Overview

The Clinical Testing Industry

Clinical testing is an essential element in the delivery of healthcare services. Physicians use laboratory tests to assist in the detection, diagnosis, evaluation, monitoring and treatment of diseases and other medical conditions.

Most laboratory tests are performed by one of three types of laboratories: commercial clinical laboratories; hospital-affiliated laboratories; and physician-office laboratories. In 2008, we estimate that hospital-affiliated laboratories accounted for approximately 60% of the market, commercial clinical laboratories approximately one-third and physician-office laboratories the balance.

Orders for laboratory testing are generated from physician offices, hospitals and employers and can be affected by a number of factors. For example, changes in the United States economy can affect the number of unemployed and uninsured, and design changes in healthcare plans can affect the number of physician office and hospital visits, and can impact the utilization of laboratory testing.

While the recent economic slow down in the United States may temporarily reduce industry growth rates, we believe the clinical testing industry will continue to grow over the long term because clinical testing is an essential healthcare service and because of the following key trends:

- the growing and aging population;
- continuing research and development in the area of genomics (the study of DNA, genes and chromosomes) and proteomics (the analysis of individual proteins and collections of proteins), which is expected to yield new, more sophisticated and specialized diagnostic tests;
- increasing recognition by consumers and payers of the value of laboratory testing as a means to improve health and reduce the overall cost of healthcare through early detection and prevention;
- increasing affordability of, and access to, tests due to advances in technology and cost efficiencies; and
- the growing demand for healthcare services in emerging markets and global demographic changes.

The diagnostic testing industry is subject to seasonal fluctuations in operating results and cash flows. Typically, testing volume declines during the summer months, year-end holiday periods and other major holidays, reducing net revenues and operating cash flows below annual averages. Testing volume is also subject to declines due to severe weather or other events, which can deter patients from having testing performed and which can vary in duration and severity from year to year.

Reimbursement for Services

Payments for clinical testing services are made by physicians, hospitals, employers, healthcare plans, patients and the government. Physicians, hospitals and employers are typically billed on a fee-for-service basis based on negotiated fee schedules. Fees billed to healthcare plans and patients are based on the laboratory's patient fee schedule, subject to any limitations on fees negotiated with the healthcare plans or with physicians on behalf of their patients. Medicare and Medicaid reimbursements are based on fee schedules set by governmental authorities.

Government payers, such as Medicare and Medicaid, as well as healthcare plans and larger employers, have taken steps and may continue to take steps to control the cost, utilization and delivery of healthcare services, including clinical testing services. Despite the added cost and complexity of participating in the Medicare and Medicaid programs, we continue to participate in such programs because we believe that our other business may depend, in part, on continued participation in these programs, since certain customers may want a single laboratory capable of performing all of their clinical testing services, regardless of who pays for such services.

Healthcare plans, which typically negotiate directly or indirectly on behalf of their members, represent approximately one-half of our clinical testing volumes and one-half of our net revenues from our clinical testing business. Larger healthcare plans typically prefer to use large commercial clinical laboratories because they can provide services to their members on a national or regional basis. In addition, larger clinical laboratories are better able to achieve the low-cost structures necessary to profitably service the members of large healthcare plans and can provide test utilization data across various products in a consistent format. In certain markets, such

as California, healthcare plans may delegate their covered members to independent physician associations ("IPAs"), which in turn negotiate with laboratories for clinical testing services on behalf of their members.

The trend of consolidation among physicians, hospitals, employers, healthcare plans, pharmaceutical companies and other intermediaries has continued, resulting in fewer but larger customers and payers with significant bargaining power to negotiate fee arrangements with healthcare providers, including clinical laboratories. Healthcare plans often require that clinical testing service providers accept discounted fee structures or assume all or a portion of the utilization risk associated with providing testing services to their members enrolled in highly-restricted plans through capitated payment arrangements. Under these capitated payment arrangements, we and the healthcare plans agree to a predetermined monthly reimbursement rate for each member enrolled in the healthcare plan's restricted plan, generally regardless of the number or cost of services provided by us. Our cost to perform work reimbursed under capitated payment arrangements is not materially different from our cost to perform work reimbursed under other arrangements with healthcare plans. Since average reimbursement rates under capitated payment arrangements are typically less than our overall average reimbursement rate, the testing services reimbursed under capitated payment arrangements are generally less profitable. In 2008, we derived approximately 14% of our testing volume and 5% of our net revenues from capitated payment arrangements.

Most healthcare plans also offer programs such as preferred provider organizations ("PPOs") and consumer driven health plans that offer a greater choice of healthcare providers. Pricing for these programs is typically negotiated on a fee-for-service basis, which generally results in higher revenue per requisition than under capitation arrangements. Most of our agreements with major healthcare plans are non-exclusive arrangements. As a result, under these non-exclusive arrangements, physicians and patients have more freedom of choice in selecting laboratories, and laboratories are likely to compete more on the basis of service and quality than they may otherwise. If consumer driven plans and PPO plans continue to increase in popularity, it will be increasingly important for healthcare providers to differentiate themselves based on quality, service and convenience to avoid competing on price alone.

Despite the general trend of increased choice for patients in selecting a healthcare provider, recent experience indicates that some healthcare plans may actively seek to limit the choice of patients and physicians if they feel it will give them increased leverage to negotiate lower fees, by consolidating services with a single or limited network of contracted providers. Historically, healthcare plans, which had limited their network of laboratory service providers, encouraged their members, and sometimes offered incentives, to utilize only contracted providers. Patients who use a non-contracted provider may have a higher co-insurance responsibility, which may result in physicians referring testing to contracted providers to minimize the expense to their patients. In cases where members choose to use a non-contracted provider due to service quality or convenience, the non-contracted provider would be 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 laboratory service provider with quality and service preferred by physicians and patients to that of contracted providers, could potentially realize greater profits than if it was a contracted provider, provided that physicians and patients continue to have choice in selecting their provider, and any potential additional cost to the patient of using a non-contracted provider is not considered prohibitive. Physicians requiring testing for patients are the primary referral source of our clinical testing volume, and often refer work to us as a non-contracted provider.

We expect that reimbursements for the diagnostic testing industry will continue to remain under pressure. Today, the federal and many state governments face serious budget deficits and healthcare spending is subject to reductions, and efforts to reduce reimbursements and stringent cost controls by government and other payers for existing tests may continue. However, we believe that as new tests are developed which either improve on the effectiveness of existing tests or provide new diagnostic capabilities, government and other payers will add these tests as covered services, because of the importance of laboratory testing in assessing and managing the health of patients. We continue to emphasize the importance and the high value of laboratory testing with healthcare plans and government payers at the federal and state level.

Our Company

Quest Diagnostics is the world's leading provider of diagnostic testing, information and services, providing insights that enable patients, physicians and others to make decisions to improve health. Quest Diagnostics, with a leading position in most of its domestic geographic markets and service offerings, is well positioned to benefit from the long-term growth expected in the industry. Over 90% of our revenues are derived from clinical testing with the balance derived from insurer services, clinical trials testing, diagnostic products and healthcare

information technology. Clinical testing is generally categorized as clinical laboratory testing and anatomic pathology services. Clinical laboratory testing is performed on blood and body fluids, such as urine. Anatomic pathology services are performed on tissues, such as biopsies, and other samples, such as human cells. With the acquisition of AmeriPath Group Holdings, Inc. ("AmeriPath") in May 2007, we have become the world's premier cancer diagnostics company, focused on anatomic pathology including dermatopathology and molecular diagnostics and are now able to provide interpretive consultation through the largest medical and scientific staff in the industry, with approximately 900 M.D.s and Ph.D.s primarily located in the United States. In addition, we are the leading provider of gene-based testing and other esoteric testing, risk assessment services for the life insurance industry and testing for drugs-of-abuse. We are also a leading provider of testing for clinical trials. The Company's diagnostics products business, which includes the operations of HemoCue, Enterix and certain of Focus Diagnostics' operations, manufactures and markets diagnostic test kits and specialized point-of-care testing. Through our MedPlus subsidiary, we empower healthcare organizations and clinicians with state-of-the-art information technology solutions that can improve patient care and medical practice.

