FINAL TRANSCRIPT

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MDZ - Q4 2008 MDS Inc. Earnings Conference Call

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CORPORATE PARTICIPANTS

Kim Lee
MDS, Inc. - Senior Director of IR

Stephen DeFalco
MDS, Inc. - President and CEO

Doug Prince
MDS, Inc. - CFO

CONFERENCE CALL PARTICIPANTS

Maher Yaghi
Desjardins Securities - Analyst

Max Paris
CIBC World Markets - Analyst

David Martin
Dundee Securities - Analyst

Dave Windley
Jefferies & Co. - Analyst

Doug Miehm
RBC Capital Markets - Analyst

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 Kim Lee, Senior Director of Investor Relations. Please go ahead, Ms. Lee.

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

Good morning, everyone, and thank you for joining us today. A press release for our fourth-quarter results was issued this morning. If you have not received a copy, it is posted on our website at mdsinc.com.

We are webcasting this event live on our website, where you will find a PowerPoint presentation highlighting the details of the call. The archived version will remain on our website after the call today. Joining 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 Q4 financials. Prior to our Q&A session, we will turn it back to Stephen for a few closing comments.

During the call, we will be making forward-looking statements about MDS's businesses. These statements are not a guarantee of future performance and are subject to risks and uncertainties that could cause actual results to differ materially. Some of these risks are disclosed in the reports and other documents filed with the relevant Canadian and US securities regulators and are available on our website.

Let me remind everyone that all financial data today is shown on a US GAAP basis and in US dollars unless otherwise indicated. In addition to standard GAAP measures, we also make reference to 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 set the performance of the business and as a basis for management compensation.

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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 detailed reconciliations between GAAP and non-GAAP measures in today's press release and our 2007 annual report, which are available on our website.

I will now turn it over to Stephen DeFalco.

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

Thank you, Kim. Good morning, everyone, and thank you for joining us. MDS performed well in Q4 despite a dynamic and difficult economic environment. For the quarter, MDS reported net revenues of $295 million versus $307 million last year. Normalized for foreign exchange, acquisitions, and divestitures, revenue grew 4%. Adjusted EBITDA was $37 million, up 6% from last year. Q4 reported results were impacted by a $13 million non-cash charge on a long-term contract at Nordion.

We also announced two significant charges. In the case of MAPLE, given the difficulty of projecting a specific outcome for any dispute as complex as ours against AECL and the Government of Canada, we determined that a full write down for MAPLE was appropriate under applicable accounting rules. Importantly this chart is an accounting matter and has no bearing on our cash position, day-to-day operations, or the strength of our legal case. We believe we have a strong case against AECL and the Government of Canada.

The Pharma Services goodwill charge is a part of our annual goodwill testing. We determined that a non-cash write-down was appropriate to align the fair value of this business. Doug will provide more details on foreign exchange, the embedded derivative, and the write-downs in his comments.

Now turning to our businesses. Let me start with Nordion. Operationally Nordion delivered strong performance this quarter. In Q4, Nordion demonstrated flawless execution and operational excellence driving revenues and profitabilities to record levels. During the quarter, Nordion saw strong cobalt shipments and stepped up to accommodate additional isotopes from the NRU to help alleviate the global shortage for medical isotopes.

Analytical Technologies. The effect of the global economy and more specifically the pullback of capital spending by North American pharma companies is most hard felt at this business unit. We continue to see growth from applied markets and demand from customers in developing countries. Importantly, we continue to innovate, staying at the forefront of technology and maintaining a strong pipeline of products as the lifeblood of this business.

To complement our software launches earlier this spring, in Q4 we introduced the next-generation mass spectrometry platform with the launch of two of the most advanced mass spectrometry systems ever built. The AB SCIEX Triple Quad 5500 and QTRAP 5500. These two new systems provide researchers with complete workflow solutions and deliver superior functionality, speed, and performance. These systems were very well received by customers. In fact, once we announced them on October 9, orders were received and systems shipped and installed in the quarter.

At Analytical Technologies, we continue to adjust for the business cycle and have completed the restructuring that we announced in Q3. We are anticipating further moves as we head into 2009 and intend to take a charge of approximately $5 million to further realign our resources to serve the markets that continue to show strong growth prospects in 2009.

Moving on to Pharma Services. In Q4 we saw growth in early-stage, Phase I, and bioanalytical. This growth however was offset by delays in Phase II through IV as customers continued to reprioritize their pipelines during these uncertain times. With customers taking a more cautious approach to development spending across all segments, we saw a sequential decline in new business wins to $131 million. This resulted in a backlog of $485 million, which is up 14% from last year. With more than 40% of the backlog denominated in currencies outside of the US and a weakening euro during the quarter, backlog decreased 12% sequentially.

