HILLIARD LYONS

COMPANY UPDATE / ESTIMATE CHANGE

Medical Devices
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Key Metrics

NEOG - NASDAQ (as of 03/21/17)		$65.62
Price Target		N/A
52-Week Range		$69.09 - $43.79
Shares Outstanding (mm)		38.5
Market Cap. ($mm)		$2,492
1-Mo. Average Daily Volume		101,922
Institutional Ownership		87%
Debt / Total Capital		0.0%
ROE (TTM)		16.3%
Book Value / Share		$11.72
Price / Book Value		5.6x
Indicated Dividend / Yield	$0.00	0.0%
TTM Operating Margin		17.5%

Operating (non-GAAP) EPS FYE 5/31

	2016A	Prior 2017E	Curr. 2017E	Prior 2018E	Curr. 2018E
1Q	$0.25		$0.25A	$0.31	$0.30
2Q	$0.25		$0.29A	$0.33	$0.33
3Q	$0.21		$0.24A	$0.30	$0.29
4Q	$0.27	$0.35	$0.33	$0.39	$0.38
Year	$0.98	$1.14	$1.12	$1.33	$1.30
P/E	66.7x		58.5x		50.5x

Figures may not add up due to rounding

Revenue ($mm)

	2016A	Prior 2017E	Curr. 2017E	Prior 2018E	Curr. 2018E
1Q	$74.9		$83.6A	$96.3	$95.8
2Q	$79.6		$90.7A	$102.7	$102.2
3Q	$76.7		$88.4A	$102.4	$98.9
4Q	$90.1	$104.3	$103.8	$115.4	$114.7
Year	$321.3	$369.7	$366.6	$416.8	$411.5

Company Description *– Based in Lansing, Michigan, Neogen develops, manufactures, and markets food and animal safety diagnostics and equipment. Neogen currently operates in two reportable segments: Food Safety and Animal Safety. Food Safety products include diagnostic test kits and complementary products sold to food producers and processors. Animal Safety products include pharmaceuticals, rodenticides, insecticides, disinfectants, veterinary instruments, and genomics services.*

Neogen Corporation

NEOG – NASDAQ – Neutral – 3

3Q17 Not Pretty but Not Concerning Either

- **3Q17 Results:** Neogen reported revenues of $88.4 million, growth of 15% from the same period a year ago. This fell short of our estimate of $91.1 million and the Street consensus estimate of $90.1 million. Operating EPS increased 15% to $0.24 compared to our estimate of $0.25 and the Street consensus of $0.27. GAAP EPS of $0.27 were boosted by Other Income.
- **Positive Highlights:** Veterinary Instruments & Disposables grew 10% versus our expectations of a small decline. Dehydrated Culture Media & Other grew 57% thanks to acquisitions and international GeneSeek strength. Solid expense control in Sales & Marketing helped keep operating expenses below our estimate on a dollar basis and in line on a percentage basis.
- **Negative Highlights:** Most categories in the Animal Safety segment fell short of our expectations, as organic growth was roughly flat. Additionally, the gross margin registered at 46.3% versus our estimate of 47.0% and the Street consensus of 48.1%.
- **Outlook and Estimates:** The long-term story remains positive in our view, as regulatory changes, consumer trends, and international opportunities continue to provide additional support to this well-managed company. We decreased our FY17 revenue estimate to $366.6 million from $369.7 million and decreased our FY17 EPS estimate to $1.12 from $1.14. We decreased our FY18 revenue estimate to $411.5 million from $416.8 million and decreased our FY18 EPS estimate to $1.30 from $1.33.
- **Valuation:** NEOG closed yesterday at 62.1X trailing operating EPS and 52.4X our next twelve months operating EPS estimate. While these multiples are above historical norms, we believe the market is pricing in lower tax rates, whereas we are not modeling them until final numbers are legislated. Thus, we feel the shares are appropriately valued and encourage investors to wait for a better entry point.

