Quest Diagnostics Incorporated
Conference Call Prepared comments
For the Quarter Ended March 31, 2013

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Dan Haemmerle: Thank you and good morning. I am here with Steve Rusckowski, our president and chief executive officer, and Bob Hagemann, our chief financial officer.

During this call, we may make forward-looking statements. 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' 2012 Annual Report on Form 10-K and 2013 Current Reports on Form 8-K.

A copy of 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.

I'd like to take you through the top-line performance and then review progress against our five point strategy. Then Bob will provide detail on the results.

In January we told you we anticipated continued revenue softness in the first half of this year and that our efforts to restore growth would result in gradual improvement through the rest of the year.

As expected, we saw continued revenue softness in the first quarter. Now there are a number of factors that impacted year-over-year comparisons. As you'll hear from Bob later, after considering those factors our underlying volume was down about 2% versus the prior year.

While some of this may be driven by continued softness in healthcare utilization, we believe there is more we can do to restore growth, and I'll share details on those efforts in a few minutes.

In addition, we saw revenues per requisition lower by 3.4% in the first quarter, primarily due to a combination of commercial pricing pressures and Medicare cuts. We continue to expect it to be down about 3% for the full year.

Our five point strategy is aimed at addressing several of the fundamental factors that contributed to this quarter's softness and we are making progress on each of these elements.

Our primary focus in 2013 is on driving operational excellence and restoring growth.

Turning first to driving operational excellence, we continued to make excellent progress with our Invigorate cost initiative, which mitigated much of the bottom line impact of the revenue softness. We exited 2012 with a run rate of $200 million in savings, and we are building on that momentum.

In connection with our strategic goal of simplifying the organization, we have implemented a new organizational structure that will remove three layers of management from the business. I'm happy to report we are on track to meet our earlier commitment to reduce 400-600 management positions this year. It is already enabling us to be more agile, collaborative and customer focused, and is contributing significant cost savings.

In addition, we are building a more performance oriented culture, which includes the creation of a new management process and performance management system. We have begun to educate all our employees on new behaviors and cultural norms, one of which is being more externally oriented so we can focus more on customers.

We have taken a number of steps to restore growth.

- We have expanded our sales force and now have more sales people in place than we have ever had.
- We have filled virtually every management position in the new, unified sales organization.
- We held our first ever national sales meeting in February.
- And I can tell you the team left that meeting excited about their new assignments, their new selling tools and a new, simplified compensation system that went into effect April 1.
- We have completed the vast majority of customer transitions along sales reps to make sure they're efficiently addressing their new sales territories.
- We have reorganized the way we approach health plan customers, and are having greater engagement at all levels.
- And then finally, we've built a new hospital professional services organization, and are seeing strong interest from integrated delivery networks throughout the country.

We are executing our plan to restore growth that we shared with you in November, and, as we have said, it will take some time to see improvement. The results of these efforts may not be visible in the numbers yet, but we believe we're doing all the right things to motivate, incentivize, and focus the sales organization, and we continue to expect results from our efforts to gradually build throughout the remainder of the year.

We continued to make solid progress on the remaining two points of our strategy: refocusing on diagnostic information services and delivering disciplined capital deployment. We completed the previously announced sale of HemoCue and plan to re-deploy the $300 million in proceeds into share repurchases during the second quarter.

In addition, we completed the acquisition of the UMass outreach diagnostic services business and announced the planned acquisition of certain outreach testing operations of Dignity Health. We expect to complete additional fold-in acquisitions, consistent with our goal of delivering 1% to 2% growth per year through strategically aligned, accretive acquisitions.

The Dignity transaction, combined with the UMass partnership, positions us extremely well in two states that are leading the way in health reform and is one more indication that hospitals are, indeed, looking for more cost ways to manage their diagnostic testing needs. We are excited about these two opportunities as well as the growing number of discussions we are having with hospital systems interested in working with us.

Well since we introduced our new vision, goals and strategy at Investor Day last November, we have been driving transformational change at Quest Diagnostics. Whenever a company undergoes major change at a rapid pace, you might think these disruptions – even significant disruptions. And this is something that I have been personally monitoring closely. I have been spending time meeting with employees, and particularly sales reps around the country and accompanying them on many customer visits. My conversations with the sales reps and employees have shown them to be engaged, enthusiastic and focused. And we are not seeing evidence of disruptions. In fact, I believe we are doing a good job executing our way through a challenging period.

I'm proud of some significant recent accomplishments.

- First of all during the quarter, we launched several significant new service offerings, including a dementia panel and a non-invasive pre-natal genetic test. In addition, an important HIV genetic test was introduced last year benefited from a recent HHS guideline change. Each of these addresses a growing area of demand.
- Just this week, we welcomed Jim Davis; Jim is a veteran of GE's healthcare business, as Senior Vice President to lead our Diagnostic Solutions business. He will oversee Diagnostic Products; Insurer and Employer Services; Clinical Trials; and Healthcare IT.
- And, then finally we were recognized as one of Fortune's World's Most Admired Companies this year, and ranked first in our industry category.

We see 2013 as a building year, and we will improve operations and begin to restore growth.

Now I'll turn it over to Bob for detailed analysis of the numbers.

Bob Hagemann**:** Thanks, Steve.

Starting with revenues…

Consolidated revenues of $1.8 billion were 6.4% below the prior year.

Our Diagnostic Information Services revenues, which account for over 90% of total revenues, were 6.7% below the prior year. Volume was 3.4% below the prior year, with approximately 2% due to fewer business days in the quarter compared to last year, and about half a percent due to the impact of severe weather. Partially offsetting those factors was about a 1% volume contribution from the UMass acquisition, which we completed in early January.

