HILLIARD LYONS

COMPANY UPDATE / ESTIMATE CHANGE

Medical Devices
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J.J.B. Hilliard, W.L. Lyons, LLC
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Key Metrics

VIVO - NASDAQ (as of close 01/25/18)		$16.20
Price Target		$17.00
52-Week Range		$12.15 - $16.25
Shares Outstanding (mm)		42.7
Market Cap. ($mm)		$685.4
1-Mo. Average Daily Volume		261,441
Institutional Ownership		91.4%
Debt / Total Capital		22.1%
ROE (TTM)		12.7%
Book Value / Share		$4.05
Price / Book Value		4.0x
Indicated Dividend / Yield	$0.50	3.1%
TTM Operating Margin		21.4%

Operating EPS FYE 9/30

	2017A	Prior 2018E	Curr. 2018E	Prior 2019E	Curr. 2019E
1Q	$0.15		$0.16A	$0.20	$0.18
2Q	$0.21	$0.24	$0.23	$0.25	$0.25
3Q	$0.16	$0.20	$0.19	$0.22	$0.21
4Q	$0.15	$0.18	$0.18	$0.20	$0.19
Year	$0.67	$0.78	$0.76	$0.86	$0.83
P/E	24.3x		21.4x		19.6x

Figures may not add up due to rounding

Revenue ($mm)

	2017A	Prior 2018E	Curr. 2018E	Prior 2019E	Curr. 2019E
1Q	$46.8		$52.3A	$50.1	$51.5
2Q	$54.1	$55.0	$55.9	$56.4	$57.6
3Q	$50.1	$51.2	$51.5	$52.4	$53.1
4Q	$49.7	$51.1	$51.5	$52.5	$53.1
Year	$200.8	$206.0	$211.2	$211.4	$215.3

