HILLIARD LYONS

Medical Devices

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COMPANY UPDATE / ESTIMATE CHANGE / PRICE TARGET CHANGE

Key Metrics

VIVO - NASDAQ (as of close 07/28/17)		$13.95
Price Target		$14.00
52-Week Range		$10.75 - $19.85
Shares Outstanding (mm)		42.6
Market Cap. ($mm)		$588.7
1-Mo. Average Daily Volume		225,771
Institutional Ownership		90.2%
Debt / Total Capital		24.3%
ROE (TTM)		17.7%
Book Value / Share		$4.01
Price / Book Value		3.5x
Indicated Dividend / Yield	$0.50	3.6%
TTM Operating Margin		22.6%

Operating EPS FY 9/30

	2016A	Prior 2017E	Curr. 2017E	Prior 2018E	Curr. 2018E
1Q	$0.21		$0.15A	$0.14	$0.15
2Q	$0.24		$0.21A	$0.21	$0.21
3Q	$0.21		$0.16A	$0.17	$0.17
4Q	$0.14	$0.13	$0.13	$0.13	$0.14
Year	$0.79	$0.66	$0.65	$0.66	$0.66
P/E	17.8x		21.5x		21.0x

Figures may not add up due to rounding

Revenue ($mm)

	2016A	Prior 2017E	Curr. 2017E	Prior 2018E	Curr. 2018E
1Q	$47.2		$46.8A	$48.0	$48.1
2Q	$51.3		$54.1A	$54.2	$54.2
3Q	$50.7		$50.1A	$49.0	$50.3
4Q	$47.0	$46.4	$47.8	$46.8	$48.4
Year	$196.1	$195.9	$198.9	$198.0	$200.9

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.*

Meridian Bioscience, Inc.

