HENRY SCHEIN INC
Form 10-Q
November 04, 2009

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
FORM 10-Q

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

For the quarterly period ended September 26, 2009

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 incorporation or organization)	(I.R.S. Employer Identification No.)

135 Duryea Road
Melville, New York
(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 X No __

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

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 X	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 X

As of October 29, 2009, there were 90,483,640 shares of the registrant’s common stock outstanding.

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

HENRY SCHEIN, INC.
CONSOLIDATED BALANCE SHEETS
(in thousands, except share and per share data)

	September 26, 2009 (unaudited)	December 27, 2008 (Adjusted - Notes 1 & 8)
ASSETS		
Current assets:		
Cash and cash equivalents	$317,607	$369,570
Accounts receivable, net of reserves of $47,890 and $42,855	764,285	734,027
Inventories, net	770,370	731,654
Deferred income taxes	40,747	36,974
Prepaid expenses and other	186,744	193,841
Total current assets	2,079,753	2,066,066
Property and equipment, net	257,602	247,835
Goodwill	977,054	922,952
Other intangibles, net	212,042	214,093
Investments and other	176,888	148,264
Total assets	$3,703,339	$3,599,210
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	$507,462	$554,773
Bank credit lines	1,731	4,936
Current maturities of long-term debt	23,933	156,405
Accrued expenses:		
Payroll and related	148,665	135,523
Taxes	83,951	69,792
Other	263,392	262,236
Total current liabilities	1,029,134	1,183,665
Long-term debt	242,511	256,648
Deferred income taxes	107,953	95,399
Other liabilities	72,038	58,109
Redeemable noncontrolling interests	177,513	233,035
Commitments and contingencies		
Stockholders' equity:		
Preferred stock, $.01 par value, 1,000,000 shares authorized, none outstanding	-	-
Common stock, $.01 par value, 240,000,000 shares authorized, 90,448,417 outstanding on September 26, 2009 and 89,351,849 outstanding on December 27, 2008	904	894

Additional paid-in capital	533,508	492,505
Retained earnings	1,406,199	1,181,454
Accumulated other comprehensive income	71,863	29,721
Total Henry Schein, Inc. stockholders' equity	2,012,474	1,704,574
Noncontrolling interests	61,716	67,780
Total stockholders' equity	2,074,190	1,772,354
Total liabilities and stockholders' equity	$3,703,339	$3,599,210

See accompanying notes.

HENRY SCHEIN, INC.
CONSOLIDATED STATEMENTS OF INCOME
(in thousands, except per share data)
(unaudited)

	Three Months Ended		Nine Months Ended	
	September 26, 2009	September 27, 2008 (Adjusted - Notes 1, 4 & 8)	September 26, 2009 (Adjusted - Note 4)	September 27, 2008 (Adjusted - Notes 1, 4 & 8)
Net sales	$ 1,659,433	$ 1,644,209	$ 4,752,255	$ 4,799,234
Cost of sales	1,183,166	1,168,615	3,361,707	3,389,847
Gross profit	476,267	475,594	1,390,548	1,409,387
Operating expenses:				
Selling, general and administrative	362,382	360,180	1,060,062	1,094,512
Restructuring costs	-	-	4,043	-
Operating income	113,885	115,414	326,443	314,875
Other income (expense):				
Interest income	2,387	4,260	7,674	12,217
Interest expense	(5,171)	(9,240)	(18,329)	(26,816)
Other, net	1,938	(4,863)	1,595	(5,524)
Income from continuing operations before taxes, equity in earnings of affiliates and noncontrolling interests	113,039	105,571	317,383	294,752
Income taxes	(15,864)	(34,355)	(83,402)	(98,787)
Equity in earnings of affiliates	1,200	1,602	3,777	4,020
Income from continuing operations	98,375	72,818	237,758	199,985
Income (loss) from discontinued operations, net of tax	2,373	(52)	2,715	(828)
Net income	100,748	72,766	240,473	199,157
Less: Net income attributable to noncontrolling interests	(4,327)	(5,278)	(15,728)	(15,659)
Net income attributable to Henry Schein, Inc.	$ 96,421	$ 67,488	$ 224,745	$ 183,498
Amounts attributable to Henry Schein, Inc.:				
Income from continuing operations	$ 94,045	$ 67,548	$ 222,143	$ 184,239
	2,376	(60)	2,602	(741)

Income (loss) from discontinued operations, net of tax								
Net income	$	96,421	$	67,488	$	224,745	$	183,498
Earnings per share attributable to Henry Schein, Inc.:								
From continuing operations:								
Basic	$	1.06	$	0.76	$	2.50	$	2.07
Diluted	$	1.03	$	0.74	$	2.45	$	2.00
From discontinued operations:								
Basic	$	0.03	$	0.00	$	0.03	$	(0.01)
Diluted	$	0.02	$	0.00	$	0.03	$	0.00
From net income:								
Basic	$	1.09	$	0.76	$	2.53	$	2.06
Diluted	$	1.05	$	0.74	$	2.48	$	2.00
Weighted-average common shares outstanding:								
Basic		88,796		88,930		88,843		89,216
Diluted		91,513		91,376		90,576		91,908

See accompanying notes.

HENRY SCHEIN, INC.
CONSOLIDATED STATEMENT OF CHANGES IN STOCKHOLDERS' EQUITY
(in thousands, except share data)
(unaudited)

	Common Stock $.01 Par Value Shares	Amount	Additional Paid-in Capital	Retained Earnings	Accumulated Comprehensive Income	Noncontrolling Interests	Total Stockholders' Equity
Balance, December 27, 2008 - as previously reported	89,351,849	$ 894	$ 705,799	$ 1,195,771	$ 29,721	$ -	$ 1,932,185
Cumulative impact of adopting ASC Topic 470-20	-	-	19,741	(14,317)	-	-	5,424
Cumulative impact of adopting ASC Topic 810-10-65	-	-	-	-	-	67,780	67,780
Cumulative impact of adopting ASC Topic 480-10	-	-	(233,035)	-	-	-	(233,035)
Balance, December 27, 2008 - as adjusted	89,351,849	$ 894	$ 492,505	$ 1,181,454	$ 29,721	$ 67,780	$ 1,772,354
Net income	-	-	-	224,745	-	15,728	240,473
Foreign currency translation gain	-	-	-	-	29,060	4,180	33,240
Unrealized gain from foreign currency hedging activities, net of tax of $7,774	-	-	-	-	14,029	-	14,029
Unrealized investment gain, net of tax of $42	-	-	-	-	13	-	13
Pension adjustment loss, net of tax of $120	-	-	-	-	(960)	-	(960)
Total comprehensive income						19,908	286,795
Dividends paid	-	-	-	-	-	(2,382)	(2,382)
Noncontrolling interest of acquired companies	-	-	(47,533)	-	-	(23,590)	(71,123)
	-	-	55,522	-	-	-	55,522

Decrease in redeemable noncontrolling interests							
Shares issued to 401(k) plan	100,778	1	5,300	-	-	-	5,301
Shares issued upon exercise of stock options, including tax benefit of $1,635	311,491	3	11,321	-	-	-	11,324
Stock-based compensation expense	751,560	7	18,337	-	-	-	18,344
Shares withheld for payroll taxes	(67,261)	(1)	(2,028)	-	-	-	(2,029)
Liability for cash settlement stock option awards and other	-	-	84	-	-	-	84
Balance, September 26, 2009	90,448,417	$ 904	$ 533,508	$ 1,406,199	$ 71,863	$ 61,716	$ 2,074,190

See accompanying notes.

