

MERIDIAN BIOSCIENCE INC

Form 10-Q

May 02, 2007



**MERIDIAN BIOSCIENCE, INC. AND SUBSIDIARIES  
INDEX TO QUARTERLY REPORT ON FORM 10-Q**

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<p><i>The Private Securities Litigation Reform Act of 1995 provides a safe harbor from civil litigation for forward-looking statements accompanied by meaningful cautionary statements. Except for historical information, this report contains forward-looking statements which may be identified by words such as "estimates", "anticipates", "projects", "plans", "seek", "may", "will", "expects", "intends", "believes", "should" and similar expressions or the negative versions thereof and which may be identified by their context. Such statements, whether expressed or implied, are based upon current expectations of the Company and speak only as of the date made. The Company assumes no obligation to publicly update any forward-looking statements. These statements are subject to various risks, uncertainties and other factors that could cause actual results to differ materially, including, without limitation, the following: Meridian's continued growth depends, in part, on its ability to introduce into the marketplace enhancements of existing products or new products that incorporate technological advances, meet customer requirements and respond to products developed by Meridian's competition. While Meridian has introduced a number of internally developed products, there can be no assurance that it will be successful in the future in introducing such products on a timely basis. Ongoing</i></p>	

*consolidations of reference laboratories and formation of multi-hospital alliances may cause adverse changes to pricing and distribution. Costs and difficulties in complying with laws and regulations administered by the United States Food and Drug Administration can result in unanticipated expenses and delays and interruptions to the sale of new and existing products. Changes in the relative strength or weakness of the U.S. dollar can change expected results. One of Meridian's main growth strategies is the acquisition of companies and product lines. There can be no assurance that additional acquisitions will be consummated or that, if consummated, will be successful and the acquired businesses successfully integrated into Meridian's operations. In addition to the factors described in this paragraph, Part I, Item 1A Risk Factors of our Form 10-K contains a list of uncertainties and risks that may affect the financial performance of the Company.*

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**MERIDIAN BIOSCIENCE, INC. AND SUBSIDIARIES**  
**Consolidated Statements of Operations (Unaudited)**  
(in thousands, except per share data)

	<b>Three Months</b>		<b>Six Months</b>	
	<b>Ended March 31,</b>		<b>Ended March 31,</b>	
	<b>2007</b>	<b>2006</b>	<b>2007</b>	<b>2006</b>
NET SALES	\$32,094	\$28,272	\$60,814	\$53,180
COST OF SALES	13,271	11,692	24,394	21,450
Gross profit	18,823	16,580	36,420	31,730
<b>OPERATING EXPENSES:</b>				
Research and development	1,718	1,203	3,033	2,355
Sales and marketing	4,064	4,053	8,259	8,271
General and administrative	4,207	4,347	8,251	7,957
Total operating expenses	9,989	9,603	19,543	18,583
Operating income	8,834	6,977	16,877	13,147
<b>OTHER INCOME (EXPENSE):</b>				
Interest income	357	238	752	487
Interest expense	(8)	(32)	(38)	(67)
Other, net	27	63	91	(29)
Total other income (expense)	376	269	805	391
Earnings before income taxes	9,210	7,246	17,682	13,538
INCOME TAX PROVISION	3,329	2,523	6,237	4,853
NET EARNINGS	\$ 5,881	\$ 4,723	\$11,445	\$ 8,685
BASIC EARNINGS PER COMMON SHARE	\$ 0.22	\$ 0.18	\$ 0.44	\$ 0.33
DILUTED EARNINGS PER COMMON SHARE	\$ 0.22	\$ 0.18	\$ 0.43	\$ 0.32
AVERAGE NUMBER OF COMMON SHARES OUTSTANDING BASIC	26,345	26,142	26,267	26,050

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DILUTIVE COMMON STOCK OPTIONS	648	694	640	696
AVERAGE NUMBER OF COMMON SHARES OUTSTANDING DILUTED	26,993	26,836	26,907	26,746
ANTI-DILUTIVE SECURITIES:				
Common stock options		11	12	6
Shares from convertible debentures		190		190
DIVIDENDS DECLARED PER COMMON SHARE	\$ 0.160	\$ 0.115	\$ 0.275	\$ 0.195

The accompanying notes are an integral part of these consolidated financial statements.

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**MERIDIAN BIOSCIENCE, INC. AND SUBSIDIARIES**  
**Consolidated Statements of Cash Flows (Unaudited)**  
(dollars in thousands)

<b>Six Months Ended March 31,</b>	<b>2007</b>	<b>2006</b>
<b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>		
Net earnings	\$ 11,445	\$ 8,685
Non-cash items:		
Depreciation of property, plant and equipment	1,371	1,344
Amortization of intangible assets and deferred costs	818	913
Stock based compensation	774	319
Deferred income taxes	820	314
Loss on disposition of fixed assets	2	44
Change in accounts receivable, inventory, and prepaid expenses	(1,110)	(1,323)
Change in accounts payable, accrued expenses, and income taxes payable	(5,773)	(3,882)
Other	(51)	66
Net cash provided by operating activities	8,296	6,480
<b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>		
Acquisitions of property, plant and equipment	(1,680)	(2,054)
Proceeds from sales of property, plant and equipment		34
Purchase of intangibles	(265)	
Acquisition payments	(971)	(1,494)
Sales of short-term investments	4,000	
Net cash provided by (used for) investing activities	1,084	(3,514)
<b>CASH FLOWS FROM FINANCING ACTIVITIES:</b>		
Repayment of debt obligations	(29)	(469)
Dividends paid	(7,220)	(5,089)
Proceeds and tax benefits from exercises of stock options	1,392	825
Other		(3)
Net cash used for financing activities	(5,857)	(4,736)
Effect of Exchange Rate Changes on Cash and Equivalents	57	8
Net Increase (Decrease) in Cash and Equivalents	3,580	(1,762)
Cash and Equivalents at Beginning of Period	36,348	33,085
Cash and Equivalents at End of Period	\$ 39,928	\$ 31,323

The accompanying notes are an integral part of these consolidated financial statements.

