Quest Diagnostics Incorporated
Conference Call Prepared Comments
For the Quarter Ended December 31, 2015

Conference operator: Welcome to the Quest Diagnostics Fourth Quarter and Full Year 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 a few comments on industry dynamics, and review progress on our five-point strategy. Then Mark will provide more detail on the results and take you through guidance.

We continued to make progress on our path forward, delivering a strong year and positioning ourselves very well for 2016.

Before turning to the quarter, let me recap our performance for the year:

- Revenues grew by 2% on an equivalent basis,
- Adjusted operating income as a percent of revenue expanded by about 110 basis points and
- Adjusted EPS excluding amortization grew by 6%.

During the fourth quarter:

- Revenues of $1.85 billion dollars grew by 60 basis points on an equivalent basis

- Adjusted EPS excluding amortization was $1.19. This was our seventh consecutive quarter of year on year EPS growth.

Before I get to our strategy update, I'd like to talk about industry dynamics, staring with the recent CMS proposal related to the PAMA legislation, which as you know stands for the Protecting Access to Medicare Act.

As you have heard me say before, PAMA needs to be built on a representative view of the market. The current proposal limits the definition of an applicable lab to exclude a large portion of the market. We also believe that a 2017 effective date will be a significant challenge for all parties.

With strong support from the American Hospital Association, the American Medical Association, and members of Congress, we remain optimistic that together, industry and government can still achieve a reasonable outcome.

Second, I would like to discuss the proposed FDA Guidance on the regulation of Lab Developed Tests. We understand the FDA's concerns but we continue to believe that what the FDA has proposed would result in labs being subject to both CLIA and FDA regulations that may be overlapping, duplicative and sometimes contradictory in their requirements. This has the potential to raise health care costs for patients and potentially hinder medical innovation.

The House draft legislation is a good first step in the legislative process. We share ACLA's goal of promoting and supporting diagnostic innovations that provide physicians with the insights necessary to advance patient care and save lives.

We want to work with Congress to get the right balance in legislation – right for the industry, right for physicians and right for patients who depend upon our diagnostic insights to make informed health care decisions.

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 our diagnostic information services business; and
- Deliver disciplined capital deployment.

Let's start with growth.

- Just 3 years ago, this business was shrinking by more than 4%. We slowed the organic decline to 2% in 2014 and have now grown organically on an equivalent basis for the 5th consecutive quarter.
- We grew 2015 full year revenue by 2% on an equivalent basis and we are well positioned for 2016.
- Our gene based and esoteric testing business grew approximately 5% to $1.8 billion dollars for the year.
    - We continued to see strong growth in our infectious disease testing and prescription drug monitoring.

  - Additionally, in late 2015 we launched two companion diagnostic solutions for non-small cell lung cancer. This week we announced another complementary diagnostic test for melanoma.

  - Quest's expertise, scale and collaborations with top organizations such as Dako and Bristol-Myers Squibb position us to provide companion and complementary diagnostic test services for immunotherapies on a scale other providers can't match.

  - We are encouraged by the progress of our clinical franchise teams and expect to continue to build momentum going forward.

- Second, over the past few years, we have outlined our strategy to partner more effectively with hospital systems.

  - We have shared our view that hospitals will look to partner with us to develop and execute their lab strategy.

  - In November, we announced the acquisition of Hartford Healthcare's outreach business. We have been working on detailed integration plans and now expect this relationship to close later in Q1 2016.

  - In December, we announced a professional laboratory services relationship with Barnabas Health, New Jersey's #1 health system. Under this relationship, we will manage inpatient laboratory testing services for seven of their locations throughout New Jersey. We are currently working through the transition plans. We expect clinical testing volumes to be fully transitioned by mid-year 2016.

  - These are two strong proof points of an evolving market where hospitals are looking for high value, world class partners. We continue to be encouraged by the robust pipeline of opportunities we have developed.