HENRY SCHEIN, INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS
(in thousands)
(unaudited)

	Nine Months Ended	
	September 26, 2009	September 27, 2008 (Adjusted - Notes 1 & 8)
Cash flows from operating activities:		
Net income	$ 240,473	$ 199,157
Adjustments to reconcile net income to net cash provided by operating activities:		
Gain on sale of discontinued operation, net of tax	(2,382)	-
Depreciation and amortization	60,930	59,183
Amortization of bond discount	4,473	4,214
Stock-based compensation expense	18,344	23,060
Provision for losses on trade and other accounts receivable	2,754	3,711
Benefit from deferred income taxes	(29,633)	(2,705)
Stock issued to 401(k) plan	5,301	4,662
Undistributed earnings of affiliates	(3,777)	(4,020)
Other	2,535	(2,132)
Changes in operating assets and liabilities, net of acquisitions:		
Accounts receivable	(12,788)	(66,751)
Inventories	(10,234)	(68,182)
Other current assets	(806)	(3,460)
Accounts payable and accrued expenses	(56,813)	41,927
Net cash provided by operating activities	218,377	188,664
Cash flows from investing activities:		
Purchases of fixed assets	(38,417)	(38,119)
Payments for equity investment and business acquisitions, net of cash acquired	(97,911)	(25,930)
Cash received from business divestitures	12,716	-
Purchases of available-for-sale securities	-	(35,925)
Proceeds from sales of available-for-sale securities	8,730	1,572
Net proceeds from foreign exchange forward contract settlements	275	9,090
Other	(11,258)	3,607
Net cash used in investing activities	(125,865)	(85,705)
Cash flows from financing activities:		
Repayments of bank borrowings	(3,829)	(5,786)

Principal payments for long-term debt		(153,452)		(30,139)
Proceeds from issuance of stock upon exercise of stock options		9,689		25,041
Payments for repurchases of common stock		-		(54,945)
Excess tax benefits related to stock-based compensation		2,821		10,635
Other		(2,127)		(1,856)
Net cash used in financing activities		(146,898)		(57,050)
Net change in cash and cash equivalents		(54,386)		45,909
Effect of exchange rate changes on cash and cash equivalents		2,423		(5,135)
Cash and cash equivalents, beginning of period		369,570		247,590
Cash and cash equivalents, end of period	$	317,607	$	288,364

See accompanying notes.

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 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 27, 2008.

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 26, 2009 are not necessarily indicative of the results to be expected for any other interim period or for the year ending December 26, 2009.

Effective December 28, 2008, we adopted the provisions of Accounting Standards Codification ("ASC") Topic 810-10-65, which requires that a noncontrolling interest in a subsidiary be reported as equity in the consolidated financial statements. Consolidated net income includes 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. As of December 27, 2008, we included noncontrolling interests totaling approximately $67.8 million in Stockholders' equity within our consolidated balance sheets, as the cumulative impact of adopting ASC Topic 810-10-65.

Effective December 28, 2008, we have adopted the provisions of ASC Topic 480-10. ASC Topic 480-10 is applicable for noncontrolling interests where we are or may be required to purchase all or a portion of the outstanding interest in a consolidated subsidiary from the noncontrolling interest holder under the terms of a put option or other contractual agreements. As a result of the adoption of the provisions of ASC Topic 480-10, we have recorded the approximate redemption amount fair value of the put options as Redeemable noncontrolling interests ($177.5 million and $233.0 million at September 26, 2009 and December 27, 2008, respectively) and reduced Additional paid-in capital within the Stockholders' equity section of our consolidated balance sheets. The change in fair value of put options at September 26, 2009 compared to December 27, 2008 was primarily due to purchases of additional interests in consolidated subsidiaries offset by changes in the fair value of the put options. Changes in the estimated redemption amounts of the noncontrolling interests subject to put options are adjusted at each reporting period with a corresponding adjustment to equity. These adjustments will not impact the calculation of earnings per share.

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HENRY SCHEIN, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)
(in thousands, except share and per share data)
(unaudited)

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.

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 21 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.

The following tables present information about our reportable segments:

	Three Months Ended		Nine Months Ended	
	September 26, 2009	September 27, 2008 (1)	September 26, 2009 (1)	September 27, 2008 (1)
Net Sales:				
Healthcare distribution (2):				
Dental (3)	$622,065	$641,487	$1,838,240	$1,905,206
Medical (4)	410,617	423,675	1,088,875	1,080,084
International (5)	583,540	538,033	1,699,053	1,693,017
Total healthcare distribution	1,616,222	1,603,195	4,626,168	4,678,307
Technology (6)	43,211	41,014	126,087	120,927
Total	$1,659,433	$1,644,209	$4,752,255	$4,799,234

(1) Adjusted to reflect the effects of discontinued operations.

(2) 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.

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

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

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

(6) 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.

	Three Months Ended		Nine Months Ended	
	September 26, 2009	September 27, 2008 (1)	September 26, 2009 (1)	September 27, 2008 (1)
Operating Income:				
Healthcare distribution	$98,250	$100,887	$280,618	$272,952
Technology	15,635	14,527	45,825	41,923
Total	$113,885	$115,414	$326,443	$314,875

(1) Adjusted to reflect the effects of discontinued operations.

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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 ASC Topic 718, “Stock Compensation,” of $6.0 million ($4.1 million after-tax) and $18.3 million ($12.4 million after-tax) for the three and nine months ended September 26, 2009, respectively, and $6.9 million ($4.7 million after-tax) and $23.1 million ($15.3 million after-tax) for the three and nine months ended September 27, 2008, 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 (net of estimated forfeitures) as compensation expense on a straight-line basis 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. Prior to March 2009, awards under the Plans principally included a combination of at-the-money stock options and restricted stock (including restricted stock units).

In March 2009, equity-based awards were granted solely in the form of restricted stock and restricted stock units, with the exception of stock options for certain pre-existing contractual obligations.

Grants of restricted stock are common stock awards granted to recipients with specified vesting provisions. We issue restricted stock that vests solely 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 and the recipient’s continued service over time (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 at time of grant.

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 and the related compensation expense is adjusted upward or downward based upon our estimation of achieving such performance targets. The ultimate number of shares delivered to recipients and the related compensation cost recognized as an expense will be based on our actual performance metrics as defined under the Plans.

Restricted stock units are unit awards that we grant to certain employees that entitle the recipient to shares of common stock upon vesting. We grant restricted stock units with the same time-based and performance-based vesting that we use for restricted stock. The fair value of restricted stock units 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 26, 2009 was $54.9 million, which is expected to be recognized over a weighted-average period of approximately 2.4 years.

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:

	2009	2008
Expected dividend yield	0%	0%
Expected stock price volatility	28%	20%
Risk-free interest rate	1.88%	2.75%
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 26, 2009:

	Shares	Weighted Average Exercise Price	Weighted Average Remaining Contractual Life in Years	Aggregate Intrinsic Value
Outstanding at beginning of period	6,791,828	$ 39.85		
Granted	42,206	38.33		
Exercised	(311,491)	31.11		
Forfeited	(90,427)	48.53		
Outstanding at end of period	6,432,116	$ 40.16	5.6	$ 99,208
Options exercisable at end of period	4,957,845	$ 35.76	4.9	$ 95,507

The following tables summarize the status of our non-vested restricted stock/units for the nine months ended September 26, 2009:

	Time-Based Restricted Stock/Units		
	Shares/Units	Weighted Average Grant Date Fair Value	Aggregate Intrinsic Value
Outstanding at beginning of period	285,225	$ 14,771	
Granted	344,036	12,013	
Vested	(1,315)	(49)	
Forfeited	(22,783)	(1,100)	
Outstanding at end of period	605,163	$ 25,635	$ 33,139

	Performance-Based Restricted Stock/Units		
	Shares/Units	Weighted Average Grant Date Fair Value	Aggregate Intrinsic Value
Outstanding at beginning of period	347,141	$ 17,704	
Granted	780,289	12,110	
Vested	(179,719)	(8,503)	
Forfeited	(7,980)	(372)	
Outstanding at end of period	939,731	$ 20,939	$ 51,460

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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 26, 2009. 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.

Divestitures

On August 5, 2009, we completed the sale of a wholesaler of dental consumables for aggregate consideration of $14.2 million. Prior results for this business have been presented as discontinued operations in the accompanying consolidated statements of income. The total pretax income from discontinued operations is $6.5 million ($2.6 million after taxes) consisting of a $6.0 million ($2.4 million after taxes) gain on the sale and $0.5 million ($0.2 million after taxes) income from operations.

