

NEOGEN CORP  
Form 10-Q  
December 28, 2018  
Table of Contents

**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**  
**Washington, D.C. 20549**

**FORM 10-Q**

(Mark One)

**QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE  
ACT OF 1934**

**For the quarterly period ended November 30, 2018.**

**or**

**TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE  
ACT OF 1934**

**For the transition period from \_\_\_\_\_ to \_\_\_\_\_**

**Commission file number 0-17988**

**Neogen Corporation**

**(Exact name of registrant as specified in its charter)**

**Michigan** **38-2367843**  
**(State or other jurisdiction of** **(IRS Employer**  
**incorporation or organization)** **Identification Number)**

**620 Leshar Place**

**Lansing, Michigan 48912**

**(Address of principal executive offices, including zip code)**

**(517) 372-9200**

**(Registrant's telephone number, including area code)**

**N/A**

**(Former name, former address and former fiscal year, if changed since last report)**

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file reports), and (2) has been subject to such filing requirements for the past 90 days. YES NO

Indicate by check mark whether the registrant has submitted electronically every Interactive Data File required to be submitted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit such files). YES NO

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer (see definition of "accelerated filer and large accelerated filer" in Rule 12b-2 of the Exchange Act):

Large accelerated filer

Accelerated filer

Non-accelerated filer

Smaller Reporting Company

Emerging growth company

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act): YES NO

As of November 30, 2018, there were 52,081,876 shares of Common Stock outstanding.



**Table of Contents**

**NEOGEN CORPORATION AND SUBSIDIARIES**

**TABLE OF CONTENTS**

	<b>Page No.</b>
<b>PART I. FINANCIAL INFORMATION</b>	
Item 1. <u>Interim Consolidated Financial Statements (unaudited)</u>	2
<u>Consolidated Balance Sheets – November 30, 2018 and May 31, 2018</u>	2
<u>Consolidated Statements of Income – Three and six months ended November 30, 2018 and 2017</u>	3
<u>Consolidated Statements of Comprehensive Income – Three and six months ended November 30, 2018 and 2017</u>	4
<u>Consolidated Statement of Equity – Six months ended November 30, 2018</u>	5
<u>Consolidated Statements of Cash Flows – Six months ended November 30, 2018 and 2017</u>	6
<u>Notes to Interim Consolidated Financial Statements – November 30, 2018</u>	7
Item 2. <u>Management’s Discussion and Analysis of Financial Condition and Results of Operations</u>	19
Item 3. <u>Quantitative and Qualitative Disclosures About Market Risk</u>	26
Item 4. <u>Controls and Procedures</u>	26
 <b>PART II. OTHER INFORMATION</b>	
Item 1. <u>Legal Proceedings</u>	27
Item 6. <u>Exhibits</u>	27
 <b><u>SIGNATURES</u></b>	
<b>CEO Certification</b>	
<b>CFO Certification</b>	
<b>Section 906 Certification</b>	28

**Table of Contents****PART I FINANCIAL INFORMATION****Item 1. Interim Consolidated Financial Statements****Neogen Corporation and Subsidiaries****Consolidated Balance Sheet***(in thousands, except share and**per share amounts)*

	<b>November 30, 2018 (Unaudited)</b>	<b>May 31, 2018 (Unaudited)</b>
<b><u>Assets</u></b>		
Current Assets		
Cash and cash equivalents	\$ 101,585	\$ 83,074
Marketable securities (at fair value, which approximates cost)	139,385	127,736
Accounts receivable, less allowance of \$1,700 and \$1,550	82,282	79,086
Inventories	79,473	76,005
Prepaid expenses and other current assets	11,569	9,888
<b>Total Current Assets</b>	<b>414,294</b>	<b>375,789</b>
Net Property and Equipment	73,910	73,069
Other Assets		
Goodwill	103,309	99,558
Other non-amortizable intangible assets	15,423	14,783
Amortizable customer-based intangibles, net of accumulated amortization of \$26,292 and \$24,579 at November 30, 2018 and May 31, 2018, respectively	30,022	31,841
Other non-current assets, net of accumulated amortization of \$11,440 and \$12,470 at November 30, 2018 and May 31, 2018, respectively	23,534	22,969
<b>Total Assets</b>	<b>\$ 660,492</b>	<b>\$ 618,009</b>
<b><u>Liabilities and Equity</u></b>		
Current Liabilities		
Accounts payable	\$ 20,555	\$ 20,750
Accrued compensation	5,216	6,065
Income taxes	1,533	165
Other accruals	11,456	11,708
<b>Total Current Liabilities</b>	<b>38,760</b>	<b>38,688</b>
Deferred Income Taxes	14,144	14,103
Other Non-Current Liabilities	5,514	5,043

Edgar Filing: NEOGEN CORP - Form 10-Q

Total Liabilities	58,418	57,834
Commitments and Contingencies (Note 8)		
Equity		
Preferred stock, \$1.00 par value, 100,000 shares authorized, none issued and outstanding		
Common stock, \$0.16 par value, 60,000,000 shares authorized, 52,081,876 and 51,735,732 shares issued and outstanding at November 30, 2018 and May 31, 2018, respectively	8,334	8,278
Additional paid-in capital	215,615	202,572
Accumulated other comprehensive loss	(12,234)	(9,746)
Retained earnings	390,359	359,071
Total Stockholders' Equity	602,074	560,175
Total Liabilities and Equity	\$ 660,492	\$ 618,009

See notes to interim consolidated financial statements.

**Table of Contents****Neogen Corporation and Subsidiaries****Consolidated Statements of Income (unaudited)***(in thousands, except per share amounts)*

	<b>Three Months Ended November 30,</b>		<b>Six Months Ended November 30,</b>	
	<b>2018</b>	<b>2017</b>	<b>2018</b>	<b>2017</b>
<b>Revenues</b>				
Product revenues	\$ 89,562	\$ 84,471	\$ 172,522	\$ 164,016
Service revenues	17,536	16,227	34,202	30,891
<b>Total Revenues</b>	<b>107,098</b>	<b>100,698</b>	<b>206,724</b>	<b>194,907</b>
<b>Cost of Revenues</b>				
Cost of product revenues	47,305	43,252	90,255	84,236
Cost of service revenues	9,760	9,197	19,707	17,498
<b>Total Cost of Revenues</b>	<b>57,065</b>	<b>52,449</b>	<b>109,962</b>	<b>101,734</b>
<b>Gross Margin</b>	<b>50,033</b>	<b>48,249</b>	<b>96,762</b>	<b>93,173</b>
<b>Operating Expenses</b>				
Sales and marketing	18,499	16,793	35,732	32,869
General and administrative	10,121	10,491	20,319	19,817
Research and development	3,167	2,967	5,986	6,065
<b>Total Operating Expenses</b>	<b>31,787</b>	<b>30,251</b>	<b>62,037</b>	<b>58,751</b>
<b>Operating Income</b>	<b>18,246</b>	<b>17,998</b>	<b>34,725</b>	<b>34,422</b>
<b>Other Income</b>				
Interest income	1,028	429	1,955	798
Other income	427	626	158	1,069
<b>Total Other Income</b>	<b>1,455</b>	<b>1,055</b>	<b>2,113</b>	<b>1,867</b>
<b>Income Before Taxes</b>	<b>19,701</b>	<b>19,053</b>	<b>36,838</b>	<b>36,289</b>
<b>Provision for Income Taxes</b>	<b>3,650</b>	<b>1,900</b>	<b>5,550</b>	<b>7,200</b>
<b>Net Income</b>	<b>16,051</b>	<b>17,153</b>	<b>31,288</b>	<b>29,089</b>
<b>Net (Income) Attributable to Non-Controlling Interest</b>		<b>(53)</b>		<b>(75)</b>
<b>Net Income Attributable to Neogen</b>	<b>\$ 16,051</b>	<b>\$ 17,100</b>	<b>\$ 31,288</b>	<b>\$ 29,014</b>
<b>Net Income Attributable to Neogen Per Share</b>				
Basic	\$ 0.31	\$ 0.33	\$ 0.60	\$ 0.57

Diluted	\$	0.31	\$	0.33	\$	0.60	\$	0.56
---------	----	------	----	------	----	------	----	------

See notes to interim consolidated financial statements.

Table of Contents

## Neogen Corporation and Subsidiaries

## Consolidated Statements of Comprehensive Income (unaudited)

*(in thousands)*

	Three Months Ended		Six Months Ended	
	November 30,		November 30,	
	2018	2017	2018	2017
Net income	\$ 16,051	\$ 17,153	\$ 31,288	\$ 29,089
Other comprehensive income (loss), net of tax:				
currency translation adjustments	290	534	(2,488)	737
Comprehensive income	16,341	17,687	28,800	29,826
Comprehensive (income) attributable to non-controlling interest		(53)		(75)
Comprehensive income attributable to				
Neogen Corporation	\$ 16,341	\$ 17,634	\$ 28,800	\$ 29,751

See notes to interim consolidated financial statements.

