

MERIDIAN BIOSCIENCE INC

Form 10-Q

August 09, 2006

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**SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549  
Form 10-Q**

**QUARTERLY REPORT PURSUANT TO SECTION 13 or 15(d) OF THE SECURITIES  
EXCHANGE ACT OF 1934**  
**For the Quarterly Period Ended June 30, 2006**

**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 0-14902**  
**MERIDIAN BIOSCIENCE, INC.**

Incorporated under the laws of Ohio

31-0888197

(I.R.S. Employer Identification No.)

3471 River Hills Drive  
Cincinnati, Ohio 45244  
(513) 271-3700

Indicate by a 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 such reports), and (2) has been subject to such filing requirements for the past 90 days.

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

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes  No

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date.

Class	Outstanding July 31, 2006
Common Stock, no par value	26,121,179

**MERIDIAN BIOSCIENCE, INC. AND SUBSIDIARIES  
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*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, seeks, may, will, expects, intends, believes, should and similar expressions or the negative versions thereof and which also may be identified by their context. Such statements 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, 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 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.*

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

	<b>Three Months Ended June 30,</b>		<b>Nine Months Ended June 30,</b>	
	<b>2006</b>	<b>2005</b>	<b>2006</b>	<b>2005</b>
NET SALES	\$ 26,583	\$ 25,421	\$ 79,763	\$ 67,949
COST OF SALES	10,228	9,735	31,678	27,673
Gross profit	16,355	15,686	48,085	40,276
<b>OPERATING EXPENSES:</b>				
Research and development	1,278	1,190	3,633	2,884
Sales and marketing	3,955	3,647	12,226	11,019
General and administrative	4,229	5,141	12,186	12,000
Total operating expenses	9,462	9,978	28,045	25,903
Operating income	6,893	5,708	20,040	14,373
<b>OTHER INCOME (EXPENSE):</b>				
Interest income	290	2	777	16
Interest expense	(29)	(176)	(96)	(691)
Other, net	155	(19)	126	130
Total other income (expense)	416	(193)	807	(545)
Earnings before income taxes	7,309	5,515	20,847	13,828
<b>INCOME TAX PROVISION</b>	2,447	2,017	7,300	5,024
<b>NET EARNINGS</b>	<b>\$ 4,862</b>	<b>\$ 3,498</b>	<b>\$ 13,547</b>	<b>\$ 8,804</b>
<b>BASIC EARNINGS PER COMMON SHARE</b>	<b>\$ 0.19</b>	<b>\$ 0.15</b>	<b>\$ 0.52</b>	<b>\$ 0.38</b>
<b>DILUTED EARNINGS PER COMMON SHARE</b>	<b>\$ 0.18</b>	<b>\$ 0.14</b>	<b>\$ 0.51</b>	<b>\$ 0.37</b>
<b>AVERAGE NUMBER OF COMMON SHARES OUTSTANDING BASIC</b>	<b>26,097</b>	<b>23,652</b>	<b>26,070</b>	<b>23,217</b>

DILUTIVE COMMON STOCK OPTIONS	691	650	698	675
AVERAGE NUMBER OF COMMON SHARES OUTSTANDING DILUTED	26,788	24,302	26,768	23,892
ANTI-DILUTIVE SECURITIES:				
Common stock options	4		10	2
Shares from convertible debentures	189	497	189	497
DIVIDENDS DECLARED PER COMMON SHARE	\$ 0.115	\$ 0.08	\$ 0.31	\$ 0.23

