HILLIARD LYONS

COMPANY UPDATE / ESTIMATE CHANGE

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Meridian Bioscience, Inc.

VIVO – NASDAQ – Neutral – 3

Solid Quarter Carried by Respiratory and Zika Sales

- **2Q17 Results:** Meridian reported revenues of $54.1 million, a 5.6% increase from the same period a year ago. An organic decrease of ~1.5% was offset by the acquisition of Magellan Diagnostics. Revenues beat our estimate of $50.1 million and the Street consensus of $51.2 million. Operating EPS were $0.21, ahead of our estimate and the Street consensus of $0.19. GAAP EPS of $0.22 benefitted from ~$0.4 million of "Other Income."
- **Positive Highlights:** Both the Diagnostics and Life Science segments beat our estimates, with the former registering $37.8 million versus our estimate of $36.4 million and the latter pulling in $16.4 million versus our estimate of $14.5 million. A large order of Zika biologicals aided the Life Science beat.
- **Negative Highlights:** Magellan Diagnostics was flat to slightly down versus our estimate of double-digit growth. It appears some demand was pulled forward into 1Q17; as such we are not concerned with the miss for this subsidiary. The gross margin contracted 354 basis points to 62.0% versus our estimate of 64.0% and the Street consensus of 63.6%. This miss is concerning and is the primary driver of our unchanged EPS estimate for FY18.
- **Estimates Update:** We are increasing our FY17 revenue estimate to $196.5 million versus $193.8 million previously, and increasing our FY17 EPS estimate to $0.68 from $0.66. We are upping our FY18 revenue estimate to $199.1 million versus our prior estimate of $197.0 million but leaving our EPS estimate unchanged at $0.68.
- **Valuation and Rating:** VIVO closed yesterday at 22.1X our next 12 month EPS estimate, which is a significant boost over recent lows around 18X and more in line with its history over the past five years or so. We are sticking with a forward P/E of 20X and our price target of $14, Although shares are trading above this price target, we are comfortable with our Neutral rating due to the dividend yield (3.3%) and the "malaria call option."

Key Metrics

VIVO - NASDAQ (as of 04/27/17)		$15.00
Price Target		$14.00
52-Week Range		$21.49 - $10.75
Shares Outstanding (mm)		42.6
Market Cap. ($mm)		$633.0
1-Mo. Average Daily Volume		306,033
Institutional Ownership		90.6%
Debt / Total Capital		25.8%
ROE (TTM)		17.7%
Book Value / Share		$4.01
Price / Book Value		3.7x
Indicated Dividend / Yield	$0.50	3.3%
TTM Operating Margin		24.0%

Operating EPS FY 9/30

	2016A	Prior 2017E	Curr. 2017E	Prior 2018E	Curr. 2018E
1Q	$0.21		$0.15A	$0.16	$0.15
2Q	$0.24		$0.21A	$0.19	$0.21
3Q	$0.21	$0.18	$0.18	$0.19	$0.18
4Q	$0.14	$0.14	$0.14	$0.14	$0.14
Year	$0.79	$0.66	$0.68	$0.68	$0.68
P/E	19.1x		22.2x		22.1x