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**MERIDIAN BIOSCIENCE, INC. AND SUBSIDIARIES**  
**Consolidated Balance Sheets (Unaudited)**  
**(dollars in thousands)**

	<b>March 31, 2007</b>	<b>September 30, 2006</b>
<b>ASSETS</b>		
<b>CURRENT ASSETS:</b>		
Cash and equivalents	\$ 39,928	\$ 36,348
Short term investments		4,000
Accounts receivable, less allowances of \$420 and \$408 for doubtful accounts	20,340	19,645
Inventories	18,864	17,680
Prepaid expenses and other current assets	1,858	2,109
Deferred income taxes	1,141	1,387
Total current assets	82,131	81,169
<b>PROPERTY, PLANT AND EQUIPMENT:</b>		
Land	878	701
Buildings and improvements	16,824	15,963
Machinery, equipment and furniture	23,799	22,902
Construction in progress	564	870
Subtotal	42,065	40,436
Less: accumulated depreciation and amortization	23,924	22,629
Net property, plant and equipment	18,141	17,807
<b>OTHER ASSETS:</b>		
Deferred debenture offering costs, net		106
Goodwill	9,898	9,864
Other intangible assets, net	10,270	10,816
Restricted cash	1,000	1,000
Other assets	185	193
Total other assets	21,353	21,979
<b>TOTAL ASSETS</b>	<b>\$ 121,625</b>	<b>\$ 120,955</b>

The accompanying notes are an integral part of these consolidated financial statements.



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**MERIDIAN BIOSCIENCE, INC. AND SUBSIDIARIES**  
**Consolidated Balance Sheets (Unaudited)**  
**(dollars in thousands)**

	<b>March 31, 2007</b>	<b>September 30, 2006</b>
<b>LIABILITIES AND SHAREHOLDERS EQUITY</b>		
<b>CURRENT LIABILITIES:</b>		
Accounts payable	\$ 3,199	\$ 3,671
Accrued payroll costs	4,478	7,896
Purchase business combination liabilities		937
Other accrued expenses	4,634	3,955
Income taxes payable	2,605	4,158
Total current liabilities	14,916	20,617
CONVERTIBLE SUBORDINATED DEBENTURES		1,803
DEFERRED INCOME TAXES	3,621	3,758
<b>COMMITMENTS AND CONTINGENCIES</b>		
<b>SHAREHOLDERS EQUITY:</b>		
Preferred stock, no par value, 1,500,000 shares authorized, none issued		
Common shares, no par value, 50,000,000 shares authorized, 26,468,353 and 26,157,185 shares issued, respectively		
Additional paid-in capital	78,822	74,950
Retained earnings	24,142	19,917
Accumulated other comprehensive income (loss)	124	(90)
Total shareholders equity	103,088	94,777
<b>TOTAL LIABILITIES AND SHAREHOLDERS EQUITY</b>	<b>\$ 121,625</b>	<b>\$ 120,955</b>

The accompanying notes are an integral part of these consolidated financial statements.

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**MERIDIAN BIOSCIENCE, INC. AND SUBSIDIARIES**  
**Consolidated Statement of Changes in Shareholders Equity (Unaudited)**  
**(dollars and shares in thousands)**

	Common Shares	Additional Paid-in Capital	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Comprehensive Income (Loss)	Total Shareholders Equity
<b>Balance at September 30, 2006</b>	26,157	\$74,950	\$19,917	\$ (90)	\$	\$ 94,777
Dividends paid			(7,220)			(7,220)
Exercise of stock options, net of tax	128	1,421				1,421
Stock based compensation		774				774
Bond conversion	183	1,677				1,677
Comprehensive income:						
Net earnings			11,445		11,445	11,445
Hedging activity				(33)	(33)	(33)
Other comprehensive income taxes				(117)	(117)	(117)
Foreign currency translation adjustment				364	364	364
Comprehensive income					\$ 11,659	
<b>Balance at March 31, 2007</b>	26,468	\$78,822	\$24,142	\$ 124		\$103,088

The accompanying notes are an integral part of these consolidated financial statements.

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**MERIDIAN BIOSCIENCE, INC. AND SUBSIDIARIES**  
**Notes to Consolidated Financial Statements**  
**(Unaudited)**

**1. Basis of Presentation:**

The consolidated financial statements included herein have not been audited by an independent registered public accounting firm, but include all adjustments (consisting of normal recurring entries), which are, in the opinion of management, necessary for a fair presentation of the results for such periods.

Certain information and footnote disclosures normally included in financial statements prepared in accordance with generally accepted accounting principles have been omitted pursuant to the requirements of the Securities and Exchange Commission. Meridian believes that the disclosures included in these financial statements are adequate to make the information not misleading.

