

FINAL TRANSCRIPT

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MDZ - Q4 2007 MDS Inc. Earnings Conference Call

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PRESENTATION

Operator

Good morning, ladies and gentlemen. Welcome to the MDS fourth quarter results conference call. I would now like to turn the meeting over to Sharon Mathers, Vice President of Investor Relations and External Communications. Please go ahead, Ms. Mathers.

Sharon Mathers - *MDS, Inc. - SVP IR & External Communications*

Thank you, and good morning everyone, and thanks for joining us today. Our fourth quarter results were issued this morning along with our MD&A and financial statements. If you have not been able to get a copy of these documents they are posted on

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our website at MDSInc.com. We are also webcasting this event live on our website where you will find a power point presentation highlighting the details of our comments; as well 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 Price, Executive Vice President of Finance and CFO. Stephen will begin the call with his perspective on the quarter and the year, and Doug will follow with the financial and operating highlights. Prior to our Q&A session we will turn this back briefly to Stephen for a few closing comments.

During the call we will be making forward-looking statements about MDS's businesses; these statements are subject to risks and uncertainties that could cause actual results to differ materially. Some of these risks are disclosed in the MD&A portion of the company's annual report and in the annual information form filed with the relevant securities regulators and are also available on our website. Let me remind everyone that our consolidated statements of income, financial position, comprehensive income and cash flow are all calculated on a GAAP basis. All financial measures today originate from these statements. 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 readers gain a clear understanding of our non-GAAP measures such as adjusted EBITDA and adjusted earnings per share we provide detailed reconciliations between GAAP and non-GAAP measures in our financial statements.

As we discuss the results of our operations we also isolate variances that relate to changes and exchange rates and acquisitions and divestitures. To isolate the effect of currency movements we eliminate the impact of foreign currency hedging activities in both periods and recalculate the base figures for the period, the prior period using exchange rates that were in effect for the current period. We believe the use of these measures provides management and our investors with an enhanced understanding of the underlying performance of our businesses. All figures in our financial statements, MD&A, Q4 presentation and in our discussion this morning are all in US dollars unless otherwise stated.

Now before I turn things over to Stephen, I just wanted to briefly provide you an update on ACL supply disruption. As I'm sure those of you who have been following the news know, late yesterday evening the government of Canada passed emergency legislation through Bill C.38 to allow AECL to restart the NRU reactor immediately. Once AECL receives instructions that they can restart the reactor it will then take seven days before they are in full production. MDS Nordion is fully prepared once we receive supply to turn it around as quickly as possible and get it to the patients who need it. Given the currently available information, we expect to be in a position to ship product to customers earlier than the timeframe we set out in our December 5th press release. And therefore it will have less of an impact on MDS Nordion's first quarter results than anticipated.

And with that I will turn it over to Stephen DeFalco.

Stephen DeFalco - MDS, Inc. - President & CEO

Thanks, Sharon. Good morning everyone. And thank you for joining us. 2007 was a transformational year for MDS. We delivered strong results and significantly repositioned MDS to support our strategy. I am pleased to announce that we closed the year with a strong operation and financial performance in Q4 despite facing an unprecedented and challenging foreign exchange environment. I remind everyone MDS's year end is on October 31, which was nearly the low point foreign exchange with the US dollar at C\$0.94. During the quarter the US dollar fell \$0.12 against the Canadian dollar and \$0.09 against the euro. It is not only negatively impacted our costs, but also the value of our US dollar denominated assets outside of the US.

In the face of this challenging environment, we delivered strong financial performance. We recorded net revenues of \$318 million, up 22%, increased adjusted EBITDA 91% to \$44 million from \$23 million last year, and delivered adjusted earnings per share of \$0.09, up from \$0.02 last year. These results were delivered in a quarter where we saw \$15 million of unfavorable currency impact versus our adjusted EBITDA in Q4 of 2006. All three of our business units delivered solid results.

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During the quarter we made a number of product and service announcements that include the launch of Cliquid Drug Screen and Quant Software, a new automated toxicology testing application designed to better identify drugs of abuse; the introduction of MetaMorph ICS confocal microscope to support researchers in their full exploration of live cell and function imaging; the expansion of our central lab facilities in Beijing, China to offer a fivefold increase in testing capacity, four times the space to produce clinical trial kits and a wider range of specialized clinical trial testing services.

We also announced expansion of our long-term contract Rosenergoatom for our cobalt-60. With the addition of these new contracts we have grown our capacity to support a 30% increase in our sterilization franchise within ten years. The volume will begin kicking in to a small degree in 2008 but won't really be meaningful until 2010.

Subsequent to the quarter, MDS Nordion divested two product lines. These assets were non-core slower growth product lines with relatively low margins. Their sale was a key step in executing MDS Nordion's growth strategy to become a leading innovator in molecular medicine.

I'd like to take a couple of minutes to talk about how we have positioned our business for success in 2008. In 2007 we completed the largest divestiture and the largest acquisition in the company's history, as well as a \$500 million substantial issuer bid. Against foreign exchange headwinds we delivered improved operational performance across the board. In 2007 we transformed MDS Analytical Technologies from a mass spectrometer category killer into a broad product platform. A product platform better able to benefit from pharma biotech capital spending trends and to serve a global industry that is constantly eager for innovation and new products. Against this backdrop MDS Analytical Technologies delivered strong results in 2007. Integration activities of Molecular Devices are tracking well to plan and we are confident that we will exceed our first-year acquisition targets. Revenues of \$190 million and \$45 million to \$50 million in EBITDA.

In addition, MDS Analytical Technologies continues to transfer product manufacturing to Asia to take advantage of the low-cost opportunities in that region. MDS Nordion delivered four solid quarters in 2007 and made a number of investments to improve the growth profile of that business. MDS Nordion signed a collaborative deal with Abbott Pharmaceuticals to develop imaging compounds for Alzheimer's disease, their third collaboration in eighteen months. Once the molecular imaging center of excellence with the University of Ottawa Heart Institute to advance cardiology research, established four European centers of excellence for TheraSphere, and expanded the operations in Fleurus, Belgium to meet the growing demand for our PET imaging agent, GlucoTrace.

