

FINAL TRANSCRIPT

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TMO - Q1 2008 Thermo Fisher Scientific Earnings Conference Call

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PRESENTATION

Operator

Good morning, ladies and gentlemen, and welcome Thermo Fisher Scientific first quarter 2008 earnings conference call. At this time all lines are in a listen-only mode. Later we will conduct a question-and-answer session and instructions will be given at that time. (OPERATOR INSTRUCTIONS)

I would now like to introduce our moderator for the call, Mr. Kenneth Apicerno, Vice President Investor Relations. Mr. Apicerno, you may begin the call.

Kenneth Apicerno - *Thermo Fisher Scientific, Inc. - VP, IR*

Good morning, and thank you for joining us. On the call today we have Marijn Dekkers, our President and Chief Executive Officer, Marc Casper, Executive Vice President, and Pete Wilver, our Chief Financial Officer. Please be aware that this call is being webcast live and will be archived on our website thermofisher.com until May 23, 2008. To reach the replay on our website, click on investors, then webcasts, then presentations. Please also be aware the copy of the press release setting forth our first quarter 2008 earnings and future expectations is available in the investors section of our website under the heading quarterly results.

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With that I'd like to begin by reading the Safe Harbor statement. Various remarks we may make about the company's expectations, plans and prospects constitute forward-looking statements for purposes of the Safe Harbor provisions under the Private Securities Litigation Reform Act of 1995. Actual results may differ materially from those indicated by the forward-looking statements as a result of various important factors including those discussed in the company's Form 10K for the year ended December 31, 2007, under the caption risk factors which is on file with the Securities and Exchange Commission and available in the investors section of our website under the heading SEC Filings.

While we may elect to update forward-looking statements at some point in the future, we specifically disclaim any obligation to do so even if our estimates change and therefore you should not rely on these forward-looking statements as representing our views as of any date subsequent to today. During this call, we will be referring to certain financial measures not prepared in accordance with general accepted accounting principals, or GAAP. A reconciliation of the nonGAAP financial measures used on this call the most directly comparable GAAP measures is available in the press release setting forth our first quarter 2008 earnings and future expectations and in the tables accompanying such releases in the investor section of our website thermofisher.com under the heading quarterly results. Related information is also available on the investor section of our website under the heading webcasts and presentations. With that I'd like to now turn the call over to Marijn.

Marijn Dekkers - *Thermo Fisher Scientific, Inc. - President, CEO*

Thank you, Ken, and good morning, everyone. Thanks for joining us for the review of the first quarter of 2008. I am very pleased to report that we are off to a good start for the year. We had strong financial performance in the quarter and a lot of exciting developments that will contribute to our growth going forward. So let me give you an overview of our results, some comments on what we are seeing in our markets and talk about a number of recent business highlights.

First the financial highlights. Since we completed our first full year as Thermo Fisher Scientific in 2007, our results can now be compared on an apples-to-apples basis. No more need for pro forma comparison. Our Q1 revenues grew 9% to a record \$2.6 billion. Adjusted EPS rose 25%. Adjusted operating income increased 19%. And we continued our trend of significant adjusted operating margin expansion with 140 basis points of improvement. So we believe we delivered a strong quarter even though we lost between 1% and 2% of our revenue growth year to year because we had fewer dates in the first quarter of 2008.

We are very pleased with the way our financial business model is working. From our top line growth, we are able to pull through significant earnings growth and margin expansion. In addition, our focus on operating discipline and continued productivity as well as synergies from acquisitions further strengthens our profit margin. An important part of our business model, and I want to emphasize this as I did last quarter, is that we run the company by striking a balance between our four key financial metrics: top line growth, operating margins, EPS, and free cash flow. We believe this balanced approach is the best way to create shareholder value over the long term.

So moving on to the markets, let me say a few words on what we are seeing at this point in the year. Our major life sciences and health care end markets remain strong, and overall, we have not experienced any change from what we have seen over the past few quarters. The safety market, however, continues to be very weak, specifically the domestic preparedness segment, which led to poor results in that part of our catalog business. We also saw some softening of demands in certain industrial markets late in the quarter, specifically oil and gas and semiconductors, which are both relatively small markets for us. So, apart from some weakness in these smaller markets, in general, we have not seen any significant change. I am confident that our balanced mix of markets, global presence, products and services will limit our exposure to certain economic headwinds that we are hearing a lot about. This, along with our proven operating discipline, puts us in a strong position to deliver on our financial goals for 2008.

So a few words on new developments. Another advantage for us is we have the resources to continue to build on our product portfolio and global presence to fortify our position as the world's leader in serving science. We have had a number of exciting developments in the past few months that I want to spend a few minutes on. We had an excellent showing of new products at

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Pittcon and Analytica. And let me mention some of the highlights under our Thermo Scientific brand. One, we completely redesigned our Raman and FTIR Spectroscopy platforms to make these technologies available to the non-expert. These advanced techniques, which in the past were limited to specialists in the lab can now be used by just about any operator. For example, technicians in a busy forensic lab.

Secondly, in mass spectrometry we launched new enhancements for our highly successful Orbitrap platform, adding MALDI and ETD capabilities for ever higher levels of sensitivity and mass accuracy. The Orbitrap with ETD allows scientists to significantly increase a number of proteins they can identify without increasing the experiment time. The Orbitrap with MALDI is especially suited to the imaging of whole tissue samples to precisely understand, for instance, how new drugs may affect the brain and other organs. We also introduced a new atomic absorption spectrometer called the ICE3000 series. This new AA system is designed for highly regulated laboratory environments, such as food safety, environmental pharma and metals and materials application. I'd have to say that between both of these conferences; we had the strongest new product line up ever in our history, which demonstrates our ongoing commitment to technology innovation. Our product development and marketing teams did a superb job to pull this off and I'm confident this will pay dividends in the future.

