

With 510(k) clearance for marketing, physicians who operate CLIA-certified moderately complex laboratories may now use these two products to quickly produce results in a single office visit. These two tests can help physicians quickly determine the possible presence of an infection and allow physicians to make more informed and immediate treatment decisions for their patients. We have applied for CLIA-waived status for these two products which, if granted, would permit physicians to use these products in a much larger segment of physician offices. In 2008, a CLIA waiver was granted for our urine albumin test.

Enterix, an Australia-based company, manufactures the InSure® fecal immunochemical test (FIT™) for screening for colorectal cancer and has developed the InSure® Quik FIT™ test for processing by the physician in his or her office.

International. We have laboratory facilities in Mexico City, Mexico; San Juan, Puerto Rico; Gurgaon, India; and Heston, England. These laboratories support our clinical trials business and clinical testing in their local markets. In India, our laboratory also supports our risk assessment services and sales directly to employers and consumers. We also have sales representatives dedicated to offering our point-of-care test products in countries outside the United States. We see opportunities to bring our experience and expertise in diagnostic testing and point-of-care products to international markets, particularly developing countries where the testing markets are highly fragmented and less mature.

Healthcare Information Technology. We empower healthcare organizations and clinicians with information technology solutions that can improve patient care and medical practice. We develop differentiated products that are designed to support the creation and management of patient records, by bringing together, in one patient-centric view, information from various sources, including physician's records and laboratory and hospital data. We believe that these products enhance the value we provide to our customers and result in increased customer loyalty by providing more convenient ordering and reporting of clinical tests and better access to patient-centric information.

We develop and integrate clinical connectivity and data management solutions for healthcare organizations, physicians and clinicians primarily through our Care360 suite of products and the ChartMaxx® electronic document management system for hospitals. The Care360 products, including our Care360 Physician Portal, enable physicians to order diagnostic tests and review test results from Quest Diagnostics online. In addition, the Care360 Physician Portal enables physicians to electronically prescribe medication, view clinical and administrative information in a patient-centric record maintained in our repository and share confidential information with medical colleagues in a HIPAA-compliant manner. Demand has been growing for our information technology solutions as physicians have expanded their usage of the Internet. By the end of 2008, approximately 140,000 physicians had access to Care360 products. Excluding our AmeriPath business, over 70% of our test orders and approximately 85% of our test results were being transmitted electronically. E-prescribing medications processed through Care360 in 2008 more than doubled compared to 2007. The annualized rate as we exited 2008 was 4.5 million. We believe that recent e-prescribing incentives promulgated by the Centers for Medicare and Medicaid Services ("CMS") will foster increased demand for our information technology solutions.

Additionally, in 2007 we acquired the capabilities to deploy a health information exchange system comprised of proprietary technologies that enable healthcare providers to access and manage a range of patient data from multiple sources at the point-of-care. These capabilities will enable us to provide solutions to the many health information exchanges that are being developed.

In 2008, we collaborated with Google to launch Google Health™. Google Health™ enables patients and physicians to share diagnostic laboratory data online, and allows users to save, organize and manage their medical records and personal health information online. Using our Care360 connectivity products, physicians can securely provide diagnostic data with a brief explanation of test results to a patient's Google Health™ account.

THE UNITED STATES CLINICAL TESTING MARKET

Most clinical tests are performed by one of three types of laboratories: commercial clinical laboratories; hospital-affiliated laboratories; and physician-office laboratories. We believe that hospital-affiliated laboratories account for approximately 60% of the market, commercial clinical laboratories approximately one-third and physician-office laboratories the balance.

Key Trends. There are a number of key trends that we expect to have a significant impact on the clinical testing business in the United States and on our business. These trends present both opportunities and risks. The recent economic slowdown may temporarily reduce industry growth rates. However, because clinical testing is an essential healthcare service and because of the key trends discussed below, we believe that the industry will

continue to grow over the long term and that we are well positioned to benefit from the long-term growth expected in the industry.

Demographics. The growing and aging population is increasing the demand for clinical testing.

Increased testing. We believe that we have entered the decade of diagnostics, moving from greater focus on curative care to a greater recognition of the value of detection, prevention and personalized care. Physicians increasingly are relying on testing to help identify risk factors and symptoms of disease, the choice of therapeutic regimen and the evaluation of treatment results. Physicians, consumers and payers increasingly recognize the value of testing as a means to improve health and reduce the overall cost of healthcare through early detection and prevention.

Science and technology advances. Medical advances allow for more accurate and earlier diagnosis and treatment of diseases. Continuing research and development in the area of genomics is expected to yield new, more sophisticated and specialized tests. These advances also are spurring interest in and demand for personalized or tailored medicine, which relies on diagnostic and prognostic testing. In addition, pharmacogenetic testing increasingly is used as a parameter to help speed drug approval processes and to better focus therapy based on patient and tumor-specific genetic markers.

