HENRY SCHEIN INC
Form 10-Q
November 06, 2007

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

(Mark One)

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

For the quarterly period ended September 29, 2007

OR

o **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)

Registrant s telephone number, including area code: (631) 843-5500

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 þ No o

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of accelerated filer and large accelerated filer in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer þ Accelerated filer o Non-accelerated filer o

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

Yes o No þ

As of October 31, 2007, there were 89,537,726 shares of the registrant s common stock outstanding.

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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 29, 2007 (unaudited)	December 30, 2006
ASSETS		
Current assets:		
Cash and cash equivalents	$ 207,458	$ 248,647
Available-for-sale securities	27,750	47,999
Accounts receivable, net of reserves of $42,006 and $40,536	764,590	610,020
Inventories, net	676,557	584,103
Deferred income taxes	31,742	28,240
Prepaid expenses and other	145,372	125,839
Total current assets	1,853,469	1,644,848
Property and equipment, net	236,309	225,038
Goodwill	887,285	773,801
Other intangibles, net	203,389	161,542
Investments and other	103,041	75,917
Total assets	$ 3,283,493	$ 2,881,146
LIABILITIES AND STOCKHOLDERS EQUITY		
Current liabilities:		
Accounts payable	$ 514,830	$ 414,062
Bank credit lines	2,856	2,528
Current maturities of long-term debt	29,050	41,036
Accrued expenses:		
Payroll and related	122,898	110,401
Taxes	77,882	59,007
Business acquisition	61,615	
Other	204,760	183,054
Total current liabilities	1,013,891	810,088
Long-term debt	432,279	455,806
Deferred income taxes	71,916	62,334
Other liabilities	62,206	60,209
Minority interest	29,646	21,746
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, 89,503,384 outstanding on September 29, 2007 and 88,499,321 outstanding on December 30, 2006		895		885
Additional paid-in capital		665,013		614,551
Retained earnings		926,786		808,164
Accumulated other comprehensive income		80,861		47,363
Total stockholders equity		1,673,555		1,470,963
Total liabilities and stockholders equity	$	3,283,493	$	2,881,146

See accompanying notes.

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

	Three Months Ended		Nine Months Ended	
	September 29, 2007	**September 30, 2006**	**September 29, 2007**	**September 30, 2006**
Net sales	$ 1,505,575	$ 1,246,553	$ 4,202,720	$ 3,573,127
Cost of sales	1,076,245	887,495	2,968,567	2,521,303
Gross profit	429,330	359,058	1,234,153	1,051,824
Operating expenses:				
Selling, general and administrative	332,630	296,457	972,880	852,228
Operating income	96,700	62,601	261,273	199,596
Other income (expense):				
Interest income	4,378	3,485	12,766	11,980
Interest expense	(6,216)	(6,504)	(18,381)	(21,107)
Other, net	3,917	2,294	4,342	2,165
Income from continuing operations before taxes, minority interest and equity in earnings (losses) of affiliates	98,779	61,876	260,000	192,634
Income taxes	(33,682)	(21,695)	(89,788)	(69,062)
Minority interest in net income of subsidiaries	(4,247)	(1,181)	(11,004)	(4,447)
Equity in earnings (losses) of affiliates	(182)	246	(687)	581
Income from continuing operations	60,668	39,246	158,521	119,706
Discontinued operations:				
Income (loss) from operations of discontinued components (including write-down of long-lived assets of $32.7 million in 2007 and a loss on sale of discontinued operation of $1.5 million in 2007 and $32.3 million in 2006 Note 4)	(1,742)	59	(34,302)	(31,601)
Income tax benefit (expense)	647	(20)	12,685	12,657
Income (loss) from discontinued operations	(1,095)	39	(21,617)	(18,944)
Net income	$ 59,573	$ 39,285	$ 136,904	$ 100,762

Earnings from continuing operations per share:

Basic	$ 0.68	$ 0.44	$ 1.79	$ 1.36
Diluted	$ 0.66	$ 0.44	$ 1.75	$ 1.34
Loss from discontinued operations per share:				
Basic	$ (0.01)	$ 0.00	$ (0.24)	$ (0.21)
Diluted	$ (0.01)	$ 0.00	$ (0.24)	$ (0.21)
Earnings per share:				
Basic	$ 0.67	$ 0.44	$ 1.55	$ 1.15
Diluted	$ 0.65	$ 0.44	$ 1.51	$ 1.13
Weighted-average common shares outstanding:				
Basic	88,790	88,291	88,383	87,820
Diluted	91,399	90,015	90,779	89,554

See accompanying notes.

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

	Nine Months Ended	
	September 29, 2007	September 30, 2006
Cash flows from operating activities:		
Net income	$ 136,904	$ 100,762
Adjustments to reconcile net income to net cash provided by operating activities:		
Loss on sale of discontinued operation, net of tax	929	19,363
Depreciation and amortization	53,021	46,891
Stock-based compensation expense	16,720	13,933
Impairment from write down of long-lived assets of discontinued operations	32,667	
Provision for losses on trade and other accounts receivable	1,062	2,343
Benefit from deferred income taxes	(16,730)	(2,662)
Stock issued to 401(k) plan	4,104	3,565
Undistributed earnings (losses) of affiliates	687	(581)
Minority interest in net income of subsidiaries	11,004	4,447
Other	(2,870)	(2,549)
Changes in operating assets and liabilities, net of acquisitions:		
Accounts receivable	(82,521)	(9,418)
Inventories	(31,941)	(35,967)
Other current assets	(9,841)	7,376
Accounts payable and accrued expenses	36,730	(82,877)
Net cash provided by operating activities	149,925	64,626
Cash flows from investing activities:		
Purchases of fixed assets	(33,023)	(49,927)
Payments for equity investment and business acquisitions, net of cash acquired	(124,298)	(186,132)
Cash received from business divestitures	5,061	36,527
Purchases of available-for-sale securities	(115,066)	(164,037)
Proceeds from sales of available-for-sale securities	135,315	286,767
Proceeds from maturities of available-for-sale securities		1,280
Net payments for foreign exchange forward contract settlements	(16,980)	(16,895)
Other	(11,037)	(6,604)
Net cash used in investing activities	(160,028)	(99,021)
Cash flows from financing activities:		
Proceeds from issuance of long-term debt	483	
Proceeds from (repayments of) bank borrowings	(4,554)	297
Principal payments for long-term debt	(42,529)	(30,677)

