

FINAL TRANSCRIPT

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MDZ - Q3 2008 MDS Inc. Earnings Conference Call

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PRESENTATION

Operator

Good morning, ladies and gentlemen, welcome to the MDS third-quarter results conference call.

I would like to turn the call over to Kim Lee, Director of investor relations. Please go ahead Ms. Lee.

Kim Lee - MDS, Inc. - Director of IR

Thanks, [Joe]. Good morning, everyone and thank you for joining us today. Our third-quarter results were issued this morning along with our MD&A and financial statements. If you have not received a copy of these documents they are posted on our web site at www.mdsinc.com. We are webcasting this event live on our web site, where you will find a PowerPoint presentation highlighting the details of the call. The archived version will remain on our web site after the call today.

Joining me this morning are Stephen DeFalco, President and CEO of MDS, and Doug Prince, Executive Vice President of Finance and CFO. Stephen will begin the call with his perspective on the quarter and Doug will follow with his comments on Q3. Prior to our Q & A session, we will turn it back to Stephen for a few closing comments.

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During the call we will be making forward-looking statements about MDS's businesses. These statements are not a guarantee of future performance and are subject to risk and uncertainty that could cause actual results to differ materially. Some of these risks are disclosed in the reports and other documents filed with the relevant Canadian and US securities regulators and are available on our web site. Let me remind everyone that all financial data today is shown on a US GAAP basis and in US dollars unless otherwise indicated.

In addition to standard GAAP measures we make reference to selected non-GAAP financial that we believe provide meaningful information to investors. Both GAAP and non-GAAP measures referenced here are used by management to assess the performance of the business and as a basis for management compensation.

To help our investors gain a clear understanding of our GAAP measures, such as net revenue, adjusted EBITDA and adjusted earnings per share, we provide detailed reconciliation between GAAP and non-GAAP measures in the MD&A of our July 31, 2008 interim financial reports and our 2007 Annual Report which are available on our web site.

With that, I will turn it over to Stephen DeFalco.

Stephen DeFalco - MDS, Inc. - President and CEO

Good morning, everyone and thank you for joining us. Q3 was stronger than Q2 with adjusted EBITDA of 21%. Although overall performance was mixed and a decline versus a strong quarter in 2007.

MDS Nordion delivered solid steady performance and MDS Analytical Technologies showed sequential improvement despite a difficult environment. MDS Pharma Services continues to see business wins which have resulted in a record backlog. However, the conversion to revenue and earnings growth is taking longer than expected which is not where we want to be.

We are driving efficiencies in our business and continue to make investments to better serve our customers. For the quarter, MDS reported net revenues of \$298 million versus \$308 million last year. Adjusted EBITDA of 41 million, down 16% from last year and up 21% versus Q2. Now looking across our businesses. MDS Nordion delivered strong performance in the quarter and we are making progress with our innovation agenda. Nordion continues to partner with pharmaceutical and biotech companies to develop new and exciting technologies for molecular imaging.

We also took action to address the long-term isotope supply issue by commencing arbitration with AECL and filing a \$1.6 billion claim against AECL and the Government of Canada. MDS Analytical Technologies showed sequential improvement in what is still a somewhat soft North America pharma market. We continue to see great opportunities in our applied markets and strength in Asia. During the quarter we won seven leading edge software solutions at the American Society for Mass Spectrometry to further our position in the fast growing applied markets.

They included Analyst 1.5 software, an updated version of our core operating system for mass spectrometry systems that increases customer productivity. Analyst is capable of identifying more than 600 contaminants in a single analysis of food or water, more than double the amount that can be detected by alternative testing solutions. And I methods which provide customers with customizable turnkey solutions for routine food and beverage testing. LightSight Software, an application package that contains automated method creation for metabolite identification with our triple quadrupole and Q trap mass spectrometry systems.

We expect these software offerings to revolutionize the user experience and provide us better access to the growing applied market and further our penetration of the life sciences market. Our acquisition of Blue Shift Biotechnologies this quarter allowed us to expand the breadth of our cellular imaging portfolio with a high throughput offering. [LysSight] a bench top laser scanning cytometer, expands our capabilities in cellular analysis and further strengthens our global sales and service offering. We are seeing market enthusiasm for this new product and received additional orders during the quarter.

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19 million in R&D was invested in the quarter which continues to fuel a robust product pipeline. We are now preparing to launch new and exciting hardware, combined with our leading edge suite of software solutions, we will have a full array of new solutions in the market for our customers. Moving to Pharma Services. As I stated earlier, the business continues to see strong new business wins and a growing backlog. However, conversion to revenue in late stages is taking longer than anticipated. In Q3, we announced new restructuring actions as process improvements have led to productivity gains at a number of our sites.

Highlights from our plan include, top grading our business development team and improving business development activities and processes. Launching our quality on time brand, utilizing our lean Sigma process improvement methodology, implementing customer service systems such as Apollo, Clean Quick and SAS, and expanding in high-growth areas such as our Beijing central lab facility and state of the art phase one facility in Phoenix, Arizona.

Our efforts have resulted in strong orders performance as customers come back to a revitalized MDS Pharma Services. Our priority is to translate those new business wins into top and bottom line growth. Our early stage business is improving nicely. We expect late stage to take a little longer as we continue to deal with previous quarter cancellations and delays in the start of new projects.

With three consecutive quarters of new business wins in excess of 160 million and a backlog that has grown more than 100 million year to date to 486 million, a record for Pharma Services, we are encouraged about our prospects going into 2009. We expect modest improvements for the balance of the year.

I will now turn it over to Doug Prince to provide the financial details for the quarter.

Doug Prince - MDS, Inc. - EVP, Finance and CFO

Thank you, Stephen. Before I get into the financial results, I would like to remind everyone that in addition to the GAAP financial results included in the press release, we also provide commentary on the items that impact the comparability of our results.

