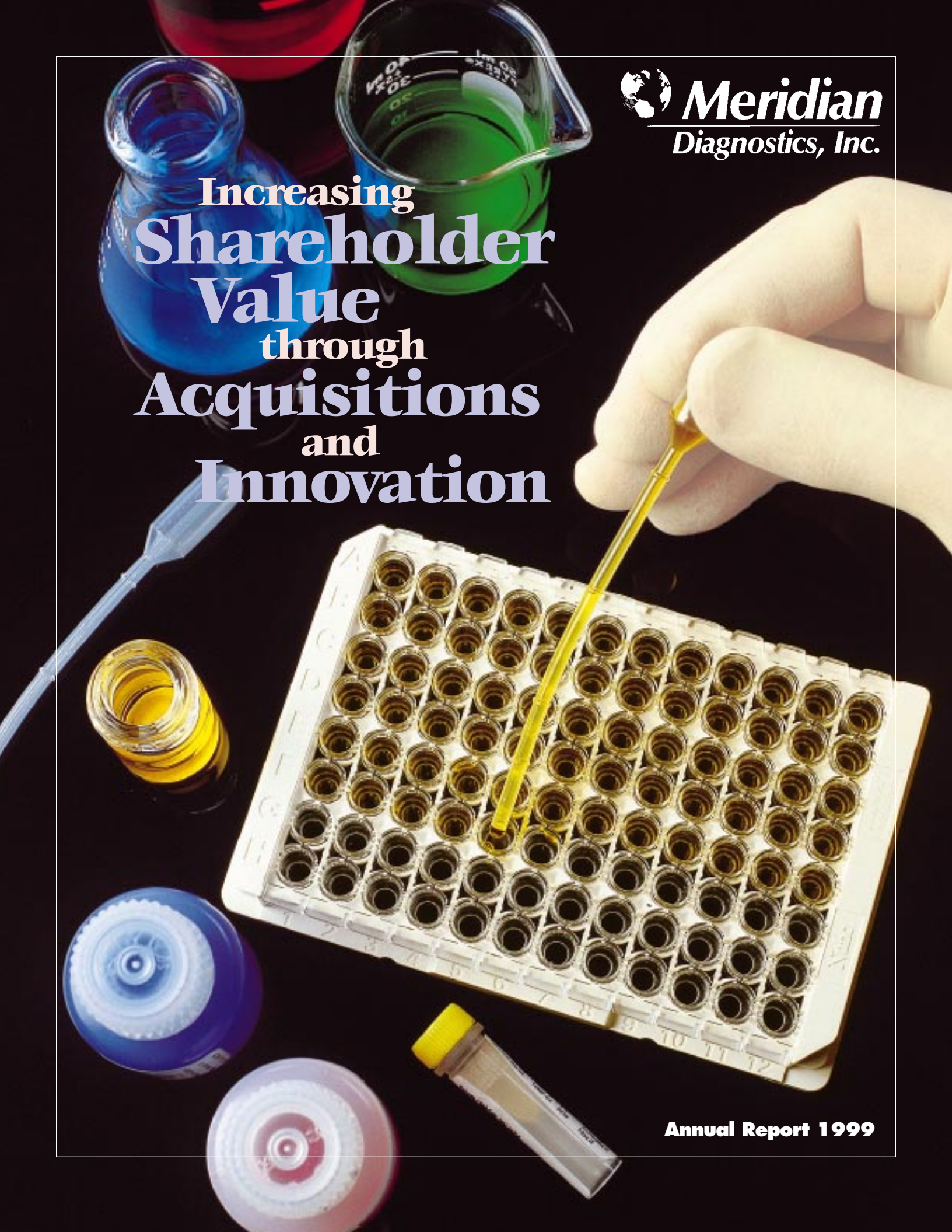
Attachment to
Annual Report to Shareholders

THIS FISCAL YEAR 1999 ANNUAL REPORT TO SHAREHOLDERS SHOULD BE READ IN CONJUNCTION WITH THE COMPANY'S FISCAL YEAR 1999 ANNUAL REPORT ON FORM 10-K/A BECAUSE OF THE FOLLOWING MATTER:

The Company's fiscal year 1999 consolidated financial statements and related management's discussion and analysis of financial condition and results of operations included in its fiscal year 1999 Annual Report to Shareholders, have been restated to reflect the correction of a bookkeeping error related to sales to the Company's German subsidiary. The impact of this restatement to earnings for the year ended September 30, 1999 was as follows (in thousands, except per share amounts):

	As Reported	Correction	As Restated
Net sales	$54,351	$(424)	$53,927
Cost of sales	19,473	85	19,558
Gross profit	34,878	(509)	34,369
Earnings before income taxes	5,321	(509)	4,812
Provision for income taxes	2,935	(196)	2,739
Net income	2,386	(313)	2,073
Basic earnings per share	0.17	(0.03)	0.14
Diluted earnings per share	0.16	(0.02)	0.14

The Company's fiscal year 1999 consolidated financial statements, as restated, are included in an amended Annual Report on Form 10-K/A. The Company also restated its fiscal year 1999 and fiscal period 2000 (balance sheets only) consolidated financial statements for this matter, with such financial statements included in amended Quarterly Reports on Form 10-Q for the quarters ended June 30, 1999, December 31, 1999 and March 31, 2000.


Meridian
Diagnostics, Inc.
Increasing
Shareholder
Value
through
Acquisitions
and
Innovation
Annual Report 1999

Selected Financial Data

(Dollar amounts in thousands, except for per share data and number of employees)

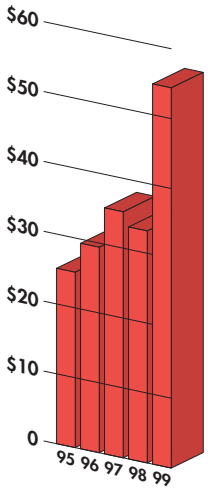
Operational Efficiency Creates Opportunities for Earnings Growth

Meridian Diagnostics, Inc. and Subsidiaries

Summary of Operations

Years Ended September 30,	**1999**	1998	1997	1996	1995
Net sales	**$54,351**	$33,169	$35,229	$29,391	$25,110
Gross profit	**34,878**	22,519	22,931	20,424	17,101
Operating expenses, including merger integration and purchased in-process research and development	**27,842**	14,168	13,021	11,910	10,525
Operating income	**7,036**	8,351	9,910	8,514	6,576
% of sales	**12.9%**	25.2%	28.1%	29.0%	26.2%
Other income (expense)	**(1,715)**	(297)	(199)	379	(616)
Earnings before income taxes	**5,321**	8,054	9,711	8,893	5,960
Income taxes	**2,935**	3,096	3,729	3,601	2,436
Net earnings	**$ 2,386**	$ 4,958	$ 5,982	$ 5,292	$ 3,524
% of sales	**4.4%**	14.9%	17.0%	18.0%	14.0%
Diluted earnings per common share	**$.16**	$.34	$.41	$.36	$.28
Number of employees	**324**	192	178	173	156
Cash dividends declared and paid per common share	**$.20**	$.22	$.19	$.16	$.10
Diluted weighted average number of shares outstanding	**14,580**	14,703	14,661	14,758	14,507
Return on beginning shareholders' equity	**6.9%**	15.2%	20.2%	28.0%	26.6%
Net sales growth—increase/(decrease)	**63.9%**	(5.8%)	19.9%	17.0%	14.8%
Per share earnings growth—increase/(decrease)	**(52.9%)**	(17.1%)	13.9%	28.6%	47.4%

Refer to page 26 for Ten-Year Summary

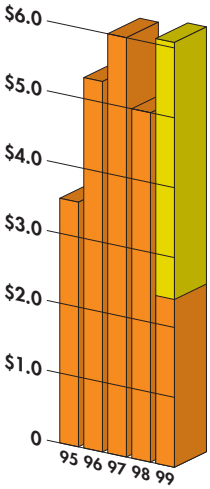


Net Sales

(dollars in millions)

5-Year Compound Growth Rate 20%.

The fiscal 1999 increase in net sales reflects a 7% increase in the core business with the remaining attributable to strong performance of the Gull products since the acquisition.

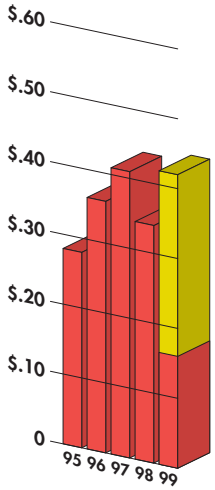


Net Earnings

(dollars in millions)

5-Year Compound Growth Rate 20%*

Fiscal 1999 net earnings reflect the after-tax impact of one-time merger integration costs of $2.2 million and the impact of purchased in-process research and development of $1.5 million. Excluding these nonrecurring items, on an after-tax basis, net earnings were $6.1 million growing at a compound annual growth rate of 20%.



Diluted Earnings Per Share

5-Year Compound Growth Rate 17%*

Fiscal 1999 diluted earnings per share reflect the after tax impact of merger integration costs of $0.15 and the impact of purchased in-process research and development of $0.10. Excluding these nonrecurring items, diluted earnings grew at a compound annual growth rate of 17%.

**excluding impact of one-time charges*

Corporate Profile

Meridian Diagnostics, Inc. is a fully integrated medical diagnostic company that manufactures, markets and distributes a broad range of innovative diagnostic test kits, purified reagents and related products. Utilizing a variety of technologies, these products provide accuracy, simplicity and speed in the early diagnosis and treatment of common medical conditions, such as gastrointestinal, viral, urinary and respiratory infections. All Meridian products are used outside of the human body and require little or no special equipment. The Company's products are designed to enhance patient well-being while reducing the total outcome costs of healthcare. Meridian has strong market positions in the areas of gastrointestinal infections, serology, parasitology and fungal disease diagnosis. The Company markets its products to hospitals, reference laboratories, research centers and physician offices in more than 60 countries around the world.

Contents

Effective Growth Strategies Produce Results in 1999

Meridian's growth strategies, highlighted by the acquisition of Gull Laboratories in November 1998 and aggressive new product development throughout the year, led the Company to new record levels in fiscal 1999. Net sales increased 64%, from $33.2 million to $54.4 million. Sales growth was driven primarily by the Gull acquisition plus a strong contribution from sales of Meridian core products, which grew approximately 7% versus fiscal 1998.

Net earnings increased 23% to $6.1 million, after allowing for the effects of one-time charges relating to the acquisition of Gull Laboratories. As expected, gross margin declined from 68% to 64% due to the Gull product inventories produced in the Salt Lake City facility at lower margins during the year. It is our expectation that the manufacture of Gull products will be fully integrated into our Cincinnati facility in early fiscal 2000. Gross margins should begin to return to historically high levels once Salt Lake City produced product is sold out, which is expected to occur during the second fiscal quarter.

William J. Motto, Chairman and Chief Executive Officer (left) and John A. Kraeutler, President and Chief Operating Officer (right).

Excluding the effects of one-time charges related to the acquisition of Gull Laboratories, operating income increased 43%. Importantly, earnings before interest, taxes, depreciation and amortization (EBITDA) was $12.3 million. Without merger-related charges, EBITDA for the year was $16.0 million, a record for Meridian.

Clearly, the highlight of fiscal 1999 was the acquisition and successful integration of Gull Laboratories into our Meridian facilities and customer channels. During the year, we were able to stabilize the Gull business, which had been declining for the prior four years. In addition, we reported strong growth from our new BIODESIGN research reagents business. The integration of Gull Laboratories has demanded the full commitment of all of Meridian's human resources. While there is still work to be done, we believe our path to success is clear.

Once again, Meridian led its markets in new product innovations. Our unique, patented stomach ulcer test, Premier Platinum HpSA™ (HpSA), gained additional

claims for post-treatment testing. In addition, good progress has been made towards establishing reimbursement levels that are compatible with the product's value and contribution to lowering heathcare costs.