Proceeds from issuance of stock upon exercise of stock options	32,719	32,900
Payments for repurchases of common stock	(30,689)	(25,700)
Excess tax benefits related to stock-based compensation	11,597	13,150
Other	(1,879)	1,665
Net cash used in financing activities	(34,852)	(8,365)
Net change in cash and cash equivalents	(44,955)	(42,760)
Effect of exchange rate changes on cash and cash equivalents	3,766	8,147
Cash and cash equivalents, beginning of period	248,647	210,683
Cash and cash equivalents, end of period	$ 207,458	$ 176,070

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 30, 2006.

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 29, 2007 are not necessarily indicative of the results to be expected of any other interim period or for the year ending December 29, 2007.

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 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 20 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 and the United Kingdom. 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 and continuing education services for practitioners.

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

Note 2. Segment Data (Continued)

The following tables present information about our reportable segments:

	Three Months Ended		Nine Months Ended	
	September 29, 2007	September 30, 2006 (1)	September 29, 2007	September 30, 2006 (1)
Net Sales:				
Healthcare distribution (2):				
Dental (3)	$ 616,972	$ 538,493	$ 1,780,790	$ 1,532,399
Medical (4)	444,990	355,968	1,152,057	983,635
International (5)	411,772	327,499	1,177,742	986,338
Total healthcare distribution	1,473,734	1,221,960	4,110,589	3,502,372
Technology (6)	31,841	24,593	92,131	70,755
Total	$ 1,505,575	$ 1,246,553	$ 4,202,720	$ 3,573,127

(1) Adjusted to reflect the effects of discontinued operations. See Note 4.

(2) Consists of consumable products, small equipment, laboratory products, large dental 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 and Canada.

	Three Months Ended		Nine Months Ended	
	September 29, 2007	**September 30, 2006 (1)**	**September 29, 2007**	**September 30, 2006 (1)**
Operating Income:				
Healthcare distribution	$ 85,372	$ 54,171	$ 226,984	$ 173,277
Technology	11,328	8,430	34,289	26,319
Total	$ 96,700	$ 62,601	$ 261,273	$ 199,596

(1) Adjusted to reflect the effects of discontinued operations. See Note 4.

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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

Effective January 1, 2006, we adopted the provisions of Statement of Financial Accounting Standards No. 123(R), Share-Based Payment (FAS 123(R)). We previously applied Accounting Principles Board Opinion No. 25, Accounting for Stock Issued to Employees, and related Interpretations and provided the required pro forma disclosures of FAS 123, Accounting for Stock-Based Compensation, in our consolidated financial statements. We elected to adopt the modified retrospective application method provided by FAS 123(R).

Our accompanying unaudited consolidated statements of income reflect pretax share-based compensation expense of $6.0 million ($4.0 million after-tax) and $16.7 million ($11.0 million after-tax) for the three and nine months ended September 29, 2007 and $4.5 million ($2.9 million after-tax) and $13.9 million ($8.9 million after-tax) for the three and nine months ended September 30, 2006.

Our accompanying unaudited consolidated statements of cash flows present our stock-based compensation expense as an adjustment to reconcile net income to net cash provided by operating activities for all periods presented. Benefits of $11.6 million and $13.2 million associated with tax deductions in excess of recognized compensation expense are presented as a cash inflow from financing activities for the nine months ended September 29, 2007 and September 30, 2006.

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

Stock-based awards are provided to certain employees and non-employee directors under the terms of our 1994 Stock Incentive Plan, as amended, and our 1996 Non-Employee Director Stock Incentive Plan, as amended (together, the Plans). The Plans are administered by the Compensation Committee of the Board of Directors. Awards under the Plans principally include a combination of at-the-money stock options and restricted stock (including restricted stock units). As of September 29, 2007, there were 23,777,270 shares authorized and 5,064,809 shares available to be granted under the 1994 Stock Incentive Plan and 800,000 shares authorized and 266,837 shares available to be granted under the 1996 Non-Employee Director Stock Incentive Plan.

Stock options are awards that allow the recipient to purchase shares of our common stock at a fixed price. Stock options are granted at an exercise price equal to our closing stock price on the date of grant. These awards, which generally vest 25% per year based on the recipient s continued service subject to the terms and conditions of the Plans, are fully vested four years from the grant date and have a contractual term of ten years from the grant date. Additionally, recipients may not sell any shares that they acquire through exercising their stock options until the third anniversary of the date of grant of such options. We estimate the fair value of stock options using the Black-Scholes valuation model.

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

With respect to time-based restricted stock, we estimate the fair value on the date of grant based on our closing stock price. With respect to performance-based restricted stock, the number of shares that ultimately vest and are received by the recipient is based upon our earnings per share performance measured against specified targets over a three-year period as determined by the Compensation

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

Note 3. Stock-Based Compensation (Continued)

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, assuming that performance targets will be achieved. Over the performance period, the number of shares of common stock that will ultimately vest and be issued is adjusted upward or downward based upon our estimation of achieving such performance targets. The ultimate number of shares delivered to recipients and the related compensation cost recognized as an expense will be based on our actual performance metrics.

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

We record deferred income tax assets for awards that result in deductions on our income tax returns, based on the amount of compensation cost recognized and our statutory tax rate in the jurisdiction in which we will receive a deduction. Differences between the deferred income tax assets recognized for financial reporting purposes and the actual tax deduction reported on our income tax return are recorded in additional paid-in capital (if the tax deduction exceeds the deferred income tax asset) or in earnings (if the deferred income tax asset exceeds the tax deduction and no additional paid-in capital exists from previous awards).

