

QUEST DIAGNOSTICS INCORPORATED AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(dollars in thousands unless otherwise indicated)

1. DESCRIPTION OF BUSINESS

Quest Diagnostics Incorporated and its subsidiaries (“Quest Diagnostics” or the “Company”) 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 offers patients and physicians the broadest access to diagnostic laboratory services through the Company’s nationwide network of laboratories and owned patient service centers. The Company provides 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. Quest Diagnostics is the leading provider of clinical testing, including gene-based testing and other esoteric testing, anatomic pathology services and testing for drugs-of-abuse, and the leading provider of risk assessment services for the life insurance industry. The Company is also a leading provider of testing for clinical trials. The Company’s diagnostics products business manufactures and markets diagnostic test kits and specialized point-of-care testing. Quest Diagnostics empowers healthcare organizations and clinicians with state-of-the-art information technology solutions that can improve patient care and medical practice.

During 2008, Quest Diagnostics processed approximately 150 million requisitions through its extensive network of laboratories in virtually every major metropolitan area throughout the United States.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Principles of Consolidation

The consolidated financial statements include the accounts of all entities controlled by the Company through its direct or indirect ownership of a majority voting interest and the accounts of any variable interest entities, as defined in Financial Accounting Standards Board (“FASB”) Interpretation No. 46 “Consolidation of Variable Interest Entities,” where the Company is subject to a majority of the risk of loss from the variable interest entity’s activities, or entitled to receive a majority of the entity’s residual returns or both. The Company’s relationships with variable interest entities were not material at both December 31, 2008 and 2007. Investments in entities which the Company does not control, but in which it has a substantial ownership interest (generally between 20% and 49%) and can exercise significant influence, are accounted for using the equity method of accounting. As of December 31, 2008 and 2007, the Company’s investments in affiliates accounted for under the equity method of accounting totaled \$38.4 million and \$37.5 million, respectively. The Company’s share of equity earnings from investments in affiliates, accounted for under the equity method, totaled \$29.7 million, \$27.0 million and \$28.5 million, respectively, for 2008, 2007 and 2006. All significant intercompany accounts and transactions are eliminated in consolidation.

Basis of Presentation

During the third quarter of 2006, the Company completed its wind-down of NID, a test kit manufacturing subsidiary, and classified the operations of NID as discontinued operations. The accompanying consolidated statements of operations and related disclosures have been prepared to report the results of NID as discontinued operations for all periods presented. See Note 15 for a further discussion of discontinued operations.

In addition, certain reclassifications have been made to conform to the current year presentation.

Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Revenue Recognition

The Company primarily recognizes revenue for services rendered upon completion of the testing process. 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

QUEST DIAGNOSTICS INCORPORATED AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED
(dollars in thousands unless otherwise indicated)

settlement. In 2008, 2007 and 2006, approximately 18%, 17% and 17%, respectively, of the Company's net revenues were generated by Medicare and Medicaid programs. Under capitated arrangements with healthcare plans, the Company recognizes revenue based on a predetermined monthly reimbursement rate for each member of an insurer's health plan regardless of the number or cost of services provided by the Company.

Taxes on Income

The Company uses the asset and liability approach to account for income taxes. Under this method, deferred tax assets and liabilities are recognized for the expected future tax consequences of differences between the carrying amounts of assets and liabilities and their respective tax bases using tax rates in effect for the year in which the differences are expected to reverse. A valuation allowance is provided when it is more likely than not that some portion or all of the deferred tax assets will not be realized. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period when the change is enacted.

On January 1, 2007, the Company adopted FASB Interpretation No. 48 "Accounting for Uncertainty in Income Taxes" ("FIN 48"). FIN 48 clarifies the accounting for uncertainty in income taxes recognized in financial statements in accordance with Statement of Financial Accounting Standards ("SFAS") No. 109 "Accounting for Income Taxes." FIN 48 provides guidance on recognizing, measuring, presenting and disclosing in the financial statements uncertain tax positions that a company has taken or expects to take on a tax return. See Note 4 for further information related to FIN 48.

Earnings Per Share

Basic earnings per common share is calculated by dividing net income by the weighted average common shares outstanding. Diluted earnings per common share is calculated by dividing net income by the weighted average common shares outstanding after giving effect to all potentially dilutive common shares outstanding during the period. Potentially dilutive common shares include the dilutive effect of outstanding stock options, performance share units, restricted common shares and restricted stock units granted under the Company's Amended and Restated Employee Long-Term Incentive Plan and its Amended and Restated Director Long-Term Incentive Plan.

The computation of basic and diluted earnings per common share was as follows (in thousands, except per share data):

	<u>2008</u>	<u>2007</u>	<u>2006</u>
Income from continuing operations	\$632,184	\$ 553,828	\$625,692
Loss from discontinued operations	(50,694)	(213,889)	(39,271)
Net income available to common stockholders.....	<u>\$581,490</u>	<u>\$ 339,939</u>	<u>\$586,421</u>
Weighted average common shares outstanding – basic	194,283	193,241	196,985
Effect of dilutive securities:			
Stock options.....	1,675	2,019	2,535
Restricted common shares, restricted stock units and performance share units	<u>1</u>	<u>2</u>	<u>22</u>
Weighted average common shares outstanding – diluted	<u>195,959</u>	<u>195,262</u>	<u>199,542</u>
Earnings per common share – basic:			
Income from continuing operations	\$ 3.25	\$ 2.87	\$ 3.18
Loss from discontinued operations	(0.26)	(1.11)	(0.20)
Net income.....	<u>\$ 2.99</u>	<u>\$ 1.76</u>	<u>\$ 2.98</u>
Earnings per common share – diluted:			
Income from continuing operations	\$ 3.23	\$ 2.84	\$ 3.14
Loss from discontinued operations	(0.26)	(1.10)	(0.20)
Net income.....	<u>\$ 2.97</u>	<u>\$ 1.74</u>	<u>\$ 2.94</u>

QUEST DIAGNOSTICS INCORPORATED AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED
(dollars in thousands unless otherwise indicated)

The following securities were not included in the diluted earnings per share calculation due to their antidilutive effect (in thousands):

	<u>2008</u>	<u>2007</u>	<u>2006</u>
Stock options.....	2,676	3,114	2,443
Restricted common shares, restricted stock units and performance share units.....	1,339	731	786

Stock-Based Compensation

SFAS No. 123, “Accounting for Stock-Based Compensation” (“SFAS 123”), as amended by SFAS No. 148, “Accounting for Stock-Based Compensation – Transition and Disclosure – an amendment of FASB Statement No. 123” (“SFAS 148”) encouraged, but did not require, companies to record compensation cost for stock-based compensation plans at fair value. In addition, SFAS 148 provided alternative methods of transition for a voluntary change to the fair value based method of accounting for stock-based employee compensation, and amended the disclosure requirements of SFAS 123 to require prominent disclosures in both annual and interim financial statements about the method of accounting for stock-based employee compensation and the effect of the method used on reported results.

In December 2004, the FASB issued SFAS No. 123, revised 2004, “Share-Based Payment” (“SFAS 123R”). SFAS 123R requires that companies recognize compensation cost relating to share-based payment transactions based on the fair value of the equity or liability instruments issued. The Company adopted SFAS 123R effective January 1, 2006 using the modified prospective approach and therefore has not restated results for prior periods. Under this approach, awards that are granted, modified or settled after January 1, 2006 will be measured and accounted for in accordance with SFAS 123R. Unvested awards that were granted prior to January 1, 2006 will continue to be accounted for in accordance with SFAS 123, as amended by SFAS 148, except that compensation cost will be recognized in the Company’s results of operations.

Pursuant to the provisions of SFAS 123R, the Company records stock-based compensation as a charge to earnings net of the estimated impact of forfeited awards. As such, the Company recognizes 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 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. The terms of the Company’s 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 (“ELTIP”) 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. 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. The Company recognizes stock-based compensation expense related to the Company’s Amended Employee Stock Purchase Plan (“ESPP”) based on the 15% discount at purchase. See Note 12 for a further discussion of stock-based compensation.

Fair Value Measurements

On January 1, 2008, the Company adopted SFAS No. 157, “Fair Value Measurements” (“SFAS 157”). SFAS 157 provides a single definition of fair value and a common framework for measuring fair value as well as new disclosure requirements for fair value measurements used in financial statements. Fair value measurements are based upon the exit price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants exclusive of any transaction costs, and are determined by either the principal market or the most advantageous market. The principal market is the market with the greatest level of activity and volume for the asset or liability. Absent a principal market to measure fair value, the Company would use the most advantageous market, which is the market that the Company would receive the highest

QUEST DIAGNOSTICS INCORPORATED AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED
(dollars in thousands unless otherwise indicated)

selling price for the asset or pay the lowest price to settle the liability, after considering transaction costs. However, when using the most advantageous market, transaction costs are only considered to determine which market is the most advantageous and these costs are then excluded when applying a fair value measurement. The adoption of SFAS 157 did not have a material effect on the Company's financial position, results of operations or cash flows.

In February 2008, the FASB issued FASB Staff Position ("FSP") FAS 157-1, "Application of FASB Statement No. 157 to FASB Statement No. 13 and Other Accounting Pronouncements That Address Fair Value Measurements for Purposes of Lease Classification or Measurement under Statement 13" ("FSP FAS 157-1"). FSP FAS 157-1 amended SFAS 157 to exclude from its scope SFAS No. 13, "Accounting for Leases," and its related interpretive accounting pronouncements that address leasing transactions. However, this exclusion does not apply to the Company's impairment of long-lived assets under a capital lease pursuant to SFAS No. 144, "Accounting for Impairment or Disposal of Long-Lived Assets," the Company's cost to terminate an operating lease under SFAS No. 146, "Accounting for Costs Associated with Exit and Disposal Activities," and the measurement of acquired leases in a business combination pursuant to SFAS No. 141 or 141(R), "Business Combinations." Also in February 2008, the FASB issued FSP FAS 157-2, "Effective Date of FASB Statement No. 157" ("FSP FAS 157-2"). FSP FAS 157-2 amended SFAS 157 to defer the effective date of SFAS 157 for one year for non-financial assets and non-financial liabilities, except for items that are recognized or disclosed at fair value in the financial statements on a recurring basis, at least annually. The impact of SFAS 157 on the Company's non-financial assets and non-financial liabilities measured at fair value on a nonrecurring basis is not expected to have a material effect on the Company's financial position, results of operations or cash flows.

SFAS 157 creates a three-level hierarchy to prioritize the inputs used in the valuation techniques to derive fair values. The basis for fair value measurements for each level within the hierarchy is described below with Level 1 having the highest priority and Level 3 having the lowest.

- Level 1: Quoted prices in active markets for identical assets or liabilities.
- Level 2: Quoted prices for similar assets or liabilities in active markets; quoted prices for identical or similar instruments in markets that are not active; and model-derived valuations in which all significant inputs are observable in active markets.
- Level 3: Valuations derived from valuation techniques in which one or more significant inputs are unobservable.

The following table provides a summary of the recognized assets and liabilities that are measured at fair value on a recurring basis.

	December 31, 2008	Basis of Fair Value Measurements		
		Quoted Prices in Active Markets for Identical Assets/ Liabilities Level 1	Significant Other Observable Inputs Level 2	Significant Unobservable Inputs Level 3
Assets:				
Trading securities	\$25,383	\$25,383	\$ -	\$ -
Cash surrender value of life insurance policies	11,767	-	11,767	-
Foreign currency forward contracts	2,617	-	2,617	-
Available-for-sale securities	255	233	22	-
Total	<u>\$40,022</u>	<u>\$25,616</u>	<u>\$14,406</u>	<u>\$ -</u>
Liabilities:				
Interest rate swaps	\$ 5,888	\$ -	\$ 5,888	\$ -
Foreign currency forward contracts	4,142	-	4,142	-
Deferred compensation liabilities	39,304	-	39,304	-
Total	<u>\$49,334</u>	<u>\$ -</u>	<u>\$49,334</u>	<u>\$ -</u>

QUEST DIAGNOSTICS INCORPORATED AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED
(dollars in thousands unless otherwise indicated)

The Company offers certain employees the opportunity to participate in a supplemental deferred compensation plan. A participant's deferrals, together with Company matching credits, are invested in a variety of participant-directed stock and bond mutual funds as well as Company common stock and are classified as trading securities. Changes in the fair value of these securities are measured using quoted prices in active markets based on the market price per unit multiplied by the number of units held exclusive of any transaction costs. A corresponding adjustment for changes in fair value of the trading securities is also reflected in the changes in fair value of the deferred compensation obligation. The deferred compensation liabilities are classified within Level 2 because their inputs are derived principally from observable market data by correlation to the trading securities.

In connection with the acquisition of AmeriPath Group Holdings, Inc. ("AmeriPath") in May 2007, the Company assumed a non-qualified deferred compensation program AmeriPath offers to certain employees. A participant's deferrals, together with Company matching credits, are "invested" at the direction of the employee in a hypothetical portfolio of investments which are tracked by an administrator. The Company purchases life insurance policies, with the Company named as beneficiary of the policies, for the purpose of funding the program's liability. Changes in the cash surrender value of the life insurance policies are based upon earnings and changes in the value of the underlying investments. Changes in the fair value of the deferred compensation obligation are derived using quoted prices in active markets based on the market price per unit multiplied by the number of units. The cash surrender value and the deferred compensation obligations are classified within Level 2 because their inputs are derived principally from observable market data by correlation to the hypothetical investments.

The fair value measurements for available-for-sale securities are based upon the quoted price in active markets multiplied by the number of shares owned exclusive of any transaction costs and without any adjustments to reflect discounts that may be applied to selling a large block of the securities at one time. The Company does not believe that the changes in fair value of these assets will materially differ from the amounts that could be realized upon settlement or that the changes in fair value will have a material effect on the Company's results of operations, liquidity and capital resources.

The fair value measurements of foreign currency forward contracts are obtained from a third-party pricing service. The fair value measurements of the Company's interest rate swaps are model-derived valuations as of a given date in which all significant inputs are observable in active markets including certain financial information and certain assumptions regarding past, present and future market conditions. The Company does not believe that the changes in the fair values of its foreign currency forward contracts and interest rate swaps will materially differ from the amounts that could be realized upon settlement or maturity or that the changes in fair value will have a material effect on its results of operations, liquidity and capital resources.

SFAS No. 159, "The Fair Value Option for Financial Assets and Financial Liabilities" ("SFAS 159") became effective for the Company on January 1, 2008. SFAS 159 provides companies with an option to irrevocably elect to measure certain financial assets and financial liabilities at fair value on an instrument-by-instrument basis with the resulting changes in fair value recorded in earnings. The objective of SFAS 159 is to reduce both the complexity in accounting for financial instruments and the volatility in earnings caused by using different measurement attributes for financial assets and financial liabilities. As of January 1, 2008 and for the period 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.