**Table of Contents**

**Neogen Corporation and Subsidiaries**  
**Consolidated Statement of Equity (unaudited)**

*(in thousands)*

	<b>Common Stock</b>		<b>Additional</b>	<b>Accumulated</b>	<b>Retained</b>	<b>Total</b>
	<b>Shares</b>	<b>Amount</b>	<b>Paid-in</b>	<b>Other</b>	<b>Earnings</b>	
			<b>Capital</b>	<b>(Loss)</b>		
Balance at May 31, 2018	51,736	\$ 8,278	\$ 202,572	\$ (9,746)	\$ 359,071	560,175
Issuance of shares under share-based compensation plan	338	54	12,526			12,580
Issuance of shares under employee stock purchase plan	8	2	517			519
Net income for the six months ended November 30, 2018					31,288	31,288
Other comprehensive (loss)				(2,488)		(2,488)
Balance at November 30, 2018	52,082	\$ 8,334	\$ 215,615	\$ (12,234)	\$ 390,359	\$ 602,074

See notes to interim consolidated financial statements.

**Table of Contents**

**Neogen Corporation and Subsidiaries**  
**Consolidated Statements of Cash Flows (unaudited)**

*(in thousands)*

	<b>Six Months Ended November 30,</b>	
	<b>2018</b>	<b>2017</b>
<b>Cash Flows From Operating Activities</b>		
Net Income	\$ 31,288	\$ 29,089
Adjustments to reconcile net income to net cash from operating activities:		
Depreciation and amortization	8,597	8,268
Share-based compensation	2,831	2,666
Change in operating assets and liabilities, net of business acquisitions:		
Accounts receivable	(3,615)	(5,859)
Inventories	(3,787)	(218)
Prepaid expenses and other current assets	(2,025)	(7,916)
Accounts payable, accruals and other changes	(706)	1,377
<b>Net Cash From Operating Activities</b>	<b>32,583</b>	<b>27,407</b>
<b>Cash Flows From Investing Activities</b>		
Purchases of property, equipment and other non-current intangible assets	(6,720)	(10,409)
Proceeds from the sale of marketable securities	179,839	123,601
Purchases of marketable securities	(191,488)	(168,943)
Business acquisitions, net of cash acquired	(4,903)	(468)
<b>Net From Investing Activities</b>	<b>(23,272)</b>	<b>(56,219)</b>
<b>Cash Flows From Financing Activities</b>		
Exercise of stock options and issuance of employee stock purchase plan shares	10,268	16,395
<b>Net Cash From Financing Activities</b>	<b>10,268</b>	<b>16,395</b>
Effect of Exchange Rate on Cash	(1,068)	(725)
<b>Net Increase (decrease) In Cash and Cash Equivalents</b>	<b>18,511</b>	<b>(13,142)</b>
Cash and Cash Equivalents, Beginning of Period	83,074	77,567
<b>Cash and Cash Equivalents, End of Period</b>	<b>\$ 101,585</b>	<b>\$ 64,425</b>

See notes to interim consolidated financial statements.

**Table of Contents**

**NEOGEN CORPORATION AND SUBSIDIARIES**

**NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)**

**1. ACCOUNTING POLICIES**

**BASIS OF PRESENTATION AND CONSOLIDATION**

The accompanying unaudited consolidated financial statements include the accounts of Neogen Corporation ( Neogen or the Company ) and its wholly owned subsidiaries and have been prepared in accordance with accounting principles generally accepted in the United States of America (generally accepted accounting principles) for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by generally accepted accounting principles for complete financial statements.

In the opinion of management, all adjustments (consisting only of normal recurring adjustments) considered necessary for a fair presentation have been included in the accompanying unaudited consolidated financial statements. All intercompany balances and transactions have been eliminated in consolidation. The results of operations for the six-month period ended November 30, 2018 are not necessarily indicative of the results to be expected for the fiscal year ending May 31, 2019. For more complete financial information, these consolidated financial statements should be read in conjunction with the audited consolidated financial statements and the notes thereto included in our Annual Report on Form 10-K for the fiscal year ended May 31, 2018.

Share and per share amounts reflect the December 29, 2017 4-for-3 stock split as if it took place at the beginning of the period presented.

**Recently Adopted Accounting Standards**

*Revenue Recognition*

On June 1, 2018, we adopted ASU No. 2014-09 Revenue from Contracts with Customers (Topic 606). Refer to the Revenue Recognition section of Note 1 for further information.

*Classification of Cash Receipts and Payments*

In August 2016, the FASB issued ASU No. 2016-15 Classification of Certain Cash Receipts and Cash Payments (a consensus of the Emerging Issues Task Force). The amendments in ASU 2016-15 address eight specific cash flow issues and apply to all entities that are required to present a statement of cash flows under FASB Accounting Standards Codification (FASB ASC) 230, Statement of Cash Flows. The amendments in ASU 2016-15 are effective for public business entities for fiscal years beginning after December 15, 2017, and interim periods within those fiscal years. We adopted this ASU on June 1, 2018; the impact on our consolidated financial statements was immaterial.

**Recent Accounting Pronouncements Not Yet Adopted**

*Leases*

In February 2016, the FASB issued ASU No. 2016-02 Leases to increase transparency and comparability among organizations by recognizing lease assets and lease liabilities on the balance sheet and disclosing key information

about leasing arrangements. A lessee should recognize in the statement of financial position a liability to make lease payments (the lease liability) and a right-of-use asset representing its right to use the underlying asset for the lease term. The recognition, measurement and presentation of expenses and cash flows arising from a lease by a lessor have not significantly changed from previous U.S. GAAP. This ASU is effective for annual periods, including interim periods within those annual periods, beginning after December 15, 2018; early adoption is permitted. Modified retrospective application is required with certain practical expedients. We will adopt this ASU on June 1, 2019 and are currently in the process of evaluating our lessee and lessor arrangements to determine the impact of this pronouncement on our consolidated financial condition and results of operations. This evaluation includes a review of revenue through leasing arrangements as well as lease expenses, which are primarily through operating lease arrangements at most of our facilities.

*Financial Instruments- Credit Losses*

In June 2016, the FASB issued ASU No. 2016-13 Measurement of Credit Losses on Financial Instruments, which changes how companies measure credit losses on most financial instruments measured at amortized cost and certain other instruments, such as loans, receivables and held-to-maturity debt securities. Rather than generally recognizing credit losses when it is probable that the loss has been incurred, the revised guidance requires companies to recognize an allowance for credit losses for the difference between the amortized cost basis of a financial instrument and the amount of

## **Table of Contents**

amortized cost that the company expects to collect over the instrument's contractual life. ASU 2016-13 is effective for fiscal periods beginning after December 15, 2019 and must be adopted as a cumulative effect adjustment to retained earnings. Early adoption is permitted. We do not believe adoption of this guidance will have an impact on our consolidated financial statements.

## **Comprehensive Income**

Comprehensive income represents net income and any revenues, expenses, gains and losses that, under U.S. generally accepted accounting principles, are excluded from net income and recognized directly as a component of equity. Accumulated other comprehensive income (loss) consists solely of foreign currency translation adjustments.

## **Fair Value of Financial Instruments**

The carrying amounts of our financial instruments other than cash equivalents and marketable securities, which include accounts receivable and accounts payable, approximate fair value based on either their short maturity or current terms for similar instruments. Fair value measurements are determined based upon the exit price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants exclusive of any transaction costs. We utilize a fair value hierarchy based upon the observability of inputs used in valuation techniques as follows:

Level 1: Observable inputs such as quoted prices in active markets;

Level 2: Inputs, other than quoted prices in active markets, that are observable either directly or indirectly; and

Level 3: Unobservable inputs in which there is little or no market data, which require the reporting entity to develop its own assumptions.

## **Cash and Cash Equivalents**

Cash and cash equivalents consist of bank demand accounts, savings deposits, certificates of deposit and commercial paper with original maturities of 90 days or less. The carrying value of these assets approximates fair value due to the short maturity of these instruments and meets the Level 1 criteria.

## **Marketable Securities**

The Company has marketable securities held by banks or broker-dealers at November 30, 2018, consisting of short-term domestic certificates of deposit and commercial paper rated at least A-2/P-2 with maturities between 91 days and one year. These securities are classified as available for sale. The primary objective of our short-term investment activity is to preserve capital for the purpose of funding operations, capital expenditures and business acquisitions; short-term investments are not entered into for trading or speculative purposes. These securities are recorded at fair value (that approximates cost) based on recent trades of similar securities or pricing models and therefore meet the Level 2 criteria. Interest income on these investments is recorded within Other Income on the consolidated statements of income.

## **ESTIMATES AND ASSUMPTIONS**

The preparation of these financial statements requires that management make estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses, and related disclosures of contingent assets and

liabilities. On an ongoing basis, management evaluates the estimates, including, but not limited to, variable consideration related to revenue recognition, allowances for doubtful accounts, the market value of, and demand for, inventories, stock-based compensation, provision for income taxes and related balance sheet accounts, accruals, goodwill and other intangible assets. These estimates are based on historical experience and on various other assumptions that are believed to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates under different assumptions or conditions.