Stock-based compensation expense for the nine months ended September 29, 2007 and September 30, 2006 was generated through stock options, restricted stock and restricted stock unit grants. The weighted-average grant date fair value of stock-based awards granted before forfeitures was $24.37 and $21.01 per share during the three months ended September 29, 2007 and September 30, 2006, and $21.61 and $23.37 per share during the nine months ended September 29, 2007 and September 30, 2006. For the three and nine months ended September 29, 2007, the fair value of stock-based awards issued was evenly divided between stock options and restricted stock (including RSUs).

Total unrecognized compensation cost related to non-vested awards as of September 29, 2007 was $47.1 million, which is expected to be recognized over a weighted-average period of approximately two years. There were no significant capitalized stock-based compensation costs as of September 29, 2007.

The following table summarizes stock option activity under the Plans during the nine months ended September 29, 2007:

	Shares	Weighted Average Exercise Price	Weighted Average Remaining Contractual Life in Years	Aggregate Intrinsic Value
Outstanding at beginning of period	7,477,321	$ 30.54		
Granted	930,844	51.26		
Exercised	(1,384,109)	23.81		
Forfeited	(69,466)	41.75		
Outstanding at end of period	6,954,590	34.55	6.6	$ 182,850,628
Options exercisable at end of period	4,953,907	$ 30.02	5.8	$ 152,687,329

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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 (Continued)

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

	2007	2006
Expected dividend yield	0%	0%
Expected stock price volatility	20%	25%
Risk-free interest rate	4.75%	4.75%
Expected life of options (years)	4.5	5

We have not declared cash dividends on our stock in the past and we do not anticipate declaring cash dividends in the foreseeable future. The expected stock price volatility is based on the evaluation of implied volatilities from traded call options on our stock and from call options embedded in our existing convertible debt, historical volatility of our stock and other factors. The risk-free interest rate is based on the U.S. Treasury yield curve in effect on the date of grant in conjunction with considering the expected life of options. The expected life of options represents the approximate period of time that granted options are expected to be outstanding and is based on historical data, including, among other things, option exercises, forfeitures and cancellations. Estimates of fair value are not intended to predict actual future events or the value ultimately realized by recipients of stock options, and subsequent events are not indicative of the reasonableness of the original estimates of fair value made by us.

The total intrinsic value, the amount by which the fair value of the underlying stock exceeds the exercise price of the option, of stock options exercised was $12.7 million and $12.0 million for the three months ended September 29, 2007 and September 30, 2006, and $42.2 million and $48.6 million for the nine months ended September 29, 2007 and September 30, 2006. The total cash received as a result of stock option exercises for the nine months ended September 29, 2007 and September 30, 2006 was approximately $32.7 million and $32.9 million. In connection with these exercises, the tax benefits that we realized for the nine months ended September 29, 2007 and September 30, 2006 were $9.7 million and $12.0 million. We settle employee stock option exercises with newly issued common shares.

The total intrinsic value of restricted stock (including RSUs) that vested was $44 and $38 during the three months ended September 29, 2007 and September 30, 2006, and $125 and $110 during the nine months ended September 29, 2007 and September 30, 2006. The following table summarizes the status of our non-vested restricted shares/units for the nine months ended September 29, 2007:

	Time-Based Restricted Stock/Units	
	Shares/Units	Weighted Average Grant Date Fair Value
Outstanding at beginning of period	113,994	$ 5,042,725
Granted	99,398	5,101,444
Vested	(2,317)	(72,842)
Forfeited	(4,470)	(217,166)
Outstanding at end of period	206,605	$ 9,854,161

	Performance-Based Restricted Stock/Units	
	Shares/Units	Weighted Average Grant Date Fair Value
Outstanding at beginning of period	225,543	$ 10,657,767
Granted	94,329	5,036,684
Forfeited	(4,470)	(217,166)
Outstanding at end of period	315,402	$ 15,477,285

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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, Discontinued Operations, Divestitures, and Other Transactions

Acquisitions

In July 2007, we completed the acquisition of the fifty percent of Becker-Parkin Dental Supply Co. (Becker-Parkin) that we did not own for a purchase price of approximately $22 million. We then integrated the full service and special markets portions of this business into our existing dental operations. We recorded a pretax gain of approximately $2.4 million relating to the dispositions of certain non-core businesses of Becker-Parkin. These dispositions included the contribution of certain non-core businesses of Becker-Parkin into an unconsolidated entity. We will continue to account for this investment using the equity method.

In August 2007, we acquired W&J Dunlop, Ltd., a leading supplier of animal health products and services to veterinary clinics in the United Kingdom, with revenues of approximately $340 million for the year ended September 29, 2007, for a purchase price, including fees, of approximately $68.4 million.

In September 2007, we received sufficient acceptances of our offer to acquire Software of Excellence International Ltd., (NZX: SOE), for NZ$2.90 per share, and we made our offer unconditional as of September 29, 2007. The total purchase price, including fees, was approximately $62.2 million. The transaction closed on October 26, 2007.

We completed certain other acquisitions during the three months ended September 29, 2007. 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.

Discontinued Operations

During the three-month period ended June 30, 2007, we reached a decision to divest our lower-margin oncology pharmaceutical and specialty pharmacy businesses (the Discontinued Businesses), which are components of our healthcare distribution business. These Discontinued Businesses were not strategic to the medical group, and their divestiture will allow for enhanced focus on the sale of more profitable products to office-based practitioners. Please see the Divestitures section below for a discussion of the sale of our oncology pharmaceutical business.

We intend to sell the remaining specialty pharmacy business within the next nine months, and consequently have classified the operating results of these Discontinued Businesses as discontinued operations in the accompanying consolidated statements of income for all periods presented. In connection with this decision, we assessed our long-lived assets for impairment, which resulted in the recording of an impairment charge during the second quarter of 2007 of $32.7 million ($20.6 million after-tax) for the write-down of all long-lived assets, including goodwill of $30.1 million.

Net sales generated by these Discontinued Businesses were $20.4 million and $25.5 million for the three-month periods ended September 29, 2007 and September 30, 2006, and $70.6 million and $81.0 million for the nine-month periods ended September 29, 2007 and September 30, 2006.