- In addition, we are building our portfolio of health information technology solutions. Our capabilities help payers, providers and patients to improve care, lower cost and manage populations. We are rolling out our new suite of solutions called *"Quanum"* internally to our sales force this week.

  - A good example of a *"Quanum"* solution is our recent partnership with Inovalon to deliver real-time insights at the point of care, which we call Data Diagnostics. We launched this solution in December, are seeing strong interest, and have already begun to sign business. We're very encouraged by the opportunity.

  - You will hear more about Data Diagnostics and our *"Quanum"* solutions later this quarter at HIMSS.

The second element of our strategy is Driving Operational Excellence.

- At our Investor Day in November 2014, we outlined our goal to increase our cumulative run rate savings to $1.3 billion by the end of 2017. To achieve that, we needed to deliver an additional $600 million in run rate savings by the end of 2017.

- We made progress on the major objectives of our program which include building e-enabling services; standardizing our processes, data and systems; and improving cash collections.

- We delivered over $200 million dollars in realized savings in 2015, enabling us to deliver 10% growth in pre-tax earnings for the year as we continue to move closer to our Invigorate goal of $1.3 billion.

- We are improving the customer experience while at the same time lowering cost by removing waste from the system.

We continue to Simplify and strengthen our organization, which is the third element of our strategy.

- During the year:
  - We launched our new Brand - *Action from Insight.* Our brand promise is more than a refreshed logo… it's really about recommitting to a superior customer experience. We recently launched *Everyday Excellence,* a new initiative that focuses on our customers. Already we've rolled it out to more than one third of our workforce, but it's not just for our front line. Everyday Excellence is for all of our employees, and it starts with me.

  - We also invested and trained over 150 senior leaders at our Leading Quest Academy.

  - And we deployed our Quest Management System to create a standard framework for running our business.

- Our 44,000 employees are the key to our success. In a recent company-wide survey we experienced a record rate of engagement from our employees, and the results put us on par or above the performance of high performing companies in several key areas. There is a clear link between employee engagement and performance at the most successful companies. Our employees are providing us with valuable feedback, and we are listening.

- On a recent visit to our facilities in California, as with so many visits with our operations, I came away both impressed and grateful for our employees' passion and commitment to our customers.

The fourth element of the strategy is to Refocus on our Diagnostic Information Services business.

- During the year, we contributed our clinical trials testing business into the newly formed joint venture with Quintiles, called Q Squared Solutions. The JV's performance is on track with our expectations and we are excited to be part of this growing business.

And, finally, we remain committed to the fifth element of our strategy, delivering disciplined capital deployment.

- In 2015, we returned over $400 million dollars to our shareholders through a combination of dividends and share buybacks.

- We returned 80 percent of our free cash flow to shareholders in 2015 – well in excess of our commitment to return the majority of free cash to shareholders.

- During the quarter, we increased the Company's share repurchase authorization by $500 million.

- And earlier today, we announced a 5% increase in our quarterly dividend. This is our 5th dividend increase since 2011.

- We continued to invest in the business. We announced the Hartford Healthcare outreach acquisition in the quarter and closed two acquisitions earlier in 2015. These acquisitions are aligned to our objective of growing revenues through strategically aligned M&A.

Now, Mark will provide an overview on our fourth quarter financial performance and walk you through the details of our 2016 outlook, which considers several of the recently announced relationships I noted earlier.

Mark Guinan: Thanks, Steve.

Starting with revenues…

Consolidated fourth quarter revenues of $1.85 billion increased 0.6% versus the prior year on an equivalent revenue basis; that is, excluding the fourth quarter 2014 clinical trials revenue. On a reported basis, revenues were lower by 1.8%.

Revenues for Diagnostic Information Services grew by 40 basis points versus a year ago.

Volume, measured by the number of requisitions, grew by 30 basis points versus the prior year. Volume grew on an organic basis by 20 basis points.