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On the bottom line, Pharma Services delivered $8 million in adjusted EBITDAR, which is a year-over-year and a sequential improvement. This result was buoyed by favorable foreign exchange and the restructuring actions that we took in Q3. With restructuring in North America about complete Europe targeted for calendar Q1, we anticipate the majority of the restructuring benefits will be seen in 2009.

We continue to work with a high sense of urgency to improve this business and our initiatives and investments to improve operations and better meet client needs are taking hold. In Q4, MDS Pharma Services moved its Singapore global central lab operation to a new larger facility, enabling us to better meet the current and emerging needs of our clients in the Asia-Pacific region.

Also in the quarter as a testament to our client service, I am pleased to report that we received two awards for superior clinical trial management from Good Clinical Practice Journal magazine. During Q4, MDS continued to show progress against its strategic plan and focused improvement initiatives.

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

Doug Prince - *MDS, Inc. - CFO*

Thank you, Stephen. Before I get into the financial results, I would like to remind everyone that in addition to the preliminary and unaudited 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 asset write-downs and write offs, restructuring initiatives, valuation provisions, and acquisition integration expense.

We are 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.

Note that today's press release is preliminary and unaudited. All amounts referenced in our press release and on this call are preliminary and are subject to change as we finalized our results. Final 2008 audited results will be reported in our MD&A financial statements and notes in January 2009.

Let me now discuss our new disclosure process. For the first, second, and third quarters, our MD&A financial statements and notes will be posted on our website and filed with relevant regulators on the same day that we issue our press release. For the fourth quarter beginning today, we will issue a press release with preliminary and unaudited results in December and will provide audited financials when we file our MD&A financial statements and notes in January.

Next, our preliminary Q4 results. In Q4, total revenue was $322 million including $27 million of reimbursement revenue. Net revenues were $295 million, down 4% from $307 million last year. Excluding the impact of foreign exchange, acquisitions and divestitures, net revenues increased 4% driven by strong performance at Nordion. Revenue declined at Analytical Technologies and Pharma Services on soft demand in our North American markets.

Our reported gross margin which is net revenues less associated cost of revenues was 41%, the same as last year. SG&A for the quarter was $77 million compared to $84 million last year. SG&A as a percent of net revenues improved by 100 basis points from 27% last year to 26% this year.

In the fourth quarter, we spent $14 million on R&D, 5% of net revenues compared to $20 million or 7% in 2007 due to lower spending at Analytical Technologies as key projects were completed. Adjusted EBITDA was $37 million compared to $35 million last year, up 6%. Our adjusted EBITDA margin increased to 13% from 11% in the prior year.

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Q4 2008 results, adjusted financial results exclude $2 million of restructuring expense, $2 million of acquisition integration expense, $8 million in write-downs of long-term investments, and as disclosed last week, a $246 million net write-off for MAPLE and a write down of Pharma Services goodwill in the range of $270 million to $370 million. In the fourth quarter of 2007, adjustments included restructuring charges, valuation provisions, a loss on the sale of a business, and acquisition integration expense.

As noted in our Q3 MD&A, we have continued to assess the status of our MAPLE assets. During the fourth quarter, we determined that a write-off of the MAPLE facilities was appropriate under applicable accounting rules. As a result, we will record a non-cash charge of $341 million before tax and $246 million after tax.

In addition, we have also disclosed today a change to our historical accounting for MAPLE. During the fourth quarter, we determined that our original accounting treatment for the 2006 long-term supply agreement with AECL was incorrect. As a result, we have restated historical financial results to reflect the MAPLE asset as a construction in progress under lease accounting. Details of the restatement are included in our press release.

Relative to the write-down of Pharma Services goodwill, MDS annually reviews goodwill in the fourth quarter of each fiscal year to determine if the fair value of a business unit is aligned with its carrying value. This quarter, given the recent decline in overall CRO market valuations, the uncertain economic outlook and the previously disclosed delay in profit recovery, we have determined that a write-down of MDS Pharma Services goodwill is appropriate. We currently estimate this charge to be in the range of $270 million to $370 million.

We are still working to complete our fair value analysis and report the actual amount of this write-down in our audited financial results in January. Including the net $246 million charge to write off the MAPLE assets but excluding the Pharma Services write-down, the preliminary GAAP net loss for the quarter is $255 million. Preliminary GAAP earnings per share from continuing operations excluding the Pharma Services write-down were a loss of $2.11 in Q4 compared to earnings of $0.14 per share last year.

