FINAL TRANSCRIPT

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MDZ - Q1 2009 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 like to turn the meeting over to Kim Lee, Senior Director of Investor Relations. Please go ahead, Miss Lee.

Kim Lee - *MDS Inc. - Senior Director of IR*

Thank you, Donna. Good morning, everyone. Thank you for joining us today. A press release of our first quarter results was issued this morning. If you have not received a copy, it is posted along with the MD&A and financial statement and notes on our website at mdsinc.com.

As a reminder, we implemented a new disclosure process last quarter -- for fiscal first, second and third quarters, we'll issue a press release with summary financial tables. Respective MD&A and financial statement and notes will be posted on our website and filed with relevant security regulators. We're 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 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 his comments on Q1 financials. Prior to our Q&A session, we'll turn it back to Stephen for a few closing comments.

During the call, we'll 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 US securities regulators and are available on our website. 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 also make reference to select non-GAAP financial

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measures 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 non-GAAP measures such as net revenue, adjusted EBITDA and adjusted earnings per share, we provide reconciliations between GAAP and non-GAAP measures in today's press release, MD&A in our 2008 annual report which are available on our website.

I will now turn it over to Stephen.

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

Good morning, everyone. Thank you for joining us. In Q1, MDS delivered solid margins in a difficult economic environment.

For the quarter, MDS reported net revenues of $257 million versus $296 million last year. Normalized for foreign exchange and divestitures, revenues declined 1%. Adjusted EBITDA of $32 million with a margin of 12% compared with $40 million and 14% last year. We improved our cash and liquidity position. We increased our cash balance by $32 million to the end of the quarter with nearly $150 million in cash currently on hand. We remain focused on streamlining our operations and improving operating efficiency. In the quarter, restructuring and productivity initiatives delivered $14 million in savings.

Now, looking across our businesses, I'll start with Nordion. Nordion delivered another solid quarter. In Q1, Nordion delivered $66 million in revenue, up 10% on a reported basis. Normalized for foreign exchange and the divestiture that was completed by Nordion last year, Nordion's revenue increased 48%. This growth was primarily driven by strong medical isotope sales against a relatively weak shipment quarter last year. Nordion continued to demonstrate operational excellence by stepping up production to process additional isotopes. This helped alleviate the global shortage of medical isotopes due to the shutdown of the [Petton] reactor in Europe. On Monday, we announced a launch of an improved administration kit for TheraSphere. TheraSphere is our breakthrough treatment for patients with inoperable liver cancer. The new administration kit provides ease of use, enhanced safety and optimal dose delivery for patients. TheraSphere revenue grew almost 50% in 2008.

Moving to MDS Analytical Technologies, pressure on CapEx budgets at large Pharma due to the global economy is impacting demand for our instruments. We continue to see growth from certain countries in Asia and areas in the implied markets. We are also seeing strength in end user service revenues. We're taking steps to strengthen our business and improve margins as we work to accelerate the transition of our manufacturing base to Asia and execute on our previously announced restructuring actions. We remain focused on innovation, staying at the forefront of technology and maintaining our strong spect line of products as the lifeblood of this business. Consistent with our leadership and food safety tasting, we announced the validation of two more [assays] for the detection of melamine on our and hardware and software , the SpectraMax microplate reader and SoftMax Pro software.

Earlier this week, at PITTCON, together with our joint venture partner Life Technologies, we announced iMethods Tests -- a suite of methods that simplify the use of mass spectrometry for food and water quality testing, forensic toxicology and clinical research. Also at PITTCON, our AB SCIEX QTRAP 5500, one of the most advanced mass spectrometry systems ever built was named best spectrometer -- spectroscopy product of the year by SelectScience. Pharma Services -- with the continued focus on improved productivity, Pharma Services delivered another quarter of improved EBITDA. The economic crisis is creating uncertainty for many of our clients. They continue to take a more cautious approach to development spending and are reprioritizing their pipelines. In general, we're seeing a flight to quality among our customers with our early stage business continuing to show signs of strength. Due to our relative scale, our late stage is challenged in this difficult environment.

As a result in Q1, new business wins were $104 million, down 21% sequentially, largely due to declines in late stage orders. This resulted in a backlog of $458 million, up 2% from last year. Excluding the impact of foreign exchange, backlog increased 8% year over year. Early stage achieved backlog growth of 30%. As of the end of the quarter, we have completed the majority of the workforce reductions related to our restructuring plans announced last year.

