FINAL TRANSCRIPT

Thomson StreetEvents℠

MDZ - Q2 2009 MDS Inc. Earnings Conference Call

Event Date/Time: Jun. 11. 2009 / 9:30AM ET

CORPORATE PARTICIPANTS

Kim Lee
MDS Inc. - Senior Director IR

Stephen DeFalco
MDS Inc. - President and CEO

Doug Prince
MDS Inc. - EVP and CFO

CONFERENCE CALL PARTICIPANTS

Lennox Gibbs
TD Newcrest - Analyst

David Martin
Dundee Securities - Analyst

Maher Yaghi
Desjardins Securities - Analyst

Hari Sambasivam
National Bank Financial - Analyst

Tim Livens
Jefferies & Co. - Analyst

PRESENTATION

Operator

Good morning, ladies and gentlemen, welcome to the MDS second results conference call.

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

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

Thank you, Valerie. Good morning, everyone and welcome to MDS' 2009 second quarter earnings conference call and Webcast. A press release of our second quarter results was issued this morning. If you have not received your copy, it is posted, along with the MD&A and financial statement and notes on our Website at mdsinc.com. We are broadcasting this event live on our Website, where you will find a Power Point presentation highlighting the details of the call. The archived version will remain on our Website after the call today. Joining me this morning are Stephen DeFalco, President and CEO of MDS; and Doug Prince, Executive Vice President of Finance and CFO. Stephen will begin the call with his perspective on the quarter and Doug will follow with his comments on Q2 financials. Prior to our Q&A session, we will turn it back to Stephen for a few closing comments.

Before we begin the commentary, I would like to remind you that during the call, we will be making forward-looking statements about MDS' 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.

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 selected non-GAAP financial 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 clearer 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 and our 2008 annual report, which are available on our Website. With that, I'll turn it over to Stephen.

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

Thank you Kim. Good morning, everyone, and thank you for joining us. Over the past several quarters, MDS has taken steps to offset the impact of soft markets during a challenging economic period. Our productivity initiatives and cost controls helped to deliver solid margins and strong cash flows in Q2. For the quarter, MDS reported net revenues of $257 million versus versus $326 million last year. Normalized for foreign exchange and divestitures, revenues declined 10%; adjusted EBITDA of $31 million with a margin of 12%, compared with $34 million and 10% last year. We increased our cash balance by $94 million, to end the quarter with $243 million in cash and cash equivalents. Our focus on productivity, restructuring and Lean Sigma delivered $15 million in savings this quarter.

Following the end of the quarter, we had two significant events; The strategic shift to focus MDS pharma services on early stage and the shutdown of AECL's NRU reactor. I'll comment on both of these events later. Let me first review our businesses. We'll start with MDS analytical technologies. While we continue to see soft demand in our core market, particularly with large pharma, trends appear to be stabilizing. We are seeing some growth in applied markets, particularly in Asia, and strength in our service business. Against this backdrop, we remain focused on launching innovative new products and are driving forward with cost productivity initiatives.

On the new product front, I am encouraged by customer feedback and demand for our new 5500 series of mass spectrometers, which were launched last October. Both the AB SCIEX 5500 QTRAP and Triple Quad are experiencing solid order flow. This quarter, we had a number of exciting product introductions. We launched the AB SCIEX TOF/TOF 5800. This MALDI-based mass spectrometer will help researches advance the discovery of biomarkers to improve the understanding of disease. With its increased speed and sensitivity, AB SCIEX 5800 can deliver analytical results in less than a day, compared to two weeks or more with other MALDI systems.

We announced a new suite of iMethods test. These tests simplify the use of our mass spectrometers for food and water quality testing, forensic toxicology and clinical research. We have established Leadership in this growing market and intend to build on our position. Also in the quarter, we introduced the MetaXpressPowerCore and MetaXpress 3.0 image acquisition and analysis software. Aligned with our emphasis on software and work flow enhancements, MetaXpressPowerCore software reduces overall time required for high content screenings. And MetaXpress 3.0 introduces a number of ease of use improvements, including new data management utilities.

Cost productivity remains key during market softness. Our manufacturing and supply shifts to Asia is progressing well and is helping us to offset the impact of volume declines.

Moving on to pharma services. The economic downturn continues to impact our clients. We are seeing pharmaceutical mergers, pipeline reprioritizations and decreased funding for biotech companies. Our clients appear cautious, lengthening the period of time it takes for them to place a study and they're also delaying project starts in certain cases. Although customer demand in the CRO space remains soft, the productivity and restructuring actions taken over the past year helps us deliver an additional $4 million in adjusted EBITDA versus last year.

After the end of the quarter, we announced a strategic shift to focus on the delivery of early stage services and our intent to sell a late stage business. We signed an agreement to sell our Phase II-IV business to INC Research, a leading global provider of CRO services. We are seeking a suitable buyer for Central Labs. Our focus on early stage, moves from a top 10 CRO to a top three in the early stage segment. Our historical strength and core compentancies have been in early stage, where we have benefited from larger market shares and deeper and stronger client relationships.