Continuing on its positive trajectory, MDS Pharma Services closed the year with its fifth straight quarter of improved sequential profitability. Over the 12 months MDS Pharma Services has continued to execute their strategy while delivering improved financial results. The FDI activities in Montreal have substantially wound down and restructuring initiatives launched in Q2 this year are near completion. As of today, 80% of the planned headcount reductions have already been implemented.

To support future growth, MDS Pharma Services has made a number of investments which include adding 25% more drug safety capacity in Leon, France. And as I mentioned earlier, expanding our central lab facility in Beijing, China. In addition, we are on track to open our new 300-bed Phase I facility in Phoenix, Arizona in January 2008. MDS Pharma Services is also made investments in IT to better serve customers and recently launched the Apollo system, an IT solution which will enable more effective real-time tracking of samples and results by our customers.

In addition, MDS Pharma Services has embraced Lean Sigma and currently has over 100 projects underway to enhance productivity, quality and compress our timelines to better serve customers. MDS Pharma Services upgrading its business development team to accelerate growth on the top line as we move through 2008. Looking back in 2007, I am pleased with our performance. We have demonstrated our continued ability to execute and steady improvements across all of our businesses. In 2007 we closed an interesting chapter in our company's history and enter 2008 with momentum.

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

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

Thanks, Stephen. 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 fourth quarter adjusted financial results exclude charges related to restructuring, valuation provisions, interest rate swaps, investment tax credits related to MAPLE, final liquidation proceeds and acquisition related costs. Where appropriate for year-over-year comparability I will describe the impact of foreign exchange, acquisitions and divestitures. Additional details, including reconciling tables to GAAP measures can be found in our MD&A, which was issued with our press release this morning.

This quarter we changed our presentation to include revenues related to reimbursement of certain out-of-pocket costs incurred by Pharma Services. Like other CROs these reimbursement revenues are amounts received from clients for out-of-pocket expenses incurred by Pharma Services while performing client studies. Reimbursement revenues cover out-of-pocket costs only and do not yield any gross profit, operating income, net income, earnings per share or cash flow. In prior periods these reimbursements were netted against expenses.

Going forward, reimbursement revenues will be broken out separately for better comparability with other CROs. Additional details on this change in presentation are documented in our MD&A. For the discussion today I will focus most of my remarks on net revenue. That is revenue for products and services excluding reimbursement revenue. All revenue growth figures and margin percents are based on net revenues which is the true driver of growth and profitability for our business.

Unconsolidated results for Q4 our total revenues were \$338 million including \$20 million of reimbursement revenues. Net revenues were \$318 million, up 22% from \$260 million last year. The acquisition Molecular Devices contributed 21% to this growth and foreign exchange contributed approximately 3% to revenue growth.

GAAP operating income increased to \$25 million, up 39% from \$18 million last year. Adjusted EBITDA was \$44 million compared to \$23 million last year, up 91% or nearly double in spite of approximately \$15 million in unfavorable foreign exchange impact. The acquisition of Molecular Devices contributed \$11 million to this growth. Adjusted EBITDA margins increased 500 basis points to 14%.

Our reported gross margin which is net revenue less associated cost of revenue was 44%, up from 35% last year. This year-over-year improvement was driven by pricing and productivity gains in all of our businesses, plus the inclusion of Molecular Devices. SG&A for the quarter was \$92 million or 29% of revenues and compares to \$59 million and 23% last year. The addition of Molecular Devices accounted for \$17 million of the \$33 million increase in SG&A and \$10 million of the remaining \$16 million was due to foreign exchange.

In the fourth quarter we spent \$22 million on R&D activities, of which we expensed \$8 million. This compares to \$14 million spent and \$7 million expensed last year. The addition of Molecular Devices contributed the majority of the increase in R&D spend.

Our effective tax rate this quarter was 32%. This was below the expected rate of 36% as final liquidation proceeds recorded during the quarter are not subject to income tax. On a reported basis our GAAP earnings per share from continuing operations were \$0.14 versus \$0.10 last year. Following the adjustments mentioned earlier, our adjusted earnings per share increased to \$0.09 compared to \$0.02 last year.

Let me now discuss business unit results. For the quarter Pharma Services revenues were \$123 million versus \$122 million last year, up 1%. Late stage revenue grew 10% year-over-year. However, this growth was offset by a 6% decline in early stage revenues. Weakness in early stage was attributed to declines in bioanalytical and discovery preclinical. We saw strong growth in toxicology and improvement in Phase I.

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Backlog averaged \$385 million this quarter, down 10% from last year. While we saw improving contract awards in most business lines, our Phase II through IV business saw a significant increase in contract cancellations related to compound safety. This increased rate of industry typical cancellations drove the overall decrease in average backlog for the quarter.

In our early stage businesses we are seeing strength in new orders, particularly in bioanalytical business where orders have increased 85% year-over-year and 33% over Q3. We believe this is a positive indicator of returning customers for this business.

GAAP operating income was breakeven in Q4 versus a loss of \$15 million last year. Adjusted EBITDA improved to \$5 million in Q4 compared to a loss of \$7 million last year. Up \$12 million in the face of \$6 million of unfavorable foreign exchange impact. During the quarter we spent \$6 million to reimburse customers for FDA related audit costs. These outlays were netted against the \$61 million provision recorded in Q2. Since the establishment of this reserve we have utilized a total of \$11 million. At this time we believe we have substantially completed all generic site audits, and we are seeing only a limited number of requests for innovator audits. We believe that study sponsors will continue to request reimbursement in 2008 for work that is already completed and that the remaining provision is sufficient to cover all future costs.

As of Q4 we have implemented 80% of the restructuring initiatives we announced earlier this year to put MDS Pharma Services on a profitable growth trajectory. During the quarter we completed the transfer of Bioanalysis and DMPK operations from Montreal to Lincoln, Nebraska and Bothell, Washington, respectively. And we transferred our central lab operations from Hamburg, Germany to Baillet, France.

