Quest Diagnostics Incorporated
Conference Call Prepared Comments
For the Quarter Ended June 30, 2015

Conference operator: Welcome to the Quest Diagnostics Fourth Quarter and Full Year 2014 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 Dan Haemmerle, Executive Director of Investor Relations for Quest Diagnostics. Go ahead, please.

Conference operator: Welcome to the Quest Diagnostics Second Quarter 2015 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 Dan Haemmerle, Executive Director of Investor Relations for Quest Diagnostics. Go ahead, please.

Dan Haemmerle: Thank you and good morning. I am here with Steve Rusckowski, our 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. 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' 2014 Annual Report on Form 10-K, quarterly reports on Form 10-Q and Current Reports on Form 8-K.

Our earnings press release is available, and the text of our prepared remarks will be available later today, in the Investor Relations "Quarterly Updates" section of our website at www.questdiagnostics.com.

A PowerPoint presentation and spreadsheet with our results and supplemental analysis are also available on the website.

Now, here is Steve Rusckowski.

Steve Rusckowski: Thanks, Dan. And thanks, everyone, for joining us today.

This morning, I'll provide you with highlights of the quarter, share industry trends, and also review progress we are making executing on our five-point strategy. Then Mark will provide more detail on the results and take you through guidance.

Well, we grew revenues, margins and earnings in the second quarter, and made progress executing our strategy.

- Revenues grew 1% to $1.9 billion;
- Adjusted operating income grew 9%;
- Adjusted net income grew more than 8%; and
- Adjusted EPS increased 5% to $1.25.

This was the second consecutive quarter in which operating income grew faster than revenues, underscoring that we are executing our five point strategy. We're not just interested in growth at any cost; we're focused on driving profitable growth. I'll speak more about this in a moment.

Before I get to our strategy update, I'd like to spend some time on the industry dynamics.

After two years of some of the heaviest government reimbursement pressure this industry has faced, we are seeing a moderation of that government reimbursement pressure in 2015 and we don't see any significant headwinds for 2016.

Any changes to the clinical lab fee schedule proposed as part of the Protecting Access to Medicare Act (also known as PAMA) would go into effect in 2017. As you know, CMS continues to work on the rulemaking process and the data collection that will help determine future reimbursement schedules. We appreciate the work done by CMS as well as the complexity of the task, and will continue to collaborate with CMS throughout the process.

On utilization, we continued to see stability in test volumes on a "same-provider" basis during the quarter.

Turning to the Affordable Care Act, we continue to believe it will be a net positive for our company and our industry.

- The Supreme Court removed uncertainty regarding the future of the act in King v Burwell.
- As we look at the impact on our business to date, there are a lot of moving parts and we do not have perfect information. What we can say is that we are seeing growth in our Medicaid and Managed Medicaid volumes in different markets around the country, as well as a decrease in our uninsured patient volumes. These trends appear to be consistent with our expectations related to the new lives coming into the system. We expect that this will improve over time as additional uninsured patients begin to access healthcare.

With greater certainty related to the Affordable Care Act, payer consolidation has dominated the headlines in recent weeks.

Today, Quest serves <u>all</u> major national payers with an unsurpassed national network of laboratories, information services and logistics. Healthcare in general, and diagnostic testing in particular, are characterized by significant disparities in price for similar services. It is not unusual for a test performed by a hospital lab to cost 2 to 5 times as much as Quest.

We offer tremendous value, providing the highest quality at a competitive price.

We are very well positioned to help health plans narrow networks, achieve their most efficient network design and provide members with outstanding service.

Now let me shift to the progress we are making on our five-point strategy which is to:

- Restore growth;
- Drive operational excellence;
- Simplify the organization;
- Refocus on core diagnostic information services; and
- Deliver disciplined capital deployment.

Starting with growth…

This was the third consecutive quarter of organic revenue growth on a consolidated basis. It was also the first quarter we reported revenue per requisition growth in three years. Now, I'll talk about several drivers.

- Our regional sales teams are now better aligned with the clinical franchises and the Professional Lab Services team.
    - We grew revenues in the quarter from several recent clinical franchise service launches, including BRCA, CardioIQ, non-invasive prenatal screening and HIV fourth generation testing. We also continued to see growth in Prescription Drug Monitoring.
    - Last quarter we shared that gene-based and esoteric testing revenues grew at the fastest rate in a year. We were pleased to see that growth rate continue during the second quarter.
    - This focus on esoteric and gene-based testing has contributed to the increase in revenue per requisition.
- We continue to grow revenues from new relationships with hospitals and integrated delivery networks by helping them improve health outcomes and reduce costs.
    - Most recently, we announced an agreement to acquire MemorialCare Health System's laboratory outreach service business. This transaction fits well within our M&A guidelines and is a smaller, tuck-in type acquisition compared to some of the more recent deals we have completed. We expect the transaction to close in August.
    - Our pipeline is strong, and we are optimistic about the opportunities our team is pursuing.

