FINAL TRANSCRIPT

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MDZ - Q1 2008 MDS Inc. Earnings Conference Call

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PRESENTATION

Operator

Good morning, ladies and gentlemen. Welcome to the MDS first quarter results conference call.

I would now like to turn the meeting over to Kim Lee, Director of Investor Relations. Please go ahead Ms. Lee.

Kim Lee - *MDS Inc. - Director, IR*

Thank you. Good morning everyone, and thank you for joining us today.

Our first 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 website at mdsinc.com. We are webcasting this event live on our website, where you will find a PowerPoint presentation highlighting the details of the call. The archived version will remain on our website after the call today.

Joining us this morning are Stephen DeFalco, President and CEO of MDS, and Doug Prince, Chief Financial Officer. Stephen will begin the call with his perspective on the quarter, and Doug will follow with the financial and operating highlights. Prior to our Q&A session, we will turn it back to Stephen for a few closing comments.

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 risks and uncertainties, 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 U.S. Securities regulators, and are available on our website.

Let me remind everyone that all financial data today is shown on a U.S. GAAP basis, and in U.S. dollars, unless otherwise indicated. In addition to standard GAAP measures, we also make reference to selected non-GAAP financial measures, that we believe provides 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 consultation.

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

As we discuss the results of our operations, we also discuss new orders and backlogs related to MDS Pharma Services. We believe the use of these measures provides management and our investors, with an enhanced understanding of the performance of our business.

I will now turn it over to Stephen DeFalco.

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

Thank you, Kim. Good morning, everyone and thank you for joining us. We ended Q4 with nice momentum and off to a solid start in 2008. In Q1, we delivered financial performance, with double digit growth in net revenues and adjusted EBITDA.

For the quarter, MDS reported net revenues of $296 million, up 23%. Increased adjusted EBITDA to $40 million, up 33% from last year. We saw improved performance at MDS Pharma Services and MDS Analytical Technologies. MDS Nordion, as expected, had a tough start to the year.

A few highlights. We upgraded business development teams and processes at MDS Pharma Services throughout the back half of 2007. We are seeing the benefit of these initiatives. In Q1, we reported $177 million in new business wins, a number that has been climbing steadily, and set a record for the last four quarters. MDS Analytical Technologies delivered solid growth at Sciex and Molecular Devices. I have to single out Molecular Devices, which delivered the highest quarterly revenues in it's history, both pre and post acquisition.

We acquired this company less than a year ago, and it has already exceeded our first year revenue targets. It was a perfect storm for MDS Nordion, which had a tough quarter, given the supply disruptions in November and December, and light cobalt shipments in Q1. For the quarter, adjusted earnings per share was $0.05, compared to $0.07 last year.

During the quarter we made a number of exciting service and product announcements. We launched our Apollo system, our new proprietary study management process, which gives our central lab clients, real-time access to study data anywhere in the world, no matter where their study samples are located. We held a Grand Opening of our state-of-the-art Phase I facility in Phoenix, Arizona. We had over 40 clients attend. This 420-bed facility is the largest on the U.S. West Coast.

We also expanded our presence in South America, with the opening of a new Phase II through IV office in Sao Paulo, Brazil. Latin America is a burgeoning center for drug development activity. This region provides our clients with a diverse population, abundant healthcare resources, and the opportunity for year-round testing of drugs that test seasonal conditions. And we announced the divestiture of two non-core product lines. These assets are slower growth product lines, with relatively low margins. Their sale was a key step in executing our growth strategy to position Nordion better.

I will now turn it over to Doug Prince, our Chief Financial Officer, to provide the financial details for the quarter.

Doug Prince - *MDS Inc. - CFO*

Thanks, Stephen. Before I get into the financial results, I would like to remind everyone that we have transitioned to U.S. GAAP reporting, and all amounts we are referring to this morning are in U.S. dollars and U.S. GAAP, unless specified otherwise. Additional information on historical results in U.S. GAAP is available on our website.

In addition to the GAAP financial results, included in the press release, we provide commentary on items that impact the comparability of our results. For the first quarter, adjusted financial results exclude charges related to restructuring initiatives, acquisition and divestiture, interest rate, swaps, and certain tax gains. Where appropriate, for year-over-year comparability, I will describe the impact of foreign exchange, acquisitions, and divestitures. For the discussion today, all revenue figures, and all margin percents are based on net revenues, that is revenue from products and services, excluding reimbursement revenues.

On a consolidated basis for Q1, our total revenues, including reimbursement revenues were $322 million. Net revenues were $296 million, up 23% from $241 million last year. With $56 million in Q1 revenues, the acquisition of Molecular Devices contributed the bulk of this quarter's revenue growth. Excluding Molecular Devices, growth in our Sciex brand products, was offset by declines at MDS Nordion, where revenues were impacted by a disruption in isotope supply and lower cobalt shipments.