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During Q1, MDS stayed close to its customers and managed change in volatile markets with a focus on innovative products and services. We took steps to improve margins and build cash reserves. We entered Q2 with a strong and improving balance sheet.

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

Doug Prince - *MDS Inc. - EVP of Finance & 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 items that impact the comparability of our results.

For the first quarter 2009, adjusted financial results exclude $6 million in restructuring expense and a $1 million investment write-down. Prior year results exclude acquisition integration costs, a loss on the sale of two product lines, a gain on a mortgage settlement, and a reduction in deferred taxes. 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 revenues for products and services excluding reimbursement revenue.

Now to our Q1 results. In Q1, our total revenue was $275 million, including $18 million of reimbursement revenue. Net revenues were $257 million, down 13% from $296 million last year. Excluding the impact of foreign exchange, acquisitions and divestitures, net revenues declined 1%. Nordion reported higher revenues on strong isotope sales. Analytical Technologies and Pharma Services saw revenues decline on soft demand in our North American and European markets.

Our reported gross margin which is net revenues less associated cost of revenues was 38% versus 37% last year. SG&A for the quarter was $60 million compared to $64 million last year. The decrease was mainly a result of foreign exchange and lower spending, partially offset by a year-over-year increase in stock-based compensation costs. SG&A as a percent of net revenues, increased from 22% last year to 23% this year. In the first quarter, we spent $14 million on R&D, 5% of net revenues compared to $20 million or 7% in 2008. About half of this decline is driven by foreign exchange, and the remainder is related to lower outsourced R&D spends at Analytical Technologies following the launch of new hardware and software offerings in 2008.

Adjusted EBITDA was $32 million compared to $40 million last year, down 20%. Excluding the impact of foreign exchange, acquisitions and divestitures, adjusted EBITDA declined $2 million or 6%. We maintained a double digit adjusted EBITDA margin of 12% in Q1 compared to 14% in the prior year, largely due to cost savings from restructuring and productivity initiatives including supply chain and Lean Sigma. GAAP earnings per share were $0.02 in Q1 compared to earnings of $0.16 per share last year. Excluding the adjusting items mentioned earlier, our adjusted earnings per share were $0.06 in Q1 compared to $0.07 last year.

Now, to our business unit results starting with Pharma Services. For the quarter, Pharma Services reported net revenues of $106 million, down 12% over the same quarter last year. Half of the decline was driven by the impact of foreign exchange. In early stage, higher Phase I revenues were offset by lower preclinical and bioanalytical services revenue. In late stage, while certain large Phase II through Phase IV projects ramped up late in the quarter, overall late stage revenues decreased in both central lab and Phase II through Phase IV.

Adjusted EBITDA in the first quarter was $8 million, compared to $6 million last year. This improvement was largely driven by cost savings from restructuring, supply chain and Lean Sigma initiatives. As of the end of Q1, MDS Pharma Services implemented the majority of the work force reduction actions announced in the third quarter of 2008. An additional $1 million of restructuring expense was incurred this quarter.

During the first quarter, new business wins totaled $104 million, down 41% from $177 million last year. This decline was primarily driven by declines in late stage orders as customers reprioritize their R&D projects, further compounded by the impact of foreign

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exchange. Our quarter ending backlog was $458 million, up 2% from $448 million last year and down 6% sequentially. The sequential design is predominantly driven by cancellations and the negative impact of foreign exchange. Excluding foreign exchange, backlog increased year over year by approximately $35 million or 8% with late stage backlog essentially flat and early stage backlog up approximately 30%. Most of our customer base is well funded. However, in the current economic environment, some companies may be experiencing financing difficulties. Based on our analysis, we estimate that 5% to 8% of Pharma Services revenues are derived from clients who, we perceive, as potentially risky or underfunded.

Next, on to Nordion. Nordion reported revenues of $66 million, up 10% from $60 million last year. Driven by higher isotope sales due to a current year shutdown of a European reactor compared to relatively light isotope shipments last year. Foreign exchange and divestitures had a negative impact of $11 million and $7 million respectively on revenue growth. Excluding this impact, Q1 revenue increased by $24 million or 48% compared to Q1 of 2008. Adjusted EBITDA was $18 million versus $11 million last year, driven for the most part by higher medical isotope sales. Incremental isotope volume related to the European reactor shutdown contributed approximately $6 million of adjusted EBITDA in the first quarter compared to $5 million of negative impact from supplier disruptions last year. Foreign currency fluctuations in particular the strengthening of the US dollar to the Canadian dollar reduced adjusted EBITDA by $3 million and resulted in an unrealized embedded derivative charge of $5 million compared to a similar noncash charge of $4 million last year.