The resulting underlying volume was about 2% below the prior year, and consistent with the comparable measure last quarter. This is also consistent with what we shared in January when we indicated we expect to see continued volume softness in the first half of the year, with improvement in the second half due to more favorable year-over-year comparisons and building momentum on our efforts to restore growth.

Revenue per requisition in Q1 was down 3.4% compared to the prior year. This compares to a year-over-year decrease of 2% reported in the fourth quarter of last year, with most of the change due to the Medicare fee schedule reduction, including pathology reductions, as well as certain commercial fee schedule changes, all of which went into effect January 1. The 3.4% decrease reported for the quarter is principally reimbursement driven, as positive test mix is essentially being offset by business mix. We continue to expect that for the full year the reimbursement decline will average about 3%, with about 1% of the year-over-year impact we saw in the first quarter expected to anniversary later in the year. Consistent with what we shared with you in January, we continue to plan for average reimbursement pressure of 1-2% through 2015.

Q1 revenues in our Diagnostic Solutions businesses, which include risk assessment, clinical trials testing, healthcare IT, and our remaining products businesses, were down about 2% compared to the prior year.

Adjusted operating income at 15.2% of revenues was about 1.5% below the prior year, with the decrease due principally to lower revenues, particularly the lower reimbursement. A significant portion of the reimbursement and volume impacts is being offset by continued progress with our Invigorate initiative. As we indicated on our last call, we exited last year with about $200 million in run-rate savings compared to a 2011 baseline. We expect to achieve $600 million in run-rate savings as we exit 2014, and we are on track to reach about 2/3 of that by the end of this year. Our goal remains to bring that number to $1 billion over time.

Adjusted EPS of $.89 was $0.16 below the prior year, with the decrease principally due to lower revenues, partially offset with cost savings realized from Invigorate.

Restructuring and integration costs totaling $45 million reduced reported operating income as a percentage of revenues by 2.5% and reported EPS by 17 cents. Last year's first quarter included $20 million of costs associated with restructuring, integration, and CEO succession, which reduced reported operating income as a percentage of revenues by 1% and reported EPS by 8 cents.

Bad debt expense as a percentage of revenues, which is typically highest in the first quarter due to increased patient responsibility associated with unmet deductible and co-pays, improved 20 basis points from the prior year to 4%. DSOs were 46 days, down one day from last quarter.

Cash from operations was $47 million in the quarter compared to $161 million in the prior year. Cash flow in Q1 is seasonally the weakest of the year, and as we explained on our last call, in this quarter was further impacted by about $70 million of income tax payments which were deferred from Q4.

Capital expenditures were $49 million in the quarter, compared to $30 million a year ago.

During the quarter we repurchased 1.1 million common shares at an average price of $57.81 for a total of $62 million dollars. We plan to deploy the entire $300 million in proceeds received from the HemoCue disposition into share repurchases in the second quarter.

Turning to guidance:

We expect results from continuing operations, before special items, as follows:
- Revenues to approximate the prior year level, compared to previous guidance of 0-1% growth.

The remaining elements of guidance are unchanged:
- Earnings per diluted share to be between $4.35 and $4.55;
- Cash provided by operations to approximate $1 billion;
- And capital expenditures to approximate $250 million.

In considering the full year guidance in the context of Q1 performance it is important to keep in mind several factors:
- As we've previously indicated, the comps versus the prior year will become much more favorable in the second half of the year. While the number of business days, coupled with the weather effect, adversely impacted revenue comparisons by about 2.5% in the first quarter, those same factors are expected to contribute to favorable year over year comparisons of almost 2% in the second half of the year.
- Revenue per requisition, which was down 3.4% versus the prior year, is expected to be down about 3% for the full year, with about 1% of the impact we saw in the first quarter expected to anniversary later in the year.
- We expect the Dignity Health acquisition and other fold-in acquisitions to contribute about 1% of revenue growth in the second half of the year, or about half a percent for the full year. This is in addition to the 1% revenue contribution we expect from the UMass transaction.
- Lastly on the revenue front, our efforts to restore growth are gaining traction and we expect to see increasing progress as the year unfolds.
- Regarding our Invigorate program, we are solidly on track to deliver our commitment of $600 million run rate savings as we exit 2014, and as we saw last year, expect the amount realized this year will continue to ramp up as the year progresses.
- And finally, we plan to deploy the $300 million of proceeds from the HemoCue transaction into share repurchases in the second quarter. This amount is additive to our commitment to return the majority of our free cash flow to shareholders through a combination of dividends and share repurchases. In addition, we are actively exploring opportunities to monetize the Celera products business and drug assets, which could present an opportunity for additional share repurchases.

For these reasons, we are confident in the expected performance improvement during the remainder of the year required to achieve our new full year guidance.

Now I'll turn it back to Steve.

Steve Rusckowski: Thanks, Bob.

So what you've heard from Bob is that there are a number of reasons to believe we will see improved performance as the year progresses.

I would like to add a few thoughts.

I've personally seen the efforts our commercial team is making and it gives me confidence we will start to see signs of improvement soon.

As you heard, our guidance does contemplate additional fold-in acquisitions, and, based upon the discussions we are having, I am confident that we will see additional contributions from acquisitions later this year.

We are actively exploring options to monetize our Celera product and drug assets, and this could present additional flexibility for incremental share repurchases.

In summary, we continue to see 2013 as a building year and we have confidence that executing our five point strategy will drive increased value for shareholders over the long term.

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