The carrying amounts of cash and cash equivalents, accounts receivable and accounts payable and accrued expenses approximate fair value based on the short maturities of these instruments. In accordance with the provisions of SFAS No. 107, "Disclosures About Fair Value of Financial Instruments" at December 31, 2008 and December 31, 2007, the fair value of the Company's debt was estimated at \$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.

QUEST DIAGNOSTICS INCORPORATED AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED
(dollars in thousands unless otherwise indicated)

Foreign Currency

The Company predominately uses the U.S. dollar as its functional currency. The functional currency of the Company's foreign subsidiaries is the applicable local currency. Assets and liabilities denominated in non-U.S. dollars are translated into U.S. dollars at exchange rates as of the end of the reporting period. Income and expense items are translated at average exchange rates prevailing during the year. The translation adjustments are recorded as a component of "accumulated other comprehensive (loss) income" within stockholders' equity. Gains and losses from foreign currency transactions are included within "other operating (income) expense, net" in the consolidated statements of operations. Transaction gains and losses have not been material.

Cash and Cash Equivalents

Cash and cash equivalents include all highly-liquid investments with original maturities, at the time acquired by the Company, of three months or less.

Concentration of Credit Risk

Financial instruments that potentially subject the Company to concentrations of credit risk are principally cash, cash equivalents, short-term investments and accounts receivable. The Company's policy is to place its cash, cash equivalents and short-term investments in highly-rated financial instruments and institutions. Concentration of credit risk with respect to accounts receivable is mitigated by the diversity of the Company's payers and their dispersion across many different geographic regions, and is limited to certain payers who are large buyers of the Company's services. To reduce risk, the Company routinely assesses the financial strength of these payers and, consequently, believes that its accounts receivable credit risk exposure, with respect to these payers, is limited. While the Company has receivables due from federal and state governmental agencies, the Company does not believe that such receivables represent a credit risk since the related healthcare programs are funded by federal and state governments, and payment is primarily dependent on submitting appropriate documentation.

Accounts Receivable and Allowance for Doubtful Accounts

Accounts receivable are reported at realizable value, net of allowances for doubtful accounts, which is estimated and recorded in the period the related revenue is recorded. The Company has a standardized approach to estimate and review the collectibility of its 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, the Company regularly assesses the state of its billing operations in order to identify issues which may impact the collectibility of these receivables or reserve estimates. Revisions to the allowances for doubtful accounts estimates are recorded as an adjustment to bad debt expense within selling, general and administrative expenses. Receivables deemed to be uncollectible are charged against the allowance for doubtful accounts at the time such receivables are written-off. Recoveries of receivables previously written-off are recorded as credits to the allowance for doubtful accounts.

Inventories

Inventories, which consist principally of testing supplies and reagents, are valued at the lower of cost (first in, first out method) or market.

Property, Plant and Equipment

Property, plant and equipment is recorded at cost. Major renewals and improvements are capitalized, while maintenance and repairs are expensed as incurred. Costs incurred for computer software developed or obtained for internal use are capitalized for application development activities and expensed as incurred for preliminary project activities and post-implementation activities. Capitalized costs include external direct costs of materials and services consumed in developing or obtaining internal-use software, payroll and payroll-related costs for employees who are directly associated with and who devote time to the internal-use software project, and interest costs incurred, when material, while developing internal-use software. Capitalization of such costs ceases when

QUEST DIAGNOSTICS INCORPORATED AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED
(dollars in thousands unless otherwise indicated)

the project is substantially complete and ready for its intended purpose. Certain costs, such as maintenance and training, are expensed as incurred. The Company capitalizes interest on borrowings during the active construction period of major capital projects. Capitalized interest is added to the cost of the underlying assets and is amortized over the expected useful lives of the assets. Depreciation and amortization are provided on the straight-line method over expected useful asset lives as follows: buildings and improvements, ranging from ten to thirty years; laboratory equipment and furniture and fixtures, ranging from three to seven years; leasehold improvements, the lesser of the useful life of the improvement or the remaining life of the building or lease, as applicable; and computer software developed or obtained for internal use, ranging from three to seven years.

Goodwill

Goodwill represents the cost of acquired businesses in excess of the fair value of assets acquired, including separately recognized intangible assets, less the fair value of liabilities assumed in a business combination. The Company uses a nonamortization approach to account for purchased goodwill. Under a nonamortization approach, goodwill is not amortized, but instead is periodically reviewed for impairment.

Intangible Assets

Intangible assets are recognized as an asset apart from goodwill if the asset arises from contractual or other legal rights, or if it is separable. Intangible assets, principally representing the cost of customer relationships, customer lists and non-competition agreements acquired, are capitalized and amortized on the straight-line method over their expected useful life, which generally ranges from five to twenty years. Intangible assets with indefinite useful lives, consisting principally of acquired tradenames, are not amortized, but instead are periodically reviewed for impairment.

Recoverability and Impairment of Goodwill

Under the nonamortization provisions of SFAS No. 142, "Goodwill and Other Intangible Assets" ("SFAS 142"), goodwill and certain intangibles are periodically reviewed for impairment and an impairment charge is recorded in the periods in which the recorded carrying value of goodwill and certain intangibles is more than its estimated fair value. The provisions of SFAS 142 require that a goodwill impairment test be performed annually or in the case of other events that indicate a potential impairment. The annual impairment tests of goodwill were performed at the end of each of the Company's fiscal years on December 31st and indicated that there was no impairment of goodwill as of December 31, 2008 or 2007.

The Company evaluates the recoverability and measures the potential impairment of its goodwill under SFAS 142. 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. Management's estimate of fair value considers publicly available information regarding the market capitalization of the Company as well as (i) the financial projections and future prospects of the Company's 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, management compares the estimate of fair value for the reporting unit to the book value of the reporting unit. If the book value is greater than the estimate of fair value, the Company 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. Management believes its estimation methods are reasonable and reflective of common valuation practices.

On a quarterly basis, management performs a review of the Company's 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, the

QUEST DIAGNOSTICS INCORPORATED AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED
(dollars in thousands unless otherwise indicated)

Company would perform an impairment test of goodwill as of the end of the quarter, consistent with the annual impairment test, and record any noted impairment loss.

Recoverability and Impairment of Intangible Assets and Other Long-Lived Assets

The Company evaluates the possible impairment of its long-lived assets, including intangible assets which are amortized pursuant to the provisions of SFAS 142, under SFAS No. 144, "Accounting for Impairment or Disposal of Long-Lived Assets." The Company reviews the recoverability of its long-lived assets when events or changes in circumstances occur that indicate that the carrying value of the asset may not be recoverable. Evaluation of possible impairment is based on the Company's ability to recover the asset from the expected future pretax cash flows (undiscounted and without interest charges) of the related operations. If the expected undiscounted pretax cash flows are less than the carrying amount of such asset, an impairment loss is recognized for the difference between the estimated fair value and carrying amount of the asset.

Investments

The Company accounts for investments in equity securities, which are included in "other assets" in the consolidated balance sheet, in conformity with SFAS No. 115, "Accounting for Certain Investments in Debt and Equity Securities," which requires the use of fair value accounting for trading or available-for-sale securities. Both realized and unrealized gains and losses for trading securities are recorded currently in earnings as a component of non-operating expenses within "other expense, net" in the consolidated statements of operations. Unrealized gains and losses, net of tax, for available-for-sale securities are recorded as a component of "accumulated other comprehensive (loss) income" within stockholders' equity. Recognized gains and losses for available-for-sale securities are recorded in "other expense, net" in the consolidated statements of operations. Gains and losses on securities sold are based on the average cost method.

The Company periodically reviews its investments to determine whether a decline in fair value below the cost basis is other than temporary. The primary factors considered in the determination are: the length of time that the fair value of the investment is below carrying value; the financial condition, operating performance and near term prospects of the investee; and the Company's intent and ability to hold the investment for a period of time sufficient to allow for a recovery in fair value. If the decline in fair value is deemed to be other than temporary, the cost basis of the security is written down to fair value.

Investments at December 31, 2008 and 2007 consisted of the following:

	<u>2008</u>	<u>2007</u>
Available-for-sale equity securities	\$ 255	\$ 9,690
Trading equity securities	25,383	33,903
Other investments	<u>15,539</u>	<u>16,460</u>
Total	<u>\$41,177</u>	<u>\$60,053</u>

Investments in available-for-sale equity securities consist of equity securities in public corporations. Investments in trading equity securities represent participant-directed investments of deferred employee compensation and related Company matching contributions held in a trust pursuant to the Company's supplemental deferred compensation plan (see Note 12). Other investments do not have readily determinable fair values and consist of investments in preferred and common shares of privately held companies and are accounted for under the cost method.

As of December 31, 2008 and 2007, the Company had gross unrealized losses from available-for-sale equity securities of \$0.6 million and \$3.5 million, respectively. For the year ended December 31, 2008 and 2007, "other expense, net," within the consolidated statements of operations, includes \$8.9 million and \$4.0 million, respectively, of charges associated with the write-down of available-for-sale equity securities. For the year ended December 31, 2006, "other expense, net," within the consolidated statements of operations, includes \$16.2 million of charges associated with the write-down of available-for-sale equity securities, \$10.0 million of charges associated with the write-down of other investments and a \$15.8 million gain associated with the sale of an investment. For the years ended December 31, 2008, 2007 and 2006, (losses) gains from trading equity securities totaled \$(9.9) million, \$2.7 million and \$3.2 million, respectively, and are included in "other expense, net."

QUEST DIAGNOSTICS INCORPORATED AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED
(dollars in thousands unless otherwise indicated)

Derivative Financial Instruments

The Company uses derivative financial instruments to manage its market risks. This includes the use of interest rate swap agreements to manage its exposure to movements in interest rates and foreign currency forward contracts to manage its exposure to foreign exchange rates. The Company has established policies and procedures for risk assessment and the approval, reporting and monitoring of derivative financial instrument activities. These policies prohibit holding or issuing derivative financial instruments for speculative purposes.

Interest rate swaps involve the periodic exchange of payments without the exchange of underlying principal or notional amounts. Net payments are recognized as an adjustment to interest expense. When the swaps are terminated, unrealized gains or losses are deferred in stockholders' equity, as a component of "accumulated other comprehensive (loss) income," and are amortized as an adjustment to interest expense over the shorter of the remaining original term of the hedging instrument or the remaining life of the underlying debt instrument.

The Company formally documents its hedge relationships, including identifying the hedging instruments and the hedged items, as well as its risk management objectives and strategies for undertaking the hedge transaction. On the date the derivative is entered into, the Company designates the type of derivative as a fair value hedge or cash flow hedge, and accounts for the derivative in accordance with its designation as prescribed by SFAS No. 133, "Accounting for Derivative Instruments and Hedging Activities" ("SFAS 133"), as amended. The Company currently holds only cash flow hedges, designated as a hedge of the variability of cash outflows related to the Company's long-term debt due to changes in interest rates. Both at inception and at least quarterly thereafter, the Company also formally assesses whether the derivatives that are used in hedging transactions are highly effective in offsetting changes in the cash flows of the hedged item. All components of each derivative financial instrument's gain or loss are included in the assessment of hedge effectiveness.

The Company accounts for derivatives in conformity with SFAS No. 133, as amended, and records derivatives as either an asset or liability measured at its fair value. The fair value is based upon quoted market prices obtained from third-party institutions. For derivatives that have been formally designated as a cash flow hedge (interest rate swap agreements), the effective portion of changes in the fair value of the derivatives is recorded in "accumulated other comprehensive (loss) income." Changes in the fair value of derivatives are recorded each period in current earnings or other comprehensive income, depending on whether a derivative is designated as part of a hedge transaction and, if it is, the type of hedge transaction based on the specific qualifying conditions in SFAS 133. Amounts in "accumulated other comprehensive (loss) income" are reclassified into earnings in "interest expense, net" during the same period in which the hedged item affects earnings. If it is determined that a derivative ceases to be a highly effective hedge, the Company discontinues hedge accounting, and any deferred gains or losses are recorded in the consolidated statement of operations.

Comprehensive Income (Loss)

Comprehensive income (loss) encompasses all changes in stockholders' equity (except those arising from transactions with stockholders) and includes net income, net unrealized capital gains or losses on available-for-sale securities, foreign currency translation adjustments and deferred gains related to the settlement of certain treasury lock agreements (see Note 10).

New Accounting Standards

In September 2007, the FASB ratified Emerging Issues Task Force Issue No. 07-1 "Accounting for Collaborative Agreements," ("EITF 07-1"). EITF 07-1 defines collaborative agreements as contractual arrangements that involve a joint operating activity. These arrangements involve two (or more) parties that are both active participants in the activity and are exposed to significant risks and rewards dependent on the commercial success of the activity. EITF 07-1 provides guidance that revenues generated and costs incurred by participants from transactions with parties outside the collaborative agreement should be reported either on a gross basis or a net basis depending on whether the participant is a principal or agent to the transaction. EITF 07-1 also provides that a company should report the effects of adoption as a change in accounting principle through retrospective application to all periods and requires additional disclosures about a company's collaborative arrangements. EITF 07-1 is effective for the Company as of January 1, 2009. The adoption of EITF 07-1 is not expected to have a material impact on the Company's consolidated financial statements.

QUEST DIAGNOSTICS INCORPORATED AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED
(dollars in thousands unless otherwise indicated)

In December 2007, the FASB issued SFAS No. 141(R) "Business Combinations" ("SFAS 141(R)"). SFAS 141(R) changes several underlying principles in applying the purchase method of accounting. Among the significant changes, SFAS 141(R) requires a redefining of the measurement date of a business combination, expensing direct transaction costs as incurred, capitalizing in-process research and development costs as an intangible asset and recording a liability for contingent consideration at the measurement date with subsequent re-measurements recorded in the results of operations. SFAS 141(R) also requires that costs for business restructuring and exit activities related to the acquired company will be included in the post-combination financial results of operations and also provides new guidance for the recognition and measurement of contingent assets and liabilities in a business combination. In addition, adjustments to acquisition-related tax contingencies and deferred tax valuation allowances for both past and prospective business combinations will no longer be an adjustment to goodwill, but rather reflected in earnings in the period of adjustment. SFAS 141(R) requires several new disclosures, including the reasons for the business combination, the factors that contribute to the recognition of goodwill, the amount of acquisition related third-party expenses incurred, the nature and amount of contingent consideration, and a discussion of pre-existing relationships between the parties. SFAS 141(R) is effective for the Company as of January 1, 2009. The Company expects that the adoption of SFAS 141(R) is likely to have a significant impact on how the Company allocates the purchase price of an acquired business, including the expensing of direct transaction costs and costs to integrate the acquired business. Transaction costs for potential business combinations that had not closed by December 31, 2008 were written off on January 1, 2009 and were not material.