There is a lot of innovation going on in our life sciences consumables businesses as well, and we had two great examples in the past few months. First we introduced a breakthrough in RNAi technology that greatly simplifies the method for gene silencing during drug discovery. Our new Accell platform makes it possible for researchers to deliver siRNA directly into cells without using the delivery reagent which can affect the results of their experiments. Because this can be applied to many types of cells, it opens the door for significant new biomedical and pharmaceutical research. And then in our microbiology business we received FDA clearance for a new MRSA test called Spectra that can screen patients for staph infection when they are admitted to the hospital. Our test is highly accurate, provides results in 24 hours, is easy to administer and is very cost effective. This means that more medical facilities will use it and more patients will be protected from this life threatening infection which is often called the super bug.

And finally we introduced our first Fisher Scientific catalog in Chinese targeted specifically to the growing demands of customers in research, testing, and processing facilities in that country. This is a great opportunity for us to leverage our strong Fisher Scientific brand to establish a strong customer channel in China. We continue to see double digit growth in Asian markets and are investing heavily to extend our presence there, primarily in China and India. The Chinese catalog is one example. Our acquisitions of Qualigens Fine Chemicals last year is another example, making us a leading laboratory chemical supplier in India. In addition, construction of our nuclear packaging facilities are underway and should begin shipping supplies this fall.

So final words on guidance before I hand it over to Pete. To wrap up here, we feel very good about our prospects for overall growth and fully expect to deliver on our financial goals for 2008. Last quarter we said we expected to report revenue growth of 8% to 9% over 2007 and we now expect our revenues to be in the range of \$10.6 billion to \$10.7 billion or 9% to 10% growth this is primarily the result of more favorable currency translation. Our increased revenue estimate also leads us to raise our adjusted EPS guidance by \$0.02. We now expect to report a range of \$3.07 to \$3.17 for 2008, which is a 16% to 20% increase over 2007. So with that I will turn the call over to our CFO, Pete Wilver, for his financial review. Pete.

Peter Wilver - *Thermo Fisher Scientific, Inc. - CFO*

Thanks, Marijn, good morning, everyone. During the first quarter of 2008, we realigned our product portfolio to transfer a few small businesses representing approximately \$70 million in annual revenue from the analytical technology segment to our laboratory products and services segment. The 2007 data in our earnings release and in my comments today has been restated to reflect those changes. And since we completed our first full year as Thermo Fisher Scientific last quarter we no longer have to talk about pro forma comparisons to the prior year. As Marijn said, we had another strong quarter with 25% growth in our adjusted earnings per share to \$0.74 compared to \$0.59 in Q1 last year. GAAP earnings per share in Q1 were \$0.53 up from \$0.31 in the prior year's quarter primarily as a result of improved operating performance and lower merger-related charges, partially offset by higher acquisition intangible amortization. Our press release contains a detailed reconciliation between GAAP and

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adjusted EPS. Revenues in Q1 increased 9% year over year to \$2.55 billion, organic revenue growth in the quarter was 4% excluding favorable currency translation of 4% and acquisitions net of divestitures of 1%.

Organic revenue growth in the quarter particularly in our consumables businesses was negatively impacted by two days or between 1% and 2% as a result of the shift from the Easter holiday from Q2 and having one less day in the fiscal quarter as compared to Q1 2007. Bookings slightly exceeded revenues in the quarter by about 1/2%. In the analytical technologies segment, Q1 revenues rose 10% on a reported basis and 4% organically. In the quarter we saw good organic growth in our life sciences and health care markets, however, a few of our smaller industrial markets showed some softness later in the quarter. Our new product introductions continued to be a growth driver, specifically in our mass spectrometry and environmental product lines. In the laboratory products and services segment, Q1 revenues rose -- increased 9% on a reported basis and 4.5% organically.

During the quarter our research and health care catalogs in our biopharma outsourcing services businesses all exhibited strong growth. This was partially offset by continued top line weakness in our safety catalog business which negatively impacted total company organic growth by approximately 1%. By geography, we saw organic growth across all our major regions with the exception of Europe which was essentially flat against particularly strong growth in the year ago quarter. North America grew at slightly below the company average and Asia Pacific grew in the high teens. The rest of the world grew at close to 30% albeit from a very small base. Q1 adjusted operating income increased 19% year over year to \$447 million. Adjusted operating margin was 17.5% up 140 basis points from 16.1% in the year ago quarter. The margin expansion was driven by pull through on our incremental organic revenues including increased prices, our integration, sourcing and productivity initiatives and slightly lower stock compensation expense. Analytical technologies Q1 adjusted operating income increased by 23% year-over-year and adjusted operating margin was 21%, up 220 basis points versus 18.8% last year.

Laboratory products and services Q1 adjusted operating income increased by 15% and adjusted operating margin increased by 60 basis points to 13.9% as compared to 13.3% in the prior year. Adjusted gross margin was 41.1% in Q1, up 66 basis points from 40.5% in the year ago quarter, primarily as a result of price increases net of inflation, volume leverage, and the impact of our sourcing and productivity initiatives. We are continuing to see increased inflationary pressure on raw material costs primarily in steel, copper and plastics. Adjusted SG&A was 21.2% of revenue in Q1, down 66 basis points from 21.9% in the year ago quarter, primarily as a result of volume leverage and integration synergies. R&D expense was 2.4% of revenue in Q1, down 13 basis points from the year ago quarter primarily as a result of volume leverage.