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

Revenue Growth	3Q17 Y/Y	Segment Quick Review
Life Sciences	34.7%	Continued benefit from truck driver drug testing legislation in Brazil; forensic kits up 39%
Veterinary Instruments & Disposables	10.2%	Strength in the durable syringes product lineup
Animal Care & Other	-23.6%	ThyroKare likely knocked off ~$1.4 million; segment still declined ex. ThyroKare
Rodenticides, Disinfectants, & Insecticides (Biosecurity)	20.8%	Rodenticides and insecticides down on tough comps but disinfectants up due to acquisitions
DNA Testing Service	11.1%	Growth from poultry and cattle; slowdown due to Scotland subsidiary cannibalization
Total Animal Safety	**8.1%**	**Organic growth was roughly flat**
Natural Toxins, Allergens, & Drug Residues	10.5%	Mycotoxin outbreak and new products led to a 29% spike in kit sales; allergen tests were up 14%
Bacteria & General Sanitation	1.3%	Automated spoilage detection systems and equipment grew 12%
Dehydrated Culture Media & Other	56.8%	Strong international GeneSeek results and acquisitions
Total Food Safety	**23.7%**	**Organic growth of 12%, or 16% in constant currency**
Neogen Revenue Growth	**15.2%**	

Source: Company Reports

ADDITIONAL COMMENTARY

Earnings Conference Call Notes

- International growth remained strong but, as expected, currency headwinds prevented much of that performance from making it to the financials. Currency headwinds deducted $1.7 million from the top line and $0.01 from EPS. Despite the currency headwinds, the company generated approximately 5% organic growth (7% constant currency) in the quarter. Intra-quarter acquisitions added about $4 million to revenue this quarter.
- Neogen's Scotland-based operations reported a 31% increase in local currency (12% after currency translation) as genomics and mycotoxin kit sales delivered strong growth. Neogen's Brazilian revenues grew 47% before dollar conversion, partially due to the acquisition of a genomics business there. The Mexican subsidiary expanded 15% in constant currency terms but showed a 2% decline after dollar conversion.
- Despite the problems a stronger dollar presents, cheaper potential international acquisitions now await, which has been stressed the past couple of quarters. This, combined with what we believe is a desire to diversify their largely domestic manufacturing base to tamp down gross margin volatility and boost their international presence, leads us to think acquisitions will be internationally focused in the near term.

- A prime example of Neogen expanding their international manufacturing footprint is their recent acquisition of Quat-Chem (announced December 1st). Quat-Chem, a developer and manufacturer of cleaners and disinfectants. Quat-Chem sells to a wide range of industries, including familiar territory for Neogen such as food and beverage and livestock producers. Quat-Chem produces roughly $12 million in revenue annually and management indicated operating margins are in line with the Animal Safety segment. On December 27th, Neogen also acquired Brazil-based Rogama, a developer of rodenticides and insecticides. Rogama's annual revenues are approximately $8 million with customers in agronomic, professional, and retail markets. The company is also a major supplier to public health agencies, including a long-term partnership with the Pan American Health Organization.
- Veterinary Instruments & Disposables delivered the first beat relative to our estimates for the first time in a few quarters. Commentary on the call was light regarding this sub-segment, but management noted strong growth in durable syringes.
- As a reminder, the Animal Care & Other sub-segment growth was impacted by the halting of ThyroKare sales. The company stopped selling its ThyroKare medicine for hypothyroidism in canines at the end of July. Lloyd Inc. disrupted the market by pursuing an official FDA approval, whereas thyroid medicines had previously been under FDA discretion. This means Neogen now has to pursue official FDA approval. ThyroKare sales were $6.6 million in FY16 and spread fairly evenly throughout the year. The 10-K stated the company expects approval in FY18, and management stated earlier in the fiscal year they expect clinical trials to wrap up in six months or so.
- GeneSeek revenue grew 20% on a worldwide basis, resulting in 24% growth fiscal year-to-date. The domestic growth was the result of increased poultry business and strength in cattle due to new offerings in dairy. International growth was strong due to increased capacity at the Scotland facility. Management repeated the fact that sample volume has more than doubled in the past two years.
- In early February, GeneSeek rolled out a new genomics offering, the GeneSeek Genomic Profiler Bovinge 50K. This test is a second generation product used to predict the traits of seedstock cattle, primarily the Bos Taurus and Bos Indicus breeds. The company stated over 10 years of genomics research has led to this product, and genetic data from all 30 cattle chromosomes are available. The division also announced a partnership with the International Brangus Breeders Association (IBBA) to introduce a new DNA test for replacement heifers, using Neogen's Igenity Brangus profiler.
- Rodenticides, after a long run of strong growth, not only slowed but actually declined year-over-year. Management cited tough comparisons due to the resolution of a vole outbreak in the Northwestern U.S., but we note a partial, albeit small, benefit still remained from Neogen's acquisition of Virbac Group's rodenticide business. Insecticides were also down due to tough comps as the company executed a spring booking program in 3Q16. Management noted the recently acquired Preserve is exceeding their internal budget projections, and they believe they are now the largest domestic player in cleaners and disinfectants. The bird flu outbreak in Tennessee, which appears to be contained for now, could prompt potential customers to increase disinfectant application.
- Neogen terminated the manufacturing and marketing agreement with SenesTech for their unique rodenticide, which worked as a contraceptive rather than a poison. The cause for termination is the narrow regulatory approval from the EPA that significantly limits Neogen's ability to sell it in their end markets. Also, Lanxess cancelled a distribution agreement with Neogen for its disinfectants that should cost the company about $1 million in revenue in 4Q17 according to management.
- Allergen test kits grew 14% with management citing increasing concerns about food allergens.
- Mycotoxin kits sales jumped 29% as a result of the mycotoxin outbreak in U.S., Canada, and Europe. A record corn crop in North America had the unusual effect of exacerbating a mycotoxin outbreak, as crops had to be temporarily stored on the ground outside. The tarps covering the crops were conducive to mold growth that created the mycotoxins. Neogen has received very positive feedback on several new water-based tests for mycotoxins. Management also noted their new tests were the only ones on the market that allowed testing with the same sample for multiple different types of mycotoxins. Drug residue kits were down.