Now, on to Analytical Technologies. The recent slowdown in Cap Ex spending had the most significant impact at MDS Analytical Technologies. Analytical Technologies recorded revenue of $85 million in Q1, down 27% from $116 million last year. Foreign exchange had a negative impact on revenues of $10 million or 9%. The primary driver of the revenue decline was soft market demand across all product lines. Including the impact of foreign exchange, total Analytical Technologies end user revenue decreased 12% including a 7% decline in mass spectrometry end user revenues. Despite the overall decline, we continue to see some strength across Asia and in applied markets for food, water and environmental testing. In addition, end user service revenues also increased versus the prior year.

Adjusted EBITDA in the first quarter was $13 million compared to $27 million last year. This decline was primarily driven by lower product sales partially offset by savings from restructuring, the manufacturing shift to Asia and reduced R&D expense. In addition, we had a well-established foreign exchange hedge position and we were therefore unable to fully realize the full benefit of the strengthening of the US dollar on our results. As disclosed last quarter, MDS Analytical Technologies recorded a $5 million restructuring charge in Q1 to reduce expenses and to accelerate the shift of our manufacturing base to Asia.

Turning next to cash flow. During the first quarter, we generated $32 million of cash, increasing our cash balance to about -- to $149 million. Including the benefits from our Lean Sigma initiatives on working capital, we generated $38 million of cash flow from operations in Q1. We incurred $7 million in capital expenditures and repaid $6 million of debt. Our $400 million revolving line of credit remains undrawn. Looking ahead, we have $13 million of debt payable this year and we expect to collect approximately $70 million in notes receivable in 2009. In particular, roughly $60 million is due from Borealis this month.

Given the above, plus our productivity and working capital initiatives, we continue to believe that cash on hand, cash from operations and cash from existing financing sources will provide sufficient liquidity to fund their future operating needs. That concludes my financial comments for the quarter. With that, I'll now turn it back to Stephen for his closing remarks.

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

Thank you, Doug.

MDS remains proactive in strengthening our businesses during the current economic environment. We continue to take actions to improve our cost structure, increase productivity and make investment decisions in the growth. We're effectively managing our capital expenditures and working capital. We expect increases in our cash position throughout 2009. We have a strong

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balance sheet and solid cash flows which leaves us well-positioned. Our experienced board and management team continue to operate with a steadfast focus on delivering value to our shareholders.

Let me turn it back to Kim for question and answer.

Kim Lee - *MDS Inc. - Senior Director of IR*

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

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) The first question is from Lennox Gibbs from TD Securities. Please go ahead.

Lennox Gibbs - *TD Securities - Analyst*

Good morning, thanks. Pharma Services, there was a 21% sequential decline in new business bookings and another sequential decline in the backlog. So, the release attributed to noise in the marketplace, M&A restructuring, et cetera. However, your declines are significantly worse than it appears. Is there something about the business mix or client mix that might explain why you would be slowing faster than the peers?

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

Thank you very much for joining us this morning.

I don't think if you look at the analysis, you'll find it is that different from peers. I know a lot of what we're look at -- one is, look at the numbers after FX so you can understand that impact for us. I think second thing is the broad trend that I laid out is -- if you're comparing us to a late stage peer or something like that, I don't know that that's quite helpful given our mix of business. We have seen our late stage win rate -- I'm sorry, late stage activity soften. And, we're a top ten player in late stage, more closer to eight, nine or ten than we are to top. We've seen a lot of strength in our early stage where backlog is up 30%.

Some other folks in the industry are indicating the opposite trends. I think we -- right now, are seeing that we have good facilities, brand new IT systems, lots of good process work. We're seeing clients coming to us more and more in our core franchises.

Lennox Gibbs - *TD Securities - Analyst*

Just with respect to the more recent new bookings trend, has there been any inflection since the [sabrey second] announcement regarding the strategic review? It could be a concern that with some of the strategic uncertainty declines may be less willing to please, particularly late stage longer term business with your CRO.