This decision supports MDS pharma services' efforts to advance its leadership position in early stage. It also leverages our recent investment in these key operations, which include a full service bioanalytical laboratory at our drug safety facility in Lyon , France. The launch of our next generation proprietary Clean Quick electronic system for Phase I study set up, data capture, project tracking and personnel credential management. A state of the art 300 bed Phase I facility in Phoenix, Arizona. And the upcoming expansion and renovation of our preclinical operations in Taiwan, which will double capacity to better serve emerging demand in the Asia Pacific region. We're excited about this new focus for pharma services and we're pleased that it has been well received by both customers and employees. We believe our new strategic focus on early stage services presents us with many opportunities to strengthen our support for customers.

Nordion delivered strong performance in Q2. Normalized for foreign exchange and divestitures, Nordion's revenues and adjusted EBITDA increased year-over-year on strength in medical isotopes. Nordion continues to build its radiopharmaceuticals business. In May, we announced the opening of our new Glucotrace production facility in Fleurus, Belgium. The new facility provides additional capacity to support the growth of this product line in Europe.

Yesterday, we announced that we began manufacturing CardioGen-82 for Bracco Diagnostics. CardioGen is the only FDA approved PET imaging agent used in profusion studies of the heart to examine blood flow through heart vessels. We are manufacturing this product in a dedicated FDA-approved, GMP compliant facility at our Ottawa site.

Subsequent to the quarter, we learned that the NRU reactor developed a heavy water leak and will be shut down for repairs. The most recent estimates indicate that the NRU will be out of service for at least three months. The NRU shut down and the recent shut down of the Petten reactor in the Netherlands, also the result of a water leak, further demonstrates the need for a new isotope supply capacity. The NRU is the largest producer of medical isotopes, providing approximately 30% to 40% of global demand, followed by the Petten reactor, which provides approximately 30%. These reactors are two of five reactors in the world capable of producing commercial quantities of isotopes and they are all approximately 50 years old.

MDS Nordion is working closely with its supply network to source additional isotopes, however, the reality is supply is scarce. The nuclear medicine community and industry associations know that there are no domestic or international sources that can fully mitigate this shortage. Indeed, the Petten reactor is scheduled for a four-week shut down in mid-July. In addition, the leak in that reactor has not been fully repaired. And we understand it will be shut down again for several months in the new year to address the situation.

While MDS has commercial interests to protect in this area, we should not forget that medical isotopes are used to treat and diagnose more than 20 million patients a year. Nordion medical isotopes are used in approximately 50,000 procedures each day, 5,000 of those in Canada. These procedures include diagnosis and treatment of cardiac, neurological conditions and several types of cancer. We believe the solution to the current issue and to providing long-term stability resides with the MAPLE reactors. Both MAPLE 1 and MAPLE 2 and the processing facility are a 100% completely constructed. And the MAPLE's do work, they have created isotopes.

MDS recently urged the government of Canada and AECL to consult with international experts to activate the MAPLE reactors. The infrastructure is in place and the assistance of an international consortium of nuclear experts, we believe the MAPLE reactors can be producing medical isotopes. We believe the government's decision to abandon the MAPLE's was not a reasonable public policy for Canada or for the world. It was wong decision. Despite a growing number of voices urging the government to activate the MAPLE reactors, we have seen no positive sign that there is a willingness to do so.

Indeed as you are probably aware, Canadian Prime Minister, Stephen Harper, said yesterday that he anticipates Canada will eventually get out of the isotope business. We find his comments curious, particularly since AECL's CEO Hugh MacDiarmid issued a statement on the same day, in which he declared, "We view the production of isotopes as part of our core mission for Canada and indeed for the world." The government's comments appear to ignore the fact that AECL entered into a contract with MDS to bring the MAPLE reactors into service and to provide 40 years of isotope supply. MDS paid AECL hundreds of millions of dollars under our contracts and would continue to pay AECL for the isotopes it produces.

We are pursuing an arbitration to compel AECL to perform. We have also filed a court claim in this regard. We will continue to urge the government to change public policy and restart the MAPLE project. The solution to global supply is clear and the world is waiting for Canada to take action. We are pressing forward with this issue, as it is important for our customers, for our shareholders, and ultimately, for the patients who rely on our medical isotopes.

We are also taking action to secure longer term solutions. In April, we announced a collaboration with TRIUMF, Canada's national laboratory for particle and nuclear physics to study the feasibility of producing a viable and reliable supply of photo fission-based molybdenum-99. This is a potential longer term solution and does not address immediate concerns and current supply shortfalls. I will now turn it over to Doug Prince to provide the financial details for the quarter.