In December 2007, the FASB issued SFAS No. 160 "Noncontrolling Interests in Consolidated Financial Statements, an Amendment of ARB No. 51," ("SFAS 160"). SFAS 160 establishes accounting and reporting standards for the noncontrolling interest in a subsidiary and for the deconsolidation of a subsidiary. SFAS 160 requires noncontrolling interests in subsidiaries initially to be measured at fair value and classified as a separate component of equity. SFAS 160 also requires a new presentation on the face of the consolidated financial statements to separately report the amounts attributable to controlling and non-controlling interests. SFAS 160 is effective for the Company as of January 1, 2009. The adoption of SFAS 160 is not expected to have a material impact on the Company's consolidated financial statements.

In March 2008, the FASB issued SFAS No. 161 "Disclosures About Derivative Instruments and Hedging Activities – an amendment of FASB Statement No. 133" ("SFAS 161"). SFAS 161 amends SFAS No. 133, "Accounting for Derivative Instruments and Hedging Activities," by requiring expanded disclosures about an entity's derivative instruments and hedging activities. SFAS 161 requires qualitative disclosures about objectives and strategies for using derivatives, quantitative disclosures about fair value amounts of and gains and losses on derivative instruments, and disclosures about credit-risk-related contingent features in derivative instruments. SFAS 161 is effective for the Company as of January 1, 2009. The adoption of SFAS 161 is not expected to have a material impact on the Company's consolidated financial statements.

In May 2008, the FASB issued SFAS No. 162 "The Hierarchy of Generally Accepted Accounting Principles" ("SFAS 162"). SFAS 162 identifies the sources of accounting principles and the framework for selecting the principles used in the preparation of financial statements of nongovernmental entities that are presented in conformity with generally accepted accounting principles (the GAAP hierarchy). SFAS 162 will become effective 60 days following the SEC's approval of the Public Company Accounting Oversight Board amendments to AICPA Professional Standards AU Section 411, "The Meaning of Present Fairly in Conformity With Generally Accepted Accounting Principles." The adoption of SFAS 162 is not expected to have a material impact on the Company's consolidated financial statements.

In June 2008, the FASB issued FSP EITF 03-6-1, "Determining Whether Instruments Granted in Share-Based Payment Transactions Are Participating Securities" ("FSP EITF 03-6-1"). FSP EITF 03-6-1 addresses whether instruments granted in share-based payment transactions are participating securities prior to vesting and, therefore, need to be included in computing earnings per share under the two-class method described in SFAS No. 128, "Earnings Per Share." FSP EITF 03-6-1 is effective for the Company as of January 1, 2009 and in accordance with its requirements it will be applied retrospectively. The Company does not expect the adoption of FSP EITF 03-6-1 to have a material impact on its consolidated financial statements.

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" ("FSP FAS 157-3"). FSP FAS 157-3 clarifies the application of

QUEST DIAGNOSTICS INCORPORATED AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED
(dollars in thousands unless otherwise indicated)

SFAS 157 in a market that is not active and illustrates how an entity would determine fair value when the market for a financial asset is not active. FSP FAS 157-3 provides guidance on how an entity's own assumptions about cash flows and discount rates should be considered when measuring fair value when relevant market data does not exist, how observable market information in an inactive or dislocated market affects fair value measurements and how the use of broker and pricing service quotes should be considered when applying fair value measurements. FSP FAS 157-3 was effective immediately as of September 30, 2008 and for all interim and annual periods thereafter. The adoption of FSP FAS 157-3 did not have a material impact on the Company's consolidated financial statements.

In November 2008, the FASB ratified the consensus reached under EITF Issue No. 08-7, "Accounting for Defensive Intangible Assets" ("EITF 08-7"). EITF 08-7 requires that certain intangible assets acquired in a business combination that will be held for defensive purposes shall be measured at their fair value when they are obtained. The useful life of a defensive intangible asset will be based on the period in which the asset is expected to directly or indirectly contribute to future cash flows up through the date it is effectively abandoned. EITF 08-7 is effective for the Company as of January 1, 2009. The purchase price allocations in prospective business combinations will require the Company to ascribe a fair value to intangible assets it intends to hold for defensive purposes and to amortize such assets over their estimated useful lives.

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" ("FSP FAS 140-4 and FIN 46(R)-8"). FSP FAS 140-4 and FIN 46(R)-8 changes the accounting and reporting for transfers and securitizations of financial assets and the use of qualified special purpose entities (QSPEs) and other variable interest entities (VIEs) by modifying the rules for de-recognition of transferred financial assets, eliminating the concept QSPEs and modifying the consolidation model for VIEs to require a continual reassessment of consolidation conclusions. The consolidation model will include a two-step approach that will consider qualitative attributes of the relationship with a VIE as well as a quantitative approach that analyzes the expected losses and expected residual returns of the VIE. FSP FAS 140-4 and FIN 46(R)-8 is effective for the Company as of December 31, 2008. The Company currently does not securitize any of its financial assets through QSPEs and its relationship with VIEs has not been material.

3. BUSINESS ACQUISITIONS

2007 Acquisitions

Acquisition of HemoCue

On January 31, 2007, the Company completed its acquisition of POCT Holding AB ("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. HemoCue is the leading international provider in point-of-care for hemoglobin, with a growing share in professional glucose and microalbumin testing.

In conjunction with the acquisition of HemoCue, the Company repaid approximately \$113 million of debt, representing substantially all of HemoCue's existing outstanding debt as of January 31, 2007.

The Company financed the aggregate purchase price of \$344 million, which includes transaction costs of approximately \$7 million, of which \$2 million was paid in 2006, and the repayment of substantially all of HemoCue's outstanding debt with the proceeds from a \$450 million term loan and cash on-hand. On May 31, 2007, the Company refinanced this term loan. In January 2008, the Company received a payment of approximately \$23 million from an escrow fund established at the time of the acquisition which reduced the aggregate purchase price to \$321 million.

The acquisition of HemoCue was accounted for under the purchase method of accounting. As such, the cost to acquire HemoCue was allocated to the respective assets and liabilities acquired based on their estimated fair values as of the closing date. The consolidated financial statements include the results of operations of HemoCue subsequent to the closing of the acquisition.

Of the aggregate purchase price of \$321 million, \$298 million was allocated to goodwill, \$38 million was allocated to customer relationships that are being amortized over 20 years and \$39 million was allocated to technology that is being amortized over 14 years.

QUEST DIAGNOSTICS INCORPORATED AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED
(dollars in thousands unless otherwise indicated)

In addition to the amortizable intangibles noted above, \$53.8 million was allocated to tradenames, which is not subject to amortization, and \$4.0 million was allocated to in-process research and development (“IPR&D”). The IPR&D was expensed in the Company’s results of operations during the first quarter of 2007, in accordance with FASB Interpretation No. 4, “Applicability of FASB Statement No. 2 to Business Combinations Accounted for by the Purchase Method,” and is included in “other operating (income) expense, net” within the consolidated statements of operations.

Supplemental pro forma combined financial information has not been presented as the acquisition is not material to the Company’s consolidated results of operations.

Acquisition of AmeriPath

On May 31, 2007, the Company completed its acquisition of AmeriPath, in an all-cash transaction valued at approximately \$2.0 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 and generated annual revenues of approximately \$800 million.

Through the acquisition, the Company 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. The Company 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 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, the Company completed an \$800 million senior notes offering. The net proceeds of the senior notes offering were used to repay the \$780 million bridge loan. See Note 9 for further descriptions of the Company’s debt outstanding.

The acquisition of AmeriPath was accounted for under the purchase method of accounting. As such, the cost to acquire AmeriPath was allocated to the respective assets and liabilities acquired based on their estimated fair values as of the closing date. The consolidated financial statements include the results of operations of AmeriPath subsequent to the closing of the acquisition.

The following table summarizes the Company’s purchase price allocation of the cost to acquire AmeriPath:

	Estimated Fair Values as of May 31, 2007
Current assets.....	\$ 200,930
Property and equipment	125,817
Intangible assets	561,300
Goodwill	1,415,193
Other assets	67,685
Total assets acquired	<u>2,370,925</u>
Current liabilities	141,435
Long-term liabilities.....	213,044
Long-term debt	<u>801,424</u>
Total liabilities assumed	<u>1,155,903</u>
Net assets acquired	<u><u>\$1,215,022</u></u>

The acquired amortizable intangibles are being amortized over their estimated useful lives as follows:

	Estimated Fair Value	Weighted Average Useful Life
Customer relationships	\$327,500	20 years
Non-compete agreement.....	5,800	5 years
Tradename	2,500	2 years

QUEST DIAGNOSTICS INCORPORATED AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED
(dollars in thousands unless otherwise indicated)

In addition to the amortizable intangibles noted above, \$226 million was allocated to certain tradenames, which are not subject to amortization.

Of the amount allocated to goodwill and intangible assets, approximately \$100 million is expected to be deductible for tax purposes.

During 2008, the Company decreased the amount of goodwill recorded in connection with the acquisition of AmeriPath by approximately \$45 million, primarily as a result of changes in judgments regarding the realization of certain pre-acquisition net operating loss carryforwards.

2006 Acquisitions

Acquisition of Focus Diagnostics

On July 3, 2006, the Company completed its acquisition of Focus Technologies Holding Company (“Focus Diagnostics”) in an all-cash transaction valued at \$208 million, including approximately \$3 million of assumed debt. Focus Diagnostics is a leading provider of infectious and immunologic disease testing and develops and markets diagnostic products. It offers its reference testing services and diagnostic products to large academic medical centers, hospitals and commercial laboratories. The Company financed the aggregate purchase price of \$205 million, which included \$0.5 million of related transaction costs, and the repayment of substantially all of Focus Diagnostics’ outstanding debt with \$135 million of borrowings under its secured receivables credit facility and with cash on-hand.

The acquisition of Focus Diagnostics was accounted for under the purchase method of accounting. As such, the cost to acquire Focus Diagnostics was allocated to the respective assets and liabilities acquired based on their estimated fair values as of the closing date. The consolidated financial statements include the results of operations of Focus Diagnostics subsequent to the closing of the acquisition.

Of the aggregate purchase price of \$205 million, \$142 million was allocated to goodwill, \$33 million was allocated to customer relationships that are being amortized over 10-15 years and \$9.1 million was allocated to trade names that are not subject to amortization. Substantially all of the goodwill is not expected to be deductible for tax purposes.

Supplemental pro forma combined financial information has not been presented as the acquisition is not material to the Company’s consolidated financial statements.

Acquisition of Enterix

On August 31, 2006, the Company completed its acquisition of Enterix Inc. (“Enterix”), a privately held Australia-based company that develops and manufactures the InSure™ Fecal Immunochemical Test, a Food and Drug Administration (“FDA”)-cleared test for use in screening for colorectal cancer and other sources of lower gastrointestinal bleeding, for approximately \$44 million in cash. The acquisition is not material to the Company’s consolidated financial statements.

Pro Forma Combined Financial Information

The following unaudited pro forma combined financial information for the years ended December 31, 2007 and 2006 assumes that the AmeriPath acquisition and related financing, including the Company’s June 2007 senior notes offering, were completed on January 1, 2006. Supplemental pro forma combined financial information for HemoCue, Focus and Enterix has not been presented as the acquisitions are not material to the Company’s consolidated results of operations (in thousands, except per share data).

QUEST DIAGNOSTICS INCORPORATED AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED
(dollars in thousands unless otherwise indicated)

	<u>2007</u>	<u>2006</u>
Net revenues	\$7,038,781	\$7,020,980
Net income	263,225	593,677
Basic earnings per common share:		
Net income	\$ 1.36	\$ 3.01
Weighted average common shares outstanding – basic.....	193,241	196,985
Diluted earnings per common share:		
Net income	\$ 1.35	\$ 2.98
Weighted average common shares outstanding – diluted.....	195,262	199,542

The unaudited pro forma combined financial information presented above reflects certain reclassifications to the historical financial statements of AmeriPath to conform the acquired company's accounting policies and classification of certain costs and expenses to that of Quest Diagnostics. These adjustments had no impact on pro forma net income. Pro forma results for the year ended December 31, 2007 exclude transaction related costs of \$44 million, which were incurred and expensed by AmeriPath in conjunction with its acquisition by Quest Diagnostics.

4. TAXES ON INCOME

The Company's pretax income (loss) from continuing operations consisted of \$1.02 billion, \$920 million and \$1.02 billion from U.S. operations and approximately \$(1.2) million, \$(7.1) million and \$8.6 million from foreign operations for the years ended December 31, 2008, 2007 and 2006, respectively.

The components of income tax expense (benefit) for 2008, 2007 and 2006 were as follows:

	<u>2008</u>	<u>2007</u>	<u>2006</u>
Current:			
Federal.....	\$299,937	\$267,138	\$360,806
State and local.....	57,750	59,625	93,292
Foreign.....	3,833	1,093	4,586
Deferred:			
Federal.....	20,764	23,787	(26,897)
State and local.....	10,029	10,774	(24,206)
Foreign.....	(5,545)	(3,843)	-
Total.....	<u>\$386,768</u>	<u>\$358,574</u>	<u>\$407,581</u>

A reconciliation of the federal statutory rate to the Company's effective tax rate for 2008, 2007 and 2006 was as follows:

	<u>2008</u>	<u>2007</u>	<u>2006</u>
Tax provision at statutory rate	35.0%	35.0%	35.0%
State and local income taxes, net of federal benefit	4.6	4.6	4.3
Impact of foreign operations	(1.1)	(0.8)	0.3
Non-deductible expenses, primarily meals and entertainment expenses.....	0.5	0.3	0.3
Other, net.....	(1.0)	0.2	(0.5)
Effective tax rate.....	<u>38.0%</u>	<u>39.3%</u>	<u>39.4%</u>

QUEST DIAGNOSTICS INCORPORATED AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED
(dollars in thousands unless otherwise indicated)

The tax effects of temporary differences that give rise to significant portions of the deferred tax assets (liabilities) at December 31, 2008 and 2007 were as follows:

	<u>2008</u>	<u>2007</u>
Current deferred tax assets:		
Accounts receivable reserves	\$ 82,594	\$ 54,226
Liabilities not currently deductible.....	<u>135,825</u>	<u>95,615</u>
Total current deferred tax assets.....	<u>\$ 218,419</u>	<u>\$ 149,841</u>
Non-current deferred tax assets (liabilities):		
Liabilities not currently deductible.....	\$ 125,693	\$ 117,647
Stock-based compensation.....	55,413	36,664
Net operating loss carryforwards	52,394	29,131
Depreciation and amortization.....	<u>(423,074)</u>	<u>(393,134)</u>
Total non-current deferred tax liabilities	<u>\$(189,574)</u>	<u>\$(209,692)</u>

During 2008, the Company increased deferred tax assets related to accounts receivable reserves by approximately \$32 million, with a corresponding decrease in goodwill, for changes in estimates regarding the realization of tax benefits associated with acquired reserve balances.

At December 31, 2008 and 2007, non-current deferred tax liabilities of \$190 million and \$210 million, respectively, are included in other long-term liabilities in the consolidated balance sheet.

As of December 31, 2008, the Company had estimated net operating loss carryforwards for federal, state and foreign income tax purposes of \$73 million, \$647 million and \$42 million, respectively, which expire at various dates through 2028. As of December 31, 2008 and 2007, deferred tax assets associated with net operating loss carryforwards of \$66 million and \$71 million, respectively, have each been reduced by a valuation allowance of \$14 million and \$42 million, respectively.