During the first quarter, we launched Premier *Giardia lamblia* and Premier *Cryptosporidium*, two superior assays designed to diagnose serious infection related to waterborne parasites. These products, plus our Merifluor® *Cryptosporidium/Giardia*, will provide a basis for achieving significant market share capture during fiscal 2000.

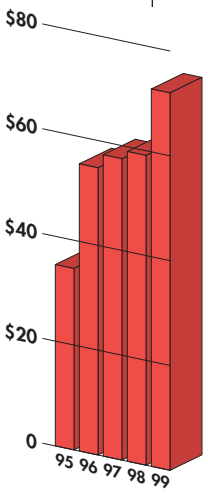
In the fourth quarter, we launched *Immuno*Card **STAT!**™ *E. coli* 0157 *Plus* for the rapid detection of the most virulent strain of E. coli. This product arrived just in time as severe *E. coli* poisonings were being reported around the U.S. Taken as a group, these new products added more than $2 million in incremental revenue growth for the fiscal year.

In Germany, France, Belgium and the Netherlands, we accomplished the transfer of those Meridian customers, previously serviced via distributors, to our own direct sales organizations in those countries. In addition, we saw a rebound in our Pacific Rim markets led by several key regulatory approvals in Japan. For fiscal 1999, international sales achieved 34% of total revenues, moving us even closer to our goal of 50%.

In fiscal 1999, we continued our commitment to our corporate healthcare partners by offering effective diagnostic solutions to their ever-present cost and service pressures. It is our belief that, by understanding the pressures and opportunities faced by the large hospital, reference laboratory and proficiency organizations, we are better able to position Meridian's resources to satisfy each other's respective goals.

BIODESIGN, our research products business, helped to expand our vision beyond traditional infectious disease diagnostics. Through sales of unique, high-quality biological reagents to academic and industrial clients worldwide, BIODESIGN grew by more than 14% last year. To service such a large customer base, BIODESIGN has effectively utilized a combination of catalog, Internet and direct selling to satisfy its markets. In fiscal 2000, BIODESIGN will inaugurate our first interactive web site within Meridian, making e-commerce a reality.

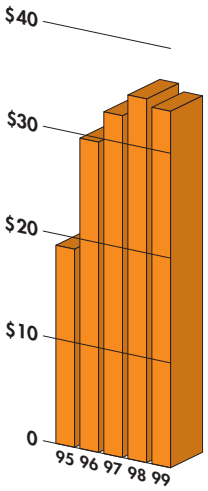
For fiscal 2000, Meridian's Board of Directors recommended an annual dividend of $0.24, an increase of 20%, again demonstrating its belief in the Company's achievements and growth plans.



Total Assets

(dollars in millions)

While fiscal 1999 cash and investments decreased $16.5 million due to the cash used to acquire Gull, total assets grew $13.0 million primarily as a result of the Gull acquisition.



Shareholders' Equity

(dollars in millions)

Fiscal 1999 shareholders' equity decreased to $33.9 million reflecting the after-tax impact of nonrecurring merger-related items of approximately $3.7 million and the payment of $2.9 million in dividends.

Fiscal 1999 was a very satisfying year for Meridian Diagnostics. We are encouraged and emboldened by the achievements we have managed through the integration of Gull Laboratories. We continue to develop and launch innovative products that truly bring down the total costs of healthcare while improving patient well-being. We believe in our ability to continue to grow in the international market based upon the same core principles that have driven our growth to date. We are proud of our industry-leading operating performance driven by growth of high-value products and efficient manufacturing.

We will continue to actively promote our success story so that Meridian's market value becomes better recognized and appreciated. And, finally, we thank each of you, our customers, employees, suppliers and shareholders for your efforts and encouragement.

William J. Motto
Chairman and
Chief Executive Officer

John A. Kraeutler
President and
Chief Operating Officer

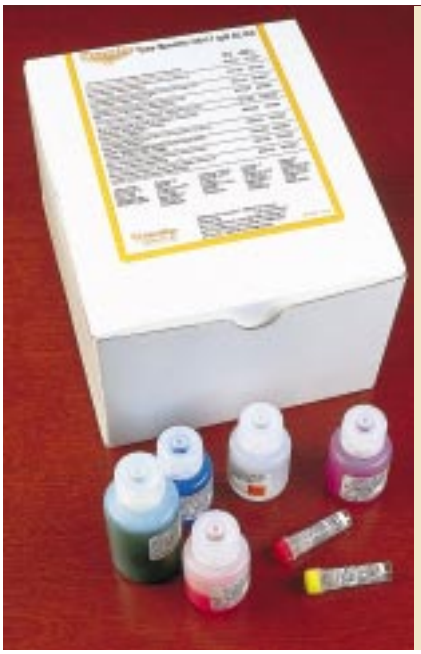
Profits Increase Through Targeted Acquisitions and Effective Integration

In November 1998, Gull Laboratories, Inc. was acquired for $19.7 million in cash, including related legal and professional fees. The acquisition resulted in an increase in Meridian's market share in new areas, due to the Gull brand of high-quality diagnostic test kits for the detection of diseases such as Epstein-Barr virus, herpes simplex and chicken pox. The acquisition of Gull offers synergistic growth potential in both domestic and international markets, access to new, growing markets such as clinical lab and proficiency testing, and bioresearch reagent sales to scientists in academic and commercial research. See the chart (below right) for a breakdown of the eleven-month Gull product line sales.

The Gull acquisition has contributed more rapidly from a financial standpoint than originally projected. Pro forma fiscal 1999 annualized sales of $20.4 million were comparable to pro forma fiscal 1998, a significant turnaround from the pre-acquisition sales performance, which was declining at a rate of about 9% per year. These incremental sales pushed Meridian's consolidated sales to over $54 million for fiscal 1999, an increase of 64%. Net earnings, excluding one-time charges, increased to $6.1 million, a new record for Meridian Diagnostics, Inc.

Increased operating efficiencies should begin to impact the bottom line positively in the latter half of fiscal 2000 as manufacturing operations formerly in Salt Lake City, Utah, and Bad Homburg, Germany, are fully integrated into the Company's Cincinnati facility. Coupled with the elimination of redundant operating expenses in the U.S. and Europe, earnings are expected to grow significantly beginning in fiscal 2000 and will be fully realized in fiscal 2001, barring unforeseen circum-

BREAKTHROUGH IN HERPES TESTING



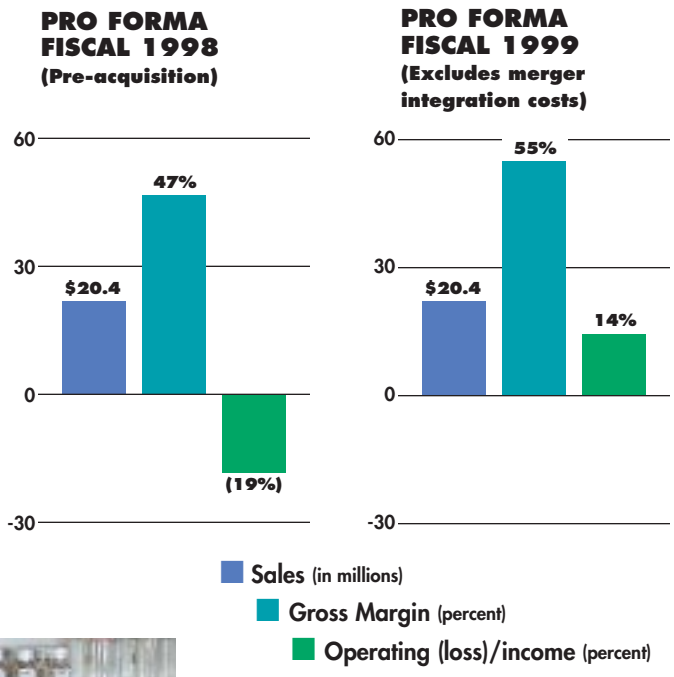
One in six American adults are infected with genital herpes, yet, until recently, no simple diagnostic test existed to distinguish between Herpes Simplex Virus (HSV) Type 1 (oral herpes) and Type 2 (genital herpes). As a result, many cases went undiagnosed. Upon acquiring Gull Laboratories, Meridian accelerated the U.S. Food and Drug Administration (FDA) clearance effort and, in July, was the first company to receive clearance from the FDA to market the two new HSV blood tests. Precise diagnosis through these simple tests will help decrease the spread of HSV infection, decrease healthcare costs and improve the quality of life for many individuals. The two tests, Premier™ Type-Specific HSV-1 IgG ELISA Test and Premier™ Type-Specific HSV-2 IgG ELISA Test, were launched in October 1999.

stances. See the pro forma charts (right) for operating efficiencies achieved already in fiscal 1999.

By January 2000, the Company plans to close the Salt Lake City facility, after completing the transfer of all equipment and technologies to Cincinnati. The facility is expected to be sold. Renovation of the Cincinnati facility to accommodate the added manufacturing is expected to be completed by the end of December.

Through the Gull acquisition, Meridian has expanded its direct presence in Belgium, France, Germany and the Netherlands, and now employs a sales force of approximately 25 people in Europe, including Italy. In addition to the expanded distribution in Europe, with the Gull acquisition, Meridian brings a broader product line to the U.S. and European markets. The direct sales presence, along with the expanded product line offering and strong customer support team, is expected to enhance Meridian's ability to achieve global sales excellence.

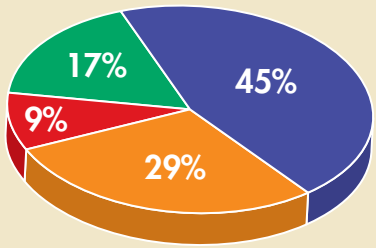
IMPROVED PERFORMANCE AT GULL



Manufacturing Directors (left to right) Chuck Snyder, Joe Holland and Ric Wethington inspect one of the new virology laboratories already completed to accommodate the transfer of Gull operations from Salt Lake City and Germany to Cincinnati.

Along with strong sales in the diagnostic test arena, the Gull Laboratories acquisition brings growing sales in the proficiency testing and bioresearch reagent markets.

GULL LABORATORIES 1999 Sales



International –
$8.5 million (45%)

Domestic –
$5.4 million (29%)

Clinical Lab/Proficiency Testing –
$1.7 million (9%)

Bioresearch Reagent Sales –
$3.1 million (17%)

New Products Lead To Faster Diagnosis And Better Quality Care

When life, or simply the quality of life, is at stake, wouldn't you want your physician to use the most rapid and effective test available to diagnose the condition?

With each of the new products it develops and markets, Meridian strives to put the right diagnostic tools in laboratory technicians' hands so that physicians may diagnose more rapidly, intervene more quickly, improve the patient's quality of life and keep healthcare costs as low as possible. All Meridian products are used outside of the human body and require little or no special equipment. Hospitals, reference laboratories and physician offices in more than 60 countries around the world use Meridian's simple diagnostic tests every day.

In 1999, the Company strengthened its product line through FDA clearance to market six new products, by acquisition of the Gull line of serology products and various product improvements. With the increasing prevalence of stomach ulcers and herpes infection, and with increasing outbreaks of *E. coli*, *Giardia* and *Cryptosporidium*, demand for Meridian's diagnostic testing expertise is expected to continue to grow rapidly. Meridian's product development strategy is driven by three core concepts—accuracy, simplicity and speed—all of which contribute to patient well-being and reduced healthcare costs. The concepts are exemplified in the new product releases discussed below.

