

HENRY SCHEIN INC  
Form 10-Q  
November 05, 2008  
UNITED STATES

**SECURITIES AND EXCHANGE COMMISSION**

**Washington, D.C. 20549**

**FORM 10-Q**

(Mark One)

**QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

**For the quarterly period ended September 27, 2008**

**or**

**TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

**For the transition period from \_\_\_\_\_ to \_\_\_\_\_**

**Commission File Number:** 0-27078

**HENRY SCHEIN, INC.**

(Exact name of registrant as specified in its charter)

**Delaware**

**11-3136595**

(State or other jurisdiction of

(I.R.S. Employer Identification No.)

incorporation or organization)

**135 Duryea Road**

**Melville, New York**

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(Address of principal executive offices)

11747

(Zip Code)

(631) 843-5500

(Registrant's telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days:

Yes

No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer

Accelerated filer

Non-accelerated filer  (Do not check if a smaller reporting company)

Smaller reporting company

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes

No

As of October 30, 2008, there were 89,353,847 shares of the registrant's common stock outstanding.

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**HENRY SCHEIN, INC.**

**INDEX**

**Page**

**PART I. FINANCIAL INFORMATION**

|                |   |    |
|----------------|---|----|
| <b>ITEM 1.</b> | <b>Consolidated Financial Statements:</b>   |    |
|                | Balance Sheets as of September 27, 2008 and December 29, 2007   | 3  |
|                | Statements of Income for the three and nine months ended<br>September 27, 2008 and September 29, 2007 | 4  |
|                | Statements of Cash Flows for the nine months ended<br>September 27, 2008 and September 29, 2007       | 5  |
|                | Notes to Consolidated Financial Statements  | 6  |
| <b>ITEM 2.</b> | <b>Management's Discussion and Analysis of<br/>Financial Condition and Results of Operations</b>      | 16 |
| <b>ITEM 3.</b> | <b>Quantitative and Qualitative Disclosures About Market Risk</b>                                     | 32 |
| <b>ITEM 4.</b> | <b>Controls and Procedures</b>  | 32 |

**PART II. OTHER INFORMATION**

|                |  |    |
|----------------|--|----|
| <b>ITEM 1.</b> | <b>Legal Proceedings</b>   | 33 |
| <b>ITEM 2.</b> | <b>Unregistered Sales of Equity Securities and Use of Proceeds</b> | 33 |
| <b>ITEM 6.</b> | <b>Exhibits</b>  | 34 |
|                | <b>Signature</b>   | 34 |



**PART I. FINANCIAL INFORMATION****ITEM 1. CONSOLIDATED FINANCIAL STATEMENTS****HENRY SCHEIN, INC.****CONSOLIDATED BALANCE SHEETS**

(in thousands, except share and per share data)

|  | <b>September 27,<br/>2008<br/>(unaudited)</b> | <b>December 29,<br/>2007</b> |
|--|---|------------------------------|
| <b>ASSETS</b>  |   |                              |
| Current assets:  |   |                              |
| Cash and cash equivalents  | \$ 288,364                                    | \$ 247,590                   |
| Available-for-sale securities  | -   | 997                          |
| Accounts receivable, net of reserves of \$40,750 and \$41,315                      | 767,304                                       | 708,307                      |
| Inventories, net   | 731,514                                       | 666,786                      |
| Deferred income taxes  | 32,340  | 32,827                       |
| Prepaid expenses and other   | 194,740                                       | 192,292                      |
| Total current assets   | 2,014,262                                     | 1,848,799                    |
| Property and equipment, net  | 247,345                                       | 247,671                      |
| Goodwill   | 917,258                                       | 917,194                      |
| Other intangibles, net   | 174,772                                       | 192,420                      |
| Investments and other  | 152,937                                       | 107,900                      |
| Total assets   | \$ 3,506,574                                  | \$ 3,313,984                 |
| <b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>  |   |                              |
| Current liabilities:   |   |                              |
| Accounts payable   | \$ 511,655                                    | \$ 474,009                   |
| Bank credit lines  | 6,226   | 8,977                        |
| Current maturities of long-term debt   | 153,802                                       | 24,319                       |
| Accrued expenses:  |   |                              |
| Payroll and related  | 132,000                                       | 136,291                      |
| Taxes  | 81,577  | 73,278                       |
| Other  | 215,438                                       | 223,765                      |
| Total current liabilities  | 1,100,698                                     | 940,639                      |
| Long-term debt   | 268,990                                       | 423,274                      |
| Deferred income taxes  | 86,351  | 80,260                       |
| Other liabilities  | 52,303  | 53,906                       |
| Minority interest  | 50,710  | 35,923                       |
| Commitments and contingencies  |   |                              |
| Stockholders' equity:  |   |                              |
| Preferred stock, \$.01 par value, 1,000,000 shares authorized,<br>none outstanding | -   | -                            |

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|  |              |              |
|--|--------------|--------------|
| Common stock, \$.01 par value, 240,000,000 shares authorized,<br>89,909,757 outstanding on September 27, 2008 and<br>89,603,660 outstanding on December 29, 2007 | 899          | 896          |
| Additional paid-in capital   | 712,670      | 673,763      |
| Retained earnings  | 1,156,950    | 1,005,055    |
| Accumulated other comprehensive income   | 77,003       | 100,268      |
| Total stockholders' equity   | 1,947,522    | 1,779,982    |
| Total liabilities and stockholders' equity   | \$ 3,506,574 | \$ 3,313,984 |

See accompanying notes.

## HENRY SCHEIN, INC.

**CONSOLIDATED STATEMENTS OF INCOME**  
(in thousands, except per share data)  
(unaudited)

|   | Three Months Ended    |                       | Nine Months Ended     |                       |
|---|-----------------------|-----------------------|-----------------------|-----------------------|
|   | September 27,<br>2008 | September 29,<br>2007 | September 27,<br>2008 | September 29,<br>2007 |
| Net sales   | \$ 1,650,771          | \$ 1,505,575          | \$ 4,821,367          | \$ 4,202,720          |
| Cost of sales   | 1,172,190             | 1,076,245             | 3,403,138             | 2,968,567             |
| Gross profit  | 478,581               | 429,330               | 1,418,229             | 1,234,153             |
| Operating expenses:   |                       |                       |                       |                       |
| Selling, general and administrative   | 363,303               | 332,630               | 1,104,367             | 972,880               |
| Operating income  | 115,278               | 96,700                | 313,862               | 261,273               |
| Other income (expense):   |                       |                       |                       |                       |
| Interest income   | 4,260                 | 4,378                 | 12,217                | 12,766                |
| Interest expense  | (7,933)               | (6,216)               | (23,040)              | (18,381)              |
| Other, net (see Note 7)   | (4,791)               | 3,917                 | (5,465)               | 4,342                 |
| Income from continuing operations before taxes, minority interest and equity in earnings (losses) of affiliates   | 106,814               | 98,779                | 297,574               | 260,000               |
| Income taxes  | (34,713)              | (33,682)              | (99,703)              | (89,788)              |
| Minority interest in net income of subsidiaries   | (5,278)               | (4,247)               | (15,659)              | (11,004)              |
| Equity in earnings (losses) of affiliates   | 1,602                 | (182)                 | 4,020                 | (687)                 |
| Income from continuing operations   | 68,425                | 60,668                | 186,232               | 158,521               |
| Discontinued operations:  |                       |                       |                       |                       |
| Loss from operations of discontinued components (including write-down of long-lived assets of \$32.7 million and a loss on sale of discontinued operation of \$1.5 million) | -                     | (1,742)               | -                     | (34,302)              |
| Income tax benefit  | -                     | 647                   | -                     | 12,685                |
| Loss from discontinued operations   | -                     | (1,095)               | -                     | (21,617)              |
| Net income  | \$ 68,425             | \$ 59,573             | \$ 186,232            | \$ 136,904            |
| Earnings from continuing operations per share:  |                       |                       |                       |                       |
| Basic   | \$ 0.77               | \$ 0.68               | \$ 2.09               | \$ 1.79               |
| Diluted   | \$ 0.75               | \$ 0.66               | \$ 2.03               | \$ 1.75               |
| Loss from discontinued operations per share:  |                       |                       |                       |                       |
| Basic   | \$ 0.00               | \$ (0.01)             | \$ 0.00               | \$ (0.24)             |
| Diluted   | \$ 0.00               | \$ (0.01)             | \$ 0.00               | \$ (0.24)             |
| Earnings per share:   |                       |                       |                       |                       |
| Basic   | \$ 0.77               | \$ 0.67               | \$ 2.09               | \$ 1.55               |

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|   |    |        |    |        |    |        |    |        |
|---|----|--------|----|--------|----|--------|----|--------|
| Diluted                                     | \$ | 0.75   | \$ | 0.65   | \$ | 2.03   | \$ | 1.51   |
| Weighted-average common shares outstanding: |    |        |    |        |    |        |    |        |
| Basic                                       |    | 88,930 |    | 88,790 |    | 89,216 |    | 88,383 |
| Diluted                                     |    | 91,376 |    | 91,399 |    | 91,908 |    | 90,779 |

See accompanying notes.

4



## HENRY SCHEIN, INC.

## CONSOLIDATED STATEMENTS OF CASH FLOWS

(in thousands)

(unaudited)

|   | Nine Months Ended     |                       |
|---|-----------------------|-----------------------|
|   | September 27,<br>2008 | September 29,<br>2007 |
| <b>Cash flows from operating activities:</b>                                      |                       |                       |
| Net income  | \$ 186,232            | \$ 136,904            |
| Adjustments to reconcile net income to net cash provided by operating activities: |                       |                       |
| Loss on sales of discontinued operation, net of tax                               | -                     | 929                   |
| Depreciation and amortization   | 59,183                | 53,021                |
| Stock-based compensation expense  | 23,060                | 16,720                |
| Impairment from write-down of long-lived assets of discontinued operations        | -                     | 32,667                |
| Provision for losses on trade and other accounts receivable                       | 3,711                 | 1,062                 |
| Benefit from deferred income taxes  | (1,291)               | (16,730)              |
| Stock issued to 401(k) plan   | 4,662                 | 4,104                 |
| Undistributed (earnings) losses of affiliates                                     | (4,020)               | 687                   |
| Minority interest in net income of subsidiaries                                   | 15,659                | 11,004                |
| Other   | (2,132)               | (2,870)               |
| Changes in operating assets and liabilities, net of acquisitions:                 |                       |                       |
| Accounts receivable   | (66,751)              | (82,521)              |
| Inventories   | (68,182)              | (31,941)              |
| Other current assets  | (3,494)               | (9,841)               |
| Accounts payable and accrued expenses   | 41,927                | 36,730                |
| Net cash provided by operating activities   | 188,564               | 149,925               |
| <b>Cash flows from investing activities:</b>                                      |                       |                       |
| Purchases of fixed assets   | (38,119)              | (33,023)              |
| Payments for equity investment and business acquisitions, net of cash acquired    | (25,930)              | (124,298)             |
| Cash received from business divestitures  | -                     | 5,061                 |
| Purchases of available-for-sale securities  | (35,925)              | (115,066)             |
| Proceeds from sales of available-for-sale securities                              | 1,572                 | 135,315               |
| Net proceeds from (payments for) foreign exchange forward contract settlements    | 9,090                 | (16,980)              |
| Other   | 3,707                 | (11,037)              |
| Net cash used in investing activities   | (85,605)              | (160,028)             |
| <b>Cash flows from financing activities:</b>                                      |                       |                       |
| Proceeds from issuance of long-term debt  | -                     | 483                   |
| Repayments of bank borrowings   | (5,786)               | (4,554)               |
| Principal payments for long-term debt   | (30,139)              | (42,529)              |
| Proceeds from issuance of stock upon exercise of stock options                    | 25,041                | 32,719                |
| Payments for repurchases of common stock  | (54,945)              | (30,689)              |
| Excess tax benefits related to stock-based compensation                           | 10,635                | 11,597                |
| Other   | (1,856)               | (1,879)               |
| Net cash used in financing activities   | (57,050)              | (34,852)              |