Loan and Investment Agreement

On December 12, 2008, we converted $10.4 million of loan receivables and related accrued interest into an equity interest of 15.33% in D4D Technologies, LLC (“D4D”). Due to the conversion, we now account for our equity interest in D4D under the equity method of accounting prospectively from the date of conversion.

In addition, under our previous agreement, if certain product specification and performance milestones occurred, we were required to pay additional amounts (as equity contributions) to D4D and certain of its members equal to $16.0 million. On August 3, 2009, we entered into an amendment whereby we paid D4D and certain of its members approximately $8.0 million and agreed to make two contingent payments in each of 2010 and 2011 of up to $4.0 million each based on D4D’s financial performance. All payments made under the amended agreement are being accounted for as increases in the carrying value of our investment in D4D and any underlying allocations to intangible assets are being determined at time of payment.

Note 5. Earnings Per Share

Basic earnings per share is computed by dividing net income attributable to Henry Schein, Inc. 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 nine months ended September 26, 2009, our convertible debt was not convertible at a premium and thus the impact of an assumed conversion was not applicable.

For the three months ended September 26, 2009 and the three and nine months ended September 27, 2008, 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.

HENRY SCHEIN, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)
(in thousands, except share and per share data)
(unaudited)

Note 5. Earnings Per Share (Continued)

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

	Three Months Ended		Nine Months Ended	
	September 26, 2009	September 27, 2008	September 26, 2009	September 27, 2008
Basic	88,796,152	88,929,672	88,843,067	89,216,159
Effect of dilutive securities:				
Stock options, restricted stock and restricted units	2,241,503	1,579,672	1,732,922	1,760,015
Effect of assumed conversion of convertible debt	475,081	866,457	-	932,091
Diluted	91,512,736	91,375,801	90,575,989	91,908,265

Weighted-average options to purchase 1,971,851 shares of common stock at exercise prices ranging from $51.10 to $62.05 per share and 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 26, 2009 and September 27, 2008, respectively, were excluded from the computation of diluted earnings per share. Weighted-average options to purchase 2,741,364 shares of common stock at exercise prices ranging from $45.85 to $62.05 per share and 833,041 shares of common stock at exercise prices ranging from $56.69 to $62.05 per share that were outstanding during the nine months ended September 26, 2009 and September 27, 2008, 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 U.S. GAAP, 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, foreign currency translation adjustments, unrealized gains (losses) on hedging activity and investment and pension adjustments. The following table presents our comprehensive income:

	Three Months Ended		Nine Months Ended	
	September 26, 2009	September 27, 2008 (1) (2)	September 26, 2009 (1)	September 27, 2008 (1) (2)
Comprehensive income	$130,098	$17,938	$286,795	$175,892
Comprehensive income attributable to Henry Schein, Inc.	122,706	15,836	266,887	161,024
Comprehensive income attributable to noncontrolling interests	7,392	2,102	19,908	14,868

(1) Adjusted to reflect the effects of discontinued operations.

(2) Adjusted to reflect the effects of the adoption of provisions contained within ASC Topic 470-20, "Debt with Conversion and Other Options."

HENRY SCHEIN, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)
(in thousands, except share and per share data)
(unaudited)

Note 7. Fair Value Measurements

Effective December 30, 2007, we adopted provisions of ASC Topic 820, "Fair Value Measurements and Disclosures" ("ASC Topic 820") as they relate to financial assets and financial liabilities. ASC Topic 820 establishes a framework for measuring fair value in generally accepted accounting principles and expands disclosures about fair value measurements. ASC Topic 820 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 ASC Topic 820 did not have a material impact on our consolidated financial statements.

ASC Topic 820 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. ASC Topic 820 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).

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 ASC Topic 820 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.

The following section describes the valuation methodologies that we used to measure different financial instruments at fair value.

Cash equivalents and trade receivables

Due to the short-term maturity of such investments, the carrying amounts are a reasonable estimate of fair value.

Available-for-sale securities

The fair value of available-for-sale securities at September 26, 2009 is estimated based on internally generated discounted cash flow models.

Long-term investments and notes receivable

There are no quoted market prices available for investments in unconsolidated affiliates and long-term notes receivable; however, we believe the carrying amounts are a reasonable estimate of fair value.

HENRY SCHEIN, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)
(in thousands, except share and per share data)
(unaudited)

Note 7. Fair Value Measurements (Continued)

Auction-rate securities

As of September 26, 2009, we have approximately $22.3 million ($20.3 million net of temporary impairments) invested in auction-rate securities ("ARS"), which are included as part of Investments and other within our consolidated balance sheets. ARS are publicly issued securities that represent long-term investments, typically 10-30 years, in which interest rates had reset periodically (typically every 7, 28 or 35 days) through a "dutch auction" process. Approximately $19.6 million ($17.6 million net of temporary impairments) of our ARS are backed by student loans that are backed by the federal government and the remaining $2.7 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 failure of these auctions has resulted in our inability to liquidate our ARS in the near term. 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.

During 2009, we have received approximately $4.6 million and $4.2 million of redemptions, at par, for our closed-end municipal bond funds and our student loan portfolios, respectively.

As of September 26, 2009, we have classified our closed-end municipal bond funds, as well as our student loan portfolios, as Level 3 within the fair value hierarchy due to the lack of observable inputs and the absence of significant refinancing activity.

Based upon the information currently available and the use of a discounted cash flow model in accordance with applicable authoritative guidance, our previously recorded cumulative temporary impairment at December 27, 2008 of $2.0 million related to our closed-end municipal bond funds and our student loan portfolios was unchanged during the nine months ended September 26, 2009. The temporary impairment has been recorded as part of Accumulated other comprehensive income within the equity section of our consolidated balance sheet.

Money market fund

As of September 26, 2009, we had an investment of approximately $2.5 million ($2.2 million net of reserves) 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 below $1.00. Currently, this fund is in the process of being liquidated. During 2009, we have received approximately $2.7 million of distributions from the Reserve Primary Fund. As of September 26, 2009, the value of our holdings in this fund are included 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.

Debt

The fair value of our debt is estimated based on quoted market prices for our traded debt and on market prices of similar issues for our private debt. The fair value of our debt as of September 26, 2009 and December 27, 2008 was estimated at $311.4 million and $426.8 million.

HENRY SCHEIN, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)
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Note 7. Fair Value Measurements (Continued)

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.

The fair values for the majority of our foreign currency derivative contracts are obtained by comparing our contract rate to a published forward price of the underlying currency, which is based on market rates for comparable transactions and are classified within Level 2 of the fair value hierarchy.

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 26, 2009:

	Level 1	Level 2	Level 3	Total
Assets:				
Auction-rate securities	$-	$-	$20,353	$20,353
Money market fund	-	-	2,234	2,234
Derivative contracts	-	3,773	-	3,773
Total assets	$-	$3,773	$22,587	$26,360
Liabilities:				
Derivative contracts	$-	$7,416	$-	$7,416
Total liabilities	$-	$7,416	$-	$7,416

HENRY SCHEIN, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)
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Note 7. Fair Value Measurements (Continued)

As of September 26, 2009, 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. As a result of these analyses, our previously recorded cumulative temporary impairment at December 27, 2008 of $2.0 million was unchanged during the nine months ended September 26, 2009.

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. The reserve recorded in 2008 of $0.8 million related to our holdings within the Reserve Primary Fund was reduced by $0.5 million during the third quarter of 2009, based upon anticipated collections, and as of September 26, 2009 the reserve is $0.3 million. The following table presents a reconciliation of our assets measured at fair value on a recurring basis using unobservable inputs (Level 3):

	Level 3 (Unobservable Inputs) Closed-End Municipal Bond Fund and Student Loan Backed Auction-Rate Securities and Money Market Fund		
Balance, December 27, 2008	$	33,546	
Transfers to Level 3		-	
Redemptions (at par)		(11,514	)
Gains and (losses):			
Reported in earnings - Reserve Primary Fund reserve reduction		500	
Reported in accumulated other comprehensive income		55	
Balance, September 26, 2009	$	22,587	

Note 8. Convertible Debt

Effective December 28, 2008, we adopted the provisions of ASC Topic 470-20, “Debt with Conversion and Other Options,” as it relates to our convertible debt. ASC Topic 470-20 requires that we 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.

