

NEOGEN CORP  
Form 10-Q  
September 29, 2017  
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**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 August 31, 2017.**

**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**  
**(State or other jurisdiction of**  
**incorporation or organization)**

**38-2367843**  
**(IRS Employer**  
**Identification Number)**

**620 Lesher 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 and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted 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 and post 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 (Do not check if a smaller reporting company)

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

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As of August 31, 2017 there were 38,233,260 shares of Common Stock outstanding.

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**NEOGEN CORPORATION AND SUBSIDIARIES**

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

	<b>August 31, 2017 (Unaudited)</b>	<b>May 31, 2017 (Audited)</b>
<b><u>Assets</u></b>		
Current Assets		
Cash and cash equivalents	\$ 58,456	\$ 77,567
Marketable securities (at fair value, which approximates cost)	101,534	66,068
Accounts receivable, less allowance of \$1,900 and \$2,000	66,341	68,576
Inventories	73,413	73,144
Prepaid expenses and other current assets	11,190	7,606
Total Current Assets	310,934	292,961
Net Property and Equipment	63,285	61,748
Other Assets		
Goodwill	105,073	104,759
Other non-amortizable intangible assets	14,346	14,323
Amortizable customer-based intangibles, net of accumulated amortization of \$21,931 and \$20,846 at August 31, 2017 and May 31, 2017	35,011	35,983
Other non-current assets, net of accumulated amortization of \$10,167 and \$9,931 at August 31, 2017 and May 31, 2017	18,685	18,635
Total Assets	\$ 547,334	\$ 528,409
<b><u>Liabilities and Equity</u></b>		
Current Liabilities		
Accounts payable	\$ 16,665	\$ 16,244
Accrued compensation	5,079	5,002
Income taxes	6,032	936
Other accruals	10,546	13,820
Total Current Liabilities	38,322	36,002
Deferred Income Taxes	16,917	17,048
Other Non-Current Liabilities	4,842	3,602

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Total Liabilities		60,081	56,652
Commitments and Contingencies (note 9)			
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, 38,233,260 and 38,199,367 shares issued and outstanding at August 31, 2017 and May 31, 2017, respectively		6,117	6,112
Additional paid-in capital		180,131	176,779
Accumulated other comprehensive loss		(7,000)	(7,203)
Retained earnings		307,773	295,926
Total Neogen Corporation Stockholders Equity		487,021	471,614
Non-controlling interest		232	143
Total Equity		487,253	471,757
Total Liabilities and Equity		\$ 547,334	\$ 528,409

See notes to interim consolidated financial statements.

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**Neogen Corporation and Subsidiaries**  
**Consolidated Statements of Income (unaudited)**

*(in thousands, except per share amounts)*

	<b>Three Months Ended August 31,</b>	
	<b>2017</b>	<b>2016</b>
Revenues		
Product revenues	\$ 80,567	\$ 72,245
Service revenues	14,689	11,400
Total Revenues	95,256	83,645
Cost of Revenues		
Cost of product revenues	41,084	35,535
Cost of service revenues	8,301	7,631
Total Cost of Revenues	49,385	43,166
Gross Margin	45,871	40,479
Operating Expenses		
Sales and marketing	17,024	14,797
General and administrative	9,325	8,262
Research and development	3,098	2,678
Total Operating Expenses	29,447	25,737
Operating Income	16,424	14,742
Other Income		
Interest income	369	123
Other income	443	369
Total Other Income	812	492
Income Before Taxes	17,236	15,234
Provision for Income Taxes	5,300	5,300
Net Income	11,936	9,934
Net (Income) Attributable to Non-Controlling Interest	(22)	(53)
Net Income Attributable to Neogen	\$ 11,914	\$ 9,881
Net Income Attributable to Neogen Per Share		
Basic	\$ 0.31	\$ 0.26

Diluted	\$ 0.31	\$ 0.26
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See notes to interim consolidated financial statements.



**Table of Contents****Neogen Corporation and Subsidiaries****Consolidated Statements of Comprehensive Income (unaudited)***(in thousands)*

	<b>Three Months Ended August 31,</b>	
	<b>2017</b>	<b>2016</b>
Net income	\$ 11,936	\$ 9,934
Other comprehensive income (loss), net of tax: currency translation adjustments	203	(2,578)
<b>Comprehensive income</b>	<b>12,139</b>	<b>7,356</b>
Comprehensive (income) attributable to non-controlling interest	(22)	(53)
<b>Comprehensive income attributable to Neogen Corporation</b>	<b>\$ 12,117</b>	<b>\$ 7,303</b>

See notes to interim consolidated financial statements.