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|  |            |            |
|--|------------|------------|
| Net change in cash and cash equivalents                      | 45,909     | (44,955)   |
| Effect of exchange rate changes on cash and cash equivalents | (5,135)    | 3,766      |
| Cash and cash equivalents, beginning of period               | 247,590    | 248,647    |
| Cash and cash equivalents, end of period                     | \$ 288,364 | \$ 207,458 |

See accompanying notes.

5

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**HENRY SCHEIN, INC.**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**(in thousands, except share and per share data)**

**(unaudited)**

**Note 1. Basis of Presentation**

Our consolidated financial statements include our accounts, as well as those of our wholly-owned and majority-owned subsidiaries. Certain prior period amounts have been reclassified to conform to the current period presentation.

Our accompanying unaudited consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States ("U.S. GAAP") for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnote disclosures required by U.S. GAAP for complete financial statements. The December 29, 2007 consolidated balance sheet information was derived from audited consolidated financial statements as of that date.

The consolidated financial statements reflect all adjustments considered necessary for a fair presentation of the consolidated results of operations and financial position for the interim periods presented. All such adjustments are of a normal recurring nature. These unaudited interim consolidated financial statements should be read in conjunction with the audited consolidated financial statements and notes to the consolidated financial statements contained in our Annual Report on Form 10-K for the year ended December 29, 2007.

The preparation of financial statements in conformity with U.S. GAAP requires us to make estimates and assumptions that affect the reported amounts of assets and liabilities, and disclosure of contingent assets and liabilities, at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. The results of operations for the nine months ended September 27, 2008 are not necessarily indicative of the results to be expected for any other interim period or for the year ending December 27, 2008.

**Note 2. Segment Data**

We conduct our business through two reportable segments: healthcare distribution and technology. These segments offer different products and services to the same customer base. The healthcare distribution reportable segment aggregates our dental, medical (including animal health) and international operating segments. This segment consists of consumable products, small equipment, laboratory products, large dental and medical equipment, equipment repair services, branded and generic pharmaceuticals, vaccines, surgical products, diagnostic tests, infection-control products and vitamins.

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Our dental group serves office-based dental practitioners, schools and other institutions in the combined United States and Canadian dental market. Our medical group serves office-based medical practitioners, surgical centers, other alternate-care settings, animal health clinics and other institutions throughout the United States. Our international group serves 18 countries outside of North America.

Our technology group provides software, technology and other value-added services to healthcare practitioners, primarily in the United States, Canada, the United Kingdom, Australia and New Zealand. Our value-added practice solutions include practice-management software systems for dental and medical practitioners and animal health clinics. Our technology group offerings also include financial services, e-services and continuing education services for practitioners.

**HENRY SCHEIN, INC.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

(in thousands, except share and per share data)

(unaudited)

**Note 2. Segment Data (Continued)**

The following tables present information about our reportable segments:

|                               | <b>Three Months Ended</b>     |                               | <b>Nine Months Ended</b>      |                               |
|-------------------------------|-------------------------------|-------------------------------|-------------------------------|-------------------------------|
|                               | <b>September 27,<br/>2008</b> | <b>September 29,<br/>2007</b> | <b>September 27,<br/>2008</b> | <b>September 29,<br/>2007</b> |
| <b>Net Sales:</b>             |                               |                               |                               |                               |
| Healthcare distribution (1):  |                               |                               |                               |                               |
| Dental (2)                    | \$ 644,871                    | \$ 616,972                    | \$ 1,916,193                  | \$ 1,780,790                  |
| Medical (3)                   | 426,853                       | 444,990                       | 1,091,230                     | 1,152,057                     |
| International (4)             | 538,033                       | 411,772                       | 1,693,017                     | 1,177,742                     |
| Total healthcare distribution | 1,609,757                     | 1,473,734                     | 4,700,440                     | 4,110,589                     |
| Technology (5)                | 41,014                        | 31,841                        | 120,927                       | 92,131                        |
| Total                         | \$ 1,650,771                  | \$ 1,505,575                  | \$ 4,821,367                  | \$ 4,202,720                  |

- (1) Consists of consumable products, small equipment, laboratory products, large dental and medical equipment, equipment repair services, branded and generic pharmaceuticals, vaccines, surgical products, diagnostic tests, infection-control products and vitamins.
- (2) Consists of products sold in the United States and Canada.
- (3) Consists of products sold in the United States' medical and animal health markets.
- (4) Consists of products sold in the dental, medical and animal health markets, primarily in Europe.
- (5) Consists of practice-management software and other value-added products and services, which are distributed primarily to healthcare providers in the United States, Canada, the United Kingdom, Australia and New Zealand in 2008 and the United States and Canada in 2007.

|                          | <b>Three Months Ended</b>         |                               | <b>Nine Months Ended</b>      |                               |
|--------------------------|-----------------------------------|-------------------------------|-------------------------------|-------------------------------|
|                          | <b>September<br/>27,<br/>2008</b> | <b>September 29,<br/>2007</b> | <b>September 27,<br/>2008</b> | <b>September 29,<br/>2007</b> |
| <b>Operating Income:</b> |                                   |                               |                               |                               |
| Healthcare distribution  | \$ 100,751                        | \$ 85,372                     | \$ 271,939                    | \$ 226,984                    |

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|            |            |           |            |            |
|------------|------------|-----------|------------|------------|
| Technology | 14,527     | 11,328    | 41,923     | 34,289     |
| Total      | \$ 115,278 | \$ 96,700 | \$ 313,862 | \$ 261,273 |

7

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**HENRY SCHEIN, INC.**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**(in thousands, except share and per share data)**

**(unaudited)**

**Note 3. Stock-Based Compensation**

Our accompanying unaudited consolidated statements of income reflect share-based pretax compensation expense, recorded in accordance with the provisions of FAS No. 123(R), "Share-Based Payment," of \$6.9 million (\$4.6 million after-tax) and \$23.1 million (\$15.3 million after-tax) for the three and nine months ended September 27, 2008, respectively, and \$6.0 million (\$4.0 million after-tax) and \$16.7 million (\$11.0 million after-tax) for the three and nine months ended September 29, 2007, respectively.

Stock-based compensation represents the cost related to stock-based awards granted to employees and non-employee directors. We measure stock-based compensation at the grant date, based on the estimated fair value of the award, and recognize the cost as compensation expense on a straight-line basis (net of estimated forfeitures) over the requisite service period. Our stock-based compensation expense is reflected in selling, general and administrative expenses in our consolidated statements of income.

Stock-based awards are provided to certain employees and non-employee directors under the terms of our 1994 Stock Incentive Plan, as amended, and our 1996 Non-Employee Director Stock Incentive Plan, as amended (together, the "Plans"). The Plans are administered by the Compensation Committee of the Board of Directors. Awards under the Plans principally include a combination of at-the-money stock options and restricted stock (including restricted stock units).

Grants of restricted stock are common stock awards granted to recipients with specified vesting provisions. We issue restricted stock that vests based on the recipient's continued service over time (four-year cliff vesting) and restricted stock that vests based on our achieving specified performance measurements (three-year cliff vesting).

With respect to time-based restricted stock, we estimate the fair value on the date of grant based on our closing stock price. With respect to performance-based restricted stock, the number of shares that ultimately vest and are received by the recipient is based upon our earnings per share performance as measured against specified targets over a three-year period as determined by the Compensation Committee of the Board of Directors. Though there is no guarantee that performance targets will be achieved, we estimate the fair value of performance-based restricted stock, based on our closing stock price.

The Plans provide for adjustments to the performance-based restricted stock targets for significant events such as acquisitions, divestitures, new business ventures and share repurchases. Over the performance period, the number of shares of common stock that will ultimately vest and be issued is adjusted upward or downward based upon our estimation of achieving such performance targets. The ultimate number of shares

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delivered to recipients and the related compensation cost recognized as an expense will be based on our actual performance metrics.

Restricted stock units, or RSUs, are unit awards that we grant to certain non-U.S. employees that entitle the recipient to shares of common stock upon vesting after four years for time-based awards or three years for performance-based awards. The fair value of RSUs is determined on the date of grant, based on our closing stock price.

Total unrecognized compensation cost related to non-vested awards as of September 27, 2008 was \$51.3 million, which is expected to be recognized over a weighted-average period of approximately two years. There were no significant capitalized stock-based compensation costs as of September 27, 2008.