It is suggested that these consolidated interim financial statements be read in conjunction with the consolidated annual financial statements and notes thereto, included in Meridian's Annual Report on Form 10-K for the Year Ended September 30, 2006.

The results of operations for the interim periods are not necessarily indicative of the results to be expected for the year.

**2. Significant Accounting Policies:**

***(a) Revenue Recognition***

Meridian's revenues are derived primarily from product sales. Revenue is generally recognized when product is shipped and title has passed to the buyer. Revenue for the US Diagnostics operating segment is reduced at the date of sale for estimated rebates that will be claimed by customers. Rebate agreements are in place with certain independent national distributors and are designed to reimburse such distributors for their cost in handling Meridian's products. Management estimates rebate accruals based on historical statistics, current trends, and other factors. Changes to these rebate accruals are recorded in the period that they become known.

Life Science operating segment revenue for contract services may come from standalone arrangements for process development and/or optimization work (contract research and development services) or custom manufacturing, or multiple-deliverable arrangements that include process development work followed by larger-scale manufacturing (both contract research and development services and contract manufacturing services). Revenue is recognized based on the nature of the arrangements, using the principles in EITF 00-21, *Revenue Arrangements with Multiple Deliverables*. The framework in EITF 00-21 is based on each of the multiple deliverables in a given arrangement having distinct and separate fair values. Fair values are determined via consistent pricing between standalone arrangements

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and multiple deliverable arrangements, as well as a competitive bidding process. Contract research and development services may be performed on a time and materials basis or fixed fee basis. For time and materials arrangements, revenue is recognized as services are performed and billed. For fixed fee arrangements, revenue is recognized upon completion and acceptance by the customer. For contract manufacturing services, revenue is recognized upon delivery of product and acceptance by the customer.

**(b) Comprehensive Income**

Comprehensive income represents the net change in shareholders' equity during a period from sources other than transactions with shareholders. Meridian's comprehensive income is comprised of net earnings, foreign currency translation, and changes in the fair value of forward exchange contracts accounted for as cash flow hedges.

Assets and liabilities of foreign operations are translated using period-end exchange rates with gains or losses resulting from translation included in accumulated other comprehensive income (loss). Revenues and expenses are translated using exchange rates prevailing during the period. Meridian also recognizes foreign currency transaction gains and losses on certain assets and liabilities that are denominated in the Euro currency. These gains and losses are included in other income and expense in the accompanying consolidated statements of operations.

Comprehensive income for the interim periods ended March 31 was as follows (in thousands):

	<b>Three Months</b>		<b>Six Months</b>	
	<b>Ended March 31,</b>		<b>Ended March 31,</b>	
	<b>2007</b>	<b>2006</b>	<b>2007</b>	<b>2006</b>
Net earnings	\$5,881	\$4,723	\$11,445	\$8,685
Hedging activity	6		(33)	
Income taxes	(33)	5	(117)	(41)
Foreign currency translation adjustment	89	(18)	364	154
Comprehensive income	\$5,943	\$4,710	\$11,659	\$8,798

**(c) Income Taxes -**

The provision for income taxes includes federal, foreign, state, and local income taxes currently payable and those deferred because of temporary differences between income for financial reporting and income for tax purposes.

Meridian prepares estimates of permanent and temporary differences between income for financial reporting purposes and income for tax purposes. These differences are adjusted to actual upon filing of Meridian's tax returns, which typically occurs in the third and fourth quarters of the current fiscal year for the preceding fiscal year's estimates.

From time to time, Meridian's tax returns in federal, state, and foreign jurisdictions are examined by the applicable tax authorities. Meridian's tax provisions take into consideration the judgmental nature of certain tax positions through the establishment of reserves for differences between the probable tax determinations and the as filed tax

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positions of certain assets and liabilities. To the extent that tax benefits result from the completion of these examinations or the passing of statutes of limitation, they will affect tax liabilities and earnings in the period known. Meridian believes that the results of any tax authority examinations would not have a significant adverse impact on financial condition or results of operation.

***(d) Stock-based Compensation***

Meridian accounts for stock-based compensation pursuant to SFAS No. 123R, *Share-Based Payment*. SFAS No. 123R requires recognition of compensation expense for all share-based awards made to employees and outside directors, based upon the fair value of the share-based award on the date of the grant.

***(e) Cash equivalents***

Meridian considers most short-term investments with original maturities of 90 days or less to be cash equivalents. Auction-rate securities are separately classified as short-term investments in the consolidated financial statements.

***(f) Short-term investments***

Auction rate securities are classified as short-term investments in the consolidated financial statements and are accounted for as available-for-sale securities under SFAS No. 115, *Accounting for Certain Investments in Debt and Equity Securities*. As such, unrealized holding gains and losses are reported as a component of other comprehensive income until realized. The carrying value of these securities was equal to their fair value as of September 30, 2006. Meridian did not own any auction rate securities as of March 31, 2007.

***(g) Derivative financial instruments***

Meridian accounts for its foreign currency forward exchange contracts in accordance with SFAS No. 133, *Accounting for Derivative Instruments and Hedging Activities*, as amended. These instruments are designated as cash flow hedges, and therefore, the effective portion of the net gain or loss on the derivative instrument is reported as a component of other comprehensive income and reclassified into earnings in the same period or periods during which the hedged transaction affects earnings. For the ineffective portion of the hedge, gains or losses are charged to earnings in the current period. All derivative instruments are recognized as either assets or liabilities at fair value in the consolidated balance sheets. See Note 7.