Health information technologies. Demand is growing toward comprehensive care management solutions that serve patients, payers and practitioners by improving access to patient data, increasing patient participation in care management, reducing medical errors and improving clinical outcomes. There is an increasing focus on interconnectivity, the ability to interact with other software and systems, and real time data aggregation. Electronic medical records and patient health records continue to grow.

Customer and payer consolidation. Our customers and payers, including physicians, health insurance plans, employers, pharmaceutical companies and other intermediaries, have been consolidating. We expect that this trend will continue. Consolidation is increasing customer and payer bargaining power, enhancing purchasing sophistication and encouraging internalization of testing.

Highly competitive. The clinical testing industry remains fragmented, is highly competitive and is subject to new competition. Competition is growing from non-traditional competitors. New market entrants with extensive resources may make acquisitions or expand into our traditional areas of operations. We also are expanding into new diagnostic testing areas that are highly competitive.

Regulatory and policy environment. Government oversight of and attention to the healthcare industry in the United States is significant and may increase. There has been extensive discussion of healthcare reform. While it is not possible to predict whether change in U.S. government regulation of healthcare will occur, or the nature or impact of any such change, we believe that any such change should recognize the value and importance of diagnostic testing to patient care.

Globalization. There is a growing demand for healthcare services in emerging market countries. Opportunities are arising to participate in the restructuring or growth of the healthcare systems in these countries. Additionally, our customers are establishing positions outside the United States. Demographic changes globally may also create opportunities.

Customers and Payers. We provide testing services to a broad range of customers, with orders for clinical testing generally generated by physicians, hospitals and employers. In most cases, the customer that orders the testing is not responsible for the payments of services. We consider a party that refers a test to us a “customer” and a party that reimburses us a “payer.” Depending on the billing arrangement and applicable law, the payer may be (1) a third party responsible for providing health insurance coverage to patients, such as a health insurance plan, self-insured employer benefit fund, or the traditional Medicare or Medicaid program, (2) the patient or (3) the physician or other party (such as a hospital, another laboratory or an employer) who referred the testing to us.

The following table shows current estimates of the breakdown of the percentage of our total volume of requisitions and net revenues associated with our clinical testing business during 2008 applicable to each payer group:

	Requisition Volume as % of <u>Total Volume</u>	Net Revenues as % of Total Clinical Laboratory Testing <u>Net Revenues</u>
Traditional Medicare and Medicaid Programs	15% - 20%	15% - 20%
Physicians, Hospitals, Employers and Other Monthly-Billed Clients.....	30% - 35%	20% - 25%
Health Plans: Fee-for-Service.....	30% - 35%	40% - 45%
Health Plans: Capitated	15% - 20%	5% - 10%
Patients	2% - 5%	5% - 10%

Health plans, including managed care organizations and other health insurance providers, typically reimburse us as a contracted provider on behalf of their members for clinical testing services performed. Reimbursement from our two largest health insurer payers totaled approximately 13% of our net revenues in 2008. Aetna, which accounted for over 7% of our consolidated net revenues for 2008, was our largest health insurer payer.

Physicians. Physicians requiring testing for patients are the primary referral source of our clinical testing volume. Physicians determine which laboratory to recommend or use, based on a variety of factors, including: service; patient access and convenience, including inclusion in a health plan network; price; and depth and breadth of test and service offering. Physicians also order our point-of-care tests.

Most of our clinical testing is referred by primary care physicians. We historically have provided a strong value proposition in routine and esoteric clinical testing. In 2007, we acquired AmeriPath, expanding our service capabilities. This will enable us to leverage our capabilities and to more effectively compete in several physician sub-specialties, including dermatology, urology, gastroenterology, hematology and oncology, where historically we had a smaller market share. We plan to continue to enhance our test menu and service capabilities.

Health Plans. Health plans typically negotiate directly or indirectly with a number of clinical laboratories, and represent approximately one-half of our total clinical testing volumes and one-half of our net revenues from clinical testing. In certain markets, such as California, health plans may delegate to independent physician associations (“IPAs”) the ability to negotiate for clinical testing services on behalf of certain members. The trend of consolidation among health plans has continued.

Health plans and IPAs often require that clinical test service providers accept discounted fee structures or assume all or a portion of the financial risk associated with providing testing services through capitated payment arrangements and discounted fee-for-service arrangements. Under capitated payment arrangements, we provide services at a predetermined monthly reimbursement rate for each covered member, generally regardless of the number or cost of services provided by us. Average reimbursement rates under capitated payment arrangements are typically lower than our overall average reimbursement rate. Health plans continue to focus product offerings on point-of-service (“POS”) plans, and consumer driven health plans (“CDHPs”) that offer a greater choice of healthcare providers. Reimbursement under these programs is typically negotiated on a fee-for-service basis, which generally results in higher revenue per requisition than under capitation arrangements. In addition, several health plans have made strategic acquisitions or have developed products to more broadly serve the individual (non-group) market. We do not expect that the design of these plans will pose a significant barrier to accessing clinical testing services. Increased number of patients in CDHPs and high deductible plans, such as those offered in the individual market, involve greater patient cost-sharing; this could negatively impact patient collection experience.