Excluding the adjusting items mentioned earlier, our adjusted earnings per share were $0.02 in Q4 compared to adjusted earnings per share of $0.10 last year. As noted in our press release, the reported net loss including the non-cash write-downs will have a negative impact on cumulative net income. As a result, a debt covenant in our US notes will restrict MDS from further share repurchases for the foreseeable future.

Now to our business unit results starting with Pharma Services. For the quarter, Pharma Services recorded net revenues of $112 million, down 9% from the same quarter last year. Early-stage revenues were flat while late stage revenues declined primarily as a result of delays in the start of new projects. Adjusted EBITDA in the fourth quarter was $8 million compared to $1 million last year, driven primarily by savings from our 2007 restructuring actions and a favorable FX gain of $3 million in 2008, compared to an FX charge of $6 million in 2007. These favorable variances were partially offset by inflation and lower revenue.

Before I discuss new business wins in backlog, let me also mention that during the quarter we identified certain foreign-exchange adjustments related to our historical backlog. These adjustments are shown in our press release and increased our historical backlog. There is no change to previously reported new business wins.

During the fourth quarter, we continued to see new business wins in excess of revenue as we delivered $131 million in new orders. Sequentially, new business wins decreased 22% as our clients continued to reprioritize their projects. Our quarter-ending backlog was $485 million and declined sequentially by 12% largely driven by foreign exchange fluctuations as more than 40% of the backlog is denominated in non-US currencies. Despite this FX adjustment, Q4 backlog increased 14% year-over-year, driven by a 25% increase in new business wins during 2008.

Next on to Nordion. MDS Nordion reported revenues of $84 million, up 11% from $76 million last year, driven by strong cobalt shipments and incremental demand for isotopes as a result of the European reactor shutdown. Foreign exchange and divestitures

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had a negative impact on revenue growth. After backing out $10 million of prior-year revenue for the two product lines sold earlier this year, Q4 revenue at Nordion increased 27%.

Adjusted EBITDA was $21 million versus $20 million last year driven primarily by higher sales of cobalt and medical isotopes. Incremental volume related to the European reactor shutdown contributed approximately $6 million of adjusted EBITDAR in the fourth quarter. These benefits were largely offset by the impact of an unrealized embedded derivative expense.

I would like to give you a little more color on the embedded derivative. Under US GAAP accounting, we have an embedded derivative related to the long-term Russian cobalt supply agreement that we signed in October 2007. Under this contract, Nordion has committed to buy Russian cobalt in US dollars over the next 16 years. As the US dollar strengthens, a derivative is created because Nordion with a Canadian dollar functional currency will incur more Canadian dollar costs to purchase cobalt over the next 16 years. Under accounting rules, we are required to record this future liability as a current period expense.

During the fourth quarter of 2008, the US dollar strengthened versus the Canadian dollar by about 18%. This resulted in a $13 million embedded derivative charge in Q4. Last year the US dollar weakened in the fourth quarter and $4 million gain was recorded from the embedded derivatives. The year-over-year impact is a swing of $17 million. Excluding this $17 million swing from embedded derivatives, adjusted EBITDA at Nordion more than doubled year-over-year on strong sales of cobalt and medical isotopes.

Now onto Analytical Technologies. MDS Analytical Technologies recorded revenue of $99 million in Q4 down from $108 million last year. Foreign exchange had a negative impact on revenue of $3 million. The primary driver of the revenue decline was lower shipments of mass spectrometers as end-user revenue decreased 11%.

Although we continue to see strength across Asia and in applied markets for food, water, and environmental testing, customer demand for high-end instruments in the North American and European markets has softened.

Adjusted EBITDA in the fourth quarter was $17 million compared to $27 million last year. This decline was primarily driven by the lower revenues. To better serve our fastest-growing markets and to further improve profitability, we are accelerating the transfer of our manufacturing base to Asia. These actions and others are expected to generate roughly $7 million of annual savings. We expect to record a restructuring charge in the first quarter of 2009 of approximately $5 million.

Turning next to cash flow. During the fourth quarter, we used $10 million of cash resulting in an ending cash balance of $120 million. During the quarter, we generated $53 million of operating cash flow and incurred $15 million of capital expenditures. We repaid $15 million that we drew on our credit facilities in Q3 and made $8 million in interest payments on our long-term notes. Our revolver is currently undrawn.

We also purchased one million common shares for $12 million under our [NCIB]. We continue to believe that cash on hand, cash from operations, and cash from existing financing sources will provide sufficient liquidity to fund our future operating needs.