***(h) Reclassifications***

Certain reclassifications have been made to the prior period financial statements to conform to the current year presentation.

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Inventories are comprised of the following (in thousands):

	March 31, 2007	September 30, 2006
Raw materials	\$ 4,311	\$ 3,973
Work-in-process	5,578	5,139
Finished goods	8,975	8,568
	\$18,864	\$ 17,680

**4. Segment Information:**

Meridian's reportable operating segments are US Diagnostics, European Diagnostics, and Life Science. The US Diagnostics operating segment consists of manufacturing operations in Cincinnati, Ohio, and the sale and distribution of diagnostic test kits in the US and countries outside of Europe, Africa and the Middle East. The European Diagnostics operating segment consists of the sale and distribution of diagnostic test kits in Europe, Africa and the Middle East. The Life Science operating segment consists of manufacturing operations in Memphis, Tennessee, Saco, Maine, and Boca Raton, Florida, and the sale and distribution of bulk antigens, antibodies, and bioresearch reagents domestically and abroad. The Life Science operating segment also includes the contract development and manufacture of proteins and other biologicals for use by biopharmaceutical and biotechnology companies engaged in research for new drugs and vaccines.



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Segment information for the interim periods ended March 31, 2007 and 2006 is as follows (in thousands):

	US Diagnostics	European Diagnostics	Life Science	Eliminations <sup>(1)</sup>	Total
<b>Three Months 2007</b>					
Net sales -					
Third-party	\$ 19,866	\$ 6,274	\$ 5,954	\$	\$ 32,094
Inter-segment	2,041		89	(2,130)	
Operating income	6,814	1,207	848	(35)	8,834
Total assets (March 31, 2007)	104,575	14,192	43,170	(40,312)	121,625
<b>Three Months 2006</b>					
Net sales -					
Third-party	\$ 17,012	\$ 5,319	\$ 5,941	\$	\$ 28,272
Inter-segment	1,930		298	(2,228)	
Operating income	4,748	933	1,319	(23)	6,977
Total assets (September 30, 2006)	109,678	12,716	42,178	(43,617)	120,955
<b>Six Months 2007</b>					
Net sales -					
Third-party	\$ 38,820	\$ 11,529	\$ 10,465	\$	\$ 60,814
Inter-segment	4,261		358	(4,619)	
Operating income	13,995	2,092	867	(77)	16,877
<b>Six Months 2006</b>					
Net sales -					
Third-party	\$ 33,006	\$ 9,554	\$ 10,620	\$	\$ 53,180
Inter-segment	3,627		422	(4,049)	
Operating income	9,818	1,539	1,805	(15)	13,147

(1) Eliminations consist of intersegment transactions.

Transactions between operating segments are accounted for at established intercompany prices for internal and management purposes with all intercompany amounts eliminated in consolidation. Total assets for US Diagnostics and Life Science include goodwill of \$1,579,000 and \$8,319,000, respectively, at March 31, 2007, and \$1,579,000 and \$8,285,000, respectively, at September 30, 2006.

**5. Intangible Assets:**

A summary of Meridian's acquired intangible assets subject to amortization, as of March 31, 2007 and September 30, 2006 is as follows (in thousands):

	Wtd Avg Amort Period (Yrs)	March 31, 2007		September 30, 2006	
		Gross Carrying Value	Accumulated Amortization	Gross Carrying Value	Accumulated Amortization
Core products and cell lines	15	\$ 4,698	\$ 2,168	\$ 4,698	\$ 2,023
Manufacturing technologies	15	5,907	3,910	5,907	3,743
Trademarks, licenses and patents	12	2,270	1,625	2,005	1,545

Customer lists and supply agreements	13	10,636	5,538	10,633	5,116
		\$23,511	\$ 13,241	\$23,243	\$ 12,427

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The aggregate amortization expense for these intangible assets for the three months ended March 31, 2007 and 2006 was \$407,000 and \$432,000, respectively. The aggregate amortization expense for these intangible assets for the six months ended March 31, 2007 and 2006 was \$814,000 and \$864,000, respectively.

**6. Debenture Conversion and Redemption Transactions:**

As of September 30, 2006, Meridian had outstanding a total of \$1,803,000 principal amount of convertible subordinated debentures due September 1, 2013, bearing interest at 5%. These debentures were convertible at the option of the holder into common shares at a price of \$9.67. During the first quarter of 2007, holders converted \$317,000 principal amount of debentures into 32,778 common shares.

On January 30, 2007, Meridian called for redemption the remaining \$1,486,000 principal of outstanding 5% convertible debentures. Prior to the redemption date, holders converted an additional \$1,458,000 principal of debentures into 150,768 common shares. On March 1, 2007, the remaining \$28,000 principal of debentures were redeemed at a 1% premium, as per the original terms. The cash cost of this redemption was approximately \$28,000. Paid-in-capital was increased by approximately \$83,000 for the extinguishment of related deferred debenture costs during the second quarter of 2007. The fiscal 2007 conversion and redemption transactions will reduce annual interest expense by \$90,000.