Income taxes payable including those classified in other long-term liabilities in the consolidated balance sheets at December 31, 2008 and 2007, were \$88 million and \$83 million, respectively.

As of January 1, 2007, the Company adopted FASB Interpretation No. 48, "Accounting for Uncertainty in Income Taxes" ("FIN 48"). FIN 48 clarifies the accounting for uncertainty in income taxes recognized in financial statements and provides guidance on the recognition and measurement of tax positions taken or expected to be taken by an entity. The adoption of FIN 48 resulted in an increase to our contingent tax liability reserves of \$30 million with corresponding charges to retained earnings, goodwill and additional paid-in capital. The contingent liabilities for tax positions under FIN 48 primarily relate to uncertainties associated with the realization of tax benefits derived from certain state net operating loss carryforwards, the allocation of income and expense among state jurisdictions, the characterization and timing of certain tax deductions associated with business combinations and employee compensation, and income and expenses associated with certain intercompany licensing arrangements.

The recognition and measurement of certain tax benefits includes estimates and judgment by management and inherently involves subjectivity. Changes in estimates may create volatility in the Company's effective tax rate in future periods and may be due to settlements with various tax authorities (either favorable or unfavorable), the expiration of the statute of limitations on some tax positions and obtaining new information about particular tax positions that may cause management to change its estimates.

QUEST DIAGNOSTICS INCORPORATED AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED
(dollars in thousands unless otherwise indicated)

The total amount of unrecognized tax benefits as of and for the years ended December 31, 2008 and 2007 consists of the following:

	<u>2008</u>	<u>2007</u>
Balance, beginning of year	\$107,943	\$ 91,856
Additions:		
for tax positions of current year	3,775	14,341
for tax positions of prior years	3,916	14,698
Reductions:		
Changes in judgment	(32,684)	(1,494)
Expirations of statutes of limitations	(2,724)	(4,423)
Settlements	<u>(9,349)</u>	<u>(7,035)</u>
Balance, end of year	<u>\$ 70,877</u>	<u>\$107,943</u>

The total amount of unrecognized tax benefits as of December 31, 2008, that, if recognized, would affect the effective tax rate is \$51 million. Based upon the expiration of statutes of limitations, settlements and/or the conclusion of tax examinations, the Company believes it is reasonably possible that the total amount of unrecognized tax benefits for the items previously discussed may decrease by up to \$34 million within the next twelve months.

Accruals for interest expense on contingent tax liabilities are classified in income tax expense in the consolidated statements of operations. Accruals for penalties have historically been immaterial. As a result of changes in judgment and favorable resolutions of uncertain tax positions, \$5 million of net interest was credited to income tax expense in 2008. Interest expense included in income tax expense in 2007 was approximately \$6 million. As of December 31, 2008 and 2007, the Company has approximately \$18 million and \$23 million, respectively, accrued, net of the benefit of a federal and state deduction, for the payment of interest on uncertain tax positions. The Company does not consider this interest part of its fixed charges.

In the regular course of business, various federal, state and local and foreign tax authorities conduct examinations of the Company's income tax filings and the Company generally remains subject to examination until the statute of limitations expires for the respective jurisdiction. The Internal Revenue Service has completed its examinations of the Company's consolidated federal income tax returns up through and including the 2004 tax year. The Company is currently appealing an issue with regards to its 2005 tax year. Certain state tax authorities are conducting audits for various years between 2004 and 2007. In December 2008, the Company reached a settlement agreement to pay a state tax authority approximately \$44 million in taxes, penalties and interest (\$26 million, net of federal and state benefits) for certain tax positions associated with intercompany licensing arrangements. This settlement is expected to be paid in 2009. At this time, the Company does not believe that there will be any material additional payments beyond its recorded contingent liability reserves that may be required as a result of these tax audits. As of December 31, 2008, a summary of the tax years that remain subject to examination for the Company's major jurisdictions are:

United States – federal	2004–2008
United States – various states	2004–2008

In conjunction with its acquisition of SmithKline Beecham Clinical Laboratories, Inc. ("SBCL"), which operated the clinical testing business of SmithKline Beecham plc ("SmithKline Beecham"), the Company entered into a tax indemnification arrangement with SmithKline Beecham that provides the parties with certain rights of indemnification against each other.

QUEST DIAGNOSTICS INCORPORATED AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED
(dollars in thousands unless otherwise indicated)

5. SUPPLEMENTAL CASH FLOW AND OTHER DATA

	<u>2008</u>	<u>2007</u>	<u>2006</u>
Depreciation expense	\$ 227,300	\$ 209,975	\$184,844
Interest expense	(185,476)	(186,329)	(96,454)
Interest income	<u>5,712</u>	<u>8,015</u>	<u>5,029</u>
Interest, net	(179,764)	(178,314)	(91,425)
Interest paid	189,294	157,502	102,055
Income taxes paid	359,336	315,745	381,348
<u>Businesses acquired:</u>			
Fair value of assets acquired	\$ -	\$2,954,728	\$278,078
Fair value of liabilities assumed	-	1,395,867	28,453

6. PROPERTY, PLANT AND EQUIPMENT

Property, plant and equipment at December 31, 2008 and 2007 consisted of the following:

	<u>2008</u>	<u>2007</u>
Land	\$ 35,786	\$ 36,272
Buildings and improvements	365,481	360,442
Laboratory equipment, furniture and fixtures	1,182,376	1,042,890
Leasehold improvements	348,821	318,552
Computer software developed or obtained for internal use	259,851	255,408
Construction-in-progress	<u>57,478</u>	<u>92,918</u>
	2,249,793	2,106,482
Less: accumulated depreciation and amortization	<u>(1,370,106)</u>	<u>(1,194,484)</u>
Total	<u>\$ 879,687</u>	<u>\$ 911,998</u>

7. GOODWILL AND INTANGIBLE ASSETS

The changes in goodwill, net for the years ended December 31, 2008 and 2007 are as follows:

	<u>2008</u>	<u>2007</u>
Balance as of January 1	\$5,220,104	\$3,391,046
Goodwill acquired during the year	9,260	1,799,101
Other purchase accounting adjustments	(120,105)	5,955
(Decrease) increase related to foreign currency translation	<u>(54,333)</u>	<u>24,002</u>
Balance as of December 31	<u>\$5,054,926</u>	<u>\$5,220,104</u>

For the year ended December 31, 2008, goodwill acquired during the year was associated with several immaterial acquisitions. Other purchase accounting adjustments were primarily due to changes in estimates regarding the realization of certain pre-acquisition net operating loss carryforwards, the reduction in certain acquired pre-acquisition tax loss contingencies, and a payment received from an escrow fund established at the time of the HemoCue acquisition (see Note 3 for further discussion). Approximately 90% of the Company's goodwill as of December 31, 2008 and December 31, 2007 was associated with its clinical testing business.

For the year ended December 31, 2007, goodwill acquired during the year was primarily related to the acquisitions of AmeriPath and HemoCue, and other purchase accounting adjustments were primarily due to the impact on goodwill as a result of the adoption of FIN 48. (See Notes 3 and 4 for further discussions).

QUEST DIAGNOSTICS INCORPORATED AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED
(dollars in thousands unless otherwise indicated)

Intangible assets at December 31, 2008 and 2007 consisted of the following:

	Weighted Average Amortization Period	December 31, 2008			December 31, 2007		
		Cost	Accumulated Amortization	Net	Cost	Accumulated Amortization	Net
		Amortizing intangible assets:					
Customer-related intangibles	19 years	\$585,963	\$ (99,384)	\$486,579	\$ 589,418	\$ (70,036)	\$519,382
Non-compete agreements	5 years	54,382	(48,298)	6,084	53,832	(46,476)	7,356
Other	13 years	53,934	(13,258)	40,676	64,214	(8,394)	55,820
Total	19 years	694,279	(160,940)	533,339	707,464	(124,906)	582,558
Intangible assets not subject to amortization:							
Tradenames		294,064	-	294,064	304,175	-	304,175
Total intangible assets		<u>\$988,343</u>	<u>\$(160,940)</u>	<u>\$827,403</u>	<u>\$1,011,639</u>	<u>\$(124,906)</u>	<u>\$886,733</u>

Amortization expense related to intangible assets was \$37.3 million, \$27.9 million and \$10.8 million for the years ended December 31, 2008, 2007 and 2006, respectively.

The estimated amortization expense related to amortizable intangible assets for each of the five succeeding fiscal years and thereafter as of December 31, 2008 is as follows:

Fiscal Year Ending December 31,	
2009.....	\$ 36,086
2010.....	35,309
2011.....	35,049
2012.....	33,831
2013.....	32,851
Thereafter.....	360,213
Total	<u>\$533,339</u>

8. ACCOUNTS PAYABLE AND ACCRUED EXPENSES

Accounts payable and accrued expenses at December 31, 2008 and 2007 consisted of the following:

	2008	2007
Trade accounts payable	\$ 191,219	\$ 205,067
Accrued wages and benefits.....	299,374	318,285
Accrued expenses	412,106	359,355
Accrued settlement reserves.....	316,920	242,009
Total	<u>\$1,219,619</u>	<u>\$1,124,716</u>

9. DEBT

Short-term borrowings and current portion of long-term debt at December 31, 2008 and 2007 consisted of the following:

	2008	2007
Borrowings under Secured Receivables Credit Facility	\$ -	\$100,000
Current portion of long-term debt.....	5,142	63,581
Total short-term borrowings and current portion of long-term debt.....	<u>\$5,142</u>	<u>\$163,581</u>

QUEST DIAGNOSTICS INCORPORATED AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED
(dollars in thousands unless otherwise indicated)

Long-term debt at December 31, 2008 and 2007 consisted of the following:

	<u>2008</u>	<u>2007</u>
Industrial Revenue Bonds due September 2009.....	\$ 1,800	\$ 3,585
Term Loan due December 2008.....	-	60,000
Senior Notes due November 2010.....	399,724	399,574
Senior Notes due July 2011.....	274,724	274,613
Term Loan due May 2012.....	1,092,000	1,385,000
Senior Notes due November 2015.....	498,907	498,747
Senior Notes due July 2017.....	374,320	374,240
Senior Notes due July 2037.....	420,526	420,369
Debentures due June 2034.....	3,070	3,013
Other.....	18,160	21,652
Total.....	<u>3,083,231</u>	<u>3,440,793</u>
Less: current portion.....	<u>5,142</u>	<u>63,581</u>
Total long-term debt.....	<u>\$3,078,089</u>	<u>\$3,377,212</u>

Senior Unsecured Revolving Credit Facility

In May 2007, the Company entered into a \$750 million senior unsecured revolving credit facility (the “Credit Facility”) which replaced the Company’s \$500 million senior unsecured revolving credit facility. The Credit Facility matures in May 2012. Interest on the Credit Facility is based on certain published rates plus an applicable margin that will vary over a range from 40 basis points to 125 basis points based on changes in the Company’s public debt ratings. At the option of the Company, it may elect to enter into LIBOR-based interest rate contracts for periods up to six months. Interest on any outstanding amounts not covered under LIBOR-based interest rate contracts is based on an alternate base rate, which is calculated by reference to the prime rate or federal funds rate. As of December 31, 2008 and 2007, the Company’s borrowing rate for LIBOR-based loans under the Credit Facility was LIBOR (0.4% and 4.6% at December 31, 2008 and 2007, respectively) plus 0.40%. The Credit Facility is guaranteed by certain of the Company’s domestic, wholly-owned subsidiaries (the “Subsidiary Guarantors”). The Credit Facility contains various covenants, including the maintenance of certain financial ratios, which could impact the Company’s ability to, among other things, incur additional indebtedness. At December 31, 2008 and 2007, there were no outstanding borrowings under the Credit Facility.

The Company incurred \$3.1 million of costs associated with the Credit Facility, which is being amortized over the term of the related debt.

Secured Receivables Credit Facility

In June 2008, the Company amended its existing receivables securitization facility (the “Secured Receivables Credit 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, the Company replaced the \$125 million portion of the 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.

At December 31, 2008 and 2007, the Company’s borrowing rate under the Secured Receivables Credit Facility was 3.6% and 5.4%, respectively. Borrowings outstanding under the Secured Receivables Credit Facility are classified as a current liability on the Company’s consolidated balance sheet. At December 31, 2008, there were no borrowings outstanding under the facility. At December 31, 2007, borrowings under the facility totaled \$100 million.

QUEST DIAGNOSTICS INCORPORATED AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED
(dollars in thousands unless otherwise indicated)

Term and Bridge Loan Credit Facilities

On May 31, 2007, the Company entered into a five-year term loan facility (the "Term Loan due 2012"), pursuant to which it borrowed \$1.6 billion, and a \$1.0 billion bridge loan facility (the "Bridge Loan"), pursuant to which it borrowed \$780 million. The Company used the proceeds to finance the acquisition of AmeriPath, and related transaction costs, to repay substantially all of AmeriPath's outstanding debt and to repay the \$450 million outstanding under an interim credit facility used to finance the acquisition of HemoCue and repay substantially all of HemoCue's outstanding debt.

The Term Loan due 2012 matures on May 31, 2012 and requires principal repayments of 1.25% of the amount borrowed on the last day of each calendar quarter starting on September 30, 2007, with the quarterly payments increasing on September 30, 2009 to 2.5% of the amount borrowed and on September 30, 2011 to 17.5% of the amount borrowed, with the remainder of the outstanding balance due on May 31, 2012. The Term Loan due 2012 is guaranteed by the Subsidiary Guarantors. Interest under the Term Loan due 2012 is based on certain published rates plus an applicable margin that will vary over a range from 40 basis points to 125 basis points based on changes in the Company's public debt ratings. At the Company's option, it may elect to enter into LIBOR-based interest rate contracts for periods up to six months. Interest on any outstanding amounts not covered under LIBOR-based interest rate contracts is based on an alternate base rate, which is calculated by reference to the prime rate or federal funds rate. As of December 31, 2008 and 2007, the Company's borrowing rate for LIBOR-based loans was LIBOR (2.2% and 5.1% at December 31, 2008 and 2007, respectively) plus 0.50%.

The Company incurred \$7 million of costs associated with the Term Loan due 2012, which is being amortized over the term of the related debt.

During the year ended December 31, 2008 and 2007, the Company repaid \$293 million and \$215 million, respectively, of borrowings outstanding under the Term Loan due 2012.

AmeriPath Debt

In connection with the acquisition of AmeriPath, the Company repaid substantially all of AmeriPath's outstanding debt and related accrued interest, which approximated \$780 million, as well as approximately \$31 million representing the tender premium and solicitation fees related to the Company's tender offer and consent solicitation for \$350 million aggregate principal amount of 10.5% Senior Subordinated Notes of AmeriPath, Inc. due 2013 (the "AmeriPath Senior Subordinated Notes"), which commenced on May 21, 2007.