As we've said before, we're enhancing our diagnostic information services to help customers with population health, data analytics and decision support tools. These tools are driving growth and helping us deliver a superior customer experience.

For example:

- For physicians: Our Interactive Insights offer providers trending data; interactive features, such as customizable reports; and additional content, such as videos and articles, related to specific conditions and diseases. We have piloted these solutions with approximately 70 physician providers and are encouraged by feedback.
- For hospitals: More than 100 customers are now using our IntelliTest Analytics solutions. This easy-to-use tool provides hospitals, integrated delivery networks, and physician practices with timely access to utilization insights to assist with laboratory test optimization decisions and driving cost controls.

- For health plans: We've expanded pilots with health plans for our Quest Analytics Platform. This self-service informatics tool enables health plan customers to query our massive database to help manage populations of patients and encourage the appropriate use of screening and monitoring tests to drive better health and follow guidelines. We've received positive feedback.

We continue to build on our data analytics tools and will update you on progress.

And, finally, consumerism is an emerging trend in healthcare, and we offer a number of compelling services in this exciting space. We began to offer our Blueprint for Wellness health risk assessment directly to consumers in 2010. Now we are getting ready to offer Blueprint for Athletes to help athletes and their coaches and trainers, as well as weekend warriors, gain valuable insights on tailored training and recovery regimens, peak performance conditions and optimal dietary consumption.

- We also recently announced an agreement with HealthTap, a digital healthcare provider. HealthTap's virtual network of physicians can now easily order tests for patients from Quest Diagnostics. Doctors can see test results on HealthTap's platform, and patients can access their own results using our patient portal, the MyQuest app.
- More than 1.8 million patients have now downloaded our MyQuest app. A growing portion of those consumers are paying us a premium to gain access to their historical lab results and maintain access to longitudinal test results.
- And last week we began offering direct access testing to consumers in Arizona, where a new law just took effect, enabling people to order tests without a physician's script. We're operating there through our joint venture partner, Sonora Quest Laboratories, which builds on the strengths of our partner Banner Health, the leading healthcare provider in Arizona. Initial interest in the service is strong.

As the responsibility for managing and paying for healthcare shifts rapidly to consumers, we are well positioned to be the consumer friendly diagnostic testing provider.

The second element of our strategy is Driving Operational Excellence. Our Drive Program is focused on delivering a superior customer experience as well as allowing us to become more efficient.

We perform more than 3,000 different diagnostic tests in our large network of laboratories, many of which came to us through acquisition with different laboratory information and billing systems.

We are always looking for ways to improve the service we deliver, whether it's providing more than 90% of our results to doctors by 8 am the next morning or making more than 5 million phone calls a year to notify physicians of critical results they need to act on.

At our Investor Day last fall, we said we would be standardizing systems and processes. Since then, the proportion of legacy systems that are standardized has increased from 70% to 75%.

- Our latest system conversion occurred without any disruption to clients, which is very encouraging.

We also track a number of medical quality and service metrics related to a superior customer experience. Many of our service elements, such as availability of our Care360 physician portal and our specimen tracking performance, are already at Six Sigma levels. In addition, we saw continued improvement in several key areas, including wait times at patient service centers; and installation of EMR interfaces to onboard new clients.

We continue to move closer to achieving our Invigorate goal of $1.3 billion in cumulative run rate savings by the end of 2017.

As I mentioned at the beginning of this call, this quarter's strong operating income performance demonstrates the value we're creating from our improved efficiency.

The third element of our strategy is to simplify and strengthen our organization. We have been focusing on execution and building a performance-oriented culture.

- Our Quest Management System is the way we run the company, by using a set of standard tools and processes.
- Additionally, we have been training our leaders and recently launched the "Leading Quest Academy" to provide a rigorous forum for putting our Quest Management System tools to the test.
- Academy graduates are now hard at work on teams focused on addressing opportunities and challenges facing our business.

The fourth element of the strategy is to refocus on our core Diagnostic Information Services business. We made substantial progress during the past 90 days.

- As you know, we launched our newest joint venture, Q Squared Solutions, with Quintiles, in a capital-efficient way that provides us with a path to generating better growth and profitability from that business than if we had operated it as a standalone entity.
  - We have a great partner and are excited about the opportunities for that venture.
  - Quintiles will share more on the joint venture, including expectations related to financial performance, in their upcoming earnings call.
  - We are excited to be working with Quintiles exclusively for a period of time to combine our respective data sets to help biopharma customers improve their drug discovery and development process.