**7. Hedging Transactions:**

Meridian has historically entered into forward exchange contracts that were not designated as hedging instruments under SFAS No. 133, but rather, were used to offset the earnings impact related to the variability in the US dollar/Euro exchange rate on certain intercompany sales transactions denominated in the Euro currency. Changes in the fair values of these contracts were immediately recognized in earnings to offset the re-measurement of intercompany receivables denominated in the Euro currency.

During the third quarter of fiscal 2006, Meridian began designating newly executed forward exchange contracts as cash flow hedges under SFAS No. 133. The purpose of these contracts is to hedge cash flows related to forecasted intercompany sales denominated in the Euro currency.

The following table presents Meridian's hedging portfolio as of March 31, 2007 (in thousands).

Notional Amount	Contract Value	Estimated Fair Value	Average Exchange Rate	Maturity
1,550	\$2,046	\$2,078	1.3203	FY 2007

At March 31, 2007, \$20,000 of unrealized losses were included in accumulated other comprehensive income in the consolidated balance sheet, compared to unrealized gains of \$13,000 at September 30, 2006. This amount is expected to be reclassified into net earnings within the next twelve months. The estimated fair value of forward contracts outstanding at March 31, 2007 and September 30, 2006 is based on quoted amounts provided by the counterparties to these contracts.

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**8. Subsequent Event:**

On April 19, 2007, the Company announced a three-for-two stock split, with fractional shares paid in cash. The split will be effective on May 11, 2007, for shareholders of record on May 4, 2007. All references in this Quarterly Report to number of shares and per share amounts are exclusive of the effects of the upcoming stock split.

**ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS**

*Refer to Forward Looking Statements following the Index in front of this Form 10-Q.*

**Operating Segments:**

Meridian's reportable operating segments are US Diagnostics, European Diagnostics, and Life Science. The US Diagnostics operating segment consists of manufacturing operations in Cincinnati, Ohio, and the sale and distribution of diagnostic test kits in the US and countries outside of Europe, Africa and the Middle East. The European Diagnostics operating segment consists of the sale and distribution of diagnostic test kits in Europe, Africa and the Middle East. The Life Science operating segment consists of manufacturing operations in Memphis, Tennessee, Saco, Maine, and Boca Raton, Florida, and the sale and distribution of bulk antigens, antibodies, and bioresearch reagents domestically and abroad. The Life Science operating segment also includes the contract development and manufacture of proteins and other biologicals for use by biopharmaceutical and biotechnology companies engaged in research for new drugs and vaccines.

Revenues for the Diagnostics operating segments, in the normal course of business, may be affected from quarter to quarter by buying patterns of major distributors, seasonality and strength of certain diseases and foreign currency exchange rates. Revenues for the Life Science operating segment, in the normal course of business, may be affected from quarter to quarter by the timing and nature of arrangements for contract services work, which may have longer production cycles than bioresearch reagents and bulk antigens and antibodies, as well as buying patterns of major customers. Meridian believes that the overall breadth of its product lines serves to reduce the variability in consolidated sales from quarter to quarter. Meridian has implemented hedging strategies that are intended to reduce the effects of foreign currency translation on sales of the European Diagnostics operating segment.

**Results of Operations:**

*Three Months Ended March 31, 2007 Compared to Three Months Ended March 31, 2006*

***Net sales***

Overall, net sales increased 14% to \$32,094,000 for the second quarter of fiscal 2007 compared to the second quarter of fiscal 2006. Net sales for the US Diagnostics operating segment increased \$2,854,000, or 17%, for the European Diagnostics operating segment increased \$955,000, or 18%, and for the Life Science operating segment increased \$13,000.

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For the US Diagnostics operating segment, the sales increase was primarily related to *C. difficile* products (increased \$1,178,000), *H. pylori* products (increased \$653,000), specimen transport products (\$296,000) and parasitology products (increased \$263,000). The increase in sales of *C. difficile* products related primarily to volume increases for ImmunoCard<sup>®</sup> Toxins A & B and Premier<sup>™</sup> Toxins A & B. The increase in sales of *H. pylori* products was driven by managed care efforts and increased marketing of Premier<sup>™</sup> Platinum HpSA PLUS. Two national distributors accounted for 47% and 45% of total sales for the US Diagnostics operating segment for the second quarters of fiscal 2007 and 2006, respectively.

For the European Diagnostics operating segment, the sales increase includes currency translation gains in the amount of \$513,000. Sales in local currency increased 10% for the second quarter of fiscal 2007. The increase in local currency was primarily driven by sales of *C. difficile* products (increased \$364,000), including ImmunoCard<sup>®</sup> Toxins A & B rapid diagnostic test and *H. pylori* products (increased \$133,000).

For the Life Science operating segment, the slight sales increase for the second quarter of fiscal 2007 was primarily attributable to volume growth in make-to-order bulk antigens and antibodies, offset by lower sales activity from contract research and development and contract manufacturing services. Sales to one customer accounted for 21% and 14% of total sales for the Life Science operating segment for the second quarters of fiscal 2007 and fiscal 2006, respectively.

For all operating segments combined, international sales were \$9,687,000, or 30% of total sales, for the second quarter of fiscal 2007 compared to \$9,127,000, or 32% of total sales, for the second quarter of fiscal 2006. Combined domestic exports for the US Diagnostics and Life Science operating segments were \$3,413,000 for the second quarter of fiscal 2007, compared to \$3,806,000 for the second quarter of fiscal 2006. The remaining international sales were generated by the European Diagnostics operating segment.