Figures may not add up due to rounding

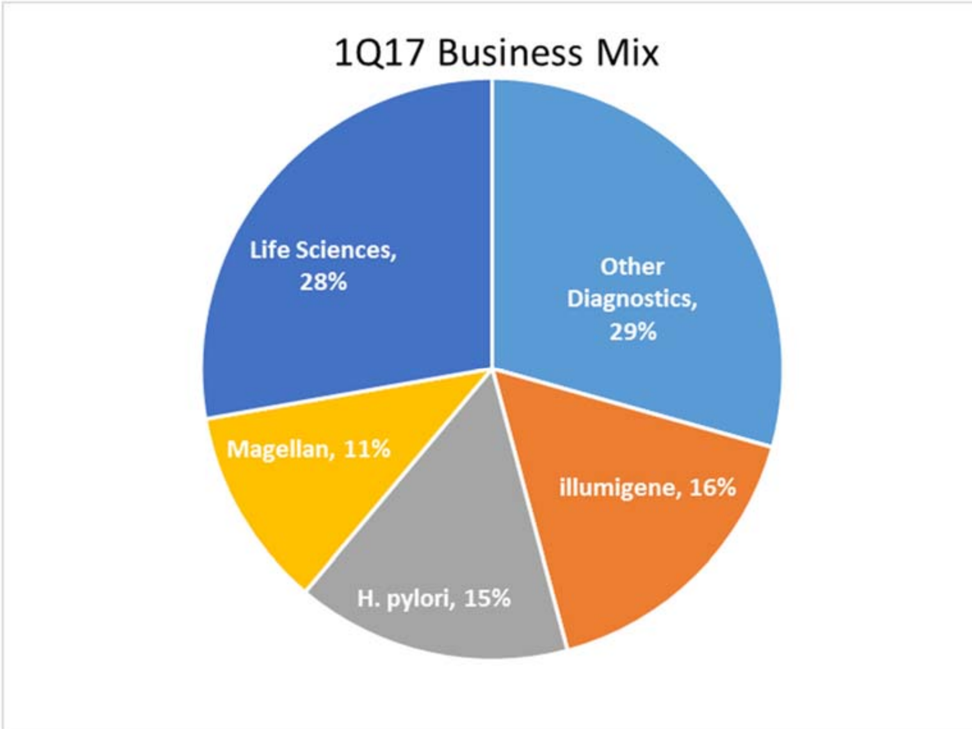
Revenue ($mm)

	2016A	Prior 2017E	Curr. 2017E	Prior 2018E	Curr. 2018E
1Q	$47.2		$46.8A	$48.5	$48.1
2Q	$51.3		$54.1A	$51.5	$54.3
3Q	$50.7	$49.0	$48.9	$49.5	$49.5
4Q	$47.0	$47.0	$46.7	$47.6	$47.2
Year	$196.1	$193.8	$196.5	$197.0	$199.1

Company Description *– Based in Cincinnati, Ohio, Meridian Bioscience develops, manufactures, and markets in vitro diagnostic equipment and products used for specimen collection and transport. The company also manufactures and sells laboratory chemicals associated with research and diagnostic manufacturing.*

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

ADDITIONAL COMMENTARY



Source: Company reports; 2Q17 not represented as details are not yet available

- The Diagnostic segment grew 1.1% year-over-year to $37.8 million in the quarter versus our estimate of $36.4 million. Organically, the segment declined ~8.5%. The ***illumi***gene product line grew ~6% outside of *C. difficile* tests. However, *C. difficile* makes up roughly half of ***illumi***gene revenue and the struggles in *C. difficile* led to a decrease of ~1.5% for the total ***illumi***gene category. We estimate ***illumi***gene *C. difficile* revenues were down close to 10%. The press release noted the respiratory category as a whole (including immunoassay products) grew 14%; management informed us most of the growth occurred in the ***illumi***gene platform.
- *H. pylori* assay revenue decreased 6%, which was below the flattish results we expected. Management noted last year's aggressive stock-and-block program in anticipation of patent expiration maintained its headwind as a tough comparison for this quarter as well. Management did note that the competitive landscape has not changed significantly despite the patent expiration, and the company expects growth from the category with no competitors on the near term horizon. Management has previously hinted at launching an additional test in the category.
- Magellan Diagnostics was roughly flat or slightly down, falling well short of our expectations, although admittedly we likely underestimated the extent to which demand was pulled forward into 1Q17 due to international orders from organizations such as the Red Cross. We remind investors the company's LeadCare II product received Chinese regulatory approval this past August and they signed a distribution agreement with China-based MedCaptain Medical Technology in December. They also signed a distribution agreement with Biofirm Technologies in early March for access to the East and Central Africa regions. Management noted partnerships with distributors is a key first step for international expansion, but it will still take some time for education to lead to adoption.
- We discussed with management progress on malaria testing growth. Management noted about 100 hospitals in Europe are testing migrants and they expect continued expansion in the region. In terms of