The carrying amounts of the major classes of the assets held-for-sale for the remaining specialty pharmacy business as of September 29, 2007 included accounts receivable, net of reserves, of $4.0 million and inventories, net of reserves, of $1.8 million.

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

Note 4. Business Acquisitions, Discontinued Operations, Divestitures, and Other Transactions (Continued)

Divestitures

On August 13, 2007, we completed the sale of our oncology pharmaceutical business for aggregate consideration of $5.9 million. The total pretax loss on discontinued operations is $2.0 million (consisting of a $1.5 million loss on the sale and a $0.5 million loss from operations, which has been reported as discontinued operations in the accompanying unaudited consolidated statements of income).

On April 1, 2006, we sold substantially all of the assets of our hospital supply business, previously reported as part of our healthcare distribution reportable segment. The sale price was $36.5 million, which was received in 2006. As a result of this sale, included in the operating results from discontinued operations for the nine months ended September 30, 2006 is a $32.3 million ($19.4 million after-tax) loss on the sale, including $3.5 million ($2.1 million after-tax) of transitional service obligations and selling costs.

Loan and Investment Agreement

As of September 29, 2007, we loaned D4D Technologies, LLC (D4D) $12.0 million and, if certain operational milestones are achieved, an additional $4.0 million loan is expected to be made by the second quarter of 2008. The loans are repayable between December 2007 and July 2013.

We also agreed to make additional equity investments in D4D totaling $27.7 million contingent upon the achievement of specified D4D operational milestones. We have the option to fund a portion of our second equity investment in D4D by utilizing the loan amounts due to us from D4D. We expect to account for such investments under the equity method prospectively from the date of our first equity investment.

Note 5. Earnings Per Share

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

For the three and nine months ended September 29, 2007 and September 30, 2006, diluted earnings per share includes the effect of common shares issuable upon conversion of our convertible debt. During the period, the debt was convertible at a premium as a result of the conditions of the debt. As a result, the amount in excess of the principal is presumed to be settled in common shares and is reflected in our calculation of diluted earnings per share.

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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 29, 2007	September 30, 2006	September 29, 2007	September 30, 2006
Basic	88,790,332	88,290,865	88,383,249	87,820,407
Effect of assumed exercise of stock options	1,106,356	1,202,392	1,204,435	1,437,371
Effect of assumed vesting of restricted stock	517,478	251,425	459,898	198,288
Effect of assumed conversion of convertible debt	984,790	270,437	731,384	98,350
Diluted	91,398,956	90,015,119	90,778,966	89,554,416

Weighted-average options to purchase 2,388 shares of common stock at exercise prices ranging from $50.15 to $51.10 per share that were outstanding during the three months ended September 30, 2006 were excluded from the computation of diluted earnings per share. Weighted-average options to purchase 3,321 shares of common stock at an exercise price of $55.18 per share and 640,546 shares of common stock at exercise prices ranging from $47.31 to $51.10 per share that were outstanding during the nine months ended September 29, 2007 and September 30, 2006, respectively, were excluded from the computation of diluted earnings per share. In each of these periods, such options exercise prices exceeded the average market price of our common stock, thereby causing the effect of such options to be anti-dilutive.

Note 6. Comprehensive Income

Comprehensive income includes certain gains and losses that, under accounting principles generally accepted in the United States, are excluded from net income as such amounts are recorded directly as an adjustment to stockholders equity. Our comprehensive income is primarily comprised of net income and foreign currency translation adjustments, but also includes unrealized gains and losses on hedging activity and pension adjustments. Comprehensive income totaled $84.3 million and $170.4 million for the three and nine months ended September 29, 2007 and $35.7 million and $120.9 million for the three and nine months ended September 30, 2006.

Note 7. Income Taxes

In July 2006, the Financial Accounting Standards Board issued FAS Interpretation No. 48, Accounting for Uncertainty in Income Taxes an interpretation of FAS No. 109 (FIN 48). FIN 48 clarifies the accounting for uncertainty in income taxes recognized in the financial statements in accordance with FAS No. 109, Accounting for Income Taxes. FIN 48 prescribes a recognition threshold and a measurement attribute for the financial statement recognitions and measurement of tax positions taken or expected to be taken in a tax return. For those benefits to be recognized, a tax position must be more likely than not to be sustained upon examination by the taxing authorities. The amount recognized is measured as the largest amount of benefit that is greater than 50% likely of being realized upon ultimate audit settlement. The adoption of FIN 48, effective December 31, 2006, resulted in a decrease to stockholders equity of approximately $0.3 million.

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

Note 7. Income Taxes (Continued)

The total amount of unrecognized tax benefits as of the date of adoption was approximately $12.7 million, all of which would affect the effective tax rate if recognized. The total amount of unrecognized tax benefits as of September 29, 2007 was approximately $10.3 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, which are classified as a component of the provision for income taxes, were approximately $2.0 million and $0, respectively, as of the date of adoption. The total amount of interest and penalties classified as a component of income tax expense was insignificant. 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.

As a result of tax legislation enacted in Germany and the United Kingdom in the third quarter of 2007, deferred income taxes were revalued resulting in a $3.2 million reduction in deferred income tax accounts and a corresponding reduction of income tax expense. Additionally, in response to the legislation enacted in Germany, a restructuring was implemented in the third quarter resulting in a non-recurring income tax charge of $3.5 million.

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

Note 8. Supplemental Cash Flow Information

Cash paid for interest and income taxes was:

	Nine Months Ended	
	September 29, 2007	**September 30, 2006**
Interest	$26,296	$ 26,528
Income taxes	64,920	54,083

During the nine months ended September 29, 2007, we had a $1.0 million non-cash net unrealized gain related to hedging activities. During the third quarter of 2007, we received $3.5 million of the $5.9 million sales proceeds related to the sale of our oncology pharmaceutical business. Further, in connection with our sale of our hospital supply business, we received $34.5 million of the $36.5 million sales proceeds on April 3, 2006, with the balance received during the remainder of 2006. In connection with our acquisition of Software of Excellence International Ltd., we recorded a $61.6 million liability which remained outstanding as of September 29, 2007.