For the third quarter, adjusted financial results exclude charges related to restructuring initiatives, asset impairment, a loss on the sale of a business, and integration costs. Where appropriate for year-over-year comparability, I will describe the impact of foreign exchange and acquisitions and divestitures. In addition, when I refer to revenue growth figures and margin percentages, these are based on net revenues; that is, revenue from product and services excluding reimbursement revenue. Now for our consolidated results.

In Q3 our total revenue was 321 million, including 23 million of reimbursement revenue. Net revenues were 298 million, down 3% from 308 million last year and down 5% excluding the impact of foreign exchange. Revenue declines were reported at Analytical Technologies and Nordion. The decline at Nordion was primarily related to the previously announced sale of two product lines which contributed 7 million in revenue during the third quarter of last year. Our Q3 GAAP operating loss including restructuring and asset repair charges, was 22 million for the quarter versus a loss of \$4 million last year. Adjusted EBITDA was \$41 million compared to \$49 million in 2007, down 16%.

In 2008 adjusted financial results exclude \$12 million in restructuring charges, an \$11 million asset repair charges for a Pharma Services facility, and a \$1 million loss related to the sale of a business. In the third quarter of 2007, adjustments include \$11 million of Molecular Devices integration expense and \$3 million of restructuring cost. Our adjusted EBITDA margin declined to 14% from 16% in the prior year. This decrease in EBITDA, adjusted EBITDA was driven by declines at Pharma Services and Analytical Technologies.

Our reported gross margin, which is net revenues less associated cost of revenues fell 3% due to a decline in gross margins at Pharma Services. SG&A for the quarter was 63 million compared to \$66 million last year. As a percent of net revenues, SG&A was level at 21%. In the third quarter, we spent \$19 million on R&D, 6% of revenues compared to 20 million or 6% spent last

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year. On a reported basis, GAAP earnings per share from continuing operations was a loss of \$.08 in Q3, 2008 compared to earnings of \$.06 last year. Excluding the adjusting items mentioned earlier, our adjusted earnings per share were \$.06 in 2008 compared to \$0.13 last year.

Now to our business unit results starting with Pharma Services. For the quarter, Pharma Services reported net revenues of \$122 million, up 3% over the same quarter last year. These revenues reflect a favorable impact from foreign exchange of approximately \$6.5 million. Adjusted for foreign exchange, early stage delivered revenue growth while late-stage revenue declined, primarily as a result of previously reported cancellations and delays in the start of new projects.

Q3 continued to demonstrate a high level of new business wins with \$169 million in new orders. Based on the strength of these new orders, our quarter-end backlog increased \$55 million or 13% sequentially to 486 million. On a GAAP basis, Pharma Services reported an operating loss of \$31 million for the quarter, compared to an operating loss of \$5 million last year. Excluding \$8 million of restructuring expense, \$11 million of asset impairment charges, adjusted EBITDA was a \$2 million loss this year compared to a gain of \$4 million last year. This decrease was primarily the result of lower revenues in our late-stage businesses and increased investments in growth.

In 2007, the late-stage business also benefited from a favorable mix of higher margin services. These factors, plus inflationary pressures offset the productivity savings achieved from our 2007 restructuring actions. As previously announced, in addition to their ongoing productivity initiatives, Pharma Services has initiated actions to reduce headcount and close several offices. This has resulted in a restructuring charge of \$8 million during the quarter with another \$6 to \$8 million charge expected in the fourth quarter, in line with our previous announcement.

Next on to Nordion. MDS Nordion reported revenue of \$72 million down 5% from \$76 million last year. In the third quarter of last year, we reported \$7 million of revenue associated with product lines that were sold in Q3 of 2008. During the quarter, MDS Nordion's revenue increased by \$2 million as a result of foreign exchange. Excluding the impact of divestitures and foreign exchange, third-quarter revenues were \$1 million higher, compared to the same period last year, primarily driven by increased cobalt sales.

GAAP operating income was \$20 million, compared to \$18 million last year. Adjusted EBITDA was \$23 million versus \$22 million last year, primarily driven by increased sales of higher margin cobalt. Now on to Analytical Technologies. It has been over a year since we acquired Molecular Devices. Going forward, we will no longer refer to the sight and Molecular Devices brands. Where appropriate, we will now comment on the key product families mass spectrometers, drug discovery and bio research.

MDS Analytical Technologies recorded revenue of \$104 million in Q3, down from \$114 million last year. Adjusted for foreign exchange, reported revenues decreased approximately 12%. The primary driver of the revenue decline was lower shipments of mass spectrometers to our joint ventures. End user revenue for mass spectrometers actually increased 5% in the third quarter with strong demand in applied markets in Asia, offset by soft demand for high-end instruments in North America.

Analytical Technologies reported a GAAP operating loss of \$9 million in Q3 compared to a \$11 million loss last year. In addition to equity earnings, major adjusting items include \$4 million of restructuring charges in 2008 and 11 million of integration expense in 2007. Adjusted EBITDA was \$21 million in Q2 compared to \$27 million last year. The \$6 million decrease was primarily driven by lower sales of high-end, high margin instruments, plus increased manufacturing costs related to our shift to Asia manufacturing. While we continue to see soft demand for high-end instruments, sequential growth in end user revenue and effective cost controls resulted in margin improvement compared to the second quarter.

Analytical Technologies implemented a number of productivity initiatives in Q3, including headcount reductions in North America, which resulted in a \$4 million restructuring charge this quarter. Turning next to cash flow in the balance sheet. In Q3 we generated \$5 million of cash resulting in an ending cash balance of \$130 million. During the quarter, we generated \$23 million of operating cash flow and incurred \$14 million of capital expenditures. We received \$15 million from the sale of two product lines at Nordion, and spent \$14 million on the acquisition of Blue Shift for Analytical Technologies.