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

Thank you, Stephen. Before I get into the financial results, I would like to remind everyone, we also provide commentary on items that impact the comparability of our results. For the second quarter 2009, adjusted financial results exclude an asset writedown of $16 million, a $9 million tax asset writedown and a $1 million gain on the settlement of a contingency. Prior year results exclude income related to a change in the FDA provision, a writedown on asset-backed commercial paper, an acquisition-related credit and a restructuring charge. Where appropriate for year-over-year comparability, I will describe the impact of foreign exchange and acquisitions and divestitures. In addition, when I refer to revenue growth figures and margin percentages, these are based on net revenues. That is revenue for products and services, excluding reimbursement revenue.

Now, to our Q2 results. In Q2, our total revenue was $282 million, including $25 million of reimbursement revenue. Net revenues were $257 million, down 21% from $326 million last year. Excluding the impact of foreign exchange, acquisitions and divestitures, net revenues declined 10%. Analytical technologies and pharma services saw year-over-year revenue declines on continued soft demand in North American and European markets. Adjusted for foreign exchange and divestitures, Nordion saw a 6% increase in revenue, driven by higher medical isotope sales.

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 $62 million, compared to $75 million last year. The decrease was mainly driven by foreign exchange, productivity savings, and the $4 million reduction in stock-based compensation expense. SG&A, as a percent of net revenues, increased from 23% last year to 24% this year. In the second quarter, we spent $14 million on R&D, 5% of net revenues; compared to $22 million or 7% in 2008. This decline was driven by the strengthening of the US dollar and the completion of several major hardware and software projects late last year.

Adjusted EBITDA was $31 million, compared to $34 million last year, down 9%. Excluding the impact of foreign exchange and divestitures, adjusted EBITDA increased by approximately $5 million or 16%. In Q2, our adjusted EBITDA margin increased approximately 200 basis points, from 10% last year to 12% this year. Largely driven by cost reductions from restructuring and productivity initiatives, including supply chain savings and Lean Sigma projects. GAAP loss per share was $0.15 in Q2, compared to earnings of $0.11 per share last year. This decline was primarily driven by a $16 million pretax writedown of pharma services' Central Lab assets, and a $9 million aftertax writedown of deferred tax assets. Excluding the adjusting items mentioned earlier, our adjusted earnings per share were $0.03 in Q2, compared to earnings of $0.08 last year, primarily driven by lower reported adjusted EBITDA and higher interest expense.

Now, to our business unit results, starting with pharma services. For the quarter, pharma services reported net revenues of $105 million, down 18% over the same quarter last year. $9 million of the decline was driven by the impact of foreign exchange. In early stage, declines were largely driven by lower revenues in bioanalytical services. Late stage declines were primarily due to lower demand in Central Labs. Adjusted EBITDA in the second quarter was $3 million, compared to a loss of $1 million last year. This improvement was largely driven by cost savings from restructuring and productivity initiatives, partially offset by lower volumes.

To further improve operating performance in a soft economy, to sharpen our focus on early stage and to reduce overhead associated with late stage, we have initiated additional restructuring actions in the third quarter of 2009. The estimated cost of these actions is approximately $4 million and we expect to generate about $9 million in annual savings. During the second quarter, new business wins totaled $114 million, down 31%, from $165 million last year. Sequentially, new business wins increased 10%. The year-over-year decline was driven by soft demand related to economic factors, pharma mergers and biotech funding challenges, compounded by the impact of foreign exchange.

Our quarter ending backlog was $442 million, down 11% from the $496 million last year. The decline was predominantly driven by the negative impact of foreign exchange, plus declines in late stage, partially offset by an increase in early stage backlog of approximately 10%. On June 1, we announced the agreement to sell our Phase II-IV operations for $50 million, including certain transition services and subject to customary post-closing contingencies and adjustments. Given the success of our Q2 working capital initiatives, the most significant adjustment could be a reduction in price related to working capital.

Next on to Nordion. Nordion reported revenues of $65 million, down 19%, from $80 million last year. Foreign exchange and divestitures each negatively impacted growth by approximately $10 million. Excluding these items, Q2 revenues increased by $4 million or 6%, driven by strength in medical isotopes. Adjusted EBITDA was $23 million, versus $24 million last year. The current quarter includes an embedded derivative gain of $3 million, compared to a $2 million gain last year. Excluding the impact of foreign exchange and divestitures, adjusted EBITDA increased approximately $3 million or 12%, also on the strength in medical isotopes.

Now, on to analytical technologies. Analytical technologies recorded revenue of $87 million in Q2, down 26%, from $118 million last year. Foreign exchange had a negative impact of approximately $11 million. The primary driver of the revenue decline was soft demand in pharma markets across all product lines. Including the impact of foreign exchange, total analytical technologies end user revenue decreased 13%, including an 11% decline in mass spectrometer end user revenue. Despite the overall decline, we continue to see increased demand for mass spec instruments in applied markets for food, water and environmental testing. In addition, after adjusting for foreign exchange, end user service revenues were also higher year-over-year.

Adjusted EBITDA in the second quarter was $13 million, compared to $17 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 saw foreign exchange hedge losses this quarter from positions we established last year and therefore, we did not fully realize the benefit of the year-over-year strengthening of the US dollar.