**Gross Profit**

Gross profit increased 14% to \$18,823,000 for the second quarter of fiscal 2007 compared to the second quarter of fiscal 2006. Gross profit margins were 59% for the second quarters of both fiscal 2007 and 2006.

Meridian's overall operations consist of the sale of diagnostic test kits for various disease states and in alternative test formats, as well as bioresearch reagents, bulk antigens and antibodies, proficiency panels, and contract research and development and contract manufacturing services. Product sales mix shifts, in the normal course of business, can cause the consolidated gross profit margin to fluctuate by several points.

**Operating Expenses**

Operating expenses increased 4% to \$9,989,000, for the second quarter of fiscal 2007 compared to the second quarter of fiscal 2006. The overall increase in operating expenses for the second quarter of fiscal 2007 is discussed below. Research and development expenses increased 43% to \$1,718,000 for the second quarter of fiscal 2007 compared to the second quarter of fiscal 2006, and as a percentage of sales, were 5% and 4%,

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respectively for the second quarters of fiscal 2007 and 2006. Of this increase, \$511,000 related to the US Diagnostics operating segment and \$4,000 related to the Life Science operating segment. The increase for the US Diagnostics operating segment was primarily attributable to clinical trial and other costs associated with new product development.

Sales and marketing expenses increased \$11,000 for the second quarter of fiscal 2007 compared to the second quarter of fiscal 2006, and as a percentage of sales, decreased from 14% for the second quarter of fiscal 2006 to 13% for the second quarter of fiscal 2007. Of this increase, \$23,000 related to the US Diagnostics operating segment and \$102,000 related to the European Diagnostics operating segment, partially offset by a decrease of \$114,000 for to the Life Science operating segment. The increase for the European Diagnostics operating segment primarily related to currency fluctuations. The decrease for the Life Science operating segment relates to synergies realized through consolidation of the BIODESIGN and OEM Concepts businesses, which occurred throughout fiscal 2005 and fiscal 2006.

General and administrative expenses decreased 3% to \$4,207,000 for the second quarter of fiscal 2007 compared to the second quarter of fiscal 2006, and as a percentage of sales, were 13% and 15% for the second quarters of fiscal 2007 and 2006, respectively. Of this decrease, \$174,000 related to the US Diagnostics operating segment and \$53,000 related to the European Diagnostics operating segment, partially offset by an increase of \$87,000 related to the Life Science operating segment. The US Diagnostics operating segment had increased stock compensation expense, offset by lower spending.

***Operating Income***

Operating income increased 27% to \$8,834,000 for the second quarter of fiscal 2007, as a result of the factors discussed above.

***Other Income and Expense***

Interest income was \$357,000 for the second quarter of fiscal 2007 compared to \$238,000 for the second quarter of fiscal 2006. This increase was caused by higher investment yields and investment balances in fiscal 2007 to date.

***Income Taxes***

The effective rate for income taxes was 36% for the second quarter of fiscal 2007 compared to 35% for the second quarter of fiscal 2006. The increase in the effective tax rate was primarily attributable to the phase-out of the benefit for the extra-territorial income exclusion under the America Jobs Creation Act of 2004.

From time to time, Meridian's tax returns in federal, state, and foreign jurisdictions are examined by the applicable tax authorities. Meridian's tax provisions take into consideration the judgmental nature of certain tax positions through the establishment of reserves for differences between the probable tax determinations and the as filed tax positions of certain assets and liabilities. To the extent that tax benefits result from the completion of these examinations or the passing of statutes of limitation, they will affect tax liabilities and earnings in the period known. Meridian believes that the results of any tax authority examinations would not have a significant adverse impact on

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financial condition or results of operation.

*Six Months Ended March 31, 2007 Compared to Six Months Ended March 31, 2006*

***Net sales***

Overall, net sales increased 14% for the first six months of fiscal 2007 compared to the first six months of fiscal 2006. Net sales for the US Diagnostics operating segment increased \$5,814,000, or 18%, for the European Diagnostics operating segment increased \$1,975,000, or 21%, and for the Life Science operating segment decreased \$155,000, or 1%.

For the US Diagnostics operating segment, the sales increase was primarily related to *C. difficile* products (increased \$2,529,000), respiratory products (increased \$1,087,000), *H. pylori* products (increased \$1,043,000), parasitology products (increased \$617,000), and food-borne illness products (increased \$337,000). The increase in sales of *C. difficile* products related primarily to volume increases for ImmunoCard<sup>®</sup> Toxins A & B and Premier<sup>™</sup> Toxins A & B. The increase in sales of respiratory products was driven by increased market share and increased purchases by one national distributor. Two distributors accounted for 52% and 48% of total sales for the US Diagnostics operating segment for the first six months of fiscal 2007 and fiscal 2006, respectively.

For the European Diagnostics operating segment, the sales increase includes currency translation gains in the amount of \$919,000. Sales in local currency increased 11% for the first six months of fiscal 2006. The increase in local currency was primarily driven by sales of *C. difficile* products (increased \$778,000) and *H. pylori* products (increased \$367,000).

For the Life Science operating segment, the sales decrease for the first six months of fiscal 2007 was primarily attributable to lower sales activity from contract research and development and contract manufacturing services. Sales to one customer accounted for 19% and 18% of total sales for the Life Science operating segment for the first six months of fiscal 2007 and fiscal 2006, respectively.