We have established operations in Gurgaon, India, where we will offer many of our services. The diagnostic testing business in India is poised for rapid expansion. We see significant opportunities for us to strengthen the delivery of healthcare services in India utilizing our quality diagnostics and technology expertise.

Six Sigma and Standardization Initiatives/Efforts to Improve Operating Efficiency

The diagnostic testing industry is labor intensive. Employee compensation and benefits constitute approximately one-half of our total costs and expenses. Cost of services consists principally of costs for obtaining, transporting and testing specimens. Selling, general and administrative expenses consist principally of the costs associated with our sales and marketing efforts, billing operations (including bad debt expense), and general management and administrative support. In addition, performing diagnostic testing involves significant fixed costs for facilities and other infrastructure required to obtain, transport and test specimens. Therefore, relatively small changes in volume can have a significant impact on profitability in the short-term.

A large portion of our costs are fixed, making it more challenging to fully mitigate the profit impact of lost volume in the short term. In July 2007, we announced a program to adjust our cost structure while maintaining and, in some cases improving, service levels. During 2008, we continued to take actions which have enabled us to improve margins as a percentage of revenues over the course of the year and achieve a level which exceeded that of the prior year. As we exited 2008, we estimate that our program has resulted in over $300 million of annualized cost reductions, and we expect that our program will result in $500 million of annualized cost reductions as we exit 2009.

We intend to become recognized as the quality leader in the healthcare services industry through utilizing the Six Sigma approach and Lean Six Sigma principles. Six Sigma is a management approach that enhances quality and requires a thorough understanding of customer needs and experience, root cause analysis, process improvements and rigorous tracking and measuring of key metrics. Lean Six Sigma streamlines processes and eliminates waste. We utilize the Six Sigma approach and Lean Six Sigma principles to increase the efficiency of our operations and to reduce operating cost. We have utilized Six Sigma to implement the initiatives which are part of our cost reduction program and provide a better customer experience. These initiatives relate to standardizing our operations and processes, and adopting identified company best practices. One of these key initiatives is to deploy Lean Six Sigma in our laboratories to realize productivity gains. Additionally, we expect to realize efficiencies in other areas by better aligning our service capacity with patient and sample flows. We are driving more of our purchasing through master contracts to take better advantage of our scale. We are expanding the use of customer connectivity which reduces costs in specimen data entry and billing, and helps lower our bad debt. We are improving the efficiency of our logistics routes using advanced route optimization tools and we have streamlined our management structure and administrative functions to improve efficiency and increase focus. As additional detailed plans to implement these opportunities are approved and executed, some will result in charges to earnings associated with the implementation. These charges may be material to the results of operations and cash flows in the periods recorded or paid.

Recent Acquisitions

The clinical testing industry in the United States remains fragmented and highly competitive. Our growth will be comprised of a combination of organic and acquired growth. We expect to continue to selectively evaluate potential acquisitions of domestic clinical laboratories that can be integrated into our existing laboratories, thereby increasing access for patients and enabling us to reduce costs and improve efficiencies. While over the long term we believe positive industry factors in the United States diagnostic testing industry and

the differentiated services we offer to our customers will enable us to grow organically, we believe there will continue to be opportunities to grow beyond our current principal business of offering clinical testing in the United States. Technology is enabling testing to be performed closer to the patient, whether in the physician's office or at the hospital bedside, in the form of point-of-care testing. Given that physicians and hospitals are primary sources for both point-of-care testing and laboratory performed tests, we believe providing both services will strengthen our relationships with customers and accelerate our growth.

Additionally, diagnostic testing in international markets, particularly developing countries, is highly fragmented and less mature. Continued expansion into point-of-care testing and international markets will diversify our revenue base, and add businesses in markets which are growing faster and are more profitable than our principal business of United States based clinical testing.

Acquisition of AmeriPath

On May 31, 2007, we completed the acquisition of AmeriPath, in an all-cash transaction valued at approximately $2 billion, including approximately $780 million of assumed debt and related accrued interest. AmeriPath is a leading provider of anatomic pathology, including dermatopathology, and esoteric testing which generated annual revenues of approximately $800 million.

Through the acquisition, we acquired all of AmeriPath's operations. AmeriPath, with its team of approximately 400 board certified pathologists, operates 40 outpatient anatomic pathology testing locations and provides inpatient anatomic pathology and medical director services for approximately 200 hospitals throughout the United States. We financed the all-cash purchase price and related transaction costs, together with the repayment of approximately $780 million of principal and related accrued interest representing substantially all of AmeriPath's debt, as well as the refinancing of the $450 million term loan used to finance the acquisition of HemoCue, with $1.6 billion of borrowings under a five-year term loan facility, $780 million of borrowings under a one-year bridge loan, and cash on-hand. In June 2007, we completed an $800 million senior notes offering. The net proceeds of the senior notes offering were used to repay the $780 million bridge loan. The acquisition was accounted for under the purchase method of accounting.

Acquisition of HemoCue

On January 31, 2007, we acquired HemoCue, a Sweden-based company specializing in point-of-care testing, in an all-cash transaction valued at approximately $450 million, including $113 million of assumed debt of HemoCue. The transaction was financed through an interim credit facility, which was refinanced during the second quarter of 2007 in connection with the financing of the AmeriPath acquisition.

HemoCue is the leading international provider in point-of-care testing for hemoglobin, with a growing share in professional glucose and microalbumin testing.

Critical Accounting Policies

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires us to make estimates and assumptions and select accounting policies that affect our reported financial results and the disclosure of contingent assets and liabilities.

While many operational aspects of our business are subject to complex federal, state and local regulations, the accounting for most of our business is generally straightforward with net revenues primarily recognized upon completion of the testing process. Our revenues are primarily comprised of a high volume of relatively low dollar transactions, and about one-half of our total costs and expenses consist of employee compensation and benefits. Due to the nature of our business, several of our accounting policies involve significant estimates and judgments:

- revenues and accounts receivable associated with clinical testing;
- reserves for general and professional liability claims;
- reserves for other legal proceedings;
- accounting for and recoverability of goodwill; and
- accounting for stock-based compensation expense.

Revenues and accounts receivable associated with clinical testing

The process for estimating the ultimate collection of receivables associated with our clinical testing business involves significant assumptions and judgments. Billings for services reimbursed by third-party payers, including Medicare and Medicaid, are recorded as revenues net of allowances for differences between amounts billed and the estimated receipts from such payers. Adjustments to the estimated receipts, based on final settlement with the third-party payers, are recorded upon settlement as an adjustment to net revenues.

We have a standardized approach to estimate and review the collectibility of our receivables based on a number of factors, including the period they have been outstanding. Historical collection and payer reimbursement experience is an integral part of the estimation process related to allowances for doubtful accounts. In addition, we regularly assess the state of our billing operations in order to identify issues, which may impact the collectibility of receivables or allowance estimates. We believe that the collectibility of our receivables is directly linked to the quality of our billing processes, most notably those related to obtaining the correct information in order to bill effectively for the services we provide. As such, we have implemented "best practices" to reduce the number of requisitions that we receive from healthcare providers with missing or incorrect billing information. Revisions to the allowances for doubtful accounts estimates are recorded as an adjustment to bad debt expense within selling, general and administrative expenses. We believe that our collection and allowance estimation processes, along with our close monitoring of our billing operations, help to reduce the risk associated with material revisions to reserve estimates. Less than 5% of our net accounts receivable as of December 31, 2008 were outstanding more than 150 days.