A few comments on total year results. On a year-over-year basis, net revenues were up 9% to $1.2 billion. Adjusted EBITDA was up 5% to $152 million. Following the two write-downs described earlier, we expect a loss from continuing operations and a corresponding net loss per share. A comparison of our preliminary and unaudited results versus our September guidance is described in our press release.

In 2008, we provided detailed guidance to help our readers understand our conversion to US GAAP. Given that the conversion is now complete, we do not intend to provide guidance going forward.

That concludes my financial comments for the quarter and with that, I will now turn it back to Stephen for his closing remarks.

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

Think you, Doug. In 2008, MDS continued to achieve both revenue and EBITDA growth. Looking ahead to 2009, we see continued difficulty in the global economic environment. While we believe our industry will weather the storm better than most, we believe it will affect pipeline and CapEx decisions across the pharmaceutical industry.

In these times, given this economic turmoil, MDS is positioned with a strong mix of revenue with 50% services, 25% reagents and consumables, and 25% instruments. We have strong cash flow and a solid balance sheet. Most importantly, we have an experienced Board and management team that is taking the appropriate steps to align our spending plans to position MDS well through this business cycle.

Let me turn it back to Kim for Q&A.

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

Thanks, Stephen. Before I ask the operator to open the lines up for Q&A, I would like to ask you to limit yourself to one primary and one follow-up question. Melanie, can you please open the lines up?

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Maher Yaghi, Desjardins Securities.

Maher Yaghi - *Desjardins Securities - Analyst*

Thank you for taking my questions. First question, Steve, I have is on the MDS Pharma services EBITDA, it increased substantially I guess on lower revenues, but can you help us understand where the margin improvement is coming from on that side?

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

Thank you for joining us. As you know, we have been doing a lot of things to improve that business and driving improvement there; the new branding initiatives, the new facilities, the systems and certainly the big steps we've made to improve the cost structure. I'd say in Q4 a little bit of FX was a good guy for us, which is a welcome relief after really two years trying to fight against that in that business. Clearly we are getting the benefit of some of the restructuring moves. And so those were able to offset a little softer revenue.

Maher Yaghi - *Desjardins Securities - Analyst*

Okay and as it relates to the backlog and new business wins, correct me if I'm wrong but I was trying -- I was doing some calculations on your backlog. It seems to me -- correct me if I'm wrong -- but more than half of the decline was related to less orders. I mean less to do with exchange currency exchange. What was your cancellation rate in Q4 versus Q3 because I'm thinking here it was a lot higher? But can you give us some numbers on that?

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

I will let Doug give you the specific numbers, but cancellations were fairly typical. Q3 was a little light. The earlier quarters were a little heavier but the cancellation wasn't much. FX was the big part of it. Let me let Doug walk you through it.

Doug Prince - *MDS, Inc. - CFO*

As Stephen mentioned, we did see a moderate level of cancellations. However, our new business wins were $130 million. Our revenue was $112 million. The primary driver of the decline in backlog was foreign exchange, where we have over 40% of our backlog in non-US currencies. The US dollar strengthened against those currencies about 20% in the fourth quarter and that is the primary driver of the decline versus Q3.

Maher Yaghi - *Desjardins Securities - Analyst*

That's exactly my numbers. I was using 40% of your backlog down 20%. That gets you down $42 million, so we're still missing a good chunk here like $15 million, $20 million. I would have suspected the backlog to not decline more because your orders are higher than your revenue. So I'm kind of trying to understand the discrepancy here and it seems to me that your cancellation rate was higher in the fourth quarter than the third quarter. Am I right?

Doug Prince - *MDS, Inc. - CFO*

Cancellations are lumpy quarter-to-quarter and they were higher in Q4 than they were in Q3.

Maher Yaghi - *Desjardins Securities - Analyst*

Okay. Just my final question on the covenant and I will get back in the queue. In the covenant statements that you gave out, does the covenant stop you from making new investments in businesses that you would like to grow? Can you just answer that and that will be all from me.

Doug Prince - *MDS, Inc. - CFO*

There are no restrictions that prohibit us from making investments in Pharma Services, Nordion, Analytical Technologies. So there are no problems with making the investments we need to strengthen MDS.

Maher Yaghi - *Desjardins Securities - Analyst*

But no acquisitions of new businesses, right? New sites or new companies, other companies?

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

No, none that -- that concern us whatsoever.

Maher Yaghi - *Desjardins Securities - Analyst*

Okay, thank you very much.

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Operator

Max Paris, CIBC World Markets.

Max Paris - *CIBC World Markets - Analyst*

Good morning, thank you for taking my questions. First on the margins that Analytical Technologies were a bit disappointing. I understand the cause there with the softness in high-end instruments and in the North American market, but is this a new run rate in terms of margins? Can you help us out a little bit? What should we be expecting going forward on Analytical Technologies?