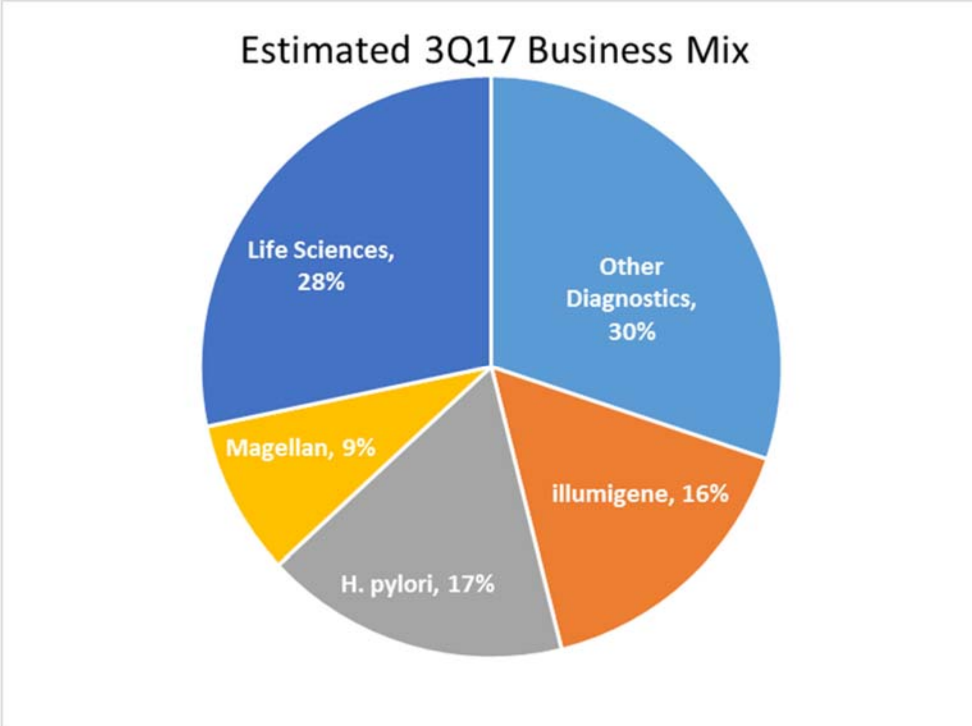
VIVO – NASDAQ – Neutral – 3

Solid Quarter Despite Magellan Write-down

- **3Q17 Results:** Meridian reported revenues of $50.1 million, a 1% decrease from the same period a year ago. Revenues beat our estimate of $48.6 million and the Street consensus of $49.2 million. Operating EPS were $0.16, below our estimate and the Street consensus of $0.17. A goodwill impairment dropped GAAP EPS to $0.01.
- **Positive Highlights:** Both the Diagnostics and Life Science segments beat our estimates, with the former registering $35.9 million versus our estimate of $35.5 million and the latter pulling in $14.2 million versus our estimate of $13.1 million. The Life Science segment appears to be growing right through the exit of the biopharma enabling business.
- **Negative Highlights:** Not only did the business cause a goodwill impairment, but Magellan Diagnostics also disappointed on the top line. The gross margin contracted 273 basis points to 62.2% versus our estimate of 62.5% and the Street consensus of 62.9%. The gross margin has yet to show signs of stabilizing after peaking in 1Q16.
- **Estimates Update:** We are increasing our FY17 revenue estimate to $198.9 million versus $195.9 million previously but decreasing our FY17 EPS estimate to $0.65 from $0.66. We are upping our FY18 revenue estimate to $200.9 million versus our prior estimate of $198.0 million but leaving our EPS estimate unchanged at $0.66. We are also initiating a FY19 EPS estimate of $0.70.
- **Valuation and Rating:** VIVO closed Friday at 21.5X 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 raising our price target to $14 from $13, as our valuation model rolls forward and factors in a more attractive FY19. Thus, we are maintaining our Neutral rating.

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

ADDITIONAL COMMENTARY



Source: Company reports; estimates only as details are not yet available

- The Diagnostic segment declined 4.2% year-over-year to $35.9 million in the quarter versus our estimate of $35.5 million. The ***illumi***gene product line grew 9% outside of *C. difficile* tests. However, *C. difficile* comprises a large portion of ***illumi***gene revenue and the struggles in *C. difficile* led to a decrease of roughly 20% for the total ***illumi***gene category. We estimate ***illumi***gene *C. difficile* revenues were down close to 40%. The *C. difficile* line had tough comps but this was still far worse than we expected.
- *H. pylori* assay revenue increased 5%, which was just above the low single digit growth we expected. Management noted the headwind of last year's aggressive stock-and-block program in anticipation of patent expiration has dissipated. 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 to detect clarithromycin resistance. We do believe this could further entrench their market position if pricing is managed appropriately.
- Magellan Diagnostics revenue was down about 9%, with results impacted by one additional week in last year's quarter due to the acquisition and $0.2 million from the FDA issues. Management previously noted only about 10% of tests ran are venous; capillary tests are still permitted. This quarter fell about $0.7 million short of our expectations. This is concerning as we believed this quarter would be more normalized after international orders made the first two quarters of this fiscal year volatile. This is even more concerning in light of the FDA issues of this past quarter.
- As a reminder to investors, The FDA and CDC issued a warning that lead tests using venous blood manufactured by Magellan Diagnostics could be inaccurate. The agencies said any children or pregnant or nursing women that have been tested going back to 2014 may want to consult with their healthcare provider about being retested. The FDA and CDC stated all tests using a finger or heel stick are still acceptable. The news even prompted a letter from 12 U.S. Senators. About a month later, the FDA proceeded to issue an inspection report (Form 483) listing eight observations. Some were relatively

minor, but others showed noticeable weakness in controls and even poor customer service, in our opinion, as complaints were downplayed and some issues were not addressed for over 100 days. As we noted, Meridian wrote down $6.6 million in goodwill due to the Form 483. Management expects a Warning Letter to come, requiring periodic reporting on remediation, potential delays in reinstating the venous testing method, potential delays in obtaining approval for new Magellan products, and potential delays in obtaining export certifications. Regarding the last point, Meridian can still sell product in international markets where a certification and approval has already been obtained. Management stressed they are working tirelessly to remediate all issues.

