Quest Diagnostics Incorporated
Conference Call Prepared Comments
For the Quarter Ended June 30, 2014

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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' 2013 Annual Report on Form 10-K, quarterly reports on Form 10-Q and 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.

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

We restored growth in the second quarter, with:

- Revenues growing 5% to $1.9 billion;
- Adjusted EPS increasing 2% to $1.08; and
- Cash from operations strong at $280 million, up 34% from 2013.

Let's start with the industry trends, where the reimbursement outlook has been improving.

- First, we saw some signs that healthcare utilization improved during the second quarter.

- Also, in April the Congress passed the so-called "Doc Fix" legislation that delayed adjustments to the Clinical Lab Fee Schedule until 2017. This provides for a rulemaking process to define new rates based on a market weighted median of commercial rates from a broad range of labs, which includes both large and small independent labs as well as hospital outreach labs. And it also restricts the authority of CMS to make discretionary cuts. We are now working through the rulemaking process.
- Earlier this month, CMS released a proposal for the 2015 physician fee schedule. That proposal is a modest improvement from the current fee schedule, which is much needed after the significant cuts experienced over the past few years.
- And last week, we learned that Tricare had committed to restoring payment for 40 molecular codes that had previously been denied in some cases.
- Finally, our trade association has been getting the message out about the value of diagnostic information to health care. We're making some progress as an industry but the reimbursement dynamics continue to evolve and there's much more to do.

As we have said, diagnostic information is a powerful lever for transforming healthcare and we are determined to be paid appropriately for the value we provide.

- We saw continued sequential progress on reimbursement during the quarter.
- Being appropriately reimbursed for the value we provide is critical to our success. We compete on a compelling value proposition, not solely on price. You'll hear more about this later in the call from Mark.
- Regarding the Affordable Care Act, enrollment through the exchanges ramped up late in the first quarter. While it's still early, we did see modest shifts from uninsured patient volume into certain payer types during the second quarter. We continue to expect the ACA to be neutral to slightly positive for our business in 2014, and a net positive over the long run.
- I expect to update you further on our views of the market and the competitive landscape at our next Investor Day, which will take place November 5 in New York City.

Now let's look at the progress we're making executing our five point strategy. Our top priority is restoring growth, and we made solid progress in the quarter.

The investments we've made and efforts to improve our sales effectiveness are starting to yield positive results. We are seeing continued improvement in sequential trends in revenues, organic volume and organic price.

- We're seeing continued improvement in sales productivity.
- We saw strong revenue growth in several product categories, driven by our clinical franchises, including prescription drug monitoring, health and wellness, and infectious disease.
- In addition, the clinical franchises are positioning us for future growth. I would like to share a few comments on two partnerships focused on precision medicine that we established during the quarter.
    - First, we are very pleased to be partnering with Memorial Sloan Kettering to use molecular testing and next generation sequencing to improve physicians' ability to treat patients with a variety of solid tumor cancers, which account for 90% of all cancers diagnosed in the U.S every year.
    - The goal is to give local community based oncologists access to the strengths of Quest and Memorial Sloan Kettering to improve their ability to treat their cancer patients.

    - Initially, physicians who order Quest's OncoVantage tumor panel will benefit from the Memorial Sloan Kettering data through a co-branded clinical annotation report to assess a patient's prognosis, guide treatment selection and monitor disease progression.
    - Over time, the goal is to build on the partnership to develop new diagnostic solutions, in addition to research and clinical trials.
  - Second, we also partnered with Sequenom to offer national access to its MaterniT21 Plus non-invasive prenatal test.
  - Beyond these two collaborations, our clinical franchises are also delivering insights from our extensive database to improve health. Let me share two brief examples.
    - You may have seen that the Wall Street Journal covered our latest Health Trends report showing that only about half of patients comply with their prescriptions for pain medication.
    - In addition, we continue to empower patients to manage their health information through the MyQuest app, powered by Care360, which now has nearly 1 million users.
    - These are great examples of how we're delivering on our vision of empowering better heath with diagnostic insights.