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. The Company made payments totaling \$386 million to holders of such notes with respect to the cash tender offer and consent solicitation including tender premium and related solicitation fees and accrued interest.

During 2008, the remaining \$2 million of outstanding principal under the AmeriPath Senior Subordinated Notes was repaid.

Industrial Revenue Bonds

In connection with the acquisition of LabOne in November 2005, the Company assumed \$7.2 million of Industrial Revenue Bonds. Principal is payable annually in equal installments through September 1, 2009. Interest is payable monthly at a rate which is adjusted weekly. At December 31, 2008 and 2007, the rate was 2.0% and 4.9%, respectively. At December 31, 2008 and 2007, the remaining principal outstanding was \$1.8 million and \$3.6 million, respectively. The bonds are secured by the Lenexa, Kansas laboratory facility and an irrevocable bank letter of credit.

Term Loan due December 2008

On December 19, 2003, the Company entered into a \$75 million amortizing term loan facility (the "Term Loan due December 2008"), which was funded on January 12, 2004. Interest under the Term Loan due December 2008 is based on LIBOR plus an applicable margin that can fluctuate over a range of up to 119 basis points, based on changes in the Company's public debt rating. As of December 31, 2007, the Company's

QUEST DIAGNOSTICS INCORPORATED AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED
(dollars in thousands unless otherwise indicated)

borrowing rate for LIBOR-based loans was LIBOR plus 0.55%. The entire outstanding principal balance was repaid in full in December 2008.

Senior Notes

In conjunction with its 2001 debt refinancing, the Company completed a \$550 million senior notes offering in June 2001 (the "2001 Senior Notes"). The 2001 Senior Notes were issued in two tranches: (a) \$275 million aggregate principal amount of 6¾% senior notes due 2006 ("Senior Notes due 2006"), issued at a discount of approximately \$1.6 million and (b) \$275 million aggregate principal amount of 7½% senior notes due 2011 ("Senior Notes due 2011"), issued at a discount of approximately \$1.1 million. On July 12, 2006, the Company repaid the \$275 million outstanding under the Senior Notes due 2006. After considering the discount, the effective interest rate on the Senior Notes due 2011 is 7.6%. The Senior Notes due 2011 require semiannual interest payments. The Senior Notes due 2011 are unsecured obligations of the Company and rank equally with the Company's other unsecured senior obligations. The Senior Notes due 2011 are guaranteed by the Subsidiary Guarantors and do not have a sinking fund requirement.

On October 31, 2005, the Company completed its \$900 million private placement of senior notes (the "2005 Senior Notes"). The 2005 Senior Notes were priced in two tranches: (a) \$400 million aggregate principal amount of 5.125% senior notes due November 2010 ("Senior Notes due 2010"); and (b) \$500 million aggregate principal amount of 5.45% senior notes due November 2015 ("Senior Notes due 2015"). The Company used the net proceeds from the 2005 Senior Notes, together with cash on-hand, to pay the cash purchase price and transaction costs of the LabOne acquisition and to repay \$127 million of LabOne's debt. The Senior Notes due 2010 and 2015 were issued at a discount of \$0.8 million and \$1.6 million, respectively. After considering the discounts, the effective interest rates on the Senior Notes due 2010 and 2015 are approximately 5.3% and 5.6%, respectively. The 2005 Senior Notes require semiannual interest payments, which commenced on May 1, 2006. The 2005 Senior Notes are unsecured obligations of the Company and rank equally with the Company's other unsecured senior obligations. The 2005 Senior Notes are guaranteed by the Subsidiary Guarantors. Under a registration rights agreement executed in connection with the offering and sale of the 2005 Senior Notes and related guarantees, the Company filed a registration statement which was declared effective on February 16, 2006, to enable the holders of the 2005 Senior Notes to exchange the notes and guarantees for publicly registered notes and guarantees and all the holders exchanged the notes and guarantees for publicly registered notes and guarantees.

On June 22, 2007, the Company completed an \$800 million senior notes offering (the "2007 Senior Notes"). The 2007 Senior Notes were priced in two tranches: (a) \$375 million aggregate principal amount of 6.40% senior notes due July 2017 (the "Senior Notes due 2017"), issued at a discount of approximately \$0.8 million and (b) \$425 million aggregate principal amount of 6.95% senior notes due July 2037 (the "Senior Notes due 2037"), issued at a discount of approximately \$4.7 million. After considering the discounts, the effective interest rates on the Senior Notes due 2017 and the Senior Notes due 2037 are approximately 6.4% and 7.0%, respectively. The 2007 Senior Notes require semiannual interest payments, which commenced on January 1, 2008. The 2007 Senior Notes are unsecured obligations of the Company and rank equally with the Company's other unsecured obligations. The 2007 Senior Notes do not have a sinking fund requirement and are guaranteed by the Subsidiary Guarantors.

The Company incurred \$6.3 million of costs associated with the 2007 Senior Notes, which is being amortized over the term of the related debt.

The Company used the net proceeds from the 2007 Senior Notes to repay the \$780 million of borrowings under the Bridge Loan, discussed above.

Debentures due June 2034

In connection with the acquisition of LabOne in November 2005, the Company assumed \$103.5 million of 3.50% convertible senior debentures of LabOne due June 15, 2034 (the "Debentures due June 2034"). As a result of the change in control of LabOne, the holders of the debentures had the right from November 1, 2005 to December 1, 2005 to: (i) have their debentures repurchased by LabOne for 100% of the principal amount of the debentures, plus accrued and unpaid interest thereon through November 30, 2005; or (ii) have their debentures

QUEST DIAGNOSTICS INCORPORATED AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED
(dollars in thousands unless otherwise indicated)

converted into the amount the respective holder would have received if the holder had converted the debentures prior to November 1, 2005, plus an additional premium. As a result of the change in control of LabOne, and as provided in the indenture to the debentures, the conversion rate increased so that each \$1,000 principal amount of the debentures was convertible into cash in the amount of \$1,280.88 if converted by December 1, 2005. As a result of the change in control of LabOne, of the total outstanding principal balance of the Debentures due June 2034 of \$103.5 million, \$99 million of principal was converted for \$126.8 million in cash, reflecting a premium of \$27.8 million. The remaining outstanding principal of the Debentures due June 2034 totaling \$4.5 million was adjusted to its estimated fair value of \$2.9 million on the date of the acquisition, reflecting a discount of \$1.6 million based on the net present value of the estimated remaining obligations, at then current interest rates. The Debentures due June 2034 require semi-annual interest payments in June and December.

As of December 31, 2008, long-term debt maturing in each of the years subsequent to December 31, 2009 is as follows:

<u>Year ending December 31,</u>	
2010.....	\$ 401,287
2011.....	808,335
2012.....	561,397
2013.....	670
2014.....	276
Thereafter.....	<u>1,306,124</u>
Total long-term debt	<u>\$3,078,089</u>

10. FINANCIAL INSTRUMENTS

Treasury Lock Agreements

In October 2005, the Company entered into interest rate lock agreements with two financial institutions for a total notional amount of \$300 million to lock the U.S. treasury rate component of a portion of the Company's offering of its debt securities in the fourth quarter of 2005 (the "Treasury Lock Agreements"). The Treasury Lock Agreements, which had an original maturity date of November 9, 2005, were entered into to hedge part of the Company's interest rate exposure associated with the minimum amount of debt securities that were issued in the fourth quarter of 2005. In connection with the Company's private placement of its Senior Notes due 2015 on October 25, 2005, the Treasury Lock Agreements were settled and the Company received \$2.5 million, representing the gain on the settlement of the Treasury Lock Agreements. These gains are deferred in stockholders' equity, as a component of "accumulated other comprehensive (loss) income", and amortized as an adjustment to interest expense over the term of the Senior Notes due 2015.

Treasury Forward Agreements

In June 2007, the Company entered into forward starting interest rate swap agreements with three financial institutions for a total notional amount of \$300 million to lock the interest rate of a portion of the Company's offering of its debt securities in the second quarter of 2007 (the "Treasury Forward Agreements"). The Treasury Forward Agreements were entered into to hedge a portion of the Company's interest rate exposure associated with the debt securities that were issued in the second quarter of 2007. In connection with the Company's 2007 Senior Notes issued in June 2007, the Treasury Forward Agreements were settled and the Company paid \$3.5 million, representing the loss on the settlement of the Treasury Forward Agreements. These losses are deferred in stockholders' equity, as a component of "accumulated other comprehensive (loss) income", and are amortized as an adjustment to interest expense over the term of the Senior Notes due 2017.

Interest Rate Swap Agreements

In August 2007, the Company entered into various variable-to-fixed interest rate swap agreements ("the Interest Rate Swap Agreements"), whereby the Company fixed the interest rates on \$500 million of its Term Loan due May 2012 for periods ranging from October 2007 through October 2009. As of December 31, 2008,

QUEST DIAGNOSTICS INCORPORATED AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED
(dollars in thousands unless otherwise indicated)

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%.

The Interest Rate Swap Agreements qualify as cash flow hedges under the requirements of SFAS 133. As such, gains and losses on the Interest Rate Swap Agreements are deferred into “accumulated other comprehensive (loss) income” until the hedged transaction impacts the Company’s earnings. During the year ended December 31, 2008 and 2007, the Company deferred losses of \$0.9 million and \$2.7 million, respectively, into “accumulated other comprehensive (loss) income.” The cash flow hedges were effective during 2008 and 2007.

11. PREFERRED STOCK AND COMMON STOCKHOLDERS’ EQUITY

Series Preferred Stock

Quest Diagnostics is authorized to issue up to 10 million shares of Series Preferred Stock, par value \$1.00 per share. The Company’s Board of Directors has the authority to issue such shares without stockholder approval and to determine the designations, preferences, rights and restrictions of such shares. Of the authorized shares, 1,300,000 shares have been designated Series A Preferred Stock and 1,000 shares have been designated Voting Cumulative Preferred Stock. No shares are currently outstanding.

Common Stock

On May 4, 2006, the Company’s Restated Certificate of Incorporation was amended to increase the number of shares of common stock, par value \$0.01 per share, from 300 million shares to 600 million shares.

Accumulated Other Comprehensive (Loss) Income

The components of accumulated other comprehensive (loss) income for 2008, 2007 and 2006 were as follows:

	<u>Foreign Currency Translation Adjustment</u>	<u>Market Value Adjustment</u>	<u>Deferred Gain (Loss)</u>	<u>Accumulated Other Comprehensive (Loss) Income</u>
Balance, December 31, 2005.....	\$ (1,948)	\$(6,711)	\$ 2,454	\$ (6,205)
Translation adjustment.....	2,460	-	-	2,460
Market value adjustment, net of tax benefit of \$2,501.....	-	(3,815)	-	(3,815)
Reversal of market value adjustment, net of tax expense of \$(5,053).....	-	7,707	-	7,707
Deferred gain reclassifications.....	-	-	(212)	(212)
Balance, December 31, 2006.....	512	(2,819)	2,242	(65)
Translation adjustment.....	30,820	-	-	30,820
Market value adjustment, net of tax benefit of \$24.....	-	(36)	-	(36)
Reversal of market value adjustment, net of tax expense of \$(510).....	-	802	-	802
Deferred loss, less reclassifications.....	-	-	(6,242)	(6,242)
Balance, December 31, 2007.....	31,332	(2,053)	(4,000)	25,279
Translation adjustment.....	(94,326)	-	-	(94,326)
Market value adjustment, net of tax benefit of \$261.....	-	(398)	-	(398)
Reversal of market value adjustment, net of tax expense of \$(1,257).....	-	2,161	-	2,161
Deferred loss, less reclassifications.....	-	-	(784)	(784)
Balance, December 31, 2008.....	<u>\$(62,994)</u>	<u>\$ (290)</u>	<u>\$(4,784)</u>	<u>\$(68,068)</u>

The market value adjustments for 2008, 2007 and 2006 represented unrealized holding gains (losses), net of taxes. The reversal of market value adjustments for 2008, 2007 and 2006 represented prior periods unrealized

QUEST DIAGNOSTICS INCORPORATED AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED
(dollars in thousands unless otherwise indicated)

holding losses for investments where the decline in fair value was deemed to be other than temporary in 2008, 2007 and 2006, and the resulting loss was recognized in the consolidated statements of operations (see Note 2). The deferred loss for 2008 primarily represented deferred losses on the Company's interest rate swap agreements, net of amounts reclassified to interest expense. The deferred loss for 2007 represented the \$3.5 million the Company paid upon the settlement of its Treasury Forward Agreements, net of amounts reclassified as an increase to interest expense, and \$2.7 million in deferred losses on its Interest Rate Swap Agreements (see Note 10). Foreign currency translation adjustments are not adjusted for income taxes since they relate to indefinite investments in non-U.S. subsidiaries.

Dividend Program

During each of the quarters of 2008, 2007 and 2006, the Company's Board of Directors has declared a quarterly cash dividend of \$0.10 per common share.

Share Repurchase Plan

During the fourth quarter of 2008, the Board of Directors expanded the Company's common stock share repurchase authorization by an additional \$150 million.

For the year ended December 31, 2008, the Company repurchased 5.5 million shares of its common stock at an average price of \$46.09 per share for \$254 million, and reissued 1.5 million shares in connection with employee benefit plans. For the year ended December 31, 2007, the Company repurchased 2.8 million shares of its common stock at an average price of \$52.14 per share for \$146 million, and reissued 2.9 million shares in connection with employee benefit plans. For the year ended December 31, 2006, the Company repurchased 8.9 million shares of its common stock at an average price of \$53.23 per share for \$472 million, and reissued 4.2 million shares in connection with employee benefit plans.

At December 31, 2008, the share repurchase authorization was essentially fully utilized. In January 2009, the Company's Board of Directors authorized the Company to repurchase an additional \$500 million of the Company's common stock. The share repurchase authorization has no set expiration or termination date.

12. STOCK OWNERSHIP AND COMPENSATION PLANS

Employee and Non-employee Directors Stock Ownership Programs

In 2005, the Company established the ELTIP to replace the Company's prior Employee Equity Participation Programs established in 1999 (the "1999 EEPP") and 1996, as amended (the "1996 EEPP"). The ELTIP provides for three types of awards: (a) stock options, (b) stock appreciation rights and (c) stock awards. The ELTIP provides for the grant to eligible employees of either non-qualified or incentive stock options, or both, to purchase shares of Company common stock at a price of no less than the fair market value on the date of grant. The stock options are subject to forfeiture if employment terminates prior to the end of the vesting period prescribed by the Board of Directors. Grants of stock appreciation rights allow eligible employees to receive a payment based on the appreciation of Company common stock in cash, shares of Company common stock or a combination thereof. The stock appreciation rights are granted at an exercise price at no less than the fair market value of the Company's common stock on the date of grant. Stock options and stock appreciation rights granted under the ELTIP expire on the date designated by the Board of Directors but in no event more than seven years from date of grant. No stock appreciation rights have been granted under the ELTIP or the 1999 EEPP. The ELTIP allows eligible employees to receive awards of shares, or the right to receive shares, of Company common stock, the equivalent value in cash or a combination thereof. These shares are generally earned on achievement of financial performance goals and are subject to forfeiture if employment terminates prior to the end of the vesting period prescribed by the Board of Directors. For performance share unit awards granted prior to 2008, the actual amount of performance share awards earned is based on the Company's earnings per share growth 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 is based on the cumulative annual growth rate of the Company's earnings per share from continuing operations over a three year period. Key executive, managerial and technical employees are eligible to participate in the ELTIP. The provisions of the

QUEST DIAGNOSTICS INCORPORATED AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED
(dollars in thousands unless otherwise indicated)

1999 EEP and the 1996 EEP were similar to those outlined above for the ELTIP. Certain options granted under the 1999 EEP remain outstanding.