- The Bacteria & General Sanitation category edged modestly higher as sales of automated spoilage detection equipment and supplies grew 12%. It will be interesting to see if legislation that benefits Neogen comes from the Brazilian meat inspector bribing scandal currently being investigated.
- Management also noted they are working with some large meat producers in genotyping foodborne parasites to potentially identify where they came from.

Other Income Statement Notes

- The gross margin, which has struggled of late from a myriad of factors, expanded year-over-year to 46.3% in 3Q17 compared to 45.9% in 3Q16. This fell short of our estimate of 47.0% and the Street consensus of 48.1%. The currency headwinds and missing ThyroKare continued to be an issue but this quarter had the benefit of a positive business mix. The mycotoxin outbreak, as well as allergen test growth, benefited the gross margin as these products carry noticeably higher margins than the company as a whole.
- Operating expenses were lower than our estimate on a dollar basis and in line as a percent of sales. Sales & Marketing expenses were about $1.2 million lower than our estimate while Research & Development and General & Administrative expenses were roughly equal to our estimate. All three items grew slower than revenue. The operating margin of 16.2% was lower than our estimate of 16.6% and the Street consensus of 18.3%
- Other Income was $1.4 million with $1.1 million coming from the SenesTech breakup ($660,000) and currency gain ($440,000). These two factors contributed $0.03 to EPS.
- The effective tax rate of 34.0% for the quarter was lower than our 35.7% estimate. Last quarter, management guided to an effective tax rate around 35% for FY17.
- Operating (non-GAAP) net income was $9.4 million versus our estimate of $9.7 million. With 38.53 million diluted shares outstanding (versus our estimate of 38.25 million), operating EPS came in at $0.24 versus our estimate of $0.25 and the Street consensus estimate of $0.27.

Balance Sheet and Cash Flow Review

- Neogen has generated $45.4 million in cash from operations year-to-date, a ~62% increase year-over-year. The company has invested about $8.9 million in property and equipment this fiscal year.
- Neogen has no long-term debt, cash and securities of $124.6 million, and a comfortable current ratio of 8.0X. Total liabilities/equity is a conservative 12.3%.

ESTIMATES UPDATE

The biggest drivers of our revenue estimate changes are the addition of Rogama and the loss of distribution from Lanxess. We also decreased Rodenticide, Insecticide, & Disinfectant estimates due to concerns about rodenticide growth, although we note disinfectants could get a boost from heightened concern about avian influenza. Finally, the other noteworthy adjustments to our revenue model were a boost in Veterinary Instruments & Disposables (better than expected results) and a decrease in Bacteria & General Sanitation (another miss relative to our estimates).

We decreased our gross margin estimate slightly for FY18 to 48.0% from 48.2%. The Street consensus prior to yesterday’s report was 48.6%. From an operating expense standpoint, we have revised our outlook for Sales & Marketing to generate further operating leverage, as we are impressed with progress in this line item. Our estimates for the other operating expenses were largely unchanged. We have also decreased our tax assumptions slightly.