Moving to below the line items, adjusted net interest expense was \$20 million in Q1, down \$8 million from the prior year primarily as a result of reductions in our debt and increased cash. Other income was a loss of \$1.5 million, down \$3 million from the prior year primarily as a result of currency translation losses on foreign entity cash. Our adjusted tax rate for the quarter was 24.3% in line with our full year 2007 actual and 2008 forecast rate of 24%. The Q1 2008 adjusted tax rate was down .7% from the prior year primarily as a result of the tax planning we implemented during 2007. Average diluted shares were 436 million for the quarter, down five million from last year and four million from the prior quarter reflecting the benefit of the share buy back program we initiated in Q3 2007. During the quarter we used \$102 million to repurchase 1.8 million shares which completes our outstanding \$1 billion share buy back authorization which resulted in a total repurchase of 18.2 million shares. In terms of balance sheet performance, we ended the quarter with \$748 million in cash and investments, up \$109 million from Q4 as our free cash flow was partially offset by share repurchases. Our debt was essentially flat with the prior quarter at \$2.2 billion.

Accounts receivable days sales outstanding was 56 days, up one day from the prior year. Excluding the quarter end versus average impact of foreign currency translation, which ramped up significantly towards the end of the quarter, DSO was flat with the prior year. Inventory days of supply was 75 days, down one day from the prior year. Excluding the impact of average versus ending foreign currency translation, inventory days of supply improved by two days versus the prior year. Finally Q1 cash flow from continuing operations was \$243 million and after deducting net capital expenditures of \$53 million, free cash flow from continuing ops was \$190 million.

Moving on to our 2008 guidance, we are increasing our full year reported revenue guidance by \$100 million to a range of \$10.6 billion to \$10.7 billion, primarily as a result of favorable foreign currency translation. This range represents 9% to 10% growth

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versus our 2007 actual revenue \$9.75 billion. We are also increasing our adjusted EPS guidance by \$0.02 to a range of \$3.07 to \$3.17 as a result of higher revenues which represents 16% to 20% growth versus the \$2.65 we reported in 2007. With that I'll turn the call over to the operator for Q&A. We're open for questions.

QUESTIONS AND ANSWERS

Operator

Thank you. (OPERATOR INSTRUCTIONS) And in order to allow everyone in the queue an opportunity to address the Thermo Fisher Scientific management team, I would like to ask that you limit your time on the call to one or two questions. If you have an additional question, please return to the queue and pose your question in turn. One moment for the next question. Our first question is from Jonathan Groberg with Merrill Lynch. Go ahead, please.

Jonathan Groberg - Merrill Lynch - Analyst

Good morning. Thanks for taking the call. Congratulations on a good quarter.

Peter Wilver - Thermo Fisher Scientific, Inc. - CFO

Thank you, Jonathan.

Jonathan Groberg - Merrill Lynch - Analyst

I just had a couple questions. The first one relating to Pete's comments about commodities and we continue to see all of these prices go up at fairly rapid levels. I am wondering what is the lag between when you are seeing that commodity price inflation show up in your manufacture products and your ability to pass on the prices to customers?

Peter Wilver - Thermo Fisher Scientific, Inc. - CFO

Well, it impacts us mostly in the areas where we are fairly vertically integrated so we are buying the raw material and bending and painting steel and things like that. We see that impact relatively quickly in those areas. And that's -- we started to see it the second half of last year and in Q1 it ramped up a little bit. We see it probably with a higher lag where we are buying subassemblies and components that have those materials in them because our suppliers have a harder time passing those costs on to us. So it is somewhat of a mix but I would say we are seeing the impact pretty heavily. I don't think there is another lag that we will see a bigger impact going into Q2 or Q3, if that's your question.

Jonathan Groberg - Merrill Lynch - Analyst

And do you think -- are you able to pass that pricing on, or are your prices -- for these types of items, is that an ongoing negotiation, or do you have list prices that are going to last throughout the year?

Peter Wilver - Thermo Fisher Scientific, Inc. - CFO

It is difficult to pass those costs on directly on those types of products. Certainly our competitors are seeing the same things we are in those areas. So if this continues on, certainly the market price should go up, but in the near term it is hard to pass those cost increases on directly to customers.

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Jonathan Groberg - Merrill Lynch - Analyst

But what you've seen in the last little bit, you are still comfortable with your margin expectations for the year?

Peter Wilver - Thermo Fisher Scientific, Inc. - CFO

Certainly. Even though we saw pretty significant material cost inflation, if you look at net sourcing savings, we are still positive, so we are saving more money on material than the inflation is costing us.

Jonathan Groberg - Merrill Lynch - Analyst

Okay. Great. And then, Marijn, can you address -- there has been a lot of talk around the hospital acquired infections and you guys don't talk as much about some of your diagnostic capabilities. But can you maybe address, in a little more detail why you think that your MRSA solution is going to be well received by hospitals, relative to some of the molecular tests that are maybe a bit more rapid out there?