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. 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. For the nine months ended September 26, 2009, our convertible debt was not convertible at a premium and thus the impact of an assumed conversion was not applicable.

Upon the retrospective implementation of ASC Topic 470-20, we recorded a debt discount of $32.6 million, as of August 9, 2004, representing the difference between the fair value of our $240.0 million 3% convertible debt at the time of issuance and the face amount of the convertible debt. We also recorded a related deferred tax liability of $12.1 million representing the tax impact of recording the debt discount. This debt discount is being amortized over a period of six years from the date our convertible debt was issued until August 9, 2010. An offsetting amount was recorded in Additional paid-in capital to reflect the impact of the debt discount, net of the related deferred tax liability.

HENRY SCHEIN, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)
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Note 8. Convertible Debt (Continued)

The principal amounts of the outstanding notes, the unamortized discount and the net carrying value at September 26, 2009 were $240.0 million, $5.5 million and $234.5 million and at December 27, 2008 were $240.0 million, $10.0 million and $230.0 million.

As of December 28, 2008, retained earnings includes a cumulative adjustment to interest expense of $22.6 million ($14.7 million, net of taxes) representing the non-cash difference between the stated interest rate (3%) on our convertible debt and our non-convertible debt borrowing rate (5.74%) at the time of issuance of our convertible debt.

For the three and nine months ended September 26, 2009, we recorded additional non-cash interest expense of $1.5 million ($1.0 million, net of taxes) and $4.5 million ($3.0 million, net of taxes), respectively, and for the three and nine months ended September 27, 2008 we recorded additional non-cash interest expense of $1.4 million ($1.0 million, net of taxes) and $4.2 million ($2.8 million, net of taxes), respectively, representing the difference between the stated interest rate on our convertible debt and our non-convertible debt borrowing rate at the time of issuance of our convertible debt.

For the three and nine month periods ended September 26, 2009 and September 27, 2008, contractual interest expense relating to our convertible debt was $1.8 million ($1.2 million, net of taxes) and $5.4 million ($3.6 million, net of taxes), respectively.

Note 9. Income Taxes

For the three months ended September 26, 2009, our effective tax rate from continuing operations was 14.0% compared to 32.5% for the prior year period. The difference in our effective tax rates is primarily related to a reduction in the valuation allowance on foreign deferred tax assets during the third quarter of 2009.

During the third quarter of 2009, we were able to substantially complete a planned reorganization outside the United States that will allow us to utilize tax loss carryforwards to offset taxable income beginning in 2010 in certain tax jurisdictions. As a result, we have determined that it is more likely than not that a portion of deferred tax assets previously fully reserved will be realized. Therefore, the provision for income taxes includes a $21.0 million reduction of the valuation allowance which is based on an estimate of future taxable income available to be offset by the tax loss carryforwards.

The total amount of unrecognized tax benefits as of September 26, 2009 was approximately $13.9 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 12 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 resulting from unrecognized tax benefits were approximately $2.4 million and $0, respectively, for the nine months ended September 26, 2009. 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 2006 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.

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HENRY SCHEIN, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)
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Note 10. Supplemental Cash Flow Information

Cash paid for interest and income taxes was:

	Nine Months Ended	
	September 26, 2009	September 27, 2008
Interest	$20,892	$28,513
Income taxes	114,176	77,516

During the nine months ended September 26, 2009, we had a $15.4 million non-cash net unrealized gain related to hedging activities. During the nine months ended September 27, 2008, we had a $0.4 million non-cash net unrealized loss related to hedging activities.

Note 11. Plan of Restructuring

On November 5, 2008, we announced certain actions to reduce operating costs, which have resulted in the elimination of 430 positions from our operations and the closing of several smaller facilities. For the nine months ended September 26, 2009, we recorded restructuring costs of approximately $4.0 million (approximately $2.8 million after taxes). The costs associated with the restructuring are included in a separate line item, “Restructuring costs” within our consolidated statements of income.

The following table shows the amounts expensed and paid for restructuring costs that were incurred during the nine months ended September 26, 2009 and the remaining accrued balance of restructuring costs as of September 26, 2009, which is included in Accrued expenses: Other and Other liabilities within our consolidated balance sheets:

	Balance at December 27, 2008	Provision	Payments and Other Adjustments	Balance at September 26, 2009
Severance costs (1)	$14,330	$2,451	$(12,289)	$4,492
Facility closing costs (2)	3,688	1,531	(2,933)	2,286
Other professional and consulting costs	519	61	(379)	201
Total	$18,537	$4,043	$(15,601)	$6,979

(1) Represents salaries and related benefits for employees separated from the Company.

(2) Represents costs associated with the closing of certain smaller facilities (primarily lease termination costs) and property and equipment write-offs.

We expect that the majority of these costs will be paid in 2009.

The following table shows, by reportable segment, the restructuring costs incurred during 2009 and the remaining accrued balance of restructuring costs as of September 26, 2009:

	Balance at December 27, 2008	Provision	Payments and Other Adjustments	Balance at September 26, 2009
Healthcare distribution	$18,457	$4,043	$(15,592)	$6,908
Technology	80	-	(9)	71
Total	$18,537	$4,043	$(15,601)	$6,979

HENRY SCHEIN, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)
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Note 12. Derivatives and Hedging Activities

Effective December 28, 2008, we adopted provisions of ASC Topic 815-10 relating to our derivative and hedging activities. ASC Topic 815-10 requires enhanced disclosures of our derivatives and hedging activities. ASC Topic 815-10 does not change the accounting for derivatives and hedging activities, but rather provides more detailed disclosures concerning our objectives for our use of derivatives, the locations within our consolidated financial statements of both the derivative positions existing at period end and the effect of using derivatives during the period and the impact that the use of derivatives and hedging activities had on our consolidated financial statements.

We are exposed to market risks, which include changes in interest rates, as well as changes in foreign currency exchange rates as measured against the U.S. dollar and each other, and changes to the credit markets. We attempt to minimize these risks by using interest rate swap agreements, foreign currency forward and swap contracts and by maintaining counter-party credit limits. These hedging activities provide only limited protection against interest rate, currency exchange and credit risks. Factors that could influence the effectiveness of our hedging programs include interest rate volatility, currency markets and availability of hedging instruments and liquidity of the credit markets. All interest rate swap and foreign currency forward and swap contracts that we enter into are components of hedging programs and are entered into for the sole purpose of hedging an existing or anticipated interest rate and currency exposure. We do not enter into such contracts for speculative purposes and we manage our credit risks by diversifying our investments, maintaining a strong balance sheet and having multiple sources of capital.

The value of certain foreign currencies as compared to the U.S. dollar may affect our financial results. Fluctuations in foreign exchange rates may positively or negatively affect our revenues, gross margins, operating expenses, and retained earnings, all of which are expressed in U.S. dollars. Where we deem it prudent, we engage in hedging programs using primarily foreign currency forward and swap contracts aimed at limiting the impact of foreign currency exchange rate fluctuations on earnings. We purchase short-term (i.e., 12 months or less) foreign currency forward and swap contracts to protect against currency exchange risks associated with intercompany loans due from our international subsidiaries and the payment of merchandise purchases to our foreign suppliers. We do not hedge the translation of foreign currency profits into U.S. dollars, as we regard this as an accounting exposure, not an economic exposure.

