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

Conference operator: Welcome to the Quest Diagnostics Third Quarter 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.

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.

During the third quarter, we delivered against our expectations, continued to make progress against our strategy and reported top and bottom line growth. In the quarter:

- Revenues grew 6.5% to $1.9 billion;
- Adjusted EPS increased 8% to $1.10; and
- Cash from operations was strong at $271 million.

I'd like to start with a few brief comments on industry trends.

- **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.**

- Our trade association has been getting the message out about the value of diagnostic information to health care. We're making progress as an industry, but the reimbursement dynamics continue to evolve and there's much more to do.

- For example in July, Tricare announced it had committed to restoring payment for 40 molecular codes that had previously been denied in some cases. During the third quarter, we saw progress and payment on codes that previously had been denied.. This is a nice sign of progress we are making as an industry.

- In April, Congress passed the so-called "Doc Fix" legislation that delayed adjustments to the Clinical Lab Fee Schedule until 2017. We have been working with our industry trade association to participate in a rulemaking process. This will 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. We remain hopeful this will produce a representative view of market-based pricing.

- Being appropriately reimbursed for the value we provide is critical to our success. We compete on a compelling value proposition, not solely on price.

- Also, we continue to work closely with our trade association on another important issue – to oppose the FDA's proposal to regulate laboratory developed tests referred to as LDTs. We strongly believe that unnecessary and duplicative regulation could delay patient access to life saving treatments and compromise America's leadership in diagnostic discovery.

- **Regarding the Affordable Care Act**, while it's still early, we continued to see modest shifts from uninsured patient volumes in the third quarter to government and other payers.

- **Regarding the market dynamics**, we saw additional signs of improvement in healthcare utilization during the quarter.

- We will provide an update on our views of the market and the competitive landscape at Investor Day in New York City on November 5th.

Now let's look at the progress we're making executing our five point strategy.

Our top priority is restoring growth, and we again made solid progress in the quarter.

- The investments we've made and efforts to improve our sales effectiveness are yielding positive results.

We saw continued improvement in sequential trends in revenues, organic volume and organic price. If we exclude business we walked away from, organic revenues would be favorable.

- Revenues showed strong growth in several product categories, driven by our clinical franchises, including prescription drug monitoring, health and wellness, and infectious disease.

- Last quarter we told you about our partnership with Memorial Sloan Kettering Cancer Center. Our plans were to provide annotated reports on solid tumor analyses based on a panel of mutations of 34 clinically actionable genes. We launched that expanded OncoVantage panel during the third quarter. Solid tumor cancers account for 90% of all cancers diagnosed in the U.S every year.

- Also, as promised, we began to offer our customers national access to Sequenom's non-invasive prenatal test.

- We continue to build our professional laboratory services business, and finalized yet another agreement with a medium-sized community hospital on the East Coast. We are making good progress advancing conversations from our pipeline into proposals and new business.

- These are great examples of how we are empowering better health with our diagnostic insights and making this a healthier world.

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 "lab of the future" in Marlborough Massachusetts, which will use advanced automation technology to improve the quality and efficiency of diagnostic testing for the New England market.

- The Invigorate program remains on track to deliver the expected cost savings this year. As you know, the company shared an initial target of $500 million in July 2011. Since then, we have increased that target to $600 million, delivered the original target a year early, and now expect to exceed the new run-rate target by delivering $700 million in run-rate savings as we exit 2014.

- Over the past year, we have been advising you that we will update our future plans for Invigorate at Investor Day. We intend to deliver on that commitment, which will provide you with additional details on our plans to deliver total run-rate savings in excess of $1 billion.

- In addition, we made progress integrating recent acquisitions. We told you that Solstas and Summit were expected to be dilutive for the first half of 2014 but accretive in the back half as we worked through our integration plans. We are pleased with the progress we have made realizing the expected synergies. I'm happy to report that these acquisitions, as well as Steward and ConVerge, were all accretive on an adjusted basis during the quarter.

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 strengthen the management team and to build a high performance culture.
- And we have also continued to strengthen our Board.
- Recently, the Board elected Dr. Jeffrey Leiden as our newest Director. He currently serves as Chairman, CEO and President of Vertex Pharmaceuticals. Jeff is the third new Board member added this year with significant CEO experience. Coupling this with his deep management, scientific and clinical background in healthcare, this will strengthen and complement our Board's capabilities.

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

- We generated $271 million in cash from operations during the quarter.
- We utilized that strong cash flow performance to return value to our shareholders through our dividend and stock buyback programs, and repay debt associated with the Solstas transaction.