Our FY18 revenue forecast has been decreased to $411.5 million (% growth) from $416.8 million. With a new operating margin estimate of 18.6% (18.9% previously), we have decreased our FY18 EPS forecast to $1.30 from $1.33. We are also unveiling FY19 estimates: $453.2 million in revenue, a 19.1% operating margin, and $1.46 EPS.

VALUATION & SUITABILITY

Our next 12 month operating EPS estimate reflects an impressive 18.4% growth. Our FY18 operating EPS estimate suggests 15.9% growth compared to FY17. NEOG closed yesterday at 62.1X trailing operating EPS and 52.4X our next twelve months operating EPS estimate. While these multiples are modestly above historical norms, we believe the market is pricing in lower tax rates, whereas we are not modeling them until final numbers are legislated. Thus, we feel the shares are appropriately valued and encourage investors to wait for a better entry point.

Neogen is well diversified for a mid-cap company in terms of products and customer base but does experience some event-driven revenues, which can be unreliable. Additionally, relatively low trading volumes and a high multiple are factors in our suitability rating of 3.

RISKS & CONSIDERATIONS

- **Integration of acquisitions** – Neogen has been very acquisitive throughout its history, and we anticipate that trend to continue. Failure to successfully integrate acquisitions could lead to financial results below expectations.
- **Failure of new products –** Neogen also internally develops new products and product lines. Failure to successfully develop and sell new products could harm profitability.
- **Proprietary protection** – Neogen has many products that are not under patent protection, and they rely on trade secrets to protect proprietary methods and formulas. Financial harm could arise should Neogen fail to protect trade secrets.
- **Dependence on agricultural industry** – Neogen derives a significant amount of revenue from customers in or associated with the agricultural industry, which is subject to many factors beyond their control, such as weather.
- **Event-driven revenue –** Neogen is a frequent beneficiary of food safety problems, such as foodborne pathogen outbreaks, allergen contamination, etc. Failure of these events to occur could lead to lower than anticipated revenue growth.
- **Legal –** Product lawsuits are common in the health care sector. An unfavorable court decision could hamper the ability to market a product, whether a current patent under Neogen is successfully challenged or Neogen is determined to have infringed upon the patent of a competitor.
- **Regulatory –** Neogen has some products that are subject to regulatory approval. Additionally, the food safety industry is anticipating new regulations, which could have uncertain effects on industry participants.

NEOGEN CORPORATION										NEOG: NEUTRAL
In millions	**2014 A**	**2015 A**	**2016 A**	**1Q17 A**	**2Q17 A**	**3Q17 A**	**4Q17 E**	**2017 E**	**2018 E**	**2019 E**
Fiscal Period End	**5/31/2014**	**5/31/2015**	**5/31/2016**	**8/31/2016**	**11/30/2016**	**2/28/2017**	**5/31/2017**	**5/31/2017**	**5/31/2018**	**5/31/2019**
Animal Safety Revenue	131.1	151.6	175.4	44.6	50.0	45.4	53.9	193.9	208.7	227.9
Food Safety Revenue	116.3	131.5	145.8	39.0	40.8	42.9	47.4	170.1	192.6	206.5
Other							2.5	6.5	10.3	18.8
Total Revenue	**247.4**	**283.1**	**321.3**	**83.6**	**90.7**	**88.4**	**103.8**	**366.6**	**411.5**	**453.2**
Gross Margin %	*49.6%*	*49.3%*	*47.6%*	*48.4%*	*48.1%*	*46.3%*	*47.2%*	*47.5%*	*48.0%*	*48.4%*
Gross Profit	**122.6**	**139.7**	**153.1**	**40.5**	**43.6**	**40.9**	**49.0**	**174.0**	**197.4**	**219.3**
Sales and marketing	46.4	51.8	57.6	14.8	15.7	15.3	18.2	64.0	71.7	78.7
General and administrative	24.4	25.2	29.2	8.3	8.3	8.5	8.6	33.7	37.0	40.2
Research and development	8.3	9.6	9.9	2.7	2.8	2.6	2.5	10.6	12.3	14.0
Total Operating Expenses	79.2	86.6	96.7	25.7	26.7	26.5	29.3	108.3	120.9	132.9
Operating Income	**43.4**	**53.1**	**56.4**	**14.7**	**16.9**	**14.4**	**19.7**	**65.6**	**76.5**	**86.5**
Operating Margin %	*17.5%*	*18.8%*	*17.6%*	*17.6%*	*18.6%*	*16.2%*	*19.0%*	*17.9%*	*18.6%*	*19.1%*
Royalty Income	0.2	0.2	0.2	-	-	-	0.2	0.2	0.2	0.2
Non-operating items	(0.6)	(1.2)	(1.1)	0.5	(0.1)	1.4	0.3	2.0	0.3	0.3
Non-GAAP Pretax Income	**43.6**	**53.3**	**56.6**	**14.7**	**16.9**	**14.4**	**19.9**	**65.8**	**76.7**	**86.7**
Effective Tax Rate	*34.6%*	*35.6%*	*34.2%*	*34.8%*	*33.4%*	*34.0%*	*35.0%*	*34.3%*	*34.4%*	*34.4%*
***Non-GAAP Net Income**	**28.5**	**34.3**	**37.2**	**9.6**	**11.2**	**9.4**	**12.9**	**43.1**	**50.4**	**56.9**
Diluted Shares Outstanding	37.3	37.5	37.9	38.2	38.3	38.5	38.6	38.4	38.8	39.0
Non-GAAP Diluted EPS	**$ 0.77**	**$ 0.92**	**$ 0.98**	**$ 0.25**	**$ 0.29**	**$ 0.24**	**$ 0.33**	**$ 1.12**	**$ 1.30**	**$ 1.46**