There have been no significant changes to the critical accounting policies and estimates disclosed in our Annual Report on Form 10-K for the fiscal year ended May 31, 2018, except for the new revenue recognition standard the Company adopted effective June 1, 2018. See below sections Revenue Recognition and Recently Adopted Accounting Standards for further information on revenue recognition.

There were no significant changes to the contractual obligations or contingent liabilities and commitments disclosed in our Annual Report on Form 10-K for the fiscal year ended May 31, 2018.

## **Table of Contents**

### **Accounts Receivable Allowance**

Management attempts to minimize credit risk by reviewing customers' credit history before extending credit and by monitoring credit exposure on a regular basis. An allowance for doubtful accounts receivable is established based upon factors surrounding the credit risk of specific customers, historical trends and other information. Collateral or other security is generally not required for accounts receivable. Once a receivable balance has been determined to be uncollectible, that amount is charged against the allowance for doubtful accounts.

### **Inventory**

The reserve for obsolete and slow-moving inventory is reviewed at least quarterly based on an analysis of the inventory, considering the current condition of the asset as well as other known facts and future plans. The reserve required to record inventory at lower of cost or net realizable value is adjusted as conditions change. Product obsolescence may be caused by shelf-life expiration, discontinuance of a product line, replacement products in the marketplace or other competitive situations.

### **Goodwill and Other Intangible Assets**

Goodwill represents the excess of purchase price over fair value of tangible net assets of acquired businesses after amounts are allocated to other identifiable intangible assets. Other intangible assets include customer relationships, trademarks, licenses, trade names, covenants not-to-compete and patents. Customer-based intangibles are amortized on either an accelerated or straight-line basis, reflecting the pattern in which the economic benefits are consumed, while all other amortizable intangibles are amortized on a straight-line basis; intangibles are generally amortized over 5 to 25 years. We review the carrying amounts of goodwill and other non-amortizable intangible assets annually, or when indications of impairment exist, to determine if such assets may be impaired by performing a quantitative assessment. If the carrying amounts of these assets are deemed to be less than fair value based upon a discounted cash flow analysis and comparison to comparable EBITDA multiples of peer companies, such assets are reduced to their estimated fair value and a charge is recorded to operations.

### **Long Lived Assets**

Management reviews the carrying values of its long-lived assets to be held and used, including definite-lived intangible assets, for possible impairment whenever events or changes in business conditions warrant such a review. The carrying value of a long-lived asset is considered impaired when the anticipated separately identifiable undiscounted cash flows over the remaining useful life of the asset indicate that the carrying amount of the asset may not be recoverable. In such an event, fair value is determined using discounted cash flows and, if lower than the carrying value, impairment is recognized through a charge to operations.

### **Equity Compensation Plans**

Share options awarded to employees and shares of stock awarded to employees under certain stock purchase plans are recognized as compensation expense based on their fair value at grant date. The fair market value of options granted under the Company stock option plans was estimated on the date of grant using the Black-Scholes option-pricing model with assumptions for inputs such as interest rates, expected dividends, volatility measures and specific employee exercise behavior patterns based on statistical data. Some of the inputs used are not market-observable and have to be estimated or derived from available data. Use of different estimates would produce different option values, which in turn would result in higher or lower compensation expense recognized. To value options, several recognized valuation models exist. None of these models can be singled out as being the best or most correct one. The model

applied by us can handle most of the specific features included in the options granted, which is the reason for its use. If a different model were used, the option values could differ despite using the same inputs. Accordingly, using different assumptions coupled with using a different valuation model could have a significant impact on the fair value of employee stock options. Fair value could be either higher or lower than the number provided by the model applied and the inputs used. Further information on our equity compensation plans, including inputs used to determine the fair value of options, is disclosed in Note 5 to the unaudited consolidated financial statements.

### **Income Taxes**

We account for income taxes using the asset and liability method. Under this method, deferred income tax assets and liabilities are determined based on differences between the financial reporting and tax bases of assets and liabilities and for tax credit carryforwards and are measured using the enacted tax rates in effect for the years in which the differences are expected to reverse. Deferred income tax expense represents the change in net deferred income tax assets and liabilities during the period.

---

**Table of Contents**

On December 22, 2017, the Tax Cuts and Jobs Act of 2017 (the Tax Act) was signed into law making significant changes to the Internal Revenue Code. Changes include a federal corporate tax rate reduction from 35% to 21% for tax years beginning after December 31, 2017, the transition of U.S. international taxation from a worldwide tax system to a territorial system, and a one-time transition tax on the mandatory deemed repatriation of foreign earnings. The Tax Act also includes a provision to tax global intangible low taxed income ( GILTI ) of foreign subsidiaries, which became effective for us beginning June 1, 2018. In the fourth quarter of fiscal 2018, we recorded an estimated net charge of \$4.8 million related to the Tax Act, due to the impact of the reduction in the tax rate on deferred tax assets and liabilities of \$6.0 million, partially offset by \$1.2 million of one-time transition tax on the deemed repatriation of foreign earnings. Due to the timing of the enactment and the complexity in applying the provisions of the Tax Act, these charges and benefits were recorded based on reasonable estimates and are subject to revisions as we complete our analysis of the Tax Act, collect and prepare necessary data, and interpret any additional guidance issued by the Internal Revenue Service. During the month of December 2018, immaterial adjustments to these provisions were recorded to tax expense, within the measurement period under SAB 118.

**Revenue Recognition**

In May 2014, the FASB issued ASU No. 2014-09 Revenue from Contracts with Customers (Topic 606). The new standard outlines a single comprehensive model for entities to use in accounting for revenue arising from contracts with customers and supersedes most current revenue recognition guidance, including industry-specific guidance. The core principle of the revenue model is that an entity should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. The standard is designed to create greater comparability for financial statement users across industries and jurisdictions and also requires enhanced disclosures. In April 2016, the FASB issued Accounting Standards Update No. 2016-10 Revenue from Contracts with Customers (Topic 606), which amends and adds clarity to certain aspects of the guidance set forth in ASU 2014-09 related to identifying performance obligations and licensing. The guidance became effective for the Company on June 1, 2018. The guidance permits two methods of adoption: a full retrospective method to each prior reporting period presented or a modified retrospective approach with the cumulative effect of initially applying the guidance recognized at the date of initial application. We adopted this standard using the full retrospective approach. This approach was chosen to provide appropriate comparisons against our prior year financial statements; accordingly, historical information for the year ended May 31, 2018, including interim periods therein, has been adjusted to conform to the new standard.

Prior to the adoption, we identified all revenue streams at each significant subsidiary and reviewed contracts to evaluate the impact of adopting the new standard on our revenue recognition policies, procedures and control framework and ultimately on our consolidated financial statements and related disclosures. In our review of contracts in each revenue stream, we noted no material impact in the implementation of the standard. We determined the impact of adopting the standard on our control framework and noted minimal, insignificant changes to our system and other controls processes.

We derive revenue from two primary sources – product revenue and service revenue.

Product revenue consists primarily of shipments of:

Diagnostic test kits, culture media and related products used by food producers and processors to detect harmful natural toxins, foodborne bacteria, allergens and levels of general sanitation;

Consumable products marketed to veterinarians and animal health product distributors; and

Rodenticides, disinfectants and insecticides to assist in the control of rodents, insects and disease in and around agricultural, food production and other facilities.

Service revenue consists primarily of:

Genomic identification and related interpretive bioinformatic services; and

Other commercial laboratory services.

Revenues for our genomics and commercial laboratory services are recognized and invoiced when the applicable laboratory service is performed and the results are conveyed to the customer.

Under Topic 606, the Company determines the amount of revenue to be recognized through application of the following steps:

Identification of the contract with a customer;

Identification of the performance obligations in the contract;

Determination of the transaction price;

Allocation of the transaction price to the performance obligations in the contract; and

Recognition of revenue when or as the Company satisfies the performance obligations.

**Table of Contents**

Essentially all our revenue is generated through contracts with our customers. A performance obligation is a promise in a contract to transfer a product or service to a customer. We generally recognize revenue at a point in time when all our performance obligations under the terms of a contract are satisfied. With the adoption of Topic 606, revenue is recognized upon transfer of control of promised products and services in an amount that reflects the consideration the Company expects to receive in exchange for those products or services. The collectability of consideration on the contract is reasonably assured before revenue is recognized. To the extent that customer payment has been received before all recognition criteria are met, these revenues are initially deferred in other accruals on the balance sheet and the revenue is recognized in the period that all recognition criteria have been met. In certain situations, we provide rebates, marketing support, credits or incentives to selected customers, which are accounted for as variable consideration when estimating the amount of revenue to recognize on a contract. Variable consideration reduces the amount of revenue that is recognized. These variable consideration estimates are updated at the end of each reporting period based on information currently available.