For all operating segments combined, international sales were \$18,221,000, or 30% of total sales, for the first six months of fiscal 2007, compared to \$16,399,000, or 31% of total sales, for the first six months of fiscal 2006. Combined domestic exports for the US Diagnostics and Life Science operating segments were \$6,692,000 for the first six months of fiscal 2007, compared to \$6,845,000 for the first six months of fiscal 2006. The remaining international sales were generated by the European Diagnostics operating segment.

***Gross Profit***

Gross profit increased 15% for the first six months of fiscal 2007 compared to the first six months of fiscal 2006.

Gross profit margins were 60% for the both the first six months of fiscal 2007 and 2006.

Meridian's overall operations consist of the sale of diagnostic test kits for various disease states and in alternative test formats, as well as bioresearch reagents, bulk antigens and antibodies, proficiency panels, and contract research and development and contract manufacturing services. Product sales

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mix shifts, in the normal course of business, can cause the consolidated gross profit margin to fluctuate by several points.

***Operating Expenses***

Operating expenses increased 5% for the first six months of fiscal 2007 compared to the first six months of fiscal 2006. The overall increase in operating expenses for the first six months of fiscal 2007 is discussed below.

Research and development expenses increased 29% for the first six months of fiscal 2007 compared to the first six months of fiscal 2006, and as a percentage of sales, were 5% and 4%, respectively for the first six months of fiscal 2007 and 2006. Of this increase, \$634,000 related to the US Diagnostics operating segment and \$44,000 related to the Life Science operating segment. The increase for the US Diagnostics operating segment was primarily attributable to clinical trial and other costs associated with new product development.

Selling and marketing expenses decreased \$12,000 for the first six months of fiscal 2007 compared to the first six months of fiscal 2006, and as a percentage of sales, decreased from 16% in fiscal 2006, to 14% in fiscal 2007. Of this decrease, \$292,000 related to the US Diagnostics operating segment and \$86,000 related to the Life Science operating segment, partially offset by an increase of \$366,000 for the European Diagnostics operating segment. The decrease for the US Diagnostics operating segment was primarily attributable to lower costs for sales promotions, advertising costs and distributor incentives. The increase for the European Diagnostics operating segment was primarily due to currency fluctuations and increased sales bonus expense.

General and administrative expenses increased 4% for the first six months of fiscal 2007 compared to the first six months of fiscal 2006, and as a percentage of sales, decreased from 15% for the first six months of fiscal 2006, to 14% for the first six months of fiscal 2007. Of this increase, \$300,000 related to the US Diagnostics operating segment and \$58,000 related to the Life Science operating segment, partially offset by a decrease of \$64,000 related to the European Diagnostics operating segment. The increase for the US Diagnostics operating segment was primarily attributable to higher costs for stock-based compensation.

***Operating Income***

Operating income increased 28% for the first six months of fiscal 2007, as a result of the factors discussed above.

***Other Income and Expense***

Interest income was \$752,000 for the first six months of fiscal 2007 compared to \$487,000 for the first six months of fiscal 2006. This increase was caused by higher investment yields and investment balances in fiscal 2007 to date.

***Income Taxes***

The effective rate for income taxes was 35% and 36% for the first six months of fiscal 2007 and 2006, respectively. The decrease in the effective tax rate was primarily attributable to the favorable



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effects of tax-exempt interest and the federal research and development tax credit that was renewed and extended by Congress and the President in December 2006.

**Liquidity and Capital Resources:**

***Comparative Cash Flow Analysis***

Meridian's operating cash flow and financing requirements are determined by analyses of operating and capital spending budgets and consideration of acquisition plans. Meridian has historically maintained line of credit availability to respond quickly to acquisition opportunities. This line of credit was supplemented by the proceeds from the September 2005 common share offering, which are invested in tax-exempt, cash-equivalent securities.

Net cash provided by operating activities was \$8,296,000 for the first six months of fiscal 2007 compared to \$6,480,000 for the first six months of fiscal 2006. This increase was driven by increases in net income levels.

Net cash provided by investing activities increased to \$1,084,000 for the first six months of fiscal 2007 compared to net cash used in investing activities of \$3,514,000 for the first six months of fiscal 2006. This increase was primarily attributable to sales of short-term investments and decreased investment in capital assets. However, the Life Science operating segment completed the purchase of land and a building in Saco, Maine in February 2007 at a cost of approximately \$900,000. The building was previously leased by Meridian's BIODESIGN subsidiary. This purchase allows for future expansion and growth.

Net cash used for financing activities was \$5,857,000 for the first six months of 2007, compared to \$4,736,000 for the first six months of fiscal 2006. Proceeds and tax benefits from the exercise of stock options were \$1,392,000 for the first six months of fiscal 2007, compared to \$825,000 for the first six months of fiscal 2006. Dividends paid to shareholders were \$7,220,000 for the first six months of 2007, compared to \$5,089,000 for the first six months of 2006, reflecting increased numbers of shares outstanding related to stock option exercises and bond conversions, as well as higher dividends declared per share.

Net cash flows from operating activities are anticipated to fund working capital requirements and dividends during the next twelve months.

***Capital Resources***

Meridian has a \$25,000,000 credit facility with a commercial bank. This facility includes \$2,500,000 of term debt and capital lease capacity and a \$22,500,000 revolving line of credit that expires in September 2007. As of April 30, 2007, there were no borrowings outstanding under of this facility. Meridian expects to renew this facility during the third quarter of fiscal 2007.