GAAP operating income was a loss of $6 million, a $3 million improvement over the loss of $9 million last year. Adjusted EBITDA was $40 million, compared to $30 million last year, up 33%. The acquisition of Molecular Devices contributed $11 million to this growth. Both MDS Analytical Technologies and MDS Pharma Services delivered adjusted EBITDA growth, which was offset by MDS Nordion, which as noted earlier was adversely impacted by the medical isotope supply disruption, and a $4 million noncash charge for embedded derivatives.

First quarter adjusted EBITDA also includes a $7 million gain related to certain stock-based compensation programs, compared to a gain of $1 million last year. Also $4 million of foreign exchange balance sheet gain was realized in Q1, versus a $3 million gain last year. This gain results from the change in foreign exchange rates between year end and the first quarter.

Operations were also negatively impacted by $3 million after hedging, due to the year-over-year decline in the U.S. dollar. Our adjusted EBITDA margin increased 110 basis points to 14%. Our reported gross margin, which is net revenues less associated cost of revenues was 37%, up from 33% last year. This year-over-year improvement was largely driven by the inclusion of Molecular Devices, as improved margins at Pharma Services and Sciex were offset by declines at Nordion.

SG&A for the quarter was $64 million, or 22% of net revenues, and compares to $54 million and 22% last year. The year-over-year increase in SG&A is attributed to the addition of Molecular Devices and foreign exchange, which were offset by lower stock-based compensation and FDA-related expenses incurred last year.

In the first quarter, we spent $20 million on R&D activities. This compares to $12 million spent last year. The addition of Molecular Devices and higher investment related to Sciex products, contributed the majority of the increase in R&D spending. For the quarter, we also recognized a tax recovery of $7 million, as a result of a deferred tax gain of $11 million, associated with the reduction of future Canadian income tax rates, and $1 million of investment tax credits. Excluding these items, our tax rate for the quarter would have been approximately 35%.

On a reported basis, our GAAP earnings per share from continuing operations were $0.14 in Q1 2008, versus breakeven last year. Following the adjustments mentioned earlier, and the impact of higher intangible amortization related to the acquisition of Molecular Devices, our adjusted earnings per share was $0.05, compared to $0.07 last year.

Let me now discuss business unit results. For the quarter, Pharma Services reported revenues of $120 million, essentially flat to last year. These revenues reflect a positive impact from foreign exchange of approximately $9 million. Adjusted for foreign exchange, revenues declined for both early and late-stage services.

Our late-stage revenues were impacted by contract cancellations that occurred in Q4, and continued into Q1. Despite these cancellations, Q1 saw the highest levels of new business wins in over a year, with $177 million in new orders, up 32% sequentially. This is the third quarter in a row that we have seen a sequential increase in new orders. Based on the strength of these new orders, our quarter end backlog increased by $20 million to $395 million. This increase in backlog, which grew for both early stage and late stage, is expected to drive revenue growth in the second half of 2008.

For the quarter, we reported GAAP operating loss of $1 million, compared to a loss of $15 million last year. Adjusted EBITDA improved to $6 million in Q1, up substantially from $1 million reported last year. Improvement in adjusted EBITDA was largely driven by restructuring savings, lower stock-based compensation cost, and 2007 FDA-related expense, which offset pressures from lower revenue and inflation.

Reconciling items between GAAP operating income and adjusted EBITDA in Q1 included a $2 million gain related to a favorable third-party settlement, and $9 million of depreciation and amortization. Reconciling items for the similar period in 2007, included an $8 million restructuring charge, and $8 million of depreciation and amortization. As of Q1, we have now implemented 90% of the restructuring initiatives we announced last year.

The balance of actions are expected to be substantially completed during the second quarter of 2008. To date, we have utilized $13 million of the $61 million provision we recorded last year to reimburse customers for FDA-related costs. We believe the remaining provision is sufficient to cover all future costs.

MDS Nordion reported revenues of $60 million, down 10% from $67 million last year. During the quarter, MDS Nordion's revenues benefited from $9 million in foreign exchange impact, and were negatively impacted by the isotope supply disruption and lower cobalt shipments. GAAP operating income was $4 million, compared to $17 million last year. Nordion's adjusted EBITDA of $11 million, compares to $20 million in Q1 of last year. This year-over-year decline in adjusted EBITDA was largely driven by lower revenues, including $5 million of EBITDA impact, from the previously announced disruption in the supply of isotopes. Nordion also recorded a $4 million embedded derivative charge in the quarter.

Reconciling items between GAAP operating income and adjusted EBITDA in Q1, include a $4 million loss associated with the expected sale of two product lines, and $3 million of depreciation and amortization. Reconciling items for the same period in 2007 include $3 million of depreciation and amortization.

Now on Analytical Technologies, MDS's Analytical Technologies revenue more than doubled to $116 million in Q1, up from $53 million last year. For the quarter, Molecular Devices contributed $56 million in revenues, representing a revenue increase of 8%, compared to the same three-month period in 2007, and the highest quarterly revenue in MD history. Sciex revenues grew by 13%. Reported end user revenues for Sciex products grew by 5% versus last year. Sciex growth was driven by continued strength in our core LC/MS products, and was supported by strong demand for our ICP mass spec products.