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We repurchased one million common shares for \$15 million under our normal course issuer bid. And borrowed \$15 million under our revolver over quarter end. That draw has since been repaid and as of today, there are no borrowings on that 500 million facility. For the remainder of fiscal 2008 we expect to have net operating cash inflows. We believe that cash on hand, cash from operations and cash from existing financing source also provide sufficient liquidity to fund ongoing operations, capital expenditures, R&D expenses, customer FDA settlements and restructuring costs.

Now to our 2008 guidance. We are updating our guidance today to reflect our expectations for the balance of the year. Primarily as a result of this slower than expected revenue ramp at Pharma Services, we now expect net revenues for 2008 to be in the range of 1.23 to 1.25 billion. Our adjusted EBITDA and adjusted earnings per share guidance has remained unchanged at 160 to 170 million and \$0.27 to \$0.33, respectively. As the cost reduction actions that we have implemented are expected to offset the lower revenues.

As a result of the restructuring and asset impairment charges announced in the quarter and certain other adjusting items, income from continuing operations is expected to be in the \$18 to \$28 million range with basic earnings per share between \$.15 and \$.23. We have also deferred several investment projects to 2009 and capital expenditures are now expected to be in the range of \$50 million to \$60 million. Our effective tax rate for 2008 remains unchanged. And finally, our outlook.

We took tough actions in Q3 to deliver improved EBITDA following a disappointing Q2. AT has executed cost reduction actions to improve profitability while also driving innovation through R&D and acquisitions. Nordion has sharpened their portfolio via the divestiture of slower growth product lines, and is more focused than ever on their mission as a premier provider of molecular imaging technologies.

At Pharma Services, our investments in business development have resulted in their highest backlog ever. Coupled with a cost reduction actions currently under way, the record back log is expected to drive increased revenue and adjusted EBITDA in Q4 and 2009.

That concludes my financial comments for the quarter. With that I will turn it back to Stephen for closing remarks.

Stephen DeFalco - MDS, Inc. - President and CEO

Thank you, Doug. We made continued progress in executing our strategy in the third quarter which improved performance over Q2. Rolling into Q4, we see strengthening across all of our businesses. We continue to take actions to drive EBITDA expansion and position ourselves well for 2009 and beyond. I'll now turn it back to Kim.

Kim Lee - MDS, Inc. - Director of IR

Thanks, Stephen. Before I ask the operator to open the lines up for Q&A, I would like to ask you limit yourself to one primary question and one follow-up. Before you queue up again for additional questions. [Joe], please open the lines for questions.

QUESTIONS AND ANSWERS

Operator

Thank you. (OPERATOR INSTRUCTIONS). The first question will be from Lennox Gibbs from TD Securities. Please go ahead. Your line is now open.

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Lennox Gibbs - TD Securities - Analyst

Good morning, thank you. I was going to start, just a little off topic. At Nordion. Recently Covidian announced another molybdenum supply interruption out of their facility in the Netherlands. Recall back in '05, '06 there was a similar event that created a pretty tight even flow for MDS. Can you comment on your ability to meet market demand caused by the shortfall and whether or not we should expect to see an uptick in your moly business as a result?

Stephen DeFalco - MDS, Inc. - President and CEO

Good morning, Lennox, thank you for joining us. We are watching that situation very closely. All of the reactor suppliers and industry participants are talking to each other. A little different than last time. What happened last time was Covidian's generator line went down. This is a little different in that the reactor, the [Petton] reactor in Holland is down.

And you know, the news keeps changing how long it will be out, but it is going to be out for a little while. We are working with our customers and ramping up our production. But as you know, the -- the news in the early days -- it gets -- the precision and accuracy of the news gets better over time because everybody knows more. And so it is a situation we are watching closely.

Lennox Gibbs - TD Securities - Analyst

Then just secondly, in terms of the recovery in the early development segment where it doesn't look to be a very compelling top line trend. I know that you previously commented that 70% of the top ten customers were back which sounds like a pretty dramatic reversal. Why is this not translated to a more robust top-line recovery and maybe if you could just comment on competitive issues and if there are any, and on your penetration of those top customers?

Stephen DeFalco - MDS, Inc. - President and CEO

Yes, as I said, Lennox, this has taken longer than we expected and we are not happy of where we are. I would say early stage is recovering quite nicely. Customers are coming back. Revenue is ramping. It is more profitable. And we are seeing the trend lines.

We are a little bit here in Q3 dealing with some issues in late stage which given our scale, one -- one cancellation and one or two project start delays will wreak some havoc on us here. I think on early stage we have a good beat on it; it's moving nicely. I think late stage will take us another couple of quarters here to really be able to see that trend line.

Lennox Gibbs - TD Securities - Analyst

But just back to the early stage for a second. Are you where you thought you might have been at this point given that so many customers have come back relatively quickly? Shouldn't one had expected sort of a more steep trajectory here?

Stephen DeFalco - MDS, Inc. - President and CEO

No. I think we are where about where we want to be. I mean, understand when a customer comes back, right, they may give us a project, but that project might be scheduled for their reasons in calendar Q1, right. That's because that's when their molecule will pass its other milestones and be ready.

So you see that more in the backlog building. Most of them would have their business already booked out for call it the next six to eight weeks, right. They have already made commitments and whatnot.

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So they place business, but business is a little further out. It is sort of their next available molecule when it is ready. I think we are doing a good job winning that as you are seeing in the backlog numbers.

Lennox Gibbs - *TD Securities - Analyst*

Thanks very much.

Operator

Thank you. The next question will be from Maher Yaghi from Desjardins Securities. Please go ahead your line is now open.

Maher Yaghi - *Desjardins Securities - Analyst*

Yes, thanks for taking my question. I want to ask a question on Nordion. You mention in the press release that you are uncomfortable with the current situation in which a even if NRU reactor would have been given approval to continue operating beyond 2011, that the situation is not suitable for MDS. Can you maybe elaborate a little bit about why you feel that even if the NRU continued to operate beyond 2011 that would not be appropriate for you guys?