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

*(in thousands)*

	Common Stock		Additional Paid-in Capital	Accumulated Other Comprehensive Income (Loss)	Retained Earnings	Non- controlling Interest	Total
	Shares	Amount	Capital	(Loss)	Earnings	Interest	Total
Balance, May 31, 2017	38,199	\$ 6,112	\$ 176,779	\$ (7,203)	\$ 295,926	\$ 143	471,757
Issuance of shares under share-based compensation plan	26	4	2,868				2,872
Issuance of shares under employee stock purchase plan	8	1	484				485
Conversion of minority interest purchase to retained earnings					(67)	67	
Net income for the three months ended August 31, 2017					11,914	22	11,936
Other comprehensive income				203			203
Balance August 31, 2017	38,233	\$ 6,117	\$ 180,131	\$ (7,000)	\$ 307,773	\$ 232	\$ 487,253

See notes to interim consolidated financial statements.

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

*(in thousands)*

	<b>Three Months Ended August 31,</b>	
	<b>2017</b>	<b>2016</b>
<b>Cash Flows From Operating Activities</b>		
Net Income	\$ 11,936	\$ 9,934
Adjustments to reconcile net income to net cash provided from operating activities:		
Depreciation and amortization	3,993	3,476
Share-based compensation	1,401	1,516
Excess income tax benefit from the exercise of stock options (see note 5)		(728)
Change in operating assets and liabilities:		
Accounts receivable	2,227	7,684
Inventories	(276)	(5,910)
Prepaid expenses and other current assets	(3,590)	42
Accounts payable, accruals and other changes	2,980	4,262
<b>Net Cash From Operating Activities</b>	<b>18,671</b>	<b>20,276</b>
<b>Cash Flows Used In Investing Activities</b>		
Purchases of property, equipment and other non-current intangible assets	(4,415)	(3,446)
Proceeds from the sale of marketable securities	44,502	28,116
Purchases of marketable securities	(79,968)	(28,616)
<b>Net Cash Used In Investing Activities</b>	<b>(39,881)</b>	<b>(3,946)</b>
<b>Cash Flows From Financing Activities</b>		
Exercise of stock options	1,956	4,053
Excess income tax benefit from the exercise of stock options (see note 5)		728
<b>Net Cash From Financing Activities</b>	<b>1,956</b>	<b>4,781</b>
Effect of Exchange Rate on Cash	143	(181)
<b>Net Increase In Cash and Cash Equivalents</b>	<b>(19,111)</b>	<b>20,930</b>
Cash And Cash Equivalents At Beginning Of Period	77,567	55,257
<b>Cash And Cash Equivalents At End Of Period</b>	<b>\$ 58,456</b>	<b>\$ 76,187</b>

See notes to interim consolidated financial statements.

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## NEOGEN CORPORATION AND SUBSIDIARIES

## NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

**1. BASIS OF PRESENTATION**

The accompanying unaudited consolidated financial statements 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. The results of operations for the three month period ended August 31, 2017 are not necessarily indicative of the results to be expected for the fiscal year ending May 31, 2018. For more complete financial information, these consolidated financial statements should be read in conjunction with the May 31, 2017 audited consolidated financial statements and the notes thereto included in the Company's annual report on Form 10-K for the year ended May 31, 2017.

**2. INVENTORIES**

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

	August 31, 2017	May 31, 2017
	<i>(in thousands)</i>	
Raw materials	\$ 34,364	\$ 33,190
Work-in-process	5,185	4,831
Finished and purchased goods	33,864	35,123
	\$ 73,413	\$ 73,144

**3. NET INCOME PER SHARE**

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

	Three Months Ended August 31,	
	2017	2016
	<i>(in thousands, except per share amounts)</i>	
Numerator for basic and diluted net income per share:		
Net income attributable to Neogen	\$ 11,914	\$ 9,881
Denominator for basic net income per share:		
Weighted average shares	38,211	37,615

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Effect of dilutive stock options	465	550
Denominator for diluted net income per share	38,676	38,165
Net income attributable to Neogen per share:		
Basic	\$ 0.31	\$ 0.26
Diluted	\$ 0.31	\$ 0.26

**Table of Contents****4. SEGMENT INFORMATION**

The Company has 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, dehydrated 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.