Year-to-date we have utilized \$15 million of the restructuring provision established in Q2. As of October 31 we have \$11 million remaining on our balance sheet.

Nordion. Nordion reported revenues of \$76 million, level with last year. Excluding the benefit of a prior year cancellation payment, Nordion revenues were up 3%. GAAP operating income was \$21 million, up from \$19 million last year. And adjusted EBITDA of \$21 million was level with prior year. Productivity, price and lower R&D spending offset approximately \$2 million of unfavorable foreign exchange impact at Nordion.

For Analytical Technologies, their revenues grew 92% to \$119 million in Q4, up from \$62 million last year. For the quarter Molecular Devices contributed \$54 million in revenues, which is net of \$2 million in purchase price adjustments. MD revenues increased 15% compared to the same three-month period in 2006. Sciex revenues grew 5% and reported end-user revenues for Sciex products grew 4%. Sciex growth was driven by strong demand for a high-end triple quad and ion trap instruments serving the small molecule market and continued strength in our ICP MS product lines.

Analytical technologies reported GAAP operating income of \$13 million, up 30% from \$10 million last year. Adjusted EBITDA was \$32 million compared to \$15 million last year, with Molecular Devices contributed \$11 million. Excluding the impact of Molecular Devices and foreign exchange, adjusted EBITDA for Sciex grew 74% year-over-year as a result of improved gross margins, increased capitalization of R&D and a \$2 million gain associated with the sale of land.

Turning now to the balance sheet and cash flow. We ended Q4 with \$350 million in cash and short-term investments, up from \$314 million in Q3. Our businesses contributed \$86 million of operating cash flow in Q4, bringing us to \$200 million for the year. Our Q4 capital expenditures totaled \$28 million compared to \$14 million last year. The year-over-year increase was driven by strategic investments to accelerate growth, primarily at Pharma Services, including the 300-bed expansion in Phoenix, the central lab expansion in Beijing and customer focused IT initiatives.

Depreciation and amortization for the quarter increased \$8 million to \$26 million from \$18 million last year. \$6 million of this was related to ongoing amortization of intangible assets acquired with Molecular Devices. We do not believe the current liquidity issues affecting asset-backed commercial paper markets will have any significant impact on our liquidity. In early August we invested \$17 million in these assets and have since written them down by \$2 million. Overall we expect our operating cash flows to remain strong throughout 2008.

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Before I close, I would like to remind you that in January we will be reporting fiscal 2007 year-end results in US GAAP. To help you prepare for this change we will be posting to our website a US GAAP conversion primer outlining some of the key items that will be affected by our move to US GAAP. That concludes the financial highlights for the quarter, and I will now turn it back over to Stephen for closing remarks.

Stephen DeFalco - MDS, Inc. - President & CEO

Thank you, Doug. In 2007 we completed the transition of MDS to a global life sciences company. I think of 2007 as the end of the beginning. We are entering 2008 as a different company, a focused company, a better company. As we think about 2008 and beyond we remain focused on building our leading life sciences platforms into larger, more global, more competitive players in the markets we serve. Each of our businesses are now more streamlined, more agile and better poised to deliver on top line growth. MDS Analytical Technologies now has a direct sales and service channel, a strong pipeline of innovative products and established low-cost manufacturing presence in Asia.

Today MDS Nordion is a more sales and marketing focused organization with a track record of deals and partnerships devoted to driving innovation in molecular medicine. MDS Pharma Services is rightsized its global footprint and a renewed focus on customer oriented activities. They have invested in customer facing IT initiatives and have revitalized business development with global account focused across selling teams. They have streamlined their operating structure with expanded capacity for future growth. We are excited by the opportunities in the markets that we serve and look to expand our global reach. Throughout 2007 we delivered strong performance. Entering 2008 we have never been so well poised to deliver for our shareholders. Thank you.

Sharon Mathers - MDS, Inc. - SVP IR & External Communications

Thank you, Stephen. Before I ask the operator to open the lines for Q&A I would just ask that each of you limit yourselves to one primary and one follow-up question before you queue up again for a follow-up question. And now operator, if you please open up the lines for Q&A.

QUESTIONS AND ANSWERS

Operator

(OPERATOR INSTRUCTIONS) Lennox Gibbs, TD Securities.

Lennox Gibbs - TD Newcrest - Analyst

Good morning. Thank you. Nordion, the oversight that seems to have taken place at AECL over the last 15 months doesn't inspire a ton of confidence in AECL. At the same time this is obviously a critical supply chain for MDS. What oversight does MDS exercise with respect to the NRU operation? Is it sufficient?

Stephen DeFalco - MDS, Inc. - President & CEO

Your question is a good one. Quite frankly, we work fairly closely with AECL on an operational basis. And by and large that works well. I think what you have here is a bit of a miscommunication between them and the regulator. And so between a crown corporation and a branch of the government. And quite frankly, that's not an area we get involved with because we don't operate, nor do we build nuclear reactors. That is sort of their part of the business.

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I am upset about this entire event because one, I don't think it should have happened and second, it really does affect patients. And there is no one listening on the phone or in this room who doesn't know somebody who probably was affected during this crisis because the product we make is so critical and so pervasive in the healthcare system. I am actually quite encouraged by what I am seeing in terms of support here in the government. And I think understanding of the role that we play in the global market. And I think I don't want to use the word oversight, but I think it would bring renewed attention to this issue. And I think that will all be good for us and for our shareholders going forward.

Lennox Gibbs - *TD Newcrest - Analyst*

It's pretty standard practice in the pharmacy industry and the medical device industry supply chains for clients to regularly run rigorous compliance audits on key suppliers. Is this something that you have done, intend to do? How should I look at that? With respect to AECL and the NRU?