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

That's something that we're conscious of. I think it is hard to pick a trend line in late stage with that short a period of time because the orders come in as big orders or they're quite lumpy in the way they come in. It is hard to draw a good statistic.

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Some of that might be taking place. But I think it is hard for us to separate an economy where clients are reprioritizing their pipeline, a CRO business where we have great strength in early stage and they're wishing good solidness, late stage, we've always been a smaller scale player. Then any of the potential announcements that are out there. But I know what we're seeing and that's good, strong strength in early stage.

Lennox Gibbs - *TD Securities - Analyst*

And, then just lastly, on Nordion and the NRU. We know of two shutdowns in the past three months which could give an impression the shutdowns are becoming more frequent. Have unscheduled downtime production interruptions trended up over the past three years?

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

The NRU has continued to run and be really reliable. The NRU has been essentially servicing the majority of the world here from what, October through February. Any reactor from time to time as you bring it down and bring it up, you get little hiccups but it really hasn't impacted supply at all. And so we actually feel good and it always feels good that the NRU is as reliable as it is. So, we feel pretty confident. You've followed us for awhile. I would say the track record is for every week or so that we're out, it seems our competitors are out for months.

Lennox Gibbs - *TD Securities - Analyst*

Agreed.

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

So, I think -- no, I don't see any trend line there at all. I actually see a lot of effort given in the 2009 budget to make a number of upgrades on the NRU to support the licensing out to 2016. So, I think things there remain as they have for the past 20 years or 30 years. That's a good, strong reactor and the bulk of the world supply.

Lennox Gibbs - *TD Securities - Analyst*

Thanks very much.

Operator

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

Maher Yaghi - *Desjardins Securities - Analyst*

Thanks for taking my question. Question follow-up on the CRO. You mentioned that 8% to 10% of your backlog is coming from underfunded biotechs at risk and also I wanted to ask you is there a risk in your accounts receivable right now that these customers have already -- you've already done work for these guys and they might not pay for you?

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

Yeah, thank you, Maher for joining us this morning. So, we didn't say 8% to 10%. We said 5% to 8%.

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Maher Yaghi - *Desjardins Securities - Analyst*

5% to 8%, sorry.

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

Basically what we did -- and everyone in this environment is doing this and broadly across MDS, we're looking at all of our suppliers and we're looking at all of our customers. We're taking -- call it an extra sharp pencil -- to manage any business risks. And we do it because we're very, very diligent. I also think most companies right now are doing something like that.

When we go through that, we say okay, how much of our revenue and backlog in Pharma Services is big Pharma and well funded Pharma and Pharma with good cash flows. We get down to -- despite the 8% that our smaller biotechs -- those would be biotechs that are venture capital based or biotechs pre-revenue and therefore rely on the capital markets. So, we're going to watch that group more closely. We're going to watch those receivables more closely. It doesn't mean that in any way they're in risk of default but it certainly means we're going to watch them as you would expect us to in this environment.

Lennox Gibbs - *TD Securities - Analyst*

So, how much of your accounts receivable come from these guys?

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

I would say -- I would say it is relatively the same. It is about 5% to 8% of revenue. It is 5% to 8% of accounts receivable. Probably about the same on the backlog.

Lennox Gibbs - *TD Securities - Analyst*

Okay. And just a follow-up question on more your outlook for Analytical Technologies. We've seen more M&A in the big Pharma industry. I know you guys -- your mass spectrometry division is geared toward Pharma industry, big Pharma. What is your sense about the recent M&A activity on potentially the business in 2009 and the past that had been a -- somewhat negative short to medium term. Are we starting to see some cancellations in orders from big Pharma? Or your salespeople are telling you that the trends are changing because of these M&As?

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

Yes, I think it is a question I appreciate and certainly one we're on top of. I would say again, somebody who's been in that industry and seen a few cycles, I think as we -- and all of our competitors have seen in a soft economic environment, Pharma is being very careful with their CapEx expenditures. And we see this from time to time in the cycle. I would say that while normal -- I would say I've never seen it at this level. And so, for us, that means for a salesperson, the time between the researcher saying "yes, I want yours" and the purchase order being caught, it can get delayed in the financing team. At our client, as they look at an individual quarter and try to manage their cash flows in this environment. To me, that's probably the megatrend that the whole industry is seeing here in early 2009.