Healthcare insurers

Healthcare insurers reimburse us for approximately one-half of our net revenues. Reimbursements from healthcare insurers are based on negotiated fee-for-service schedules and on capitated payment rates.

Receivables due from healthcare insurers represent approximately 28% of our net accounts receivable. Substantially all of the accounts receivable due from healthcare insurers represent amounts billed under negotiated fee-for-service arrangements. We utilize a standard approach to establish allowances for doubtful accounts for such receivables, which considers the aging of the receivables and results in increased allowance requirements as the aging of the related receivables increases. Our approach also considers historical collection experience and other factors. Collection of such receivables is normally a function of providing complete and correct billing information to the healthcare insurers within the various filing deadlines. For healthcare insurers, collection typically occurs within 30 to 60 days of billing. Provided healthcare insurers have been billed accurately with complete information prior to the established filing deadline, there has historically been little to no collection risk. If there has been a delay in billing, we determine if the amounts in question will likely go past the filing deadline, and if so, we will reserve accordingly for the billing.

Approximately 5% of our net revenues are reimbursed under capitated payment arrangements in which case the healthcare insurers typically reimburse us in the same month services are performed, essentially giving rise to no outstanding accounts receivable at month-end. If any capitated payments are not received on a timely basis, we determine the cause and make a separate determination as to whether or not the collection of the amount from the healthcare insurer is at risk and if so, would reserve accordingly.

Government payers

Payments for clinical testing services made by the government are based on fee schedules set by governmental authorities. Receivables due from government payers under the Medicare and Medicaid programs represent approximately 15% of our net accounts receivable. Collection of such receivables is normally a function of providing the complete and correct billing information within the various filing deadlines. Collection typically occurs within 30 days of billing. Our processes for billing, collecting and estimating uncollectible amounts for receivables due from government payers, as well as the risk of non-collection, are substantially the same as those noted above for healthcare insurers under negotiated fee-for-service arrangements.

Client payers

Client payers include physicians, hospitals, employers and other commercial laboratories, and are billed based on a negotiated fee schedule. Receivables due from client payers represent approximately 34% of our net accounts receivable. Credit risk and ability to pay are more of a consideration for these payers than healthcare insurers and government payers. We utilize a standard approach to establish allowances for doubtful accounts for such receivables, which considers the aging of the receivables and results in increased allowance requirements as

the aging of the related receivables increase. Our approach also considers specific account reviews, historical collection experience and other factors.

Patient receivables

Patients are billed based on established patient fee schedules, subject to any limitations on fees negotiated with healthcare insurers or physicians on behalf of the patient. Receivables due from patients represent approximately 23% of our net accounts receivable. Collection of receivables due from patients is subject to credit risk and ability of the patients to pay. We utilize a standard approach to establish allowances for doubtful accounts for such receivables, which considers the aging of the receivables and results in increased allowance requirements as the aging of the related receivables increases. Our approach also considers historical collection experience and other factors. Patient receivables are generally fully reserved for when the related billing reaches 210 days outstanding. Balances are automatically written off when they are sent to collection agencies. Reserves are adjusted for estimated recoveries of amounts sent to collection agencies based on historical collection experience, which is regularly monitored.

Reserves for general and professional liability claims

As a general matter, providers of clinical testing services may be subject to lawsuits alleging negligence or other similar legal claims. These suits could involve claims for substantial damages. Any professional liability litigation could also have an adverse impact on our client base and reputation. We maintain various liability insurance coverages for claims that could result from providing or failing to provide clinical testing services including inaccurate testing results and other exposures. Our insurance coverage limits our maximum exposure on individual claims; however, we are essentially self-insured for a significant portion of these claims. While the basis for claims reserves considers actuarially determined losses based upon our historical and projected loss experience, the process of analyzing, assessing and establishing reserve estimates relative to these types of claims involves a high degree of judgment. Changes in the facts and circumstances associated with claims could have a material impact on our results of operations, principally costs of services, and cash flows in the period that reserve estimates are revised or paid. Although we believe that our present insurance coverage and reserves are sufficient to cover currently estimated exposures, it is possible that we may incur liabilities in excess of our insurance coverage or recorded reserves.

Reserves for other legal proceedings

Our business is subject to extensive and frequently changing federal, state and local laws and regulations. In addition, we are aware of certain pending lawsuits related to billing practices filed under the qui tam provisions of the False Claims Act and other federal and state statutes. See Notes 14 and 15 to the Consolidated Financial Statements for a discussion of the various legal proceedings that involve the Company. We have a comprehensive compliance program that is intended to ensure the strict implementation and observance of all applicable laws, regulations and Company policies. Management periodically reports to the Quality, Safety & Compliance Committee of our Board of Directors regarding compliance operations. As an integral part of our compliance program, we investigate all reported or suspected failures to comply with federal and state healthcare reimbursement requirements. Any non-compliance that results in Medicare or Medicaid overpayments is reported to the government and reimbursed by us. As a result of these efforts, we have periodically identified and reported overpayments. Upon becoming aware of potential overpayments, we consider all available facts and circumstances to estimate and record the amounts to be reimbursed. While we have reimbursed these overpayments and have taken corrective action where appropriate, the government may not in each instance accept these actions as sufficient.

The process of analyzing, assessing and establishing reserve estimates relative to legal proceedings involves a high degree of judgment. Management has established reserves for legal proceedings in accordance with generally accepted accounting principles. Changes in facts and circumstances related to such proceedings could lead to significant revisions to reserve estimates for such matters and could have a material impact on our results of operations, cash flows and financial condition in the period that reserve estimates are revised or paid.

Accounting for and recoverability of goodwill

Goodwill is our single largest asset. We evaluate the recoverability and measure the potential impairment of our goodwill under Statement of Financial Accounting Standards ("SFAS") No. 142, "Goodwill and Other Intangible Assets." The annual impairment test is a two-step process that begins with the estimation of the fair

value of the reporting unit. The first step screens for potential impairment and the second step measures the amount of the impairment, if any. Our estimate of fair value considers publicly available information regarding the market capitalization of our Company, as well as (i) the financial projections and future prospects of our business, including its growth opportunities and likely operational improvements, and (ii) comparable sales prices, if available. As part of the first step to assess potential impairment, we compare our estimate of fair value for the reporting unit to the book value of the reporting unit. If the book value is greater than our estimate of fair value, we would then proceed to the second step to measure the impairment, if any. The second step compares the implied fair value of goodwill with its carrying value. The implied fair value is determined by allocating the fair value of the reporting unit to all of the assets and liabilities of that unit as if the reporting unit had been acquired in a business combination and the fair value of the reporting unit was the purchase price paid to acquire the reporting unit. The excess of the fair value of the reporting unit over the amounts assigned to its assets and liabilities is the implied fair value of goodwill. If the carrying amount of the reporting unit's goodwill is greater than its implied fair value, an impairment loss will be recognized in the amount of the excess. We believe our estimation methods are reasonable and reflect common valuation practices.

On a quarterly basis, we perform a review of our business to determine if events or changes in circumstances have occurred which could have a material adverse effect on the fair value of the Company and its goodwill. If such events or changes in circumstances were deemed to have occurred, we would perform an impairment test of goodwill as of the end of the quarter, consistent with the annual impairment test performed at the end of our fiscal year on December 31st, and record any noted impairment loss.