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

We do work very closely with our suppliers, and you've been around long enough to know most of the time that really works well with AECL and we are the most reliable supplier in the world. I want to emphasize this isn't a mechanical problem. This isn't a quality problem. This is a matter of dispute between them and the regulator. And so it is not a normal supply issue. This is a bit of an interesting and somewhat odd event. I think that we are noted for being pretty reliable and certainly the highest quality supplier in the market. And that is because we work very closely on those matters, making sure they take care of their paperwork with their regulator quite frankly is more their matter. So I am encouraged by the renewed attention to it.

Lennox Gibbs - *TD Newcrest - Analyst*

Thanks very much.

Operator

John Maletic, Scotia Capital.

John Maletic - *Scotia Capital - Analyst*

Just a couple questions on Pharma Services. First off, you had stated that you are about 80% through the restructuring plan that you implemented earlier in the year. At what point are we likely to see a marked improvement in this margin, or is it going to be a gradual incremental improvement over a series of quarters?

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

John, just a, we are 80% implemented. A lot of that stuff does windup at the end of the queue. So you get a little bit of a lag effect between when you notify and execute versus when you are able to see it in the financial results but it is not a long lag. Quite frankly, you would have seen a huge bump up here in Q4 had the dollar not go to \$0.94. And having a Halloween year end did not serve us well in that I think we couldn't have done a better job of predicting a low point. And so we don't say that because we are whining. We are just saying that so folks can see the operational improvement in the business versus what we saw as ongoing affect issues which we handled pretty well. And we got productivity and price to offset those and I think have been powering through that. But I think some onetime -- when it moves that quickly you have onetime issues as you mark all your assets to market when you do your close on that date. So without that we would have been sort of in the \$11 million range here on EBITDA and we would have been having a whole different conversation, right?

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John Maletic - Scotia Capital - Analyst

So can we just expect a further improvements as part of this previous restructuring effort?

Stephen DeFalco - MDS, Inc. - President & CEO

Yes, you should just expect continued, steady, good improvement. If the dollar stays where it is, it will begin to accelerate more in Q1. If the dollar goes back to \$0.92 we are going to have to power through that but unfortunately it would be a little more muted. And so we're going to go deliver good operational performance in any exchange rate environment but the ability to measure it externally will be -- you'll have to see through that as you do your analysis.

John Maletic - Scotia Capital - Analyst

And secondly, on the pipeline, the performance of the backlog has been lagging the industry by quite a bit. I just want to know if you can give me some I guess as to what the difference might be here and where you expect the trend to go.

Stephen DeFalco - MDS, Inc. - President & CEO

I agree with your statement, your observation, and indicate most that we are on top of it. This business certainly coming into 2007 in the first half it was a somewhat difficult selling environment given everything we had. I think during that we learned that we needed to upgrade our business development teams and to modernize them and we've been working fairly carefully on that. And this is an area where David Spaight brings unbelievable strength given his prior experiences. And so we've been upgrading our BD teams. And most of our lines of businesses, our order momentum is quite good. In our Phase II through IV business we've had a higher rate of cancellation here and as you know we are relatively small player there so two or three that swing into a given quarter or given period of time will have a big impact.

It has my attention, and I think the teams are executing well. So I like looking at the metrics. I like where the funnel looks. And so I am feeling good about it. But the bottom line in Pharma Services next step is we've got to refill the pipeline in late stage where we've had good revenue growth. And we've got to turn the order velocity in early stage into revenue growth. And so that is the agenda for the first half of 2008, as well as moving on the productivity stuff. And I feel good the team has focused on that and we will be able to make gains on that.

Operator

Dave Windley, Jefferies & Co.

Dave Windley - Jefferies & Co. - Analyst

Want to follow-up on that last. Stephen, with the number of quarters now that I think it is two or three in a row where backlog has compressed, and you and I talked about maybe some issues -- comparability issues among companies -- but nonetheless your company comparing yourselves backlog down several quarters in a row. Yet as you mentioned late stage revenue is actually improved, suggesting that you are burning it off quickly. I guess the bottom line question here is don't I have to assume that late stage revenue is going down before it goes back up at this point?

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

I think, Dave, you're right in that our revenue conversion has improved and that is a function of better processes here and start studies quicker and all those things. But I agree with your bottom line which is we've got to be able to refill our pipeline. And so that is what we are focused on. I think we probably -- we don't want this trend to continue but it probably isn't going to impact revenue. If we kept it this way there would probably be two quarters out but we are on top of that. Again, the pipeline looks pretty good. And a couple can swing one way or the other.

The issue here is, of course, we've changed the focus to tell the BD teams only win high margin profitable work. And quite frankly, if I flip the switch tomorrow and said go back to the old way; they could sew it up in a week. And we don't want them to do that. We want them to keep focused on high margin work, and be very disciplined about the work we take, particularly in our Phase II through IV business. So we are on it. But I agree with your statement in that it needs -- we need to reverse that trend. But probably have a little more time than you're thinking to do that.

Dave Windley - *Jefferies & Co. - Analyst*

Okay, and notwithstanding the fact that the decline in backlog actually you mentioned two quarters started two quarters ago. Shouldn't that now be showing up?

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

Understood, but it actually -- our backlog at the early stages increasing and we are able to turn that revenue faster, and so that is why -- I certainly don't want to be arguing with you that we don't have a sense of urgency on this issue. We do have a sense of urgency on this issue, but I view it more important that the team continues to build momentum against profitable work versus call it work hard and do a flash on that metric. I am more driven to make sure good, profitable, sustained growth always through 2008. But we are on it. We have a sense of urgency on this.

Dave Windley - *Jefferies & Co. - Analyst*

Let me just one more topic and I will jump off, and that is going back several quarters as we approach the end of the period when you were going to be reporting in Canadian dollar and shifting over to US dollar, the talk was we were several times warned that the effectiveness of the hedges was going to be declining. And now it looks as if we are really seeing that in the results; if the FX impact on your results is what, 60% to the EBITDA line. Could have been 60% higher. What is being -- what can you do or what is being done to kind of reinstate hedging mechanisms that will allow the earnings power of the business to come through a little bit more purely?