- We continue to focus on opportunities to work more collaboratively with hospital systems and IDNs. Last quarter, we announced our fourth professional lab services relationship. All of these are now operational and generating revenues. Our pipeline of new opportunities continues to expand.

- Additionally, our M&A program enabled us to restore growth this quarter.
  - We completed the acquisition of Summit Health to bolster our growing Wellness business.
  - We also completed the acquisition of Steward Health System's Outreach business and made progress on the Solstas integration.
  - In total, acquisitions added approximately 7% to revenues during the quarter and have also been a way for us to add some very talented people to the organization.

We are also making progress on other key areas of our strategy.

We made a number of advances in our effort to improve our customer experience by driving Operational Excellence.

- We opened our two new National Operations Centers – one in Kansas City and one in Tampa – to enhance and extend customer services for clients and employees throughout the United States. We have added jobs in each of these markets and put in state of the art technology to enable these teams to deliver a superior customer experience.
- We began moving into our new state of the art facility in Marlborough Massachusetts, which will use advanced automation technology to improve the quality and efficiency of diagnostic testing for the New England health care community.
- And overall, our Invigorate program remains on track to deliver the expected cost savings this year.
  - We plan to provide you with additional details on our plans to not just meet but also exceed our longer term goal of $1 billion in cost savings at our Investor Day later this fall.

The third element of our strategy is to simplify the organization to enable our top priorities of growth and operational excellence. Our simplify strategy extends well beyond our organizational redesign to also include improving our organizational capabilities, culture and processes.

- We continue to embed capabilities in our organization aimed at building a high performance culture.
  - We have been driving transformational change for the past 18 months, and we've made a lot of progress. But this type of work takes time and we are still in the very early stages of this process.
- We have strengthened capabilities in our management ranks, and also, we are strengthening the capabilities on our Board.
  - We recently welcomed Vicky Gregg as a new Director. She recently retired as CEO of BlueCross BlueShield of Tennessee. She has also held a series of senior roles at Humana and served on the Board of the Blue Cross Blue Shield Association.
  - Her healthcare insurance perspective and also her deep expertise in healthcare information technology will strengthen our Board.

Finally, we continue to deliver disciplined capital deployment and refocus on our core diagnostic information services business.

- We generated $280 million in cash from operations during the quarter, which reflects progress in our approach to deliberately managing working capital.
- In line with our plan we made investments in the business, made two acquisitions and continued to return cash to shareholders through dividends and share repurchases.

We are on track to meet our commitments for 2014.

- Mark will provide an overview on our second quarter financial performance and update you on our latest view on guidance.

Mark Guinan: Thanks, Steve.

Starting with revenues…

Consolidated revenues of $1.9 billion were 4.8% ahead of the prior year.

Our Diagnostic Information Services revenues, which account for over 90% of total revenues, grew by 5.3% compared to the prior year.

Revenue per requisition in Q2 was down 2.3% compared to the prior year. The impact of recent acquisitions negatively impacted revenue per requisition by approximately 1%. The remainder is attributed to changes in our business mix and price erosion. Pure price erosion was less than 1% in the quarter.

We recognize that price erosion has been a challenge for our business. We will remain focused on receiving appropriate reimbursement for the value that we provide. Part of my focus will be on ensuring a disciplined approach to pricing. And along those lines, we will --- and have already begun --- to make prudent decisions as we move forward.

Volume for the quarter was 7.7% favorable to the prior year. Recent acquisitions added approximately 8.5% to volumes. As I mentioned, we have already begun to make prudent decisions regarding pricing and in some cases that means walking away from existing business. During the quarter, such decisions reduced our underlying volumes by approximately 1%. Excluding acquisitions and these deliberate portfolio decisions, our underlying volumes were slightly favorable in the quarter compared to a year ago. Again, we are making sequential improvement on volume.