Turning next to cash flow. During the second quarter, we generated $94 million of cash flow, increasing our cash balance 63% to $243 million. This increase was primarily driven by our Lean Sigma working capital initiatives, in particular at pharma services, and the collection of a $60 million note related to the sale of diagnostic services back in 2007. During the quarter, we incurred $7 million in capital expenditures and repaid $1 million of debt. Our CAD500 million revolving line of credit remains undrawn.

Finally, I'd like to comment on the NRU shutdown and liquidity. As described in the MD&A, an extended NRU shutdown and the corresponding loss of revenue, EBITDA and cash flow at Nordion; could have a material adverse effect on MDS' business, operations and financial results, including compliance with our debt covenants. We have identified this risk, are taking actions to prevent it from occurring. And believe that if necessary, we can use our strong cash position, combined with new financing at market rates, to remedy this situation should it occur in the the future.

As of the end of the second quarter, we had $243 million in cash. Our $276 million in debt includes a $39 million government loan that is offset by a financial instrument. And therefore, in summary, the sum of our cash and debt as of the end of the second quarter was essentially $0. That concludes my financial remarks for the quarter. And with that, I will now turn it back to Stephen for his closing remarks.

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

Thank you, Doug. For the balance of the year, we expect to be operating in a demand environment similar to current market conditions. We will continue to drive aggressive plans to improve our cost productivity, launch new products and improve our customer services offerings. We will be working hard to close the Phase II-IV transaction and ensure those clients are well attended to during that transition. We will continue to work out short term and long term isotope supply issues. Let me now turn it back over to Kim for Q&A.

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

Thanks, Stephen. That concludes our formal remarks. Valerie, could you please open the lines for questions.

QUESTIONS AND ANSWERS

Operator

Thank you, Ms. Lee. (Operator Instructions) Our first question is from Lennox Gibbs from TD Newcrest.

Lennox Gibbs - *TD Newcrest - Analyst*

Morning, thanks. With respect to the MAPLE, as early the late 90's, I think this is when MDS actually owned the MAPLE, there was expert opinion statement that the reactor design was aggressive and unlikely to work. And that's largely proven true. There's been consultation with experts out of the US, the Brookhaven National Laboratory, et cetera, et cetera. And as you note, last evening, the Prime Minister made it clear that the Government of Canada wants out of the medical isotope business. Yet, the strategy I hear today seems to hinge on the revival of the MAPLE. What is the exact status of the TRIUMF project? And why has MDS not done more to date to develop a contingency to the NRU and the MAPLE?

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

Lennox, thank you for joining us. A fairly long question. Let me try to take it piece by piece. We're very excited about the TRIUMF deal. We had TRIUMF as a partner of ours for years and years. We have a lot of respect for those physicists and those scientists at that facility. We're excited about the potential of making molybdenum using photo fission. But I would caveat all of that with, that's a longer term R&D project, that's going to take a little while to prove out all of the science.

I think we know it's -- probably have a strong feeling it's feasible. We're trying to figure out whether or not the economics work in any kind of form that makes it kind of viable to take to market. So, we are excited about that. And we are pursuing a number of other of those arrangements, both with people who have existing reactors around the world for, I would say, more traditional moly production, as well as some new technologies.

I don't agree with your assertions about the MAPLE's. And so, the MAPLE project was designed to be a several year construction project that was $145 million and was going to be brought into service in 2000. As you know, I wasn't at MDS at the time but it was a fairly straightforward construction project. It obviously didn't go as planned and there's sort of a lot of history around that. As I said in my comments, I find Stephen Harper's comments yesterday a little bit confusing, given other messages coming out from other areas in the government.

I think our perspective; and quite frankly, the perspective of the broader medical community; and quite frankly, the perspective of the scientific experts in the United States; and quite frankly, the perspective of AECL's own expert witnesses at the Parliamentary testing -- at the Parliamentary hearings lat June is that; The only viable solution is the MAPLE's in terms of dealing with the current situations. And I think you have to remember that the MAPLE project was built explicitly to avoid the current situation the Canadian Government finds themselves in. And we're looking at obviously, the NRU outage, but the Petten reactor is also a very old reactor, that has its set of issues. And the world needs supply of these medical isotopes. So we are looking and working with our stakeholder groups to bring, I think, some sensibility to that set of decisions here.

Lennox Gibbs - *TD Newcrest - Analyst*

Well, not to get into a dispute, but it seems as though this is -- it sounds as though you're simply asking to have a different set of experts. Because as I said, Brookhaven has looked at it and even MDS' own testimony at the Parliamentary subcommittee meetings a year ago, was to the effect that the MAPLE project was risky. So anyway, I'll move on. Just with respect to the Dr. Reddy lawsuit, it's been about 15 months since you press released that you'd completed the repeat testing and the validation process that flowed out of the 900 letters the FDA sent out. What transpired with respect to the MDF Dr. Reddy filed through that period? Did you complete the revalidation work for Dr. Reddy? Have you been in negotiation with him? Has it been adversarial prior to the lawsuit coming out?