Africa, management stated discussions are ongoing with non-governmental organizations (NGOs) such as the World Health Organization and Gates Foundation. Although not explicitly stated, we infer there may be some push back on pricing, as the NGOs prefer budget-conscious testing given the high volume, although those tests are generally less accurate. Management told us they are exploring a hybrid model for the NGOs where cheap, less sensitive tests are used for symptomatic patients. For asymptomatic patients – who can be a carrier of the disease and a substantial problem if the goal is eradication – where an outbreak has occurred, the NGOs could turn to the substantiated most sensitive malaria assay in the world, ***illumi***gene. This would allow the NGOs to quarantine and/or treat the asymptomatic patients and prevent further spreading. We think this is a shrewd move by management, but we admittedly do not have much insight into these organizations. Further, the asymptomatic population could be massive and therefore be uneconomical to the NGOs. We believe the hybrid model would likely be tested in a small region first, should the approach gain any interest. If the hybrid model is tested, the malaria business in Africa, for Meridian, represents a binary outcome, where upside could be significant.

- The legacy product category (mostly immunoassay tests) struggled for a fourth consecutive quarter. We estimate the quarter represented a ~13% year-over-year decline, which is an improvement over the past three quarters but by no means reassuring. Although it is difficult to discern which product lines sold in which region, we note the Americas region in diagnostics, which was cited as a source of pain last quarter, declined ~26% and ~18% organically in 1Q17. Management seemed confident a renewed focus with distributors and new sales leadership domestically would turn the category around.
- The Life Science segment expanded 17.6% to $16.4 million versus our estimate of $14.5 million. Management stated there was a large order of Zika biologicals. Further, the impact of the company's exit from biopharma enabling services was minimal this quarter and year-to-date; we had estimated a more noticeable impact. As a reminder to investors, the biopharma business pulled in $2-3 million in revenue annually. Thus, although we remain bullish on the segment, we would caution reading too much into this strong quarter.
- The gross margin for the quarter was 62.0% versus 65.5% in 2Q16 and our estimate of 64.0%. We acknowledge last year was a tough comparison due to product mix but were still surprised by the erosion.
- Operating expenses were $19.3 million, exactly in line with our estimate. However, considering the revenue strength this quarter, Selling & Marketing expense was well controlled, in our opinion. S&M expenses were only $8.0 million versus our estimate of $8.5 million. Research & Development expenses were higher than expected, registering $3.9 million versus our estimate of $3.4 million. General & Administrative expenses of $7.4 million were in line with our estimate.
- Operating income was $14.2 million, handily exceeding our expectations of $13.3 million. This marked a 13.3% decline compared to 2Q16. The operating margin of 26.2% edged our estimate of 26.0%.
- The effective tax rate was 34.4%, below our estimate of 36.0 %.
- Operating EPS came in at $0.21, ahead of our estimate and the Street consensus of $0.19.
- Management maintained guidance, with revenues expected to be between $193 million and $199 million and diluted EPS between $0.64 and $0.69.

FINANCIAL CONDITION

Balance Sheet Review

Full balance sheet details and the complete cash flow statement for 2Q17 are not released until a few weeks after Meridian announces earnings. Based on data given for this quarter, Meridian has cash and equivalents of $54.7 million, and a current ratio of 6.5X. Total liabilities/equity is a conservative 0.47X. The cash balance could cover the new dividend rate for over 2.5 years. We consider the new dividend rate well covered. As a reminder to investors, Meridian cut the dividend last quarter to an annual rate of $0.50 from $0.80.