All historical share and per share data has been adjusted for the September 2, 2005 three-for-two stock split. 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>Nine Months Ended June 30,</b>	<b>2006</b>	<b>2005</b>
<b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>		
Net earnings	\$ 13,547	\$ 8,804
Non-cash items:		
Depreciation of property, plant and equipment	1,997	1,941
Amortization of intangible assets and deferred costs	1,307	1,179
Stock based compensation	800	174
Deferred income taxes	915	(410)
Loss on disposition of fixed assets	39	
Change in accounts receivable, inventory, and prepaid expenses	(2,257)	(535)
Change in accounts payable, accrued expenses, and income taxes payable	(1,945)	1,394
Other	43	(111)
Net cash provided by operating activities	14,446	12,436
<b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>		
Acquisitions of property, plant and equipment	(2,570)	(2,726)
Proceeds from sales of property, plant and equipment	42	
Acquisition earnout payments	(1,494)	(678)
Purchases of short-term investments	(3,000)	
Proceeds from sales of short-term investments	2,000	
Acquisition of customer list	(60)	
Acquisition of OEM Concepts, Inc.		(6,391)
Net cash used for investing activities	(5,082)	(9,795)
<b>CASH FLOWS FROM FINANCING ACTIVITIES:</b>		
Net activity on revolving credit facility		4,267
Repayment of debt obligations	(790)	(2,277)
Dividends paid	(8,091)	(5,270)
Exercise of stock options	1,168	2,748
Other		(11)
Net cash used for financing activities	(7,713)	(543)
Effect of Exchange Rate Changes on Cash and Equivalents	(8)	(53)
Net Increase in Cash and Equivalents	1,643	2,045

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Cash and Equivalents at Beginning of Period	33,085	1,983
Cash and Equivalents at End of Period	\$34,728	\$ 4,028

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)**

**ASSETS**

	<b>June 30, 2006</b>	<b>September 30, 2005</b>
<b>CURRENT ASSETS:</b>		
Cash and equivalents	\$ 34,728	\$ 33,085
Short-term investments	1,000	
Accounts receivable, less allowances of \$439 and \$360 for doubtful accounts	18,409	17,366
Inventories	18,024	16,785
Prepaid expenses and other current assets	2,058	1,666
Deferred income taxes	808	1,258
Total current assets	75,027	70,160
<b>PROPERTY, PLANT AND EQUIPMENT:</b>		
Land	699	693
Buildings and improvements	15,575	15,510
Machinery, equipment and furniture	22,294	21,053
Construction in progress	1,336	433
Subtotal	39,904	37,689
Less-accumulated depreciation and amortization	21,928	20,229
Net property, plant and equipment	17,976	17,460
<b>OTHER ASSETS:</b>		
Goodwill	8,960	8,779
Other intangible assets, net	12,015	13,249
Other assets	858	921
Total other assets	21,833	22,949
<b>TOTAL ASSETS</b>	<b>\$ 114,836</b>	<b>\$ 110,569</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)**  
**LIABILITIES AND SHAREHOLDERS' EQUITY**

	<b>June 30, 2006</b>	<b>September 30, 2005</b>
<b>CURRENT LIABILITIES:</b>		
Current portion of long-term debt	\$	\$ 556
Accounts payable	2,699	2,949
Accrued payroll costs	5,969	7,707
Purchase business combination liabilities		1,313
Other accrued expenses	4,326	3,993
Income taxes payable	3,642	3,273
Total current liabilities	16,636	19,791
<b>LONG-TERM DEBT:</b>		
Bank debt		233
Convertible subordinated debentures	1,823	2,451
DEFERRED INCOME TAXES	4,237	4,326
<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, 26,106,312 and 25,940,080 shares issued, respectively		
Treasury stock, at cost, 0 and 12,450 shares, respectively		(32)
Additional paid-in capital	74,152	71,568
Retained earnings	18,143	12,687
Accumulated other comprehensive loss	(155)	(455)
Total shareholders' equity	92,140	83,768
<b>TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY</b>	<b>\$ 114,836</b>	<b>\$ 110,569</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 Issued	Shares Held in Treasury	Treasury Stock	Additional Paid-in Capital	Retained Earnings	Accumulated Other Comprehensive Income		Total Shareholders' Equity
						(Loss)	(Loss)	
<b>Balance at September 30, 2005</b>	25,940	(12)	\$ (32)	\$ 71,568	\$ 12,687	\$ (455)	\$	\$ 83,768
Dividends paid					(8,091)			(8,091)
Exercise of stock options, net of tax	114			1,225				1,225
Stock based compensation				800				800
Bond conversion	64			591				591
Treasury shares retired	(12)	12	32	(32)				
Comprehensive income:								
Net income					13,547			13,547
Foreign currency translation adjustment						328	328	328
Change in fair value of derivatives						(28)	(28)	(28)
Comprehensive income							\$ 13,847	
<b>Balance at June 30, 2006</b>	26,106		\$	\$ 74,152	\$ 18,143	\$ (155)		\$ 92,140

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, although 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, 2005.