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

Yes, I'm not going to comment on an ongoing lawsuit. We were disappointed that they did that. We had worked with them on a number of areas and so a number compounds. Obviously, we're going to vigorously defend ourselves against that and feel we have strong case. We also have insurance coverage on that. So, not something I'm going to comment on, as now, it's a legal matter.

Lennox Gibbs - *TD Newcrest - Analyst*

Thanks very much.

Operator

Thank you. Our next question is from David Martin from Dundee Securities. Please go ahead.

David Martin - *Dundee Securities - Analyst*

Thank you. I'm just wondering, kind of following on Lennox' two questions, do you have expert advice right now that it would be safe to turn on MAPLE, or are your advisors telling you it has to be looked into further and maybe it will be safe to turn it on? That's the first question,

---

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

Look, I don't want to get into specific issues of safety. The MAPLE's need work to solve in the technical issues. The question is, are those technical issues solvable and certainly solvable under something we view as a reasonable time frame in order to avert the current crisis that we see for patients? We're not alone in our perspective that the right expertise, brought around that problem, can solve it. This is something that came out of a report from the National Academy of Sciences in the United States, as they evaluated the isotope issue on request from the US Congress. And it stated pretty clearly, the MAPLE's are that solution and that they -- we need an international panel of experts in there and to fix them.

The AECL expert witness, at the last June's Parliamentary hearing, said very clearly, we need to complete the testing. And there are a number of avenues that we can pursue in order to solve the technical issues and bring these safely online and commissioned.

And quite frankly, we think now is the time to pull together the best minds around the world. Get them focused on that issue and get it solved. Because without that, we have patients around the world who are at the beginning of their treatment regimens, who now can't get diagnosis. And so, we often say they can't get their scans but quite frankly, they can't get treated for cardiac disease and cancer because those scans are necessary to make that diagnosis. And we're urging folks to get the right set of minds together and make sure that the world has a reliable supply of these products. So it's not us alone, it is a broad group of folks and it's fairly well documented out there with the materials.

David Martin - *Dundee Securities - Analyst*

Okay. Thanks. The second question is, I noticed in the MD&A that there's been a second lawsuit launched in regards to the bioequivalents problems. And this seems like a relatively few number of your clients who have entered legal proceedings on this front. I'm just wondering, are you expecting there could be more or do think it's going to stay fairly limited? And if it is going to stay limited, was there something unique about these two situations that have led to lawsuits, that probably don't apply to other situations?

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

We've worked very closely with our clients and supported them well through that situation and took care of them and took care of them from a financial reimbursement. Most of those clients are happy, most of them are doing business with them. You can't say never, but no, we don't anticipate anything else kind of going forward. And as to why they decided to go a litigation route, I don't really know if I can answer that effectively but again, it's a legal matter now.

David Martin - *Dundee Securities - Analyst*

Okay. And then the last question, just really quickly. In analytical technologies, mass spec revenues were down 11% year-over-year. And the MDCC stuff, the drug discovery and bioresearch was down 18%. When you put it all total for the entire AT business, AT was down 26%. I don't know how 50% of the business down 11%, 50% of the business down 18% ends up to the whole business down 26%. And just wondering how that -- what pulled everything down?

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

Part of that is the way the JV accounting is in there. So our stated revenues on the mass spec business would more reflect almost our cost structure in that business, as opposed to end-user revenues.

David Martin - *Dundee Securities - Analyst*

Okay.

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

And then, there's a little FX action in there, too, I think in your numbers. So, we'll be happy to walk you through that on a follow-up call.

David Martin - *Dundee Securities - Analyst*

Okay. Thanks.

Operator

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

Maher Yaghi - *Desjardins Securities - Analyst*

Thank you for taking my questions. I just had a question on the covenant situation. Can you maybe detail for us, what is the ratio that you have for that covenant not to be hit? And given your current outlook for the business and if the NRU shutdown extends until next year, which quarter you'd expect that this possibility could hit, that the covenant could be hit?

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

Thank you, Maher, this is Doug. Our covenants are related to our US dollar notes, as well as our revolver. They both were signed when we reported on Canadian GAAP in Canadian dollars and they're on that basis. The ratio is approximately three times EBITDA to interest, on a rolling four quarter basis, over most recent 12 months. And at this point in time, there's a number of variables that would have to be considered but we believe that we may be able to stay above that covenant and never have a problem. But if one does occur, it's potentially likely to occur sometime in 2010.

Maher Yaghi - *Desjardins Securities - Analyst*

So if the NRU reactor continues to be shut down, that is the factory that you're talking about?

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

Well, it would be that, as well as other factors, such as recovery in the AT markets and the pharmas markets and a wide variety of other issues.