Marijn Dekkers - Thermo Fisher Scientific, Inc. - President, CEO

Well, yes. It is a price difference. Our test costs about \$3 and the rapid tests cost about \$30. And in some European countries where the screening has started, a number of years ago, the number of infections -- patients that get infected with the super bug in a hospital has now basically dwindled down to negligible levels. So it's fairly obviously that the screening of patients coming into the hospital is the right thing to do to avoid these infections but it has been incredibly expensive, and we are now coming out with something that only costs \$3, 10 times less than what is typically used and what is a more rapid test. So we think there will be great reception for that price difference in the market and will allow more hospitals to screening it, even though it takes a day rather than a few hours.

Jonathan Groberg - Merrill Lynch - Analyst

And what was the -- I'm sorry, the time difference previously. Now this is about 24 hours and now your new test, I think in your press release you said, and what was it previously?

Marijn Dekkers - Thermo Fisher Scientific, Inc. - President, CEO

I think it has to do more with accuracy. So you really get now a definitive result. The previous tests were -- similar tests were also 24 hours but much less definitive and you would have to do a follow-on test if you saw certain results, so that would make it take another 24 hours. Now after 24 hours you have the definitive answer.

Jonathan Groberg - Merrill Lynch - Analyst

Okay. Great. Thanks. Congratulations.

Marijn Dekkers - Thermo Fisher Scientific, Inc. - President, CEO

Thank you, Jonathan.

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Operator

Thank you. Our next question is from Derik De Bruin with UBS. Go ahead, please.

Derik De Bruin - UBS - Analyst

Good morning.

Peter Wilver - Thermo Fisher Scientific, Inc. - CFO

Good morning, Derik.

Derik De Bruin - UBS - Analyst

I have been getting a few questions about the product testing and inspection market and some of the growth opportunities there. Specifically that, these markets potentially more cyclical than some people expect give than the economy is under pressure. And also the fact that, you have the Beijing Olympics and there is some concern that China might pull back in terms of spending after that happening. Could you just talk about how you see the product inspection and safety markets -- food safety markets and stuff like that just expanding and a little bit in terms of what you see in the past through economic cycles in those markets.

Marijn Dekkers - Thermo Fisher Scientific, Inc. - President, CEO

Yes, Derik, that is a very difficult question, actually. Good question, but very difficult one. Because I do not think that in the previous economic downturn cycle in 2001, 2002, we were importing as much food and related items from China as a western world as we are today. So, the way I view it is, it's very hard to predict with absolute certainty how strong these markets will be by quarter. But I do believe that the world has gotten increasingly nervous about what is going on in terms of food quality, infections like we were just talking about, lead in paint, which was another big to-do a few quarters ago, and that the world is much more alert of what is safe what is healthy, what is clean, than even eight years ago. And I think it has a lot to do with the fact that the world has become a lot more global, there's much more easy to transfer of products and goods across the world, including things that we put in our bodies.

So, with that, I think the need for compliance with western quality control systems for anybody who wants to import into the western country is going be more and more relevant. And as China and India are developing their economies, they will have to beef up their capability to meet these western standards. So I don't think that is going go away in an economic cycle, necessarily, if they want to continue to export.

Derik De Bruin - UBS - Analyst

Okay. That is great. And I want to stick on safety and go to the catalog safety business. This dog has not hunted since Fisher had it back in 2005. And I'm just wondering when are you going to pull the plug? What is your expectations for that business?

Marijn Dekkers - Thermo Fisher Scientific, Inc. - President, CEO

We don't -- we won't pull the plug on it. Let me just explain what the situation is. We basically have a number of Fisher catalogs. And you could say we have a research catalog, we have a health care catalog and a safety catalog, and the safety catalog is by far the smallest one, it's about \$350 million of revenue. But it is completely integrated with the other catalogs, so it is being

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served out of the same warehouses and the same back office, the same basic infrastructure that supports it. So it is very -- basically impossible to break it off, okay, if we would want to.

What has happened is that the base business of the safety catalog is doing fine. It basically mostly serves laboratories or some industrial environment with safety gear and it is doing fine just like the overall research catalog is doing well. The part that isn't doing well is anything that has to do with preparedness for terrorist attacks, or a fire, or anything homeland security related, army, things like that, because the government is really not spending a lot of money right now here in the U.S. on domestic preparedness and all the money is spent obviously overseas. We have a huge ramp up in spending in that area in the 2002, 2003, 2004 time frame. Very good times. And now it is coming down. And it is coming down very, very significantly. So it is a small part of the business, but it is coming down a lot. But my point is, at some point it will level off to maybe next to nothing, but it will level off. And that is not far away, by the way, that time frame. And it is all supported through the same back office structure anyway.

So there is no ability for us to carve it out or do something creative with it, divest it. It is what it is. And on the other hand, I hate to say this, we are only one terrorist attack away from the business booming again. Okay? So it is serving a need, the business is there, we are capable of serving the customers when they need it. They just don't need the products right now, and it makes for a soft year-over-year comparison. Because as Pete said it costs us 1% organic growth for the company. But it is what it is. And over time, over -- as some quarters go by here in 2008, we will see less decline because it just cannot decline much further, quite honestly.

Derik De Bruin - UBS - Analyst

Thanks for the color, but unfortunately it does not make me feel any safer.

Marijn Dekkers - Thermo Fisher Scientific, Inc. - President, CEO

No, no. I can see that. And know that is not the context of my comments.

Peter Wilver - Thermo Fisher Scientific, Inc. - CFO

The only other point, Derik, is that dog actually did hunt in Q1 last year. That business actually showed growth last year, so it was a really tough comparison. The comparison, as Marijn said, get easier as we get through the year.