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

David, thanks for that question. I am going to defer a little bit. We're going to have an investor day in February and I think then we're going to lay out a lot more but we are more sophisticated in how we model business, by the way. Call it in our new set of clothes because the business just looks dramatically different than it did twelve months ago on that front. We are more balanced than ever but it is still an issue. And I think more sophisticated in how we approach and hedge, but I want to kind of make a point which is hedging helps you smooth to some degree. It helps you on the operating earnings. What we got hit with in Q4 was just kind of almost to the day our quarter ended at the end of October, we were at the low and a 12% swing. And that is just an extraordinary amount of movement in a single quarter.

And I don't want to give the, any impression that with all of the good financial instruments in the world you would ever really fully protect yourself against that. Now quite frankly, if it stays where it is we're going to get some of that back in Q1. So we're going to disclose that in good times and in bad and we are going to disclose it when it hurts us. We're going to disclose it when

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it helps us and we will just give all of you the right information you need to see the underlying trendline. So I, like you, would love that 60% of missing EBITDA to have shown up here in Q4. But I focus on the things I can control, which is mostly winning back customers and doing profitable work for them.

Douglas Miehm - *RBC Capital Markets - Analyst*

Thanks a lot.

Operator

Hari Sambasivam, Merrill Lynch.

Hari Sambasivam - *Merrill Lynch - Analyst*

David, just two questions, the first actually is just a clarification on the pharma side. You are continuing to have further weakness on the early stage side, and I'm just wondering considering that the bulk of the Montreal facility, the bioanalysis there is done, where else are you actually seeing the weakness? Is it just affiliated sort of a Phase I type of stuff? It doesn't look like that but I am just trying to get a sense of where that weakness is coming.

And the second question I have really related to the overruling of this Canadian nuclear safety commission by the government. And obviously it has an impact in terms of the near-term shipments of both (inaudible) from the NRU reactor. But I am wondering whether that has any implications regarding the impasse that you've had regarding the design of the MAPLE and how does it impact that?

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

I want to thank you for bringing up the M word as fast as you possibly could; I knew somebody would. Let me answer your first question. I think in our early stage business we are seeing customers coming back. Our Phase I business, if you said Q over Q about level with where it was in Q4 but it is up subsequently, and we are certainly seeing the order strengthening there. Bioanalytical also up sequentially. And so I am actually relatively bullish on the trendlines in those business. And again, stronger new BD teams who seem to be delivering as we want them to. And I think we have a better operational footprint to do that work. So that is moving through the system kind of nicely, and I think tracking at or slightly ahead of where my expectations were on it.

On the NRU issue here I don't want to confuse this, Stephen with the other Stephen. And so understand that this is a government issue. I am amazed at how Stephen Harper has jumped into it with an incredible amount of energy. As a US citizen living in Canada I can tell you I'd vote for this guy for President in the US election in 2008 because he looks like one of the stronger players in the field. Look, I think this has been tough on patients. It is a little tough on us here in Q1. But I think long-term this is all good for us because it is going to get all of the attention it needs to get on what is the absolutely critical product that the world desperately needs. We need the NRU to operate reliably which it has, this isn't a reliability issue. This is a matter of confusion between AECL and the regulator, not anything to do with the mechanical operation of that reactor which has been the gold standard in the world on the liability. But I think it will put a lot more attention on the government's MAPLE project to replace those reactors. And so I think that at the end of the day this will be good for the patients who need to be served by that critical isotope.

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Hari Sambasivam - Merrill Lynch - Analyst

Do you see any sort of a movement on some of the design issues and some of this intractable stuff that has been going on between the two agencies previously, Stephen, because of this issue?

Stephen DeFalco - MDS, Inc. - President & CEO

I can't imagine a higher level of excruciating pressure on this issue than there has been this week. So this is an all-time high, and I am encouraged by the dialogue taking place within the government and which we are a part of on this critical issue. And I -- to me that couldn't be better. If we wanted attention on a critical issue that is important to our customers, we couldn't ask for more attention than watching Steve Harper on television debating on the floor the importance of this to the world market. And I think everyone in the government is reeducated about the role of Canada and MDS plays in serving these patients around the world. And that is good for us, but it's not good for the patients and that is the thing that is bothering me most this morning as I talk to you.

Operator

Joseph Walewicz, CIBC World Markets.

Joseph Walewicz - CIBC World Markets - Analyst

Just a few quick questions. I think following on your comments on Nordion there perhaps I will switch a little bit and focus on cobalt for a second. We've seen a few quarters where you've talked about shortage of supplies; just wondering if you could talk -- you talked about the new contract with the Russian reactors, but just generally your outlook for cobalt for 2008. And then I'll follow up after that. Thanks.

Stephen DeFalco - MDS, Inc. - President & CEO

So our sterilization business, as you know, has been a good, strong performer for us and it has a slightly lumpy revenue pattern, and that has to do with how we harvest the cobalt out of the power reactors. We're trying to smooth that out a little bit. You so that we expanded the contract with the Russians. And that is good for us. And if you look out a few years you see it is about a 30% increase in that business, and it comes in different pieces and different years. But we think for a relatively modest capital investment here we are going to have some nice growth and a very profitable franchise.

2008 on that looks a little stronger than what we did in 2007. We think we're going to have a little bit more product for the market and that's good. As you know at times to times those schedules get moved, and so we remain very vigilant and sort of managing that for us and our suppliers. But right now the outlook looks better than it was in 2007, which is good.

Joseph Walewicz - CIBC World Markets - Analyst

Thanks. And on the CapEx for the quarter and for the year obviously quite high. Some of that relating to Arizona. Just wondering if you can give us some thoughts on your outlook for '08 and beyond on the CapEx line specifically. Thanks.

Stephen DeFalco - MDS, Inc. - President & CEO

I think we will probably save that for our investor day in February, but I would say think in the range of roughly where we wound up in 2007, so we are in the low 70s here. So think something in the 65 to 80 range for 2008 going forward. I think what you will see, too, is a lot more of that capital spent on customer growth initiatives versus I think some of the historical spending patterns.