Analytical Technologies reported a GAAP operating loss of $5 million in Q1, level with last year. Adjusted EBITDA was $27 million in Q1, up 125% from $12 million last year. With Molecular Devices contributing $11 million. Excluding Molecular Devices, adjusted EBITDA grew 33% to $16 million. Molecular Devices continues to perform well. In the first 10 months of ownership by MDS, Molecular Devices has delivered $194 million in revenue, exceeding our first-year revenue goal of $190 million.

With $44 million of adjusted EBITDA since the acquisition, we expect Molecular Devices to meet or exceed our first-year target of 45 to $50 million. Reconciling items between GAAP operating income and adjusted EBITDA in Q1 include, $14 million in equity earnings, $3 million of acquisition costs, and $15 million of depreciation and amortization. Q1 reconciling items include $14 million in equity earnings, and $3 million of depreciation and amortization.

Now let's turn to the balance sheet and cash flow. We ended Q1 with $144 million in cash and short-term investments, down from $337 million in Q4 2007. During the quarter, primary uses of cash included $89 million of long-term debt and interest payments, $57 million of income taxes for the 2007 gain on the sale of the Diagnostics business. Year-end compensation payouts, and a decrease in Accounts Payable, largely due to the $15 million of lower CapEx in Q1.

Our Q1 Capital Expenditures totaled $13 million, compared to $9 million last year, and $28 million in Q4. Our business had net operating cash outflows of $57 million in Q1. For the remainder of fiscal 2008, we expect to have net operating cash inflows. During the quarter, we repurchased and canceled 252,000 shares for $5 million, under our normal course issuer bid. We believe that cash on hand, cash generated from operations, and our financing sources, will provide sufficient liquidity to fund ongoing operations, capital expenditures, R&D expenses, restructuring costs and potential acquisitions.

I have a few comments relative to our outlook. As we look ahead for MDS Pharma Services, we believe our restructuring savings combined with investments in new facilities, new systems, and improved business development, will accelerate growth and margin expansion in the second half of 2008. After a tough Q1, we expect MDS Nordion to return to more traditional levels of revenue and adjusted EBITDA in the second quarter of 2008. Customer demand for innovative new products remains strong in MDS Analytical Technologies markets. Given our pipeline of new products and the manufacturing shift to Asia, we expect continued growth in revenues and profits in this business.

That concludes the financial highlights for the quarter. And with that, I will turn it back to Stephen for closing remarks.

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

Thank you, Doug. Q1 was a solid start for us. In spite of our challenges at Nordion, adjusted EBITDA increased $10 million versus prior year, and $5 million versus Q4. I feel good about the growth initiatives across MDS, and the momentum we have gained.

We are excited about the ramp-up of business wins at MDS Pharma Services, and the continued success of our Molecular Devices acquisition. We fully expect MDS Nordion to be back on-track in Q2. A few words about about the NRU issue. The NRU has been back up and in production since December 16th. Reliability to date as usual, and as the history of this facility has been pristine. The November/December disruptions have elevated the importance of having a reliable, secure, and longer term supply of isotopes, to serve physicians and patients all over the world.

Since this event, there are now new leaders in place both at AECL and at the regulator, CNSC, both of which we met with. There has been a tremendous amount of dialogue and discussions on the criticality of isotope supply. In fact, MDS has had more than 50 meetings, e-mails and phone calls with all levels of the government, to discuss and plan for the reliable operation of the NRU, and securing a longer term supply.

I am very encouraged that all parties are actively dialoguing to insure the events of November/December is never repeated. We believe that MDS is well-positioned to drive growth and improved profitability throughout 2008. In closing, I would just like to remind all of you that our Annual Shareholder Meeting is being held in Toronto at 4:00 this afternoon. We hope to see a number of you there.

Thank you, and I will turn it back to Kim for questions and answers.

Kim Lee - *MDS Inc. - Director, IR*

Thank you, Stephen. Before I ask the operator to open the lines up for Q&A, I would like to ask you to limit yourself to one primary question and one follow-up question, before you queue up again for follow-up questions. Dana, would you please open up the line for questions?

QUESTIONS AND ANSWERS

Operator

Thank you. We will now take questions from the telephone lines. (OPERATOR INSTRUCTIONS) The first question is from John Maletic of Scotia Capital. Please go ahead.

John Maletic - *Scotia Capital - Analyst*

Good morning. Just a couple of questions on Pharma Services. As far as the new order wins go, what is the relative breakdown between late stage and early stage, and just to tie into that, I just want to get an update on the potential for returning customers to the early stage business, and whether you have seen any increased activity there?

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

John, thank you. We don't break it back down by early and late stage, but what I would say we are seeing strength actually across the business, in terms of order wins. I would say that our cancellations tend to hit our late stage business, and as you saw in the quarter we did have a number of cancellations. We are getting more back month growth in early stage, but I would say the velocity of new order wins is essentially across the business, all product lines are up, and are strengthening for us.

John Maletic - *Scotia Capital - Analyst*

Okay. And then as far as returning customers to the early stage business. Any update there? Have you seen more or less from the previous update that we had?