Derik De Bruin - UBS - Analyst

Thanks.

Peter Wilver - Thermo Fisher Scientific, Inc. - CFO

Okay.

Operator

Thank you. Our next question is from Tony Butler with Lehman Brothers. Go ahead, please.

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Tony Butler - *Lehman Brothers - Analyst*

Thank you very much. A couple questions, Pete. You made a reference to some of the smaller industrial -- end markets having slowed and I would like for you to explore exactly what those may be from a Thermo perspective. And Marijn, last quarter you made reference to having pretty good visibility on at least six months out, maybe a little longer on your overall business. And now that we are a quarter in, can you make more qualitative comments as it relates to your vision? Thanks again.

Marijn Dekkers - *Thermo Fisher Scientific, Inc. - President, CEO*

Tony, the second question is also related to the industrial markets, I assume, the six months out?

Tony Butler - *Lehman Brothers - Analyst*

That is correct.

Marijn Dekkers - *Thermo Fisher Scientific, Inc. - President, CEO*

Yes. I will take both questions because they are connected. We have seen, as I said in my prepared comments, particularly towards the end of the quarter some softness in some markets and they are relatively small markets for us, but semiconductor, basically anything that has to do with semiconductor equipment and semiconductor production is very weak and also oil and gas was also weak as an end market in terms of demand toward the end of the quarter. Again small market for us. But that is what we did see. The other markets have continued the way they are, basically still stimulated by high commodity pricing. And that let's people to want to continue to invest in expansion of their capacity. And the comments I have made in the past about our visibility in that it is actually not that we have specific visibility, but we do have a relatively significant backlog typically in process-oriented applications.

So if people are going to be building a new mine or a new steel plant, and commodity prices drop in the middle of that project, they are not going to just let it sit there half finished. They will finish it up. So we then have an opportunity, even though commodity prices would have come down significantly to deliver those orders that are in backlog. And that is why there is not an immediate effect from processed instruments typically on to our revenue in a specific quarter. Does that make sense?

Tony Butler - *Lehman Brothers - Analyst*

It does, Marijn. Thank you very much.

Peter Wilver - *Thermo Fisher Scientific, Inc. - CFO*

Thank you, Tony.

Operator

Thank you. Our next question is from Ross Muken with Deutsche Bank. Go ahead, please.

Ross Muken - *Deutsche Bank - Analyst*

Hi. Good morning, gentlemen.

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Marijn Dekkers - *Thermo Fisher Scientific, Inc. - President, CEO*

Good morning, Ross.

Ross Muken - *Deutsche Bank - Analyst*

I think the commentary on new product introductions is certainly encouraging. You guys have done a phenomenal job of this over the last few years. Are we getting to a point where it will be harder and harder to sort of move that metric that you guys track in terms of new product introductions comprising a certain percentage of current sales? Are we hitting diminishing returns there? Is there still a lot of leg way to go? And then is that part of the reason gross margins exceeded and came in at such a high level for the quarter? Because typically you obviously get good pricing on your new product introductions.

Marijn Dekkers - *Thermo Fisher Scientific, Inc. - President, CEO*

There is no end to our capability to come out with better new products. And there is no saturation there. You have to work hard on it, but it will be the same thing as saying the first Apple computer was the best it could ever be. There real will is no end to innovation. And if you think about what our customers are trying to do in the laboratory, the complexity in terms of life science and how many questions are still unanswered in life sciences and health care, then the complexity of the precisely measuring things like the super bug and lead in toys that are already on the store of -- in the store of toy manufacturers. I really do not see an end to the need for better new products and I don't see an end to our capability to deliver them. So that process will be ongoing. And there is a trend here that I think our customers want the products to be easier to use. It is harder and harder for them to hire first class scientists or chemist or biologists to do the work in the laboratory. That has become more complicated. So there is a lot of focus not just on how good of a quality experiment can you do, but how easy is it to do the experiment. And that leads to a whole different set of innovations that are also fueling our future growth. And you are right, typically when we come out with a new product, we do sell it at higher margins than older products and it helps us drive our margin improvement. It has done that over the years and I believe it will continue to do so.

Ross Muken - *Deutsche Bank - Analyst*

And, as we look at sort of the big pharma group as a customer, could you compare and contrast what you saw during the quarter in terms of their spending habits relative to sort of analytical tools versus lab products? Was there any sort of difference on buying pattern on the higher end of instrumentation or consumables? And was there the demand pattern relatively stable throughout the quarter? Or did we have a weak start and maybe a stronger close to the quarter?

Marijn Dekkers - *Thermo Fisher Scientific, Inc. - President, CEO*

Well, this is a complicated question, but I -- essentially we did well with pharma in the first quarter as a company, and it has a lot to do with our specific focus on the corporate account level of tailoring to the needs of large pharma, in particular, because the strategy we have talked about in the past, these large customers are buying inefficiently and we are trying to help them buy more efficiently and that leads to some share gains for us. So we did well with large pharma. At the same time I think some of our peers have said that in Europe in particular, it was a slow quarter for higher cost items in large pharma. And we saw the same thing. So we did see the same behavior in larger European pharma companies of delaying -- hopefully delaying orders.