**HENRY SCHEIN, INC.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

(in thousands, except share and per share data)

(unaudited)

**Note 3. Stock-Based Compensation (Continued)**

The following weighted-average assumptions were used in determining the fair values of stock options using the Black-Scholes valuation model:

|                                  | <b>2008</b> |   | <b>2007</b> |   |
|----------------------------------|-------------|---|-------------|---|
| Expected dividend yield          | 0           | % | 0           | % |
| Expected stock price volatility  | 20          | % | 20          | % |
| Risk-free interest rate          | 2.75        | % | 4.75        | % |
| Expected life of options (years) | 4.5         |   | 4.5         |   |

The following table summarizes stock option activity under the Plans during the nine months ended September 27, 2008:

|   | <b>Shares</b> | <b>Weighted<br/>Average<br/>Exercise<br/>Price</b> | <b>Weighted<br/>Average<br/>Remaining<br/>Contractual<br/>Life in Years</b> | <b>Aggregate<br/>Intrinsic Value</b> |
|---|---------------|--|---|--------------------------------------|
| Outstanding at<br>beginning of period   | 6,829,453     | \$34.67  |   |                                      |
| Granted                                 | 1,124,795     | 59.78  |   |                                      |
| Exercised                               | (961,874)     | 26.16  |   | \$ 30,825                            |
| Forfeited                               | (91,943)      | 42.57  |   |                                      |
| Outstanding at end of<br>period         | 6,900,431     | \$39.85  | 6.5   | \$ 108,729                           |
| Options exercisable at<br>end of period | 4,958,016     | \$34.35  | 5.7   | \$ 102,226                           |

The following table summarizes the status of our non-vested restricted stock/units for the nine months ended September 27, 2008:

|                                    | <b>Time-Based Restricted Stock/Units</b> |   |
|------------------------------------|--|---|
|                                    | <b>Shares/Units</b>                      | <b>Weighted Average Grant Date Fair Value</b> |
| Outstanding at beginning of period | 204,668                                  | \$ 9,769,979                                  |
| Granted                            | 120,503                                  | 7,106,103                                     |
| Vested                             | (22,518 )                                | (1,195,563 )                                  |
| Forfeited                          | (4,512 )                                 | (228,873 )                                    |
| Outstanding at end of period       | 298,141                                  | \$ 15,451,646                                 |

  

|                                    | <b>Performance-Based Restricted Stock/Units</b> |   |
|------------------------------------|---|---|
|                                    | <b>Shares/Units</b>                             | <b>Weighted Average Grant Date Fair Value</b> |
| Outstanding at beginning of period | 314,237   | \$ 15,417,508                                 |
| Granted                            | 258,923   | 14,366,054                                    |
| Forfeited                          | (4,512 )  | (228,873 )                                    |
| Outstanding at end of period       | 568,648   | \$ 29,554,689                                 |

**HENRY SCHEIN, INC.**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**(in thousands, except share and per share data)**

**(unaudited)**

**Note 4. Business Acquisitions and Other Transactions**

*Acquisitions*

We completed certain acquisitions during the nine months ended September 27, 2008. The operating results of our acquisitions are reflected in our financial statements from their respective acquisition dates. Such acquisitions were immaterial to our financial statements individually and in the aggregate.

*Loan and Investment Agreement*

As of September 27, 2008, we loaned D4D Technologies, LLC ("D4D") \$13.4 million and, if certain milestones are achieved, up to an additional \$16.4 million of loans may be made in increments by May 2010. We have also advanced certain amounts to fund D4D's operating needs without regard to the milestones. The loans, a portion of which can be converted to equity investments, are repayable on various dates through July 2013. We expect to account for any such equity investments under the equity method prospectively from the date of our first equity investment. We are in discussions with D4D to amend the terms of some or a portion of the D4D loans, including provisions relating to further amounts that may be payable and those relating to conversion of certain amounts to equity.

**Note 5. Earnings Per Share**

Basic earnings per share is computed by dividing net income by the weighted-average number of common shares outstanding for the period. Our diluted earnings per share is computed similarly to basic earnings per share, except that it reflects the effect of common shares issuable upon vesting of restricted stock and upon exercise of stock options using the treasury stock method in periods in which they have a dilutive effect.

For the three and nine months ended September 27, 2008 and September 29, 2007, diluted earnings per share includes the effect of common shares issuable upon conversion of our convertible debt. During the period, the debt was convertible at a premium as a result of the conditions of the debt. As a result, the amount in excess of the principal is presumed to be settled in common shares and is reflected in our calculation of diluted earnings per share.

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A reconciliation of shares used in calculating earnings per basic and diluted share follows:

|  | <b>Three Months Ended</b>     |                               | <b>Nine Months Ended</b>      |                               |
|--|-------------------------------|-------------------------------|-------------------------------|-------------------------------|
|  | <b>September 27,<br/>2008</b> | <b>September 29,<br/>2007</b> | <b>September 27,<br/>2008</b> | <b>September 29,<br/>2007</b> |
| Basic  | 88,929,672                    | 88,790,332                    | 89,216,159                    | 88,383,249                    |
| Effect of assumed exercise of stock options      | 714,934                       | 1,106,356                     | 953,346                       | 1,204,435                     |
| Effect of assumed vesting of restricted stock    | 864,738                       | 517,478                       | 806,669                       | 459,898                       |
| Effect of assumed conversion of convertible debt | 866,457                       | 984,790                       | 932,091                       | 731,384                       |
| Diluted  | 91,375,801                    | 91,398,956                    | 91,908,265                    | 90,778,966                    |

Weighted-average options to purchase 1,087,289 shares of common stock at exercise prices ranging from \$56.21 to \$62.05 per share that were outstanding during the three months ended September 27, 2008 were excluded from the computation of diluted earnings per share. Weighted-average options to purchase 833,041 shares of common stock at exercise prices ranging from \$56.69 to \$62.05 per share and 3,321

**HENRY SCHEIN, INC.**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**(in thousands, except share and per share data)**

**(unaudited)**

**Note 5. Earnings Per Share (Continued)**

shares of common stock at an exercise price of \$55.18 per share that were outstanding during the nine months ended September 27, 2008 and September 29, 2007, respectively, were excluded from the computation of diluted earnings per share. In each of these periods, such options' exercise prices exceeded the average market price of our common stock, thereby causing the effect of such options to be anti-dilutive.

**Note 6. Comprehensive Income**

Comprehensive income includes certain gains and losses that, under accounting principles generally accepted in the United States, are excluded from net income as such amounts are recorded directly as an adjustment to stockholders' equity. Our comprehensive income is primarily comprised of net income and foreign currency translation adjustments, but also includes unrealized gains on hedging activity, unrealized losses on available-for-sale securities and pension adjustments. Comprehensive income totaled \$13.6 million and \$163.0 million for the three and nine months ended September 27, 2008, respectively, and \$84.3 million and \$170.4 million for the three and nine months ended September 29, 2007, respectively.

**Note 7. Fair Value Measurements**

Effective December 30, 2007, we adopted SFAS No. 157, "Fair Value Measurements" ("FAS 157"), as it relates to financial assets and financial liabilities. FAS 157 establishes a framework for measuring fair value in generally accepted accounting principles and expands disclosures about fair value measurements. FAS 157 applies under other previously issued accounting pronouncements that require or permit fair value measurements but does not require any new fair value measurements. The adoption of FAS 157 did not have a material impact on our consolidated financial statements.

FAS 157 defines fair value as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. FAS 157 establishes a fair value hierarchy that distinguishes between (1) market participant assumptions developed based on market data obtained from independent sources (observable inputs) and (2) an entity's own assumptions about market participant assumptions developed based on the best information available in the circumstances (unobservable inputs).

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The fair value hierarchy consists of three broad levels, which gives the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (Level 1) and the lowest priority to unobservable inputs (Level 3). The three levels of the fair value hierarchy under FAS 157 are described as follows:

- Level 1 - Unadjusted quoted prices in active markets for identical assets or liabilities that are accessible at the measurement date.

- Level 2 - Inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly or indirectly. Level 2 inputs include quoted prices for similar assets or liabilities in active markets; quoted prices for identical or similar assets or liabilities in markets that are not active; inputs other than quoted prices that are observable for the asset or liability; and inputs that are derived principally from or corroborated by observable market data by correlation or other means.

- Level 3 - Inputs that are unobservable for the asset or liability.

**HENRY SCHEIN, INC.**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**(in thousands, except share and per share data)**

**(unaudited)**

**Note 7. Fair Value Measurements (Continued)**

The following section describes the valuation methodologies that we used to measure different financial instruments at fair value, including an indication of the level in the fair value hierarchy in which each instrument is classified.

**Auction-rate securities**

As of September 27, 2008, we have approximately \$34.9 million invested in auction-rate securities (“ARS”). ARS are publicly issued securities that represent long-term investments, typically 10-30 years, in which interest rates reset periodically (typically every 7, 28 or 35 days) through a “dutch auction” process. Approximately \$23.8 million of our ARS are backed by student loans that are backed by the federal government and the remaining \$11.1 million are invested in closed-end municipal bond funds. Our ARS portfolio is comprised of investments that are rated AAA by major independent rating agencies. Since the middle of February 2008, ARS auctions have failed to settle due to an excess number of sellers compared to buyers. The continuing failure of these auctions could result in our inability to liquidate our ARS in the near future. We are currently not aware of any defaults or financial conditions that would negatively affect the issuers’ ability to continue to pay interest and principal on our ARS. We continue to earn and receive interest at contractually agreed upon rates. We believe that the current lack of liquidity related to our ARS investments will have no impact on our ability to fund our ongoing operations and growth opportunities.

Recently, there has been a decrease in the level of refinancing activity within the closed-end municipal bond fund market. Based upon the lack of activity, we reclassified \$11.1 million of holdings to long-term, available-for-sale securities during the quarter ended September 27, 2008.

As of September 27, 2008, we have changed the classification of our closed-end municipal bond fund portfolio from Level 2 to Level 3 within the fair value hierarchy due to the lack of observable inputs and the absence of refinancing activity.

Based upon the continued lack of activity within the student loan market, we continue to classify \$23.8 million of holdings, as of September 27, 2008, as long-term available-for-sale securities and as Level 3 within the fair value hierarchy.

**Money market fund**

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As of September 27, 2008, we had \$25.0 million invested in the Reserve Primary Fund. This money market fund included in its holdings commercial paper of Lehman Brothers. As a result of the Chapter 11 bankruptcy of Lehman Brothers Holdings, Inc., the net asset value of the fund decreased from \$1.00 to \$0.97. Currently, this fund is in the process of being liquidated. As of September 27, 2008, we have recorded a charge of approximately \$0.8 million (in Other expense, net) in our consolidated statements of income due to the uncertainty of the amount that we will ultimately receive from the fund. As of September 27, 2008, the value of our holdings in this fund have been classified within Prepaid expenses and other in our consolidated balance sheets and as Level 3 within the fair value hierarchy, due to the lack of observable inputs and the absence of trading activity.

### **Derivative contracts**

Derivative contracts are valued using quoted market prices and significant other observable and unobservable inputs. We use derivative instruments to minimize our exposure to fluctuations in interest rates and foreign currency exchange rates. Our derivative instruments include interest rate swap agreements related to our long-term fixed rate debt and foreign currency forward and swap agreements related to intercompany loans and certain forecasted inventory purchase commitments with suppliers.



**HENRY SCHEIN, INC.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

(in thousands, except share and per share data)

(unaudited)

**Note 7. Fair Value Measurements (Continued)**

The fair values for the majority of these derivative contracts are based upon current quoted market prices. These financial instruments are typically exchange-traded and are classified within Level 2 of the fair value hierarchy.

Near the end of the third quarter, we had 16 open foreign exchange contracts with Lehman Brothers Special Financing, Inc. (with settlement dates ranging from September 19 to December 12, 2008) consisting of forwards established primarily for the hedging of intercompany loans. On September 25, 2008, as a result of the bankruptcy of Lehman Brothers Holdings, Inc., we sent an early termination notice to Lehman Brothers for all outstanding contracts as it appeared likely they would not be able to honor their obligation for these hedges.