Accounting for stock-based compensation expense

Effective January 1, 2006, we adopted SFAS No. 123, revised 2004, "Share-Based Payment" ("SFAS 123R"), using the modified prospective approach and therefore have not restated results for prior periods. Pursuant to the provisions of SFAS 123R, we record stock-based compensation as a charge to earnings net of the estimated impact of forfeited awards. As such, we recognize stock-based compensation cost only for those stock-based awards that are estimated to ultimately vest over their requisite service period, based on the vesting provisions of the individual grants.

The process of estimating the fair value of stock-based compensation awards and recognizing stock-based compensation cost over their requisite service periods involves significant assumptions and judgments. We estimate the fair value of stock option awards on the date of grant using a lattice-based option-valuation model which requires management to make certain assumptions regarding: (i) the expected volatility in the market price of the Company's common stock; (ii) dividend yield; (iii) risk-free interest rates; and (iv) the period of time employees are expected to hold the award prior to exercise (referred to as the expected holding period). The expected volatility under the lattice-based option-valuation model is based on the current and historical implied volatilities from traded options of our common stock. The dividend yield is based on the approved annual dividend rate in effect and current market price of the underlying common stock at the time of grant. The risk-free interest rate is based on the U.S. Treasury yield curve in effect at the time of grant for bonds with maturities ranging from one month to seven years. The expected holding period of the awards granted is estimated using the historical exercise behavior of employees. In addition, SFAS 123R requires us to estimate the expected impact of forfeited awards and recognize stock-based compensation cost only for those awards expected to vest. We use historical experience to estimate projected forfeitures. If actual forfeiture rates are materially different from our estimates, stock-based compensation expense could be significantly different from what we have recorded in the current period. We periodically review actual forfeiture experience and revise our estimates, as considered necessary. The cumulative effect on current and prior periods of a change in the estimated forfeiture rate is recognized as compensation cost in earnings in the period of the revision.

Finally, the terms of our performance share unit grants allow the recipients of such awards to earn a variable number of shares based on the achievement of the performance goals specified in the awards. For performance share unit awards granted prior to 2008, the actual amount of any stock award earned is based on the Company's earnings per share growth as measured in accordance with its Amended and Restated Employee Long-Term Incentive Plan for the performance period compared to that of a peer group of companies. Beginning with performance share unit awards granted in 2008, the performance measure for these awards will be based on the cumulative annual growth rate of the Company's earnings per share from continuing operations over a three year period. Stock-based compensation expense associated with performance share units is recognized based on management's best estimates of the achievement of the performance goals specified in such awards and the resulting number of shares that will be earned. If the actual number of performance share units earned is different from our estimates, stock-based compensation could be significantly different from what we have recorded in the

current period. We periodically obtain and review publicly available financial information for the members of the peer group and compare that to actual and estimated future performance of the Company, including historical earnings per share growth as well as published estimates of projected earnings per share growth. This information is used to evaluate our progress towards achieving the performance criteria and our estimate of the number of performance share units expected to be earned at the end of the performance period. The cumulative effect on current and prior periods of a change in the estimated number of performance share units expected to be earned is recognized as compensation cost in earnings in the period of the revision. While the assumptions used to calculate and account for stock-based compensation awards represent management's best estimates, these estimates involve inherent uncertainties and the application of management's judgment. As a result, if revisions are made to our assumptions and estimates, our stock-based compensation expense could vary significantly from period to period. In addition, the number of awards made under our equity compensation plans, changes in the design of those plans, the price of our shares and the performance of our Company can all cause stock-based compensation expense to vary from period to period.

Results of Operations

Our clinical testing business currently represents our one reportable business segment. The clinical testing business for each of the three years in the period ended December 31, 2008 accounted for more than 90% of net revenues from continuing operations. Our other operating segments consist of our risk assessment services business, our clinical trials testing business, our healthcare information technology business, MedPlus, and our diagnostic products business. On April 19, 2006, we decided to discontinue the operations of a test kit manufacturing subsidiary, NID. During the third quarter of 2006, we completed the wind down of NID and classified the operations of NID as discontinued operations for all periods presented. Our business segment information is disclosed in Note 16 to the Consolidated Financial Statements.

Year Ended December 31, 2008 Compared with Year Ended December 31, 2007

Continuing Operations

Income from continuing operations for the year ended December 31, 2008 was $632 million, or $3.23 per diluted share, compared to $554 million, or $2.84 per diluted share, in 2007. The increase in income from continuing operations was principally driven by revenue growth and actions we have taken to reduce our cost structure.

Results for the year ended December 31, 2008 include charges totaling $25.1 million, or $0.08 per diluted share consisting of: a third quarter charge of $8.9 million, or $0.03 per diluted share, associated with the write-down of an equity investment; and a fourth quarter charge of $16.2 million, or $0.05 per diluted share, principally associated with workforce reductions. These charges were offset in part by favorable resolutions of certain tax contingencies in 2008, which increased diluted earnings per share by $0.08.

In addition, for 2008 we estimate the impact of hurricanes in the third quarter of 2008 reduced the increase in operating income for the year ended December 31, 2008 by approximately $8 million or $0.02 per diluted share, compared to the prior year.

During the first quarter of 2007, we became a non-contracted provider to United Healthcare Group Inc., ("UNH"). As a result of the change in status, our revenues and earnings were significantly impacted for the first quarter and full year 2007. However, the ongoing profit impact was successfully mitigated by the end of 2007 as a result of our actions to reduce costs, and higher reimbursement for the testing we continued to perform for UNH members as a non-contracted provider.

Results for the year ended December 31, 2007 include first quarter pre-tax charges of $10.7 million, or $0.03 per diluted share, associated with workforce reductions in response to reduced volume levels, and a first quarter pre-tax charge of $4.0 million, or $0.01 per diluted share, related to in-process research and development expense associated with the HemoCue acquisition.

Net Revenues

Net revenues for the year ended December 31, 2008 grew by 8.1% over the prior year level to $7.2 billion, with the carry-over impact from the 2007 acquisition of AmeriPath contributing approximately 5.0% to revenue growth in 2008.

For 2008, revenues of our clinical testing business, which accounts for over 90% of our net revenues, grew 8.3% above the prior year level, with AmeriPath contributing 5.5% growth. Volume, measured by the number of

requisitions, increased 2.7% for the year ended December 31, 2008, with 2.4% due to the impact of the AmeriPath acquisition. Our pre-employment drug testing volume, which accounted for approximately 7% of our total volume in 2008, declined approximately 11% and reduced consolidated volume by approximately 1%. We believe the volume decrease in pre-employment drug testing is principally due to slower hiring by employers served by this business. Revenue per requisition increased 5.5% for the year ended December 31, 2008, with AmeriPath contributing 2.9% to the improvement. The balance of the increase was primarily driven by a positive mix, partially offset by price reductions on various health plan contracts.

Our businesses other than clinical testing accounted for approximately 9% of our net revenues in 2008. These businesses include our risk assessment services business, our clinical trials testing business, our healthcare information technology business, MedPlus, and our diagnostic products business. The revenues for these businesses as a group grew 6% for the year ended December 31, 2008 with the increase primarily driven by our healthcare information technology and point-of-care businesses.

Operating Costs and Expenses

Total operating costs and expenses for the year ended December 31, 2008 increased $414 million from the prior year period. These increases were primarily due to the full year effect of costs associated with the acquired operations of AmeriPath, and increased costs associated with annual compensation adjustments, partially offset by actions taken to improve our operating efficiency and reduce the size of our workforce. Results for the year ended December 31, 2008 also include fourth quarter charges of $16.2 million primarily associated with workforce reductions ($7.7 million recorded in costs of services and $8.5 million included in selling, general and administrative).

Results for the year ended December 31, 2007 reflect first quarter costs of $10.7 million associated with workforce reductions ($3.9 million included in cost of services and $6.8 million included in selling, general and administrative), $4 million of in-process research and development costs associated with the acquisition of HemoCue, which was recorded in "other operating (income) expense, net", and costs associated with efforts to retain business and clarify for patients, physicians and employers misinformation regarding the UNH contract change.

