Q4/FY 2016
CONFERENCE CALL SCRIPT
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Conference operator: Welcome to the Quest Diagnostics Fourth Quarter and Full Year 2016 conference call. At the request of the company, this call is being recorded. The entire contents of the call, including the presentation and question and answer session that will follow, are the copyrighted property of Quest Diagnostics with all rights reserved. Any redistribution, retransmission or rebroadcast of this call in any form without the express written consent of Quest Diagnostics is strictly prohibited. Now I'd like to introduce Shawn Bevec, Executive Director of Investor Relations for Quest Diagnostics. Go ahead, please.

Shawn Bevec: Thank you and good morning. I am here with Steve Rusckowski, our Chairman, President and Chief Executive Officer, and Mark Guinan, our Chief Financial Officer. During this call, we may make forward-looking statements and also discuss non-GAAP measures. For this call, references to adjusted EPS refer to adjusted diluted EPS excluding amortization. Actual results may differ materially from those projected. Risks and uncertainties that may affect Quest Diagnostics' future results include, but are not limited to, those described in Quest Diagnostics' 2015 Annual Report on Form 10-K, quarterly reports on Form 10-Q and Current Reports on Form 8-K.

The text of our prepared remarks will be available later today in the Investor Relations page of our website.

Now, here is Steve Rusckowski.

Steve Rusckowski: Thanks, Shawn, and thanks, everyone, for joining us today.

This morning, I'll provide you with highlights of the quarter and review progress on our strategy. Then Mark will provide more detail on the results and take you through our 2017 guidance.

We finished the year on a high note. We grew revenues, operating income, margins and operating cash flow in the fourth quarter, capping a strong year in which we achieved our commitments and created value for shareholders.
While Mark will take you through the fourth quarter, here are some key highlights for the full year 2016:

- Revenues were up 30 basis points on a reported basis and grew 2.6% on an equivalent basis;
- EPS was down 7.4% on a reported basis but grew 8% on an adjusted basis; and
- Cash from operations increased 30% to $1.1 billion.

2016 was the third consecutive year of progress in delivering on our commitments and creating shareholder value.

Before I describe the progress we have made, I'd like to talk about a few dynamics impacting our industry…

- First, we are waiting to see what the new Congress and administration decides to do with the Affordable Care Act. As we've said in the past, we never realized the full benefit from the ACA that we expected, so we wouldn't expect any significant near term impact if it were to be repealed. We hope that any potential alternative appropriately recognizes the value of diagnostic information services in health care.

- Second, as you know, CMS has begun to execute a process to refresh its clinical laboratory fee schedule under PAMA. We are preparing to submit pricing data to CMS later this quarter.

- Having said that, we are working with our trade association to understand the impact on PAMA of recent pronouncements by the Trump administration on regulatory review.

- Congress has also expressed its intent to act quickly on tax reform. We are closely monitoring developments and wanted to share the expected impact of potential changes.
  - With a majority of our taxable income earned in the United States, we could benefit from any material reduction in U.S. corporate tax rates. We would expect to use a portion of potential tax savings to invest in accelerating growth.
  - Second, with little foreign exposure and overseas cash, we aren't likely to benefit significantly from changes in repatriation rules.

Now, let's review progress we've made.

We grew revenues, operating income, margins and operating cash flow in the fourth quarter, capping a strong year in which we achieved our commitments and created value for shareholders.

As we detailed at our Investor Day in November, we are now laser focused on our two point strategy to accelerate growth and continue to drive operational excellence.

We grew revenue in the quarter, in part by expanding relationships with hospital health systems.

- During the quarter we entered into another professional laboratory services agreement with Montefiore Health System (MHS), a premier academic health system and the university hospital for Albert Einstein College of Medicine.
- Under the agreement, Quest Diagnostics will provide laboratory services for the Montefiore Health System to help enhance the quality and value of diagnostic services to patients and their doctors at the system's six hospitals.
- Quest is collaborating with an increasing number of hospital partners, including leading academic institutions like Montefiore, that are looking to focus on their core business by taking advantage of our expertise, innovation and scale to help implement their lab strategy.
- We continue to expand the work we do with other leading hospital health systems, including RWJBarnabas in New Jersey, HCA in Denver and many others. Our pipeline for developing new relationships is also strong.
- In addition, our gene-based and esoteric testing grew mid-single digits in the quarter and approximately 4% for the year.
  - Major drivers include: Noninvasive Prenatal Testing, Hepatitis C, prescription drug monitoring and SureSwab.
  - Also, we strengthened our efforts to grow advanced diagnostics by adding a senior executive to our team. I'm pleased that Carrie Eglinton Manner has joined us from GE Healthcare to provide leadership in this important growth opportunity.
  - We are also making great progress executing our strategy to be the provider of choice for consumers.
    - At of the end of 2016 we had opened patient service centers in 56 Safeway supermarkets. Consumer satisfaction is high, and so is our employee satisfaction. We are on track to

open a total of 200 PSCs in Safeway stores by the end of 2017. This improves the customer experience while also helping us better manage our real estate costs.
    - Also, we are on track to start performing genetic testing for AncestryDNA at our Marlborough lab later this month. AncestryDNA recently reported it sold 1.4 million DNA tests in the fourth quarter, more than in all of 2015.
  - Finally, our emerging data analytics business is gaining traction.
    - We offer Data Diagnostics in partnership with Inovalon. The Data Diagnostics customer list is growing and includes premier health plan payers such as Anthem and Harvard Pilgrim.
    - We're also proud that an independent panel of 50 industry analysts and influential journalists named the Data Diagnostics service the Most Innovative Product of the Year for Healthcare.

We continue to drive operational excellence.