Neogen's 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 the Company's 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 August 31, 2017</b>				
Product revenues to external customers	\$ 42,282	\$ 38,285	\$	\$ 80,567
Service revenues to external customers	4,452	10,237		14,689
Total revenues to external customers	46,734	48,522		95,256
Operating income (loss)	8,777	8,669	(1,022)	16,424
Total assets	194,857	209,404	143,073	547,334
<b>As of and for the three months ended August 31, 2016</b>				
Product revenues to external customers	\$ 35,693	\$ 36,552	\$	\$ 72,245
Service revenues to external customers	3,464	7,936		11,400
Total revenues to external customers	39,157	44,488		83,645
Operating income (loss)	7,999	7,780	(1,037)	14,742
Total assets	143,990	210,176	114,449	468,615

(1)

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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.

**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 the Company's 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 ten years. A summary of stock option activity during the three months ended August 31, 2017 follows:

	<b>Shares</b>	<b>Weighted-Average Exercise Price</b>
Options outstanding June 1, 2017	2,031,000	\$ 43.84
Granted	75,000	63.95
Exercised	(46,000)	31.66
Forfeited		
Options outstanding August 31, 2017	2,060,000	44.85

During the three month period ended August 31, 2017 and 2016, the Company recorded \$1,401,000 and \$1,516,000, respectively, of compensation expense related to its share-based awards. On June 1, 2017, the Company adopted ASU No. 2016-09, which simplifies the accounting for share-based payments to employees. The guidance requires the recognition of the income tax effects of awards in the income statement when the awards vest or are settled, thus eliminating additional paid-in capital pools. The guidance also allows for a policy election to account for forfeitures as they occur, rather than on an estimated basis, and requires that excess tax benefits be classified as an operating activity on the Statement of Cash Flows. The Company has elected to account for forfeitures as they occur. The adoption of this ASU reduced income tax expense by \$396,000 in the first quarter of fiscal 2018.

The weighted-average fair value per share of stock options granted during fiscal years 2018 and 2017, estimated on the date of grant using the Black-Scholes option pricing model, was \$15.59 and \$15.86, respectively. The fair value of stock options granted was estimated using the following weighted-average assumptions.

	<b>FY2018</b>	<b>FY2017</b>
Risk-free interest rate	1.6%	1.2%
Expected dividend yield	0.0%	0.0%
Expected stock price volatility	27.2%	35.2%
Expected option life	4.0 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. NEW ACCOUNTING PRONOUNCEMENTS**

In May 2014, the FASB issued ASU No. 2014-09 Revenue from Contracts with Customers. 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 is effective for fiscal years, and interim periods within those years, beginning after December 15, 2017. 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. The Company has formed an internal team to implement this ASU and is currently identifying revenue streams and evaluating the potential impact of each stream on its consolidated financial statements. The Company currently expects to adopt using the modified retrospective approach.

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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. Modified retrospective application is permitted with certain practical expedients. Early adoption is permitted. The Company is in the process of evaluating its lessee and lessor arrangements to determine the impact of this amendment on its 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 the Company's facilities.

In March 2016, the FASB issued ASU No. 2016-09 Compensation-Stock Compensation (Topic 718): Improvements to Employee Share-Based Payment Accounting to provide guidance that changes the accounting for certain aspects of share-based payments to employees. The guidance requires the recognition of the income tax effects of awards in the income statement when the awards vest or are settled, thus eliminating additional paid-in capital pools. The guidance also allows for the employer to repurchase more of an employee's shares for tax withholding purposes without triggering liability accounting. In addition, the guidance allows for a policy election to account for forfeitures as they occur rather than on an estimated basis. This ASU is effective for annual periods, including interim periods within those annual periods, beginning after December 15, 2016 with early adoption permitted. The Company adopted this standard effective June 1, 2017; this resulted in a reduction of federal income tax expense of \$396,000 in the first quarter of fiscal 2018. The Company believes that tax benefits related to share-based payments will result in a lower effective tax rate in fiscal 2018 and could increase earnings per share by between one to three cents per quarter for the remainder of the fiscal year.