Q2 revenues in our Diagnostic Solutions businesses, which include risk assessment, clinical trials testing, healthcare IT, and our remaining products businesses, were down 1.1% compared to the prior year. The decline is entirely due to the divestiture of Enterix last year. Excluding the impact of this divestiture, our Diagnostic Solutions business would have improved by approximately 1%.

Adjusted operating income at 15.5% of revenues was about 1.4% below the prior year, with the decrease due principally to reimbursement pressure and recent acquisitions which carry lower initial operating margins. Of note, this was the first full quarter of integration for Solstas. As we shared previously, we expected Solstas to be dilutive in the first half of the year. Given the magnitude of that business and the fact that we haven't yet fully realized the synergies, it had an impact on our margins. We estimate that Solstas eroded our margins by more than 50 basis points during the second quarter.

Additionally, we continue to make progress on our Invigorate program, which offset increases in our wage bill as well as price erosion. As we indicated on our last call, we continue to expect to achieve approximately $200 million in realized savings during 2014 and approach approximately $700 million in run rate savings as we exit 2014, with a longer term goal of greater than $1 billion over time.

Adjusted EPS of $1.08 was 1.9% better than a year ago.

As a result of the company's ongoing efforts to restore growth, drive operational excellence and simplify the organization, reported operating income was reduced by $34 million, principally restructuring and integration costs. This reduced reported operating income as a percentage of revenues by 1.7% and reported EPS by 16 cents. Last year's second quarter included $19 million of costs associated with restructuring and integration charges which reduced reported operating income as a percentage of revenues by 1.0% and reported EPS by 7 cents.

As expected, bad debt expense as a percentage of revenues improved 40 basis points from the prior quarter and increased 20 basis points from the prior year to 3.9%.

Our DSOs improved by 2 days from last quarter to 47 days.

Cash from operations was $280 million in the quarter compared to $208 million in the prior year.

Capital expenditures were $49 million in the quarter, compared to $56 million a year ago.

During the quarter we repurchased $25 million of our common shares at an average price of $57.74. We plan to meet our capital deployment commitments by returning the majority of our free cash flow to shareholders through a combination of dividends and share repurchases, as well as meet our debt repayment commitments, which we discussed on the last call.

Turning to guidance:

We expect full year 2014 results from continuing operations, before special items, as follows:

- Revenues to increase 2.5 to 3.5% compared to a year ago, versus prior guidance of an increase of 2 to 4% compared to a year ago;
- Adjusted diluted earnings per share to be between $4.00 and $4.10, compared to prior guidance of $3.95 to $4.15;
- Cash provided by operations to approximate $900 million;
- And capital expenditures to approximate $300 million.

We took another positive step forward to restoring growth this quarter and continue to make nice progress against our Invigorate targets. With that in mind, we remain committed to providing guidance that is realistic and achievable.

Finally, I'd like to remind you of some data points to help put our guidance into perspective.

- Regarding reimbursement, certain commercial contracts will anniversary later this year;
- On volumes, we anticipate that our focus on pricing discipline will create some additional headwinds that will continue through the remainder of the year. Ensuring that we are paid appropriately for the value we provide will enable us to build value over the long run.
- Regarding acquisitions, you should assume Solstas will continue to benefit our revenues in the back half of the year by approximately 5%. But also keep in mind that we have two acquisitions – Dignity Health and ATN – that anniversaried in the second quarter;
- With that said, we expect our recent acquisitions to begin to benefit EPS gradually through the year as we realize synergies.

As a result of these items, we now expect third quarter adjusted EPS to be better than the 2013 level and closely approximate our second quarter performance.

Now I'll turn it back to Steve.

Steve Rusckowski: Thanks, Mark.

To summarize:

- **We restored growth in the quarter.**
- **Trends improved across the board in pricing, volume and revenue.**
- **We continued to make good progress executing our strategy, and have more to do.**
- **And, we are on track to meet our commitments for 2014.**