Maher Yaghi - *Desjardins Securities - Analyst*

Okay. Thank you for detailing this. The second question I had, and I'll get on the queue after, is regarding the NRU now and MAPLE. Lennox talked about the advice that was given to AECL by Brookhaven but also by -- there's one that was done by the Idaho National Laboratory. They both confirm that there is an actual positive power coefficient of reactivity in the nuclear reactor itself. Are you suggesting that the Government of Canada or AECL, put the NRU -- the MAPLE reactor on a production mode, even with a positive PCR in the reactor core?

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

Yes, there is a fairly complex issue. Let me try to break it down for you best I can. The issue with the MAPLE reactor that needs to be solved is the understanding the reactor physics, which is a little different than the way it was envisioned when AECL constructed those. And so, as you said, there's a positive coefficient power. By the way, there are other reactors in the world, in Canada actually, that are license for a positive coefficient of power. You just have to understand the physics and design the safety case around that. So, that's one option.

The second option is to remove the positive power coefficient. With most experts saying the easiest and simple path to do that is to redesign the fuel. And in a sense, put fuel in there with less power. And that would then bring the power coefficient to be what is was designed to be, which is slightly negative. And so, it's not a case of, if positive power coefficient, the answer is you can't use reactors. It's you understand that and you design a safety case around it. That's a possibility that a lot of people think can be explored. I think the second possibility is you redesign the fuel and through redesigning the fuel, you lower the coefficient of reactivity.

Maher Yaghi - *Desjardins Securities - Analyst*

Okay.

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

And so, I think the other thing I'd like to kind of maybe remind everyone of, is the way the MAPLE project was envisioned was either MAPLE could serve the world, so MAPLE 1 or MAPLE 2 could serve the entire needs of the world, with the other one as backup. So, what we're really looking to do here is not turn the MAPLE's on. What we're really looking to do here is get a parallel path, where we evaluate what it would take to run them at probably only -- run one of them at only 40% output to alleviate the current shortage for patients. And we believe with the right scientific minds around it, right, you could kind of get into a very acceptable safety envelope to be able to accomplish that purpose. And so, it's not -- it is a complex issue but it's an issue where the best scientific minds in the industry, around the world, believe it's solvable. Right? And I think the question is getting them around there, so we can make that happen.

Maher Yaghi - *Desjardins Securities - Analyst*

What did you mean, Stephen, by "curious," when you were referring to the discussions by the Prime Minister?

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

I'm sorry?

Maher Yaghi - *Desjardins Securities - Analyst*

What did you mean by, when you said that you found discussions by the Prime Minister yesterday to be curious? What do you mean by that?

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

Well, there was -- Prime Minister Harper made a couple of statements at a press conference, at the same time the CEO of AECL made other statements in a price release that seemed to contradict each other. At the same time that Minister Raitt made a number of comments in her press conference that all appear a little contradictory on this issue. And so, quite frankly, I would say it's only been 12 hours later, I think we've got to kind of figure out exactly what's going on. And I think in some sense, it's probably a little bit of an issue where the government is feeling a lot of pressure from a number of parties who have a tremendously high concern for the impact this is having on cancer and cardiac patients.

Maher Yaghi - *Desjardins Securities - Analyst*

So you think Stephen Harper's remarks might be overturned by -- he might change his mind?

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

I'm not going to comment on what the Prime Minister may or may not do. I am sure he has a set of issues that he's trying to solve. I think the one thing I'd would point out, look, the National Academy of Sciences, which is a non-profit organization in the United States, asked to write a report on this issue from the US Congress. In it's January 2009 report, the report is called "Medical Isotope Production," AECL could probably contract with another organization to fix the MAPLE reactors if it does not have the necessary technical in-house expertise to do the work itself. And the report is very clear that it is the only solution, given the fact that if you tried to start a new project tomorrow, you'd be a good 10 to 12 years before you'd be producing isotopes.

So I think what really happened here is the government, last June, made a set of decisions and made that set of decisions, I hope, believing that the NRU was very reliable and would be able to bridge the gap to 2016. I think what we've learned in the last couple of months is that set of assumptions was not very sound and was not very valid. I also, as I stated in my notes, it's not an easy thing to reverse a political decision. Right?

Maher Yaghi - *Desjardins Securities - Analyst*

Exactly.

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

But I think, quite frankly, this is a political decision that was made with the wrong set of assumptions and I think it needs to be revisited. And if it was all about money or pride or something else, I would say the probability of that is very low, but quite frankly, there are a tremendous amount of patients that are going to be put at risk by this. We are looking at the Petten shutting down in July and then again next year for a few months. I think of a large portion of the cancer and cardiac patients in the world not having the required technology necessary to diagnosis their disease, so they can begin a treatment regimen.

So, this is a little bit uncharted waters. We have a a clear point of view. We think more and more, the patient side of this debate is going to gain momentum. And quite frankly, we think the government needs to revisit this decision. So let's see how it goes. You read the same papers I do. We'll see how it goes but we've clearly laid out our point of view on the issue.

Maher Yaghi - *Desjardins Securities - Analyst*

Okay. Thank you very much.

