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. The other piece of the business (therapy and commissioning) was flat or down slightly year-over-year due to approximately $300,000 less in commissioning business, which is very episodic by nature. The operating margin in the segment declined to 6.8% from 8.3% in 1Q16; we estimated a 9.5% margin. Management noted the lower commissioning business significantly impacted the 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.
- Corporate operating expenses were $4.5 million for the quarter, topping our estimate of $4.0 million. This is a 14.2% increase from $3.9 million in 1Q16. The increase was due to $300,000 in higher stock compensation and $200,000 in proxy expenses.
- The company-wide gross margin increased to 52.3% from 50.7% in 1Q16, exceeding our estimate of 48.7%. Management stated $400,000 of the real estate tax refund was stored in cost of goods sold, so a normalized gross margin would have been closer to 51.2%. Management also stated the military sales boosted the gross margin. Total Selling, General, & Administrative expenses were $12.2 million, resulting in an operating margin of 19.8% versus the 1Q16 operating margin of 17.1% and our estimate of 16.2%. Within SG&A, unexpected proxy expenses offset the remainder of the real estate tax refund. Netting these two items results in a normalized operating margin of 18.7%.
- Our non-GAAP EBITDA calculation, which excludes Equity in Income of JVs, Other Income and $400,000 for this quarter (net impact of real estate tax and proxy expenses), resulted in $9.7 million for the quarter, exceeding our estimate of $8.9 million. We remind investors we believe this is the key metric to watch, as EPS can swing significantly due to an uncertain tax situation and small number of shares outstanding.
- Equity in Income of JVs was $0.6 million, a jump of 111.3% from a year ago. That compares to our estimate of $0.4 million.
- Net interest expense was $0.8 million versus $0.9 million last year, as the company has paid down approximately $20.1 million in debt from this time last year using the proceeds from the sale of a business. The company paid down $1.5 million this quarter.
- The effective tax rate was 34.2% versus our estimate of 30.5%. We remind investors this will likely be volatile over the next couple of years, as the company noted the Medical Products sale will enable them

to monetize approximately $20 million in tax assets over the next four years or so. Management noted the cash tax rate was less than 10% for the quarter.
- Net income was $4.40 million. Our calculation of operating net income was $4.35 million, an increase of 16.0% year-over-year. GAAP EPS were $0.46 versus $0.38 a year ago. Operating EPS were $0.45 versus $0.40 a year ago. Our estimate was $0.39 and the Street consensus was $0.45.

Balance Sheet and Cash Flow Review

- Total debt-to-equity decreased to 8.2X from 8.3X last quarter. Long-term debt to EBITDA decreased to 3.3X from an elevated 4.2X last quarter.
- Free cash flow interest coverage decreased to 5.8X from 11.1X last quarter due to a significant sequential decrease in deferred taxes. EBITDA interest coverage increased to 12.8X from 12.3X in 4Q16. Free cash flow dividend coverage decreased to 1.7X from 2.8X last quarter.
- Cash flow from operations increased 9.2% year-over-year while free cash flow growth was 4.7%. The gains were driven largely by an increase in deferred taxes, but partially offset by not repatriating dividends from joint ventures.

ESTIMATES UPDATE

Our estimate changes largely reflect the results of this quarter, with some noticeable shifting in the timing of future revenue and increased operating margin assumptions in Radiation Measurement, only partially offset by lower estimates for Medical Physics. We now have a better idea of when to expect military revenue for the year. Within Radiation Measurement, we increased our FY17 revenue estimate to $109.0 million from $108.6 million previously. We also increased our operating margin estimate in the segment to 36.0% from 34.0%. The majority of this increase was simply the result of this quarter’s surprise, although we did tweak the remaining quarters upward as well. We have decreased our Medical Physics revenue estimate to $42.1 million (versus $42.8 million previously) and decreased our operating margin assumptions here; we now expect the operating margin to be 9.0% versus our prior estimate of 9.9%. We still expect Medical Physics margins to expand but continue to increase our time horizon for the company to realize efficiencies. For FY17, our total company estimates are now $151.1 million in revenue, $36.9 million in adjusted EBITDA, and $1.73 in operating EPS. This compares to previous estimates of $151.4 million, $36.1 million, and $1.67, respectively. We note our operating EPS exceeds management’s GAAP EPS guidance, but our GAAP EPS estimate of $1.71 is at the top end of management’s range.