Stephen DeFalco - *MDS, Inc. - President and CEO*

Yes. I think, Maher, nothing has changed on that at all and I will kind of go back to what we've stated before, right. MDS has always been concerned and has been making investments to ensure long-term supply. I think we are fine in the short to medium term. I think NRU operates every day. It's the world's most reliable reactor.

We will see that reconfirmed here over the next couple of weeks given things that are kind of going on in that industry. And, we would expect that to get relicensed in the mid-term, and I think people are speculating that will be a five-year license and would take us out to 2016. That is not for certain.

But, so I think in the short to medium term. We're fine. Nordion is a good leader in that business, that's a very profitable business for us. What is not satisfactory is the long-term solutions and that's why we are taking the actions we are taking. And we are very consistent on that.

Maher Yaghi - *Desjardins Securities - Analyst*

So even if the NRU reactor would continue to operate even long term, you are not looking to continue to get your supply from the NRU? Even if it is available?

Stephen DeFalco - *MDS, Inc. - President and CEO*

No, we will absolutely get our supply from the NRU for as long as the NRU operates, which looks like it will be short to medium term. That doesn't solve what we think are longer term issues. Quite frankly they're industry issues.

Every one of the reactors in the industry is 50ish years old. What is not acceptable to us is not having a -- a solution past the NRU. But as long as the NRU operates, we will be working with the NRU and supplying our customers around the world.

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Maher Yaghi - *Desjardins Securities - Analyst*

Okay. And just a follow-up question on Analytical Technologies. Can you split up the sales number for Sciex and [MD] like you did in the past?

Stephen DeFalco - *MDS, Inc. - President and CEO*

No, we don't intend to do that going forward. It is MDS Analytical Technologies.

Maher Yaghi - *Desjardins Securities - Analyst*

So if I may, I wanted to ask you about the revenue line at Analytical Technologies. If I look at industry numbers, there is still quite in the top teens level growth on the top line. Beyond mass spectrometry decline in revenue, not shipments like you said, but revenues, was there weakness also at MD like we saw last quarter or that situation has reasserted itself?

Stephen DeFalco - *MDS, Inc. - President and CEO*

Yes I would -- we don't think right now that the industry is growing at 14%. So I think if you get an organic number on that, it won't nearly be at that rate and certainly we follow all our competition and their press releases. So don't know that I agree with your assertion there. Our end user revenue and mass spec are growing at 5% which we actually think is pretty close to mid top of the pack there.

Molecular Devices I think is tracking with its segments. And I think everybody in the industry is feeling a little softness in North America, and quite frankly good, strong growth in Asia. Those products participate less in the applied markets which are the markets for us that have been on fire. And so those continue to really, really ramp strongly.

I think every time you see a -- a food testing issue or environmental issue hit the newspaper, that is good for mass spec sales and participating in those applied markets. And molecular devices is a little bit more driven straight by the core life sciences markets?

Maher Yaghi - *Desjardins Securities - Analyst*

So product mix, was it negatively impacting MD this quarter like last quarter? Or you are back to maybe Q4 or Q3 type of product mix?

Stephen DeFalco - *MDS, Inc. - President and CEO*

No, we are certainly having a little bit of shift away from our high-end boxes to our low-end boxes, just because the high-end boxes get caught up in capital expense approvals and so that is a little more sluggish. No, generally I think this is the mix we will have for a little while here probably until we see some broader good news in the economy and pharma North America?

Operator

Thank you. The next question will be from John Maletic from Scotia Capital. Please go ahead. Your line is now open.

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John Maletic - Scotia Capital - Analyst

Hi, good morning. Just a follow-up question on Pharma Services. Has there been any change in the level of cancellations in this quarter? Or are you still talking about the lingering effects of past quarter's cancellations?

Stephen DeFalco - MDS, Inc. - President and CEO

No, our cancellations have been running pretty low. As you know we don't really control cancellations that much. They mostly have to do with customers identifying that that molecule isn't acceptable to take forward and that's partly because we do good testing for them. So it is not something in our control. But cancellation is relatively low.

In late stage, we had some previous cancellations which are effecting where we are right now. We were anticipating those will all be running projects and revenues in this quarter. And we have seen some pushouts as I think pharmaceutical and biotech clients either don't meet the milestones that they were heading for in the previous phase or rejuggle their portfolios. But, I think it is all -- I think the issue for us is in our late-stage business given our size, one or two of those can really wreak havoc for us?

John Maletic - Scotia Capital - Analyst

So then it isn't a handful of delays, it's just one or two that causing this? And it's not, say, a broader increase in the duration of your backlog?

Stephen DeFalco - MDS, Inc. - President and CEO

No. And then we did not have any big cancellations this quarter.

John Maletic - Scotia Capital - Analyst

Okay. And then secondly, on currency, given the weakness in the Canadian dollar over the near term, has there been any change to how you're viewing it as far as guidance there? Are you still baking in parity for the remainder of the year and what kind of impact -- positive impact do you expect to see in the continuation of these trends?

Stephen DeFalco - MDS, Inc. - President and CEO

Yes, John, great question. I think as a policy, I try to not predict foreign exchange rates. I think it is a little outside of my expertise area, particularly I see the best economists in the world don't do that great a job with it. I think our broad philosophy is to make sure that we can make money at any exchange rates and manage our business appropriately from an operations point of view.

All things being equal, a strengthening US dollar is good for us, as you can well imagine. You have followed the stock a long time and so you have seen us deliver profit improvement in an environment where declining with a weakening US dollar. That becomes even better with -- with accelerating US dollar. So I think that that -- that would be good news for us, but I wouldn't hold your breath. I think --

John Maletic - Scotia Capital - Analyst

Okay. But am I right to assume that in your current guidance, you are being conservative in assuming that we don't have a significant improvement because -- so there could be potential upside if we see that number?