The performance obligations in our contracts are generally satisfied well within one year of the contract inception. In such cases, we have elected the practical expedient to not adjust the promised amount of consideration for the effects of a significant financing component. We have elected to utilize the practical expedient to recognize the incremental costs of obtaining a contract as an expense when incurred because the amortization period for the prepaid costs that would otherwise have been deferred and amortized is one year or less. The Company accounts for shipping and handling for products as a fulfillment activity when goods are shipped. Revenue is recognized net of any tax collected from customers; the taxes are subsequently remitted to governmental authorities. The Company's terms and conditions of sale generally do not provide for returns of product or reperformance of service except in the case of quality or warranty issues. These situations are infrequent; due to immateriality of the amount, warranty claims are recorded in the period incurred.

The following table presents disaggregated revenue by major product and service categories for the three and six months ended November 30, 2018 and 2017:

	<b>Three Months Ended</b>		<b>Six Months Ended</b>	
	<b>November 30,</b>		<b>November 30,</b>	
	<b>2018</b>	<b>2017</b>	<b>2018</b>	<b>2017</b>
	<i>(in thousands)</i>		<i>(in thousands)</i>	
<b><u>Food Safety</u></b>				
Natural Toxins, Allergens & Drug Residues	\$ 20,571	\$ 18,989	\$ 39,409	\$ 38,153
Bacterial & General Sanitation	10,822	9,324	21,288	18,443
Culture Media & Other	12,191	11,041	24,408	21,173
Rodenticides, Insecticides & Disinfectants	5,943	6,126	12,569	10,817
Genomics Services	4,223	3,726	8,259	6,911
<b><u>Animal Safety</u></b>				
Life Sciences	\$ 53,750	\$ 49,206	\$ 105,933	\$ 95,497
Veterinary Instruments & Disposables	\$ 1,891	\$ 2,394	\$ 3,971	\$ 4,820
Animal Care & Other	11,683	11,687	22,087	22,174
Rodenticides, Insecticides & Disinfectants	9,064	8,237	15,617	15,649
Genomics Services	18,673	17,786	35,664	35,167
	12,037	11,388	23,452	21,600
	<b>\$ 53,348</b>	<b>\$ 51,492</b>	<b>\$ 100,791</b>	<b>\$ 99,410</b>

<b>Total Revenues</b>	\$ 107,098	\$ 100,698	\$ 206,724	\$ 194,907
-----------------------	------------	------------	------------	------------

**Restatement of Previously Issued Financial Statements**

The Company has historically classified certain variable consideration components resulting from volume rebates, distributor support, and other marketing discounts as cost of product revenues or sales and marketing expense in our consolidated financial statements of income. These amounts should have been classified as contra revenue in product or service revenues. The Company had determined in prior periods that the misstatements were clearly immaterial, individually and in the aggregate, to each of the reporting periods affected. The Company began properly classifying these items as contra revenues beginning in the three-month period ended August 31, 2018, the first quarter of the Company's current fiscal year, and has revised the prior year's quarter and year-to-date periods to conform to the current period presentation. These immaterial adjustments had no impact on our operating income, income before taxes, net income or reported earnings per share, and no change to stockholders' equity.

**Table of Contents**

The effects of the revisions on the line items within our unaudited consolidated statements of income for the three and six months ended November 30, 2017 are as follows:

	Three Months Ended November 30, 2017			Six Months Ended November 30, 2017		
	As		As Revised	As		As Revised
	Previously Reported	Adjustments (in thousands)		Previously Reported	Adjustments (in thousands)	
<b>Revenues</b>						
Product revenues	\$ 85,590	\$ (1,119)	\$ 84,471	\$ 166,157	\$ (2,141)	\$ 164,016
Service revenues	16,227		16,227	30,916	(25)	30,891
<b>Total revenues</b>	<b>101,817</b>	<b>(1,119)</b>	<b>100,698</b>	<b>197,073</b>	<b>(2,166)</b>	<b>194,907</b>
<b>Cost of revenues</b>						
Cost of product revenues	43,349	(97)	43,252	84,433	(197)	84,236
Cost of service revenues	9,197		9,197	17,498		17,498
<b>Total cost of revenues</b>	<b>52,546</b>	<b>(97)</b>	<b>52,449</b>	<b>101,931</b>	<b>(197)</b>	<b>101,734</b>
<b>Gross margin</b>	<b>49,271</b>	<b>(1,022)</b>	<b>48,249</b>	<b>95,142</b>	<b>(1,969)</b>	<b>93,173</b>
<b>Operating expenses</b>						
Sales and marketing	17,815	(1,022)	16,793	34,838	(1,969)	32,869
<b>Total operating expenses</b>	<b>31,273</b>	<b>(1,022)</b>	<b>30,251</b>	<b>60,720</b>	<b>(1,969)</b>	<b>58,751</b>
<b>Operating income</b>	<b>17,998</b>		<b>17,998</b>	<b>34,422</b>		<b>34,422</b>

Presented below are the effects of the revisions on the line items within the previously issued unaudited consolidated statements of income for the three and nine months ended February 28, 2018 and the consolidated statements of income for the years ended May 31, 2018 and 2017. Revised consolidated statements of income related to these periods will be presented in the Forms 10-Q and Form 10-K to be filed in the succeeding periods of this fiscal year.

	Three Months Ended February 28, 2018			Nine Months Ended February 28, 2018		
	As		As Revised	As		As Revised
	Previously Reported	Adjustments (in thousands)		Previously Reported	Adjustments (in thousands)	
<b>Revenues</b>						
Product revenues	\$ 78,142	\$ (958)	\$ 77,184	\$ 244,298	\$ (3,098)	\$ 241,200
Service revenues	17,750	(31)	17,719	48,667	(56)	48,611
<b>Total revenues</b>	<b>95,892</b>	<b>(989)</b>	<b>94,903</b>	<b>292,965</b>	<b>(3,154)</b>	<b>289,811</b>
<b>Cost of revenues</b>						
Cost of product revenues	40,352	(69)	40,283	124,785	(265)	124,520
Cost of service revenues	10,019		10,019	27,517		27,517

Edgar Filing: NEOGEN CORP - Form 10-Q

Total cost of revenues	50,371	(69)	50,302	152,302	(265)	152,037
Gross margin	45,521	(920)	44,601	140,663	(2,889)	137,774
Operating expenses						
Sales and marketing	17,492	(920)	16,572	52,331	(2,889)	49,442
Total operating expenses	29,608	(920)	28,688	90,328	(2,889)	87,439
Operating income	15,913		15,913	50,335		50,335

**Table of Contents**

	Year Ended May 31, 2018			Year Ended May 31, 2017		
	As Previously Reported	Adjustments (in thousands)	As Revised	As Previously Reported	Adjustments (in thousands)	As Revised
<b>Revenues</b>						
Product revenues	\$ 335,554	\$ (4,266)	\$ 331,288	\$ 306,512	\$ (3,390)	\$ 303,122
Service revenues	66,698	(56)	66,642	55,082	73	55,155
<b>Total revenues</b>	<b>402,252</b>	<b>(4,322)</b>	<b>397,930</b>	<b>361,594</b>	<b>(3,317)</b>	<b>358,277</b>
<b>Cost of revenues</b>						
Cost of product revenues	174,067	(342)	173,725	156,568	(273)	156,295
Cost of service revenues	37,933		37,933	33,058		33,058
<b>Total cost of revenues</b>	<b>212,000</b>	<b>(342)</b>	<b>211,658</b>	<b>189,626</b>	<b>(273)</b>	<b>189,353</b>
<b>Gross margin</b>	<b>190,252</b>	<b>(3,980)</b>	<b>186,272</b>	<b>171,968</b>	<b>(3,044)</b>	<b>168,924</b>
<b>Operating expenses</b>						
Sales and marketing	70,909	(3,980)	66,929	62,424	(3,044)	59,380
<b>Total operating expenses</b>	<b>120,058</b>	<b>(3,980)</b>	<b>116,078</b>	<b>107,023</b>	<b>(3,044)</b>	<b>103,979</b>
<b>Operating income</b>	<b>70,194</b>		<b>70,194</b>	<b>64,945</b>		<b>64,945</b>

The revisions had no impact on our audited consolidated balance sheets as of May 31, 2018 and 2017 and no impact on our unaudited consolidated statements of equity or unaudited consolidated statements of cash flows for the three and six months ended November 30, 2017 and the three and nine months ended February 28, 2018.