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 multiple-deliverable arrangements that include process development work followed by larger-scale manufacturing (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*. 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. For fixed fee arrangements, revenue is recognized upon completion and

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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. Comprehensive income for the interim periods ended June 30 was as follows (in thousands):

	<b>Three Months Ended June 30,</b>		<b>Nine Months Ended June 30,</b>	
	<b>2006</b>	<b>2005</b>	<b>2006</b>	<b>2005</b>
Net income	\$4,862	\$3,498	\$13,547	\$8,804
Foreign currency translation	215	(433)	328	(186)
Cash flow hedges	(28)		(28)	
Comprehensive income	\$5,049	\$3,065	\$13,847	\$8,618

**(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.

**(d) Stock-based Compensation**

Meridian accounts for stock-based compensation pursuant to SFAS No. 123R, *Share-Based Payment*, which was adopted as of July 1, 2005. SFAS No. 123R requires recognition of compensation expense for all share-based awards made to employees, based upon the fair value of the share-based award on the date of the grant. Meridian elected to adopt the provisions of SFAS No. 123R, utilizing the modified prospective method, which requires compensation expense be measured and recognized based on grant-date fair value for stock option awards granted after July 1, 2005 and portions of stock options awards granted prior to July 1, 2005, but not vested as of July 1, 2005.

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Prior to July 1, 2005, Meridian accounted for its stock based compensation plans pursuant to the intrinsic value method in APB No. 25. Had compensation cost for these plans been determined using the fair value method provided in SFAS No. 123R, Meridian's net earnings for the third quarter of fiscal 2005 and the first nine months of fiscal 2005 would have been \$3,417,000 and \$8,593,000, respectively, compared to reported amounts of \$3,498,000 and \$8,804,000, respectively. Basic earnings per share for the third quarter of fiscal 2005 and the first nine months of fiscal 2005 would have been \$0.14 and \$0.37, respectively, compared to reported amounts of \$0.15 and \$0.38, respectively. Diluted earnings per share for the third quarter of fiscal 2005 and the first nine months of fiscal 2005 would have been \$0.14 and \$0.36, respectively, compared to reported amounts of \$0.14 and \$0.37, respectively.

***(e) Cash equivalents and short-term investments***

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) Derivative financial instruments***

Meridian accounts for most derivative financial instruments 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.

***(g) Recently Issued Accounting Pronouncements***

During July 2006, the Financial Accounting Standards Board issued Interpretation 48, Accounting for Uncertainty in Income Taxes: An Interpretation of FASB Statement No. 109. Interpretation 48 establishes criteria that an individual tax position would have to meet for some or all of the benefit of that position to be recognized in an entity's financial statements. An entity would recognize the financial statement benefit of a tax position if it determines that it is *more likely than not* that the position will be sustained upon examination. *More likely than not* means a likelihood of more than 50%. Meridian will be required to adopt Interpretation 48 in fiscal 2008. At the present time, Meridian believes that adoption of Interpretation 48 will not have a material effect on its results of operations, financial condition or cash flows.