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

Thanks for the question. We are really seeing some major pullback in the North American pharmaceutical industry CapEx spending and a little bit we are monitoring that week to week. We've seen all our competitors talking about the same set of issues. Our Applied business continues to remain very strong, but right now particularly over the past 60 days; we've seen a big pullback in that. So I think we are going to let that unfold in 2009 month by month, but we are reading the papers. You are reading the papers. We are talking closely to our customers.

I think a number of the big pharma companies are going to announce this week and we're going to pay close attention to that also.

Max Paris - *CIBC World Markets - Analyst*

Okay, great. Thanks. Then on your long-term investments on your balance sheet, I see from your release you've got a write-down of $8 million on your long-term investments. The long-term investment line goes down from $172 million at the end of Q3 to $127 million at the end of Q2. Can you tell us what went on there?

Doug Prince - *MDS, Inc. - CFO*

Part of that is driven by foreign exchange, but let me get back to you on that one.

Max Paris - *CIBC World Markets - Analyst*

Okay, then one final question. Can you give us a CapEx update or a CapEx requirement update -- are the write-downs and restructuring impacting at all? What should we be looking for going forward? Thanks. I will leave it at that.

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

On the CapEx line going forward, we have cut our CapEx substantially over the past couple of years and I think as we look into 2009 we're going to be quite frugal with any new investments, making sure that they can immediately turn into revenue. I think that's really a function of looking at the external market environment. As Doug said, we provided guidance this year to make the transition here to US GAAP. I think going forward, we are not going to provide guidance. I think we'll be giving updates on CapEx quarter by quarter here as it unfolds.

Max Paris - *CIBC World Markets - Analyst*

Okay, but without being too specific, do you think we should see it go up or down or would it be flat? Tough to say?

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

I think it will be flattish to down.

Max Paris - *CIBC World Markets - Analyst*

Great, thank you very much.

Operator

David Martin, Dundee Securities.

David Martin - *Dundee Securities - Analyst*

Thank you, I've got two questions. The first one is can you help me understand a little more than $9 million of foreign exchange improvement in Pharma Services? I'm wondering in particular if currencies stay where they were in fiscal Q4, would you expect EBITDA in the $8 billion range going forward on the same revenue base or was there a one-time gain in fourth quarter due to hedging or something else?

Doug Prince - *MDS, Inc. - CFO*

David, this is Doug Prince. There was a gain, a one-time gain of $3 million in the fourth quarter.

David Martin - *Dundee Securities - Analyst*

Okay. So if currencies stayed where they were in the fourth quarter, you wouldn't get that gain in sequential quarters?

Doug Prince - *MDS, Inc. - CFO*

That is correct.

David Martin - *Dundee Securities - Analyst*

Okay. And then Maher kind of asked you whether the covenants affect your ability to invest in things going forward. I'm wondering on the other side of things, do covenant changes affect your ability to do other strategic things as like spinning out businesses or selling businesses?

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

So there's two sets of conversations. So on the set of covenants that prevent us from doing what the NCIB, no, there's no restrictions on that. If we were to do a major spin out of one of the businesses, it would require us to refinance the US notes that we have on the balance sheet.

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David Martin - *Dundee Securities - Analyst*

Okay, thank you.

Operator

Dave Windley, Jefferies.

Dave Windley - *Jefferies & Co. - Analyst*

Clarification questions to start. Is the $485 million in backlog average or ending?

Doug Prince - *MDS, Inc. - CFO*

That is the ending backlog.

Dave Windley - *Jefferies & Co. - Analyst*

Okay, and the new wins are net or gross?

Doug Prince - *MDS, Inc. - CFO*

Those are net. Excuse me, those are gross wins. They include the new business wins and change orders.

Dave Windley - *Jefferies & Co. - Analyst*

Okay, then more strategically in that Pharma Services business, Stephen, your delays in late stage are I guess a little different than what we're hearing from others in terms of where delays are coming and early stage actually held up pretty well, which is where other people seem to be seeing some weakness I guess. I was hoping you could provide some additional insight into, say, if there's a common profile of client that is delaying starting later stage studies, what visibility you have that those delays will turn into business as opposed to cancellations down the road?

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

David, I think it's a good question. Let me kind of walk you through what we are seeing but what I would kind of emphasize most in this answer is we are seeing things changing month-to-month here as everyone who reads the paper is kind of watching different messages come in the economy. So I would say our early-stage business has held up well, particularly strengthened our Phase I business, which is a very good franchise for us. I would say in other parts of the early-stage business, we've seen kind of mixed order flow.