Cost of services, which includes the costs of obtaining, transporting and testing specimens, was 58.7% of net revenues for the year ended December 31, 2008, compared to 59.2% of net revenues in 2007. The improvement over the prior year reflects actions taken to reduce our cost structure and higher revenue per requisition.

Selling, general and administrative expenses, which include the costs of the sales force, billing operations, bad debt expense, and general management and administrative support, were 24.0% of net revenues for the year ended December 31, 2008, compared to 24.1% in the prior year period. The improvement was primarily due to actions taken to reduce our cost structure and higher revenue per requisition, partially offset by the full year impact of the acquired operations of AmeriPath and costs associated with workforce reductions.

Selling, general and administrative expenses for the year ended December 31, 2007 included costs associated with workforce reductions and costs associated with efforts to retain business and clarify for patients, physicians and employers misinformation regarding the UNH contract change.

For the year ended December 31, 2008, bad debt expense was 4.5% of net revenues similar to 2007. For 2008, the full year inclusion of AmeriPath, which carries a higher bad debt rate than the rest of our business, primarily due to its revenue and customer mix, increased the consolidated bad debt rate by approximately half a percent for 2008. The impact was principally offset by progress in our billing and collection processes, resulting in improvements in bad debt, days sales outstanding and the cost of our billing operation. With our disciplined approach, we expect to see continued strong performance in our billing and collection metrics, despite a slowing economy.

Amortization of intangible assets for the year ended December 31, 2008 increased $9.4 million over the prior year period. This increase was primarily due to the amortization of intangible assets acquired in conjunction with the acquisition of AmeriPath.

Other operating (income) expense, net represents miscellaneous income and expense items related to operating activities, including gains and losses associated with the disposal of operating assets and provisions for restructurings and other special charges. For the year ended December 31, 2007, other operating (income) expense, net includes a $4.0 million first quarter charge related to in-process research and development expense recorded in connection with the acquisition of HemoCue.

Operating Income

Operating income for the year ended December 31, 2008 was $1.2 billion, or 16.9% of net revenues, compared to $1.1 billion, or 16.3% of net revenues, in the prior year period. The increase in operating income, as a percentage of net revenues, was primarily due to revenue growth and the actions we have taken to reduce our cost structure, partially offset by the full year impact of the acquired operations of AmeriPath. In addition, we estimate the impact of hurricanes in the third quarter of 2008 reduced the increase in operating income for the year ended December 31, 2008 by approximately $8 million, compared to the prior year.

In addition, the operating income percentage for the year ended December 31, 2008, reflects the impact of a fourth quarter charge of $16.2 million, principally associated with workforce reductions and the impact of the various items which affected cost of services and selling, general and administrative expenses as a percentage of net revenues.

Other (Income) Expense

Other expense, net represents miscellaneous income and expense items related to non-operating activities such as gains and losses associated with investments and other non-operating assets. For the year ended December 31, 2008, other expense, net includes a third quarter charge of $8.9 million associated with the write-down of an equity investment and losses of $9.9 million associated with investments held in a trust pursuant to our supplemental deferred compensation plan. For the year ended December 31, 2007, other expense, net includes a $4 million charge related to the write-down of an investment.

Income Tax Expense

The effective income tax rate for the year ended December 31, 2008 decreased 1.3 percentage points, compared to the prior year period. This decrease was primarily due to the favorable resolution of certain tax contingencies in 2008.

Discontinued Operations

During the third quarter of 2008, the Company and NID, a former test kit manufacturing subsidiary of the Company, reached an agreement in principle with the United States Attorney's Office to settle the previously disclosed federal government investigation involving NID and the Company regarding NID test kits and tests performed using those test kits.

The agreement in principle provides for a comprehensive settlement of federal claims. As part of the agreement, NID, which was closed in 2006, is expected to enter a guilty plea to a single count of felony misbranding. The terms of the settlement are subject to the final negotiation and execution of definitive agreements, which is expected to include a corporate integrity agreement, and the approval by the United States Department of Justice and the United States Department of Health and Human Services and satisfactory resolution of related state claims. There can be no assurance, however, when or whether a settlement may be finalized, or as to its terms. If a settlement is not finalized, the Company would defend itself and NID and could incur significant costs in doing so.

As a result of the agreement in principle in 2008, the Company recorded charges of $75 million in discontinued operations to increase its reserve for the settlement and related matters. As of December 31, 2008, the total reserve was $316 million. The Company has recorded deferred tax benefits of $58 million on the reserve, reflecting the Company's current estimate of the portion of the reserve expected to be deductible for tax purposes. The reserve reflects the Company's current estimate of the expected probable loss with respect to these matters, assuming the settlement is finalized. If a settlement is not finalized, the eventual losses related to these matters could be materially different than the amount reserved and could be material to the Company's results of operations, cash flows and financial condition in the period that such matters are determined or paid.

Loss from discontinued operations, net of taxes, for the year ended December 31, 2008 was $51 million, or $0.26 per diluted share, compared to $214 million, or $1.10 per diluted share in 2007. Results for the year ended December 31, 2008 and 2007 reflect charges of $75 million and $241 million, respectively, to reserve for the settlement and related matters in connection with various government claims, which is more fully described in Note 14 and Note 15 to the Consolidated Financial Statements.

Year Ended December 31, 2007 Compared with Year Ended December 31, 2006

Continuing Operations

Income from continuing operations for the year ended December 31, 2007 was $554 million, or $2.84 per diluted share, compared to $626 million, or $3.14 per diluted share in 2006. The decrease in income from continuing operations was principally due to the impact of the change in contract status with UNH. However, we successfully mitigated the ongoing impact during the third quarter of 2007 as a result of actions taken to reduce costs, and higher reimbursement for the testing we continue to perform for UNH members. During the second half of the year our profits, before considering the acquisition of AmeriPath, exceeded those of the prior year, when we were a contracted provider to UNH. The acquisition of AmeriPath, which was completed in May 2007, also served to reduce income from continuing operations compared to the prior year. We expect the acquisition of AmeriPath to improve our revenue growth and earnings once the anticipated growth opportunities and cost synergies associated with the acquisition are realized. Results for the year ended December 31, 2007 include first quarter pre-tax charges of $10.7 million, or $0.03 per diluted share, associated with workforce reductions in response to reduced volume levels and $4.0 million, or $0.01 per diluted share, related to in-process research and development expense associated with the HemoCue acquisition.

Net Revenues

Net revenues for the year ended December 31, 2007 grew by 7.0% over the prior year level to $6.7 billion. The acquisition of AmeriPath contributed approximately 8% to revenue growth. Our acquisitions of Focus Diagnostics, Enterix and HemoCue contributed approximately 1.7% to revenue growth. We estimate the impact of our change in status with UNH reduced revenue growth by approximately 5%.

Our clinical testing business, which accounted for over 90% of our 2007 net revenues, grew approximately 5.6% for the year, with AmeriPath contributing 8.3% growth and the change in status with UNH reducing revenues by approximately 5%. Volume, measured by the number of requisitions, declined 4.1% for the year ended December 31, 2007, primarily due to our change in status with UNH, which reduced volume by an estimated 7%, partially offset by the impact of the AmeriPath acquisition, which increased volume by about 3%. Revenue per requisition increased 10.2% for the year ended December 31, 2007 and was impacted by the results of AmeriPath, which contributed 5.1% to the improvement, and a 2% increase due to higher reimbursement on the retained business with UNH, which was reimbursed at a higher rate as a non-contracted provider, with the balance of the increase primarily driven by a positive test mix.