***(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):

	June 30, 2006	September 30, 2005
Raw materials	\$ 4,131	\$ 4,059
Work-in-process	6,217	4,888
Finished goods	7,676	7,838
	\$ 18,024	\$ 16,785

**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 diagnostics 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 diagnostics 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 consists of the Viral Antigens, BIODESIGN, and OEM Concepts businesses, including the contract 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 June 30, 2006 and 2005 is as follows (in thousands):

	US Diagnostics	European Diagnostics	Life Science	Eliminations <sup>(1)</sup>	Total
<b>Three Months 2006</b>					
<b>Net sales</b>					
<b>Third-party</b>	\$ 15,533	\$ 5,287	\$ 5,763	\$	\$ 26,583
Inter-segment	1,785		141	(1,926)	
Operating income	5,240	1,021	686	(54)	6,893
Total assets (June 30, 2006)	102,785	13,567	40,467	(41,983)	114,836
<b>Three Months 2005</b>					
<b>Net sales</b>					
<b>Third-party</b>	\$ 13,646	\$ 4,880	\$ 6,895	\$	\$ 25,421
Inter-segment	1,826		222	(2,048)	
Operating income	3,296	835	1,744	(167)	5,708
Total assets (September 30, 2005)	99,878	11,552	39,382	(40,243)	110,569
<b>Nine Months 2006</b>					
<b>Net sales</b>					
<b>Third-party</b>	\$ 48,539	\$ 14,841	\$ 16,383	\$	\$ 79,763
Inter-segment	5,412		563	(5,975)	
Operating income	15,058	2,560	2,491	(69)	20,040
<b>Nine Months 2005</b>					
<b>Net sales</b>					
<b>Third-party</b>	\$ 40,035	\$ 13,805	\$ 14,109	\$	\$ 67,949
Inter-segment	5,227		567	(5,794)	
Operating income	9,949	1,985	2,548	(109)	14,373

(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 \$1,612,000 and \$7,348,000, respectively, at June 30, 2006, and \$1,612,000 and \$7,167,000, respectively, at September 30, 2005.

**5. Intangible Assets:**

A summary of Meridian's acquired intangible assets subject to amortization, as of June 30, 2006 and September 30, 2005 is as follows (in thousands):

June 30, 2006		September 30, 2005	
Gross Carrying Value	Accumulated Amortization	Gross Carrying Value	Accumulated Amortization

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Core products and cell lines	\$ 4,698	\$ 1,951	\$ 4,698	\$ 1,733
Manufacturing technologies	5,907	3,641	5,907	3,373
Trademarks, licenses and patents	1,941	1,529	1,941	1,450
Customer lists and supply agreements	11,459	4,869	11,396	4,137
	\$24,005	\$11,990	\$23,942	\$10,693

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The aggregate amortization expense for these intangible assets for the three months ended June 30, 2006 and 2005 was \$433,000 and \$422,000, respectively. The aggregate amortization expense for these intangible assets for the nine months ended June 30, 2006 and 2005 was \$1,297,000 and \$1,093,000, respectively.

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

As of September 30, 2005, Meridian had outstanding a total of \$2,451,000 principal amount of convertible subordinated debentures due September 1, 2013, bearing interest at 5%. These debentures are convertible at the option of the holder into common shares at a price of \$9.67. Holders converted \$628,000 principal amount of debentures into 64,000 common shares during the first nine months of fiscal 2006.

**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 inter-company 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 inter-company 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 inter-company sales denominated in the Euro currency. The following table presents Meridian's hedging portfolio as of June 30, 2006 (amounts in thousands).

Notional Amount	Contract Value	Estimated Fair Value	Average Exchange Rate	Maturity
300	\$ 383	\$ 386	1.2758	FY 2006
2,100	\$2,696	\$ 2,721	1.2838	FY 2007

At June 30, 2006, unrealized losses of \$28,000 were included in accumulated other comprehensive income in the consolidated balance sheet. This amount is expected to be reclassified into net earnings within the next twelve months.

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 diagnostics test kits in the US and countries

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outside of Europe, Africa and the Middle East. The European Diagnostics operating segment consists of the sale and distribution of diagnostics 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 consists of the Viral Antigens, BIODESIGN, and OEM Concepts businesses, including the contract 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 begun employing 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 June 30, 2006 Compared to Three Months Ended June 30, 2005*

***Net sales***

Overall, net sales increased 5% to \$26,583,000 for the third quarter of fiscal 2006 compared to the third quarter of fiscal 2005. Net sales for the US Diagnostics operating segment increased \$1,887,000, or 14%, for the European Diagnostics operating segment increased \$407,000, or 8%, and for the Life Science operating segment decreased \$1,132,000, or 16%.