**Table of Contents****2. INVENTORIES**

Inventories are stated at the lower of cost, determined by the first-in, first-out method, or net realizable value. The components of inventories follow:

	<b>November 30, 2018</b>	<b>May 31, 2018</b>
	<i>(in thousands)</i>	
Raw materials	\$ 36,563	\$ 36,702
Work-in-process	7,601	5,993
Finished and purchased goods	35,309	33,310
	\$ 79,473	\$ 76,005

**3. NET INCOME PER SHARE**

The calculation of net income per share attributable to Neogen Corporation follows:

	<b>Three Months Ended November 30, 2018</b>		<b>Six Months Ended November 30, 2018</b>	
	<b>2018</b>	<b>2017</b>	<b>2018</b>	<b>2017</b>
	<i>(in thousands, except per share amounts)</i>			
Numerator for basic and diluted net income per share:				
Net income attributable to Neogen	\$ 16,051	\$ 17,100	\$ 31,288	\$ 29,014
Denominator for basic net income per share:				
Weighted average shares	52,019	51,264	51,820	51,109
Effect of dilutive stock options	572	697	721	669
Denominator for diluted net income per share	52,591	51,961	52,541	51,778
Net income attributable to Neogen per share:				
Basic	\$ 0.31	\$ 0.33	\$ 0.60	\$ 0.57
Diluted	\$ 0.31	\$ 0.33	\$ 0.60	\$ 0.56

**Table of Contents****4. SEGMENT INFORMATION AND GEOGRAPHIC DATA**

We have two reportable segments: Food Safety and Animal Safety. The Food Safety segment is primarily engaged in the development, production and marketing of diagnostic test kits, culture media and related products used by food producers and processors to detect harmful natural toxins, foodborne bacteria, allergens and levels of general sanitation. The Animal Safety segment is primarily engaged in the development, production and marketing of products dedicated to animal safety, including a complete line of consumable products marketed to veterinarians and animal health product distributors; this segment also provides genomic identification and related interpretive bioinformatic services. Additionally, the Animal Safety segment produces and markets rodenticides, disinfectants and insecticides to assist in the control of rodents, insects and disease in and around agricultural, food production and other facilities.

Our international operations in the United Kingdom, Mexico, Brazil, China and India originally focused on the Company's Food Safety products, and each of these units reports through the Food Safety segment. In recent years, these operations have expanded to offer our complete line of products and services, including those usually associated with the Animal Safety segment such as cleaners, disinfectants, rodenticides, insecticides, veterinary instruments and genomics services. These additional products and services are managed and directed by existing management and are reported through the Food Safety segment.

The accounting policies of each of the segments are the same as those described in Note 1.

Segment information follows:

	<b>Food Safety</b>	<b>Animal Safety</b>	<b>Corporate and Eliminations (1)</b>	<b>Total</b>
	<i>(in thousands)</i>			
<b>As of and for the three months ended November 30, 2018</b>				
Product revenues to external customers	\$ 48,256	\$ 41,306	\$	\$ 89,562
Service revenues to external customers	5,494	12,042		17,536
Total revenues to external customers	53,750	53,348		107,098
Operating income (loss)	10,342	9,057	(1,153)	18,246
Total assets	201,291	218,231	240,970	660,492
<b>As of and for the three months ended November 30, 2017 Revised (2)</b>				
Product revenues to external customers	\$ 44,367	\$ 40,104	\$	\$ 84,471
Service revenues to external customers	4,839	11,388		16,227
Total revenues to external customers	49,206	51,492		100,698
Operating income (loss)	8,668	10,529	(1,199)	17,998
Total assets	175,836	215,099	190,093	581,028

Edgar Filing: NEOGEN CORP - Form 10-Q

- (1) Includes corporate assets, consisting principally of cash and cash equivalents, marketable securities, current and deferred tax accounts and overhead expenses not allocated to specific business segments. Also includes the elimination of intersegment transactions.
- (2) Segment revenues for the three months ended November 30, 2017 have been revised as discussed in Note 1. For the three months ended November 30, 2017, product revenues were reduced by \$354,000 in the Food Safety segment and \$765,000 in the Animal Safety segment; service revenues were unchanged in the Food Safety segment and in the Animal Safety segment.

**Table of Contents**

	<b>Food Safety</b>	<b>Animal Safety</b>	<b>Corporate and Eliminations (1)</b>	<b>Total</b>
	<i>(in thousands)</i>			
<b>For the six months ended November 30, 2018</b>				
Product revenues to external customers	\$ 95,189	\$ 77,333	\$	\$ 172,522
Service revenues to external customers	10,744	23,458		34,202
Total revenues to external customers	105,933	100,791		206,724
Operating income (loss)	21,215	15,763	(2,253)	34,725
<b>For the six months ended November 30, 2017 Revised (2)</b>				
Product revenues to external customers	\$ 86,206	\$ 77,810	\$	\$ 164,016
Service revenues to external customers	9,291	21,600		30,891
Total revenues to external customers	95,497	99,410		194,907
Operating income (loss)	17,446	19,198	(2,222)	34,422

(1) Includes the elimination of intersegment transactions.

(2) Segment revenues for the six months ended November 30, 2017 have been revised as discussed in Note 1. For the six months ended November 30, 2017, product revenues were reduced by \$798,000 in the Food Safety segment and \$1,343,000 in the Animal Safety segment; service revenues were unchanged in the Food Safety segment and reduced by \$25,000 in the Animal Safety segment.

The following table presents the Company's revenue disaggregated by geographic location:

	<b>Three Months ended November 30, 2018</b>		<b>Six Months Ended November 30, 2018</b>	
	<b>2018</b>	<b>2017</b>	<b>2018</b>	<b>2017</b>
	<i>(in thousands)</i>		<i>(in thousands)</i>	
<b>Revenues by Geographic Location</b>				
Domestic	\$ 65,033	\$ 62,452	\$ 124,879	\$ 122,588
International	42,065	38,246	81,845	72,319
Total revenue	107,098	100,698	206,724	194,907

**Table of Contents****5. EQUITY COMPENSATION PLANS**

Qualified and non-qualified options to purchase shares of common stock may be granted to directors, officers and employees of the

Company under the terms of our stock option plans. These options are granted at an exercise price of not less than the fair market value of the stock on the date of grant. Options vest ratably over three and five year periods and the contractual terms are generally five or 10 years. A summary of stock option activity during the six months ended November 30, 2018 follows:

	<b>Shares</b>	<b>Weighted-Average Exercise Price</b>
Options outstanding June 1, 2018	2,497,124	\$ 42.63
Granted	525,750	62.93
Exercised	(340,023)	29.49
Forfeited	(91,620)	45.87
Options outstanding November 30, 2018	2,591,231	48.40

During the three and six month periods ended November 30, 2018 and 2017, the Company recorded \$1,400,000 and \$1,264,000 and \$2,831,000 and \$2,666,000, respectively, of compensation expense related to its share-based awards.

The weighted-average fair value per share of stock options granted during fiscal year 2018 and fiscal 2019, estimated on the date of grant using the Black-Scholes option pricing model, was \$14.47 and \$14.91, respectively. The fair value of stock options granted was estimated using the following weighted-average assumptions.

	<b>FY 2019</b>	<b>FY 2018</b>
Risk-free interest rate	2.6%	1.6%
Expected dividend yield	0.0%	0.0%
Expected stock price volatility	27.0%	27.2%
Expected option life	3.5 years	4.0 years

The Company has an employee stock purchase plan that provides for employee stock purchases at a 5% discount to market price. The discount is recorded in administrative expense as of the date of purchase.

**6. BUSINESS AND PRODUCT LINE ACQUISITIONS**

The Consolidated Statements of Income reflect the results of operations for business acquisitions since the respective dates of purchase. All are accounted for using the acquisition method. Goodwill recognized in the acquisitions discussed below relates primarily to enhancing the Company's strategic platform for the expansion of available product offerings.

On September 1, 2017, the Company acquired the assets of The University of Queensland Animal Genetics Laboratory, an animal genomics laboratory located near Brisbane, Australia. This acquisition is intended to accelerate the growth of the Company's animal genomics business in Australia and New Zealand. Consideration for the purchase

was \$2,063,000; \$468,000 was paid in cash on the acquisition date with the remainder due in annual installments over the next five years. The final purchase price allocation, based upon the fair value of these assets and liabilities determined using the income approach, included inventory of \$19,000, equipment of \$419,000, non-current liabilities of \$1,629,000, intangible assets of \$902,000 (with an estimated life of 5-15 years) and the remainder to goodwill (non-deductible for tax purposes). These values are Level 3 fair value measurements. The new business, renamed Neogen Australasia, continues to operate in its current location, reporting within the Animal Safety segment.

On August 1, 2018, the Company acquired the stock of Clarus Labs, Inc., a manufacturer of water testing products. Neogen has distributed Clarus Colitag water test to the food and beverage industries since 2004 and this acquisition gives the Company access to sell this product to new markets. Consideration for the purchase was \$4,204,000 in cash and approximately \$1.3 million of contingent consideration, due at the end of each of the first five years, based on an excess net sales formula. The preliminary purchase price allocation, based upon the fair value of these assets and liabilities determined using the income approach, included inventory of \$32,000, machinery and equipment of \$120,000, accounts payable of \$53,000, contingent consideration accrual of \$1,256,000, non-current deferred tax liability of \$426,000, non-amortizable intangible assets of \$750,000, intangible assets of \$1,100,000 (with an estimated life of 5-15 years) and the remainder to goodwill (non-deductible for tax purposes). These values are Level 3 fair value

measurements. Manufacturing of these products was moved to the Company's Lansing, Michigan location in October, reporting within the Food Safety segment.