Ross Muken - *Deutsche Bank - Analyst*

And, I just want to follow up one quick thing to that. So when you announced the Fisher deal, one of the longer term stories on the revenue synergy line was obviously sort of the ability to continue to drive more share within the big pharma customer

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base and really focusing on the top 20 accounts and being able to capture a bigger piece of that pie. Given your commentary around what you saw in first quarter do you feel one year into the deal that you are finally starting to get some momentum relative to that effort? And -- or maybe not sizable amounts of revenue moving the needle really, but to the point where you feel like that initial thought is finally starting to manifest itself in your P&L?

Marijn Dekkers - *Thermo Fisher Scientific, Inc. - President, CEO*

Yes, I mean it is. And it is different for every different pharma. You cannot generalize the pick up on that is different by account. Some pharma customers are very, very interested in doing this and are really working with us to drive the level of standardization of laboratory supplies that they have not had before. And others are not maybe that interested at this particular point in time. Not because they are not interested in the efficiency that could come from it or the savings, but it's just not yet a priority for them. But as we have talked about before, Ross, we are a big believer that even big pharma at some point will have to become an efficient buyer of all the goods and services that they buy, and will be well positioned to serve them in that context.

Ross Muken - *Deutsche Bank - Analyst*

And just actually one sort of quick other follow up. Relative to your commentary around sort of less selling days and around the movement of Easter into the March quarter, is that also, Pete, part of the reason that Europe was probably a little weaker than expected coming in relatively flat for the quarter despite having also a tough comp from last year?

Peter Wilver - *Thermo Fisher Scientific, Inc. - CFO*

Yes. Certainly we do not have a way to empirically prove that, but certainly you would expect the Easter holiday to have a bigger impact in Europe, just because they tend to take more of an Easter week rather than one holiday..

Ross Muken - *Deutsche Bank - Analyst*

Perfect. Thank you very much.

Marijn Dekkers - *Thermo Fisher Scientific, Inc. - President, CEO*

But they make it up some other time.

Ross Muken - *Deutsche Bank - Analyst*

Great.

Operator

Thank you. Our next question is from John Sullivan with Leerink Swann. Go ahead, please.

John Sullivan - *Leerink Swann - Analyst*

Hey, guys. Good morning. Can you hear me?

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Marijn Dekkers - *Thermo Fisher Scientific, Inc. - President, CEO*

Yes.

John Sullivan - *Leerink Swann - Analyst*

Great. Couple of quick ones. First of all, can you talk about opportunity that you feel like is still available to you at the facility's level, both from the Fisher deal and in your own business? Do you feel like you have significant consolidation opportunities still available to you?

Marijn Dekkers - *Thermo Fisher Scientific, Inc. - President, CEO*

Yes, John. Good morning. Yes, we do. That has been part of our cost synergy plan for the first three years after the merger. I think we talked about eight factories that we felt that we could close strictly as a result of the merger between Thermo and Fisher. And that is in the works. The announcements have been made in most cases, and this will be happening over the next year and a half.

John Sullivan - *Leerink Swann - Analyst*

Thanks very much. And then could you talk about the hospital business just a little bit? And specifically, I am just wondering, it is around 20% of your revenues. As a distribution channel, do you feel like you have more room to put more products through to the hospital clients and is that a priority for you?

Marijn Dekkers - *Thermo Fisher Scientific, Inc. - President, CEO*

I mean the 20% is roughly -- 10% of it is -- 10%, half of it is, our specialty diagnostics capability, which is all self-manufactured and diagnostic testing, anatomic biology to microbiology. I was talking about things like that. And the other half is the customer channel catalog that we have that services the health care market. That is the other half of the revenue. And if you ask about our abilities there to put more products through that catalog, certainly, we believe we have a very strong franchise there. And it has a very good reputation and we're having multiple discussions with suppliers to see if we can broaden the scope of what that catalog offers. So we do believe we have opportunity there.

John Sullivan - *Leerink Swann - Analyst*

And then just to kind of circle back to the first comment on the hospital business, obviously this MRSA test that was just approved, you already have full distribution capability for that test, right?

Marijn Dekkers - *Thermo Fisher Scientific, Inc. - President, CEO*

Yes.

John Sullivan - *Leerink Swann - Analyst*

Okay. Thank you very much.

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Marijn Dekkers - *Thermo Fisher Scientific, Inc. - President, CEO*

Okay. Thank you, John.

Operator

Thank you. Our next question is from Quintin Lai from Robert W. Baird. Go ahead, please.

Quintin Lai - *Robert W. Baird - Analyst*

Hi. Good morning.

Marijn Dekkers - *Thermo Fisher Scientific, Inc. - President, CEO*

Good morning.

Quintin Lai - *Robert W. Baird - Analyst*

As we -- to follow up on Ross' question but to focus on the consumables side, this earnings season we have seen decent numbers on the pure play consumables companies and they also mentioned price increase. Could you decouple softness in European large pharma with respect to overall consumables and price?

Marijn Dekkers - *Thermo Fisher Scientific, Inc. - President, CEO*

Let me think about this. The consumables business has a number of aspects to it. You have high end life sciences reagents and then you have the more routine consumables that are being used in laboratories. And I think your question must be related to high end life sciences reagents if you compare it with some of the peers, right?

Quintin Lai - *Robert W. Baird - Analyst*

Yes, that is right.

Marijn Dekkers - *Thermo Fisher Scientific, Inc. - President, CEO*

Yes. Yes. So, I think that business is doing quite well in general. But it depends very much -- it is very application dependent. For instance anything that has to do with cell research is doing very well. Cell science. Anything that has to do with RNAi is doing very well. Things that have to do with novel DNA sequencing, doing well. But there are also other applications that are not growing so fast and they tend to be the more mature applications. So it is hard to generalize because they're really --

It is almost like watching fashion on the consumables side in terms of growth. And you see, I think more than an instrument, relatively big swings over a number of years of -- where people are spending the money. And it has, I think, a lot to do with scientists who do not work in cell biology or don't work in RNAi for instance, deciding that is an area that want to get into and really become new customers in that field.