Most of our agreements with major health plans are non-exclusive arrangements. Certain health plans, however, have limited their laboratory network to only a single national laboratory to obtain improved pricing. In cases where members choose to use a non-contracted provider due to service, quality or convenience, the non-contracted provider is generally reimbursed at rates considered “reasonable and customary.” Contracted rates are generally lower than “reasonable and customary” rates because of the potential for greater volume as a contracted provider. A non-contracted clinical test service provider with quality and service preferred by physicians and patients to that of contracted providers may realize greater profits than if it were a contracted provider, if physicians and patients continue to have choice in selecting their clinical test provider and any potential additional cost to the patient of using a non-contracted provider is not considered prohibitive.

We also may be a member of a “complementary network.” A complementary network is generally a set of contractual arrangements that a third party will maintain with various providers that allow for discounted fees for the benefit of members of the customers that arrange access through the third party. A member of a health plan may choose to access a non-contracted provider that is a member of a complementary network; if so, the provider will be reimbursed at a rate negotiated by the complementary network.

We attempt to strengthen our relationships with health plans and increase the volume of testing services by offering health plans services and programs that leverage our Company’s expertise and resources, including in such areas as wellness and disease management.

Hospitals and Other Laboratories. Hospitals generally maintain an on-site laboratory to perform the significant majority of clinical testing for their patients and refer less frequently needed and highly specialized procedures to outside laboratories, which typically charge the hospitals on a negotiated fee-for-service basis. Fee schedules for hospital reference testing typically are negotiated on behalf of hospitals by group purchasing organizations. We provide services to hospitals throughout the United States, including esoteric testing, helping manage their laboratories and serving as the medical directors of the hospital’s histology or clinical laboratory. We believe that we are the industry’s market leader in servicing hospitals. Hospitals generally continue to look for ways to fully utilize their existing laboratory capacity: they perform tests their patients need and compete with commercial laboratories for outreach (non-hospital patients) testing. Continuing to obtain referrals from hospitals depends on our ability to provide high quality services that are more cost-effective than if the hospitals were to perform the services themselves. We believe that our combination of full-service, bi-coastal esoteric testing capabilities, medical and scientific professionals available for consultation, innovative connectivity products, point-of-care testing products, focus on Six Sigma quality and dedicated sales and service professionals has positioned us to be an attractive partner for hospital customers.

Most physicians have admitting privileges or other relationships with hospitals as part of their medical practice. Many hospitals seek to leverage their relationships with community physicians by encouraging the physicians to send their outreach testing to the hospital’s laboratory. In addition, hospitals that own physician practices generally require the physicians to refer tests to the hospital’s affiliated laboratory. Hospitals can have greater leverage with health insurers than do commercial clinical laboratories, particularly hospitals that have a significant market share; hospitals thus are frequently able to negotiate higher reimbursement rates with health insurance plans than commercial clinical laboratories for comparable clinical testing services.

We also have joint venture arrangements with leading integrated healthcare delivery networks in several metropolitan areas. These joint venture arrangements, which provide testing for affiliated hospitals as well as for unaffiliated physicians and other local healthcare providers, serve as our principal laboratory facilities in their service areas. Typically, we have either a majority ownership interest in, or day-to-day management responsibilities for, our hospital joint venture relationships.

We also provide testing services to federal, state and local governmental agencies, and perform esoteric testing services for other commercial clinical laboratories that do not have a full range of testing capabilities. These customers are charged on a fee-for-service basis.

Employers. Employers use clinical tests for drugs-of-abuse to determine an individual’s employability and his or her “fitness for duty.” Companies with high turnover and safety conscious environments provide the highest volumes of testing. Factors such as the general economy and job market can impact the utilization of clinical testing. We seek to grow our employer volumes through offering new and innovative programs to help companies with their goal in maintaining a safe and productive workplace. We also offer employers our Blueprint for Wellness program, providing wellness screenings to employers for their employees, to help employers manage increasing healthcare costs and to capitalize on trends in personalized health.

GENERAL

Competition. While there has been significant consolidation in the clinical testing industry in recent years, our industry remains fragmented and highly competitive. We primarily compete with three types of clinical testing providers: hospital-affiliated laboratories, other commercial clinical laboratories and physician-office laboratories. Our largest independent clinical laboratory competitor is Laboratory Corporation of America Holdings, Inc. In addition, we compete with many smaller regional and local commercial clinical laboratories, specialized esoteric laboratories and laboratories owned by physicians and hospitals. In anatomic pathology, additional competitors include anatomic pathology practices, including those in academic institutions. In addition, there has been a trend among specialty physician practices to bring pathologists into those practices.