Our businesses other than clinical testing accounted for approximately 9% of net revenues in 2007. These businesses include our risk assessment services business, our clinical trials testing business, our healthcare information technology business, MedPlus, and our diagnostics products business. The revenues for these businesses as a group grew 23% for the year ended December 31, 2007 as compared to the prior year period, with the increase primarily driven by our acquisitions of HemoCue, Focus Diagnostics and Enterix.

Operating Costs and Expenses

Total operating costs and expenses for the year ended December 31, 2007 increased $473 million from the prior year period. Costs associated with the acquired operations of AmeriPath, Focus Diagnostics, Enterix and HemoCue increased costs by approximately $552 million for the year ended December 31, 2007. This increase was offset in part by actions taken to improve our operating efficiency and reduce the size of our workforce. Results for the year ended December 31, 2007 include first quarter charges of $10.7 million associated with workforce reductions ($3.9 million included in costs of services and $6.8 million in selling, general and administrative) and $4.0 million of in-process research and development costs associated with the acquisition of HemoCue, which was recorded in other operating (income) expense, net.

Cost of services, which includes the costs of obtaining, transporting and testing specimens, was 59.2% of net revenues for the year ended December 31, 2007, compared to 59.0% of net revenues in 2006. The increase in cost of services as a percentage of revenues was primarily due to lower volumes in our clinical testing business and costs associated with workforce reductions. Partially offsetting these increases were improvements related to the increase in average revenue per requisition and actions taken to reduce costs.

Selling, general and administrative expenses, which include the costs of the sales force, billing operations, bad debt expense and general management and administrative support, were 24.1% of net revenues during the year ended December 31, 2007, compared to 22.5% in the prior year period. This increase was primarily due to lower volume levels in our clinical testing business; costs associated with workforce reductions; costs associated

with efforts to retain business and clarify for patients, physicians and employers misinformation regarding the UNH contract change; and the impact of the acquired operations of AmeriPath and HemoCue.

For the year ended December 31, 2007, bad debt expense was 4.5% of net revenues, compared to 3.9% in the prior year period. The increase was principally driven by the inclusion of AmeriPath, which carries a higher bad debt rate than the rest of our business, primarily due to its revenue and customer mix, and by higher bad debt expense associated with billing patients directly for a portion of the UNH volume.

Other operating (income) expense, net represents miscellaneous income and expense items related to operating activities, including gains and losses associated with the disposal of operating assets and provisions for restructurings and other special charges. For the year ended December 31, 2007, other operating (income) expense, net included a $4.0 million charge related to in-process research and development expense recorded in connection with the acquisition of HemoCue. For the year ended December 31, 2006, other operating (income) expense, net included pre-tax charges of $27 million, principally associated with integration activities related to LabOne and our operations in California.

Operating Income

Operating income for the year ended December 31, 2007 was $1.1 billion, or 16.3% of net revenues, compared to $1.1 billion, or 18.0% of net revenues, in the prior year period. The decrease in operating income as a percentage of net revenues was principally due to lower volume levels in our clinical testing business, the various items which served to increase cost of services and selling, general and administrative expenses as a percentage of revenues, and the impact of the acquired operations of AmeriPath and HemoCue. These decreases were offset in part by actions we have taken to reduce our cost structure and higher revenue per requisition.

Other Income (Expense)

Interest expense, net for the year ended December 31, 2007 increased $87 million over the prior year. The increase in interest expense, net was primarily due to additional interest expense associated with borrowings to fund acquisitions, as described more fully in Note 9 to the Consolidated Financial Statements.

Other expense, net represents miscellaneous income and expense items related to non-operating activities such as gains and losses associated with investments and other non-operating assets. For the year ended December 31, 2007, other expense, net includes a $4 million charge related to the write-down of an investment. For the year ended December 31, 2006, other expense, net includes $26 million of charges related to the write-downs of investments partially offset by a gain of $16 million on the sale of an investment.

Discontinued Operations

In connection with the investigation of NID, which is described earlier, during the third quarter of 2007, the government and the Company began settlement discussions. In the course of those discussions, the government disclosed to the Company certain of the government's legal theories regarding the amount of damages allegedly incurred by the government, which include alleged violations of civil and criminal statutes including the False Claims Act and the Food, Drug and Cosmetics Act. Violations of these statutes and related regulations could lead to a warning letter, injunction, fines or penalties, exclusion from federal healthcare programs and/or criminal prosecution, as well as claims by third parties. The Company analyzed the government's position and presented its own analysis which argued against many of the government's claims. In light of that analysis and based on the status of settlement discussions, the Company established a reserve, in accordance with generally accepted accounting principles, reflected in discontinued operations, of $241 million in connection with these claims. See Note 14 and Note 15 to the Consolidated Financial Statements for a further description of these matters.

Loss from discontinued operations, net of tax, for the year ended December 31, 2007 was $214 million, or $1.10 per diluted share, compared to $39 million, or $0.20 per diluted share in 2006. Results for the year ended December 31, 2007 reflect a charge of $241 million to establish a reserve as described above. Results for the year ended December 31, 2006 reflect pre-tax charges of $32 million, primarily related to the wind down of NID's operations.

Quantitative and Qualitative Disclosures About Market Risk

We address our exposure to market risks, principally the market risk of changes in interest rates, through a controlled program of risk management that may include the use of derivative financial instruments. We do not hold or issue derivative financial instruments for trading purposes. We believe that our exposures to foreign

exchange impacts and changes in commodities prices are not material to our consolidated financial condition or results of operations. See Note 10 to the Consolidated Financial Statements for additional discussion of our financial instruments and hedging activities.

At December 31, 2008 and 2007, the fair value of our debt was estimated at approximately $2.9 billion and $3.6 billion, respectively, using quoted market prices and yields for the same or similar types of borrowings, taking into account the underlying terms of the debt instruments. At December 31, 2008, the carrying value exceeded the estimated fair value of the debt by $155 million and at December 31, 2007, the estimated fair value exceeded the carrying value of the debt by $59 million. A hypothetical 10% increase in interest rates on our total debt portfolio (representing approximately 53 and 61 basis points at December 31, 2008 and 2007, respectively) would potentially reduce the estimated fair value of our debt by approximately $75 million and $78 million at December 31, 2008 and 2007, respectively.

Borrowings under our senior unsecured revolving credit facility, our secured receivables credit facility and our term loan due May 2012 are subject to variable interest rates. Interest on our secured receivables credit facility is based on rates that are intended to approximate commercial paper rates for highly-rated issuers. Interest rates on our senior unsecured revolving credit facility and term loan due May 2012 are subject to a pricing schedule that can fluctuate based on changes in our credit ratings. As such, our borrowing cost under these credit arrangements will be subject to both fluctuations in interest rates and changes in our credit ratings. As of December 31, 2008, the borrowing rates under these credit facilities were: for our secured receivables credit facility 3.6%; for our senior unsecured credit facility, LIBOR plus 0.40%; and for our term loan due May 2012, LIBOR plus 0.50%. At December 31, 2008, the weighted average LIBOR rate was 2.2%. At December 31, 2008, there was $1.1 billion outstanding under our term loan due May 2012, and no borrowings outstanding under our $500 million secured receivables credit facility and our $750 million senior unsecured revolving credit facility.

We have entered into various variable-to-fixed interest rate swap agreements, whereby we fixed the interest rates on $500 million of our term loan due May 2012 for periods through October 2009. As of December 31, 2008, variable-to-fixed interest rate swap agreements on $200 million of the term loan due May 2012 remain in place through October 2009 with fixed interest rates ranging from 5.13% to 5.27%. Based on our net exposure to interest rate changes, a hypothetical 10% change in interest rates on our variable rate indebtedness (representing approximately 25 basis points) would impact annual net interest expense by approximately $2.8 million, assuming no changes to the debt outstanding at December 31, 2008.