Now, you lay on the backdrop, a couple of big mergers have been out there, every one of those mergers are top customers of ours because given our very, very strong franchise in that arena, all of the top customers are customers of ours. What we normally see in that is a period of -- I'm going to say six to nine months -- where our clients are trying to sort out who's in what role and what mission going forward for each of the facilities. And so there's usually a period where we see our sales soften at that client.

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And then post merger, it usually goes back to the level it was at before. And while we are very proud of the fact that our mass spects sell for numbers like $0.5 million apiece -- or better -- quite frankly for our clients, it is a productivity tool. The molecule is worth $1 billion to them, our next generation mass spects are able to give them new levels of speed and performance that make that purchase look relatively modest in the big scheme of things for them -- being the breakthrough they get in terms of enabling capability.

And so what we see is they go quiet for a little while, while they internally sort things out and do their integration then they come back and begin to make purchases and so often, catch up purchases from where they were before because technology is compelling. I think I feel very good about the job that my team has done to get new products out on the market. Particularly this 5500 QTRAP which is getting all kinds of awards and getting all kinds of kudos from customers. As customers see that and the 5500 triple quad, the response is definitely "I want one of those" and then they'll go and sort out when they'll have a budget for those. As long as we move the technology forward, it is a pretty cost-effective investment for them to make.

So, we'll watch the cycle play out probably similar to other cycles. I would say -- 2009, across every industry, people are watching their cash closely as we are. As you've seen in our results.

Lennox Gibbs - *TD Securities - Analyst*

How much of your top sales in analytical technologies go to big Pharma?

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

I can get back to you with that number but I would say -- first thing in that business, about 20% of service these days which is -- if anything, is holding up well or improving. People keep older instruments, generally service revenues are a pretty abundant and then a good now -- north of 20% goes into the applied markets. If you broke it all the way down, you would probably wind up with about 40% -- in big Pharma on the instrument purchase side.

Lennox Gibbs - *TD Securities - Analyst*

On the purchase side. Okay, great. Thank you very much.

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

40%, 50%.

Lennox Gibbs - *TD Securities - Analyst*

40%, 50% okay, thanks.

Operator

Thank you. The next question is from [Harry Sambathavan] from National Bank Financial. Please go ahead. Please go ahead.

Harry Sambathavan - *National Bank Financial - Analyst*

Yes, thank you. Stephen, just a couple of quick questions.

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In terms of Analytical Technologies, I know these things are expensive pieces of equipment and year after year, I think when you come up with new generations, there is an emphasis on speed sensitivity, throughput, et cetera. I'm wondering -- given a major [C-change] in Pharma with obviously cost reductions R&D reductions, et cetera, going forward -- In terms of the type of equipment that you come up with in the future, is there a thought towards maybe coming up with less expensive equipment or things that are a little bit more -- little bit less expensive? I'm just thinking about the pricing issue here. Whether you need to rethink that or have you -- do you need to rethink that I guess is my question.

My second question actually is on Pharma Services and in terms of pre-clinical services you've seen a reduction, same with the your Central Labs. Both of these are a high fixed cost businesses -- and I'm just wondering in this environment, how do you go about managing that fixed cost base?

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

Harry, good question. First of all, Harry, welcome back. It is good to have you back.

Harry Sambathavan - *National Bank Financial - Analyst*

Thank you.

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

Let's talk first about the mass spectrometer. So, the way we look at it is we are the premium brand in the industry with the strongest line-up of hardware and software. We do for particularly our Pharma clients are interested in speed and sensitivity breakthroughs. We talk a lot about that. When we do that, we can capture a nice premium.

What we also then do is we don't obsolete the line. We usually slide the line down. So, we come out with the 5500. We reposition the pricing of the 5000, 4000 and 3000. So, that 3000 now which is a phenomenal instrument and very, very well-liked and well understood and well-performing instrument -- is going to move down in price and begin to carve out more and more of the lower end of the market for us. And so we use it as -- call it a dynamic model to keep expanding the amount of market that we're going after.