## **Table of Contents**

On September 4, 2018, the Company acquired the assets of Livestock Genetic Services, LLC, a Virginia-based company that specializes in genetic evaluations and data management for cattle breeding organizations. Livestock Genetic Services has been a long-time strategic partner of Neogen and the acquisition will enhance the Company's in-house genetic evaluation capabilities. Consideration for the purchase was \$1,100,000 in cash, with \$700,000 paid at closing and \$400,000 payable to the former owner on September 1, 2019, and approximately \$385,000 of contingent consideration, payable over the next three years. The preliminary purchase price allocation, based upon the fair value of these assets and liabilities determined using the income approach, included office equipment of \$15,000, contingent consideration accrual of \$385,000, intangible assets of \$860,000 (with an estimated life of 5-15 years) and the remainder to goodwill (deductible for tax purposes). These values are Level 3 fair value measurements. Services provided by this company are now performed at the Company's Lincoln, Nebraska location, reporting within the Animal Safety segment.

## **7. LONG TERM DEBT**

We have a financing agreement with a bank providing for a \$15,000,000 unsecured revolving line of credit, which was amended on November 30, 2018 to extend the maturity from September 30, 2019 to September 30, 2021. There were no advances against the line of credit during fiscal 2018 and there have been none thus far in fiscal 2019; there was no balance outstanding at November 30, 2018. Interest on any borrowings remained at LIBOR plus 100 basis points (rate under the terms of the agreement was 3.51% at November 30, 2018). Financial covenants include maintaining specified levels of tangible net worth, debt service coverage, and funded debt to EBITDA, each of which the Company was in compliance with at November 30, 2018.

## **8. COMMITMENTS AND CONTINGENCIES**

The Company is involved in environmental remediation and monitoring activities at its Randolph, Wisconsin manufacturing facility and accrues for related costs when such costs are determined to be probable and estimable. The Company expenses annual costs of remediation, which have ranged from \$38,000 to \$74,000 per year over the past five years. The Company's estimated liability for these costs was \$916,000 at November 30, 2018 and May 31, 2018, measured on an undiscounted basis over an estimated period of 15 years; \$100,000 of the liability is recorded within current liabilities, and the remainder is recorded within other non-current liabilities on the consolidated balance sheets. During the second quarter of fiscal 2019, the Company's environmental consultant performed an updated Corrective Measures Study on the Randolph site, per a request from the Wisconsin Department of Natural Resources. Based on the results of the study, the Company plans to continue the current remediation and monitoring program, with no changes proposed.

The Company is subject to certain legal and other proceedings in the normal course of business that, in the opinion of management, should not have a material effect on its future results of operations or financial position.

## **9. STOCK PURCHASE**

In October 2018, the Company's Board of Directors passed a resolution canceling the Company's prior stock buyback program, which had been approved in December 2008, and authorized a new program to purchase, subject to market conditions, up to 3,000,000 shares of the Company's common stock. As of November 30, 2018, there had been no purchases of common stock in the current fiscal year under either program. In December 2018, the Company purchased 50,000 shares under the new program in negotiated and open market transactions for a total price, including commissions, of \$3,134,727. Shares purchased under the program have been retired.



**Table of Contents**

**PART I FINANCIAL INFORMATION**

**Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations**

The information in this Management's Discussion and Analysis of Financial Condition and Results of Operations contains both historical financial information and forward-looking statements. Neogen does not provide forecasts of future financial performance. While management is optimistic about our long-term prospects, historical financial information may not be indicative of future financial results.

**Safe Harbor and Forward-Looking Statements**

Forward-looking statements, within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended, are made throughout this Quarterly Report on Form 10-Q. For this purpose, any statements contained herein that are not statements of historical fact may be deemed to be forward looking statements. Without limiting the foregoing, the words believes, anticipates, plans, expects, seeks, estimates, and similar expressions are intended to identify forward-looking statements. There are a number of important factors, including competition, recruitment and dependence on key employees, impact of weather on agriculture and food production, identification and integration of acquisitions, research and development risks, patent and trade secret protection, government regulation and other risks detailed from time to time in the Company's reports on file at the Securities and Exchange Commission, that could cause Neogen Corporation's results to differ materially from those indicated by such forward-looking statements, including those detailed in this Management's Discussion and Analysis of Financial Condition and Results of Operations.

In addition, any forward-looking statements represent management's views only as of the day this Quarterly Report on Form 10-Q was first filed with the Securities and Exchange Commission and should not be relied upon as representing management's views as of any subsequent date. While management may elect to update forward-looking statements at some point in the future, it specifically disclaims any obligation to do so, even if its views change.

---

**Table of Contents**

**Executive Overview**

Consolidated revenues were \$107.1 million in the second quarter of fiscal 2019, an increase of 6% compared to \$100.7 million in the second quarter of fiscal 2018. Organic sales in the second quarter also increased 6%. For the six month period, consolidated revenues were \$206.7 million, an increase of 6% compared to \$194.9 million in the same period in the prior fiscal year. On a year to date basis, organic sales increased 5%.

Food Safety segment sales were \$53.8 million in the second quarter of the current fiscal year, an increase of 9% compared to \$49.2 million in the same period of the prior year. Organic sales in this segment also increased 9%, with a minor contribution from the August 1, 2018 acquisition of Clarus Labs. For the year to date, Food Safety segment sales were \$105.9 million, an increase of 11% compared to \$95.5 million in the same period of the prior fiscal year; the organic sales increase was also 11%.

Animal Safety segment sales were \$53.3 million in the second quarter of fiscal 2019, an increase of 4% compared to \$51.5 million in the second quarter of fiscal 2018. Organic sales in this segment also increased 4% in the second quarter, with a minor contribution from the September 1, 2018 acquisition of Livestock Genetic Services. For the six month period, Animal Safety segment sales were \$100.8 million, an increase of 1% compared to \$99.4 million in the same period a year ago. Year to date organic sales were flat, after excluding three months of the September 1, 2017 acquisition of Neogen Australasia and one month of the Livestock Genetic Services acquisition.

International sales in the second quarter of fiscal 2019 were 39% of total sales compared to 38% of total sales in the second quarter of fiscal 2018. For the year to date, fiscal 2019 international sales were 40% of total sales compared to 37% of total sales in the same period of the prior year.

Our effective tax rate in the second quarter was 18.5% compared to an effective tax rate of 10.0% in the prior year second quarter; the fiscal 2019 year to date effective tax rate was 15.1% compared to the year to date effective tax rate of 19.8% in the prior fiscal year. The U.S. statutory rate is 21% in the current fiscal year and was 35% in the first six months of fiscal 2018. Differences from the statutory rate are primarily due to tax deductions resulting from stock option exercises, provisions included in the corporate tax reform, and state and local taxes.

Net income for the quarter ended November 30, 2018 was \$16.1 million, or \$0.31 per diluted share, a decrease of 6% compared to \$17.1 million, or \$0.33 per share in the same period in the prior year. For the year to date, net income was \$31.3 million, or \$0.60 per share, an increase of 8% compared to prior year to date net income of \$29.0 million, or \$0.56 per diluted share.

Cash provided from operating activities in the first six months of fiscal 2019 was \$32.6 million, compared to \$27.4 million in the first half of fiscal 2018.

Edgar Filing: NEOGEN CORP - Form 10-Q

Neogen's results reflect an increase in international sales of 10% in the second quarter of fiscal 2019 and 13% for the year to date, each compared to the same respective periods in the prior year. We continue to focus on increasing our presence and market share throughout the world, while also integrating recent international acquisitions into our product portfolio. Sales fluctuations in the three and six month periods of fiscal 2019 compared to the same respective periods in the prior year are as follows for each of our international locations:

	Three Months Ended November 30, 2018		Six Months Ended November 30, 2018	
	Revenue	Revenue	Revenue	Revenue
	% Increase/(Decrease) USD	% Increase/(Decrease) Local Currency	% Increase USD	% Increase Local Currency
Neogen Europe (including Lab M & Quat-Chem)	8%	10%	13%	13%
Neogen do Brasil (including Deoxi & Rogama)	6%	29%	23%	48%
Neogen Latinoamerica	(7)%	(2)%	9%	15%
Neogen China	1%	6%	4%	6%
Neogen India	83%	105%	81%	99%

Currency translations reduced revenues by approximately \$2.0 million in the second quarter of fiscal 2019 compared to the same quarter a year ago, primarily due to increased strength of the U.S. dollar relative to the Brazilian real, the British pound, and the Mexican peso. For the year to date, currency translations reduced revenues by approximately \$3.3 million compared to the prior year.

**Table of Contents**

The increase in revenues at Neogen Europe was led by a 30% increase in sales of genomics services, primarily in the porcine and bovine markets; genomics sales increased 28% for the year to date. Neogen Europe also had strong sales of our products to detect spoilage organisms in processed foods, due to equipment placements, and *Listeria* Right Now. At Neogen do Brasil, sales of natural toxins test kits increased 62% and 73% for the three and six months, respectively, both compared to the same periods a year ago, as we continued to gain significant new business testing for the presence of aflatoxin in corn. Sales of forensic test kits increased 166% in the second quarter and year to date sales more than tripled over the prior year due to increased demand from commercial laboratories located in Brazil and business that shifted from U.S. labs to labs in Brazil.