**Non-GAAP Net Income is calculated after allocations to non-controlling interests, which are not shown in this table*

Source: Company Reports and Hilliard Lyons estimates

Prices of other stocks mentioned: SenesTech Inc. (SNES - $8.26)

Additional information is available upon request

Analyst Certification

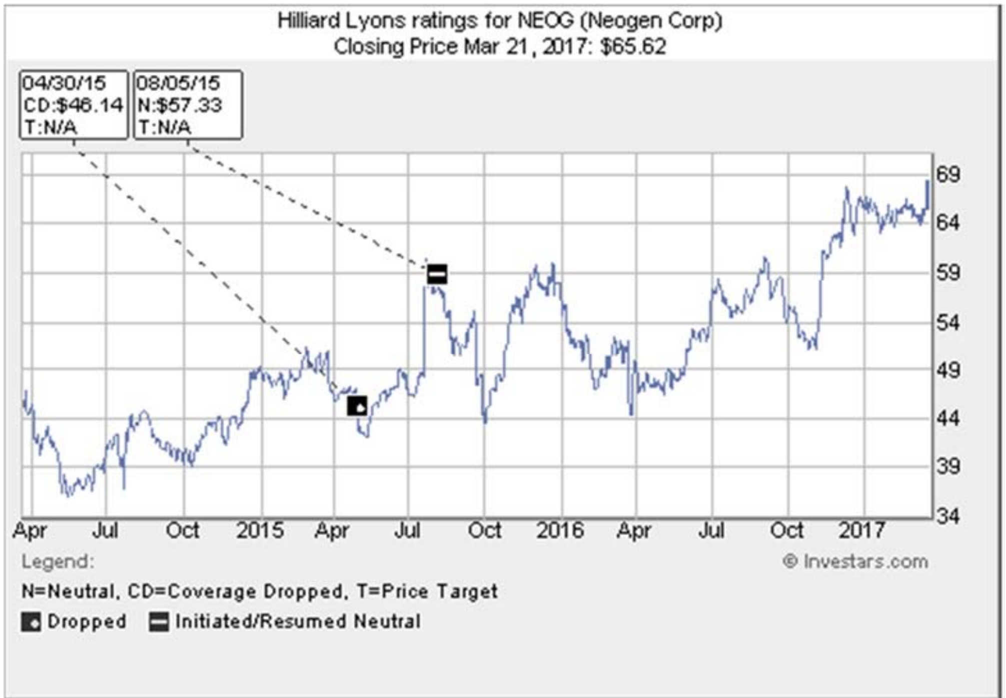
I, Kurt A. Kemper, hereby certify that the views expressed in this research report accurately reflect my personal views about the subject company(ies) and its (their) securities. I also certify that I have not been, am not, and will not be receiving direct or indirect compensation in exchange for expressing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

Definitions of 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	35	29%	14%	86%
Hold/Neutral	71	59%	6%	94%
Sell	15	12%	7%	93%

As of 8 March 2017

Other Disclosures

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