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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, f project, anticipate or other comparable terms.

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

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

Executive-Level Overview

We believe we are the largest distributor of healthcare products and services primarily to office-based healthcare practitioners in the combined North American and European markets. We serve more than 500,000 customers worldwide, including dental practitioners and laboratories, physician practices and animal health clinics, as well as government and other institutions. We believe that we have a strong brand identity due to our more than 75 years of experience distributing healthcare products.

We are headquartered in Melville, New York, employ nearly 12,000 people and have operations in the United States, Australia, Austria, Belgium, Canada, China, the Czech Republic, France, Germany, Ireland, Israel, Italy, Lebanon, Luxembourg, the Netherlands, New Zealand, Portugal, Spain, Switzerland, the United Arab Emirates and the United Kingdom. We also have an affiliate in Iceland.

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 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 20 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 and the United Kingdom. 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 and continuing education services for practitioners.

Industry Overview

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

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

Industry Consolidation

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 $22.0 billion in 2006 in the combined North American and European markets. The industry ranges from sole practitioners working out of relatively small offices to group practices or service organizations ranging in size from a few practitioners to a large number of practitioners who have combined or otherwise associated their practices.

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

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

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

As industry consolidation continues, we believe that we are positioned to capitalize on this trend, as we believe we have the ability to support increased sales through our existing infrastructure. In the U.S. dental market, we estimate that there are currently more than 300 smaller distributors holding approximately 25% of the market. In the U.S. medical market, we estimate that more than 500 smaller distributors hold approximately 50% of the market, and in the European dental market, we estimate that more than 200 smaller distributors hold approximately 80% of the market.

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

Aging Population and Other Market Influences

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

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

As a result of these market dynamics, annual expenditures for healthcare services continue to increase in the United States. The Centers for Medicare and Medicaid Services (CMS) published National Health Care Expenditures Projections: 2005 2015 indicating that total national healthcare spending reached $1.9 trillion in 2004, or 16.0% 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 $4.0 trillion in 2015, an estimated 20.0% of the nation s gross domestic product.

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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 29, 2007 and September 30, 2006, and cash flows for the nine months ended September 29, 2007 and September 30, 2006 (in thousands):

	Three Months Ended		Nine Months Ended	
	September 29, 2007	September 30, 2006 (1)	September 29, 2007	September 30, 2006 (1)
Operating Results:				
Net sales	$ 1,505,575	$ 1,246,553	$ 4,202,720	$ 3,573,127
Cost of sales	1,076,245	887,495	2,968,567	2,521,303
Gross profit	429,330	359,058	1,234,153	1,051,824
Operating expenses:				
Selling, general and administrative	332,630	296,457	972,880	852,228
Operating income	$ 96,700	$ 62,601	$ 261,273	$ 199,596
Other expense, net	$ 2,079	$ (725)	$ (1,273)	$ (6,962)
Income from continuing operations	60,668	39,246	158,521	119,706
Cash Flows:				
Net cash provided by operating activities			$ 149,925	$ 64,626
Net cash used in investing activities			160,028	99,021
Net cash used in financing activities			34,852	8,365

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

Three Months Ended September 29, 2007 Compared to Three Months Ended September 30, 2006

Net Sales

Net sales from continuing operations for the three months ended September 29, 2007 and September 30, 2006 were as follows (in thousands):

	September 29, 2007	% of Total	September 30, 2006 (1)	% of Total
Healthcare distribution (2):				
Dental (3)	$ 616,972	41.0%	$ 538,493	43.2%
Medical (4)	444,990	29.6	355,968	28.5
International (5)	411,772	27.3	327,499	26.3
Total healthcare distribution	1,473,734	97.9	1,221,960	98.0
Technology (6)	31,841	2.1	24,593	2.0

Total	$ 1,505,575	100.0%	$ 1,246,553	100.0%

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

(2) Consists of consumable products, small equipment, laboratory products, large dental 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 and Canada.

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The $259.0 million, or 20.8%, increase in net sales for the three months ended September 29, 2007 includes increases of 18.3% local currency growth (13.0% internally generated primarily due to volume growth and 5.3% from acquisitions) and 2.5% related to foreign currency exchange.

The $78.5 million, or 14.6%, increase in dental net sales for the three months ended September 29, 2007 includes increases of 13.8% local currency growth (10.4% internally generated primarily due to increased volume and 3.4% from acquisitions) and 0.8% related to foreign currency exchange. The 13.8% local currency growth was due to dental consumable merchandise sales growth of 9.9% (6.0% internal growth and 3.9% from acquisitions) and dental equipment sales and service growth of 25.9% (24.1% internal growth and 1.8% from acquisitions).

The $89.0 million, or 25.0%, increase in medical net sales for the three months ended September 29, 2007 includes internal growth of 22.5% and acquisition growth of 2.5%. The 22.5% internal sales growth was due to influenza vaccine net sales growth of 15.6% and other products net sales growth of 6.9%. During the quarter we sold approximately 7.3 million doses of influenza vaccine.

The $84.3 million, or 25.7%, increase in international net sales for the three months ended September 29, 2007 includes increases of 17.4% in local currencies (6.9% internally generated and 10.5% from acquisitions), and 8.3% related to foreign currency exchange.

The $7.2 million, or 29.5%, increase in technology net sales for the three months ended September 29, 2007 includes increases of 29.0% in local currency growth (15.5% internally generated and 13.5% from acquisitions) and 0.5% related to foreign currency exchange. The increase was driven by growth in electronic services, software and financial services revenue.

Gross Profit

Gross profit and gross margin percentages from continuing operations by segment and in total for the three months ended September 29, 2007 and September 30, 2006 were as follows (in thousands):

	September 29, 2007	Gross Margin %	September 30, 2006 (1)	Gross Margin %
Healthcare distribution	$ 405,536	27.5%	$ 340,249	27.8%
Technology	23,794	74.7	18,809	76.5
Total	$ 429,330	28.5	$ 359,058	28.8

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

For the three months ended September 29, 2007, gross profit increased $70.3 million, or 19.6%, 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 those of other distribution companies. Additionally, we realize substantially higher gross margin percentages in our technology segment than in our healthcare distribution segment. These higher gross margins result from being both the developer and seller of software products combined with the nature of the software industry, in which developers typically realize higher gross margins to recover investments in research and development.