The one area you didn't talk about which I will is one of the big areas of competition besides the speed and performance is the software. And we are more and more and more building, growing and driving our sales through our software. And we just came up with another one here with the iMethod software. Because the software is the enabling step to take a very high-end sophisticated instrument and put it into the hands of a novice user or technician and have them deliver great results. And our software like -- I don't want to steal someone else's brand -- but our software like on an Apple computer forces our users into a simple workflow that allows them to get great results. I'll just give you an example of this. When the melamine scare came out last year with the food tainting in China, we put a melamine method on our website. If you owned one of our products with that software, you could download that method from the website and it then takes over the computer, the software --- it does all of the settings and calibrations for you -- and within a couple of hours, you're running melamine samples. That would have taken a PhD scientist three weeks to develop that method on their own, even five years ago. And so we are definitely opening up another front in our competition that says speed, sensitivity, value and now the most compelling software that's application designed to allow the mass spect back into arenas that it really wouldn't have been able to perform in.

That's the way we look at competition. We do look constantly at increasing our margins. You see that in us now manufacturing the bulk of our products in Singapore versus here in Canada. And while also looking at our designs, working on supply chain initiatives, working on Lean Sigma initiatives. The way we look at that though, Harry is -- we create margin and we look at it from a capacity point of view.

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Based on our win-loss ratios in the segments we want to win at, where do we premium price our product to get to where we want to be? We can use that as we will. We like to put some of that aside, obviously to improve margin for our shareholders. We also like to use it competitively to make sure that we win in the segments we want to win. And so that's something we constantly look at. And we look at our win-loss ratios versus our competitors. So, I would separate your thinking that our products are costly to make with the premiums we capture -- because we have the highest margins in the industry -- so the answer is we're pretty good at making the products pretty cost-effectively and we're getting better. We capture high margins because we're able to pull through that value given the performance of our offering versus others.

Harry Sambathavan - *National Bank Financial - Analyst*

Just a clarification, Stephen, on the software, is that captured in the service revenues or is that captured elsewhere? And secondly, just a sense of the trend between your software versus your instrument revenue, Stephen and just in terms of rough percentages?

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

Most of it is captured in the instrument revenue.

Harry Sambathavan - *National Bank Financial - Analyst*

Okay.

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

There's some follow on -- we provide software upgrades to people who have extended contracts.

Harry Sambathavan - *National Bank Financial - Analyst*

What percent of instrument sales would be software?

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

We don't break it up like that because of it's a bundle sale.

Harry Sambathavan - *National Bank Financial - Analyst*

But it is an increasing number?

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

An increasing number of our products are purchased because clients love the software.

Harry Sambathavan - *National Bank Financial - Analyst*

Right. Okay.

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

Is that the right way to think of it?

Harry Sambathavan - *National Bank Financial - Analyst*

Fair enough.

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

So, it is hard for me to say of a $400,000 sale, how much was software and hardware because we don't break it. But we know the customer bought that because he wanted to do food analysis, he demoed every product and he said "Wow, yours gives me incredible performance and is really easy to use." That's how we look at our statistics.

On your second part of your question, just to be clear, we're continuing to see strength in our early stage arena and we are managing our cost very carefully in there and you've seen that with the actions we've taken over time. We're seeing strength there. The area where we are seeing some softness is in the late stage and as you said, Central Labs is a -- more of a fixed cost business than certainly the Phase II through Phase IV four is. So, we're actively managing that. The best we can.

Harry Sambathavan - *National Bank Financial - Analyst*

Thank you.

Operator

Thank you. (Operator Instructions) The next question is from Randall Stanicky from Goldman Sachs. Please go ahead.

Stefan - *Goldman Sachs - Analyst*

Hi, good morning, guys, this is actually Stefan filling in for Randall Stanicky. I have two questions around the Pharma Services business. You guys mentioned in the late stage, you saw a ramp up toward the end of the quarter. Can you give us an idea of how that's been trending so far?

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

I'm sorry. Randall, I couldn't hear your question quite. Could you please repeat it?

Stefan - *Goldman Sachs - Analyst*

I'm sorry. You mentioned there has been a ramp up in late stage toward the end of the quarter. Could you give us some idea of how that's been going since the end of January?

Doug Prince - *MDS Inc. - EVP of Finance & CFO*

Hi. This is Doug Prince. Thanks for your question. What's happening there, when we get these large orders, we'll put them in the backlog then we work with our customers to schedule those as their molecule gets ready for the next phase. And what happened here is that we've had some pretty large orders in our backlog, the start of the trial had been delayed, and one of the

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-- couple of the big ones started up in January. So, again, those would be long multiyear contracts and again we would expect that that would continue into Q2 and beyond.