The fair value of the interest rate swap agreements at December 31, 2008 was a liability of $5.9 million. A hypothetical 10% decrease in interest rates (representing approximately 18 basis points) would potentially increase the fair value of the liability of these instruments by approximately $0.4 million at December 31, 2008. A hypothetical 10% increase in interest rates would potentially decrease the fair value of the liability of these instruments by approximately $0.4 million at December 31, 2008. For details regarding our outstanding debt and our financial instruments, see Notes 9 and 10 to the Consolidated Financial Statements.

Risk Associated with Investment Portfolio

Our investment portfolio includes equity investments in publicly held companies that are classified as available-for-sale securities and other strategic equity holdings in privately held companies. These securities are exposed to price fluctuations and are generally concentrated in the life sciences industry. The carrying values of our available-for-sale equity securities and privately held securities were $16 million at December 31, 2008.

We regularly evaluate the fair value measurements of our equity investments to determine if losses in value are other than temporary and if an impairment loss has been incurred. The evaluation considers if the security has the ability to recover and, if so, the estimated recovery period. Other factors that are considered in this evaluation include the amount of the other-than-temporary decline and its duration, the issuer's financial condition and short-term prospects and whether the market decline was caused by overall economic conditions or conditions specific to the individual security.

We do not hedge our equity price risk. The impact of an adverse movement in equity prices on our holdings in privately held companies cannot be easily quantified, as our ability to realize returns on investments depends on, among other things, the enterprises' ability to raise additional capital or derive cash inflows from continuing operations or through liquidity events such as initial public offerings, mergers or private sales.

Fair Value Measurements

On January 1, 2008, we adopted SFAS No. 157, "Fair Value Measurements." Adoption of this accounting standard did not have a material effect on our financial position, results of operations or cash flows. See Note 2 to the Consolidated Financial Statements for further details.

SFAS No. 159, "The Fair Value Option for Financial Assets and Financial Liabilities" ("SFAS 159") became effective for the Company on January 1, 2008. As of January 1, 2008 and for the year ended December 31, 2008, the Company has elected not to apply the fair value option to any of its financial assets or financial liabilities on-hand, which were not already measured at fair value, because the Company does not believe that application of SFAS 159's fair value option is appropriate given the nature of its business operations. See Note 2 to the Consolidated Financial Statements for further details.

Liquidity and Capital Resources

Cash and Cash Equivalents

Cash and cash equivalents at December 31, 2008 totaled $254 million, compared to $168 million at December 31, 2007. Cash and cash equivalents consist of highly liquid short-term investments, including time deposits with highly-rated banks, and various insured money market funds, including those that invest in U.S. Treasury securities. The Company has not suffered any losses associated with its cash and cash equivalents. Cash flows from operating activities in 2008 were $1.1 billion, which were used to fund investing and financing activities of $199 million and $778 million, respectively. Cash and cash equivalents at December 31, 2007 totaled $168 million, compared to $150 million at December 31, 2006. Cash flows from operating activities in 2007 were $927 million which, together with $850 million of cash flows from financing activities, were used to fund investing activities of $1.8 billion.

Cash Flows from Operating Activities

Net cash provided by operating activities for 2008 was $1.1 billion compared to $927 million in 2007. This increase was primarily due to higher earnings in the current year. Net cash provided by operating activities for the year ended December 31, 2007 was reduced by $57 million of fees and other expenses paid in connection with the acquisition of AmeriPath. Days sales outstanding, a measure of billing and collection efficiency, were 44 days at December 31, 2008 compared to 48 days at December 31, 2007.

Net cash provided by operating activities for 2007 was $927 million compared to $952 million in 2006. This decrease was primarily due to lower earnings in 2007 and increased payments associated with variable compensation earned in the prior year, coupled with the payment of $57 million of fees and other expenses associated with the acquisition of AmeriPath. Partially offsetting these items was a net source of funds from reductions in net accounts receivable in the current year compared to a net use of funds in the prior year.

Cash Flows from Investing Activities

Net cash used in investing activities in 2008 was $199 million, consisting principally of capital expenditures of $213 million, partially offset by $23 million related to the receipt of a payment from an escrow fund established at the time of the acquisition of HemoCue.

Net cash used in investing activities in 2007 was $1.8 billion, consisting primarily of $1.2 billion related to the acquisition of AmeriPath, $309 million related to the acquisition of HemoCue and capital expenditures of $219 million.

Cash Flows from Financing Activities

Net cash used in financing activities in 2008 was $778 million, consisting primarily of net reductions of debt of $459 million. Debt repayments of $482 million, consisting primarily of the repayment of $120 million on our Secured Receivables Credit Facility, $60 million on our term loan due December 31, 2008 and $293 million on our term loan due May 31, 2012, were partially offset by borrowings of $20 million under our Secured Receivables Credit Facility. Since the completion of the AmeriPath acquisition in May 2007, we have reduced our total debt by $876 million.

Net cash used by financing activities for the year ended December 31, 2008 also included $33 million in proceeds from the exercise of stock options, including related tax benefits, offset by purchases of treasury stock

totaling $254 million and dividend payments of $78 million. The $254 million of treasury stock purchases represents 5.5 million shares of our common stock purchased at an average price of $46.09 per share.

Net cash provided by financing activities in 2007 was $850 million, primarily associated with new borrowings and repayments related to the acquisitions of AmeriPath and HemoCue.

During the first quarter of 2007, we entered into an interim credit facility (the "Interim Credit Facility") and borrowed $450 million to finance the acquisition of HemoCue and to repay substantially all of HemoCue's outstanding debt.

During the second quarter of 2007, we borrowed $1.6 billion under a five-year term loan facility and $780 million under a bridge loan facility to finance the acquisition of AmeriPath and repay the Interim Credit Facility used to finance the HemoCue acquisition.

In connection with the acquisition of AmeriPath, we repaid substantially all of AmeriPath's outstanding debt and related accrued interest. On May 21, 2007, we commenced a cash tender offer and consent solicitation for the $350 million aggregate principal amount of 10.5% Senior Subordinated Notes of AmeriPath, Inc. due 2013 (the "AmeriPath senior subordinated notes"). In conjunction with the cash tender offer, approximately $348 million in aggregate principal amount, or 99.4% of the $350 million outstanding under the AmeriPath senior subordinated notes, was tendered. We made payments of $386 million to holders with respect to the cash tender offer and consent solicitation, including tender premium and related solicitation fees and accrued interest.

We completed an $800 million senior notes offering in June 2007 (the "2007 Senior Notes"). The 2007 Senior Notes were sold in two tranches: (a) $375 million of 6.40% senior notes due 2017; and (b) $425 million of 6.95% senior notes due 2037. We used the net proceeds from the 2007 Senior Notes offering to repay the $780 million of borrowings under the bridge loan facility. The 2007 Senior Notes, term loans and the bridge loan are further described in Note 9 to the Consolidated Financial Statements.

Net cash provided by financing activities for the year ended December 31, 2007 also included $95 million in proceeds from the exercise of stock options, including related tax benefits, offset by purchases of treasury stock totaling $146 million and dividend payments of $77 million. The $146 million of treasury stock purchases represents 2.8 million shares of our common stock purchased at an average price of $52.14 per share.

Dividend Program

During each of the quarters of 2008 and 2007, our Board of Directors declared a quarterly cash dividend of $0.10 per common share. We expect to fund future dividend payments with cash flows from operations, and do not expect the dividend to have a material impact on our ability to finance future growth.