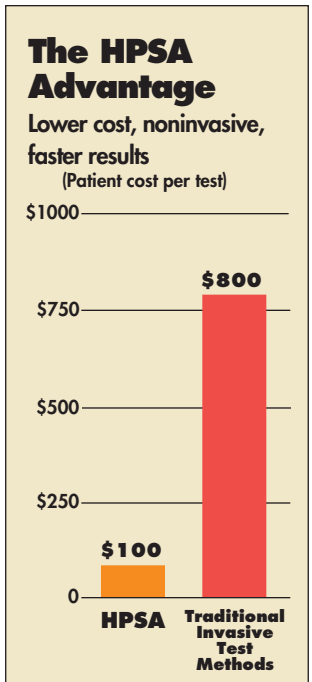
New Claims for HpSA Test

H. pylori bacteria affects approximately 50% of the world's population and is recognized as the leading cause of stomach ulcers as well as a contributing factor in certain types of stomach cancer. Once detected, peptic ulcer disease can be successfully treated with commonly available drugs, but often the condition is not correctly diagnosed. In March 1998, Meridian Diagnostics received clearance from the FDA to market a noninvasive, stool-based test for the diagnosis of *H. pylori* infection. Premier Platinum HpSA, with its rapid turnaround time, low cost and higher accuracy rate, was a major advance in the treatment of peptic ulcer disease.

In December 1998, the FDA approved additional claims for Premier Platinum HpSA. Now, not only can this patented test be used to diagnose *H. pylori* infection, but it also can be used to monitor the effectiveness of the therapy and confirm the post-therapy test-of-cure. No other test on the market can make all three claims.

Meridian has applied for additional patents to protect its leadership position with Premier Platinum HpSA, and it has met with the Health Care Financing Administration on an ongoing basis to establish appropriate Medicare reimbursement rates for this cost-saving test. (See chart at left). The accuracy and cost effectiveness of Merdian's test should put Premier Platinum HpSA in an increasingly favorable reimbursement position.

In July 1999, the esteemed medical journal *THE LANCET*, published an article that reported on a study designed to confirm the accuracy of Premier Platinum HpSA. Currently, the Company is working on expanding the claims for HpSA and on making it even faster and easier to use.



Meridian's HpSA test offers several key advantages over traditional test methods such as endoscopy or surgical procedures. The HpSA test is a noninvasive stool based test making it more convenient for the patient and the physician. Additionally, it is significantly more cost effective and provides test results more quickly than traditional invasive test methods.

Looking for a Simpler Solution

As one of the nation's prominent gastroenterologists, Dr. Nimish Vakil frequently used endoscopy and breath tests to diagnose the H. pylori *bacteria in patients with stomach ulcers. However, he found that "these tests are neither cost-effective nor convenient. We were looking for a test that was simple, noninvasive and inexpensive. Meridian's HpSA test is ideal for diagnosing the problem, monitoring the effectiveness of therapy and as a post-therapy test-of-cure. Patients do not have to take a significant amount of time off work or undergo lengthy, invasive procedures. And in many small towns, where health facilities are not equipped to do breath tests, patients would often require endoscopies if it were not for the HpSA test. This test really extends our reach to help more patients."*

Nimish Vakil, M.D., F.A.C.G.
University of Wisconsin Medical School
Sinai Samaritan Medical School

Continuing to enhance the accuracy, speed and ease of use will help ensure Meridian's peptic ulcer disease test remains the market leader.

New Test for *E. coli*

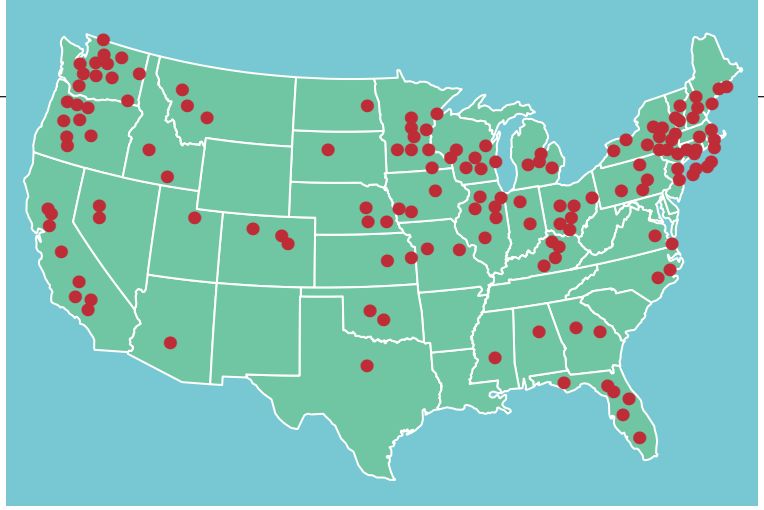
In August 1999, the FDA gave Meridian Diagnostics clearance to market its new *Immuno*Card **STAT!™** *E. coli* 0157 *Plus* test. This rapid test detects the most prevalent toxigenic strain of *E. coli*, *E. coli* 0157:H7, which is often transmitted via ground beef, vegetables and other foods. *E. coli* 0157 infects as many as one million individuals each year in the U.S. and can be especially devastating in young children and the elderly.

The *Immuno*Card **STAT!™** *E. coli* 0157 *Plus* test can be performed in only 10 minutes, which enables laboratories to report accurate results much sooner than conventional culture methods that can take 24 to 72 hours to process. This rapid and highly accurate test allows physicians to manage the illness more effectively, thereby minimizing its progression to a more severe and potentially fatal disease, and eliminating unnecessary surgical procedures.

Thanks to another Meridian test for the *E. coli* bacteria, called Premier EHEC, public health officials were able to quickly diagnose more than 50 young adults impacted by a 1999 outbreak of toxigenic *E. coli* in Texas. Testing ruled out the most commonly known form of *E. coli*. Meridian's Premier EHEC then detected

THE LANCET and other renowned medical journals have recently publicized the greater than 90% accuracy rate of Meridian's Premier Platinum HpSA test for stomach ulcers.

the presence of Shiga toxins produced by a different strain. Results were ready in less than three hours compared to standard methods requiring at least two days. It is important to detect all strains of Shiga toxin-producing *E. coli* to reduce the risk of kidney failure and possibly death.



More than 130 outbreaks of the* E. coli *bacteria have occurred in the United States in the last five years, including the outbreak that affected 52 young adults in Texas in July 1999.

Outbreaks of *E. coli* throughout the U.S. over the past five years alone, indicate the growing potential for Meridian's diagnostic tests (see the map above). Rapid diagnosis is critical so that physicians can treat the illness correctly from the onset, quickly pinpoint the source of the outbreak and eradicate it before it harms a greater number of people.

New Tests for Waterborne Parasites

Improperly treated drinking water can carry parasitic diseases such as *Giardia*, which infects more than two million people annually in the U.S., and *Cryptosporidium*, which seriously affects persons with AIDS and other immuno-compromised conditions. In December 1998, Meridian announced that the FDA had cleared two of its new tests to detect these waterborne parasites. Premier *Giardia* and Premier *Cryptosporidium* can detect the presence of their respective parasite antigens in less than two hours from a simple stool specimen. The worldwide market for this type of testing is approximately $20 million annually.

Meridian's Premier *Giardia* and Premier *Cryptosporidium* tests, along with the existing Merifluor® *Cryptosporidium/Giardia* test and the *Hydrofluor* test for testing public water supplies, provide important diagnostic tools to clinical and environmental testing laboratories.

As the need arises in alternative markets such as food, water and animal testing, Meridian Diagnostics will continue to develop innovative tests to meet these needs. Currently, Meridian products are used to test ground beef from one of America's leading fast-food restaurant chains and to test the water supplies of several major cities. The Company will continue to pursue these non-clinical segments where product synergies with alternative test markets are identified.

Quickly Pinpointing the Problem

Known for his role in the Jack in the Box Restaurant E. coli *outbreak in January 1993, Dr. Phil Tarr continues to be involved in subsequent outbreaks in the pacific northwest. He observes that "while we still use traditional culture methods for diagnosis, we've found that the new method of rapid, direct testing for* E. coli *in stools can be extremely valuable in outbreak situations. When outbreaks occur, many people are concerned that they are infected, and the health department must determine the common source. We have found that a positive test correlates very well with traditional, but slower, culture techniques. The accurate and rapid detection of such infected patients at point of care in outbreaks can accelerate the public health department's investigation. This reliable testing also allows doctors to immediately focus their efforts, and to avoid unnecessary or potentially harmful therapies or diagnostic procedures."*

Phil Tarr, M.D.
Children's Hospital and Regional Medical Center
Seattle, Washington

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Gull Laboratories Inc. Acquisition

On November 5, 1998, the Company acquired all of the approximately eight million shares of common stock of Gull Laboratories, Inc. (Gull) for $19,700,000, in cash, including acquisition costs of $1,700,000. The purchase price was financed by cash and cash equivalents on hand. Gull is engaged in the development, manufacture and marketing of high-quality diagnostic test kits for the detection of infectious diseases and autoimmune disorders. Gull also offers a line of instrumentation for laboratory automation. Gull's HLA tissue typing products for transplantation were sold in 1999.

For accounting purposes, the acquisition was effective October 31, 1998. The results of operations of Gull are included in the consolidated results of operations of the Company from that date forward. The acquisition was accounted for as a purchase. The resulting intangibles and goodwill from this transaction, which represent a substantial portion of the purchase price, are being amortized over lives ranging from three to twenty years. See Note 2 of the Notes to Consolidated Financial Statements for further information.

Fiscal 1999 Compared to Fiscal 1998

Consolidated net sales increased $21,182,000, or 64%, to $54,351,000 in fiscal 1999, principally from the impact of the continued strong performance of the Gull products since the Gull acquisition and growth in the Meridian core business. The increase of $21,182,000 is comprised of volume growth of $19,362,000, or 58%, pricing of $1,846,000, or 6%, and unfavorable currency of $26,000.

Core business product sales increased about 7% versus the prior year, a major turnaround from the first six months, which were down 2% versus the previous year as a result of distributor order patterns in the U.S. and Europe. New product sales in total, led by Premier Platinum HpSA™ (HpSA), Premier Giardia/Cryptosporidium and the *Immuno*Card STAT! line of products, contributed approximately $3,692,000 of total net sales or $2,081,000 of incremental revenues for the year. All other key product groups were performing ahead of the prior year. OEM sales declined $305,000 compared to last year, reflecting the anticipated reduction in sales of virology and mononucleosis products.

International sales in total were $18,499,000, up $9,627,000, or 109% from $8,872,000 in fiscal 1998 and represented 34% of total sales compared to 27% in fiscal 1998. This increase was primarily accounted for from the acquisition of Gull.

Gross profits increased $12,359,000, or 55%, to $34,878,000 for the year compared to the sales increase of 64%. Gross profit decreased as a percentage of sales to 64% from 68%. The gross profit reflects improved pricing as noted above, offset primarily by the impact of the lower margins for Gull product sales compared to the historical Meridian margins, resulting in an overall decrease of four points as a percent of sales. In addition, the strengthening of the dollar versus the Deutch Mark during the third and fourth quarter in particular, contributed to the unfavorable impact on gross margin. The Company expects that this drag on the gross profit will continue until the Company completes the integration of Gull's production into its Cincinnati facilities and the sellout of Gull's Salt Lake City production, which is expected to occur by March 31, 2000.

Total operating expenses increased $13,674,000, or 97%, to $27,842,000 for the fiscal year 1999 compared to fiscal 1998, and increased to 51% of sales from 43% last year, primarily due to the Gull acquisition. Research and development costs decreased $8,000, and decreased to 4% of sales, down from 6% in the prior year. The increase from Gull research and development expenses was largely offset by clinical study costs associated with Premier Platinum HpSA, incurred in fiscal 1998 that did not recur in fiscal 1999. As of March 1, 1999, all research and development activity formerly in Salt Lake City was consolidated at Meridian's headquarters in Cincinnati. Selling and marketing expenses increased $3,680,000, or 49%, for fiscal 1999 primarily due to Gull, but declined approximately 2 points from 23% of sales to 21% for fiscal 1999. General and administrative costs increased $5,087,000, or 109%, and increased as a percent of sales to 18% from 14% for the fiscal year. This increase is attributable to the Gull acquisition, including $1,350,000 of amortization of Gull-related intangibles and goodwill for the year. In connection with the Gull acquisition, the Company incurred merger integration costs of approximately $3,415,000 during the year. These costs consist of payments made to distributors to terminate contracts in markets with duplicate distributor agreements or in markets that will now be covered by the Company's sales forces, training, travel, product validation costs and professional fees incurred in connection with the integration of the Gull business. Additionally, the Company incurred a one-time charge for purchased in-process research and development of $1,500,000 in connection with the Gull acquisition.