For the US Diagnostics operating segment, the sales increase was primarily related to *C. difficile* products (increased \$1,059,000), *H. pylori* products (increased \$444,000), and volume increases in parasitology products (increased \$306,000). The increase in sales of *C. difficile* products was driven by the first quarter 2005 launch of the ImmunoCard® *C. difficile* Toxins A & B rapid diagnostic test in domestic markets, as well as volume growth in Meridian's *C. difficile* Toxins A & B high-volume Premier format. Recent outbreaks of *C. difficile* infections and increased awareness within the marketplace for the need to test for both Toxins A and B have driven volume growth for *C. difficile* products. The increase in sales of *H. pylori* products is primarily attributable to Meridian's efforts to educate physicians on the benefits of direct antigen testing, supported by recently issued AGA guidelines. The increase in parasitology products primarily relates to increased volume from a competitor's departure from the market and Meridian's subsequent market share increases. Two distributors accounted for 44% and 41% of total sales for the US Diagnostics operating segment for the third quarters of fiscal 2006 and fiscal 2005, respectively.

For the European Diagnostics operating segment, sales in local currency increased 8% for the third quarter of fiscal 2006, partially offset by currency translation losses in the amount of \$35,000. The increase in local currency was primarily driven by sales of *C. difficile* products (increased

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\$233,000), including ImmunoCard® *C. difficile* Toxins A & B rapid diagnostic test and *H. pylori* products (increased \$422,000).

For the Life Science operating segment, the sales decrease for the third quarter of fiscal 2006 was primarily attributable to shifts in buying patterns by one large diagnostic manufacturing customer and one large defense customer, as well as the timing and number of contract services arrangements. Contract services revenue was \$927,000 for the quarter. Sales to one customer accounted for 8% and 17% of total sales for the Life Science operating segment for the third quarters of fiscal 2006 and fiscal 2005, respectively.

For all operating segments combined, international sales were \$8,538,000, or 32% of total sales, for the third quarter of fiscal 2006, compared to \$8,308,000, or 33% of total sales, for the third quarter of fiscal 2005. Combined domestic exports for the US Diagnostics and Life Science operating segments were \$3,251,000 for the third quarter of fiscal 2006, compared to \$3,428,000 for the third quarter of fiscal 2005. The remaining international sales were generated by the European Diagnostics operating segment.

***Gross Profit***

Gross profit increased 4% to \$16,355,000 for the third quarter of fiscal 2006 compared to the third quarter of fiscal 2005. Gross profit margins were 62% for the third quarters of fiscal 2006 and 2005.

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 decreased 5% to \$9,462,000, for the third quarter of fiscal 2006 compared to the third quarter of fiscal 2005. The overall decrease in operating expenses for the third quarter of fiscal 2006 is discussed below.

Research and development expenses increased 7% to \$1,278,000 for the third quarter of fiscal 2006 compared to the third quarter of fiscal 2005, and as a percentage of sales, were 5% for both periods. Of this increase, \$26,000 related to the US Diagnostics operating segment and \$62,000 related to the Life Science operating segment.

Selling and marketing expenses increased 8% to \$3,955,000 for the third quarter of fiscal 2006 compared to the third quarter of fiscal 2005, and as a percentage of sales, were 15% and 14%, respectively. Of this increase, \$253,000 related to the US Diagnostics operating segment and \$151,000 related to the Life Science operating segment, partially offset by a decrease for the European Diagnostics operating segment of \$96,000. The increase for the US Diagnostics operating segment was primarily attributable to increased costs associated with sales force incentive compensation related to higher sales levels.