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Stephen DeFalco - MDS, Inc. - President and CEO

That is a good assumption. We are assuming future looks like where we are.

John Maletic - Scotia Capital - Analyst

Okay, thanks.

Operator

Thank you. The next question will be from David Martin from Dundee Securities. Please go ahead, your line is now open.

David Martin - Dundee Securities - Analyst

Thank you. A couple of questions. It first one is you indicated in the MD&A that the mass spec end user sales are up, but that you are shipping lower volumes of units to the joint ventures. I am wondering are the joint venture reducing their inventories, do you expect this to continue? Why are they doing it? And linked to that have you talked to Invitrogen about their strategy for mass spec business and it is any different than ABI?

Stephen DeFalco - MDS, Inc. - President and CEO

I think -- just to your questions in order. Yes, there is no big, I would say, inventory management process going on, and you shouldn't reading is in from increasing or decreasing inventory. The truth is in mass spec we don't hold much inventory. I think it really has to do with how we do the accounting for the joint venture and the fact that the revenue we report and our reported results really have to do with our shipments out as opposed to end user acceptance criteria if you would.

So if we ship it into the joint venture. This quarter we shipped a little less, but end user revenues was up 5%. I think the end user revenues is what you want to key on in terms of long-term prospects and that's why we give that number. In terms of Invitrogen. Just in context, MDS and ABI have work together over the last two decades to really build the premier global mass spec franchise. It's a great business. We are working very closely with our partner to continue to build this business to make sure our new products get to market, to make sure our customers get outstanding service.

We are very focused with ABI and Invitrogen on ensuring we serve those customers well. At the same time, the change of control of our partner does give us certain rights under our agreement. We are assessing all possible options with the view to what is best for MDS shareholders. The mass spec business is a business we like a lot, and MDS is very committed to that business.

MDS is going to continue to focus on serving our customers in mass spec, short and long term. And so, I think we are working with them day to day, and making sure we get those product announcements out, those product launches done, and that the customers feel an extra-special hug during this period of time.

David Martin - Dundee Securities - Analyst

Okay. Thanks. My follow-up question is, the Corporate SG&A was two million this quarter and this is quite a bit lower than it has been in recent quarters. I'm wondering why we are getting that lumpiness and do we expect to move forward with two million a quarter?

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Doug Prince - *MDS, Inc. - EVP, Finance and CFO*

Hi. Hi, David. This is Doug. We saw -- we see some favorability from foreign exchange and stock-based compensation in this quarter.

I would say you've got to kind of look at the average that that one runs as to be a more realistic kind of view. So it is a little lower than we have seen in other quarters, so I would look back and kind of use an average.

David Martin - *Dundee Securities - Analyst*

Okay, thanks. I will get back in the queue.

Operator

Thank you. The next question will be from Randall Stanicky from Goldman Sachs. Please go ahead. Your line is now open.

Randall Stanicky - *Goldman Sachs - Analyst*

Great. Thanks for the questions. Stephen, just a quick question around the profitability in Pharma Services. You've talked historically about working through some of the lower margin backlog and then you also referred today to the business mix in 2007 from a profitability perspective, being pretty good. How do we think about the current profitability of the book of business that you have now as we look to the future?

Stephen DeFalco - *MDS, Inc. - President and CEO*

Yes, the business that we are winning is at much better profitability than the historical backlog. So every quarter we get a little bit ahead of that curve. And feel good about processing that business. A little bit why pushouts are not good for us, but, again, that's a matter of timing.

Randall Stanicky - *Goldman Sachs - Analyst*

Did you touch on -- I may have missed it but you did you touch on split between the early and late in what the last three quarters have been pretty strong an orders perspective?

Stephen DeFalco - *MDS, Inc. - President and CEO*

Yes, we talked about that a little bit before. I think our early stage business which has been our historical platform of strength is performing very well. Good trend line. Customer coming back. We are able to turn that into revenue and profitability.

I think late stage, we have done great job winning new business and having customers take a serious look at us in late stage and give us their business. However, turning that into revenue and profitability is taking longer than -- longer than we want quite frankly and longer than we had expected. And I think a little bit -- we had some cancellations a few quarters back, and we are still -- we get pushed out in that business often and one or two of those will affect it. So that one is going to take a little while longer for us to be able to see those trends clearly in the reported results, and we're driving real hard on that.

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Randall Stanicky - *Goldman Sachs - Analyst*

If we -- if we think about your comments thus far this year in that we are going to have a back half recovery giving those cancellations in Q4, Q1, clearly that is not happening from a revenue or profitability perspective at least in this quarter. How do we think about timing going forward for some of that backlog conversion to take place and also from the cost side? When do we see that business turn profitable, and then tying that together, we talked last quarter about exiting '09 with industry average margins. Is that something that you are still looking at or are we now thinking fiscal 2010?

Stephen DeFalco - *MDS, Inc. - President and CEO*

Yes. I think you gave a pretty good description, here our history. I think that describes why we are not happy where we are here in Q3. Again, I think we have good visibility into the early stage and that is improving nicely. I need another couple of quarters here on late stage to get a better trend line I think in order to refresh that.

We are still driving very hard in that business, winning customers and trying to push the profitability. But I would say that really getting a good grasp on the timeline and late stage is probably something that will evolve over the next quarter or two. We expect it to improve in Q4, but I don't expect kind of a hockey stick in Q4. I expect good steady improvement moving forward.

Randall Stanicky - *Goldman Sachs - Analyst*

But profitable in Q4?

Stephen DeFalco - *MDS, Inc. - President and CEO*

We do.

Randall Stanicky - *Goldman Sachs - Analyst*

Okay. Thank you.

Operator

Thank you. The next question will be from Max Paris from CIBC World Markets. Please go ahead, your line is now open.