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

Yes, we have, you know I think last I updated out of the top 10, we had four. We got four more back at this point. So I would say for practical purposes, we are getting everybody there to come back, and begin to put work back in our facilities. We are excited about that.

I think the Phoenix launch was a good event. A lot of clients showed up at that. We had 40 clients at the event, that saw the new facilities. And so I think that has been a good, steady progress, for all practical purposes, I think everybody is back and working with us again, and now the goal is to win the majority of their business.

John Maletic - *Scotia Capital - Analyst*

Okay. And then just on the outlook, you had mentioned that you expect the second half to be better for Pharma Services relative to the first half, so are you not expecting Q2 to pick up?

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

Yes, I think Q2 will be an okay quarter for Pharma Services. I think we will see more of the ramp in the back end of the year. Obviously we were not doing what we needed to do in terms of new business wins earlier in '07. That leaves our backlog right now a little lower than we want it to be. We are seeing those new orders pick up, but probably the inflection point will be out more in Q3 than in Q2.

John Maletic - *Scotia Capital - Analyst*

Is Phoenix the primary driver?

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

No no, I think again it is across the board. Every product line, a stronger sales implementation. We have upgraded our business development teams. We have upgraded those processes. We have rebranded the business. We have had a tremendous amount of messaging and contact with our customers. We are seeing it across the board.

Events are good because they always spike it up a little. So Phoenix was a great event for us. I would say the Beijing lab launch last year was a big event, with a ton of customers. I would also say the Apollo launch and Central Lab has been extremely well received. We have had a couple of very large customers come in, and do a full analysis of the system, and really giving us some remarks that indicate that we probably have the best one in the industry. So it has been kind of a steady stream of things, but yes, Phoenix was big for us.

John Maletic - *Scotia Capital - Analyst*

Okay. Thanks.

Operator

Thank you. The next question is from Maher Yaghi of Desjardins Securities. Please go ahead.

Maher Yaghi - *Desjardins Securities - Analyst*

Thanks for taking my questions. I also have just a follow-up question on the Pharma Services business. Now can you just tell us your early feedback from the Phase I expansion in Arizona? How are you seeing demand coming in? Can you tell us a little bit about the utilization rate of the beds at that facility, and where you expect the utilization rate to end up, maybe in the back half of the year?

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

Yes, Maher, I don't think, first of all, the reaction to the facility was very strong. We had 40 clients show up at the launch. I think that they saw the capabilities in that business, but also, we don't talk facility to facility. We talk globally about our Phase I network.

I don't want to get into the utilization of one facility, because I think it's probably a fairly unhelpful statistic. The way we will ramp up Phoenix, really has more to do with us being able to recruit and train up the staff, and do that in a way that is aggressive but controlled, so that we don't have any hiccups in that process. So we have the ability to bring on so many staff per month, train them up. We want people to be trained once or twice as a #2, before they run their own study.

The other thing in that facility is specifically designed to do very large QTC studies. And as you know, that is an incredibly hot part of the market. And so essentially that QTC facility is more or less sold out here for a number of months already.

Maher Yaghi - *Desjardins Securities - Analyst*

Right.

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

We are seeing actually, a pickup across the Phase I facility. So it has been good for us across the board.

Maher Yaghi - *Desjardins Securities - Analyst*

How many employees do you plan to hire for that facility in total? And maybe you can tell us how many you have hired already?

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

We had 150 at the original facility. I think fully staffed, the new facility would be in the range of 400. My guess is right now we are in the 250 range, using rough numbers.

Maher Yaghi - *Desjardins Securities - Analyst*

Okay. Great. And just a follow-up question, on maybe just tell us a little bit about the cancellation that took place early in the quarter, before we saw the spike in the new orders that you elaborated on? Can you tell us if there are basically the same type of cancellations we saw in Q4, mainly on molecule failure, and were they with the same customers that we saw in Q4, or were these new different molecules?

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

So the cancellations are 100% a function of compound failures. As you know not every drug that enters Phase II through IV exits successfully, and the question is when do they get the data to let them know that they should work on a different compound? And so we have had actually a pretty high string of it, statistically it bounces around for me and everyone else in the industry. That is partially actually how we exist as an industry, is quite frankly, to be able to load across a number of clients.

Your question about, is it the same client? My answer is no. Because it is kind of a random event that occurs across as different compounds run around. There might be one or two clients that have had one or two studies in there that have failed. But there is certainly no trend there.

Maher Yaghi - *Desjardins Securities - Analyst*

Okay. Are they mainly located in the same indication, cardiology, or CNS, or are they across the board?

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

They are across the board.

Maher Yaghi - *Desjardins Securities - Analyst*

Okay. Thank you very much.

Operator

Thank you. The next question is from Dave Martin of Dundee Securities. Please go ahead.

David Martin - *Dundee Securities - Analyst*

Thank you. First question is in Pharma Services, your SG&A was quite a bit lower than our expectations, and lower on a percentage of revenue basis compared to the last three quarters, but the cost of revenues in Pharma Services were quite a bit higher, and I am wondering, have you moved some of the SG&A expense up to cost of revenues this quarter, and are we likely to see this type of trend going forward?