As of the date of the termination notice, the net cash settlement exposure on all the outstanding Lehman Brothers contracts was approximately \$3.7 million, a claim for which we plan to file under the bankruptcy liquidation proceedings. Due to the uncertainty of the collection of this amount, we have fully reserved (in Other, net in our consolidated statements of income) approximately \$3.7 million at September 27, 2008.

The following table presents our assets and liabilities that are measured and recognized at fair value on a recurring basis classified under the appropriate level of the fair value hierarchy as of September 27, 2008:

|                               | Level 1 | Level 2  | Level 3   | Total     |
|-------------------------------|---------|----------|-----------|-----------|
| <b>Assets:</b>                |         |          |           |           |
| Available-for-sale securities | \$ -    | \$ -     | \$ 34,932 | \$ 34,932 |
| Money market fund             | -       | -        | 24,250    | 24,250    |
| Derivative contracts          | -       | 2,536    | -         | 2,536     |
| Total assets                  | \$ -    | \$ 2,536 | \$ 59,182 | \$ 61,718 |
| <b>Liabilities:</b>           |         |          |           |           |
| Derivative contracts          | \$ -    | \$ 555   | \$ -      | \$ 555    |
| Total liabilities             | \$ -    | \$ 555   | \$ -      | \$ 555    |



**HENRY SCHEIN, INC.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

(in thousands, except share and per share data)

(unaudited)

**Note 7. Fair Value Measurements (Continued)**

As of September 27, 2008, we have estimated the value of our closed-end municipal bond fund ARS portfolio and our student loan backed ARS portfolio based upon a discounted cash flow model. The assumptions used in our valuation model include estimates for interest rates, timing and amount of cash flows and expected holding periods for the ARS portfolio. We estimated the value of our holdings within the Reserve Primary Fund based upon the net asset value of the fund as of September 16, 2008, subsequent to the declaration of bankruptcy by Lehman Brothers Holdings, Inc. As a result of these analyses, for the three months ended September 27, 2008, we recorded a temporary impairment loss of \$0.1 million related to our ARS portfolio and a permanent loss of \$0.8 million related to our holdings within the Reserve Primary Fund as of September 27, 2008. The following table presents a reconciliation of our assets measured at fair value on a recurring basis using unobservable inputs (Level 3):

|  | <b>Level 3 (Unobservable Inputs)<br/>Closed-End Municipal Bond Fund<br/>and<br/>Student Loan Backed<br/>Auction-Rate Securities<br/>and Money Market Fund</b> |        |
|--|---|--------|
| Balance, June 28, 2008                             | \$  | 23,868 |
| Transfers to Level 3                               |   | 39,961 |
| Gains and losses:                                  |   |        |
| Reported in earnings                               | (4,511  | )      |
| Reported in accumulated other comprehensive income | (136  | )      |
| Balance, September 27, 2008                        | \$  | 59,182 |

There were no purchases, sales or material realized gains or losses associated with our Level 3 ARS during the three or nine months ended September 27, 2008.



**HENRY SCHEIN, INC.**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

(in thousands, except share and per share data)

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**Note 8. Income Taxes**

The total amount of unrecognized tax benefits as of September 27, 2008 was approximately \$13.1 million, all of which would affect the effective tax rate if recognized. It is expected that the amount of unrecognized tax benefits will change in the next twelve months; however, we do not expect the change to have a material impact on our consolidated financial statements.

The total amounts of interest and penalties were approximately \$2.3 million and \$0, respectively, for the nine months ended September 27, 2008. It is expected that the amount of interest will change in the next twelve months; however, we do not expect the change to have a material impact on our consolidated financial statements.

The tax years subject to examination by major tax jurisdictions include the years 2004 and forward by the U.S. Internal Revenue Service, the years 1996 and forward for certain states and the years 1997 and forward for certain foreign jurisdictions.

**Note 9. Supplemental Cash Flow Information**

Cash paid for interest and income taxes was:

|              | <b>Nine Months Ended</b>      |                               |
|--------------|-------------------------------|-------------------------------|
|              | <b>September 27,<br/>2008</b> | <b>September 29,<br/>2007</b> |
| Interest     | \$ 28,513                     | \$ 26,296                     |
| Income taxes | 77,516                        | 64,920                        |

During the nine months ended September 27, 2008, we had a \$0.4 million non-cash net unrealized loss related to hedging activities. During the nine months ended September 29, 2007, we had a \$1.0 million non-cash net unrealized gain related to hedging activities.

**Note 10. Subsequent Event**

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On November 5, 2008, we announced certain expense reduction actions to reduce costs in light of the current economic environment. The actions will include the elimination of approximately 300 positions from our operations around the world, or approximately 2.5% of our workforce, and the closing of several smaller facilities. These actions will result in a one-time pretax charge of approximately \$22 million to \$25 million, which we expect to record in the fourth quarter of 2008.

## ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

### Cautionary Note Regarding Forward-Looking Statements

In accordance with the "Safe Harbor" provisions of the Private Securities Litigation Reform Act of 1995, we provide the following cautionary remarks regarding important factors that, among others, could cause future results to differ materially from the forward-looking statements, expectations and assumptions expressed or implied herein. All forward-looking statements made by us are subject to risks and uncertainties and are not guarantees of future performance. These forward-looking statements involve known and unknown risks, uncertainties and other factors that may cause our actual results, performance and achievements or industry results to be materially different from any future results, performance or achievements expressed or implied by such forward-looking statements. These statements are identified by the use of such terms as "may," "could," "expect," "intend," "believe," "plan," "estimate," "forecast," "project," "anticipate" or other comparable terms.

Risk factors and uncertainties that could cause actual results to differ materially from current and historical results include, but are not limited to: competitive factors; changes in the healthcare industry; changes in regulatory requirements that affect us; risks associated with our international operations; fluctuations in quarterly earnings; our dependence on third parties for the manufacture and supply of our products; transitional challenges associated with acquisitions, including the failure to achieve anticipated synergies; financial risks associated with acquisitions; regulatory and litigation risks; the dependence on our continued product development, technical support and successful marketing in the technology segment; our dependence upon sales personnel and key customers; our dependence on our senior management; possible increases in the cost of shipping our products or other service trouble with our third-party shippers; risks from rapid technological change; risks from potential increases in variable interest rates; possible volatility of the market price of our common stock; certain provisions in our governing documents that may discourage third-party acquisitions of us; and changes in tax legislation that affect us. The order in which these factors appear should not be construed to indicate their relative importance or priority.

We caution that these factors may not be exhaustive and that many of these factors are beyond our ability to control or predict. Accordingly, any forward-looking statements contained herein should not be relied upon as a prediction of actual results. We undertake no duty and have no obligation to update forward-looking statements.

### Executive-Level Overview

We believe we are the largest distributor of healthcare products and services primarily to office-based healthcare practitioners in the combined North American and European markets. We serve more than 550,000 customers worldwide, including dental practitioners and laboratories, physician practices and animal health clinics, as well as government and other institutions. We believe that we have a strong brand identity due to our more than 75 years of experience distributing healthcare products.

We are headquartered in Melville, New York, employ more than 12,000 people (of which over 5,000 are based outside the United States) and have operations in the United States, Australia, Austria, Belgium, Canada, the Czech Republic, France, Germany, Ireland, Italy, Luxembourg, the Netherlands, New Zealand, Portugal, Spain, Switzerland and the United Kingdom. We also have affiliates in Iceland, Israel and the United Arab Emirates.





We have established strategically located distribution centers to enable us to better serve our customers and increase our operating efficiency. This infrastructure, together with broad product and service offerings at competitive prices, and a strong commitment to customer service, enables us to be a single source of supply for our customers' needs. Our infrastructure also allows us to provide convenient ordering and rapid, accurate and complete order fulfillment.

We conduct our business through two reportable segments: healthcare distribution and technology. These segments offer different products and services to the same customer base. The healthcare distribution reportable segment aggregates our dental, medical (including animal health) and international operating segments. This segment consists of consumable products, small equipment, laboratory products, large dental and medical equipment, equipment repair services, branded and generic pharmaceuticals, vaccines, surgical products, diagnostic tests, infection-control products and vitamins.

Our dental group serves office-based dental practitioners, schools and other institutions in the combined United States and Canadian dental market. Our medical group serves office-based medical practitioners, surgical centers, other alternate-care settings, animal health clinics and other institutions throughout the United States. Our international group serves 18 countries outside of North America and is what we believe to be a leading European healthcare supplier serving office-based practitioners.

Our technology group provides software, technology and other value-added services to healthcare practitioners, primarily in the United States, Canada, the United Kingdom, Australia and New Zealand. Our value-added practice solutions include practice-management software systems for dental and medical practitioners and animal health clinics. Our technology group offerings also include financial services, e-services and continuing education services for practitioners.

#### *Industry Overview*

In recent years, the healthcare industry has increasingly focused on cost containment. This trend has benefited distributors capable of providing a broad array of products and services at low prices. It also has accelerated the growth of HMOs, group practices, other managed care accounts and collective buying groups, which, in addition to their emphasis on obtaining products at competitive prices, tend to favor distributors capable of providing specialized management information support. We believe that the trend towards cost containment has the potential to favorably affect demand for technology solutions, including software, which can enhance the efficiency and facilitation of practice management.

Our operating results in recent years have been significantly affected by strategies and transactions that we undertook to expand our business, domestically and internationally, in part to address significant changes in the healthcare industry, including consolidation of healthcare distribution companies, potential healthcare reform, trends toward managed care, cuts in Medicare and collective purchasing arrangements.

#### *Industry Consolidation*

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The healthcare products distribution industry, as it relates to office-based healthcare practitioners, is highly fragmented and diverse. This industry, which encompasses the dental, medical and animal health markets, was estimated to produce revenues of approximately \$25.5 billion in 2007 in the combined North American and European markets. The industry ranges from sole practitioners working out of relatively small offices to group practices or service organizations ranging in size from a few practitioners to a large number of practitioners who have combined or otherwise associated their practices.

Due in part to the inability of office-based healthcare practitioners to store and manage large quantities of supplies in their offices, the distribution of healthcare supplies and small equipment to office-based healthcare practitioners has been characterized by frequent, small-quantity orders, and a need for rapid, reliable and substantially complete order fulfillment. The purchasing decisions within an office-based healthcare practice are typically made by the practitioner or an administrative assistant. Supplies and small equipment are generally purchased from more than one distributor, with one generally serving as the primary supplier.

We believe that consolidation within the industry will continue to result in a number of distributors, particularly those with limited financial and marketing resources, seeking to combine with larger companies that can provide growth opportunities. This consolidation also may continue to result in distributors seeking to acquire companies that can enhance their current product and service offerings or provide opportunities to serve a broader customer base.