The ELTIP increased the maximum number of shares of Company common stock that may be optioned or granted to 48 million shares. In addition, any remaining shares under the 1996 EEP are available for issuance under the ELTIP.

In 2005, the Company established the Amended and Restated Director Long-Term Incentive Plan (the "DLTIP"), to replace the Company's prior plan established in 1998. The DLTIP provides for the grant to non-employee directors of non-qualified stock options to purchase shares of Company common stock at a price of no less than the fair market value on the date of grant. The DLTIP also permits awards of restricted stock and restricted stock units to non-employee directors. The maximum number of shares that may be issued under the DLTIP is 2 million shares. The stock options expire seven years from date of grant and generally become exercisable in three equal annual installments beginning on the first anniversary date of the grant of the option regardless of whether the optionee remains a director of the Company. During 2008, 2007 and 2006, grants under the DLTIP totaled 77, 81 and 95 thousand shares, respectively.

In general, the Company's practice has been to issue shares related to its stock-based compensation program from shares of its common stock held in treasury. See Note 11 for further information regarding the Company's share repurchase program.

The fair value of each stock option award granted was estimated on the date of grant using a lattice-based option valuation model. The expected volatility under the lattice-based option-valuation model was based on the current and the historical implied volatilities from traded options of the Company's common stock. The dividend yield was 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 of each stock option granted was 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 options granted was estimated using the historical exercise behavior of employees. The weighted average assumptions used in valuing options granted in the periods presented are:

	<u>2008</u>	<u>2007</u>	<u>2006</u>
Weighted average fair value of options at grant date	\$11.58	\$18.05	\$13.91
Expected volatility	22.5%	21.5%	18.2%
Dividend yield	0.8%	0.7%	0.7%
Risk-free interest rate	2.6% - 2.8%	4.7% - 4.8%	4.6%
Expected holding period, in years	5.2 - 5.9	5.3 - 6.2	5.6 - 6.2

The fair value of restricted stock awards and performance share units is the average market price of the Company's common stock at the date of grant.

Transactions under the stock option plans for 2008 were as follows:

	<u>Shares (in thousands)</u>	<u>Weighted Average Exercise Price</u>	<u>Weighted Average Remaining Contractual Term (in years)</u>	<u>Aggregate Intrinsic Value (in millions)</u>
Options outstanding, beginning of year	13,938	\$41.91		
Options granted	1,453	47.66		
Options exercised	(987)	30.92		
Options forfeited and cancelled	<u>(411)</u>	<u>47.96</u>		
Options outstanding, end of year	<u>13,993</u>	<u>\$43.12</u>	4.4	\$126
Exercisable, end of year	10,030	\$41.11	4.0	\$110
Vested and expected to vest, end of year	13,161	\$42.64	4.4	\$125

The aggregate intrinsic value in the table above represents the total pre-tax intrinsic value (the difference between the Company's closing common stock price on the last trading day of 2008 and the exercise price, multiplied by the number of in-the-money options) that would have been received by the option holders had all option holders exercised their options on December 31, 2008. This amount changes based on the fair market

QUEST DIAGNOSTICS INCORPORATED AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED
(dollars in thousands unless otherwise indicated)

value of the Company's common stock. Total intrinsic value of options exercised in 2008, 2007 and 2006 was \$20 million, \$52 million and \$106 million, respectively.

As of December 31, 2008, there was \$14 million of unrecognized stock-based compensation cost related to stock options which is expected to be recognized over a weighted average period of 1.7 years.

The following summarizes the activity relative to stock awards, including restricted stock awards, restricted stock units and performance share units, for 2008, 2007 and 2006:

	2008		2007		2006	
	Shares (in thousands)	Weighted Average Grant Date Fair Value	Shares (in thousands)	Weighted Average Grant Date Fair Value	Shares (in thousands)	Weighted Average Grant Date Fair Value
Shares outstanding, beginning of year ..	677	\$52.24	450	\$52.41	107	\$49.71
Shares granted	843	47.60	538	52.05	1,020	52.32
Shares vested	(175)	51.67	(74)	52.30	(39)	50.26
Shares forfeited and canceled	(62)	50.16	(100)	52.38	(56)	51.92
Adjustment to estimate of performance share units to be earned..	<u>222</u>	<u>52.39</u>	<u>(137)</u>	<u>51.94</u>	<u>(582)</u>	<u>51.94</u>
Shares outstanding, end of year	<u>1,505</u>	<u>\$49.77</u>	<u>677</u>	<u>\$52.24</u>	<u>450</u>	<u>\$52.41</u>

In 2008, 2007 and 2006, the Company revised its estimate of the number of performance share units expected to be earned at the end of the performance periods as a result of revising its estimates of projected performance and increased (reduced) the number of performance share units by 0.2 million, (0.1) million and (0.6) million, respectively.

As of December 31, 2008, there was \$23 million of unrecognized stock-based compensation cost related to nonvested stock awards, which is expected to be recognized over a weighted average period of 1.8 years. Total fair value of shares vested was \$8.4 million, \$3.8 million and \$2.1 million for the year ended December 31, 2008, 2007 and 2006, respectively. The amount of unrecognized stock-based compensation cost is subject to change based on revisions, if any, to 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 at the end of the performance periods.

For the years ended December 31, 2008, 2007 and 2006, stock-based compensation expense totaled \$71 million, \$57 million and \$55 million, respectively. Income tax benefits related to stock-based compensation expense totaled \$28 million, \$23 million and \$22 million for the year ended December 31, 2008, 2007 and 2006, respectively.

Employee Stock Purchase Plan

Under the Company's Employee Stock Purchase Plan ("ESPP"), which was approved by the Company's shareholders at the 2006 Annual Meeting of Shareholders, substantially all employees can elect to have up to 10% of their annual wages withheld to purchase Quest Diagnostics common stock. The purchase price of the stock is 85% of the market price of the Company's common stock on the last business day of each calendar month. Under the ESPP, the maximum number of shares of Quest Diagnostics common stock which may be purchased by eligible employees is 5 million. Approximately 436, 448 and 474 thousand shares of common stock were purchased by eligible employees in 2008, 2007 and 2006, respectively.

Defined Contribution Plans

The Company maintains qualified defined contribution plans covering substantially all of its employees, and matches employee contributions up to a maximum of 6%. The Company's expense for contributions to its

QUEST DIAGNOSTICS INCORPORATED AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED
(dollars in thousands unless otherwise indicated)

defined contribution plans aggregated \$78 million, \$76 million and \$69 million for 2008, 2007 and 2006, respectively.

Supplemental Deferred Compensation Plan

The Company's supplemental deferred compensation plan is an unfunded, non-qualified plan that provides for certain management and highly compensated employees to defer up to 50% of their salary in excess of their defined contribution plan limits and for certain eligible employees, up to 95% of their variable incentive compensation. The Company matches employee contributions up to a maximum of 6%. The compensation deferred under this plan, together with Company matching amounts, are credited with earnings or losses measured by the mirrored rate of return on investments elected by plan participants. Each plan participant is fully vested in all deferred compensation, Company match and earnings credited to their account. The amounts accrued under this plan were \$25 million and \$34 million at December 31, 2008 and 2007, respectively. Although the Company is currently contributing all participant deferrals and matching amounts to a trust, the funds in the trust, totaling \$25 million and \$34 million at December 31, 2008 and 2007, respectively, are general assets of the Company and are subject to any claims of the Company's creditors. The Company's expense for matching contributions to this plan were approximately \$1 million for 2008, 2007 and 2006.

13. RELATED PARTY TRANSACTIONS

At December 31, 2008, GlaxoSmithKline plc ("GSK"), the parent company of SmithKline Beecham, beneficially owned approximately 19% of the outstanding shares of Quest Diagnostics common stock.

Quest Diagnostics is the primary provider of testing to support GSK's clinical trials testing requirements worldwide (as amended, the "Clinical Trials Agreements"). Net revenues, primarily derived under the Clinical Trials Agreements were \$71 million, \$79 million and \$87 million for 2008, 2007 and 2006, respectively. At December 31, 2008 and 2007, accounts receivable due from GSK were \$9.1 million and \$10.6 million, respectively.

In addition, in connection with the acquisition of SBCL, SmithKline Beecham has agreed to indemnify Quest Diagnostics, on an after tax basis, against certain matters primarily related to taxes and billing and professional liability claims.

At December 31, 2008, liabilities included \$13 million due to SmithKline Beecham, primarily related to tax benefits associated with certain pre-acquisition tax loss carryforwards. At December 31, 2007, liabilities included \$27 million due to SmithKline Beecham, primarily related to tax benefits associated with indemnifiable matters.

14. COMMITMENTS AND CONTINGENCIES

Letter of Credit Lines and Contractual Obligations

The Company has a line of credit with a financial institution totaling \$85 million for the issuance of letters of credit (the "letter of credit line"). The letter of credit line, which is renewed annually, matures on November 19, 2009 and is guaranteed by the Subsidiary Guarantors.

In support of its risk management program, to ensure the Company's performance or payment to third parties, \$89 million in letters of credit were outstanding at December 31, 2008. The letters of credit primarily represent collateral for current and future automobile liability and workers' compensation loss payments. In addition, \$5.3 million of bank guarantees were outstanding at December 31, 2008 in support of certain foreign operations.

QUEST DIAGNOSTICS INCORPORATED AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED
(dollars in thousands unless otherwise indicated)

Minimum rental commitments under noncancelable operating leases, primarily real estate, in effect at December 31, 2008 are as follows:

<u>Year ending December 31,</u>	
2009.....	\$174,025
2010.....	142,509
2011.....	103,174
2012.....	66,562
2013.....	42,183
2014 and thereafter.....	<u>106,126</u>
Minimum lease payments.....	634,579
Noncancelable sub-lease income	<u>(7,086)</u>
Net minimum lease payments.....	<u>\$627,493</u>

Operating lease rental expense for 2008, 2007 and 2006 aggregated \$190 million, \$171 million and \$153 million, respectively. Rent expense associated with operating leases that include scheduled rent increases and tenant incentives, such as rent holidays, is recorded on a straight-line basis over the term of the lease.

The Company has certain noncancelable commitments to purchase products or services from various suppliers, mainly for telecommunications and standing orders to purchase reagents and other laboratory supplies. At December 31, 2008, the approximate total future purchase commitments are \$82 million, of which \$43 million are expected to be incurred in 2009, \$33 million are expected to be incurred in 2010 through 2011 and the balance thereafter.

Contingent Lease Obligations

The Company remains subject to contingent obligations under certain real estate leases that were entered into by certain predecessor companies of a subsidiary prior to the Company's acquisition of the subsidiary. While the title to the properties and interest to the subject leases have been transferred to third parties on several occasions over the course of many years, the lessors have not released the subsidiary predecessor companies from their original obligations under the leases and therefore remain contingently liable in the event of default. The remaining terms of the lease obligations and the Company's corresponding indemnifications range from 15 to 39 years. The lease payments under certain leases are subject to market value adjustments and therefore, the total contingent obligations under the leases cannot be precisely determined but are likely to total several hundred million dollars. A claim against the Company would be made only upon the current lessee's default and after a series of claims and corresponding defaults by third parties that precede the Company in the order of indemnification. The Company also has certain indemnification rights from other parties to recover losses in the event of default on the lease obligations. The Company believes that the likelihood of its performance under these contingent obligations is remote and no liability has been recorded for any potential payments under the contingent lease obligations.

Legal Matters

The Company is involved in various legal proceedings. Some of the proceedings against the Company involve claims that are substantial in amount.

NID Investigation

NID and the Company each received a subpoena from the United States Attorney's Office for the Eastern District of New York during the fourth quarter of 2004. The subpoenas requested a wide range of business records, including documents regarding parathyroid hormone ("PTH") test kits manufactured by NID and PTH testing performed by the Company. The Company has voluntarily and actively cooperated with the investigation, providing information, witnesses and business records of NID and the Company, including documents related to PTH tests and test kits, as well as other tests and test kits. In the second and third quarters of 2005, the FDA conducted an inspection of NID and issued a Form 483 listing the observations made by the FDA during the course of the inspection. NID responded to the Form 483.

QUEST DIAGNOSTICS INCORPORATED AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED
(dollars in thousands unless otherwise indicated)

During the fourth quarter of 2005, NID instituted its second voluntary product hold within a six-month period, due to quality issues, which adversely impacted the operating performance of NID. As a result, the Company evaluated a number of strategic options for NID, and on April 19, 2006, decided to cease operations at NID. Upon completion of the wind down of operations in the third quarter of 2006, the operations of NID were classified as discontinued operations. During the third quarter of 2006, the government issued two additional subpoenas, one to NID and one to the Company. The subpoenas covered various records, including records related to tests and test kits in addition to PTH.

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, during 2007 the Company established a reserve, in accordance with generally accepted accounting principles, reflected in discontinued operations, of \$241 million in connection with these claims. During 2007, the Company recorded a deferred tax benefit associated with that portion of the reserve that it expected would be tax deductible.

During 2008, the Company continued discussions with the United States Attorney's Office to resolve the investigation. During the third quarter of 2008, the Company and the United States Attorney's Office reached an agreement in principle to resolve these 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.

Other Matters

The Company has in the past entered into several settlement agreements with various government and private payers relating to industry-wide billing and marketing practices that had been substantially discontinued. The federal or state governments may bring additional claims based on new theories as to the Company's practices which management believes to be in compliance with law. In addition, certain federal and state statutes, including the qui tam provisions of the federal False Claims Act, allow private individuals to bring lawsuits against healthcare companies on behalf of government or private payers alleging inappropriate billing practices. The Company is aware of certain pending lawsuits, including a class action lawsuit, and has received several subpoenas related to billing practices.

During the second quarter of 2005, the Company received a subpoena from the United States Attorney's Office for the District of New Jersey. The subpoena seeks the production of business and financial records regarding capitation and risk sharing arrangements with government and private payers for the years 1993 through 1999. Also, during the third quarter of 2005, the Company received a subpoena from the United States Department of Health and Human Services, Office of the Inspector General. The subpoena seeks the production of various business records including records regarding our relationship with health maintenance organizations, independent physician associations, group purchasing organizations, and preferred provider organizations relating

QUEST DIAGNOSTICS INCORPORATED AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED
(dollars in thousands unless otherwise indicated)

back to as early as 1995. The Company is cooperating with the United States Attorney's Office and the Office of the Inspector General.