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General and administrative expenses decreased 18% to \$4,229,000 for the third quarter of fiscal 2006 compared to the third quarter of fiscal 2005, and as a percentage of sales, were 16% and 20%, respectively. Of this decrease, \$940,000 related to the US Diagnostics operating segment, and \$164,000 related to the Life Science operating segment, partially offset by an increase of \$192,000 related to the European Diagnostics operating segment. The decrease for the US Diagnostics operating segment was primarily attributable to lower incentive compensation expense pursuant to Meridian's corporate incentive plan because in 2006, company performance was such that additional compensation began to be accrued in the second quarter while this did not occur until third quarter in 2005. Additionally, the Company incurred less costs related to Sarbanes-Oxley compliance and received an insurance recovery. All of these reductions were partially offset by costs for stock-based compensation related to adoption of SFAS No. 123R.

***Operating Income***

Operating income increased 21% to \$6,893,000 for the third quarter of fiscal 2006, as a result of the factors discussed above.

***Other Income and Expense***

Interest income was \$290,000 for the third quarter of fiscal 2006, and related primarily to interest earned on proceeds from the September 2005 common share offering that have been primarily invested in tax-exempt securities.

Interest expense declined 84% to \$28,000 for the third quarter of fiscal 2006 compared to the third quarter of fiscal 2005. This decrease was primarily attributable to lower overall debt levels outstanding for the bank term debt, as well as the effects of conversion and redemption transactions related to Meridian's 7% and 5% convertible debentures.

***Income Taxes***

The effective rate for income taxes was 33% for the third quarter of fiscal 2006 compared to 37% for the third quarter of fiscal 2005. The decrease in the effective tax rate was primarily attributable to the favorable effects of tax-exempt interest, the domestic production activities deduction for US manufacturers, and favorable book-to-return adjustments related to federal and state taxes. For the fiscal year ending September 30, 2006, Meridian expects the effective tax rate to approximate 35% to 36%.

***Nine Months Ended June 30, 2006 Compared to Nine Months Ended June 30, 2005***

***Net sales***

Overall, net sales increased 17% for the first nine months of fiscal 2006 compared to the first nine months of fiscal 2005. Net sales for the US Diagnostics operating segment increased \$8,504,000, or 21%, for the European Diagnostics operating segment increased \$1,036,000, or 8%, and for the Life Science operating segment increased \$2,274,000, or 16%.

For the US Diagnostics operating segment, the sales increase was primarily related to *C. difficile* products (increased \$4,542,000), respiratory products (increased \$1,094,000), parasitology products

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(increased \$734,000), fungal products (increased \$576,000), *H. pylori* products (increased \$560,000), food borne products (increased \$473,000), specimen transport products (increased \$319,000), and rotavirus products (increased \$291,000). The increase in sales of *C. difficile* products was driven by the first quarter 2005 launch of the ImmunoCard® *C. difficile* Toxins A & B rapid diagnostic test in domestic markets, as well as volume growth in Meridian's *C. difficile* Toxins A & B high-volume Premier format. Recent outbreaks of *C. difficile* infections and increased awareness within the marketplace for the need to test for both Toxins A and B have driven volume growth for *C. difficile* products. The increase in sales for respiratory products related to volume growth in tests for Respiratory Syncytial Virus and Mycoplasma. Two distributors accounted for 48% and 44% of total sales for the US Diagnostics operating segment for the first nine months of fiscal 2006 and fiscal 2005, respectively.

For the European Diagnostics operating segment, the sales increase includes currency translation losses in the amount of \$899,000. Sales in local currency increased 13% for the first nine months of fiscal 2006, following an 11% increase during full-year fiscal 2005. The increase in local currency was primarily driven by sales of *H. pylori* products (increased \$1,052,000), *C. difficile* products (increased \$604,000), and respiratory products (increased \$298,000).

For the Life Science operating segment, the sales increase was primarily attributable to the addition of the OEM Concepts business for a full nine months in fiscal 2006 and growth in bulk antigen products. Sales to one customer accounted for 14% of total sales for the Life Science operating segment for the first nine months of fiscal 2006, compared to 17% for the same period of fiscal 2005.