Lastly, we continue to review our portfolio, looking at options for non-core assets that can build value for our shareholders.

The fifth element of our strategy, delivering disciplined capital deployment.

During April, we completed the refinancing of more than $1.2 billion of our debt that will lower interest expense for years to come. We also deployed our cash to reinvest in the business and continue to make progress on our commitment to shareholders by returning approximately $250 million year to date through a combination of share buybacks and dividends.

Now, Mark will provide an overview on our second quarter financial performance and walk you through the details of our 2015 outlook which is based on our strong operational performance.

Mark Guinan: Thanks, Steve.

Starting with revenues…

Consolidated revenues of $1.93 billion increased by 1.2% versus the prior year, and grew organically by 80 basis points.

Revenues for Diagnostic Information Services, or DIS for short, grew by 0.4% compared to the prior year.

Volume, measured by the number of requisitions, declined by 0.4% versus the prior year.

However, revenue per requisition was 0.9% better than the prior year, and, as Steve mentioned, it was the first increase in three years. While reimbursement pressure continued to be moderate at just under 1%, we were more than able to offset that pressure through favorable test and business mix shifts. The favorable test mix shift reflects the strong growth in our gene based and esoteric testing.

Moving to our Diagnostic Solutions business, which includes risk assessment, clinical trials testing, healthcare IT, and our remaining products businesses, revenues grew by 11% compared to the prior year.

Our Diagnostic Solutions revenues will be lower on a reported basis in the second half of 2015 as a result of the contribution of our clinical trials business to the joint venture with Quintiles. To provide you with a representative view of the operational performance of the business, we will communicate our reported 2015 revenue against 2014 revenue on an equivalent basis.

Revenue for 2014 on an equivalent basis excludes clinical trials revenues reported in the third and fourth quarter of 2014. The 2014 revenue excluded is $41 million and $46 million in the third and fourth quarter, respectively.

Adjusted operating income for the quarter was $321 million, or 16.7% of revenues, compared to $296 million, or 15.5% of revenues, a year ago. The improvement of 120 basis points can be primarily attributed to the benefits of our tests and business mix, Invigorate program and continued integration synergies from our 2014 acquisitions.

Lower amortization in the quarter versus a year ago negatively impacted the comparison of cash EPS to the prior year by 3 cents.

For the quarter, adjusted EPS, excluding amortization, grew 5% to $1.25.

The company recorded after tax charges totaling $52 million in the quarter, $41 million of which is associated with our recent debt refinancing. The charges also included restructuring and integration costs associated with our Invigorate program and recent acquisitions, and combined to reduce reported EPS by 36 cents. Last year’s second quarter included $24 million of after tax costs associated with restructuring and integration charges which reduced reported EPS by 16 cents.

As a reminder, we also expect to book a gain related to the valuation of the joint venture with Quintiles. We will adjust this one-time gain out of our earnings.

Bad debt expense as a percentage of revenues was 4.1%, 20 basis points better than last quarter, and up 20 basis points compared to a year ago. Our DSOs were 44 days, 1 day lower than last quarter and 3 days lower than a year ago.

Consistent with the first quarter, we are adjusting our cash for the first half of this year to exclude cash charges for the debt refinancing.

Adjusted cash provided by operations was $324 million in the second quarter of 2015. Reported cash provided by operations in the second quarter of 2015 was $275 million and was negatively impacted by cash charges of $49 million associated with the early retirement of debt in connection with the company's debt refinancing. In the second quarter of 2014, reported cash provided by operations was $280 million.

Typically cash flow is stronger in the second half. However, this year we have an extra payroll cycle and a tax payment associated with a previously disposed business that together account for about $100 million. Despite these headwinds we now expect adjusted cash provided by operations to exceed $850 million.

Capital expenditures were $61 million in the quarter, compared to $49 million a year ago.

Moving to guidance, we expect full year 2015 results, before special items, as follows:

- Revenues are now expected to be between $7.49 billion and $7.57 billion, an increase of 2% to 3% versus 2014 revenues on an equivalent basis.
- Adjusted diluted EPS is unchanged to be between $4.70 and $4.85;
- Adjusted cash provided by operations to exceed $850 million; and
- And capital expenditures to approximate $300 million are also unchanged.

Now, let me turn it back to Steve.

Steve Rusckowski: Thanks, Mark.

To summarize:

- **We delivered solid bottom line growth in the second quarter.**
- **It was our third consecutive quarter of organic revenue growth.**
- **We continue to make good progress executing our strategy.**
- **Thanks for your support.**

STEVE: Thanks again for joining our call today.

- We had another good quarter
- We are making solid progress executing our strategy.
- We appreciate your support.
- Goodbye.