

FINAL TRANSCRIPT

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MDZ - Q1 2010 MDS Inc. Earnings Conference Call

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CORPORATE PARTICIPANTS

Peter Dans

MDS Inc. - CFO and SVP

Steve West

MDS Inc. - CEO

CONFERENCE CALL PARTICIPANTS

David Windley

Jefferies & Co. - Analyst

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 Peter Dans, Chief Financial Officer. Please go ahead, Mr. Dans.

Peter Dans - MDS Inc. - CFO and SVP

Thank you, Jenny.

Good morning and welcome to MDS's conference call and webcast for the first quarter of 2010. A press release discussing the highlights of our 2010 first quarter results was issued this morning. If you have not received a copy, it is posted on our website at mdsinc.com. You will also find a copy of our first quarter's management discussion and analysis, along with financial statements and notes on our website. All documents were filed this morning.

Joining us this morning is Steve West, Chief Executive Officer of MDS. Steve will begin the call with his perspective on the quarter, and I will follow with comments on the Q1 financials.

As you know, in September 2009 MDS announced its strategic repositioning that included the agreement to sell MDS Analytical Technologies, as well as the intent to discuss the MDS Pharma Services Early Stage businesses. Both of these sales have now closed. Similar to the fourth quarter of 2009 and our 2009 annual filings, the Company is reporting current results for these businesses as discontinued operations, and for all periods reported.

Let me remind you that during the call we will be making forward-looking statements about MDS. These statements are not a guarantee of future performance, and are subject to the risks and uncertainties that could cause actual results to differ materially. These risks are disclosed in today's press release, as well as other documents which are filed with the relevant Canadian and U.S. security regulators, and are also available on our website.

With the completion of our strategic repositioning, and in order to simplify our disclosures, beginning this quarter and going forward we have decided to discontinue the use of non-GAAP measures such as adjusted EBITDA. Historically, to the help our investors gain a clearer understanding of our use of non-GAAP measures such as EBITDA and adjusted earnings per share, we provided reconciliations of GAAP and non-GAAP measures in documents, including our 2009 MD&A and our 2009 annual report, and other reports which are available on our website.

I will now turn it over to Steve West.



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Steve West - MDS Inc. - CEO

Thank you, Peter, and good morning to everyone that has joined us today, and in particular Peter, welcome in your first earnings call as CFO.

With the strategic repositioning of MDS complete, and the sale of both MDS Analytical Technologies and MDS Pharma Services Early Stage closed, the Company has reported the results for these businesses as discontinued operations. I will speak to continuing operations which are Nordion and corporate functions, and Peter Dans will address discontinued operations and our financial results.

Starting with continuing operations, for the first quarter MDS reported revenues of \$46 million, compared with \$66 million in the corresponding period last year. Excluding the impact of foreign exchange, revenues decreased by 35%. A loss from continuing operations of \$43 million in the first quarter includes a \$33 million pretax restructuring charge, compared with income of \$3 million for the prior year period. We ended the quarter with a strong cash balance of \$871 million from early June to the close of the MDS Analytical Technologies divestiture of \$641 million in cash.

Now let me address Nordion results. Despite the isotope supply shortage, Nordion results were positively impacted by strength in its radio therapeutics operations, largely driven by global TheraSphere growth and increased cobalt volume. On the medical isotope supply front we continued with our efforts to identify alternative sources of long-term supply. We recently completed our assessment of the potential to receive additional supply of molybdenum-99 from the Karpov Institute of Physical Chemistry in Moscow, and we determined that this opportunity was not commercially viable at this time. We also continue working in collaboration with our long-term partner, Triumph, on a feasibility study regarding photo-fission produced molybdenum-99.