The following table presents the fair value of our derivative instruments:

	Asset Derivatives September 26, 2009		Liability Derivatives September 26, 2009	
	Balance Sheet Location	Fair Value	Balance Sheet Location	Fair Value
Derivatives designated as hedging instruments under ASC Topic 815-10:				
Interest rate contracts	Prepaid expenses and other	$ 568	Accrued expenses other	$ -
Foreign exchange contracts	Prepaid expenses and other	1,789	Accrued expenses other	4,260

Total			2,357			4,260
Derivatives not designated as hedging instruments under ASC Topic 815-10:						
Foreign exchange contracts	Prepaid expenses and other		1,416	Accrued expenses other		3,156
Total derivatives		$	3,773		$	7,416

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HENRY SCHEIN, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)
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Note 12. Derivatives and Hedging Activities (Continued)

Fair Value Hedges

Our fair value hedges consist of interest rate swaps and foreign exchange contracts. Gains (losses) associated with these foreign exchange contracts are recorded in Other, net within our consolidated statements of income and totaled $(0.5) million and $7.4 million for the three and nine months ended September 26, 2009. Forward points related to these foreign exchange contracts, recorded in Interest expense within our consolidated statements of income, totaled $0 and $0.4 million for the three and nine months ended September 26, 2009.

Cash Flow Hedges

Our cash flow hedges consist of foreign exchange contracts. The amounts recorded in Accumulated other comprehensive income ("AOCI") primarily represent the change in spot rates at the time of the initial hedge compared to the spot rate when marked to market. The gain recognized in AOCI (effective portion) for the three and nine months ended September 26, 2009 was $1.5 million and $2.0 million, respectively.

The activity recorded within our consolidated statements of income relating to cash flow hedges include amounts reclassified from AOCI (effective portion) and forward points (ineffective portion). The following table presents the effect of our cash flow hedges:

	Gain (Loss) Reclassified from AOCI into Income (Effective Portion)			Amount of Forward Points Recognized in Income on Derivative (Ineffective Portion)	
Location of Gain (Loss) Reclassified from AOCI into Income (Effective Portion)	Three Months Ended September 26, 2009	Nine Months Ended September 26, 2009	Location where Forward Points are Recognized in Income on Derivative (Ineffective Portion)	Three Months Ended September 26, 2009	Nine Months Ended September 26, 2009
Other, net	$(2,262)	$(370)	Interest income	$123	$140
Cost of sales	4,069	4,279	Other, net	(1)	(15)

Undesignated Hedges

Our undesignated hedges consist of foreign exchange contracts. Losses associated with these foreign exchange contracts are recorded in Other, net within our consolidated statements of income and totaled $3.4 million and $8.9 million for the three and nine months ended September 26, 2009, respectively. Forward points related to these foreign exchange contracts, which are recorded in Interest expense within our consolidated statements of income, totaled $0 and $0.1 million for the three and nine months ended September 26, 2009, respectively.

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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," "foreca "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: decreased customer demand and changes in vendor credit terms; disruptions in financial markets; general economic conditions; 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 issues 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. We serve more than 575,000 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 76 years of experience distributing healthcare products.

We are headquartered in Melville, New York, employ more than 12,500 people (of which approximately 5,000 are based outside the United States) and have operations in the United States, Australia, Austria, Belgium, Canada, China, the Czech Republic, France, Germany, Ireland, Israel, Italy, Luxembourg, the Netherlands, New Zealand, Portugal, Slovakia, Spain, Switzerland and the United Kingdom. We also have affiliates in Iceland, Saudi Arabia 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 21 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.

Our current and future results have been and could be impacted by the current economic environment and uncertainty, particularly impacting overall demand for our products and services.

Industry Consolidation

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 $27.5 billion in 2008 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.

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, partially offset by the affects of increased unemployment on 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.

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 grow at slower rates. The Centers for Medicare and Medicaid Services, or CMS, published "National Health Expenditure Projections 2008 – 2018" indicating that total national healthcare spending reached $2.4 trillion in 2008, or 16.6% of the nation's gross domestic product, the benchmark measure for annual production of goods and services in the United States. Healthcare spending is projected to reach $4.4 trillion in 2018, approximately 20.3% 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 is currently the subject of a major Presidential initiative, and legislation expanding coverage and making other significant changes in the healthcare system is expected. Currently, and for the foreseeable future, a large portion of the total cost of medical care is and will be paid by government and private insurance programs. The reform effort may substantially modify rules governing such programs, affecting payment methods, rates and limits, as well as other matters. Additionally, the U.S. Food and Drug Administration ("FDA") has announced a new enforcement strategy to achieve more effective enforcement through new policies and accelerated procedures. We continue to work with our suppliers to comply with all applicable FDA rules and regulations.

The Medicare Prescription Drug, Improvement, and Modernization Act of 2003 has been the largest expansion of the Medicare program since its inception, and provides participants with voluntary outpatient prescription drug benefits. This Act also includes provisions relating to medication management programs, generic substitution and provider reimbursement.

As a distributor of equipment, supplies and drugs for medical, dental and animal health offices, we are subject to numerous federal laws regulating the intersection between healthcare providers and suppliers of goods and services to those providers. These laws make it unlawful to pay any remuneration, direct or indirect, to induce the referral, recommendation or arrangement of any healthcare services paid by a federal reimbursement program (e.g., Medicare and Medicaid). A violation may result in criminal or severe civil damages, and recent changes to the federal False Claims Act adopted in 2009 have expanded the potential liability. Many states have adopted similar laws, and recently, their own state false claims acts. A number of states have also recently passed legislation regulating interactions between vendors and practitioners, and more states may effect similar laws in the future.

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 human 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 human 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 human 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.

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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 26, 2009 and September 27, 2008 and cash flows for the nine months ended September 26, 2009 and September 27, 2008 (in thousands):

	Three Months Ended		Nine Months Ended	
	September 26, 2009	September 27, 2008 (1) (2)	September 26, 2009 (1)	September 27, 2008 (1) (2)
Operating results:				
Net sales	$1,659,433	$1,644,209	$4,752,255	$4,799,234
Cost of sales	1,183,166	1,168,615	3,361,707	3,389,847
Gross profit	476,267	475,594	1,390,548	1,409,387
Operating expenses:				
Selling, general and administrative	362,382	360,180	1,060,062	1,094,512
Restructuring costs	-	-	4,043	-
Operating income	$113,885	$115,414	$326,443	$314,875
Other expense, net	$(846)	$(9,843)	$(9,060)	$(20,123)
Income from continuing operations	98,375	72,818	237,758	199,985
Income from continuing operations attributable to Henry Schein, Inc.	96,421	67,488	224,745	183,498
Cash flows:				
Net cash provided by operating activities			$218,377	$188,664
Net cash used in investing activities			(125,865)	(85,705)
Net cash used in financing activities			(146,898)	(57,050)

(1) Adjusted to reflect the effects of discontinued operations.

(2) Adjusted to reflect the effects of the adoption of provisions contained within ASC Topic 470-20, “Debt with Conversion and Other Options.”

Plan of Restructuring

On November 5, 2008, we announced certain actions to reduce operating costs, which included the elimination of 430 positions from our operations and the closing of several smaller facilities. For the nine months ended September 26, 2009, we recorded restructuring costs of approximately $4.0 million (approximately $2.8 million after taxes). The costs associated with the restructuring are included in a separate line item, “Restructuring costs,” within our consolidated statements of income. We expect that the majority of these costs will be paid in 2009.

Annual pretax cost savings from this initiative are expected to be between $24.0 million and $27.0 million.

Three Months Ended September 26, 2009 Compared to Three Months Ended September 27, 2008

Net Sales

Net sales from continuing operations for the three months ended September 26, 2009 and September 27, 2008 were as follows (in thousands):

	September 26, 2009	% of Total	September 27, 2008 (1)	% of Total	Increase / (Decrease) $	%
Healthcare distribution (2):						
Dental (3)	$ 622,065	37.5 %	$ 641,487	39.0 %	$ (19,422)	(3.0)%
Medical (4)	410,617	24.7	423,675	25.8	(13,058)	(3.1)
International (5)	583,540	35.2	538,033	32.7	45,507	8.5
Total healthcare distribution	1,616,222	97.4	1,603,195	97.5	13,027	0.8
Technology (6)	43,211	2.6	41,014	2.5	2,197	5.4
Total	$ 1,659,433	100.0%	$ 1,644,209	100.0%	$ 15,224	0.9

(1) Adjusted to reflect the effects of discontinued operations.

(2) 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.

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

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

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

(6) 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.