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Quintin Lai - Robert W. Baird - Analyst

Thank you for that. And then, Pete, with respect to cash flow guidance, forgive me. Did you provide an update on that? And could you give us a little more color on potential for a new authorization for share repurchase or future M&A?

Peter Wilver - Thermo Fisher Scientific, Inc. - CFO

I did not provide updated guidance on the free cash flow. Last quarter I had said something in the range of \$1.2 billion. We had good cash flow in Q1, but nothing that would indicate to me that we ought to change that number at this point. So I will stick with something in the range of \$1.2 billion for the year and we will assess it again at the end of Q2. In terms of share buy back we really do not talk about future plans on share buy back, authorizations. Obviously that is a board decision. But certainly with \$750 million of cash on the balance sheet, certainly we have a strong M&A pipeline, and our goal is always to use our cash and our balance sheet to create value for shareholders. So I don't think you will see that cash sitting around for a long time.

Quintin Lai - Robert W. Baird - Analyst

Thank you.

Operator

Thank you. (OPERATOR INSTRUCTIONS) Our next question is from Peter Lawson with Thomas Weisel. Go ahead, please.

Peter Lawson - Thomas Weisel - Analyst

Pete, what was the driver in gross margins in the quarter? I wonder if you could quantify, was it mostly pricing or volume or savings?

Peter Wilver - Thermo Fisher Scientific, Inc. - CFO

It is split about a third, a third, a third, between the pull through on incremental organic including price increases, integration synergies and then the net of sourcing savings offset by inflation and all of the productivity initiatives that we embark on with our PPI program.

Peter Lawson - Thomas Weisel - Analyst

And you feel all three chunks are sustainable for the year?

Peter Wilver - Thermo Fisher Scientific, Inc. - CFO

Certainly. Yes.

Peter Lawson - Thomas Weisel - Analyst

And then, Marijn, on the oil and gas weakness, is that continuing into the second quarter and is that mostly associated with high ASP weaknesses or is it across the board?

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Marijn Dekkers - *Thermo Fisher Scientific, Inc. - President, CEO*

I don't know. I honestly don't know. It is too early to tell to see whether or not that is systemic or not. A little bit of a surprise to me, quite honestly. I would not say that the oil and gas companies are really suffering right now. But maybe there is a level of saturation that they have reached in terms of their need for new instrumentation. Process instrument station. Particularly flow meters. So, it is too early to tell, Peter. Too early to tell.

Peter Lawson - *Thomas Weisel - Analyst*

So it was not just on high ASP equipment?

Marijn Dekkers - *Thermo Fisher Scientific, Inc. - President, CEO*

No. No. Actually to the contrary, it was on basic relatively routine instrumentation.

Peter Lawson - *Thomas Weisel - Analyst*

Okay. And then Peter, the amount of reclassification from the analytical business, how much was that, or what were the pro forma numbers?

Peter Wilver - *Thermo Fisher Scientific, Inc. - CFO*

It is about \$70 million that moved on an annual basis from analytical over to laboratory products and services. And those numbers are in our analyst package that's out on the website.

Peter Lawson - *Thomas Weisel - Analyst*

Okay. Thank you so much.

Marijn Dekkers - *Thermo Fisher Scientific, Inc. - President, CEO*

Thanks, Peter.

Peter Wilver - *Thermo Fisher Scientific, Inc. - CFO*

Thank you.

Operator

Thank you. Our next question is from Jon Wood with Bank of America Securities. Go ahead, please.

Jon Wood - *Bank of America Securities - Analyst*

Thanks. Marijn, has the acquisition pipeline changed at all thus far in '08? Are you seeing more properties available, and have valuation expectations changed at all?

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Marijn Dekkers - *Thermo Fisher Scientific, Inc. - President, CEO*

Maybe yes, so slightly more available, I would say. Valuation expectations have not really changed but for smaller private equity, much less in the mix as it used to be as a potential competitor for those properties. So valuation expectations may not have changed, but for smaller, private companies, the fact that there is not a lot of private equity interference any more may help prices to be more reasonable.

Jon Wood - *Bank of America Securities - Analyst*

Has the size of the opportunities changed at all?

Marijn Dekkers - *Thermo Fisher Scientific, Inc. - President, CEO*

No. I mean, most of them typically are between \$10 million and \$100 million to tuck-in acquisitions. And that is the majority of them. And then whether or not a bigger company becomes available is -- I don't know. That is so hard to predict. And the circumstances of that usually are unique company by company.

Jon Wood - *Bank of America Securities - Analyst*

Okay. Great. On the clinical lab side, if I'm not mistaken, you recently picked up the Quest contract. Is that piece of business material and has it started yet?

Marijn Dekkers - *Thermo Fisher Scientific, Inc. - President, CEO*

It is good business. It's material in the sense that any new business we pick up is material to us. But, no, it is a very good contract and it has already started. Yes.

Jon Wood - *Bank of America Securities - Analyst*

Okay. And then one last one on the stock comp. Is that still expected to increase by \$0.03 this year?