For FY18, we have left revenue growth assumptions largely unchanged, but now building off a higher base in Radiation Measurement. We still expect Verifii growth to offset declining military revenue, which we still are not modeling despite our recent change in valuation of this business (see our last report). We also increased our operating margin expansion assumptions in Radiation Measurement while decreasing our operating margin assumptions in Medical Physics. For FY18, our total company estimates are now $154.0 million in revenue, $37.7 million in adjusted EBITDA, and $1.85 in EPS. This compares to previous estimates of $152.5 million, $36.8 million, and $1.80, respectively. Our FY18 estimates are well below the Street’s consensus (based on numbers prior to yesterday’s earnings release). The Street has FY18 revenues at $158.0 million and EPS at $2.11.

OUTLOOK & VALUATION

Our outlook for Landauer has not changed significantly. We believe the company could face pricing pressure in the near term and is too dependent on military business for growth in the Radiation Measurement segment this year – our estimates for FY17 point to a decline in the segment outside of the military boost. Further, the past few quarters have seen a noticeable bump in international product sales, which are not recurring in nature. While we note the likelihood of higher military spending has increased, we believe it would be imprudent to assume a contract will come through. Any lack of military business should bring Street consensus estimates down, in our opinion. Finally, we expect a smooth Verifii launch but note the risk still remains high.

Valuation

The stock closed yesterday at 14.9X trailing EV/EBITDA and 15.7X our forward 12 month EBITDA estimate, both of which are well above historical norms. The likely reason behind the extended valuation is the promise of tax reform, which would deliver a significant boost to domestically concentrated Landauer. Also potentially aiding shares could be military spending expectations and the presence of an activist shareholder.

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. We project the military dosimetry business, which is a non-recurring source of revenues, to account for just under 10% of next twelve months EBITDA. We believe investors should apply a lower valuation to this business, as Landauer's historical premium to the market is derived from its annuity-like revenue sources, in our opinion. The military business, which we believe is still a great source of cash flow for debt reduction and other activities, is not worth almost twice as much as the S&P 500 on an EV/EBITDA basis, which is where Landauer has historically traded, in our view. As such, we are applying a 12.4X EV/EBITDA valuation, below its historical median of ~13X, to our next twelve months estimates to derive our $36 price target. We note our increased EBITDA estimates did not increase the price target, as we have lowered our debt pay down assumptions. The company only retired $1.5 million in debt this quarter whereas we previously assumed a more aggressive pace.