Service revenue was \$17.5 million in the second quarter of fiscal 2019, an increase of 8% over prior year second quarter revenues of \$16.2 million, including a minor contribution from the September 2018 acquisition of Livestock Genetics Services. For the six month period, service revenue was \$34.2 million, an increase of 11% over prior year revenues of \$30.9 million. Year to date revenues were aided by the Livestock Genetics Services acquisition and the September 2017 acquisition of Neogen Australasia. The growth was led by increases in sales of genomic services to the global beef markets, and porcine markets in Europe.

**Table of Contents****Revenues**

	<b>Three Months Ended November 30,</b>			
	<b>2018</b>	<b>2017</b>	<b>Increase/ (Decrease)</b>	<b>%</b>
	<i>(in thousands)</i>			
<b><u>Food Safety</u></b>				
Natural Toxins, Allergens & Drug Residues	\$ 20,571	\$ 18,989	\$ 1,582	8%
Bacterial & General Sanitation	10,822	9,324	1,498	16%
Culture Media & Other	12,191	11,041	1,150	10%
Rodenticides, Insecticides & Disinfectants	5,943	6,126	(183)	(3)%
Genomics Services	4,223	3,726	497	13%
	\$ 53,750	\$ 49,206	\$ 4,544	9%
<b><u>Animal Safety</u></b>				
Life Sciences	\$ 1,891	\$ 2,394	\$ (503)	(21)%
Veterinary Instruments & Disposables	11,683	11,687	(4)	0%
Animal Care & Other	9,064	8,237	827	10%
Rodenticides, Insecticides & Disinfectants	18,673	17,786	887	5%
Genomics Services	12,037	11,388	649	6%
	\$ 53,348	\$ 51,492	\$ 1,856	4%
<b>Total Revenues</b>	<b>\$ 107,098</b>	<b>\$ 100,698</b>	<b>\$ 6,400</b>	<b>6%</b>

	<b>Six Months Ended November 30,</b>			
	<b>2018</b>	<b>2017</b>	<b>Increase/ (Decrease)</b>	<b>%</b>
	<i>(in thousands)</i>			
<b><u>Food Safety</u></b>				
Natural Toxins, Allergens & Drug Residues	\$ 39,409	\$ 38,153	\$ 1,256	3%
Bacterial & General Sanitation	21,288	18,443	2,845	15%
Culture Media & Other	24,408	21,173	3,235	15%
Rodenticides, Insecticides & Disinfectants	12,569	10,817	1,752	16%
Genomics Services	8,259	6,911	1,348	20%
	\$ 105,933	\$ 95,497	\$ 10,436	11%
<b><u>Animal Safety</u></b>				
Life Sciences	\$ 3,971	\$ 4,820	\$ (849)	(18)%
Veterinary Instruments & Disposables	22,087	22,174	(87)	0%
Animal Care & Other	15,617	15,649	(32)	0%
Rodenticides, Insecticides & Disinfectants	35,664	35,167	497	1%
Genomics Services	23,452	21,600	1,852	9%

Edgar Filing: NEOGEN CORP - Form 10-Q

	\$ 100,791	\$ 99,410	\$ 1,381	1%
<b>Total Revenues</b>	<b>\$ 206,724</b>	<b>\$ 194,907</b>	<b>\$ 11,817</b>	<b>6%</b>

---

**Table of Contents****Food Safety**

**Natural Toxins, Allergens & Drug Residues** Sales in this category increased 8% and 3% for the three and six month periods ended November 30, 2018, respectively, compared to the same periods in the prior year. For the second quarter, natural toxin test kit revenues increased 17%, due to strong sales of aflatoxin test kits in Brazil and DON test kits and readers in Canada, and sales of our allergens product line increased 6%. This was partially offset by a 6% decrease in dairy drug residue test kits caused by lower demand in Europe and timing of distributor orders.

**Bacterial & General Sanitation** Revenues in this category increased 16% in the second quarter and 15% for the year to date, both compared to the same periods in the prior year. In the second quarter, sales of test kits to detect pathogens increased 24%, as we continued to gain new business with our *Listeria* Right Now test kit that launched in fiscal 2018. Sales of products to detect spoilage organisms in processed foods increased 24%, due to equipment placements and related consumables, and sales of our AccuPoint sanitation monitoring product line increased 6%.

**Culture Media & Other** Sales in this category increased 10% in the quarter ended November 30, 2018 compared to the second quarter in the prior year; the year to date increase is 15%. In the second quarter, sales of Neogen Culture Media, formerly marketed as the Acumedia and Lab M brands, increased 8%, aided in part by the August 2018 acquisition of Clarus Labs, which consists of the Colitag product and reports in the culture media product line. This category also includes forensic test kits sold within Brazil, which increased significantly in both the second quarter and for the year to date due to increased demand from commercial laboratories in that country and a shift in business from labs in the U.S. to labs in Brazil.

**Rodenticides, Insecticides & Disinfectants** Revenues in this category decreased 3% in the second quarter of fiscal 2019 compared to the same period a year ago, due to order timing of rodenticides from customers in Mexico, as those sales were strong in the first quarter. Partially offsetting this were increases of disinfectant sales to customers in Europe, China and India. Year to date revenues increased 16% due to the strength of rodenticide sales in Mexico. The year to date increase also included the final shipment of a large insecticide order in the first quarter to a government health organization in Brazil; we do not believe this business, which was part of a bid won in fiscal 2018, will recur in fiscal 2019.

**Genomics Services** Sales in this category increased 13% and 20% for the three and six month periods ended November 30, 2018, respectively. The increase came primarily from higher sales in the European porcine and bovine markets; lower sales in Mexico partially offset this increase due to a large research project completed in the second quarter of fiscal 2018 that did not recur in the current year.

**Animal Safety**

**Life Sciences** Sales in this category decreased 21% in the second quarter, as compared to the same period in the prior year, as a portion of forensic test kit sales shifted to our operations in Brazil. The products were formerly served by our Animal Safety operation in Lexington, KY. For the year to date, the decrease in this product line is 18%.

**Veterinary Instruments & Disposables** Revenues in this category were flat compared to the prior year, for both the three and six month periods ended November 30, 2018. Protective wear sales decreased 25% in the second quarter, resulting from poor economic conditions in the dairy market; this decline was offset by a 7% increase in veterinary instruments sales, led by strength in needles and syringes.

**Animal Care & Other** Sales of these products increased 10% in the second quarter but were flat for the year to date. For the second quarter, the growth was led by small animal supplements, which rose 49%, and antibiotics, up 24% due

to order timing from a large distributor. The increase in the second quarter was offset by an overall decrease in the first quarter, primarily due to order timing from large distributors.

**Rodenticides, Insecticides & Disinfectants** Revenues in this category increased 5% and 1% for the three and six month periods ended November 30, 2018, respectively. In the second quarter, insecticides sales increased 22% due to new private label business and increased demand in the U.S. Cleaners and disinfectants increased 7%, due to market share gains in the U.S., while rodenticide sales were flat, with new business earned offset by the loss of toll manufacturing business from the prior year.

**Genomics Services** Sales in this category increased 6% in the second quarter and 9% for the year to date period, both compared to the prior year; the year to date increase was aided by three months of sales from the September 2017 acquisition of Neogen Australasia. For both the three and six month periods, growth in the beef cattle markets was offset by revenue decreases in U.S. poultry and porcine markets, resulting from a shift to lower priced chips and services.

**Table of Contents****Gross Margin**

Gross margin was 46.7% in the second quarter of fiscal 2019 compared to 47.9% in the same quarter a year ago. The decline in gross margin is due to product mix within the Animal Safety segment, with higher revenue increases on product lines with lower gross margins than the historical average within this segment. Gross margin for the six month period ended November 30, 2018 was 46.8% compared to 47.8% in the same period of the prior year, for the same reasons.

**Operating Expenses**

Operating expenses were \$31.8 million in the second quarter, compared to \$30.3 million in the same quarter of the prior year, an increase of \$1.5 million, or 5%. Sales and marketing expenses increased \$1.7 million, or 10%, primarily due to increases in salaries and related personnel costs, shipping expense, and bad debt expense due to the prior year reversal of reserves for collected receivables. General and administrative expense decreased \$370,000, or 4%, which includes recognition of \$240,000 of state economic incentive credits in the current quarter; no credits were recognized in the second quarter of the prior year. The largest increases in general and administrative were salaries, stock option expense, and recruiting fees, offset by a decrease in outside contracted services related to IT projects, and lower amortization expense due to one-time adjustments related to acquisition valuations recorded in the second quarter of the prior year. Research and development expense increased \$200,000, or 7%, led by increases in salaries and personnel related costs. For the year to date, operating expenses increased \$3.3 million, or 6%.

**Operating Income**

Operating income was \$18.2 million in the second quarter of fiscal 2019, compared to \$18.0 million in the same period of the prior year; year to date operating income was \$34.7 million compared to \$34.4 million in the prior year. Expressed as a percentage of sales, operating income was 17.0% for the second quarter and 16.8% for the year to date, compared to 17.9% and 17.7%, respectively, in the prior year. The decline in operating margin percentage for each period in the current fiscal year was the result of the lower gross margin percentage.