Max Paris - *CIBC World Markets - Analyst*

Yes, good morning. Thank you for taking my questions. First on Analytical Technologies. What should we be expecting here in the long term?

Do you see the North American market for mass spec recovering? And do you see your margins going back up? Also on your new product offerings, you were talking about launching -- the launch of a new software solutions. When should we be seeing new hardware solutions?

Stephen DeFalco - *MDS, Inc. - President and CEO*

Great, Max, thanks for joining us this morning. Let me start I think at the macro level, which is the -- on the markets, I have seen the cycle a number of times, basically you can hold back on your CapEx for only so long. But the truth is customers really need

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these instruments because they drive great productivity in their drug development pipeline. So they can delay it for a while but certainly it comes back.

Predicting when? I am not sure. I am not expecting, quite frankly, any strengthening for the balance of calendar 2009, I'm sorry any strengthening for the balance of calendar 2008. I think as we go into 2009, let's kind of see where we are and let's see when that will turn -- it will turn in 2009. I am just not quite sure when, it will. I think I've seen it is usually tough to predict the right inflections.

I think in the meantime, we are driving hard to improve the margins in any business conditions; not waiting for them to come back. And you saw that with the restructuring that we took and you saw that with a step-up in profits in that business, from Q2 and Q3. And so I think we will continue with those activities.

We are very excited about our new software. We are probably spending half of our R&D budget these days on software. And so sometimes everybody gets more excited about the hardware sometimes than the software because they like the box. The software is really driving what's the penetration in the applied markets.

It is taking an amazingly sophisticated -- albeit I will describe it as occasionally finicky -- method and putting it in the hands of novice users which through turnkey capability, deliver outstanding results and quite frankly be up and running in a day versus needing two or three weeks of training. These instruments were normally run by Ph.D. scientists four or five years ago. Software is very, very important. Method development, speed, precision, signal analysis. So, literally with seven new pieces of software on the market, we have basically revamped our whole suite of software, including our core offering. SO we are very excited about that.

We today have what we believe and what customers will usually would say in any survey is the best hardware in the market. We are still the leading mass spec provider. I think, as usual, we will be announcing new products over the next 18 months and some of those will be some pretty exciting hardware offerings also. But quite frankly I like where I am sitting right now because I think we have the best hardware and software in the market, and I think we are doing quite well.

I think nothing helps in a sluggish market than a couple of exciting, new offerings, but you need to announce them when you are ready to ship them, right. If you were announce them before you are ready to ship them it doesn't do good things for your market. So we like where we are sitting here at this point in '08, and we are very excited about '09

Max Paris - *CIBC World Markets - Analyst*

Great. That is very helpful. Then on your \$1.6 million claim against AECL and the Canadian Government. When is the next data point here? Is there a hearing date scheduled? What should we be expecting in the next few months?

Stephen DeFalco - *MDS, Inc. - President and CEO*

Yes, I think now this has gone into the realm of a legal case, don't expect us to be making a lot of comments here. As anyone knows who progresses through a legal case, there is a lot of hurry up and wait kind of activities and I would never like to get into the habit of predicting the courts and how the courts operate. The next step here is really picking an arbitrator and beginning the arbitration process and we are working through those issues. But don't expect a blow-by-blow on this.

Max Paris - *CIBC World Markets - Analyst*

Great. One follow-up if I can on the bio analytical review in Montreal. You've got a remaining reserve of \$32 million. But the six month time period has past. Do you think we should -- you could see a reversal of that? You're saying on one side that you've

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got the \$32 million will be sufficient to cover the potential claims, on the other hand, the six-month period is past. Do you think you could see reversal of that?

Stephen DeFalco - MDS, Inc. - President and CEO

Yes, well, we review that every quarter and when we renew that obviously with our accounting team and our auditors. And, we continue to work through customers. I think that, we will continue to look at that. Right now we are very confident it's more -- it's sufficient to cover anything coming down the pike, and if at some point we deem that it is more than sufficient, we would be taken a reversal on that, but we are not at that point at this point in time.

Max Paris - CIBC World Markets - Analyst

Okay. Thank you very much.

Operator

Thank you. The next question will be from David Windley from Jefferies & Company. Please go ahead your line is now open.

David Windley - Jefferies & Company - Analyst

Hi, thanks for taking the questions. First one just to clarify on the back log and new business, the \$169 million that you are reporting, that is a net number, net of cancellations? Is that correct?

Doug Prince - MDS, Inc. - EVP, Finance and CFO

That is our new business wins, David. This is Doug.

David Windley - Jefferies & Company - Analyst

All right.

Doug Prince - MDS, Inc. - EVP, Finance and CFO

So what we've got in the release is you can see our beginning backlog, beginning of the quarter. You can see our new business wins. You can also subtract revenue, and then you can see what the difference is to ending backlog. And that difference would include cancellations, foreign exchange, and other adjustments.

David Windley - Jefferies & Company - Analyst

Okay. So foreign exchange was a fairly large positive adjustment in the quarter?

Doug Prince - MDS, Inc. - EVP, Finance and CFO

Yes, it was a bit positive there and as Stephen commented earlier, really no cancellations to speak of within the quarter.

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David Windley - *Jefferies & Company - Analyst*

Okay. Stephen, on the -- if I look back a year or so your revenue base in Pharma Services was fairly similar to where it came out in this third quarter. Profitability was quite a bit different.

You have taken at least one restructuring that you discussed on the call and taking costs. You have been generally taking costs out of the business. So I guess my interest is in where have costs actually gone into the business to make that same revenue base not as profit -- or a similar revenue base not as profitable now as it was a year ago?

Stephen DeFalco - *MDS, Inc. - President and CEO*

So David, there's a couple of factors at play, right. I would say we have made investment in new systems, we have made investments in new facilities in Beijing and Phoenix. We have made big investments in our business development team, which you -- you see in terms of the orders coming in. And obviously the business has normal things like inflation and what not which with a business that is a service business you have a pretty big salary component against it.