***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.

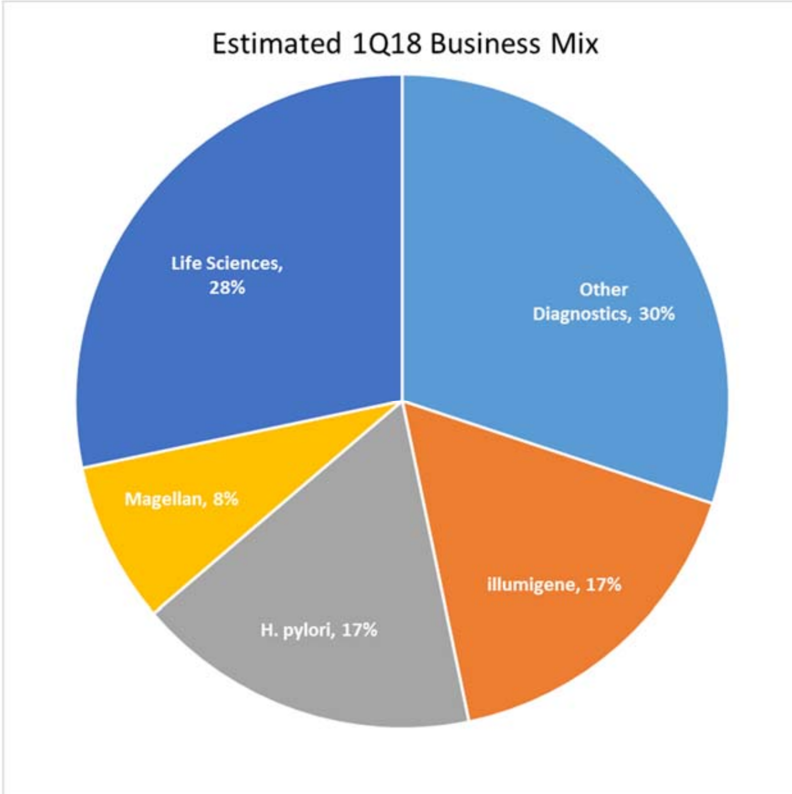
VIVO – NASDAQ – Neutral – 3

Solid Quarter even without Respiratory Boost

- **1Q18 Results:** Meridian reported revenues of $52.3 million, a 12% increase from the same period a year ago. Revenues beat our estimate of $48.7 million and the Street consensus of $49.0 million. Operating EPS were $0.16, above our estimate and the Street consensus of $0.15. Expenses related to the CEO transition and legal battles more than offset a one-time net benefit from tax reform and thus dropped GAAP EPS to $0.15.
- **Positive Highlights:** Both the Diagnostics and Life Science segments beat our estimates, with the former registering $37.5 million versus our estimate of $34.6 million and the latter pulling in $14.8 million versus our estimate of $14.1 million.
- **Negative Highlights:** The gross margin contracted 212 basis points to 60.8% versus our estimate of 62.4% and the Street consensus of 62.3%. The gross margin has yet to show signs of stabilizing after peaking in 1Q16. Operating expenses were also higher than we forecasted, coming in at $22.2 million versus our estimate of $20.0 million.
- **Estimates Update:** We are increasing our FY18 revenue estimate to $211.2 million versus $206.0 million previously but decreasing our FY18 EPS estimate to $0.76 from $0.78 due to higher operating expense estimates. We are upping our FY19 revenue estimate to $215.3 million versus our prior estimate of $211.4 million but lowering our EPS estimate to $0.83 from $0.86, primarily due to our ongoing adjustments related to tax reform. We note our operating income estimate for FY19 is down only slightly.
- **Valuation and Rating:** VIVO closed yesterday at 20.9X our next 12 month EPS estimate, which is a significant boost over 2017 lows around 18X and more in line with its history over the past five years or so. We are maintaining the forward P/E assumption of 20X and leaving our price target unchanged at $17. After yesterday's strong price performance, we are maintaining our Neutral rating.

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

ADDITIONAL COMMENTARY



Source: Company reports; estimates only – details not yet available

- The Diagnostic segment grew 10.9% year-over-year to $37.5 million in the quarter versus our estimate of $34.6 million. While aided ~1% by currency tailwinds, this was still the strongest growth rate for the segment since 2013.
- **The "Other" diagnostic** category (mostly immunoassay technology with foodborne assays being a large portion) continues to recover. Management noted that foodborne assays grew double digits; some of this growth was from easy comps but the competitive field has also stabilized. Payer pushback on expensive panels has led customers to reevaluate the economics and in some cases turn back to Meridian assays as a first-line use. In addition to foodborne strength, the company undoubtedly benefitted from a strong and early respiratory season. We estimate the quarter represented a ~14% increase year-over-year for the "Other" category in total.
- The ***illumi***gene product line grew ~12% as management indicated *C. difficile* remains relatively stable after multiple years of decline. Just as the "Other" category was boosted by respiratory revenues, this product line also benefitted.
- ***H. pylori*** assay revenue increased over 20%, which was well above the mid-single digit growth we expected. The category has historically been volatile but this is still a really strong quarter, in our opinion. With more normalized comps after a FY16 stock-and-block program, we expect solid growth this year, but that assumes no competitors entering the market. Meridian stated in the 10-K that two competitors are in clinical trials for similar *H. pylori* assays following the patent expiration in May 2016. Meridian is engaged in an intellectual property lawsuit with one of the competitors, DiaSorin. That nevertheless leaves at least one competitor likely to enter the market of this high-margin product. We therefore expect a decline in FY19, before a recovery in FY20 as Meridian rolls out a clarithromycin-resistance assay that we believe could dig a deeper moat around the franchise.

