Q2 2017
CONFERENCE CALL SCRIPT
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Conference operator: Welcome to the Quest Diagnostics Second Quarter 2017 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 written consent of Quest Diagnostics is strictly prohibited. Now I'd like to introduce Shawn Bevec, Executive Director of Investor Relations for Quest Diagnostics. Go ahead, please.

Shawn Bevec: Thank you and good morning. I am here with Steve Rusckowski, our Chairman, 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. For this call, references to reported EPS refers to reported diluted EPS and references to adjusted EPS refer to adjusted diluted EPS excluding amortization. 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 our most recent Annual Report on Form 10-K and subsequently filed quarterly reports on Form 10-Q and Current Reports on Form 8-K.

The text of our prepared remarks will be available later today in the Investor Relations page of our website.

Now, here is Steve Rusckowski.

Steve Rusckowski: Thanks, Shawn, and thanks, everyone, for joining us today.

This morning, I'll provide you with highlights of the quarter and review progress on our strategy. Then Mark will provide more detail on the results and take you through updates to our 2017 guidance.

- We turned in another strong quarter and are delivering on all five elements of our strategy to accelerate growth.

Here are some key highlights:

- Revenues were up approximately 2 percent on a reported basis and up 2.3 percent on an equivalent basis;
- <u>Reported</u> EPS of $1.37 was flat from 2016. <u>Adjusted</u> EPS grew approximately 16% to $1.55, which includes an increase of 8 cents over the prior year of excess tax benefit associated with stock-based compensation.

Based on our progress in the first half, we have raised our outlook for revenues, EPS and cash from operations for the full year 2017.

Before I describe the progress we have made to accelerate growth and drive operational excellence, I'd like to briefly discuss PAMA.

This month a number of ACLA board members met with the Executive Branch as well as key members of the Senate Finance Committee and both the Ways and Means and Energy and Commerce Health Subcommittees, reiterating our belief that the current regulations effectively exclude hospital outreach labs, which are a significant segment of the laboratory market.

Last month our trade association sent a letter to CMS recommending:

- Postponing the calculation and publication of a new Clinical Lab Fee Schedule
- Refining the definition of "applicable laboratory" to ensure it includes hospital outreach laboratories; and
- Upon gathering data from hospital outreach laboratories, publishing new Clinical Lab Fee Schedule rates effective no earlier than July 1, 2018.

While we support reform of the Medicare payment system, we believe any modifications should be market-based and appropriately include all applicable independent and hospital outreach laboratories.

At this point, we've made a strong case to CMS and Congress. While we continue to believe that CMS has not carried out the Congressional intent of PAMA, we recognize that a new CLFS could be in place by January, 2018, and we will be prepared.

Now, let's review progress we've made executing our two-point strategy to accelerate growth and drive operational excellence.

In the second quarter we delivered on all five elements of our strategy to accelerate growth.

The first element of our growth strategy is to grow 1-2% per year through strategically aligned, accretive acquisitions, which we expect to achieve for the fifth consecutive year.

- We built on our leadership position in advanced diagnostics with our recently-completed acquisition of Med Fusion and ClearPoint.

Under the second element of our growth strategy, we continued to expand relationships with hospital health systems.

- On May 1st we completed our acquisition of the outreach operations of PeaceHealth Laboratories and began managing 11 PeaceHealth laboratories serving medical centers in three states in the Pacific Northwest. We began to recognize revenues from this acquisition and the PLS agreement in the second quarter.

Our existing Professional Lab Services relationships with hospital health systems such as RWJBarnabas, HCA and Montefiore, also continue to perform well and drive revenue growth.

The third element of our growth strategy is to offer the broadest access to diagnostic innovation.

- Our acquisition of Med Fusion and Clear Point will not only accelerate Quest's growth in advanced diagnostics, but also holds the promise of improving cancer care.
    - Quest will become a preferred provider of advanced oncology diagnostics for the U.S. Oncology Network, consisting of more than 1,400 independent, community-based

physicians. In addition, Quest will be a preferred provider of a full range of inpatient and outpatient diagnostic services for 12 hospitals of Baylor Scott & White Health in North Texas.