Our trend with regard to acquisitions has been to expand our role as a provider of products and services to the healthcare industry. This trend has resulted in expansion into service areas that complement our existing operations and provide opportunities for us to develop synergies with, and thus strengthen, the acquired businesses.

As industry consolidation continues, we believe that we are positioned to capitalize on this trend, as we believe we have the ability to support increased sales through our existing infrastructure. In the U.S. dental market, we estimate that there are currently more than 300 smaller distributors holding approximately 27% of the market. In the U.S. medical market, we estimate that more than 500 smaller distributors hold approximately 38% of the market, and in the European dental market, we estimate that more than 200 smaller distributors hold approximately 80% of the market.

As the healthcare industry continues to change, we continually evaluate possible candidates for merger or acquisition and intend to continue to seek opportunities to expand our role as a provider of products and services to the healthcare industry. There can be no assurance that we will be able to successfully pursue any such opportunity or consummate any such transaction, if pursued. If additional transactions are entered into or consummated, we would incur merger and/or acquisition-related costs, and there can be no assurance that the integration efforts associated with any such transaction would be successful.

#### *Aging Population and Other Market Influences*

The healthcare products distribution industry continues to experience growth due to the aging population, increased healthcare awareness, the proliferation of medical technology and testing, new pharmacology treatments and expanded third-party insurance coverage. In addition, the physician market continues to benefit from the shift of procedures and diagnostic testing from acute care settings to alternate-care sites, particularly physicians' offices. As the cosmetic surgery and elective procedure markets continue to grow, physicians are increasingly performing more of these procedures in their offices. The elder-care market continues to benefit from the increasing growth rate of the population of elderly Americans.

The January 2000 U.S. Bureau of the Census estimated that the elderly population in the United States will more than double by the year 2040. In 2000, four million Americans were aged 85 or older, the segment of the population most in need of long-term care and elder-care services. By the year 2040, that number is projected to more than triple to more than 14 million. The population aged 65 to 84 years is projected to more than double in the same time period.

As a result of these market dynamics, annual expenditures for healthcare services continue to increase in the United States. Given current operating, economic and industry conditions, we believe that demand for our products and services will remain relatively consistent with recent trends for the foreseeable future. The Centers for Medicare and Medicaid Services, or CMS, published "National Health Expenditure Projections 2007 – 2017" indicating that total national healthcare spending reached \$2.1 trillion in 2006, or 16.0% of the nation's gross domestic product, the

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benchmark measure for annual production of goods and services in the United States. Healthcare spending is projected to reach \$4.3 trillion in 2017, approximately 19.5% of the nation's gross domestic product.

### *Government Influences*

The healthcare industry is subject to extensive government regulation, licensure and operating compliance procedures. National healthcare reform has been the subject of a number of legislative initiatives by Congress. Additionally, government and private insurance programs fund a large portion of the total cost of medical care. The Balanced Budget Act passed by Congress in 1997 significantly reduced reimbursement rates for nursing homes and home healthcare providers, affecting spending levels and the overall financial viability of these institutions.

The Medicare Prescription Drug, Improvement, and Modernization Act or the Medicare Act, is the largest expansion of the Medicare program since its inception, and provides participants with voluntary prescription drug benefits through an interim drug discount card. The Medicare Act also includes provisions relating to medication management programs, generic substitution and provider reimbursement.

There have been increasing efforts by various levels of government, including state departments of health, state boards of pharmacy and comparable agencies, to regulate the pharmaceutical distribution system in order to prevent the introduction of counterfeit, adulterated or mislabeled pharmaceuticals into the distribution system. An increasing number of states, including Florida, have already adopted laws and regulations, including drug pedigree tracking requirements, that are intended to protect the integrity of the pharmaceutical distribution system. Regulations adopted under the federal Prescription Drug Marketing Act, effective December, 2006, require the identification and documentation of transactions involving the receipt and distribution of prescription drugs, that is, drug pedigree information. Other states and government agencies are currently considering similar laws and regulations. We continue to work with our suppliers to help minimize the risks associated with counterfeit products in the supply chain and potential litigation.

### **E-Commerce**

Traditional healthcare supply and distribution relationships are being challenged by electronic online commerce solutions. Our distribution business is characterized by rapid technological developments and intense competition. The advancement of online commerce will require us to cost-effectively adapt to changing technologies, to enhance existing services and to develop and introduce a variety of new services to address the changing demands of consumers and our customers on a timely basis, particularly in response to competitive offerings.

Through our proprietary, technologically-based suite of products, we offer customers a variety of competitive alternatives. We believe that our tradition of reliable service, our name recognition and large customer base built on solid customer relationships position us well to participate in this growing aspect of the distribution business. We continue to explore ways and means to improve and expand our Internet presence and capabilities.

### **Expense Reduction Initiative**

On November 5, 2008, we announced certain expense reduction actions to reduce costs in light of the current economic environment. The actions will include the elimination of approximately 300 positions from our operations around the world, or approximately 2.5% of our workforce, and the closing of several smaller facilities. These actions will result in a one-time pretax charge of approximately \$22 million to \$25 million, which we expect to record in the fourth quarter of 2008.

**Results of Operations**

The following table summarizes the significant components of our operating results from continuing operations for the three and nine months ended September 27, 2008 and September 29, 2007, and cash flows for the nine months ended September 27, 2008 and September 29, 2007 (in thousands):

|   | <b>Three Months Ended</b>     |                               | <b>Nine Months Ended</b>      |                               |
|---|-------------------------------|-------------------------------|-------------------------------|-------------------------------|
|   | <b>September 27,<br/>2008</b> | <b>September 29,<br/>2007</b> | <b>September 27,<br/>2008</b> | <b>September 29,<br/>2007</b> |
| <b>Operating results:</b>                 |                               |                               |                               |                               |
| Net sales                                 | \$ 1,650,771                  | \$ 1,505,575                  | \$ 4,821,367                  | \$ 4,202,720                  |
| Cost of sales                             | 1,172,190                     | 1,076,245                     | 3,403,138                     | 2,968,567                     |
| Gross profit                              | 478,581                       | 429,330                       | 1,418,229                     | 1,234,153                     |
| Operating expenses:                       |                               |                               |                               |                               |
| Selling, general and administrative       | 363,303                       | 332,630                       | 1,104,367                     | 972,880                       |
| Operating income                          | \$ 115,278                    | \$ 96,700                     | \$ 313,862                    | \$ 261,273                    |
| Other expense, net                        | \$ (8,464 )                   | \$ 2,079                      | \$ (16,288 )                  | \$ (1,273 )                   |
| Income from continuing operations         | 68,425                        | 60,668                        | 186,232                       | 158,521                       |
| <b>Cash flows:</b>                        |                               |                               |                               |                               |
| Net cash provided by operating activities |                               |                               | \$ 188,564                    | \$ 149,925                    |
| Net cash used in investing activities     |                               |                               | 85,605                        | 160,028                       |
| Net cash used in financing activities     |                               |                               | 57,050                        | 34,852                        |

**Three Months Ended September 27, 2008 Compared to Three Months Ended September 29, 2007***Net Sales*

Net sales from continuing operations for the three months ended September 27, 2008 and September 29, 2007 were as follows (in thousands):

|                               | <b>September 27,<br/>2008</b> | <b>% of<br/>Total</b> |   | <b>September 29,<br/>2007</b> | <b>% of<br/>Total</b> |   |
|-------------------------------|-------------------------------|-----------------------|---|-------------------------------|-----------------------|---|
| Healthcare distribution (1):  |                               |                       |   |                               |                       |   |
| Dental (2)                    | \$ 644,871                    | 39.0                  | % | \$ 616,972                    | 41.0                  | % |
| Medical (3)                   | 426,853                       | 25.9                  |   | 444,990                       | 29.6                  |   |
| International (4)             | 538,033                       | 32.6                  |   | 411,772                       | 27.3                  |   |
| Total healthcare distribution | 1,609,757                     | 97.5                  |   | 1,473,734                     | 97.9                  |   |
| Technology (5)                | 41,014                        | 2.5                   |   | 31,841                        | 2.1                   |   |
| Total                         | \$ 1,650,771                  | 100.0                 | % | \$ 1,505,575                  | 100.0                 | % |

(1) Consists of consumable products, small equipment, laboratory products, large dental and medical equipment, equipment repair services, branded and generic pharmaceuticals, vaccines, surgical products, diagnostic tests, infection-control products and vitamins.

(2) Consists of products sold in the United States and Canada.

(3) Consists of products and equipment sold in the United States' medical and animal health markets.

(4) Consists of products sold in the dental, medical and animal health markets, primarily in Europe.

(5) Consists of practice management software and other value-added products and services, which are distributed primarily to healthcare providers in the United States, Canada, the United Kingdom, Australia and New Zealand in 2008 and the United States and Canada in 2007.

The \$145.2 million, or 9.6%, increase in net sales for the three months ended September 27, 2008 includes increases of 8.0% local currency growth (2.2% internally generated and 5.8% from acquisitions) and 1.6% related to foreign currency exchange.

The \$27.9 million, or 4.5%, increase in dental net sales for the three months ended September 27, 2008 includes increases of 4.4% local currency growth (all internally generated) and 0.1% related to foreign currency exchange. The 4.4% local currency growth was due to dental



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consumable merchandise sales growth of 4.8% (all internally generated) and dental equipment sales and service growth of 3.4% (all internally generated).

The \$18.1 million, or 4.1%, decrease in medical net sales for the three months ended September 27, 2008 includes a decline in internal growth of 4.2% and acquisition growth of 0.1%. This decrease was due to a reduction of sales of certain lower-margin pharmaceutical products. Excluding sales of these products, internal medical net sales growth was approximately 3.4% or approximately 2.0% excluding sales of influenza vaccine.

The \$126.2 million, or 30.7%, increase in international net sales for the three months ended September 27, 2008 includes increases of 24.7% in local currencies (5.2% internally generated and 19.5% from acquisitions), and 6.0% related to foreign currency exchange.

The \$9.2 million, or 28.8%, increase in technology net sales for the three months ended September 27, 2008 includes an increase in internal growth of 11.3% and acquisition growth of 17.5%. The increase in net sales growth was primarily driven by last year's acquisition of Software of Excellence and by growth in our electronic and financial services businesses.