- **Magellan Diagnostics** revenue declined 20%, with tough comps due to a large purchase by the Red Cross; this was nevertheless worse than our 16% forecasted decline. Results continue to be impacted by the ongoing FDA regulatory issues regarding the inaccuracy of venous blood tests (previously ~10% of testing volume); capillary tests are still considered accurate and therefore permitted. As we noted to investors in a morning comment, the FDA sent a warning letter to Becton Dickinson regarding unauthorized changes to devices, among other regulatory violations. The facility inspections that led to the warning letter were prompted by Magellan suggesting that their problems with venous blood tests may be related to BD's Vacutainer blood collections tubes. The FDA thus far has not verified Magellan's claims but did state the unauthorized changes were related to the collection tubes. Management hopes to verify Magellan's claims and bring the product back to market later this fiscal year. This story seems to be playing out in-line with our thesis when the FDA news first broke: a clear negative from the loss in venous assays and a distraction to tamp down growth. But, just as we stated in our estimate revision report following the news, we still like the business in the intermediate and long-term: 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 related to the FDA issues.
- The **Life Science** segment expanded an impressive 13.8% to $14.8 million versus our estimate of $14.1 million. Both the molecular components business and the immunoassay business were up double digits. International strength, particularly in Asia (115% growth in China), and new products in high demand fields (next-generation sequencing, for example) are driving strength. The only negative for the segment: its operating margin contracted 630 basis points, so operating income still contracted 15% despite top line strength. This is something to keep an eye on going forward.
- The gross margin for the quarter was 60.8% versus 62.9% in 1Q17 and our estimate of 62.4%. The metric has yet to stabilize since peaking in 1Q16. Management noted the Life Science segment is a part of that factor, as Chinese revenue growth typically comes in at a lower margin.
- Operating expenses were $22.2 million, significantly ahead of our estimate of $20.0 million. However, considering the revenue surprise this quarter, Selling & Marketing expenses were only modestly higher than expected. Research & Development expenses were also modestly higher than expected, registering $4.5 million versus our estimate of $4.0 million. We remind investors R&D expenses are anticipated to remain elevated as new products are in clinical trials (***illumi***gene cytomegalovirus), nearing clinical trials (*H. pylori* clarithromycin-resistance), or nearing launch (the Curian platform). General & Administrative expenses of $8.9 million were higher than our estimate of $8.2 million. G&A continues to absorb additional costs related to Magellan's FDA woes. Other Expenses, which we exclude from operating earnings, were $1.5 million, resulting primarily from legal expenses and the CEO transition.
- Operating income was $9.5 million, falling short of our expectations of $10.4 million. This marked a ~6% decline compared to the same period a year ago. The operating margin of 18.3% was well below our estimate of 21.3% and represented a decrease from 21.5% in 1Q17.
- The effective tax rate was 17.7% due to one-time items related to tax reform. In addition to tax reform, Meridian should also benefit from the medical device tax suspension until 2020 as a result of the deal to end the government shutdown.
- Operating EPS came in at $0.16, just ahead of our estimate and the Street consensus of $0.15.
- Management maintained FY18 guidance, with revenues expected to be between $207 million and $212 million and operating EPS to be between $0.64 and $0.69. Management is still assessing the impact of tax reform and expects it to be beneficial. Updated guidance will be provided at a later date. Management also maintained the quarterly dividend at $0.125.

FINANCIAL CONDITION

Balance Sheet Review

Full balance sheet details and the complete cash flow statement for 1Q18 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 5.8X. Total liabilities/equity is a conservative 45.7%. The cash balance could cover the new dividend rate for over two years with no change from cash flow. We consider the dividend well covered.