In terms of our legal proceedings against ACL and the Government of Canada, our primary focus remains on the confidential arbitration process. Hearings for the arbitration have been scheduled beginning in the Fall of 2010, and continue to our second fiscal quarter of 2011, and the Company expects a decision from the panel thereafter during 2011. On March 11, 2010, at the Annual and Special Meeting of Shareholders, a special resolution approving the name change of the company to Nordion Inc. was passed. We expect the implementation process to change the name to Nordion Inc. to be underway by the Fall of this year.

Let's look at the progress made with the strategic repositioning of MDS. On January 29, 2010, we completed the divestiture of MDS Analytical Technologies for \$641 million in cash, including preliminary working capital adjustments. On March 5, 2010, MDS completed the divestiture of the MDS Pharma Services Early Stage business, which included \$13 million in cash based on preliminary adjustments for working capital and other items, and a five-year \$25 million note, and certain other minority interests.

With the closing of the MDS Pharma Services Early Stage transaction, MDS has now completed its strategic repositioning, and disbanded its Special Committee. MDS continues to provide transitional services to the businesses it has sold, and the Company will continue to see the impact of strategic repositioning on its financial results for the next few quarters. We are now focused on preparing Nordion to become a well-positioned, stand-alone business.

For the remainder of 2010, my attention will be focused on the following activities. Completing the transition, and implementing a plan to reduce costs and enhance efficiencies; and that will result in the wind-down of our Toronto office, and consolidating all corporate functions at Nordion's Ottawa headquarters by the end of 2010. Also I will be focused on building Nordion's core strengths and leadership positions in medical imaging and radio therapeutics, and sterilization technologies, to enable the Company to deliver positive financial returns. Also, we will be leveraging our core competencies as a platform for growth through disciplined investment in innovation.

Thank you very much for your time, and now I would like to hand it over to Peter, who will provide a more detailed view of our financials, and then we will begin the Q&A session.



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Peter Dans - MDS Inc. - CFO and SVP

Thanks, Steve.

As with our Q4 and 2009 year end results, in the first quarter of 2010 our financial results reflect both continuing operations and discontinued operations. Please note that continuing operations includes our MDS Nordion business and corporate functions, and discontinued operations includes the Analytical Technologies and Pharma Services businesses.

I would like to note that today's results are unaudited. In addition, our unaudited first quarter results have been reported in our management discussion and analysis, and financial statements and notes, which were filed today and are available on our website.

I will start with results from continuing operations. For MDS Inc. total revenue was \$46 million, down \$66 million -- down 30% from \$66 million last year. Excluding the impact of foreign exchange, revenues declined 35%. In the quarter we reported a loss from continuing operations of \$43 million, compared to income of \$3 million last year. Our loss per share from continuing operations was \$0.36 in Q1 2010, compared to earnings per share of \$0.03 last year.

For Nordion, the decline in revenue from \$66 million in the first quarter of last year to \$46 million in our first quarter of this year was primarily driven by the 50% decline of medical imaging and radio therapeutics revenue, mainly due to the impact of the NRU shutdown. In addition, in Q1 2009 we saw higher medical isotope revenue as the NRU was able to increase supply during the period that the Petten Reactor in The Netherlands was shut down.

We saw global growth in radio therapeutics, led by TheraSphere, which grew by over 50% on a year-over-year basis. In addition, the CardioGen product, which began -- we began producing in the second half of 2009, also contributed to the growth in radio therapeutics.

Revenue from sterilization technologies in the first quarter of 2010 was over 10% higher than the same quarter of 2009, due to an increase in cobalt shipments, partially offset by the sale of a production irradiator in the first quarter of 2009.

Cobalt revenue was lower on a sequential basis, when compared to the fourth quarter of 2009. We continue to expect that cobalt volumes will be higher in fiscal 2010 compared to fiscal 2009. However, the amount shipped in each quarter is expected to continue to fluctuate, based on the timing of delivery of cobalt from our suppliers and the timing of customer requirements.

Gross margins in Q1 were 39% compared to 50% last year, with the decline primarily due to the impact of the shut down of the NRU. SG&A in the first quarter was \$10 million, versus \$9 million last year, primarily due to the negative impact of foreign exchange, which was partially offset by lower insurance expense due to the NRU reactor shutdown, and delays in spending on certain marketing activities.