- We lowered estimates and our price target at the time of the initial news, as we viewed it material enough to produce a modest headwind until remediation issues are resolved. This quarter appears to have proven our point. Our views on Magellan have soured somewhat, but we note competition is basically non-existent, the domestic market is still not saturated, and international opportunities are substantial even in the face of delayed export certifications.
- Management stated malaria testing continues to grow in Europe and now a few other markets such as South Africa. Management stressed any potential large contracts with governments or non-governmental organizations (NGOs) will take a lot of time and education, and sounded a bit less optimistic, in our opinion.
- The legacy diagnostic category (mostly immunoassay tests) finally stopped bleeding. We estimate the quarter represented a 4% increase year-over-year. Management noted foodborne testing was up 11%. Perhaps the new domestic sales leadership and renewed focus with distributors are turning the category around, but we think it is too early to tell given the seasonality and volatility of foodborne outbreaks (Chipotle shareholders may agree).
- The Life Science segment expanded 8.0% to $14.2 million versus our estimate of $13.1 million. The segment's strength is completely masking its exit from biopharma enabling services. As a reminder to investors, the biopharma business pulled in $2-3 million in revenue annually. The molecular components business was up 10% and the immunoassay business was up 7%. International strength, particularly in Asia, and new products in high demand fields are driving strength. The only negative for the segment: its operating margin contracted 425 basis points, so operating income still contracted 8% despite top line strength. This is something to keep an eye on going forward.
- The gross margin for the quarter was 62.2% versus 65.0% in 3Q16 and our estimate of 62.5%. The metric has yet to stabilize despite the tough comps of pre-Magellan business mix no longer providing a headwind.
- Operating expenses were $20.3 million, significantly ahead of our estimate of $18.9 million. However, considering the revenue surprise this quarter, Selling & Marketing expenses were well controlled, in our opinion. S&M expenses were only $7.9 million versus our estimate of $8.0 million. Research & Development expenses were higher than expected, registering $3.9 million versus our estimate of $3.6 million. General & Administrative expenses of $8.5 million were much higher than our estimate of $7.3 million. Management noted R&D expenses are anticipated to increase over the next several quarters to prepare for new products nearing launch and G&A expenses were high due to legal costs surrounding both Magellan and the company's intellectual property protection.
- Operating income was $10.9 million, falling short of our expectations of $11.5 million. This marked a 20% decline compared to the same period a year ago. The operating margin of 21.8% was well below our estimate of 23.6% and represented a decrease from 27.1% in 3Q16.
- The GAAP tax rate was 93.9% due to the goodwill impairment charge skewing the quarter. We estimate the non-GAAP tax rate was around 34.8% versus our estimate of 34.7%.
- Operating EPS came in at $0.16, just shy of our estimate and the Street consensus of $0.17.
- 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 3Q17 are not released until a few weeks after Meridian announces earnings. Based on data given for this quarter, Meridian has cash and equivalents of $55.3 million, and a current ratio of 6.5X. Total liabilities/equity is a conservative 48%. The cash balance could cover the new dividend rate for over two years with no change from cash flow. We consider the new dividend rate well covered. As a reminder to investors, Meridian cut the dividend earlier this year to an annual rate of $0.50 from $0.80.