For all operating segments combined, international sales were \$24,937,000, or 31% of total sales, for the first nine months of fiscal 2006, compared to \$22,409,000, or 33% of total sales, for the first nine months of fiscal 2005.

Combined domestic exports for the US Diagnostics and Life Science operating segments were \$10,096,000 for the first nine months of fiscal 2006, compared to \$8,604,000 for the first nine months of fiscal 2005. The remaining international sales were generated by the European Diagnostics operating segment.

**Gross Profit**

Gross profit increased 19% for the first nine months of fiscal 2006 compared to the first nine months of fiscal 2005. Gross profit margins were 60% for the first nine months of fiscal 2006 compared to 59% for the first nine months of fiscal 2005.

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. Favorable margins on new products and reductions in diagnostic manufacturing costs due to efficiencies and investments in automation also contributed to the improvement in gross profit margins for the first nine months of fiscal 2006.

**Operating Expenses**

Operating expenses increased 8% for the first nine months of fiscal 2006 compared to the first nine

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months of fiscal 2005. The overall increase in operating expenses for the first nine months of fiscal 2006 is discussed below.

Research and development expenses increased 26% for the first nine months of fiscal 2006 compared to the first nine months of fiscal 2005, and as a percentage of sales, were 5% for the first nine months of 2006, compared to 4% for the same period of 2005. Of this increase, \$211,000 related to the US Diagnostics operating segment and \$538,000 related to the Life Science operating segment. The increase for the US Diagnostics operating segment was primarily attributable to legal and professional costs associated with European H. *pylori* patent defense, as well as fees for new product development technologies. The increase for the Life Science operating segment was primarily related to the component of research and development scientists labor related to contract work for third-party customers, which is classified in cost of sales or inventory depending on the stage of completion. During the first nine months of fiscal 2006, such labor was primarily focused on internal research and development work, and therefore charged to research and development expense, rather than being classified in cost of sales or inventory.

Selling and marketing expenses increased 11% for the first nine months of fiscal 2006 compared to the first nine months of fiscal 2005, and as a percentage of sales, decreased from 16% in fiscal 2005, to 15% in fiscal 2006. Of this increase, \$635,000 related to the US Diagnostics operating segment and \$586,000 related to the Life Science operating segment, partially offset by a decrease of \$14,000 related to the European Diagnostics operating segment. The increase for the US Diagnostics operating segment was primarily attributable to distributor incentives and incentive compensation associated with higher sales levels, as well as higher salaries and benefits costs. The increase for the Life Science operating segment was primarily due to business development costs and a full nine months of costs for the OEM Concepts business, acquired during the second quarter of fiscal 2005.

General and administrative expenses increased 2% for the first nine months of fiscal 2006 compared to the first nine months of fiscal 2005, and as a percentage of sales, decreased from 18% for the first nine months of fiscal 2005, to 15% for the first nine months of fiscal 2006. Of this increase, \$19,000 related to the US Diagnostics operating segment, \$78,000 related to the European Diagnostics operating segment, and \$89,000 related to the Life Science operating segment. The increase for the US Diagnostics operating segment was primarily attributable to costs for stock-based compensation related to adoption of SFAS No. 123R, offset by decreased expense related to Sarbanes-Oxley compliance and an insurance recovery received. The increase for the Life Science operating segment was primarily attributable to a full nine months of costs for the OEM Concepts business, including amortization of acquired intangibles.

***Operating Income***

Operating income increased 39% for the first nine months of fiscal 2006, as a result of the factors discussed above.

***Other Income and Expense***

Interest income was \$777,000 for the first nine months of fiscal 2006, and related primarily to interest earned on proceeds from the September 2005 common share offering that primarily have been invested in both taxable and tax-exempt securities.



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Interest expense declined 86%, or \$595,000, for the first nine months of fiscal 2006 compared to the first nine months of fiscal 2005. This decrease was primarily attributable to lower overall debt levels outstanding for the bank term debt, as well as the effects of conversion and redemption transactions related to Meridian's 7% and 5% convertible debentures.