Share Repurchase Plan

For the year ended December 31, 2008, we repurchased 5.5 million shares of our common stock at an average price of $46.09 per share for $254 million. Through December 31, 2008, we have repurchased 49.6 million shares of our common stock at an average price of $45.43 for $2 billion under our share repurchase program. During the fourth quarter of 2008, our Board of Directors expanded our share repurchase authorization by an additional $150 million, which together with the amounts remaining from previous authorizations, was fully utilized prior to December 31, 2008. In January 2009, our Board of Directors authorized $500 million of additional share repurchases.

Contractual Obligations and Commitments

The following table summarizes certain of our contractual obligations as of December 31, 2008. See Notes 9 and 14 to the Consolidated Financial Statements for further details.

	Payments due by period (in thousands)				
Contractual Obligations	**Total**	**Less than 1 year**	**1–3 years**	**3–5 years**	**After 5 years**
Long-term debt	$3,065,070	$ 1,800	$1,206,449	$560,000	$1,296,821
Capital lease obligations	18,161	3,342	3,173	2,067	9,579
Interest payments on outstanding debt	1,446,716	159,887	280,256	169,488	837,085
Operating leases	634,579	174,025	245,683	108,745	106,126
Purchase obligations	82,088	42,849	32,831	5,939	469
Total contractual obligations	$5,246,614	$381,903	$1,768,392	$846,239	$2,250,080

Interest payments on our long-term debt have been calculated after giving effect to our interest rate swap agreements, using the interest rates as of December 31, 2008 applied to the December 31, 2008 balances, which are assumed to remain outstanding through their maturity dates.

As of December 31, 2008, our total liabilities for unrecognized tax benefits were approximately $71 million, which were excluded from the table above. Based upon the expiration of statutes of limitations, settlements and/or the conclusion of tax examinations, we believe it is reasonably possible that this amount may decrease by up to $34 million within the next twelve months. For the remainder, we cannot make reasonably reliable estimates of the timing of the future payments of these liabilities. See Note 4 to the Consolidated Financial Statements for information regarding our contingent tax liability reserves.

As of December 31, 2008, the reserve for the settlement and related matters in connection with the investigation of NID of $316 million has been excluded from the table above. See Note 14 to the Consolidated Financial Statements for additional information.

Our credit agreements relating to our senior unsecured revolving credit facility and our term loan due May 2012 contain various covenants and conditions, including the maintenance of certain financial ratios, that could impact our ability to, among other things, incur additional indebtedness. We do not expect these covenants to adversely impact our ability to execute our growth strategy or conduct normal business operations.

Unconsolidated Joint Ventures

We have investments in unconsolidated joint ventures in Phoenix, Arizona; Indianapolis, Indiana; and Dayton, Ohio, which are accounted for under the equity method of accounting. We believe that our transactions with our joint ventures are conducted at arm's length, reflecting current market conditions and pricing. Total net revenues of our unconsolidated joint ventures equal less than 6% of our consolidated net revenues. Total assets associated with our unconsolidated joint ventures are less than 2% of our consolidated total assets. We have no material unconditional obligations or guarantees to, or in support of, our unconsolidated joint ventures and their operations.

Requirements and Capital Resources

We estimate that we will invest approximately $200 million during 2009 for capital expenditures to support and expand our existing operations, principally related to investments in information technology, equipment, and facility upgrades. During 2008, we continued to make investments in support of our plans to develop and deploy standard systems across both the AmeriPath practices and our clinical laboratories. We have completed the enhancements to the AmeriPath laboratory and billing systems and began deployment of the enhanced systems during the second quarter of 2008. These investments will enable significant productivity gains and improved customer service.

In June 2008, we amended our existing receivables securitization facility and increased it from $375 million to $400 million. The secured receivables credit facility was supported by back-up facilities provided on a committed basis by two banks: (a) $125 million, which matured on December 13, 2008 and (b) $275 million, which originally matured on June 10, 2009.

In December 2008, we replaced the $125 million portion of our secured receivables credit facility and amended the existing receivables securitization facility to increase it from $400 million to $500 million. The secured receivables credit facility continues to be supported by back-up facilities provided on a committed basis by two banks: (a) $225 million, which matures on December 11, 2009 and (b) $275 million, which also matures on December 11, 2009. Interest on the secured receivables credit facility is based on rates that are intended to approximate commercial paper rates for highly-rated issuers.

As of December 31, 2008, $1.3 billion of borrowing capacity was available under our existing credit facilities, consisting of $500 million available under our secured receivables credit facility and $750 million available under our senior unsecured revolving credit facility. No borrowings are currently outstanding under either facility.

We believe the banks participating in our various credit facilities are predominantly highly-rated banks, and that the entire amounts under the credit facilities are currently available to us. Should one or several banks no longer participate in either of our credit facilities, we would not expect it to impact our ability to fund operations. We expect to continue to generate positive cash flow despite a slowing economy, and have only $5 million of debt maturing over the next twelve months. We expect to be able to fund payments associated with the agreement in principle related to NID, out of cash on-hand and available credit facilities.

We believe that cash and cash equivalents on-hand and cash from operations, together with our borrowing capacity under our credit facilities, will provide sufficient financial flexibility to meet seasonal working capital requirements and to fund capital expenditures, debt service requirements, cash dividends on common shares, share repurchases and additional growth opportunities for the foreseeable future. We believe that our credit profile should provide us with access to additional financing, if necessary, to fund growth opportunities that cannot be funded from existing sources.

Outlook

As discussed in the Overview, despite the continued consolidation among healthcare insurers, and their continued efforts to reduce reimbursement for providers of diagnostic testing, and the general economic conditions, we believe that the underlying fundamentals of the diagnostic testing industry will continue to improve and that over the long term the industry will continue to grow. As the world's leading provider of diagnostic testing, information and services, we believe we are well positioned to benefit from the growth expected in our industry.

We believe our focus on delivering a superior patient experience and Six Sigma quality as well as the investments we are continuing to make in our distribution network, our industry leading test menu and our information technology solutions will further differentiate us over the long-term and strengthen our industry leadership position. In addition, we plan to leverage our knowledge and expertise in diagnostic testing to further expand into international markets and point-of-care testing.

Our strong cash generation, balance sheet and credit profile position us well to take advantage of these growth opportunities.

Inflation

We believe that inflation generally does not have a material adverse effect on our results of operations or financial condition because the majority of our contracts are short term.

Impact of New Accounting Standards

In September 2007, the Financial Accounting Standards Board ("FASB") ratified Emerging Issues Task Force ("EITF") Issue No. 07-1 "Accounting for Collaborative Agreements." In December 2007, the FASB issued SFAS No. 141(R) "Business Combinations" and SFAS No. 160 "Noncontrolling interests in Consolidated Financial Statements, an Amendment of ARB No. 51." In February 2008, the FASB issued FASB Staff Position ("FSP") No. FAS 157-2 "Effective Date of FASB Statement No. 157." In March 2008, the FASB issued SFAS No. 161, "Disclosures About Derivative Instruments and Hedging Activities – an amendment of FASB Statement No. 133." In May 2008, the FASB issued SFAS No. 162, "The Hierarchy of Generally Accepted Accounting Principles." In June 2008, the FASB issued FSP EITF 03-6-1, "Determining Whether Instruments Granted in Share-Based Payment Transactions Are Participating Securities." In October 2008, the FASB issued FSP No. FAS 157-3, "Determining the Fair Value of a Financial Asset When the Market for That Asset Is Not Active." In November 2008, the FASB ratified the consensus reached under EITF Issue No. 08-7, "Accounting for Defensive Intangible Assets." In December 2008, the FASB issued FSP No. FAS 140-4 and FIN 46(R)-8, "Disclosures by Public Entities (Enterprises) about Transfers of Financial Assets and Interests in Variable Interest Entities." The impact of these accounting standards is discussed in Note 2 to the Consolidated Financial Statements.