I would say in our late stage business, what we are mostly in is a lot of dialogue with clients about their pipelines and quite frankly some of those dialogs result in them looking at three projects and deciding to go forward with two and wanting to accelerate those two and then put the third one on back burner. And question -- was that awarded yet? Was it not awarded yet?

I think -- so we are just seeing lots of flux in that pipeline. And for the clients that we're not seeing any action, we are in a lot of dialogue with them where we know that they are reviewing that and relooking at that program and maybe that's going to be

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a bigger program and what can we do on an accelerated basis? Or they might reprioritize around some other programs. And so to the degree that not all of that has hit our numbers, I think we are in pretty active dialogue on all of it as I think everyone is in the industry.

So we will -- again, I think we will see how the first half of 2009 shakes out. You know, my view, and not that I am a particular soothsayer on the future of the industry is -- my view is we are going to watch this reprioritization for at least a couple of months. And then I think the question is will this affect people's propensity to outsource on a longer-term basis? You know, I think the CROs have proven they are better, faster, and cheaper at getting this work done. And I think we might see some more accelerated outsourcing, but I think we are first going to see this pipeline moves, that come quicker.

Dave Windley - *Jefferies & Co. - Analyst*

Okay, all right, thanks.

Operator

Doug Miehm, RBC Capital Markets.

Doug Miehm - *RBC Capital Markets - Analyst*

Good morning. My first question just has to do with CRO, I guess it's everyone's question today. Because the results were quite strong at seeing the context of the market we are in and I guess it's a testament to how well you're doing with the restructuring. My question though is more one of outlook in terms of the backlog.

Are you expecting it to sequentially decrease over the next quarter or two based on what you are seeing today? And even if that were to occur, do you have enough business so that 2009 can maintain the type of level in terms of margins that we saw in Q4 ex that currency gain of $3 million? So a $5 million run rate?

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

Doug, thanks for your question. You know, a little bit again -- let me put a big underline on -- you know, it's a period where I've seen in business where visibility is difficult. And that's because our clients are changing on a daily basis based on how they are reading the economy and to some degree dealing with not having access to capital markets. That particularly affects our small biotech folks.

I appreciate your comments on Q4. We've been working hard on that division, so it was nice to have a good quarter here, but I would also temper it back a little bit with some of that with some FX help and as Doug said, if the FX rates stay where they are, we will have some of that on an ongoing basis. Some of it is the balance sheet stuff that you get during the change period.

So we are going to -- we are working real hard. We've got clients coming back. We had a good streak of new business wins, but that has softened for us here a little bit in Q4. And you know, a couple of big programs either way can kind of move that number around. So again, we are going to be watching that month by month and making sure we are very close to our core clients and that we are the CRO they can turn to in these difficult times.

I think it is -- our backlog is a better quality, higher margin than it has ever been and with a more substantial set of customers. But having said that, I don't think we fully understand how the economy is going to shake out in 2009 and how that will affect everyone in the industry both the biotech and the pharmaceutical spectrum.

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Doug Miehm - *RBC Capital Markets - Analyst*

Okay, so just one of the questions in there was just looking out to Q1, would you expect to be sequentially down in the backlog based on the issues that we are seeing right now? Is that pretty fair?

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

I'd rather not be predicting Q1 right now. It's difficult in this environment to predict it.

Doug Miehm - *RBC Capital Markets - Analyst*

Okay. Second question then has to do with write-downs and those sorts of things. I think you touched on that with respect to the $8 million, but what type of additional exposure for example? -- what was that $8 billion exactly? What type of incremental exposure do you have here to any type of mortgages, commercial real estate? Is there anything along those lines that could get us into trouble?

Then just on the embedded derivative, when do you expect that that -- like the $13 million we saw in Nordion, when do you expect that that is going to be behind us? Because otherwise that business would have looked very strong. Thanks.

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

I'm going to turn it over to Doug for a minute, but I think that business does look very strong in Q4. And I think our shareholders understand the difference between operational performance and a non-cash charge. That derivative will move around a little with the exchange rates given that it's a forward-looking 16-year contract. I think though people should step back from the accounting there which is a non-cash charge versus the fact that that's a phenomenal contract for us. That's doing exactly what we want to do which is increase our supply of cobalt so that we can fund -- so that we can support the growth of our sterilization business.

And I think when you think about it economically, that cobalt is going to be sold in US dollars and so there's really not an economic exposure. I would describe it more as an accounting exposure. So I just want to make sure that that part of it is kind of clear and so that people can put in the right context. I'll let Doug answer the rest of your question.