R&D expense this quarter was \$1 million, level with the same period last year. Spending this quarter was largely due to the costs associated with the TheraSphere clinical program. This quarter the embedded derivative related to our Russian cobalt supply contract resulted in a gain of \$2 million, compared to a charge of \$5 million in the first quarter of 2009. In the quarter, Nordion incurred a pretax restructuring charge of \$2 million, which related to additional stock compensation that was triggered by the closing of the sale of MDS Analytical Technologies.

In summary, MDS Nordion's operating income was \$3 million in Q1, down from \$15 million in the same quarter last year. The decline in operating income was primarily due to lower revenues, which was partially offset by a \$7 million change in the embedded derivative expense.

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I will now discuss corporate and other. The corporate and other operating loss of \$46 million in Q1, compared to a \$14 million in 2009, was primarily due to a \$31 million restructuring charge that was recorded in the quarter. SG&A expense of \$11 million was flat compared to the prior year, due to the impact of lower compensation costs from a smaller workforce in Toronto, as we continue to wind down that office offset by the unfavorable impact of foreign exchange and professional fees related to our substantial issuer bids. Please note that SG&A in the first quarter also includes certain costs related to transition services being provided to the Phase 2 to 4 and central labs businesses that were sold in fiscal 2009. Following the completion of transition activities associated with the strategic repositioning, including the wind-down of the Toronto office, we currently expect our SG&A for corporate and other to be approximately \$3 million per quarter.

Corporate restructuring charges for the first quarter were \$31 million. The restructuring charges were made up of several components. \$14 million in severance was recorded, which primarily related to an Executive Officer; as well, \$5 million of tax gross-up was reported for certain Executive Officers, subject to U.S. tax requirements. \$6 million of stock-based compensation was vested upon the close of sale of MDS Analytical Technologies, and \$3 million of transaction incentive plan payments to certain Executives were also recorded. Additional amounts related to the transaction incentive plan are expected to be recorded in the second quarter of 2010. Finally, this quarter we recorded a charge of \$3 million for future rent payments net of estimated sublease revenue that are expected related to our Toronto office, that we plan to substantially vacate in the third quarter of fiscal 2010.

Other expense of \$1 million for the quarter included a \$3 million foreign exchange loss on the revaluation of certain assets and liabilities, which was partially offset by \$2 million of transition service income recognized in relation to the Late Stage businesses that we sold last year. Our tax expense for continuing operations for the first quarter of 2010 was nil. This primarily resulted from an increase in valuation provisions associated with the sale of MDS Analytical Technologies which were recorded in continuing operations, which offset tax recovery associated with the net loss for the quarter.

Now to discontinued operations. In Q1, we reported a loss from discontinued operations of \$100 million, compared to a loss of \$1 million in 2009. The loss for MDS Pharma Services was \$79 million, compared to nil last year. An additional estimated loss on the sale of MDS Pharma Services early stage of \$50 million was recorded in the first quarter of 2010, bringing the total estimated loss to \$63 million. The loss will be updated to reflect best estimates in the second quarter of 2010. In addition, the \$32 million operating loss for Early Stage included a \$12 million asset impairment charge related to certain assets that we will retain, and \$5 million of insurance expense that was recorded related to the potential settlement of litigation claims associated with the Montreal [FDA] issues.

The loss from MDS Analytical Technologies was \$21 million, compared with an operating loss of \$1 million in 2009. Based on our current estimates, we expect that the final net proceeds from the sale of MDS Analytical Technologies will equal the carrying value of the business. An [equal] amount of \$23 million was recorded in the first quarter of fiscal 2010 in MDS Analytical Technologies. We expect that there may be additional post-close adjustments related both -- to both the sale of MDS Analytical Technologies and Early Stage, that may affect both the gain/loss calculation and the future cash flows associated with these transactions.