As you can see, we continued to make progress executing our five-point strategy.

Now, Mark will provide an overview on our third quarter financial performance and update you on our latest guidance details.

Mark Guinan: Thanks, Steve.

Starting with revenues…

Consolidated revenues of $1.9 billion were 6.5% ahead of the prior year. Excluding acquisitions and the divestiture of the Enterix business last year, our underlying consolidated revenues were essentially flat to the prior year – reflecting another sequential step forward in our path to Restoring growth.

Our Diagnostic Information Services revenues, which account for over 90% of total revenues, grew by 7.1% compared to the prior year.

Revenue per requisition in Q3 was 60 basis points lower than the prior year. Excluding the effect of acquisitions, revenue per requisition was slightly favorable versus the prior year, and improved sequentially from the second quarter of 2014. Compared to a year ago, price pressure continued to moderate and we benefited from favorable test mix.

Volume for the quarter was 7.8% favorable to the prior year. Recent acquisitions added approximately 8% to volumes. Last quarter, I shared that we had made prudent decisions regarding pricing and in some cases decided to walk away from existing business. Excluding the impact on revenue from these decisions, our underlying volumes were favorable to the prior year by approximately 1.5% and represents another quarter of sequential improvement in year over year volume growth.

Q3 revenues in our Diagnostic Solutions businesses, which include risk assessment, clinical trials testing, healthcare IT, and our remaining products businesses, were lower by about 70 basis points compared to the prior year. The divestiture of Enterix reduced revenues for our Diagnostic Solutions businesses by nearly 2%. Excluding this impact, our Diagnostic Solutions business grew by approximately 1% compared to the third quarter of a year ago.

Adjusted operating income at 16% of revenues was about 50 basis points below the prior year, with the decrease due principally to the increased funding of management compensation compared to a year ago and the initial lower margin profile on our recent acquisitions.

Earlier this year we shared with you that we expected the Summit and Solstas acquisitions to be dilutive in the first half of the year and accretive in the back half of the year. I am happy to report that these acquisitions were accretive in the third quarter on an adjusted basis as we made nice progress on those integration plans.

In addition to delivering on our integration plans, we continued to make progress on our Invigorate program. 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. As I shared last quarter, we will provide additional details at our Investor Day in November.

Adjusted EPS of $1.10 was 7.8% 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 $48 million, principally related to restructuring and integration costs. This reduced reported operating income as a percentage of revenues by 2.6% and reported EPS by 22 cents. Last year's third quarter reported operating income from continuing operations included the gain on sale of Ibrutinib royalty rights, the loss on sale of the Enterix business and restructuring and integration costs. These items resulted in a net benefit to reported operating income of $395 million, or $1.64 per diluted share.

Bad debt expense as a percentage of revenues was 4.0% - essentially unchanged from the prior quarter and an increase of 40 basis points from the prior year. Our DSOs were 46 days – a 1 day improvement from last quarter.

Cash from operations was $271 million in the quarter compared to $186 million in the prior year.

Capital expenditures were $102 million in the quarter, compared to $51 million a year ago.

During the quarter we repurchased $25 million of our common shares at an average price of $62.03. We plan to meet our capital deployment commitments for the year by returning the majority of our free cash flow to shareholders through a combination of dividends and share repurchases. We also made progress against our debt repayment commitment by reducing our debt by approximately $90 million in the quarter.

Turning to guidance:

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

- Revenues to grow approximately 3.5% compared to a year ago, versus 2.5% to 3.5% previously;
- Adjusted diluted earnings per share to be between $4.03 and $4.07, compared to previous guidance of $4.00 and $4.10;
- Cash provided by operations to approximate $900 million;
- And capital expenditures to approximate $300 million.

Now I'll turn it back to Steve.

Steve Rusckowski: Thanks.

Mark, you recently had your one-year anniversary at Quest. A year ago on this call you shared several priorities. Those included improving our predictability and supporting the business to achieve our five point strategy. Just as we are making progress on our five point strategy, we are also making progress on our commitment to improve our guidance and deliver on our commitments.

To summarize:

- **We delivered a second solid quarter of top line growth as we continue to build momentum.**
- **We made good progress executing our strategy, and our Invigorate program remains firmly on track.**
- **As a result, we delivered 8% adjusted earnings per share growth and we are on track to meet our commitments for 2014.**
- **And finally, I want to share that I look forward to seeing many of you at our upcoming Investor Day where we will provide some longer term perspective and deeper updates on our strategic**