As of September 30, 2006, Meridian had outstanding a total of \$1,803,000 principal amount of convertible subordinated debentures due September 1, 2013, bearing interest at 5%. These debentures were convertible at the option of the holder into common shares at a price of \$9.67. Holders converted \$317,000 principal amount of debentures into 32,778 common shares during the first quarter of fiscal 2007.

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On January 30, 2007, Meridian called for redemption \$1,486,000 principal of outstanding 5% convertible debentures, which was completed on March 1, 2007. Unconverted debentures of \$28,000 were redeemed at a 1% premium, as per the terms of the debentures. The cash cost of the redemption was \$28,000. The fiscal 2007 conversion and redemption transactions are expected to reduce annual interest expense by \$90,000.

The Viral Antigens acquisition, completed in fiscal 2000, provided for additional purchase consideration, contingent upon Viral Antigens future earnings through September 30, 2006. Earnout consideration was payable each year, following the period earned. Final earnout consideration in the amount of \$853,000 relating to fiscal 2006 was paid from operating cash flows during the second quarter of fiscal 2007.

The OEM Concepts acquisition, completed in fiscal 2005, provides for additional purchase consideration up to a maximum remaining amount of \$1,971,000, contingent upon future calendar-year sales and gross profit of OEM Concepts products through December 31, 2008. Earnout consideration is payable each year, following the period earned. Earnout consideration in the amount of \$118,000 related to calendar 2006 was paid from operating cash flows during the second quarter of fiscal 2007.

Meridian's capital expenditures are estimated to be \$4,000,000 for fiscal 2007 and may be funded with operating cash flows, availability under the \$25,000,000 credit facility, or cash equivalent investments. Capital expenditures relate to manufacturing and other equipment of a normal and recurring nature.

Meridian does not utilize any special-purpose financing vehicles or have any undisclosed off balance sheet arrangements. Similarly, the Company holds no fair-value contracts for which a lack of marketplace quotations would necessitate the use of fair value techniques.

**ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK**

There have been no material changes in the Company's exposure to market risk since September 30, 2006. Additional information can be found in Note 6, Hedging Transactions, which appears on pages 57-58 of the Annual Report on Form 10-K for the fiscal year ended September 30, 2006.

**ITEM 4. CONTROLS AND PROCEDURES**

As of March 31, 2007, an evaluation was completed under the supervision and with the participation of Meridian's management, including Meridian's Chief Executive Officer and Chief Financial Officer, of the effectiveness of the design and operation of Meridian's disclosure controls and procedures pursuant to Rule 13a-15(b) and 15d-15(b) promulgated under the Securities Exchange Act of 1934, as amended. Based on that evaluation, Meridian's management, including the CEO and CFO, concluded that Meridian's disclosure controls and procedures were effective as of March 31, 2007. There have been no changes in Meridian's internal control over financial reporting identified in connection with the evaluation of internal control that occurred during the second fiscal quarter that has materially affected, or is reasonably likely to materially affect, Meridian's internal control over financial reporting, or changes in other factors that could materially

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affect internal control subsequent to March 31, 2007.

**PART II. OTHER INFORMATION**

**ITEM 1A. RISK FACTORS**

There have been no material changes from risk factors as previously disclosed in the registrant's Form 10-K for the fiscal year ended September 30, 2006 in response to Item 1A to Part I of Form 10-K.

**ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS**

Meridian's Annual Meeting of Shareholders was held on January 18, 2007. Each of the following matters was voted upon and approved by Meridian's shareholders as indicated below:

(1) Election of the following six directors:

James A. Buzard, 22,413,979 votes for, zero votes withheld, and 595,238 abstentions.

John A. Kraeutler, 16,698,988 votes for, zero votes withheld, and 6,310,229 abstentions.

Gary P. Kreider, 14,572,778 votes for, zero votes withheld, and 8,436,439 abstentions.

William J. Motto, 17,366,760 votes for, zero votes withheld, and 5,642,457 abstentions.

David C. Phillips, 22,495,727 votes for, zero votes withheld, and 513,490 abstentions.

Robert J. Ready, 21,475,575 votes for, zero votes withheld, and 1,533,642 abstentions.

(2) Approval of the Meridian Bioscience, Inc. Officers' Performance Compensation Plan and annual net earnings as the factor used to determine the amount of cash bonus payments to be awarded under the business achievement levels under the Plan: 22,577,984 votes for, 360,450 votes against, and 70,782 abstentions.

(3) Ratification of appointment of Grant Thornton LLP as Meridian's independent public accountants for fiscal year 2007: 22,972,607 votes for, 14,985 votes against, and 21,625 abstentions.

**ITEM 6. EXHIBITS**

31.1 Certification of Principal Executive Officer Pursuant to Securities Exchange Act Rule 13a-14(a)/15d-14(a)

31.2 Certification of Principal Financial Officer Pursuant to Securities Exchange Act Rule 13a-14(a)/15d-14(a)

32 Certification of Chief Executive Officer and Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

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Signature:

Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned there-unto duly authorized.

**MERIDIAN BIOSCIENCE, INC.**

Date: May 2, 2007

/S/ Melissa Lueke

Melissa Lueke  
Vice President and Chief Financial  
Officer

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