Operating income for fiscal 1999 decreased $1,315,000, or 16%, and declined as a percent of sales to 13% from 25%. Excluding the merger integration costs of $3,415,000 and purchased in-process research and development of $1,500,000, operating income increased $3,600,000, or 43%. Other expense increased $1,418,000 for the fiscal year. This increase is primarily related to $506,000 in net interest expense for Gull-related obligations coupled with the effect of an $835,000 reduction in interest income due to the use of cash and investments to acquire Gull.

The Company's effective tax rate increased to approximately 55%, up from 38% for fiscal 1998. This increase is due to the effect of purchased in-process research and development and goodwill amortization, which are not deductible for tax purposes. These two items had the effect of increasing the effective tax rate by approximately 10 percentage points. While the tax impact of purchased in-process research and development is a one-time event, the

goodwill amortization will have an ongoing effect of slightly increasing the effective tax rate. The remaining increase of 7 percentage points is the result of higher tax rates in certain European countries, recognition of a valuation allowance for a portion of the losses in the foreign operations acquired from Gull and a higher state and local effective tax rate due to an increased presence in certain states as a result of the Gull acquisition. The Company has developed operational and tax planning strategies designed to improve the profitability of foreign operations acquired from Gull and to utilize post-acquisition net operating losses. The realization of deferred tax assets in foreign jurisdictions is dependent upon the generation of future taxable income in certain European countries. Management has considered the levels of currently anticipated pre-tax income in foreign jurisdictions in assessing the required level of the deferred tax asset valuation allowance. Taking into consideration historical pre-tax loss levels, tax planning strategies and other factors, management believes that it is more likely than not that the net deferred tax asset for foreign jurisdictions, after consideration of the valuation allowance which has been established, will be realized. The amount of the net deferred tax asset considered realizable in foreign jurisdictions, however, could be reduced in future years if estimates of future taxable income during the carryforward period are reduced. Tax planning strategies include restructuring European distribution operations, closing production operations in Germany and changes in the cost structure.

Net earnings decreased $2,572,000, or 52%, for fiscal year 1999 compared to fiscal 1998 and decreased to 4% of sales from 15% last year. Excluding the after tax impact of merger integration costs of $2,193,000, and the impact of purchased in-process research and development of $1,500,000 which is not tax deductible, net earnings increased $1,121,000, or 23%.

Diluted earnings per share, excluding the after tax impact of merger integration costs and purchased in-process research and development, were $0.42 compared to $0.34 in the prior year, an increase of 24%. Including merger integration costs and purchased in-process research and development, diluted earnings per share were $0.16.

Fiscal 1998 Compared to Fiscal 1997

Net sales decreased $2,060,000 or 6% to $33,169,000 in fiscal 1998. This decline in sales was more than accounted for by a decrease in sales of Premier EHEC and Premier E. coli O157:H7 of approximately $2 million as a result of an E. coli outbreak in Japan in fiscal 1997 which did not repeat in fiscal 1998, a reduction in sales to our major distributors, which reflects their decision to lower inventory carrying levels, the unfavorable impact of currency from the stronger dollar versus the Lira which equated to over $400,000, plus lower OEM sales - primarily Epstein Barr Virus and mononucleosis products which, on a combined basis, were down year-over-year about $450,000.

Seven new products introduced during the year, including HpSA, five one-step products in the *Immuno*Card STAT! format and Spin-CON, a novel addition to the Company's parasitology line, provided incremental sales revenue of over $1,400,000. HpSA, introduced in the United States in late May, achieved consolidated sales of over $1,250,000 compared to fiscal 1997 sales of about $200,000. In addition to the new products, Mycoplasma sales were up $254,000 or 32% as were H. pylori sales in the Premier and *Immuno*Card formats (excluding HpSA), which combined, were up $727,000 or 48%.

The decrease in sales compared to the prior year was composed of volume of $576,000 down 2%, lower pricing of $1,076,000 down 3% and currency down $409,000, or 1%. Compared to fiscal 1997, the major impact was in unit volume as explained above. The impact from pricing improved, down 3% in 1998 versus 5% in 1997, while the currency impact remained comparable.

International sales in total were $8,872,000, down $1,409,000, or 14%, from $10,281,000 in 1997 and represented about 27% of total sales compared to 29% in fiscal 1997. This change was more than accounted for by the extraordinary E. coli sales in the Pacific Rim in 1997, which were made under endemic conditions. Excluding the impact of E. coli sales in fiscal 1997, international sales grew about 5%. European operations were relatively flat due to the unfavorable currency which offset volume growth and favorable pricing. Growth in the rest of the world was about 28%.

Gross profit decreased $412,000 or 2% to $22,519,000 for fiscal 1998 compared to the decrease in sales of 6% resulting in an improvement in the gross profit to sales ratio of approximately 3 points to 68% in fiscal 1998 compared to 65% for the prior year. This improvement was primarily related to the integration of the June 1996 Cambridge acquisition which reflects the higher margin in the Cambridge line of enteric products manufactured in the Company's facility versus the prior year's higher costs associated with the purchase of inventory from Cambridge during the transition period. Also contributing to the improvement was the reduction in amortization of certain acquisition costs related to the Cambridge supply agreement and inventory purchase agreement plus the impact of favorable inventory variances and improved product mix, primarily in the *Immuno*Card and Premier formats. Inventory scrap/obsolescence costs increased about $125,000 compared to the prior year from E. coli inventories which expired.

Total operating expenses increased $1,147,000 or 9% for fiscal 1998 compared to fiscal 1997 and increased as a percent of sale to 43% from 37%. Research and development expenses increased dramatically by $492,000 or 33% to $1,994,000 and increased to 6% as a percent of sales, up from 4% in 1997. This increase was largely from the HpSA multi-site clinical studies conducted during the year, clinical studies associated with the additional claim for therapeutic

monitoring and higher personnel costs. Selling and marketing expenses increased $269,000 or 4% for fiscal 1998 reflecting the launch expenses for the introduction of HpSA in the United States. The increase in general and administrative expenses of $386,000, or 9%, compared to the prior year was related to other administrative expenses including depreciation, computer maintenance charges, outside service fees associated with a company-wide initiative to enhance customer service and revisions in fiscal 1997 to the amortization of certain intangible costs related to prior product line acquisitions. European operating expenses in total, adjusted for currency, increased $76,000 or 4%.

Operating income, as a result of the above, declined $1,559,000 or 16% for fiscal 1998 versus 1997. As a percent of sales, operating income declined approximately 3 percentage points but remained in excess of 25% of sales despite the unusual sales decline and the heavy investment in HpSA.

Other expense (net) increased $98,000 for the year ended September 30, 1998. Interest expense increased $428,000 from revisions in fiscal 1997 to interest expense associated with certain prior period product line acquisitions and interests costs associated with new capital leases. Interest income improved by over 29% through improved yields on higher average investment levels. Currency gains also increased by about $74,000 compared to the prior year.

The Company's effective tax rate was 38% in 1998.

Net earnings decreased $1,024,000 or 17% to $4,958,000 for the twelve months ended September 30, 1998 compared to $5,982,000 in the prior year and declined about two percentage points to 15% of sales in fiscal 1998 versus 17% in 1997.

Basic and diluted earnings per share were $.34 in fiscal 1998 compared to $.42 and $.41 for the prior year, respectively.

Liquidity and Capital Resources

On November 5, 1998, Meridian acquired all of the approximately 8 million shares of common stock of Gull Laboratories, Inc. for $19,700,000 in cash, including acquisition costs. This acquisition was funded by cash and investments on hand.

As of September 30, 1999, the Company had cash and cash equivalents of $6,229,000, investments of $1,002,000 and working capital of $18,655,000.

Net cash flow provided by operating activities was $9,014,000 for twelve-month period ended September 30, 1999, up $2,149,000 or 31% from the prior year period. Despite lower net earnings, cash flow from operations increased as a result of the $4,289,000 increase in non-cash items, including purchased in-process research and development charges, depreciation and amortization. The effect of other operating cash items was relatively comparable to the prior year.

Net cash used for investing activities was $17,891,000, which was more than accounted for by the Gull acquisition which utilized approximately $19,100,000 in cash. Capital expenditures for the twelve months ended September 30, 1999 were $2,153,000. The major expenditures included the modifications to the Cincinnati facilities to accommodate the transfer of the Gull product line production from Salt Lake City. The Company's anticipated total capital expenditures for fiscal 2000 are estimated to be about $4,600,000 primarily consisting of facility modifications, integrated computer systems implementation and normal operating equipment additions and replacements. The Company expects to fund these capital expenditures with a combination of cash from operating activities, leasing arrangements and other bank financing. The sale of investments provided $3,367,000. Net cash used for financing activities was $4,033,000, up $721,000 or 22%, primarily due to higher debt payments attributable to Gull.

On November 17, 1999, the Board of Directors declared the regular cash dividend of $0.05 per share payable December 7, 1999 to shareholders of record on November 24, 1999. The Board also announced its intention, barring unforeseen circumstances, to increase the annual dividend rate to $0.24 per share for fiscal 2000, an increase of 20%.

Total dividends paid during fiscal 1999, were $2,877,000 compared to $3,127,000 paid in fiscal 1998 which included a special year end dividend.

On September 27, 1996, the Company issued $20 million of 7% convertible subordinated debentures due in 2006. The majority of the net proceeds of $18,755,000 were used to acquire Gull.

Capital expenditures related to the Gull acquisition as well as certain costs associated with integration of the Gull operations required some interim financing. The Company has a $20,000,000 unsecured line of credit with a commercial bank under which $3,354,000 was used at September 30, 1999. The Company also has cash and cash equivalents and investments of approximately $7,231,000 at September 30, 1999. The line, which expires on July 1, 2000, is expected to be renewed.

Market Risk Exposure

Information concerning the maturities and fair value of the Company's interest-rate-sensitive investments and debt is included in Notes 3 and 6 to the Consolidated Financial Statements. The Company has a defined investment policy that limits investments in instruments with only an A-1/P-1 rating which is administered by professional investment advisors. The Company considered factors such as interest rate risk, the maturity of the instruments and expected funding needs and credit risks when it established its investment policy. The Company also monitors the investment advisor's compliance with the established investment policy.

The Company's exposure to interest risk is minimal due to the relatively small amount of investments and variable rate debt. The Company is exposed to currency rate fluctuations as a result of its distribution operations in

Europe. To date, exchange rate gains and losses have been immaterial and no hedging activities have been employed.

Impact of Year 2000

The Year 2000 issue results from date sensitive computer programs that only use the last two digits to refer to a year. Such computer programs may not properly recognize years subsequent to 1999. This issue impacts the Company and virtually every business that relies on a computer. If not corrected, system failures or miscalculations could occur causing disruption of the Company's operations, including among other things, a temporary inability to process transactions or to engage in similar normal business activities.

A project team was formed to address the Company's Year 2000 readiness. Information technology (IT) systems, such as any hardware or software used to process daily operational data and information, as well as non-information technology systems, such as computer chips embedded in manufacturing, laboratory and telecommunications equipment, have been assessed for Year 2000 compliance.