Stefan - *Goldman Sachs - Analyst*

Great. And looking at early stage, I mean you mention it has been strong with pre-clinical. You're seeing some weaknesses. Could you just give us some outlook around the pre-clinical industry and what you guys expect for 2009?

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

On 2009, I would tell you that I'm not sure that visibility is all that great for anyone right now -- in March. We are seeing strength in the pre-clinical business, particularly our Phase I business is holding up very strongly. And we, like you, are look at the headlines out there. There's a -- we have all refurbished facilities, we have modern IT systems, we have done so much great Lean Sigma work there, we have standard SOPs, every one of our facilities runs identically for clients.

And as we're watching the industry facing a number of challenges, we, like you are watching announcements out there that other people are closing facilities and we think certainly a lot of people who have small single facilities are having a lot of trouble there. So, we feel good and think that we're really winning based on our capability in that arena right now. Versus -- I would say any external market trends we can get our hands around. I think the Phase I market is holding up okay. We're doing quite well. And I think we're probably gaining a little bit relatively here on other folks who have older facilities or smaller facilities.

Stefan - *Goldman Sachs - Analyst*

Great, guys. Thanks a lot.

Operator

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

Dave Windley - *Jefferies & Company - Analyst*

Hi. Excuse me. Stephen, you've talked about -- there we go. Can you hear me okay, Stephen?

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

Yes.

Dave Windley - *Jefferies & Company - Analyst*

You talked about manufacturing moving to Asia. That's been ongoing for awhile. What percentage of the AT manufacturing is in Asia at this point? And how much longer to get the rest of it there?

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

So, as I said, we've been doing it long enough. I think we're good at it now. But we do it thoughtfully, product line by product line. I think by the end of this year, we'll have 80% of the mass spect line there and about 40% of the molecular devices stuff -- 60% Doug is telling me -- by the end of the year. And obviously the stuff in California had started a little later.

I think though the key on that is you -- I don't want you to assume that you move the product there and everything happens in a month because it really doesn't. You move the product there, you certainly get the labor savings nearly immediately. You have to remove the overheads that you have at the sending location and I think the other part of that is the big savings there is localizing the supply chain. And we're getting more and more momentum on that because our products -- generally in the Analytical Technologies area -- typically, we would have 80% purchase goods in our COGS, maybe 8% labor and 12% overhead. What you're really getting in Asia is the savings labor in your purchase materials. And that just takes time as you -- get suppliers up to speed. You qualify them. You're able to get in first quantities and inspect them and what not.

But we're starting to get into in my mind, the meat of the curve on the stuff that's moved there already and so every month, this has been improving for us. Which is very good right now.

Dave Windley - *Jefferies & Company - Analyst*

Absolutely. On the CRO business, I wanted to clarify, it was my understanding from the prepared remarks that within early development, Phase I, you said this several times, Phase I is strong. But it was my understanding from the prepared remarks that the pre-clinical facility in France did see some softness but your answers to questions in the Q&A have not reiterated -- they have refuted that. I wanted to get that clear. Free clinical, [fox] France, strong or weak?

Doug Prince - *MDS Inc. - EVP of Finance & CFO*

Dave, this is Doug. Thanks for asking me that. Stephen's comments on the strength were more on the orders front.

Dave Windley - *Jefferies & Company - Analyst*

Okay.

Doug Prince - *MDS Inc. - EVP of Finance & CFO*

We're seeing strengthening in orders. But the Q1 revenue was a little bit soft versus prior year.

Dave Windley - *Jefferies & Company - Analyst*

And that is strengthening in orders is toward the end of the quarter or since the end of the quarter?

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

It is --

Doug Prince - *MDS Inc. - EVP of Finance & CFO*

Throughout.

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

Ramped up throughout the quarter.

Dave Windley - *Jefferies & Company - Analyst*

Okay.

Doug Prince - *MDS Inc. - EVP of Finance & CFO*

We finished strong in Q1 on those orders. Feeling better -- I think a lot of it was related to the real softness in orders was in the October through December time frame. I think is a lot of clients around the world are really trying to figure out what was happening with the markets.

Dave Windley - *Jefferies & Company - Analyst*

Okay. That's helpful. Thank you.

Operator

Thank you. This will conclude the question-and-answer session. I would like to turn the meeting back over to Miss Lee.

Kim Lee - *MDS Inc. - Senior Director of IR*

Thank you, Donna. Thank you all 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 great day.

Operator

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

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