Doug Miehm - *RBC Capital Markets - Analyst*

Thanks.

Doug Prince - *MDS, Inc. - CFO*

Yes, on the write-downs, we do a thorough review in particular at year-end but throughout the year we are always reviewing our assets. And during the fourth quarter, we determined that there was a write-off related to an investment we made years ago in Iconix. That business was then acquired by another company called Entelos and that investment has never paid off.

Given the status of it, we determined it was appropriate to write that down in Q4. We have done a thorough review of all of our assets and our cash position and at this point in time, we believe we have made all of the appropriate adjustments. I would say, though, it's a little bit like trying to predict demand for instruments going forward. Given the status of that global economies, is it's difficult to say what's going to unfold over the next several months, so we will continue to keep everybody informed of any changes. But at this point in time, we've made all the adjustments that are appropriate.

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Doug Miehm - *RBC Capital Markets - Analyst*

Thank you.

Operator

Maher Yaghi, Desjardins Securities.

Maher Yaghi - *Desjardins Securities - Analyst*

Yes, thanks. I just had a follow-up question on the recording, the change in the recording of the MAPLE reactor from intangible assets to construction progress. Can you maybe go back and explain just why it was changed initially from construction in progress intangibles and why now you have decided to bring it back to the way it was?

Doug Prince - *MDS, Inc. - CFO*

Sure, this is Doug Prince. On that one, in 2006, it was a complicated transaction that involved the exchange of our construction in progress along with inventories and then interim supply agreement. We did a thorough review at that point in time and our determination given accounting rules was that it was appropriate to record in '06 a conversion of the construction in progress to [allow] intangible asset for long-term supply.

We have recently undergone a significant -- a standard SEC review of our 2006 financials and we are -- every year we typically get an SEC or an OSC inquiry into our reports. This was a standard report and they questioned our 2006 accounting on the MAPLE transaction. Upon thorough review and including the advice of external experts along with our auditors, we have revisited that transaction and have determined that it should have been recorded as an under capital lease accounting and remain in a construction in progress.

As a result, we are reversing the loss that was recorded in 2006. We are capitalizing the interest since '06 on that construction in progress. It effectively increases our earnings per share historically. However, it makes the write-off in Q4 that much bigger.

Maher Yaghi - *Desjardins Securities - Analyst*

Is there an implicit assumption in the way it was changed back to construction on progress that the intangible assets which were represented by the long-term contract were not really long-term contract in nature and that -- does that have any bearing on the lawsuits that you have with the Canadian government?

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

I think that's a great question. This has no bearing at all on the lawsuit with the Canadian government. Nor does it indicate an increase or a lack of confidence on that lawsuit in any way, shape, or form. I think again, this is a fairly unique transaction in the world of call it arcane accounting. Quite frankly, it's treated differently under Canadian GAAP and US GAAP, which I think a little bit was part of the problem given the team that made that determination at that time.

I think this is just Doug with a fresh set of eyes and the current team and advisers going through that and it really does fall under this special slot in US GAAP that treats it the way it does here as a capital lease. So it's not -- you know, --

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Maher Yaghi - *Desjardins Securities - Analyst*

So you don't somebody can use it against you?

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

Absolutely not. I don't think --. No, not in any way, shape, or form.

Maher Yaghi - *Desjardins Securities - Analyst*

Okay, thank very much.

Operator

Dave Windley, Jefferies.

Dave Windley - *Jefferies & Co. - Analyst*

I wanted to ask several follow-ups here. The goodwill, Doug, on just doing some rough calculations I think coming into the quarter your book value is around $14, $15 a share. Stocks trading obviously well below that. Some of the write-offs you are taking in the fourth quarter will take that book value down but not necessarily to where the stock price is trading today. It's my understanding from talking to some accountants here recently that FASB views market value as a pretty solid determinant of fair value.

And so I'm wondering if you have implication -- if you're write-off of goodwill in Pharma Services is to zero and in addition to that if you have -- because of where the stock is trading -- if you have potential pressure to write down [NDDC] goodwill and as you get book value down to where the stock is trading.

Doug Prince - *MDS, Inc. - CFO*

Dave, thanks. On that point, on the pharma side to your point, there's a pretty thorough evaluation and that includes the market multiples. And I think the SEC has had a conference last week and has told everybody they are going to be -- everybody needs to look at this. So clearly we had that already underway and the multiples are a clear indicator. That's part of the analysis and that is one of the first triggers as to whether you have an impairment.

You then have to go through further analysis to determine the amount and that's where we are right now. We've gone through a similar evaluation on the molecular devices goodwill and there are no issues there at this time and none expected.