In November 1997, the Company completed a major upgrade of its computer hardware and primary business system applications in the U.S. as part of planned system enhancements to support the business. The cost of the upgrades, which are Year 2000 compliant, was approximately $400,000. The Company identified and assessed the compliance of other critical IT and non-IT systems and has completed remediation plans on the critical systems. Remediation efforts include modifications or replacement of software and certain hardware.

Costs specifically associated with the Company's Year 2000 efforts have consisted primarily of systems software and hardware replacements and upgrades, and non-IT systems replacements and upgrades. The total of such costs is approximately $400,000, which consists primarily of costs to implement the Company's primary business system in Germany.

The Company has evaluated the status of significant customers and suppliers to determine the extent to which it is vulnerable to these third parties. The Company believes its broad customer base and availability of alternate suppliers will mitigate any risks associated with these third parties. The Company has also developed a contingency plan in the event normal operations are impacted by the Year 2000. The contingency plan includes reverting to manual systems and other manual work-arounds.

The Company believes that the Year 2000 issue will not pose significant operational problems. However, if a major third party fails to properly remediate its Year 2000 issues, the Year 2000 issue could have a material effect on the Company's operations. While the Company is not currently aware of any significant exposure, there can be no assurance that the Year 2000 issue will not have a material impact on the business and operations of the Company.

The Company's systems are being updated to process Euro transactions. The Company does not currently believe the conversion to the Euro will have a material impact on the business and operations; however, there can be no assurances.

Recently Released Accounting Pronouncements

In 2001, the Company will be required to adopt the provisions of Statement of Financial Accounting Standards (SFAS) No. 133 "Accounting for Derivative Instruments and Hedging Activities". This accounting pronouncement is not expected to have any impact on the Company's financial position or operating results as the Company does not utilize derivative instruments.

Consolidated Balance Sheets

(Dollars in thousands)

Meridian Diagnostics, Inc. and Subsidiaries

As of September 30,	1999	1998
Assets		
Current Assets:		
Cash and cash equivalents (Note 3)	**$ 6,229**	$19,400
Investments (Notes 1 and 3)	**1,002**	4,369
Accounts receivable, less allowance of $380 in 1999 and $171 in 1998 for doubtful accounts	**12,932**	9,707
Inventories (Notes 1 and 4)	**10,357**	5,569
Prepaid expenses and other	**890**	379
Deferred tax assets (Note 7)	**562**	339
Total current assets	**31,972**	39,763
Property, Plant and Equipment (Note 1):		
Land	**969**	332
Buildings and improvements	**10,427**	7,095
Machinery, equipment and furniture	**11,986**	8,524
Construction in progress	**811**	171
	24,193	16,122
Less-accumulated depreciation and amortization	**9,987**	7,313
Net property, plant and equipment	**14,206**	8,809
Other Assets (Notes 1 and 2):		
Long-term receivables and other	**940**	1,035
Deferred tax assets (Note 7)	**—**	740
Deferred debenture offering costs, net of accumulated amortization of $407 in 1999 and $272 in 1998	**922**	1,057
Other intangible assets, net of accumulated amortization of $9,258 in 1999 and $6,730 in 1998 (Note 5)	**20,760**	6,537
Cost in excess of net assets acquired, net of accumulated amortization of $806 in 1999 and $539 in 1998	**3,589**	1,206
Total other assets	**26,211**	10,575
Total assets	**$72,389**	$59,147
Liabilities and Shareholders' Equity		
Current Liabilities:		
Current portion of long-term and capital lease obligations (Note 6)	**$ 821**	$ 213
Notes payable to bank (Note 6)	**3,354**	—
Note payable to third party (Note 2)	**1,000**	—
Accounts payable	**3,495**	1,050
Accrued payroll and payroll taxes	**2,154**	853
Accrued expenses	**2,693**	1,753
Total current liabilities	**13,517**	3,869
Long-Term and Capital Lease Obligations (Note 6)	**21,366**	20,595
Commitments and Contingencies (Note 6)	**—**	—
Deferred Tax Liabilities (Note 7)	**3,602**	—
Shareholders' Equity (Note 8):		
Preferred stock, no par value, 1,000,000 shares authorized; none issued	**—**	—
Common stock, no par value, 50,000,000 shares authorized; 14,429,151 and 14,382,613 shares issued and outstanding at September 30, 1999 and 1998 respectively, stated at	**2,424**	2,397
Additional paid-in capital	**20,855**	20,653
Retained earnings	**11,444**	11,935
Accumulated other comprehensive loss	**(819)**	(302)
Total shareholders' equity	**33,904**	34,683
Total liabilities and shareholders' equity	**$72,389**	$59,147

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

Consolidated Statements of Earnings

(Dollars in thousands except per share data, shares in thousands)

Meridian Diagnostics, Inc. and Subsidiaries

For the Years Ended September 30,	1999	1998	1997
Net Sales	**$54,351**	$33,169	$35,229
Cost of Sales	**19,473**	10,650	12,298
Gross profit	**34,878**	22,519	22,931
Operating Expenses:			
Research and development	**1,986**	1,994	1,502
Selling and marketing	**11,172**	7,492	7,223
General and administrative	**9,769**	4,682	4,296
Merger integration (Note 2)	**3,415**	—	—
Purchased in-process research and development (Note 2)	**1,500**	—	—
Total operating expenses	**27,842**	14,168	13,021
Operating income	**7,036**	8,351	9,910
Other Income (Expense):			
Interest income	**505**	1,340	1,037
Interest expense	**(2,143)**	(1,624)	(1,196)
Other, net	**(77)**	(13)	(40)
Total other income (expense)	**(1,715)**	(297)	(199)
Earnings before income taxes	**5,321**	8,054	9,711
Income Taxes (Note 7)	**2,935**	3,096	3,729
Net earnings	**$ 2,386**	$ 4,958	$ 5,982
Basic Weighted Average Number of Common Shares Outstanding	**14,385**	14,376	14,342
Basic Earnings Per Common Share	**$.17**	$.34	$.42
Diluted Weighted Average Number of Common Shares Outstanding	**14,580**	14,703	14,661
Diluted Earnings Per Common Share	**$.16**	$.34	$.41

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

Consolidated Statements of Shareholders' Equity

(Dollars in thousands except per share data, shares in thousands)

Meridian Diagnostics, Inc. and Subsidiaries

	Number of Common Shares Issued and Outstanding	Comprehensive Income	Common Stock	Additional Paid-In Capital	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Total
Balance at September 30, 1996	14,279	—	$2,386	$ 20,526	$ 6,810	$ (154)	$ 29,568
Cash dividends paid—							
$.19 per share	—	—	—		(2,688)	—	(2,688)
Exercise of stock options, net	86	—	8	45	—	—	53
Comprehensive income:							
Net earnings	—	$5,982	—	—	5,982	—	5,982
Other comprehensive income (loss):							
Foreign currency translation adjustment	—	(276)	—	—	—	(276)	(276)
Comprehensive income	—	5,706	—	—	—	—	—
Balance at September 30, 1997	14,365	—	2,394	20,571	10,104	(430)	32,639
Cash dividends paid—							
$.22 per share	—	—	—		(3,127)	—	(3,127)
Exercise of stock options, net	18	—	3	82	—	—	85
Comprehensive income:							
Net earnings	—	4,958	—	—	4,958	—	4,958
Other comprehensive income (loss):							
Foreign currency translation adjustment	—	128	—	—	—	128	128
Comprehensive income	—	5,086	—	—	—	—	—
Balance at September 30, 1998	14,383	—	2,397	20,653	11,935	(302)	34,683
Cash dividends paid—							
$.20 per share	—	—	—	—	(2,877)	—	(2,877)
Exercise of stock options, net	46	—	27	202	—	—	229
Comprehensive income:							
Net earnings	—	2,386	—	—	2,386	—	2,386
Other comprehensive income (loss):							
Foreign currency translation adjustment	—	(517)	—	—	—	(517)	(517)
Comprehensive income	—	$1,869	—	—	—	—	—
Balance at September 30, 1999	**14,429**	**—**	**$2,424**	**$20,855**	**$11,444**	**$(819)**	**$33,904**

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

Consolidated Statements of Cash Flows

(Dollars in thousands)

Meridian Diagnostics, Inc. and Subsidiaries

For the Years Ended September 30,	**1999**	1998	1997
Cash Flows from Operating Activities:			
Net earnings	**$ 2,386**	$ 4,958	$ 5,982
Non-cash items—			
Purchased in-process research and development	**1,500**	—	—
Depreciation of property, plant and equipment	**2,674**	1,370	1,240
Amortization of other intangible assets, goodwill and deferred debentures offering costs	**2,999**	1,514	1,777
Deferred income taxes, net of the impact of acquisitions	**(953)**	(51)	(516)
Changes in current assets excluding cash/cash equivalents and investments, net of the impact of acquisitions	**559**	259	(2,075)
Changes in current liabilities excluding current portion of long-term obligations, net of the impact of acquisitions	**(676)**	(626)	(230)
Long-term receivable and payable, net of the impact of acquisitions	**525**	(559)	275
Net cash provided by operating activities	**9,014**	6,865	6,453
Cash Flows from Investing Activities:			
Acquisition of Gull Laboratories, Inc., net of cash acquired	**(19,084)**	—	—
Property, plant, and equipment acquired, net	**(2,153)**	(1,321)	(1,579)
Sale of short-term investments	**3,367**	6,844	2,881
Purchase of product license	**—**	(200)	—
Patents	**—**	—	(45)
Advance royalties paid	**(21)**	(25)	—
Net cash provided by (used for) investing activities	**(17,891)**	5,298	1,257
Cash Flows from Financing Activities:			
Subordinated debentures, offering costs	**—**	—	(66)
Proceeds from other long-term obligations	**3,354**	—	60
Repayment of long-term obligations	**(4,739)**	(270)	(161)
Dividends paid	**(2,877)**	(3,127)	(2,688)
Proceeds from issuance of common stock	**229**	85	53
Net cash (used for) financing activities	**(4,033)**	(3,312)	(2,802)
Effect of Exchange Rate Changes on Cash	**(261)**	26	(33)
Net Increase (Decrease) in Cash and Cash Equivalents	**(13,171)**	8,877	4,875
Cash and Cash Equivalents at Beginning of Period	**19,400**	10,523	5,648
Cash and Cash Equivalents at End of Period	**$ 6,229**	$19,400	$10,523
Supplemental Disclosure of Cash Flow Information:			
Cash paid during the year for—			
Income taxes	**$ 4,583**	$ 3,982	$ 3,035
Interest	**1,805**	1,469	1,459

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

(1) Summary of Significant Accounting Policies

(a) Principles of Consolidation—The consolidated financial statements include the accounts of Meridian Diagnostics, Inc. and its subsidiaries, Meridian Diagnostics Corporation, Omega Technologies, Inc., Meridian Diagnostics Europe s.r.1. Meridian Diagnostics International, Inc. and Gull Laboratories, Inc. and its subsidiaries: BIODESIGN International, Gull Laboratories GmbH, Gull Europe S.A., Gull Belgium S.A., and Gull Netherlands N.V. (collectively, "Meridian" or the "Company"). All significant intercompany accounts and transactions have been eliminated.

(b) Short-Term Investments—Debt securities for which the Company does not have the intent or ability to hold to maturity are classified as available for sale, along with any equity securities. The estimated fair value of investments approximates cost, and therefore, there are no unrealized gains or losses reported as of September 30, 1999 or 1998.

(c) Inventories—Inventories are stated at the lower of cost, determined on a first-in, first-out basis, or market.