The $15.2 million, or 0.9%, increase in net sales for the three months ended September 26, 2009 includes an increase of 4.0% local currency growth (0.6% decline internally generated revenue offset by 4.6% growth from acquisitions) offset by a decrease of 3.1% related to foreign currency exchange. Excluding sales of seasonal influenza vaccines, which declined from prior year's third quarter, net sales increased 3.7%, or 6.9% growth in local currencies.

The $19.4 million, or 3.0%, decrease in dental net sales for the three months ended September 26, 2009 includes a decrease of 2.5% in local currencies (4.9% decline in internally generated revenue offset by 2.4% growth from acquisitions) and a decrease of 0.5% related to foreign currency exchange. The 2.5% decline in local currency sales was due to a decline in dental equipment sales and service revenues of 12.8% (13.4% decline in internally generated revenue offset by 0.6% growth from acquisitions) offset by dental consumable merchandise sales growth of 1.3% (1.8% decline in internally generated revenue offset by 3.1% growth from acquisitions).

The $13.1 million, or 3.1%, decrease in medical net sales for the three months ended September 26, 2009 includes a decrease in internally generated revenue of 4.2% offset by acquisition growth of 1.1%. The decrease in medical net sales is primarily due to significantly lower sales of influenza vaccines versus the prior year. Excluding the effect of

influenza vaccine sales, internal medical net sales increased 7.2%. Approximately 3.1% of that growth was due to products related to the H1N1 virus.

The $45.5 million, or 8.5%, increase in international net sales for the three months ended September 26, 2009 includes sales growth of 16.9% in local currencies (7.0% internally generated growth and 9.9% growth from acquisitions) offset by a decrease of 8.4% related to foreign currency exchange.

The $2.2 million, or 5.4%, increase in technology net sales for the three months ended September 26, 2009 includes an increase of 7.3% local currency growth (4.6% internally generated growth and 2.7% growth from acquisitions) offset by a decrease of 1.9% related to foreign currency exchange.

Gross Profit

Gross profit and gross margin percentages from continuing operations by segment and in total for the three months ended September 26, 2009 and September 27, 2008 were as follows (in thousands):

	September 26, 2009	Gross Margin %	September 27, 2008 (1)	Gross Margin %	Increase / (Decrease) $	%
Healthcare distribution	$ 445,060	27.5 %	$ 445,245	27.8 %	$ (185)	0.0 %
Technology	31,207	72.2	30,349	74.0	858	2.8
Total	$ 476,267	28.7	$ 475,594	28.9	$ 673	0.1

(1) Adjusted to reflect the effects of discontinued operations.

For the three months ended September 26, 2009, gross profit increased $0.7 million, or 0.1%, 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, as well as certain financial services. The software industry typically realizes higher gross margins to recover investments in research and development.

Healthcare distribution gross profit decreased $0.2 million for the three months ended September 26, 2009 from the comparable prior year period. Healthcare distribution gross profit margin decreased to 27.5% for the three months ended September 26, 2009 from 27.8% for the comparable prior year period primarily due to changes in the product sales mix.

Technology gross profit increased $0.9 million, or 2.8%, for the three months ended September 26, 2009 from the comparable prior year period. Technology gross profit margin decreased to 72.2% for the three months ended September 26, 2009 from 74.0% 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 three months ended September 26, 2009 and September 27, 2008 were as follows (in thousands):

	September 26, 2009	% of Respective Net Sales	September 27, 2008 (1)	% of Respective Net Sales	Increase / (Decrease) $	%
Healthcare distribution	$ 346,810	21.5 %	$ 344,358	21.5 %	$ 2,452	0.7 %
Technology	15,572	36.0	15,822	38.6	(250)	(1.6)
Total	$ 362,382	21.8	$ 360,180	21.9	$ 2,202	0.6

(1) Adjusted to reflect the effects of discontinued operations.

Selling, general and administrative expenses increased $2.2 million, or 0.6%, to $362.4 million for the three months ended September 26, 2009 from the comparable prior year period. This increase results from $5.7 million in expense reductions offset by a $7.9 million net increase from selling, general and administrative costs of operations acquired offset by foreign exchange favorability. As a percentage of net sales, selling, general and administrative expenses decreased to 21.8% from 21.9% for the comparable prior year period.

As a component of selling, general and administrative expenses, selling expenses of $241.5 million for the three months ended September 26, 2009 remained consistent with the comparable prior year period. As a percentage of net sales, selling expenses decreased to 14.6% from 14.7% for the comparable prior year period.

As a component of selling, general and administrative expenses, general and administrative expenses increased $2.2 million, or 1.9%, to $120.9 million for the three months ended September 26, 2009 from the comparable prior year period. As a percentage of net sales, general and administrative expenses increased to 7.3% from 7.2% for the comparable prior year period.

Other Expense, Net

Other expense, net, from continuing operations for the three months ended September 26, 2009 and September 27, 2008 were as follows (in thousands):

	September 26, 2009	September 27, 2008 (1)	Increase / (Decrease) $	%
Interest income	$ 2,387	$ 4,260	$ (1,873)	(44.0)%
Interest expense	(5,171)	(9,240)	4,069	44.0
Other, net	1,938	(4,863)	6,801	139.9
Other expense, net	$ (846)	$ (9,843)	$ 8,997	91.4

(1) Adjusted to reflect the effects of discontinued operations and the adoption of provisions contained within ASC Topic 470-20, “Debt with Conversion and Other Options.”

Other expense, net decreased $9.0 million for the three months ended September 26, 2009 from the comparable prior year period. This decrease was primarily the result of decreased interest expense of $4.1 million due to repayment of our $130.0 million senior notes on June 30, 2009, interest rate swaps as well as lower interest rates on our floating rate debt, partially offset by a decrease in interest income of $1.9 million resulting from lower interest rates on our invested funds. In addition, Other, net increased by $6.8 million due primarily to net proceeds received from litigation settlements in the third quarter of 2009 and non-recurring charges incurred during the third quarter of 2008 relating to the bankruptcy of Lehman Brothers Holdings, Inc.

Income Taxes

For the three months ended September 26, 2009, our effective tax rate from continuing operations was 14.0% compared to 32.5% for the prior year period. The difference in our effective tax rates is primarily related to a reduction in the valuation allowance on foreign deferred tax assets during the third quarter of 2009. Absent the effects of the reversal of a portion of the valuation allowance on certain foreign deferred tax assets in the third quarter of 2009, our effective tax rate for the three months ended September 26, 2009 would have been 32.5%.

Nine Months Ended September 26, 2009 Compared to Nine Months Ended September 27, 2008

Net Sales

Net sales from continuing operations for the nine months ended September 26, 2009 and September 27, 2008 were as follows (in thousands):

	September 26, 2009 (1)	% of Total	September 27, 2008 (1)	% of Total	Increase / (Decrease) $	%
Healthcare distribution (2):						
Dental (3)	$ 1,838,240	38.7 %	$ 1,905,206	39.7 %	$ (66,966)	(3.5)%
Medical (4)	1,088,875	22.9	1,080,084	22.5	8,791	0.8
International (5)	1,699,053	35.8	1,693,017	35.3	6,036	0.4
Total healthcare distribution	4,626,168	97.4	4,678,307	97.5	(52,139)	(1.1)
Technology (6)	126,087	2.6	120,927	2.5	5,160	4.3
Total	$ 4,752,255	100.0%	$ 4,799,234	100.0%	$ (46,979)	(1.0)

(1) Adjusted to reflect the effects of discontinued operations.

(2) 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.

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

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

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

(6) 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.

The $47.0 million, or 1.0%, decrease in net sales for the nine months ended September 26, 2009 includes an increase of 4.9% local currency growth (4.7% growth from acquisitions and 0.2% internally generated revenue) offset by a decrease of 5.9% related to foreign currency exchange. Excluding sales of seasonal influenza vaccines, which declined from prior year's comparable period, net sales decreased 0.1% and increased 5.9% in local currencies.