**Gross Profit**

Gross profit and gross margin percentages from continuing operations by segment and in total for the three months ended September 27, 2008 and September 29, 2007 were as follows (in thousands):

|                         | <b>September 27,<br/>2008</b> | <b>Gross<br/>Margin %</b> |  | <b>September 29,<br/>2007</b> | <b>Gross<br/>Margin %</b> |
|-------------------------|-------------------------------|---------------------------|--|-------------------------------|---------------------------|
| Healthcare distribution | \$ 448,232                    | 27.8 %                    |  | \$ 405,536                    | 27.5 %                    |
| Technology              | 30,349                        | 74.0                      |  | 23,794                        | 74.7                      |
| Total                   | \$ 478,581                    | 29.0                      |  | \$ 429,330                    | 28.5                      |

For the three months ended September 27, 2008, gross profit increased \$49.3 million, or 11.5%, from the comparable prior year period. As a result of different practices of categorizing costs associated with distribution networks throughout our industry, our gross margins may not necessarily be comparable to other distribution companies. Additionally, we realize substantially higher gross margin percentages in our technology segment than in our healthcare distribution segment. These higher gross margins result from being both the developer and seller of software products combined with the nature of the software industry, in which developers typically realize higher gross margins to recover investments in research and development.

Healthcare distribution gross profit increased \$42.7 million, or 10.5%, for the three months ended September 27, 2008 from the comparable prior year period. Healthcare distribution gross profit margin increased to 27.8% for the three months ended September 27, 2008 from 27.5% for the comparable prior year period primarily due to changes in the product sales mix.

Technology gross profit increased \$6.6 million, or 27.5%, for the three months ended September 27, 2008 from the comparable prior year period. Technology gross profit margin decreased to 74.0% for the three months ended September 27, 2008 from 74.7% for the comparable prior year period primarily due to changes in the product sales mix.

**Selling, General and Administrative**

Selling, general and administrative expenses from continuing operations by segment and in total for the three months ended September 27, 2008 and September 29, 2007 were as follows (in thousands):

| <b>September 27,<br/>2008</b> | <b>% of<br/>Respective<br/>Net Sales</b> | <b>September 29,<br/>2007</b> | <b>% of<br/>Respective<br/>Net Sales</b> |
|-------------------------------|--|-------------------------------|--|
|-------------------------------|--|-------------------------------|--|

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|                         |            |      |   |            |      |   |
|-------------------------|------------|------|---|------------|------|---|
| Healthcare distribution | \$ 347,481 | 21.6 | % | \$ 320,164 | 21.7 | % |
| Technology              | 15,822     | 38.6 |   | 12,466     | 39.2 |   |
| Total                   | \$ 363,303 | 22.0 |   | \$ 332,630 | 22.1 |   |

Selling, general and administrative expenses increased \$30.7 million, or 9.2%, to \$363.3 million for the three months ended September 27, 2008 from the comparable prior year period. As a percentage of net sales, selling, general and administrative expenses decreased to 22.0% from 22.1% for the comparable prior year period.

As a component of selling, general and administrative expenses, selling expenses increased \$19.2 million, or 8.5%, to \$244.2 million for the three months ended September 27, 2008 from the comparable prior year period. As a percentage of net sales, selling expenses decreased to 14.8% from 15.0% for the comparable prior year period.

As a component of selling, general and administrative expenses, general and administrative expenses increased \$11.5 million, or 10.7%, to \$119.1 million for the three months ended September 27, 2008 from the comparable prior year period. As a percentage of net sales, general and administrative expenses increased to 7.2% from 7.1% for the comparable prior year period.

***Other Expense, Net***

Other expense, net, from continuing operations for the three months ended September 27, 2008 and September 29, 2007 were as follows (in thousands):

|                    | <b>September 27,<br/>2008</b> |   | <b>September 29,<br/>2007</b> |
|--------------------|-------------------------------|---|-------------------------------|
| Interest income    | \$ 4,260                      |   | \$ 4,378                      |
| Interest expense   | (7,933                        | ) | (6,216                        |
| Other, net         | (4,791                        | ) | 3,917                         |
| Other expense, net | \$ (8,464                     | ) | \$ 2,079                      |

Other expense, net, increased \$10.5 million for the three months ended September 27, 2008 from the comparable prior year period. Approximately \$3.7 million of the increase was due to a reserve for losses associated with open foreign exchange contracts for hedging intercompany loans with Lehman Brothers Special Financing, Inc., whose parent, Lehman Brothers Holdings, Inc. filed for Chapter 11 bankruptcy on September 15, 2008. An additional \$0.8 million was attributable to a reserve for losses in our investment in the Reserve Primary Fund, a money market fund that decreased its net asset value from \$1.00 to \$0.97 due to investments in Lehman Brothers debt. The prior period's results also reflect a gain recorded from the divestiture of certain non-core businesses related to the acquisition of a dental supply company in the third quarter of 2007.

***Income Taxes***

For the three months ended September 27, 2008, our effective tax rate from continuing operations was 32.5% compared to 34.1% for the prior year period. The difference between our effective tax rates and the federal statutory tax rates for both periods primarily relates to state and foreign income taxes.



**Nine Months Ended September 27, 2008 Compared to Nine Months Ended September 29, 2007**

*Net Sales*

Net sales from continuing operations for the nine months ended September 27, 2008 and September 29, 2007 were as follows (in thousands):

|                               | <b>September 27,<br/>2008</b> | <b>% of<br/>Total</b> |   | <b>September 29,<br/>2007</b> | <b>% of<br/>Total</b> |   |
|-------------------------------|-------------------------------|-----------------------|---|-------------------------------|-----------------------|---|
| Healthcare distribution (1):  |                               |                       |   |                               |                       |   |
| Dental (2)                    | \$ 1,916,193                  | 39.8                  | % | \$ 1,780,790                  | 42.4                  | % |
| Medical (3)                   | 1,091,230                     | 22.6                  |   | 1,152,057                     | 27.4                  |   |
| International (4)             | 1,693,017                     | 35.1                  |   | 1,177,742                     | 28.0                  |   |
| Total healthcare distribution | 4,700,440                     | 97.5                  |   | 4,110,589                     | 97.8                  |   |
| Technology (5)                | 120,927                       | 2.5                   |   | 92,131                        | 2.2                   |   |
| Total                         | \$ 4,821,367                  | 100.0                 | % | \$ 4,202,720                  | 100.0                 | % |

(1) Consists of consumable products, small equipment, laboratory products, large dental and medical equipment, equipment repair services, branded and generic pharmaceuticals, vaccines, surgical products, diagnostic tests, infection-control products and vitamins.

(2) Consists of products sold in the United States and Canada.

(3) Consists of products and equipment sold in the United States' medical and animal health markets.

(4) Consists of products sold in the dental, medical and animal health markets, primarily in Europe.

(5) Consists of practice management software and other value-added products and services, which are distributed primarily to healthcare providers in the United States, Canada, the United Kingdom, Australia and New Zealand in 2008 and the United States and Canada in 2007.

The \$618.7 million, or 14.7%, increase in net sales for the nine months ended September 27, 2008 includes increases of 11.2% local currency growth (3.0% internally generated and 8.2% from acquisitions) and 3.5% related to foreign currency exchange.

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The \$135.4 million, or 7.6%, increase in dental net sales for the nine months ended September 27, 2008 includes increases of 6.7% local currency growth (5.7% internally generated and 1.0% from acquisitions) and 0.9% related to foreign currency exchange. The 6.7% local currency growth was due to dental consumable merchandise sales growth of 6.2% (5.2% internally generated and 1.0% from acquisitions) and dental equipment sales and service growth of 8.2% (7.3% internally generated and 0.9% from acquisitions).

The \$60.8 million, or 5.3%, decrease in medical net sales for the nine months ended September 27, 2008 includes a decline in internal growth of 5.7% and acquisition growth of 0.4%. This decrease was due to a reduction of sales of certain lower-margin pharmaceutical products. Excluding sales of these products, internal medical net sales growth was 3.2% or approximately 2.6% excluding sales of influenza vaccine.

The \$515.3 million, or 43.8%, increase in international net sales for the nine months ended September 27, 2008 includes increases of 32.4% in local currencies (7.2% internally generated and 25.2% from acquisitions), and 11.4% related to foreign currency exchange.

The \$28.8 million, or 31.3%, increase in technology net sales for the nine months ended September 27, 2008 includes increases of 30.9% in local currency growth (7.8% internally generated and 23.1% from acquisitions) and 0.4% related to foreign currency exchange. The increase in net sales growth was primarily driven by last year's acquisition of Software of Excellence and by growth in our electronic and financial services businesses.

**Gross Profit**

Gross profit and gross margin percentages from continuing operations by segment and in total for the nine months ended September 27, 2008 and September 29, 2007 were as follows (in thousands):

|                         | <b>September 27,<br/>2008</b> | <b>Gross<br/>Margin %</b> |  | <b>September 29,<br/>2007</b> | <b>Gross<br/>Margin %</b> |
|-------------------------|-------------------------------|---------------------------|--|-------------------------------|---------------------------|
| Healthcare distribution | \$ 1,328,633                  | 28.3 %                    |  | \$ 1,165,059                  | 28.3 %                    |
| Technology              | 89,596                        | 74.1                      |  | 69,094                        | 75.0                      |
| Total                   | \$ 1,418,229                  | 29.4                      |  | \$ 1,234,153                  | 29.4                      |

For the nine months ended September 27, 2008, gross profit increased \$184.1 million, or 14.9%, from the comparable prior year period.

Healthcare distribution gross profit increased \$163.6 million, or 14.0%, for the nine months ended September 27, 2008 from the comparable prior year period. Healthcare distribution gross profit margin remained constant at 28.3% for the nine months ended September 27, 2008 compared with the comparable prior year period.

Technology gross profit increased \$20.5 million, or 29.7%, for the nine months ended September 27, 2008 from the comparable prior year period. Technology gross profit margin decreased to 74.1% for the nine months ended September 27, 2008 from 75.0% for the comparable prior year period primarily due to changes in the product sales mix.

**Selling, General and Administrative**

Selling, general and administrative expenses from continuing operations by segment and in total for the nine months ended September 27, 2008 and September 29, 2007 were as follows (in thousands):

|                         | <b>September 27,<br/>2008</b> | <b>% of<br/>Respective<br/>Net Sales</b> |  | <b>September 29,<br/>2007</b> | <b>% of<br/>Respective<br/>Net Sales</b> |
|-------------------------|-------------------------------|--|--|-------------------------------|--|
| Healthcare distribution | \$ 1,056,694                  | 22.5 %                                   |  | \$ 938,074                    | 22.8 %                                   |
| Technology              | 47,673                        | 39.4                                     |  | 34,806                        | 37.8                                     |
| Total                   | \$ 1,104,367                  | 22.9                                     |  | \$ 972,880                    | 23.1                                     |



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Selling, general and administrative expenses increased \$131.5 million, or 13.5%, to \$1.1 billion for the nine months ended September 27, 2008 from the comparable prior year period. As a percentage of net sales, selling, general and administrative expenses decreased to 22.9% from 23.1% for the comparable prior year period.

As a component of selling, general and administrative expenses, selling expenses increased \$94.3 million, or 14.5%, to \$745.0 million for the nine months ended September 27, 2008 from the comparable prior year period. As a percentage of net sales, selling expenses remained constant at 15.5% compared with the comparable prior year period.