(d) Property, Plant and Equipment—Property, plant and equipment are stated at cost. Upon retirement or other disposition of property, plant and equipment, the cost and related accumulated depreciation and amortization are removed from the accounts and the resulting gain or loss is reflected in earnings. Maintenance and repairs are expensed as incurred. Depreciation and amortization are computed on the straight-line method in amounts sufficient to write-off the cost over the estimated useful lives as follows:

Buildings and improvements—5 to 33 years
Machinery, equipment and furniture—3 to 10 years

(e) Other Assets—Other intangible assets are stated at cost less accumulated amortization and are being amortized on a straight-line basis over their estimated useful lives:

Covenants not to compete—3 to 10 years
Core products—15 years
Manufacturing processes—15 years
Contracts—15 years
Customer lists—15 years
Workforce—5 years
License agreements—3 to 13 years
Patents, tradenames and distributorships—1 to 15 years

Cost in excess of net assets acquired is being amortized on a straight-line basis over 15 to 20 years. Deferred debenture offering costs are being amortized on a straight-line basis over 10 years.

The Company continually evaluates whether subsequent events and circumstances have occurred that indicate the remaining estimated useful lives of intangible assets may warrant revision or that the remaining balances of these assets may not be recoverable. When factors indicate that an intangible asset should be evaluated for possible impairment, the Company uses an estimate of the related cash flows over the remaining life of the asset in measuring whether the asset is recoverable. For the three years ended September 30, 1999, there were no adjustments to the carrying value of intangible assets resulting from these evaluations.

(f) 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. Research and experimentation credits are reflected as a reduction in income taxes when realized.

(g) Earnings Per Common Share—Basic earnings per share is computed by dividing income available to common shareholders by the weighted average number of common shares outstanding. Diluted earnings per share is computed by adding to the weighted average number of common shares outstanding, the dilutive effect of additional common shares that would have been outstanding if dilutive potential common shares had been issued.

The table below shows the amounts used in computing earnings per share and the effect of dilutive potential common stock on income and the weighted average number of shares for the three years ended September 30, 1999. (Amounts in thousands except per share data)

	Year Ended								
	September 30, 1999			September 30,1998			September 30,1997		
	Income (Numerator)	**Shares (Denominator)**	**Per Share Amount**	Income (Numerator)	Shares (Denominator)	Per Share Amount	Income (Numerator)	Shares (Denominator)	Per Share Amount
Basic Earnings Per Share									
Net income available to common shareholders	**$2,386**	**14,385**	**$.17**	$4,958	14,376	$.34	$5,982	14,342	$.42
Effect Of Dilutive Securities									
Stock Options	**—**	**195**	**—**	—	327	—	—	319	—
Diluted Earnings Per Share									
Net income available to common shareholders and assumed conversions	**$2,386**	**14,580**	**$.16**	$4,958	14,703	$.34	$5,982	14,661	$.41
Antidilutive Securities Excluded from Earnings Per Share Calculation:									
Options		**265**			282			986	
Convertible Debentures		**1,243**			1,243			1,243	

During 1999, 1998 and 1997, the impact of assuming the 1997 convertible debentures were converted, net of the impact of pro forma after tax interest expense, was antidilutive.

(h) Research and Development Costs—Research and development costs are charged to earnings as incurred.
(i) Revenue Recognition—Revenue is recognized from sales when a product is shipped. Income from licensing agreements is recognized as earned and as stipulated by the respective agreements.
(j) Advertising—Advertising costs are charged to earnings as incurred. Expenditures for advertising in 1999, 1998 and 1997 were approximately $327,000, $205,000, and $119,000 respectively.
(k) Use of Estimates—The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.
(l) Translation of Foreign Currency—Assets and liabilities of foreign operations are translated using year-end exchange rates with gains or losses resulting from translation included in a separate component of accumulated other comprehensive income (loss). Revenues and expenses are translated using exchange rates prevailing during the year. Gains and losses resulting from transactions in foreign currencies were immaterial.
(m) Reclassifications—Certain reclassifications have been made to 1998 and 1997 amounts to conform with the 1999 presentation.

(2) Gull Laboratories, Inc. Acquisition

On November 5, 1998, the Company acquired all of the common stock of Gull Laboratories, Inc. (Gull) for $19,700,000, in cash including acquisition costs of $1,700,000. The purchase price was financed by cash and cash equivalents on hand. Gull is engaged in the development, manufacture and marketing of high-quality diagnostic test kits for the detection of infectious diseases and autoimmune disorders. Gull also offers a line of instrumentation for laboratory automation. Gull's products related to HLA tissue typing for transplantation were sold. The acquisition was accounted for as a purchase. For accounting purposes, the acquisition was effective on October 31, 1998 and the results of operations of Gull are included in the consolidated results of operations of the Company from that date forward.

The following unaudited pro forma combined results of operations for the two years ended September 30, 1999, assume the Gull acquisition occurred as of October 1, 1997 (dollars in thousands, except per share data). Pro forma adjustments consist of reductions in interest income due to the use of cash and investments to fund the acquisition, additional amortization of intangible assets and goodwill, purchased in-process research and development costs and adjustments to the tax provision assuming the utilization of a portion of Gull U.S. losses and the establishment of valuation reserves for potentially unrealizable deferred tax assets related to pro forma operating losses.

The unaudited pro forma financial information presented is not necessarily indicative of either the results of operations that would have occurred had the acquisition taken place on October 1, 1997 or the results of operations of the combined companies.

Year Ended September 30,	1999	1998
Net sales	$55,841	$53,535
Net earnings (loss)	$ 3,959	$ (1,613)
Earnings (loss) per share:		
Basic	$ 0.28	$ (0.11)
Diluted	$ 0.27	$ (0.11)

In connection with the acquisition of Gull, assets were acquired and liabilities were assumed as follows, (dollars in thousands):

FAIR VALUE OF ASSETS ACQUIRED INCLUDING:	
Cash and cash equivalents	$ 640
Accounts and notes receivable	3,030
Inventories	5,615
Other current assets	640
Property, plant and equipment	5,915
Intangibles	16,500
Other non-current assets	785
Goodwill	2,610
Purchased in-process research and development	1,500
	37,235
Less: Cash paid for net assets, including acquisition costs	19,725
	$17,510
LIABILITIES ASSUMED INCLUDING:	
Liabilities and debt	$11,065
Additional purchase liabilities	1,420
Deferred tax liabilities, net	5,025
	$17,510

The estimated fair market value of intangibles acquired was based on projected discounted cash flows or the cost basis. The estimated fair market values and lives of the intangibles are as follows:

($ in thousands)	Value	Life
Manufacturing processes	$ 6,400	15
Core products	5,300	15
Customer lists	2,400	15
Contracts	900	15
Covenants not to compete	800	3
Workforce	500	5
Trademarks	200	15
	$16,500	

In fiscal 2000, the Company plans to close the Salt Lake City production facilities, sell the Gull land and buildings in Salt Lake City, and transfer equipment, technology and manufacturing capabilities to the Company's headquarters in Cincinnati. The facility in Salt Lake City is currently being marketed for sale. Additional purchase liabilities recorded include approximately $1,400,000 for severance and costs related to the shut down and consolidation of the acquired facilities in Salt Lake City and Germany. Approximately half of this amount has been paid as of September 30,1999. In connection with the acquisition, the Company agreed to pay certain amounts owed by Gull to its former parent company. At September 30, 1999, $1,000,000 was recorded as a note payable to third party representing the final amount payable to the former parent. This note was paid on November 16,1999.

To date, Gull research and development activities have been consolidated into Meridian's Cincinnati operations and production facilities in Germany have been shut down. The renovation of the Cincinnati facilities is scheduled to be completed by December 31, 1999 to accommodate the manufacture of Gull products although certain Gull products are already being produced in Cincinnati.

The major components of the merger integration costs incurred during fiscal 1999 are as follows:

($ in thousands)	Amount
Product validation costs (materials and labor)	$ 1,175
Travel and training	590
Professional fees primarily related to reorganization of European operations	410
Termination payments to distributors	440
Other	800
Total merger integration costs	$ 3,415

Substantially all merger integration costs have been paid as of September 30, 1999. The Company expects fiscal year 2000 merger integration costs to be immaterial.

(3) Cash and Cash Equivalents, and Investments

Cash and cash equivalents have original maturities of less than three months and consist of cash and money market accounts.

Investments are comprised of the following: (amounts in thousands)

September 30,	1999	1998
U.S. government direct and indirect obligations	$ —	$ 998
Mortgage-backed securities	998	3,366
Common stock	4	5
	$1,002	$4,369

At September 30, 1999 and 1998, the market value of the Company's investments approximated cost. Mortgage-backed securities, which consist of Federal Home Loan Bank and Mortgage Corporation securities, mature between December 2000 and February 2001 and have interest rates ranging from 4.9% to 5.0% at September 30,1999.

(4) Inventories

Inventories are comprised of the following: (amounts in thousands)

September 30,	1999	1998
Raw materials	$ 2,469	$1,480
Work-in-process	3,211	1,714
Finished goods	4,677	2,375
	$10,357	$5,569

(5) Other Intangible Assets

Other intangible assets are comprised of the following: (amounts in thousands)

September 30,	1999	1998
Covenants not to compete	$ 6,321	$ 5,521
Core products	5,300	—
Manufacturing processes	8,641	2,241
Trademarks, licenses, patents,	3,188	2,737
Customer lists	5,168	2,768
Workforce	500	—
Contracts	900	—
	30,018	13,267
Less accumulated amortization	(9,258)	(6,730)
	$20,760	$ 6,537

(6) Bank Credit Arrangements, Long-Term and Capital Lease Obligations, Commitments and Contingencies

(a) Bank Credit Arrangements—As part of a bank credit arrangement the Company has a $20,000,000 unsecured line of credit which expires on July 1, 2000 and calls for interest at prime floating less 1/2% or the LIBOR rate plus 2.25%. Borrowings of $3,354,000 were outstanding on the line of credit at September 30, 1999 at a weighted average interest rate of 7%. In connection with the bank credit arrangement, the Company has agreed, among other things, to limit additional indebtedness. The Company has complied with all debt covenants and requirements.

(b) Long-Term Obligations—Long-term obligations are comprised of the following at: (amounts in thousands)

September 30,	1999	1998
Convertible Subordinated Debentures, unsecured, 7% annual interest payable semi-annually on March 1 and September 1, principal due September 1, 2006	$20,000	$20,000
Other	333	34
	20,333	20,034
Less current portion	—	—
	$20,333	$20,034

The Company issued $20 million of 7% Convertible Subordinated Debentures on September 27, 1996 which are due in 2006. The Debentures are convertible into Common Stock at $16.09 per share. These debentures were issued at par and do not have a discount feature. The fair market value of the Company's debt is approximately $15,700,000 based on limited trading of the debentures. Maturities on the above long-term obligations are all after 2001.

(c) Capital Lease Obligations—At September 30, 1999, the Company has equipment with cost and related accumulated depreciation of $4,446,000 and $3,491,000 respectively, under capital leases expiring in various years through 2005. Amortization of assets under capital leases is included in depreciation expense.

The future minimum annual rentals under the capital leases at September 30, 1999 are as follows: (amounts in thousands)

2000	$ 964
2001	695
2002	288
2004	70
Thereafter	51
Subtotal	$2,068
Less: portion of payments representing interest	214
Present value of lease payments	$1,854
Less: current portion	821
	$1,033

(d) Commitments—The Company has entered into various license agreements, twenty-five of which are active. These agreements have different terms, include a variety of renewal options and were acquired either directly by the Company or via assignment as a result of acquisitions. These license agreements require the Company to pay a specified percentage of the sales of licensed products (1% to 8%). These royalty expenses are recognized on an as-earned basis and recorded in the year earned as a component of cost of sales. Annual royalty expenses associated with these agreements were approximately $907,000, $859,000, and, $1,006,000 respectively, for the years ended September 30, 1999, 1998 and 1997.

The Company also has capital expenditure commitments of approximately $2,700,000 related to the completion of the renovation of its Cincinnati production facilities to handle the Gull production. Rent expense was $170,000, in fiscal 1999. The Company had no rent expense in fiscal 1998 and 1997. Future commitments for operating leases are not material.