And so those investments and inflationary things have -- more or less cancelled out I think the benefit that we have gotten through the productivity and the restructuring and the improvement. I think though at this point we have a good cost structure, we have good processes. We have customers coming back. The key to turn that into a revenue ramp is really the next step here this process to drive the profitability.

As I would say, think that with we may miscalculated that. I think in early stage we have seen that and it is working nicely, I think in late stage here, we're a couple of quarters behind where we wanted to be. Certainly where we thought we would be. So we have to -- that's why we are doing the things that we are doing. But I think we are pretty excited about turning those new business wins into revenue, particularly at the profitable they were won at.

David Windley - *Jefferies & Company - Analyst*

Okay. On your headcount reductions, just a quick question on that one and one more on the overall business. And on the headcount reductions, are those having -- are those or that plus other turnover that the business may be seeing having an effect on your ability to execute on projects?

And then more broadly speaking on Pharma Services, how do you think about the -- the business and systems and management team that you have in place for that business today? Relative to your ability to compete, do you need to make acquisitions or conversely, do you need to think about putting that business in the hands of a larger -- larger player in the industry that could perhaps leverage that infrastructure more fully?

Stephen DeFalco - *MDS, Inc. - President and CEO*

I think in terms of our processes and capabilities, those are improving nicely. In terms of places where is we took headcount out, it was really places where is our lean Sigma project had led to some pretty good productivity savings. So we don't have any -- we are not taking headcount out where we have profitable business that needs to be executed. So I feel good about the projects in the pipeline and our ability to service them well.

And I think the new business wins I think really talks to call it our competitiveness, right. We wouldn't be winning business at that rate if clients didn't view us as a competitive offering and a place that wanted to do work. And I think the other part of your question. I would say again, I would separate -- early stage we are doing fine. We are competitive, we are of sufficient scale. I think all of that is working pretty well.

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I think in late stage, the issue for us is we focus on a spot in the market, which is small pharma, big biotech. I think there we have been very successful winning business. We have to turn it into revenue and profit which as I stated before. I think, though, we -- we miscalculated our ability to do that and are off here by a quarter or two, and we will have to go and really get that to ramp. So that's how I look at it.

David Windley - *Jefferies & Company - Analyst*

Okay, thank you.

Operator

Thank you. The next question will be from Doug Miehm from RBC Capital Markets. Please go ahead, your line is now open.

Doug Miehm - *RBC Capital Markets - Analyst*

Yes. Good morning. Two questions. Number one has to do with the salespeople in the pharmaceutical services division. I am curious as to how their they are bonus and commissioned when they get paid relative to when they book this backlog. Do they get paid before the business is complete? Or do they have to wait to be bonused until next year when this business is complete?

Stephen DeFalco - *MDS, Inc. - President and CEO*

Yes. Doug, I think broadly, we have a new head of business development that came in, [Teresa Winslow]. That group is all under a single leader. I think a very coordinated set of processes and procedures. The exact nature of their commission plans is not something we really want to discuss.

We view it as somewhat confidential information, but we have thought that through pretty carefully and quite frankly take a little different approach in a short-cycle business than in a long-cycle business, right. And so if they are booking business that will be executed over multiple months and might have changeover parts and stuff like that, you don't pay that commission all up front.

Quite frankly if their in more business where is revenue bookings turn into revenue at a shorter cycle, then we have different programs in place. But they are very well aligned with what we want from a business results and are shareholder perspective.

Doug Miehm - *RBC Capital Markets - Analyst*

So in effect MDS isn't bearing all the risk here? It is being equally distributed between the front sales force and the Company and shareholders?

Stephen DeFalco - *MDS, Inc. - President and CEO*

I would say the -- the sales force incentives are well aligned to what we are trying to achieve from a business results and shareholder perspective.

Doug Miehm - *RBC Capital Markets - Analyst*

And their in line with industry standards?

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Stephen DeFalco - MDS, Inc. - President and CEO

Yes. I don't know how standard the industry is, but it is a relatively new industry so I don't know how standard it is from competitor to competitor. We get pretty good data on that because we have people who have worked at other companies before. So I think we look at that, but certainly nothing that is out of the market.

Doug Miehm - RBC Capital Markets - Analyst

I guess at the end of the day, the only thing I am asking there is what is the risk to -- to us as investors? When we look at these backlog numbers, how firm are they or are they just bookings that is are being put in place that can ultimately be cancelled?

Stephen DeFalco - MDS, Inc. - President and CEO

No, that's -- that's -- if that's the heart of your question, I mean, every single order that gets into our backlog goes through a scrutiny and assessment by our financial team. It is very well understood. We have visibility into all of the future ones. We know the margin of that business. We participated in the decision whether or not to take that business at that margin. So, no, there is a lot of formal procedures there.

Can items in backlog be cancelled because the client [moleculery] decides not to develop it or for example he booked a Phase I project and the molecule failed in animal testing. Yes, that can happen. That is part of the industry. That's -- quite frankly we market ourselves as helping our customers bring safe molecules to market quickly.

But often what we do is help them to determine that that molecule has failed and they should work on another molecule because most of them don't make it. So for those reasons projects get cancelled, but not for order integrity issues. We have never had any of that.

Doug Miehm - RBC Capital Markets - Analyst

Okay. That's great. That really helps. Second one, more general question, sort of getting to the last question as well. When I think the market looks at the implied value of the various assets of this company, and let's say especially the Pharma Services group when you look at it relative to other companies in the marketplace today.

It honestly looks like there is a fairly significant discount between the implied value and where these things should trade if ultimately they can put up some good numbers. How over the next six to 12 months do you expect to help to close that discount to what people would see as net asset value? How would you expect to do that? Getting back to the question of Pharma Services. At what point would you be unhappy with the late-stage business that you would be willing to get rid of it?