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And so we look at how much capital we spend because it is an important and disciplined use of our shareholders money, but we also look at where it is going into. And I think two years ago you saw a lot of capital going into I would call it infrastructure building. And now your seeing a lot more of it go into growth arenas. So I think we'll lay that more out in February. But I think roughly about where we wound up in 2007, which was a little higher than we probably thought we were going to wind up in. But we had the ability to accelerate a couple of projects here.

Joseph Walewicz - CIBC World Markets - Analyst

Great. Thank you.

Operator

David Martin, Dundee Securities.

David Martin - Dundee Securities - Analyst

Thank you for taking my question. You made comments about foreign exchange impact on EBITDA, and I am wondering is that just the US dollar impact on EBITDA, or is that global foreign exchange changes? Because you do report in US dollar and the euro was quite strong against the US dollar. So are those net impacts of all foreign exchange, or was that just the US dollar changes?

Stephen DeFalco - MDS, Inc. - President & CEO

It is net impacts on all foreign exchange. And of the \$15 million that hit us in the quarter, about half of it was call it operating and about half of it was asset related.

David Martin - Dundee Securities - Analyst

Okay.

Stephen DeFalco - MDS, Inc. - President & CEO

As you kind of market the end of the quarter and get those assets back the reporting currency.

David Martin - Dundee Securities - Analyst

Another question on that front. How much of your expenses or what percent of your expenses are in Canadian dollar, kind of a rough idea?

Stephen DeFalco - MDS, Inc. - President & CEO

Again I think we will give a better read on that in February. And quite frankly, it is a dynamic situation because again it has changed radically in twelve months. Selling diagnostics, selling source, moving Sciex production to Singapore, changing some of the terms and contracts at Nordion. So I would say today it is probably high 30s of our cost structure is sitting in Canadian dollars.

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David Martin - Dundee Securities - Analyst

And it was higher -- was quite a bit higher previously I take it?

Stephen DeFalco - MDS, Inc. - President & CEO

Quite a bit higher. Well, if you take in -- go way back, you go take in diagnostics and source, and then when Montreal was at its peak and when we were doing 100% of our production for Sciex and Concord, that was probably the all-time high. So we will give you that number, but it's more important I think to see the dynamics of that and also the dynamics of how we are managing our revenue side to try to get more balance in those numbers.

If it is a kind of funny thing, because I said here in a quarter where it hurt us for \$15 million, which is not pleasant on anybody's radar screen. And we are more balanced today than we've ever been. If we had done nothing and we had the cost structures we had two years ago, this would --.

David Martin - Dundee Securities - Analyst

It would have hurt.

Stephen DeFalco - MDS, Inc. - President & CEO

This would have killed us, yes.

David Martin - Dundee Securities - Analyst

Yes, okay. One quick question on NRU. I'm just wondering, is there anything anticipated in maintenance or upgrades that go beyond what is usual for NRU? Is there anything that you anticipate that could take the reactor down again, or is this the key issue and once it's out of the way, you are free and clear?

Stephen DeFalco - MDS, Inc. - President & CEO

Yes. First of all, I want to make it clear that we don't invest in the NRU. That's something that AECL does with the portion of monies that we pay for their product, so it never hits our CapEx line. And that is quite different than it was two years ago on the reactor front. But on an ongoing basis, that reactor gets maintenance and upgrades.

Again, I just want to emphasize this isn't a reliability or a mechanical problem, which is the part of it that probably aggravates me the greatest, is this was not necessary. People understand when things from time to time don't work. This isn't the case. The NRU works fine. This was a matter of AECL getting out of sync with the regulator on what was on the reactor and what wasn't on the reactor.

So every time we shut it down for maintenance, I would say we do some -- AECL does some set of preventive maintenance, and that's a schedule we understand. And we work with them to try to make sure that doesn't impact customers. We pick low weeks. We do a number of other things. By and large, that process works pretty smoothly. This was a mix-up in documentation that led to a disagreement between two government entities, and that is why Stephen Harper is smart to be outraged, because this was just not -- this was preventable. It was not necessary.

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David Martin - Dundee Securities - Analyst

Okay, thank you.

Operator

Alex Alvarez, Goldman Sachs.

Alex Alvarez - Goldman Sachs - Analyst

Good morning. Just two quick ones for me. The first one, as it relates to the growth in orders for the early-stage services, has that improvement in new bioanalytical orders continued into the current quarter? And then has that improvement, the improvement that you mentioned in the press release, is that being driven by the customers that you highlighted in the prior quarter, or are you starting to see some additional customers return to MDS?

Stephen DeFalco - MDS, Inc. - President & CEO

I think yes to all your questions. Yes, we are looking at the early-quarter orders trends in that business. They continue to track pretty strongly. Some combination of those returning customers placing second, third and fourth orders on us, some combination of more coming back and starting to place their early orders on us.

So both trends look up year-over-year and up versus Q3. So we are -- yes.

Alex Alvarez - Goldman Sachs - Analyst

Good to hear. Then as it relates to the European regulatory agencies, it seems like nothing has sort of developed there. Is there a sense that they will eventually want to request something from MDS, or does it look like they are just trying to keep an eye on how things are progressing?

Stephen DeFalco - MDS, Inc. - President & CEO

It's probably best I don't speculate a lot. I would say we have good dialogue with them. We had a good inspection visit. We've had good verbal conversations, but the final report is what we are waiting for. I would say on this front, generally no news is good news, and the dialogue is very constructive.

Alex Alvarez - Goldman Sachs - Analyst

Thank you.

Operator

Douglas Miehme, RBC Capital Markets.

Douglas Miehme - RBC Capital Markets - Analyst

Two questions. If you look at the backlog losses that we've seen over the last couple quarters, first of all can you quantify how many there were and then describe the nature? I think you did indicate or someone did that it was related to safety. But I am

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just trying to get a better sense of were they all do to safety issues? Products not moving forward or were there some alternative issues associated with those contracts as well?