ESTIMATES UPDATE

We are updating our FY17 revenue estimate to $196.5 million, or roughly flat from FY16, versus our prior estimate of $193.8 million. This is just above the midpoint of guidance. We project Diagnostic revenues of $142.0 million versus our prior estimate of $140.1 million. We modestly lowered our *H. pylori* and Magellan estimates to reflect this quarter, although our outlook for those categories is largely unchanged. We increased our estimates for legacy products to reflect the quarter, but remain wary of a quick turnaround for the category. We also increased our estimates for ***illumi***gene revenues, but this increase largely reflects this quarter's surprise as well, and our outlook for the platform has only slightly improved. We don't believe stiff pricing competition in *C. difficile* will let up, and new product launches from competitors in respiratory diseases leads us to take caution on projecting too much growth for the rest of the ***illumi***gene portfolio. As discussed above, we think malaria revenues will continue to grow, but any material uptick is essentially a call option on NGOs coming on board. At this point, we don't incorporate that into our estimates, but are comfortable with the stock pricing in the opportunity. Finally, we increased our Life Science estimate to $54.6 million versus our previous estimate of $53.7 million. The small increase (despite this quarter's large beat) comes as it appears the biopharma business exit headwind is concentrated in the back half of the fiscal year.

We are decreasing our FY17 gross margin estimate to 62.5% from 63.1%, reflecting this quarter's surprise and our belief the erosion will continue as the product mix becomes less favorable. We are actually increasing our operating expense estimate marginally to $77.2 million from $77.1 million, as we don't believe S&M expense control will remain as strong as it was this quarter. Finally, we are increasing our FY17 EPS estimate to $0.68 from $0.66. This is toward the top of the guidance range.

We are updating our FY18 revenue estimate to $199.1 million versus our prior estimate of $197.0 million. The increase comes mostly from the legacy product category. We still expect a decline in FY18 but this quarter's surprise and modest boost of our estimates for the last two quarters provide a higher base for future erosion. We also mildly increased ***illumi***gene estimates. *H. pylori*, Magellan, and Life Science estimates are unchanged. Our operating expense assumptions were tweaked slightly higher, but a lower gross margin assumption prevents any increase in our EPS estimate. We are leaving our FY18 EPS estimate unchanged at $0.68.

VALUATION

VIVO closed yesterday at 22.1X our next 12 month EPS estimate, which is a significant boost over recent lows around 18X and more in line with its history over the past five years or so. We are sticking with a forward P/E of 20X. Given a lack of growth in our forecast, we were tempted to use an even lower multiple but believe the potential of corporate tax reform – which we do not incorporate in our estimates – warrants a higher multiple for a small, domestically focused company like Meridian. Thus, we are maintaining our price target of $14, derived by applying a 20 forward P/E multiple to our FY18 estimates. Although shares are trading above this price target, we are comfortable with our Neutral rating due to the dividend yield (3.3%) and the "malaria call option."

SUITABILITY

Meridian is diversified in terms of its end user base, but does rely on distributors and generates over 20% of total company revenues from two distributors. Further, the Diagnostic segment is largely dependent on a few disease categories. Stiff competition, low trading volumes, and relatively weak liquidity are also factors in our suitability rating of 3.

RISKS & CONSIDERATIONS

- **Competition and technological innovation –** Meridian is constantly subject to intense competition in the diagnostics field. Further, technological innovation is high in the industry, presenting Meridian with challenges from existing competitors and the threat of new entrants.
- **Failure of new products –** Meridian internally develops new tests and often brings new technologies in-house for the final stages of development. Failure to successfully develop and sell new products could harm profitability.
- **Proprietary protection –** Meridian has several products that are not under patent protection, and the company relies on trade secrets to protect proprietary methods and formulas. Significant financial harm could arise should Meridian fail to protect trade secrets.
- **Patent Expiration** – Meridian also has several products under patent. Patent expirations can lead to new competition and potential revenue declines.
- **Distributor Dependence** – Meridian relies on relationships with distributors in the diagnostics industry. Should relationships sour or a distributor is acquired, Meridian could face potential financial harm.
- **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 Meridian is successfully challenged or Meridian is determined to have infringed upon the patent of a competitor.
- **Regulatory –** Most of Meridian's products are subject to regulatory clearance. If Meridian's products are determined to be inadequate or harmful to consumers, the company could be forced to halt production or possibly recall products.