Assuming tax reform takes the corporate rate in the U.S. to 20%, we believe that could deliver a 15% boost to FY18 EPS (we currently assume at 30.0% effective tax rate). Applying this 15% to our EV/ EBITDA multiple, we get a $43 price target. We are not changing our price target until legislation becomes reality but feel investors should be aware of the difference. Tax reform or not, we believe shares are overvalued and maintain 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 pushed our risk rating to 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	2014 A	2015 A	2016 A	1Q17 A	2Q17 E	3Q17 E	4Q17 E	2017 E	2018 E
Fiscal Period End	9/30/2014	9/30/2015	9/30/2016	12/31/2016	3/31/2017	6/30/2017	9/30/2017	9/30/2017	9/30/2018
Income Statement									
Radiation Measurement	113.6	106.0	104.2	27.6	28.6	27.2	25.6	109.0	109.6
Operating Margin %	*33.7%*	*33.6%*	*36.3%*	*38.5%*	*39.7%*	*34.6%*	*28.3%*	*36.0%*	*35.5%*
Medical Physics	32.2	35.4	39.2	9.9	10.6	10.8	10.9	42.1	44.4
Operating Margin %	*5.7%*	*8.8%*	*8.2%*	*6.8%*	*9.5%*	*9.5%*	*10.0%*	*9.0%*	*10.9%*
Medical Products	9.3	9.9	5.8						
Operating Margin %	*-673.3%*	*15.5%*	*18.3%*						
Total Revenue	**155.1**	**151.3**	**149.2**	**37.6**	**39.1**	**38.0**	**36.5**	**151.1**	**154.0**
Gross Margin %	*52.2%*	*52.0%*	*50.6%*	*52.3%*	*52.6%*	*50.6%*	*47.8%*	*50.8%*	*51.2%*
Gross Profit	**80.9**	**78.7**	**75.5**	**19.6**	**20.6**	**19.2**	**17.4**	**76.8**	**78.8**
SG&A Expenses	54.9	54.0	48.8	12.2	12.7	12.4	13.2	50.5	51.7
Non-GAAP Operating Income	**26.0**	**24.7**	**26.6**	**7.4**	**7.8**	**6.8**	**4.2**	**26.3**	**27.1**
Operating Margin %	*16.8%*	*16.3%*	*17.9%*	*19.8%*	*20.0%*	*18.0%*	*11.5%*	*17.4%*	*17.6%*
Adjusted EBITDA*	**39.9**	**37.1**	**37.7**	**9.7**	**10.8**	**9.5**	**6.9**	**36.9**	**37.7**
EBITDA Margin %	*25.7%*	*24.5%*	*25.3%*	*25.9%*	*27.7%*	*25.0%*	*18.8%*	*24.4%*	*24.5%*
Non-recurring Items**	(66.0)	(1.0)	0.0	0.0	(0.4)	0.0	0.0	0.0	0.0
Equity in Income of JVs	2.9	2.3	1.5	0.6	0.5	0.5	0.5	2.1	2.4
Interest Expense	(3.4)	(4.4)	(3.4)	(0.8)	(0.8)	(0.8)	(0.8)	(3.1)	(3.2)
Other Income	(0.0)	(0.3)	3.6	(0.3)	0.0	0.0	0.0	0.0	0.0
Pre-tax Income	**(40.5)**	**21.3**	**28.4**	**7.0**	**7.6**	**6.5**	**3.9**	**25.3**	**26.3**
Effective Tax Rate	*39.0%*	*29.4%*	*34.9%*	*34.2%*	*31.0%*	*31.0%*	*31.0%*	*31.5%*	*30.0%*
Net Income	**(24.7)**	**15.0**	**18.5**	**4.6**	**5.2**	**4.5**	**2.7**	**17.0**	**18.4**
Non-GAAP Operating Net Income**	**18.2**	**15.3**	**17.0**	**4.5**	**5.5**	**4.5**	**2.7**	**17.2**	**18.4**
Net income attributed to noncontrolling interest	0.5	0.5	0.7	0.2	0.2	0.2	0.2	0.6	0.6
Diluted Shares Outstanding	9.5	9.6	9.6	9.6	9.6	9.6	9.6	9.6	9.7
Diluted EPS Attributed to LDR Shareholders	**($2.65)**	**$1.52**	**$1.86**	**$0.46**	**$0.53**	**$0.45**	**$0.27**	**$1.71**	**$1.85**
Operating EPS Attributed to LDR Shareholders***	**$1.86**	**$1.55**	**$1.71**	**$0.45**	**$0.55**	**$0.45**	**$0.27**	**$1.73**	**$1.85**
Balance Sheet									
Cash and Equivalents	6.8	15.3	13.3	12.4	20.8	23.5	26.8	26.8	33.2
Other Current Assets	47.6	46.4	42.7	44.7	46.8	44.0	41.9	41.9	43.9
Total Current Assets	**54.3**	**61.8**	**56.0**	**57.1**	**67.5**	**67.5**	**68.7**	**68.7**	**77.1**
Net PP&E	46.8	46.4	46.4	46.1	57.6	57.3	56.8	56.8	56.8
Equity in Joint Ventures	23.8	24.0	26.2	25.0	25.0	25.0	25.0	25.0	25.0
Intangible Assets	57.3	48.1	43.1	42.3	33.3	33.3	33.3	33.3	33.3
Other Assets	34.4	28.5	19.1	17.3	13.5	12.6	11.7	11.7	8.2
Total Assets	**216.6**	**208.7**	**190.8**	**187.8**	**196.9**	**195.7**	**195.5**	**195.5**	**200.4**
Current Liabilities	44.7	38.5	34.5	33.1	39.7	38.6	38.7	38.7	39.4
Long-term Debt	133.6	133.4	109.1	107.6	105.6	103.6	101.6	101.6	92.6
Other Non-Current Liabilities	24.5	24.5	26.6	26.7	26.7	26.7	26.7	26.7	26.7
Total Liabilities	**202.9**	**196.4**	**170.2**	**167.3**	**172.0**	**168.8**	**166.9**	**166.9**	**158.6**
Total LDR Shareholders' Equity******	**12.3**	**11.2**	**19.2**	**19.2**	**23.7**	**25.6**	**27.4**	**27.4**	**40.6**

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

***Excludes impairment and restructuring charges*

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

*****Excludes non-controlling interests*

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	30%	17%	83%
Hold/Neutral	76	62%	7%	93%
Sell	10	8%	0%	100%

As of 6 February 2017

Other Disclosures

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