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 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. The Company does not believe the adoption of this guidance will have an impact on its consolidated financial statements.

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. Early adoption is permitted, including adoption during an interim period. The Company has not yet adopted this update and is currently evaluating the impact of ASU No. 2016-15 on its consolidated financial statements.

**7. 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 December 1, 2016, the Company acquired the stock of Quat-Chem Ltd., a chemical company that manufactures biosecurity products, based in Rochdale, England. Consideration for the purchase was \$21,606,000 in cash and up to \$3,778,000 of contingent consideration, due at the end of each of the first two years, based on an excess net sales formula. The preliminary purchase price allocation included accounts receivable of \$4,684,000, inventory of \$1,243,000, land, property and equipment of \$2,715,000, accounts payable of \$2,197,000, deferred tax liability of \$1,133,000, contingent consideration accrual of \$1,105,000, other current liabilities of \$604,000, non-amortizable intangible assets of \$1,637,000, intangible assets of \$5,682,000 (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. This business continues to operate in its current location and is managed by Neogen Europe, reporting within the Food Safety segment.

On December 27, 2016, the Company acquired the stock of Rogama Industria e Comercio, Ltda., a company that develops and manufactures rodenticides and insecticides, based near Sao Paulo, Brazil. Consideration for the purchase was \$12,423,000 in cash and up to \$2,069,000 of contingent consideration, due at the end of each of the first two years, based on an excess net sales formula. The preliminary purchase price allocation included accounts receivable of \$1,863,000, inventory of \$1,026,000, property and equipment of

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\$1,840,000, current liabilities of \$2,177,000, contingent consideration accrual of \$430,000, non-current deferred tax liability of \$1,307,000, non-amortizable intangible assets of \$591,000, intangible assets of \$3,252,000 (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. This business continues to operate in its current location and is managed by Neogen do Brasil, reporting within the Food Safety segment.

Subsequent to the end of the quarter, on September 1, 2017, the Company acquired the assets of The University of Queensland Animal Genetics Laboratory (AGL), 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 \$2,014,000 in cash. Due to the timing of the transaction, the preliminary purchase price allocation was not complete at the time of filing.

## **8. LONG TERM DEBT**

The Company has a financing agreement with a bank providing for an unsecured revolving line of credit, which was amended on November 30, 2016 to increase the line from \$12,000,000 to \$15,000,000, and extend the maturity from September 1, 2017 to September 30, 2019. There were no advances against the line of credit during fiscal 2017 and there have been none thus far in fiscal 2018; there was no balance outstanding at August 31, 2017. Interest on any borrowings remained at LIBOR plus 100 basis points (rate under the terms of the agreement was 2.28% at August 31, 2017). 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 August 31, 2017.

## **9. 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 \$57,000 per year over the past five years. The Company's estimated liability for these costs was \$916,000 at August 31, 2017 and May 31, 2017, measured on an undiscounted basis over an estimated period of 15 years; \$54,000 of the liability is recorded within current liabilities and the remainder is recorded within other non-current liabilities in the consolidated balance sheet.

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.

## **10. STOCK PURCHASE**

The Company has a stock repurchase program, authorized by the Board of Directors in calendar year 2008, to purchase, subject to market conditions, up to 1,125,000 shares of the Company's common stock. As of August 31, 2017, 1,012,974 shares were available to be repurchased under the program. There were no purchases in fiscal year 2017 and there have been none thus far in fiscal 2018.

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**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 the Company's 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.

**Critical Accounting Policies and Estimates**

The discussion and analysis of the Company's financial condition and results of operations are based on the consolidated financial statements that have been prepared in accordance with accounting principles generally accepted in the United States. 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 disclosure of contingent assets and liabilities. On an ongoing basis, management evaluates the estimates, including, but not limited to, those related to receivable allowances, inventories, 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 were no significant changes to the contractual obligations or contingent liabilities and commitments disclosed in the Company's Annual Report on Form 10-K for the fiscal year ended May 31, 2017.

The Company adopted ASU No. 2016-09 related to share based-compensation on June 1, 2017. There have been no other material changes to the critical accounting policies and estimates disclosed in the Company's Annual Report on Form 10-K for the fiscal year ended May 31, 2017.