MERIDIAN BIOSCIENCE							VIVO: NEUTRAL	
In millions	2015 A	2016 A	1Q17 A	2Q17 A	3Q17 E	4Q17 E	2017 E	2018 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
Income Statement								
Diagnostic Revenue	146.1	145.1	33.8	37.8	35.9	34.5	142.0	141.9
Life Science Revenue	48.7	51.0	13.0	16.4	13.1	12.1	54.6	57.2
Total Revenue	**194.8**	**196.1**	**46.8**	**54.1**	**48.9**	**46.7**	**196.5**	**199.1**
Gross Margin %	*62.6%*	*65.2%*	*62.9%*	*62.0%*	*63.5%*	*61.7%*	*62.5%*	*62.5%*
Gross Profit	**121.9**	**127.8**	**29.5**	**33.5**	**31.1**	**28.8**	**122.8**	**124.5**
Research and development	12.6	13.8	3.4	3.9	3.6	3.7	14.6	14.7
Selling and marketing	25.6	29.9	7.5	8.0	8.0	8.1	31.6	32.5
General and administrative	27.6	30.8	8.4	7.4	7.3	7.8	31.0	31.7
Total Operating Expenses	65.8	74.5	19.4	19.3	18.9	19.6	77.2	78.9
Non-GAAP Operating Income	**56.1**	**53.3**	**10.1**	**14.2**	**12.2**	**9.2**	**45.7**	**45.5**
Operating Margin %	*28.8%*	*27.2%*	*21.5%*	*26.2%*	*24.8%*	*19.8%*	*23.2%*	*22.9%*
Other Income, Net	(1.0)	(0.7)	(0.4)	0.0	(0.4)	(0.4)	(1.6)	(1.3)
Effective Tax Rate	*35.5%*	*36.4%*	*35.1%*	*34.4%*	*34.7%*	*34.0%*	*34.8%*	*34.8%*
Non-GAAP Net Income	**36.2**	**33.3**	**6.3**	**9.0**	**7.7**	**5.8**	**28.8**	**28.9**
Diluted Shares Outstanding	42.0	42.4	42.5	42.6	42.6	42.6	42.6	42.7
Non-GAAP Diluted EPS	**$0.86**	**$0.79**	**$0.15**	**$0.21**	**$0.18**	**$0.14**	**$0.68**	**$0.68**
Balance Sheet								
Cash and Equivalents	50.0	47.2	49.3					
Other Current Assets	72.9	79.6	76.8					
Total Current Assets	**122.9**	**126.8**	**126.0**	**128.8**	**130.0**	**130.2**	**130.2**	**137.8**
Net PP&E	27.5	30.5	30.4					
Intangible Assets	28.3	91.8	90.1					
Other Assets	4.7	2.7	3.5					
Total Assets	**183.3**	**251.8**	**250.1**	**251.9**	**252.7**	**252.5**	**252.5**	**259.0**
Current Liabilities	15.3	22.6	21.0	19.9	19.9	19.6	19.6	19.7
Non-Current Liabilities	2.2	62.8	63.3	61.2	60.2	59.2	59.2	53.9
Total Liabilities	**17.4**	**85.4**	**84.3**	**81.1**	**80.1**	**78.7**	**78.7**	**73.7**
Total Shareholders' Equity	**165.9**	**166.5**	**165.7**	**170.8**	**172.6**	**173.7**	**173.7**	**185.4**

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.

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	36	30%	14%	86%
Hold/Neutral	71	58%	6%	94%
Sell	15	12%	7%	93%

As of 5 April 2017

Other Disclosures

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