As a component of selling, general and administrative expenses, general and administrative expenses increased \$37.2 million, or 11.6%, to \$359.4 million for the nine months ended September 27, 2008 from the comparable prior year period. As a percentage of net sales, general and administrative expenses decreased to 7.5% from 7.7% for the comparable prior year period.

**Other Expense, Net**

Other expense, net, from continuing operations for the nine months ended September 27, 2008 and September 29, 2007 were as follows (in thousands):

|                    | <b>September 27,<br/>2008</b> |   | <b>September 29,<br/>2007</b> |   |
|--------------------|-------------------------------|---|-------------------------------|---|
| Interest income    | \$ 12,217                     |   | \$ 12,766                     |   |
| Interest expense   | (23,040                       | ) | (18,381                       | ) |
| Other, net         | (5,465                        | ) | 4,342                         |   |
| Other expense, net | \$ (16,288                    | ) | \$ (1,273                     | ) |

Other expense, net, increased \$15.0 million for the nine months ended September 27, 2008 from the comparable prior year period. Approximately \$3.7 million of the increase was due to a reserve for losses associated with open foreign exchange contracts for hedging intercompany loans with Lehman Brothers Special Financing, Inc., whose parent, Lehman Brothers Holdings, Inc. filed for Chapter 11 bankruptcy on September 15, 2008. An additional \$0.8 million was attributable to a reserve for losses in our investment in the Reserve Primary Fund, a money market fund that decreased its net asset value from \$1.00 to \$0.97 due to investments in Lehman Brothers debt. The prior period's results also reflect a gain recorded from the divestiture of certain non-core businesses related to the acquisition of a dental supply company in the third quarter of 2007.

**Income Taxes**

For the nine months ended September 27, 2008, our effective tax rate from continuing operations was 33.5% compared to 34.5% for the prior year period. The difference between our effective tax rates and the federal statutory tax rates for both periods primarily relates to state and foreign income taxes.

## Liquidity and Capital Resources

Our principal capital requirements include the funding of working capital needs, purchases of available-for-sale securities and fixed assets, funding of acquisitions, repayments of debt principal and repurchases of common stock. Working capital requirements generally result from increased sales, special inventory forward buy-in opportunities and payment terms for receivables and payables. Since sales tend to be stronger during the third and fourth quarters and special inventory forward buy-in opportunities are most prevalent just before the end of the year, our working capital requirements have generally been higher from the end of the third quarter to the end of the first quarter of the following year.

We finance our business primarily through cash generated from our operations, revolving credit facilities, debt placements and stock issuances. Our ability to generate sufficient cash flows from operations is dependent on the continued demand of our customers for our products and services, and access to products and services from our suppliers. Given current operating, economic and industry conditions, we believe that demand for our products and services will remain relatively consistent with recent trends in the foreseeable future.

Net cash flow provided by operating activities was \$188.6 million for the nine months ended September 27, 2008, compared to \$149.9 million for the comparable prior year period. This net change of \$38.7 million was primarily due to increased net income, increased non-cash stock-based compensation expense, as well as changes in deferred income taxes, partially offset by a non-cash charge in the prior year from the write-down of long-lived assets of discontinued operations and an increase in the use of net working capital.

Net cash used in investing activities was \$85.6 million for the nine months ended September 27, 2008, compared to \$160.0 million for the comparable prior year period. The net change of \$74.4 million was primarily due to a reduction in payments for business acquisitions, increased net proceeds from foreign exchange forward contract settlements and a decrease in purchases of available-for-sale securities, partially offset by a decrease in proceeds from sales of available-for-sale securities. We expect to invest approximately \$12.0 million to \$17.0 million during the remainder of the fiscal year in capital projects to modernize and expand our facilities and computer systems and to integrate certain operations into our core structure.

Net cash used in financing activities was \$57.1 million for the nine months ended September 27, 2008, compared to \$34.9 million for the comparable prior year period. The net change of \$22.2 million was primarily due to increased repurchases of common stock, decreases in cash proceeds received and tax benefits related to stock option exercises, partially offset by a decrease in repayments for long-term debt.

The following table summarizes selected measures of liquidity and capital resources (in thousands):

|  | September 27,<br>2008 | December 29,<br>2007 |
|--|-----------------------|----------------------|
| Cash and cash equivalents                  | \$ 288,634            | \$ 247,590           |
| Available-for-sale securities - short-term | -                     | 997                  |
| Available-for-sale securities - long-term  | 34,932                | -                    |

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|                                      |            |            |
|--------------------------------------|------------|------------|
| Money market fund                    | 24,250     | -          |
| Working capital                      | 913,564    | 908,160    |
| Debt:                                |            |            |
| Bank credit lines                    | \$ 6,226   | \$ 8,977   |
| Current maturities of long-term debt | 153,802    | 24,319     |
| Long-term debt                       | 268,990    | 423,274    |
| Total debt                           | \$ 429,018 | \$ 456,570 |

27

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Our cash and cash equivalents consist of bank balances and investments in money market funds representing overnight investments with a high degree of liquidity. At September 27, 2008, our available-for-sale securities consisted of auction-rate securities (“ARS”), as discussed in further detail below. At December 29, 2007, our available-for-sale securities consisted of an investment in stock of a single company, which was sold in 2008.

As of September 27, 2008, we have approximately \$34.9 million invested in ARS. ARS are publicly issued securities that represent long-term investments, typically 10-30 years, in which interest rates reset periodically (typically every 7, 28 or 35 days) through a “dutch auction” process. Approximately \$23.8 million of our ARS are backed by student loans that are backed by the federal government and the remaining \$11.1 million are invested in closed-end municipal bond funds. Our ARS portfolio is comprised of investments that are rated AAA by major independent rating agencies. Since the middle of February 2008, these auctions have failed to settle due to an excess number of sellers compared to buyers. The continuing failure of these auctions could result in our inability to liquidate our ARS in the near future. We are currently not aware of any defaults or financial conditions that would negatively affect the issuers’ ability to continue to pay interest and principal on our ARS. We continue to earn and receive interest at contractually agreed upon rates. We believe that the current lack of liquidity related to our ARS investments will have no impact on our ability to fund our ongoing operations and growth opportunities.

Recently, there has been a decrease in the level of refinancing activity within the closed-end municipal bond fund market. Based upon the lack of activity, we reclassified our approximately \$11.1 million of holdings to long-term, available-for-sale securities during the quarter ended September 27, 2008.

Based upon the lack of activity within the student loan market, we will continue to classify our approximately \$23.8 million holdings as of September 27, 2008 as long-term, available-for-sale securities.

Our business requires a substantial investment in working capital, which is susceptible to fluctuations during the year as a result of inventory purchase patterns and seasonal demands. Inventory purchase activity is a function of sales activity, special inventory forward buy-in opportunities and our desired level of inventory. We anticipate future increases in our working capital requirements as a result of continuing sales growth.

Our accounts receivable days sales outstanding from continuing operations decreased to 41.3 days for the nine months ended September 27, 2008 from 42.2 days for the comparable prior year period. During the three and nine months ended September 27, 2008, we wrote-off approximately \$1.8 million and \$4.7 million, respectively, of fully reserved accounts receivable against our trade receivable reserve, which had no effect on our earnings. Our inventory turnover from continuing operations for the nine months ended September 27, 2008 was 6.5 turns compared to 6.6 turns for the comparable prior year period.

In 2004, we completed an issuance of \$240.0 million of convertible debt. These notes are senior unsecured obligations bearing a fixed annual interest rate of 3.0% and are due to mature on August 15, 2034. Interest on the notes is payable on February 15 and August 15 of each year. The notes are convertible into our common stock at a conversion ratio of 21.58 shares per one thousand dollars of principal amount of notes, which is equivalent to a conversion price of \$46.34 per share, under the following circumstances:

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- if the price of our common stock is above 130% of the conversion price measured over a specified number of trading days;
- during the five-business-day period following any 10-consecutive-trading-day period in which the average of the trading prices for the notes for that 10-trading-day period was less than 98% of the average conversion value for the notes during that period;

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- if the notes have been called for redemption; or
- upon the occurrence of a fundamental change or specified corporate transactions, as defined in the note agreement.

Upon conversion, we are required to satisfy our conversion obligation with respect to the principal amount of the notes to be converted, in cash, with any remaining amount to be satisfied in shares of our common stock. We currently have sufficient availability of funds through our \$400.0 million revolving credit facility (discussed below) along with cash on hand to fully satisfy the cash portion of our conversion obligation. We also will pay contingent interest during any six-month-interest period beginning August 20, 2010, if the average trading price of the notes is above specified levels. We may redeem some or all of the notes on or after August 20, 2010. The note holders may require us to purchase all or a portion of the notes on August 15, 2010, 2014, 2019, 2024 and 2029 or, subject to specified exceptions, upon a change of control event.

Our \$170.0 million of senior notes include \$130.0 million of notes, which bear interest at a fixed rate of 6.9% per annum and mature on June 30, 2009, and \$40.0 million of notes which bear interest at a fixed rate of 6.7% per annum and mature at a rate of \$20.0 million per annum on September 25, 2009 and September 27, 2010, respectively. Interest on both notes is payable semi-annually.

In 2003, we entered into agreements relating to our \$170.0 million remaining senior notes to exchange their fixed interest rates for variable interest rates. The value of debt exchanged to a variable rate of interest reduces according to the repayment schedule of the senior notes. As of September 27, 2008, there is \$170.0 million of principal remaining with a weighted-average interest rate of 7.02%. This weighted-average variable interest rate is comprised of LIBOR plus a spread and resets on the interest due dates for such senior notes.

On September 5, 2008, we entered into a new \$400.0 million revolving credit facility with a \$100.0 million expansion feature. The \$400.0 million credit line expires in September 2013. This credit line replaced our then existing \$300.0 million revolving credit line, which would have expired in May 2010. As of September 27, 2008, there were \$11.1 million of letters of credit provided to third parties and no borrowings outstanding under this revolving credit facility.

From June 21, 2004 through September 27, 2008, we repurchased \$214.4 million or 5,065,542 shares under our common stock repurchase programs, with \$85.6 million available for future common stock share repurchases, under repurchase programs approved by our Board of Directors.

Some minority shareholders in certain of our subsidiaries have the right, at certain times, to require us to acquire their ownership interest in those entities at fair value based on third-party valuations or at a price pursuant to a formula as defined in the agreements, which approximates fair value. Additionally, some prior owners of such acquired subsidiaries are eligible to receive additional purchase price cash consideration if certain profitability targets are met. We accrue liabilities that may arise from these transactions when we believe that the outcome of the contingency is determinable beyond a reasonable doubt.