Revenue per requisition was 10 basis points better than the prior year. Reimbursement pressure was moderate in the quarter, and for the year, which is consistent with what we shared at our investor day in 2014. Both test and business mix continued to have net positive impact, reflecting our strategy to grow our esoteric testing and drive profitable growth.

Adjusted operating income for the quarter was $288 million, or 15.5% of revenues, compared to $283 million, or 15% of revenues, a year ago. The improvement of 50 basis points can be primarily attributed to efficiencies from our Invigorate program and business mix.

For the quarter, adjusted EPS excluding amortization was $1.19, or 80 basis points better than a year ago.

Fourth quarter 2015 reported income from continuing operations includes a net benefit of $31 million, or $0.21 per share, related to deferred income tax benefits recognized during the quarter partially offset by charges primarily related to restructuring and integration costs.

In the fourth quarter of 2014, reported income from continuing operations included a net benefit of $27 million, or $0.18 per share, from the favorable resolution of tax contingencies offset by charges related primarily to restructuring and integration costs.

Bad debt expense as a percentage of revenues was 3.5%, 30 basis points better than last year and 40 basis points better than last quarter. This is primarily due to a one time bad debt benefit in the fourth quarter. It remains a challenging collection environment and we remain focused on improving our operational activities. Our DSOs were 47 days, 1 day lower than the prior year and 3 days higher than last quarter.

Reported cash provided by operations was $271 million in the fourth quarter of 2015 compared to $303 million in the fourth quarter of 2014. Cash provided by operations was lower than a year ago largely due to an additional payroll cycle.

Excluding the net cash charges related to the recent debt refinancing, adjusted cash provided by operations was $899 million for the full year 2015.

Capital expenditures were $94 million in the quarter, compared to $89 million a year ago. Total capital expenditures in 2015 were $263 million.

Before moving to guidance, I'll share a few comments to help you think about our outlook.

- First, a few of you recently asked about the 8% to 10% earnings CAGR shared at our investor day in 2014. Reflecting on 2015, we delivered 6% adjusted earnings excluding amortization. Keep in mind that the compare in 2015 was negatively impacted by amortization and a discrete tax benefit in 2014. These two items reduced our earnings growth by about 2%, mostly because we beat 2014 by about a nickel.

Taking these items into consideration, we feel we are on track compared to our objectives outlined at investor day in 2014.

- Second, because of the newly formed Q Squared Solutions JV we no longer consolidate the clinical trials revenue. Our clinical trials business reported revenues of $85 million in the first half of 2015 that you should consider as you update your model.

- Finally, as you think about our revenue projections, we have been on a favorable trajectory but one that has been building over time. We expect that we will continue to show improvement as we progress through the year. Specifically, you should consider:

  - The Barnabas Health opportunity that will phase in over the first half of the year; and

  - The recently announced outreach acquisition which we expect to be completed late in the first quarter.

Moving to guidance, we now expect full year 2016 results, before special items, as follows:

- Revenues are expected to be between $7.52 billion and $7.59 billion, an increase of 1.5% to 2.5% on an equivalent basis.

  - For comparative purposes, equivalent revenues will exclude the 2015 revenues associated with our clinical trials business.

- Adjusted diluted EPS excluding amortization to be between $5.02 and $5.17.

- Cash provided by operations to approach $1 billion.

- And capital expenditures to be between $250 million to $300 million.

Now, let me turn it back to Steve.

Steve Rusckowski: Thanks, Mark.

- We have the right strategy to restore growth and build value for our shareholders.
- We delivered another solid quarter and a good year.
- We are building momentum with our focus on esoteric testing, hospital partnerships, and expansion of our health information solutions.
- We have now delivered adjusted EPS growth for 7 consecutive quarters.
- We are positioned well to deliver on our commitments in 2016.

STEVE: Thanks again for joining our call today.

- We had another solid quarter and finished the year strong.
- We appreciate your support.
- Have a good day.