The $67.0 million, or 3.5%, decrease in dental net sales for the nine months ended September 26, 2009 includes a decrease of 2.2% in local currencies (4.5% decline in internally generated revenue offset by 2.3% growth from acquisitions) and a decrease of 1.3% related to foreign currency exchange. The 2.2% decline in local currency sales was due to a decline in dental equipment sales and service revenues of 12.2% (12.7% decline in internally generated revenue offset by 0.5% growth from acquisitions) offset by dental consumable merchandise sales growth of 1.3% (1.7% decline in internally generated revenue offset by 3.0% growth from acquisitions).

The $8.8 million, or 0.8%, increase in medical net sales for the nine months ended September 26, 2009 includes a decrease in internally generated revenue of 0.4% offset by acquisition growth of 1.2%.

The $6.0 million, or 0.4%, increase in international net sales for the nine months ended September 26, 2009 includes sales growth of 15.4% in local currencies (5.3% internally generated growth and 10.1% growth from acquisitions) offset by a decrease of 15.0% related to foreign currency exchange.

The $5.2 million, or 4.3%, increase in technology net sales for the nine months ended September 26, 2009 includes sales growth of 7.7% in local currencies (6.8% internally generated growth and 0.9% growth from acquisitions) offset by a decrease of 3.4% related to foreign currency exchange.

Gross Profit

Gross profit and gross margin percentages from continuing operations by segment and in total for the nine months ended September 26, 2009 and September 27, 2008 were as follows (in thousands):

	September 26, 2009 (1)	Gross Margin %	September 27, 2008 (1)	Gross Margin %	Increase / (Decrease) $	%
Healthcare distribution	$ 1,299,397	28.1 %	$ 1,319,791	28.2 %	$ (20,394)	(1.5)%
Technology	91,151	72.3	89,596	74.1	1,555	1.7
Total	$ 1,390,548	29.3	$ 1,409,387	29.4	$ (18,839)	(1.3)

(1) Adjusted to reflect the effects of discontinued operations.

For the nine months ended September 26, 2009, gross profit decreased $18.8 million, or 1.3%, from the comparable prior year period.

Healthcare distribution gross profit decreased $20.4 million, or 1.5%, for the nine months ended September 26, 2009 from the comparable prior year period. Healthcare distribution gross profit margin decreased to 28.1% for the nine months ended September 26, 2009 from 28.2% for the comparable prior year period primarily due to changes in the product sales mix.

Technology gross profit increased $1.6 million, or 1.7%, for the nine months ended September 26, 2009 from the comparable prior year period. Technology gross profit margin decreased to 72.3% for the nine months ended September 26, 2009 from 74.1% 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 26, 2009 and September 27, 2008 were as follows (in thousands):

	September 26, 2009 (1)	% of Respective Net Sales	September 27, 2008 (1)	% of Respective Net Sales	Increase / (Decrease) $	%
Healthcare distribution	$ 1,014,736	21.9 %	$ 1,046,839	22.4 %	$ (32,103)	(3.1)%
Technology	45,326	35.9	47,673	39.4	(2,347)	(4.9)
Total	$ 1,060,062	22.3	$ 1,094,512	22.8	$ (34,450)	(3.1)

(1) Adjusted to reflect the effects of discontinued operations.

Selling, general and administrative expenses decreased $34.5 million, or 3.1%, to $1.1 billion for the nine months ended September 26, 2009 from the comparable prior year period. This decrease consists of $29.7 million in expense

reductions and a $4.8 million net reduction from the effects of favorable foreign exchange offset by the additional selling, general and administrative costs from operations acquired. As a percentage of net sales, selling, general and administrative expenses decreased to 22.3% from 22.8% for the comparable prior year period.

As a component of selling, general and administrative expenses, selling expenses decreased $32.9 million, or 4.5%, to $703.8 million for the nine months ended September 26, 2009 from the comparable prior year period. As a percentage of net sales, selling expenses decreased to 14.8% from 15.4% for the comparable prior year period.

As a component of selling, general and administrative expenses, general and administrative expenses decreased $1.6 million, or 0.4%, to $356.3 million for the nine months ended September 26, 2009 from the comparable prior year period. As a percentage of net sales, general and administrative expenses remained constant at 7.5% when compared with the comparable prior year period.

Other Expense, Net

Other expense, net, from continuing operations for the nine months ended September 26, 2009 and September 27, 2008 were as follows (in thousands):

	September 26, 2009 (1)	September 27, 2008 (1) (2)	Increase / (Decrease) $	%
Interest income	$ 7,674	$ 12,217	$ (4,543)	(37.2)%
Interest expense	(18,329)	(26,816)	8,487	31.6
Other, net	1,595	(5,524)	7,119	128.9
Other expense, net	$ (9,060)	$ (20,123)	$ 11,063	55.0

(1) Adjusted to reflect the effects of discontinued operations.

(2) Adjusted to reflect the effects of the adoption of provisions contained within ASC Topic 470-20, “Debt with Conversion and Other Options.”

Other expense, net decreased $11.1 million for the nine months ended September 26, 2009 from the comparable prior year period. This decrease was primarily the result of decreased interest expense of $8.5 million due to interest rate swaps, repayment of our $130.0 million senior notes on June 30, 2009, as well as lower interest rates on our floating rate debt, partially offset by a decrease in interest income of $4.5 million resulting from lower interest rates on our invested funds. In addition, Other, net increased by $7.1 million due primarily to net proceeds received from litigation settlements in the third quarter of 2009 and non-recurring charges incurred during the third quarter of 2008 relating to the bankruptcy of Lehman Brothers Holdings, Inc.

Income Taxes

For the nine months ended September 26, 2009, our effective tax rate from continuing operations was 26.3% compared to 33.5% for the prior year period. The difference in our effective tax rates is primarily related to a reduction in the valuation allowance on foreign deferred tax assets during the third quarter of 2009. Absent the effects of the reversal of a portion of the valuation allowance on certain foreign deferred tax assets in the third quarter of 2009, our effective tax rate for the nine months ended September 26, 2009 would have been 32.9%. The remaining difference in our effective tax rate between 2009 and 2008 is due to foreign and state income taxes.

Liquidity and Capital Resources

Our principal capital requirements include the funding of working capital needs, repayments of debt principal, funding of acquisitions, purchases of securities and fixed assets 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. Historically, sales have tended to be stronger during the third and fourth quarters and special inventory forward buy-in opportunities have been most prevalent just before the end of the year, causing our working capital requirements to have been higher from the end of the third quarter to the end of the first quarter of the following year. While recent history has resulted in flat to declining sales, we expect our historical seasonality of sales to continue in the foreseeable future.

We finance our business primarily through cash generated from our operations, revolving credit facilities and debt placements. 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 may decline slightly.

Net cash flow provided by operating activities was $218.4 million for the nine months ended September 26, 2009, compared to $188.7 million for the comparable prior year period. This net change of $29.7 million was primarily due to increased net income and changes in working capital. The timing of certain vendor payments occurring early in the year unfavorably affected cash flow by approximately $40 million to $50 million.

Net cash used in investing activities was $125.9 million for the nine months ended September 26, 2009, compared to $85.7 million for the comparable prior year period. The net change of $40.2 million was primarily due to increases in payments for business acquisitions and other investments, partially offset by proceeds received from a business divestiture and the absence of purchases of available-for-sale securities in the current year. We expect to invest approximately $10 million to $20 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 existing structure.

Net cash used in financing activities was $146.9 million for the nine months ended September 26, 2009, compared to net cash used in financing activities of $57.1 million for the comparable prior year period. The net change of $89.8 million was primarily due to increased payments for long-term debt, including repayment of $130.0 million of our senior notes on June 30, 2009, partially offset by the absence of stock repurchases in the current year.

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

	September 26, 2009	December 27, 2008 (1)
Cash and cash equivalents	$317,607	$369,570
Available-for-sale securities - long-term	20,353	29,028
Working capital	1,050,619	882,401
Debt:		
Bank credit lines	$1,731	$4,936
Current maturities of long-term debt	23,933	156,405
Long-term debt	242,511	256,648
Total debt	$268,175	$417,989

(1) Adjusted to reflect the adoption of provisions contained within ASC Topic 470-20, “Debt with Conversion and Other Options.”