We finance our business to provide adequate funding for at least 12 months. Funding requirements are based on forecasted profitability and working capital needs, which, on occasion, may change. Consequently, we may change our funding structure to reflect any new requirements.

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We believe that our cash and cash equivalents, our ability to access private debt markets and public equity markets, and our available funds under existing credit facilities, provide us with sufficient liquidity to meet our currently foreseeable short-term and long-term capital needs. We have no off balance sheet arrangements.



### **Critical Accounting Policies and Estimates**

There have been no material changes in our critical accounting policies and estimates from those disclosed in Item 7 of our Annual Report on Form 10-K for the year ended December 29, 2007.

### **Recently Issued Accounting Standards**

In September 2006, the FASB issued FAS No. 158, "Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans - an amendment of FASB Statements No. 87, 88, 106 and 132(R)" ("FAS 158"). FAS 158 requires an employer to recognize the over- or under-funded status of a defined benefit plan as an asset or liability in the statement of financial position and to recognize changes in that funded status, net of tax through comprehensive income, in the year in which the changes occur. FAS 158 also requires an employer to measure the funded status of a defined benefit plan as of the date of its year end statement of financial position. The provisions of FAS 158 became effective for our year ended December 30, 2006, with the exception of the requirement to measure the funded status of retirement benefit plans as of our fiscal year end, which is effective for our fiscal year ending December 27, 2008. During December 2006, we implemented the requirement to recognize the funded status of our defined benefit plans. Recognizing the funded status of our defined benefit plans did not have a material impact on our statement of financial position. We do not expect the requirement to measure the funded status of our defined benefit plans as of December 27, 2008 to have a material impact on our consolidated financial statements.

In December 2007, the FASB issued Statement No. 141 (revised 2007), "Business Combinations," and Statement No. 160, "Noncontrolling Interests in Consolidated Financial Statements." FAS No. 141 (revised 2007) requires an acquirer to measure the identifiable assets acquired, the liabilities assumed and any noncontrolling interest in the acquiree at their fair values on the acquisition date, with goodwill being the excess value over the net identifiable assets acquired. This standard also requires the fair value measurement of certain other assets and liabilities related to the acquisition such as contingencies. FAS 141 (revised 2007) applies prospectively to business combinations and is effective for fiscal years beginning on or after December 15, 2008. We are currently evaluating the impact that FAS 141 (revised 2007) will have on our accounting for past and future acquisitions and our consolidated financial statements.

Statement No. 160 requires that a noncontrolling interest in a subsidiary be reported as equity in the consolidated financial statements. Consolidated net income should include the net income for both the parent and the noncontrolling interest with disclosure of both amounts on the consolidated statement of income. The calculation of earnings per share will continue to be based on income amounts attributable to the parent. The presentation provisions of FAS 160 are to be applied retrospectively, and FAS 160 is effective for fiscal years beginning on or after December 15, 2008. We are currently evaluating the impact that FAS 160 will have on our consolidated financial statements.

In February 2008, the FASB issued FSP 157-2, "Partial Deferral of the Effective Date of Statement 157" ("FSP 157-2"). FSP 157-2 delays the effective date of SFAS 157 for all nonfinancial assets and nonfinancial liabilities, except those that are recognized or disclosed at fair value in the financial statements on a recurring basis (at least annually) to fiscal years beginning after November 15, 2008. We are currently evaluating the impact of SFAS 157 on nonfinancial assets and nonfinancial liabilities, but do not expect the adoption to have a material impact on our consolidated financial statements.



In March 2008, the FASB issued FAS 161, "Disclosures about Derivative Instruments and Hedging Activities, an amendment of FASB Statement No. 133" ("FAS 161"). FAS 161 requires disclosures of the fair values of derivative instruments and their gains and losses in a tabular format. FAS 161 requires qualitative disclosures about objectives and strategies for using derivatives, quantitative disclosures about fair value amounts of gains and losses on derivative instruments and disclosures about credit-risk-related contingent features in derivative agreements. FAS 161 is effective for financial statements issued for fiscal years and interim periods beginning after November 15, 2008. We are currently evaluating the impact that FAS 161 will have on our consolidated financial statements.

In April 2008, the FASB issued Action Alert No. 08-14 in reference to FASB Staff Position ("FSP") APB 14-a, "Accounting for Convertible Debt Instruments That May Be Settled in Cash upon Conversion (Including Partial Cash Settlement)." The FSP indicates that we have to allocate the liability and equity components of the convertible debt and reflect our non-convertible debt borrowing rate for the interest component of the convertible debt. The final FSP will be effective for financial statements issued for fiscal years beginning after December 15, 2008, and will be applied retrospectively to all periods presented. Upon the retrospective implementation of this FSP, we will record an unamortized debt discount of approximately \$32.6 million, which will be amortized over a period of six years. The annual impact that this FSP will have on our consolidated financial statements is approximately \$5.3 million pre-tax (or approximately \$3.4 million after-tax which approximates \$0.04 per share).

In October 2008, the FASB issued FASB Staff Position No. FAS 157-3, "Determining the Fair Value of a Financial Asset When the Market for That Asset Is Not Active." This FSP applies to financial assets within the scope of accounting pronouncements that require or permit fair value measurements in accordance with SFAS 157. This FSP clarifies the application of SFAS 157 in determining the fair values of assets or liabilities in a market that is not active. This FSP is effective upon issuance, including prior periods for which financial statements have not been issued. The adoption of this of this FSP did not have a material impact on our consolidated financial statements.

**ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK**

There have been no material changes in our exposure to market risk from that disclosed in Item 7A of our Annual Report on Form 10-K for the year ended December 29, 2007.

**ITEM 4. CONTROLS AND PROCEDURES**

*Evaluation of Disclosure Controls and Procedures*

Under the supervision and with the participation of management, including our principal executive officer and principal financial officer, we evaluated the effectiveness of the design and operation of our disclosure controls and procedures as of the end of the period covered by this quarterly report as such term is defined in Rules 13a-15(e) and 15d-15(e) promulgated under the Securities Exchange Act of 1934, as amended (the "Exchange Act"). Based on this evaluation, our management, including our principal executive officer and principal financial officer, concluded that our disclosure controls and procedures were effective as of September 27, 2008 to ensure that all material information required to be disclosed by us in reports that we file or submit under the Exchange Act is accumulated and communicated to them as appropriate to allow timely decisions regarding required disclosure and that all such information is recorded, processed, summarized and reported as specified in the SEC's rules and forms.

*Changes in Internal Control Over Financial Reporting*

There have been no changes in our internal control over financial reporting that occurred during the quarter ended September 27, 2008 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

*Limitations of the Effectiveness of Internal Control*

A control system, no matter how well conceived and operated, can provide only reasonable, not absolute, assurance that the objectives of the internal control system are met. Because of the inherent limitations of any internal control system, no evaluation of controls can provide absolute assurance that all control issues, if any, within a company have been detected.

**PART II. OTHER INFORMATION**

**ITEM 1. LEGAL PROCEEDINGS**

Our business involves a risk of product liability and other claims in the ordinary course of business, and from time to time we are named as a defendant in cases as a result of our distribution of pharmaceutical, medical devices and other healthcare products. As a business practice, we generally obtain indemnification from our suppliers.

We have various insurance policies, including product liability insurance, covering risks in amounts that we consider adequate. In many cases in which we have been sued in connection with products manufactured by others, the manufacturer provides us with indemnification. There can be no assurance that the insurance coverage we maintain is sufficient or will be available in adequate amounts or at a reasonable cost, or that indemnification agreements will provide us with adequate protection. In our opinion, all pending matters are covered by insurance or will not otherwise have a material adverse effect on our financial condition or results of operations.

As of September 27, 2008, we had accrued our best estimate of potential losses relating to product liability and other claims that were probable to result in a liability and for which we were able to reasonably estimate a loss. This accrued amount, as well as related expenses, was not material to our financial position, results of operations or cash flows. Our method for determining estimated losses considers currently available facts, presently enacted laws and regulations and other external factors, including probable recoveries from third parties.

**ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS**

*Purchases of equity securities by the issuer*

Our current share repurchase program, announced on June 21, 2004, originally allowed us to repurchase up to \$100.0 million of shares of our common stock, which represented approximately 3.5% of the shares outstanding at the commencement of the program. On October 31, 2005 and on March 28, 2007, our Board of Directors authorized an additional \$100.0 million and \$100.0 million, respectively, of shares of our common stock to be repurchased under this program. As of September 27, 2008, we had repurchased \$214.4 million of common stock (5,065,542 shares) under this initiative, with \$85.6 million available for future common stock share repurchases.

The following table summarizes repurchases of our common stock under our stock repurchase program during the fiscal quarter ended September 27, 2008:

| Total | Total Number<br>of Shares | Maximum Number<br>of Shares |
|-------|---------------------------|-----------------------------|
|-------|---------------------------|-----------------------------|

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| <b>Fiscal Month</b>       | <b>Number<br/>of Shares<br/>Purchased (1)</b> | <b>Average<br/>Price Paid<br/>per Share</b> | <b>Purchased as Part<br/>of Our Publicly<br/>Announced<br/>Program</b> | <b>that May Yet<br/>Be Purchased<br/>Under<br/>Our Program (2)</b> |
|---------------------------|---|---|--|--|
| 06/29/08 through 08/02/08 | 411,300                                       | \$ 51.40                                    | 411,300  | 1,662,599  |
| 08/03/08 through 08/30/08 | -   | -   | -  | 1,500,263  |
| 08/31/08 through 09/27/08 | 40,000  | 53.91                                       | 40,000   | 1,561,376  |
| <b>Total</b>              | <b>451,300</b>                                | <b>\$ 51.63</b>                             | <b>451,300</b>   |  |

(1) All repurchases were executed in the open market under our existing publicly announced authorized program.

(2) The maximum number of shares that may yet be purchased under this program is determined at the end of each month based on the closing price of our common stock at that time.

**ITEM 6. EXHIBITS**

Exhibits.

- 10.1 Credit Agreement among the Company, the several lenders parties thereto, JPMorgan Chase Bank, N.A., as administrative agent, HSBC Bank USA, N.A., The Bank of New York Mellon and UniCredit Markets and Investment Banking, as co-syndication agents, dated as of September 5, 2008
- 10.2 Amendment dated September 30, 2008 to Employment Agreement between the Company and Stanley M. Bergman\*\*
- 31.1 Certification Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
- 31.2 Certification Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
- 32.1 Certification Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

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\*\* Indicates management contract or compensatory plan or agreement.

**SIGNATURE**

Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has duly caused this Report to be signed on its behalf by the undersigned thereunto duly authorized.

Henry Schein, Inc.  
(Registrant)

By: /s/ Steven Paladino  
Steven Paladino  
Executive Vice President and

Chief Financial Officer  
(Authorized Signatory and Principal Financial  
and Accounting Officer)

Dated: November 5, 2008

34

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