During the second quarter of 2006, each of the Company and its subsidiary, Specialty Laboratories, Inc. ("Specialty"), received a subpoena from the California Attorney General's Office. The subpoenas seek various documents including documents relating to billings to MediCal, the California Medicaid program. The subpoenas seek documents from various time frames ranging from three to ten years. During the third quarter of 2008, the Company received a request for additional information. The Company and Specialty are cooperating with the California Attorney General's Office.

In the first quarter of 2008, the United States Department of Justice informally requested records from the Company regarding AmeriPath's billing practices for flow cytometry testing panels performed on blood, bone marrow and lymph node specimens. The inquiry sought to determine whether AmeriPath may have billed for laboratory tests that were not medically necessary. The Company cooperated fully with the inquiry. In December 2008, the government declined to intervene in the underlying qui tam complaint that led to the inquiry. Following the government's declination, the qui tam relator voluntarily dismissed his complaint.

The Company understands that there may be pending qui tam claims brought by former employees or other "whistle blowers" as to which the Company cannot determine the extent of any potential liability. The Company also is aware of certain pending individual or class action lawsuits related to billing practices filed under the qui tam provisions of the Civil False Claims Act and/or other federal and state statutes, regulations or other laws.

Several of these other matters are in their early stages of development and involve responding to and cooperating with various government investigations and related subpoenas. While the Company believes that at least a reasonable possibility exists that losses may have been incurred, based on the nature and status of the investigations, the losses are either currently not probable or cannot be reasonably estimated.

Management has established reserves in accordance with generally accepted accounting principles for the other matters discussed above. Such reserves totaled less than \$5 million as of December 31, 2008. Although management cannot predict the outcome of such matters, management does not anticipate that the ultimate outcome of such matters will have a material adverse effect on the Company's financial condition but may be material to the Company's results of operations or cash flows in the period in which the impact of such matters is determined or paid. However, there may be pending qui tam claims brought by former employees or other "whistle blowers," or other pending claims as to which the Company has not been provided with a copy of the complaint and accordingly cannot determine the extent of any potential liability.

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 the Company's client base and reputation. The Company maintains various liability insurance coverage for claims that could result from providing or failing to provide clinical testing services, including inaccurate testing results and other exposures. The Company's insurance coverage limits its maximum exposure on individual claims; however, the Company is essentially self-insured for a significant portion of these claims. Reserves for such matters are established by considering actuarially determined losses based upon the Company's historical and projected loss experience. Management believes that present insurance coverage and reserves are sufficient to cover currently estimated exposures. Although management cannot predict the outcome of any claims made against the Company, management does not anticipate that the ultimate outcome of any such proceedings or claims will have a material adverse effect on the Company's financial condition but may be material to the Company's results of operations or cash flows in the period in which the impact of such claims is determined or paid.

15. DISCONTINUED OPERATIONS

During the fourth quarter of 2005, NID instituted its second voluntary product hold within a six-month period due to quality issues, which adversely impacted the operating performance of NID. As a result, the Company evaluated a number of strategic options for NID. On April 19, 2006, the Company decided to discontinue NID's operations. During the third quarter of 2006, the Company completed its wind down of NID and classified the operations of NID as discontinued operations. Results of operations for NID have been reported

QUEST DIAGNOSTICS INCORPORATED AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED
(dollars in thousands unless otherwise indicated)

as discontinued operations in the accompanying consolidated statements of operations and related disclosures for all periods presented.

During the third quarter of 2007, the government and the Company began settlement discussions with respect to the government's on going investigation involving NID and the Company, as discussed above (see Note 14). 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. 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 during 2007 in connection with these claims.

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

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. See Note 14 for further details.

Summarized financial information for the discontinued operations of NID is set forth below:

	<u>2008</u>	<u>2007</u>	<u>2006</u>
Net revenues	\$ -	\$ -	\$ 3,610
Loss from discontinued operations before income taxes	(79,582)	(250,278)	(59,169)
Income tax benefit.....	28,888	36,389	19,898
Loss from discontinued operations, net of taxes	<u>\$(50,694)</u>	<u>\$(213,889)</u>	<u>\$(39,271)</u>

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 (see Note 14 for further details).

Results for 2006 reflect losses from NID's operations, due to its voluntary product hold instituted late in the second quarter of 2005 in connection with a quality review of all its products. In addition, results for 2006 also reflect pre-tax charges of \$32 million, primarily related to the wind down of NID's operations. These charges included: inventory write-offs of \$7 million; asset impairment charges of \$6 million; employee severance costs of \$6 million; contract termination costs of \$6 million; facility closure costs of \$2 million; and costs to support activities to wind-down the business comprised primarily of employee costs and professional fees of \$5 million.

The settlement reserve is included in "accounts payable and accrued expenses" in the consolidated balance sheet at December 31, 2008 and 2007. The deferred tax asset recorded in connection with establishing the reserve is included in "deferred income taxes" in the consolidated balance sheet at December 31, 2008 and 2007. The remaining balance sheet information related to NID was not material at December 31, 2008 and 2007.

16. BUSINESS SEGMENT INFORMATION

Clinical testing is an essential element in the delivery of healthcare services. Physicians use clinical tests to assist in the detection, diagnosis, evaluation, monitoring and treatment of diseases and other medical conditions. 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. Customers of the clinical testing business include patients, physicians, hospitals, employers, governmental institutions and other commercial clinical

QUEST DIAGNOSTICS INCORPORATED AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED
(dollars in thousands unless otherwise indicated)

laboratories. The clinical testing business accounted for greater than 90% of net revenues from continuing operations in 2008, 2007 and 2006.

All other operating segments include the Company's non-clinical testing businesses and consist of its risk assessment services business, its clinical trials testing business, its healthcare information technology business, MedPlus and its diagnostics products businesses. The Company's risk assessment business provides underwriting support services to the life insurance industry including teleunderwriting, paramedical examinations, laboratory testing and medical record retrieval. The Company's clinical trials testing business provides clinical testing performed in connection with clinical research trials on new drugs and vaccines. MedPlus is a developer and integrator of clinical connectivity and data management solutions for healthcare organizations, physicians and clinicians. The Company's diagnostics products business manufactures and markets diagnostic test kits.

On April 19, 2006, the Company decided to discontinue NID's operations and results of operations for NID have been classified as discontinued operations for all years presented (see Note 15).

During the third quarter of 2006, the Company acquired Focus Diagnostics and Enterix, in the first quarter of 2007, it acquired Hemocue, and in the second quarter of 2007, it acquired AmeriPath (see Note 3). Enterix and Hemocue are included in the Company's other operating segments. The majority of Focus Diagnostics' operations are included in the Company's clinical testing business, with the remainder in other operating segments. AmeriPath's operations are included in the Company's clinical testing business.

At December 31, 2008, substantially all of the Company's services are provided within the United States, and substantially all of the Company's assets are located within the United States.

The following table is a summary of segment information for the three years ended December 31, 2008, 2007 and 2006. Segment asset information is not presented since it is not reported to or used by the chief operating decision maker at the operating segment level. Operating earnings (loss) of each segment represents net revenues less directly identifiable expenses to arrive at operating income for the segment. General management and administrative corporate expenses, including amortization of intangible assets, are included in general corporate expenses below. The accounting policies of the segments are the same as those of the Company as set forth in Note 2.

	<u>2008</u>	<u>2007</u>	<u>2006</u>
Net revenues:			
Clinical testing business	\$6,617,006 (a)	\$6,108,746 (b)	\$5,782,926
All other operating segments.....	<u>632,441</u>	<u>596,161</u>	<u>485,733</u>
Total net revenues.....	<u>\$7,249,447</u>	<u>\$6,704,907</u>	<u>\$6,268,659</u>
Operating earnings (loss):			
Clinical testing business	\$1,318,904 (a)	\$1,191,139 (b)(c)	\$1,230,383 (d)
All other operating segments.....	56,677 (e)	45,285 (f)	16,484
General corporate expenses	<u>(153,205)</u>	<u>(145,088)</u>	<u>(118,790)</u>
Total operating income	1,222,376	1,091,336	1,128,077
Non-operating expenses, net	<u>(203,424)(g)</u>	<u>(178,934)(h)</u>	<u>(94,804)(i)</u>
Income from continuing operations before income taxes	1,018,952	912,402	1,033,273
Income tax expense	<u>386,768 (j)</u>	<u>358,574</u>	<u>407,581</u>
Income from continuing operations.....	632,184	553,828	625,692
Loss from discontinued operations, net of taxes	<u>(50,694)(k)</u>	<u>(213,889)(k)</u>	<u>(39,271)(k)</u>
Net income.....	<u>\$ 581,490</u>	<u>\$ 339,939</u>	<u>\$ 586,421</u>

(a) For 2008, management estimates the impact of hurricanes in the third quarter of 2008 reduced consolidated revenue growth and the increase in operating income for the year ended December 31, 2008 by approximately \$10 million and \$8 million, respectively, compared to the prior year. In addition, operating income for 2008 includes \$14.0 million of charges, primarily associated with workforce reductions.

QUEST DIAGNOSTICS INCORPORATED AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED
(dollars in thousands unless otherwise indicated)

- (b) In the fourth quarter of 2006, the Company announced that it would not be a national contracted provider of laboratory services to United Healthcare Group Inc. (“UNH”) beginning January 1, 2007. UNH accounted for approximately 7% of the Company’s net revenues in 2006, with some of its regional laboratories having concentrations as high as 15% to 20%. The Company estimates that no longer being a contracted provider to UNH reduced its clinical testing volume in 2007 by 7%, most of that resulting from the direct loss of previously contracted work, and some of it associated with the loss of other work from physicians who choose to consolidate their testing with a single laboratory. The impact of the change in status with UNH was the principal driver of lower earnings in 2007 compared to the prior year, due to the significant impact it had during the first half of the year. However, the Company 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 work the Company continues to perform for UNH members.
- (c) Operating income for 2007 includes \$9.9 million of charges associated with workforce reductions in response to reduced volume levels.
- (d) Operating income for 2006 includes \$27 million of special charges, primarily associated with integration activities.
- (e) Operating income for 2008 includes \$2.2 million of charges, primarily associated with workforce reductions.
- (f) Operating income for 2007 includes \$0.8 million of charges associated with workforce reductions in response to reduced volume levels, and a \$4 million charge related to the expensing of in-process research and development associated with the acquisition of HemoCue (see Note 3).
- (g) For the year ended December 31, 2008, non-operating expenses, net includes a charge of \$8.9 million associated with the write-down of an available-for-sale equity investment.
- (h) For the year ended December 31, 2007, non-operating expenses, net includes a charge of \$4.0 million associated with the write-down of an equity investment.
- (i) For the year ended December 31, 2006, non-operating expenses, net includes \$16.2 million of charges associated with the write-down of available-for-sale equity securities, \$10.0 million of charges associated with the write-down of other investments and a \$15.8 million gain associated with the sale of an investment.
- (j) Income tax expense for 2008 includes a benefit of \$16.5 million primarily associated with favorable resolutions of certain tax contingencies.
- (k) Results for the year ended December 31, 2008 and 2007 reflect pre-tax charges of \$75 million and \$241 million, respectively, related to the government investigation of NID (see Note 14). Results for 2006 reflect losses from NID’s operations, due to its voluntary product hold instituted late in the second quarter of 2005 in connection with a quality review of all its products. In addition, results for 2006 also reflect pre-tax charges of \$32 million, primarily related to the wind down of NID’s operations.

	<u>2008</u>	<u>2007</u>	<u>2006</u>
Depreciation and amortization:			
Clinical testing business.....	\$208,115	\$189,939	\$167,586
All other operating segments	18,414	19,301	16,461
General corporate.....	38,064	28,639	11,640
Discontinued operations	-	-	1,711
Total depreciation and amortization.....	<u>\$264,593</u>	<u>\$237,879</u>	<u>\$197,398</u>
Capital expenditures:			
Clinical testing business.....	\$178,505	\$193,785	\$168,636
All other operating segments	22,891	17,760	17,291
General corporate.....	11,285	7,556	6,722
Discontinued operations	-	-	773
Total capital expenditures	<u>\$212,681</u>	<u>\$219,101</u>	<u>\$193,422</u>

QUEST DIAGNOSTICS INCORPORATED AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED
(dollars in thousands unless otherwise indicated)

17. SUMMARIZED FINANCIAL INFORMATION

The Company's Senior Notes due 2010, Senior Notes due 2011, Senior Notes due 2015, Senior Notes due 2017 and Senior Notes due 2037 are fully and unconditionally guaranteed by the Subsidiary Guarantors. With the exception of Quest Diagnostics Receivables Incorporated (see paragraph below), the non-guarantor subsidiaries are primarily foreign and less than wholly-owned subsidiaries. In July 2006, the Company repaid at maturity the \$275 million outstanding under its Senior Notes due 2006.

In conjunction with the Company's Secured Receivables Credit Facility, the Company maintains a wholly-owned non-guarantor subsidiary, Quest Diagnostics Receivables Incorporated ("QDRI"). The Company and certain of its Subsidiary Guarantors transfer certain domestic receivables to QDRI. QDRI utilizes the transferred receivables to collateralize borrowings under the Company's Secured Receivables Credit Facility. The Company and the Subsidiary Guarantors provide collection services to QDRI. QDRI uses cash collections principally to purchase new receivables from the Company and the Subsidiary Guarantors.

The following condensed consolidating financial data illustrates the composition of the combined guarantors. Investments in subsidiaries are accounted for by the parent using the equity method for purposes of the supplemental consolidating presentation. Earnings (losses) of subsidiaries are therefore reflected in the parent's investment accounts and earnings. The principal elimination entries relate to investments in subsidiaries and intercompany balances and transactions.

