

Quest Diagnostics Incorporated
Second Quarter 2004 Conference Call
July 22, 2004, 8:30 am EST

Laure Park: Thank you and good morning. I am here with Surya Mohapatra, our president and chief executive officer, and Bob Hagemann, our chief financial officer.

Some of our commentary and answers to questions may contain forward-looking statements that are based on current expectations and involve risks and uncertainties that could cause actual results and outcomes to be materially different. Certain of these risks and uncertainties may include, but are not limited to, competitive environment, changes in government regulations, changing relationships with customers, payers, suppliers and strategic partners and other factors described in the Quest Diagnostics Incorporated 2003 Form 10-K and subsequent filings.

As we have previously indicated, this is the last year in which we will provide quarterly guidance. To keep everyone's focus on the longer term, after this year we will begin providing financial guidance for the full-year only.

A copy of our earnings press release, together with any information that would be required under Regulation G, and the text of our prepared remarks will be available in the "press room" section of our website later today at www.questdiagnostics.com.

Now, here is Surya Mohapatra.

Surya Mohapatra: Thank you, Laure. We reported strong financial results during the second quarter.

- Earnings per share grew by 14%.
- Revenues grew more than 6%, reflecting continued improvement in the rate of organic growth.
- Margins continued to expand.
- Cash flow was strong at over \$200 million, and earlier this morning we announced that the Board has expanded our share repurchase authorization by \$300 million.

I am encouraged by the continued improvement in organic revenue growth, reflecting our focused efforts and the growing recognition by customers of the value we offer. At Quest Diagnostics we have a passion for the patient. And our passion for the patient is matched only by our passion for performance.

Now, Bob will discuss the quarterly results and guidance.

Bob Hagemann: Thanks, Surya.

The second quarter continued to build on the momentum of the past two quarters. We reported strong earnings growth, fueled by continued improvement in organic revenue growth, and we met or exceeded each element of our guidance.

Revenues grew 6.4%. Volume increased 2.1% over the prior year and represents the third consecutive quarter of underlying improvement. Recall that in the first quarter, pro forma volume growth, adjusted for the favorable impact of Leap Year and less severe weather, was about 1%.

Revenue per requisition grew 3.7% for the quarter. Improvements in test mix and increases in the number of tests ordered per requisition continue to be the principal drivers of the increase.

Drugs of abuse testing, which is among our lowest-priced services and accounts for about 6% of our volume and 3% of revenues, grew for the second consecutive quarter after several years of decline.

Our clinical trials testing business continued to report strong growth and contributed about half a point to consolidated revenue growth in the quarter.

Operating income, before the charge for the recently completed CEO succession, improved 60 basis points as a percentage of revenues, principally driven by improvement in bad debt expense.

We expect to continue expanding operating margins through a combination of profitable growth and efficiency gains from our Six Sigma and standardization initiatives. We are expanding margins at the same time we are investing to ensure that our value proposition remains unmatched.

As we disclosed last quarter, we expected to record charges associated with the CEO succession process and the company's debt refinancing. These charges have been finalized and totaled \$13.2 million pre-tax, or eight cents per share, in the second quarter.

\$2.9 million was associated with the write-off of deferred financing costs, and \$10.3 million was related to the acceleration of certain pension obligations in connection with the CEO succession. We have been able to record the entire charge in the second quarter, versus recording it over the remainder of the year, as previously anticipated. It is important to remember that these charges are discrete items and not ongoing costs of doing business.

Cash from operations was strong, totaling \$207 million during the quarter, compared to \$169 million in the prior year. Days sales outstanding were 47 days, unchanged from a year ago and two days above the first quarter level. The increase is temporary and is due to lab and billing systems conversions at two of our laboratories.

During the quarter we repurchased 2.7 million shares of common stock for \$226 million at an average price of about \$85 per share. This includes a block of 1.2 million shares we purchased directly from GlaxoSmithKline. GSK continues to hold just over 20% of our stock.

We have now repurchased a total of 7.2 million shares for \$529 million at an average price of \$73.54 per share since initiating our repurchase program in May, 2003. Including the additional \$300 million authorization announced this morning, we have \$371 million authorized for repurchases.

As we have said before, our first priority with respect to our excess cash flow is to invest in growth opportunities to drive long-term shareholder value. When those opportunities are not available on appropriate terms, we expect to return cash to shareholders, beyond the level of dividend payments, in the form of stock repurchases.

Turning to our outlook:

- For the full year we now expect revenue growth to exceed the 7% rate we projected at the end of quarter one.
- Full year earnings per diluted share are expected to increase to between \$4.80 and \$4.90, before the second quarter charges, unchanged from our previous guidance. A reconciliation of the EPS guidance with and without the charges is included in Footnote 7 of our earnings release.
- We continue to expect cash from operations to approximate \$700 million, operating income as a percentage of revenues to approximate 18% and capital expenditures to be between \$180 and \$190 million.