(e) Contingencies—The Company is party to litigation that it believes is in the normal course of business. The ultimate resolution of these matters is not expected to have a materially adverse effect on the Company's financial position, results of operations or cash flows.

(7) Income Taxes

The provision for income taxes includes the following components: (amounts in thousands)

Years Ended September 30,	**1999**	1998	1997
Federal:			
Currently payable	**$2,640**	$2,497	$2,912
Temporary differences—			
Tax depreciation greater (less) than book depreciation	**(98)**	(54)	(60)
State franchise taxes	**71**	(6)	(54)
Currently nondeductible expenses	**323**	(14)	(21)
Intangible asset amortization	**(534)**	(125)	(94)
Utilization of net operating loss carryforwards	**226**	—	—
Other, net	**(87)**	42	24
	2,541	2,340	2,707
State and local	**531**	445	577
Foreign	**(137)**	311	445
Total provision for income taxes	**$2,935**	$3,096	$3,729

The following is a reconciliation between the statutory US income tax rate and the effective rate derived by dividing the provision for income taxes by earnings before income taxes. The US and foreign components of earnings before income taxes in fiscal 1999 were income of $6,600,000 and a loss of $1,300,000 respectively. The foreign components of earnings before income taxes in fiscal 1998 and 1997 were immaterial. (amounts in thousands)

	1999		1998		1997	
Years Ended September 30,	**Amount**	**Rate**	Amount	Rate	Amount	Rate
Computed provision for income taxes at statutory rate	**$1,809**	**34.0%**	$2,738	34.0%	$3,302	34.0%
Increase/(decrease) in taxes resulting from:						
Goodwill amortization	**38**	**0.7**	—	—	—	—
Purchased in-process research and development	**510**	**9.6**	—	—	—	—
State and local income taxes, net of federal income tax effect	**350**	**6.6**	293	3.6	385	4.0
Foreign taxes	**313**	**5.9**	81	1.0	191	2.0
Foreign Sales Corporation benefit	**(135)**	**(2.5)**	(92)	(1.1)	(121)	(1.3)
Other, net	**50**	**0.9**	76	0.9	(28)	(0.3)
Actual provision for income taxes	**$2,935**	**55.2%**	$3,096	38.4%	$3,729	38.4%

The components of net deferred tax assets (liabilities) were as follows at: (amounts in thousands)

Years Ended September 30,	**1999**	1998
Deferred tax assets:		
Nondeductible expenses	**$ 673**	$ 281
Intangible asset amortization	**—**	744
Valuation reserves	**191**	—
Net operating loss carryforwards in foreign jurisdictions	**5,381**	—
Other	**25**	218
Total deferred tax assets:	**6,270**	1,243
Valuation allowance	**(3,491)**	—
	2,779	1,243
Deferred tax liabilities:		
Fixed asset depreciation	**(684)**	—
Intangible asset amortization	**(4,881)**	—
Other	**(254)**	(164)
Total deferred tax liabilities:	**(5,819)**	(164)
Net deferred tax asset (liability)	**$(3,040)**	$1,079

For income tax purposes, the Company has tax benefits related to operating loss carryforwards of $2,156,000, $508,000, $34,000 and $2,683,000 in Belgium, France, the Netherlands and Germany, respectively. The operating loss carryforward in France expires between 2000 and 2004. The operating loss carryforwards in Belgium and Germany have no expiration. The Company has recorded deferred tax assets for these carryforwards, inclusive of a valuation allowance in the amount of $3,491,000 at September 30, 1999. Valuation allowances for preacquisition net operating loss carryforwards amount to $2,788,000, while valuation allowances for post acquisition net operating loss carryforwards are $703,000. If tax benefits are recognized in future years for preacquisition operating losses, such benefits will be allocated to reduce goodwill and acquired intangible assets. No valuation allowance was recorded against deferred tax assets at September 30, 1998.

The realization of deferred tax assets in foreign jurisdictions is dependent upon the generation of future taxable income in certain European countries. Management has considered the levels of currently anticipated pre-tax income in foreign jurisdictions in assessing the required level of the deferred tax asset valuation allowance. Taking into consideration historical pre-tax loss levels, tax planning strategies and other factors, management believes that it is more likely than not that the net deferred tax asset for foreign jurisdictions, after consideration of the valuation allowance which has been established, will be realized. The amount of the net deferred tax asset considered realizable in foreign jurisdictions, however, could be reduced in future years if estimates of future taxable income during the carryforward period are reduced. Tax planning strategies include restructuring European distribution operations and closing production operations in Germany and changes in cost structure.

(8) Employee Benefits

(a) Savings and Investment Plan—The Company has a profit sharing and retirement savings plan covering substantially all full-time employees. Profit sharing contributions to the plan, which are discretionary, are determined by the Board of Directors. The plan permits participants to contribute to the plan through salary reduction. Under terms of the plan, the Company will match up to 3% of an employee's contributions. Discretionary and matching contributions by the Company to the plan amounted to approximately $386,000, $311,000, and $291,000, during fiscal 1999, 1998 and 1997, respectively.

(b) Stock-Based Compensation Plans—The Company has three expired stock option plans, the 1986 Stock Option Plan, the 1990 Directors' Stock Option Plan and the 1994 Directors' Stock Option Plan collectively ("The Expired Plans"), and three active plans, the 1996 Stock Option Plan Amended and Restated effective January 22, 1999 ("The 1996 Plan"), the

1999 Directors' Stock Option Plan ("The 1999 Plan") and the Employee Stock Purchase Plan ("The ESP Plan") which became effective October 1, 1997. The Company accounts for these plans under APB Opinion No. 25, under which no compensation cost has been recognized. Had compensation cost for these plans been determined consistent with FASB Statement No. 123, the Company's net income and earnings per share would have been reduced to the following pro forma amounts: (amounts in thousands, except per share data)

	1999	1998	1997
Net Income:			
As Reported	**$2,386**	$4,958	$5,982
Pro Forma	**2,075**	4,817	5,886
Basic EPS:			
As Reported	**$.17**	$.34	$.42
Pro Forma	**$.14**	.34	.41
Diluted EPS:			
As Reported	**$.16**	.34	.41
Pro Forma	**$.14**	.33	.40

Because the Statement 123 method of accounting has not been applied to options granted prior to October 1, 1995, the resulting pro forma compensation cost may not be representative of that to be expected in future years.

Effective October 1, 1997, the Company may sell shares of stock to its full-time and part-time employees under the ESP Plan up to the number of shares equivalent to a 1% to 15% payroll deduction from an employee's base salary plus an additional 5% dollar match of this deduction by the Company. On a cummulative basis 5,285 and 2,935 shares were sold under the ESP Plan as of September 30, 1999 and 1998, respectively.

The Company may grant options for up to 700,000 shares under the 1996 Plan and 50,000 shares under the 1999 Plan. The Company has granted options of 1,020,612 shares under the Expired Plans compared to 1,441,235 shares authorized for option grants, and has granted 355,417 options under the 1996 Plan through September 30, 1999. No options have been granted under the 1999 Plan. Options may be granted at exercise prices varying from 95% to 110% of the market value of the underlying common stock on the date of grant and become exercisable on vesting schedules established at the time of grant. All options contain provisions restricting their transferability and limiting their exercise in the event of termination of employment or the disability or death of the optionee. Options may be granted both as incentive stock options designed to provide certain tax benefits under the Internal Revenue Code and as nonqualified options without such tax benefits.

A summary of the status of the Company's stock option plans at September 30, 1999, 1998 and 1997 and changes during the years then ended is presented in the tables and narrative below:

	1999		1998		1997	
	Shares	**Wtd Avg Ex Price**	Shares	Wtd Avg Ex Price	Shares	Wtd Avg Ex Price
Outstanding at beginning of period	**838,615**	**$6.84**	717,388	$ 5.77	810,594	$ 5.21
Granted	**140,368**	**6.67**	164,918	11.54	40,301	12.80
Exercised*	**(58,864)**	**5.68**	(37,712)	6.49	(120,621)	4.26
Expired	**(83,345)**	**7.34**	(5,979)	10.83	(12,886)	6.81
Outstanding at end of period	**836,774**	**6.84**	838,615	6.84	717,388	5.77
Exercisable at end of period	**547,520**	**5.42**	571,112	4.89	498,499	4.56
Wtd avg fair value of options granted		**$3.89**		$ 5.76		$ 5.92

*Includes 13,026, 20,658, and 34,320 shares surrendered in conjunction with the exercise of stock options in 1999, 1998 and 1997 respectively.

The range of exercise prices, the weighted average exercise price and the weighted average remaining contractual life is summarized below for options which are outstanding and those that are exercisable.

	Options Outstanding			Exercisable	
Range of Exercise Prices	Number Outstanding at 9/30/99	Weighted Average Remaining Contractual Life	Weighted Average Exercise Price	Number Outstanding at 9/30/99	Weighted Average Exercise Price
$1.00—5.00	193,489	1.4 years	$ 1.60	193,489	$ 1.60
$5.01—10.00	435,047	5.9 years	$ 6.50	286,083	$ 6.27
$10.01—16.00	208,238	7.4 years	$12.39	67,948	$12.72
Total	836,774	5.2 years	$ 6.84	547,520	$ 5.42

The fair value of each option grant is estimated on the date of grant using the Black-Scholes option-pricing model with the following weighted-average assumptions:

	1999	1998
Risk-free interest rates	**4.7% - 6.2%**	5.7% - 6.2%
Dividend yield	**1.8%**	1.7%
Life of option	**3-8 years**	3-8 years
Share price volatility	**52%**	46.5%

Subsequent to year-end, 134,900 stock options were granted which would have an immaterial impact on the diluted EPS, if granted prior to year-end.

(c) Other Benefits—The Company does not provide post-retirement or post-employment benefits to its employees.

(9) Major Customers and Segment Data

The Company was formed in June 1976 and functions as a research, development, manufacturing, marketing and sales organization with primary emphasis in the field of diagnostic tests for infectious diseases. The Company grants credit under normal terms to its customers, primarily to hospitals, commercial laboratories and distributors in the United States and the rest of the world.

Consolidated sales in thousands of dollars to individual customers constituting 10% or more of net sales were as follows:

Years Ended September 30, ($ in thousands)	1999	1998	1997
Customer A	**$6,849 (13%)**	$4,512 (14%)	$6,533 (19%)
Customer B	**6,780 (12%)**	$5,839 (18%)	$4,991 (14%)

Meridian operates in two geographic segments, Meridian Diagnostics, Inc. (MDI) and Meridian Diagnostics Europe (MDE). MDI operations consist of the manufacture and sale of diagnostic test kits in the U.S. and countries outside of Europe, Africa and the Middle East. It also includes sales of bioresearch reagents and sales of proficiency tests, which combined, represent approximately 10% of total Company revenues. MDI export sales were as follows:

($ in thousands)	1999	1998	1997
Net sales	**$4,059**	$3,614	$4,515

MDE distributes diagnostic test kits in Europe, Africa and the Middle East. Accounts receivable which are largely dependent upon funds from the Italian government represent approximately 20% of the accounts receivable balance at September 30, 1999. Significant country information for MDE is as follows:

($ in thousands)	1999	1998	1997
Italy			
Sales	**$6,013**	$5,267	$5,766
Identifiable Assets	**5,872**	5,560	5,123
Germany			
Sales	**9,310**	—	—
Identifiable Assets	**$6,406**	—	—

Sales are attributed to the geographic area based on the location from which the product is shipped to the customer.