- We ended the year with $1.1 billion in run-rate cost savings through our Invigorate initiative, as we projected at Investor Day. We are on track to deliver $1.3 billion in run-rate savings as we exit 2017.
- Our revenue services partnership with Optum is off to a good start. The transition occurred in mid-November, and we expect to drive improvements in bad debt and denials in 2017 and beyond.

In terms of capital deployment, during the quarter, we increased the dividend 12.5% to $1.80 a share on an annual basis and repurchased $150 million of our shares. In December our Board approved a $1 billion increase in our share repurchase authority leaving us with $1.4 billion remaining for future buybacks.

We continue to expect to deliver 1% to 2% revenue growth from acquisitions and have an active M&A pipeline.

Our 2017 guidance, which Mark will discuss shortly, reflects expectations for accelerated top line growth and is consistent with the earnings outlook we provided at our Investor Day in November.

Now, Mark will provide an overview on our fourth quarter and full year financial performance and provide you with our 2017 outlook.

Mark Guinan: Thanks, Steve.

Starting with revenues…

Consolidated revenues of $1.86 billion were up 0.7% versus the prior year on a reported basis while equivalent revenues grew 1.9%.

Revenues for Diagnostic Information Services, or DIS for short, grew by 2.0% compared to the prior year. Of this growth, nearly 1% was organic.

Volume, measured by the number of requisitions, increased 1.5% versus the prior year. Acquisitions contributed about 1% to volumes in the quarter. However, note that the impact of Hurricane Matthew presented a headwind of approximately 50 basis points of organic growth in the fourth quarter.

Revenue per requisition in the fourth quarter increased 40 basis points versus the prior year. As a reminder, revenue per req is not a proxy for price. It includes a number of variables such as: unit price variation; business mix; test mix; and tests per req.

Unit price headwinds were slightly less than 50 basis points in the fourth quarter, and approximately 70 basis points for the full year. While unit price headwinds moderated in the second half of 2016, we note that price fluctuations can vary from quarter to quarter. We continue to believe that in 2017 unit price headwinds will be consistent with the last few years at approximately 1%.

As we highlighted throughout 2016, our PLS engagements such as RWJBarnabas Health and HCA carry lower revenue per requisition due to the nature of the work we are performing. The strength of our PLS engagements in the fourth quarter continued to impact our revenue per requisition.

Other mix elements, including test and payer mix, contributed more than 2% to revenue per req in the quarter.

Reported operating income for the quarter was $276 million, or 14.8% of revenues, compared to $239 million, or 12.9% of revenues, a year ago. On an adjusted basis, operating income was $305 million, or 16.4% of revenues, compared to $288 million, or 15.5% of revenues last year.

The impact of our former products businesses in the fourth quarter of 2015 benefitted adjusted operating income by approximately $13 million or roughly 40 basis points. Excluding this impact, operating margin would have grown by 130 basis points year over year.

Reported EPS was $1.09 in the quarter compared to $1.29 a year ago due to a one-time tax benefit in 2015 associated with winding down a subsidiary. Adjusted EPS was $1.31, up 10% from $1.19 last year.

The company recorded after-tax charges totaling $18 million in the quarter, representing primarily restructuring and integration costs. The net impact of these items reduced our reported EPS by 13 cents.

Bad debt expense as a percentage of revenues was 3.6%, 40 basis points better than the previous quarter and 10 basis points higher than the fourth quarter of 2015. As a reminder, bad debt expense typically improves modestly throughout the year as patients hit their health insurance deductibles. Note that the year-over-year compare is negatively impacted by the fact that our products business had a lower associated bad debt rate. When taking this into consideration, our bad debt rate was flat year over year.

Income tax expense in the quarter benefited from the adoption of the new accounting standard related to stock based compensation. The impact amounted to an EPS benefit of roughly a penny in Q4.

Our DSOs were approximately 47 days, flat year over year.

Cash provided by operations in 2016 was $1.1 billion versus $821 million last year which was stronger than the guidance we provided in October due largely to better than expected earnings and improved cash collections.

Capital expenditures during the year were $293 million, compared to $263 million a year ago.

Now, turning to guidance. We are providing the following outlook for 2017:

- Revenues to be between $7.64 billion and $7.72 billion, an increase of 1.7 to 2.7% versus the prior year on a reported basis, and an increase of about 2 to 3% on an equivalent basis.
- Reported diluted EPS to be between $4.65 and $4.80 and adjusted EPS to be between $5.37 and $5.52.
- Cash provided by operations to be approximately $1.1 billion; and finally
- Capital expenditures to be between $250 million and $300 million.

I'd like to provide a few items to consider as you think about our 2017 guidance:

- First, as a reminder, we benefitted from favorable weather and an extra day due to leap year in the first quarter of 2016. This sets up a difficult compare in the first quarter of 2017. We therefore expect our earnings growth will not be proportional, with Q1 coming in lower than the balance of the year. Given this, consensus EPS estimates for the first-quarter are higher than our current expectations.
- Second, our revenue guidance of 2 to 3% equivalent growth includes some M&A primarily related to carryover from the CLP acquisition which closed at the end of February, 2016.
- Finally, our capex guidance includes an outlay related to the previously-announced headquarters move to Secaucus.

Now, let me turn it back to Steve.

Steve Rusckowski: Thanks, Mark.

To summarize:

- **We continued our success in 2016 and ended the year on a high note.**
- **We are laser focused on our two point strategy to accelerate growth and drive operational excellence.**
- **Our 2017 guidance is both reasonable and achievable.**

STEVE: Thanks again for joining our call today.

- We had a strong quarter and a solid 2016.
- We are looking forward to accelerating growth and driving operational excellence in 2017
- Thank you very much for your continued support.
- Goodbye.