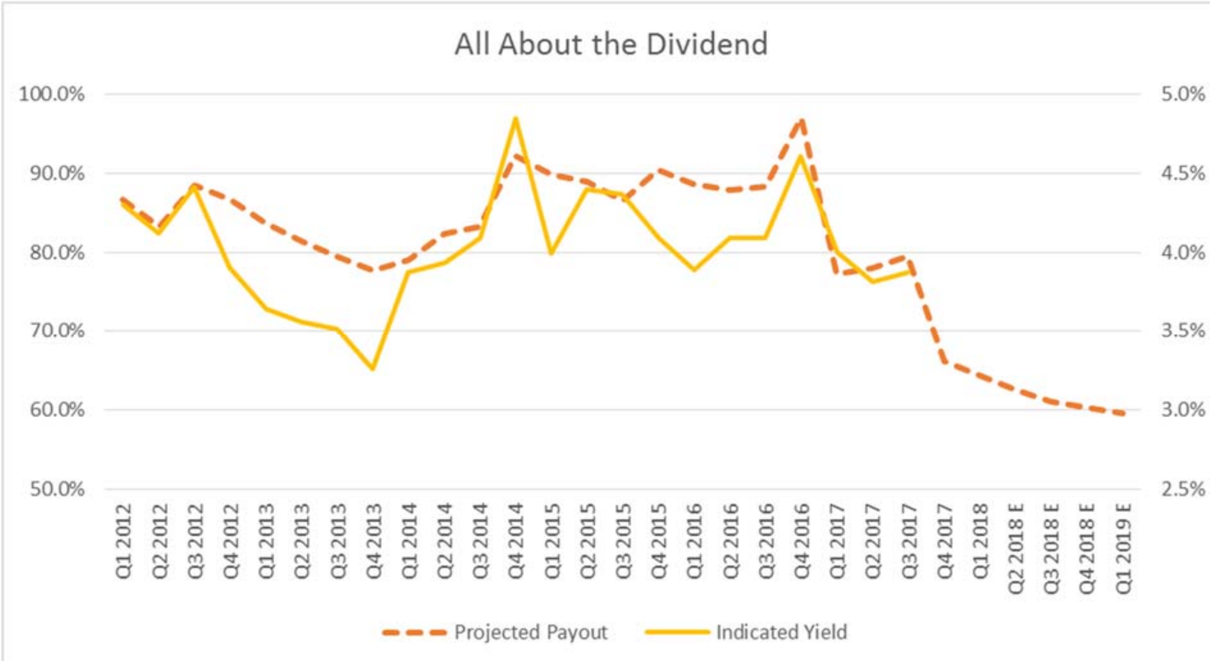
ESTIMATES UPDATE

We are updating our FY18 revenue estimate to $211.2 million, or growth of 5.2% from FY17, versus our prior estimate of $206.0 million. This is now at the upper end of guidance. We raised our FY19 revenue estimate to $215.3 million versus our prior estimate of $211.4 million. For FY18, we project Diagnostic revenues of $149.2 million versus our prior estimate of $145.3 million. Much of the change was a result of the strong beat this quarter and expectations that a strong respiratory season will continue and enable the company to manage tough comps. While we suspect a large order in the volatile *H. pylori* category this quarter, we tweaked other quarters higher as well. Turning to FY19, tough comps created by this quarter and new competition lead us to forecast a decline in *H. pylori* revenue. We tweaked Magellan estimates lower for FY18 but left it unchanged in FY19. We increased expectations for the “Other Diagnostics” category both as a result of foodborne strength and expectations for the Curian platform. Finally, we increased our Life Science estimate to $62.1 million versus our previous estimate of $60.7 million for this year and increased FY19 estimates for the category by $1.5 million. The positive revision is both a reflection of the quarter and more confidence that the impressive growth rate of recent can be maintained.

We lowered our FY18 gross margin estimate to 61.9% from 62.3% simply as a reflection of this quarter. We decreased the FY19 estimate to 61.7% from 62.2% as we continue to be concerned about competition in the high margin *H. pylori* category. We raised our operating expenses estimates for both FY18 and FY19 but the FY19 increase is more a reflection of increased revenue expectations. Finally, we continue to tweak our tax rate estimates. Greater clarity on certain deductions led us to increase our FY19 tax rate estimate to 22.7% from 21.1% previously. As a result of the changes to our model, we lowered FY18 operating EPS estimates to $0.76 from $0.78 and FY19 estimates to $0.83 from $0.86.

VALUATION

VIVO closed yesterday at 20.9X our next 12 month EPS estimate, which is a significant boost over 2017 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 the multiple corresponding to a pattern of valuing this dividend stock according to projected payout ratio, as seen in the chart on the next page. 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, in our view. We remind investors we decided to flat line our dividend estimate for FY19 in our most recent report. We had previously projected an increase to $0.56 annually versus the indicated $0.50 for FY18. This new dividend projection corresponds to a 60% payout ratio based on our FY18 estimates. In turn, this would lead to a 3.0% dividend yield and $17 price target. We note this price target also matches a 20X multiple applied to our FY19 EPS estimate. Thus, we are maintaining our $17 price target and Neutral rating.