Stephen DeFalco - MDS, Inc. - President & CEO

Yes, so Doug, thanks for your question. You know, when we say a safety issue what we do is we test new compounds. And as you know, there is a pretty high fallout rate of new compounds in the Phase II through III area. And you take the industry estimates or whatever about one of out of five of those are going to emerge as approved drug. Depending on when the drug, when people realize the drug isn't ready it will affect different contracts. And so I would say as we look back particularly over the past six months we've had kind of a string of those pop up that had a pretty big impact on our backlog. And so if we have a \$25 million contract, we are \$20 million through it, it cancels, probably \$3 million comes out of your backlog because you get paid to wind it down.

If you are in the first month of dosing patients and you see something you don't like, then it's going to be a bigger hit, and that is what kind of happened here to us. But no, there is no -- most of it has been compounds that through the testing process people have realized are not ready and need to either go back and be reformulated or possibly rejected in favor of other compounds.

And then there was one fairly big one we talked about in Q3 where we had won a contract, and that biotech was immediately bought by a big pharma and big pharma bought it for that specific compound. And essentially was going to cancel that Phase II through III program and was going to reformulate and go out with a different Phase II through III program because it had a different marketing ambition, launch ambition, indication ambitions for that compound. And that piece of work hasn't gone to market. We are trying our best, but it went from call it a client that we were very close to and had already won the business to someone we hadn't done much business with. And so we are working to see what we can do. But there was one per acquisition related. The rest of them were I don't want to call it industry normal because been a higher than average wait but industry normal reasons, right, which is what we do is we test compounds.

Douglas Miehm - RBC Capital Markets - Analyst

Understand. Okay. And then my second question just has to go back to the NRU situation. Is there any concern here over -- and you'd be well aware of this -- from a US perspective relying too heavily on a single supplier end, I know that this is probably going to help bring along the MAPLE reactors but at the same time could the US market start to feel that there is too much reliance on a single supplier. So even if you bring the MAPLE reactors on, is there a chance here that they try to source out alternative suppliers here?

Stephen DeFalco - MDS, Inc. - President & CEO

Doug, that's a good question; because I think this is a little of a double-edged sword in that one, is I just want to emphasize, my greatest concern here is serving our patients. And so that is the number one issue, and I think that is the thing we are all over and we're going to do whatever we can do to move this product the moment we've got it back into the hands of patients. But if you step back and say Stephen, what is the longer-term landscape here? Well, to the degree that we spend a lot of time getting the market to understand the value of our product and particularly in our pricing initiatives, right, this isn't going to hurt us. This is going to help us to the degree that we remind the world that they are dependent on really three facilities in the world, this isn't going to help us.

Now if you said we are going to go and we're going to create our own facility and we're going to do -- it is a very long haul. And as you can see from the government's attempt to build this MAPLE reactor it is not an easy haul. And as you can imagine, it is not a simple thing to get zoning for. So on the big scheme of things could that affect us? Well, we would like to not let it by

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getting back to our reliability story after this hiccup. If it was too effected is it something that someone could turn on 24 months. Absolutely not. There is a reason that only a couple places in the world do this, and there is a reason that the barriers to entry are so high. And there is a reason that as a correspondent to that our profits are pretty high in this arena. So a concern we always manage and particularly what we -- how we manage that well is during these situations as during the big hiccups of our competitor in '06, quite frankly we are conscious to not take advantage of those and to make sure that we are showing that we're doing the right thing here for the patients. And that is critical. And at the end of the day that usually is what everybody wants to see.

Douglas Miehm - *RBC Capital Markets - Analyst*

Thanks. Good answer.

Operator

John Sullivan, Leerink Swann.

John Sullivan - *Leerink Swann - Analyst*

Good morning. A couple of quick questions; first of all, could you just speak for a second about how you think about the capacity of your distribution channel in MDS Analytical Technologies, relative to the Molecular Devices products that are going through it right now? What sort of capacity do you feel like you could handle in that distribution channel?

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

Good morning, John, welcome to call. I am not sure I kind of understand; you mean manufacturing capacity or?

John Sullivan - *Leerink Swann - Analyst*

No, no, how fully do you feel like you are leveraging the sales service and marketing distribution channel?

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

Okay. I would say this is a tale of two cities. We are thrilled with the way that field has performed since the acquisition. They have just shown us months after month that they are very happy to be part of MDS and quite frankly want to show us what they can do. And the organic growth pickup in this thing since we acquired it has been phenomenal. And so I am very happy with that.

On a relative scale what a job they've done. On an absolute scale, quite frankly we -- our shares are a lot higher in North America than they are in Europe and Asia. And that is a function of old Molecular Devices could only afford to expand that so much in terms of making investments. As we are getting synergies and delivering that for our shareholders we are also investing a lot in building out a lot more capability across Europe. And certainly expanding our teams in China and our distribution arrangements in India.

So I think that there is a lot of call it, juice Jew left in that as we can drive those shares up to what we think would be more normal based, and based on what we've demonstrated in North America. I think that team could easily take some new products. And I think that is a nice piece of the acquisition, which is the ability to kind of do bolt-on deals whether those are licensing deals or acquisitions of smaller technologies and we can bring now global distribution to that. And that is just not we didn't have

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that quiver -- we didn't have that arrow in our quiver last year and I think as we exit this year we are able to have that option for our shareholders as opportunities open for us.

John Sullivan - *Leerink Swann - Analyst*

Thanks very much for that. And lastly, could you talk about plans regarding the high end of the Sciex line? You launched the API 5000 in early 2005. Just wondering should we expect a refreshing of high-end triple quadrupole instruments at some point?

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

Yes, you should expect a refreshing of high-end triple quadrupole instrument at some point.

John Sullivan - *Leerink Swann - Analyst*

Thank you.

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

I think our pipeline of new products is full; we got a couple of really exciting things coming. But it is -- we will let you know when we announce them because we like to surprise the market and our competitors.