Healthcare distribution gross profit increased $65.3 million, or 19.2%, for the three months ended September 29, 2007 from the comparable prior year period. Healthcare distribution gross profit margin decreased to 27.5% for the three months ended September 29, 2007 from 27.8% for the comparable prior year period as a result of changes in the product sales mix.

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Technology gross profit increased $5.0 million, or 26.5%, for the three months ended September 29, 2007 from the comparable prior year period. Technology gross profit margin decreased to 74.7% for the three months ended September 29, 2007 from 76.5% 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 29, 2007 and September 30, 2006 were as follows (in thousands):

	September 29, 2007	% of Respective Net Sales	September 30, 2006 (1)	% of Respective Net Sales
Healthcare distribution	$ 320,164	21.7%	$ 286,076	23.4%
Technology	12,466	39.2	10,381	42.2
Total	$ 332,630	22.1	$ 296,457	23.8

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

Selling, general and administrative expenses increased $36.2 million, or 12.2%, to $332.6 million for the three months ended September 29, 2007 from the comparable prior year period. As a percentage of net sales, selling, general and administrative expenses decreased to 22.1% from 23.8% for the comparable prior year period.

As a component of selling, general and administrative expenses, selling expenses increased $27.3 million, or 13.7%, to $226.2 million for the three months ended September 29, 2007 from the comparable prior year period. As a percentage of net sales, selling expenses decreased to 15.0% from 16.0% for the comparable prior year period. This decrease was due to our continued leveraging of higher sales volume across our established infrastructure, as well as higher influenza vaccine sales versus the comparable prior year period.

As a component of selling, general and administrative expenses, general and administrative expenses increased $8.9 million, or 9.1%, to $106.4 million for the three months ended September 29, 2007 from the comparable prior year period. As a percentage of net sales, general and administrative expenses decreased to 7.1% from 7.8% for the comparable prior year period. This decrease was due to our continued leveraging of higher sales volume across our established infrastructure, as well as higher influenza vaccine sales versus the comparable prior year period.

Other Expense, Net

Other expense, net, from continuing operations for the three months ended September 29, 2007 and September 30, 2006 were as follows (in thousands):

	September 29, 2007	September 30, 2006 (1)
Interest income	$ 4,378	$ 3,485
Interest expense	(6,216)	(6,504)
Other, net	3,917	2,294

Other income (expense), net	$	2,079	$	(725)

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

Other income, net, increased $2.8 million for the three months ended September 29, 2007 from the comparable prior year period. This increase was primarily due to higher interest income due to higher interest rates on higher cash and investment balances, as well as a $2.4 million pretax gain resulting from the divestiture of certain non-core businesses of Becker-Parkin.

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Income Taxes

For the three months ended September 29, 2007, our effective tax rate from continuing operations decreased to 34.1% from 35.1% for the comparable prior year period. The decrease was impacted by additional tax planning initiatives, revaluation of deferred income taxes, a non-recurring tax charge resulting from a European restructuring and higher income from lower taxing jurisdictions.

As a result of tax legislation enacted in Germany and the United Kingdom in the third quarter of 2007, deferred income taxes were revalued resulting in a $3.2 million reduction in deferred income tax accounts and a corresponding reduction of income tax expense. Additionally, in response to the legislation enacted in Germany, a restructuring was implemented in the third quarter of 2007, resulting in a non-recurring income tax charge of $3.5 million.

The difference between our effective tax rate and the federal statutory tax rate for both periods related primarily to foreign and state income taxes. We expect our effective tax rate to be in the 34% to 35% range for the remainder of 2007. For 2008, we expect our effective tax rate to be in the range of 35% to 36%.

Nine Months Ended September 29, 2007 Compared to Nine Months Ended September 30, 2006

Net Sales

Net sales from continuing operations for the nine months ended September 29, 2007 and September 30, 2006 were as follows (in thousands):

	September 29, 2007	% of Total	September 30, 2006 (1)	% of Total
Healthcare distribution (2):				
Dental (3)	$ 1,780,790	42.4%	$ 1,532,399	42.9%
Medical (4)	1,152,057	27.4	983,635	27.5
International (5)	1,177,742	28.0	986,338	27.6
Total healthcare distribution	4,110,589	97.8	3,502,372	98.0
Technology (6)	92,131	2.2	70,755	2.0
Total	$ 4,202,720	100.0%	$ 3,573,127	100.0%

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

(2) Consists of consumable products, small equipment, laboratory products, large dental 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 and Canada.

The $629.6 million, or 17.6%, increase in net sales for the nine months ended September 29, 2007 includes increases of 15.2% local currency growth (8.8% internally generated primarily due to volume growth and 6.4% from acquisitions, net of divestitures) and 2.4% related to foreign currency exchange.

The $248.4 million, or 16.2%, increase in dental net sales for the nine months ended September 29, 2007 includes increases of 15.9% local currency growth (10.3% internally generated primarily due to increased volume and 5.6% from acquisitions) and 0.3% related to foreign currency exchange. The 15.9% local currency growth was due to dental consumable merchandise sales growth of 13.0% (6.3% internal growth and 6.7% from acquisitions) and dental equipment sales and service growth of 25.6% (23.3% internal growth and 2.3% from acquisitions).

The $168.4 million, or 17.1%, increase in medical net sales for the nine months ended September 29, 2007 includes 10.5% internal growth and 6.6% growth from acquisitions, net of divestitures. The 10.5% internal sales growth was due to influenza vaccine net sales growth of 7.9% and other products net sales growth of 2.6%. During the nine months ended September 29, 2007, we sold approximately 7.3 million doses of influenza vaccine.

The $191.4 million, or 19.4%, increase in international net sales for the nine months ended September 29, 2007 includes increases of 10.9% in local currencies (4.1% internally generated and 6.8% from acquisitions) and 8.5% related to foreign currency exchange.