QUEST DIAGNOSTICS INCORPORATED AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED
(dollars in thousands unless otherwise indicated)

Condensed Consolidating Balance Sheet
December 31, 2008

	<u>Parent</u>	<u>Subsidiary Guarantors</u>	<u>Non- Guarantor Subsidiaries</u>	<u>Eliminations</u>	<u>Consolidated</u>
<u>Assets</u>					
Current assets:					
Cash and cash equivalents	\$ 218,565	\$ 6,715	\$ 28,666	\$ -	\$ 253,946
Accounts receivable, net	4,426	134,005	694,442	-	832,873
Other current assets	<u>52,407</u>	<u>262,952</u>	<u>98,631</u>	<u>(3,990)</u>	<u>410,000</u>
Total current assets	275,398	403,672	821,739	(3,990)	1,496,819
Property, plant and equipment, net	211,847	631,921	35,919	-	879,687
Goodwill and intangible assets, net	153,213	5,303,312	425,804	-	5,882,329
Intercompany receivable (payable)	576,236	(184,426)	(391,810)	-	-
Investment in subsidiaries	5,323,173	-	-	(5,323,173)	-
Other assets	<u>179,222</u>	<u>33,301</u>	<u>39,951</u>	<u>(107,479)</u>	<u>144,995</u>
Total assets	<u>\$6,719,089</u>	<u>\$6,187,780</u>	<u>\$ 931,603</u>	<u>\$(5,434,642)</u>	<u>\$8,403,830</u>
<u>Liabilities and Stockholders' Equity</u>					
Current liabilities:					
Accounts payable and accrued expenses	\$ 552,094	\$ 628,958	\$ 42,557	\$ (3,990)	\$1,219,619
Short-term borrowings and current portion of long-term debt	-	2,886	2,256	-	5,142
Total current liabilities	552,094	631,844	44,813	(3,990)	1,224,761
Long-term debt	2,498,342	245,472	334,275	-	3,078,089
Other liabilities	63,757	473,579	66,227	(107,479)	496,084
Stockholders' equity	<u>3,604,896</u>	<u>4,836,885</u>	<u>486,288</u>	<u>(5,323,173)</u>	<u>3,604,896</u>
Total liabilities and stockholders' equity	<u>\$6,719,089</u>	<u>\$6,187,780</u>	<u>\$ 931,603</u>	<u>\$(5,434,642)</u>	<u>\$8,403,830</u>

Condensed Consolidating Balance Sheet
December 31, 2007

	<u>Parent</u>	<u>Subsidiary Guarantors</u>	<u>Non- Guarantor Subsidiaries</u>	<u>Eliminations</u>	<u>Consolidated</u>
<u>Assets</u>					
Current assets:					
Cash and cash equivalents	\$ 111,610	\$ 14,847	\$ 41,137	\$ -	\$ 167,594
Accounts receivable, net	27,309	234,532	620,126	-	881,967
Other current assets	<u>46,986</u>	<u>183,505</u>	<u>101,055</u>	<u>(6,750)</u>	<u>324,796</u>
Total current assets	185,905	432,884	762,318	(6,750)	1,374,357
Property, plant and equipment, net	215,062	654,341	42,595	-	911,998
Goodwill and intangible assets, net	153,848	5,422,270	530,719	-	6,106,837
Intercompany receivable (payable)	859,841	(610,371)	(249,470)	-	-
Investment in subsidiaries	5,149,196	-	-	(5,149,196)	-
Other assets	<u>167,105</u>	<u>48,433</u>	<u>38,054</u>	<u>(81,091)</u>	<u>172,501</u>
Total assets	<u>\$6,730,957</u>	<u>\$5,947,557</u>	<u>\$1,124,216</u>	<u>\$(5,237,037)</u>	<u>\$8,565,693</u>
<u>Liabilities and Stockholders' Equity</u>					
Current liabilities:					
Accounts payable and accrued expenses	\$ 451,944	\$ 634,079	\$ 45,443	\$ (6,750)	\$1,124,716
Short-term borrowings and current portion of long-term debt	-	62,386	101,195	-	163,581
Total current liabilities	451,944	696,465	146,638	(6,750)	1,288,297
Long-term debt	2,829,927	247,573	299,712	-	3,377,212
Other liabilities	124,844	457,837	74,352	(81,091)	575,942
Stockholders' equity	<u>3,324,242</u>	<u>4,545,682</u>	<u>603,514</u>	<u>(5,149,196)</u>	<u>3,324,242</u>
Total liabilities and stockholders' equity	<u>\$6,730,957</u>	<u>\$5,947,557</u>	<u>\$1,124,216</u>	<u>\$(5,237,037)</u>	<u>\$8,565,693</u>

QUEST DIAGNOSTICS INCORPORATED AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED
(dollars in thousands unless otherwise indicated)

Condensed Consolidating Statement of Operations
For the Year Ended December 31, 2008

	<u>Parent</u>	<u>Subsidiary Guarantors</u>	<u>Non- Guarantor Subsidiaries</u>	<u>Eliminations</u>	<u>Consolidated</u>
Net revenues.....	\$ 829,484	\$5,999,552	\$653,183	\$(232,772)	\$7,249,447
Operating costs and expenses:					
Cost of services.....	486,922	3,527,559	241,675	-	4,256,156
Selling, general and administrative.....	191,583	1,234,815	334,772	(24,236)	1,736,934
Amortization of intangible assets.....	268	30,857	6,168	-	37,293
Royalty (income) expense.....	(424,404)	424,404	-	-	-
Other operating expense (income), net.....	404	(511)	(3,205)	-	(3,312)
Total operating costs and expenses.....	<u>254,773</u>	<u>5,217,124</u>	<u>579,410</u>	<u>(24,236)</u>	<u>6,027,071</u>
Operating income.....	574,711	782,428	73,773	(208,536)	1,222,376
Non-operating expense, net.....	<u>(188,720)</u>	<u>(198,595)</u>	<u>(24,645)</u>	<u>208,536</u>	<u>(203,424)</u>
Income from continuing operations before taxes.....	385,991	583,833	49,128	-	1,018,952
Income tax expense.....	<u>130,746</u>	<u>237,119</u>	<u>18,903</u>	-	<u>386,768</u>
Income from continuing operations.....	255,245	346,714	30,225	-	632,184
Income (loss) from discontinued operations, net of taxes.....	-	(55,511)	4,817	-	(50,694)
Equity earnings from subsidiaries.....	<u>326,245</u>	<u>-</u>	<u>-</u>	<u>(326,245)</u>	<u>-</u>
Net income.....	<u>\$ 581,490</u>	<u>\$ 291,203</u>	<u>\$ 35,042</u>	<u>\$(326,245)</u>	<u>\$ 581,490</u>

Condensed Consolidating Statement of Operations
For the Year Ended December 31, 2007

	<u>Parent</u>	<u>Subsidiary Guarantors</u>	<u>Non- Guarantor Subsidiaries</u>	<u>Eliminations</u>	<u>Consolidated</u>
Net revenues.....	\$ 821,908	\$5,488,797	\$715,478	\$(321,276)	\$6,704,907
Operating costs and expenses:					
Cost of services.....	458,544	3,265,817	245,487	-	3,969,848
Selling, general and administrative.....	162,857	1,153,522	319,934	(23,455)	1,612,858
Amortization of intangible assets.....	222	21,013	6,669	-	27,904
Royalty (income) expense.....	(393,975)	393,975	-	-	-
Other operating expense (income), net.....	51	(2,578)	5,488	-	2,961
Total operating costs and expenses.....	<u>227,699</u>	<u>4,831,749</u>	<u>577,578</u>	<u>(23,455)</u>	<u>5,613,571</u>
Operating income.....	594,209	657,048	137,900	(297,821)	1,091,336
Non-operating expense, net.....	<u>(178,849)</u>	<u>(282,187)</u>	<u>(15,719)</u>	<u>297,821</u>	<u>(178,934)</u>
Income from continuing operations before taxes.....	415,360	374,861	122,181	-	912,402
Income tax expense.....	<u>157,270</u>	<u>150,994</u>	<u>50,310</u>	-	<u>358,574</u>
Income from continuing operations.....	258,090	223,867	71,871	-	553,828
Income (loss) from discontinued operations, net of taxes.....	-	(213,917)	28	-	(213,889)
Equity earnings from subsidiaries.....	<u>81,849</u>	<u>-</u>	<u>-</u>	<u>(81,849)</u>	<u>-</u>
Net income.....	<u>\$ 339,939</u>	<u>\$ 9,950</u>	<u>\$ 71,899</u>	<u>\$(81,849)</u>	<u>\$ 339,939</u>

QUEST DIAGNOSTICS INCORPORATED AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED
(dollars in thousands unless otherwise indicated)

Condensed Consolidating Statement of Operations
For the Year Ended December 31, 2006

	<u>Parent</u>	<u>Subsidiary Guarantors</u>	<u>Non- Guarantor Subsidiaries</u>	<u>Eliminations</u>	<u>Consolidated</u>
Net revenues.....	\$ 942,692	\$4,995,640	\$710,692	\$(380,365)	\$6,268,659
Operating costs and expenses:					
Cost of services.....	501,942	2,958,591	235,473	-	3,696,006
Selling, general and administrative.....	147,862	1,020,774	264,488	(22,408)	1,410,716
Amortization of intangible assets.....	1,451	8,924	468	-	10,843
Royalty (income) expense.....	(394,693)	394,693	-	-	-
Other operating (income) expense, net.....	(3,358)	24,704	1,671	-	23,017
Total operating costs and expenses.....	<u>253,204</u>	<u>4,407,686</u>	<u>502,100</u>	<u>(22,408)</u>	<u>5,140,582</u>
Operating income.....	689,488	587,954	208,592	(357,957)	1,128,077
Non-operating (expense) income, net.....	<u>(160,244)</u>	<u>(295,672)</u>	<u>3,155</u>	<u>357,957</u>	<u>(94,804)</u>
Income from continuing operations before taxes.....	529,244	292,282	211,747	-	1,033,273
Income tax expense.....	<u>201,426</u>	<u>118,441</u>	<u>87,714</u>	<u>-</u>	<u>407,581</u>
Income from continuing operations.....	327,818	173,841	124,033	-	625,692
Loss from discontinued operations, net of taxes.....	-	(28,980)	(10,291)	-	(39,271)
Equity earnings from subsidiaries.....	<u>258,603</u>	<u>-</u>	<u>-</u>	<u>(258,603)</u>	<u>-</u>
Net income.....	<u>\$ 586,421</u>	<u>\$ 144,861</u>	<u>\$113,742</u>	<u>\$(258,603)</u>	<u>\$ 586,421</u>

Condensed Consolidating Statement of Cash Flows
For the Year Ended December 31, 2008

	<u>Parent</u>	<u>Subsidiary Guarantors</u>	<u>Non- Guarantor Subsidiaries</u>	<u>Eliminations</u>	<u>Consolidated</u>
Cash flows from operating activities:					
Net income.....	\$ 581,490	\$ 291,203	\$ 35,042	\$(326,245)	\$ 581,490
Adjustments to reconcile net income to net cash provided by (used in) operating activities:					
Depreciation and amortization.....	53,116	193,975	17,502	-	264,593
Provision for doubtful accounts.....	11,261	106,804	208,163	-	326,228
Provision for special charge.....	-	72,650	-	-	72,650
Other, net.....	(279,394)	56,698	10,638	326,245	114,187
Changes in operating assets and liabilities.....	<u>462,768</u>	<u>(470,560)</u>	<u>(288,307)</u>	<u>-</u>	<u>(296,099)</u>
Net cash provided by (used in) operating activities.....	829,241	250,770	(16,962)	-	1,063,049
Net cash (used in) provided by investing activities.....	(144,149)	(149,004)	14,137	80,133	(198,883)
Net cash used in financing activities.....	<u>(578,137)</u>	<u>(109,898)</u>	<u>(9,646)</u>	<u>(80,133)</u>	<u>(777,814)</u>
Net change in cash and cash equivalents.....	106,955	(8,132)	(12,471)	-	86,352
Cash and cash equivalents, beginning of year.....	<u>111,610</u>	<u>14,847</u>	<u>41,137</u>	<u>-</u>	<u>167,594</u>
Cash and cash equivalents, end of year.....	<u>\$ 218,565</u>	<u>\$ 6,715</u>	<u>\$ 28,666</u>	<u>\$ -</u>	<u>\$ 253,946</u>

QUEST DIAGNOSTICS INCORPORATED AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED
(dollars in thousands unless otherwise indicated)

Condensed Consolidating Statement of Cash Flows
For the Year Ended December 31, 2007

	<u>Parent</u>	<u>Subsidiary Guarantors</u>	<u>Non- Guarantor Subsidiaries</u>	<u>Eliminations</u>	<u>Consolidated</u>
Cash flows from operating activities:					
Net income.....	\$ 339,939	\$ 9,950	\$ 71,899	\$ (81,849)	\$ 339,939
Adjustments to reconcile net income to net cash provided by (used in) operating activities:					
Depreciation and amortization.....	50,726	170,344	16,809	-	237,879
Provision for doubtful accounts.....	11,219	83,240	205,767	-	300,226
Provision for restructuring and other special charges.....	-	238,781	-	-	238,781
Other, net.....	(64,298)	37,970	20,596	81,849	76,117
Changes in operating assets and liabilities..	<u>634,379</u>	<u>(200,171)</u>	<u>(700,226)</u>	<u>-</u>	<u>(266,018)</u>
Net cash provided by (used in) operating activities.....	971,965	340,114	(385,155)	-	926,924
Net cash used in investing activities.....	(2,200,512)	(1,334,217)	(316,554)	2,092,090	(1,759,193)
Net cash provided by financing activities ..	<u>1,205,559</u>	<u>1,001,289</u>	<u>735,465</u>	<u>(2,092,090)</u>	<u>850,223</u>
Net change in cash and cash equivalents...	(22,988)	7,186	33,756	-	17,954
Cash and cash equivalents, beginning of year.....	<u>134,598</u>	<u>7,661</u>	<u>7,381</u>	<u>-</u>	<u>149,640</u>
Cash and cash equivalents, end of year....	<u>\$ 111,610</u>	<u>\$ 14,847</u>	<u>\$ 41,137</u>	<u>\$ -</u>	<u>\$ 167,594</u>

Condensed Consolidating Statement of Cash Flows
For the Year Ended December 31, 2006

	<u>Parent</u>	<u>Subsidiary Guarantors</u>	<u>Non- Guarantor Subsidiaries</u>	<u>Eliminations</u>	<u>Consolidated</u>
Cash flows from operating activities:					
Net income.....	\$ 586,421	\$ 144,861	\$ 113,742	\$(258,603)	\$ 586,421
Adjustments to reconcile net income to net cash provided by operating activities:					
Depreciation and amortization.....	46,674	140,103	10,621	-	197,398
Provision for doubtful accounts.....	5,934	51,258	186,251	-	243,443
Provision for restructuring and other special charges.....	-	47,868	7,920	-	55,788
Other, net.....	(316,207)	55,233	22,948	258,603	20,577
Changes in operating assets and liabilities..	<u>200,269</u>	<u>(129,327)</u>	<u>(222,673)</u>	<u>-</u>	<u>(151,731)</u>
Net cash provided by operating activities.....	523,091	309,996	118,809	-	951,896
Net cash used in investing activities.....	(13,177)	(120,444)	(9,748)	(271,033)	(414,402)
Net cash used in financing activities.....	<u>(452,257)</u>	<u>(186,650)</u>	<u>(112,110)</u>	<u>271,033</u>	<u>(479,984)</u>
Net change in cash and cash equivalents.....	57,657	2,902	(3,049)	-	57,510
Cash and cash equivalents, beginning of year.	<u>76,941</u>	<u>4,759</u>	<u>10,430</u>	<u>-</u>	<u>92,130</u>
Cash and cash equivalents, end of year.....	<u>\$ 134,598</u>	<u>\$ 7,661</u>	<u>\$ 7,381</u>	<u>\$ -</u>	<u>\$ 149,640</u>