Operator

Thank you. Our next question is from Randall Stanicky from Goldman Sachs. Please go ahead.

Unidentified Participant - *Goldman Sachs - Analyst*

Thanks for the question, guys. This is actually [Stefan] calling for Randall. I just had a couple of questions, hoping you could touch on very quickly. As it -- to the pharma services part of the business, you guys mentioned lower bioanalytical services demand but we saw that there were some solid bookings there. I was wondering how your early stage outlook is for the rest of the year and how much visibility you have into this?

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

I think the entire market, we're seeing as relatively soft. I don't think our visibility is that high. Nor is it for anyone in the industry, as we hear things from the industry association and listen to our competitors. And so, I think we're seeing what most folks are. I would say, at the same time, we're having an unprecedently large number of conversations, particularly with large pharma, of a strategic nature where they're relooking at how they outsource and what work they do on their own. And those all have a certain gestation period. Occasionally, they're interrupt by a merger or acquisition.

And so, I would say, RFP flow that's less than it was last year. Visibility not great. But a tremendous number of clients looking at fundamentally closing all of their Phase I, or whatever, facilities that they have and entering into much longer term, much larger volume deals. And so, with that, I think it's a market that's in a little flux. I think we have a couple of more quarters of some difficult conditions. Quite frankly, I think this might be, long term, a boom for the CRO market because think the big pharma clients are really relooking at their drug development business systems.

Unidentified Participant - *Goldman Sachs - Analyst*

Great, thanks. And as it applies to the reprioritization, you did mention that it has been something that has been ongoing. Where do think that is now, where do you think the progress is? Do you think there will be much more as we approach the end of the year? And what do you expect from deals closing, from these pharma M&A deals in 4Q?

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

I'm sorry, I'm not sure I understood the question fully.

Unidentified Participant - *Goldman Sachs - Analyst*

I'm sorry. As it applies to the reprioritization, where do you think pharma or your clients are in this process? We know this started lat late year and they've been delaying deals and reprioritizing their work. Do you think we have much more of this to come and with --?

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

I think we're going to be in this for a little while. And quite frankly, I think in order to fully answer your question intelligently, you'd have to have a very good bead on where healthcare reform is going to go in the United States and how it's going to impact them. And so my sense is, this is an industry that's going to be shifting and changing and adjusting itself to a stronger industry. And it's probably going to be over some more reasonable time frame. I think what we see, also, is in any of those scenarios, we think outsourcing is definitely going to accelerate. So that's probably the best I could do for you.

Unidentified Participant - *Goldman Sachs - Analyst*

Great. Perfect. Thanks a lot, guys.

Operator

Thank you. Our next question is from Hari Sambasivam from National Bank Financial. Please go ahead.

Hari Sambasivam - *National Bank Financial - Analyst*

Yes, thank you. Stephen, just a question on the focusing on the early stage of the CRO business. Could you characterize what sort of -- you've obviously gotten rid of the late stage portions and you're not particularly large. You don't have the dominance, for example, on toxicology. So I'm wondering whether if you can characterize for us where you actually have leadership positions, where you would consider yourself to be either number one or number two? And where you think you might need to add additional sort of strengths to make yourself like a truly top one or top two in your selected area? So that's the first question.

And the second question is perhaps a question for Doug. It's regarding moly-99 and I'm wondering, depending on how long this takes in terms of the shutdown, at what stage does an accounting rule trip to say that you may have to sort of consider writing down this asset or writing down future profitability? How do you think about that particular issue?

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

Great, Hari, so thanks for joining us this morning. Our early stage business, I would characterize it as a very strong franchise. We're clearly one of the leaders, if not the leader in the Phase I business. And in that business, we have all modern facilities, new IT systems, a strong reputation. So, in many ways, we feel that we are the partner of choice for big pharma in that arena, just given our network of beds. We see a number of our competitors actually closing facilities and pulling back in that business.

In bioanalytical, while that business is clearly not the size it was a few years ago, we're still probably number one or number two in that business, and have strong capability and expertise. If the tox business, you characterized it kind of right, we're not in tox in North America but we're quite a strong player in tox in Europe. We're particularly in the high end of the market where a lot of technical expertise. Our Lyon facility just has a great reputation and a very, very strong client following. And then, we're one of the top players in early screening and early models. And particularly with the strength of our Taiwan facility, quite strong in Asia Pacific.

So I think given all of that, we feel very strongly that we have the scale to compete in early stage. We're a top three player. We have good customer reputations and expertise. Having said that, I think we'll see how the industry kind of develops over time to see what opportunities create themselves.

Hari Sambasivam - *National Bank Financial - Analyst*

Where do you think you have holes that you need to fill in terms of early stage, Stephen?

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

Quite frankly, we really believe clients are buying a set of services that say, I'm going from screening potential molecules to a proof of concept, those Phase 1 studies. And we feel that we can bring that offering to clients and bring it to them in a compelling way, I think, distinctively from other CRO's. So I actually feel that we think that we have a good line-up of services to do exactly that.