The $21.4 million, or 30.2%, increase in technology net sales for the nine months ended September 29, 2007 includes increases of 30.0% in local currency growth (19.5% internally generated and 10.5% from acquisitions) and 0.2% related to foreign currency exchange. The increase was driven by growth in electronic services, software and financial services revenue.

Gross Profit

Gross profit and gross margin percentages from continuing operations by segment and in total for the nine months ended September 29, 2007 and September 30, 2006 were as follows (in thousands):

	September 29, 2007	Gross Margin %	September 30, 2006 (1)	Gross Margin %
Healthcare distribution	$ 1,165,059	28.3%	$ 997,528	28.5%
Technology	69,094	75.0	54,296	76.7
Total	$ 1,234,153	29.4	$ 1,051,824	29.4

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

For the nine months ended September 29, 2007, gross profit increased $182.3 million, or 17.3%, from the comparable prior year period.

Healthcare distribution gross profit increased $167.5 million, or 16.8%, for the nine months ended September 29, 2007 from the comparable prior year period. Healthcare distribution gross profit margin decreased to 28.3% from 28.5% for the comparable prior year period as a result of changes in the product sales mix.

Technology gross profit increased $14.8 million, or 27.3%, for the nine months ended September 29, 2007 from the comparable prior year period. Technology gross profit margin decreased to 75.0% for the nine months ended September 29, 2007 from 76.7% for the comparable prior year period primarily due to changes in the product sales mix.

Selling, General and Administrative

Selling, general and administrative expenses from continuing operations by segment and in total for the nine months ended September 29, 2007 and September 30, 2006 were as follows (in thousands):

	September 29, 2007	% of Respective Net Sales	September 30, 2006 (1)	% of Respective Net Sales

Healthcare distribution	$ 938,074	22.8%	$ 824,249	23.5%
Technology	34,806	37.8	27,979	39.5
Total	$ 972,880	23.1	$ 852,228	23.9

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

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Selling, general and administrative expenses increased $120.7 million, or 14.2%, to $972.9 million for the nine months ended September 29, 2007 from the comparable prior year period. As a percentage of net sales, selling, general and administrative expenses decreased to 23.1% from 23.9% for the comparable prior year period.

As a component of selling, general and administrative expenses, selling expenses increased $77.8 million, or 13.5%, to $654.2 million for the nine months ended September 29, 2007 from the comparable prior year period. As a percentage of net sales, selling expenses decreased to 15.6% from 16.1% for the comparable prior year period. This decrease was due to our continued leveraging of higher sales volume across our established infrastructure, as well as higher influenza vaccine sales versus the comparable prior year period.

As a component of selling, general and administrative expenses, general and administrative expenses increased $42.9 million, or 15.5%, to $318.7 million for the nine months ended September 29, 2007 from the comparable prior year period. As a percentage of net sales, general and administrative expenses decreased to 7.6% from 7.7% for the comparable prior year period. This decrease was due to our continued leveraging of higher sales volume across our established infrastructure, as well as higher influenza vaccine sales versus the comparable prior year period.

Other Expense, Net

Other expense, net, from continuing operations for the nine months ended September 29, 2007 and September 30, 2006 were as follows (in thousands):

	September 29, 2007	September 30, 2006 (1)
Interest income	$ 12,766	$ 11,980
Interest expense	(18,381)	(21,107)
Other, net	4,342	2,165
Other expense, net	$ (1,273)	$ (6,962)

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

Other expense, net, decreased $5.7 million for the nine months ended September 29, 2007 from the comparable prior year period. This decrease was primarily due to lower interest expense resulting from the conversion of U.S. LIBOR based borrowings to Euro LIBOR based borrowings and net foreign currency gains, as well as a $2.4 million pretax gain resulting from the divestiture of certain non-core businesses of Becker-Parkin.

Income Taxes

For the nine months ended September 29, 2007, our effective tax rate from continuing operations decreased to 34.5% from 35.9% for the comparable prior year period. The decrease was impacted by additional tax planning initiatives, revaluation of deferred income taxes, a non-recurring tax charge resulting from a European restructuring and higher income from lower taxing jurisdictions.

As a result of tax legislation enacted in Germany and the United Kingdom in the third quarter of 2007, deferred income taxes were revalued resulting in a $3.2 million reduction in deferred income tax accounts and a corresponding reduction of income tax expense. Additionally, in response to the legislation enacted in Germany, a restructuring was implemented in the third quarter of 2007, resulting in a non-recurring income tax charge of $3.5 million.

The difference between our effective tax rate and the federal statutory tax rate for both periods related primarily to foreign and state income taxes. We expect our effective tax rate to be in the 34% to 35% range for the remainder of 2007. For 2008, we expect our effective tax rate to be in the range of 35% to 36%.

Liquidity and Capital Resources

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

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

Net cash flow provided by operating activities was $149.9 million for the nine months ended September 29, 2007, compared to $64.6 million for the comparable prior year period. This net change of $85.3 million was primarily due to higher income from continuing operations, an increase in net working capital and a non-cash charge for impairment from a write-down of long-lived assets of discontinued operations, offset by an increase in the benefit for deferred income taxes.

Net cash used in investing activities was $160.0 million for the nine months ended September 29, 2007, compared to $99.0 million for the comparable prior year period. The net change of $61.0 million was primarily due to a decrease in net security sales and cash received from a business divestiture in the prior year, partially offset by a reduction in payments for business acquisitions. We expect to invest approximately $12.0 million to $17.0 million during the remainder of the fiscal year in capital projects to modernize and expand our facilities and computer systems infrastructure and to integrate certain operations into our core structure.

Net cash used in financing activities was $34.9 million for the nine months ended September 29, 2007, compared to $8.4 million used in financing activities for the comparable prior year period. The net change of $26.5 million was primarily due to increased repayments of long-term debt, repayments of bank borrowings and increased repurchases of our common stock during the nine months ended September 29, 2007.