ESTIMATES UPDATE

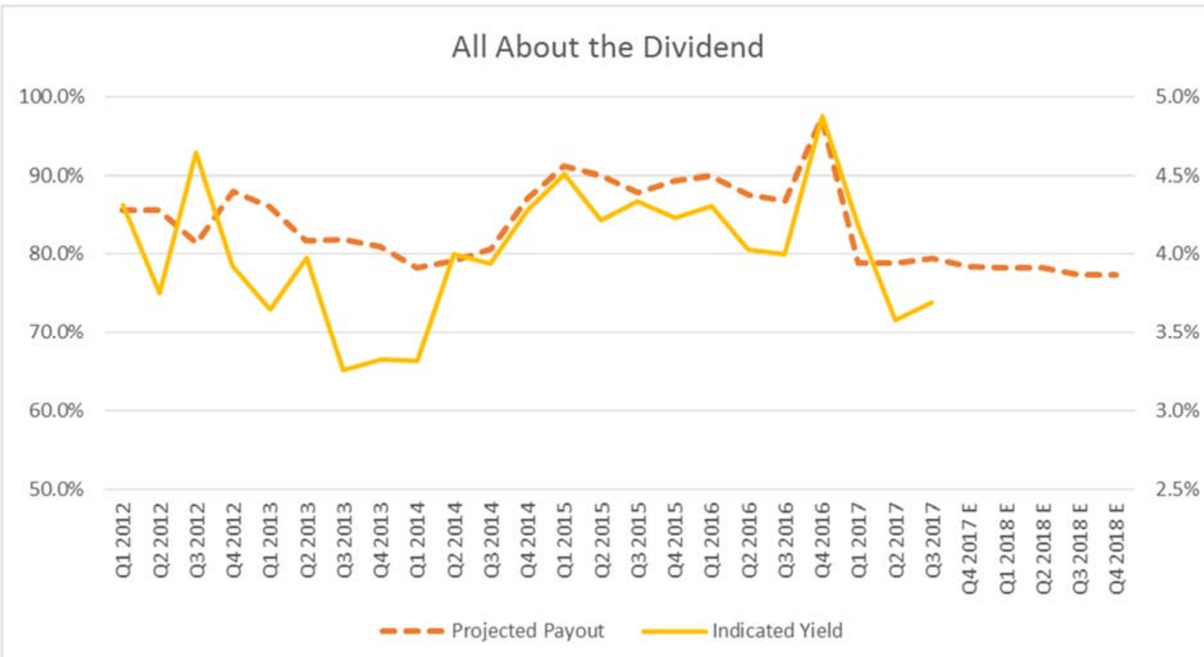
We are updating our FY17 revenue estimate to $198.9 million, or roughly up 1% from FY16, versus our prior estimate of $195.9 million. This is toward the upper end of guidance. We raised our FY18 revenue estimate to $200.9 million versus our prior estimate of $198.0 million. For FY17, we project Diagnostic revenues of $142.7 million versus our prior estimate of $141.4 million. We lowered our ***illumi***gene estimates, mostly to reflect this quarter more so than a changed outlook; we still expect *C. difficile* to shrink in absolute terms and as a percent of the category. And while we expect growth in other diseases on the platform, we think competition will limit the amount of growth. As discussed previously, we think ***illumi***gene 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 somewhat. Switching categories, we tweaked *H. pylori* higher for the year and increased forecasts for FY18, as we feel more comfortable with the product line after a volatile start to the fiscal year. We also increased our legacy product estimates both as a reflection of the quarter and an improved outlook, but we want to emphasize we still expect a decline in FY18. As one could expect based on our tone, we lowered Magellan estimates for this year and next but expect growth to pick up in FY19 as remediation issues are put in the past. Finally, we increased our Life Science estimate to $56.2 million versus our previous estimate of $54.6 million for this year and increased FY18 estimates for the category by $1.8 million. The positive revision is both a reflection of the quarter and an improved outlook.

We lowered our FY17 gross margin estimate to 62.0% from 62.1% but actually increased the FY18 estimate to 62.4% from 62.3%. We raised our R&D and G&A estimates for both FY17 and FY18 but lowered S&M expense assumptions. Net, we increased our operating expense estimates to $79.6 million from $77.2 million in FY17 and up to $80.8 million from $78.9 million in FY18. As a result of positive revisions to revenue assumptions offset by increased operating expenses, our 4Q17 and FY18 non-GAAP EPS estimates are unchanged.

We are initiating FY19 estimates. From a top line perspective, we expect the Diagnostic segment to be roughly flat as strength and weakness in various product categories offset. We anticipate Life Science revenues to continue solid growth, leading to total sales increasing a little over 2%. Due to expectations that R&D and G&A expenses will wind down after a high FY18, we anticipate operating leverage to result in ~6% earnings growth. We initiate a FY19 EPS estimate of $0.70.

VALUATION

VIVO closed Friday at 21.5X 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 due to minimal growth over the near term horizon. Additionally, we believe the multiple corresponds to a clear pattern of valuing this dividend stock according to projected payout ratio, as seen in the chart below. The company's commitment to a dividend payout policy of 75-85% makes the dividend a key piece of the valuation, and a higher projected payout should result in shares trading for a higher yield given a lower ability to raise the dividend. We expect the company to raise the dividend by $0.02 in FY18 and FY19. This corresponds to a 77% payout ratio based on our FY19 estimates. In turn, this would lead to a 3.9% dividend yield and $14 price. We note this also matches a 20X multiple applied to our FY19 EPS estimate. Thus, we are raising our price target to $14 from $13 and maintaining a Neutral rating. We note our increased price target is the result of rolling our model forward and looking further into a more attractive FY19, as our FY18 estimates are unchanged.