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**Table of Contents****Executive Overview**

Revenues for the Company for the first quarter ended August 31, 2017 were \$95.3 million, an increase of 14%, or \$11.6 million, compared to revenues of \$83.6 million in the same period of the prior year. Net income attributable to Neogen for the first quarter of fiscal year 2018 increased 21% to \$11.9 million, or \$0.31 per fully diluted share, compared to \$9.9 million, or \$0.26 per fully diluted share, in the first quarter of fiscal 2017.

Food Safety revenues increased 19% and Animal Safety revenues increased 9%, each compared to the same period in the prior year. The overall organic sales increase for the Company was 9%; organic growth was also 9% for each segment. The acquisitions of Quat-Chem and Rogama, both occurring in December 2016 and reporting through Food Safety, contributed \$4.2 million to the overall revenue growth.

International sales were \$34.5 million, or 36.2% of total sales, in the first quarter of fiscal 2018 compared to \$29.0 million, or 34.7% of total sales, in last year's first quarter. Currency translations had an immaterial impact on comparative consolidated revenues for the quarter, due to the pound, euro, real and peso stabilizing against the dollar. Neogen Europe recorded a revenue increase of 1% in U.S. dollars in the first quarter, with a 19% increase in genomics revenues offset by lower mycotoxin sales, as last year's deoxynivalenol (DON) outbreak in France and Germany did not repeat in the current year. Sales at Lab M, the Company's subsidiary in England, increased 34% as its dehydrated culture media products were integrated into Neogen's global sales and marketing efforts. Neogen Latinoamerica recorded a sales decrease of 2% in U.S. dollars, primarily due to lower sales of agricultural cleaners and disinfectants, the result of the termination of a distribution agreement earlier in the calendar year; revenues for the group's food safety diagnostic products increased 25%. Neogen do Brasil revenues increased 39% in U.S. dollars on increased sales of mycotoxin and drug residue test kits. Neogen China sales increased 12% in U.S. dollars in the first quarter of the current fiscal year compared to the first quarter a year ago, led by sales of the Company's Acumedia and Lab M brands of dehydrated culture media and genomics services.

Service revenue was \$14.7 million in the quarter ended August 31, 2017, an increase of \$3.3 million, or 29%, compared to \$11.4 million in the first quarter of the prior fiscal year. The growth was led by increases in sales to the global cattle and companion animal markets. Sales of genomic testing in the poultry market also increased by approximately 25% as the Company continued to increase testing volumes with a large customer.

Gross margin was 48.2% in the first quarter of fiscal 2018 compared to 48.4% in the same quarter a year ago. This is primarily due to the impact from the two acquisitions in the prior year, Quat-Chem and Rogama, both of which have gross margins that are lower than the historical average for the Company. Excluding these acquisitions, the gross margin in the current year would have been approximately 110 basis points higher.

Total operating expense increased \$3.7 million, or 14%, in the first quarter, consistent with the increase in revenues. Sales and marketing expense increased \$2.2 million, or 15%, primarily due to increases in salaries and commissions and shipping expense. Approximately \$500,000 of this increase is due to the recent acquisitions of Quat-Chem and Rogama. General and administrative expense increased \$1.1 million, or 13%; \$625,000 of this increase is directly attributable to the recent acquisitions and includes amortization expense of acquired intangible assets. Additional increases were for salaries and other compensation related expenses, and depreciation expense primarily from investment in information technology. Research and development expense increased 16% in the first quarter over the same period in the prior year, primarily from increases in personnel related expenses and contracted outside services related to new product development. Operating income was \$16.4 million, or 17.2% of sales, for the quarter, compared to \$14.7 million, or 17.6% of sales, in last year's first quarter.

Other income in the first quarter of fiscal 2018 was \$812,000 compared to other income of \$492,000 in the first quarter of fiscal 2017. Gains on currency exchange totaled \$465,000 in the current quarter compared to currency gains of \$246,000 in the prior year. The Company also recorded \$369,000 of interest income, compared to \$123,000 in the first quarter of the prior year. The Company's effective income tax rate in the first quarter of fiscal 2018 was 30.7% compared to 34.8% in the first quarter of the prior year. The calculation of the tax rate includes a credit of \$396,000 recorded to federal income tax expense related to a new accounting standard regarding share-based compensation, which was adopted by the Company at the beginning of the current fiscal year; previously, excess gains on the exercise of stock options would have been recorded as a credit to shareholders' equity on the balance sheet. Net income attributable to Neogen increased \$2.0 million, or 21%, in the first quarter of 2018.