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

Dave, just so you know how this is done a little bit and I could probably explain it more in layman's terms, given my level of knowledge. But essentially right, you have your future cash flows and then you apply them against the market valuations and so you mentioned MDS's share price. It's more the share price of that whole sector. And so as you know and as I read your reports, if you said the sector was trading at 12 to 14 a year ago, well now the sector is trading at half of that. So even if you had a same cash flow calculation, you wind up looking at that goodwill and it doesn't pass the test.

That's just a function of the industry multiples coming down. But I think as Doug said, we don't think we have any other exposures with goodwill on our balance sheet. But as Doug also said, the SEC is looking at this and I just think that given where the Dow

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is, you are probably going to see a number of companies having to deal with this. So it's -- I think you're going to see a little bit more of it out there. But right now we feel very comfortable given the thoroughness of our accounting team as they went through this.

Dave Windley - *Jefferies & Co. - Analyst*

Okay, a follow-up on my earlier question. On the softness in late stage, in the past you've talked about how as a Pharma Services division and a player in that space you've kind of eschewed the big global contract and targeted explicitly more the midtier, thinking that that was a client -- I don't want to put words in your mouth. But I think you said that that was the client that you thought you served best or that matched your profile and created the opportunity for best profits, etc.

I guess what I'm wondering is where does client mix stand today? Again, what type of clients were causing those delays? And am I reading too much into your avoidance of global contracts and thinking that big pharma is not a big portion of your client base?

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

I think big pharma is a big portion of our client base in early stage, but less so in late stage. So exactly what you said is true. Let me take it piece by piece. It's not -- it's a big portion of our backlog in early stage. It's a big portion of our backlog in central labs but specifically in Phase II through IV, it's a relatively smaller question of our backlog as we have steered that business exactly as you said to its midsized pharma and large biotech. Because we saw better margins and better ability to serve in that arena. So I think that covers it. I'm not (multiple speakers)

Dave Windley - *Jefferies & Co. - Analyst*

Right. So are those -- I presume when you are talking about delays of studies in late stage, does that statement apply to both central labs and your Phase II to IV business or is it more to one or the other?

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

I would say -- I think the phrase I used was reprioritizing the pipeline. And in some places that's asking for larger and accelerated studies and in some case, it is delaying certain things. You know, just given our relative size, one or two orders breaking one way or the other in a quarter can kind of impact us. So now I think it is -- I would say mostly Phase II through IV, but we are also seeing it in central labs.

Dave Windley - *Jefferies & Co. - Analyst*

Okay, pricing environment in Pharma Services across the board, is it still fairly rational or are -- because of the slowing demand, are people starting to get more aggressive?

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

I think we are seeing pricing by and large being rational. I don't -- I think our biggest selling issue right now is are they going forward with the program? More than specific pricing because -- a little bit of a flight to safety. And so I think people are more looking at technical confidence, your ability to start the project right away and execute in a quality way is still dominating the conversation over pricing. But we will see how that rolls out over 2009.

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As I said, I think if they revisit the pricing question a lot, it's probably likely to lead to more outsourcing, right? And that trend that we saw -- we have seen that trend going on for five years. The question is in this economic environment, is that likely to accelerate or not? I think let's watch how 2009 unfolds. I believe that the entire industry is going to take a good hard look at their cost structure and when they do it will lead to greater outsourcing. But don't know that that's the way it will play out and if so, I don't think you are going to see the effect of that until the back end of '09.

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

Right, and last one real quick here. What is the outlook for -- I apologize if you answered this already -- but what is the outlook for getting NRU authorization extended?

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

You know, a lot of dialogue right now going on and it's been in the Canadian press a lot actually the past couple of weeks. There's a new Canadian government, with that a new Minister of Natural Resources Canada, which is where AECL reports into. And so what I hear from everyone both in my one-on-one conversations as well as in the public statements is a strong desire of the Canadian government to work with the Crown Corporation and the regulator to get the NRU relicensed past 2011.

Having said that, I think they are putting together the technical cases. I don't generally in a relicensing exercise, they don't get it done early. They usually take it right up to the six-month time before then. I think because a lot of people who are expressing desires that they'd like to see them get rid of that uncertainty and make sure that license is out there. But I think historically that hasn't been the case. But I haven't -- if anything, I've seen is stepping up on the activity in that arena and so we continue to advocate.

Dave Windley - *Jefferies & Co. - Analyst*

Okay, thank you.

Operator

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

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

Thanks, Melanie. Thank you all for joining us this morning. If you have any additional questions, please do not hesitate to give me a call. Thanks again and have a great day.

Operator

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

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