Source: Thomson Reuters, 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. A recent patent expiration regarding *H. pylori* assays could present a significant headwind.
- **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	2017 A	1Q18 A	2Q18 E	3Q18 E	4Q18 E	2018 E	2019 E
Fiscal Period End	9/30/2015	9/30/2016	9/30/2017	12/31/2017	3/31/2018	6/30/2018	9/30/2018	9/30/2018	9/30/2019
Income Statement									
Diagnostic Revenue	146.1	145.1	143.5	37.5	38.9	36.1	36.6	149.2	148.9
Life Science Revenue	48.7	51.0	57.3	14.8	17.0	15.4	14.9	62.1	66.4
Total Revenue	**194.8**	**196.1**	**200.8**	**52.3**	**55.9**	**51.5**	**51.5**	**211.2**	**215.3**
Gross Margin %	*62.6%*	*65.2%*	*62.2%*	*60.8%*	*62.5%*	*62.7%*	*61.8%*	*61.9%*	*61.7%*
Gross Profit	**121.9**	**127.8**	**124.8**	**31.8**	**34.9**	**32.3**	**31.8**	**130.9**	**132.9**
Research and development	12.6	13.8	15.7	4.5	4.5	4.5	4.5	18.1	17.8
Selling and marketing	25.6	29.9	32.1	8.8	9.2	8.4	9.0	35.5	35.8
General and administrative	27.6	30.8	32.3	8.9	8.2	8.5	8.2	33.7	32.1
Total Operating Expenses	65.8	74.5	80.1	22.2	21.9	21.4	21.7	87.2	85.8
Non-GAAP Operating Income	**56.1**	**53.3**	**44.8**	**9.5**	**13.0**	**10.9**	**10.1**	**43.6**	**47.1**
Operating Margin %	*28.8%*	*27.2%*	*22.3%*	*18.3%*	*23.3%*	*21.2%*	*19.7%*	*20.7%*	*21.9%*
Other Income, Net	(1.0)	(0.7)	(1.0)	(0.4)	(0.3)	(0.3)	(0.3)	(1.4)	(1.2)
Effective Tax Rate	*35.5%*	*36.4%*	*40.8%*	*17.7%*	*22.7%*	*22.7%*	*22.7%*	*21.7%*	*22.7%*
Non-GAAP Net Income	**36.2**	**33.3**	**28.4**	**6.7**	**9.8**	**8.2**	**7.6**	**32.3**	**35.5**
Diluted Shares Outstanding	42.0	42.4	42.6	42.7	42.8	42.8	42.8	42.8	42.9
Non-GAAP Diluted EPS	**$0.86**	**$0.79**	**$0.67**	**$0.16**	**$0.23**	**$0.19**	**$0.18**	**$0.76**	**$0.83**
Diluted GAAP EPS	**$0.85**	**$0.76**	**$0.51**	**$0.15**	**$0.21**	**$0.18**	**$0.17**	**$0.71**	**$0.83**
Dividend Per Share	**$0.800**	**$0.800**	**$0.500**	**$0.125**	**$0.125**	**$0.125**	**$0.125**	**$0.500**	**$0.500**
Balance Sheet									
Cash and Equivalents	50.0	47.2	57.1	54.7					
Other Current Assets	72.9	79.6	76.8	81.9					
Total Current Assets	**122.9**	**126.8**	**133.9**	**136.6**	**140.0**	**141.0**	**142.9**	**142.9**	**157.7**
Net PP&E	27.5	30.5	30.5						
Intangible Assets	28.3	91.8	81.6						
Other Assets	4.7	2.7	3.8						
Total Assets	**183.3**	**251.8**	**249.8**	**252.0**	**255.0**	**255.7**	**257.1**	**257.1**	**271.1**
Current Liabilities	15.3	22.6	22.9	23.5	24.2	23.1	23.2	23.2	23.8
Non-Current Liabilities	2.2	62.8	57.3	55.6	54.4	53.3	52.2	52.2	47.7
Total Liabilities	**17.4**	**85.4**	**80.2**	**79.1**	**78.7**	**76.4**	**75.4**	**75.4**	**71.5**
Total Shareholders' Equity	**165.9**	**166.5**	**169.6**	**172.9**	**176.3**	**179.2**	**181.6**	**181.6**	**199.6**

Source: Company Reports and Hilliard Lyons estimates

Additional information is available upon request.

Prices of other stocks mentioned: Becton Dickinson (BDX - $242.35)

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	31	28%	10%	90%
Hold/Neutral	75	67%	9%	91%
Sell	6	5%	0%	100%

As of 8 January 2018

Other Disclosures

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