Turning to cash flow, in the first quarter of 2010 we received \$641 million of cash proceeds net of \$9 million of preliminary working capital and other adjustments, following the close of the sale of MDS Analytical Technologies. Not including restricted cash, our cash balance at the end of Q1 was \$871 million. In December 2009, we repaid \$23 million of our senior unsecured notes that had matured. In addition, subsequent to the end of Q1, the remaining outstanding notes were repaid in full at a cost of \$223 million, which included \$199 million of principal, accrued interest of \$1 million, and the [23 make well] amount.

On January 29, 2010, MDS cancelled its Canadian \$500 million revolving credit facility. In the first quarter of 2010, we used approximately \$20 million of cash to collateralize outstanding letters of credit. This \$20 million is now included in our restricted cash. As well, as we launched a substantial issuer bid on February 19, 2010, and plan to redeem up to \$450 million of stock through the bid, which is scheduled to expire on March 29, 2010. Upon the completion of the substantial issuer bid, we currently expect our initial cash balance to be in the range of \$95 million to \$115 million to support ongoing operations and obligations,



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including those retained and related to the businesses we have sold. In addition, we intend to hold additional cash to fund any unpaid transaction and associated costs associated with the strategic repositioning.

With the completion of the strategic repositioning, we are evaluating the way we will operate and report financial results going forward. We expect to be able to provide you with additional detail on Nordion's operations and revenues in the future.

That concludes my financial comments for the quarter. Before I ask the Operator to open the lines for Q&A, I would ask you to limit yourself to one primary question and one follow-up question. Now, Jenny, would you please open the lines for questions?

QUESTIONS AND ANSWERS

Operator

(Operator Instructions)

Your first question is from David Windley with Jefferies & Co. Please go ahead.

David Windley - Jefferies & Co. - Analyst

Good morning, thanks for taking the questions. Peter, you mentioned on -- I believe it was in the corporate discussion specifically, that you expect that the quarterly run rate would run around the \$3 million level; did I understand that correctly?

Peter Dans - MDS Inc. - CFO and SVP

That's correct, Dave.

David Windley - Jefferies & Co. - Analyst

And how long to get there?

Peter Dans - MDS Inc. - CFO and SVP

Again, we said we expect the transition services and the transition to Ottawa to basically be complete by the end of the year. Therefore, it's really sort of an exiting 2010 level of spend.

David Windley - Jefferies & Co. - Analyst

And that's fiscal or calendar, just to be certain?

Peter Dans - MDS Inc. - CFO and SVP

Really coming out of the ends of our fiscal year, but sort of in the 2010 calendar year end timeframe. So again, you would see it sort of in our Q1 results of 2011.

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David Windley - Jefferies & Co. - Analyst

Okay. And my follow-up then would be on the medical isotope revenue that you described as down 50%, I guess I'm curious what else is in that besides moly?

Peter Dans - MDS Inc. - CFO and SVP

So within -- it was really the medical isotope and radio therapeutics part of the business. So in addition to moly, we have additional cyclotron isotopes, as well as some additional reactor-based isotopes that we source outside of the NRU. And as well as our radio therapeutic product line was included in there, so the TheraSphere and the CardioGen that I mentioned as well were in that overall 50% reduction. So the actual reduction, again, from the NRU was we went from the revenue we had last year to basically nothing on the moly side.

David Windley - Jefferies & Co. - Analyst

Okay. All right, thanks for the clarification.

Operator

Thank you.

(Operator Instructions)

Mr. Dans, there are know further questions registered.

Peter Dans - MDS Inc. - CFO and SVP

Okay, thank you, Jenny. Thank you all for joining us this morning. If you do have any additional questions, please do not hesitate to give Catherine a call and we will follow up with you later. Thanks.

Operator

Thank you, gentlemen. This concludes today's conference call. Please disconnect your lines, and thank you for your participation.

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