- For the third quarter, we expect revenues to grow approximately 6%. Operating income as a percentage of revenues is expected to exceed 18%, and earnings per diluted share are expected to be between \$1.25 and \$1.30.

Now, I'll turn it over to Surya.

Surya Mohapatra: Thanks, Bob.

As you heard from Bob, we had a strong quarter.

We are making progress in driving organic revenue growth. Put simply, we are seeing more doctors ordering more tests on behalf of more patients. There is no single factor that is responsible for driving the improvement. Rather, we are realizing the benefits of a number of concerted efforts we have undertaken and investments we have made.

As Bob mentioned, we continue to invest in our value proposition as the primary driver of growth. This enables us to differentiate ourselves from our competitors and maintain pricing discipline. The investments we have made in the past are driving results today. And investments we are making now will position us for growth in the future. For

example:

- We continue to invest in Six Sigma quality – and more recently, in Lean Six Sigma to improve customer service and efficiency. And we are also investing in infrastructure – making our PSC's more patient-friendly and convenient, providing additional training for phlebotomists, standardizing our laboratories and expanding our ability to serve new providers.
- We are training our sales reps to better communicate the medical value of new tests and technologies. We are seeing growth coming from sub specialists and from expansion into new geographies where historically we have not been a strong competitor.
- Gene-based testing continues to be the fastest-growing segment of our business, growing at approximately 15% compared to last year. Primary drivers of the improvement are tests for women's health, which include chlamydia, gonorrhea, HPV and cystic fibrosis.
- Volumes for recently introduced tests such as the Insure colorectal cancer screening test from Enterix, have shown strong growth. Similarly, in the allergy testing area, the ImmunoCAP test, offered in collaboration with Pharmacia Diagnostics, is gaining physician acceptance. Regarding the OvaCheck ovarian cancer blood test, our clinical evaluation continues.
- Customers are utilizing our advanced information technology products in record numbers and we have added resources to keep up with the rapid deployment schedule. By the end of June, we were transmitting greater than 40% of test results and receiving greater than 30% of test orders via the Internet. This is up more than 70% over last year.
- We are expanding the capabilities of our information technology products, which are sold to physicians and hospitals. We have added new tools to the eMaxx physician portal to enable doctors to prescribe drugs electronically; view a patient's prescription history, cumulative lab results and other medical information; and share this information with other physicians.
- Additionally, our ChartMaxx patient-centric electronic hospital record continues to win acceptance by leading hospitals. It recently enabled MedPlus, our healthcare I.T. company, to rank as the number one document management vendor by KLAS, a leading independent healthcare IT research firm.

These investments will set us apart from the competition and drive growth.

Now some brief comments about the industry. I am excited about our industry and our opportunities. As you know, demographic and technology trends favor us. As the

population grows and ages, diagnostic testing plays an increasingly important role not only for diagnosis and treatment but also for prognosis and prevention. Every day we read or hear news relating to healthcare. Medical societies and the popular press are making consumers more knowledgeable about the importance of early diagnosis. Consumers are getting more involved in their healthcare decisions. Their first visit is often not to the doctor's office, but to the Internet.

Let me give a few examples of recent news and what they mean for us.

- A recent report from the World Health Organization and the International Diabetes Federation estimates some 3.2 million deaths can be attributed to diabetes each year. This global figure is three times higher than the previous estimate. Diabetes has become one of the leading causes of premature illness and death. This report is set to put greater pressure on healthcare systems to address the need for timely diagnosis of this preventable disease and take appropriate measures to reduce morbidity and mortality.
- From the New England Journal of Medicine, an important report on PSA velocity. This is the rate of change in PSA levels. A rise in PSA velocity can help doctors identify men at high risk of death from prostate cancer. The measure can also be used for monitoring the effectiveness of treatment. The concept of velocity may have broader application for other diagnostic tests. Again, it highlights the value of regular lab testing and cumulative reporting over time.
- From the medical journal Circulation, updated guidelines for managing LDL cholesterol levels. Experts now want to use more aggressive drug therapy to reduce LDL levels in patients at very high risk of heart attack to 70 milligrams per deciliter or below. The current range is 100 to 130. This type of aggressive drug therapy has to be combined with regular testing to monitor not only lipid levels, but also other parameters including liver enzymes.

Increasingly, consumers are seeing diagnostic testing as a valued tool to help them in their quest to better understand and manage their personal health risks.

Coming back to Quest Diagnostics, our efforts to drive profitable growth are producing results.

In summary:

- We had a strong second quarter in which we accelerated revenue and volume growth while we expanded operating margin.
- Cash generation was strong and we continue to invest in our future.
- And, we are well positioned to take advantage of the changing trends in our industry and continue providing superior returns for shareholders.

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