- Advanced diagnostics, including genetic and molecular-based tests, as well as general diagnostics, grew in the quarter.

    - Drivers of advanced diagnostics growth include: Q-Natal, which is our offering for noninvasive prenatal screening, core infectious disease testing, and Quantiferon TB testing. Within general diagnostics, prescription drug monitoring and Hepatitis C screening continue strong double digit growth.

    - We recently expanded our tumor profiling offered through "IBM Watson Genomics from Quest Diagnostics" to include a 50-gene panel. With this enhanced insight, doctors can take more informed actions for treatment and feel more certain about the best path forward.

    - Finally, last week we launched QHerit™, a new genetic screening service that provides women and men with insight into their genetic risk of passing on heritable disorders to their offspring.

We also made significant progress executing the fourth element of our growth strategy, which is to be the provider of choice for consumers.

- Our relationship with Safeway continues to expand, as we are now operating in over 100 stores. We still have a clear line of sight to operating in 200 stores, and now expect to reach that number by mid-2018.

    - Patient satisfaction and convenience scores are above 90% for our Safeway locations, and feedback from these sites remains overwhelmingly positive.

    - We can't sum it up any better than two of our recent customers who provided feedback on our Safeway locations.

    - An Aetna member from Alexandria, Virginia recently wrote, "I really like the location of this Quest center in Safeway. It saves me time...grocery shopping, pharmacy, and Quest blood tests all in the same location."

    - Here's my personal favorite from a customer in Longmont, Colorado:

        - "The best blood draw I have ever had!!!! You rock!!!"

- In this exciting era of the empowered healthcare consumer, more and more people are taking control of their health and asking to receive their lab results in the palm of their hand. More than 4 million patients are receiving their lab results through our MyQuest mobile application, and we are on track to reach 5 million users by the end of 2017.
- Finally, in late June we announced our collaboration with Walmart to help improve access to care and, over time, help lower health care costs through providing basic healthcare services.

- The collaboration will initially launch in approximately 15 Walmart stores in Florida and Texas by the end of 2017. These co-branded sites will initially provide laboratory testing services. Over time, offerings are expected to expand to include other basic healthcare services.

- In the future, these services will help us to deliver on the fifth element of our growth strategy, which is to support population health with data analytics and extended care services.

Turning to the second part of our two-point strategy to drive operational excellence, we remain on track to deliver $1.3 billion in Invigorate run-rate savings as we exit 2017.

As we indicated at our Investor Day last Fall, we also believe we will be able to generate additional savings beyond 2017.

As we drive operational efficiency, we continue to improve the customer experience.

- We are e-enabling our processes behind the scenes as well as in our PSCs.
- More than 600 PSCs are now live with e-Check-in. We plan to deliver this digital experience to 1,000 PSCs by the end of the year.

    - At these locations patients use a tablet to sign in for their appointment, and are provided with an estimated wait time. They know they are "in the system" and when they will be seen. That's good for patients. It's good for us too. On the back end this data provides us real-time insight into patients' flow, enabling us to direct phlebotomists to the locations where they are needed most.

    - Since we introduced this service earlier this year, more than 7 million people have utilized this service to date.

Finally, 2017 is our 50th anniversary of empowering better health with diagnostic insights. We have held numerous events around the company to mark the occasion, and our employees have enjoyed engaging with former leaders and learning more about our history.
We are proud of our 50 year legacy and look forward to promoting a healthy world, building value, and creating an inspiring workplace over the next fifty years.

Now, let me turn it over to Mark, who will take you through our financial performance in detail.

Mark Guinan: Thanks, Steve.

Starting with revenues…

Consolidated revenues of $1.94 billion were up 1.9% versus the prior year on a reported basis while equivalent revenues grew 2.3%.
Revenues for Diagnostic Information Services grew by 2.5% compared to the prior year with approximately 40 basis points attributed to the PeaceHealth outreach acquisition which was completed in May.

Volume, measured by the number of requisitions, increased 1.8% versus the prior year, of which 1.4% was organic.