Doug Prince - *MDS Inc. - CFO*

This is Doug, and a big driver of that is foreign exchange. And the impact from the balance sheet impacts the SG&A number.

David Martin - *Dundee Securities - Analyst*

Okay.

Doug Prince - *MDS Inc. - CFO*

And so with the year-end rate going from Canadian dollars 94.5 to about parity, we have got a balance sheet gain in the revals.

David Martin - *Dundee Securities - Analyst*

Okay.

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

And you book that against SG&A.

Doug Prince - *MDS Inc. - CFO*

And that goes to SG&A.

David Martin - *Dundee Securities - Analyst*

So do we expect that type of thing in quarters going forward?

Doug Prince - *MDS Inc. - CFO*

We are forecasting at parity going forward.

David Martin - *Dundee Securities - Analyst*

Okay.

Doug Prince - *MDS Inc. - CFO*

But if the rate changes up or down, yes, it would impact us. In Q4, the rate went the other way, and we had a big balance sheet reval charge in SG&A. So you will see some lumpiness there.

David Martin - *Dundee Securities - Analyst*

Okay. Other housekeeping issue. The corporate SG&A has been bouncing around a lot in recent quarters. I am wondering if the $5 million loss at corporate this quarter is likely to be reflected going forward? And then you had a tax gain this year. I wonder if it was all taken this quarter, or are we will see benefits of that in the remaining quarters?

Doug Prince - *MDS Inc. - CFO*

The corporate side, a couple of swing items there include stock-based compensation, as well as CapEx. So again, we get some lumpiness in those areas, and on the tax side, the big tax gain recognized this quarter is related to the announced future reduction of Canadian tax rates, and that drives favorability to our deferred tax liabilities, and we recognized all of that in Q1. The investment tax credits continue, and we typically recognize those every quarter.

David Martin - *Dundee Securities - Analyst*

So what tax rate should we tax you at going forward for the remainder of the year?

Doug Prince - *MDS Inc. - CFO*

Typically, we do about 35%, and then you subtract from that investment tax credits.

David Martin - *Dundee Securities - Analyst*

Okay. I got a couple of other questions, but I will get back in the queue. Thanks.

Operator

Thank you. The next question is from Joe Walewicz of CIBC World Markets. Please go ahead.

Joe Walewicz - *CIBC World Markets - Analyst*

Yes, good morning. Just a quick question on the FDA, the reserve that you have established for that, you have $52 million left, you spent $2 million in the quarter. I am just wondering at what point, or what event, or what timeline, you think that you will kind of revisit that issue, specifically it doesn't look like it will take a lot of quarters to get through that. I am just wondering if it is the ending of the European review. Is there some other event that you are looking for on that? And then maybe I will have a follow-up question after that. Thanks.

Doug Prince - *MDS Inc. - CFO*

Yes, we take a look at that every quarter. And to your point, as information stabilizes, then we are able to make that adjustment.

Joe Walewicz - *CIBC World Markets - Analyst*

Okay. And then I will leave it at that on that one. On the cobalt shipments in the quarter, just if you could provide a little more color on the Asian shipping delays, and just curious as to how that translates into a mid-'08 improvement, just if you could explain that one? Thanks.

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

Yes. Joe, this is Stephen. So the one thing I want to follow up on your question with the FDA is the work is done now. I want to make this kind of clear. Quite frankly our clients have been slow to send us requests for reimbursement, but I don't want anyone confused between the work being done and completed and executed, versus what has been, I think a little bit of a slower trail of payments on that.

On the cobalt, yes, as our cobalt business is lumpy, and so when we get it late in the quarter, it is hard for us to sometimes turn it around in quarter, and so some of that revenue has popped out of Q1, and it will show up in Q2. You have been around long enough to know that that happens from time to time with us.

Joe Walewicz - *CIBC World Markets - Analyst*

Okay. Great. Thanks.

Operator

Thank you. The next question is from Hari Sambasivam of Merrill Lynch. Please go ahead.

Hari Sambasivam - *Merrill Lynch - Analyst*

Hi, yes. Thank you. Stephen, I am just wondering, could you perhaps give us a quick sense as to the kind of metrics that you are employing for the new business wins in the contract research business? I know there has been a bit of a focus on sort of getting better quality backlog, or better quality studies. And I am wondering, is it simply pricing, or are you thinking about different things? And I am just wondering whether you can sort of maybe elaborate on the thought process there, as to what you pick?

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

Yes. The ramp up of new business wins is a function of a couple of things. One it is the function of that team's leadership, in terms of essentially the back end of the 2007, rebuilding the business development team. The historical business development team was quite frankly very focused on generics, and quite frankly, as we found during the difficult times there, more order takers than they were good, strong BD folks.

We have hired a number of top-notch business development folks. We got them very aligned, they are all on a common CRM system, all of the common metrics, and I think just a lot of visibility around that. I personally have been spending a lot of my time, as well as David Spade out with customers. The message to the team in the set of metrics, and we have them by business and by geography, and in some cases by accounts, for our big accounts, it is very clear, which is ramping up business wins, but the quality of the backlog is the most paramount thing.