Source: Thomson Reuters Eikon, Hilliard Lyons Research estimates

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 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									
Diagnostic Revenue	146.1	145.1	33.8	37.8	35.9	35.2	142.7	141.9	142.0
Life Science Revenue	48.7	51.0	13.0	16.4	14.2	12.6	56.2	59.1	63.2
Total Revenue	**194.8**	**196.1**	**46.8**	**54.1**	**50.1**	**47.8**	**198.9**	**200.9**	**205.2**
Gross Margin %	*62.6%*	*65.2%*	*62.9%*	*62.0%*	*62.2%*	*61.0%*	*62.0%*	*62.4%*	*62.5%*
Gross Profit	**121.9**	**127.8**	**29.5**	**33.5**	**31.2**	**29.2**	**123.4**	**125.3**	**128.1**
Research and development	12.6	13.8	3.4	3.9	3.9	4.0	15.2	15.7	15.9
Selling and marketing	25.6	29.9	7.5	8.0	7.9	8.0	31.4	31.9	32.5
General and administrative	27.6	30.8	8.4	7.4	8.5	8.7	33.0	33.1	32.9
Total Operating Expenses	65.8	74.5	19.4	19.3	20.3	20.6	79.6	80.8	81.3
Non-GAAP Operating Income	**56.1**	**53.3**	**10.1**	**14.2**	**10.9**	**8.5**	**43.8**	**44.5**	**46.8**
Operating Margin %	*28.8%*	*27.2%*	*21.5%*	*26.2%*	*21.8%*	*17.9%*	*22.0%*	*22.2%*	*22.8%*
Other Income, Net	(1.0)	(0.7)	(0.4)	0.0	(0.4)	(0.4)	(1.2)	(1.3)	(1.2)
Effective Tax Rate	*35.5%*	*36.4%*	*35.1%*	*34.4%*	*93.9%*	*34.0%*	*34.7%*	*34.7%*	*34.7%*
Non-GAAP Net Income	**36.2**	**33.3**	**6.3**	**9.1**	**6.9**	**5.4**	**27.6**	**28.3**	**29.9**
Diluted Shares Outstanding	42.0	42.4	42.5	42.6	42.6	42.6	42.6	42.7	42.8
Non-GAAP Diluted EPS	**$0.86**	**$0.79**	**$0.15**	**$0.21**	**$0.16**	**$0.13**	**$0.65**	**$0.66**	**$0.70**
Dividend Per Share	**$0.800**	**$0.800**	**$0.125**	**$0.125**	**$0.125**	**$0.125**	**$0.500**	**$0.520**	**$0.540**
Balance Sheet									
Cash and Equivalents	50.0	47.2	49.3	54.7					
Other Current Assets	72.9	79.6	76.8	74.0					
Total Current Assets	**122.9**	**126.8**	**126.0**	**128.8**	**129.2**	**124.3**	**124.3**	**131.0**	**138.5**
Net PP&E	27.5	30.5	30.4	30.2					
Intangible Assets	28.3	91.8	90.1	89.3					
Other Assets	4.7	2.7	3.5	3.6					
Total Assets	**183.3**	**251.8**	**250.1**	**251.9**	**245.1**	**239.8**	**239.8**	**245.2**	**252.1**
Current Liabilities	15.3	22.6	21.0	19.9	20.0	20.9	20.9	21.0	21.3
Non-Current Liabilities	2.2	62.8	63.3	61.2	60.1	58.9	58.9	54.4	49.9
Total Liabilities	**17.4**	**85.4**	**84.3**	**81.1**	**80.1**	**79.8**	**79.8**	**75.4**	**71.2**
Total Shareholders' Equity	**165.9**	**166.5**	**165.7**	**170.8**	**167.5**	**160.0**	**160.0**	**169.8**	**180.9**

Source: Company Reports and Hilliard Lyons estimates

Additional information is available upon request.

Prices of other stocks mentioned: Chipotle Mexican Grill (CMG - $350.50)

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	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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