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

		September 29, 2007		**December 30, 2006**
Cash and cash equivalents	$	207,458	$	248,647
Available-for-sale securities		27,750		47,999
Working capital		839,578		834,760
Debt:				
Bank credit lines	$	2,856	$	2,528
Current maturities of long-term debt		29,050		41,036
Long-term debt		432,279		455,806
Total debt	$	464,185	$	499,370

Our cash and cash equivalents consist of bank balances and investments in money market funds representing overnight investments with a high degree of liquidity. At September 29, 2007 and December 30, 2006, our available-for-sale securities consisted of highly liquid tax-efficient securities, including primarily auction-rate securities and variable-rate demand notes.

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

Our accounts receivable days sales outstanding from continuing operations improved to 42.2 days for the nine months ended September 29, 2007 from 42.6 days for the comparable prior year period. During the nine months ended September 29, 2007, we wrote-off approximately $5.6 million of fully reserved accounts receivable against our trade receivable reserve, which had no effect on our earnings. Our inventory turnover from continuing operations for the nine months ended September 29, 2007 was 6.6 turns compared to 6.4 turns for the nine months ended September 30, 2006.

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 $300.0 million revolving credit facility (discussed below) along with cash on hand to fully satisfy the cash portion of our conversion obligation. We also will pay contingent interest during any six-month-interest period beginning August 20, 2010, if the average trading price of the notes is above specified levels. We may redeem some or all of the notes on or after August 20, 2010. The note holders may require us to purchase all or a portion of the notes on August 15, 2010, 2014, 2019, 2024 and 2029 or, subject to specified exceptions, upon a change of control event.

Our $130.0 million senior notes are due on June 30, 2009 and bear interest at a fixed rate of 6.9% per annum. On September 28, 2007, we made our second annual principal payment of $20.0 million on our $100.0 million senior notes, which bear interest at a fixed rate of 6.7% per annum. Remaining principal payments are due annually on September 25, 2008 through 2010. Interest on both notes is payable semi-annually.

In 2003, we entered into 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 29, 2007, there was $190.0 million of principal remaining with a weighted-average variable interest rate of 8.4%. 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 May 24, 2005, we entered into a $300.0 million revolving credit facility with a $100.0 million expansion feature. This facility expires in May 2010. As of September 29, 2007, there were $9.2 million of letters of credit provided to third parties and no borrowings outstanding under this revolving credit facility.

During 2007, we have repurchased $30.7 million or 639,100 shares under our common stock repurchase programs, with $140.5 million available for future common stock share repurchases, under repurchase programs approved by our Board of Directors.

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

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

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.

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.

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 30, 2006.

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Recently Issued Accounting Standards

In September 2006, the Financial Accounting Standards Board (FASB) issued FAS No. 157, Fair Value Measurements (FAS 157). FAS 157 establishes a framework for measuring fair value in generally accepted accounting principles and expands disclosures about fair value measurements. FAS 157 applies under other previously issued accounting pronouncements that require or permit fair value measurements but does not require any new fair value measurements. FAS 157 is effective for financial statements issued for fiscal years beginning after November 15, 2007, and interim periods within those fiscal years. We are currently evaluating the impact of FAS 157 on our consolidated financial statements.

In February 2007, FASB issued FAS No. 159, The Fair Value Option for Financial Assets and Financial Liabilities (FAS 159), including an amendment to FASB No. 115. FAS 159 gives entities the irrevocable option to measure eligible financial assets, financial liabilities and firm commitments at fair value, on an instrument-by-instrument basis, that are otherwise not permitted to be accounted for at fair value under other accounting standards. The election, called the fair value option, will enable entities to achieve an offset accounting effect for changes in fair value of certain related assets and liabilities without having to apply complex hedge accounting provisions. FAS 159 is effective as of the beginning of a company s first fiscal year that begins after November 15, 2007. We are currently evaluating the impact of FAS 159 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 30, 2006.

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 29, 2007 to ensure that all material information required to be disclosed by us in reports that we file or submit under the Exchange Act is accumulated and communicated to them as appropriate to allow timely decisions regarding required disclosure and that all such information is recorded, processed, summarized and reported as specified in the SEC s rules and forms.

Changes in Internal Control Over Financial Reporting

There have been no individual changes in our internal control over financial reporting that occurred during the quarter ended September 29, 2007, that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting. However, there have been a number of initiatives which have carried over from prior quarters, or commenced this quarter, relating to acquisition integrations and system implementations, that when considered in the aggregate, currently represent a material change in our internal control over financial reporting.

Acquisitions, including W & J Dunlop, Ltd. and Software of Excellence International Ltd. which were completed during the quarter, with approximate aggregate annual revenues of $378.0 million, that utilize separate information and financial accounting systems, have been included in our consolidated financial statements. In addition, acquisitions occurring during the quarter including Becker-Parkin, with approximate aggregate annual revenues of $47.5 million, combined with acquisitions completed in prior quarters, have been integrated into our existing enterprise resource planning (ERP) system in the United States and are covered by our existing system of internal control over financial reporting. Finally, there have been ongoing implementations of new ERP systems, eCommerce systems, and businesses integrations involving existing systems with approximate aggregate annual revenues of $516.0 million.

All acquisitions, acquisition integrations and new system 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. We expect our assessment of these changes in internal control to be completed in 2007.

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 and other healthcare products. As a business practice, we generally obtain product 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, including those described below, are covered by insurance or will not otherwise have a material adverse effect on our financial condition or results of operations.

As of September 29, 2007, 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 in shares of our common stock, which represented approximately 3.5% of the shares outstanding at the commencement of the program. On October 31, 2005, our Board of Directors authorized an additional $100.0 million of shares in our common stock to be repurchased under this program. On March 28, 2007, our Board of Directors authorized an additional $100.0 million of shares in our common stock to be repurchased under this program. As of September 29, 2007, we had repurchased $159.5 million or 4,012,242 shares under this initiative, with $140.5 million available for future common stock share repurchases.

During the fiscal quarter ended September 29, 2007, 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
07/01/07 through 08/04/07	2,562,900
08/05/07 through 09/01/07	2,414,913
09/02/07 through 09/29/07	2,309,727

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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 6, 2007