So we have not been cutting prices. As a matter of fact we have been raising prices in a number of areas, and seeking better margin work, and very specific work that we think we are the best provider of. So I think the quality is quite strong. We keep seeing it ramp up.

Hopefully the cancellations here will statistically get back to some more normal levels, and then we will be able to see that really turn into some backlog acceleration. I feel very good about that momentum. We now have three solid quarters of stepped up performance there.

Hari Sambasivam - *Merrill Lynch - Analyst*

If I were to ask a follow-up on that, does that mean studies for longer duration? I am curious as to how your backlog changes because of this focus? And I guess I were also to ask a question as to, on the Phoenix side and the central lab side, what is the sort of average lead time do you think, before you start getting the pickup from those specific facilities? Thanks.

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

We are getting the pickup already, and again, to some degree as I answered, before we are throttling that back, based on our ability to train quality staff, to make sure that we do great work there. On the duration of backlog, I don't know if I can answer that specifically. But I would say that we are getting backlog growth across the portfolio. Obviously the earlier stage backlog is just shorter duration by its nature. The late stage backlog, I don't think the duration has changed. Again, we are getting some cancellations there, so my gut says our backlog duration has not changed very much.

Hari Sambasivam - *Merrill Lynch - Analyst*

That is great. Thank you.

Operator

Thank you. The next question is from Dave Windley of Jefferies & Company. Please go ahead.

David Windley - *Jefferies & Co. - Analyst*

Thanks for taking my questions. I did get on late, so I apologize if you hit on a couple of these. One of the things that we were looking at, or certainly thinking about from the discussion coming out of the last quarter, was that order pace for early development had picked up and was showing some nice uptick, after clearly you have been dealing with the FDA review and that kind of thing, as a little bit of an overshadow. On that basis, we were expecting early development revenue to be a little better.

And so I guess I am wondering, did we mistime our expectations on when that would begin to hit? And I heard the earlier comment, Stephen, about more of the second half of the fiscal year moreso than the second quarter. I wanted to try to square my timing expectations on particularly early development orders, which should turn pretty fast.

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

Yes, that is a good question, Dave. Basically, I think it probably is a bigger lag than the expectations were out there, and certainly than my expectations. I mean, we are ramping up nicely in terms of the new business wins. I think unfortunately in Q1 here, we are dealing with where the backlog was, really 100 days ago. And so I think it will probably take another quarter before we see a stronger acceleration.

David Windley - *Jefferies & Co. - Analyst*

Okay. And that as a general statement, I know you don't want to get into too much detail, but can you give some relative strength between Phase I bed activity, bioanalytical lab activity, and toxicology activity?

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

They were all up about the same. We are seeing strength across the board.

David Windley - *Jefferies & Co. - Analyst*

Do you feel like, in tox, it seems like, I guess that is maybe a relatively smaller business for you, but not something I hear you talk about specifically very much. Do you feel like you are keeping up with the competition in tox?

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

You know, our facility is in Europe. We are certainly very well booked there with very good business, and we have had a great number of new order wins in that business. I would say that usually I look at that business, versus our European competitors. Against those, we are doing quite strongly. North America right now is a very hot market, and certainly is for a couple of other people in the industry.

David Windley - *Jefferies & Co. - Analyst*

Yes. And is there a thought in the strategy to expand that business, expand that platform to be more than just a European player?

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

We would like to expand it. As you know, there are a limited number of quality facilities to get your foothold in. I think if you were to get a facility in North America, it would probably be one that we got from our clients would be my guess, because there are not too many that are independent, that are something really good that would fit well into our network. We also look for facilities in Asia, which I think would have a better return on investment for our shareholders right now.

David Windley - *Jefferies & Co. - Analyst*

And have you explored taking facilities over from clients, I mean it seems like from some of the other management teams, one of the biggest issues is kind of difference in culture, and difference in cost structure, in assuming a facility like that.

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

Yes, that is all correct. It is a difficult thing to do, given our expectations on utilization, and the way we design facilities.

David Windley - *Jefferies & Co. - Analyst*

Okay. Last question real quickly. Doug, on the tax rate, you said similar things at the Investor Day, kind of 35% less investment tax credits. What is the magnitude of the investment tax credit? How much impact can that have?

Doug Prince - *MDS Inc. - CFO*

A little bit of variability on that, but the Q1 results are fairly stable, around that range, per quarter.

David Windley - *Jefferies & Co. - Analyst*

And the Q1, if you exclude the benefit in the quarter, the Q1 rate was--?

Doug Prince - *MDS Inc. - CFO*

About $1 million. 1 to $2 million a quarter.

David Windley - *Jefferies & Co. - Analyst*

1 to $2 million a quarter in investment tax credit?

Doug Prince - *MDS Inc. - CFO*

Yes.

David Windley - *Jefferies & Co. - Analyst*

Okay. Thank you.

Operator

Thank you. The next question is from [Doug Lyon] of RBC Capital Markets. Please go ahead.