John Sullivan - *Leerink Swann - Analyst*

Thanks very much.

Operator

Maher Yaghi, Desjardins Securities.

Maher Yaghi - *Desjardins Securities - Analyst*

Thank you for taking my question. Stephen, I wanted to ask you about -- looking forward two quarters from now or more, we are still benefiting from the Molecular Device acquisition to the top line. But when I look at the organic growth of the business, all three businesses are basically flat. How do you see organic growth taking place in 2008? Maybe just broad line question, I don't want specifics, but just do you see the organic growth kicking in? And just relating to that question the organic growth that we see in the table for Analytical Technologies of 2%, does that include organic growth at Molecular Devices or just the old Sciex business?

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

One is I think we are going to see an acceleration here of our organic growth. If you just go back a year or two that number was always in the high single digits. I think at Analytical Technologies specific on that table that would be same-store sales, not including the acquisitions. I think Sciex side that tends to be a tad lumpy, and we've focused folks on the end-user revenues, cause think that is probably the best indicator which has been doing fine all year. This wasn't a great quarter. It was a little more muted this order but I always tell people signal average over a few quarters on that. I think Molecular Devices we've seen a real

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nice kick up here in the organic growth rate of that product set pro forma from last year when we didn't own it. But same-store sales of that product, and we disclosed some of that. So that's fine.

Nordion of course had the unbelievable year in '06. '07 looks a little muted. I think as we go into '08 expect something more normal, which is sort of 5%, 6% here on the organic growth line here when we can factor out the things we, the FX. Again, (inaudible) organic we know that. And then our Pharma Services we never were able to grow the late stage. We now have that growing nicely and profitable. The early stage, of course, was always our bread and butter. We've had our challenges there. And it looks like we are coming out of that. So yes, I am excited as we go into 2008. I think we've got most of the trendlines here, all of the trendlines moving in the right direction. The question is a little bit acceleration. And I think operationally we are accelerating fine. A little more stable FX environment will help us show that all to our shareholders.

Maheer Yaghi - *Desjardins Securities - Analyst*

Right, so just to make sure the 2% same-store, as you mentioned, is it same-store also for Molecular Devices or it is only Sciex?

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

I'm sorry, that would only be the Sciex side. And the number was 5% end-user growth.

Maheer Yaghi - *Desjardins Securities - Analyst*

Okay, including Molecular Devices?

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

No.

Maheer Yaghi - *Desjardins Securities - Analyst*

No, just Sciex.

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

5%, just Sciex. I think Molecular Devices year-over-year Doug, do you have that number?

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

Yes, 15% up the same period prior year for Molecular Devices.

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

Molecular Devices up 15%, end-user Sciex up 5%.

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Maher Yaghi - *Desjardins Securities - Analyst*

Great. And just a follow-up question. On the Pharma Services business you have accustomed us to give us maybe the backlog at the end of the quarter for the past two quarters. Is it possible maybe to give us the backlog how the quarter ended instead of the average supplied in the table?

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

I think we will stick with our current disclosure methodology there.

Maher Yaghi - *Desjardins Securities - Analyst*

Okay, great. Thank you.

Operator

Brian Bapty, Raymond James.

Brian Bapty - *Raymond James - Analyst*

One fairly simple housekeeping question. If you could update us on your employee count and maybe give us a geographic distribution in general.

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

Good question. It is about 5500 at year end, and distribution is a little over 30% in Canada, about 30% now in Europe, 5% in Asia and call it, 1% in South America and the rest in the US.

Brian Bapty - *Raymond James - Analyst*

And in terms of where you foresee building out, would I guess Asia and US would be growth and Canada stable?

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

We just actually analyzed these trends because Asia is up 2.5 times what it was as we entered 2007. So we got nice expansions here in Beijing. We've got the factory in Shanghai, we've got the factory in Singapore, and we've got the distribution channel in China. And so that is going to be a trendline that just run that out five years. Very important part of the globe. I spend a lot more time there. We see big opportunities in India and China. I think in general the rest of the, and that will steal percentagewise from the other areas, is probably the right way to think about it. I don't know that any areas are going to be on the decline, but they will probably be slower growing certainly as a percentage of the group. North America, yes, there is growth there, but that is a pretty productive market for us already. And we have pretty good positions there.

Brian Bapty - *Raymond James - Analyst*

Great. And just a bit of a theoretical question. It has been a challenge obviously in MDS Pharma Services. Is there anything there in terms of broader initiatives that could potentially drive growth that you are considering, be it trying to build out the capacity in a specific I guess discipline within preclinical or other, that we might be able to look at for longer-term growth opportunity?

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

I think what we've got to do is, again, turn some of that orders momentum into revenue growth here in future quarters. That is the most important thing. We are seeing that in Phase I. We have a nice capacity expansion coming online in Phoenix. I think our preclinical business, tox and our screening business both doing very well and have been doing very well historically, good strong businesses for us.

Bioanalytical is starting to win folks back. So that was for us the mega-franchise a few years ago. We will continue to grow that profitably. And so I think generally we feel pretty good. I think as the business strengthens and we see better and better operating capability as a team, I think from time to time we would look to do a bolt-on acquisition in areas where we have strength there in Pharma Services. And some of that might be both on service lines in North America. But it also might be more interested in the geographic expansion like we just did here China and our Beijing lab. And that is a great expansion for our shareholders and we have a killer position there in China in our central labs business and certainly wanted to put a lot of disciplined capital into that expansion.

Brian Bapty - *Raymond James - Analyst*

Thanks very much. Best of the seasons.

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

All right, thank you very much.

Operator

Thank you. This concludes the question-and-answer session. I would now like to turn it back over to Ms. Mathers.

Sharon Mathers - *MDS, Inc. - SVP IR & External Communications*

Thank you, and thanks to all of you for joining us today. And if you do have any follow-up questions please feel free to give me a call. We will be available all afternoon. And the best of the season to all of you. Take care.

Operator

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

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