Stephen DeFalco - MDS, Inc. - President and CEO

Yes, I think -- Doug you are asking the question in the wrong context, right. Because you are asking a question about being happy and getting rid of something. That not the context I would have, right. I believe that we have a great opportunity to create value in businesses and that we are the right owner and we drive hard to deliver on that shareholder value. If at some point in time we determine we are not the best to do that, we take action.

You've known me for three years. You have seen us make a number of portfolio moves, both acquisitions and divestitures which I think most shareholders would agree were very well executed and were done at very good prices. I think that, to me have kind of what determines it. I am not happy where Pharma Services is right now. And so I think that's pretty clear.

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And what we need to do is continue to drive. I am very happy with the new business wins. And I am happy with the new systems and customer who are using the services and turning that into repeat business. But, we need to accelerate that EBITDA ramp there. And, I think that we are on it.

Doug Miehm - *RBC Capital Markets - Analyst*

Okay. Thanks very much, Steve.

Operator

Thank you. We have a follow-up question this time from Lennox Gibbs of TD Securities. Please go ahead, your line is now open.

Lennox Gibbs - *TD Securities - Analyst*

Thanks again. Nordion, it's been a few months since the fed's surprise announcement regarding the MAPLE reactor. I think we are clear on the litigation strategy, but what can you tell us with respect to contingencies you may be considering on the operating side? And we are aware that there are emerging players in the US who claim to have alternate moly technology. Is that a route that you might consider?

Stephen DeFalco - *MDS, Inc. - President and CEO*

Yes, so Lennox, absolutely we would consider. So we are in discussions with everyone in the industry, right. I want to make it clear that we are not part of AECL. We are a separate company and what we do is take processed moly and turn it into pharmaceutical product, and then work in the distribution and logistics of it.

So, yes, any new opportunities there are in the world to source moly would be things that we have conversations on and quite frankly most of those people would come to talk to us given our position in the industry. But, I think for -- as I said before, and I will say again, I think this short to medium-term, we are fine. We are connected to the world's most reliable reactor.

It has great capability and that is a business we have built over the years. I think -- what we are really trying to do is solve of a longer-term issue here that is a little further out. And on that, yes, we are looking at all possibilities. Because I think just the situation we are in will dictate that as the prudent course.

Lennox Gibbs - *TD Securities - Analyst*

Thanks very much.

Operator

Thank you. We have a follow-up question from Maher Yaghi of Desjardins Securities. Please go ahead, your line is open.

Maher Yaghi - *Desjardins Securities - Analyst*

Yes, thank you. I just have a follow question also on Nordion. You mention in the press release that you are evaluating the current value of the MAPLE reactor on your balance sheet. Can you maybe just give us a bit more clarity about what determines in your judgment the timing, if any, that you might have to decide to write down the 336 million in the MAPLE reactor on your intangible assets?

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Doug Prince - MDS, Inc. - EVP, Finance and CFO

Hi, Maher, this is Doug Prince. On that question, the intangible asset is related to the MAPLE supply, and as we say in the disclosure, our belief is that the contract requires a sale to complete that MAPLE project hence the arbitration. So I think we are going to have to watch how the arbitration develops over the coming months and then we will make a call as appropriate should -- based on the outcomes.

Maher Yaghi - Desjardins Securities - Analyst

If the arbitration goes to court, and we take the next step to go to court, is that a trigger point for -- for that test?

Stephen DeFalco - MDS, Inc. - President and CEO

No that would not be a hard trigger point. I mean our -- our perspective is we have a contract. The contract says they need to complete that facility and provide 40 years worth of supply. And so if at some point we view that -- we view that as not the position, that would then determine some of the thinking about that. But we don't -- it is not arbitration to court. It is arbitration on a set issues caught on a set of other issues.

Maher Yaghi - Desjardins Securities - Analyst

Okay. Thank you very much.

Operator

Thank you. The last follow-up question will be from David Martin of Dundee Securities. Please go ahead, your line is open.

David Martin - Dundee Securities - Analyst

Thank you. In the late stage, obviously you referred to delayed projects in the Central Lab and the Phase II to IV business. I am wondering. I guess that is a number of projects. If you took the three biggest of them, when do you think those projects will get started or lost indefinitely? And (Inaudible - technical difficulties) get started what kind of revenue and EBITDA contribution do you expect from the top three projects collectively on a quarterly basis?

Stephen DeFalco - MDS, Inc. - President and CEO

Yes, David. We are not going to go into that level of depth on three specific customer situations and quite frankly we are always managing this number of situations. And then differences of a couple of weeks can affect the quarter. So they are very hard to estimate the exact start date, and obviously it is mostly tied to our clients getting regulatory approval from their last milestone in order to proceed with this project. And so we are -- we monitor that pretty closely.

David Martin - Dundee Securities - Analyst

So a majority of what you are talking about here is definitely short-term delays then?

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Stephen DeFalco - MDS, Inc. - President and CEO

As we have current information it's short-term delays and quite frankly tomorrow we can hear that we have a brand-new order that is coming in that is a rush job, they want us to start immediately. And the day after that we can hear that one of our clients got acquired and the new owner does not want to go forward with that molecule.

And I think that is part of the industry we are in and quite frankly the value that we supply to our clients is to make that a variable cost. And so it is a bit of a changing environment that we manage. I think, unfortunately, in Q2 and Q3 here, we have had a couple of big ones that have sort of impacted us pretty hard in late stage.

Operator

Thank you. There are no further questions registered at this time, so I would like to turn the meeting back to Ms. Lee.

Kim Lee - MDS, Inc. - Director of IR

Thanks, [Joe]. Thank you for joining us this morning. If you have any additional questions please do not hesitate to give me a call. Thanks again and have a nice day.

Operator

Thank you. The conference call has concluded. You may disconnect your telephone lines at this time. We thank you very much for your participation.

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