Doug Lyon - *RBC Capital Markets - Analyst*

Yes, hi, Stephen. Quick question with respect to another part of your business that seems to be doing very well right now, and that is the MD business. That is putting up the best numbers that you have seen. Maybe you could give a few more details on where the strength is, if those exercises you have gone through to expand the sales force overseas are working for you?

And then second question is just with respect to strategic growth, given the success of the MD acquisition, are you currently contemplating a number of others in that area as well? And I will leave it there.

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

So, thanks, Doug, and thanks for joining us this morning. I will answer the question second first, which is we don't really comment on ongoing business development initiatives, but nice try. And then on the first one, yes, we are just very pleased. There are really two things driving the growth.

One is a great array of new products, where we seem to be able to really launch stuff something every 60 to 90 days, it' has created good momentum. It keeps the sales force very excited. Obviously the customer take-up on those products has been really good. I think the second as you said, we continue to have good strength in North America, but boy, the European team has just come on really strong. And I think they have done an outstanding job all throughout the back end of '07, and here in the first quarter of '08.

Asia is picking up steadily and nicely. The market there is very, very buoyant, but I don't know that we have gotten the full benefit there of our efforts. I think that will continue to build over the next couple of quarters.

Doug Lyon - *RBC Capital Markets - Analyst*

So you are quite comfortable then with the sustainability of the type of growth you are seeing on the MD side of your business?

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

Yes, we are seeing good strong growth, and again, I think we have gotten a lot of products out there with some very unique capabilities right now.

Doug Lyon - *RBC Capital Markets - Analyst*

Excellent. Thank you very much.

Operator

Thank you. The next question is from Chad Clark of Harris. Please go ahead.

Chad Clark - *Harris Assoc. - Analyst*

Hi. Thanks for taking the questions. Just two. First of all, on working capital, can you just talk about the nature of the cash outflow, and whether that will work itself out over the course of the year, and secondly, kind of given where the stock price is today, can you just talk about your thoughts with respect to share repurchases?

Doug Prince - *MDS Inc. - CFO*

This is Doug. I will take the working capital question. Again, I mean the primary drivers there were as disclosed, the CapEx, we had a very high CapEx in Q4, and that flushed through the Accounts Payable in Q1 and then the timing of other events, such as the compensation expenditures, which are on an annual basis, those typically flesh out in Q1. As I stated, we expect more positive cash inflows from operations for the balance of the year.

Chad Clark - *Harris Assoc. - Analyst*

Great.

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

Chad, on the second part of your question. We have a normal course issuer bid in place, and we constantly assess the use of that. As you saw, we used it a little bit in Q1. We do view our shares right now as attractively priced. We have that in place to have that that flexibility.

Chad Clark - *Harris Assoc. - Analyst*

Thanks.

Operator

Thank you. The next question is from Maher Yaghi of Desjardins Securities. Please go ahead.

Maher Yaghi - *Desjardins Securities - Analyst*

Well, thanks for taking my follow-up question. Just strategically for Pharma Services, we have seen you expand recently in Phase I aggressively, and I am just trying to understand longer term, where do you plan to take your Phase I business? Where do you think a good market share that you are trying to obtain in that business globally? And should we expect additional phase one expansions in 2008? And if you are planning to do expansions, maybe you can tell us how many number of beds you are planning to add in 2008?

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

So Maher, we do like that business a lot. As you know, we are a leader in that market place. I think all of our facilities are good, strong facilities, and we are very excited about that expansion, because it given has us very unique capability, in a very, very good marketplace.

Phoenix demographics could not be better for the study conduct, and particularly the way that facility was outfitted specifically to do QTC studies, large QTC studies which is a big part of the demand. We feel good about that. We look from time to time for expansion. I think what we are going to focus on right now, is making sure the Phoenix launch is very successful, and ramping that up well.

I think if we did expansions in Phase I, we would probably be looking more strongly at facilities outside of North America. And, you know, we don't have any plans, and as soon as we announce an expansion, we will be sure to let everybody know about it.

Maher Yaghi - *Desjardins Securities - Analyst*

Are you thinking of going to potentially India and setting up a shop there, or mostly eastern Europe?

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

Both of those are possibilities that we look at, and maybe something like that happens at some time in the future.

Maher Yaghi - *Desjardins Securities - Analyst*

But right now the number of beds at let's say, by the end of fiscal year '08, you expect it to be approximately where we stand right now?

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

I think that is good enough for planning purposes.

Maher Yaghi - *Desjardins Securities - Analyst*

Okay. Great. Thank you very much.

Operator

Thank you. The next question is from Dave Martin of Dundee Securities. Please go ahead.

David Martin - *Dundee Securities - Analyst*

Yes, I am just wondering, how much of Molecular Devices revenues are now coming from Europe, and what should we look for, with respect to your expansion initiatives in Europe, as far as incremental revenues and SG&A cost in 2008 over 2007? And then you had mentioned in Pharma Services that the SG&A was low because of the FX gain, but there was the other half of that, the cost of revenues went up as a percent of revenues this quarter, versus the last three or four quarters, and I am wondering why the cost of revenues went up.

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

You mean cost of revenues on a percent basis?