**Other Income**

<i>(dollars in thousands)</i>	<b>Three Months Ended</b>		<b>Six Months Ended</b>	
	<b>November 30,</b>	<b>November 30,</b>	<b>November 30,</b>	<b>November 30,</b>
	<b>2018</b>	<b>2017</b>	<b>2018</b>	<b>2017</b>
Interest income (net of expense)	\$ 1,028	\$ 429	\$ 1,955	\$ 798
Foreign currency transactions	(72)	497	(458)	962
Royalty income	37	75	59	75
Deoxi contingent consideration		(50)	(9)	(99)
Quat-Chem contingent consideration	422		422	
Other	40	104	144	131
<b>Total Other Income</b>	<b>\$ 1,455</b>	<b>\$ 1,055</b>	<b>\$ 2,113</b>	<b>\$ 1,867</b>

The increase in interest income in both the three and six month periods of fiscal 2019 compared to the same periods a year ago was the result of higher cash and marketable securities balances and rising interest rates on those balances.

Other income resulting from foreign currency transactions was primarily the result of changes in the value of foreign currencies relative to the U.S. dollar in countries in which we operate.

### **Income Tax Expense**

Income tax expense in the second quarter of fiscal 2019 was \$3.7 million, an effective tax rate of 18.5% compared to \$1.9 million, an effective tax rate of 10.0%, in the same period of the prior year. Corporate tax reform enacted in December 2017 reduced the U.S. statutory income tax rate from 35% to 21%. The second quarter of the prior year included a credit of \$3.8 million to federal income tax expense for tax benefits resulting from the exercise of stock options; this credit was \$484,000 in the current year second quarter. The timing of stock option exercises by quarter is due to a tranche of options that expired in the first quarter of fiscal 2019; a different tranche expired in the second quarter in fiscal 2018. For the first six months of fiscal 2019, income tax expense was \$5.6 million compared to \$7.2 million in the prior year; the year to date effective tax rate was 15.1%, compared to an effective tax rate of 19.8% in the prior fiscal year. For the year to date period, the Company recorded a total credit of \$2.8 million to federal income tax expense for tax benefits resulting from the exercise of stock options, compared to \$4.2 million in the prior year.

## **Table of Contents**

### **Net Income**

Net income was \$16.1 million in the second quarter of fiscal 2019, compared to \$17.1 million in the same period in the prior year. Earnings in the prior year quarter included \$4.2 million in tax benefits resulting from the exercise of stock options; this benefit was \$484,000 in the current year quarter. For the year to date, net income increased 8% from \$29.0 million to \$31.3 million; six month net income was favorably impacted by corporate tax reform, partially offset by lower overall benefit from the exercise of stock options.

### **Financial Condition and Liquidity**

The overall cash, cash equivalents and marketable securities position of Neogen was \$241.0 million at November 30, 2018, compared to \$210.8 million at May 31, 2018. Approximately \$32.6 million was generated from operations during the first six months of fiscal 2019. Net cash proceeds of \$10.3 million were realized from the exercise of stock options and issuance of shares under our Employee Stock Purchase Plan during the first six months of fiscal 2019. We spent \$6.7 million for property, equipment and other non-current assets in the first six months of fiscal 2019.

Accounts receivable balances were \$82.3 million at November 30, 2018, an increase of \$3.2 million, compared to \$79.1 million at May 31, 2018. Days sales outstanding, a measurement of the time it takes to collect receivables, were 63 days at November 30, 2018, compared to 64 days at August 31, 2018 and 60 days at May 31, 2018; the increase in the current year is attributable to the higher levels of sales at our international operations, which generally take more time to collect. All customer accounts are actively managed and no losses in excess of amounts reserved are currently expected.

Net inventory balances were \$79.5 million at November 30, 2018, an increase of \$3.5 million, or 5%, compared to a May 31, 2018 balance of \$76.0 million; the increase is attributable to our increased revenues. We actively monitor our inventory levels and balance the need for adequate levels of product availability to minimize backorders with a desire to improve inventory turnover and efficiency levels. We have continued with our active programs to improve our turnover in fiscal 2019.

Inflation and changing prices are not expected to have a material effect on operations, as management believes it will continue to be successful in offsetting increased input costs with price increases and/or cost efficiencies.

Management believes that our existing cash and marketable securities balances at November 30, 2018, along with available borrowings under our credit facility and cash expected to be generated from future operations, will be sufficient to fund activities for the foreseeable future. However, existing cash and borrowing capacity may not be sufficient to meet our cash requirements to commercialize products currently under development or its plans to acquire other organizations, technologies or products that fit within our mission statement. Accordingly, we may choose to issue equity securities or enter into other financing arrangements for a portion of our future financing needs.

**Table of Contents**

**PART I FINANCIAL INFORMATION**

**Item 3. Quantitative and Qualitative Disclosures About Market Risk**

We have interest rate and foreign exchange rate risk exposure but no long-term fixed rate investments or borrowings. Our primary interest rate risk is due to potential fluctuations of interest rates for variable rate borrowings (no long-term borrowings at November 30, 2018) and short-term investments.

Foreign exchange risk exposure arises because we market and sell our products throughout the world. Revenues in certain foreign countries as well as certain expenses related to those revenues are transacted in currencies other than the U.S. dollar. Our operating results are exposed to changes in exchange rates between the U.S. dollar and the British pound sterling, the euro, the Brazilian real, the Mexican peso, the Chinese yuan, the Australian dollar, and to a lesser extent, the Indian rupee and the Canadian dollar. When the U.S. dollar weakens against foreign currencies, the dollar value of revenues denominated in foreign currencies increases. When the U.S. dollar strengthens, the opposite situation occurs. Additionally, previously recognized revenues in the course of collection can be affected positively or negatively by changes in exchange rates. The Company enters into forward contracts to help mitigate the economic impact of fluctuations in certain currency exchange rates. These contracts are adjusted to fair value through earnings.

Neogen has assets, liabilities and operations outside of the United States, located in Scotland, England, Brazil, Mexico, China, India, Canada, and Australia where the functional currency is the British pound sterling, Brazilian real, Mexican peso, Chinese yuan, Indian rupee, Canadian dollar and the Australian dollar, respectively, and transacts business throughout Europe in the euro. The Company's investments in foreign subsidiaries are considered to be long-term.

**PART I FINANCIAL INFORMATION**

**Item 4. Controls and Procedures**

**Evaluation of Disclosure Controls and Procedures**

An evaluation of the effectiveness of the design and operation of our disclosure controls and procedures as of November 30, 2018 was carried out under the supervision and with the participation of the Company's management, including the Chief Executive Officer and the Vice President & Chief Financial Officer (the Certifying Officers). Based on the evaluation, the Certifying Officers concluded that the Company's disclosure controls and procedures are effective.

**Changes in Internal Control over Financial Reporting**

No changes in our controls over financial reporting were identified as having occurred during the quarter ended November 30, 2018 that have materially affected, or are reasonably likely to materially affect, internal control over financial reporting.

**Table of Contents****PART II OTHER INFORMATION****Item 1. Legal Proceedings**

The Company is subject to legal and other proceedings in the normal course of business. In the opinion of management, the outcomes of these matters are not expected to have a material effect on the Company's future results of operations or financial position.

**Item 6. Exhibits**

## (a) Exhibit Index

3	<u>Articles of Incorporation, as restated</u>
10	<u>Amended and Restated Credit Agreement dated as of November 30, 2018 between Registrant and JPMorgan Chase N.A. (incorporated by reference to Exhibit 10.A to the registrant's Form 8-K filed on December 6, 2018).</u>
31.1	<u>Certification of Chief Executive Officer pursuant to Rule 13a-14(a).</u>
31.2	<u>Certification of Chief Financial Officer pursuant to Rule 13a-14(a).</u>
32	<u>Certification pursuant to 18 U.S.C. section 1350</u>
101.INS	XBRL Instance Document
101.SCH	XBRL Taxonomy Extension Schema Document
101.CAL	XBRL Taxonomy Extension Calculation Linkbase Document
101.DEF	XBRL Taxonomy Extension Definition Document
101.LAB	XBRL Taxonomy Extension Label Linkbase Document
101.PRE	XBRL Taxonomy Extension Presentation Linkbase Document

**Items 1A, 2, 3, 4, and 5 are not applicable or removed or reserved and have been omitted.**

Table of Contents

**SIGNATURES**

Pursuant to the requirements of the Securities Exchange Act of 1934, as amended, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

NEOGEN CORPORATION  
(*Registrant*)

Dated: December 28, 2018

/s/ John E. Adent  
John E. Adent  
President & Chief Executive Officer  
(Principal Executive Officer)

Dated: December 28, 2018

/s/ Steven J. Quinlan  
Steven J. Quinlan  
Vice President & Chief Financial Officer  
(Principal Financial Officer and Principal Accounting  
Officer)