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

	<b>Three Months ended August 31,</b>			
	<b>2017</b>	<b>2016</b>	<b>Increase/ (Decrease)</b>	<b>%</b>
	<i>(in thousands)</i>			
<b><u>Food Safety</u></b>				
Natural Toxins, Allergens & Drug Residues	\$ 19,163	\$ 17,597	\$ 1,566	9%
Bacterial & General Sanitation	9,119	8,579	540	6%
Dehydrated Culture Media & Other	10,577	9,538	1,039	11%
Rodenticides, Insecticides & Disinfectants	4,690	996	3,694	371%
Genomics Services	3,185	2,446	739	30%
	<b>\$ 46,734</b>	<b>\$ 39,156</b>	<b>\$ 7,578</b>	<b>19%</b>
<b><u>Animal Safety</u></b>				
Life Sciences	\$ 2,427	\$ 2,255	\$ 172	8%
Veterinary Instruments & Disposables	10,487	9,632	855	9%
Animal Care & Other	7,780	6,984	796	11%
Rodenticides, Insecticides & Disinfectants	17,591	17,681	(90)	(1)%
Genomics Services	10,237	7,937	2,300	29%
	<b>\$ 48,522</b>	<b>\$ 44,489</b>	<b>\$ 4,033</b>	<b>9%</b>
<b>Total Revenues</b>	<b>\$ 95,256</b>	<b>\$ 83,645</b>	<b>\$ 11,611</b>	<b>14%</b>

The Company's Food Safety segment revenues were \$46.7 million in the quarter ended August 31, 2017, an increase of 19% compared to the same period in the prior year. Organic growth for the segment was 9%, with the acquisitions of Quat-Chem and Rogama, both occurring in December 2016, contributing the remainder of the growth. Natural Toxins, Allergens & Drug Residues sales increased 9% in the first quarter over the same period in the prior year. Within this category, sales of allergen test kits rose 17%, with tests to detect gliadin (gluten), milk, soy, peanut and treenuts contributing the majority of the growth. The market for these kits continues to expand due to increased consumer awareness regarding allergenic contamination of food and its adverse impact on human health. Sales of test kits to detect the presence of natural toxins in grain crops increased 9%, primarily the result of a 23% increase in aflatoxin test kits, due to moderate outbreaks in the midwest U.S. and Brazilian corn crops. Drug residue test kits, primarily used to detect the presence of antibiotics in raw milk, rose by 1%, as new products began to gain traction in the market. This product group had declined 4% in fiscal 2017. Bacterial & General Sanitation revenues increased 6% in the first quarter of fiscal 2018. Within this product category, the Company's AccuPoint sanitation monitoring product line increased 15%, on strength in both readers and samplers, while sales of test kits to detect pathogens increased 6%, led by strong growth in the ANSR product line. Revenues for the company's Soleris and BioLumix product lines, used to detect spoilage organisms in processed foods, were flat; in the prior year first quarter, equipment sales reported in this category had increased 55%.

Dehydrated Culture Media & Other revenues increased 11% over the prior year, as worldwide Lab M revenues grew 15%; the Company's Acumedia line of dehydrated culture media rose 12% in the first quarter. Rodenticides, Insecticides & Disinfectants recorded revenues of \$4.7 million for the quarter, compared to \$1.0 million in last year's first quarter. The increase was the result of \$4.2 million in revenues provided by the Rogama and Quat-Chem

acquisitions, which were completed in the second half of the 2017 fiscal year, partially offset by the termination of a distribution agreement in last fiscal year's third quarter, which resulted in a \$430,000 decline in cleaner and disinfectant revenues in Latin America. Genomics Services revenue recorded in the Food Safety segment increased 29% for the comparative quarter, due primarily to growth in Europe, and to a lesser extent, higher volumes in Brazil.

Sales for the Company's Animal Safety segment were \$48.5 million, an increase of 9% in the first quarter compared to the same period in the prior year; all of that growth was organic. Sales of Life Sciences products increased 8%, primarily the result of increased volume from commercial labs for forensic kits to meet requirements for drug testing of commercial truck drivers in Brazil. Veterinary Instruments & Disposables sales increased 9% in the first quarter of fiscal 2018, primarily the result of strength in detectable needles and syringes. Additionally, animal marking products rose 27% for the period; these products had declined throughout fiscal 2017, due to inventory destocking at a number of the Company's large customers.