David Martin - *Dundee Securities - Analyst*

Yes. They were at about 73%, and they had been down in the 66% range.

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

Okay. So let me try to answer both of those. Molecular Devices, our European sales are in the range of 20 to 30% of those revenues, and are growing probably 200 basis points faster than the average in that business. And so that gives you kind of a rough cut view. I don't know that you will see, we were pretty disciplined on keeping SG&A very efficient and so, consider that ramping up with sales, because we are pretty efficient today out there in the field.

On Pharma Services, the thing you have to look at, maybe it is the part of your calculation that you are struggling with, is the business reported flat revenue year-over-year, but given the FX environment, that would be down organically. And so that is really what you are seeing is a little bit of compression in the margins because of FX swings. What FX swings literally means is that we win a global trial out of North America U.S. dollar based, but the work is being done everywhere else in the world, right, and in a quarter where you have FX moving, it will make your margins look a little tight. Right.

David Martin - *Dundee Securities - Analyst*

Okay.

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

In a sense, you should really think of Pharma Services year-over-year, as revenue down and EBITDA up.

David Martin - *Dundee Securities - Analyst*

Okay.

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

That is essentially what is happening on an operating basis. I think with the FX in there, you are seeing revenue flat, EBITDA up, right, but actually the EBITDA expansion --

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David Martin - *Dundee Securities - Analyst*

Comes from the SG&A?

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

No. The EBITDA expansion comes from all of the work we have done on that business, streamlining it and improving it from a restructuring basis, but it is actually much greater on an organic basis, than you would see there on the reported number.

David Martin - *Dundee Securities - Analyst*

Okay. Thank you.

Operator

Thank you. Your next question is from Dave Windley of Jefferies & Company. Please go ahead.

David Windley - *Jefferies & Co. - Analyst*

I just wanted to follow up on that last one. I think we discussed this also a little bit in the Investor Day, but to what extent are there steps being taken to match revenue and expense to the geography where the work is being done?

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

Yes, to a great extent, it is being done. We have some historical contracts, and you do that in two ways. One is you literally match revenues and expenses. Right now, the U.S. dollar is at an absurdly weak level.

So what you wouldn't do is start putting bricks and mortars in a place in North America, with the idea that that is the right thing in the long term. You structure your contract in a way to have tight collars around FX. We are doing all of those things a lot better going forward, but at the end of the day, there is still an FX component to any global business and you manage it.

These are quite interesting times for all global businesses from a foreign exchange perspective. Right? So I used to say the foreign exchange markets, I never saw anything more volatile, but that is before I saw the Q1 capital markets. Both are pretty choppy right now on a global basis for all companies and all industries.

David Windley - *Jefferies & Co. - Analyst*

Are clients are open to a discussion around actually structuring the contract to pay you in Euros or Sterling, or whatever if that is, for parts of the contract where that is where the work is being done. Are they open to that, or do you achieve that end by putting FX collar movement adjustments into the contract?

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

Yes, I would say if the work is being done at a single site, which is pretty typical, our early stage work, they are pretty open to making that make sense, and making it make sense for me is either working in the native currency, or having a collar in the contract. The work that is being done globally, they understand the collars in the contracts.

David Windley - *Jefferies & Co. - Analyst*

And do either of those two approaches achieve basically the same end, or does one not protect you as well as the other?

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

They basically get you to the same spot.

David Windley - *Jefferies & Co. - Analyst*

Okay. And Stephen, just on the Pharma Services, order flow and backlog, I mean, you are given us ending and average, and the ending appears to have picked up a little bit, and it sounds like work flow and traction is improving. I am going to ask at this at my own risk, but is it possible to give us some kind of feel for how we should expect orders and backlog to progress over the balance of 2008? I mean, even if you put it in terms of the industry, are you going to keep up with the industry growth rate, which is pretty darn steep?

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

Yes. So I think, first of all, we have shift to going to quarter ending backlog, and to give all the numbers that everyone can use to calculate, and that is done 100% to just give people a better transparency, and to have people have better numbers by which to bill their models, and what not. So that is the goal. I think average backlog will continue to give it just for legacy purposes, but at some point we will stop giving it, would be my guess, because I think what we are giving now is much more descriptive and clear.

So Dave to answer your questions, we feel very good about having $177 million in new business wins. We feel better translating it into backlogs, but again on the cancellations we really can't control that. I think you can continue to see that ramp up and at Investor Day, we gave you three quarters, and now we have just given you the fourth.

I think you can work a trend line there, that will probably make some sense. You could take a look at what the industry is doing, but you can take a good look at our trend line, which is fairly sustained now over a long enough period of time. That is how I would advise you to kind of look at it from a modeling perspective.

David Windley - *Jefferies & Co. - Analyst*

Okay. Thank you.

Operator

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

Kim Lee - *MDS Inc. - Director, IR*

Thank you everyone for joining us this morning. If you have any additional questions, please don't hesitate to give me a call, and I hope to see some of you today, this afternoon at our meeting. Thanks.

Operator

Thank you. The conference has now ended. Please disconnect your lines at this time. We thank you for your participation.