Segment information for the years ended September 30, 1999, 1998, and 1997 is as follows:

($ in thousands)	MDI	MDE	ELIM[1]	TOTAL
1999				
Net sales	$ 45,106	$15,323	$ (6,078)	$54,351
Depreciation	2,139	535	—	2,674
Amortization	2,999	—	—	2,999
Interest expense	1,920	453	(230)	2,143
Interest income	680	55	(230)	505
Merger integration costs	3,108	307	—	3,415
In-process research and development	1,500	—	—	1,500
Income tax provision/ (benefit)	3,095	(137)	(23)	2,935
Net income (loss)	3,607	(1,188)	(33)	2,386
Total assets	97,743	12,867	(38,221)	72,389
Capital expenditures	$ 2,003	$ 150	$ —	$ 2,153
1998				
Net sales	$ 30,208	$ 5,267	$ (2,306)	$33,169
Depreciation	1,256	114	—	1,370
Amortization	1,514	—	—	1,514
Interest expense	1,615	192	(183)	1,624
Interest income	1,494	29	(183)	1,340
Income tax provision	2,803	311	(18)	3,096
Net income	4,546	365	47	4,958
Total assets	56,155	5,560	(2,568)	59,147
Capital expenditures	$ 1,203	$ 118	$ —	1,321
1997				
Net sales	$ 32,073	$ 5,766	$ (2,610)	$35,229
Depreciation	1,127	113	—	1,240
Amortization	1,777	—	—	1,777
Interest expense	1,178	200	(182)	1,196
Interest income	1,196	23	(182)	1,037
Income tax provision	3,319	421	(11)	3,729
Net income	5,636	314	32	5,982
Total assets	55,150	5,123	(2,783)	57,490
Capital expenditures	$ 1,461	$ 118	$ —	$ 1,579

(1) Eliminations consist of intersegment transactions.

The account policies of the segments are the same as those described in the summary of significant accounting policies in Note 1. Transactions between geographic segments are accounted for as intercompany sales at established intercompany prices for internal and management purposes with all intercompany amounts eliminated in consolidation. The MDI segment data for total assets includes corporate goodwill and intangibles of $24,349,000, $7,743,000, and $10,061,000 for the years ended September 30,1999, 1998 and 1997 respectively.

Report of Independent Public Accountants

Meridian Diagnostics, Inc. and Subsidiaries

To Meridian Diagnostics, Inc.:

We have audited the accompanying consolidated balance sheets of MERIDIAN DIAGNOSTICS, INC. and subsidiaries as of September 30, 1999 and 1998, and the related consolidated statements of earnings, shareholders' equity and cash flows for each of the three years in the period ended September 30, 1999. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Meridian Diagnostics, Inc. and subsidiaries as of September 30, 1999 and 1998, and the results of their operations and their cash flows for each of the three years in the period ended September 30, 1999, in conformity with generally accepted accounting principles.

ARTHUR ANDERSEN LLP

Cincinnati, Ohio
November 16, 1999

Quarterly Financial Data

Meridian Diagnostics, Inc. and Subsidiaries

Unaudited (Amounts in thousands, except for per share data)

For the Quarter Ended in Fiscal 1999	**December 31**	**March 31**	**June 30**	**September 30**
Net sales	**$11,720**	**$14,653**	**$13,825**	**$14,153**
Gross profit	**7,632**	**9,076**	**9,165**	**9,005**
Net earnings	**553**	**1,257**	**1,345**	**(769)**
Diluted earnings per common share[1]	**.04**	**.09**	**.09**	**(.05)**
Cash dividends per common share[1]	**.05**	**.05**	**.05**	**.05**

For the Quarter Ended in Fiscal 1998	December 31	March 31	June 30	September 30
Net sales	$8,448	$9,542	$8,226	$6,953
Gross profit	5,523	6,426	5,860	4,710
Net earnings	972	1,703	1,429	854
Diluted earnings per common share[1]	.07	.12	.10	.06
Cash dividends per common share[1,2]	.07	.05	.05	.05

(1) The sum of the basic diluted earnings per common share and the cash dividends per share may not equal the annual earnings and cash dividends per share due to interim quarter rounding.

(2) Includes special 1997 year-end cash dividend of $0.025 per share

Ten-Year Summary

(Dollars in thousands except per share data and number of employees)

Meridian Diagnostics, Inc. and Subsidiaries

	Selected Financial And Operating Data For the Years Ended September 30,									
	1999	1998	1997	1996	1995	1994	1993	1992	1991	1990
Net Sales	**$54,351**	$33,169	$35,229	$29,391	$25,110	$21,877	$16,171	$14,003	$11,085	$ 8,478
Cost of Sales	**19,473**	10,650	12,298	8,967	8,009	7,518	5,098	4,582	3,973	3,467
Gross Margin	**34,878**	22,519	22,931	20,424	17,101	14,359	11,073	9,421	7,112	5,011
Percent of Sales	**64.17%**	67.89%	65.09%	69.49%	68.10%	65.64%	68.47%	67.28%	64.16%	59.11%
Operating Expenses										
Research & Development	**1,986**	1,994	1,502	1,499	1,432	1,433	1,165	1,157	1,102	908
Sales & Marketing	**11,172**	7,492	7,223	5,991	5,229	4,747	3,716	3,166	2,564	1,649
General & Administrative	**9,769**	4,682	4,296	4,420	3,864	3,365	2,667	2,482	2,090	1,637
Merger Integration	**3,415**	—	—	—	—	—	—	—	—	—
Purchased research and development	**1,500**	—	—	—	—	—	—	—	—	—
Total Operating Expenses	**27,842**	14,168	13,021	11,910	10,525	9,545	7,548	6,805	5,756	4,194
Operating Income	**7,036**	8,351	9,910	8,514	6,576	4,814	3,525	2,616	1,356	817
Percent of Sales	**12.95%**	25.18%	28.13%	28.97%	26.19%	22.00%	21.80%	18.68%	12.23%	9.64%
Other Income										
Licensing & Related Fees	**—**	—	14	45	103	—	55	55	55	55
Interest Income	**505**	1,340	1,037	379	436	254	57	50	144	210
Interest Expense	**(2,143)**	(1,624)	(1,196)	(390)	(1,135)	(1,092)	(179)	(89)	(10)	(15)
Cost of Withdrawn Stock Offering	**—**	—	—	—	—	—	(405)	—	—	—
Other, Net	**(77)**	(13)	(54)	345	(20)	8	48	(27)	(21)	16
Total Other Income (Expense)	**(1,715)**	(297)	(199)	379	(616)	(830)	(424)	(11)	168	266
Minority Interest in Earnings of Subsidiary	**—**	—	—	—	—	—	—	—	(7)	(7)
Earnings Before Income Taxes	**5,321**	8,054	9,711	8,893	5,960	3,984	3,101	2,605	1,517	1,076
Income Taxes	**2,935**	3,096	3,729	3,601	2,436	1,543	1,212	952	559	391
Net Earnings	**$ 2,386**	$ 4,958	$ 5,982	$ 5,292	$ 3,524	$ 2,441	$ 1,889	$ 1,653	$ 958	$ 685
Percent of Sales	**4.39%**	14.95%	16.98%	18.01%	14.03%	11.16%	11.68%	11.80%	8.64%	8.08%
Cash Dividends Declared & Paid per Common Share*	**$0.20**	$0.22	$0.19	$0.16	$0.10	$0.08	$0.06	$0.05	$0.05	—
Basic Weighted Average Number of Common Shares Outstanding*	**14,385**	14,376	14,342	14,172	12,355	12,277	12,264	11,866	11,775	11,680
Basic Earnings Per Common Share*	**$0.17**	$0.34	$0.42	$0.37	$0.29	$0.20	$0.15	$0.14	$0.08	$0.06
Diluted Weighted Average Number of Common Shares Outstanding*	**14,580**	14,703	14,661	14,758	14,507	12,521	12,534	12,141	11,965	11,680
Diluted Earnings Per Common Share*	**$0.16**	$0.34	$0.41	$0.36	$0.28	$0.19	$0.15	$0.14	$0.08	$0.06
Total Assets	**$72,389**	$59,147	$57,491	$54,751	$34,569	$32,329	$26,247	$14,099	$10,997	$10,555
Cash Marketable Securities & Investments	**7,231**	23,769	21,736	19,743	8,919	8,832	9,476	1,810	1,590	2,704
Capital Expenditures	**2,153**	1,321	1,579	1,245	2,472	1,426	718	1,999	934	165
Net Working Capital	**18,455**	35,895	33,570	29,332	15,670	13,000	13,759	5,164	4,046	4,452
Shareholders' Equity	**33,904**	34,683	32,639	29,568	18,878	13,232	11,617	10,676	9,519	8,998
Return on Beginning Shareholders' Equity	**6.88%**	15.19%	20.23%	28.03%	26.63%	21.01%	17.69%	17.37%	10.65%	8.24%
Year-End Stock Price	**8.00**	7.63	11.88	13.38	8.08	5.18	5.50	6.13	2.49	.97
Number of Employees	**324**	192	178	173	156	138	125	115	105	100
Sales per Employee	**168**	173	198	170	161	159	129	122	106	85
Net Earnings per Employee	**7**	26	34	31	23	18	15	14	9	7

*As adjusted for stock splits and stock dividends.

Meridian Diagnostics, Inc. and Subsidiaries

Corporate Headquarters

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

Legal Counsel

Keating, Muething & Klekamp, P.L.L.
Cincinnati, Ohio

Independent Public Accountants

Arthur Andersen LLP
Cincinnati, Ohio

Transfer Agent, Registrar and Dividend Reinvestment Administration

Fifth Third Bank
Corporate Trust Services
Mail Drop 10AT66
38 Fountain Square Plaza
Cincinnati, Ohio 45263
(800) 837-2755
(In Cincinnati) (513) 579-5320

Annual Meeting

The annual meeting of the shareholders will be held on Thursday, January 20, 2000 at 3:00 p.m. Eastern Time at The Phoenix, 812 Race Street, Cincinnati, Ohio.

SEC Form 10-K

A copy of the Company's annual report filed with the Securities and Exchange Commission on Form 10-K is available without charge upon written request to:

Gerard Blain
Chief Financial Officer
Meridian Diagnostics, Inc.
3471 River Hills Drive
Cincinnati, Ohio 45244

Common Stock Information

NASDAQ National Market System Symbol: "KITS"
Approximate number of record holders: 1,200

The following table sets forth by calendar quarter the high and low sales prices of the Common Stock on the NASDAQ National Market System.

Years Ended September 30,	**1999**		1998	
Quarter ended:	**High**	**Low**	High	Low
December 31	**7 ½**	**4 7/16**	11 7/8	9 ½
March 31	**7 ¼**	**6**	13	8 5/8
June 30	**8 ⅛**	**6**	15 ¼	12
September 30	**8 ¾**	**7 1/16**	12 5/8	5

Directors

William J. Motto
Chairman of the Board and
Chief Executive Officer

John A. Kraeutler
President and
Chief Operating Officer

James A. Buzard, Ph.D.
Retired Executive Vice President,
Merrell Dow Pharmaceuticals, Inc.

Gary P. Kreider
Senior Partner,
Keating, Muething & Klekamp, P.L.L.

Robert J. Ready
Chairman of the Board and President,
LSI Industries, Inc.

Officers

William J. Motto
Chairman and
Chief Executive Officer

John A. Kraeutler
President and
Chief Operating Officer

Gerard Blain
Executive Vice President,
Chief Financial Officer,
Treasurer and Secretary

Richard L. Eberly
Vice President,
Sales and Marketing

Antonio A. Interno
Senior Vice President,
Managing Director MDE

Kenneth J. Kozak
Vice President,
Research and Development

FORWARD LOOKING STATEMENT

The Private Securities Litigation Reform Act of 1995 provides a safe harbor from civil litigation for forward looking statements accompanied by meaningful cautionary statements. These statements identify important factors that could cause actual results to differ materially from those that might be projected. 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 the Company's competition. While the Company has introduced approximately 35 internally-developed products since 1991, 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. One of Meridian's main growth strategies is 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. The challenges faced by the Company in integrating Gull into its operations involve greater risks and uncertainties than prior acquisitions.

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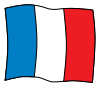

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Meridian Diagnostics, Inc.

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