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Sales in the Animal Care & Other product lines increased 11% for the comparative quarters; last year's results included sales credits totaling \$1.1 million as the Company removed its popular canine thyroid replacement product from its distribution channels after the FDA approved a new drug application for a competitive product. Rodenticides, Insecticides & Disinfectants revenues decreased 1% in the first quarter, as the termination of a distribution agreement with a manufacturer of cleaners and disinfectants resulted in lost sales of \$860,000. These losses were offset by an 11% increase in sales of insecticide products and increased sales of the Company's own line of manufactured cleaners and disinfectants. Rodenticides grew 3%, as incremental revenues from penetration in the retail agricultural market were offset by a decline in toll manufacturing sales, due to lower demand.

Genomics Services revenue reported within the Animal Safety segment increased 29% in the first quarter, compared to the same period last year. Growth was strong in the bovine market, and in particular the commercial dairy market, where revenues increased more than 200% over the prior year, as the Company continues to devote significant resources to capture this market. Additionally, the Company continued to grow in the poultry and sheep markets, up 38% and 179%, respectively. New products introduced in the companion animal market drove a 48% increase in sales to that market. Porcine service revenues declined 2% compared to last year's first quarter, primarily due to competitive pressure in that market.

## **Financial Condition and Liquidity**

The overall cash, cash equivalents and marketable securities position of the Company was \$160.0 million at August 31, 2017, compared to \$143.6 million at May 31, 2017. Approximately \$19.2 million was generated from operations during the first three months of fiscal 2018. Net cash proceeds of \$2.1 million were realized from the exercise of stock options and issuance of shares under the Company's Employee Stock Purchase Plan during the first three months of fiscal 2018. The Company spent \$4.5 million for property, equipment and other non-current assets first three months of fiscal 2018.

Accounts receivable balances were \$66.3 million at August 31, 2017, a decline of \$2.3 million, or 3%, compared to \$68.6 million at May 31, 2017. Days sales outstanding, a measurement of the time it takes to collect receivables, were 59 days at August 31, 2017, compared to 60 days at May 31, 2017. All customer accounts are actively managed and no losses in excess of amounts reserved are currently expected.

Net inventory balances were \$73.4 million at August 31, 2017, essentially flat compared to a May 31, 2017 balance of \$73.1 million. The Company actively monitors its inventory levels, and balances the need for adequate levels of product availability to minimize backorders with a desire to improve inventory turnover and efficiency levels. Formal programs have been instituted in fiscal 2018 to improve inventory turnover.

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 the Company's existing cash and marketable securities balances at August 31, 2017, along with available borrowings under its 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 the Company's cash requirements to commercialize products currently under development or its plans to acquire other organizations, technologies or products that fit within the Company's mission statement. Accordingly, the Company may choose to issue equity securities or enter into other financing arrangements for a portion of its future financing needs.



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**PART I FINANCIAL INFORMATION**

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

The Company has interest rate and foreign exchange rate risk exposure but no long-term fixed rate investments or borrowings. The Company's primary interest rate risk is due to potential fluctuations of interest rates for variable rate borrowings (no long-term borrowings at August 31, 2017) and short-term investments.

Foreign exchange risk exposure arises because the Company markets and sells its 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. The Company's 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, 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, and Canada, where the functional currency is the British pound sterling, Brazilian real, Mexican peso, Chinese yuan, Indian rupee and Canadian dollar, respectively, and also 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 the Company's disclosure controls and procedures as of August 31, 2017 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 Controls over Financial Reporting**

No changes in our control over financial reporting were identified as having occurred during the quarter ended August 31, 2017 that have materially affected, or are reasonably likely to materially affect, internal control over financial reporting.

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The Company is subject to certain 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 its future results of operations or financial position.

**Item 6. Exhibits**

## (a) Exhibit Index

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.**

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**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.

Dated: September 29, 2017

NEOGEN CORPORATION  
*(Registrant)*

Dated: September 29, 2017

/s/ James L. Herbert  
James L. Herbert  
Executive Chairman  
(Principal Executive Officer)

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