Peter Wilver - *Thermo Fisher Scientific, Inc. - CFO*

No. It's probably going to be more like \$0.01 for the full year. The Q1 was particularly low, you can't take Q1 and multiply it by four and get the full year. You will see a ramp up in Q2, three, and four. I think it is around \$0.09 for the year.

Jon Wood - *Bank of America Securities - Analyst*

Okay. Thanks a lot.

Marijn Dekkers - *Thermo Fisher Scientific, Inc. - President, CEO*

Thanks, Jon.

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Operator

Thank you. Our next question is from Tycho Peterson with JPMorgan. Go ahead, please.

Tycho Peterson - JPMorgan - Analyst

Good morning.

Marijn Dekkers - Thermo Fisher Scientific, Inc. - President, CEO

Good morning, Tycho.

Tycho Peterson - JPMorgan - Analyst

I appreciate the additional color you guys gave on the pharma spending trends. I guess given the headlines about pharma in general moving to reduce the global R&D footprint, and the fact that you guys typically have pretty good early indicators with the workstations business, are you seeing new lab space being built out or is most of the growth you're seeing coming from higher volumes at existing accounts?

Marijn Dekkers - Thermo Fisher Scientific, Inc. - President, CEO

No. I mean I think the overall laboratory builds far as we can tell because that is not that easy to track, but as far as we can tell, it is relatively stable compared to 2007. So there does not seem to be a big change there. I think, the piece that a lot of people forget is that -- or forget or not always think about is that CROs are doing very well. They are building out lab space because they are doing work that, before would happen at pharmaceutical companies. So there is a shift there of work and therefore a shift of tools that come with it. And actually, I said it before, that drives, in some cases to an accelerated replacement cycle our industry is benefiting from right now.

Tycho Peterson - JPMorgan - Analyst

Okay. In terms of some of the operating initiatives you have laid out in the past and particular things like PPI, can you give us a sense of where we are in the implementation of lower cost sourcing, some of these initiatives? They have obviously been nice drivers of margin expansion? Where are we in the life cycles implementation? And then also just in terms of divesting and trimming the portfolio, is that still a focus?

Marijn Dekkers - Thermo Fisher Scientific, Inc. - President, CEO

Well, on PPI and the other operational discipline areas like sourcing -- local sourcing, rationalization of factory, that really stems from eight years of experience now on the Thermo side of driving that operational discipline. And we have sort of gotten reinvigorated in terms of opportunities with the Fisher merger because, not all of the Fisher businesses have that level of operating discipline. So we are implementing those principles, particularly PPI into some of the legacy Fisher businesses. And that gives us a lot of opportunity to improve our processes for the next three to five years, I would say. Because it is not a turn of a switch. Just an ongoing continuous improvement plan. From a divesting point of view, we are very happy with our portfolio. We would like to strengthen it. We don't spend a lot of time thinking about divestitures quite honestly. Maybe some small ones here or there, but it would be very minor.

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Tycho Peterson - JPMorgan - Analyst

Okay. And then finally you had talked a while ago about the initiatives and disposable bio manufacturing. Can you give us a sense in where we are in that business and where you see that opportunity playing out over the next year or two?

Marijn Dekkers - Thermo Fisher Scientific, Inc. - President, CEO

The opportunity is terrific, we believe, because it is going to grow more and more to the bioprocess area to disposable manufacturing around these clumsy steel tanks that take forever to clean up. We have a very good position in terms of our biodisposable reactors, and the bags, the containers, things like. We are actually expanding our capacity in Logan, Utah, to serve that demand. So, that is going well. I do believe that overall the bioprocessing industry is in a little bit of a slow down, which has more to do with some individual issues with certain drugs that -- at some of the biotech companies, but the long term trends for that, I believe, is very positive.

Tycho Peterson - JPMorgan - Analyst

Do you see a lot of opportunity for pull through from that business if you get specked into that business early on?

Marijn Dekkers - Thermo Fisher Scientific, Inc. - President, CEO

Yes, because it is the serum or the media, the containers, the bags -- these people are not looking for an integrated solution when it is available.

Tycho Peterson - JPMorgan - Analyst

Okay.

Marijn Dekkers - Thermo Fisher Scientific, Inc. - President, CEO

But it is not a laboratory, right? It is -- very often you have a small pilot facility in the lab, but we are not just servicing the small part -- there are different scales of pilot facility, very small and then medium. Then you can get into production. And it shows some of the pilot plans are relatively separate from the laboratory environment. Of course the specifications are done in the laboratory environment so it is good to have that relationship, but then it moves away from the lab into really an independent pilot facility and then real production later.

Tycho Peterson - JPMorgan - Analyst

But then I guess in terms of your detection capabilities, is there obvious derivative place here for process monitoring and things like that?

Marijn Dekkers - Thermo Fisher Scientific, Inc. - President, CEO

Yes. There are. Yes.

Tycho Peterson - JPMorgan - Analyst

Okay. Thank you very much.

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Kenneth Apicerno - *Thermo Fisher Scientific, Inc. - VP, IR*

I think we are out of time for questions so we will just wrap it up here. Marijn, do you have comments?

Marijn Dekkers - *Thermo Fisher Scientific, Inc. - President, CEO*

Yes. Closing comments here. So thank you again for being on the call, and thank you for your support of Thermo Fisher Scientific. We believe we had a very strong performance this quarter again, and are well positioned for the balance of the year. And so thanks. And we look forward to update you again next quarter.

Operator

Ladies and gentlemen, thank you for your participation. That concludes the conference. You may disconnect, and have a wonderful day.

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