***Income Taxes***

The effective rate for income taxes was 35% for the first nine months of fiscal 2006, compared to 36% for fiscal 2005. For the fiscal year ending September 30, 2006, Meridian expects the effective tax rate to approximate 35% to 36%.

**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 has been supplemented by the proceeds from the September 2005 common share offering.

Net cash provided by operating activities was \$14,446,000 for the first nine months of fiscal 2006 compared to \$12,436,000 for the first nine months of fiscal 2005. Higher earnings levels in fiscal 2006 have been offset by higher investments in accounts receivable due to higher sales levels, payment of income taxes in US jurisdictions, and fiscal 2005 bonus payments and accruals related to the company's corporate incentive plan.

Net cash used for investing activities decreased to \$5,082,000 for the first nine months of fiscal 2006 compared to \$9,795,000 for the first nine months of fiscal 2005. This decrease was primarily attributable to the acquisition of OEM Concepts (\$6,391,000) in fiscal 2005.

Net cash used for financing activities was \$7,713,000 for the first nine months of 2006, compared to \$543,000 for the first nine months of fiscal 2005. Borrowings under the revolving credit facility in fiscal 2005 were used to fund a portion of the purchase price for the acquisition of the OEM Concepts business. Proceeds from the exercise of stock options and excess tax benefits were \$1,168,000 for the first nine months of fiscal 2006, compared to \$2,748,000 for the first nine months of fiscal 2005. Dividends paid to shareholders were \$8,091,000 for the first nine months of 2006, compared to \$5,270,000 for the first nine months of 2005, reflecting increased numbers of shares outstanding related to stock option exercises, the September 2005 offering, and bond conversions, as well as higher dividends declared per share.

Net cash flows from operating activities are anticipated to fund working capital requirements, debt service, and dividends during fiscal 2006 and 2007.

***Capital Resources***

Meridian has a \$25,000,000 credit facility with a commercial bank. This facility includes

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\$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 July 31, 2006, there were no borrowings outstanding on the line of credit portion of this facility.

As of September 30, 2005, Meridian had outstanding a total of \$2,451,000 principal amount of convertible subordinated debentures due September 1, 2013, bearing interest at 5%. These debentures are convertible at the option of the holder into common shares at a price of \$9.67. Holders converted \$623,000 principal amount of debentures into 64,000 common shares during the first nine months of fiscal 2006. These conversion transactions are expected to reduce annual interest expense by approximately \$31,000.

The Viral Antigens acquisition, completed in fiscal 2000, provides for additional purchase consideration up to a maximum remaining amount of \$3,491,000, contingent upon Viral Antigens' future earnings through September 30, 2006. Earnout consideration is payable each year, following the period earned. Earnout consideration in the amount of \$1,313,000 related to fiscal 2005 was paid during the second quarter of fiscal 2006 from operating cash flows.

The OEM Concepts acquisition, completed in fiscal 2005, provides for additional purchase consideration up to a maximum remaining amount of \$2,089,000, contingent upon OEM Concepts' future calendar-year sales and gross profit through December 31, 2008. Earnout consideration is payable each year, following the period earned. Earnout consideration in the amount of \$181,000 related to calendar 2005 was paid during the second quarter of fiscal 2006 from operating cash flows.

Meridian's capital expenditures are estimated to be \$3,500,000 to \$4,000,000 for fiscal 2006, and may be funded with operating cash flows, availability under the \$25,000,000 credit facility, or proceeds from the September 2005 common share offering. Capital expenditures relate to manufacturing and other equipment of a normal and recurring nature, as well as capacity expansions for the Maine and Florida facilities.

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

Meridian has market risk exposure related to foreign currency transactions. See Note 7.

**ITEM 4. CONTROLS AND PROCEDURES**

As of June 30, 2006, 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 June 30, 2006. 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 third 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 affect internal control subsequent to June 30, 2006.

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**PART II. OTHER INFORMATION**

**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: August 9, 2006

/s/ Melissa Lueke

Melissa Lueke

Vice President and Chief Financial Officer

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