Revenue per requisition in the second quarter grew by 70 basis points versus the prior year. As a reminder, revenue per req is not a proxy for price. It includes a number of variables such as: unit price variation; test mix; and tests per req.

Unit price headwinds in the second quarter were less than 100 basis points. While price fluctuations can vary from quarter to quarter, we continue to expect that unit price headwinds will remain moderate in 2017 and consistent with the last few years.

Beyond unit price and the impact of growth in our PLS partnerships, other mix elements, including test mix, contributed between 100-200 basis points, which is consistent with the trends we've observed for several quarters.

Reported operating income for the quarter was $319 million, or 16.4% of revenues, compared to $422 million, or 22.1% of revenues, a year ago. Keep in mind, our reported operating income in 2016 included a one-time gain related to the divestiture of our Focus products business.

On an adjusted basis, operating income was $343 million, or 17.6% of revenues, compared to $324 million, or 17.0% of revenues last year.

Our Focus Diagnostics products business contributed approximately $4 million of adjusted operating income in the second quarter of 2016 which adversely impacted the growth in our operating income year over year by approximately 1 percentage point.

Excluding the impact of Focus Diagnostics, operating income grew approximately 7 percent.

Reported EPS was $1.37 in the quarter, flat with the prior year period. As noted previously, our second quarter 2016 results included a large one time gain associated with the Focus divestiture. Adjusted EPS was $1.55, up 16% from $1.34 last year.

The company recorded after-tax net charges totaling $11 million in the second quarter, or 8 cents per diluted share, representing restructuring, integration and other one-time costs partially offset by a gain on the sale of an equity interest.

Our effective tax rate in the quarter was approximately 32 percent, compared to approximately 48 percent last year. The prior year tax rate was unusually high as a result of the Focus divestiture.

The decrease in the effective tax rate was also driven by $13 million, or 10 cents per diluted share in the quarter, of excess tax benefit associated with stock based compensation, compared to a $2 million, or 2 cents per share benefit, last year. The benefit was almost entirely related to the exercise of stock options which is impossible to forecast.
Bad debt expense as a percentage of revenues was 4.2%, flat year-over-year and 20 basis points lower versus the prior quarter.

Through the first half of 2017, cash provided by operations was $490 million versus $464 million last year. Capital expenditures year to date were $107 million, compared to $104 million a year ago.

Before turning to guidance, I'd like to remind you that we have now annualized all of the portfolio changes as part of our efforts to refocus the business on diagnostic information services. Therefore, the quarterly year over year comparisons will no longer refer to equivalent growth, but the year to date comparisons will refer to equivalent growth for the remainder of 2017.

With that said, we are providing the following updated outlook for 2017:

- Revenues now expected to be between $7.69 billion and $7.74 billion, an increase of 2.3 to 3.1% versus the prior year on a reported basis, and an increase of 2.6 to 3.4% on an equivalent basis.

- Reported diluted EPS to be between $4.90 and $5.00 and adjusted EPS to be between $5.62 and $5.72.

- Cash provided by operations is now expected to be approximately $1.2 billion; and finally

- Capital expenditures remain between $250 million and $300 million.

Our increased revenue, EPS and cash from operations outlook is based on first half performance and reflects the completion of two previously announced acquisitions including the PeaceHealth outreach deal in May as well as the Med Fusion and ClearPoint labs which closed last week.

In addition to our first half performance, our raised EPS outlook reflects the higher than expected level of excess tax benefit associated with stock based compensation.

Now, let me turn it back to Steve.

Steve Rusckowski: Thanks, Mark.

To summarize:

- **We turned in another strong quarter and are delivering on all five elements of our strategy to accelerate growth.**

- **Based on our progress in the first half, we have raised our outlook and are well-positioned to meet our expectations.**

Now we'd be happy to take your questions.

STEVE: Thanks again for joining our call today.

- We had a strong first half of 2017.

- We look forward to continue meeting our commitments by executing our two-point strategy of accelerating growth and driving operational excellence

- Thank you very much for your continued support.

- Goodbye.