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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.

As of September 26, 2009, we have approximately $22.3 million ($20.3 million net of temporary impairments) invested in auction-rate securities ("ARS"). ARS are publicly issued securities that represent long-term investments, typically 10-30 years, in which interest rates had reset periodically (typically every 7, 28 or 35 days) through a "dutch auction" process. Approximately $19.6 million ($17.6 million net of temporary impairments) of our ARS are backed by student loans that are backed by the federal government and the remaining $2.7 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 failure of these auctions has resulted in our inability to liquidate our ARS in the near term. 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. As of September 26, 2009, we have classified ARS holdings as long-term, available-for-sale and they are included in the Investment and other line within our consolidated balance sheets.

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.

Our accounts receivable days sales outstanding from continuing operations increased to 41.7 days as of September 26, 2009 from 41.2 days as of September 27, 2008. Our inventory turns from continuing operations decreased to 6.1 as of September 26, 2009 from 6.6 as of September 27, 2008. Our working capital accounts may be impacted by current and future economic conditions.

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:

- 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;
- 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 our debt obligations, including the cash portion of our convertible debt. 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 $20.0 million of remaining senior notes bear interest at a fixed rate of 6.7% per annum and mature on September 27, 2010. Interest on our senior notes is payable semi-annually.

In 2003, we entered into swap agreements relating to our $230.0 million 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 26, 2009, there is $20.0 million of principal remaining with a weighted-average interest rate of 4.72%. 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 26, 2009, there were no borrowings outstanding under this revolving credit facility and there were $10.3 million of letters of credit provided to third parties.

Under our common stock repurchase programs approved by our Board of Directors, we have $57.7 million available for future common stock share repurchases. During the quarter ended September 26, 2009, we did not repurchase any of our common stock.

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. Effective December 28, 2008, we have adopted the provisions of ASC Topic 480-10. ASC Topic 480-10 is applicable for noncontrolling interests where we are or may be required to purchase all or a portion of the outstanding interest in a consolidated subsidiary from the noncontrolling interest holder under the terms of a put option or other contractual agreements. As a result of the adoption of the provisions of ASC Topic 480-10, we have recorded the approximate redemption amount fair value of the put options as Redeemable noncontrolling interests ($177.5 million and $233.0 million at September 26, 2009 and December 27, 2008, respectively) and reduced Additional paid-in capital within the Stockholders' equity section of our consolidated balance sheets. The change in fair value of put options at September 26, 2009 compared to December 27, 2008 was primarily due to purchases of additional interests in consolidated subsidiaries offset by changes in the fair value of the put options. Changes in the estimated redemption amounts of the noncontrolling interests subject to put options are adjusted at each reporting period with a corresponding adjustment to equity. These adjustments will not impact the calculation of earnings per share. Additionally, some prior owners of such acquired subsidiaries are eligible to receive additional purchase price cash consideration if certain profitability targets are met. For acquisitions completed prior to 2009, we accrue liabilities that may arise from these transactions when we believe that the outcome of the contingency is determinable beyond a reasonable doubt. For 2009 and future acquisitions, as required by provisions contained within ASC Topic 805, "Business Combinations," we will accrue liabilities for the estimated fair value of additional purchase price adjustments at the time of the acquisition. Any adjustments to these accrual amounts will be recorded in our consolidated statement of income.

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.

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 27, 2008.

Recently Issued Accounting Standards

Accounting Pronouncements Adopted

In June 2009, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update No. 2009-01, "Generally Accepted Accounting Principles" (ASC Topic 105) which establishes the FASB Accounting Standards Codification ("the Codification" or "ASC") as the official single source of authoritative U.S. generally accepted accounting principles ("GAAP"). All existing accounting standards are superseded. All other accounting guidance not included in the Codification will be considered non-authoritative. The Codification also includes all relevant Securities and Exchange Commission ("SEC") guidance organized using the same topical structure in separate sections within the Codification. Following the Codification, the Board will not issue new standards in the form of Statements, FASB Staff Positions or Emerging Issues Task Force Abstracts. Instead, it will issue Accounting Standards Updates ("ASU") which will serve to update the Codification, provide background information about the guidance and provide the basis for conclusions on the changes to the Codification.

The Codification is not intended to change GAAP, but it will change the way GAAP is organized and presented. The Codification is effective for our third quarter 2009 financial statements and the principal impact on our financial statements is limited to disclosures as all future references to authoritative accounting literature will be referenced in accordance with the Codification.

Effective December 28, 2008, we have adopted the provisions of ASC Topic 480-10. ASC Topic 480-10 is applicable for noncontrolling interests where we are or may be required to purchase all or a portion of the outstanding interest in a consolidated subsidiary from the noncontrolling interest holder under the terms of a put option or other contractual agreements. As a result of the adoption of the provisions of ASC Topic 480-10, we have recorded the approximate redemption amount fair value of the put options as Redeemable noncontrolling interests ($177.5 million and $233.0 million at September 26, 2009 and December 27, 2008, respectively) and reduced Additional paid-in capital within the Stockholders' equity section of our consolidated balance sheets. The change in fair value of put options at September 26, 2009 compared to December 27, 2008 was primarily due to purchases of additional interests in consolidated subsidiaries offset by changes in the fair value of the put options. Changes in the estimated redemption amounts of the noncontrolling interests subject to put options are adjusted at each reporting period with a corresponding adjustment to equity. These adjustments will not impact the calculation of earnings per share.

New Accounting Pronouncements Not Yet Adopted

On September 23, 2009, the FASB ratified provisions of ASC Topic 605-25 related to revenue recognition for multiple-element arrangements. ASC Topic 605-25 amends prior guidance and requires an entity to apply the relative selling price allocation method in order to estimate the selling price for all units of accounting, including delivered items, when vendor-specific objective evidence or acceptable third-party evidence does not exist. These provisions contained within ASC Topic 605-25 are effective for revenue arrangements entered into or which contain material modifications in fiscal years beginning on or after June 15, 2010, applied prospectively. Earlier application is permitted as of the beginning of an entity's fiscal year. We are currently evaluating the potential impact that these provisions within ASC Topic 605-25 will have 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 27, 2008.

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 26, 2009 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 within the time periods specified in the SEC's rules and forms.

Changes in Internal Control Over Financial Reporting

The combination of continued acquisition activity, ongoing acquisition integrations and systems implementations undertaken during the quarter and carried over from prior quarters, when considered in the aggregate, represents a material change in our internal control over financial reporting.

Post-acquisition related activities continued for dental, medical and technology businesses acquired between December 2008 and September 2009 within the United States and internationally with approximate aggregate annual revenues of $116.0 million. These acquisitions continue to utilize separate information and financial accounting systems, and have been included in our consolidated financial statements.

During the quarter, systems implementation activities related to the upgrade of SAP were completed for European dental, medical, and animal health businesses with approximate aggregate annual revenues of $992.0 million. Additionally, acquisition integration activities were completed for international dental businesses with approximate aggregate annual revenues of $38.0 million.

All acquisitions, acquisition integrations and systems implementations involve necessary and appropriate change-management controls that are considered in our annual assessment of the design and operating effectiveness of 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.

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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 product liability 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 have a material adverse effect on our financial condition or results of operations.

As of September 26, 2009, 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 both October 31, 2005 and March 28, 2007, our Board of Directors authorized an additional $100.0 million, for a total of $300.0 million, of shares of our common stock to be repurchased under this program. As of September 26, 2009, we had repurchased $242.3 million of common stock (5,633,952 shares) under this initiative, with $57.7 million available for future common stock share repurchases.

During the fiscal quarter ended September 26, 2009, we did not repurchase any of our common stock. The maximum number of shares that may yet be purchased under this program, as shown below, is determined at the end of each month based on the closing price of our common stock at that time.

Fiscal Month	Maximum Number of Shares that May Yet Be Purchased Under Our Program
	1,123,694

06/28/09 through 08/01/09	
08/02/09 through 08/29/09	1,097,631
08/30/09 through 09/26/09	1,054,335

ITEM 6. EXHIBITS

Exhibits.

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

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 4, 2009