Hari Sambasivam - *National Bank Financial - Analyst*

Thank you. And Doug's question?

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

Sure, Hari, on the question related to the moly-99 and potential writedowns, we continue to monitor that. We look at all of our assets and do impairment testing, at least annually, and more often if there is any significant change in the environment. Obviously, the temporary shut down is an item that concerns us but will not trigger an impairment. A longer one, for instance, if for some reason they were to say it's never coming back, that would certainly cause us to look at it. The direct assets associated with the moly-99 are pretty insignificant, so I wouldn't anticipate any significant writedown associated specifically with that. But we'll continue to look at it and in the meantime, we're looking at a wide variety of alternatives for Nordion and the rest of our business. And expect to take action to, again, continue to drive productivity even in a tough market.

Hari Sambasivam - *National Bank Financial - Analyst*

Thank you.

Operator

Thank you. Our next question is from David Martin from Dundee Securities. Please go ahead.

David Martin - *Dundee Securities - Analyst*

Thank you. I just wanted to go back to the bioequivalents, the FDA warning letter and the repercussions of that. I'm just wondering how many -- a percentage of all of the clients you've had to deal with, what percent of them have there been positive resolutions? What percent negative resolutions? And what percent are still not resolved?

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

David, I'm not sure what you mean by positive resolution or negative resolution.

David Martin - *Dundee Securities - Analyst*

Well, the FDA, say they rerun a test, the FDA accepts it or they audited the test and the FDA accepted it versus not accepting the rerun or the audit.

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

We wouldn't have that specific data. Right? I could -- a couple of things that we would know as we kind of triangulate on that, one is, no drugs were pulled off the market. The FDA is very clear, there were no safety-related issues at all. We work with and successfully audited the work that had been completed during that period of times and support our clients through that. And where appropriate, reimbursed our clients for the cost of that. Most of our clients are pretty satisfied with that and most of them have been giving us business and so, I don't --.

David Martin - *Dundee Securities - Analyst*

So there's no outstanding decisions on particular products that your clients are waiting on from the FDA?

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

None that we would know of, no.

David Martin - *Dundee Securities - Analyst*

Okay. And then, the last question I had. Since you're selling the late stage CRO business now, can you break out what the contribution to EBITDA of the early stage and late stage is, say, this quarter and maybe last quarter, as well, on a percent basis?

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

David, this is Doug. We're working through that now. We'll discloses that with our Q3 results.

David Martin - *Dundee Securities - Analyst*

Okay. Thank you.

Operator

Thank you. Our next question from [Tim Livens] from Jefferies & Company. Please go ahead.

Tim Livens - *Jefferies & Co. - Analyst*

Thank you. This is Tim in for Dave Windley this morning. You've mentioned a couple of times in your comments that softness in demand was caused by mergers. And I'm wondering, is that an impact from the three large mergers that have been announced or is that coming from smaller mergers?

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

Well, the three large ones are the ones that have been announced and clearly, in all of those cases, the clients have held back on putting new work out there as they sort of sort through their integration issues. Quite frankly, we, like you, don't know which other ones are out there and could or could not be affecting demand. But I don't know that our view is that three of those is the end of it. We view that there's probably more mergers in the industry, I think, similar to most other people's perspectives.

Tim Livens - *Jefferies & Co. - Analyst*

And is that weakness mostly in early stage or late stage?

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

I think we're seeing it across the board, at the source book at CapEx spending in AT, as well as in the CRO market. And I would say similar to all of our competitors.

Tim Livens - *Jefferies & Co. - Analyst*

Okay. And then if I could turn to the Phase II-IV business for just a moment. Could you give us an idea of what RFP's looked like, particularly before the merger was announced? Have they improved at all from the fourth quarter, first quarter levels?

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

I'm sorry for the business that were --?

Tim Livens - *Jefferies & Co. - Analyst*

For the Phase II-IV business, yes.

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

That we're selling to INC Research?

Tim Livens - *Jefferies & Co. - Analyst*

Yes.

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

Again, I would emphasize that we weren't a large scale player in late stage. And so, in any quarter, two or three orders that swing one way or another would really effect the outcome. We did see the orders falling off in that business and some of that was market softness. I think, quite frankly, some of that was other things, as I think there were rumors out there that that was a business that we were potentially going to sell. I think, though, it had a fairly good order close rate right before we sold it. And we're going to certainly work with INC Research to keep that pipeline robust and make sure that we take good care of those clients.

Tim Livens - *Jefferies & Co. - Analyst*

Okay, great. And then, one more if I may, on Nordion. In the event that the MAPLE reactor is brought online, am I correct that you do have exclusive access to those isotopes?

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

That's correct.

Tim Livens - *Jefferies & Co. - Analyst*

Okay. Great. Thank you.

Operator

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

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

Thanks, Valerie. Thank you all for joining us this morning. If you have any additional questions, please do not hesitate to gave 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.